Some Thoughts on Canada's 'Productivity Emergency'[1]

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Earlier this year, a senior Bank of Canada official took the unusual step of publicly referring to Canada's stagnant productivity as an "emergency." And recently, Bank of Canada Governor Tiff Macklem reinforced the message by describing lagging productivity as Canada's "Achilles' heel".[2]

It is encouraging that the issue of productivity is now in the spotlight. Boosting productivity is the only way to deliver sustainable increases in real incomes and improvements in living standards, particularly in the long-term. It is therefore disconcerting that Canada has been struggling to make gains on this core indicator of prosperity. From 2019 through the end of 2023, the level of productivity in Canada actually declined, while advancing by 6% in the United States over the same period. Today, Canada ranks 18th globally in the level of overall productivity.[3]

Productivity is the amount of "output," or gross domestic product (GDP) adjusted for inflation, that the economy produces using a given quantity and mix of "inputs." For any individual industry, GDP captures the "value-added" of its production. Labour is a key input in the production process, and most discussions of productivity focus on "labour productivity" -- real GDP per hour worked. It can be estimated for the entire economy, the aggregate "business sector," or specific industries. For cross-country comparisons, labour productivity is the most commonly used measure.

In 2023, labour productivity in Canada stood at Cdn$63.60 per hour (in 2017 dollars). Industries with above average levels of productivity include oil and gas, pipelines, motor vehicle and parts manufacturing, aerospace manufacturing, lumber and pulp and paper manufacturing, telecommunications, and professional, scientific and technical services; those with below-average levels of productivity include accommodation and food services, retail trade, construction, and personal and household services. Owing to the absence of market (selling) prices, it is difficult to measure productivity in the public and non-profit sectors. Instead, analysts often estimate productivity by valuing the "inputs" used in non-market sectors.

Over time, there is a clear positive linkage between productivity in an industry and the wages and non-wage benefits paid to employees in that industry. The most productive industries, on average, pay their workers more -- an empirical relationship that is well-supported by recent U.S. and Canadian research.[4] As

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[1] Those interested in the sources used for this note should contact the author at Jock.Finlayson@icba.ca
[2] "Workers, jobs, growth and inflation – today and tomorrow," speech by the Governor of the Bank of Canada to the Winnipeg Chamber of Commerce, June 24, 2024.
[3] "What is productivity? And why is it such a problem in Canada?" Public Policy Forum, April 3, 2024.
[4] David Williams, "Pay and Productivity in Canada: Growing Together, Only Slower Than Ever," International Productivity Monitor, 2021.

noted in a February 2024 RBC Economics report, productivity growth is "essentially the only way that business profits and worker wages can sustainably rise at the same time."[5]

Until approximately 2000, Canada generally held its own against the United States on productivity in the broadly defined "business sector" (consisting of industries where government, in some capacity, is not the dominant supplier of goods or services).[6] Since then, we have been steadily losing ground vis-à-vis the U.S. By 2022, labour productivity in Canada's business sector stood at just 70% of the U.S. benchmark, down from 85-90% in the 1980s and early 1990s.[7]

An ever-expanding productivity gap has negative implications for future gains in real wages and incomes in Canada, compared to the United States. Among other things, it heightens the risk of a further widening of disparities in the economic returns to skills, the acquisition of credentials, entrepreneurial effort, and capital investment on our side of the border, relative to our principal trading partner and competitor for talent and capital.

Lifting Productivity

Turning around Canada's lacklustre productivity performance is a key challenge for policymakers and business leaders alike. There is no silver bullet. However, a review of Canadian and OECD academic and policy studies published over the last 5-10 years suggests the following steps can help to put Canada on a better productivity growth trajectory:

- Increase business non-residential investment in productive assets and activities, including both tangible and "intangible" capital. Canada scores poorly relative to other advanced economies on non-residential capital investment, including in the categories of 1) machinery, equipment and advanced technology products; 2) intellectual property; and 3) research and innovation.[8] We score better on investment in structures.
- Increase investment in trade-enabling infrastructure such as ports, highways, railways and other transportation assets that link Canada with global markets and facilitate the efficient movement of goods and services within the country.
- Overhaul federal and provincial tax policies to strengthen incentives for capital formation, innovation, entrepreneurial wealth creation, and business growth. In my view, this requires reducing Canada's current heavy reliance on income & capital taxation, and shifting more of the tax burden to consumption and other "non-mobile" activities and factors of production.

[5] Nathan Janzen, "Proof Point: Weak productivity is threatening Canada's post-pandemic wage surge," RBC Economics, February 28, 2024.
[66] To be clear, Canada has consistently trailed the U.S. in both economy-wide labour productivity and labour productivity in the broad business sector. But until the 2000s, the gap was not generally widening.
[7] Andrew Sharpe and Tim Sargent, "Finances of the Nation: The Canadian Productivity Landscape – An Overview," Canadian Tax Journal, volume 71, no. 4, 2023.
[8] See the annual investment tracking reports produced by the C.D. Howe Institute for details. In recent years, Canadian businesses, collectively, have been investing only 55-65% as much as their American counterparts, measured on a per worker basis.

- Streamline and reduce the cost and complexity of government regulatory frameworks affecting all sectors of the economy – notably natural resources, construction, manufacturing, transport, digital services, and infrastructure development.
- Foster and nurture competition across the economy, and scale back the extent and role of government monopolies and government-sanctioned oligopolies.
- Eliminate interprovincial restrictions on trade, investment and labour mobility to bolster the Canadian “common market.”
- Ensure that public policy does not undermine the economic viability of our high-productivity sectors – which make an outsized contribution to Canada’s prosperity. This includes oil and gas, mining, and some segments of manufacturing.