Catching Up with Canada

A Prosperity Agenda for Atlantic Canada

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Foreword

It is with immense pride and optimism that I write the foreword to the inaugural study of the Atlantic Institute for Market Studies (AIMS) as a division of the Fraser Institute. The merger of these two great institutions will create the country's only national think tank with a presence from coast to coast and provide AIMS with the depth and scope of expertise needed to make real inroads in the policies governing Atlantic Canada. It cannot be said enough times or strongly enough that policies matter and the newly merged AIMS–Fraser Institute organization will now be positioned to provide research and outreach to Canadians from one side of the country to the other with the hope of improving policies through education for a better tomorrow.

Indeed, the authors of this inaugural study personify the enormous benefits accruing to both organizations from this merger. Ben Eisen, the lead author, was previously the director of research at AIMS and Fred McMahon was one of the original senior researchers at AIMS when it launched over two decades ago. Milagros Palacios leads the quantitative economic team at the Fraser Institute, something AIMS could simply not afford given our more limited resources. And finally, Alex Whalen is AIMS's current VP of operations. Together this team brought a diversity of strengths together to create in this paper a wonderful and inspiring vision for Atlantic Canada.

The paper reiterates to Atlantic Canadians, and indeed to all Canadians, that there is no inherent, fixed reason why the region must lag the rest of Canada economically. We have a long history of ingenuity, industriousness, and entrepreneurship that, if harnessed (as it has been in the past), would create the foundation for the region's prosperity, which would enable Atlantic Canada to catch up economically with the rest of the country.

The paper rightly points out the numerous historical examples of Atlantic Canada's prosperity. In fact, at times it was booming, including most recently in the 1960s when there was "incredible economic hope," as co-author Fred McMahon so aptly describes it. It is a powerful reminder that when we Atlantic Canadians get policies right and can establish an attractive environment for entrepreneurs, workers, and business owners, there is no reason we cannot sustain a prosperity comparable with the rest of Canada.

And yet we're languishing today. Our per capita income, unemployment and employment rates, and productivity all trail the performance of the rest of the country. On average today, each of us is almost $10,000 poorer than the average Canadian. Our workers suffer from higher unemployment than exists in other parts of the country. And the level of labour productivity in Atlantic Canada continues to lag badly behind the levels enjoyed by the rest of Canada.

As the paper points out, there is no inherent reason for this underperformance. Our own history shows we can do better—and importantly, the paper discusses the real-world experience of other jurisdictions like Ireland and more recently Michigan, which like Atlantic Canada experienced lagging economic performance but were able to reform and improve their performance. Put simply, this paper establishes the goal posts for a renewed AIMS within the Fraser Institute, which is to better educate Atlantic Canadians about the economic problems in the region so as to create the foundation for an openness to reform. Those reforms can set the stage for an unprecedented economic rebound and renewed prosperity in the region.

—John Risley, Chairman of the Board, Atlantic Institute for Market Studies

Executive Summary

Taken as a whole, Atlantic Canada is a lagging economic region in Canada. But this has not always been the case. The region has experienced significant periods of prosperity and economic optimism. This history gives hope that the region's current status as a relatively weak economic performer within Canada should not necessarily be viewed as an intractable reality.

This study begins by recounting past moments of growth and optimism in the Atlantic Region.

It then goes on to measure the size of the current "prosperity gap" between Atlantic Canada and the rest of the country across a broad range of economic indicators. Key findings include:

- Gross Domestic Product per person in Atlantic Canada today is just 83.5 percent of the average in the rest of Canada, a difference of $9,773 per person.
- Atlantic Canada's unemployment rate has consistently been several points higher than in the rest of the country. In 2018, for instance, the unemployment rate in the region was 9.2 percent compared to 5.6 percent in the rest of Canada.
- Employment rates are consistently higher in the rest of Canada than in Atlantic Canada. In 2018, this gap was 6.3 percentage points.
- In 2017, the household income per person gap between the Atlantic provinces and the rest of Canada was 10.3 percent.
- Labour productivity as measured by real GDP per worker has been consistently higher in the rest of the country than Atlantic Canada for as long as Statistics Canada data on the metric exists.

The "prosperity gap" is large—but it may not be intractable. This paper outlines options for policy reform drawn from proven real-world successes in other jurisdictions (with a special focus on Ireland and the US state of Michigan) that can help boost employment rates, productivity, and real per-capita GDP in the intermediate to long term.

Further, this study calculates the rate of growth that would be necessary for Atlantic Canada's living standards to catch up with those in the rest of the country (measured as GDP per person) over 20 years. In short,

we measure what the growth rate that would be needed so a child born in the region today would enter a regional economy every bit as prosperous as the rest of Canada when he or she came of age.

Private forecasters predict long-run nation-wide GDP inflation-adjusted per-person growth of approximately 0.7 percent in the decades to come. If those forecasts come to pass, we show that Atlantic Canada's real per capita GDP would need to increase by 1.6 percent over the next 20 years in order for its economy to fully converge with the rest of Canada's. The study draws on the experiences of other fast-growing jurisdictions, and on international macroeconomic literature to support the view that this target is plausible—particularly if the region adopts pro-growth policy strategies such as have been adopted in jurisdictions like Ireland and Michigan.

Clearly, forces outside the control of policymakers will help determine whether living standards in Atlantic Canada fully converge with those in the rest of the country. However, the outcome will be significantly influenced by the extent to which the general public supports a pro-growth agenda and puts pressure on policymakers to do the same. Global evidence suggests rapid convergence by struggling regions is possible if they embrace a consistently pro-growth policy framework.

Introduction

Atlantic Canada is, and has been for some time, a lagging economic region in Canada. Notwithstanding a recent surge of economic growth in Newfoundland & Labrador (fueled largely by an oil and gas boom that brought living standards in that province closely into line with the national average), the region as a whole has long suffered from relatively low productivity, a lack of business investment (except in Newfoundland & Labrador), and low living standards relative to the rest of Canada. Although the region is currently substantially less affluent than any other in Canada and one characterized by generally sluggish growth, this has not always been the case.

This study begins by reviewing crucial moments in Atlantic Canada's economic history, showing that the region has not always had low income and slow growth. It has had significant periods of prosperity and economic optimism, which indicates that its current status as a relatively weak economic performer within Canada is not an intractable reality.

The study's next section lays out the scale of the economic challenges facing Atlantic Canada. We compare the region to the rest of Canada on a range of economic indicators, which clearly show the size of the economic gap. The next section estimates (based on current long-term growth projections for the rest of Canada) the per-capita growth rate that Atlantic Canada would need for it to catch up with the rest of Canada over time. A discussion of successful pro-growth policy reforms elsewhere follows, with a special focus on reforms in Ireland and the American state of Michigan as they may serve as partial models for Atlantic Canada.

Atlantic Canada's economy is not monolithic—each of its provinces and sub-regions within each province face their own opportunities and challenges. Having said that, this paper seeks to provide the overall region with a unified objective of accelerating regional productivity and economic growth with the ultimate goal of creating more jobs, higher incomes, higher standards of living for people in the region, and more opportunities for their children.

Remembering Atlantic Canada's History: Moments of Prosperity and Optimism

For several decades, Atlantic Canada (with the exception at times of Newfoundland & Labrador) has been an economic laggard within Canada, with living standards well below the national average. But it has also had periods of prosperity and economic optimism. This reality undermines any notion that current low living standards or weak economic production are intractable problems. The region can again prosper.

The Maritime provinces[1] all joined Canada within 5 years of Confederation; Newfoundland & Labrador joined in 1949. The early economic history of the region shows that in the 1850s and 1860s, the region enjoyed a thriving economy with a robust fisheries industry and successful export industries in lumber, shipbuilding, and agriculture, along with small manufacturing (Rawlyk, 1967). Indeed, one study has characterized the region's economy in the 1850s as one of "the world's great commercial maritime powers" (Smiley, 1967).

The decades immediately following Confederation were more economically difficult as the Maritime provinces fell behind the rest of the country. Numerous factors contributed to this decline, including the expiration of the Reciprocity Treaty with the United States, a development which dealt a heavy blow to trade-dependent Maritime Canada.

Indeed, by the 1920s, per capita incomes in the Maritime provinces were only approximately 60 percent of those in Ontario (Statistics Canada, 1969: 1126); in the years since, the region has never caught up with the rest of the country.

A brief economic resurgence began in the late 1920s as a boom in the construction and tourism industries helped revitalize the economy and the industrial base around the pulp and paper industry began to grow (Rawlyk, 1969). But this period of prosperity was short-lived. Over the first half of the twentieth century, economic production and living standards in the Maritime provinces continued to lag.[2]

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[1] The "Atlantic Provinces" used to signify the three Maritime provinces: Nova Scotia, New Brunswick, and Prince Edward Island. When Newfoundland entered Confederation, the whole region became known as "Atlantic Canada."

[2] The reasons for Maritime Canada's decline relative to the rest of the country

There was again a surge of optimism in Atlantic Canada in the 1960s, "a time of incredible economic hope in Atlantic Canada" (McMahon, 2000a: 1). Regional living standards were converging quickly with the national average, and some commentators went so far as to speculate that the period would be remembered as "the Atlantic revolution."[3] The prospects for prosperity and economic optimism during that decade were abundant. By 1970, unemployment in Atlantic Canada—historically well above the national average—was essentially on par with the rest of Canada. In fact, all three Maritime provinces saw their unemployment rates dip below the national average at some point during the late 1960s or early 1970s.

Meanwhile, rapid growth in private sector investment in the region gave further hope for an even brighter future. Over the decade from 1961 to 1971, private sector investment (adjusted for inflation) more than doubled and by 1971 was nearly aligned with the rest of the country.

Unfortunately, the optimism and growth of the 1960s gave way to an extended period of economic malaise. Starting in the early 1970s, Atlantic Canada generally stopped catching up with the rest of Canada. In some years it even lost ground relative to the rest of the country. More recently, Atlantic Canada has stopped catching up entirely. In 2002,[4] GDP per person in Atlantic Canada stood at 83 percent of the average in the rest of Canada. In 2017, that figure was nearly identical at 83.5 percent.

Of course the Atlantic region is not homogenous, and various provinces and some cities have been successful and prosperous at various points in recent history. The Halifax regional municipality has had periods of economic vibrancy and in very recent years Prince Edward Island has experienced strong growth. Still, an overall prosperity gap between Atlantic Canada and the rest of the country remains.

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following Confederation have been debated extensively. The expiration of the Reciprocity Treaty noted above is one frequently identified culprit. The National Policy implemented under Sir John A. Macdonald, which created a tariff wall that restricted previously active trade between the Maritime provinces and the New England states as well as the West Indies has been identified as a possible culprit (Savoie, 2017). Donald J. Savoie (2017) has suggested that the subsequent growth of larger cities elsewhere in the country with their own thriving manufacturing sectors further contributed to the region's slower economic growth.

[3] This account of Atlantic Canada in the 1960s draws heavily on Chapter 1 of Fred McMahon's 2000 book, *Retreat from Growth*.

[4] We use 2002 as the base year for the analysis of this section, a somewhat arbitrary choice. The final year of available data is often 2017, which enables us to look at a 15-year, medium-term time period. However, the results are generally robust and hold for any year surrounding the turn of the millennium.

How Big is the Gap Today Between Atlantic Canada and the Rest of the Country?

Before establishing the level of growth that would close the gap between Atlantic Canada and the rest of the country, it is first necessary to establish the size of that gap. This section briefly summarizes several key economic indicators, comparing the region to the rest of the country. In presenting region-wide as well as national statistics, we recognize that there are substantial differences between provinces. The data presented here compare economic indicators for the entire region with the rest of Canada.

The broadest measure of economic well-being is Gross Domestic Product per capita. It measures overall economy-wide production and is closely connected to living standards. Since 2002, inflation-adjusted GDP per person in the rest of Canada has been consistently and almost exactly 20 percent higher than in the Atlantic region (see figure 1).[5]

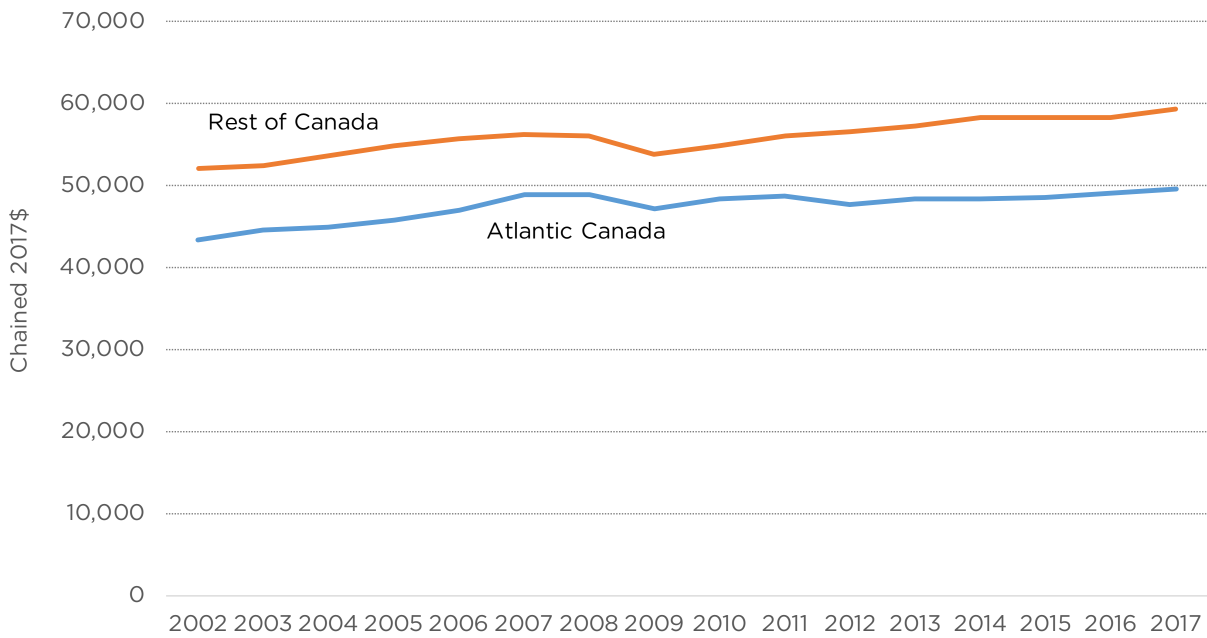
This 20 percent gap means that in 2002, GDP per capita was $8,830 higher in the rest of the country than in Atlantic Canada. By 2017, that number grew to $9,733 (using 2017 dollars in both cases). In other words, in 15 years, the gap between Atlantic Canada and the rest of the country grew by nearly $1,000.

A closely related indicator is average household income per person where the story is similar to GDP per capita. Figure 2 shows that again using inflation-adjusted dollars (set at $2017 levels), household income per person has been holding steady throughout the time examined at between 10 and 13 percent higher in the rest of Canada than in Atlantic Canada.

On labour market outcomes, Atlantic Canada has again lagged the Canadian average consistently since 2002. Figure 3 shows that every year since then, the unemployment rate (which measures the share of the workforce seeking work but unable to find jobs) has been higher in Atlantic Canada than in the rest of the country.

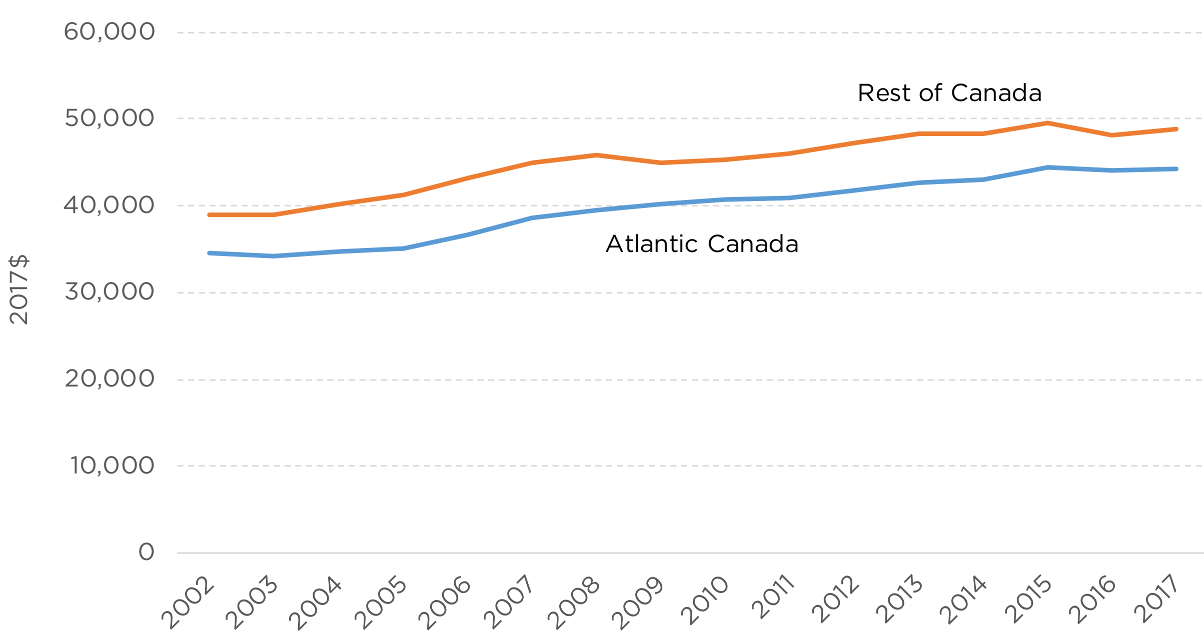
5 For this indicator and several others shown, there is a stark difference between Newfoundland & Labrador and the Maritime provinces. In this example, for instance, Newfoundland & Labrador's GDP per capita is roughly in line with the national average, whereas the gap is approximately 30 percent for the Maritime provinces.

Figure 1: Real GDP per Person (Chained 2017$), 2002–2017



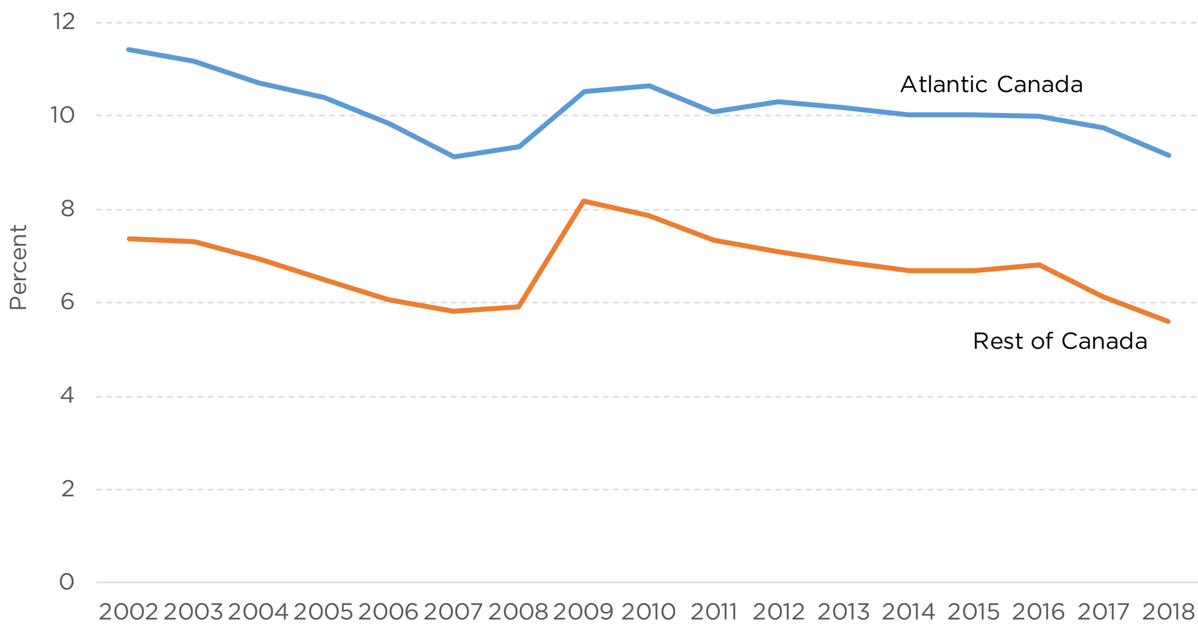
Sources: Statistics Canada, Table 36-10-0222-01, 36-10-0223-01, and 17-10-0005-01; calculations by authors.

Figure 2: Household Income per Person (2017$), 2002–2017



Sources: Statistics Canada, Table 36-10-0226-01, 18-10-0005-01, and 17-10-0005-01; calculations by authors.

Figure 3: Unemployment Rate, 2002–2018



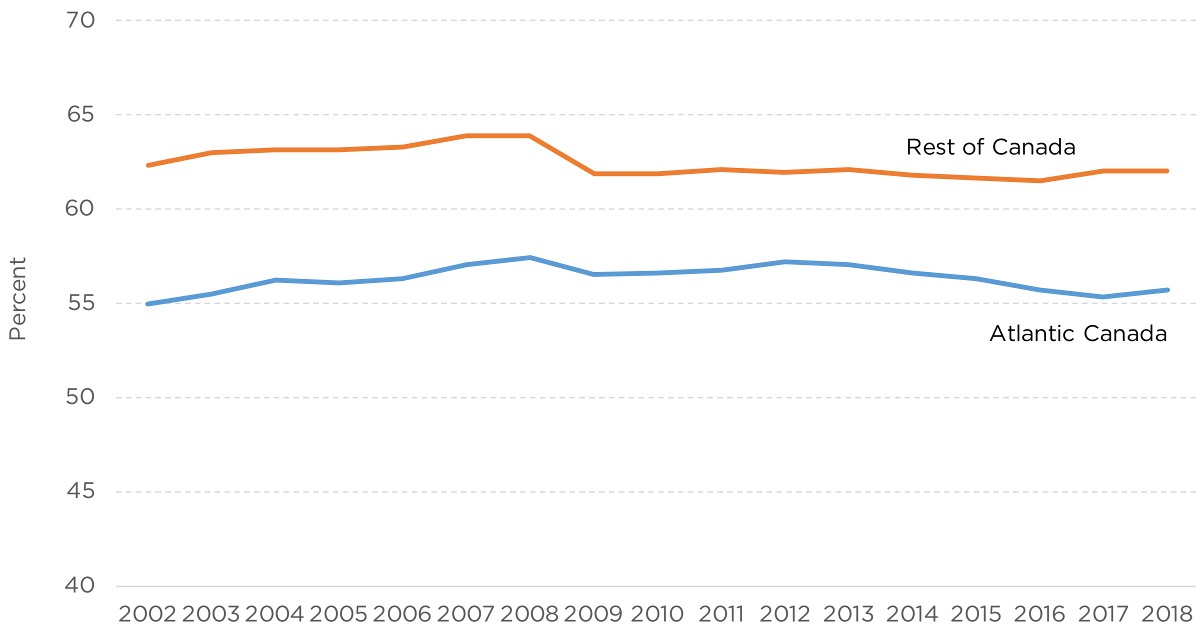
Sources: Statistics Canada, Table 14-10-0018-01; calculations by authors.

The size of the gap has varied only slightly from year to year. Every year since 2002, the unemployment rate in Atlantic Canada has been between 2.3 and 4.0 percentage points higher than in the rest of the country.

In recent years (particularly since the 2008/09 recession), the efficacy of the unemployment rate as a comprehensive measure of labour market strength has been called into question. So economists now often use a separate measure: the employment rate, which is influenced by both labour market strength and demographics. It measures the total share of the population that is working. As Figure 4 shows, the story for this indicator is much the same: the employment rate in Atlantic Canada has been consistently lower than in the rest of Canada each year since 2002. The size of the gap has ranged from a low of 4.8 percentage points in 2012 to a high of 7.5 percentage points in 2003.

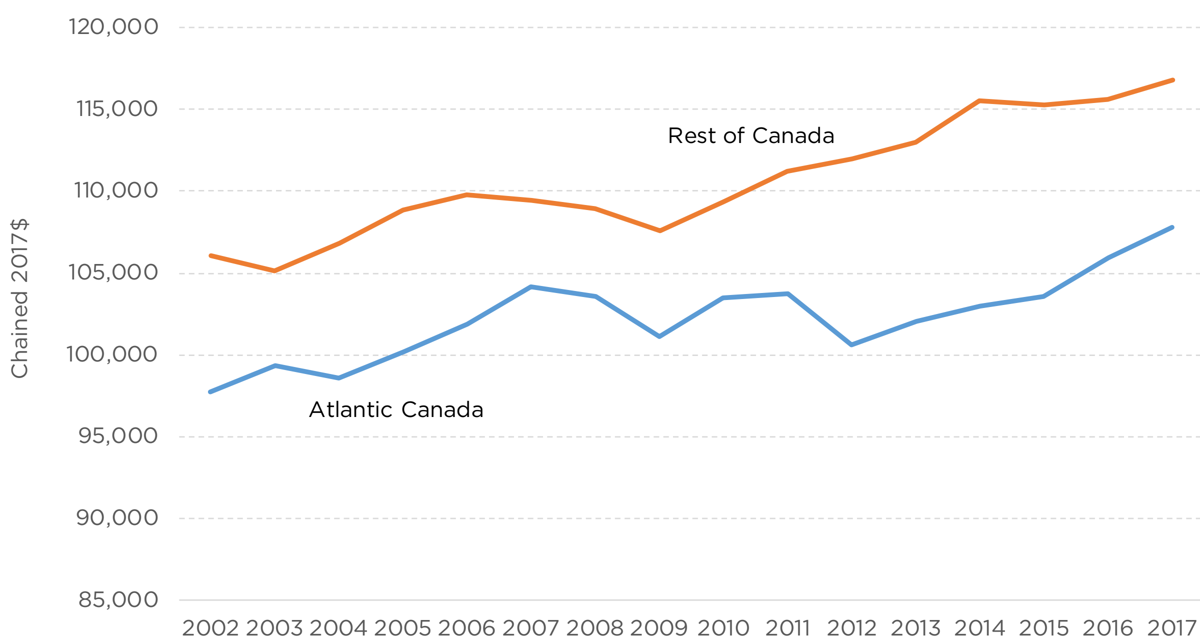
The region consistently shows lower labour productivity. Figure 5 compares labour productivity, as measured by real GDP per worker, in Atlantic Canada compared to the rest of the country. Without policy changes and or increased business investment in the region, the gap in labour productivity threatens to persist.

Figure 4: Employment Rate, 2002–2018



Sources: Statistics Canada, Table 14-10-0018-01; calculations by authors.

Figure 5: Labour Productivity, Real GDP per Employee (Chained 2017$), 2002–2017



Sources: Statistics Canada, Table 36-10-0222-01, 36-10-0223-01, and 14-10-0018-01; calculations by authors.

What Would it Take to Close the Prosperity Gap Within One Generation?

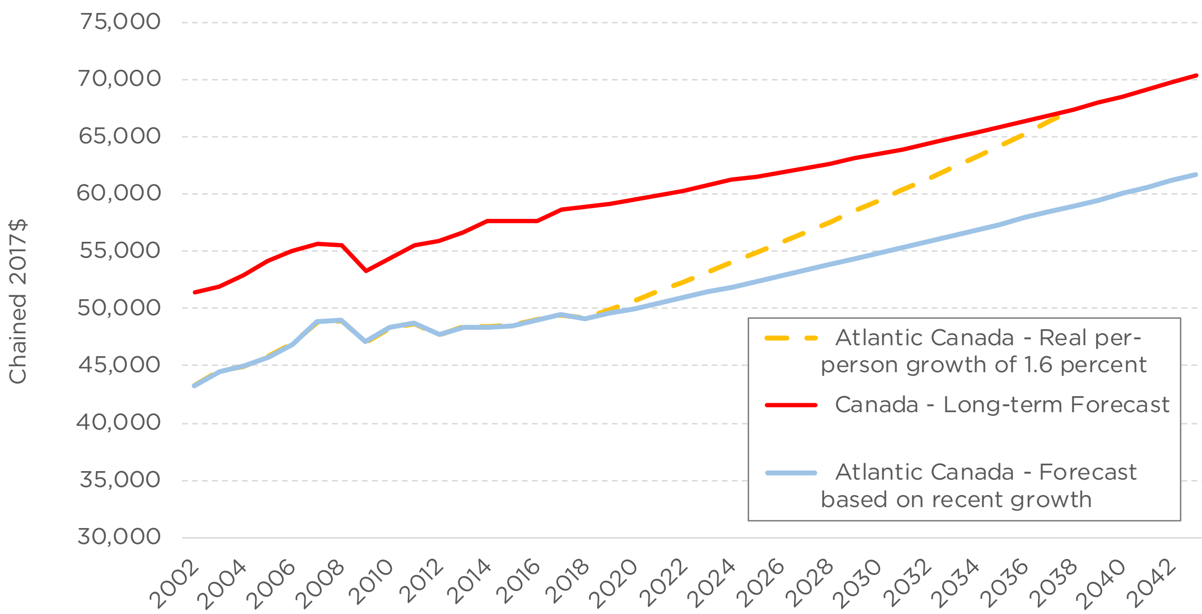
Despite the preceding section's sobering economic indicators, the first section of this paper has shown that the situation need not remain this way. What level of economic growth would be required to close the prosperity gap over the course of one generation and catch up with the rest of Canada? What level of economic growth would be required for a child born in the Atlantic region in 2018 to grow up into an economy as prosperous as the rest of the country by their twentieth birthday?

Of course, this thought experiment requires some assumptions. For instance, it is difficult to predict the economic growth rate in the rest of the country. Long-term forecasts should be viewed skeptically. That said, private forecasters provide long term projections for Canadian economic (GDP) growth, which gives us the best available assumptions about future economic growth in Canada.

These forecasters predict a long-term growth trajectory, in inflation adjusted per-person terms, of 0.7 percent for the Canadian economy. So in order to close the prosperity gap, Atlantic Canada would have to outstrip that 0.7 percent real per-person annual growth rate. This would require a significant uptick in the provinces' growth rates in recent years (again, using 2002 as the base year for this measurement), which have averaged a combined rate of 0.9 percent. Statistics Canada does not provide province-level long-term GDP growth, so for a baseline scenario, we will extend this growth rate into the future. If this scenario came to pass, 20 years from now the prosperity gap would still remain and would be almost exactly the same size (in percentage terms) as it is today.

For Atlantic Canada to catch up with the rest of the country in 20 years, it would need a per-capita growth rate of 1.6 percent in real terms between now and 2038. Under this scenario, the hypothetical baby born last year would be able to enter a labour force and economy as prosper-

Figure 6: Atlantic Canada's Real GDP per Person (Chained 2017$), Alternative Scenarios, 2002–2043



Note: The projection for Atlantic Canada is based on the average annual growth rate between 2002 and 2017.

Sources: Statistics Canada, Table 36-10-0222-01, 36-10-0223-01, 17-10-0005-01, and 17-10-0057-01; PBO; Canada, Department of Finance; TD Economics; RBC Economics; BMO Economics; CIBC Economics; calculations by authors.

ous as the average for the rest of the country when he or she turns 20 (see figure 6).

However, the positive effects of increased growth would be felt well before the 20 years was up. Throughout those 20 years, living standards in the region would be increasing and converging with the national average. For instance, in 2018, real GDP per capita was 20 percent higher in the rest of Canada than in the Atlantic region. Under the higher growth scenario for Atlantic Canada (1.6 percent real per capita), this gap would be cut in half (to ten percent) by 2027.

Is It Plausible for Growth to Exceed That in the Rest of Canada?

Given that a 1.6 percent growth rate over the next 20 years would bring the real GDP per capita of the Atlantic region to parity with the rest of the country, is this growth rate plausible, and what would it take to achieve it? Recent global economic history provides numerous examples suggesting that, yes, regional economic growth in the area of 1.6 percent per person annually is possible over an extended period, particularly if it is supported by pro-growth policy reform.

Two such examples follow, namely, the “Celtic Tiger” phenomenon in Ireland and Michigan’s dramatic economic turnaround in since 2011.

We'll begin with Ireland, a formerly economic laggard that transformed its approach to economic policy and enjoyed rapid economic growth during its "Celtic Tiger" period, which began in the mid-1990s. During this period, Ireland undertook a series of pro-growth policy reforms,[6] and subsequently enjoyed a prolonged boom that took it from being a middle-income country and a laggard within Europe to one of the world’s leading economies. During this period, Ireland experienced spectacular real per-person economic growth of 5.5 percent annually (World Bank, undated).

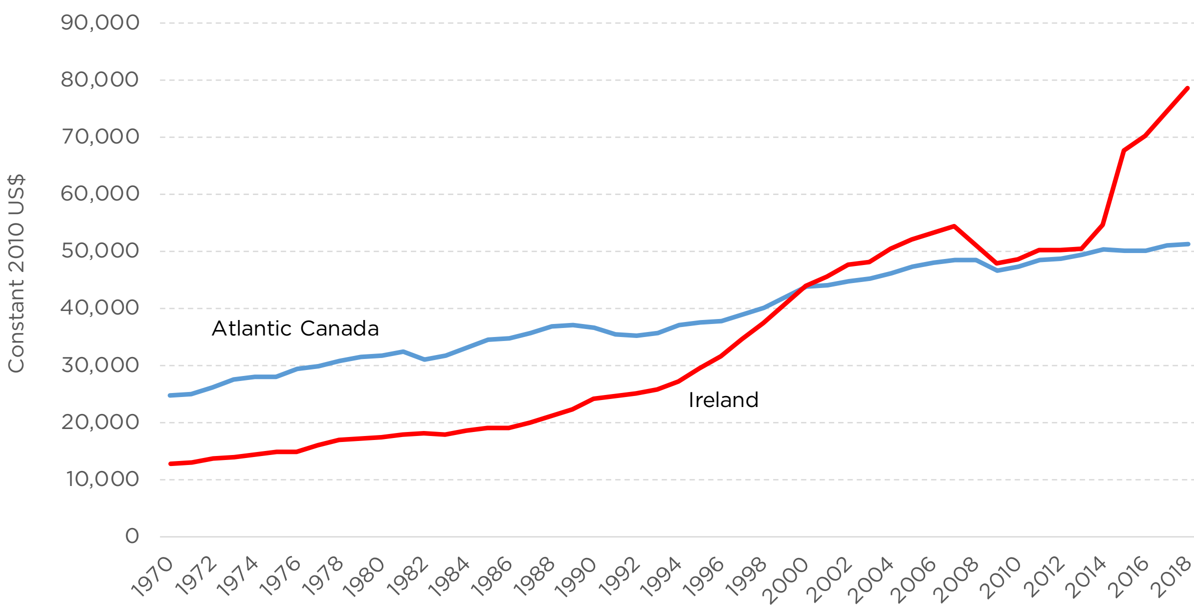
Ireland’s per capita GDP was just two-thirds of Canada’s in 1990 (World Bank, undated, measured by constant US$.)[7] By 2000—in just a decade—Ireland’s and Canada’s per capita GDP were equal (see figure 7). So catch-up can be even quicker than the 20-year period we have outlined for Atlantic Canada. Today, Ireland’s per capita GDP is one-and-a-half times Canada’s.

The Irish economy’s stunning turnaround in the wake of its economic reforms led to a much faster growth rate in that country than what was occurring in most other developed economies. This allowed Ireland to rapidly converge with, and quickly surpass, many other economies

[6] For an account of Ireland’s reforms, see McMahon (2000b), *The Road to Growth*.

[7] To compare values of different currencies, a common unit of measure is required. No such measure is perfect but US$ are widely used for such comparisons.

Figure 7: Per-capita GDP, Canada vs. Ireland (Constant 2010 US$), 1970–2018



Source: World Bank, undated.

that had been much more prosperous than Ireland was at the start of the reform period.

Closer to home and more recently, the state of Michigan had experienced more than its share of economic pain in the years prior to and during the 2008/09 global economic slowdown. During this time, the state's manufacturing sector shrank and its economy stagnated. In 2011, however, Michigan's economy began to turn around. Between 2011 and 2017, the state's real per-person growth rate was an annual average of 1.9 percent—again, materially more than the 1.6 percent growth target for Atlantic Canada described above (Eisen and Hill, 2019). Michigan's economic growth spurt, like Ireland's, coincided with a comprehensive policy reform package that included business tax reform and significant changes to labour legislation. Whether there was a causal relationship between Michigan's reforms and its period of economic growth is more hotly contested than was the case in Ireland. Nevertheless, Michigan's economic turnaround shows that it is possible for a lagging economy in North America to enjoy a prolonged period of significant real per-capita growth.

In addition to these specific examples, international macroeconomic literature suggests that the convergence rates under discussion here are plausible. Specifically, that literature suggests a convergence rate of approximately 2 percent is normal (see McMahon, 2000a). In Atlantic Canada's case, this would imply that if the rest of the country were to grow at a rate of 0.9 percent per person annually, we should expect average real per person economic growth that would be sufficient to achieve full convergence over 25 years—only slightly longer than the 20-year scenario described above.

It would be a mistake to simply assume that this international average is applicable to the specific case of Atlantic Canada. However, we include this international evidence as further support that convergence at rates similar to those under discussion in this paper are entirely normal throughout the world.[8]

Given the historical record of spectacular economic success and rapid convergence rates in Ireland and in the "Asian Tigers" previously, the target of 1.6 percent real per-person annual growth should not be considered a ceiling. While catching up with the rest of Canada over the course of a single generation is a useful and easily understood target, if the region were to achieve faster growth, the economic gap could be eliminated faster. For instance, if Atlantic Canada were to achieve annual real per-person growth of 1.9 percent, it would match the national average in 15 years, and 2.5 percent growth would bring parity in just 10.[9] Our international examples show these growth rates are not mere fantasy, but are actually achievable in certain contexts with the right policy mix.

[8] The theory of economic convergence has come under increased scrutiny in recent years. For instance, see Johnson and Papageorgiou (2018).

[9] None of this is to disguise the fact that catching up with the rest of Canada in a generation is an ambitious objective, particularly given the region's generally older population, which places natural downward pressure on GDP growth, and price differences across Canada. Some economists may prefer to focus on other measures of convergence that reflect these challenges. GDP convergence in demographic-adjusted and special-price-adjusted terms is one possible example. Under this scenario, increasing per-capita real GDP (so adjusted) in Atlantic Canada by 7.3 percent would achieve convergence. For just the Maritime provinces, it would require an increase of 18.1 percent in GDP per capita as adjusted above. Our focus on real GDP per capita as the measure of convergence throughout this paper is not that it is clearly "the best" yardstick by which to measure convergence, but that it has many great advantages, including being easily understood and therefore a useful focus for public discussion. We do recognize that some technically oriented readers may prefer one of several other possible yardsticks that adjust for demographic and price differences in Atlantic Canada compared to the rest of Canada, but these measures for convergence are not necessarily better or worse than the one we propose here.

This brings us to the second question posed at the start of this section: what would Atlantic Canada need to do to encourage stronger economic growth to help achieve the generational goal of catching up with the rest of Canada? Of course, a great many factors that influence economic growth are outside the control of policymakers. However, there is abundant evidence that public policy choices can influence economic growth (King and Rebelo). The following sub-sections discuss key dimensions of the successful economic reforms in Ireland and Michigan that Atlantic Canadian policymakers may wish to consider as they ponder their own reform options. As the data presented above imply, the GDP gap between Atlantic Canada and the rest of Canada is partly driven labour productivity and employment rates (which are themselves partly a function of demographics). As such, the reforms discussed below are intended address to help "pull both of these levers," to enhance growth in the Atlantic provinces and, in time, close the overall prosperity gap.

How Do We Get There?

Tax reform and reductions

A critical component of the economic reforms in both Ireland and Michigan was significant pro-growth tax reform. In Michigan's case, the centerpiece of tax reform was the replacement of the onerous and overly complex Michigan Business Tax (MBT) with a more straightforward corporate tax rate that lightened both the tax burden and the administrative compliance burden for firms. The state implemented other tax reforms to reduce the cost of doing business, such as phasing out personal property taxes on manufacturing equipment. The impact of Michigan's tax reforms was transformative. An analysis from the Tax Foundation (2019) found that in the area of corporate tax policy, Michigan went from having the second worst policy structure in the United States to having the seventh best.

Transformative tax reform, including both personal and corporate tax reductions, was also a key component of Ireland's economic reforms. For example, between 1989 and 2001, the top marginal personal tax rate in Ireland was reduced by 14 percentage points—from 58 cent to 44 percent (Powell, 2003).

On business taxes, Ireland's approach was every bit as ambitious. In 1996, Ireland reduced the standard corporate tax rate from 40 to 24 percent. Further reductions were introduced later on, eventually bringing Ireland's corporate tax rate to 12.5 percent—approximately half the rate of other small European countries (IDA Ireland, 2019).

Clearly, tax reform was crucial for the growth initiatives in Ireland and Michigan. A comprehensive growth agenda in Atlantic Canada should include tax reform as well. The Atlantic provinces have some of the highest provincial corporate tax rates in Canada. Corporate provincial tax rates, which of course exist on top of federal tax rates, range from 14 to 16 percent in the region. This is fully 4 points higher than the province with the next highest corporate income tax rate (12 percent) (CRA, 2019).

On personal income taxes, Atlantic Canada is similarly uncompetitive. In 2018, for instance, the four Atlantic provinces all had higher top marginal personal income tax rates than all of the other English-speaking provinces in Canada. Only Quebec's top personal income tax rate was higher (Murphy, Palacios, and Fuss, 2019).

High marginal tax rates and their effect of dampening people's desire to work or undertake other productive activities in Atlantic Canada aren't confined just to those the upper end of the income distribution. For example, the marginal tax rate for those at $50,000 of income was, again, higher than for any other English-speaking province. In all four Atlantic provinces, the marginal provincial tax rate at $50,000 was approximately twice that of British Columbia, which had the lowest personal income tax rate among the provinces (Murphy, Palacios, and Fuss, 2019).

Major tax relief and reform were centerpieces of both the Irish and Michigan pro-growth economic reform packages. Given Atlantic Canada's badly uncompetitive position on business and personal taxes, overhauling tax policy in the region with an eye to reducing the tax burden while also making the tax system more efficient (and so less harmful to the economy per dollar raised) is clearly one of the most important pro-growth policy reform initiatives the region could take.

Strengthening public finances by reducing spending

The Atlantic provinces must also consider spending reductions and restraint as part of their growth agenda. The tax reductions and reforms that Ireland and Michigan undertook were introduced along with meaningful fiscal consolidation. In other words, those jurisdictions did not allow tax reductions to lead to an increase in deficits or debt because they reduced spending by amounts either commensurate with or greater than the tax reductions.

In Ireland's case, many of the spending reforms and reductions were introduced prior to the country's tax reform in response to the looming fiscal crisis the country faced. Ireland's spending reductions were broad and touched nearly every area of government activity. Health and education expenditures were reduced by 6 to 7 percent and agricultural expenses fell 18 percent. Public sector employment was reduced by 8,000 jobs (Jacobsen, 1994).

The spending reductions successfully solved Ireland's fiscal crisis. The deficit was quickly eliminated and government debt as a share of GDP began to fall quickly (Powell, 2003). These spending reductions and the balanced budget they produced created the fiscal room that helped propel the pro-growth tax reform described earlier.

In Michigan, too, spending reductions designed to prevent the rapid emergence of public debt were a critical component of the reform efforts that began in 2011. Michigan reduced nominal expenditures by 3.2 percent in a single year. The next two years were characterized by fiscal restraint such that in 2014 nominal spending was no higher than it had been in 2011, notwithstanding upward cost pressures from inflation (Eisen and Hill, 2019).

As in Ireland, an important component of Michigan's fiscal consolidation was a reduction in the size of the public sector workforce. The savings from the reduced the number of government employees helped make the state's fiscal consolidation possible. The successful spending reductions (along with fiscal rules preventing annual deficits) in the early 2010s meant that despite the 2008/09 recession, Michigan avoided the run-up in public debt that occurred in other nearby jurisdictions, such as Ontario, that did not exercise similar restraint (Eisen and Hill, 2019).

Atlantic Canada clearly needs to make fiscal reform part of a comprehensive policy reform strategy, given the region's current fiscal and demographic challenges (PBO, 2018). One recent study conducted a detailed analysis of the fiscal challenges facing New Brunswick, concluding that the province "continues to face serious fiscal problems and frugal public management is necessary to bring expenditures closer into line with revenue and restore stability to provincial finances" (Murell and Fantauzzo, 2014). New Brunswick is not alone in this respect. All four provincial governments face significant debt burdens and fiscal challenges. Indeed, in a recent report Canada's Parliamentary Budget Office shows that the finances of all four provincial governments are currently unsustainable (PBO, 2018).

Evidence from Ireland and Michigan combined with the challenging fiscal circumstances now facing the Atlantic region suggest that a comprehensive pro-growth reform package for the region include a focus on reducing expenditures to improve the stability and sustainability of public finances, reducing the potential burden of interest payments on government debt for future taxpayers, and providing potential investors with reassurances that future tax increases will not be enacted to help service government debt.

Eliminating interprovincial trade barriers

A near-consensus amongst economists holds that free trade across provincial and national borders helps encourage economic growth. Unfortunately, in Canada, significant barriers to trade exist even within the country. These provincial barriers are a heavy brake on growth. A recent analysis by Lukas Albrecht and Trevor Tombe showed that trade liberalization would produce national GDP gains of $50 to $130 billion (Tombe and Albrecht, 2016).

Clearly, reducing interprovincial trade barriers is a national concern. However, as Albrecht and Tombe's research shows, it is particularly important in Atlantic Canada because the anti-growth effects of provincial trade barriers are largest in smaller and less wealthy provinces. The Atlantic provinces have more to gain from reductions in inter-provincial trade barriers than any other region of the country.

Questions around the resolution of interprovincial trade-barriers are long-standing and as a small region, Atlantic Canada has only a limited ability to influence larger provinces. However, the Maritime provinces can lower or eliminate trade barriers among themselves. By doing so, the region's provincial governments can help boost their own provincial and regional growth.

Reducing the role of government in the economy and promoting economic freedom

Reducing the role of government in the economy and promoting economic freedom is closely related to tax reductions, reductions in government expenditures, and the removal of trade barriers, but is worthy of independent consideration. The Irish spending reductions described above were crisis-driven—implemented to avert insolvency rather than as part of an effort to reduce the size of government relative to the size of the economy as an end in itself. Yet the reforms (along with rapid economic growth) had precisely that effect. More specifically, government program spending (ie., all spending other than interest payments) fell from 55 percent of GDP in 1985 to 41 percent in 1990 (Powell, 2003).

The reduction in the size of government in Ireland and Michigan combined with other dimensions of their reform packages had the effect of enhancing overall economic freedom for both jurisdictions. The Fraser Institute's *Economic Freedom of North America* report, which measures economic freedom in all states and provinces in North America, shows that Michigan moved from 41st place in 2011 to 22nd place in 2018. Meanwhile, Ireland was identified as one of the 15 most improved countries in the world in the *Economic Freedom of the World Annual Report* between 1985 and 1995 (Gwartney, Lawson, and Block, 1995). In the most recent rankings, published in 2019, Ireland was rated as the 6th freest economy in the world (Gwartney, Lawson, Hall, and Murphy, 2019).

It is unlikely that a simultaneous increase in economic freedom and prosperity in the two jurisdictions was coincidental. A vast body of evidence shows a clear link between economic freedom and growth and prosperity. The implications of these experiences for Atlantic Canada are clear, given that provincial-level government spending as a share of GDP is among the highest in North America in those four provinces, and all four also rank near the bottom of the *Economic Freedom of North America* report. Given clear relationship between economic freedom and growth, provincial governments in the provinces should focus explicitly on promoting economic freedom as part of a pro-growth agenda. In practical terms, this means, among other things, committing to reducing the size of government relative to provincial GDP, maintaining lower and more competitive taxes, and promoting freer trade between provinces.

Summary

Policy choices influence economic growth rates. For Atlantic Canada to have the best chance of achieving the generational goal described above, the provinces should always ask whether their proposed policy changes will advance this objective. This study has leaned heavily on shared features of successful pro-growth reform initiatives in Ireland and Michigan to outline very broadly several of the components of a pro-growth policy agenda for the region.[10]

The growth implications of specific policy choices are often small and take time to be felt, which frequently leads policymakers to embrace other priorities. However, the aggregate effect of all of a jurisdiction's or region's policy choices—even ostensibly small ones—add up and, taken together, have a material impact on growth, particularly when combined with factors that exert a significant and measurable impact on growth rates (the efficiency of the tax mix, for instance). Reducing and reforming taxes, stabilizing public finance, reducing inter provincial trade barriers, and reducing the size of government relative to the economy while promoting economic freedom are all examples of the type of policies that can help drive growth.

10 The list of areas for policy reform in this study is, of course, not exhaustive. In some additional areas, Atlantic Canadian policymakers may need help from the federal government. For example, Canada's Employment Insurance (EI) program as it is presently constituted creates harmful economic incentives for work and productivity and program rules are such that these incentives are worse in Atlantic Canada than in most other regions of the country (due to the generally higher unemployment rates in the region). As such, although changes need to be made at the federal level, EI reforms designed to encourage employment are another area of policy reform that could help encourage economic growth across Canada, particularly in the Atlantic region (McMahon, 2000a).

Conclusion

Clearly, forces outside the control of policymakers will play a role in determining whether Atlantic Canada achieves the generational goal of fully converging the region's per-person GDP with the rest of Canada. However, the outcome will be significantly influenced by the extent to which the general public embraces a pro-growth agenda and puts pressure on policymakers to do the same. Global evidence suggests it is possible for the economies of struggling regions to rapidly converge with those of their neighbours. If they embrace a consistently pro-growth policy framework, policymakers and concerned Atlantic Canadians will maximize their chances of reinvigorating a thriving regional economy with living standards comparable to those elsewhere in Canada.

Can the hypothetical child born in 2018 find themselves in an Atlantic Canada as prosperous as the rest of the country on their 20th birthday? The examples above demonstrate that this is within our reach.

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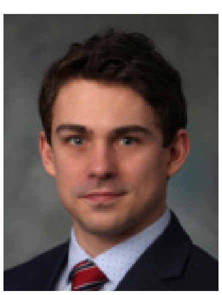

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