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The impact of competition on productivity

Sink or swim: Many believe that the pressure of freer trade spurs innovation.

“...our productivity and innovation track record have been uninspiring. Expanded trade will have a huge impact on our innovation efforts and their success.”

-Institute for Competitiveness & Prosperity, 2010

Canada's and Ontario's well-being has long been linked to international trade. At present, the growth of China, India and other developing economies provides opportunities for further tapping this wellspring of prosperity. But are Canadians ready?

A 2010 working paper of the Institute for Competitiveness and Prosperity entitled “Trade, Innovation, and Prosperity”

argues that Canada and Ontario need to step up their efforts to expand trade. The Council of Canadian Academies reached a similar conclusion in a 2009 report. These and other experts point to freer trade as one way in which Canada can overcome a major productivity obstacle: a small domestic market (made even smaller by barriers to interprovincial trade) that limits growth and efficiency.

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Still leery after all those years...

Polling carried out more than a decade after NAFTA was put in place showed that four of five Canadians believed free trade benefited large corporations in Canada. Overall, respondents were split evenly between two competing views: benefits go “mostly to large corporations and wealthy investors” versus “most Canadians benefit through jobs, taxes companies pay, and a better selection of goods.” On the other hand, most respondents recognized that the jobs at risk from freer trade were lower-wage and less skilled.

Source: “Canadian Attitudes to International Trade,” Ekos 2002

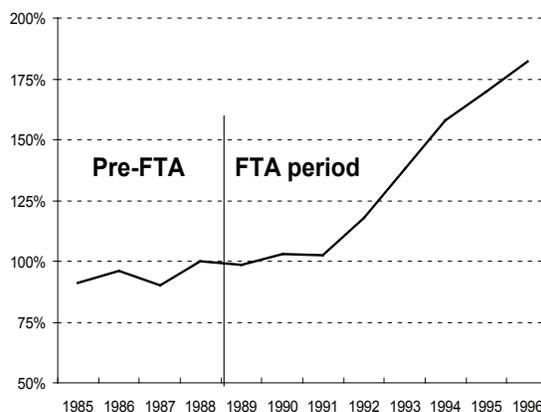
Why freer trade matters

Freer trade offers domestic firms a carrot and a stick: access to new markets balanced against the pressure of opening their home market to new entrants. There is little question about the benefits of a wider export market. Numerous studies have shown that exporters invest more in R&D and training to build their human capital, and adopt more advanced manufacturing technologies. But what about the role of competitive pressure?

Several agreements over the past several decades, of which NAFTA is the centerpiece, have brought more liberal trade to Canada, despite initial (and in some cases ongoing) resistance based on concerns about the disruptive impacts of increased competition.

A recent study for the U.S. National Bureau of Economic Research (Working Paper 13297), however, finds evidence for the benefits of freer trade.

Figure 1. Manufacturing exports to the U.S.



Source: National Bureau of Economic Research Working Paper 13927

Pathways to Productivity

ECONOMIC SYMPOSIUM

Low-productivity manufacturing plants in Canada that decided to enter the free-trade fray significantly boosted their output per worker. And the plants that invested heavily in innovation and technology, in line with their decision to export, were the big productivity gainers. This contributed to a boost in Canadian manufacturing exports to the U.S. over the 1990s, as shown in Figure 1.

Be nimble, not fearful

Since NAFTA, bilateral trade agreements with Jordan, Costa Rica, Colombia and Peru have moved Canada further towards a more open marketplace. Currently, discussions are under way to expand trade with the European Union and India.

“It has always been easy to convince governments of the virtue of opening up foreign markets. Opening up one’s own market, however, is a much more contentious proposition.”

- L. Ian MacDonald, *Free Trade: Risks and Rewards*

will soon reach an “innovation tipping point” and concludes that “to ensure our future prosperity in Canada, we need to engage with these emerging economies and step up our own innovation capabilities.”

Growing trade and low-priced imports will inevitably create challenges for low value-added industries and companies. Firms that learn from the lessons of NAFTA will embrace export markets and make the investments that are needed to boost their productivity.

“Trade, Innovation, and Prosperity,” published by the Institute for Competitiveness and Prosperity, recommends that Canada look further afield: in its view, China and other emerging economies

Factors that influence Canada’s competitive environment:

- Small domestic market and geographic fragmentation
- Interprovincial trade barriers
- Complacency of established incumbents with market share

Benefits to opening trade:

- Opens up new markets and makes Canadian exports more competitive
- Fewer trade restrictions mean that Canadian businesses can import foreign goods for less money, including capital equipment that can raise productivity

Source: Institute for Competitiveness & Prosperity, 2010

“Our global leaders have achieved success largely through innovation and by being challenged by global competition.”

-Institute for Competitiveness & Prosperity, 2010

Resources:

- National Bureau of Economic Research Working Paper 13297
- Institute for Competitiveness and Prosperity: Today’s innovation, tomorrow’s prosperity, 9th Annual Report for Ontario
- Institute for Competitiveness and Prosperity: Trade, Innovation, and Prosperity - Working Paper 14
- TD Financial Group: Economist’s Manifesto for Curing Ailing Canadian Productivity
- Council of Canadian Academies: Innovation and Business Strategy, Why Canada Falls Short
- Industry Canada: Business Sector Productivity in Canada: What do We Know?