Canada has a long-term productivity problem
Our rising incomes disguise the fact that we aren't doing as well as we should

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Canada might or might not have a short-term economic problem with recession. We'll know soon. We certainly do have a long-term problem with slow productivity growth. From 2002-2006, our lagging productivity growth meant that while Americans' inflation-adjusted income rose by fully 8.1 per cent, ours rose by only - well, er, actually ours rose by 14.3 per cent, nearly double the U.S. increase.

But, trust me, we do have a productivity problem. I'm afraid the explanation for this paradox has to do with national-income accounting, the most "eat-your-spinach" part of economics. I'll try to make the ingestion as painless as possible.

If you look at how much stuff we produced between 2002 and 2006, measuring it in barrels of oil, billions of cubic feet of natural gas, numbers of Blackberries, pickup trucks and all the other things Canadians produce, the total of all that stuff only went up 7 per cent, vs. 9.3 per cent in the States. They beat us.

Moreover, we had faster employment growth than they did, which means they got more output adding fewer workers. Their output per worker - their productivity - grew even more quickly compared with ours than their total product did. So we do have a problem.

But why worry? Be happy! Didn't our income rise faster than theirs?

How can that be? We aren't producing that much more stuff year to year. But the world has bid up the price of many things we do produce. It's no longer true that we mainly produce raw materials - we mainly produce cars - but we still do produce lots of raw materials. And the prices of most of them have been skyrocketing. So though we're not producing that much more in physical terms, we can trade what we're producing for lots more imports, and that raises our living standards.

According to Statistics Canada, this "trading gain" added fully 5.3 percentage points to our growth from 2002 to 2006, bringing it to 12.3 per cent. Because Americans don't export as many commodities they suffered a "trading loss" over the same period.

A second thing working in our favour is the difference between our "domestic income" and our "national income." You might have wondered (if you're desperate for things to wonder about) why economists sometimes talk about gross national product (GNP) and other times about gross domestic product (GDP).
Canadian GDP is what is produced within Canada's borders, whoever does the producing. Canadian GNP is what is produced by Canadians, wherever they produce it. Some of what's produced here (our GDP) is produced by foreign capital invested here. Some of what Canadians produce (our GNP) we produce elsewhere, the result of investments we've made in other countries.

For 400 years foreign investment coming into Canada exceeded Canadian investment elsewhere, so our GDP exceeded our GNP: What was produced here created more income for foreigners than our foreign investments created for us. But since the mid-1990s we have been investing more outside Canada than foreigners have been investing here. The income flows associated with foreign investment have begun to turn around. There's not quite a net inflow into Canada yet, but it's getting close.

In the U.S., meanwhile, the opposite has been happening. Foreign money has been flooding in while U.S. investment overseas has slowed. Over the last five years our income numbers got a two-percentage-point boost from this GDP/GNP effect. Theirs actually went down slightly.

Bottom line? Should we worry about our productivity or not? Well, we're Canadians so of course we should worry. The big run-up in commodity prices that has boosted our income growth beyond our output growth probably won't repeat itself. In fact, if there does turn out to be a recession this year, commodity prices might fall, which means we'll suffer a "trading loss" instead of a "trading gain" and our productivity problems will again be revealed.

In the long run, our productivity determines how well we live. But it's hard to persuade people they have a productivity problem when their income is rising so nicely.

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