



Structural Change and Canadian Competitiveness

*From “Dutch Disease” to
“the Canadian Condition”!*

*Presentation by Jim Stanford, CAW Economist
To Institute for Competitiveness and Productivity
April 2008*

Competitiveness

- The ability to participate successfully in inter-regional or international commerce while preserving a healthy share of good jobs and a strong standard of living
- Tradeable vs. non-tradeable industries
- What is the basis of competitiveness?
 - Cheap labour?
 - Capital?
 - Innovation & productivity?
 - The stuff in the ground under our feet?

ICP's Initial Finding

- Structural mix is not Canada's problem
- Canada is not a hewer of wood, drawer of water
- Improving productivity within each sector is more important than changing the sectoral mix
- Is it time to revisit that finding?

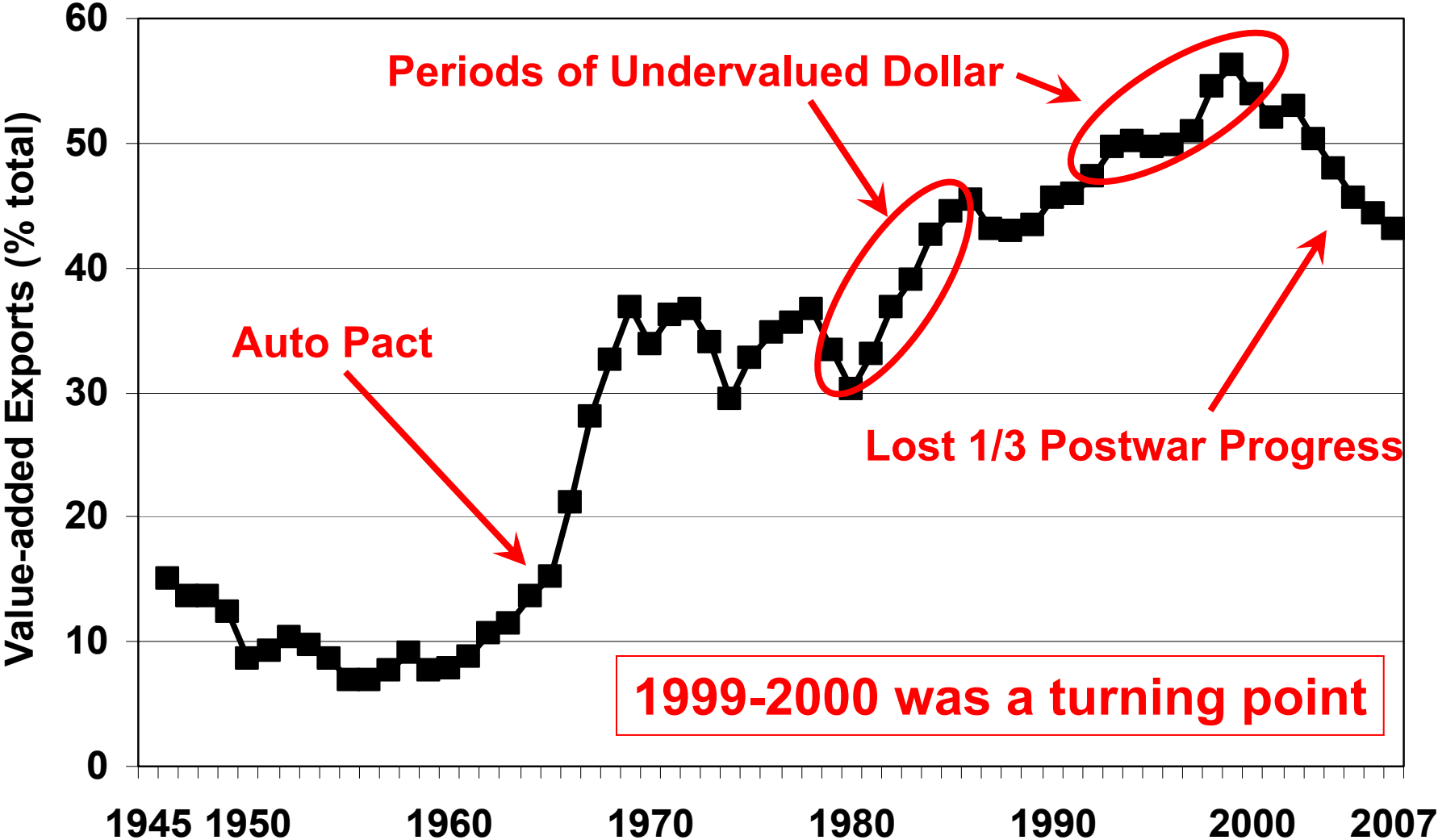
The Economic Remaking of Canada

- Renewed reliance on primary resource production and export
- Relative and absolute decline in other tradeable industries
- Resource boom drives strong overall conditions:
 - resource investment
 - labour incomes
 - supply chain
 - spin-off effects
- But for how long???
- Resource dependence raises troubling questions:
 - nature and sustainability of growth
 - Canada's role in the global economy
- Loonie appreciation is both consequence & cause of restructuring and deindustrialization

Consequences of the Remaking

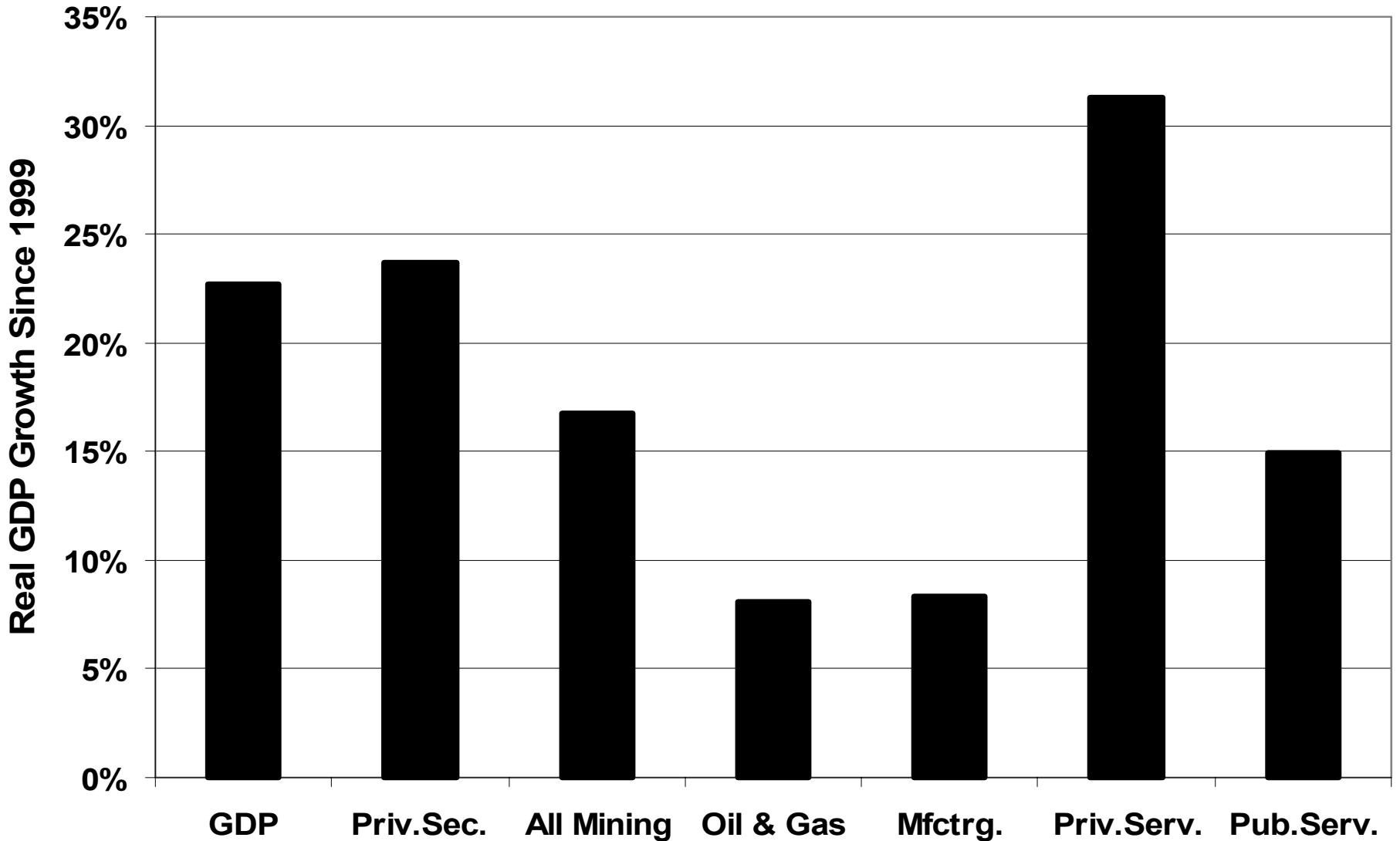
- Huge profits (but only modest growth) in resource industries
- Contraction in other tradeable industries
- Foreign investment boom (acquisitions)
- Rising dollar
- Terms of trade gains
- Shift to non-tradeable services
- Rising profit share, falling wage share
- Strong nominal income conditions
- Regional economic shifts; strains on federalism
- Environmental, geopolitical issues

Deindustrialization of Exports



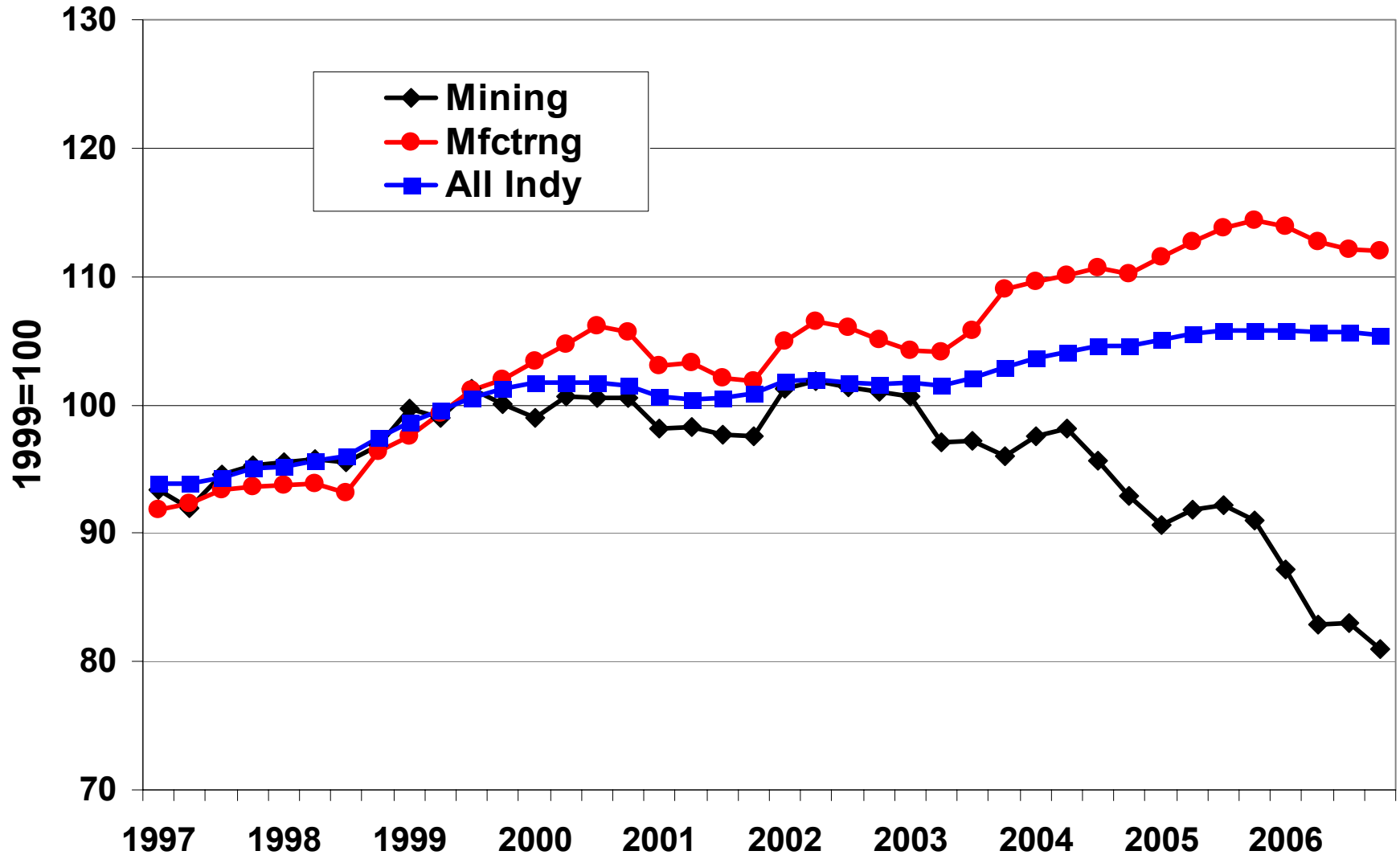
Source: CAW Research from Statistics Canada

Sluggish Growth of Minerals Production



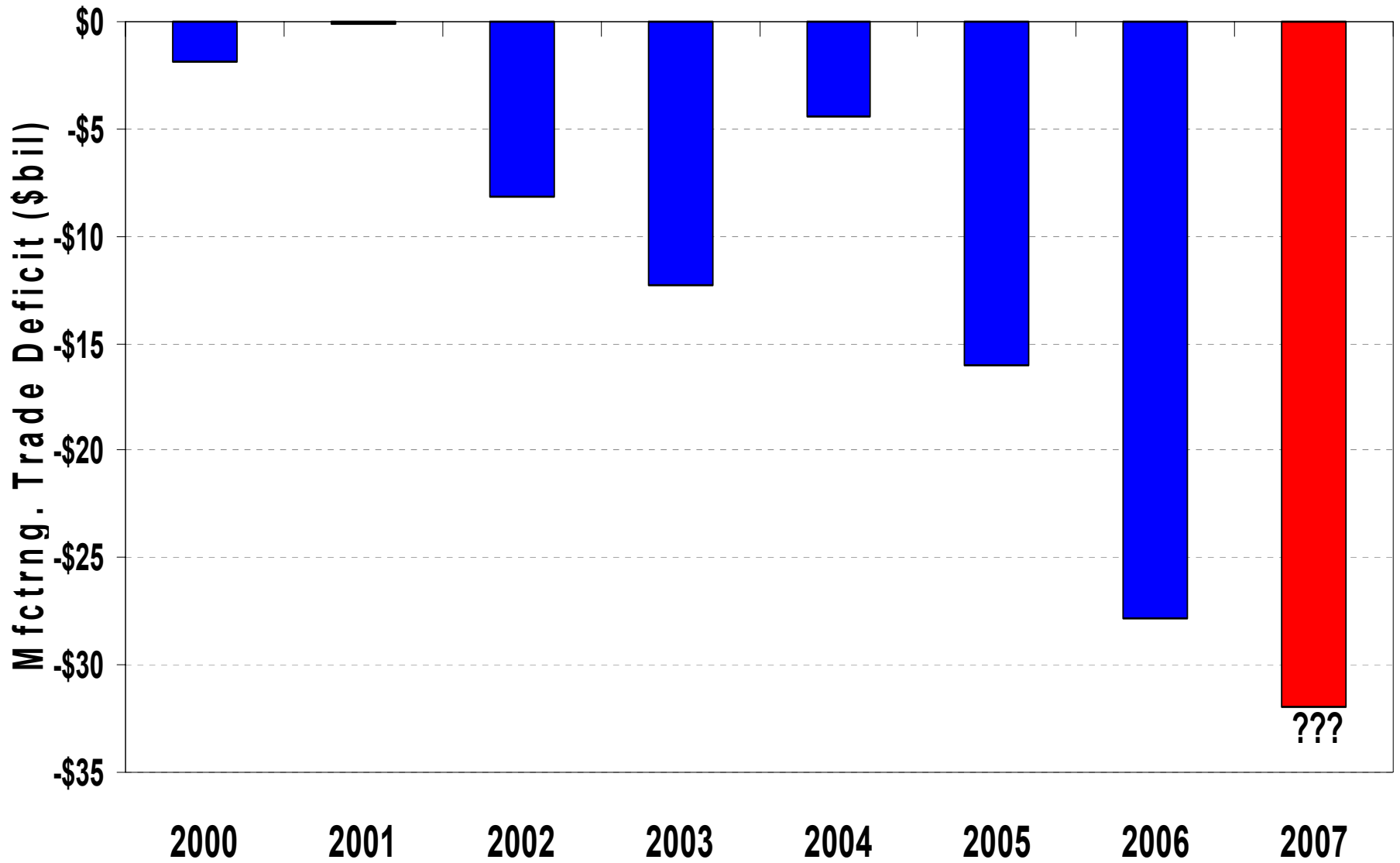
Labour Productivity by Sector

Canada, 1997-2006



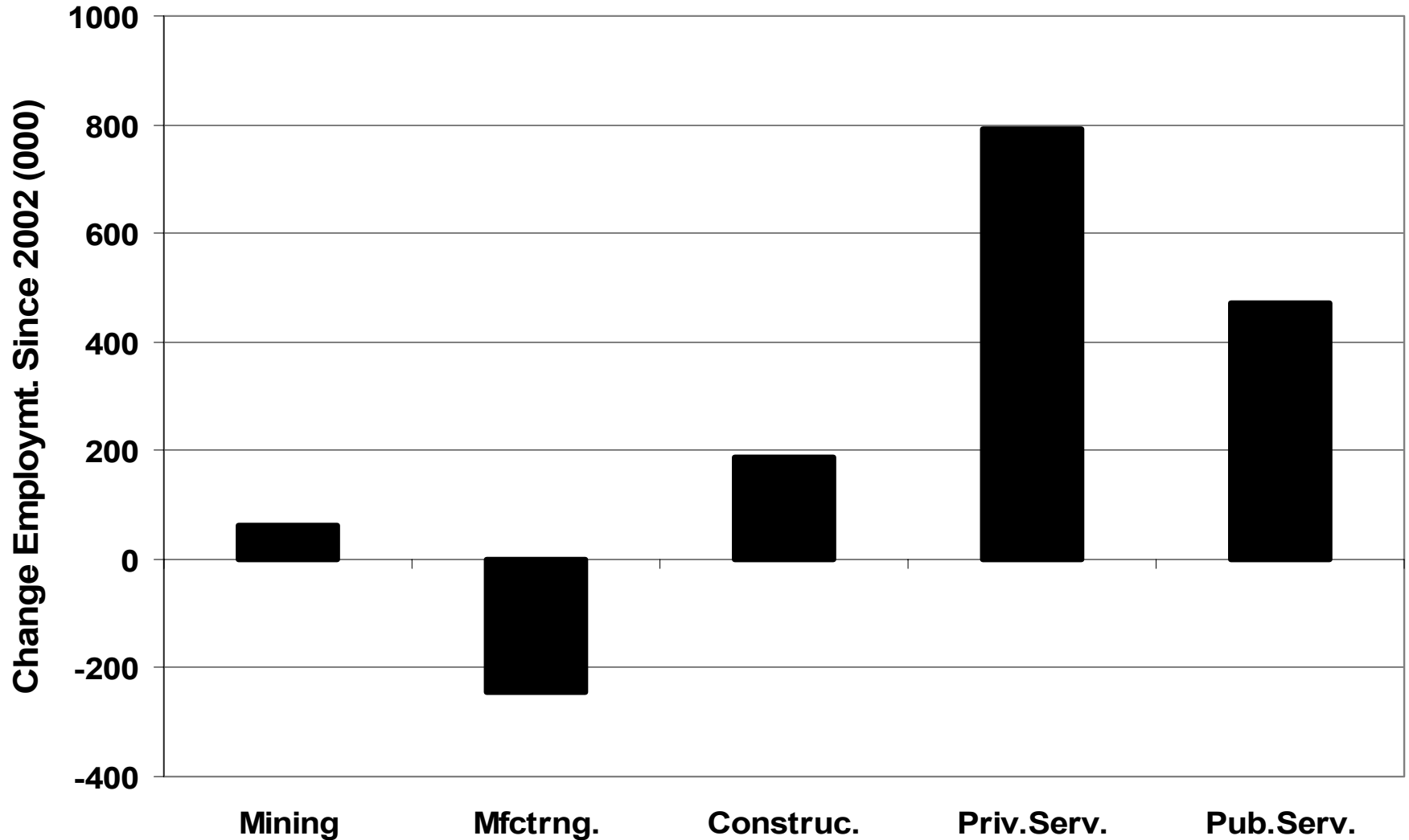
Source: From Statistics Canada; real GDP per employee.

Manufacturing Meltdown

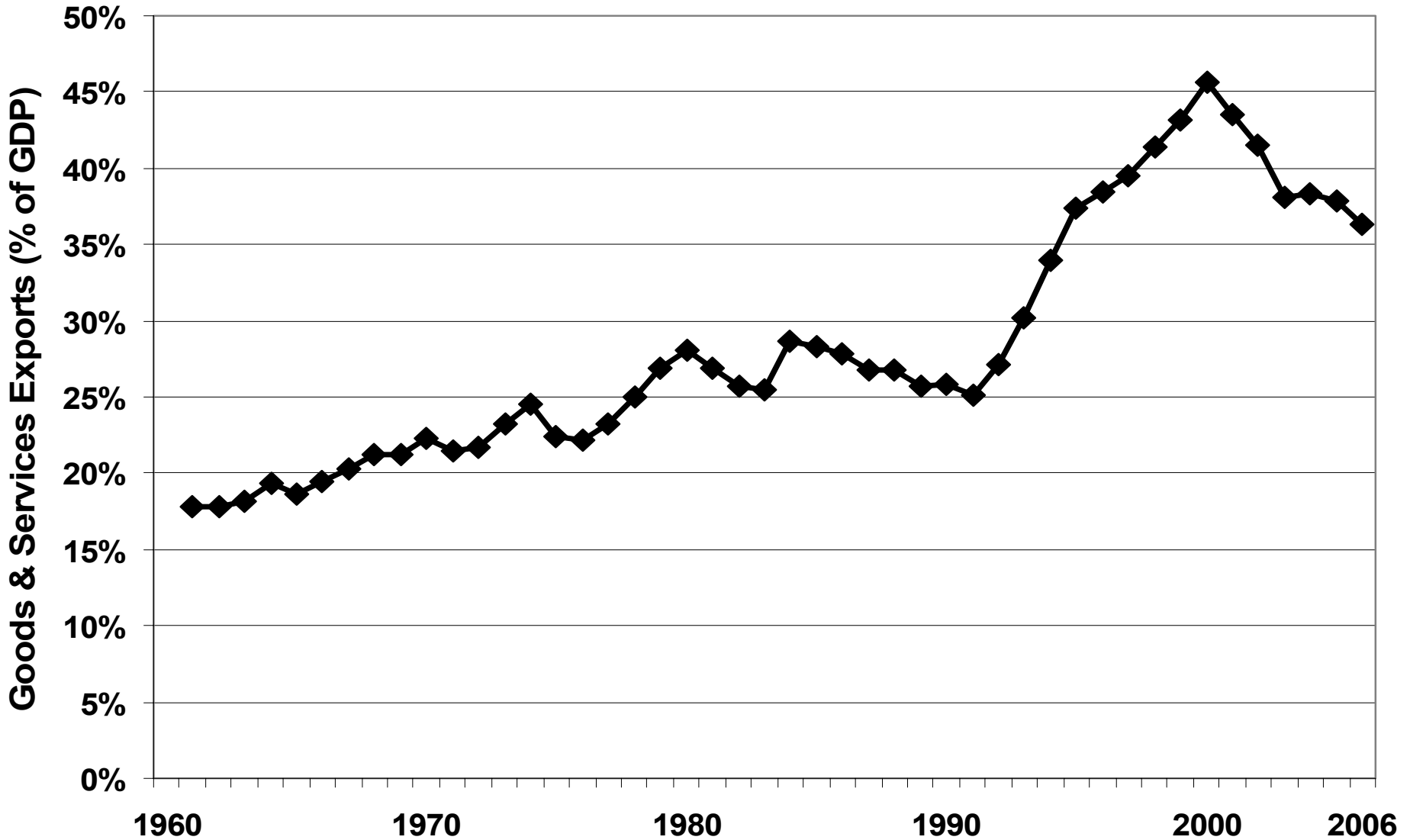


Source: Industry Canada Strategis.

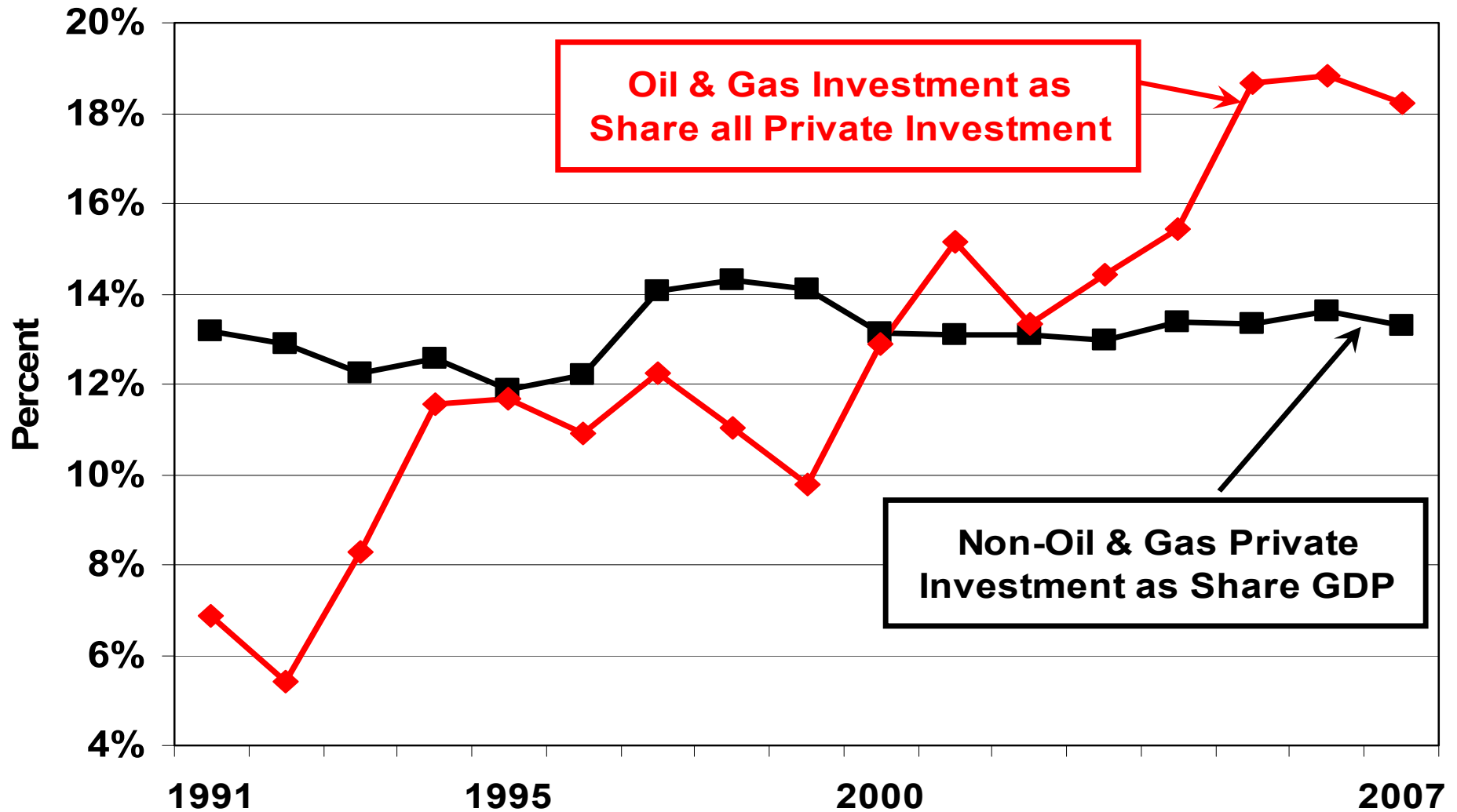
Where are the New Jobs?



Curious “Deglobalization”



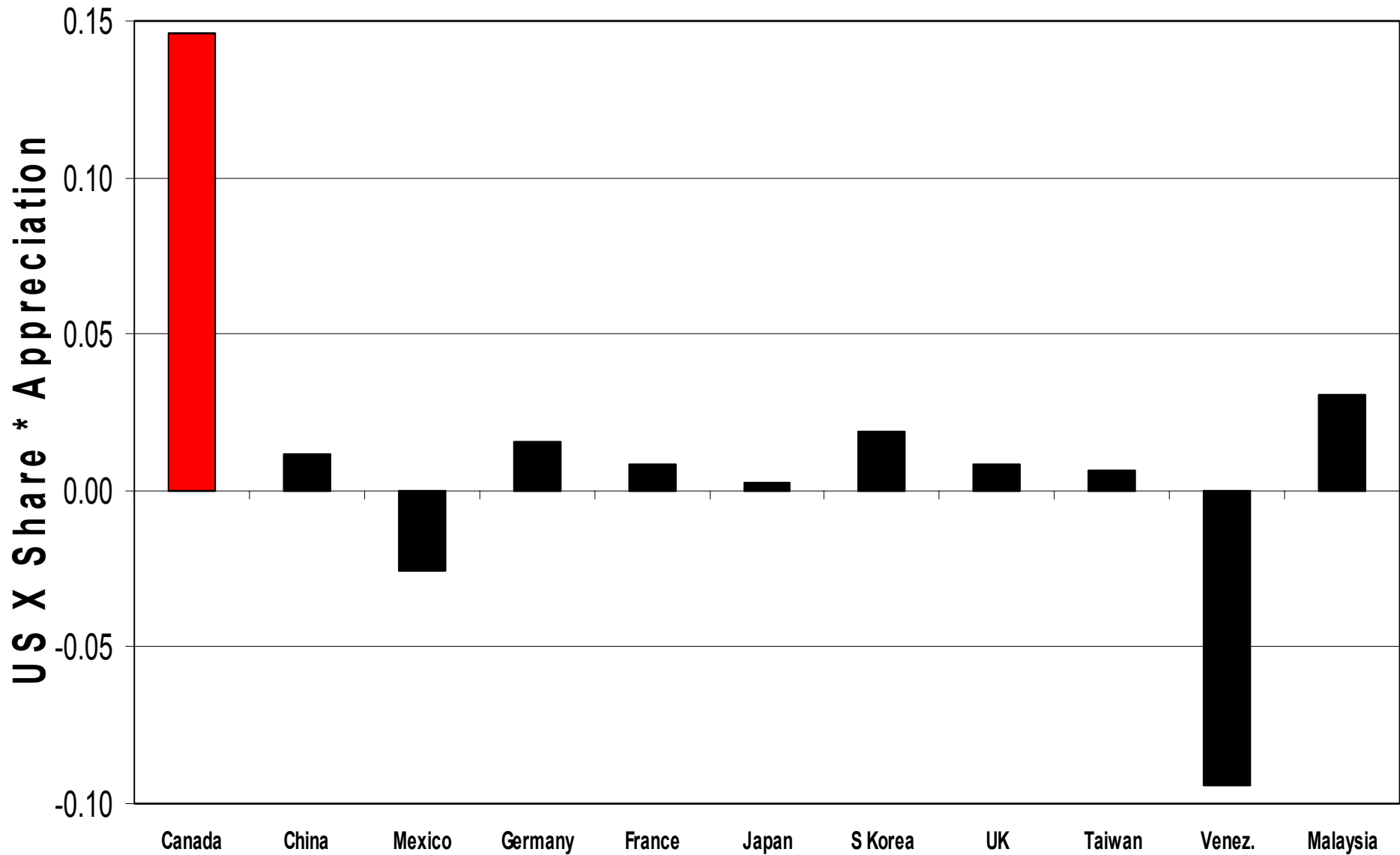
All Eggs in One Basket



The Dollar's Unique Strength



- Loonie has appreciated much more than any other major U.S. trading partner
- “Extra” rise of the loonie (relative to U.S. trade-weighted index) accounts for most of its appreciation
- Loonie is tied to commodity prices (esp. oil)
 - But exactly how? And why?

Index of Appreciation Vulnerability

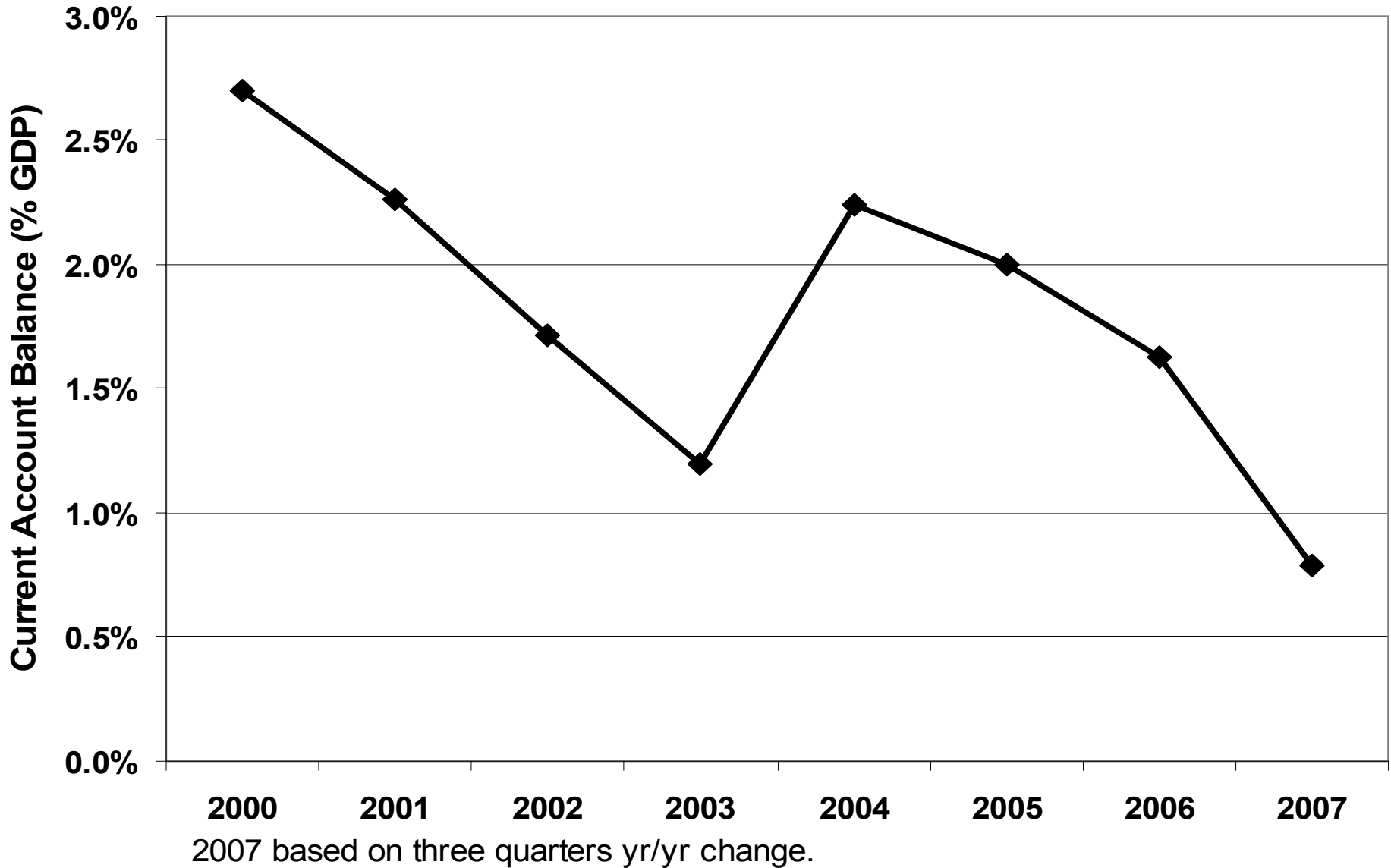


X share in 2006 * appreciation since 2002

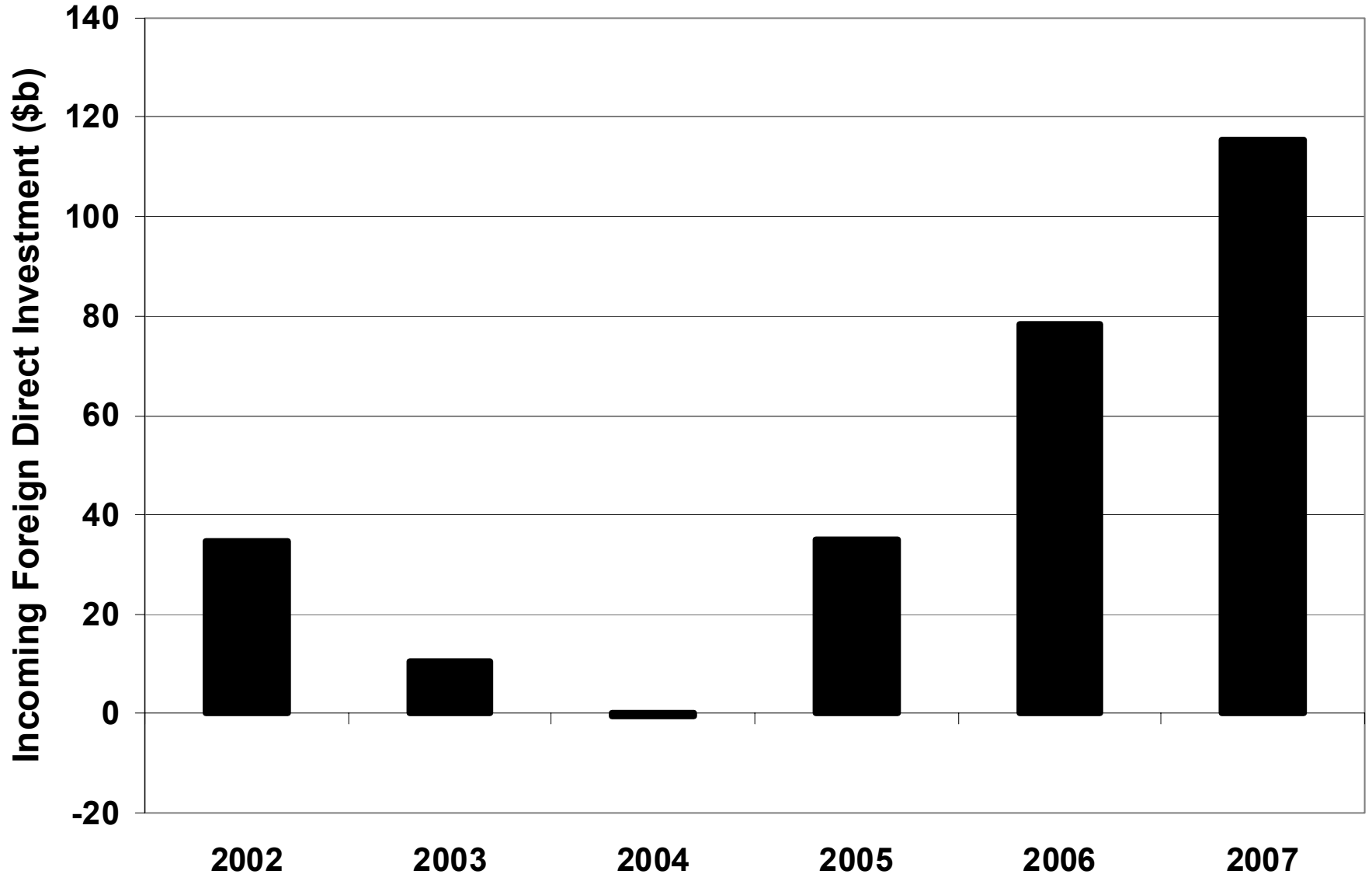
Possible Transmission Mechanisms

- Real trade surplus?
 - Real inflow of FDI?
- 
- “Real” Mechanisms**
- Corporate profitability?
 - Equity valuations?
 - Foreign takeovers?
- 
- “Financial” Mechanisms**

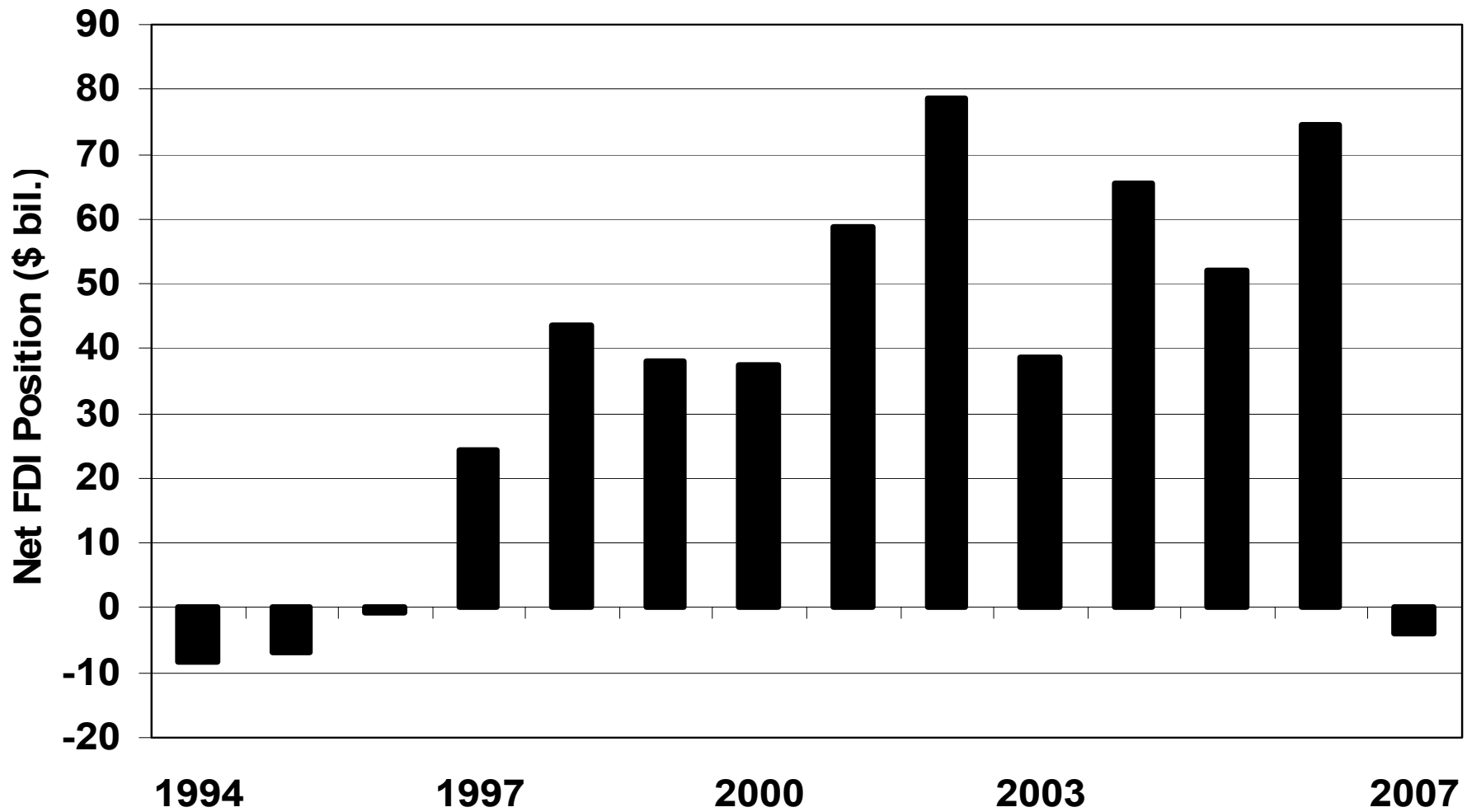
Eroding Current Account Balance



Shocking Foreign Takeover



Back in the Hole Again



2007 data to end of 3rd quarter.

Where Should the Loonie Be?

- Governor Dodge: December 6, Senate Banking Trade & Commerce Committee: *"Now 98 cents sounds very specific. I don't intend it to be nearly that specific but something in the mid- to upper 90s seemed to be pretty consistent with that."*
- Finance Minister Flaherty: Jan. 29: *"The Bank of Canada has targeted a range of 95 to 98 cents or so for the dollar, and that remains the target of the Bank of Canada, which we support."*
- Implication: Loonie in high-90s is somehow logical or even desired?

What is the Loonie's "Fair Value"?

- Rolling econometric regressions may give credence to argument that high-90s is "fair value"
 - Simply because the apparent importance of the oil price coefficient gets larger
- But does that imply that this is a sensible, sustainable, equilibrium level???
- Other benchmarks:
 - Purchasing power parity: still low 80s, rising?
 - Unit cost competitiveness: low 70s, falling

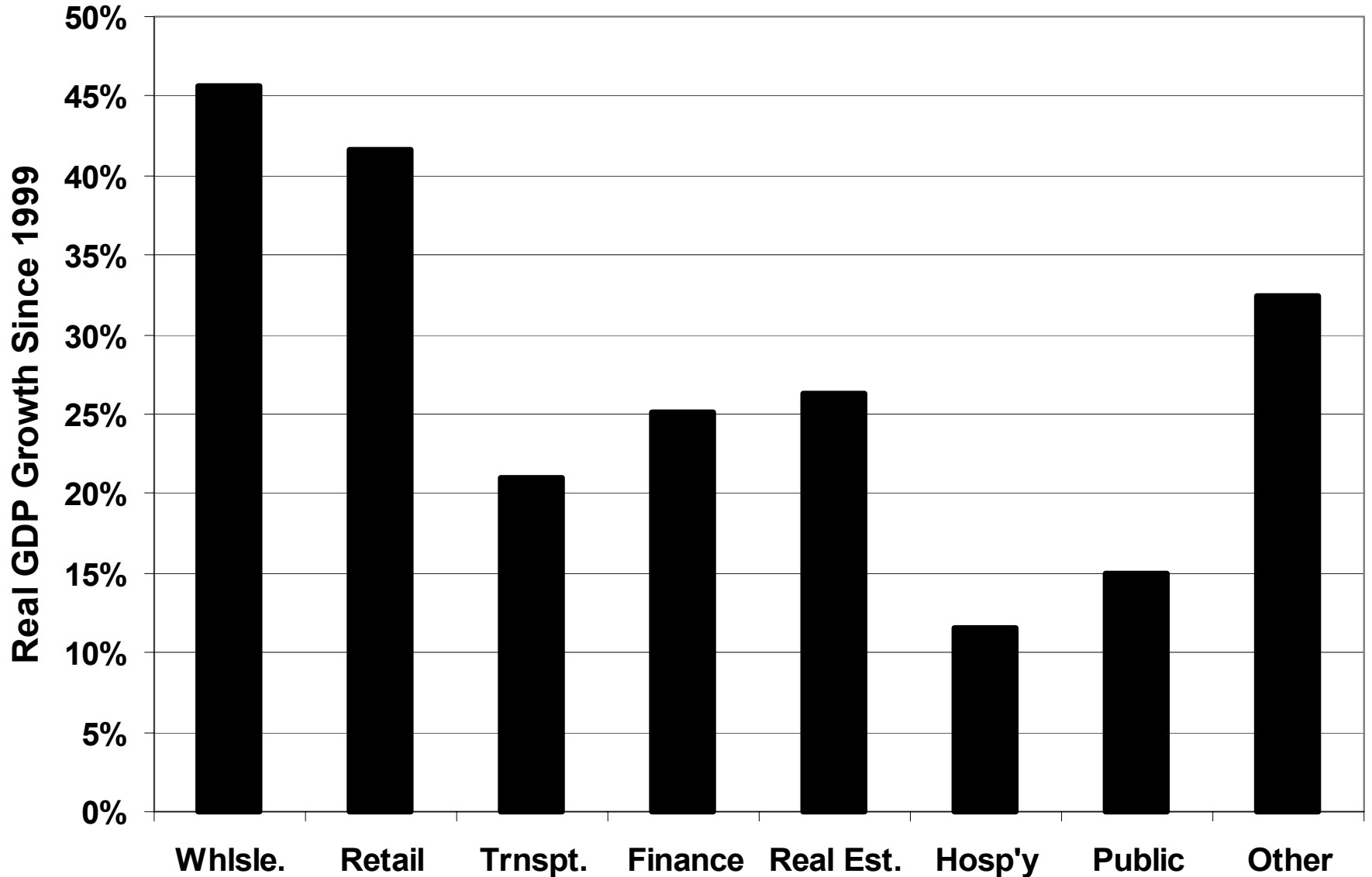
How to Bring the Loonie Back to Earth

- Other countries manage currencies, we can too
- Cut interest rates
- Change monetary policy direction
- Manage/slow the resource/investment boom:
 - Taxes
 - Approvals / environmental rules
 - Foreign investment review
- Appoint Jim Stanford Finance Minister

Brave New Services Economy?

- The dominant shift in resource allocation is from manufacturing to services
- Is there potential in services for:
 - Exports?
 - “Good” jobs?

GDP Growth by Services Sub-Sector



Composition of Employment and Earnings Services Industries, Canada, 2006

	Employment 2006	Change Since 2002	% Change Since 2002	Weekly Earnings 2006 (\$)	Share of Cdn. Average
Private: High-Wage					
Sub-Total	3,131,590	166,076	5.6%	902.57	121%
Private: Low-Wage					
Sub-Total	4,414,713	412,155	10.3%	480.95	64%
All Private, Sub-Total	7,546,303	578,231	8.3%	655.92	88%
Public					
Sub-Total	3,307,873	269,163	8.9%	783.68	105%
TOTAL SERVICES	10,854,176	847,394	8.5%	694.85	93%

Trade in Services



What's Happening

- Boom in global prices for Cdn resources
- Temporary windfall of resource rents
- Very modest expansion of resource production
 - And falling productivity to boot
- Foreign investment boom drives up currency
- Crowding out of other tradeables
- Decline in export reliance, rise of non-tradeables
- Windfall rents drive strong nominal spending
- Negative productivity, environmental, regional consequences
- What happens when the windfall ends?

A Broader Vision

- True prosperity must be based on more than what's buried beneath our feet
- Use resource wealth carefully and deliberately to foster more well-rounded form of economic growth
 - Slow down resource boom, takeovers
 - Capture more rents from resources
 - Pro-actively foster other high-value tradeable industries