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Senators, you are to be congratulated for using your position as distinguished public representatives for deliberating on this important issue. Improving productivity matters because without at least matching the output per worker of competitor nations, the very economic foundation of our social contract in Canada is in jeopardy.

From the perspective of a public policy "think-tank" headquartered in Atlantic Canada, the Atlantic Institute for Market Studies (AIMS) has seen first hand the pernicious impacts of declining productivity. Atlantic Canada's challenge in accomplishing economic convergence with the rest of Canada is parallel to the overarching challenge of improving national productivity. Barriers to greater prosperity in Atlantic Canada can be grouped into three categories: public policy barriers; human capital barriers and barriers to the adoption of new technologies. To be sure, these do not function in isolation, but they do have distinct characteristics.

Over the past few years AIMS has published extensively on these subjects. In particular, AIMS released a series of studies on equalization, most noteworthy of these is a study titled: *Taxing Incentives*, which deals with the provincial tax impact of equalization. The study's author concludes that equalization receiving provinces tend to have higher tax rates, and tend to impose heftier taxes on weaker tax bases, than do provinces that receive little or no equalization. The type of high taxes found in most equalization receiving jurisdictions is one public policy barrier currently hampering productivity growth.

On top of equalization, the federal government has piled a system of regional subsidies and support. As of this year, the federal government will provide $1.8 billion to help support industries in economically disadvantaged regions of the country. In the case of Atlantic Canada, the biggest of these regional agencies, the Atlantic Canada Opportunities Agency, has played a dubious role in the region's economy. Although ACOA is often touted as bringing productive innovations to the region, more often than not the agency's grants and contributions have added to the region's productivity challenges.

Rather than increasing the available pool of investment capital, ACOA's "free money" has pushed out investors who cannot compete with the agency's terms – namely low cost borrowing. As a result, firms pursuing innovations tend to balk at ACOA's bureaucratic approach, but face diminished options for securing private capital investment. That fact is not surprising in part due to the higher than average provincial capital and business tax rate levied in Atlantic Canada.

At the other extreme, regular – almost revolving door-like – support from ACOA has propped up unresponsive and uncompetitive firms. Rather than rewarding innovation, ACOA does the opposite often helping to offset a firm's higher production costs with a grant from Ottawa. A key measure touted by ACOA is the prospect for a grant or contribution to have maintained jobs. Rather than actually contributing to more employment, this measure and emphasis is almost a sure sign the agency is propping up low-productivity companies at the expense of an excessive tax burden on both productive workers and companies.

In both of these cases, less intervention would contribute to higher productivity, but more importantly, the menu must be rearranged to encourage more fiscally responsible provincial policies, lower business and capital taxes and an end to propping up firms that are not productivity innovators.

The last public policy barrier, labour policy, eventually bleeds into the realm of human capital. Employment Insurance is the most hotly charged and paradoxical program in Atlantic Canada. It is hotly charged, as many fear altered benefits or reduced benefits will be the death knell for many small rural communities. It is paradoxical in that the EI system has actually added to labour shortages, despite high regional levels of unemployment. The problem is that EI is not the last line of defence against economic decline, but rather EI has entrenched that decline.

Generous benefits and relaxed entry into the EI system is not only hurting business productivity and rational business investment, but it is also harming investment in human capital. Rather than encouraging businesses to opt for more productive marshalling of resources and investment, the system subsidizes low wages and the status quo. In effect, investing in more productive business systems is more costly than retaining partial employment and smaller wage bills, as long as workers have their income supplemented by EI. Similarly, workers do not upgrade or invest in new skills because there are limited opportunities to get a return on the investment and any marginal work prospects are offset by the income support provided by EI. The resulting business and labour environment is then reduced to equal parts of rational economics and rational culture.

In some regions, at key points in the year and in certain industries, there are substantial labour shortages despite the highest rates of unemployment in the country. It is paradoxical that in times of high unemployment, employers have difficulty filling positions. But that's exactly what happens throughout Atlantic Canada.

There a many examples of this happening in the region, with newspaper headlines and industry groups sounding the alarm and bemoaning the inability to fill key jobs. It is at this point that the continuum of public policy decisions is clearly not arrayed to favour economic growth and productivity. High taxes discourage investment, business subsidies chase out remaining private investment, employment shortages discourage business investment, workers earn less, acquire fewer new skills, pay less tax, and local economies suffer along with provincial governments' fiscal capacities.

Finally, the failure to adopt new technologies is a logical outgrowth of the other challenges faced by the region. Aquaculture is a good case in point. Although there has been some movement in the industry, the regulatory and policy environment has substantially discouraged the adoption of industry changing technology. Senators, I encourage you to read the many papers published by AIMS on the aquaculture industry to more fully comprehend the damage this has done to this indsuty.

At the extreme, the current gatherer mode of fishing could be replaced by a more efficient farming mode of production. By changing the production patterns of fishing, secondary fishing industries could also change, and adopt new technologies. Then there are spill-over effects, where a vibrant aquaculture industry supports a plethora of technological innovations in biotechnology, pharmaceuticals and environmental technologies. However, without that keystone industry, nothing happens. Rationalizing the regulator and property environment around aquaculture is directly relevant to Atlantic Canada, but it is also an example of larger national barriers to new modes of production and innovation.

Some will argue that big government programs, like rural broadband and environmental regulations will help Canada acquire and develop "the next big thing." But if the experience of Atlantic Canada is any indication, government would do better to get out of the way and stick to its key role, which is ensuring both physical and intellectual property rights, encouraging investment in human capital and attracting people and investment.

Fundamental reforms to equalization and employment insurance must be adopted. The work of the expert panel may offer an opportunity to make the following key changes to the program: remove natural resources from the calculations of fiscal capacity; move to a ten province standard; cap payments to 90 per cent of the average fiscal capacity; and set aside a portion of funds for debt swaps for those recipients that actually balance their books.

This would remove disincentives on the development of natural resources, discourage equalization as a long-term solution, and would reward such sensible provincial policy as balancing the books every year. Ultimately the best thing for equalization is to reward good provincial policy decisions, such as lowering income and capital taxes, which ultimately raises provincial capacity so that the program gradually puts itself out of business. As it stands, the program is an impediment to productivity growth in all receiving provinces, and does not contain the right incentives to encourage greater productivity.

Rather than continuing to encourage seasonal employment, early unskilled entry into the workforce and labour shortages, EI must be returned to its original intent as temporary income support program. To that end, area ratings should be eliminated, intensity rules imposed so that benefits decline each time a recipient returns for another round of EI, and finally initial requirements for EI qualification should be increased to discourage new workers from entering the workforce without sufficient training and long-term job prospects.

Moreover, deeper reforms should include higher premiums imposed on employers that frequently lay-off employees which would encourage greater productivity. In the United States, State Unemployment Insurance rates vary with frequency of use. For example, Maine's system penalizes employers that do not retain their workforce. When compared to neighbouring New Brunswick, Maine's unemployment rate is generally lower One of the reasons? Maine employers are less likely to hire workers for short term periods because they are forced to pay a heavier burden for unemployment. In the Canadian system, employers all pay the same EI premiums regardless of their tendency to retain, or dismiss workers.

Corporate taxes and corporate capital taxes at the federal level must continue to decline. Indeed, opting to eliminate harmful regional subsidies in favour of lower corporate taxes would be a positive step. As an example, the current $2 billion spent by these programs translates into a one percentage point reduction in the general corporate tax rate. Or instead of a general reduction in corporate rates, these programs could be eliminated in favour of regionally specific capital tax exemptions and or regional specific general tax reductions. However, these sorts of regionally specific programs must be short-term solutions aimed at eventually bringing the rest of the country to this lower corporate tax regime.

You may wonder whether such a policy actually works. It does. Take the case of Ireland. There a similar approach was used, wherein small and specific tax reductions leveraged growth and eventually allowed for broader and deeper reductions. And of course Ireland now stands as an example of a jurisdiction that was able to bring about a marked, and remarkable, economic turnaround.

The federal government can and should take a lead in fostering a favourable property rights regime. Not just safeguarding physical property, but also safeguarding intellectual property. Those industries that lead in productivity, that lead in the introduction of productive innovations, all require an effective, high level of protection for physical and intellectual property rights.

Without a concerted effort on all of these fronts, improved productivity will continue to elude Atlantic Canada and Canada at large.