

# Summary

Shoring Up the Competitive Posture of  
Canadian Manufacturers:  
What Are the Policy Levers?  
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The Canadian manufacturing sector is in the midst of an unprecedented economic crisis. Having endured nearly three years of declining output growth, it appears there are more hard times to come. While the recent weakness can be attributed to the deep US recession, Canadian manufacturers suffer from a longer-term competitiveness problem that, if not addressed, will continue long after the recession is over. This study examines the ways in which public policy can bolster manufacturing competitiveness in Canada.

Labour productivity – which measures the market value of the output a worker can produce in one hour – is a fundamental indicator of the economic health of the manufacturing sector. Not only does it represent a “speed limit” for sustainable increases in workers’ wages and benefits, it is a key determinant of cost competitiveness. Labour productivity grew faster in Canada than in the United States in the years following the 1988 Canada-US Free Trade Agreement, nearly erasing the then-small productivity gap by the mid-1990s. However, following the North American Free Trade Agreement (NAFTA) the gap grew significantly, and it is now on the order of 25 percent in favour of the United States. That it has done so in the wake of NAFTA, which was intended in part to broaden market access, increase competitive pressures and stimulate productivity improvements, presents a conundrum for policy-makers.

An exhaustive review of the research literature by the authors reveals that the main explanation of Canada’s poor productivity performance is insufficient investment of all types. Relative to that of the United States, Canada’s economy is investment poor, yet investment is precisely the vehicle through which most productivity improvements flow. This could be in the form of machines embedded with new technologies that improve the efficiency of workers, computers and networking equipment that allow for reorganization of production processes, or public infrastructure that provides the very foundation on which firms can build their competitiveness. Canada suffers from significant weakness in all these areas; addressing them is critical to improving productivity growth.

Canadian manufacturers are less innovative than their US counterparts (both in terms of new product development and more efficient production processes), despite the fact that the overall R&D gap is narrowing. Additional public investment in R&D over the past decade has not succeeded in improving business innovation in Canada. Innovative ideas for improving business efficiency and product design are not in short supply in Canada. However, to be exploited effectively, these ideas often require investment in equipment (particularly in information and communication technologies), and managerial know-how and risk-taking.

The empirical evidence examined here also decisively shows that the productivity benefits of technology imported by foreign firms that establish production facilities in Canada spill over to their Canadian counterparts – a win-win economic proposition. This might call for further loosening of foreign ownership limitations and a review of foreign direct investment criteria along the lines proposed by the Competition Policy Review Panel.

The authors conclude that the lack of demand for investment, innovation and skills in Canada needs to be acknowledged and better understood. Although the supply of factors that contribute to productivity growth in Canada is generally sufficient – for example, Canada invests heavily in R&D, and the skill level of its workers is high by international standards – the problem is a lack of demand for innovation, physical capital and highly skilled employees on the part of businesses. Reducing business taxes would increase incentives to invest in machinery and equipment, but if Canadian manufacturers are to live up to their productive potential, policy-makers will need a broader understanding of the barriers to an innovative and competitive market environment. These barriers include the role of regulatory policies, the ability and willingness of business managers to exploit the innovation opportunities of information technologies, and the relatively small size of Canada’s domestic market.