Carolyn Rogers: Time to break the glass - fixing Canada's productivity problem

Remarks by Ms Carolyn Rogers, Senior Deputy Governor of the Bank of Canada, to Halifax Partnership, Nova Scotia, 26 March 2024.

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Introduction

Good morning. Canada's economy was built by trade and immigration. Halifax is not just a key port-it has also been the landing spot for countless new Canadians. So I'm glad to be here, speaking to a group like the Halifax Partnership, which is dedicated to helping Canadian businesses grow and thrive.

We've just passed the fourth anniversary of the start of the COVID-19 pandemic. It's been four difficult years. Beyond its human toll, the pandemic upended economies around the world and sparked the biggest global inflationary episode in decades. This led central banks-including the Bank of Canada-to raise interest rates sharply so that we could get inflation under control.

For the past two years or so, the Bank's Governing Council has focused on restoring price stability. That's almost all we've talked about in our speeches. And we've heard directly from Canadians who have struggled with inflation and who are feeling the impacts of higher interest rates.

The good news is that monetary policy is working, and inflation has come a long way down. We're not all the way back to target, and we know we need to finish the job. But we have made a lot of progress. And so it's a good time to reflect on how the economy has changed in Canada and around the world and to think about what those changes mean for the future.

When we look ahead, we see a future where inflation may be more of a threat than it has been over the past few decades. We know that many of the forces that helped create a benign environment for inflation in the past, such as globalization, are going to fade away, or even reverse. We know that changing demographics and the economic impacts of climate change will tend to put upward pressure on prices. Persistent global trade tensions also raise the risk of future inflation.

So, at the Bank of Canada, we're turning our thoughts-as well as our speeches-to this future. And today I want to talk about a topic that is critical to our ability to navigate a future that's more prone to inflation: productivity.

Productivity is a way to inoculate the economy against inflation. An economy with low productivity can grow only so quickly before inflation sets in. But an economy with strong productivity can have faster growth, more jobs and higher wages with less risk of inflation. That's why I want to talk about Canada's long-standing, poor record on productivity and show you just how big the problem is. You've seen those signs that say, "In emergency, break glass." Well, it's time to break the glass.

Canada's labour productivity eked out a small gain at the end of last year, according to Statistics Canada. But that came after six straight quarters where productivity fell. Of course, the pandemic was a major disruptor for the economy. During the pandemic, the resourcefulness and ingenuity of Canadian business leaders was put to full use. Companies adjusted their business models and ways of working. Given how nimble companies were, we thought productivity would improve coming out of the pandemic as firms found their footing and workers trained back up. We've seen that happen in the US economy, but it hasn't happened here. In fact, the level of productivity in Canada's business sector is more or less unchanged from where it was seven years ago.

People have been sounding the alarm, but it can be hard to feel a sense of urgency about an abstract concept like productivity. Most people, when they hear that we need to improve productivity, think they're being told they have to work harder or work longer hours to produce more, or maybe take less time off.

That's not the case. Labour productivity measures how much an economy produces per hour of work. Increasing productivity means finding ways for people to create more value during the time they're at work. This is a goal to aim for, not something to fear. When a company increases productivity, that means more revenue, which allows the company to pay higher wages to its workers without having to raise prices. Ultimately, higher productivity helps the economy generate more wealth for everyone. The bottom line is that the benefits from raising productivity are there no matter what your role is: for workers, for businesses and, yes, for central bankers, too. I'll come back to this point later.

First, I'm going to spend some time today spelling out the factors that determine productivity. I'll review Canada's record for clues about how we can improve, and I'll talk about what we can all do to raise Canada's productivity and make our economy more resilient.

Ingredients of productivity, and Canada's record

Economists will tell you that three factors determine how productive an economy's workforce is: capital intensity, labour composition and multifactor productivity. These are the types of words that often lead non-economists to tune out. But they're important, and once you get past the jargon, they're not that complicated. So, let's look at each one.

Capital intensity is about equipping workers with better tools. If you run a snow-clearing business, your workers will be able to clear more driveways if they have solid shovels that don't break easily. Of course, give them a snow blower and they'll be able to clear many more driveways than with just shovels. Invest in pickup trucks with plows, and they can do even more.

The most natural way to think about capital intensity is in physical terms like machinery, but of course some of the biggest advances in productivity have come through improvements in computing power and the ability to use and move information. The smartphone in your pocket has way more computing power than the spaceship that first took humans to the moon. These advances continue to put more capability in the hands of employees, giving them the ability to be more productive across a wide range of industries, whether goods or services.

Labour composition in an economy measures the skill level of people in the labour force and how much training they receive. The more skills people have and the more training they receive, the more value they can generate on the job.

Finally, there's *multifactor productivity*, which measures how efficiently capital and labour are being used. This can refer to intangibles such as how much competition a company faces, economies of scale, management practices and many others. It can also refer to how well companies are taking advantage of technologies such as machine learning and generative artificial intelligence.

Those are the ingredients of productivity. Now, when people measure productivity in an economy, they are looking either at its level-how much value an economy is producing for every hour worked-or at the growth rate of that productivity. Canada has been struggling on both measures for a while.

Back in 1984, the Canadian economy was producing 88% of the value generated by the US economy per hour. That's not great. But by 2022, Canadian productivity had fallen to just 71% of that of the United States. Over this same period of time, Canada also fell behind our G7 peers, with only Italy seeing a larger decline in productivity relative to the United States.

Improving productivity in Canada needs to be a priority for everyone, and there are two basic strategies for doing it. One is to have the economy focus more on the industries that add greater value than less-productive activities. The other strategy is to keep doing the jobs we're doing but do them more efficiently. Ideally, Canada would use both strategies, leading to an economy with strong productivity growth and a large concentration of high-value industries.

Unfortunately, Canada's recent record isn't very good on either front. That may seem strange. After all, Canada is known for some high-value industries, such as energy and aerospace. But while the level of productivity here is high, the growth rates aren't necessarily strong. At the same time, some industries in Canada have shown pretty good productivity growth over the past couple of decades.[1] But these include sectors such as retail and wholesale trade, which tend not to generate the same amount of output per worker as sectors like energy or aerospace.

I want to be clear here. Improving productivity doesn't mean shutting down whole sections of the economy and telling workers they have to go learn new sets of skills. It means paying attention to where the future high-value industries are coming from. We need to ensure that the right incentives are in place to allow companies in these industries to grow and thrive. And they need the right supports, such as access to markets and financing.

I expect this resonates with you here in the room. History shows that advances in productivity often come from the start-ups, the new companies led by entrepreneurs with groundbreaking ideas. Organizations such as the Halifax Partnership and other incubators are encouraging the companies that can lead us to the next great breakthrough in productivity. And you can see examples across the region, particularly in the clean tech, ocean tech and agritech sectors.

How to improve

I want to turn now to what we can do to improve Canada's productivity. Many studies have looked at this issue over the years, and there's still no consensus about the causes of Canada's poor performance and where policy-makers should put their energies first. But we can't afford to wait for complete certainty. There is much we can all be doing to boost productivity. In fact, if I took the time to drill down into every potential priority, this breakfast speech would become a lunch speech, too. So I'm going to focus on three key areas.

The first is labour composition, or the skills workers bring to the job. For existing workers, improvement here means having access to training and reskilling programs-whether it's learning how to use new workplace technologies or gaining skills that can create opportunities to switch to a whole new job. For new entrants to the workforce, we're counting on colleges, universities and apprenticeship programs to prepare students for current and future jobs.

It's also important to acknowledge that Canada's workforce is expanding at a record-setting pace, with immigration driving this increase. In January, the working-age population grew by over 125,000 people. That's the fastest single month of workforce growth on record. In the future, Canada's productivity-and our standard of living-will depend importantly on how well we leverage and develop the skills of these new workers. Too often, new Canadians are working in jobs that don't take advantage of the skills they already possess. And too often these people wind up stuck in low-wage, low-productivity jobs. Doing better at matching jobs and workers is crucial to the future of Canada's economy.

The second key area relates to multifactor productivity. We know that small and medium-sized companies tend to lack the economies of scale that allow larger firms to become more productive. And Canada has proportionally more of these smaller firms than many other economies do. Removing disincentives to growth is always a good idea.

But if I had to pick the biggest concern in this area, I'd say it's competition. Simply put, businesses become more productive when they're exposed to competition. Competition drives companies to become more productive by innovating and by finding ways to be more efficient. In doing so, competition can make the whole economy more productive.

Canada's economy features many sectors where companies face limited levels of competition, whether from firms in other provinces, foreign rivals or new entrants. Of course, every country has certain sectors that it champions, and there can be valid reasons to protect local businesses. However, too much protection can lead to problems. It can also help to explain Canada's weak record in business investment. This brings me to the third area for improving productivity.

The need for investment

When you compare Canada's recent productivity record with that of other countries, what really sticks out is how much we lag on investment in machinery, equipment and, importantly, intellectual property. The global economy continues to change rapidly, and in many sectors, it's not machinery and equipment that are key-it's investment in intellectual property. Increasingly, companies need to own or have the rights to patents that will allow them to compete by adopting productivity-boosting processes.

Weak investment has been a problem in Canada for a long time. You can go back 50 years and find a persistent gap between the level of capital spending per worker by Canadian firms and the level spent by their US counterparts. However, the situation has become worse over roughly the past decade. While US spending continues to increase, Canadian investment levels are lower than they were a decade ago.

Economists and policy-makers across the country have worked hard to understand the root causes of why Canadian businesses seem reluctant to invest. At the Bank, we are constantly talking to companies, asking them about their challenges and opportunities. Our Business Outlook Survey consistently shows that companies say they plan to increase their spending on machinery and equipment. But we haven't seen it in the data, at least not yet.

Adding to the puzzle is the fact that Canada has many advantages that should lead to higher investment and productivity. We have a well-educated labour force. We have a strong research culture at our universities that is driving advances in technology. And we have trade agreements that give us better access to global markets than any country in the world.

To understand the lack of investment, it might be helpful to look at the incentives that companies see. If firms have high profits, high margins and limited competition, they may not feel as much pressure to invest. Statistics Canada published a report last month that draws a link between decreasing competition within Canada and declining investment levels.[2]

Another challenge for companies may be a lack of policy certainty. In some cases, incentives or regulatory approaches can change from year to year. We have also heard from companies that are naturally wary of a regulatory approval process that can be both lengthy and unpredictable.

And, of course, the past few years have been a challenging time for making investment decisions. The pandemic caused tremendous levels of instability and uncertainty. A backdrop of global trade tensions is certainly not helping matters. More recently, we've heard from firms that say the current interest rate environment is making financing more difficult. However, investment levels were also weak in the years before the pandemic, when rates were much lower than today.

More generally, in times of upheaval it's natural for companies, especially established ones, to want to be cautious and build reserves. I understand that. We see the risks out there. Yet these same forces and risks are also present in other countries. And companies in those countries-our global competitors-continue to invest, widening the gap with Canada, making it increasingly urgent that we turn the situation around.

The Bank of Canada has a role here. It's our job to deliver the economic stability that should encourage investment. You can be sure we will continue to do all we can to keep inflation low, stable and predictable, supporting the investment climate along the way. This is our contribution to helping bring about an economy that's not only more productive but also more resilient.

Conclusion

It's time for me to wrap up. I hope I've been clear about the pressing need for Canada to increase productivity. I'm saying that it's an emergency-it's time to break the glass. I've used some pretty grim statistics to support my point. But the urgency comes not only from the fate that awaits us if we don't act. It also comes from the payoff if we do. So let me conclude on a more uplifting note.

Higher productivity should be everyone's goal because it's how we build a better economy for everyone. When a business gives workers better tools and better training, those workers can produce more. That, in turn, means more revenue for the business, which allows it to absorb rising costs, including higher wages, without having to raise prices.

For our part, central bankers look at the economy as a whole, not at individual companies. And when the entire economy becomes more productive, that means the country can have more growth before we see upward pressure on inflation. We can have more jobs. We can have higher wages.

We've all just been through a wrenching period in the global economy. We've been reminded how corrosive inflation is and how difficult but necessary the remedy can be. Increasing productivity is a way to protect our economy from future bouts of inflation without having to rely so much on the cure of higher interest rates.

At the Bank of Canada, we will keep working to provide the stability that's most conducive to risk taking and investment. With governments providing the right policy background, and with the business community doing its part to invest, together we will all be able to help Canada's economy to grow-and Canadians to prosper-in the years ahead, no matter what surprises may come.

Thank you.

I would like to thank Eric Santor for his help in preparing this speech.

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[1] See C. Haun and T. Sargent, "Decomposing Canada's Post-2000 Productivity Performance and Pandemic-Era Productivity Slowdown," Centre for the Study of Living Standards, *International Productivity Monitor* 45 (2023): 5–27.

[2] See W. Gu, "Investment Slowdown in Canada after the Mid-2000s: The Role of Competition and Intangibles," Statistics Canada Analytical Studies Branch Research Paper No. 474 (February 2024).