Pathways to
Productivity
ECONOMIC SYMPOSIUM

TOPIC C

Closing the productivity gap

How can Canada's industrialized provinces boost productivity?

Canada's situation in terms of productivity and hence its standard of living is worrisome. The Centre for Productivity and Prosperity, at the Ecole des Hautes Etudes Commerciales in Montreal, has been asking why. While its work has a Quebec focus, the Centre believes that many of the problems, and potential solutions, apply to Ontario as well.

A productivity patchwork

Measured at a high level by output for each hour of a worker's time, Canada as a whole does not score badly against other economies – within the top dozen, depending on data source and time period.

"Productivity isn't everything but in the long run it is almost everything. A country's ability to improve its standard of living over time depends almost entirely on its ability to raise output per worker."

-Paul Krugman (1990), winner of the 2008 Nobel Prize in Economics

But drill down, and a different picture emerges, as Figure 1 shows. Resource-rich Alberta skews the number significantly higher than it would be otherwise.

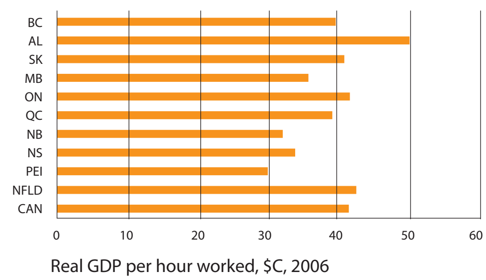
Rising energy prices have also helped provinces like Newfoundland and Saskatchewan, with their relatively small populations, boost their GDP per worker-hour.

Quebec and Ontario, traditionally the heart of Canada's manufacturing and service industries, are now in the middle of the productivity pack. Taken alone, their output numbers – both around $40 an hour – would move them way down the international productivity standings. GDP for each hour worked topped $50 U.S. in Norway, Belgium, the Netherlands, France and the U.S. in 2006, according to the International Labour Organization.

Don't blame the economy

Research done for the Centre's 2010 Overview suggests that productivity and standard of living issues are not due to current economic conditions, but have more to do with structural factors that are hard to change in the short term.

Figure 1. Resource endowments skew productivity average



Source: Centre for the Study of Living Standards

Labour productivity has almost always been the main source of the standard of living gaps between central Canada and the United States, the Centre says, and the problem is likely to intensify.

A greying population

One factor of concern for both Ontario and Quebec is demographics. Even if output per worker is stable, adding more workers increases the output of an economy. But in both Ontario and Quebec, an aging population will soon place serious pressure on that source of growth. Improving labour productivity represents the only reliable way to compensate. This would mean, however, reversing a continuing decline over the past several years.

Three sets of players help determine how a society performs in terms of productivity and prosperity:

- Individuals, through their decisions to invest in education and training.
- Businesses, through their decisions to invest in their human capital, in equipment and machinery, and in research and development.
- Governments, through the legislative, regulatory and taxation systems.

Firing up Productivity – What about more Foreign Direct Investment?

Canada ranks among the most restrictive countries in the OECD towards foreign direct investment. Researchers at the Centre for Productivity and Prosperity see this as cause for concern.

Why they believe more foreign direct investment would be a good thing:

Imitation: Local enterprises can improve their productivity by imitating a multinational's production processes, technologies, management practices and marketing techniques. This may occur when a local enterprise interacts with a multinational as a supplier or as a client.

Technology adoption: The increased competition created by the arrival of multinationals may spur local enterprises to make more effective use of their existing technologies and adopt new ones sooner.

Skills transfer: Multinationals typically invest more in personnel training than local enterprises. Multinational employees who then move to local enterprises take their knowledge with them.

Access to new markets: The presence of multinationals may pave the way for local enterprises to tap into the export business, enhancing the productivity of local enterprises.

Sectors like telecommunications are key: The spillover benefits of foreign direct investment have been observed in many countries. To happen here, major restrictions must be removed, especially in sectors like telecommunications, a key player in the economy.

Invest in ICT: Information and communications technologies are changing the relationship between individuals across space and time and altering consumer behaviour. Borders are being erased, new markets are appearing, and opportunities multiplying. New technologies can themselves generate innovation. But they must be accompanied by intangible investments requiring companies to rethink their business models.

> "… while research leads to new ideas, it takes more to turn these ideas into innovation. In this respect, Canada falls short. Simply replicating or extending past policy efforts won't solve the problem. What is needed is a complete reset on innovation in Canada.."
>
> - Public Policy Forum, 2011

Blame Canada's exports?

Canada's "abysmal" growth in labour productivity might be explained by falling demand for Canadian exports, according to the Centre for the Study of Living Standards (International Productivity Monitor, Fall 2010). Their findings show Ontario as being most affected.

Manufacturing was the industry most responsible for the decline, contributing more than half of the 2.1 percentage point fall-off in growth between the periods of 1997-2000 and 2000-2007, researchers concluded. Transportation equipment and computers and electronics accounted for the lion's share.

These findings hit Ontario hardest because so much of the manufacturing sector is located in the province. As a result, Ontario accounted for 62 per cent of the country's slowdown in aggregate economy output per hour growth over the period. Quebec and B.C. also contributed to the decline, but their impact was only a fraction of Ontario's.

Source: Centre for the Study of Living Standards

Resources:

- The Centre for Productivity and Prosperity, 2010 Outlook
- The Globe and Mail Report on Business and KPMG: The 20th Quarterly C-Suite Survey: Canada-US Economic Outlook, Productivity and Innovation
- Council of Canadian Academies: Innovation and Business Strategy: Why Canada Falls Short: Report of the Expert Panel on Business Innovation
- Institute for Competitiveness & Prosperity: Management Matters in Retail-Working Paper 1
- Institute for Research on Public Policy Canadian Priorities Agenda, Brief No. 8: Three Policies to Increase Productivity Growth in Canada
- Centre for the Study of Living Standards International Productivity Monitor: Insights into Canada's Abysmal Post-2000 Productivity
- Centre for the Study of Living Standards: Performance from Decompositions of Labour Productivity Growth by Industry and Province
- Centre for the Study of Living Standards International Productivity Monitor: Why Are Americans More Productive Than Canadians?
- The Public Policy Forum: Innovation Next: Leading Canada to Greater Productivity, Competitiveness and Resilience