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A Harvard Economist's Advice to Smallwood:

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Introduction

By the early 1960s the post-Confederation spending boom was subsiding in Newfoundland and government attempts to encourage small-scale manufacturing had had little success. Indeed, by 1963 the number of fishers had increased substantially from 1956 levels and rural, fisheries-based areas lagged well behind in terms of economic progress and access to social services.¹ Even the efforts by Premier Joseph Smallwood to encourage large-scale development through the British Newfoundland Company, Brinco, had achieved relatively little at that stage, a notable exception being its hydroelectric development of Twin Falls in western Labrador in support of the associated mining developments there. Both the slowdown in the rest of the economy and the availability of unemployment insurance to fishers contributed to the greater numbers entering or returning to that sector, despite its low productivity and dependence on low-value saltfish production.

Faced with an impasse in pushing the economy towards growth and with faltering popularity, Premier Smallwood developed a new approach. He focused on the fishery and how it, along with the many communities that relied on it, might be modernized and transformed. A key element in that strategy involved acquiring federal financial assistance to undertake such a sweeping venture.² To implement his

two-pronged strategy, Smallwood held a fisheries convention in St. John's in 1962, from which sprang Smallwood's commitment to modernize the fishery and the establishment of a Fisheries Commission to make recommendations on how to do that.³ By early the next year, Smallwood sent an extensive report to the federal government calling for a national fisheries policy and requesting federal funds for such.⁴ That report, which ultimately was not successful in obtaining the federal assistance Smallwood wanted, drew parallels between the fishery and agriculture, pointing out the extensive federal support programs for farming, which was of great benefit in farming provinces but of little impact in Newfoundland, and making the case for similar treatment of fisheries.

Among the federal supports that Smallwood wanted to tap into was the Agricultural Rural Rehabilitation Act (later the Agricultural and Rural Development Act or ARDA) funding. The ARDA program started in 1961 following its legislative birth. Its primary purpose had been to support federal-provincial efforts to assist farmers.⁵ Smallwood wanted similar treatment for fishers and their industry. Shortly after ARDA was established it was active in Newfoundland, but most of its early efforts related to research. About half the approved funds under a 1963–65 ARDA agreement with the provincial government went to a series of studies.⁶

Difficulty in translating those research efforts into actions that could be implemented likely motivated Smallwood to look for advice regarding their collective message. In September of 1963, the Premier reached out to well-known economist John Kenneth Galbraith to do the job. The Canadian-born Harvard professor was then widely known for his sweeping socio-politico-economic works, notably *The Great Crash, 1929* and *The Affluent Society*, both published in the 1950s. Never a mainstream technical economist, Galbraith's works were widely read and he was very politically active. At the time of Smallwood's request, he was working for President Kennedy and unavailable. In declining Smallwood's request, he did suggest other Harvard colleagues for the task.⁷ The first suggestion was Raymond Vernon,

and Smallwood followed through. The Premier's letter to Vernon set out what he had in mind:

Part of the ARDA scheme is for Ottawa to pay the cost of research . . . and we have between 20 and 30 separate pieces of research going on at the moment. Economists, college professors, etc. etc. from other parts of Canada and from Newfoundland itself are doing this work. We will shortly begin to receive these reports and analyse them, form some conclusions and write one overall report that would (at the very least) summarize the situation.⁸

Vernon accepted the offer, stating in his response "both the area and the industry have an enormous appeal for those of us who worry about economic development."⁹

The professor visited Newfoundland, met with various people, and ultimately fulfilled his obligation by writing his overall report in the form of a letter to Smallwood. Vernon was surprised that the studies did not cohere around a tight conceptual structure, thought that Newfoundland did not need more studies, and advocated a government department to implement and reappraise development policy. Smallwood agreed that the time was ripe for action, and soon asked the federal government for permission to spend ARDA money on pilot projects.¹⁰

That letter, dated 26 May 1964, is reproduced following this Introduction. It is available in the Edward Roberts Collection, Archives and Special Collections, Queen Elizabeth II Library, Memorial University of Newfoundland. As a document, the letter is of interest for two reasons. First, it was authored by Raymond Vernon. While he never achieved the celebrity-like status of Galbraith, Vernon did go on to become a highly influential economic thinker. When Smallwood asked for his assistance, Vernon had been at Harvard for only about six years. Prior to that, he had had a professional career, working mostly as an economist with the US federal government for about 20 years,

during which time he completed a Ph.D. from Columbia University. Interestingly, and independently of what he had done for Smallwood, just a few years later, in 1966, he published a highly influential paper entitled “International Investment and International Trade in the Product Cycle.”¹¹ That was a pioneering work in the area of the dynamic nature of international trade and globalization. His further contributions on international trade, especially on multinational enterprises and economic sovereignty, were highly influential and path-breaking in this new area of research. *The Economist* magazine described him as an “oracle of globalisation.”¹² For further background on Vernon’s distinguished academic career, see Buckley (1999).¹³

Second, the document is interesting for what this economist from afar says about the provincial economy and the challenges it was facing at the time. The letter is a non-technical assessment of the province’s prospects. It highlighted the need for a central agency in the provincial government and discussed the need for an integrated and internally consistent strategy, but most of its contents were devoted to issues related to the fisheries, including remarks about the 1962 fisheries conference. That was consistent with Smallwood’s priority at the time. The letter also discussed other industries and their prospects for absorbing the province’s “surplus labour,” namely, the unemployed and underemployed. While not highly detailed, the broad strokes of Vernon’s letter may be compared to subsequent policy strategies and analysis of the economic problems in this province.

Document

Dear Premier Smallwood

This letter is in response to your own note of September 26, 1963. At that time, you may remember, you asked me to take on the task of digesting and evaluating a group of reports on the Newfoundland economy being financed under ARDA research program. Since then, I have been stewing over these reports and other various studies of the Newfoundland economy, have been talking with various Newfoundlanders

in official and private life, and have visited Newfoundland for several days. The more I have learned about your problems, the more useful it has seemed to me to depart from the mandate which first brought me to the task.

At the time I agreed to summarize the ARDA studies, I operated under the assumption — obviously an erroneous assumption — that the studies had been designed to lay bare the major development problems of the Province of Newfoundland and to look for lines of policy which might be responsive to these problems. I now realize, of course, that nothing so systematic was designed or intended. Instead, as I now see it, the studies simply add something here and there to an understanding of Newfoundland's problems — an understanding which is already pretty deep and detailed in some respects, though quite rudimentary in others. As a result, the studies do not have and are not intended to have any tight conceptual structure.

This is no reflection on the studies; I am sure they represent money well spent. But it does raise the question what an outsider, who knows far less about Newfoundland than the men who are doing the studies or the Premier who commissioned them, can hope to add through a summary and evaluation.

At the risk of losing the principal reader for whom this letter is intended, therefore, let me exercise the prerogative of an academic — that of changing the question and then doing his best to provide the answer. What I propose to do in this letter is to trace out the steps by which Newfoundland might lay a basis for a medium-term development strategy — say, a strategy covering a five or ten year- period. In the process, I propose to summarize the salient points of the ARDA studies, wherever they may fit in, and to reach out beyond them wherever I have the basis for doing so. On the other hand, since this letter is not based on a systematic review of all the available economic materials on Newfoundland, there is a risk that I may overlook some of the things that are already known about Newfoundland's economy and may err in my statement of others. In that case, I know I can count on you and your staff not to be misled by my ignorance.

The Basic Position

The first task in formulating a strategy for an area such as Newfoundland is, of course, to define in some general way the goals to be sought; and if there are some restraints on the means that are acceptable for the achievement of these goals, to identify these as well.

Since my first exposure to the Newfoundland economy, I have been trying to read its mind on these very critical points. At different times, I have found two concepts of Newfoundland — two conflicting concepts — being urged on me. One is apparently a reflection of Newfoundland's long history; it projects the pessimism of a rough and difficult land, with poor agricultural resources, with a fisheries industry that may be losing its competitive position, with bitterly disappointing experiences in industrialization, with high living costs and low living standards, with a persistent trickle of out-migration by its young men and women. The other concept is apparently a reaction to the events of the last decade or so. According to this second characterization, incomes in Newfoundland have risen faster than those of the mainland, Newfoundlanders are tending to come home faster than they are leaving, and young men are returning to the inshore fisheries to exploit a growing demand for fish products.

Those that hold to the second picture are not unqualifiedly optimistic. They are uneasy about the fact that almost twenty per cent of the Newfoundland economy's income — and a much larger proportion of the Newfoundland government's revenue — come from Dominion grants of one sort or another. They are uneasy about the fact that Newfoundland's forests may not be getting the benefit of the most modern management methods. They are unsure if Newfoundland's "recovery" of the past ten years can last for very long; and especially if it can be made to last without continuous subsidy from Dominion sources and without an attendant erosion of the personal qualities of its people.

There is a widespread dissatisfaction among Newfoundlanders, therefore, and a deep-seated concern that present trends may lead to

disaster. What is wanted, as nearly as I can tell, is the assurance that the living standards of Newfoundland, the lowest in Canada, will grow as fast as those of the rest of the country — perhaps even a little faster. There is an unwillingness to have this come about by wholesale migration out of the Province. If they can, Newfoundlanders want to remain in Newfoundland; and they want their children to have the choice of remaining in Newfoundland under acceptable conditions.

To achieve these results, Newfoundland expects to stick pretty close to the sea; it is in the wealth of the sea that Newfoundlanders think their future lies. But I gather there is no insistence upon this point; if the children of this generation, offered a reasonable opportunity at sea, nonetheless chose to make their living on land, and if opportunities developed there, Newfoundland's leaders would not feel obliged to discourage that choice. This means, of course, that if the children so chose, there might possibly be a considerable shift of population within Newfoundland, presumably from the fishing outposts to other locations, without violating any basic tenet of Newfoundland philosophy.

As to ways and means, Newfoundland's leaders seem to think that its people are prepared to accept a more aggressive role by government than had heretofore been the case, notably in the marketing of fish. A new regime in fish exporting is to be devised, controlled by the government, to replace the hitherto legalized private export cartel. In the new regime, price guarantees, export promotion, quality standardization and control, and financing are to depend far more upon government action than in the past.

Newfoundlanders also seem to feel that, while they cannot build their future growth upon the dole, they are entitled to major continued support from the Dominion government. In the end, the Province would like to be free of special financial support for the Dominion. But as long as that aid is needed, it prefers that the aid should not come solely in the form of consumption-supporting and service-supporting subsidies; faced with a choice, aid in more creative and lasting forms, such as capital funds, would be more acceptable to Newfoundland's

leaders (provided, I suppose, that the cut in other types of support was not too rapid or too deep). Such support would reflect the common responsibility of the Dominion for insuring that its most laggard Province, brought only lately into the Dominion structure under handicaps of underdevelopment and isolation, should be carried as rapidly as possible abreast of the other provinces in opportunities and services.

But perhaps the word “aid” does not quite express Newfoundland’s full feelings about its entitlements. The Province feels that certain adjustments in the laws and regulations of the Dominion are called for to fit the special position of Newfoundland. Jutting out to the sea and separated by a water barrier from the rest of the Dominion, living off world markets more than Canadian markets, Newfoundland feels that it should not be obliged to bear the full costs of the Dominion’s protective commercial policy. Finally, it feels entitled to a recognition of the special fish-based characteristics of its economy, such as already appears in the unemployment compensation laws and is embodied in the plans of agencies such as ARDA.

So much for philosophy. While a philosophy of sorts is an indispensable prerequisite for a plan of development, it is far from being enough. Are the goals compatible which are embodied in the philosophy, or are they inconsistent; can all of them be achieved at the same time, or must some be sacrificed or subordinated to others?

No responsible program of development can be framed without some prior attempt to answer questions of this sort. A serious effort has to be made to project the future pattern of development of the Province, under various assumptions about policies and prospects, to learn if the Province has an outside chance of achieving all its goals at once.

It is unavoidable, of course, that projections of this sort should be based on fairly infirm ground. So much has to be guessed at that any credence one places in the final product is much more an act of faith than of reason. Still, economists have begun to learn how to handle problems of this sort systematically and reasonably; and with a certain skill and care, they are at times able to flush up unforeseen bottlenecks and inconsistencies in some articulated set of goals.

The economist's way of ferreting out these bottlenecks and inconsistencies is to try to elaborate in numbers roughly what a given pattern of development implies. Any pattern of future growth implies something about the amount of product which will be produced in the Province, the amount which will be imported, the amount exported. It implies something about the amount of capital which will be formed out of the savings of the Province, and the amount which will come from outside. It is related to some kind of implicit guess about the future population, the future labor force, and the kind of jobs they will be engaged in. Therefore, it also implies in some measure whether the labor force will be distributed in the outports, grouped in medium-sized towns, or concentrated in St John's; and so on. In short, it implies some sort of growth "model" for the province.

Of course, there is not just one possible "model" of this kind; there are many alternative possibilities. And the more these alternatives are explored, the more they begin to provide a basis for understanding what may be possible and what may be mere daydreaming; the more, too, they tend to identify the problem areas that urgently have to be dealt with and the ones that for the present can be left to themselves.

Take the question of the future need for the Dominion's various payments to the economy and the Newfoundland government. Suppose that the economist's various models, covering a wide range of alternative assumptions about the future, failed to come up with any plausible combination of events that could reduce the need for these payments in some form, without at the same time sacrificing the objective of increasing income. To know that fact — if it was a fact — would be cold comfort, of course; but it would be an indispensable element in the framing of future goals and building of future policy.

Or take the question of the future of education in Newfoundland. The pattern of economic growth envisaged in the "models" implies some sort of educational effort, hence suggests something about the levels of educational cost. Suppose, however, that the educational cost involved exceeded any reasonable estimate of Dominion and

Provincial revenue available for education. Something, then, would have to give; something in the plan would have to change.

Illustrations can sometimes obscure rather than illuminate a larger point. Accordingly, I do not want to place too much stress on the illustrations themselves. The larger point is that an internally consistent strategy involves many interlocking pieces of policy — on education patterns, on fiscal policy, on concessions policy, on subsidy policy, and so on. To get the bits and pieces organized so that they fit together and so that they reinforce one another in contribution to a common goal is mostly an art; but it is an art to which the economist's model building exercises can contribute a little. I would make it an objective of the first priority, therefore, to mobilize some economic talent to generate some growth models based on what is known about and what is desired for Newfoundland. Perhaps their efforts will suggest how realistic your "philosophy" for Newfoundland may be.

If you were to stop there, however, your efforts would not be very useful. Newfoundland does not simply need another study of its economy; it has not really begun to digest those that already have been made. What it needs is an organ of Provincial government and a related process inside government whose function and effect are continuously to appraise, reappraise, and adjust Newfoundland's development strategy. The new organ itself would have to wear the mantle of the Premier's office, and it would have to be staffed by experienced civil servants who either were themselves fairly skilled economists or had the support of skilled economists. Such an organ would have to be thought of as a coordinator and conciliator among the operating ministries, deriving its strategies in large part from the plans and programs of the ministries, ferreting out inconsistencies in such plans, proposing reconciliations of the inconsistencies, and testing constantly to determine if in the aggregate the proposed plans were sufficient to satisfy the goals of government. All major governmental exercises such as the annual budget and the periodic negotiations with Ottawa would, by one means or another, need to be vetted for their consistency with general strategy. It would take consummate skill, therefore, to intrude

a group of this sort in the government structure without generating some enmity and hostility from the established machinery. But the problem has been overcome in other governments. I have seen nothing in my brief encounters with the Newfoundland government to suggest that it could not be overcome there.

The size of such a staff, if experience elsewhere is any guide, need not be very large. Its prime operating principle should be the avoidance of duplication of work done elsewhere, the delegation of work to the ministries wherever delegation is possible. Given Newfoundland's size and comparative simplicity (a somewhat deceptive simplicity, perhaps) a team of eight or ten qualified professional men would probably be sufficient for the need.

The Fishing Industry

Whatever the strategy of Newfoundland's development may be, it will have to be based heavily, in the first instance, on the existence of the Province's great fish resource. Accordingly, let me try to summarize some of the problems and issues involved in the future development of the fisheries.

First of all, I have been struck by how much Newfoundland knows about itself in this regard. This, of course, is not altogether surprising, given the importance of the fisheries in Newfoundland's history. But it casts the outside expert in the role not of providing added knowledge on the subject but, at best, of providing some additional perspective.

You yourself presented an interesting summary of the relative importance of Newfoundland's fisheries at the Fisheries Conference in September 1962. There, by piecing together some numbers and impressions, you demonstrated that the fisheries accounted for direct and indirect employment on the order of one-fifth of Newfoundland's labor force. One scarcely needs to labor the point, therefore, that an understanding of the nature of the future world demand for fish is of the utmost importance to Newfoundland.

On this subject, your various reports do suggest some useful generalizations. On the whole, the demand for fish products in the aggregate promises to continue to grow. In the high-income countries such as the United States and Western Europe, the demand will take a different form over the years. There has been and presumably will continue to be a shift from the bulk, salted product to the fresh and frozen form and to processed forms of various sorts. Fish sticks are only one such form of processing; cocktail snacks of dried light salted fish are another; fishmeal for commercial animal feed is still another, one of great potentiality.

In the low-income countries, the demand for the dried or otherwise preserved and unrefrigerated product should grow as incomes grow. But here, too, changes in the patterns of demand are likely. In those countries, refrigeration in some form will probably appear almost from the first. The increase in the demand for fish products, therefore, is likely to be in forms which have not been characteristic of undeveloped markets in the past. And the use of fish products in comparatively new forms, such as commercial feed and fish flour, also seems probable. On the whole, therefore, the rapidly growing sectors of demand for fish products are likely to be found in new uses and more highly processed uses.

If the picture on the demand side is encouraging, the story on the supply side appears very mixed. On the supply side, a series of major changes seem imminent. For one thing, Newfoundland's competitors are changing in identity. One competing source, the United States, is losing its competitive position in relation to Newfoundland; high wage costs and the lure of less demanding shore jobs are driving the US fishing fleet out of business.

There are signs that some of the countries of Western Europe may be feeling similar strains. Britain's high incomes and France's labor shortages are creating problems for each of these countries in manning their fleets. While their wage levels are not yet as high as those of Canada, nonetheless, one may question whether these countries would be able to stand up to potentially much more efficient fish producers

based on Newfoundland. Part of the answer of such countries, of course, will be a much more highly mechanized fishing fleet with larger capital and lesser labor requirements. But even this response apparently has its limits (I am told, for instance, that the cost of production of fish by the more efficient British trawlers is two or three times as high as that of Newfoundland fishermen).

However, if the richer countries show some signs of reducing their role as fishing nations, the poorer ones certainly do not. The poorer countries, which once lacked the capital and technology for large-scale deep-sea fishing, show signs of overcoming those handicaps and of becoming less dependent on imports than once was the case. Modern domestic fishing industries are appearing throughout South America and are beginning to appear in Africa and Asia. So Newfoundland may face a deteriorating competitive position with respect to its more distant markets in the poorer countries. Even in the US market, Newfoundland cannot discount the possibility that third countries, following the leads of Peru and Japan, will market competitive fish products in increasing volume.

The outlook for Newfoundland's position as a fish-supplying nation, therefore, is mixed. A great deal depends upon her suppleness in shifting to different products and different markets, as changing requirements and changing competition dictate. A great deal depends also upon the alternative opportunities offered to Newfoundland's labor. It is on this issue that the Province faces a succession of nasty problems.

First of all, there is the difference in forecasts regarding the inshore fishing grounds, a difference to which I alluded earlier. At the 1962 Fisheries Conference, Dr. Templeman¹⁴ offered his best guess that the catch of the inshore fisheries could not be expanded very much above present levels; and that in any case the fish would be smaller, hence more costly to catch by inshore fishing methods. You obviously had reservations about his projections, and I have heard more reservations expressed by your staff since. When fishing experts differ in their conclusions on such matters, the wise landlubber will

remain silent. But I cannot refrain from pointing to a possible critical difference in opinion, which constitutes an important element of uncertainty.

Let us suppose, however, that Templeman proves wrong, as well he may be. The next question is whether an expansion of the inshore fisheries “solves” Newfoundland’s problems. Note that although the fisheries employ about twenty per cent of Newfoundland’s labor force, they nevertheless contribute little more than ten per cent to Newfoundland’s gross product; to put the point in other terms, the labor used in fisheries is responsible for less output per head than is Newfoundland labor on the average, measured in dollars and cents. In situations of this sort, the chances are very high that the personal income of such labor will also be lower than the average. If Newfoundland pins its hope for expansion on a sector which pays less than the average level of wages, its chances of raising income levels to those of the mainland will be subject to added handicaps.

More in the same vein. There is scarcely a part of the fisheries and the fish-processing industries of Newfoundland that is not heavily subsidized. The materials for boat-building are paid for by the government. Subsistence during the idle winter months of the inshore fisherman is underwritten by the government. And even on that basis, few people in the business seem to be making large returns. Newfoundland, therefore, cannot be said to be producing codfish at the two and a half or three cent figure that represents the going price; her real production costs are probably much higher. The subsidies provide the difference, part of them being passed on to distributors and consumers outside Newfoundland in the form of lower prices.

This is not a conclusive reason for abandoning the subsidies. A government may have good and sufficient reasons for subsidies, such as the objective of creating more jobs. But a question that can reasonably be asked is whether — given the purposes, aspirations, and goals of the government concerned — the subsidies are being used as sensibly as subsidies can be used. In the case of Newfoundland, where some of the subsidy goes to the distributor or consumer and some is used for

immediate consumption — sometimes to finance living standards well beyond the levels to which the recipients have been accustomed — there is a heavy presumption that a part of the subsidies is being wasted and misused.

If fishing is the one obvious resource which Newfoundland is in a position to exploit at present, then obviously fisheries will have to provide part of the answer. But if Newfoundland hopes to achieve not only a higher average income, it will have to exploit the fisheries at constantly increasing rates of efficiency. At this stage it may not be necessary to decide whether the Templeman projection on the inshore fisheries is right or wrong; the costs of guessing wrong on this point may not be overwhelming. The drive, in the first stages, probably ought to be for a spectacular increase in fish-catching and fish processing efficiencies, whether from the inshore or offshore sources, in the hope that Templeman is wrong — or that if he is right, the cost of assuming he was wrong would not be prohibitive. An improvement in inshore fishing technology would ensure that those men who continued as fishermen would have the technical means for obtaining larger incomes. If the inshore fishing catch should decline as a result of increased efficiencies, Newfoundland's problem in shifting men out of the fisheries will accelerate. But at least the Province will have a technological basis for providing its remaining inshore fishermen — greatly reduced in number though they may be — with the basis for earning an adequate living.

The risks for Newfoundland would be very high, I suspect, if it did not push its technology in the offshore fishing sector just as hard as in its inshore fishing. True, the patterns of employment provided by a dragger fleet would contribute less to Newfoundland's employment goals per ton of fish caught; but not very much less, according to the figures in the various studies, if one considers the likelihood that more on-shore processing labor would probably be hired as an adjunct to the draggers, and that the work would be spread over a larger part of the year. In any case, Newfoundland has little choice; either the productivity of Newfoundland labor goes up, or its income goals are not achieved.

The reasons why Newfoundland cannot afford to put all its eggs in the inshore basket are not only the uncertainties as to the supply of inshore fish, but also the uncertainties as to the continued supply of inshore fishermen. This is a subject so thoroughly wrapped up with tradition and personal feeling among Newfoundlanders that I have found it difficult to get an objective discussion of the issue. We confront the fact that, confounding the prophets, population has lately been rising in the outports, not declining. We can readily guess that the availability of unemployment insurance has something to do with the trend; but we do not know whether the trend would continue if inshore fishing could be made to provide the basis for a decent living and if the dole could be deliberately allowed to decline (or, more realistically, if the dole could be allowed to fall behind the increase in living costs). There is nothing in the studies which ensure, therefore, that over the long pull a supply of fishermen would be available to match the supply of fish.

In general, the long sweep of history provides various added reasons for worry on this score. Here and there in the studies, one sees signs that the people in the outports, while perhaps content to live there while supported partly on the dole, may be losing their historical attachment to the fishing life. Signs of the trend include the gradual desertion of the smaller islands, the rise in the pupil attendance in the high schools, and so on.

One dare not make any sure predictions about the net effects of the recent and prospective increase in the road network, now being seen in Newfoundland. The effects, whatever they are, will be complex and profound and they will not all be in a single direction. On the one hand, the possibilities of efficient fish collection by road will be increased. On the other hand, the increased mobility of youngsters and the "demonstration effects" of life in St John's and Corner Brook will also grow. On balance, judging from analogous developments in other parts of the world, such as the Greek islands, I am inclined to guess that the change will tend to concentrate the population in a smaller number of larger centers.

This is about as far as I feel secure in going in my evaluation of the recommendation of the reports, at least as they relate to the fishing industry. No one from outside can comfortably pass judgment on the efficacy of the scores of specific devices proposed in the various ARDA reports at the 1962 Fisheries Conference, until he has had an opportunity to steep himself in the politics, the law, and the local conditions of Newfoundland. On the face of it, proposals such as the reinstitution of fishgrading provisions, proposals to modify some of the unhappy features of the unemployment insurance laws, proposals to reduce the risk and uncertainties of large-scale fishing — all these seem to make eminent good sense.

The new powers of the Provincial government in the fish-marketing business, however, do suggest the likely early appearance of three kinds of problems on which analogous experiences in other countries may have some bearing. One such problem is that the government will have to distinguish the measures that may be only palliative and transitional in their intent — such as the increase in the number and location of bait stations — from the measures that are genuinely intended to increase productivity to the point at which the fishing industry can survive and expand in international competition. Faced, for instance, with a choice of increasing the number of bait stations in response to popular pressure, or increasing its expenditures on market penetration abroad in the face of popular skepticism, it would be sad if the government felt obliged always to accede to the “popular” measure. The government might then be party to a policy which, by easing the lot of the fathers, entrapped the sons in occupations which condemned them to a life of bare subsistence.

This painful choice, if I understand the facts aright, is likely to arise with particular force on the Northeast shore where comparative isolation and icebound conditions place special limitations on the possibilities for increasing the efficiency and improving the quality of the product of the inshore fishing communities. An approach to problems of this sort, however, is suggested by the existence of ARDA. That entity thinks of itself as devoted to the improvement of relatively small

pockets of stubborn poverty. True to its present philosophy, ARDA could be an enthusiastic partner in a program for ameliorating the problems of an area such as the Northeast shore (ARDA would be a more lukewarm partner and, I suspect, a much less efficient partner in any more general program designed to contribute to the well-being of Newfoundland as a whole).

The second sort of problem confronting the government in the exercise of its new powers has to do with the choice of measures in carrying them out. In broad terms, such powers may be exercised either by the use of regulations or the use of incentives — or, of course, some combination of the two. Newfoundland's traditions, I need hardly tell you, rebel at regulatory devices; and the comparative isolation of much of its population suggests that the enforcement of regulations would be especially costly and difficult. My suspicion would be, on the basis of experience elsewhere and of what little I have sensed of Newfoundland temperament and tradition, that a proper mix for Newfoundland ought to be long on the use of incentives and chary with the use of regulatory devices.

Finally, there is the question of the selection of the appropriate instrumentalities in the exercise of the governmental powers. On this point, the Newfoundland government will presumably have to take realistic account of the paucity of skilled manpower available to the government agencies; it would be a mistake, albeit a common one, for governments in lagging areas to assume responsibility for a task they were not staffed to perform. In any case, the machinery of government tends to perform certain kinds of tasks more poorly than others. Supple, swift-moving action, such as is needed in the penetration of competitive markets, does not come easily to a government agency; an agent with plenary powers, working outside the normal government structure, is often far better at this sort of operation. On the other hand, standard operations such as the grading of fish or the issuance of insurance policies can readily be performed by government agencies.

In brief, I expect that any strategy for Newfoundland will continue to rely on the fisheries as a basic part of the grand design. But reliance

on the fisheries will demand a degree of responsiveness on the part of Newfoundland's marketing structure which is far greater than it has evidenced in the recent past; if that responsiveness does not develop, Newfoundland's position may slip further. But improved marketing will not be enough. Increased efficiencies in fish production seem indispensable in increasing fishermen's income. Even at the risk of generating higher unemployment, Newfoundland's medium-term income objectives demand increased efficiencies in the inshore and offshore fisheries.

The Industrial Sector

The ARDA studies, for obvious reasons, had little to say about the industrial potential of Newfoundland. But the appropriateness of any given fishing policy turns in part on the availability of alternative opportunities.

The prudent approach in this report would perhaps be to pass this sector over very lightly. The prudence of this approach would seem particularly strong because I have not had the benefit of a detailed account of the problems of the Valdmanis episode;¹⁵ neither have I had access to the Arthur D Little post mortem nor to the other industrial analyses of the Province.¹⁶ None of these, quite obviously, formed a part of the ARDA group of studies which I was called on to summarize. Nevertheless, I think it may be useful to say a few general words about Newfoundland's industrial potentials.

Newfoundland's possibilities can be looked at in three general areas. First, there may be possibilities for "import substitution," that is, possibilities for the local manufacture of products presently brought in from the rest of Canada or abroad. Second, there may be possibilities for "export" to Canada and the rest of the world based upon Newfoundland's raw materials. Third, there are possibilities for "export" based upon the prevalence of surplus labor.

In all three areas, there are major problems. In modern industry, a

market of 500,000 is not much of a market. It is sufficient to support modern plants in only a few lines — lines in which the economies that go with large plants are limited and in which the product is perishable or bulky, such as dairy products, baked goods, beer and furniture of some types. But Newfoundland is simply not large enough, taken merely as a market, to justify most lines of manufacture. And when, as in the case of Newfoundland, competing brands are advertised through channels of communication common to all of Canada, the fractionated demand spread over a number of brands reduces even more the possibility of supporting a plant upon the basis of market proximity.

Nonetheless, some possibilities may have been overlooked. Accordingly, I was very glad to learn that a group at McGill is studying the import patterns of each of the Atlantic provinces, to see if some opportunities for import substitution existed. These studies should be followed by the Newfoundland government with great care.

We turn to Newfoundland next as a place for export, based upon the availability of raw materials for processing. The materials are, of course, the obvious ones — fish, forest products, and ores. The possible processing of the materials, however, is far less obvious.

In abstract terms, it is clear enough what kind of processing has the best chance of being located in Newfoundland. The obvious candidates are processes which reduce the weight and waste of products to be shipped; processes which demand no complicated or bulky inputs unavailable in Newfoundland; and products which for other reasons need not be produced close to their final markets.

I have already suggested some of the implications of concepts such as those for the fish industry. The unprocessed state of a considerable part of Newfoundland's fish exports presents a challenge and an opportunity. But before the challenge can be explored, it demands two things that are evidently missing: an ability in Newfoundland to find or develop an efficient marketing grid which is tied to processing facilities in Newfoundland, particularly a marketing grid in the nearby United States and Canadian markets; and the entrepreneurship to do the processing that is possible and desirable in Newfoundland. These

should be among the main objectives of the new fishing policy.

As far as the forest products industry is concerned, the implications of these general locational principles may merit some investigation. I take it for granted that the two paper companies might be able to do more processing of forest products in Newfoundland if they chose. Their choice, if they are at all like other corporations, will be made partly on the basis of habit and inertia. The result may or may not be optimal for Newfoundland. A change — a deepening of production — may or may not be advantageous to the firms. But if not advantageous to the two firms, it may still be advantageous to other firms set up in Newfoundland to use the available raw materials. In evolving a 5 or 10-year plan of development for Newfoundland, one of the objectives of the planners ought obviously to be a review of the facts in this evidently murky field.

In the area of minerals processing, the same kind of question occurs. Can the ores shipped out of Newfoundland be processed further before shipment, without involving the prohibitively costly in-movement of some other raw material? No doubt the question has been studied with exquisite care by the various concessionaires. But technologies in this field have been changing with such great rapidity that constant reappraisals are needed; and appraisals not only from the viewpoint of the particular concessionaires concerned, but also from the point of view of Newfoundland.

I suggested earlier that export industries might be based on the availability either of raw materials or of surplus labor. The exploitation of the existence of surplus labor in Newfoundland, however, seems to present its own special difficulties. One problem, of course, is that the idleness is partly seasonal. As long as this is so, a limit exists on the extent to which industry can use the labor. And if the surplus labor exists principally in areas without adequate communication or facilities, its existence could be largely academic.

The other major problem inhibiting the use of Newfoundland's surplus labor is the fact that its existence does little to reduce Newfoundland's wage scales below those of the other maritime provinces.

In fact, the figures in one study seemed to suggest that Newfoundland is, on the whole, a comparatively high wage area. The reasons for the high level of Newfoundland wages seem fairly evident. Canadian institutions, including unions, minimum wage laws, and unemployment insurance, blanket Newfoundland. Besides, migration to the mainland is possible. Hence the differences between Newfoundland and mainland wage scales cannot be expected to differ by much. Accordingly, various possibilities for the use of surplus labor, such as those suggested by the case of Puerto Rico or by the free port of Shannon, are not readily available.

Nevertheless, despite this unprepossessing appraisal of Newfoundland's industrial prospects, I would still be inclined to explore three general measures further.

One is the possibility of some sort of free port arrangement in Newfoundland. Free ports, of course, can have any dimensions: they can be unlimited in size and scope of operations; they can be limited to a tiny area, even in some cases to a single plant; they can be limited to a single product. In the case of Newfoundland, there may be a number of possibilities which investigation will suggest. An obvious possibility for exploration is the designation of free port areas for the processing of the fish catch of foreign vessels. Once the 12-mile limit has been applied — perhaps concurrently with the application of the limit — the political tolerance of Newfoundland fishermen for such a measure may grow. In any case, if St Pierre should acquire such status, the wisdom of a like step for Newfoundland will be even more apparent.

A second general area for consideration is that of freight rate structures. The efficacy of a benign structure of freight rates as an aid to development is indicated by the grain trade. Here, I understand, the transport subsidies have made it possible to land grain in Newfoundland at prices competitive with the mainland, for subsequent processing into poultry feed. But Newfoundland does not necessarily want uniformly low transport prices. What she may want is high freight rates for processed goods bound from Canada when Newfoundland is in a position to manufacture such goods; and low freight rates for the

raw materials needed for local fabrication. This appears to be a rich area for a study.

Finally, the third general area has to do with tax exemption legislation for industry. Newfoundland, like the other maritime provinces, is eligible for the benefits of such legislation. But as the first announcements under the legislation have indicated, it seems doubtful if many plants will be persuaded to come to Newfoundland on the basis of the provisions of such legislation, especially if a site on one of the other Atlantic provinces is available on equal tax terms.

Nor am I inclined to suggest that Newfoundland should demand more generous tax exemption terms than the others, assuming that such an approach were politically feasible. Numerous studies of such tax exemption provisions in other areas indicate that such exemptions are not a powerful tool for investment. Other inducements ordinarily have to exist as well.

One significant inducement which Newfoundland may perhaps be in a position to provide in its bid for industry is a reply to the problem which really worries entrepreneurs at the threshold of a new investment — the fear of losing their equity in the investment during their formative years. Insurance against equity loss for a number of years, as seen through the entrepreneur's eyes, may be a more powerful inducement than an exemption from taxes on profits which do not yet exist and which may never materialize.

It may be that the Province's present financing activities come close to providing a guarantee against equity loss in some cases. Some of the financing for fish processing plants seems to have come very close to such an arrangement. But there may be significant differences between what Newfoundland does now and what it might do — differences which perhaps count a lot in the entrepreneur's eyes. One is that under present conditions the "bail out," if it is needed, may not be assured and may depend upon the political pressure that can be brought to bear at the time of crisis. Another is that the stigma of bankruptcy may still be present under existing arrangements even if the fear of loss is not.

The ideal form of support, if it were possible, would be the one in which the entrepreneur had the right during an initial period to sell his company to a government entity at a price reflecting his initial equity plus a reasonable return. Obviously, any such approach involves many risks, only some of which can be avoided by proper safeguards. But on the basis of what little I now know, an insurance possibility of this sort bears further investigation.

The Agricultural Sector

The ARDA studies in the field of agriculture were not completed at the time this letter was written. However, having been advised that the potentialities in this sector are both obvious and limited, I determined not to wait for their completion. Instead, I had the benefit of oral briefings from several sources.

It does not do to dismiss agricultural possibilities in any area too readily; technology improves at so rapid a rate that new possibilities constantly emerge. Presumably, there is a complex of possibilities, for instance, centering about the availability of cheap grain and the presence of cheap fishmeal as feedstock for poultry and cattle. There are also some far-out possibilities such as the cultivation of hay for local feeds in the drained bog-lands of the interior.

One immediate line of possibilities which is suggested by the studies, however, has to do with the greater use of certain Newfoundland agricultural products in the urban areas of Newfoundland. Briefly, the wholesale distributors and chain stores of urban Newfoundland have followed the easy and obvious line for most agricultural products; except for a few products such as cabbage, potatoes, and carrots, they have ordered from mainland sources and thus have been assured of a reliable supply of goods over a considerable part of the year.

Newfoundland farmers encounter major blocks in any effort to widen their participation in these markets. No organized grid has existed to buy, pick up, and store the comparatively small amounts that

any individual farmer has to sell. As long as such amounts are small and dispersed, the chances of a spontaneous shift to Newfoundland sources seem slight. This is said despite the fact that the local prices for various crops in agricultural areas outside the urban centres are so low that a profitable middleman operation may be justified. This is obviously a situation justifying more investigation, and possibly experimentation, in the actual purchase, collection, storage and sale by some government agency. If this analysis is correct, the present plans, which I understand call for the construction of local storage facilities, may not go far enough to achieve the needed objective.

Conclusion

It is apparent that this letter only scratches the surface of the Newfoundland situation, dwelling largely on those areas in which the ARDA studies have been most illuminating or those areas in which experience of other countries seems to have applicability. There are, of course, a number of additional major areas in which analysis and policy would be needed on the part of any group concerned with the long-term strategy of Newfoundland's development.

One of these is fiscal policy, where my few probings encountered only a vacuum. Another is the field of tourism, which seems very promising; the startling recent rise in nonresident fishing and hunting licenses — unless it betokens only improved enforcement — certainly suggests untapped potentialities in this area. Still another is the field of transportation, which I gather moves forward under precedents and policies only loosely related to the issues of fisheries development, settlements policy, tourism, and so on, which transportation is bound profoundly to affect. I am sure that a little reflection would suggest others as well.

The principal point to be drawn from this brief survey, however, is the point with which it began. What is needed most of all is an over-all point of view and a machinery in government capable of orienting its day-to-day actions with that viewpoint. Detailed surveys of particular

problems are surely needed; but they are needed in a setting in which the relation of the problem to the total strategy of the Province is clear. Otherwise, the Province will alternately drift and shift course erratically, unsure whether the prevailing winds are carrying it in the direction it wishes to go.

Sincerely yours, Raymond Vernon

Notes

- 1 R. Blake, *Lions or Jellyfish: Newfoundland–Ottawa Relations Since 1957* (Toronto: University of Toronto Press, 2015), 117–18.
- 2 M. Wright, *A Fishery for Modern Times: The State of the Industrialization of the Newfoundland Fishery, 1934–1968* (Toronto: University of Oxford Press, 2001), ch. 6.
- 3 Blake, *Lions or Jellyfish*, 117–22.
- 4 Government of Newfoundland, *National Fisheries Development: A Presentation to the Government of Canada* (1963).
- 5 Blake, *Lions or Jellyfish*, 121.
- 6 M. Bilous, “Federal Attempts at Relieving Regional Economic Disparity: Newfoundland’s Experience with D.R.E.E.” (MA thesis. Memorial University of Newfoundland, 1973), 14.
- 7 John Kenneth Galbraith to J.R. Smallwood, 12 Sept. 1963, 3.16.123, Smallwood Collection, Archives and Special Collections (ASC), Memorial University of Newfoundland (MUN).
- 8 Smallwood to Raymond Vernon, 26 Sept. 1963, 3.16.123, Smallwood Collection, ASC, MUN.
- 9 Vernon to Smallwood, 7 Oct. 1963, 3.16.123, Smallwood Collection, ASC, MUN.
- 10 J. Webb, *Observing the Outports: Describing Newfoundland Culture, 1950–1980* (Toronto: University of Toronto Press, 2016), 289–91.
- 11 R. Vernon, “International Investment and International Trade in the Product Cycle,” *Quarterly Journal of Economics* 80 (1966): 190–207.
- 12 *The Economist*, “Raymond Vernon, oracle of globalisation,” obituary, 9 Sept. 1999, 93.

- 13 P. Buckley, "In Memory of Raymond Vernon," *Journal of International Business Studies* 30 (1999): iv.
- 14 Wilfred Templeman was the Director of the St. John's Biological Station of the Fisheries Research Board and an accomplished biologist with more than 200 published papers.
- 15 Alfred Valdmanis had been the government's Director General of Economic Development between 1950 and 1953 and had been in part responsible for enticing European companies to invest in production in Newfoundland. Despite subsidies most of these businesses failed, and in 1954 he was convicted of accepting kickbacks from construction firms that had built cement and gypsum plants. The scandal became emblematic of Smallwood's gullibility when negotiating with business. For more on Valdmanis, see G. Bassler, *Alfred Valdmanis and the Politics of Survival* (Toronto: University of Toronto Press, 2000).
- 16 In 1957 the government hired the Boston-based business-consulting firm Arthur D Little to study the challenges to industrial production in the province. The company submitted several reports: "Eckhard Mills, Ltd.: report to the Province of Newfoundland, Economic Development" (1957); "Drafts of reports to Province of Newfoundland Department of Economic Development" (1957); "Business analyses of thirteen Newfoundland companies: report to Province of Newfoundland, Department of Economic Development" (1957); "Report on preliminary review of economic development in Newfoundland to the Newfoundland and Labrador Corporation Limited" (1952); "Summary report covering company analyses: report to Province of Newfoundland, Department of Economic Development" (1957); "Evaluation of a lime products plant in Newfoundland: report to the Premier, Province of Newfoundland" (1963).