Intelligence MEMOS

From: William B.P. Robson and Miles Wu

To: Canada's Business Leaders

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Re: **Our Capital Investment Crisis**

The C.D. Howe Institute has long tracked Canada's performance in business investment compared to the United States and other developed countries. Our motive is straightforward: Private-sector investment that boosts Canada's stock of machinery, buildings, engineering infrastructure and intellectual property is critical to economic growth.

As it occurs, it creates demand for products and services, boosting output and employment. Once in place, it increases productivity, raising output per hour worked – which is critical in raising incomes and living standards over time. A recent C.D. Howe Institute E-Brief gave us the first look at how well we did in 2020 – or, to be more precise, how badly we did.

For several years, we have been going in the wrong direction. Statistics Canada's data on the country's capital stock show that the non-residential buildings, machinery and equipment, and intellectual property (IP) products available for the typical member of Canada's workforce has been declining since mid-decade (Figure 1). While we do not yet have complete numbers for 2020, data for the first three quarters indicate that spending for last year was lower than at any time since the late 1990s.

While the pandemic hurt investment everywhere in the world, Canada has done particularly poorly. Dividing national investment by national labour force numbers to produce investment per-available-worker measures for Canada, the United States, and other member countries of the Organisation for Economic Co-operation and Development (OECD) reveals that Canada's relative performance – which had improved from the early 2000s to the mid-2010s – sagged after mid-decade and plunged in 2020.

Unless Canada's business leaders have suddenly lost their mojo, which we doubt, policymakers need to improve the environment for private-sector investment. All levels of Canadian government can help. Better infrastructure, more competitive tax rates and growth-friendly tax provisions, internal and international trade liberalization and a smart balance between measures to protect health and promote economic activity in response to the COVID-19 pandemic could all help Canadian workers get the tools they need to compete and prosper.

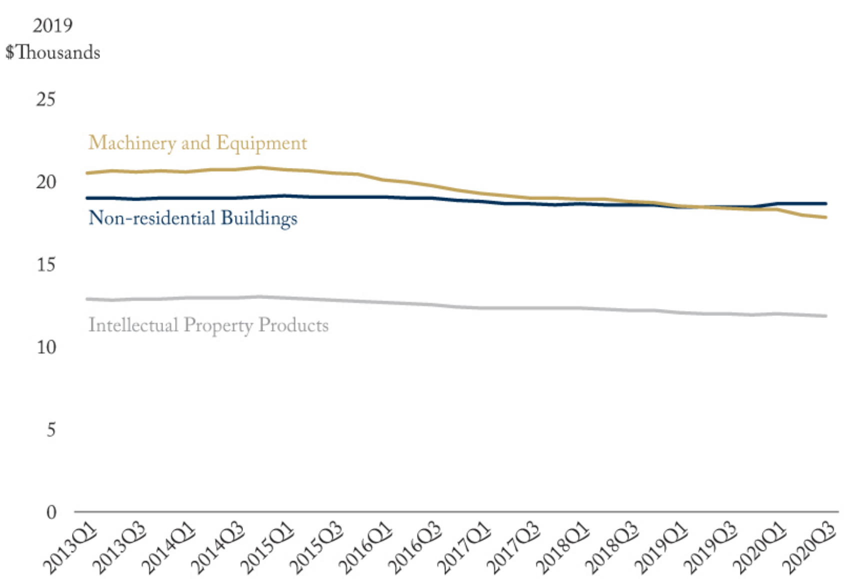
Dealing effectively with the pandemic, with more testing, targeted restrictions, and rapid vaccine rollout, rather than broader-based shutdowns of the economy, would help. Longer term, lack of investment in infrastructure – particularly energy transportation infrastructure – directly hurts the fossil fuels sector, already facing vigorous competition from a better-favoured US sector, and indirectly hurts industries that supply it.

Taxation is a suspect in Canada's lacklustre performance: in Canada, business property taxes are high from coast to coast and US corporate tax changes have made investment more attractive south of the border. Regulations that blunt competitive pressure and tax/subsidy programs that discourage business growth also need reviewing.

Canada's investment weakness has not just accentuated our excessive dependence on consumption to support economic activity in the present; it also means that Canadian workers will have less capital with which to produce goods and services, earn incomes and fund public services in the future.

The prospect that Canadians will find themselves increasingly relegated to lower-value-added activities relative to workers in the United States and elsewhere, who are raising their productivity and earnings faster, should spur Canadian policymakers to action on many fronts: infrastructure investments, lower and less distorting taxes, and incentives

Capital Stock per Available Worker, by Type



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Sources: Authors' calculations based on Statistics Canada, table 36-10-0104-01, Gross domestic product, expenditure-based, Canada, quarterly; Table 34-10-0038-01 Capital and repair expenditures, non-residential tangible assets, by type of ownership and geography; and Statistics Canada, table 14-10-0287-01, Labour force characteristics, monthly, seasonally adjusted and trend-cycle.