

Intelligence MEMOS



From: Martin Eichenbaum, Michelle Alexopoulos and Jeremy M. Kronick
To: Canadians concerned about prosperity
Date: August 13, 2024
Re: **LAGGING PRODUCTIVITY NOT JUST A NUMBER, IT'S MAKING US POORER**

Since 1985, US labour productivity has grown by roughly 100 percent. In sharp contrast, labour productivity in Canada is up 40 percent. Canadian workers are now only 70 percent as productive as US workers. And we're not just falling behind the US – the growth rate of our productivity is well below that of the UK, Germany and France.

Economists have long been aware of our productivity malaise, but we need a broader audience. Public support can help solve the problem, and this requires showing Canadians how productivity gains improve their lives.

To see the benefits of higher productivity, consider the following example: Suppose a firm with 100 workers produces 100 computers a day. Then, because of technological innovation, the firm with the same 100 workers can produce 1,000 computers a day. Other things being equal, the firm will increase revenue by a factor of 10, even though its labour costs are unchanged.

To maximize its profits, the firm will try to ramp up output by hiring workers. Such an expansion typically increases workers' wages and decreases computer prices.

Even if the firm were unwilling to hike wages/hire more workers and/or lower prices, other firms would see the potential benefits, adopt the new technology and ramp up their output. Competition ensures that the benefits from technological innovations are passed on to consumers, workers and shareholders.

This scenario is not a hypothetical fairy tale. In 1981, a basic IBM home computer cost \$4,664 in today's dollars. Today, a MacBook Air costs \$1,299. The cheaper MacBook Air makes that old IBM computer look like a paperweight in terms of its capabilities. The technology embodied in this new computer allows people to be far more productive today – software runs faster, has increased what we can do, and lets us work from virtually anywhere.

Critically, history shows that productivity gains translate into real wage gains (after accounting for inflation) for ordinary Canadians. From 1994 to mid-2024, the growth rate of productivity and real wages in Canada increased by **virtually the same amount** – roughly 35 percent. That is not a coincidence. As workers become more productive, firms compete for their services, generating upward growth in real wages.

While 35 percent over the period may sound pretty good, a closer inspection highlights how much better we could be doing. Canadian workers are getting less productive and poorer than their US counterparts. And the situation is getting worse. Last year, Canadian labour productivity fell and is now at its lowest point since the last quarter of 2018, whereas US labour productivity has risen by more than 9 percent.

The fall in Canadian labour productivity coincided with falling median real weekly wages. In 2020, the nationwide median real weekly wage was \$1,103; at the end of 2023, it was \$1,078. Put bluntly, our dismal productivity performance means we are getting poorer, relative to our US neighbours and absolutely as well.

Why is Canada falling behind? We have access to the same technology that Americans have. Our workers are as educated and dedicated as our neighbours to the south.

So what are the main barriers to productivity growth in Canada? There are many candidates: interprovincial trade barriers, too many layers of regulation, major project approval uncertainty, incentives that favour lending to mortgages over businesses, an inability to commercialize the discoveries at our world-class universities, barriers to competition, and a mismatch between the skills that firms want and the skills that workers have.

We can debate how much each of these factors inhibits Canada's productivity growth. But you can't debate that when you add them all up, it's a lot. The lack of reform is costing Canadians where it hurts – their paycheques.

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The key to a higher standard of living for Canadians is a higher productivity growth rate. Increased material prosperity also means more time and resources to pursue non-material goals, as well as a greater ability to help disadvantaged members of Canadian society. The more we produce, the more we can help each other. We do not want to fight for scraps of a small pie. We want to divide a larger pie – a goal we can achieve by solving our productivity malaise.

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