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Canadian Workers Need the Tools to Do the Job And Keep Pace in the Global Investment Race

By Danielle Goldfarb and William Robson

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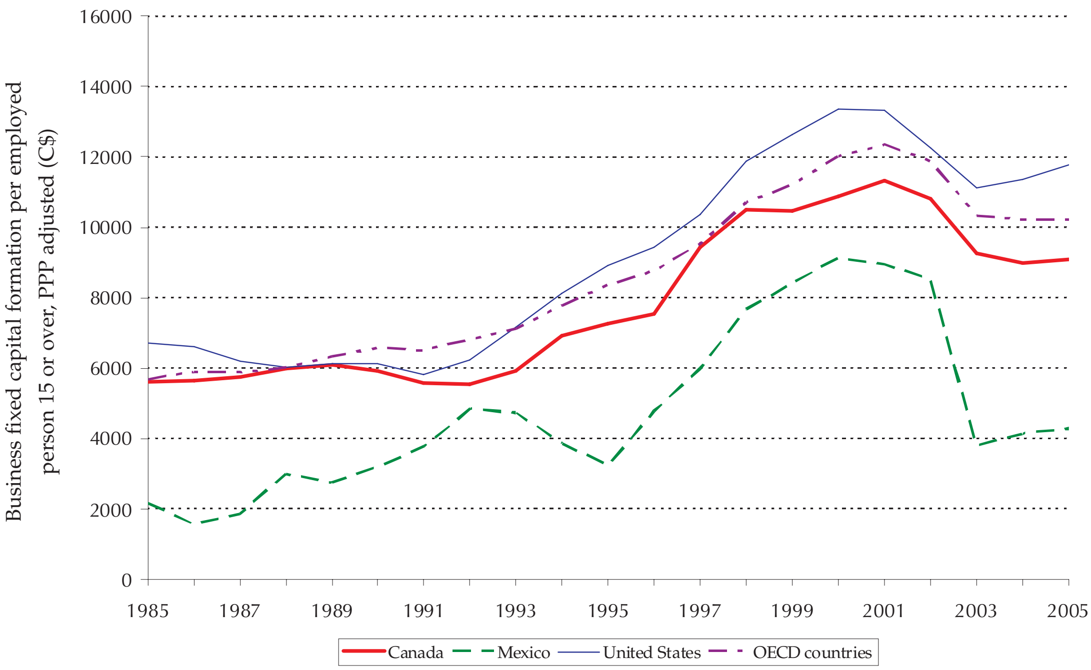
Business investment in structures and equipment is essential to growth in living standards. It helps workers create goods and services directly, which raises their salaries and provides returns on saving. It also appears to boost economic growth as new ideas become embodied in new capital. For those reasons, Canada's investment attractiveness matters for future prosperity and the ease with which Canadians can enjoy high-quality goods, services and government programs.

The competition on the investment front has intensified. More countries are developing the legal and economic infrastructure that promotes investment, and more established competitors in North America, Europe and Asia are lowering barriers to trade and capital flows, cutting taxes, and otherwise becoming more hospitable to savers. All Canadians should be concerned if these developments are making Canada an also-ran in the race for world investment.

Concerned that lagging investment might mean that Canadian workers are losing out in the quest for better tools, we recently measured Canadian and provincial investment performance against the other Organization for Economic Co-operation and Development (OECD) countries for which comparable data are available, using purchasing-power adjustments to allow comparisons in a common currency (Robson and Goldfarb 2004). We found that in most provinces and the country as a whole relative attractiveness to capital investment declined since the mid-1990s, especially with respect to the United States. Updated international figures from the OECD, as well as Statistics Canada data on provincial capital spending and investment intentions for 2005, indicate that Canada's position is still deteriorating.

Figure 1 provides an international overview of Canada's situation, showing business investment in structures and equipment per worker for Canada, the United States, Mexico and the OECD countries as a whole since the mid-1980s. All figures are in Canadian dollars at purchasing-power parity (PPP) exchange rates. In the late 1980s, a booming economy and the prospect of freer trade helped investment per worker in Canada keep pace with that in other developed nations, and enabled the country to close a long-standing gap with the United States. Since then, however, Canada's per-worker investment has slipped. In 2005, the average

Figure 1: *Business Fixed Capital Investment Per Worker (1985-2005)*



Canadian worker looks set to have some $1,150 less in investment spending than the typical worker in OECD countries generally, and fully $2,690 — about 23 percent — less than a counterpart in the United States.

A more detailed look at recent Canadian experience is available in Table 1, which shows investment per worker in Canada and in individual provinces, again using the OECD and the United States as benchmarks. With the exception of Alberta, where recent energy-related investment has accentuated a fairly steady increase since the early 1990s, in the rest of the country per worker investment is considerably less robust. British Colombia has held its own since 2000 after a difficult decade in the 1990s, and Newfoundland's resource boom overshadows some improvement in New Brunswick and Nova Scotia. In central Canada, however, the trend is downward. In 2005, workers in Manitoba, Ontario, and Quebec will have, on average, gross investment that is 36 percent, 39 percent, and 44 percent below what their U.S. counterparts will get.

A simple summary measure of Canada's relative attractiveness to investment can be arrived at by looking at domestic spending on structures and equipment as a share of that in developed countries as a whole, or in North America particularly. In the late 1980s, Canada attracted $3.34 of every $100 spent on structures and equipment in the 22 OECD countries for which we have comparable data; this year, Canada looks set to attract $3.11. Confining the comparison to North America produces a more dramatic picture: Canada attracted $8.83 of every $100 of continental investment in the late 1980s; in 2005, the figure will be around $7.42.

It is natural to wonder how including the emerging giants outside the OECD affects this picture. Comparable data on business fixed capital investment are not available for Brazil, China, India and Russia — in China, particularly, the

Table 1: *Investment per worker for provinces, Canada as a whole, OECD countries (on average), and the U.S. (C$), PPP adjusted 1990-2005*

	Alberta	British Colombia	Manitoba	New Brunswick	Newfound-land	Nova Scotia	Ontario	Prince Edward Island	Quebec	Saskat-chewan	Canada	OECD	United States
1990	8,969	5,883	4,555	4,957	4,637	4,846	5,755	3,298	5,314	6,712	5,930	6,578	6,114
1991	8,079	5,562	4,109	4,822	5,543	4,754	5,404	3,868	4,943	7,264	5,588	6,503	5,822
1992	8,070	5,199	4,144	4,427	6,491	3,788	5,483	2,567	4,934	6,795	5,528	6,814	6,244
1993	10,245	5,434	4,639	4,214	8,767	3,821	5,408	3,071	5,416	7,256	5,925	7,131	7,151
1994	13,538	6,803	4,784	4,393	11,847	4,625	6,173	5,576	5,586	8,744	6,932	7,776	8,116
1995	13,862	6,850	5,522	5,342	12,979	4,438	6,562	6,739	5,633	9,665	7,244	8,358	8,901
1996	13,930	6,361	6,299	5,857	10,321	4,946	7,158	7,045	5,812	11,080	7,542	8,763	9,419
1997	18,726	7,856	8,246	5,585	12,599	7,772	8,622	4,511	6,850	15,836	9,417	9,534	10,351
1998	21,653	8,197	8,881	7,723	12,888	9,782	9,581	5,486	7,930	14,362	10,511	10,712	11,876
1999	19,362	8,062	8,780	9,760	16,048	11,726	9,649	6,386	8,289	13,976	10,470	11,214	12,619
2000	23,225	8,351	8,668	9,638	13,976	9,325	9,625	6,239	8,578	14,135	10,892	12,027	13,368
2001	25,603	9,358	9,265	7,587	13,391	11,788	9,678	6,254	8,185	14,458	11,326	12,350	13,309
2002	24,108	8,872	9,581	7,394	15,049	11,250	9,285	6,297	7,758	13,008	10,803	11,889	12,241
2003	21,062	7,546	8,044	7,587	13,947	8,609	7,949	5,706	6,612	11,260	9,279	10,339	11,134
2004	20,509	7,502	7,961	7,038	15,272	7,901	7,483	5,697	6,556	10,440	8,973	10,218	11,373
2005	19,079	7,506	7,522	7,301	14,580	7,715	7,208	6,119	6,563	10,703	9,081	10,233	11,774
Ratio to OECD average, 2005	186	73	74	71	142	75	70	60	64	105	89	100	115
Ratio to U.S. average, 2005	162	64	64	62	124	66	61	52	56	91	77	87	100

Source: OECD, Statistics Canada, authors' calculations.

distinction between government-sector and private-sector investment is unclear. However, for a preliminary look, we took United Nations data on gross capital investment, converted using IMF PPP exchange rates, and estimated 2003, 2004 and 2005 figures using IMF forecasts for GDP and PPP exchange rates on the assumption that investment's share of the economy stayed stable. This rough measure overstates business investment in the giants and is not a reliable guide to levels. Focusing on trends, however, the emergence of these countries appears to be further reducing Canada's investment share. Against the larger sample of the emerging giants plus OECD countries, Canada's share of world investment has fallen by half a percentage point over the past eight years. (By our measure, it registered 1.9 percent in 1997, and will be around 1.4 percent in 2005.)

While some changes in economic fortunes arise from forces beyond Canadians' control, such as commodity-price cycles and natural resource wealth in some provinces and countries, natural resources may go undiscovered and unexploited in places where investors fear to tread. A glance around the world reveals that mineral and fossil fuel wealth often coincides with astonishing economic underperformance, while many of the world's richest countries have negligible resource wealth. China's explosion onto the world economic stage and India's growing clout are reminders that public policy can make an important difference.

During the long period of Canadian dollar decline in the 1990s, part of Canada's struggle might have arisen from the rising relative price of imported capital (Leung and Yuen 2005). But to the extent that the exchange rate affects Canada's investment performance, the dollar's dramatic appreciation should be improving the picture. Uncertain access to the large U.S. market may also help explain some of Canada's disappointing performance.

Among the factors that governments can control most readily, taxation looms as an important suspect in Canada's struggle to attract capital investment. The recent moves to undo the reductions in business taxes proposed in the 2005 federal budget are especially regrettable. Canadian taxes on investment are among the world's highest, and it is likely no accident that the provinces where investment has been particularly weak in recent years tend to be those where the combined impact of corporate income taxes, capital taxes, and sales taxes on purchases tends to be more onerous.

Canada has done better before, and can do better again. Improving the climate for business investment in Canada will create products, jobs and higher incomes in the near term, and promote rising living standards through productivity growth over time. Other countries are not standing still in the race for investment. Neither should Canada.

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