

## *Terms of Union*

Newfoundland's entry into Canada was given effect by the British North America Act, 1949,<sup>1</sup> passed by the Parliament of the United Kingdom. The Terms of Union, which is a schedule to the Act, sets out the terms under which Newfoundland would join and operate as Canada's tenth province. The Terms of Union, then, are very important as they provide for Newfoundland and Labrador's constitutional place within the federation.

The Commission sought an independent assessment of the Terms of Union to gain a better appreciation of what they provide for and of their continuing relevance.<sup>2</sup> In line with the findings of this study, the Commission's main conclusion is that the primary purpose and effect of the Terms of Union was, and has been, to provide a constitutional place for Newfoundland and Labrador that was not materially different from that of the other provinces. This is not to suggest that all provinces have a strictly "equal" constitutional status within Canada, as some important distinctions do exist,<sup>3</sup> however, none of these differences are so fundamental as to approach a "special" constitutional status for any province.

The Commission is not suggesting that the Terms of Union, having accomplished their main purpose, are no longer relevant. The point is that there is little within the Terms of Union that can be called upon in support of a strategy to renew and strengthen our place in Canada. This message was reinforced to the Commission by many of the participants in the Expectations Roundtable, including a member of the Newfoundland delegation to the final negotiations of the Terms of Union.

### *Challenges of Constitutional Arrangements*

While Newfoundland and Labrador was granted no special treatment under the Constitution, it must be acknowledged that these arrangements have presented special challenges for this province. In attempting to realize its economic potential, Newfoundland and Labrador has faced significant constitutional obstacles. These challenges relate both to the manner in which the federal government has exercised its jurisdiction in respect of Newfoundland and Labrador, and to judgements of the Supreme Court of Canada.

### **Federal Jurisdiction Over Fisheries**

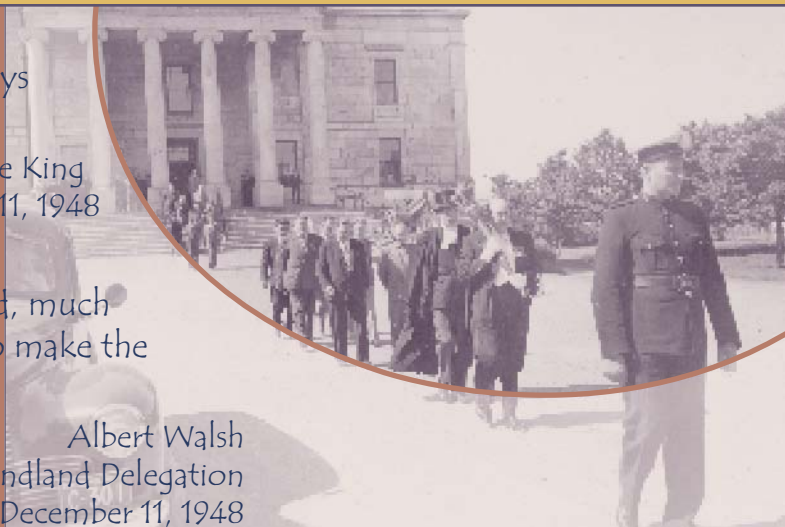
When Newfoundland joined Canada in 1949, the federal parliament assumed legislative jurisdiction over its fishery resources under section 91(12) of the Constitution Act, 1867. Term 22 fettered the discretion of the federal parliament in its exercise of these powers by providing for the maintenance of Newfoundland "Fisheries laws" for a period of five years. Under Canadian law, the fishery was unregulated in comparison to the regime already in place in Newfoundland and Labrador.<sup>4</sup> This five-year freeze, then, was provided simply to avoid a regulatory vacuum and resulting industry instability. Thereafter, the regulation of the Newfoundland and Labrador fishery became the responsibility of the federal government. The regulation

"...the linking of the fortunes of two countries in a common destiny must always be an act of faith in the future."

Prime Minister Mackenzie King  
December 11, 1948

"As in many other agreements of this kind, much depends upon the desire of both parties to make the agreement work."

Albert Walsh  
Head of the Newfoundland Delegation  
December 11, 1948



## Terms of Union

of fish processing remained with Newfoundland and Labrador, pursuant to provincial jurisdiction over property and civil rights within the province under section 92(13) of the Constitution Act, 1867.

For more than 400 hundred years, the groundfish fishery had sustained Newfoundland and Labrador. Under federal control, this great resource has been brought to the brink of extinction. As will be discussed in Chapter 10, Newfoundland and Labrador certainly made the proper regulation of this industry difficult by its own actions (e.g., the proliferation of processing licenses, and political pressure on the federal government to maintain and increase quotas). However, the fact remains that this environmental, social and economic tragedy occurred on the federal government's watch and as a result of its failure to manage the resource properly.

### Offshore Oil and Gas

One of the greatest resources Newfoundland and Labrador brought into Confederation was its massive continental shelf. Starting with the first offshore exploratory well in 1966, the people of this province have lived in hopes that oil and gas could make a meaningful contribution to improving Newfoundland and Labrador's place in Canada. An opportunity that should have brought Newfoundland and Labrador and Canada together resulted in a bitter constitutional struggle for jurisdiction. Many years were wasted in negotiation and disagreement, leading to two separate court references on the subject of constitutional jurisdiction.<sup>5</sup> In 1984, the Supreme Court of Canada determined that Canada, not Newfoundland and Labrador, had constitutional jurisdiction over the shelf and its oil and gas resources.<sup>6</sup> Ironically, under the Constitution, Canada was provided with a resource that was only available to it at international law because of the coastline of Newfoundland and Labrador.

Following this decision, the federal and provincial governments agreed to a joint approach to the development of these resources through the Atlantic Accord.<sup>7</sup> The significance of the Accord extends beyond the approach it set for the management of offshore petroleum resources and revenue sharing. It provides us, as well, with a reminder that there have been occasions when the federal and provincial governments have been able to work together to further the purpose of making Confederation work better for both parties.

### Churchill River

The ability of the province to control the development of its natural resources under the Constitution of Canada was set back by the Supreme Court of Canada's 1985 decision<sup>8</sup> regarding the Upper Churchill Water Rights Reversion Act. This Act, passed by the Newfoundland and Labrador legislature in 1980, provided for the expropriation of the water rights and assets of the developer of the Churchill Falls project, the Churchill Falls (Labrador) Corporation (CF(L)Co). The purpose of the Act was clearly stated

in section 3 as being: “to provide for the reversion to the province of unencumbered ownership and control in relation to certain waters within the province.”

On appeal from a decision of the Newfoundland Court of Appeal upholding the constitutional validity of the Act as a valid exercise of the province’s powers in relation to property and civil rights in the province, the Supreme Court of Canada found the Act to be unconstitutional. The Supreme Court of Canada determined that the true or “colourable” purpose of the legislation was to “interfere with the power contract and thus to derogate from the rights of Hydro-Québec to receive an agreed amount of power at an agreed price.”<sup>9</sup> The Court went on to find that the rights of Hydro-Québec under the Power Contract were in Québec, beyond the legislative competence of Newfoundland and Labrador. At the end of this winding road, the Supreme Court of Canada ruled the Act to be an unconstitutional attempt to impair a civil right outside the province. Newfoundlanders and Labradorians were forced to accept that, under the Constitution of Canada, their provincial legislature could grant but not rescind a water lease.

The Commission offers these examples to inform other Canadians of some of the challenges Newfoundland and Labrador has faced. These actions and decisions created a great deal of bitterness in our society but, as this Report reveals, our focus is beyond the battles and grievances of the past. Newfoundland and Labrador’s experiences, however, make the refrain “all provinces must be treated equally” hard to accept.

### *Gulf Ferry*

Term 32(1) of the Terms of Union has much continuing relevance to Newfoundland and Labrador. The courts have yet to consider Term 32(1) for the purpose of defining the precise nature and level of Gulf ferry service it requires. However, a consideration of the plain language of this term, together with the judicial interpretation of a similar term in the Prince Edward Island Terms of Union,<sup>10</sup> allows the Commission to frame the federal government’s obligations with a degree of confidence. It is important to note that it is the federal government, not Marine Atlantic, that is responsible for ensuring that the constitutional obligations stated in Term 32(1) are fulfilled. Likewise, it is the federal government that is liable for any breach of those obligations. Term 32(1) says:

*Canada will maintain in accordance with the traffic offering a freight and passenger steamship service between North Sydney and Port aux Basques, which, on completion of a motor highway between Corner Brook and Port aux Basques, will include suitable provision for the carriage of motor vehicles.*  
[Emphasis added].

Term 32(1) requires the federal government to “maintain” the Gulf ferry service at a level which is “in accordance with the traffic offering.” In the view of the Commission, this clearly requires the federal government to ensure the continuous operation of the service, without interruption, at a level of service that addresses demand for its use. To meet this obligation, the federal government must invest in the service to ensure that it anticipates, and stands ready to accommodate growing traffic demands on an ongoing basis. If this level of service was to be diminished or interrupted for any reason (except as a result of forces beyond the control of the federal government, such as the weather), the province would have the option of initiating legal action to compel the federal government to meet its constitutional obligations, and would be entitled to seek damages arising from such a breach. The Commission is also of the view that Term 32(1) requires that the service meet a standard of quality and affordability.

Whether the service provided to date has been in keeping with the federal government’s obligations under Term 32(1) is beyond the ability of the Commission to properly and fairly address, given its broad terms of reference. The provincial government has the resources to make such an assessment, and the Commission trusts that it would, if required, take legal action to compel the federal government to meet

its obligations and to pay compensation for any breach of Term 32(1). The Commission is hopeful that a new relationship between the federal and provincial governments would avoid such a result.

A cooperative relationship between the federal and provincial governments would see the two working together to improve this service for the benefit of both Canada and Newfoundland and Labrador. During the Commission's public consultations, concerns were expressed regarding the quality and affordability of this service. For many Newfoundlanders and Labradorians, the Gulf ferry service is the clearest measure of the federal government's commitment to this province. A renewed focus by the federal government on improving this service would send a strong message that it is committed to strengthening and renewing Newfoundland and Labrador's place in Canada.

The impact a work stoppage would have on the Gulf ferry service is a concern that the federal and provincial governments need to address. The mere threat of a work stoppage is damaging to the provincial economy, the most obvious impacts being on the tourism industry and small businesses. The Commission appreciates that this is a sensitive issue and recognizes that it is not its place to suggest a particular approach to this issue. The Commission hopes, however, that an approach can be found that would avoid the need for legal action by the provincial government against the federal government in the event of an interruption or diminishment of the Gulf ferry service arising from a work stoppage.

In the view of the Commission, Term 32(1) requires a quality and affordable Gulf ferry service at a level continually able to meet demand for its use. The service, however, should not be viewed just as a constitutional commitment to be enforced and respected. It is an essential infrastructure component in strengthening the province's economy. The manner in which the service is provided and improved will be a reflection of the new relationship between the federal and provincial governments.

### *Amendments to Terms of Union*

Canada's constitutional arrangements have not remained static since 1949. Changes have been accomplished, the most significant of which occurred through the 1982 package of constitutional amendments. With respect to the Terms of Union, there have been amendments since Confederation that have been key in effecting and reflecting fundamental changes within this province's society:

- Term 17, at the time of union, provided the province with legislative jurisdiction over education within the province, but it also guaranteed key denominational education rights existing at the time of Confederation and the public funding of denominational schools. Since 1949, Term 17 has been amended three times. The most recent amendment retained legislative jurisdiction for the province, but removed any protection for denominational education.<sup>11</sup>
- In 2001, the Terms of Union were amended to change the name of the province from "Newfoundland" to "Newfoundland and Labrador." This change reflects a growing and strengthening respect between residents of Labrador and Newfoundland. As noted in Chapter 5, much remains to be done to draw the two parts of the province closer together. This constitutional amendment was a small but significant step.

Newfoundland and Labrador's past success in amending the Terms of Union should be placed in context. First, it is important to note that these amendments required only the support of the federal parliament and the provincial legislature. There was no need to secure the support of other provinces. Second, these amendments did not change the division of powers between the federal parliament and provincial legislature. The interests or powers of the federal government were not directly impacted by these amendments, nor were the interests of other provinces.

During the Commission's public consultation phase, there were general calls for the renegotiation of the Terms of Union to get a better deal for Newfoundland and Labrador. With respect to the fishery, such

an approach was recently endorsed by the House of Assembly. In May of this year, a resolution passed unanimously instructing the provincial government to seek amendments to the Terms of Union to provide for shared and equal constitutional authority between the federal parliament and provincial legislature over fisheries. The resolution also proposed the negotiation and constitutional entrenchment of a new joint management board to manage fishery resources.

The Commission appreciates that fundamental change to the management of Newfoundland and Labrador's fishery is required. However, the Commission does not see constitutional amendment as a realistic or necessary way to implement such changes. The amendments advocated by the House of Assembly would require the support of seven provinces, comprising 50 per cent of Canada's total population, and the federal parliament. The federal government has already indicated that it is not interested in pursuing constitutional change. Furthermore, it would appear that Newfoundland and Labrador is far from securing the requisite support from other provinces. In the opinion of the Commission, it is highly unlikely that Newfoundland and Labrador would be able to secure the required support for such amendments in the near future.

The Commission's statements should not be taken as a condemnation of the House of Assembly's resolution. More than anything, the resolution is a symptom of the frustration that has developed in this province with respect to the federal government's approach to the management of Newfoundland and Labrador's fishery. That it took a call for constitutional change to get the federal government's attention on the most important issue facing Newfoundland and Labrador speaks directly to the weakened state of intergovernmental relations in Canada today.

The Constitution of Canada is not an impediment to improving the management of the Newfoundland and Labrador fishery. However, fundamental change is required to the attitude and approach of the federal and provincial governments toward the management of this resource and toward one another. Our past demonstrates that fundamental reshaping of the relationship between the federal and provincial governments can be accomplished without amending the Constitution of Canada. An example to look to is the provincial and federal legislation that implemented the Atlantic Accord, an agreement that provides for a joint management regime in respect to offshore oil and gas. This was accomplished without any amendment to the Constitution of Canada. What was required was a commitment to work together.

The federal government has indicated in a clear and somewhat insensitive fashion what it is not prepared to do – engage in constitutional negotiations. That is simply not good enough. The onus is on the federal government to indicate what it is willing to discuss. The Commission strongly encourages the federal and provincial governments to enter into immediate discussions of the management approach outlined in Chapter 10 of this Report. The benefits of such an approach stretch further than just one industry or resource. They could serve as an early and strong foundation for a new cooperative relationship between the federal and provincial governments.

### *Aboriginal Peoples*

The Terms of Union contain no mention of Aboriginal peoples. However, by virtue of Term 3 of the Terms of Union, the Aboriginal peoples of Newfoundland and Labrador were placed in the same position, constitutionally, as the other Aboriginal peoples of Canada. Term 3 provides for the application to Newfoundland and Labrador of other legislation comprising the Constitution of Canada, subject to a few exceptions:

The British North America Acts, 1867 to 1946, shall apply to the Province of Newfoundland in the same way and to the like extent as they apply to the provinces heretofore comprised in Canada, as if the Province of Newfoundland had been one of the provinces originally united, except insofar as varied by

these Terms and except such provisions as are in terms made or by reasonable intendment may be held to be specially applicable to or only to affect one or more and not all of the provinces originally united.

The legal effect of Term 3 was to confirm the federal parliament's legislative jurisdiction in respect of "Indians, and Lands reserved for the Indians" under section 91(24) of the Constitution Act, 1867. However, after speaking with many Aboriginal groups and reviewing relevant submissions and articles,<sup>12</sup> the Commission has come to understand that the absence of any specific mention of Aboriginal peoples in the Terms of Union was intentional.

While the Terms of Union passed jurisdiction in respect of Aboriginal peoples to the federal government, the question left unresolved was how the federal government would exercise that jurisdiction. The parties decided to remain silent on this issue in the Terms of Union in favour of future discussions between the federal and new provincial government. The place of the Aboriginal peoples, both in Newfoundland and Labrador and in Canada, was ultimately left up to the federal government to decide as a matter of policy. It appears that there were three reasons that supported the decision to put the matter off to another day:

1. That application of the Indian Act would be a retrograde step, given that the Aboriginal peoples in Newfoundland and Labrador enjoyed the right to vote, which would be lost with the application of the Indian Act.
2. The number of Aboriginal peoples in Newfoundland and Labrador was small, and the view at the time was that many had already been "absorbed" into the dominant white population.
3. The Indian Act assumed the existence of reserves which did not exist in Newfoundland and Labrador, making the delivery of services too difficult.<sup>13</sup>

The federal government has been painfully slow in recognizing its responsibilities to the Aboriginal peoples of this province. For many decades, it limited its role to providing funding to the provincial government to provide and expand public services to some, but not all, Aboriginal peoples. In effect, the federal government, for much of the province's time in Canada, has been content to abandon its responsibilities to the provincial government. The resistance of the federal government to treat the Aboriginal peoples of this province in a fair and equitable manner is of the utmost concern to this Commission.

In recent decades, a more productive relationship has been building through such initiatives as the registration of some of the Mi'kmaq population under the Indian Act and the negotiation of land claims with the Inuit and Innu in Labrador. As noted in Chapter 5, the Commission is nonetheless conscious of an unfinished agenda on Aboriginal issues.

## *Conclusions*

Newfoundland and Labrador accepted a place within Canada that was not materially different than that of the other provinces. Subject to the federal government's continuing obligation to provide the Gulf ferry service in accordance with Term 32(1), the Commission sees little else within the Terms of Union that can be called upon in support of a strategy to renew and strengthen the province's place in Canada. With respect to Term 32(1), the federal government is required to provide a quality and affordable Gulf ferry service at a level continually able to meet demand for its use. However, the service should not be viewed just as a constitutional commitment to be enforced and respected. A renewed focus by the federal government on improving this service would send a strong message that it is committed to strengthening and renewing Newfoundland and Labrador's place in Canada.

While the Commission does appreciate that fundamental change to the relationship between the federal and provincial governments is required, particularly with respect to the management of the fishery, it does

not see constitutional amendment as a necessary or realistic way to implement such changes. Fundamental change can be accomplished outside of the Constitution, as evidenced by the Atlantic Accord and its implementing legislation. The Commission, then, favors practical and cooperative approaches outside formal constitutional change as it believes such approaches have a more realistic chance of success.

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“The Terms of Union, which form the legal basis of the fusion of these two states, make no reference to Francophone and Acadian communities in Newfoundland and Labrador. According to the collective memory of the francophones on the west coast- an impoverished people- they voted by a large majority to join Canada because of the enticing picture that was painted of the guarantee of an influx of federal funds.”

*Excerpt from the Public Consultations*

“When the new volume of our history was opened in 1949 and we became citizens of youthful and virile Canada, the old way and time in which my generation had passed its youth was but a yesterday behind. It was still fresh in our memories. The new volume had opened but the old one had not been closed. The story was there for any who cared to read.”

*R.F. Sparkes, Preface to The Winds Softly Sigh*



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## *The Evolving Nature of the Federation*



### *The Changing Canadian Federation*

The Canadian federation has a very different system of government today than it did in 1949. The Canadian Constitution has been amended in significant ways, especially in 1982, to incorporate, among other changes, the Charter of Rights and Freedoms and Aboriginal rights. But fundamental change has occurred more slowly and less dramatically in the ways our federal institutions perform on a daily basis, in the ways that governments interact with one another, and in the ways that their fiscal arrangements adapt to changing economic and social circumstances. These changes have had both positive and negative consequences for Newfoundland and Labrador. On the one hand, Canadian values of sharing and commonly held views about rights, entitlements and obligations greatly enhance the benefits of the federation for this province. On the other, provinces seem to count for less in the national political culture than they did in 1949, and the federal government seems less concerned with treating provinces as equal constituent partners in the federation.

The first significant long-term trend that illustrates both the positive and negative aspects for Newfoundland and Labrador is the growing sense of Canadian nationalism, of a pan-Canadian identity and national standards. Canada today is a more integrated country than the one we joined in 1949. In the 1940s, Canadian citizenship brought with it such social entitlements as old-age pensions, family allowance and unemployment insurance. By 1970, the welfare state had expanded to include universal medical and hospital insurance, contributory pension plans, support for universities and a strong interprovincial convergence in the provision of social services and social assistance. No matter where they live, individual Canadians can expect a similar set of social entitlements and programs.

By itself this trend is unremarkable – all industrial democratic countries provided similar services in the postwar period. What was remarkable is that Canada achieved its social policy objectives while retaining substantial provincial autonomy – at least that has been the intent. The federal government helped build up welfare state programs through cost-sharing agreements with the provinces which, in the early years, placed explicit conditions on the provinces. These conditions gradually became much looser. Two other developments have helped to preserve provincial autonomy: the gradual decentralization of tax room from the federal government to the provinces, and fiscal equalization. In 1950, when Ottawa exercised strong central control over revenues, the federal government levied about 65 per cent of total revenues in Canada. By 1999, this had declined to 47 per cent.<sup>1</sup> Yet the capacity of each province to generate revenue from the same tax base differs widely because of regional economic disparities. This means that equalization is the lynchpin to the entire system. Without equalization payments, the poorest provinces would not have been able to participate in the original cost-shared agreements to build up programs such as medicare. Yet the unconditional nature of equalization – no strings attached – means that all provinces retain an important core of autonomy.

A country is nothing other than people and we are no stronger than the weakest. Each of us and all of us are better when we make decisions that reflect our long held values of compassion, fairness, respect and decency. We bring this message around the world; it is time we brought it home.

Ross Reid



## The Evolving Nature of the Federation

Canada might have taken a different route to building the welfare state after the second world war, as did other federations such as the United States and Australia. The federal government could have delivered health, education and other social programs directly, which is what the Australians do. Or it could have imposed very specific conditions on the provinces for the delivery of programs in return for federal funding, which is what the Americans do. Canada did neither of these things, because we place greater value on provincial autonomy and decentralization. We have chosen in Canada to deliver the social security of the state mainly through the provinces, supported crucially by equalization and other transfer payments. The full consequences of these choices for our province are outlined in the chapter on fiscal federalism. Suffice to say here that the Canadian federal system puts an enormous strain on the limited public finances of the Newfoundland and Labrador government to perform its role in meeting the values and expectations of provincial residents *as Canadians*.

In his paper for the Commission on the development of the Canadian federal system, political scientist Roger Gibbins points out that the way Canada has chosen to develop its social programs has been especially beneficial to Newfoundland and Labrador, in that interregional sharing has become an important national political value. However, in national politics, it has not been the very limited influence of Newfoundland and Labrador that has caused these developments as much as it has been the relative regional disparity faced by Québec.<sup>2</sup> Had Québec's economic position been above the national average for the past 50 years, rather than being below it, our national policies in this respect would have been profoundly different. Of course, in keeping with its preferences for the way the federation should work to support provincial autonomy, Québec has also been very influential in sustaining a more decentralized approach to taxation and program delivery. The other provinces, to a lesser or greater degree, share these values about maintaining provincial autonomy.

Another major trend has been Québec nationalism and the federal response to it. Since the Quiet Revolution of the 1960s, Québec society has sought to redefine itself around Québec nationalism. Efforts to contain burgeoning Québec nationalism within the federation have absorbed the energies of a generation of political leadership in Canada. These efforts led directly to the successful patriation of the Canadian Constitution in 1982 and the strengthening of pan-Canadian language rights and other broad civil and political rights of individuals in the Charter of Rights and Freedoms. Yet they also led to the two Québec referendums on sovereignty and ultimately to the federal Clarity Act which sets out rules for how a province might secede from the federation.

These two developments, Québec nationalism and the Charter, combined with the growing emphasis on Aboriginal rights, have all paradoxically had the effect of strengthening the first of the trends noted above, i.e., pan-Canadian citizenship and a sense of Canadian nationalism.<sup>3</sup> In 1949, Newfoundland and Labrador joined a Canada whose politics was resolutely territorial and where the key definition of territory was the province. By 2003, Canada's politics are much more "non-territorial" and much less

based on the provinces as key units. In other words, Canadians now derive their political identity less and less from their province of residence (in the case of Québec this is because they do not want to be “just” a province) and increasingly from “non-territorial” aspects, such as their linguistic, ethnic, gender or Aboriginal identities – or simply from their identity as Canadians. This has led to a tendency to view provincial governments as just another set of stakeholders rather than as constituent members of the federation. National politics, in particular the federal government, appears to be much less sensitive than it once was to regional differences and interests. Canada is generally recognized among federations to be more decentralized than most.<sup>4</sup> However, from the perspective of this province and many others, the central government of the federation seems clearly to be less responsive to its constituent units than other federations are.

These long-term changes in the Canadian federal system leave Newfoundland and Labrador in an ambivalent position. As a province with significant regional economic disparity, we depend on the pan-Canadian value of sharing to ensure that we benefit from Canadian citizenship. Yet our identity as Newfoundlanders and Labradorians remains very strong. As national politics and the preoccupations of the federal government shift from a province-centered to a non-territorial focus, we are concerned that the interests, needs and even identity of our place may suffer.

The population of Newfoundland and Labrador makes up less than 2 per cent of the Canadian total, a proportion that is declining every year as the overall Canadian population increases and ours declines. But as a province, we are one of ten. To be fully Canadian for us means to have Canadian federal institutions and values that reflect and reinforce the provincial composition of Canada. There are a number of elements to this. First, there need to be intergovernmental mechanisms providing us with an equal place at the table. Second, there needs to be an elected Senate with equal representation from every province. Third, the country should respect the concept of provincehood. Newfoundland and Labrador gave up its status as a dominion to be a Canadian province, not some shadow of a province. With just half a million people we are small in Canadian terms, but we are still our own political community in a way that places with similar populations, such as Mississauga, are not. If Canada loses its ability to treat its constituent political communities equally, then the country will have lost the very essence of its federalism.

### *The Federation is Not Working Well*

Canadians should understand the reality of how power and influence are exercised, and how federal policy is made – from the perspective of this province – and compare it with their own experiences. Three aspects of that reality need to be spelled out. First, the political representation in the federal legislature and executive suffers from fundamental flaws. The province’s perspectives are submerged and marginalized in existing federal institutions. These institutions need changing. Second, federal administrative presence and policy, when it comes to Newfoundland and Labrador, are inadequate and a major source of alienation and frustration. Third, the intergovernmental relationship is vital to making the federation work, but it, too, has been neglected and is often acrimonious. We need a more collaborative spirit and more effective mechanisms to achieve our goals jointly.

### **Representation in the Federal Parliament**

The reality of the province’s political representation is that there are seven members of Parliament in the House of Commons out of a national total of 308. Constitutional and legislative guarantees exist to preserve that number as the province’s minimum representation. Ontario, by contrast, has 102 seats. Newfoundland and Labrador’s much smaller number of seats means that, if there is an issue that affects only or mainly this province such as foreign overfishing on the nose and tail of the Grand Banks, compared with an issue that affects only or mainly Ontario, such as the flow of traffic on the international

bridge at Windsor, the political reality is that the Windsor bridge gets the main attention while overfishing is ignored or seen as only a regional issue.<sup>5</sup>

Since 1949, our members of Parliament have all belonged to Canada-wide federal parties: Liberal, Progressive Conservative and New Democratic. We have not had a regional party, and our seven seats would unlikely have given us much influence as a regional bloc in any case. What this means, however, is that, due to the exercise of party discipline, voters in Newfoundland and Labrador do not always get to hear their members representing their interests, as this is usually done behind the closed doors of party caucus. Initiatives to reduce party discipline on more votes, to provide more leeway for private members' motions, or to provide committees with more scope and authority could increase the capacity of elected members to better represent their provincial constituencies.

Another key form of political representation is the Cabinet. Political convention since 1949 is that Newfoundland and Labrador has at least one seat around the Cabinet table. When a strong political figure holds that post, the regional minister can make up for a lack of numbers elsewhere.<sup>6</sup> Unfortunately, whether the federal cabinet minister is considered strong or not depends on political and electoral fortunes rather than on there being an automatic or systematic feature.

The problem of small province representation in federal institutions in Canada is compounded greatly by the lack of an elected upper house in the federal parliament. In virtually all other federations, the upper house acts to directly represent the people of the constituent units of the federation (states, provinces, cantons, etc.) or their governments. In Canada, our Senate is appointed, not elected, and by the federal Prime Minister, not by the provinces. Thus, while on paper the Senate has just about the same legislative authority as the House of Commons, in practice that authority is very seldom exercised because the Senate lacks democratic legitimacy. Unlike the Canadian Senate, the United States Senate, the German Bundesrat and the Australian Senate all have effective political power which they use to ensure that national policy reflects the interests of all the regions and governments of the country. The Commission believes that, if there was an elected Senate with equal representation of the provinces, regionally sensitive issues would get a fuller hearing and require more negotiation and compromise among regional interests in Canada.

One can think of several examples of major policy issues in the past 50 years when outcomes would have been different if federal institutions had greater built-in regional sensitivities. For example, one could argue that the 1980 National Energy Program would not have proceeded in the same way and not have been as damaging to western economic interests if the federal legislation had to be negotiated with an elected Senate. Or it could be argued that federal legislation and programs for industrial and regional development would have been more complementary and consistent in terms of regional balance if reviews by Senate or House of Commons committees had sufficient influence to overrule bureaucratic bias in Ottawa. More equitable and sensitive regional representation, while not eliminating national debate on these and many other issues, would have transformed it into more productive channels which would have likely led to more judicious and quicker resolutions.

Canadians from all parts of the country know that federal institutions do not adequately reflect their interests and aspirations, but it is more than something they just have to “live with.” Political and bureaucratic power in the Government of Canada is becoming ever more concentrated within the Prime Minister's Office and other central agencies.<sup>7</sup> The system has become dysfunctional not only for this province, but for the country as a whole. Canadians continue to face major policy issues on which national consensus is hard to achieve. Institutions that are able to mobilize more stable and equitable compromises will provide more effective governance over the long term.

Finally, part of the “problem” with Ottawa, from the perspective of people who live outside Ontario in particular, is a very old Canadian phenomenon, born of the sheer geographic size and diversity of Canada. That is the reflex that treats the interests and issues of central Canada as automatically of

national importance, while treating those from elsewhere as merely “regional.” From Newfoundland and Labrador’s perspective, for example, fisheries issues often require a national response, particularly when international law and diplomacy are concerned. But it is rarely accorded national significance partly because it is not economically or socially significant to central Canada. As Rex Murphy said recently: “It may not be a pleasant thought, but distance from the centre is, in far too many ways, for far too many people, the very measurement of this confederation’s worth and meaning.”<sup>8</sup> Better regional representation in the federal parliament might help to alleviate this problem, but it is unlikely to ever disappear. Not only government, but also private institutions and civil associations in Canadian society, including the media, have a responsibility to ensure that the concerns, interests – even passions – of one part of the country are understood and appreciated in other parts of the country. It is something for which, as Canadians, we all need to take responsibility. Success will come only if we are committed to accepting that responsibility and continually seeking creative solutions.

### Federal Administrative Representation and Presence

The second reality is the application of administrative power and policy. There are two dimensions to consider: first, the role of people from Newfoundland and Labrador in Ottawa, and second, the federal administrative presence in the province. Newfoundland and Labrador is even less well represented in appointed positions in the federal government than it is in elected ones.<sup>9</sup> There has been only one deputy minister from this province since Confederation. There has never been a Supreme Court justice. We have had very sporadic representation on major federal boards and agencies. It is worth noting that the federal government has made at least three major attempts in the past 30 years to ensure that the public service in particular reflects Canada’s diversity. The first was to make the public service bilingual. The second was to make the public service reflective of our multicultural and multiracial reality and the third to increase the representation of women. The time has also come to have a more proactive policy of better representing all provinces and territories of Canada in the federal administration. This could include more extensive use of executive interchange and recruitment at all levels from a broad geographic pool.

Another important dimension is the direct federal presence in Newfoundland and Labrador. The federal bureaucratic presence outside Ottawa has been declining for some time in Canada. This goes relatively unnoticed in the larger cities, but in smaller cities, towns and rural communities the elimination of post offices, Canada Employment centres, and small craft harbour authorities among others, has a disproportionate effect on local economies. More serious for Newfoundland and Labrador were the major federal budgetary cuts of 1995 in which across-the-board reductions in the federal presence occurred. Federal employment in Newfoundland and Labrador was cut by 38 per cent, the highest proportion of cuts of any province in Canada.<sup>10</sup> More efficient public management may have resulted through contracting out, privatization and, in some cases, the downsizing of federal operations. Nonetheless, the cumulative effect in this province has been a clear sense of federal abandonment. The federal government is regarded as less visible, more remote, and less engaged in the local society and economy. These trends have happened, if less severely, all across Canada. Yet, federal government employment in the national capital region has rebounded to early 1990s levels.<sup>11</sup>

What is less evident elsewhere is the consistent downgrading of federal administrative authority which has happened in Newfoundland and Labrador. There are no departmental Atlantic regional headquarters offices in this province, although 17 regional headquarters are located in Nova Scotia and 11 in New Brunswick. Prince Edward Island houses the national headquarters of the Department of Veterans Affairs. Regional headquarters are located in Newfoundland and Labrador only in those instances where federal regions are defined as a single province, such as with Fisheries and Oceans and Human Resources Development. The Canada Customs and Revenue Agency (CCRA) maintains a Regional Income Tax Processing Centre in St. John’s, but the CCRA’s Atlantic Regional Office is in Nova Scotia. Thus, for all

but two federal agencies, local federal managers must report to and obtain authority for a wide range of decision-making from regional headquarters located in Halifax or Moncton, not to mention Ottawa.

One recent example that speaks to this issue is this year's further diminishment of Environment Canada's weather forecasting office in Gander. In this age of information technology, why should high-tech services such as weather forecasting be based in Halifax and not Gander? Why cannot Gander be the weather forecasting centre for eastern Canada? The automatic assumption, merely because of our location, seems to be that national or regional administration has to be done in Ottawa or Halifax. Given the importance to this province of fisheries management, for example, a substantial portion of central federal administration should be based here. Finally, a small but notable case is that of the federal government's Canada Hibernia Holding Corporation. This organization performs the important function of administering the federal government's investment stake in the Hibernia oilfield project. Its office is located, not in St. John's, but in Calgary where it is lost in dozens of similar offices. The Commission is not aware of any technical, commercial or administrative reason why this office should not be based in this province.

Another aspect of the federal presence in Newfoundland and Labrador is the apparent "Atlantic region" policy of the Government of Canada. For administrative convenience, the federal government has for many years treated "Atlantic Canada" as a single unit. To most people outside Newfoundland and Labrador, administrative policies and practices that combine the four Atlantic Provinces are just common sense – four small provinces with similar interests. Yet from this province's perspective there are practical problems with this approach. There is no "Atlantic region" in the sense of a common identity of the people.<sup>12</sup> While some "Maritimers" have a common identity as such, virtually no one in this province shares that identity. Instead, the Atlantic region concept creates misconceptions, reinforced by the fact that the very distinction of Maritime/Atlantic is lost on most Canadians – that the Maritimes means the three provinces of Nova Scotia, Prince Edward Island and New Brunswick, but that Atlantic refers to those three plus Newfoundland and Labrador. Newfoundland and Labrador not only has a separate history and culture and a much larger and more diverse geography, but it also has significant differences in economic, social and political interests. In some limited respects, an Atlantic regional economy may exist, but the benefits of an Atlantic-wide policy seem mainly to accrue to Halifax or Moncton.

These differences limit the degree to which the Government of Newfoundland and Labrador can cooperate effectively with the other Atlantic Provinces – even though some cooperation takes place. In the past decade or so the four Atlantic Provinces, through the Atlantic Premiers' Council and similar organizations, have achieved some success in practical integration. This includes initiatives such as an Atlantic procurement policy for purchasing goods and services, the harmonization of regulation across many fields, and joint efforts at trade and tourism promotion, educational curriculum development, and a community college consortium.<sup>13</sup> Despite these accomplishments, the Commission's view is that Newfoundland and Labrador should pursue common Atlantic Province positions or integration initiatives on a case by case basis, when they have significant potential advantages for this province. There is no compelling evidence that a more general, all-purpose common front would make a sufficient difference to warrant the watering down of our specific interests.

More fundamental is the objection to the concept of an Atlantic region. It speaks volumes about our place in Canada. It reinforces the view that this place does not merit full provincial status and that provincial borders in the "Atlantic" should dissolve. And, of course, when we are continually integrated with the Maritimes, our true needs and aspirations are often rendered invisible. Most tellingly, it enables federal bureaucrats and, increasingly, federal politicians to claim that if it has been done in and for Halifax or Moncton, somehow it has also been done for Newfoundland and Labrador.

## Intergovernmental Relations

The third way the federal system currently works is through intergovernmental affairs. Canada is a work-in-progress, and intergovernmental relations represents one of the few ways in which that work can be effectively done. It is especially important in order for provinces to ensure their place in Canada. This is so, not only for this province, but for all provinces, especially the smaller ones. Just as Canada benefits from rules, norms and institutions at the international level that temper the power of the big powers, so too smaller Canadian provinces can benefit from rules and mechanisms that enable the federation to work more equitably.

While the federal constitution attempts to divide jurisdiction as much as possible, in practice many areas of policy are shared. This interdependence was growing in Canada just as Newfoundland joined the union, and became ever more intense over the next forty years. Federal/provincial negotiations, consensus and agreement became the norm for dealing with such major policy fields as social programs (including medicare, social assistance, post-secondary education and housing), the environment, regional development and trade promotion. Intergovernmental relations involve a wide array of forms: bilateral, multilateral, regional and cross-Canada. Governments are free to pursue whichever forum suits the issues. However, for the federal system as a whole, the most important intergovernmental relationships are the joint federal/provincial/territorial ones, through which national, and not just federal policy, is often formed. The system of federal/provincial and interprovincial relations (much of the time including the three territorial governments as well) has played an enormous role in effecting cooperative change in Canada.

Intergovernmental arrangements and cooperation have served this province well since 1949. These have included bilateral agreements such as the General Development Agreements (GDA) and Economic and Regional Development Agreements (ERDA) from 1974 to 1994, the Atlantic Accord of 1985, the Hibernia agreement of 1991, as well as the multilateral agreements such as the Constitutional Accord of 1981 and the Agreement on Internal Trade of 1995. However, the federal government seems increasingly less interested in cooperative approaches, in regular intergovernmental exchange and in reaching national (i.e., federal and provincial) consensus on major issues.<sup>14</sup>

Intergovernmental relations have come under some fire in recent years. As a result of the Meech Lake situation, many Canadians came to distrust the closed and executive nature of these mechanisms, especially when such fundamental things as the constitutional future of the country were being discussed. Complex intergovernmental fiscal arrangements have blurred a sense of accountability for who is responsible for what, seen, for example, in the health care field.<sup>15</sup> Also, some critics think that competition among governments produces better results in the long run: that it is good that governments compete for electoral favour and sometimes choose to be uncooperative. This Commission does not deny that some competition can be a good thing, nor does it deny the reality that in our system of partisan politics, political leaders can have ideological and other differences that limit cooperation. However, on balance, the Commission is convinced that more collaborative relationships, not less, are required in the future. This is true nationally and internationally. The Government of Canada has been preoccupied in recent years with Canada's changing global position; it is vital that Canada has a sustainable and stable role in international matters. Whether it relates to the World Trade Organization, the Kyoto Protocol on Climate Change or global public health, effective governance means effective multi-level relations reaching from the local to the international level. Federal/provincial relations, properly conducted, can contribute to maintaining Canada's position in the world.<sup>16</sup>

Our present intergovernmental institutions have limits when it comes to effective decision-making. Federal/provincial mechanisms are too ad hoc and too dependent on the will of the federal government. The decision to have a First Ministers' meeting is in the hands of the federal Prime Minister alone; there is no regular schedule or formal agenda-setting process. The decision-making within intergovernmental

meetings is also very informal: no votes are taken and decisions are not binding in law, which often limits results to watered-down consensus. At the very least, the federal/provincial/territorial forums could build upon the practice in the past decade of the Annual Premiers' Conference (APC – Provinces and Territories). The APC has become more focused, benefits from more extensive preparation and follow-up, and has taken on a more ambitious policy role. This has led to more productive interprovincial relationships.<sup>17</sup>

Many of the major opportunities for achieving prosperity and self-reliance depend on a productive relationship between governments. Building and maintaining a successful partnership requires a strengthened intergovernmental affairs organization, led by a strong minister and supported by a team of advisors with knowledge and experience in federal/provincial matters and relationships. Also required is a carefully considered, long-term, comprehensive intergovernmental strategy. This involves setting priorities and communicating them consistently to the federal government and other provinces. The strategy should be based on careful policy research and analysis, not only with respect to relationships with the federal government, but also with the key neighbouring governments of Québec and the Maritime Provinces, with the other provinces and territories, and with our closest international neighbours, St. Pierre and Miquelon and the New England States.

The only physical border which Newfoundland and Labrador shares with any other province is with Québec. Our relationship with that province has been under strain for some years because of the Churchill Falls arrangements and the lack of the development of the Lower Churchill. It now is time to look in a much broader and longer term context at whether Newfoundland and Labrador and Québec can achieve stronger political, economic and cultural ties. This could extend, not only to hydroelectric power, but to many other areas where there are common opportunities and challenges, such as economic development and transportation on the Lower North Shore of Québec and the Straits of Labrador. There are also joint discussions which can take place on the potential offshore oil and gas development in the Gulf. Now is the time to break new ground in our relationships with Québec.

### *The Opportunity for Intergovernmental Renewal*

This Commission is reporting at a moment of significant potential change in the Canadian political landscape. Earlier this year Québecers elected a new government led by Premier Jean Charest who is placing a renewed focus on making the Canadian federation work better. Several other provinces will also hold elections this year. At the federal level, a leadership process is underway to find the Honourable Jean Chrétien's successor as Prime Minister, providing what will be in essence a new federal government.

In response to the growing dissatisfaction with our political institutions among Canadians everywhere, there now appears to be an openness to change. We see that dissatisfaction expressed in calls for electoral reform, for more openness in parliamentary debate, for a greater role for free votes and for less rigid party discipline. We see it expressed in recent proposals for Senate reform, for a Council of the Federation, and for other ways to make intergovernmental relations more effective. However, we do not see any groundswell for constitutional change, which many see as leading to conflict and paralysis.

There are both risks and opportunities for Newfoundland and Labrador in this new era of Canadian federalism. Over the years our province has supported both a strong federalist and centralist power structure in Canada, reflecting our fiscal dependence on the federal government and the need for the federal government to counterbalance the interests of larger provinces. This strategy, at least as a general proposition, has not worked to significantly change our place in Canada. Alternatively, this province has at times cast its lot with the group of provinces seeking more power from the federal government – recognizing as many Canadians do that better decisions are those made closer to the people. While such a strategy may be beneficial in specific instances, the Commission believes that there should be a strong federal government, sensitive to the needs of the provinces and territories. But there should also be strong



provinces. Such a balance is better for Newfoundland and Labrador. Ours is a small province with limited fiscal capacity. Canada needs a strong federal government to preserve its own place in the world and to work with the provinces and territories to promote common Canadian goals.

As stressed at several points in this Report, this Commission believes that the longer-term interests of Newfoundland and Labrador are best served by a *balanced and collaborative Canadian federalism*. This would have the following features:

- strong provinces and territories, among which the gaps in fiscal capacity decrease over time. The primary presumption would always be that when a province/territory is itself able to deliver a program, it would do so.<sup>18</sup>
- a strong federal government but with a much greater ability to represent all parts of Canada. This should include reform of the Senate to improve the representation of the provinces in the federal parliament.
- federal principles of sharing and sustaining the social union, which involve a recognition of a strong federal role in taxation and spending, but within the parameters of a jointly-determined approach as begun under the Social Union Framework Agreement.
- more predictable, regular and productive federal/provincial/territorial relations, led by the First Ministers. Governments should explore the options for more formal forums for federal/provincial relations.
- greater emphasis on intergovernmental partnership, not competition, to achieve collective goals. This can only happen, however, in an atmosphere of respect and trust.

Within these principles, there is much room for continued adaptation, negotiation and flexibility. As the province's experience in Canada has shown, the federation is a work-in-progress. This Commission and the people of Newfoundland and Labrador look to our provincial and federal representatives, and to the representatives and governments of other Canadians, to start working together to do just that.

The primary responsibility lies with the Government of Newfoundland and Labrador and the Government of Canada. They must deal more collaboratively with one another, seeking common solutions to such problems as restoring the groundfish fishery and achieving more equity in offshore oil revenues. This will require a conscious and concerted effort to build personal and governmental relationships at all levels. A productive and mature relationship will be based on open and frank communication and trust.

Yet there are many other kinds of alliances that our provincial government must prepare for and promote. These include:

- a tripartite partnership with Québec and the federal government on new hydroelectric developments in Labrador.
- a partnership with other resource-producing provinces on equitable resource revenue arrangements.
- a partnership with other provinces to reform the mechanisms of intergovernmental relations and to achieve consensus on an elected Senate.
- a partnership with the federal government and all the provinces and territories on such multilateral issues as fiscal arrangements (equalization, Canada Health and Social Transfer) and on broad, cross-Canada challenges such as a national strategy for rural Canada.

In forging these alliances, one realizes the truth of the old adage that “There are no permanent alliances, only permanent interests.” However, the Commission's goal generally has been to show that the Canadian

federation is only as strong as its weakest link, that the federation must work better, not only for our province, but for all.

## *Conclusions*

The Government of Newfoundland and Labrador seeks a new relationship with the federal government and other partners in the federation. The Canadian federation is founded on the principle of sharing power between federal and provincial governments. While in constitutional terms all provinces are equal, in reality they are not. Some have much larger populations and much bigger economies. The population of Newfoundland and Labrador is less than 2 per cent of the Canadian total. But, as a province, we are one in ten.

For Newfoundland and Labrador to be a full Canadian partner, it is necessary to have a federal government and other institutions with values that reflect and reinforce the provincial composition of Canada. The following provides a summary of our conclusions:

- Intergovernmental mechanisms must give provinces an equal place at the table. Smaller provinces and territories feel especially exploited and are united in their frustration over their inability to bring about change in the federation. There is an uneasy sense that the federal government has a strong bias toward diminishing the role of provinces. The Commission supports the calls made by many provinces/territories for annual and better supported First Ministers' meetings.
- An elected Senate is needed with equal representation from every province. This is a longer-term goal in that it requires constitutional amendment. The provinces should work together to achieve consensus on an agenda for Senate reform.
- The concept of provincehood should be more strongly valued in the operation of the federation. The provinces are not just another set of "stakeholders." Nor should the Government of Canada assume that Newfoundland and Labrador's needs and interests are always covered by reference to an Atlantic region policy. The federal government should respect this principle in all its policy initiatives and in program implementation. The federal public service must also be more sensitive to Canada's regional diversity. Options for improvement include: extensive travel of senior public servants to the provinces/territories, regular meetings on substantive issues held outside the nation's capital, executive interchanges between senior provincial/territorial and federal officials, and a proactive federal government policy of greater participation of all the provinces in the senior levels of the public service.
- The level of federal government presence in the province is an important economic indicator of how seriously the federal government sees its role in Newfoundland and Labrador. The recent abandonment of the weather office in Gander is a prime example of the ease with which the Government of Canada can diminish its presence in Newfoundland and Labrador based on an overall Atlantic strategy.
- The Government of Newfoundland and Labrador must become better organized to deal more effectively with the Government of Canada and other governments in the federation. The Minister of Intergovernmental Affairs should be a powerful member of Cabinet who can deal effectively across departmental lines and be a champion in Ottawa on all things important to the province's place in Canada. It would be ideal if the Intergovernmental Affairs minister were the premier of the province or, alternatively, a minister with the status of deputy premier.
- The provincial government needs to have a carefully considered, long-term comprehensive strategy for intergovernmental affairs, setting out priorities and communicating them consistently to its federation partners. The senior advisers in Intergovernmental Affairs should be second

to none within the province's public service. They should understand the complexities of the federal system and develop close working relationships with the federal and other governments. A key role of the strengthened office of Intergovernmental Affairs would be to help the federal government and its advisors gain a far better understanding of the province. The first and most important task in the new intergovernmental strategy would be to present, at the earliest possible date, a comprehensive overview of our place in Canada to federal cabinet ministers and senior advisors.

In summary, the Commission calls for a firm but reasoned approach to building the relationship between the federal and provincial governments. The Commission anticipates a broad agenda for intergovernmental renewal, and this should engage the provincial government fully. The Commission has noted that these matters are of increasing interest to Canadians throughout this country.

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“... the feeling of being left out constitutes one of the soft fractures of this Confederation, as alive in Newfoundland and the East Coast as it is, depending on the time of day, say in Alberta.

*Rex Murphy*

“We have lost control of our lives. We have a sense that we have no power.”

*Excerpt from the Public Consultations*

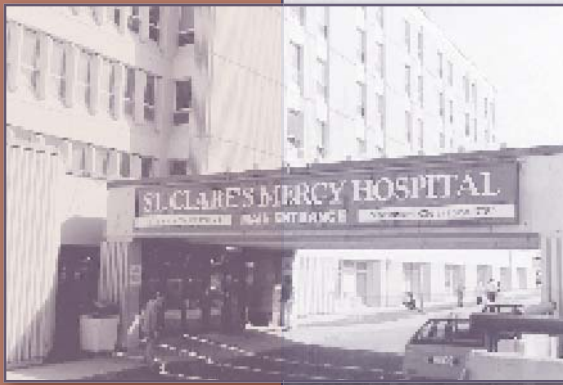
“Despite valiant efforts to avoid such a fate and strong evidence that Canada's tenth province differs substantially from its Maritime cousins, Newfoundland and Labrador found its identity submerged in a region that had already congealed in the Canadian vocabulary by 1949.”

*Margaret Conrad*

*Address to the Newfoundland Historical Society, May 2003*



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## *Fiscal Federalism*

In the Commission's hearings and consultations, many people expressed concern about the state of the province's public finances, about the inadequacy of its public services and about its not meeting Canadian standards for social programs such as health care. The Commission heard from post-secondary education institutions and their students, and from people on social assistance. These issues involve fiscal federalism, the arrangements whereby social and economic programs are funded and delivered within a federation.

In Canada, the federal government has an advantage over provincial governments when it comes to raising revenues. Provincial governments, especially in smaller provinces, recognize that an increase in provincial tax rates may cause their taxpaying citizens and businesses to relocate to other provinces. Such relocation is ineffective against federal government taxes. On the expenditure side, however, the responsibilities of provincial governments are substantial. For instance, the provincial governments must provide health care and education, both of which are very costly. Having such spending responsibilities, but with less scope than the federal government to raise revenues, causes a "fiscal gap" for provinces generally. To address this, a system of intergovernmental transfers is needed. For the federation to function properly, the transfers from the federal to provincial governments have to be sufficient to do what is required.<sup>1</sup> If not, there will inevitably be a "vertical fiscal imbalance," with the result that provincial governments will not have sufficient funds to adequately deliver the programs for which they are responsible.

The provincial and territorial governments argue that such an imbalance has existed for some time. In 2001, Québec established a Commission on Fiscal Imbalance, chaired by Yves Séguin. Its report, released in 2002, concluded that there was a serious imbalance, and warned that the federal government's strong fiscal position was allowing it to encroach into areas of provincial jurisdiction rather than partnering with provincial governments.<sup>2</sup> Subsequent to the Séguin Report, a further study prepared by the Conference Board of Canada for the provincial and territorial governments also concluded that there is a substantial vertical fiscal imbalance.<sup>3</sup> While the federal government may not agree that there is an imbalance, it cannot deny that sustaining an adequate level of social programs requires that it make transfer payments to provincial governments.

Intergovernmental transfers are made in all federations, either through formal programs or on a discretionary basis. In Canada, the federal government currently has two major intergovernmental transfer programs: the equalization program and the Canada Health and Social Transfer (CHST). Equalization provides unconditional grants to provincial governments with weak abilities to raise revenue. The CHST goes to all provincial and territorial governments and is intended to support their programs in health care, post-secondary education and social assistance. In addition, the federal government's regional development programs can include such intergovernmental transfers as cost-sharing agreements with individual provinces.

"[Intergovernmental payments] illustrate the Commission's conviction that...provincial autonomy must be respected and strengthened, and that the only true independence is financial security....They are designed to make it possible for every province to provide for its people services of average Canadian standards....They are the concrete expression of the Commission's conception of a federal system which will preserve both a healthy local autonomy and build a stronger and more unified nation."

Canada 1939 Report of the Royal Commission on Dominion-Provincial Relations Vol. 2 (King's Printer, Ottawa, p. 125.)



## Fiscal Federalism

These transfer payments reflect the practical Canadian values of provincial equality and autonomy, sharing and equity, and efficient public services. Fiscal transfers also play an important part in promoting national economic efficiency and integration by ensuring that tax burdens are not significantly greater in one part of the country compared with another, and by ensuring that people move to take up economic opportunities, not just to attain better public services and lower taxes.

Fiscal arrangements are vital to sustain the social union in Canada by helping to meet the need for similar standards of social programs and other entitlements. What Canadians want and have come to expect in terms of social entitlements differs very little from province to province. Health care is the most obvious example, but it also extends to other areas. Newfoundland and Labrador has been a strong supporter of the evolving social union over the years, including the 1998 Social Union Framework Agreement (SUFA) between the federal government and all the provinces and territories except Québec and Nunavut. That agreement provides a mechanism whereby the federal, provincial and territorial governments may establish ground rules for federal programs that fund provincial and territorial social programs, as well as for federal programs in areas of provincial and territorial jurisdiction. Thus, its purpose is to ensure that the federal government acts in partnership with provincial and territorial governments. To date, SUFA has not lived up to expectations,<sup>4</sup> but it may yet provide a basis for a balanced arrangement among all the governments to guide social program transfers.

Fiscal federalism is also a practical means to fulfill the principles enshrined in section 36 of the Constitution Act, 1982:

36(1) Without altering the legislative authority of the Parliament or of the provincial legislatures, or the rights of any of them with respect to the exercise of their legislative authority, 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 disparity in opportunities; and
- (c) providing essential public services of reasonable quality to all Canadians.

36(2) 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.

The principles in section 36(1) show that equality of opportunity is an important Canadian value. It means that specific measures to promote development in provinces with economic disparities can make important contributions to promoting equality of opportunity and reducing the disparities. "Essential

public services of reasonable quality” is also part of that commitment, which is further supported by the commitment to making equalization payments in section 36(2). These constitutional principles mean that fiscal arrangements should help promote, not hinder, major economic development opportunities that can reduce disparities and promote equality of opportunity.

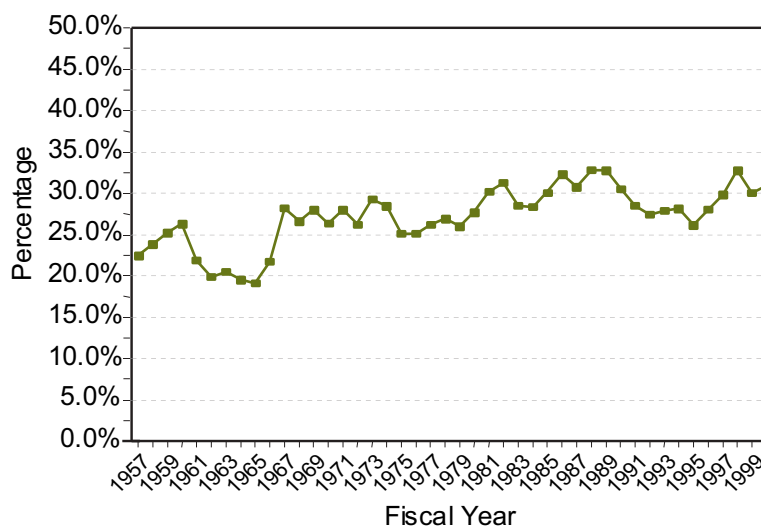
## *Equalization*

The equalization program is entirely financed by the federal government. Since its beginnings in 1957, its purpose has been to provide funds to provincial governments so that they can offer similar levels of public services without having to resort to much higher tax burdens than in other provinces. The equalization program has been an important source of revenue to most provincial governments. At times, as many as nine provincial governments have been in receipt of equalization payments from the federal government. In 2003-04, such payments from the federal government are estimated to total \$10.5 billion, of which more than \$850 million represents the entitlement of Newfoundland and Labrador.

These payments have been, and continue to be, an especially important source of revenue for Newfoundland and Labrador. Figure 9.1 shows that equalization payments have typically equalled between 20 per cent and 35 per cent of total provincial government revenues, far more than is usual in other recipient provinces.

**Figure 9.1**

### **Equalization as a Percentage of Total Revenues Newfoundland and Labrador**



**Source:** Department of Finance, Government of Newfoundland and Labrador.

The federal government has always followed a revenue-based formula as the means of calculating a provincial government’s equalization entitlement. In its most basic form, the formula uses just three steps to determine a province’s annual per capita entitlement. First, the federal government establishes a revenue benchmark, or standard, which is expressed in dollars per person. Second, it determines each provincial government’s ability to raise revenue; this is referred to as a province’s fiscal capacity, and is also expressed in dollars per person. Third, the difference between the standard and the provincial fiscal capacity is calculated. Any amount by which the standard exceeds the fiscal capacity is the amount of the province’s equalization entitlement on a per capita basis. This per capita entitlement, multiplied by

the province’s population, is the total equalization entitlement. If the standard is equal to or less than a province’s fiscal capacity, there is no equalization entitlement for that year.

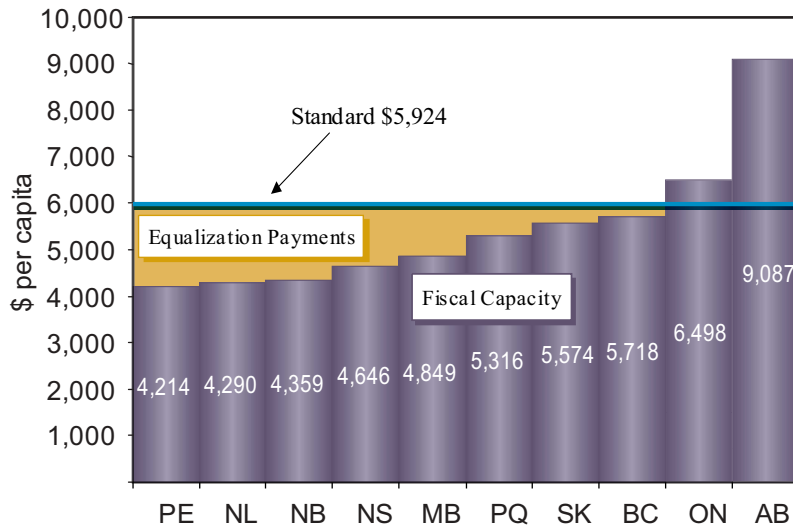
Initially, the standard was based on the ability of the two richest provinces in raising revenues from three sources: personal income tax, corporate income tax and succession duties. Over time, the standard has been considerably broadened to include many more sources of revenue, such as general sales taxes, the income of government Crown corporations, tobacco taxes and, in varying degrees, natural resource revenues. The reference set of provinces used in the standard was initially two provinces, then changed to include all ten provinces. Since 1982, five provinces have been part of the standard, namely British Columbia, Manitoba, Ontario, Québec and Saskatchewan. The standard is now the estimated per capita revenue that these five provinces would raise if they used the national average tax rates for each of over 30 revenue sources.<sup>5</sup>

A province’s fiscal capacity is currently measured as the estimate of how much revenue it could generate from the same set of revenue sources used in the standard, under the assumption that the provincial government imposed the national average tax rate corresponding to each of those sources. Thus, fiscal capacity is not how much revenue is actually collected, but an estimate of how much a provincial government could collect if it applied the national average tax rates.

Figure 9.2 shows estimates of the fiscal capacities of provincial governments and the standard for the fiscal year 2003-04. The standard is \$5,924 per capita. As can be seen in Figure 9.2, Ontario and Alberta have higher fiscal capacities than the standard and so are not entitled to equalization. Newfoundland and Labrador has a fiscal capacity of \$4,290 per capita. Since this is less than the standard, the provincial government is entitled to equalization for this year. According to Figure 9.2, seven other provincial governments are entitled to equalization for this year.

Figure 9.2

### The Equalization Formula 2003-2004



Source: Government of Canada, Department of Finance, First Equalization Estimate 2003-04, February 2003.



The dollar amount implied by the difference between the standard and a province's fiscal capacity may not be the actual entitlement for a provincial government. The federal government makes adjustments for any ceiling or floor provisions that may be in effect. Ceilings have been used to put a limit on the total amount that would be paid out in equalization. During the 1990s, the federal government tightened ceilings on total payments, leading to equalization payments substantially below those implied by the differences between the standard and fiscal capacities of the provinces. In 2003, however, the federal government agreed to remove the ceiling provision. The floor, in contrast to the ceiling, applies to individual provinces. If a province's entitlement, as determined by the difference between the standard and its fiscal capacity, falls in a specific year, the floor provision allows for payments to ensure that the loss in equalization does not exceed a certain amount. In 2001-02 and 2002-03, Newfoundland and Labrador received floor payments. In various years since 1992, New Brunswick, Saskatchewan, Prince Edward Island and Nova Scotia have also received floor payments.

Another significant component of the program is the "generic solution," introduced in 1994: if a province has 70 per cent or more of a single revenue source, then 30 per cent of that province's revenue from that source is excluded from the calculation of its fiscal capacity. The generic solution was adopted due to a recognition that a province with a very large share of a revenue source could influence the national average tax for that revenue source. In practice, the generic solution applies only to revenues from a few natural resources in some provinces; in some years it has applied to Saskatchewan's potash and heavy oil, Nova Scotia's offshore gas and Québec's asbestos. Importantly, it can also be invoked for Newfoundland and Labrador's offshore oil revenues, an issue that will be discussed later in this chapter.

In principle, the equalization program is an attractive method for determining intergovernmental transfers. Funds generated by the federal government's superior access to revenues are transferred to provincial governments that, unless they impose extraordinarily high tax rates, do not have access to revenue sources sufficient to fund the public services for which they are responsible. The most important element of the current equalization program is its unconditional nature. There are no strings attached to how the recipient provinces spend the money. This is an entirely appropriate arrangement in a federation. The provincial governments do not tell the federal government how to collect these revenues, and the federal government does not tell the provinces how to allocate the funds among the public services for which they are responsible. However, some aspects of the program are of concern. These relate to the adequacy of the payments and to the manner in which natural resource revenues are currently treated in the formula.

The first to be considered is adequacy. The overall level of funding for the equalization program has been contained by the federal government. This has been done by various means. The federal government's redefinition of the standard in 1982 had the effect of lowering the standard; excluding Alberta brought the standard down more than the exclusion of the Atlantic Provinces brought it up. During the 1990s, the tightening of the ceiling, to the point of freezing it in some years, also reduced the amount the provinces would have received under this less generous standard. The effect of these cost-containment measures, especially coming at a time of growing demands for public services that are the responsibilities of the provinces, was to place many provincial governments in difficult circumstances. The ceiling has now been removed but, unfortunately, the five-province standard has not yet been changed.

Another element of the adequacy issue relates to population decline. It is particularly important to this province, and it is likely a concern shared by other provinces, particularly Québec and Saskatchewan. The 10 per cent decline in the population of this province since 1991 has been dramatic. The decline underscores the severity of the economic challenge facing this province. It also creates an equalization-related problem. A province's equalization entitlement is equal to its per capita entitlement multiplied by its population. If the population declines, the total entitlement declines as a result. However, with sizeable

reductions in the population, it is extremely difficult to reduce program expenditures that were based on serving a larger population. Moreover, debt obligations must still be paid.

Compounding this problem is the fact that equalization entitlements are based on estimates of the population. When it turns out that a province's population has declined more than was initially estimated, or has increased less than estimated, the federal government can then seek to recover prior overpayments. This is unfair and impractical in the short term. It is impossible for provinces to adjust their spending programs retroactively, and it is impractical to make complete adjustments in the short term. In the view of the Commission, the equalization formula should include a population-floor provision in order to phase in the impact of a population loss on a province's equalization entitlement in any one year from the previous year's entitlement. This provision is distinct from the current equalization floor provision which does not address population loss, but typically limits a province's equalization losses caused by a large change in its per capita fiscal capacity relative to the per capita standard. An allowance should also be made for retroactive population estimates that are disadvantageous to any province.

Apart from adequacy, there is a second concern especially important to this province and to Nova Scotia, i.e., the treatment of natural resource revenues.<sup>6</sup> The purpose of an equalization payment is to fill any gap between a province's fiscal capacity and the equalization standard. Therefore, by design, if the gap widens, a province receives more equalization, and if the gap narrows, a province receives less. The latter effect is sometimes referred to as a "clawback." When a province's fiscal capacity improves generally, there is usually little debate about that effect. However, controversy occurs when the improvement in fiscal capacity arises from increased natural resource revenues. This controversy did not originate in Newfoundland and Labrador. It has been ongoing almost since the beginning of the program, and reflects an even longer and wider debate over the extent to which provinces should control and benefit from their natural resources.

For Newfoundland and Labrador, the extreme implications of the clawback became striking in 1982. In that year, the federal government redefined fiscal capacity to include all non-renewable natural resource revenues; at the same time, it removed all of Alberta's non-renewable natural resources from the standard by excluding that province from the reference provinces in its new five-province standard. In the five years prior to 1982, 50 per cent (rather than all) of these revenues had been included in both the standard and fiscal capacity. With the new definition, this province's revenues from offshore development would now be offset on a dollar-for-dollar basis through reductions in equalization, rather than on a 50 cents on the dollar basis as under the previous arrangement. Nova Scotia faced the same prospect with regard to oil and gas off its coast. The consequences of the situation were obvious. Without some action, offshore developments would lead to no net increase in revenues to these two equalization-dependent provinces; at the same time, the federal government would be saving on equalization payments and adding to its own revenues from applicable federal taxes.

In recognition of this problem, both the Canada-Nova Scotia Offshore Petroleum Resources Accord of 1986 and the Canada-Newfoundland Atlantic Accord of 1985 incorporated "offset" payments. Under the Atlantic Accord, Newfoundland and Labrador can receive some compensation (i.e., offset payments) from the federal government for any year-over-year reductions in equalization entitlements during the initial years of oil production. The Atlantic Accord, like the Nova Scotia Accord, is not part of the equalization formula. The Atlantic Accord will be discussed in more detail in Chapter 11.

Within the equalization program itself, there is an alternate way to avoid a dollar-for-dollar loss in equalization payments as offshore oil revenues increase. It is the generic solution. Newfoundland and Labrador's offshore revenue consists almost entirely of oil royalties and provincial corporate income taxes on oil companies. The sum of those revenues is designated as a unique revenue source in the equalization formula. Thus, by definition, the province has 100 per cent of this revenue source. Consequently, the generic solution can be applied. When it is applied, 70 per cent rather than all offshore

revenue is included in the measurement of the provincial government's fiscal capacity; this limits the decline in equalization to seventy-cents per dollar of offshore oil revenue. The federal government allows the provincial government to opt for either the Atlantic Accord offset payment provision or the generic solution, but not both. Oddly, the federal government requires the choice be made before all the revenue figures are finalized, so there is the risk of selecting the less advantageous of the two. It is the view of the Commission that the provincial government must be assured that it will receive whichever option yields the greater benefit.

For 1999-00 and 2000-01, the provincial government chose the generic solution. It opted for the Atlantic Accord's offset provisions for 2001-02, 2002-03 and 2003-04. According to federal government estimates, the offset payments for those three years amount to \$44.8 million, \$163.4 million and \$132.2 million respectively.<sup>7</sup> It is likely that the Atlantic Accord offset provisions will continue to be chosen as oil production and expected revenues rise in the next few years, after which time the generic solution will again be the more advantageous. Thus, the generic solution may be of great importance to Newfoundland and Labrador in the years ahead. The Commission recommends that, in the next scheduled federal review of the equalization program in 2004, the generic solution be enshrined for the long term.

The Commission noted that the Standing Senate Committee on Finance, in its March 2002 report, not only endorsed the idea of returning to a ten-province standard but also supported liberalizing the generic solution so that a greater share of non-renewable resource revenues could be retained by recipient provinces. Other federal bodies have made similar recommendations. The 1985 Report of the Economic Union and Development Prospects for Canada, a federal royal commission chaired by Donald Macdonald, recommended a ten-province standard and an even more liberalized treatment of natural resource revenues. Notably, it recommended that 20 to 30 per cent of natural resource revenues be included in the equalization formula.<sup>8</sup>

Finally, beyond adequacy and the treatment of offshore oil revenues, there is an ongoing, fundamental problem with equalization. The federal government can, and does, unilaterally change the program according to its interests. While the program is renewed in five-year cycles, with each renewal involving consultations with provincial governments, the federal government determines all aspects of the program. Substantial changes to the program, whether introduced at renewal time or other times, can be very disruptive to provincial governments' budgets and force abrupt policy changes as a result. While the federal government must have some latitude to adjust the program, especially in light of unanticipated events, there also should be some limiting mechanism so that the adverse impacts on provinces can be minimized. The establishment of a credible national institution to advise the federal government on equalization (e.g., Australia's Commonwealth Grants Commission) might be worthy of consideration.<sup>9</sup>

### *The Canada Health and Social Transfer*

The other major mechanism by which the federal government transfers funds to the provincial and territorial governments is the Canada Health and Social Transfer (CHST). These funds, which go to all provinces and territories on per capita basis, are specifically intended to assist in financing provincial health care, post-secondary education and social assistance programs. The federal government's total spending on the CHST is actually larger than its expenditure on the equalization payments. However, as is the case with other provinces with fiscal capacities substantially below the standard, Newfoundland and Labrador receives more in equalization payments than it does from CHST payments. Table 9.1 shows this comparison for 2002-03.

Table 9.1

Total CHST and Equalization Payments to Provinces (2002-03)		
	Estimated Payments to All Recipient Provinces	Estimated Payments to Newfoundland and Labrador
<b>CHST</b>	\$19.1 billion	\$347 million
<b>Equalization</b>	\$10.3 billion	\$904 million

Source: Department of Finance Canada “Federal Transfers to Provinces and Territories” February 2003

The federal government claims its CHST contribution is higher than its payments as shown in Table 9.1 because it states that “tax points” should be included. This refers to the fact that, in 1977, the federal government withdrew from cost-sharing health care and post secondary education programs and reduced its income taxes to give the provincial governments room to raise theirs. As such, these tax points really refer to funds raised by the provincial governments using their own taxes; there is no payment from Ottawa in relation to these tax points.

The CHST was created by the federal government in 1996. It did so by merging two existing programs: Established Program Financing (EPF) and the Canada Assistance Program (CAP). EPF was the federal government’s contribution to financing provincial health care and post-secondary education. CAP was a cost-sharing arrangement that assisted with provincial social welfare programs. When the federal government merged EPF and CAP into the CHST, it substantially reduced their total funding. As Table 9.2 shows, by 1998-99 overall funding, as well as funding to this province, was approximately 33 per cent less than in 1995-96.

Table 9.2

Estimated Federal Cuts Embodied in the Introduction of the CHST			
	1995-96 EPF and CAP	1998-99 CHST	Reduction
<b>Total</b>	\$18.5 billion	\$12.5 billion	32.4%
<b>NL</b>	\$413 million	\$276 million	33.2%

Source: Department of Finance, Government of Newfoundland and Labrador

Recently, the federal government has taken measures to alleviate the considerable hardship that accompanied those cutbacks. Still, it was only in 2001-02 that total CHST funding returned to approximately the same nominal amount as in 1995-96. Largely because of Newfoundland and Labrador’s population loss, CHST funding for this province in 2002-03 was still below the 1995-96 level. In the federal government’s 2003 budget document, *Investing in Canada’s Health Care System*, the federal government highlights its plans to increase CHST related cash transfers so that they grow nationally by an average of 7.3 per cent a year from 2000-01 to 2010-11. This increased level of funding is welcome. However, the federal government’s advertisement of its 7.3 per cent figure fails to acknowledge that it is calculated from a starting point at which funding was almost 20 per cent below its 1995-96 level and, for this province, falls short of providing a sufficient level of funding to meet its existing and increasing costs of health care.

Population losses compound the adequacy problems for Newfoundland and Labrador. As with equalization, when the population declines, our total CHST funding is reduced. Yet, it is difficult to reduce public expenditure on the associated social programs at the same rate that population is declining; even the extent of population loss is not known until some time after the fact. An economic slowdown or a shock to rural areas, such as the closure of the fisheries, can put more people on social assistance, at least

over the short-term. Facilities built for a larger population cannot be easily closed if it means denying the smaller population access to an essential social service. As this Commission has suggested with regard to equalization, some provision, perhaps a population floor, should be used in the determination of the total CHST entitlement and its planned replacements, the Canada Social Transfer (CST) and Canada Health Transfer (CHT). In its March 2003 Budget, the provincial government indicated that the population losses led to a cumulative loss in equalization and CHST related cash transfers of \$890 million from 1994-95 to 2003-04, a significant sum for a small province.

### *Federal Role in Economic Development*

By the late 1950s, it became clear that, despite strong national economic growth and development, several parts of the country lagged behind others. National economic policies did not benefit all regions to the same degree and, indeed, may have actually contributed to regional disparities.<sup>10</sup> The commitment to address regional disparities is part of the implicit bargain of Confederation: in return for the participation of its constituent parts in the national economic union, the country as a whole will assist provinces that fall behind fiscally or economically. As noted already, this commitment was explicitly included in section 36 (equalization and regional disparities) of the Constitution Act, 1982.

Since the 1960s, the federal government, usually in cooperation with the provincial and territorial governments, has undertaken a variety of programs for regional development aimed at addressing regional disparities.<sup>11</sup> Initially, regional development programs were targeted at slow growth rural areas in the Prairies and the Atlantic Provinces. By the early 1970s, such programs were expanded to Québec and, ultimately, to virtually every province and territory. In the process, this expansion weakened the original purpose of the programs. Since 1986, the Department of Employment and Immigration (now Human Resources and Development) has also been involved in rural economic development through its Community Futures initiative. By the 1990s, two factors combined to collapse this considerable effort at regional development: fiscal restraint and market-based critics of government intervention.

From the 1970s until the mid-1980s, the provincial governments increased their direct support to industry and agriculture through subsidization and other means. The federal government, through its Department of Industry and its successors, continued and expanded its support programs for targeted manufacturing sectors, mainly to those based in Ontario and Québec. Even with the revolution in public policy of the past 15 years, during which governments have abandoned many forms of market intervention and have adopted free trade as their primary industrial strategy, federal programs of support to industry continue. So, too, does funding from most provincial governments, although at lower levels. Meanwhile, federal funding for regional development has shrunk considerably. It cannot now compete, if it ever did, with the industrial programs of other branches of the federal government or the development funding of the larger provinces. Federal regional development is now a marginal activity in Canada.

A review of the past 50 years shows that this province has been a major recipient of federal funding for economic development purposes. Funding has covered a wide range of activities and purposes and has gone through a number of phases. The first phase, the 1950s and 1960s, dealt with basic catch-up infrastructure, including roads, schools, hospitals, airstrips and municipal water and sewer services. In this period, the federal government also cost-shared funding with the province for community resettlement. By the late 1960s, the focus had shifted to industrial development, including direct assistance in grants and loans to business, as well as more direct infrastructure such as industrial parks. In the 1970s and 1980s, while the direct assistance to business continued, cost-sharing with the province expanded to include broad economic development programs aimed at upgrading specific sectors and the provincial support structure for them (the 1974-1984 General Development Agreement and the 1984-1994 Economic and Regional Development Agreement). These sectors included mineral development, fisheries, agriculture, forestry, tourism, and general urban and rural development.

Some critics argue that, rather than help to lift an economy out of slow growth and dependency, regional development funding in fact perpetuates dependency by distorting market signals.<sup>12</sup> It is certainly true that the funds spent in these decades on economic development could not change nor deny the reality of market forces. However, even acknowledging that many criticisms of regional development in practice are valid – i.e., that many of these investments were wasted on poor business plans, that their delivery was excessively bureaucratic, or that funds were channelled to local projects on the basis of political “pork-barrelling,” – a more balanced assessment of regional development efforts should be made.

A balanced assessment begins with the recognition that scarce public funds must be put to the best possible use. Yet it seems that the federal government has “lost its way” in regional development policy. Over the years, too many federal agencies for regional development have suffered from blurred objectives and inconsistent and short-term application. Competition between the federal and provincial governments in Canada over economic development (a much broader pattern than just in Newfoundland and Labrador) has been held responsible for several shifts in program and policy focus and in the considerable volatility in the development and delivery of regional development programs.<sup>13</sup> In the process, the federal government has largely abandoned the idea of joint economic development planning with the provinces as entailed in comprehensive cost-shared agreements over the past 25 years.

Federal direct delivery and attempts to increase visibility can get in the way of sensible, long-term development strategy. For example, Industry Canada’s pilot program for improving broadband access in rural communities relies on “partnerships” with not-for-profit, community-based associations to compete for funds to attempt unintegrated and piecemeal development in local broadband infrastructure. The success of this program will be limited by the level of funding available (\$105 million for all of Canada) and by its reliance on voluntary organizations to provide such services. In this province, the more sensible approach would be to have an agreement with the provincial government and the private sector to build broadband access into health and education services. Such broadband access would then provide an essential network that individual consumers could use as well.

Instead, the current federal priority appears to be to use regional development funds provided by the Atlantic Canada Opportunities Agency (ACOA) to sustain political visibility. In the most recent fiscal year, 2002-03, the federal government, through the Atlantic Canada Opportunities Agency, spent approximately \$76 million per year in Newfoundland and Labrador for assistance to business and to more general community and industry-specific economic development. Meanwhile, the abandonment of a cooperative cost-shared approach is having a negative impact in the province. The \$95 million federal/provincial Comprehensive Economic Development Agreement signed in 1997 expired this year, with no successor agreement in sight. That cost-shared agreement provided critical funding for many government strategic initiatives and industry associations. Many tourism, cultural and heritage organizations told the Commission how vital funding from this agreement is to their organizations and, that without this funding, their futures are at risk. Also important for broad economic development purposes has been federal funding to the municipal infrastructure programs and funding for labour market development initiatives.

It is enormously difficult to prove cause and effect in evaluating regional development, unless one can point to a specific investment and its specific returns. Certainly, there have been some important commitments by federal governments at critical times in recent years. The financial assistance of \$1 billion to the Hibernia consortium to start up offshore oil development is not forgotten. The further assistance of the federal government’s taking an 8.5 per cent equity position in that consortium, after one of its private partners pulled out in 1992, was also a crucially important move. More recently, federal government financial assistance helped to facilitate the conclusion of an agreement between the province, Inco and its subsidiary to proceed with the development of the nickel deposit at Voisey’s Bay. These sorts of initiatives are important if this province is to break out of its “Catch-22” syndrome.

Because Newfoundland and Labrador is not rich, it cannot undertake such initiatives and, without these initiatives, it cannot become prosperous.

### *Conclusions*

The equalization program is crucially important to this province. For the program to meet its intended objectives, the Commission concludes that the following changes to the program are required:

- a return to a ten-province standard
- inclusion of a population floor provision in the formula to reduce the impact on a province's equalization entitlement due to population loss, including some accommodation for prior year losses
- preservation of the generic solution for the longer term.

In the view of the Commission, it is in the national interest to make such changes and to do so in the spirit of improving the federation for all Canadians.

An adequately funded CHST is required for provinces to provide quality health and social programs. Federal cuts to funding for these programs in the mid-1990s were severe. The current strong fiscal position of the federal government demands that this situation be rectified. The Commission is aware that CHST cash entitlements for this province are still not at the level they were prior to the cuts, despite additional federal funding this fiscal year. The Commission supports the position of the province that:

- for the health care system to be sustainable, the federal government must provide greater financial support to the province
- future federal contributions to CHST should be tied to an annual escalator that reflects program costs.
- In addition the Commission supports the inclusion of a population floor provision to reduce the impact on a province's CHST entitlement due to population loss, including some accommodation for prior year's losses

The federal and provincial governments have a role in providing strategic investments to remove obstacles to development and promote opportunities. The Commission's view is that these investments should be concentrated in two areas:

- co-operatively planned and funded economic development programs in support of research and innovation partnerships, and for communications and transportation infrastructure;
- large strategic initiatives to break barriers and to encourage major private development to get underway, such as occurred with the Hibernia project.

The Commission sees such economic development as another important aspect of a renewed partnership within Canada. The commitment to economic development is a fundamental principle underlying the Canadian federation. Canadians accept that principle, and the Constitution recognizes it.

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“We have been on the journey for 53 years now and can say with certainty that the decision to join the Canadian Confederation has improved the standard of living for our citizens. We have benefitted by becoming part of the country that the United Nations has consistently ranked among the best in the world and we pride ourselves on being part of a country that is respected in the global community.”

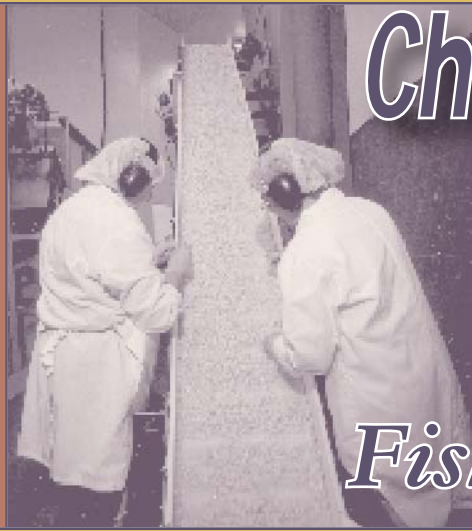
*Excerpt from the Public Consultations*

“Without a suitable improvement [in cost-shared programs], our province will continue to hemorrhage its talented artists, artisans and support personnel to other regions of Canada and beyond.”

*Excerpt from the Public Consultations*







The fishery, particularly the groundfish fishery, is at a crossroads, and its role in the provincial economy and in rural society is very uncertain. The fishery is at a point where it will either decline further or, more hopefully, regain its dominance through the rebuilding of the resource in a sustainable manner. Presently, the fishery is embroiled, yet again, in public and political debate about the recently announced closures in cod fisheries, specifically Northern cod and Northern Gulf cod stocks. The current frustrations are reminders of the failures of the past decade. These include:

- an expensive yet unsuccessful adjustment program
- cutbacks in fisheries science and enforcement that instill a sense that the federal government has given up on rebuilding the resource
- increased level of foreign overfishing
- shock and grief of rural communities which are being decimated by out-migration

The decline in the groundfish industry resonates throughout Newfoundland and Labrador. For over five hundred years, our society has been intimately intertwined with the ups and downs of the fishery. The current state of the fishery, therefore, strikes at the heart of “our place in Canada.” It is incredible that something so central to the economic and social life of Newfoundland and Labrador is rife with political infighting, intergovernmental competition and bureaucratic mismanagement.

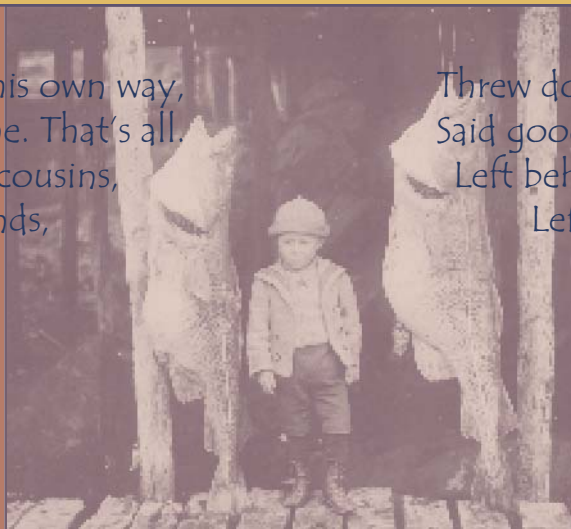
It is important to place the fishery of today in context, because the roots of the problems run deep. This chapter will briefly outline the history of the fishery and its importance to Newfoundland and Labrador. It will then address the issue of foreign overfishing and the management of “straddling stocks,” as well as the vexing issue of fisheries management.

### *The Changing Fishery and its Role in Newfoundland and Labrador*

The fishery in Newfoundland and Labrador has never been static. In 1901, when our total population reached 221,000, no less than 54,000 people, a staggering 72 per cent of those employed, were engaged in the fishery. By 1935, when the population had increased to 289,000, 46 per cent of the total workforce of 78,000 was directly employed in the industry. As late as the mid-1980s, despite 40 years of decline, the fisheries workforce was approximately 20 per cent of total employed persons, and represented over 50 per cent of those employed in the rural economy. In the current context, prior to the most recent closures, however, the fishery employed approximately 7.5 per cent of the provincial workforce. The value of landings due mainly to crab and shrimp has reached near record levels.

The fishery has played an important role in employment for females as well as males. While participation rates have changed over the years, females today make up slightly more than 20 per cent of the individuals

Each in his own way,  
They just came. That's all.  
Each in his own world of cousins,  
Sisters, loves and friends,  
One day at home in  
Europe,  
And the next  
With the movement  
already in his veins,



Threw down the reins of home  
Said good-bye to homely paths  
Left behind a native sod  
Left behind a nation growing  
Left behind a doubtful god  
And came, perhaps to fish  
for cod.

Tom Moore  
*Ancestors,*

## Fisheries

reporting fishing income. Women represent more than 50 per cent of those employed in the processing sector. However, the average income for women remains lower than for men.<sup>1</sup>

Change has also been a constant in the application of fishing technology. The most significant technological change since Confederation came as a result of the transformation to fresh-frozen production from saltfish processing. This change had major effects on employment and investment patterns; as a result, many communities were resettled in the 1950s and 1960s. Another dramatic change occurred in the 1950s with the introduction of factory-freezer trawler technology by foreign distant-water fleets. In addition, Canadians began utilizing otter-trawling technology to prosecute the offshore groundfish resources. This new harvesting technology had a dramatic negative impact on inshore (smaller coastal vessel) landings, especially by the mid-1970s. Governments at the time thought that jobs would occur elsewhere in the economy to offset the declines in the fishery. Indeed, many policy-makers saw the inshore sector of the industry as an obstacle to economic diversification.<sup>2</sup>

The decline and despair that pervaded the inshore fishery waned with the extension of Canadian fisheries jurisdiction in 1977. In fact, there was euphoria following the extension of jurisdiction by Canada and the phase-out of foreign fishing inside the 200-mile limit. There was a sense within the fishing industry and rural communities that Canada had achieved a solid recovery of most groundfish resources by extending jurisdiction to 200 miles. The extension of jurisdiction in itself was also seen to ensure an effective management of the fishery into the future.

In the years following the establishment of the 200-mile limit, the harvesting and processing sectors of the inshore and offshore fisheries launched a wave of investment. This expansion of the industry was largely financed through loans and subsidies from both the federal and provincial governments. As fish landings increased, a greater sense of community stability prevailed. By the early 1980s the industry was significantly overcapitalized. The overcapitalization, combined with the economic recession of the period and record-high interest rates, led to the failure of many firms in the groundfish sector. Following a deep financial crisis within the industry, governments and banks restructured most of the larger firms in 1983. Despite the financial restructuring, however, there was little or no rationalization of the harvesting or processing capacity within the industry.

Throughout most of the 1980s, the industry acted hastily and politically to harvest more and more groundfish and create more and more jobs; and it did so without any reasonable understanding of the state of the resource. In 1983, the Task Force on Atlantic Fisheries reported that "Canada's Atlantic coast fishermen should be able to catch about 370,000 tonnes more than they did in 1981... almost all of this increase will consist of cod... most of the growth will take place off northeast Newfoundland."<sup>3</sup> While stocks were beginning to recover following the decimation that occurred as a result of foreign fishing in prior decades, domestic fishing efforts were increasing significantly. It was not until the late 1980s that fisheries scientists began to question the true state of groundfish resources. By 1989, scientists were

recommending that annual Total Allowable Catches be reduced markedly; however, political and socio-economic considerations took priority, and fishing continued at relatively high levels. During the 1980s, foreign fleets continued to ravage the stocks beyond the 200-mile limit.

### *The Collapse of the Fishery*

By 1992, the groundfish stocks in Atlantic Canada, particularly those adjacent to Newfoundland and Labrador, were in such a depleted state that the Minister of Fisheries and Oceans declared a moratorium. Although there had been a modest level of fishing permitted for various stocks in recent years, in April 2003 the minister announced the further closure of the remaining commercial and recreational fisheries for Northern cod (2J3KL) and Northern Gulf (3Pn4RS) cod. While not nearly as large as the 1992 closures, this action will still affect an estimated 4,400 fish harvesters and plant workers, and nearly \$50 million in personal income per year.<sup>4</sup> The collapse of these key groundfish stocks has left a lasting imprint on the province. It has bred strong mistrust of fisheries management and science, and left a lingering question about why the policies of both federal and provincial governments failed to sustain such valuable and renewable resources for the benefit of present and future generations.

Over 30,000 people and hundreds of communities were directly affected by the moratoria on cod and other species. From an economic perspective, over \$600 million annually has been lost to the provincial economy from the loss of four key groundfish stocks: Northern cod, Gulf cod, Grand Banks American plaice and cod. The industry is now anchored by the shellfish sector (snow crab, shrimp and lobster) which accounts for about 80 per cent of total output and employment. Given the cyclical nature of these stocks and the over-capitalization in both harvesting and processing, there is little confidence that these fisheries are sustainable. Any significant drop in landings, especially snow crab, will cause heightened levels of uncertainty and community instability.

At the Commission's public meetings, the collapse of the fisheries became a major topic for discussion and debate. Not surprisingly, in all rural coastal areas this issue ranked as the number one concern. Many reasons for the failure were offered, including: (i) inadequate science, (ii) improved technology, (iii) too many processing licenses, (iv) too many harvesters, (v) too much reliance on the fishery as an employer of last resort, (vi) heavy reliance on the employment insurance program to sustain communities and people, (vii) too much political pressure to keep quotas high, (viii) relentless foreign overfishing, (ix) lack of action on seal populations, and (x) a general reluctance to come to grips with the reality of the declining resource because of the unthinkable result. In other words, the public recognizes – and the Commission agrees – that there is a collective responsibility for the loss of the fishery. Nevertheless, the federal government has overall responsibility for the management of the fishery. The stocks collapsed “on their watch,” and therefore the federal government must take primary responsibility for rebuilding the resource.

There can be no questioning the magnitude of the stock collapse. In the most dramatic cases, Northern cod declined from approximately 265,000 tonnes annual landings in the 1980s, to its total closure this year; similarly, the northern Gulf of St. Lawrence cod stock went from 100,000 tonnes to its total closure. According to analysis undertaken for the Commission, the chief explanation for the loss of these valuable resources is “...the failure of fisheries science and management to prevent overfishing ...”<sup>5</sup> While environmental change also contributed, “the real issues were that scientific understanding of the cod fisheries had been inadequate, and “signals” of change in the northern cod ecosystem were not sufficient to trigger any management action whatsoever.”<sup>6</sup>

A similar conclusion can be made for most of the other Canadian managed groundfish stocks. “The state of the fisheries science and its translation to management of the Newfoundland and Labrador fisheries must be judged harshly. The Federal Government of Canada, and its current Department of Fisheries and Oceans, have not been effective at conducting the necessary science and executing effective management

of Newfoundland and Labrador fisheries.”<sup>77</sup> In other words, a deadly combination of ineffective overall fisheries management, inadequate fisheries enforcement, inadequate science, foreign and domestic fishing practices, a burgeoning seal population, advances in harvesting technology, political interference and the lack of an open and transparent decision-making process – all undermined the capacity of Nature to withstand the sustained human pressures brought to bear on these stocks over several decades. As George Rose has written, the Northern cod (and by extension most of the Atlantic groundfish stocks) is “... the icon for fisheries mismanagement in the world.”<sup>78</sup> We have lost, we trust not permanently, one of the world’s great wild harvests. This was not inevitable: other major groundfish stocks in Norway, Iceland, Alaska and New Zealand have not been subject to the same mismanagement.

### *A Plan for Rebuilding and Sustaining the Fisheries*

The single most important question regarding key groundfish stocks is the time frame for stocks to recover and the extent of that recovery. Only sound stewardship of the resource will bring the fish back. This will not be easy; it will take many years and a substantial investment of resources. However, it is essential that the turnaround begin immediately. As part of an urgent action plan, the Government of Canada must commit to a comprehensive rebuilding plan for the groundfish fishery, involving a far stronger commitment to fisheries science and a more effective approach to fisheries management. The fishing industry and the Government of Newfoundland and Labrador must also commit to this rebuilding plan, and must participate in its formation and implementation over the long term.

There is now a growing convergence about what needs to be done to rebuild the stocks. The findings of the Fisheries Resource Conservation Council, the Newfoundland and Labrador All Party Committee, the House of Commons Fisheries Committee, the research conducted by DFO Science, and the research conducted for the Commission involve a multiplicity of approaches including, but by no means limited, to the following:

- restricting directed cod fishing
- reducing the size of the seal population
- implementing a moratorium on recreational cod fisheries
- imposing a ban on trawling in cod-spawning areas and areas of juvenile cod aggregation
- placing a moratorium on the commercial capelin fishery
- increasing the level of funding for DFO scientific research, including requirements for mechanisms to improve partnering among DFO science, academics and industry
- addressing the problem of foreign overfishing by establishing a more effective fisheries management regime to protect straddling stocks and their ecosystem
- enhancing fishery enforcement programs to protect recovering fish stocks from illegal fishing
- determining the feasibility of cod stock enhancement through cod grow out and release initiatives
- designating protected areas to enhance stock recovery and the protection of ecosystems in the bays and on the Grand Banks
- establishing a Newfoundland and Labrador Fisheries Science Centre at Memorial University
- reinstating funding for science vessels within DFO

- conducting research on the environmental sustainability of various harvesting methods, with measures being taken to minimize ghost-fishing, by-catch of non-targeted species and habitat destruction

What needs to be done is clear. What has been lacking since the early signs of decline in the late 1980s is an overall, long-term plan for stock rebuilding that has the political commitment of both governments and the appropriate resources for the task. The Commission is recommending, therefore, the immediate establishment of a federal/provincial “Action Team” appointed jointly by the prime minister and the premier with a six-month mandate to recommend, in consultation with industry participants, a plan for stock rebuilding. The appointment of such an action team is imperative. It will send a clear signal that stock rebuilding is of the highest priority for leadership in the Government of Canada and the Government of Newfoundland and Labrador. The urgent time frame signals that the rebuilding plan cannot await the outcome of more lengthy discussions associated with issues such as joint management. Indeed, without a successful plan to rebuild fish stocks, there will be little to worry about in terms of who is going to manage them.

While dealing with an action plan for the rebuilding of groundfish stocks is critical, the team also would be mandated to make recommendations with respect to any actions deemed necessary to ensure the ongoing sustainability of shrimp and crab stocks. The importance of this issue cannot be overstated. Should immediate action not be taken to rebuild groundfish stocks, and should snow crab and shrimp stocks significantly decline over the coming years, it can be said without fear of contradiction that the economic base of rural Newfoundland and Labrador will collapse. The Action Team would take maximum advantage of all the available research, which is substantial and recent, to expeditiously outline a groundfish rebuilding plan and a shellfish sustainability plan.

The Action Team would also make recommendations on restoring expenditures on fish science. During the 1990s the federal government substantially reduced funding and personnel for fisheries research. This made no sense in light of the circumstances facing the fishery which in fact pointed to the need for an increased scientific effort. The rejuvenation of the fisheries science program, the restoration of funding and the need for greater utilization of research vessels should therefore be a priority issue for the Action Team.

### *An Approach to Foreign Overfishing and Straddling Stocks*

While the northwest Atlantic fisheries have always been an international affair, foreign fishing on the continental shelf escalated dramatically after the introduction of factory-freezer technology in the 1950s. By 1974, this fishing effort led to the first major collapse of the province’s groundfish fishery. This occurred under an international fisheries management regime, the International Commission for the Northwest Atlantic Fisheries (ICNAF), which failed to safeguard the sustainability of virtually every commercial fish stock in the area. Lasting from 1949 to 1977, the ICNAF regime allowed catches, particularly by fleets from Europe and the Soviet Union, to go far beyond the capacity of all key groundfish stocks, thus causing the spawning biomass of most stocks to collapse.

The 1964 decision by the Government of Canada to increase Canadian fisheries jurisdiction from three to twelve nautical miles had little impact on foreign fishing given the wide distribution of fish stocks well beyond twelve miles. The increasing provincial, national and international concern over the impact of distant-water fishing efforts on a global basis finally resulted in Canada extending its jurisdiction over fisheries to 200 nautical miles on January 1, 1977. International law of the sea negotiations led to the United Nations Convention on the Law of the Sea (UNCLOS) in 1982. The UNCLOS agreement that coastal states could extend their jurisdiction to only 200 nautical miles left out an extremely productive

but vulnerable set of “straddling stocks” on one part of Canada’s continental shelf known as the “Nose” and “Tail” of the Grand Banks, as well as non-straddling stocks even farther out on the Flemish Cap.

During the Law of the Sea discussions, Newfoundland and Labrador representatives urged the Government of Canada to ensure that these straddling stocks be included in any new Canadian jurisdiction. In the end, the Canadian government acceded to the international consensus on a 200-mile regime. It expressed confidence at the time that this decision would not compromise the ability of Canada to effectively manage the straddling stocks.<sup>9</sup> This new framework provided for a far greater measure of coastal state control within 200 nautical miles. The areas outside Canada’s Exclusive Economic Zone were left to the management of ICNAF’s successor, the Northwest Atlantic Fisheries Organization (NAFO), established in 1978.

Initially, Canadian fisheries jurisdiction appeared to deliver on the promise of a greater share of resource for the Canadian fishery. By the early 1980s, however, foreign fleets displaced from inside the 200-mile limit began to concentrate on fish stocks just outside the line, ultimately undermining both Canadian and NAFO regulations. Throughout the 1980s the level of European Union catches on the Nose and Tail of the Grand Banks far exceeded their NAFO allocations. For example, between 1984 and 1990, the European Union received groundfish allocations totaling 214,000 tonnes, whereas Canadian experts estimate the actual European Union catch at 911,000 tonnes.<sup>10</sup> This overfishing by European Union countries and other fishing fleets, whether members of NAFO or not, led to a sharp decline in stock biomass. All principal trans-boundary groundfish stocks on the Nose and Tail of the Grand Banks and the Flemish Cap were placed under moratoria by the early 1990s. There is no doubt that this foreign fishing contributed to the demise of Canadian groundfish stocks, especially cod and flatfish on the Grand Banks, as well as other major resources on which the Canadian fishing industry had depended.

Since the mid-1990s, Canada has pursued a broad approach consisting of multilateral, bilateral and unilateral measures in an attempt to bring severe foreign overfishing by European Union and other vessels under control. This included strengthening Canadian legislation (such as 1994 amendments to the Coastal Fisheries Protection Act to allow for enforcement of NAFO management measures), the highly publicized arrest of the Spanish trawler *Estai* and direct negotiations with the European Union. The federal government also took the lead in negotiating the United Nations Fisheries Agreement (UNFA) of 1995, aimed at strengthening international fisheries regimes such as NAFO to better conserve and manage straddling stocks.

Despite these measures, foreign overfishing has escalated in recent years. Canada is still unable to effectively address overfishing within the NAFO framework. Actions by NAFO member countries, such as the misreporting of catches by species and area, the use of illegal mesh gear, and the continued misapplication of the objection procedure within NAFO, have compromised the very integrity of the NAFO conservation framework. These failures have led many to demand that Canada assume “custodial management” of groundfish stocks outside of its Exclusive Economic Zone. Indeed, during the Commission’s deliberations, there were repeated calls for such action. The House of Commons Standing Committee on Fisheries and Oceans also recommended unilateral action by Canada to “assume responsibility for the management and conservation of the areas of our continental shelf beyond the 200-mile limit.”<sup>11</sup>

The Commission fully supports the Standing Committee’s statement that the ultimate objective Canada must pursue is “a comprehensive, conservation-based fisheries management regime outside the 200-mile limit that is as rigorous as that inside the 200-mile limit.” Furthermore, and in this context, the Commission fully understands and supports the legitimate arguments behind the demand for custodial management. They are based on the reality that NAFO has proven itself an ineffective mechanism to properly manage straddling stocks outside the 200-mile limit.

Nevertheless, it has to be recognized that immediate unilateral action by Canada to assume responsibility for areas such as the Nose and Tail of the Grand Banks and the Flemish Cap has serious legal, diplomatic and enforcement risks. Research, conducted for the Commission,<sup>12</sup> concludes that custodial management would be seen and resisted by foreign nations as a violation of international law, including treaty obligations voluntarily assumed by Canada under the UNFA. Furthermore, Canada would have to abandon NAFO to pursue this course of action. The Commission is concerned that Canada is not presently in a position to enforce and maintain custodial management in the face of strong resistance from foreign states. There is a real risk that the abandonment of NAFO, coupled with an inability to enforce and maintain custodial management, could lead to a “free for all” much worse than the present situation. This would not be in the best interests of the resource, Newfoundland and Labrador or Canada. While the federal government has already rejected the recommendation of the Standing Committee that it take custodial management of the continental shelf outside of 200 miles, simply rejecting custodial management as an immediate option is not good enough.

The federal government has an obligation, in consultation with the province, to immediately develop a comprehensive plan to enhance the management and conservation of straddling stocks outside 200 nautical miles, and to commit the resources necessary to achieve this objective. An immediate part of this comprehensive plan would be working to enhance the management capabilities of NAFO. This cannot and should not be viewed as maintenance of the status quo. Canada must act much more forcefully within NAFO to see if reform is possible. This would include a determined effort within NAFO for operational improvements on such issues as the inspection regime, blacklisting of offending ships and publicizing violations. More fundamental improvements, such as the enhancement of member-state enforcement and inspection, should also be pursued. Negotiations within NAFO would have to be supported by other pressures such as port closures and aggressive international public education efforts aimed at building support for reform. The federal government must also increase pressure on those NAFO members, particularly the European Union, who have not ratified UNFA to do so. Thereafter, the federal government must take maximum advantage of the dispute settlement options under UNFA to force NAFO members to comply with their obligations.

The risk is that, despite all best efforts, NAFO will remain ineffective. Canada’s comprehensive strategy must, therefore, include steps to prepare for the possibility that strong unilateral action will be required should its attempts to reform NAFO fail. Canada must launch a major diplomatic effort to build international understanding and support for decisive action to protect these stocks. It must also ensure that it has the resources necessary to enforce and maintain unilateral action, such as custodial management, should such action prove necessary. The alternative – the status quo – is to stand aside and allow foreign overfishing to decimate straddling stocks with tragic results for both the resource and rural Newfoundland and Labrador. The Commission is strongly of the view that Canada must make one last effort at strengthening NAFO. At the same time, Canada must prepare itself and the international community for the reality that strong unilateral action may be necessary to conserve and protect critical straddling stocks.

### *Fisheries Management – A Dysfunctional Federal/Provincial Relationship*

The challenge of rebuilding and sustaining the fisheries of Newfoundland and Labrador is formidable, and cannot be addressed in isolation from national and provincial policy-making. That challenge includes a collaborative vision of the role that the fishery can play in the future of our rural society. Such collaboration arises from both constitutional and common sense realities. To begin with, the provincial government has overall responsibility for shaping economic and social development; this includes its rural coastal communities. The federal government also plays an important role in economic development

policy and programs. Moreover, any federal or provincial initiative is bound to fail unless it is integrated with a coordinated strategic fisheries management and development vision.

The specific regulatory responsibilities over the fishing industry are relatively straightforward, even if they are difficult to separate in reality. As with other provinces, the fisheries adjacent to Newfoundland and Labrador are under federal jurisdiction by virtue of section 91(12) “seacoast and inland fisheries” of the Constitution Act, 1867. This means that the federal minister and the Department of Fisheries and Oceans are responsible for such tasks as stock assessment and fisheries science, licensing of vessels and fishers, the allocation of stock quotas and their enforcement. The federal government is also responsible for the regulation of international and interprovincial trade, competition, product standards and international negotiations related to fisheries management outside 200 miles. The primary provincial regulatory role arises from section 92(13) “property and civil rights” of the Constitution Act, 1867. This gives the provincial government control over fish plant licensing, certain aspects of quality control and aquaculture, and more generally, labour standards, collective bargaining and occupational health and safety.

In essence then, jurisdiction and policy-making over the fisheries are fundamentally split between the two levels of government, requiring a major effort at cooperation if the overall management of the fisheries is to work.<sup>13</sup> Unfortunately, the fisheries relationship between the Government of Canada and the Government of Newfoundland and Labrador too often has been highly political and dysfunctional. This became especially evident following the extension of fisheries jurisdiction in 1977 when the fishery took on greater prominence in economic development. The provincial government advocated for a larger jurisdictional role during constitutional debate in the late 1970s and 1980s. It pushed for concurrent jurisdiction over fisheries management, to provide the province with primary responsibility for economic and social regulation of fisheries resources adjacent to the province. More recently, in May 2003, the House of Assembly passed a unanimous resolution calling upon the Government of Canada to begin negotiations leading to the establishment of a joint management regime through a constitutional amendment.<sup>14</sup>

The 1970s-1980s controversy over jurisdiction compromised any real opportunity for the development of a common policy approach to the management and development of the province’s fishing industry. Cooperation became even more unlikely when federal licensing and resource allocation policy led to increased fishing capacity by vessels based in other provinces. This occurred in the waters adjacent to Newfoundland and Labrador when new resource opportunities arose after 1977, and involved, especially, Northern cod and shrimp. Without the broad support of the fishing industry at large, the provincial government failed to achieve its jurisdictional goals. Moreover, the federal resistance on the jurisdictional issue, not surprisingly, found widespread support in the Maritime provinces. In any case, federal fisheries management continues to be wrapped in an overall Atlantic-wide fisheries policy in which there is no apparent room for an articulated policy addressing the unique needs of Newfoundland and Labrador.

The lack of any direct participation by the Government of Newfoundland and Labrador in the management of its key resource has reduced the province to an advocacy role. Newfoundland and Labrador is seen as but one of many “stakeholders,” and federal policy forces it into a competitive game with the Maritime provinces and Québec. This situation contributes to the provincial government’s condemnation of federal measures. It is no way to run the fishery. It is no way to run a federation.

While intergovernmental conflict continues, fisheries policy is increasingly regulated and restrictive. The federal government has, for many years, adopted a policy of restricted entry into the fishery and a more structured stock-by-stock management approach in both the inshore and offshore sectors, leading to the micro-management which characterizes industry regulation today. Moreover, the overall regulatory approach is marked by excessive authority solely in the hands of the federal minister as the final decision-maker. Over the years, this has left the entire system susceptible to last minute and continuing pressure



from politically connected industry factions. No other major resource industry in Canada is regulated on that basis, and fisheries should not be either.<sup>15</sup> The proof lies in the fact that the overall regulatory and decision-making structure failed to ensure the sustainable management of the dominant groundfish resources. In short, this policy approach failed the many thousands of individuals and their communities who had a major dependence on these stocks. This, in turn, has led to the erosion of confidence in the federal fisheries management structure.

It must also be acknowledged that the provincial government's management of the fish processing sector immediately after the extension of fisheries jurisdiction lacked the discipline that was critical to the evolution of a viable and stable fishery. Community expectations for the licensing of fish plants exceeded the supply of fish available for processing. The provincial government's processor licensing policy was also driven by resource projections that did not materialize, leading to overcapacity in the processing sector. And, as noted elsewhere in this Report, federal employment insurance policy, aided and abetted by the provincial government, contributed to overcapacity. Certainly much of the fisheries in the province is and will always be seasonal, and there is an appropriate role for employment insurance (EI) in sustaining workers through months of unemployment. But EI rules have encouraged the practice of spreading the returns of the fishery too widely, with overly short work periods, encouraging many more people to enter the sector than it can reasonably sustain.

The Commission's view is that the province's licensing policy remains too political and has led to a processing sector that is still seen as the employer of last resort. The shellfish industry today is a mirror image of the groundfish sector of the 1980s. Yet this excess capacity was licensed, for the most part, since the groundfish fishery collapse. It is clear that lessons have not been learned about the impact of processing overcapacity on the sustainability of fishing communities. If the snow crab resource declines significantly over the coming years, as it has in areas off Labrador, this overcapacity will lead to pressure to keep quotas at higher levels than can reasonably be sustained. If the resource follows the path of the cod, there will be an equally large disaster.

In summary, the roles and responsibilities of the Governments of Canada and of Newfoundland and Labrador are so intertwined that cooperation and collaboration are absolutely essential. The harvesting and processing sectors of the fishing industry should be managed as part of an integrated system. The fishery is too important to allow current fractured relationships in fisheries management to persist. The ongoing dysfunctional relationship leads to a lack of overall fisheries policy objectives. It compromises both the industry's contribution to the province's economy and the prospects for stock recovery. It also negatively affects many rural communities.

## Joint Management

The Commission, therefore, endorses completely the need for a mechanism which will allow the province to have a joint role in the management of the resource and, in particular, to be a strong partner in an action plan to rebuild the fish stocks. Research for the Commission and fisheries management practice in other countries suggest that it is not so much which order of government regulates the fishery so much as *how* it is done.<sup>16</sup> Far too much power has been in the hands of federal and provincial ministers who determine the economic and social shape of the fishery and are often influenced by the political lobbying of fishing interests. The public interest, including proper stewardship of the resource, has not been well served. No other major resource sector in Canada is managed in such a direct and political fashion.

The Commission's view is that institutional reform should be initiated whereby a determination of the policy framework for the conservation, management and development of the Newfoundland and Labrador fisheries can be carried out jointly by the federal and provincial governments. In this regard, the Commission was influenced by the extensive research carried out on its behalf by David Vardy, Eric Dunne and George Rose.

It is no longer acceptable for the federal government to make decisions so crucial to the province without a formal mechanism for meaningful input from the people of Newfoundland and Labrador. During the course of finalizing our recommendations on the fishery, the Government of Newfoundland and Labrador introduced a resolution into the House of Assembly seeking a formal amendment to the Terms of Union and released a White Paper entitled *Joint Management of Newfoundland and Labrador Fisheries*. This resolution and paper seek amendments to the Terms of Union to provide for shared and equal constitutional authority between the federal parliament and the provincial legislature over fisheries adjacent to the shores of Newfoundland and Labrador. They also propose the negotiation and constitutional entrenchment of a new Joint Management Fisheries Board to manage fishery resources.

The Commission endorses a joint approach for fisheries management. Such an approach does not need a change in the Terms of Union and could follow a route similar to that which led to the establishment of the Canada-Newfoundland Offshore Petroleum Board. There will have to be much discussion and consultation on the details of this approach, but the following three principles should apply to any new mechanisms:

- the primary decisions regarding the annual setting of the Total Allowable Catch (TAC), the allocations of TACs and the regulation of the harvesting and processing sectors be made jointly by the federal and provincial governments
- joint mechanisms be open, transparent and include full opportunity for stakeholder consultation
- the licensing of the harvesting and processing sectors be done on an integrated basis by an arm's length regulatory body jointly appointed by the two governments

Negotiations should begin as soon as possible to establish a Joint Management Fisheries Board. In the view of the Commission, there is every opportunity for both levels of government to make joint management work. It is no longer acceptable for the provincial government not to have a meaningful say and meaningful participation in the management of its most important natural resource. One area of caution is the extent to which the setting of TACs can be incorporated into a joint management function. This is particularly so for stocks such as 3Pn4RS (Gulf cod), where fleets from all provinces have a fishing history. It would be worthwhile to keep an open mind with respect to the exact mechanism for setting TACs, so that opponents of joint management are not afforded the opportunity to dismiss the fundamentals of joint management over the details of how to handle TACs.

In dealing with the important issues of stock rebuilding, custodial management, joint management and fishery science, the Commission had an overwhelming sense that politics and political matters are the driving forces in issues dealing with the fishery. It was not lost on the Commission, as it reviewed the various structures that could be established for joint management, that this work was being done in an environment where most of the fish had already disappeared. Indeed, it was revealing that, during the final stages of the Commission's work, an independent body of experts designated Northern cod a threatened species. There was an uneasy sense that highly charged political arguments were taking place long after they could do any significant good.

The Commission wishes to put the current debate into some perspective. It is our view that if someone could wave a magic wand and put joint management, custodial management and a stock rebuilding plan in place overnight, there would still be a period of years before stocks, particularly the Northern and Gulf cod stocks, could reasonably be expected to recover. Moreover, even if restoration were to result, it would most likely be more than ten years before stocks could sustain any significant commercial harvests. In other words, there are no easy or short-term solutions. There is, however, a need for immediate action, and nothing less than a concerted and collaborative effort by all participants is required to keep focus on achieving the objectives.

## Conclusions

This is the last chance for the fishery. Both governments have an obligation to ensure that this chance is not lost. The Commission is recommending a collaborative federal/provincial approach which includes:

- Immediate action to put in place a groundfish stock rebuilding plan and a plan to ensure the ongoing sustainability of the shrimp and crab stocks. This should be a stand-alone priority exercise undertaken by a joint Premier's-Prime Ministerial Action Team with an urgent six month mandate.
- Negotiations on joint management to take place as soon as possible. This process should not be complicated by demands for a change in the Constitution, including the Terms of Union.
- A comprehensive plan to enhance the management and conservation of straddling stocks outside 200 nautical miles, and to commit the resources necessary to achieve this objective. This plan would involve Canada making one last determined effort at strengthening NAFO, while at the same time preparing itself and the international community for the reality that strong unilateral action, such as custodial management, may be necessary should efforts within NAFO fail.

The mechanisms established to implement these approaches must ensure women have a voice in rebuilding and managing the resource.

Both levels of government should put their energy into getting on with the important issues rather than wasting it on political battles. Indeed, if both levels of government cannot find the political will to cooperate fully and jointly on the stock rebuilding plan, then it is inconceivable that they would be able to find the political will to deal with the longer-term complicated negotiations associated with such issues as independent and objective regimes in fisheries science, custodial management and joint management.

In summary, the groundfish fishery is essentially closed, and the shellfish sector is vulnerable. These fisheries can be rebuilt, but only with an overall long-term plan or strategy based on intergovernmental collaboration. Unless this collaboration happens, the Commission fears that fishery management in the future will only be a repeat of past approaches, and will therefore be doomed to failure.

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“The Grand Banks is to Newfoundland what softwood lumber is to British Columbia, oil to Alberta, wheat is to the Prairies, potatoes to Prince Edward Island, and apples to Nova Scotia. It’s about time Canada acknowledged this and take the kind of action it would take if the resources of other provinces were threatened.”

*Excerpt from the Public Consultations*

“You’ve got to put the fish first. Without the fish there is no fishery.”

*Excerpt from the Public Consultations*



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# Chapter 11

## *The Regulation of Natural Resources, Atlantic Accord and Churchill River*



The equitable development of Newfoundland and Labrador's natural resources hold great promise to help move the province toward a future of enhanced prosperity and self-reliance. Whether this promise will be realized will be determined, to a certain extent, by external market forces. But, most importantly, it will depend on the federal and provincial governments' vision of the role natural resources should play in strengthening this province's place in Canada. In the view of the Commission, the federal and provincial governments have the strongest obligation to ensure that this province's natural resources are developed for the *long-term* benefit of Newfoundland and Labrador and Canada. With respect to many natural resources, the provincial government has the primary responsibility for ensuring that developments provide the maximum possible benefits to the people of this province. Other critical natural resources, however, require an essential partnership with the federal government.

This chapter focuses on offshore petroleum and the hydroelectric resources of the Churchill River, both developed and undeveloped. With respect to offshore petroleum, the vision and commitment the Commission seeks from governments already exists in the 1985 Atlantic Accord. The challenge now for the federal and provincial governments is to ensure that this commitment is realized. The Churchill River, particularly the undeveloped potential of the Lower Churchill at Gull Island, presents the federal government with an opportunity to demonstrate in a significant way that it is committed to working with Newfoundland and Labrador in improving the province's place in Canada. This chapter begins with a general discussion of the need to ensure that all of the province's natural resources are developed and managed in a way that provides the greatest possible benefits to its people.

### *The Regulation of Natural Resources*

As discussed in Chapter 7, this province has faced some significant constitutional challenges in managing its natural resources (particular challenges facing the proper regulation of the fishery are discussed in Chapter 10). Overall, however, Newfoundland and Labrador has possessed extensive legislative powers under the Constitution of Canada to help ensure that provincial natural resources are developed and managed for the benefit of Newfoundlanders and Labradorians.

In 1982, provincial legislative powers with respect to non-renewable natural resources, forestry resources and electrical energy were strengthened by a constitutional amendment that added section 92A to the Constitution Act, 1867. Two key features of section 92A relate to provincial powers over the export of these resources and the raising of revenue. Under section 92A(2), the provinces are empowered to make laws in relation to the export of these resources to other parts of Canada, subject to the limitation that such laws cannot provide for discrimination in prices or supplies exported to another part of Canada. Before 1982, only the federal parliament could make laws in relation to the export of resources. Section 92A(4) provides the provinces with great flexibility in raising revenue from these resources. It authorizes taxation, by any mode or system, of these resources (in the case of electricity, the sites and facilities for



2. The purposes of this Accord are:

... (c) to recognize the right of Newfoundland and Labrador to be the principal beneficiary of the oil and gas resources off its shores, consistent with the requirement for a strong and united Canada.

excerpt from  
The Atlantic Accord

## The Regulation of Natural Resources, Atlantic Accord and Churchill River

generation) or their primary production. This is significant, as a tax on the production of a resource would be an indirect tax, which before this amendment was beyond the legislative power of the provinces. Furthermore, section 92A(4) makes it clear that taxation on the production from these resources is allowed even if the production is exported in whole or in part from the province. Taxation, however, cannot differentiate between production which is exported and that which is not.

During its public consultations, concerns were expressed to the Commission regarding the extent to which the province benefits, or does not benefit, from the development and management of its natural resources. Frustration was evident regarding the loss of the fishery, the lack of benefits from Churchill Falls and the unfolding loss or offset of oil royalties and taxes by reductions in equalization payments. The Commission, throughout this Report, has made recommendations regarding the management of natural resources. In Chapter 10, it made recommendations with respect to the fishery, and in this chapter it will deal specifically with the Atlantic Accord as it relates to offshore oil revenues and the development of the Lower Churchill.

Progress on these matters will help strengthen public confidence that the province's natural resources are being developed and managed in the best interests of the people. However, the provincial government must also demonstrate that it is constantly challenging itself to ensure the greatest possible returns. Periodically, it will be necessary for the provincial government to undertake a comprehensive and critical assessment of its approach to a natural resource. The provincial government's current study of electricity policy provides a valuable opportunity in this regard. In the view of the Commission, this study is critically important and should be given the utmost priority.

A key component of this review must be a careful consideration of the province's powers under the Constitution, including section 92A, to derive important and needed benefits from electricity generated from all developments on the Island and in Labrador. The benefits to be examined should include both effective access to electricity to encourage and attract new industrial developments, and reasonable taxation and royalty payments to help bolster the province's finances. The Commission appreciates that the power to legislate under the Constitution is only part of the equation. Careful consideration must also be given to costs, such as financial risks and potential impacts on the province's ability to attract future investment. Carefully conceived, such an analysis will influence not only the best actions to take on the regulation of this vital resource, but also the most advantageous timeline.

## *Offshore Petroleum and the Atlantic Accord*

### Overview

In 1985, the federal and provincial governments entered into an agreement providing for the joint management of offshore petroleum resources and the sharing of revenues. This agreement is known as the Atlantic Accord. Paragraph 2(c) of the Accord states that one of its purposes is “to recognize the right of Newfoundland and Labrador to be the *principal beneficiary* of the oil and gas resources off its shores, consistent with the requirement for a strong and united Canada.”

The Commission has reviewed the outlook for future oil revenues and the overall sharing of government revenues likely to result under the current arrangements. It is clear from this review that in 2003-04 Newfoundland and Labrador will probably receive the full net benefits of provincial revenues. Under the existing arrangements, however, this favourable revenue split will continue only for the very short term. As oil revenues begin to escalate to their full potential, the net share of revenues retained by the province will decline dramatically due to the workings of both the equalization formula and the Accord. Overall, the Commission has concluded that Newfoundland and Labrador will not be the principal beneficiary of oil revenues in the coming years. As a result, the spirit and intent of the Atlantic Accord will not be realized. Projections indicate that, over the life of the existing oil projects, the province will be the net beneficiary of only 20 to 25 per cent of total government revenues.

Unlike the failure of the fishery, which is a resource disaster that has already occurred, the oil situation represents an impending but avoidable failure in the relationship between the federal and provincial governments. Urgent joint action is required. This difficult situation has arisen because development circumstances have changed substantially from those anticipated when the Atlantic Accord was negotiated almost 20 years ago. The solution lies in an amendment to the Accord ensuring that the principal-beneficiary objective is met. While there are many important issues facing Newfoundland and Labrador over the next decade, none have more potential to help it move towards prosperity and self-reliance than changes to the Atlantic Accord.

### The Projected Revenue Shares

The Atlantic Accord states quite clearly that Newfoundland and Labrador should be the principal beneficiary of its offshore oil and gas resources. To meet this principal-beneficiary purpose, the Atlantic Accord allows the province to establish and collect revenues as if the petroleum resources were on provincial land. The federal and provincial governments of the time, however, recognized that the workings of the equalization program would frustrate the principal-beneficiary objective in the Atlantic Accord. Indeed, at the time, the workings of the equalization program would have resulted in a dollar-for-dollar loss of equalization payments. To address this concern, and based on assumptions as to the timing and magnitude of the resource revenues that would flow to the province, the two governments agreed to a system of equalization-offset payments.

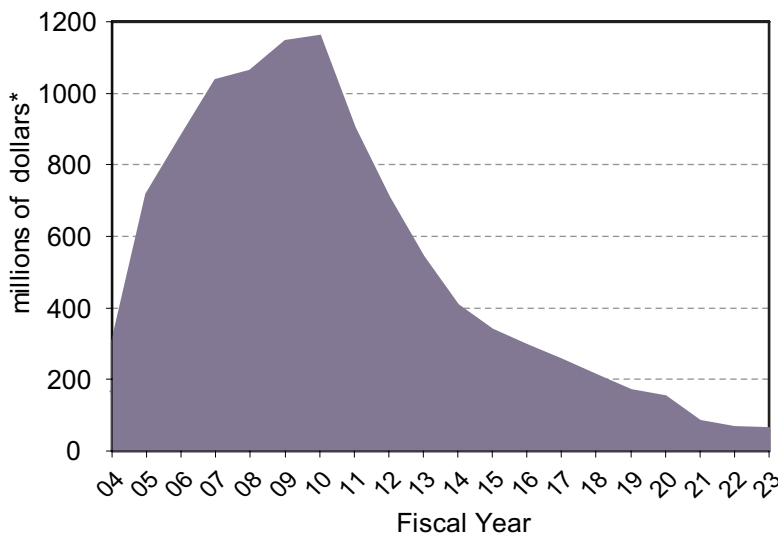
In examining whether or not the principal-beneficiary purpose of the Atlantic Accord will be achieved, the Commission reviewed a set of multi-year projections for total government tax and royalty revenues. These were based on current expectations of production from the two operating fields, Hibernia and Terra Nova, and a third field, White Rose, currently under development. The Commission is aware that the economics of a fourth project, Hebron Ben Nevis, continues to be studied by the owners, and that areas such as the Flemish Pass and Laurentian Sub Basin hold promise for new discoveries. It is also conscious of the fact that there has not been a major discovery off the coast of Newfoundland and Labrador for more than 17 years. In the Commission’s view, therefore, the most appropriate analysis is one based on the three existing developments.

The revenue forecast is based on a long-term world oil price of US \$24 a barrel adjusted for inflation. These assumptions are the same as those used in Chapter 6, as are the underlying assumptions regarding the royalty regime and provincial corporate income tax. In order to assess the overall sharing of total government revenues, it is also necessary to include projections for the federal government’s corporate income tax revenues. To do so, a judgement was made concerning the revenues that would actually be collected, given that federal corporate income tax payments are influenced by the overall level of profitability of the various companies and by allowances for exploration and development expenditures.<sup>1</sup>

Figure 11.1 illustrates the projected profile of combined government revenues from offshore oil for the next several years – the expected lifespan of the three current projects. These projections include federal corporate income tax as well as provincial corporate income tax and royalties. The combined federal/provincial revenues are projected to rise rapidly, peaking at almost \$1.15 billion in 2010; they will then decline steeply.

**Figure 11.1**

**Total Government Revenues  
from Offshore Oil**  
Combined Federal/Provincial Revenues



**Source:** Projections based on the existing projects (Hibernia, Terra Nova and White Rose). Data extracted from projections provided by the provincial Department of Finance.

**\*Note:** Constant dollars adjusted for inflation.

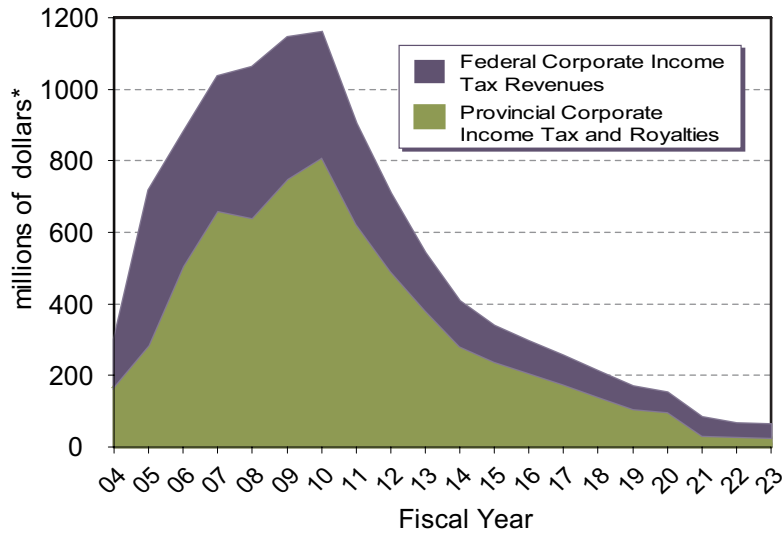
The Commission has reviewed the manner in which the overall government revenue streams might ultimately be divided between the federal and provincial governments. In this regard, the first step is to review the composition of the oil revenue stream as it is derived from federal sources and provincial sources. This is illustrated in Figure 11.2.



Figure 11.2

### Government Revenue Sources from Offshore Oil

Federal and Provincial Revenues



**Source:** Projections based on the existing projects (Hibernia, Terra Nova and White Rose). Data extracted from projections provided by the provincial Department of Finance.

**\*Note:** Constant dollars adjusted for inflation.

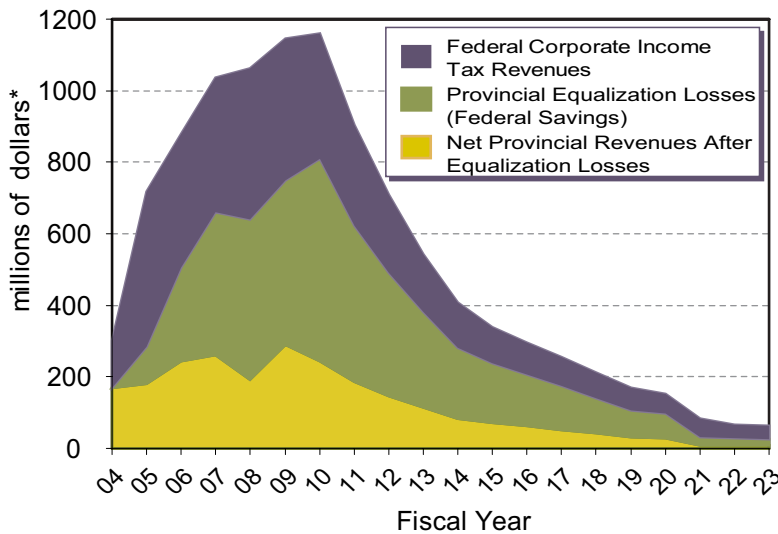
Figure 11.2 illustrates that a very significant component of the revenues will be derived from provincial corporate income tax and royalties.

The second step, and the most important analysis, relates to the assessment of the *net* share of the revenues which ultimately go to the benefit of the respective governments. The analysis, illustrated in Figure 11.3, assumes that the “generic solution” under the equalization program, which allows the province to retain 30 per cent of provincial oil revenues, will be preserved beyond 2004. In some years, such as in 2003-04, the various offset payments under the Atlantic Accord are more favourable to the province than the application of the generic solution. Until 2011, the provincial government may, in such cases, choose the formula which is most beneficial. After that, the options under the Atlantic Accord expire and the generic solution becomes the only option. Taking both the Atlantic Accord and the generic solution into account, the overall sharing of government revenues from federal and provincial sources is summarized in Figure 11.3.

Figure 11.3

## Net Sharing of Government Revenues from Offshore Oil

Reflecting the Impact of Equalization and the Atlantic Accord



**Source:** Projections based on the existing projects (Hibernia, Terra Nova and White Rose). Data extracted from projections provided by the provincial Department of Finance.

**\*Note:** Constant dollars adjusted for inflation.

This figure reveals a startling revenue split, particularly when viewed in the context of the magnitude of the revenues involved and the clear intent of the Accord. The distribution of revenues between the federal and provincial governments simply does not even come close to fulfilling the intent of Newfoundland and Labrador being the principal beneficiary from offshore oil revenues.

Figure 11.3 graphically illustrates a number of points:

- The first is that the province is currently receiving provincial taxes and royalties with minimal equalization losses – due to the important but short-term protections afforded by the Atlantic Accord. At the same time, the federal government is benefitting from its federal corporate income tax.
- The second is that, although oil revenues are projected to increase significantly in coming years, the province will receive little of that incremental revenue. This is due to the fact that the proportionate level of revenue protection afforded by the Atlantic Accord declines dramatically due to the workings of the various formulas. The equalization loss becomes increasingly more significant, thereby minimizing the net gains to the province.
- The third point is that the peak revenue years from these projects are quickly approaching, and are projected to last for a very short period between 2006 and 2012. Thereafter, the revenues are expected to decline sharply, producing the “revenue bump” evident in Figures 11.1 to 11.3.
- The fourth, and most important point, is that over the life of the existing projects, the net amount of revenue that the provincial government retains will pale in significance when compared with

the combined impact of the federal government's savings from reduced equalization payments and its federal corporate income tax.

Certainly there are short-term benefits to the province from the equalization offset provisions of the Atlantic Accord. However, over the life of the current projects, the federal government's net gain, inclusive of its savings in equalization, will amount to approximately 75 to 80 per cent of all government revenues. This leaves a net benefit to the province of just 20 to 25 per cent. For example, total government revenues from the three existing projects are projected to peak in 2010 at \$1.15 billion. Under the existing structure, after the impact of equalization, it is projected that the province would realize net revenue gains of only \$250 million in that year. This means that the Government of Canada, after taking into account its equalization savings, would be the net beneficiary of the remaining \$900 million.

It is recognized that these revenue projections, like any multi-year projections, are based on an array of assumptions. There will no doubt be a wide variety of views concerning the future trends of a number of the key variables. The Commission, however, would emphasize that the accuracy of the projections in each year is not as important as the overall trends, the relative orders of magnitude and the relationship between the net shares expected to be realized by each government. In that regard, the Commission believes the projections reasonably reflect the nature of the sharing relationship that can be expected to unfold.

### Changed Circumstances

The enormous question which the Commission attempted to address is how such an inequitable sharing is possible given the clear statement of intent and purpose in the Atlantic Accord. When the Atlantic Accord was signed in 1985, there were great expectations that offshore oil would set Newfoundland and Labrador on a course of phenomenal economic growth. The period leading up to the signing was marked by impressive exploration success and high oil prices. Hibernia (1979), Terra Nova (1984) and White Rose (1984) were all discovered prior to the signing of the Atlantic Accord. There was, therefore, great optimism at the time that new oil would soon be discovered and developed, and that the revenues flowing to Newfoundland and Labrador from the Accord would place it on a rapid road to prosperity and self-reliance. Speaking in 1984, the then Minister of Energy, Mines and Resources, the Honourable Jean Chrétien, predicted that Newfoundland and Labrador might become a "have-province" within five years of first oil from Hibernia.<sup>2</sup>

Had those optimistic assumptions been realized, the equalization-offset payments could have protected the principal-beneficiary purpose. These assumptions clearly have not been realized. As a result, the revenue sharing arrangements and time frames reflected in the Accord will not achieve the overall purpose of making Newfoundland and Labrador the principal beneficiary. The Commission has concluded, therefore, that the Accord will not work in accordance with its original spirit and intent, and that there is every reason why it should be fixed. It confounds all logic for anyone to claim that, despite the federal government receiving a net benefit of 75 to 80 per cent of offshore revenues, Newfoundland and Labrador remains the principal beneficiary.

The Commission's conclusion is supported by a research paper prepared by the Honourable John Crosbie.<sup>3</sup> In this paper Mr. Crosbie states: "Clearly Newfoundland [and Labrador] is not the primary or principal beneficiary of the offshore resources, nor of offshore revenues, but a minor beneficiary when compared to the federal government. The importance of this is that, unless the Atlantic Accord is honoured and implemented as to its original intent, Newfoundland [and Labrador] is unlikely ever to become a self-sufficient province within the Canadian federation." The Commission's concerns are also shared by the *Report of the Standing Senate Committee on National Finance, 2002*, which recommended that: "The [federal] government should undertake an evaluation of the equalization provisions of the Atlantic Accords to determine if they have met the intent for which they were designed."<sup>4</sup>

The position of the federal government, as expressed by the federal minister of Intergovernmental Affairs, is that the Government of Canada is fully respecting both the letter and intent of the Atlantic Accord, and that Newfoundland and Labrador will be the principal beneficiary of petroleum development off its shores. The federal government further claims that, as a result of the introduction of the generic solution to the equalization program in 1994, this province has received, and will continue to receive, “significantly greater benefits” than those envisaged at the time the Atlantic Accord was signed.<sup>5</sup> The projections discussed in this Report, of course, take into account the Atlantic Accord as well as the generic solution. The Commission concludes that an 80-20 or 75-25 revenue split in favour of the federal government is totally inconsistent with Newfoundland and Labrador being the principal beneficiary of its offshore oil revenue.

### Need for Revised Accord

The Commission is aware that the issues surrounding the Atlantic Accord are complicated. Indeed, it has a sense that there is not a complete understanding within the province of the significant challenge confronting the province in terms of future revenue losses. In many ways, the issues surrounding the Atlantic Accord resemble the Churchill Falls situation. In both cases agreements were made based on assumptions that did not materialize. In both cases unfolding, yet unforeseen, circumstances worked to the significant disadvantage of Newfoundland and Labrador and its place in Canada. Figure 11.3, therefore, depicts a situation which is totally unacceptable in a federation where fairness and equity should prevail.

Revenue-related amendments to the Atlantic Accord should reflect two basic principles. First, a far greater share of the provincial revenue from the offshore should be retained by this province to reflect the principal-beneficiary objective. This objective is not met by the generic solution or by the present provisions of the Atlantic Accord. Second, the province should continue to receive a proportionately greater net share of provincial oil revenues as long as it remains below the Canadian average for agreed-upon fiscal and economic measures. The Commission is recommending that the federal and provincial governments enter into immediate discussions to revise the Atlantic Accord to ensure that the principal-beneficiary objective is both honoured and achieved.

### *The Churchill River*

#### Overview

Newfoundland and Labrador brought into Canada the tremendous hydroelectric potential of the Churchill River in Labrador. In the early 1970s, the Churchill Falls site was developed, yielding 5225 megawatts of power. Two significant hydroelectric sites remain undeveloped on the Lower Churchill River, at Gull Island and Muskrat Falls.

The inequitable outcome of the Churchill Falls development, together with successive failures to develop the other sites on the Churchill River, has profoundly affected Newfoundlanders’ and Labradorians’ perceptions of their place in Canada.<sup>6</sup> Despite the passing of more than 30 years since power was first generated, the outcome of the Churchill Falls development covers Newfoundland and Labrador’s place in Canada with a long dark shadow.

#### Churchill Falls

The term of the Churchill Falls contract was initially 40 years, and debt financing was arranged successfully on that basis. After the financing was in place, however, there was an eleventh-hour demand by Hydro-Québec that extended the term of the contract to an unbelievable 65 years, with lower power

rates granted to Hydro-Québec for that final 25-year period. While the power contract arrangements were finalized in 1969, the effective date of the contract was July 1, 1976. Between the time the contract was signed and its effective date, the world went through an unprecedented energy shock, with an unexpected increase in energy prices caused by the oil crisis in the Middle East. As a result of this international energy crisis, the value of energy from Churchill Falls underwent a windfall increase estimated to be in the order of \$850 million a year.

The world events leading to this increase were not foreseen by the parties to the Churchill Falls contract (CF(L)Co. and Hydro-Québec) or by the owner of the resource (Newfoundland and Labrador). Hence, they were not provided for in the power contract and related arrangements. As a result, the huge annual windfall profits go almost entirely to Hydro-Québec. Hydro-Québec has benefitted from these annual profits for the last 27 years, and will continue to do so for the next 38 years, until 2041.

In its deliberations, the Commission heard the view, though much in minority, that Newfoundland and Labrador should put the Churchill Falls matter in the past. In a poll conducted for the Commission, however, 74 per cent of respondents refused to support this view.<sup>7</sup> At the same time, it is the opinion of the Commission that the people of this province should be prepared to move forward in realizing the potential of the Gull Island site to help deal with its growing fiscal predicament and the building of a stronger economy, particularly in Labrador. That said, the development of Gull Island should proceed in an environmentally responsible manner and in a way that is respectful of Aboriginal rights and interests.

The federal government placed Hydro-Québec in a monopolistic position during the Churchill Falls negotiations of the 1960s by not enacting legislation that would have allowed for a power corridor through Québec. Without such federal legislation, negotiations on the Churchill Falls project took place in a situation in which virtually all of the power and energy had to be sold to Hydro-Québec. Consequently, it was in a position to dictate a low price, an insignificant recall of power for use in Newfoundland and Labrador and an unprecedented time frame (65 years) governing the power contract. The inaction of the federal government in the matter of allowing a power corridor through Québec was, and still remains, contentious, especially in view of the fact that the federal parliament has passed legislation to allow the construction of oil and gas pipelines across other provincial boundaries.

The federal government also played a direct role in facilitating the conclusion of the Churchill Falls deal. This was done through amendments to the Public Utilities Income Tax Transfer Act that effectively allowed the developer, CF(L)Co., to lower its sale price for Churchill Falls power, as had been demanded by Hydro-Québec. The federal government helped make the project viable and, therefore, was an essential partner in seeing the development proceed.

The inequities of Churchill Falls have been argued with great passion for more than three decades. Some argue that it was flawed national energy policy and the lack of a power corridor through Québec that denied Newfoundland and Labrador any opportunity to export its energy and capture the economic rent. Others call the deal a home-grown disaster, the fault of Premier Smallwood who championed the project and never asked for a power corridor nor insisted on a re-opener clause. Others argue that it is a simple case of “a contract is a contract.” Still others argue that the unintended outcome of the contract was so radically different from that envisaged at the time that simple decency demands its renegotiation.

In the view of the Commission, Churchill Falls is fundamentally about whether or not fairness and equity exist in the Canadian family. It is about the Government of Canada standing on the sidelines as an observer of a situation where, due to unforeseen circumstances, Québec currently reaps a windfall profit of approximately \$850 million a year from a hydroelectric resource located in, and owned by, Newfoundland and Labrador. The first question asked by Newfoundlanders and Labradorians was: “If the situation had been reversed in the late 1960s, would not the Government of Canada have intervened in the national interest and allowed a power corridor through Newfoundland and Labrador for the export

of Québec power?” The second question asked was: “Why, in the absence of the power corridor, has the federal government refused to facilitate a reasonable sharing of the windfall profits between the two provinces?” One can only imagine the favourable impact on the fiscal position of Newfoundland and Labrador had it shared in even 50 per cent of the Churchill Falls windfall profits since 1976. It would have already meant additional annual revenues in the order of \$425 million for 27 years, or an additional \$11 billion over that period with potential revenues of equally significant amounts until 2041.

## Lower Churchill Development

The Churchill Falls dispute has been an ongoing obstacle to the development of hydroelectric potential on the Lower Churchill at Gull Island (2000 megawatts) and Muskrat Falls (800 megawatts). These two hydroelectric sites have remained undeveloped for the last three decades because Newfoundland and Labrador and Canada have failed to join forces to harness their potential for the good of all Canadians.

Nowhere is a new way of thinking and doing things required more than in the approach to the development of the Lower Churchill River. The provincial government needs revenues, the province needs energy for industrial purposes, Québec needs power and energy, as does Ontario, and Canada needs energy production which will attract Kyoto credits. Nevertheless, the potential of the Lower Churchill River remains undeveloped even though Gull Island is one of the lowest cost hydroelectric developments remaining in North America.

The early development of the \$4 billion Gull Island project would involve Newfoundland and Labrador accessing sufficient power for industrial use in Labrador, Québec purchasing power and energy for its own use, Québec wheeling power to customers in Ontario and the northeastern United States, and Canada coming to the table as a financial partner to ensure that Newfoundland and Labrador is able to earn an appropriate return as owner of the resource. The Commission strongly feels that equitable development on the Lower Churchill is long overdue. It presents a genuinely profound opportunity for the province and the federal government to demonstrate that they are committed to a renewal in their relationship.

In the fall of 2002, Newfoundland and Labrador and Québec were nearing the end of negotiations to develop the Gull Island project. While no deal was concluded, and little detailed information on the negotiations was provided, there were many concerns expressed by the public. In particular, one of the main concerns related to possible financing was that Hydro-Québec would be the financial backer of the project. The concern, at its most fundamental level, was that if Hydro-Québec would be both the major purchaser of power and the major lender for the project, Newfoundland and Labrador therefore would be negotiating from a position of significant weakness. Such a potential imbalance in negotiating power was offensive to many Newfoundlanders and Labradorians, particularly given the history and outcomes of the Churchill Falls development. In the view of the Commission, proceeding in this manner in the future would be a recipe for failure.

This situation can be overcome if the Government of Canada agrees to become a significant financial backer to the Gull Island project. This will allow contractual arrangements to be put in place so that Newfoundland and Labrador will earn appropriate returns as the owner of the resource. Without Canada’s involvement, there will be only two practical choices for the province: (i) develop the Lower Churchill on Québec’s terms, or (ii) let the water flow to the sea. It is time for Canada to come to the Lower Churchill table as a partner. Such a constructive role would demonstrate that the federal government takes seriously its constitutional commitment, as stated in section 36(1)(b) of the Constitution Act, 1982, to “furthering economic development to reduce disparity in opportunities.”

In the view of the Commission, issues related to the Churchill Falls development should not be directly linked with negotiations to develop the Gull Island site. However, in moving forward with the Gull Island development, the provincial government must ensure that it takes no action that could prejudice

its future ability to regulate the Churchill Falls resource more effectively for the benefit of the people of Newfoundland and Labrador.

### *Conclusions*

In summary, the Commission is calling upon both the federal and provincial governments to work to ensure that this province's natural resources are developed for the long-term benefit of both Newfoundland and Labrador and Canada. In particular, the Commission recommends that:

- The provincial government works constantly to ensure the greatest possible returns from resource development. The province's current review of electricity policy provides a valuable opportunity in this regard. A key component of this review must be a careful consideration of the province's powers under the Constitution, including section 92A, to derive important and needed benefits from electricity generated from all developments on the Island and in Labrador.
- The federal and provincial governments enter into immediate discussions to revise the Atlantic Accord to ensure that the spirit and intent of the Accord – that Newfoundland and Labrador be the principal beneficiary – are honoured. The province must capture significantly greater net benefits than the present forecast of 20-25 cents on each dollar of government revenue generated from offshore oil.
- A new approach to the Churchill River be adopted that looks to the future rather than the past. The provincial government, in partnership with Québec and the federal government, should pursue an early and equitable development of the Lower Churchill at the Gull Island site. The role of the Government of Canada, as a financial backer to the project, would be entirely consistent with its constitutional commitment, as stated in section 36(1)(b) of the Constitution Act, 1982, to “furthering economic development to reduce disparity in opportunities.”

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“We would be foolish if we thought anyone but ourselves can chart the future for us... the new way of thinking about Newfoundland must start here at home.”

*Excerpt from the Public Consultations*

“It was a sad day when I packed my bags and left my home to look for something that should have been in my province in the first place – a future.”

*Excerpt from the Public Consultations*



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# Chapter 12

## *Strategic Location and Infrastructure*



The Commission's mandate included an examination of the means by which Newfoundland and Labrador can take maximum advantage of its strategic location between the North American and European trading blocks, and the challenges and opportunities of the global economy. This examination reveals that the province's strategic importance has changed significantly over its history, and is changing once again in the early twenty-first century. This chapter provides a brief overview of changing strategic realities, and then turns to an assessment of the strengths and challenges of our location, dealing in turn with the resource economy, human resources and education, location as such, transportation, and communications and information technology.

### *Old and New Geographic and Strategic Realities*

Newfoundland and Labrador occupies the far northeast corner of North America. It faces three ocean environments: the Labrador sea, the Gulf of St. Lawrence and the northwest Atlantic Ocean. It flanks the northeast approaches to the continent and is the closest landmass in North America to Europe. The province is remote from any major population centre, and its subarctic climate imposes limits on some economic activities. Still, the land and sea provide access to impressive natural resources. Newfoundland and Labrador's ability to sustain a society and to develop its resources has historically depended on broader geopolitical and strategic factors. Gwynne Dyer asserts that "... geopolitical importance comes in three major forms: military, economic and national/political..." and influences to whom Newfoundland and Labrador is important, and at what time.<sup>1</sup>

In the era before European contact, the Aboriginal peoples subsisted on the wild game and fish of the interior and coastline; they relied upon the forests for shelter and warmth, and traded with other Aboriginal nations in eastern North America. For at least two centuries after Europeans discovered this place, their ventures in fisheries and whaling were of considerable significance to Europe. The English, French, Portuguese and Spanish exploited the Banks cod fishery from the late 1400s, and the Basques maintained a whaling station at Red Bay for many decades in the sixteenth century.

By the mid-eighteenth century, European settlement was well established, as farming, logging and mining began to supplement the fisheries. However, by then Newfoundland's economic significance had declined, eclipsed by the westward expansion of settlement and development of the North American continent. The society and economy continued to grow nonetheless. By the early twentieth century, the industrial revolution transformed the economy, introducing mechanization to the fishery, allowing development of hydroelectric resources, increasing the scale and scope of mining and turning timber into paper. As population shifted, the railway opened the interior of the Island, people resided as much in towns as they did in the fishing outports. Still, until well into the twentieth century, the chief economic advantage of Newfoundland and Labrador remained its position next to one of the world's most productive fisheries ecosystems.

"The assets...may change over time, but at the moment they consist of very significant natural resources...a rapidly growing reputation as a centre of artistic, cultural and intellectual creativity; a geographical location which briefly had military importance, [and] continues to be important in terms of the country's vision of itself...and a collective place for Newfoundlanders in the Canadian national consciousness which, while impossible to quantify, is a major asset in itself."

Gwynne Dyer



## Strategic Location and Infrastructure

Newfoundland and Labrador's military value, for much of its history, was tied integrally to its economic value. Newfoundland became England's first colony in 1583. Until 1763, the British and French empires militarily contested control over this asset. Throughout that period and well into the twentieth century, Britain remained Newfoundland's most important trading and financial partner. As Newfoundland became more settled, it sought to pursue competitive and beneficial economic relations both inside and outside the Empire, and traded as much as it could with the French, Americans, other British colonies, Caribbean islands and the Mediterranean. In fact, the government sought formal trade reciprocity with the United States during the 1890s and in 1905, but that goal was blocked by Britain and Canada.

The geopolitical contest between Britain and France continued here long after the peace Treaty of Paris in 1763. The French retained the islands of St. Pierre and Miquelon, as well as rights to the fishery, including exclusive exploitation of Newfoundland's west coast fishery. These "French Shore rights" continued until 1904. The maritime boundary between Canada and France around St. Pierre and Miquelon was only settled by arbitration in 1992. This small French territory continues to be a valued neighbour and trading partner. Today joint initiatives are underway between St. Pierre and Miquelon and the Burin Peninsula economic development authorities, especially in tourism. Since 1991, St. Pierre and Miquelon has been eligible for duty-free trade within the European Union; thus, interest has grown in the prospects of further processing of products in St. Pierre and Miquelon for duty-free shipment to Europe, and for transshipment of goods in St. Pierre and Miquelon originating in Canada.<sup>2</sup>

By the early 1940s, military considerations overtook economics as the more significant strategic factor of our location. Steamship technology made Newfoundland an important port-of-call in transatlantic shipping, and for the protection of those shipping lanes. During World War I, when Britain depended crucially on imported food and industrial raw materials from North America, shipping became vital. By the time of the Second World War, transatlantic air travel had also become militarily important. Thus, in the 1940s, both naval and air bases here bridged the gap between North America and Britain. Newfoundland played a vital part in the March 1941 Leased Bases Agreement between the United States and Britain by providing access to ports and strategic locations for airfields. Thousands of American, Canadian and British forces were stationed here. New communities grew up around the air bases at Gander, Goose Bay and Stephenville and at the naval base in Argentia. St. John's was also transformed by the military build-up and became especially important as a base for cross-Atlantic convoys.

Newfoundland and Labrador's military importance continued long after the Second World War. In the 1950s, Goose Bay became a base for the NORAD strategic air command, with fighter aircraft to intercept potential air threats from the Soviet Union and its allies. The province's air bases retained an important role until technology made cross-Atlantic stopovers on the way to the continental United States less vital. Labrador played an important role as the eastern flank of the various defence surveillance networks across the north during the Cold War. Today, while Canada's NATO allies maintain an air force training facility

at Goose Bay, the overall military presence here is minimal and our strategic military significance has been reduced.

Confederation with Canada again transformed the strategic factors. By 1946, the stage had been set for Newfoundland to lose the last vestiges of its British colonial ties. As Gwynne Dyer argues, Newfoundland and Labrador was to become of far more political importance to Canada than it ever was to Britain.<sup>3</sup> In strategic terms, the union “completed” Canada by bringing into the federation the last of the British North American colonies that had refused to join the American revolution. It prevented the northeastern flank of Canada from falling into American hands, and in psychological terms, kept Canadians from feeling hemmed in by the United States.

Some of the province’s economic assets were also important to Canada in 1949, particularly the iron ore and the hydroelectric potential in Labrador. The greatest long-term geopolitical advantage for Canada, however, has turned out to be in the offshore. As Gwynne Dyer notes:

When your fishing and seabed mineral rights suddenly jump from three miles offshore to two hundred miles, the province with the longest seacoast – Newfoundland and Labrador accounts for over a third of the total Canadian coast that is ice-free for at least six months of the year – is bound to jump in strategic importance too ... For the foreseeable future, however, it is the [offshore] oil that gives Newfoundland and Labrador a new relevance and importance in Canada’s national economic strategy.<sup>4</sup>

Confederation with Canada also hastened the continental integration of the province’s economy. This occurred in two steps: first, through economic, social and political integration with Canada, and second, through economic and, to a degree, social and cultural integration with the United States. Canada formalized and deepened its integration through the Canada-United States Free Trade Agreement of 1989 and the North American Free Trade Agreement of 1994. The provincial government strongly supported free trade with the United States in the 1980s and 1990s. Research indicates that the Free Trade initiatives have had three major effects for this province’s long-term strategic interests. First, it reinforced already important links with United States investors, especially important for the offshore oil sector. Second, it has led to growth in exports to the United States, although at a lower growth rate than the increase in exports to the United States from Ontario, Québec or the western provinces. Third, by eliminating tariffs and other discriminatory barriers, it has helped to counterbalance some of the disadvantages of being in the Canadian economic union.<sup>5</sup> What has been relatively neglected in the stronger continental trade relations has been the traditional North Atlantic trade patterns of Newfoundland and Labrador, especially for fish products – i.e., in Spain and Portugal, Brazil and the Caribbean. As David Alexander has demonstrated,<sup>6</sup> after Confederation the Government of Canada was unable or unwilling to promote the kind of linkages required to sustain strong export markets outside the United States.

Now the strategic factors are shifting again. In the new global economy, firms can access capital and technology from all over the world, develop products and manufacture them in a number of different countries, and distribute and market them globally. The computer and telecommunications revolution that accompanies globalization means that all business today must be, at least to some degree, electronic. Another feature, if less pronounced, is a more competitive and lower cost transportation system. This new global geometry is “dissolving historic economic geography.”<sup>7</sup> Markets are everywhere, product is found everywhere, and communication between markets and manufacturers is instantaneous. A final but vital factor in globalization, especially for the developed industrial world, is that human capital is becoming the most important strategic asset. This is especially so in the “new economy” of communications, information and e-business. It also means that few developed economies can compete on the basis of labour costs alone, and that all natural resources – with a few strategic exceptions – are in plentiful

supply. This leaves human “capital,” determined by the education and skill of the workforce, as the key competitive factor.

This changing strategic context has profound implications for Newfoundland and Labrador. First, the changes in transportation and communications technology are removing the “tyranny of distance” that has made this place seem to many to be remote and isolated. Second, the province’s export markets are already diversified beyond North America – in 2001 the province conducted over one-third of its international trade with Europe and the Far East.<sup>8</sup> We have begun to increase investment and tourism linkages with North Atlantic neighbours such as Iceland and Ireland. Europe does seem closer now, and opportunities will continue to arise exploiting the province’s position as “a mid-Atlantic island” bridging the four main time zones of North America and the three of Europe.<sup>9</sup> Finally, unlike some of the other factors that in the past were largely determined elsewhere, the increasing importance of human capital is something that can be primarily shaped by the province, at home.

In sum, the world is creating opportunities based on new geographic and strategic realities. Can the province forge a new set of strategic alliances that will enable it to take better advantage of its geographic position in this changing environment? Are there things it can do to improve the province’s strategic importance in going forward? The answers lie in a frank assessment of the strengths and challenges of our current position.

### *Strengths and Challenges*

It is the assessment of the Commission that the strengths of Newfoundland and Labrador still lie, quite simply, in its people and in its natural resources. The fundamental challenges reside in the province’s location and in the dispersal of its small population over a large geographical area. But neither obstacle is insurmountable.

### **Resource Economy**

Newfoundland and Labrador will be a resource-dominated economy for some time to come. Yet natural resource developments alone, as crucial as they are, will not solve all of this province’s fiscal and economic problems. Natural resource development involves the use of the resource, capital investment and labour. Especially for large-scale projects, capital typically comes from sources outside the province, while the benefits for Newfoundlanders and Labradorians come from employment and resource revenues collected by the provincial government. More and more, with technological improvements, capital is replacing workers; we see it in the reduced employment in existing forestry, mining and resource-related manufacturing. New resource developments will create welcome direct employment, but, once these are in operation, it is probable that the number of such jobs will decline over time. Mining and offshore oil developments are capital intensive, and once built, hydroelectric sites require relatively few workers. Even in a recovered fishery, an efficient industry means better utilized capital and likely far fewer fishers and plant workers than in the 1980s.

Where feasible and commercially viable, further processing of resources can be enormously beneficial to the communities where these facilities are located. Yet it is overly optimistic to expect that processing of resources can provide enough opportunities for all of the communities in need of employment. An important objective for resource development, therefore, should be to obtain reasonable revenues. Those revenues – especially where substantial – are of critical importance in any plan to address the province’s fiscal position, to support social programs, to provide a tax regime more conducive to entrepreneurship and private investment and to maintain and improve infrastructure.

This Report focuses on recapturing the opportunities of three sets of natural resources: fisheries, offshore petroleum and hydroelectricity. This is not done because these are the province’s only sources of resource

wealth, or that resources are the only road to wealth creation. Far from it. But they do represent the most significant single set of economic opportunities that have the potential to impact on the province's prosperity and self-reliance. There are other natural resources that should be noted here, in particular, mineral and forest resources. The Voisey's Bay nickel deposit is just beginning a new chapter in the province's economic history. The forest sector also continues to be important, but faces important resource constraints in terms of a sustainable wood supply.

The well-being of the people of the province is especially dependent on the health of the natural environment. The sense of who we are and its expression in our art, music and culture are linked in unique ways to this place with its oceans, rivers, rocks, land, forests, barrens, wildlife, fish and air. Most of the province's industries, even our tourism and cultural industries, rise from its environment – fishing, forestry, agriculture, mining, hydroelectricity, gas and oil. The world is coming to the province's door to experience our wild, open spaces. This kind of tourism will contribute to self-reliance and prosperity as long as the people are careful not to diminish the very environment they seek to exploit. Hence, whatever the approach to a renewed and strengthened place in Canada, it must be based on sound environmental principles: protection of human health, sustainable economic development, pollution prevention and community-based environmental management. The people of this province paid – and are still paying – a massive price for the inability to establish those values in the fishery, and must recognize that, as the stewards of a unique and precious environment, we must preserve it.

## Human Resources and Education

The province's human resources are part of this sustainable environment. The people of the province are, in human ecology terms, an element of biodiversity. We have become a society with its own material culture based on a relationship to the land and sea, while drawing on a heritage marvellously mixed: Aboriginal peoples, west-country English, Scots, Irish, French and recent immigrants from all over the world. What has emerged within a broader and multicultural Canadian society is a vibrant and recognizable Newfoundland and Labrador culture.

Despite the decline of many rural communities and their attendant social and cultural traditions, in recent years there has emerged in the province an exciting cultural industry in art, music, literature, theatre, film and media. This flowering of culture in the cities, towns and rural communities is exerting an influence on the country disproportionate to the size of the province's population. Although this is not the only reason for the development of our culture, the potential is there for international export of many products with the expression of our culture. The people's natural creativity is truly worthy of cultivation and promotion.

The emergence of an entrepreneurial spirit is another relatively recent trend, which has enabled the province to turn to small business to create jobs and improve incomes. Goods and services once supplied by large organizations are more and more being offered by smaller suppliers at lower cost and with greater efficiency. The transfer of ownership, risk and decision-making to smaller entrepreneurs brings a new vitality to local and provincial businesses. It is worth noting that an entrepreneurial spirit is part of the heritage of this province and was reflected in the many locally owned businesses which existed prior to 1949, but gradually disappeared as we entered the Canadian economy.

The P. J. Gardiner Institute for Enterprise and Entrepreneurship at Memorial University of Newfoundland, in its survey of small business in the province,<sup>10</sup> found that examples of business success exist today across the economic spectrum – from manufacturing and resource sectors, to a wide variety of business and personal services. These businesses have a strong orientation to export markets based on the quality and uniqueness of their products and services. The survey also found that the most important business assets were human qualities: employee expertise, dedication and a positive work ethic.

The emergence of small business is not by accident or merely the result of larger forces in the North American and global economies. The ability of local entrepreneurs to take advantage of commercial trends has not been taken for granted, certainly not by provincial and federal agencies and by business associations and educators who have worked hard to promote small business development over the past 20-30 years. The success of these enterprises comes at a vital time. They can make an important contribution to employment and income growth in the province. The entrepreneurial spirit is becoming a part of the people's sense of place.

Small business draws on another key strength – an educated workforce. While in some respects educational achievement in this province has lagged behind other parts of Canada, the gap has been closing.<sup>11</sup> However, as the submission by the Newfoundland and Labrador Teachers' Association states: "Clearly, in a province where unemployment levels remain high and where job opportunities, while improving, still do not reach countrywide norms, education is paramount."<sup>12</sup> Through public meetings and schools visits, the Commission was encouraged by the importance youth attach to education. There is a growing appreciation that, with higher levels of education, come greater employment opportunities and income levels. While perhaps not a sufficient ingredient for prosperity and self-reliance, this change of attitude is certainly a necessary one. Research into other sustainable North Atlantic societies such as Iceland and Ireland indicates that literacy and higher education are vital for the achievement of economic and social change.<sup>13</sup> Table 12.1 summarizes key facts relating to educational levels and employment rates in Newfoundland and Labrador.

Table 12.1

Relationship Between Education and Employment Newfoundland and Labrador (2002)		
Level of Schooling	Employment Rates	
	Male	Female
Some High School	36.8%	26.3%
High School Graduate	57.3%	45.7%
Post-Secondary Certificate	66.5%	63.4%
University Degree	79.4%	73.5%

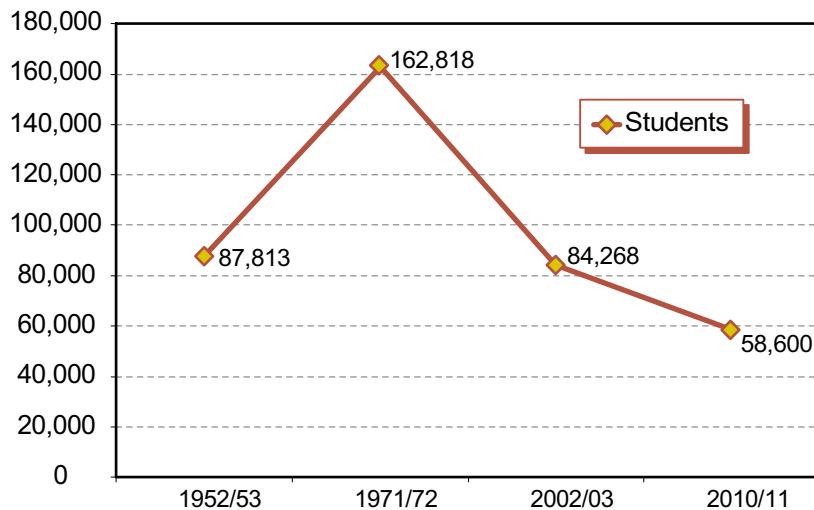
**Source:** Economics and Statistics Branch, Department of Finance

Men and women with higher levels of education also tend to earn substantially higher incomes. In 2000, the average income for males with less than high school was \$19,600, but increased to \$35,000 with a trades certificate and to \$52,900 with a university degree. Average incomes for women were considerably lower: for those with less than high school they were \$10,800, with a trades certificate \$22,700, and a university degree \$32,200.

Providing a world-class school system in Newfoundland and Labrador is no easy task. Geography and demographics present enormous challenges. The land mass of the province is great, but its population is small and dispersed across some 650 communities. As a result, the provision of education is very expensive, especially in remote rural areas. Almost 66 per cent of schools are rural; yet they serve only 45 per cent of the population, and almost 25 per cent of schools have fewer than 100 students. Out-migration and a declining and aging population are having a profound impact on the province's education system. Figure 12.1 shows the startling drop in K-12 school enrolments, which has declined from a peak of 162,818 in 1971 to approximately 84,268 in 2002-03, and is projected to further decline over the next decade to 58,600. These declines create challenges for accessibility, quality and affordability – particularly in rural settings and for particular academic programs.

Figure 12.1

### Newfoundland and Labrador School Enrolment (K-12)



Source: Department of Education Statistics.

Individual commitment to education is not enough. As a society, we must fully appreciate the value of this resource for our future. Throughout its public meetings, the Commission heard that not only must the province have a world-class and responsive education system, but it also must have an affordable system. Too many young people leave this province because their student debt levels leave them with no other choice. While every person must be encouraged to pursue their full potential, every possible opportunity for that potential to be realized in Newfoundland and Labrador must be provided. Students told the Commission that, while much more still needs to be done, they were generally encouraged by recent initiatives by the provincial government to make education more accessible and affordable. However, there is almost universal dissatisfaction with the federal government's efforts in this area.

The Commission believes that, for Newfoundland and Labrador to attain greater prosperity and self-reliance, it must increase its investment in education. Under present fiscal circumstances, it is difficult to see how this can be done. The provincial government already spends approximately 20 per cent of its budget on education. A greater commitment from the federal government is required and should be viewed as an investment that will yield long-lasting benefits for both the country and the province.

Human resources are especially important in the "new economy" of the tele-computational revolution.<sup>14</sup> This component of the economy offers real potential for the province. The new technology is being applied in our traditional and emerging wealth-creating sectors: fisheries, mining, forest products, offshore oil and gas. The public sector, notably health and education, has been transformed by the new technologies, improving cost efficiency and quality of service. The tourism sector has also been enhanced by the Internet. The information technology sector has burgeoned; the province now has approximately 400 firms creating nearly 4,000 jobs, over half of which are in St. John's.

Memorial University of Newfoundland and the College of the North Atlantic are leaders in the province in the application and dissemination of technology, and they also export educational services abroad. Universities are seen as especially important contributors to the growth of the knowledge-based economy. This role depends on a number of factors, including the experience and capacity of the university to collaborate with the private sector, the receptivity of local firms to technology-transfer opportunities,

and the sensitivity of federal research funding programs to circumstances in this province. Memorial University of Newfoundland, while strongly committed in its mandate to research and to share the results with the broader community, could improve this function through faculty incentives geared to achieving local collaboration and by the establishment of a research centre to study the knowledge economy.<sup>15</sup> The university sector across Canada receives its major research funding from the federal government as well as from private sources. Memorial University of Newfoundland has not been given its relative share of that funding, and has fallen even further behind, perhaps because these programs have been designed to reinforce the strategic strengths and longer track records of research-intensive universities in Ontario, Québec and other provinces. By adopting allocation measures for research funding more sensitive to the particular strengths and mandates of universities, the federal government can ensure the optimal use of research funding and its contribution to research, development and innovation in the Newfoundland and Labrador economy.

## Location

The strategic value of Newfoundland was shaped by its location. It was close to very productive fishing grounds and, in military terms, guarded the northeast flank of the continent and provided a bridge between North America and Europe. Neither of these strategic factors was of such importance to merit major wealth or influence, but they did sustain centuries of settlement. As strategically significant factors, both have disappeared. As our economy and society have become more and more integrated into Canada and North America, our North Atlantic role has diminished. There is no way of denying the reality that, from the perspective of the heartland of the continent, whether in central Canada or in the United States, we are seen as marginal and peripheral. They view the province as remote, difficult and expensive to reach, with a harsher climate. They do not consider the province an important domestic market. That is not to say that what the province produces is not valued, or that as a people we are not valued. But that value will always be discounted if it is measured only by Ontario or New York standards of location, population and concentration.

Another aspect of the province's location that bears reiteration is the dispersal of its small population over an enormous geography. The public service and transportation infrastructure are stretched to the limit to service remote communities. Addressing this challenge is not easy and has tested the ingenuity of our governments and businesses for a long time. We must embrace, wherever possible, new technologies that enable services to be delivered from central locations. The population distribution turns fundamentally on the broader issues of rural sustainability discussed elsewhere in this Report.

## Transportation

Transportation and communications have been vital to both the Island portion of the province and Labrador. Canada has developed and prospered in the past century by defying its huge and difficult terrain through its leadership in transportation and communications services and technology. Consider the Canadian Pacific Railway, Air Canada, the Trans-Canada Highway, the Canadian Broadcasting Corporation and Telesat. However, deregulation of transportation markets and the privatization of national carriers and ports have put at risk what was once an important Canadian strength – a viable, available, affordable transportation network across the entire national territory. Admittedly, these changes were made to increase Canada's overall economic competitiveness. The new policy framework may work for the concentrated population centres and markets in Canada, but it does not work for the more widely dispersed populations for which the original infrastructure was intended. This is especially worrying for Newfoundland and Labrador because we are so dependent on efficient transportation linkages for our global competitiveness.



What is worse, our position in the Canadian transportation network is shrinking. With the agreement of both the federal and provincial governments, the federal crown corporation that ran the Newfoundland railway closed it down completely in 1988, with the federal government providing compensation in the form of highway investments. This places a much greater burden on the competitiveness and viability of remaining road, air and sea links.

The road system in this province is absolutely essential to economic prosperity. It is a key to exports, especially fish products, other manufacturing and tourism. It plays a vital role in making an adjustment to a more viable rural economy. The Trans-Canada Highway and the regional trunk roads system have been built through a series of federal/provincial agreements.

Today, the only federal funding program specifically dedicated to highways is the Strategic Highways Infrastructure Program which in this province provides only \$11.5 million in federal funds over five years. The Canadian government, unlike the federal government in the United States, has no policy providing for substantial and long-term funding for the country's national highways system. It is time for the federal government to recognize the importance of an efficient and well-maintained highway system for the economic development and prosperity of the nation, and to partner with the provinces in a new generation of highways infrastructure investment.

Convenient and competitive air service is essential if this province is going to prosper. The quality, frequency and availability of air service to and from the rest of Canada have been downgraded consistently in the past decade, especially from airports in Labrador and on the Island outside of St. John's. The federal government's devolution of airport facilities to local authorities has the potential of jeopardizing the long-term viability of many of the airports in the province. The airline business worldwide is in turmoil with complaints mounting about declining service. Yet, convenient and competitive airline routes are an essential requirement for a globally-oriented economy if this province is to compete in human capital markets and tourism. The province simply cannot overcome its locational weaknesses without effective air transportation.<sup>16</sup>

As discussed in Chapter 7, the Gulf ferry service is a visible reminder of Newfoundland and Labrador's place in Canada, and is critically important to the economic development of this province. The Canada Marine Act (1998) and Transport Canada's Marine Policy requires Marine Atlantic to "substantially reduce its costs and increase efficiency."<sup>17</sup> While the Commission is not opposed to increased efficiency, it is important to note that such directives to Marine Atlantic do not in any way excuse the federal government from fully meeting its constitutional obligations under Term 32(1). In addition to living up to its constitutional obligations, the federal government must recognize that investments in the Gulf ferry service are an essential component of economic development in the province. In the past, the federal government's approach and attitude toward this important service has strained its relationship with Newfoundland and Labrador. A renewed focus on this service would send a clear message that it wishes to strengthen that relationship and is committed to ensuring the economic health and prosperity of the province.

## Communications and Information Technology

With the revolution in computers and telephone technology, locational disadvantages are being overcome to some extent. These advances are transforming many sectors in the province's economy and eliminating many distance barriers. Still, they will not solely turn a small community into a "new economy" powerhouse. In fact, research into the locational decisions of high technology firms across North America and Europe confirms that "agglomeration" effects are still significant. The tendency of firms to cluster together so that they can better encourage, compete and feed off one another is even more pronounced in the new economy than it was in the older one. The province's entire economy is likely too small to become a significant centre for the new economy, but, as noted already, there are hundreds of firms now

active in the direct “high tech” sectors. In the rest of the economy, existing and new businesses must apply technology and make productivity gains. In other words, even without becoming major players in the core of the new economy, the businesses need to keep applying the technology to remain competitive in the global economy.<sup>18</sup>

In theory, one can do business anywhere with a cellphone and a laptop computer. In practice, these devices require expensive infrastructure that is not available everywhere. In particular, high-speed or broadband Internet access is seen as the critical new infrastructure to support a myriad of web-based applications. Such applications need people who are willing and able to use them. The reality is that the province has a major “digital divide.” The divide relates to age, gender and economic groupings; it is also social and geographical. Some communities are connected to broadband Internet, and some are not; within communities, some will use and apply the new technology in their daily lives, and some will not or cannot. It is an important indicator of adaptation to the new economy that only 58 percent of the provincial population has Internet access.<sup>19</sup> We face a chicken and egg problem: lack of broadband service because of lack of customers; lack of customers because of lack of service. We may be able to look to the New Brunswick model of the 1980s. At that time the public and private sector made the far-reaching decision to place a digital telephone and fibre optic cable network throughout the entire province, which has reaped significant benefits since.<sup>20</sup>

The federal government has recognized the promise of a national approach to the provision of broadband access to smaller communities, but so far has only been able to proceed with small pilot projects. What is needed is a more comprehensive national program, with flexibility for intergovernmental cooperation, that can integrate the needs of provincial government service provision with the developing private market in remote communities.

## *Conclusions*

The new global economy is creating opportunities based on instantaneous communications, information and human resources. Newfoundland and Labrador has a cluster of strengths that, in a relatively small society, interact with one another to respond to this new generation of opportunity. They consist of the following:

- valuable and strategic natural resources
- a potentially sustainable environment of natural and human ecology that is unique in the world
- a determined people, with strong entrepreneurial drive and diverse work skills

If Newfoundland and Labrador is to take advantage of its location and compete in the global economy, it needs effective transportation and communications infrastructure. Since 1949, the federal and provincial governments have jointly undertaken the building and maintenance of that infrastructure. The federal government also has constitutional responsibilities with respect to the Gulf ferry. In the past decade, however, deregulation and privatization has put at risk the provision of a viable, accessible and affordable transportation network in this province. While these changes were made to increase Canada’s overall economic competitiveness, they have reduced the competitiveness of regions with widely dispersed populations such as Newfoundland and Labrador.

The Commission concludes that there are four key aspects of infrastructure to be addressed:

- There is a need for a new generation of highway investment in the Trans-Canada Highway, the Trans-Labrador Highway and the regional road system.
- Federal policies and programs must ensure a viable air transportation network to, from and within Newfoundland and Labrador.

- In addition to meeting its constitutional obligations, the federal government must recognize that investments in the Gulf ferry service are an essential component of economic development in the province.
- High-speed or broadband Internet access is critical new infrastructure. A more comprehensive federal government program for the provision of broadband access to smaller communities is required. This program should have sufficient flexibility for partnership agreements with the provincial government and the private sector.

Finally, the Commission recognizes the key significance of education and research in the ability of the province to participate in the knowledge-based economy. The kind of significant advances required to truly match the human resource potential of Newfoundland and Labrador calls for a concerted effort by both orders of government. Two key roles of the federal government are support for post-secondary students and support for research. The student debt burden is becoming a significant contributor to the out-migration of young adults from this province, and must be eased through reformed student aid programs. Efforts to make research funding to universities less tied to past research success, and more tied to emerging strengths, are also required.

Without reliable transportation and communications infrastructure and without an educated population, this province will not be able to fully participate in the new economy. It is in the best interests of the province and the country that both levels of government work together to ensure that these supports are in place in Newfoundland and Labrador.

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“Small island economies such as Newfoundland have the opportunity and, generally , the necessity, of being open and connected to the rest of the world. The ocean has always been Newfoundland’s medium, metaphorically its highway, railway, airline, shipping, literary, telegraph and satellite connection. The sea does not represent a vast emptiness bordering the coast isolating and marginalizing a society. The sea has always been a prime measure of freedom and opportunity.”

*Excerpt from the Public Consultations*

“... Newfoundland and Labrador is isolated from mainland North America- and the high cost for people and goods to and from our province is costing multi-millions in lost opportunities. These excessive charges are stifling tourism based economic growth.”

*Excerpt from the Public Consultations*

“National research funding, transfers in support of educational funding, being part of a Canadian intellectual network - -all these have contributed to making Memorial University more than what it may otherwise have been in the absence of Confederation.”

*Excerpt from the Public Consultations*

“In the past 50 years the rise of a university -educated population in the province has resulted in a shift in the attitude of its people-- from a willingness to accept imported leadership in many sectors of our society and economy to a demand that leadership must come from within - that economic and social decisions affecting Newfoundland and Labrador would be made by the people of this place.”

*Excerpt from the Public Consultations*

