

# Editor's Overview

This seventh issue of the *International Productivity Monitor* produced by the Centre for the Study of Living Standards contains seven articles. Topics covered include Canada's long-run economic performance and prospects, the impact of capital accumulation on productivity growth in Canada, differences between Gross Domestic Product and Net Domestic Product, future productivity growth in Canada, and the OECD growth study.

Readers are reminded that in addition to the hard-copy version of the *Monitor* available in English and French, all articles are available online at [www.csls.ca](http://www.csls.ca) under the *International Productivity Monitor*. Unabridged versions of many of the articles are also posted. Comments on the articles are welcome.

With a new government assuming office early in 2004, economic policy directions for Canada may change. In the lead article, **Peter Nicholson**, who until recently served as advisor to the Secretary General at the OECD and is currently serving as policy advisor to Paul Martin, discusses Canada's long-run economic performance, prospects, and policy priorities based on the framework and insights that emerged from the recent study of economic growth released by the OECD. He argues that Canada has performed remarkably well since the mid-1990s, and that by the pro-growth policy prescriptions developed by the OECD, Canada is doing most things right. However, Nicholson points out that our productivity gap relative to the United States is still large and growing and that finding ways to increase productivity growth is an increasing social and political necessity.

Nicholson develops a scorecard on Canada's economic performance based on a three-star rating scheme. He gives Canada three stars for sound macro policies, human capital, and exposure to trade, two stars for productive investment, and one star, or perhaps a little better, for innovation. Despite this strong performance, Nicholson cautions against complacency, partic-

ularly given the demographic challenge the country will be facing in the years to come.

A key source of labour productivity growth is increased capital intensity of production that arises through capital accumulation. In the second article, **Someshwar Rao, Jiamin Tang** and **Weimin Wang** of Industry Canada examine the impact of capital accumulation on Canada's recent productivity record. A key finding is that the widening of the Canada-U.S. labour productivity gap in both the business sector and in manufacturing in the second half of the 1990s was largely due to the widening of the capital intensity gap between the two countries.

Indeed, the authors find that in the business sector multifactor productivity growth in the two countries was virtually identical at around 2 per cent per year in the 1995-2000 period. This situation is explained by the marked slowdown in the pace of capital intensity growth in Canada after 1995. This development reflected the increased cost of capital relative to labour in Canada, in turn the result of higher prices for investment goods because of the depreciation of the Canadian dollar and low wage increases due to high unemployment. With the recent appreciation of the Canadian dollar and the expected decline in unemployment, the authors project in the medium-term a narrowing of Canada's capital intensity gap with the United States and hence a reduction in the labour productivity gap.

The most widely used measure of economic activity or growth is Gross Domestic Product (GDP). In the third article, **Roland Spant**, a

Swedish trade union economist, argues that Net Domestic Product (NDP) should replace GDP as a measure of economic growth for a number of purposes. The key difference between GDP and NDP is depreciation. With the shift in investment toward information technology assets with relatively short service lives, the share of depreciation in GDP has increased in most OECD countries and GDP growth now exceeds NDP growth. Spant points out that this means that the use of GDP leads to the overestimation of real output growth as well as the potential for non-inflationary real wage gains.

The key determinant of future growth in living standards in Canada will be the rate of growth of labour productivity. This issue of the *Monitor* contains a symposium of three articles that address the likely developments in this area, and factors behind these developments.

The first contribution to the symposium by **Thomas Wilson** of the University of Toronto presents forecasts based on the FOCUS macro-econometric model of the Canadian economy. This model projects labour productivity growth to grow at an average annual rate of 1.7 per cent over the 2002-2025 period. Wilson is somewhat more optimistic, seeing labour productivity growth of around 2 per cent per year. Reasons behind his more rosy scenario include a greater pace of capital deepening due to much slower labour force growth, the realization of productivity gains from past investments in information and communications technologies, a mitigation of future business cycles due to greater use of automatic stabilizers, and continued benefits from trade liberalization.

In the second contribution to the symposium, **Tiff Macklem** of the Bank of Canada compares sources of recent productivity growth in Canada and the United States. Like Wilson, Macklem also sees aggregate labour productivity growth in Canada advancing at around a 2 per cent average

annual rate in the medium term. This view is based on the increased share of machinery and equipment investment in GDP, Canada's high degree of exposure to international trade and investment, the supportive macro-economic environment of low inflation and improved fiscal positions, increased spillovers from rapid and sustained U.S. productivity growth, and the significant gap between Canadian and U.S. productivity levels, which suggests potential for catch-up.

In the third and final article in the symposium, **Benoît Robidoux** from Finance Canada observes that there has been a structural improvement in labour productivity growth in Canada since 1996 and that it is likely that this stronger productivity growth of around 2 per cent per year will continue. He points out that future productivity growth in Canada will increasingly depend on productivity trends in the expanding service sector, and in particular on the ability of this sector to incorporate information and communication technologies into the production process.

In early 2003, the OECD released a major report entitled *The Sources of Growth in OECD Countries*. In the seventh and final article, **Martin Neil Baily** from the Institute for International Economics, and former Chairman of the U.S. Council of Economic Advisers reviews the report. Baily notes that key findings include: the diversity in GDP per capita growth across OECD countries, largely reflecting differences in labour utilization; the importance for growth of exposure to international trade, sound macro policies and investment in physical and human capital; and the high returns to growth from business sector R&D activities, in contrast to a lack of any positive effect from government R&D. Baily observes that the report fails to discuss ways to improve employment growth, concluding that combining full employment with high productivity is the key challenge currently facing policymakers.