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ECONOMIC GROWTH AND INNOVATION

Equipping Ourselves in Tough Times: Canada's Improved Business Investment Performance

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- Canadian businesses have tended to equip employees with less capital investment than their G7 counterparts have over the past 15 years.
- In a promising sign for 2009 and 2010, however, Canada's investment performance should improve relative to many other countries, and particularly the United States.
- To make further progress, Canadians should focus on maintaining and, where possible, enhancing their fiscal, tax and regulatory advantages in the years ahead.

In good times and in bad, business investment to provide better tools for workers is a critical foundation for future prosperity and growth. No matter how able an employee, good tools, in the form of new machinery, equipment and buildings, are essential to productivity and incomes – for individuals, businesses, and the economy.[1] If counterparts abroad have access to more or better technology, Canadian operations will lose their competitive edge; for Canada as a whole, continuous upgrading is vital to securing better jobs and higher living standards.

The relative capital-investment performance of Canadian businesses has been disappointing over the past 15 years.[2] Looking at investment per worker, Canadian businesses have quite consistently equipped employees less well than their G7 counterparts have, on average. With the world mired in a slump, which has hit key Canadian industries such as resource extraction, manufacturing and financial services, people might reasonably fear that Canada's performance would slip further.

Amid the overall glum economic news, however, Canada's relative investment performance stands out in a promising light in 2009 and looking out to 2010. New capital spending has held up better in Canada than in many other countries, and particularly the United States. Investment per worker in Canada for 2010 should surpass that in other G7 and OECD countries – including the United States. We see this relative improvement as confirming the widespread impression that Canada went into this difficult period in better shape than other countries – and indicating that Canadians should focus on maintaining and, where possible, enhancing their fiscal, tax and regulatory advantages in the years ahead.

1 Sali-i-Martin (1997) demonstrates the positive spillover effects from investment in equipment and other capital structures on economic growth.

2 This *e-brief* updates previous years' results of this research; see Robson and Goldfarb (2004, 2005, 2006) and Banerjee and Robson (2007, 2008).

Our comparisons of business investment per worker, which include the performance of individual provinces, use several straightforward information sources. We take data on business capital formation,[3] employment, and the domestic purchasing power of national currencies (purchasing-power parity, or PPP, exchange rates) from the OECD, and we use comparable data for Canadian jurisdictions from Statistics Canada.[4]

Not surprisingly, business investment everywhere is down. In Canada, however, a less severe decline means a marked improvement in relative position (Figure 1). Domestic investment per worker should average around $11,100 in 2009 and remain at the same level in 2010 (Table 1). Examined in the light of the situation in other G7 countries, Canada's investment per worker should, for the first time in recent history, be clearly superior – the average worker in G7 countries should see $10,500 in new investment in 2009 and $10,400 in 2010.

The sharp drop in investment in the United States accounts for much of the deterioration in the G7 overall. South of the border, the average worker should enjoy about $11,000 of investment in 2009, and $10,800 in 2010. In 2009, for every dollar invested in US workers, Canadians should see about a dollar of investment also – a marked change from 90 cents last year and about 80 cents at the beginning of the decade.

Provincial Leaders

Alberta, Saskatchewan, and Newfoundland and Labrador – which have seen investment per worker rise over recent years, driven in large part by rising commodity prices – are still setting the pace.

Saskatchewan, and Newfoundland and Labrador should see continued improvement: for every dollar invested in a US worker, Saskatchewan should record $1.42 in 2009, up from $1.26 per worker in 2008, while Newfoundland and Labrador should record $1.06, up from $0.80 in 2008.

Alberta's position is somewhat less lofty than before: the average Albertan worker can expect $2.18 of investment per dollar invested in his or her US counterpart in 2009, down from $2.36 in 2008 (Table 2).

Meanwhile, British Columbia has suffered an investment decline slightly less severe than that in the United States, modestly improving its standing on this scale. Manitoba has improved by more.

In the Maritime Provinces, where investment per worker has long lagged levels elsewhere, progress is visible. For every dollar spent on a US worker, investment in those provinces ranges from 90 cents in New Brunswick to 43 cents in Prince Edward Island. Nova Scotia should see a dramatic jump in per worker investment, from 47 cents in 2008 to 61 cents in 2009.

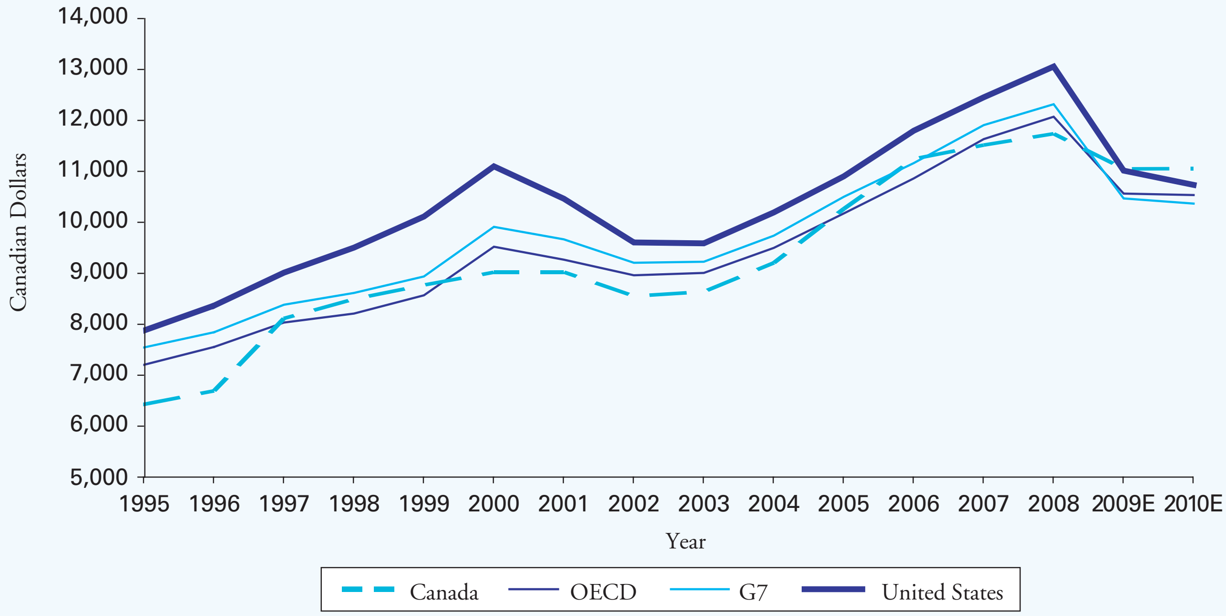
Although Ontario and Quebec should also improve their relative standing this year, their modest upticks leave them well short of where they were five years ago. Their longer-term struggles reflect continuing pressures on North American manufacturing; what is disappointing about the modest uptick is that the strong Canadian dollar ought to have made capital goods easier to afford.

While it would be interesting to compare Canada's performance against a wider group of countries – Brazil, Russia, India and China particularly – non-comparable data make evaluating levels of investment between them and OECD countries difficult. For what it is worth, however, using PPP data from the International Monetary Fund, it appears that the average per-worker investment in those countries rose from about 14 cents per dollar invested in a Canadian worker in 2002 to about 22 cents in 2008. So while Canada's improvement relative to other developed countries is heartening, major developing countries are adding to their capital stock per worker, and therefore enhancing their prospects for future living standards, more rapidly.

3 More formally, we use actual and expected business nonresidential gross fixed capital formation – a flow measure – from the OECD and Statistics Canada. These data include private businesses and government business enterprises functioning in a commercial environment.

4 Using PPP exchange rates allows more meaningful comparisons of the "bang per buck" of investment spending in different countries, since market exchange rates do not generally reflect relative domestic price levels. Ideally, we would use capital-goods-specific PPP rates, but these are not comprehensive enough to make comparisons over time. We therefore use general PPP rates, but note that prices of different components of capital investment are probably more or less sensitive to movements in market exchange rates. Construction would be relatively less sensitive; machinery and equipment more so.

Figure 1: Business Investment per Worker, Canada vs. Peers, 1995-2010E



Sources: OECD; authors' calculations.

Table 1: Business Investment per Worker for Provinces, Canada, OECD, G7 and US, 1999-2009E

Canadian Dollars												Ratio to OECD average		Ratio to G7 average	
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009E	2008	2009E	2008	2009E
AB	16,200	19,100	20,300	19,000	20,000	22,400	28,600	31,700	30,600	30,800	24,000	255	228	250	230
BC	6,700	6,900	7,500	7,100	7,200	7,800	8,500	9,800	9,700	10,400	8,900	86	84	84	85
MB	7,300	7,100	7,300	7,200	7,000	7,300	7,100	7,900	9,200	11,100	9,600	92	91	90	92
NB	8,200	8,000	6,100	5,900	6,600	6,900	7,300	9,300	10,100	10,700	9,900	89	94	87	95
NL	13,600	11,800	11,000	10,100	11,600	13,900	15,200	13,400	11,200	10,500	11,700	87	111	85	112
NS	9,900	7,800	8,000	8,200	7,500	7,000	7,100	7,000	6,500	6,100	6,600	51	63	50	63
ON	8,100	8,000	7,700	7,400	7,200	7,300	7,800	8,200	8,800	8,700	7,800	72	74	71	75
PEI	5,400	5,300	5,100	5,000	5,100	5,500	5,200	5,700	6,900	6,400	4,800	53	45	52	46
QC	6,900	7,100	6,500	6,300	6,400	6,900	6,700	7,000	7,300	7,800	7,000	64	66	63	67
SK	11,800	11,900	11,700	10,700	11,400	11,200	13,600	15,400	14,600	16,500	15,700	137	148	134	150
Canada	8,800	9,000	9,000	8,600	8,600	9,200	10,300	11,200	11,500	11,700	11,100	97	105	95	106
OECD	8,600	9,500	9,300	9,000	9,000	9,500	10,200	10,900	11,600	12,100	10,600	100	100	98	101
G7	8,900	9,900	9,700	9,200	9,200	9,700	10,500	11,200	11,900	12,300	10,500	102	99	100	100
US	10,100	11,000	10,500	9,600	9,600	10,200	10,900	11,800	12,500	13,100	11,000	108	104	106	105

Sources: OECD; Statistics Canada; authors' calculations.

Table 2: Business Investment per Worker, US = 100, 1999-2009E

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009E
AB	159.9	172.1	194.2	197.6	208.1	219.4	262.5	268.6	245.8	236.2	218.3
BC	66.6	62.3	72.0	73.7	75.5	76.4	77.7	82.7	77.5	79.5	81.0
MB	72.2	64.3	70.2	75.4	73.4	72.1	65.5	66.9	73.5	84.7	87.0
NB	80.8	71.9	58.3	61.1	68.7	67.6	66.5	78.7	81.0	82.3	90.0
NL	134.3	106.7	104.6	104.8	121.0	136.3	139.6	113.8	90.3	80.3	106.3
NS	97.4	70.3	76.5	85.5	78.3	68.8	65.0	59.4	52.2	47.0	60.1
ON	79.9	71.8	74.0	76.7	74.7	71.6	71.1	69.8	70.6	67.0	70.9
PEI	53.4	47.4	48.8	52.0	52.9	54.1	47.3	48.1	55.6	48.7	43.5
QC	68.6	64.0	62.6	65.8	67.1	67.7	61.7	59.0	58.5	59.4	63.5
SK	116.8	107.0	112.1	111.2	118.7	110.1	124.2	130.4	117.6	126.7	142.2
Canada	86.7	81.3	86.2	89.0	90.1	90.3	94.1	95.3	92.5	89.9	100.3
OECD	84.7	85.8	88.6	93.3	93.9	93.2	93.3	92.1	93.4	92.5	95.9
G7	88.4	89.3	92.4	95.9	96.2	95.5	96.3	94.6	95.6	94.3	95.1

Sources: OECD; Statistics Canada; authors' calculations.

An improvement in Canada's position relative to developed countries would be more encouraging if it resulted from an investment surge during a boom rather than a less severe collapse during a slump. Either way, however, these figures suggest that Canada has improved its domestic environment for business investment compared to other developed countries.

Progress on the Tax Front

Certainly, Canada has made progress on the tax front, with corporate income-tax rate relief and other changes that have mitigated its former unhappy position as one of the world's least hospitable tax jurisdictions. Further corporate income tax reductions are on the way federally, and in Ontario and New Brunswick. Notably, Ontario's 2009 measures to harmonize the Provincial Retail Sales Tax with the Goods and Services Tax will lower its effective tax rates on capital investment by 10.1 percent in 2012 (Smart 2007, Chen, Mintz and Tarazov 2007, Poschmann 2009).

Turning to the sources that finance capital investment, the Advisory Panel on Canada's System of International Taxation suggested several ways Canada might attract more inbound foreign investment – such as further reducing non-resident withholding taxes in future bilateral tax treaties.[5] And Canadian firms investing abroad might patriate a larger share of income earned abroad if Canadian taxes treated all foreign active business income as exempt surplus (Canada 2008). Above all, Canada needs to ensure that growing public-sector borrowing does not absorb saving and force tax rates up to pay a higher interest bill. Neither development would improve the climate for business investment.

Canadian workers are, for the first time in recent history, getting as much new plant and equipment as their counterparts abroad. If Canada as a whole, and provinces individually, continue to improve their attractiveness for investment, and if businesses respond to that opportunity, Canadians can look forward to higher productivity and incomes in the years ahead.

5 Non-resident withholding taxes in Canada make non-resident investors pay a 25 percent tax on interest, dividends, royalties, and other payments from Canadians. Under bilateral tax treaties, the tax rate is normally reduced to around 15 percent or lower. Offering national (or non-discriminatory) treatment similar to the treatment that applies to Canadian corporations operating in many foreign countries would also help boost inbound investment (Cockfield 2008).

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