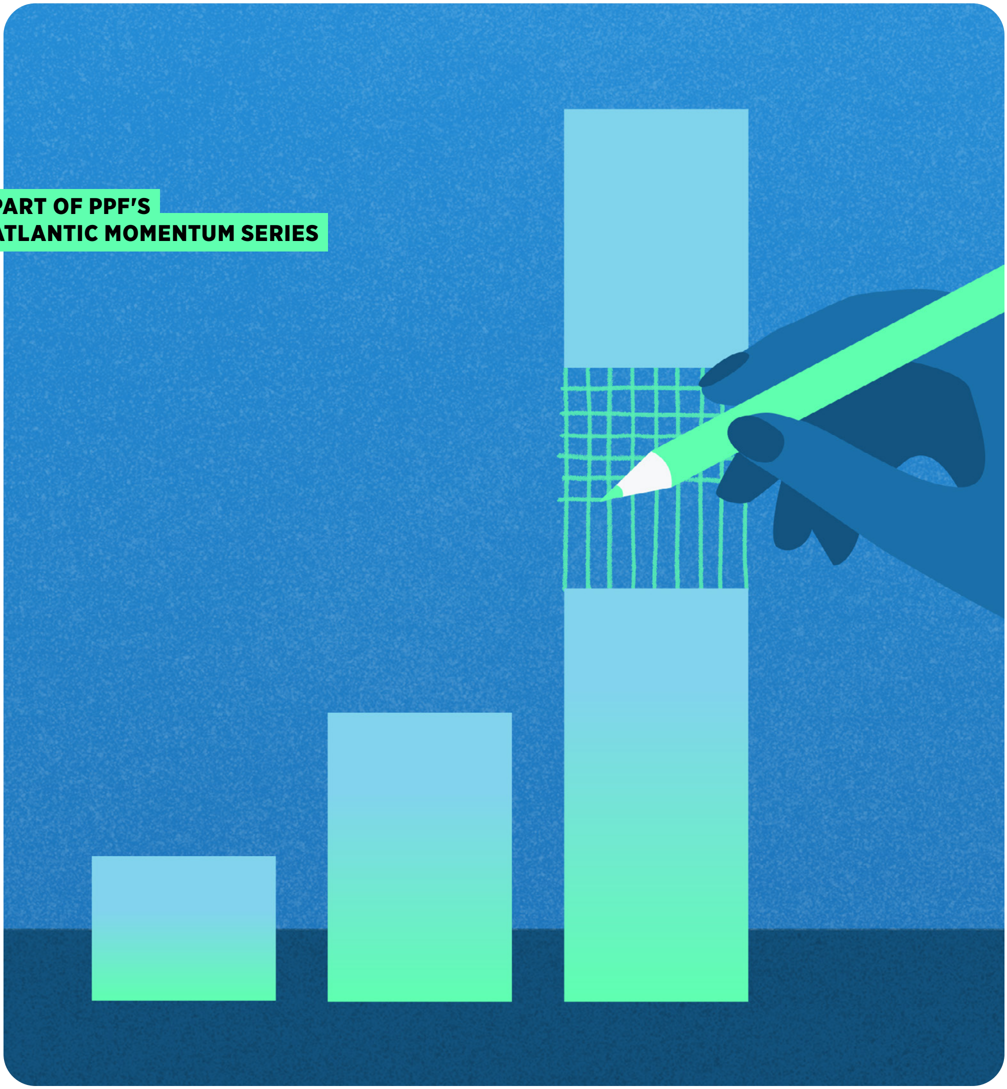
Mind the Gaps

How Atlantic Canada can keep up the momentum

BY MARK STEVENSON

PART OF PPF'S ATLANTIC MOMENTUM SERIES



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"Why Atlantic Canada Remains White and Poor" — that was the blunt and provocative headline of a column in the Globe and Mail back in 2004, and if it was a bit unsettling, the column made a serious point.

It was based on a Statistics Canada report tracking immigrant settlement patterns that showed few were choosing Atlantic Canada. As a result, the region was losing out on the social dynamism and economic opportunity immigration brings. It was indicative of a sentiment common back then in the rest of Canada: The Atlantic provinces were the poor cousins of Confederation and a drain on the rest of the country.

Not so much anymore. The region is living through a resurgence that has seen the economy grow, population increase and immigration positively boom. The remote workers who moved to Atlantic Canada during the pandemic found not just the more comfortable lifestyle they sought, but a more vibrant and diverse economy than they may have expected. All this was captured by the Public Policy Forum's Atlantic Canada Momentum Index released last March.[1] It charted 20 social and economic indicators — everything from labour productivity and median age to immigrant retention and real exports — over two periods, 2008-2015 and 2015-2021. Momentum was defined as a growth rate in the recent period that outstripped the previous one — a rise in the rate of improvement, in other words. And 16 of the indicators showed momentum.

Which does beg the question: what about the other four? It may seem like glass-half-empty thinking, but if the region wants the good times to keep rolling, there is still work to be done.

The four indicators with negative or no momentum were:

- **Employment income;**
- **Non-residential investment (which includes machinery, equipment and structures investment by government and business);**
- **Access to a family physician; and**
- **NEET (the proportion of those between the ages of 15-29 who are not employed nor in education or training).**

There are important caveats, however, on those last two. The momentum on access to a family physician was actually flat over the two periods, not decreasing, and by this measure

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Atlantic Canada is actually doing better than the country as a whole in absolute terms. (Just over 87 percent of those in the region have a family doctor, compared 85.5 percent for Canada as whole.) NEET, meanwhile, did have negative momentum, and it's worse than the country as a whole — it stands at 109 percent of the Canadian level for an indicator where a higher number is a bad thing. But the gap with the national average has closed dramatically, from 128 percent in 2008 and 115 percent in 2015.

To focus on the areas of most concern, says Andrew Sharpe, president of the Centre for the Study of Living Standards and architect of the Momentum Index, it's important to consider both momentum and Atlantic Canada's performance compared to the country as a whole. "The lower the indicator is as a proportion of the national number, the more problematic it is," Sharpe points out. Of the 20 indicators in the index, Atlantic Canada's number was less than 90 percent of the national average in seven of them. Four of those stand out.

The first is employment income, a kind of bedrock measure of prosperity. Atlantic Canada has downward momentum on this indicator, and it stood at just 83 percent of the national average in the index. It's been a perennial problem for a number of reasons: labour productivity has been lower; proportionately more small businesses and higher unemployment has meant companies simply don't need to pay their workers as much; and seasonal employment is more prevalent (it's about 30 percent higher than the rest of the country).[2]

In fairness, labour productivity has been improving, as has the employment rate. In fact, numbers released since those of the Momentum Index show employment income growing slightly faster in 2021 in Atlantic Canada than the country as a whole.[3] But the economy in Atlantic Canada still has a way to go — real GDP per capita, the most basic measure of output, sits at 87 percent of the national average (although it has considerable momentum).

The two biggest gaps with the national average are both on indicators that drive long-term growth, and the fact they trail so badly may be the biggest problem revealed by the Momentum Index. They are non-residential investment and BERD, or business enterprise in-house expenditure on research and development.

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Atlantic Canada has no momentum in non-residential investment; it fell at an annual average rate of 8.5 percent from 2015 to 2021, and although Newfoundland accounted for a good deal of that (given the decline in oil and gas), it fell as well in Nova Scotia and New Brunswick. It sits at 68 percent of the national average. BERD, though it has momentum, sits at an embarrassing *35 percent* of the national average on a per capita basis. Simply put, Atlantic Canada does not invest in things that drive innovation, productivity and economic growth at anywhere near the rate it needs to.

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It's a long-standing problem, and not just for the Atlantic provinces. Canada as a whole saw non-residential investment fall an average of 2.1 percent per year between 2015 and 2021. The country badly trails its peers — according to a 2022 C.D. Howe Institute report, Canada's non-residential investment spending per worker is just over half the level of the United States and about 27 percent below that of the Organisation for Economic Co-operation and Development (OECD) average.[4] "Having investment per worker much lower in Canada than abroad tells us that businesses see less opportunity in Canada, and prefigures weaker growth in Canadian earnings and living standards than in other OECD countries," says the report.

For research and development spending, the national trendline is somewhat better — BERD grew at an annual average rate of 4.8 percent from 2015 to 2020 in Canada as a whole — but Canada still sits in the bottom third of BERD spending as a share of GDP among OECD countries and is less than half that of the U.S.[5] For Atlantic Canada's BERD spending to be just 35 percent of an already dismal Canadian number does not bode well.

These are long-standing problems. In a March 2021 bulletin, the Atlantic Economic Council noted that firms in the region trailed the rest of the country in adopting business intelligence technologies like cloud computing and big data analytics tools, and that it lags in using Internet of Things technologies, cybersecurity and artificial intelligence.[6] It put the percentage of firms in Atlantic Canada using advanced technology at 37 percent, compared to 46 percent for Canada as a whole.

Canadian Manufacturers & Exporters (CME) has painted a similarly depressing picture for its sector. According a 2019 report, only 29 percent of manufacturers in the region were using advanced manufacturing technologies, compared to 40 percent nation-wide.[7] It cited Statistics Canada's Survey of Innovation and Business Strategy in noting that, from 2015-2017, 77 percent of Atlantic manufacturers reported introducing any kind of new innovation — the lowest rate in Canada. By comparison, 87 percent of Quebec manufacturers reported making new innovations and 88 percent of manufacturers in western Canada.

Just why Atlantic Canada should fall so short on business investment and R&D, and how it might reverse the trend, are important questions. Statistics Canada's survey said the two biggest obstacles to innovation were a lack of skills and "uncertainty and risk," followed by market size and internal financing. CME's members in Atlantic Canada said much the

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same, citing reasons for underinvestment that fell into four broad categories: labour skills and shortages; the high cost and uncertain return on investment; lack of information on new technologies; and an uncompetitive business environment, i.e. "rising business costs in the region are eroding profitability [which] leaves manufacturers with less money to invest."

Indeed, the small size of Atlantic Canada's market and the fact that it has proportionately more small businesses — which tend to invest less — than the rest of Canada, are two reasons for the region's performance. "Smaller businesses can't take advantage of economies of scale in the same way as bigger ones," says Fred Bergman, senior policy analyst at the Atlantic Economic Council. "It's an issue of scale and scope. That's some of what's in play here."

> **Immigration and immigrant retention have both improved markedly, with better momentum than the nation as a whole**

Research by the Fraser Institute points to government as a large part of the problem.[8] High taxes to fund an oversized public sector, it contends, squeeze business and leave the private sector with less money to invest and less room to grow. High personal tax rates are an issue as well, says Alex Whalen, the institute's associate director of Atlantic Canada prosperity, particularly when it comes to the innovation economy. "There are people behind these businesses. They are often highly educated people with technical backgrounds who are well paid. One key policy plank that I always go back to is the region's punishing tax rates on high performers. We have the highest top marginal tax rates in North America."

There are a myriad of government incentives and tax measures meant to encourage investment. There are Scientific Research and Experimental Development tax incentives from the federal government, as well as an Atlantic investment tax credit that allows businesses in a number of sectors, from manufacturing to fishing to new energy generation, to claim a 10 percent tax credit on capital investment in the region. Some provinces in Atlantic Canada enrich those federal programs and offer incentives of their own. There's a Nova Scotia Innovation Equity Tax Credit, a Newfoundland venture capital tax credit and a P.E.I. enriched investment tax credit for companies with a strong export focus. And, of course, there are always calls for more.

The good news is that the Momentum Index reveals a region where the conditions to create more investment and growth are improving. Immigration and immigrant retention have both improved markedly, with better momentum than the nation as a whole. University enrolment has risen dramatically in Atlantic Canada in recent years,[9] and was up another five percent last year, driven by a flood of international students — more than 70 percent of whom stay to live and work in the region.[10] The tertiary education rate, or the proportion of the population with post-secondary or trade training, is rising faster than for Canada as a whole and now sits at 95 percent of the national average, up from 89 percent in 2015.

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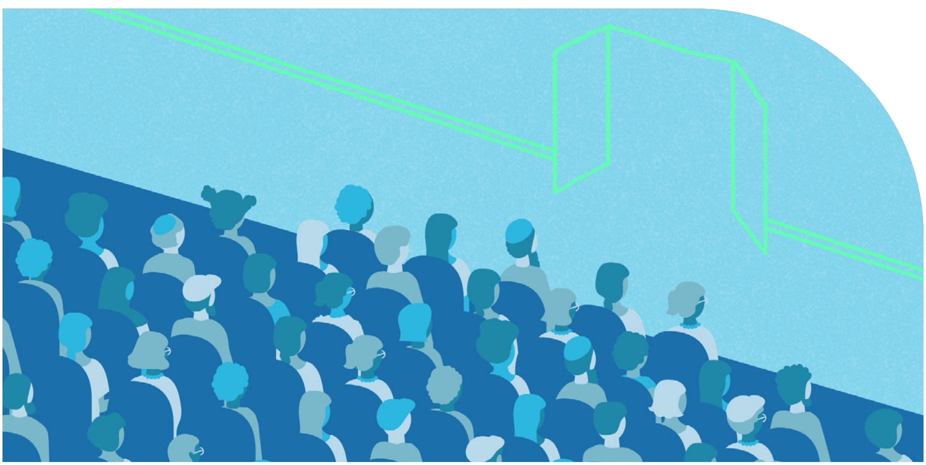

Bigger cities (Moncton and Halifax finished first and second among Canadian cities in population growth in 2021-2022[11]) will help lead to what's known as "agglomeration economies" — the advantages that come when more people and companies are squeezed together. If bigger markets and a smarter workforce are what's needed to give business the confidence and capability to invest, then those trends bode well.

Home prices jumped across Atlantic Canada during the pandemic, giving people a taste of the real estate frenzy other parts of the country have lived through

Which leads to a final trailing indicator in the Momentum Index, and one that's a particular challenge at the moment because of all that growth: housing starts. This one is a bit deceptive because it does have considerable momentum. Housing starts per thousand people grew at an average annual rate of 8.4 percent between 2015 and 2022, after having collapsed in the previous period. But that recovery masks the fact they are still running at 77 percent of that national average, better than 2015 but still below 2008 (and 2000 for that matter).

This feeds into a housing crisis the region is suddenly grappling with. Home prices jumped across Atlantic Canada during the pandemic, giving people a taste of the real estate frenzy other parts of the country have lived through and causing a good deal of angst. Prices have since moderated, but the region saw soaring rents in 2023. In Halifax the average two-bedroom rent was up 11 percent and the vacancy rate was at one percent for the third straight year, according to the Canada Mortgage and Housing Corporation (CMHC)[12]. The housing supply shortage is really focused on Nova Scotia, the biggest province. A recent study puts the shortage at 27,300 housing units in the province,[13] and CMHC estimated it's on pace to be 70,000 homes short of what it will need by 2030.[14]

In October, the province announced a five-year plan to address the problem, including more public housing, more provincial control over project approvals in Halifax and a tax break for apartment construction.[15] The Halifax Regional Municipality has already taken some measures, getting rid of minimum dimensions for single-unit homes to make way for more smaller houses, and changing bylaws to allow for rooming houses in all residential areas.

If Atlantic Canada can maintain its momentum on housing starts and close the considerable gap with the rest of Canada, that will help build on still other advantages the Momentum Index revealed — the region's life satisfaction scores, the sense of belonging to the community that its people report — and draw yet more population and investment to the region. Still, a tight real estate market is not perhaps the worst problem for Atlantic Canada to have — it's a by-product of growth and renewal, after all, of a region not so white and not so poor anymore.

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