

Economic History

The Economic Development of Canada

Richard Pomfret



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THE ECONOMIC DEVELOPMENT OF
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THE ECONOMIC DEVELOPMENT OF CANADA

RICHARD POMFRET

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The Economic Development of Canada



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Richard Pomfret

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Preface

The aim of this book is to provide an introduction to and interpretation of the development of the Canadian economy since European settlement. Easterbrooke and Aitken's *Canadian Economic History* has remained the standard work since its appearance in 1956. However, in the succeeding decades there has been considerable research on Canada's economic past, which has increasingly appeared inconsistent with their approach. The lack of an alternative framework has often made it difficult to assess the significance of new research for our wider understanding of Canadian economic development. I have attempted to bring together the results of recent research and to suggest a new framework which can accommodate further findings as they come along.

I have tried to keep the book concise rather than encyclopaedic, so that it can be read without loss of continuity or themes. Perhaps the main contrast between my view and previous interpretations of Canada's economic past is that, instead of emphasizing the continuity of Canadian economic development (with staple exports playing the leading role), I focus on the transition from the sparsely populated colonial economy of the early nineteenth century to the modern economy ranking among the seven largest market economies whose leaders now meet for economic summits. Thus, the emphasis is on the period since 1850, which I believe to be of greater relevance than the more romantic pioneer years for explaining the present nature of the Canadian economy. The relatively compact treatment of the fur trade in chapter 2 reflects this consideration and also its fairly straightforward economic impact, rather than any slighting of the fur trade's importance or length of dominance of the Canadian economy. Another consideration is the desire to report adequately the results of recent research, which has led, for example, to a long chapter on government policy whose length is in my view disproportionate to the importance of policy for Canadian economic development. Conversely, little space is given to the tertiary sector and, in particular, retailing, which has undergone huge changes affecting the economic life of all Canadians but has not been the subject of much academic research. Other omissions are due to my rather narrow definition of *economic* history, which leads me to skim over demographic and labour history.

There is no presumption of previous knowledge of either Canadian history or economic theory. All economic terms used are defined, although some of the theoretical points are more tersely dealt with than in economic principles texts. The history is economic, not political, and major political events such as the Conquest of New France or Confederation are not highlighted, despite their economic roots, because their economic consequences were not commensurate with their political significance.

My debts in writing this book clearly begin with all previous writers whose ideas and empirical work I have drawn upon. I have tried to acknowledge the source of each idea or figure which is not my own, but inevitably there will be some contributions which I have absorbed without remembering their origin, and I apologize to any slighted author. Most of the book's contents were given their first exposure to Concordia University students between 1976 and 1979. The first draft was written during the academic year 1977-78, and this and subsequent drafts were helpfully commented upon by academic colleagues and anonymous reviewers; among these readers I am especially grateful to Professor Bernice Wright for her acute criticisms of the whole manuscript. Financial and secretarial help in the book's preparation was provided by Concordia University and the Johns Hopkins University Bologna Center. I am also grateful to La Trobe University, whose visiting fellowship gave me the opportunity during the second half of 1979 to visit Australia, where I gained new perspectives on Canadian economic history from my discussions with Australian economic historians. In bringing the book through its final steps to publication I have been fortunate in the encouragement, helpfulness and efficiency of Peter Milroy, Herb Hilderley and Judith de Backer on the Methuen editorial team. Last but not least, my thanks go to Rosemary Prentice, whose identification of jargon, unclarity and inelegance helped to remove some of the evidence of an economist's poor literary style from this book.

RICHARD POMFRET
Bologna,
December 1980

Chapter 1

Introduction

No society is static at any point in time; it is the unique result of previous influences. In order to understand a present-day society it is necessary to know something about its past. The past, however, consists of a limitless number of events and forces which have directly or indirectly influenced the present. It is the purpose of this introduction to define our terms of reference—to limit the type of events and forces to be considered. The principal restriction is the concentration on economic phenomena, reflecting the belief that while economic phenomena are not the sole determinants of social change, they are of major importance.

The subject matter of economic history is the subject matter of economics applied to historical phenomena. A brief definition of economics would emphasize the questions which economists study—the production, allocation and expansion of resources, goods and services. Because economics deals primarily with the present as a point in time while economic history is more concerned with changes over time, the emphasis of the two disciplines differs. Two main issues have emerged as the dominant concerns of economic history: (1) the aggregate economic growth and/or decline of societies and accompanying structural changes in their economies; and (2) the relative economic welfare of society's component groups, i.e., consideration of what happens to people within the society during that growth and/or decline. In studying the Canadian experience we will focus on the question, "What factors influenced the rate of growth of the economy and the well-being of various segments of society as the economy grew?" It may be noted that some Canadian economic historians would consider the above summary of their discipline to be too restrictive; in particular, areas such as labour markets and business history, which have been studied on their own merits, are ignored in the present account, or at least only mentioned in their relation to the primary themes of growth and well-being.

In order to discuss meaningfully Canada's economic past we will use economic theory and historical data. All historical study has, either implicitly or explicitly, a theoretical framework; to draw some order from the anarchy of limitless facts it is necessary to have some notion of which facts are important and how the selected facts are related. In this book the hypotheses will be drawn from the body of theory most relevant to *economic* history, i.e., economic theory. Sometimes existing economic theories are unable to provide satisfactory hypotheses, in which cases we will have to search for alternatives. The decision as to whether a hypothesis is satisfactory or not is reached by testing it against the historical data, preferably using statistical techniques which have objective accepted criteria for rejecting hypotheses. The main problem in applying such

decision rules is that the historical data, especially for earlier periods, are often inadequate for rigorous statistical tests.

The study of Canadian economic history has passed through two fairly distinct phases. The "old" economic historians met the problem of inadequate data by foregoing rigorous hypothesis testing and supporting their arguments by verbal reasoning and descriptive evidence. The high points of the old economic history were a number of studies whose theoretical framework and presentation of empirical evidence were outstandingly appropriate to their subject; for example, the books by Innis (1940; 1930) and Creighton (1937) remain the classic studies of fish, fur and the St. Lawrence economy respectively. On the other hand, the absence of rigorous standards of proof led to sloppy, internally inconsistent and tendentious writing in the hands of lesser authors. In the late 1950s and the 1960s a new approach to economic history, reemphasizing the need for rigorous statement and testing of hypotheses, spread to Canada from the United States. The prime demand of the "new" economic history in the Canadian context appeared to be the improvement and organization of historical data to conform with the concepts of economic theory so that it could be used to test hypotheses drawn from economic theory. This data manipulation has taken much time and effort and is still far from completed. In consequence, the application of the new economic history to specific Canadian problems has been limited, consisting either of hypothesis tests run concurrently with the derivation of new macro-economic figures (e.g., Bertram 1963) or of studies of microeconomic problems where the data requirements could be reduced (often by the use of economic theory) to fit the available information. Despite their restricted number, the studies by new economic historians have had a major impact in modifying acceptable interpretations of the Canadian past and rejecting unacceptable hypotheses. The approach adopted here is to combine the best of the old and the new to provide a synthesis of the present state of our understanding of Canadian economic development. The methodology, however, leans in favour of the new economic history; wherever possible the theoretical framework is made explicit, statistical tests of hypotheses are valued, and quantitative evidence is generally preferred to qualitative evidence such as the opinions of contemporaries.

A common characteristic of economic theories is their use of abstraction, focussing on key interrelationships and making the simplifying assumption that other things remain unchanged ("*ceteris paribus*"). This can be a powerful tool, but in making the *ceteris paribus* assumption it is as important to be correct about what is left out of the analysis as about what is included. When dealing with questions involving changes over time, a similar problem concerns specification of the counterfactual situation. The criterion for measuring the impact of an event is not to compare the situations before and after the event, but rather to compare the situation after the event with the situation which would have existed

had the event not occurred. For example, the Reciprocity Treaty in force between 1854 and 1866 was accompanied by economic prosperity in Canada, but such contemporaneity provides no proof of a causal relationship. Many other factors contributed to the prosperity of these twelve years, and it is necessary to consider their impact before any conclusion about the causal role of one factor can be drawn. Most of the hypothesis testing in this book involves the use of time-series data to answer questions concerning the importance of individual events for Canadian economic development. Crucial to such tests is specification of the changes which would have occurred in the absence of the event, i.e., of a plausible counterfactual situation for the end date of the analysis.

Some of the terminology of economic growth and development will be so frequently used in this book that it should be clearly defined from the beginning. The term economic growth itself has two distinct meanings to economists. In popular usage, to say that a city or region is growing usually means that the number of people or the amount of business activity in that area is increasing. This phenomenon is captured by the economist's concept of *extensive growth*, i.e., an increase in the total amount of goods and services produced (an increase in Gross National Product, to use modern national accounting terminology). Extensive growth has sometimes been encouraged by governments to give their area greater power, political importance, etc., but it has no direct implication for the standard of living of the society's members. In this respect, the relevant concept is that of *intensive growth*, i.e., an increase in output per head of population. It must be noted, however, that the identification of intensive growth with increased living standards is not ideal; intensive growth only refers to an increase in the average standard of living, and if accompanied by changes in the distribution of income or a decline in non-material well-being then some members of society may feel worse off. With this caveat in mind we will use intensive growth as the best available measure of changes in material well-being. The distinction between extensive and intensive growth is an important one. Of course they often occur together, but one may take place without the other and the implications will differ depending on which type of growth has occurred. For example, if the hypothesis is accepted that the government's tariff policy after 1879 encouraged extensive growth at the cost of lower intensive growth, then evaluation of the government policy depends on whether a higher population or a higher average standard of living was more desirable.

A concept frequently used in the analysis of economic growth is the production function. The total output of goods and services (Q) is functionally related to the quantity of inputs employed, usually restricted to two factors of production, capital (K) and labour (L), i.e., $Q = f(K, L)$. The theoretical foundations of such a production function are a subject of furious academic debate, but it is perhaps more readily acceptable as a

heuristic device. Since the effect on output of an additional unit of each factor of production can usually be assumed to be positive, any increase in the labour force will lead to extensive growth, but the effect on intensive growth may be positive, zero or negative. Increases in output can also be due to increased use of capital or to technical progress, defined as a change in the functional relationship leading to a larger output being associated with given combinations of capital and labour. Either capital accumulation or technical progress will normally be associated with both extensive and intensive growth.

Technical progress used to be seen as the key to economic growth. Economic histories of the leading economic nations stressed the innovations made there; the recipe for other countries was to adopt modern techniques, usually identified with industrialization, and economic growth would follow. This approach no longer has many proponents, primarily because in a world of more or less free technology many countries desiring economic growth are failing to experience it. Thus, technology cannot be the whole story. Attention shifted during the 1950s to capital formation. Investment is defined as the addition to the real capital stock and is that part of output used not for current consumption, but to increase future output. Total new capital formation is equal to gross investment, and net investment is the net addition to the capital stock after allowing for the replacement of capital consumed in the production process. Investment can take the form of buildings, machinery and equipment or additions to inventories, in which cases it refers to an increase in the stock of physical capital, or it can be in education and training, increasing society's human capital. There are several prerequisites for investment to take place: (1) the society must generate a surplus over its current consumption needs, either by production (perhaps combined with foreign trade), by borrowing or by conquest; (2) the people controlling the surplus must channel it to productive investment, either by force (e.g., government taxation) or voluntarily; voluntary investment may be in response to market incentives (usually involving intermediaries, e.g., banks); (3) there must be people willing and able to make the productive investment, whether government or corporation employees or individual entrepreneurs.

The emphasis on investment being productive has led some economists to discriminate between different forms of investment and to stress as most important, and that which must come first, investment in social overhead capital, i.e., the infrastructure of a modern society such as a transport network, a legal system, etc. In a country with Canada's geographical characteristics, investment in social overhead capital may be of especial importance and its scale so large that the government must necessarily be involved. A final point concerning investment is that it can be closely associated with technical change. For example, the introduction of mechanical grain harvesting in the nineteenth century necessarily

involved investment in new machinery. When technical change is embodied in capital equipment, then mere availability of the new technology is insufficient to ensure its diffusion; it is also necessary to examine whether the prerequisites for the capital formation are present.

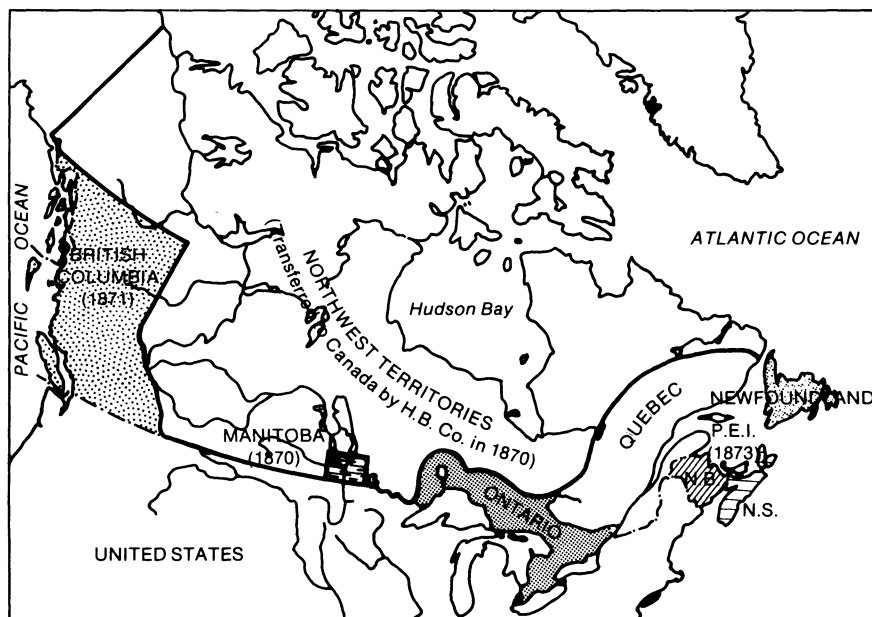
So far we have been concerned with economic growth, simply defined as an increase in the amount of goods and services produced by a society, measured either on a total or on a per head basis. Economic development is much more difficult to define, although it is not too difficult to recognize. There is general agreement concerning which countries are economically developed and which are not, but any quantitative measure (of which the most frequently used is per capita GNP) yields anomalies. Here, economic development will be considered as a process and will be rather loosely defined as involving structural change in the economy. Reference to Canada as becoming more economically developed appears to involve a favourable value judgement and will be used here to suggest greater control over man's economic environment. For most of the period under consideration such control may be summarized by the degree to which intensive growth is self-sustaining.

Having defined our subject matter and explained the methodology and most important terminology, the final task of the introduction is to limit the book's geographical and temporal boundaries. The geographical area of study is present-day Canada. After the border settlements of 1783 (in the east and centre) and 1846 (in the west) this is a clearly defined political entity, although before these dates the present boundary had no political, economic or cultural meaning and the whole North American situation must be considered (as in chapter 2). After 1783 care must be taken over the name Canada, which did not refer to the whole of British North America. The Province of Canada, created in 1791, contained only the present-day provinces of Quebec and Ontario, initially as the separate colonies of Lower and Upper Canada; and then after the 1841 Act of Union the names were changed to Canada East and Canada West. Confederation in 1867 added Nova Scotia and New Brunswick, and in 1870 the Hudson Bay lands to the west were transferred to the Dominion of Canada. British Columbia and Prince Edward Island joined Canada in 1871 and 1873 respectively, and additional provinces were created in the Prairies in 1870 (Manitoba) and in 1905 (Saskatchewan and Alberta). The political entity was completed only in 1949 when Newfoundland became the tenth province.

Any historical study of economic development is faced by the ligation problem—the choice of beginning and end dates. Since economic change is a continuous process, any starting date must involve omission of relevant preceding events. Canadian economic development stretches back to the receding of the glaciers which covered the region some ten thousand years ago, and can be seen as a mixture of indigenous developments shaped by stimuli from within and outside North America. The

beginning of European exploitation of Canadian resources for European consumption which followed Cabot's, and more especially Champlain's, voyages was the most significant of these stimuli so far as present-day Canada is concerned, and on this ground is selected as our starting point. Preceding developments within North America and within the European societies whence future settlers would come are left to anthropologists/archaeologists and to other economic historians as part of the academic division of labour. The criterion of relevance to present-day economic conditions has also led to the identification of a second significant point of discontinuity in the mid-nineteenth century (the reasons for this choice are stated at the end of chapter 2.6), and the book's emphasis is weighted towards the years after this "turning point." The terminal point of our study is not a particular day or year, but is generally conceived as the Second World War. By that time the Canadian economy had most of its existing features, and the postwar era can be considered as a unit—as my conception of present-day Canada.

Map 1
Canada, 1873



Source: From *Canada, Colony to Centennial* by D. Willows and S. Richmond, p. 199. Copyright McGraw-Hill Company of Canada Limited, 1970. Reprinted by permission.

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