Productivity key to increased personal — and national — luxuries

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If you’re like most people, the mere mention of economic policy leaves you a little glassy eyed.

What if, however, you were told most of your mortgage or all of your rent could be paid off instantly, or you could send your kids to a national daycare program? Still bored?

Yet that’s exactly what could have happened if Canada didn’t have a productivity gap with the U.S., according to Roger Martin, dean of the University of Toronto’s Rotman School of Management.

For most of the past three decades, Canada’s economy has shown less productivity growth than that of our southern neighbours. What that means in simple terms is that each hour worked in this country produces less economic benefit than one worked in the U.S.

The impact for the average Canadian is less money in their pocket, according to Martin, who says the productivity gap has led to a prosperity gap.

“If we got our prosperity back to where it was 30 years ago, people would have a lot more money in their pockets. That would generate more tax revenues for all levels of government,” said Martin, chairman of the Task Force on Competitiveness, Productivity and Economic Progress. The task force, funded by the provincial Ministry of Economic Development and Trade, monitors Ontario’s economic performance.

Martin pointed to research by the Institute for Prosperity and Competitiveness, which shows that Canada trails the U.S. in GDP per capita by $9,300. In 1981 that gap was only $2,600. If we got back to the 1981 gap, the average family would see their disposable, after-tax income go up by $8,800, according to the institute, which is the research arm for the task force chaired by Martin.

“That would be like having almost all the mortgages and rental payments disappear. It would be like having enough money to pay for a national child-care program and still have enough left over for the biggest tax cut in history,” said Martin.

Lest you assume productivity gains are more a concern of free marketers and other pro business forces, that extra income would generate another $76 billion in tax revenue for various levels of government, according to the institute. That would be enough to pay for a national daycare program, fund the healthcare recommendations by the Romanow Commission, cover the cost of Canada’s commitments under the Kyoto Accord, and pay for a $55 billion tax cut.

In a 35-country study of productivity by the Organization for Economic Cooperation and Development, Canada was in the middle of the pack, with Luxembourg leading the pack. The U.S. was fourth. Canada was dead last in the G7, slightly behind Italy. Canadians generate $43.30 in Gross Domestic Product per each hour worked, while people in Luxembourg generate $74. Americans generate $57.40, while Germans generate $53.30.

So what’s behind the gap? That depends on who you ask.

Canada’s resource boom, a lack of innovation by Canada’s businesses, and a lack of investment in new, more efficient equipment are the three biggest causes, according to Jim Stanford, an economist with the Canadian Auto Workers union.

Extracting resources such as oil from the ground might be a good money maker, but it’s labour-intensive and not particularly efficient, says Stanford.

“All those resources are hard to find. . . . By becoming more focused on resources, we’ve hurt our productivity numbers.”

The tar sands are particularly bad for productivity numbers because of the sheer amount of time and effort of extracting the oil, Stanford said.

“We used to be known as hewers of wood and drawers of water. Now we’re hewers of wood and scrapers of tar.”

When it comes to designing and producing new, innovative products, Canadian companies are laggards, says Stanford. Innovative products tend to draw higher prices – Research in Motion’s BlackBerry smartphones being one successful example.

“RIM is the exception, not the rule. We need 30 RIMs,” said Stanford.

That lack of innovation can also partly be blamed on the size of Canada's resource sector, Stanford says.

"Because it's easy to make big amounts of money extracting and exporting resources; businesses haven't had to innovate. Our abundance of natural resources is actually something of a curse," Stanford said.

In a recent speech, Bank of Canada deputy governor Tiff Macklem pointed out Canada's businesses fared poorly in international studies on research and development spending.

"In business sector spending on R&D, Canada ranks a disappointing 17th among OECD countries, and when it comes to innovation, the World Economic Forum rates us 19th, far behind the United States, Germany and Japan," Macklem told a Calgary audience. Macklem also pointed out Canadian companies don't spend much on new, efficient equipment. That means it takes a Canadian longer to make whatever's being produced, whether it's clothes, widgets or iron ore. That pushes down productivity.

Free market boosters such as the right-wing Fraser Institute say Canadian companies are reluctant to invest in new equipment or R&D because high taxes make it not worth their while.

"Higher corporate income tax rates decrease the after-tax rate of return that investors receive. That reduces their incentive to invest and grow and leaves firms with less money for productivity-enhancing investments in plants, machinery, equipment, and new technologies," Fraser Institute analyst Charles Lammam wrote last year.

But Stanford doesn't buy that suggestion. He points out corporate taxes have dropped from 29 per cent to 16.5 per cent in the last 20 years, and capital investment dropped anyway.

"It will take a lot more than just freeing our private sector. … None of that works. In fact, it takes a deliberate state strategy," argued Stanford, pointing to countries such as Finland.

Still, no matter how quickly a car or widget is made, it doesn't matter if no-one wants it, says Martin. Price can have as big an impact on productivity statistics as any kind of gains in efficiency.

"Economists, policy makers and corporations have been too focused on the denominator, and not enough on the numerator. … People always say 'gee, it's too bad that auto plant closed, even though it was really efficient and made things quickly.' Well guess what? If the price of the car gets cut to $10,000 because it's something nobody wants to buy, that affects productivity numbers too."

Productivity growth

BY THE NUMBERS

0.4% Canada's average annual productivity growth, from 2001-2010

1.2% Average annual productivity growth in 35-country OECD study

1.8% U.S. average annual productivity growth

29th Canada's ranking in OECD study

GDP per hour worked

IN U.S. DOLLARS, IN 2009

SOURCE: OECD Economic Outlook