Races to the Bottom?

Provincial Interdependence in the Canadian Federation

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Introduction

The image of a "race to the bottom" in which jurisdictions compete for footloose capital by reducing corporate taxes and environmental and labour standards has gained increasing attention in recent years. Race-to-the-bottom imagery is prevalent in debates about economic globalization as enhanced capital mobility has pitted industrialized countries with relatively high environmental and labour standards against developing countries with much weaker standards (Tonelson 2000). Fears of a race to the bottom also arise within federal systems, where provinces or states might engage in destructive tax or regulatory competition in response to an even higher level of capital mobility than exists internationally. Indeed, the unfettered mobility of individuals as well as capital within a federation raises the spectre of harmful interjurisdictional competition along another dimension, with provinces or states racing to the bottom with respect to welfare benefits in order to avoid becoming "welfare magnets" for migrants from their less generous neighbours (Peterson and Rom 1990).

The focus of this volume is interjurisdictional competition among provinces within the Canadian federation. Do Canadian provinces engage in the proverbial race to the bottom, and if so, with what consequences? The question of whether provinces are constrained in their ability to pursue independent policies is hardly new (Scott 1977). However, the prospect of races to the bottom has become increasingly salient in recent years in response to several factors. The election of tax- and benefit-cutting neoconservative governments in Alberta and Quebec in the early to mid-1990s threatened to trigger a spiral of matching cuts by other provinces. At the same time federal cuts to transfer payments to the provinces and the federal government's corresponding relaxation of some federal constraints on provincial autonomy in an effort to "renew the federation" also threatened to undermine what seemed an increasingly fragile equilibrium among the provinces. Social activists, scholars, and even some provincial governments thus raised the spectre of interprovincial races to the bottom in the context of a number of policy debates in the 1990s: concerning the Alberta government's high profile tax cuts;[1] concerning cuts to federal transfers to the provinces and the shift from cost-shared federal transfers under the Canada Assistance Plan to block funding under the Canada Health and Social Transfer (CHST),[2] concerning constraints on the federal spending power posed by the Social Union Framework Agreement;[3] concerning trucking standards;[4] and concerning the Canada-Wide Accord on Environmental Harmonization,[5] which environmentalists and some scholars depicted as a federal withdrawal from responsibility for national environmental standards.

While there has been no shortage of either political rhetoric or academic theorizing about races to the bottom, empirical studies have been in shorter supply. With respect to competition within federations, the US federal system offers an exception, not least because the presence of 50 states facilitates statistical analysis of the interactions among them. The "devolution revolution" launched by Ronald Reagan also prompted concern about interstate competition a decade earlier in the US. However, within Canada, we know relatively little about the degree to which provinces respond to each other's policy initiatives and, to the extent they do, whether the outcome is invariably a race to the bottom. The purpose of this volume is to take a first step in filling that gap. The authors apply insights from economics and political science to several Canadian policy fields: Kenneth McKenzie on corporate income taxes, Kathryn Harrison on tobacco excise taxes, Gerald Boychuk on social assistance policy, Nancy Olewiler on environmental regulation, David Green and Kathryn Harrison on minimum wage policies, and Douglas Brown on industrial incentives policies. Mark Rom complements the Canadian case studies with analysis of US interstate dynamics with respect to welfare, education, and medicare.

The chapters that follow offer several insights into provincial competition in the Canadian federation. First, there is scant evidence of provinces spiraling downward in the proverbial race to the bottom. Corporate taxes continue to increase steadily while subsidies to business have fallen, environmental standards are stable albeit increasing only infrequently, minimum wages continue to increase, and although social assistance rates have fallen across Canada since the early 1990s, there is no evidence that provinces are more influenced by neighbours' benefit rates nor that the move from matching to block grant federal funding had any effect, as one would expect if a race-to-the-bottom dynamic were at play. That is not to say that provinces do not face a less dramatic regulatory or tax "chill" that prompts them to set standards or taxes lower than they would have in the absence of mobility of capital, goods, and individuals. However, the case studies in this volume bound the possibilities and set the stage for future research into more subtle effects. To the extent that downward pressures from interprovincial competition do exist, they apparently have not precluded provincial governments from raising taxes, minimum wages, environmental standards and, at least in some periods, welfare benefits.

The chapters that follow also provide both a theoretical and empirical picture of interprovincial competition that is more complex than the popular imagery of a race to the bottom. Even where provinces face pressures, typically from business, to match the lower taxes and standards of other jurisdictions, they normally also face countervailing pressures to maintain or enhance taxes and standards. While these upward pressures vary across policy fields, jurisdictions, and over time, the authors in this volume provide evidence that governments can and do resist competitive pressures to relax their standards. Moreover, business investment, wealthy taxpayers, and welfare recipients are not the only things crossing provincial borders. Ideas and knowledge also flow freely within a national political community (and increasingly across nations as well). Governments, activists, and individual voters look to the benchmarks set by other jurisdictions. The resulting upward pressure for emulation can also counteract downward pressures from mobile actors.

Theoretical Framework

While it is reasonable to assume that politicians devise policies primarily in response to political support and opposition within their own jurisdictions, their ability to gain political credit and avoid blame from their own voters may depend on what other jurisdictions do. If so, policymakers will look to policies of other jurisdictions in formulating their own policies. Individual jurisdictions are interdependent by virtue of the permeability of borders, especially within a federation, to the flow of goods, services, capital, people, and ideas. However, the form that interdependence takes will depend on who or what is crossing borders – voters, firms, and goods or merely ideas. This section contrasts intergovernmental competition prompted by the former, which could plausibly result in a race to the bottom, with interdependence predicated on the flow of ideas.

<u>Mobility-Induced Competition</u>

There is a substantial theoretical literature in both economics and political science on intergovernmental competition "in which the free movement of goods, services, people, and capital constrains the actions of the independent governments in a federal system" (Advisory Commission on Intergovernmental Relations 1991). However, within that literature there are two quite distinct camps: those who see interjurisdictional competition for mobile actors as a destructive (McGuire 1991), harmful (Organisation for Economic Co-operation and Development. Committee on Fiscal Affairs. 1998), or inefficient force that reduces citizens' welfare, and those who view intergovernmental competition as a desirable force that enhances democratic accountability and efficiency. Different authors' normative assessments clearly turn on the weight they assign to various societal objectives, among them equality within jurisdictions, equity among jurisdictions, and efficiency. However, even if one resists imposing one's own preferences in favour of a relative standard that governments should be responsive to the preferences *of their own voters*, theoretical models of intergovernmental competition still offer very different assessments.

There are many variants of the race-to-the-bottom or "beggar-thy-neighbour" narrative. The most common is one in which jurisdictions' competition to attract or retain footloose capital prompts a downward spiral in policies that would impose costs on those actors. As a result, *all* jurisdictions end up adopting lower corporate taxes, less progressive income taxes, weaker environmental and labour standards, and lower minimum wages than they would have chosen acting independently. A similar dynamic can be envisioned with respect to social assistance, though competition in this case is to avoid costs rather than to attract benefits. Provinces' reluctance to induce "immigration" by welfare recipients from other jurisdictions thus may prompt a downward spiral in welfare benefits and eligibility restrictions.

Not all harmful interjurisdictional competition promises escalation downward, however. For instance, the flip side of a race to the bottom in corporate taxes is a race to the top with respect to subsidies and other incentives to attract investment. Interprovincial "bidding wars" or complaints of "job poaching" are by no means unknown in the Canadian federation.[6] It follows that one can, and should, distinguish between positive and normative analysis of interjurisdictional competition (Swire 1996). Downward competition is not necessarily bad, nor is upward competition necessarily good. Indeed the meaning of the terms "down" and "up" is far from obvious: for instance, a *downward* spiral in environmental standards entails jurisdictions *raising* their discharge limits for polluters. Similarly, provinces may *reduce* eligibility for welfare benefits by *increasing* the number of weeks a claimant must have been resident in the jurisdiction before qualifying. While necessarily arbitrary, the chapters in this volume follow convention in defining downward competition as that which leads to reduced government spending or regulatory effort, in other words lower taxes, weaker environmental regulations, and lower minimum wages. Whether such competition is good or bad would depend on whether the resulting policies are more or less consistent with voters' preferences in the jurisdiction in question.

The political rhetoric concerning races to the bottom has a long theoretical lineage in the fiscal federalism literature. Oates (1972) offered a model of interstate competition with respect to social assistance, in which all states were prevented from delivering the level of benefits their residents would have wanted as a result of in-migration of welfare recipients and out-migration of wealthy taxpayers. Similarly, Zodrow and Mieszkowski (1986) and Wilson (1986) provided early formal models of inefficient tax competition in which all states set tax rates below their voters' preferences lest they lose mobile taxpayers. Markusen, Morey, and Olewiler (1993, 1995) modeled competition between two jurisdictions seeking to attract a job-creating plant, in which both ended up with lower environmental standards than they would have in a single-jurisdiction universe. The same authors also demonstrated that a very different, but equally troubling, race-to-the-top dynamic can emerge if jurisdictions compete to avoid hosting an undesirable facility, such as a hazardous waste treatment facility or nuclear power plant, by raising their environmental standards.[7]

In contrast, other authors offer models of healthy competition that enhances governments' responsiveness to their voters' policy preferences. Just as competition among firms in private markets increases consumers' welfare, they argue that competition among jurisdictions can enhance voters' welfare. Tiebout's seminal article demonstrated that if citizens were completely mobile, individual jurisdictions would compete to offer packages of goods and services with the result that like-minded citizens would individually and collectively maximize their welfare by clustering in communities that offered packages of policies that best satisfied their preferences at the lowest level of taxation (Tiebout 1956). While this model offered important theoretical insights, no one suggested that the assumptions on which it was predicated – including costless mobility and irrelevance of employment prospects (Tiebout's citizens were assumed all to live on dividend income) – could ever approximate the real world.

While such a high level of mobility of individuals is implausible given resource constraints and familial and social ties, Tiebout's successors developed models of efficient interjurisdictional competition predicated on the more plausible scenario of firm mobility and citizen immobility. For instance, Oates and Schwab (Oates and Schwab 1988) reported that interstate competition will prompt each jurisdiction to set taxes at the (economically efficient) point at which the marginal costs to the polluter just equal the marginal environmental benefits to the community.[8] However, Oates and Schwab's model also relies on some rather implausible assumptions. They assume (like Tiebout) that there are an infinite number of jurisdictions who are thus "price takers" in the market for investment. In effect, the authors have defined away the prospect for strategic behaviour that is central to concerns about races to the bottom. Oates and Schwab themselves demonstrate that the outcome of intergovernmental competition is no longer guaranteed to be efficient if voters are heterogenous, with some fraction of the electorate preferring jobs and the rest preferring environmental protection. In effect, they model a situation in which regulators are captured by either industry and its allies or by environmentalists, neither of which is representative of the electorate as a whole. Public choice problems within jurisdictions thus may be exacerbated by interjurisdictional competition.

Wilson's (1996) survey of the economic literature reports that as one introduces various other departures from an idealized model of intergovernmental competition, competition again ceases to be so attractive.[9] For instance, models of tax competition typically generate efficient outcomes only if states employ "benefits taxes," that is, taxes that equal the value to the taxpayer of the goods and services provided by the state in exchange for tax revenue. Competition for business investment thus can be welfare-enhancing if states impose corporate taxes just sufficient to cover public goods such as policing, fire protection, roads and other infrastructure that are valued by investors. However, any effort by states to employ progressive ability-to-pay taxes on either firms or individuals will be hindered by interstate competition. Oates and Schwab (1991, 128) stress that interstate competition enhances public welfare only if "the federal government has fulfilled the redistributive function. Where this is not the case, the argument in favor of interjurisdictional competition is much less compelling." McGuire (1991) notes that in such a circumstance the greater mobility of wealthy than poor taxpayers will result in all states offering lower level of public goods and services than desired by their voters, including by the wealthy taxpayers. Again, the models of healthy competition seem to have defined away the issues of central concern.

Models of healthy intergovernmental competition rest on a demanding set of assumptions that are unlikely to be met in the Canadian or, for that matter, any other federation (Klevorick 1996). However, reality undoubtedly lies somewhere between simple models predicting healthy competition and those predicting an inexorable race to the bottom. Firms are not infinitely mobile, nor are citizens completely immobile. Federations do not have an infinite number of jurisdictions, but neither do they have only two. To the extent that provinces are pitted against one another in strategic games, the prospect of repeated play offers some hope that they will be able to coordinate their efforts to avoid outcomes that hurt all jurisdictions. The question is thus how significant interprovincial competition is and with what consequences.

Several propositions are suggested by theories of destructive competition. First, and rather obviously, provinces will be more vulnerable to competition to the extent they have meaningful autonomy in a given policy field. Mark Rom's chapter in this volume explores this factor by comparing interstate dynamics in policy fields with and without constraining US federal mandates.

Second, the likelihood of unhealthy competition will depend on the credibility that an actor will relocate in response to provincial policy differences. That in turn will depend on the costs and benefits of relocation. The benefits will be a function of the magnitude of policy divergence (an issue examined in the tobacco tax chapter) and the significance of that divergence for the actor in question. As Olewiler notes, the fact that pollution abatement costs typically represent only 1 to 5 per cent of a firm's production costs (Nordström, Vaughan and World Trade Organization 1999) means that the impact of even large differences in jurisdictions' environmental standards on firms' location choices may be dwarfed by other factors. On the other hand, a 20 per cent higher welfare benefit could make be a significant difference to someone for whom that is their only source of income.

The costs of relocation will depend on legal impediments to relocation, distance, and strength of an actor's ties to a particular community. The legality of relocation can be an issue, certainly with respect to individuals' mobility between countries, but also with respect to purchases of products at lower tax rates in other provinces within a federation. The stakes in moving can vary greatly. It is much easier to drive across a provincial border to purchase tax-free cigarettes (though the costs of doing so will of course depend on the distance) than it is to relocate one's family to another state. In general relocation will be less costly for capital than for individuals, who typically have familial and social ties to particular communities. However, firms are not equally footloose; those dependent on unique natural resources typically will have less credibility with which to extract concessions from the state. Finally, even if the costs are low, one cannot move if one doesn't have the resources to do so. All else being equal, the poor thus will be less mobile than the wealthy.

Third, the prospects of a race to the bottom also turn on the impact of any actor leaving or arriving in a particular jurisdiction. Governments may look the other way when confronted with a few cross-border shoppers, but relocation of large or regionally-significant important employers (e.g., those in single industry towns) will not be taken lightly. Similarly, threats of relocation and opportunities to attract investment will carry greater weight during hard times than when the economy is booming.

The forgoing propositions have several implications for the case studies in this volume. The prospect of unhealthy competition arguably is greatest with respect to corporate income taxation and business incentives. Environmental regulation also concerns potentially mobile investors, but would be expected to present less threat of interprovincial competition given the relatively low costs associated with pollution abatement for most industries. Races to the bottom with respect to social assistance seem still less worrisome. Although differences in welfare benefits could make a big difference to recipients, those who require welfare have the least resources to relocate and also would be expected to be most dependent on social support networks in their home communities. Moreover, the sheer size of Canadian provinces, in comparison to US states, would tend to deter welfare migration. The significance of divergent excise taxes is difficult to predict in advance. Long distances between provinces would tend to deter casual cross-border shopping, but as US studies have shown, organized smuggling networks can emerge when price incentives are sufficiently large.

The two remaining policy areas seem unlikely to provoke mobility-driven competition among provinces or states. Education policy is discussed by Rom in the US context. While parents can and often do relocate within communities or between neighbouring municipalities in pursuit of better schools for their children, and may even do so among closely located US states, it seems highly unlikely that a family would relocate to another Canadian province for better schools alone given the costs of finding new housing and employment. One could send one's children to private schools for considerably less. Finally, despite Ross Perot's warning of a "giant sucking sound" as low-paying jobs migrate to jurisdictions with lower wages, there is little reason to anticipate migration among Canadian provinces in response to divergent minimum wages. As with welfare recipients, minimum wage workers are hardly in a position to pull up stakes in pursuit of a few more cents per hour, particularly since their new wage would still fall short of a living wage. More importantly, minimum wage jobs in Canada are disproportionately in the hospitality and service sectors (Battle 2003). By definition, fast food has to be sold where it is produced. Similarly, jobs in tourism are tied to the sites (and sights) of interest. With little threat of capital flight, one thus would not expect politicians to engage in a race to the bottom to retain or attract minimum wage employers.

Emulation and Yardsticking

The discussion thus far has focused on competition induced by migration of mobile factors – capital, goods, wealthy taxpayers, and welfare recipients. However, people, goods, and cash are not the only things that cross borders. So too do information and ideas, particularly within a federation with shared media networks and where citizen mobility extends ties of family and friendship across provincial borders.

The flow of ideas suggests a very different form of interdependence, in which provincial governments are sensitive to the example set by other jurisdictions not because they fear that others' policies will undermine the efficacy of their own, but because other jurisdictions offer examples for how to satisfy voters' preferences or, alternatively, benchmarks against which voters will evaluate them. In terms of Hirschman's analogy, the critical issue in mobility-induced competition is the threat of "exit," while the incentive for provinces to learn from each others' example lies in voters' "voice." Although in both cases policymakers motivated by their own voters' preferences will bear other governments' policies in mind in formulating their own, competition prompted by the flow of information typically will not have the same zero-sum element.[10] A government can follow another jurisdiction's example without consequence to the other government. In contrast, in the case of mobility-induced competition, each government's very *capacity* to satisfy its own voters will depend on what other jurisdictions do.

Three quite distinction literatures pertain to this idea-driven interdependence. The first is the literature on policy innovation and diffusion launched by Walker's seminal article (Walker 1969; Gray 1973; Poel 1976; Lutz 1989; Berry and Berry 1990; Berry and Berry 1992). One need only consider the rapid spread of smoking bans in public places and, more recently, anti-pesticide ordinances among Canadian municipalities to see policy diffusion at work. At the state level, US Supreme Court justice Brandeis likened state governments to "laboratories of democracy" that experiment, innovate, and learn from each others' experience. In Canada, Pierre Trudeau (1968) offered a similar argument for the spread of health insurance among Canadian provinces from its origins in Saskatchewan. While the potential for policy diffusion among subnational governments is, at least in theory, broader than the diffusion of policy innovations, the policy diffusion literature has focused almost exclusively on the spread of *new* ideas. The literature typically employs quantitative methods to examine patterns of diffusion, with little attention to the mechanisms by which policies spread from one jurisdiction to another.

The diffusion literature is thus complemented by the literature on policy transfer or learning (Bennett 1991; Bennett and Howlett 1992; Rose 1993; Oates 1999; Dolowitz and Marsh 2000) which focuses on the particular pathways through which governments learn from each other. Students of policy transfer typically employ qualitative methodologies, especially interviews with elite informants, to trace the spread of ideas. Most of the policy transfer literature focuses on idea transfer among politicians or bureaucratic elites from different jurisdictions. Thus Rose (1993) examines "idea-mongering" among elites and Schneider and Ingram (1988) "systematic pinching of ideas" by policymakers in other jurisdictions. Indeed, Hall (1993, 28) is quite explicit in predicting that "first order learning" (i.e., setting of welfare benefits, taxes, or other standards) will be "insulated from the kind of pluralist pressures we often associate with the broader political system."

Like the policy diffusion literature, studies of policy transfer tend to focus on novel policies.[11] In contrast, a smaller literature on "yardstick" or "surrogate" competition hypothesizes that voters with limited information will look to other states' tax levels as a benchmark to evaluate their own incumbents (Advisory Commission on Intergovernmental Relations 1991; Breton 1991; Hall 1993; Besley and Case 1995). Besley and Case argue that yardstick competition is a valuable means for voters to discipline rent-seeking politicians. Similarly, Breton argues that "if the citizens of a jurisdiction use information about the policies implemented in other jurisdictions to gauge and evaluate the performance of their own government, that process will increase electoral competition at home and thus incite their governing politicians to act to their benefit more than they otherwise would do." Voters' comparison of their governments' policies to those of other jurisdictions can be facilitated by what Hoberg and colleagues (Hoberg 1991; Banting, Hoberg and Simeon 1997) call activist-driven emulation. An example of this strategy would be the "report cards" rating provincial governments issued by Canadian environmental groups in an effort to shame laggards into policy change.[12] However, coverage of provincial policymaking in national newspapers could be sufficient to alert voters to the examples set by other provinces. As Shannon (1991, 119) has observed, "the forces of competitive emulation convert yesterday's expensive novelty (or public service 'frill') into today's standard budgetary fare." As wealthy, liberal "pacesetter" provinces or states adopt new programs, like kindergarten, even poor states or provinces may feel a "catch-up" imperative (Shannon 1991).

The yardstick competition model is noteworthy in allowing that provinces or states may be interdependent when it comes to settings of well-established policy instruments, like taxes, environmental standards, and minimum wages, not only the novel policies typically examined by students of policy diffusion and transfer. Mindful of their electorates, provinces may respond to each other's example in an ongoing process, beyond the one-off "pinching" of ideas. It is noteworthy that this form of emulation could contribute pressure either upward, as when environmental groups pressure provinces to match other jurisdictions' stricter environmental standards, or downward, as when the Fraser Institute helps voters to compare "tax freedom days" in different provinces.[13]

While the focus of these three literatures is somewhat different, the central issue motivating all three is the policy implications of information and ideas flowing across borders. As discussed further below, ideational competition typically will be less worrisome than competition prompted by mobile capital and individuals. The chapters in this volume thus distinguish between emulation or benchmark competition and mobility-induced (race-to-the-bottom or -top) competition.[14] It is noteworthy, however, that the two dynamics could coexist. For instance, a province could face upward pressure to emulate another province's environmental standards even while facing downward competition as a result of an industry's threats to relocate. Shannon (1991) depicts the combination of upward pressure to match the services of other jurisdictions as a desirable break on tax competition, with the two "unseen hands" guiding jurisdictions to desirable balance. However, there is no a priori reason to believe that the two pressures will be in balance. Indeed, it is conceivable that emulation could reinforce a race-to-the-bottom dynamic, for instance if activists pressed their government to match the lower taxes of another jurisdiction.

Revisiting Domestic Politics

The focus of the discussion thus far has been on the influence of provincial governments on each other. This section revisits *intra*provincial politics in the context of the race to the bottom debate. It warrants emphasis that policies typically are contested within jurisdictions, regardless of policy choices by other jurisdictions. Even in an idealized "island state" there would still be pitched battles between those who pay for and those who receive welfare benefits, between those who place greater value on environmental protection and those who weigh heavily the potential loss of jobs, and between those who support higher minimum wages and the small business who must pay them. This observation, while seemingly trite, has several implications for the study of interjursdictional dynamics.

The first is that domestic factors still matter. Even when US studies find interjurisdictional effects on US state welfare benefits, state policies are primarily influenced by factors within the state, such as economic conditions, the level of poverty, and political competitiveness (1989). This insight presumably applies not only to race-to-the-bottom-type competition, but also to interprovincial or interstate emulation. Governments adopt policies primarily in response to local demands, and interjurisdictional dynamics thus are likely to matter only at the margin (Chubb 1991). It follows that "domestic" factors could result in persistent differences among provinces, even in the face of downward or upward pressure from other jurisdictions. Rom, Peterson, and Shreve (1998, 37) stress that the existence of interstate competition with respect to welfare "does not mean that states will necessarily race to the bottom in any literal sense of the word, nor does it mean that all states will have identical welfare policies. Factors internal to a state can still be expected to influence its welfare policy offsetting the impact of interstate competition."

The question is thus what the *marginal* impact of interdependence is on provincial policies. A corollary observation is that even if policy convergence is observed, it may not be result of interjurisdictional competition but rather of parallel forces in different jurisdictions (e.g., changes in technology or economic conditions) (Banting, Hoberg and Simeon 1997). It also follows that if environmental standards are too weak, welfare benefits too low, or subsidies to industry too high in a province relative to one's own preferences, one cannot necessarily blame interjurisdictional competition – the problems may lie within the jurisdiction itself.

A second implication of "domestic" politics within provinces is that the marginal impact, either downward or upward, of interprovincial competition will depend not only on the magnitude of the impact of other provinces' policies on the province in question but also on the political assessment of that impact. The greater the political support for a particular policy, the less vulnerable provinces will be to interjurisdictional competition. The race-to-the-bottom narrative assumes that jurisdictions actively seek to lure investment away from each other by lowering their standards. However, other scenarios are conceivable (Harrison 1996). For instance, jurisdictions may be merely reluctant to set regulations or taxes more stringently than their neighbours lest they lose capital, but not actively seeking to undercut their neighbours in order to lure capital away. Similarly, jurisdictions may be loathe to set more generous welfare benefits lest they become welfare magnets but not inclined to gut welfare benefits in a conscious effort to "export" the poor.

The differences between these scenarios can be illustrated with simple game theoretic models. Assume that province A is considering increasing a tax or regulatory standard. The province faces four possible outcomes relative to its neighbour, province B: both could raise their standards (or taxes) equally, both could decline to raise their standards, A could raise its standards while B does not, or B could raise its standards while A does not. In game-theoretic terms, these outcomes correspond respectively to cooperate-cooperate (CC), defect-defect (DD), cooperate-defect (CD), defect-cooperate (DC). How the two jurisdictions will relate to one another depends on the order of their preferences among these outcomes. If both jurisdictions set equally stringent standards, there will be no movement of capital, taxpayers, or welfare recipients. In such circumstances, both will presumably prefer to raise their standards by an equal amount (CC>DD). After all, why forgo tax revenues or environmental benefits for no reason? Conversely, if a jurisdiction is going to achieve the same level of tax revenue or environmental benefits, it will presumably prefer the scenario in which it benefits from mobility (DC>DD and CC>CD).

Additional assumptions are necessary to fully specify each jurisdiction's preferences and thus the "game" in which they are engaged. The race to the bottom is often depicted as prisoner's dilemma game (Revesz 1992; Harrison 1996). If jurisdiction A places greater weight on attracting jobs than protecting environmental quality or providing public goods with tax revenues, its ideal outcome could be to for B to regulate or tax unilaterally (DC>CC). Its worst case scenario would be to regulate/tax unilaterally itself (DD>CD). If both jurisdictions share the same resulting preference ordering – DC>CC>DD>CD – the result is the familiar prisoner's dilemma. Whether or not one jurisdiction is expect to regulate/tax, it is always in the other's interest to decline to do so, since both seek to lure jobs away from the other by declining to tax or regulate unilaterally. Paradoxically, the equilibrium result in which neither regulates/taxes (DD) is less desirable for both than if they had regulated/taxed with equal stringency (CC). This dynamic could degenerate in repeated play if individual jurisdictions compete for industry not merely by declining to regulate/tax, but by progressively relaxing their standards or taxes.

The picture is less discouraging, however, if one assumes that jurisdictions, while reluctant to get "out of line" lest they export jobs or wealthy taxpayers are not actively seeking to undercut each other. There may be sufficient political demand for environmental protection or other public goods that they prefer an outcome in which both tax/regulate to the opportunity to "beggar their neighbours" (CC>DC). The result is an "assurance game," in which there are two possible equilibria: CC and DD.[15] If a jurisdiction expects that its neighbour will regulate/tax, it will do the same. If, however, it anticipates that its neighbour will decline to raise its standards, it will also decline. To the extent that jurisdictions are risk averse or misunderstand each other's incentives, a suboptimal outcome in which both jurisdictions decline to tax or regulate could still prevail. However, there is no incentive for a downward spiral. The two jurisdictions may be stuck at a suboptimal equilibrium, but have no reason to further reduce their standards in an effort to take advantage of each other. For that same reason the assurance game presents a less formidable challenge to cooperation – harmonizing tax or environmental standards at a higher level –than the prisoner's dilemma particularly in repeated play.

The implication of the forgoing is that the spiral to rock bottom envisioned by race-to-the-bottom rhetoric is far from inevitable. As Brueckner (2000) notes, "a race to the bottom sometimes connotes a draconian tendency to slash welfare benefits to the bare minimum, mimicking the outcome in the least generous state. The theory, however, only points to a downward bias in benefits." Similarly, Oates (1998) observes that, "The results from this literature are not downward spirals 'to the bottom;' they are suboptiomal equilibria. … The real issue here is the magnitude of the deviations (if any) from the efficient outcomes." Short of an all-out race to rock bottom, jurisdictions may merely suffer from "regulatory chill" and thus remain stuck with suboptimal standards. Moreover, provinces may cooperate to overcome the latter scenario. At the limit, provinces may place sufficient weight on public goods that they are engaged in neither the prisoner's dilemma nor an insurance game, but are willing to regulate or tax unilaterally, even if that entails a risk of prompting mobility by key actors (Harrison 1996).

The discussion thus far has assumed only two jurisdictions with identical preferences. In the real world of Canadian federalism there are, of course, 10 provinces and 3 territories with considerable variability among them. At any given time, some provinces will be more vulnerable to race-to-the-bottom pressures than others both because the impact of interprovincial policy divergence will vary among the provinces and because the provinces will have different political assessments of those impacts. The presence of one province seeking to poach jobs from its neighbours (i.e., one playing the prisoner's dilemma game) could unravel a fragile equilibrium among those who are merely seeking reassurance that they are not "out of line" (i.e., those playing the assurance game). On the other hand, the presence of a province with sufficient political support that is willing to tax or regulate unilaterally could provide the necessary reassurance to pull more anxious provinces up to the higher equilibrium in an assurance game.

Policy Prescriptions

The central focus of the chapters that follow is positive analysis. The authors ask whether jurisdictions engage in policy competition, of what sort, and with what consequences. It is, however, worth noting that although mobility-induced competition and yardstick competition may exhibit the same symptoms – provinces being pulled either upward or downward by other provinces – the prescribed policy responses are quite different. The flow of ideas and information within a democracy is quite desirable. As such, emulation normally will be cause for celebration rather than concern. Voters' reliance on other jurisdictions as a benchmark provides an important mechanism for them to hold their own governments accountable given the infrequency of elections and voters' constrained choices among political parties even then. In contrast, as discussed above, there is reason to expect that intergovernmental competition prompted by the mobility of individuals, firms, or goods will tend to reduce responsiveness to the electorate.

While the prospect of a race to the bottom typically elicits calls for harmonization of standards, whether through interprovincial cooperation or federal intervention, such harmonization will tend to dampen opportunities for emulation.[16] To the extent that emulation and mobility-induced competition coexist, the cure for a race to the bottom could, in theory, be worse than the disease. National standards, while precluding downward competition, also constrain innovation, diversity, and cross-jurisdictional learning (Revesz 1992). A related line of argument sometimes offered is that even unhealthy competition can perform a useful function in counteracting other inefficiencies of the political system, such as rent-seeking. As Ken McKenzie argues in this volume, "Fiscal competition can reduce the power of Leviathan."

There are two broad options to respond to a potential race to the bottom. The first is harmonization among the provinces. This is most promising in the case of an assurance dynamic, especially so in Canada where with only 13 provinces and territories, the First Ministers can meet face to face on a regular basis. There is, however, reason for skepticism about provincial collaboration to resolve a prisoner's dilemma dynamic in which provinces have incentives to undercut each other. In that case, the very incentives for competition that prompt collaboration also encourage defection from agreed-upon standards. Gibbins (1996, 10) thus argues that "decentralization is incompatible with national standards which are anything more than window-dressing. Interprovincial agreements as an effective substitute for Parliamentary action are a mirage."

While the prospects for interjurisdictional cooperation may be limited, a critical difference between competition in an international setting and that among provinces within a federation is the existence of a federal government that may have authority to intervene. Such intervention could take various forms. In the case of competition with respect to excise taxes, the federal government can employ its authority with respect to interprovincial commerce to prohibit smuggling and other forms of interprovincial sales. In the case of regulatory competition, the federal government could set its own standards to establish a floor for downward regulatory competition if it has sufficient overlapping jurisdiction. With respect to welfare competition, Oates (1972) first made the theoretical case that shared-cost or conditional grants to subnational governments would be effective than unconditional transfers. Conditional grants also can be an effective, albeit controversial, means to promote harmonization of regulatory standards. For instance, the US federal government employed a threat to withhold highway construction grants to the states as a means to coerce states into adopting federal air quality and emissions standards. In contrast, equalization transfers are justified primarily on grounds of horizontal equity among provinces rather than as a response to a potential race to the bottom. On one hand, qqualization could have an indirect effect on interprovincial competition by mitigating poorer jurisdictions' greater temptation to engage in a race to the bottom to attract jobs. On the other hand, however, if provinces don't have to raise tax revenues themselves, they may be even more generous in engaging in a race to the top with respect to industry incentives.

While the spectre of federal government involvement is often invoked as a panacea by those who fear a race to the bottom, there is certainly no guarantee that the federal government will intervene. Indeed, the same public choice problems that prompt provinces to compete in a race to the bottom may also prompt federal government to decline to set national standards (Harrison 1996). After all, industries that oppose taxes or regulations at the provincial level employ many of the same strategies, including the threat of capital flight, at the national level. Moreover, federal intervention in ostensibly provincial matters is invariably nested in a larger constitutional game in which many provinces oppose national standards as a matter of principle.

When the federal government does intervene, there is also no guarantee that its intervention will be helpful. The US Advisory Committee on Intergovernmental Relations (1991) observed, "the federal government stimulates, impedes, and regulates interstate and interlocal competition in numerous ways." Federal intervention in one field may simply prompt provinces to compete on other grounds (Revesz 1992, 106, 123), while other national rules can have perverse effects. For instance the US Supreme Court's 1969 decision disallowing state minimum residency requirements for welfare benefits and the subsequent 1999 decision overturning two-tier state schemes (in which states paid newcomers benefits at the rate they would have received in their state of origin for some period) both had the effect of rendering state governments more sensitive to the potential costs of maintaining more generous welfare benefits than their neighbours (Rom, Peterson and Scheve 1998; Brueckner 2000).

Standards of Evidence

The theoretical landscape is complex, thus posing considerable challenges for empirical analysis. It is by no means obvious what would constitute convincing evidence of a race to the bottom. A downward policy trend among a number of provinces could be compelling, particularly if it emerged after change in conditions or policies that increased relevant actors' mobility or provincial autonomy. However, as discussed above, even if provinces face downward pressures, whether from mobility or emulation, one would not necessarily see a trend line downward. The provinces may already be "stuck at the bottom" or at least at some suboptimal equilibrium.

Similarly, policy convergence is neither necessary nor sufficient evidence of a race to the bottom. As long as "domestic" factors continue to matter, one would expect to see some measure of persistent diversity even if provinces are interdependent in their policymaking. Moreover, not all provinces will necessarily be "in the game" (Harrison 1996) or playing the same game (Rom and Garand 2001). On the other hand, parallel movement or convergence could occur if provinces are responding to common domestic forces or to emulation, rather than a race to the bottom. Those studying interprovincial competition thus are well-advised to consider alternative explanations for observed trends.

The authors in this volume have addressed these challenges in several ways. McKenzie, Olewiler, Rom, Boychuk, and Brown marshal an impressive array of measures to track policy outputs and outcomes over time. Diverse measures are important for a number of reasons. First, overlapping policies can have reinforcing or contradictory effects. As McKenzie discusses, an apparent decline in tax would not constitute evidence of a race to the bottom if it was compensated for by increases in another tax on the same actor. Second, governments may compete along different dimensions of a particular policy. For instance, Rom finds that US states' can be more or less sensitive to each other's policies with respect to welfare access or benefit levels depending on which is more politically salient. Boychuk also reports different trends in Canadian provinces' social assistance rates with respect to different recipient groups. Finally, policies simply may not be as influential as they seem. In other words, even if there is a decline in standards over time, it may not have a very significant effect. Olewiler examines not only trends in environmental standards but also resulting environmental quality and shifts in industry composition in search of a response.

Rom in the US context and Green and Harrison in the Canadian context utilize multivariate analysis to assess the degree to which provinces respond to each other after controlling for factors within each province that might influence policy choice. However, this strategy is difficult to employ in a country with only 10 provinces unless one has a long time series of data. As discussed by Olewiler, data can be in short supply even for shorter periods.

Moreover, when one finds a correlation among provincial governments' policies, it still does not tell us why. Does it reflect parallel movement, emulation, or mobility-induced competition? Authors seek to unpack this question in a number of ways. Boychuk compares provincial social assistance trends before and after the critical juncture when the federal government moved from cost-shared to block grants. He also employs counterfactual analysis to assess alternate explanations for declining welfare generosity in the 1990s. Harrison and Green and Harrison employ documentary analysis and interviews with interest group representatives, politicians, and senior bureaucrats to explore rationales for policy changes with respect to tobacco taxes and minimum wages. Finally, we are collectively able to compare findings among policy areas in which mobility is a plausible threat (corporate taxation, industrial policy, environmental regulation, and social assistance) and those where it is not (minimum wages, education).

Summary of the Cases

The clearest lesson from the chapters in this volume is that provinces within the Canadian federation do not appear to be at mercy of destructive provincial competition. The only "slam-dunk" case of a race to the bottom occurred with respect to tobacco taxation. Harrison reports that when the federal government and Quebec dramatically cut their tobacco taxes in February of 1994, a domino effect ensued as other provinces soonn matched Quebec's tax cuts to stem the tide of cross-border shopping and interprovincial smuggling. The tobacco case is also noteworthy in that politicians quite openly complained that they were trapped in a race to the bottom. However, as anticipated, provinces' vulnerability depended on geography. With distance on their side, Newfoundland and the Newfoundland and the Western provinces were able to successfully resist tax cuts. The tobacco case also reveals that vulnerability to provincial competition can change over time. Mobility of low-tax cigarettes did not become an issue until tax disparities between Canada and the US and, later, among Canadian provinces became quite substantial *and* until tobacco companies became actively involved in illegal smuggling activity. Indeed, on closer inspection, it is striking how unusual was the combination of forces that conspired to create the 1994 race to the bottom in tobacco taxes: a massive tax disparity with the US, the emergence of smuggling networks through a Native reserve that happened to straddle the Ontario, Quebec, and New York borders, a concentration of cigarette manufacturing in Quebec that rendered that province more vulnerable to threats of capital flight, an upcoming Quebec election at a time that the Parti Quebecois was surging in popularity, and the recent memory of the Oka crisis that left politicians reluctant to employ more coercive solutions to illegal smuggling. Viewed over a longer time period, the downward tax competition of early 1994 was in fact the exception -- albeit one with tragic implications for public health -- to a pattern of upward emulation before 1994, and coordinated provincial tax increases thereafter.

Corporate income taxation is the case where one would expect the find the greatest vulnerability to a race to the bottom given the mobility of capital within the national economy. Yet McKenzie shows that business taxes, measured in various ways, have steadily increased over last thirty years, with no sign of decrease on the horizon. There were hints of a potential race to the bottom with respect to corporate tax rates in 2001-2, when Ontario's announcement that it would cut corporate taxes apparently prompted Alberta to propose matching cuts. However, when Ontario declined to follow through, the race was over before it started. McKenzie concludes that, while one cannot rule out that provinces are influenced by each other, "If a race is under way it is manifesting itself in fairly subtle ways."

Brown's chapter on industry incentives complements McKenzie's analysis of corporate taxation. In Brown's case the risk is that provinces will compete for job-producing investment by offering incentives (e.g., loans, subsidies, and targeted infrastructure and tax holidays) rather than by lowering province-wide corporate tax rates. Occasional public spats in which provinces have accused each other of "job poaching" suggest that the provinces are well aware of the potential for destructive competition with respect to industrial policy. However, even there, the story is largely about the provinces' collective efforts to constrain such competition through Code of Conduct on Incentives within the Agreement on Internal Trade. Brown reports that they have had some success. Subsides to business declined in the early 1990s, and although they have increased again in more recent years, targeted subsidies have been replaced by less troubling investments in public goods like research and workforce readiness as a means to attract investment.

Boychuk reports mixed findings with respect to provincial social assistance programs. Provincial programs increased in generosity in the 1980s and early 1990s, followed by a decline beginning around 1994. However, it is by no means obvious that the downward trend observed in the 1990s is attributable to a race to the bottom. The decline preceded the federal government's move from the cost-shared Canada Assistance Plan to block grants under the Canada Health and Social Transfer (CHST), and there is no evidence of an impact on the trend line when the CHST was introduced. Moreover, provinces do not appear to be more sensitive to the welfare benefits of their immediate neighbours than other provinces, which one would anticipate given the limited mobility of welfare recipients and findings of comparable US studies. Cuts by Newfoundland in the mid-1990s did not trigger a domino effect among its neighbours; indeed the province returned to the fold itself. However, Boychuk speculates that the greater convergence among Western provinces may reflect an impact of Alberta's cuts. Moreover, Boychuk does not rule out that the downward trend in welfare and convergence among the provinces since the mid-1990s could be a race to the bottom spurred by the new ideational environment of neoconservatism and fiscal restraint.

Evidence of a race to the bottom with respect to environmental standards is also weak. Olewiler reports that "the norm in Canadian environmental policy is harmonization punctuated by bouts of competition leading to more stringent policies when demand for pollution control spikes." Many environmental indictors are improving, and in cases where they are not, there is no evidence of interactions among provinces. For instance, Quebec is an outlier with increasing sulphur dioxide emissions, but it does not appear to have prompted other provinces to relax their standards in an appeal to investors. Although many provinces made deep cuts to their environmental expenditures in the 1990s, apparently in response to a decline in public attention to the environment, there is no evidence that that has prompted any movement of pollution intensive enterprises. Olewiler concludes that "if there is a race, it is not leading to discernable changes in either economic activity or pollution levels across Canadian provinces over time." For the most part, Canadian provinces appear to be "stuck at status quo."

In contrast, Green and Harrison find considerable provincial interdependence in minimum wages policies, even though there is no credible threat of mobility of either minimum wage employers or employees. While no Canadian province has ever cut its general minimum wage,[17] provincial governments have tended to track their neighbours' minimum wages increases remarkably closely. Yet neither public statements by interests or politicians nor interviews with politicians and senior bureaucrats reveal any concerns about mobility of minimum wage jobs. Rather, the minimum wage case offers a clear example of a benchmarking dynamic in which provinces seek to reassure their electorates that they have struck a reasonable balance between the competing demands of the business community and organized labour and anti-poverty activists by showing that they are "in line" with other provinces. Within upper and lower bounds established by the ideological outliers (NDP and neoconservative governments), other provinces race to the middle. The minimum wage case suggests that pressures for emulation not only can be quite significant but that they can manifest themselves in much the same way as mobility-induced competition. This suggests a need for caution in interpreting apparent evidence of a race to the bottom.

US Comparisons

Theory would suggest that some degree of downward pressure is quite plausible, even if it falls short of the spiral to rock bottom sometimes posited by political activists. Moreover, anecdotal evidence – including statements by politicians themselves – indicate that provincial governments are mindful of the potential for destructive competition. As discussed by Boychuk, Alberta and BC engaged in a brief squabble as each offered free bus passes to welfare recipients wishing to return to another province. Ontario and Alberta appear to have tracked each other's corporate tax rates, though when Ontario backed off on a proposal to cut taxes the potential for a race downward was aborted before it began. Provincial governments' efforts to coordinate with each other on environmental standards, tobacco taxes, and industrial incentives all indicate that they are keenly aware of each other's policies and fearful of the potential consequences of policy divergence.

If so, one might ask why the authors in this volume find so little evidence of policy trends downward. The US experience suggests that the effects of mobility-induced competition may be both more subtle and more complex. Brueckner (2000) surveys the US literature on races to the bottom with respect to welfare and concludes that "Although evidence on welfare migration is mixed, the direct behavioral evidence of strategic interaction is compelling. It suggests that states are indeed playing a welfare game, which is most likely motivated by a concern about welfare migration, and that a race to the bottom may emerge." It is harder to say whether US states engage in competition with respect to environmental standards since, as discussed by Olewiler in this volume, the US federal government has for decades played a significant role in setting national environmental standards and promoting harmonization among the states. It is noteworthy, though, that US federal intervention was largely justified by Congress in response to a perceived threat of a race to the bottom (1992). In one area that US states have more discretion, setting disposal fees for hazardous wastes, Levinson's work suggests that states do engage in harmful competition, but upwards to encourage exports and deter imports (Levinson 1996; Levinson 1999).

These insights are reinforced by Rom's chapter in this volume, which provides a masterful comparison of education policy and welfare, the latter as reflected in three distinct programs (income support, Medicaid, and supplemental social security income). Rom finds clear evidence of downward competition with respect to social assistance programs, with more generous state outliers disproportionately cutting their benefits to fall back into line with their neighbours. However, as anticipated, there was no evidence of state interactions in the case of Medicare, a program that allows states minimal discretion. The effects of interstate welfare competition varied across programs, but overall "A state's welfare generosity is only modestly influenced by its neighbor's generosity." Rom concludes that "the race appears to be of turtles, not hares." Interestingly, Rom reports very different dynamics with respect to education spending, with some states racing to the top and others apparently racing to the bottom. However, the upward dynamic seems less likely to be a Tieboutian competition to attract mobile citizens than competitive emulation to impress local voters, though the latter may occur among small states or in border cities. It also seems unlikely that states actively seek to undercut each other's educational standards to attract either investment or individuals; such a dynamic is more plausibly a side effect of a race to the bottom in taxes.

Lessons from the Case Studies

It is be premature to lay to rest the prospect of races to the bottom in the Canadian federation. However, the chapters in this volume do suggest a need for a more nuanced understanding of interprovincial dynamics than implied by the popular image of the races to the bottom. The distinctive character of each province still matters, and the race to the bottom is not the only game in town

Several chapters reported evidence that "domestic" factors can be source of persistent provincial divergence as well as changes over time in any one province. Strong ideological and partisan differences still exist, and these may mute or even overwhelm concurrent pressures from interprovincial competition. Thus, the Ontario NDP government in office from 1990 to 1995 significantly increased generosity of welfare benefits in that province, regardless of any competitive pressures to retreat from redistributive programs. At the other end of the political spectrum, the Conservative government of Ralph Klein in Alberta significantly cut welfare benefits in that province. In the minimum wage case, NDP governments tended to set the highest minimum wages while neoconservative governments of Alberta and Ontario maintained the lowest minimum wages.

Many changes occur in parallel across all provinces suggesting alternate explanations when provinces track each other either up or down. The influence of national economic trends is evident in the minimum wage and possibly the welfare cases. Cyclical public attention to the environment also has been a factor across Canada. Harrison (1996) and Olewiler (this volume) argue that this variable interacts with the federal system, such that provinces are more likely to race to the top when the environment is “hot” but remain “stuck at the status quo” at other times.

The case studies also reveal spillover effects across policy fields. In the case of incentives for industry, Brown argues that efforts to negotiate the Agreement on Internal Trade (AIT) to strengthen the economic union were prompted by a combination of concern for national unity (i.e., to convince Quebec that it is worthwhile to remain in the federation) and international free trade. And while the AIT Code of Conduct on Incentives arguably has had little impact, provincial expenditures on subsidies for business have been constrained as a result of NAFTA and the WTO. While contextual factors offered a bulwark against destructive provincial competition in the incentives case, in the tobacco tax case they pushed provinces over the edge into a race to the bottom. The looming Quebec election and still raw memories of the Oka crisis caused federal and Quebec provincial policymakers to eschew either an export tax or a crackdown on illegal smuggling in favour of the alternative of cutting taxes.

As discussed above, although interjurisdictional competition may strengthen the hand of one side in political debates within provinces, one should not understate the importance of the other side. Thus, even where there are competitive pressures downward, provinces may arrive at an equilibrium in an assurance-type dynamic, rather than succumbing to the downward spiral of the prisoner’s dilemma. This was most evident in the tobacco case. Provinces were cautious lest their taxes get “out of line” with other provinces, but at the same time eager to raise revenues from a relatively popular tax and to protect public health by deterring smoking. Reassured by one or more provincial tax leaders, they were able to arrive at a stable and gradually increasing equilibrium prior to the federal and Quebec tax cuts of February 1994. Moreover, even when tax cuts in Quebec prompted matching cuts in neighbouring provinces, it is noteworthy that provinces merely settled at a lower equilibrium. Just as Quebec matched US tax rates, so too did other Eastern provinces match Quebec’s rates. None sought to undercut the others to gain competitive advantage. Similarly, Olewiler argues that Canadian provinces are, for the most part, “stuck at the status quo.” They may not increase their environmental standards unilaterally, but neither do they engage in competition to attract investment by lowering their environmental standards.

The importance of domestic politics also means that different provinces or states may be more or less vulnerable to competitive pressures. This was clearest in Rom’s analysis of US states’ education policy, in which some states were racing to the top while others appear to be racing to the bottom at the same time.

The case studies confirm that the race to the bottom is not the only game in town. Just as there are high levels of mobility of individuals and capital within a federation, so too is there a high level of communication. Frustrated with all the academic talk of races to the bottom, a senior provincial official at the workshop where the chapters in this volume were first presented declared “one of the reasons provincial policies look so much alike is simply because we all talk to each other.” Moreover, voters have opportunities to assess their own governments against the example set by other jurisdictions, with help from media, which routinely reports provincial announcements against backdrop of what other provinces are doing, and interest groups, which actively seek to promote upward emulation by reporting provincial rankings. Evidence of a benchmarking dynamic was most compelling in the case of minimum wage policies, where provincial governments closely tracked each other even though they admitted that they had no reason to fear capital mobility. In the tobacco case, politicians' resolve to raise revenues and protect public health by increasing their tobacco taxes was reinforced by activist-driven emulation, with anti-smoking activists initially informing provincial governments about other governments' tax increases privately, and later publicly shaming them through ad campaigns, research reports, and publication of "tax maps."

As discussed above, to the extent that provinces are engaged in destructive competition, there are two possible remedies: interprovincial collaboration and federal intervention. Prospects for provincial collaboration arguably are greater in the Canadian federation than in the United States, given the feasibility of bringing provincial and territorial leaders together face-to-face to negotiate harmonized standards. Provincial governments have done just that in the case of the Code of Conduct on Incentives in the Agreement on Internal Trade, which seeks to preclude provinces from engaging in bidding wars to attract or retain investment. However, Brown is not sanguine about the impact of the Code. He argues that the provinces' ability to come to agreement was more a function of external pressures from international trade agreements than self-restraint in the face of destructive competition, which does not necessarily bode well for their adherence to the Code. Moreover, Brown notes that the Canadian federation has limited institutional capacity for interprovincial coordination. Like other intergovernmental agreements, the Code of Conduct is non-binding with weak dispute resolution provisions. The provinces' reluctance to employ those dispute resolution procedures, even in the face of one particularly profile conflict, has discredited the Code and "left a collective bad taste." It is worth noting, though, that the subject of industrial incentives arguably presents greater challenges to provincial coordination than other policy areas examined in this volume, since it is characterized by bidding wars where provinces really do seek to outbid, not just match, each other (a reverse prisoner's dilemma).

Provincial efforts to coordinate their environmental standards have waxed and waned with public opinion. The federal, provincial and territorial governments reached agreement on the Canada-Wide Accord on Environmental Harmonization in 1998. While it is too soon to assess its impact, it is noteworthy that the provinces express greater interest in harmonization to avoid a race to the top during periods of heightened public attention than during periods of public inattention, when a race to the bottom or "stuck at the bottom" dynamic would be a greater concern.

Provincial governments have enjoyed greater success in harmonizing their tobacco tax increases in the wake of the 1994 tax cuts. However, cooperation in that case was facilitated by the particular form of the federal government's own tax cuts in 1994. Because the federal government matched provincial tax cuts dollar for dollar in Eastern Canada, there was a presumption that federal and provincial governments also would match each other's subsequent tax increases so that neither could claim any available tax room for itself. At the same time, there was federal pressure to coordinate tax increases among the low-tax provinces to avoid a politically controversial situation of the federal government taxing residents of some provinces more than others (though the federal government did maintain higher federal taxes in the Western provinces for several years). Even then, the provinces could only move at the pace of the most reluctant province. In effect, the provinces were only able to harmonize their tax increases at the level of the lowest common denominator.

The federal government was a central actor in several of the case studies, though not always with positive results. McKenzie speculates that equalization may render provinces less vulnerable to tax competition. Prior to 1996, the federal government sought to overcome provincial welfare competition through matching funding in the Canada Assistance Program. However, the CAP was replaced by the block grant CHST, which theory would suggest would not be as effective in deterring provincial competition. Olewiler reports that the federal government has played a minimum role in setting binding national standards in environmental policy, though its non-binding guidelines have had some impact in promoting harmonization among the provinces. Moreover, some federal interventions have been quite unhelpful. Boychuk argues that the federal prohibition of provincial residency requirements as a condition for CAP and now CHST transfers may actually have exacerbated the provinces' sensitivity to each others' benefit levels. In the tobacco tax case, the federal government played a critical role in *triggering* the race to the bottom that occurred in February 1994.

Conclusion

The chapters in this volume provide reassurance that competition for investment and to avoid benefits claimants has not decimated the provinces' capacity to govern. Contrary to the popular notion of a race to the bottom, Canadian provinces have continued to increase their taxes on capital, have maintained and on occasion increased their environmental standards, have restrained their reliance on subsidies to attract investment, and have successfully increased welfare benefits and excise taxes in at least some periods, though not others. While it is reassuring that Canadian provinces are not caught in a spiral of declining taxes and environmental standards, the US literature cautions against dismissing the prospect of harmful competition too readily. There may be real yet modest effects of interprovincial competition that would not show up as a pronounced downward trend in standards.

Our intention in undertaking this project was to take a first step in moving the debate about interprovincial races to the bottom from theory to empirical evidence. One of the clearest lessons from the theory, though, is that the situation is very complicated, thus presenting a host of methodological challenges. Multivariate statistical analyses can control for diverse factors that influence provincial policymaking to isolate any interprovincial effects. However, even when one has found statistical evidence that provinces respond to each other, questions remain about the underlying causes. Are provinces engaged in healthy competition for mobile actors, unhealthy race-to-the-bottom-type competition, or merely emulation? Qualitative studies of provincial policymaking will remain an important complement to statistical analyses in addressing those questions.

The authors' findings in this volume, while far from the last word, have laid a foundation for further research into the effects of interprovincial competition. Those who pursue that inquiry can now proceed with a bit of breathing room knowing that Canadian provinces are far from succumbing to an inexorable race to the bottom.

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[1] Marc Lee, "What are we going to do about Saudi Alberta?" Canadian Centre for Policy Alternatives, date?, available at www.policyalternatives.ca/publications/comment25.html.

[2] Canadian Council on Social Development, "Maintaining a National Social Safety Net: Recommendations on the Canada Health and Social Transfer," 5 March 1996. The Council notes that "Dramatic reductions in [social assessment benefits in] some jurisdictions will put pressure on others to match those reductions in order to avoid an influx of people, thereby precipitating a 'race to the bottom' or alternatively, to maintain higher rates while erecting barriers as in the recent case of British Columbia." Available at www.ccsd.ca/pr/pos_chst.html. The BC government stated: "How can desirable national standards of social benefits and services be maintained in a world of declining federal influence? Such standards are essential if Canada is not to witness, in the name of competitiveness, an interprovincial 'race to the bottom'

in providing social benefits." (Province of British Columbia, "1995 Budget Reports: Report G, Impact of Federal Offloading," available at www.fin.gov.bc.ca/archive/budget95/95rpt_g.htm.)

[3] Council of Canadians, "Social Union Could Pull Provinces into a Race to the Bottom, Warns Council of Canadians," 20 January 1999.

[4] "What is the Role for the Federal Government in Truck Safety?" Crash Communicator: The monthly newsletter of Canadians for Responsible and Safe Highways, May 1997, available at www.web.net/~crash/newsletter/may97.html. The article notes that, "The fundamental problem working against national safety standards is the temptation by individual provinces to gain competitive economic advantage by relaxing standards. Unless the Federal Government sets a national minimum standards, the race to the bottom by the provinces will only get worse."

[5] Canadian Institute for Environmental Law and Policy, "The Draft Environmental Management Framework Agreement and Schedules: A Commentary and Analysis," nd, at www.cielap.org/infocent/research/demfcon.html. See also Kathryn Harrison, "The Canada-Wide Accord: A Threat to National Standards," Canada Watch 6 (1988), available online at http://www.robarts.yorku.ca/canadawatch/vol_6_1/harrison.htm.

[6] Karen Gram, "Loss of 300 Vancouver jobs called poaching," Vancouver Sun, 30 November 1996, A1; Rheal Seguin, "McKenna defends bid to woo business from other provinces," Globe and Mail, 21 January 1997, A1, 6; "Nova Scotia lures SHL data centre to Cape Breton," Globe and Mail, 11 February 1995, B3; David Roberts, "Filmon defends loans to lure business: Manitoba will stop when other provinces do, Premier replies to Liberal leader," Globe and Mail, 23 March 1995, A9.

[7] The outcome is troubling not because communities should be forced to accept hazardous waste facilities or nuclear plants, but because the standards competitive jurisdictions would adopt in such a scenario would be higher than justified by their own residents' preferences.

[8] It is puzzling that, while Wallace Oates is one of the earliest and still most-cited proponents of a strong central government role to overcome state interdependence with respect to redistributional policies, he is simultaneously one of the most cited authors who dismiss the prospect of a race to the bottom with respect to environmental standards. In modeling tax competition Oates concludes that interstate competition is only efficient to the extent that states confine themselves to benefits taxes in which the benefits *to the taxpayer* in the form of public goods (e.g., police and fire protection, roads and other infrastructure) offsets to cost of the tax. If one thinks of the cost of complying with environmental regulations as a form of tax, the public goods nature of environmental quality virtually ensures that the value of a pigouvian tax set at the marginal benefit *to society* will invariably be higher than the benefits perceived *by the taxpayerr*

[9] Besides those discussed below, Wilson (1996) also discussed inefficiencies that can follow from "lumpy" investments, the existence of opportunities for tax evasion, unemployment, and monopoly power in capital markets, all of which have some plausibility.

[10] If voters pressure their governments to set the "lowest" taxes or "most stringent" environmental standards, zero-sum competition could result even in an emulation dynamic. One would expect such a dynamic to be short-lived, however. The very real costs of outdoing other provinces simply for the sake of being "the best" would soon become apparent and, presumably, unpopular with an electorate that had not fully considered the implications of being "the best." It is more problematic if politicians are driven to outdo or undercut the example of other jurisdictions not by popular opinion but by powerful interests. However, such a group's disproportionate influence likely lies with a threat of mobility. If so, we are back to the race-to-the-bottom dynamic.

[11] Berry and Berry (1994) and Hall's "first order learning" are exceptions (Hall 1993).

[12] See, for example, Canadian Nature Federation, 2001 Report Card on the Implementation of the National Accord for the Protection of Species at Risk, available at http://www.cnf.ca/species/report01/index.html.

[13] See http://www.fraserinstitute.ca/shared/taxcalc.asp.

[14] It is, however, somewhat ironic that some of those writing about yardstick competition themselves do not distinguish between the two, apparently because they view both forms of competition as healthy. See Besley and Case (1995) and Breton (1991). Others do acknowledge the distinction but do not explore it further (Rom, Peterson and Scheve 1998, ; Brueckner 2003). For instance, in a major report on intergovernmental competition, the US Advisory Committee on Intergovernmental Relations (1991), the possibility of "yardsticking" as a distinct intergovernmental dynamic warranted only a footnote. Exceptions are Shannon (1991) and Bailey and Rom (2004).

[15] There are several variants of the assurance game, but the critical feature of each is that each jurisdiction prefers to cooperate if the other does and defect if the other does. In other words, CC>DC and DD>CD.

[16] Oates (1999) has noted that, in theory, national governments are not prohibited from employing different approaches in different regions. Indeed, given the public goods character of the knowledge gained from policy innovation, provinces have incentives to free ride on each other's policy experimentation, thus undermining the benefits of decentralization. However, in practice it is difficult for a federal government to justify treating citizens in some regions differently than those in other regions, particularly given the popularity of "national standards."

[17] Some provinces, such as British Columbia, have introduced lower "training wages" for new employees.