ViewPoint: Canada Should Establish an Equitable Growth Institute

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Abstract

Canada faces serious economic challenges and needs strategic policy advice to succeed. Productivity growth must rise from the mediocre trend of recent decades. The spoils of growth should be more evenly distributed. As a carbon-intensive economy, the adjustment to net zero emissions will require fundamental change. The Government of Canada has benefited from advice from occasional advisory groups, but it has been decades since there has been a comprehensive, multi-year policy research effort. The time has come to establish an Equitable Growth Institute. It should align with the objectives of the Government but have sufficient independence to tackle tough issues. Provinces and territories must be involved as they hold many of the policy levers. In addition to having its own governance structure and researchers, it should bring together and where appropriate create networks of researchers. The Institute should delve into big questions of the day, including whether and how a Quality of Life framework can inform decision-making and whether there are trade-offs or complementarity between economic growth and equity and sustainability objectives.

Canada's weak economic growth prospects threaten the well-being of Canadians and compromise the ability of Canadian governments, at all levels, to lower the very large debt burdens being amassed during the pandemic.

The April 21, 2021 federal Budget (Finance Canada, 2021a) provided two long-term projections assuming 1.9 per cent and 2.1 per cent annual average growth respectively. Both exceed the long-term growth rate of 1.7 per cent in the last Finance Canada (2018) long-term projection published in 2018. Drummond and Laurin (2021) find the underlying assumptions behind the Budget scenarios optimistic and argue recent trends could combine with future demographics to generate only about

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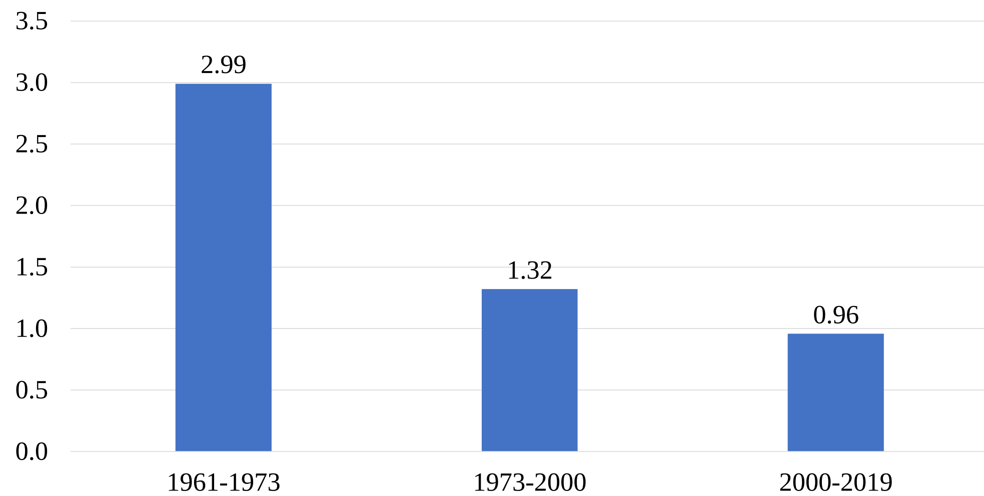
Chart 1: Total Economy Output Per Hour Growth in Canada, 1961-2019 (average annual per cent change)



Source: Aggregate Income and Productivity Trends: Canada vs United States, Centre for the Study of Living Standards. http://www.csls.ca/data/ipt1.asp.

1.5 per cent real growth in Canada over the next few decades (2026 to 2055). This would be similar to the growth rate projected in research done for the Council of the Federation in 2015 by the Centre for the Study of Living Standards (Drummond and Capeluck, 2015) that estimated the growth potential to be just slightly more than 1½ per cent.

The main reasons for such low growth are the aging population slowing labour force growth and a continuation of a long trend of modest productivity gains. Since 2000 Canada's labour productivity growth rate has averaged less than 1 per cent per annum, down sharply from the averages of 3.0 per cent 1961-1973 and 1.3 per cent 1973-2000 (Chart 1).

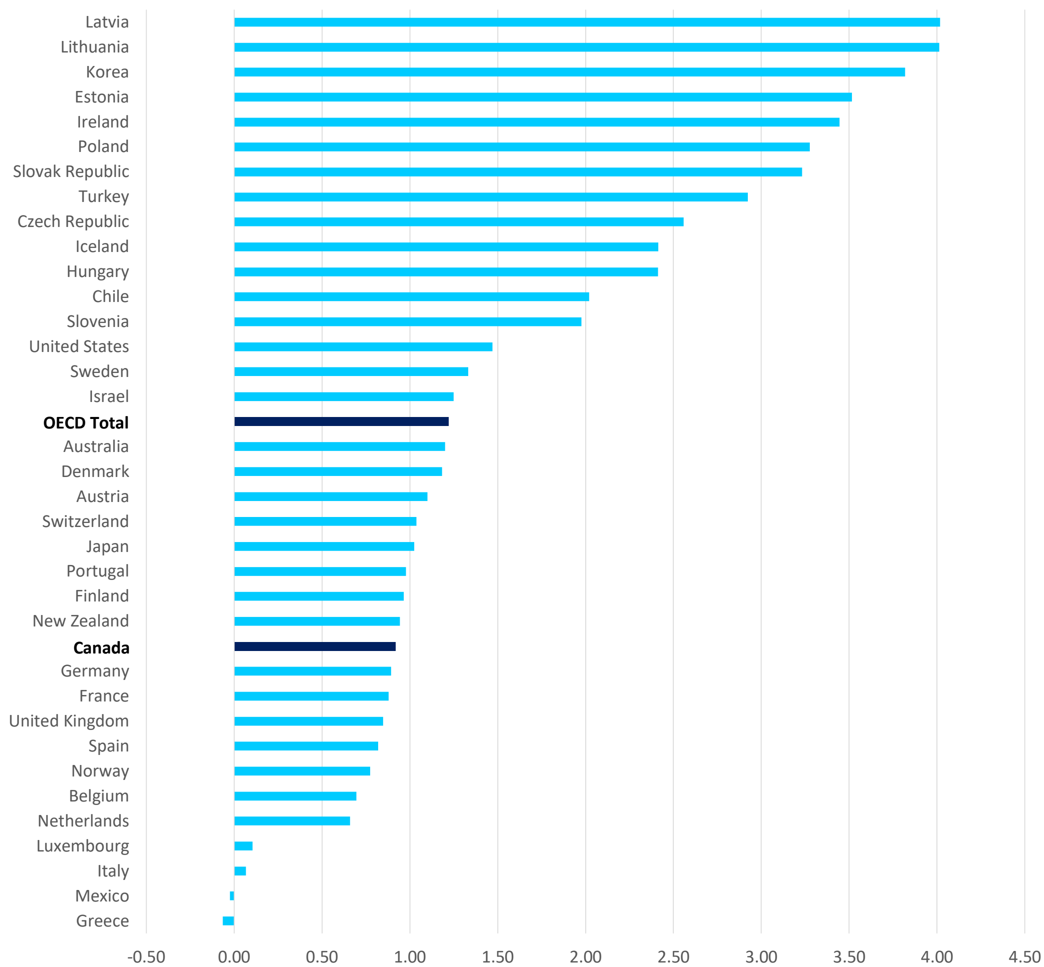
Over the past two decades Canada looks especially bad from the international perspective. Our labour productivity growth since 2000 has been 25th out of 36 OECD countries (Chart 2). The poor productivity performance has resulted in Canada's output per capita in 2019 falling 3.4 per cent below the OECD average, 11.4 per cent below the eurozone average, and 26.6 per cent below the United States.

The level of business sector productivity in Canada was 90-95 per cent that in the United States through the 1970s and into the early 1980s but has slipped since to only 70 per cent (Chart 3). Canada's modest labour productivity reflects increases in the capital stock rather than what might be thought of as innovation. If we strip capital expansion out and look at total factor productivity the Canadian record appears even worse with a slight decline since 2000.

The increase in income inequality in Canada in the last quarter of the 20th century was at least arrested in the 2000s, but little progress has been made since in narrowing inequality (Chart 4). Canada was roughly in the middle (18th of 37 OECD countries) in terms of inequality of income after taxes and transfers in 2018 (Chart 5). However. Canada can and must do better on growth and its distribution.

The Government of Canada estimates

Chart 2: Total Economy Output per Hour Growth in OECD Countries, 2000-2019 (average annual per cent change)



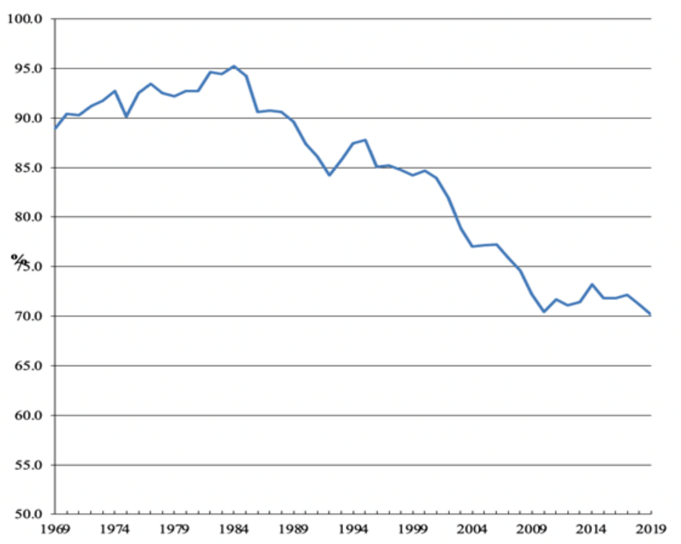
Source: https://stats.oecd.org/Index.aspx?DataSetCode=PDB_GR

existing plans, including actions in the April 2021 Budget, will reduce greenhouse gas emissions 36 per cent below the 2005 level by 2030. This leaves a significant gap to the target of a 40-45 per cent reduction. Further, the government has made a commitment to net zero emissions by 2050. It will be important to ensure the environment goals are achieved in a manner that is compatible with a strong economy.

The April 2021 Budget illustrates the sensitivity of fiscal prospects to the rate of economic growth. Lowering the average growth rate just 0.2 percentage points per annum adds 10 percentage points to the net debt-to-GDP ratio in 2055. Drummond and Laurin (2021) demonstrate that with just slight tweaks to the growth and interest assumptions the debt burden could rise from today's level of a bit over 50 per cent rather than falling to the pre-pandemic level of around 30 per cent in the Budget's favourable scenario.

Canadian governments, federal, provincial and local, need to intensity efforts to orient policy toward creating stronger growth and improving its distribution. Internal efforts have been buttressed in the

Chart 3: Relative Labour Productivity Levels (GDP per Hour) in the Business Sector in Canada, 1969-2019 (Canada as a % of the United States)



Source: CSLS estimates

past by asking advisory bodies to opine on Canada's growth problem and some recommendations have been adopted. The most recent effort was by the Advisory Council on Economic Growth (2018), chaired by Dominic Barton and reporting to the Minister of Finance.

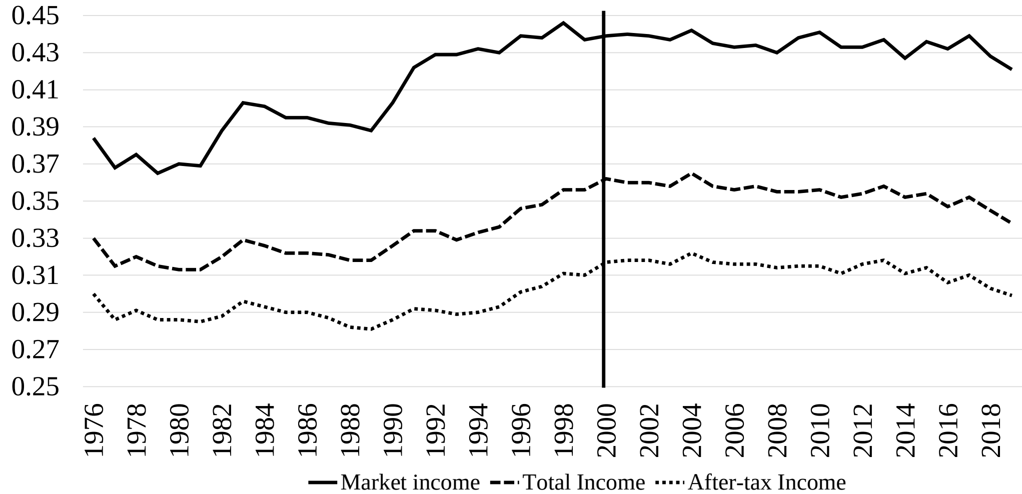
The Council provided sound ideas, but Canada's economic challenges require a deeper, broader and longer-lasting initiative – one that can do more extensive research, consult more and speak with stakeholders in the Canadian economy in the hope of building a consensus on the country's economic future. The economic future will likely be so dynamic, with the adjustment to a lower-carbon future just one of many fundamental shifts likely to happen, that it seems unlikely a temporary body can recommend a one-time re-set that will put the Canadian economy on a promising path for years. Adjustments will be required to address the ever-changing economic landscape. An Equitable Growth Institute could be designed to be permanent or at least have a multi-year horizon.

Learning the Lessons from Other Countries

As part of their attempts to strengthen economic growth, a number of other countries have created permanent research bodies on productivity or economic growth more broadly. A Canadian Equitable Growth Institute could benefit from the experiences. Dougherty and Renda (2017) analyzed and compared ten institutions and draw eight lessons from interviews with subject matter experts.[2] It should be noted that the lessons flow from a subjective

2 Australian Productivity Commission, Chilean Productivity Commission, Danish Productivity Commission, European Political Strategy Centre, France Strategie, Mexican Productivity Commission, New Zealand Productivity Commission, Norwegian Productivity Commission, US Council of Economic Advisors and Irish Competitiveness Council.

Chart 4: Gini Coefficients of Adjusted Incomes in Canada, 1976-2019



Source: Table 11-10-0134-01, Statistics Canada

methodology and are not based on analysis of what the advisory bodies might have contributed in terms of raising productivity.

The lessons are:

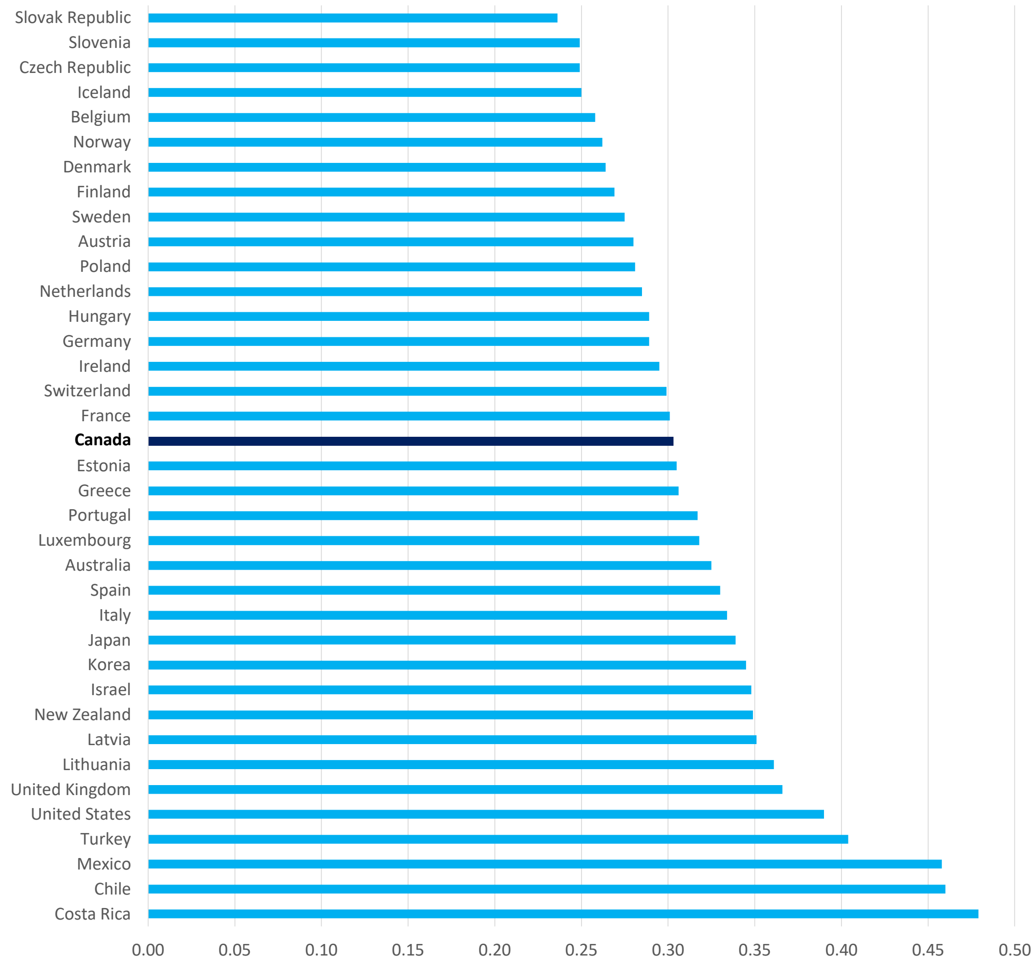
- Context matters: there is no one-size-fits-all solution when it comes to pro-productivity institutions.
- Pro-productivity institutions are no panacea: they should be part of an effort to embrace good governance and evidence-based policy-making.
- Political commitment is essential.
- Independence is important, although its extent can vary depending on the circumstances.
- Budget and human resources must be sufficient for high-quality research and quality control.
- Institutions should engage with stakeholders.
- It is important to combine short- and long-term thinking in the institution to preserve legitimacy and salience.
- Pro-productivity institutions should be "plugged into" the policy process.

Fitting the Canadian Context on What Matters

The advice that context matters should be key in designing an Institute for Canada. That starts with the objectives for the economy. While some other permanent advisory bodies are focused almost exclusively on productivity, that does not seem to fit the Canadian context. To be sure, improving productivity is necessary in Canada and should be a prime focus of the Institute. But Canadians are also concerned about the equitable and inclusive nature of the gains from economic growth and the sustainability of growth in terms of the environment.

Even on economic growth, the Canadian context calls out for a broader focus than only productivity. Canada has a fairly high labour force participation rate by historical and international standards, but it could be higher. This is particularly the case for the large and growing Indigenous population. If the Indigenous labour force participation rate gaps close and the trend toward declaring Indigenous heritage con-

Chart 5: Gini Coefficient in OECD Countries, Post Taxes and Transfers, 2018

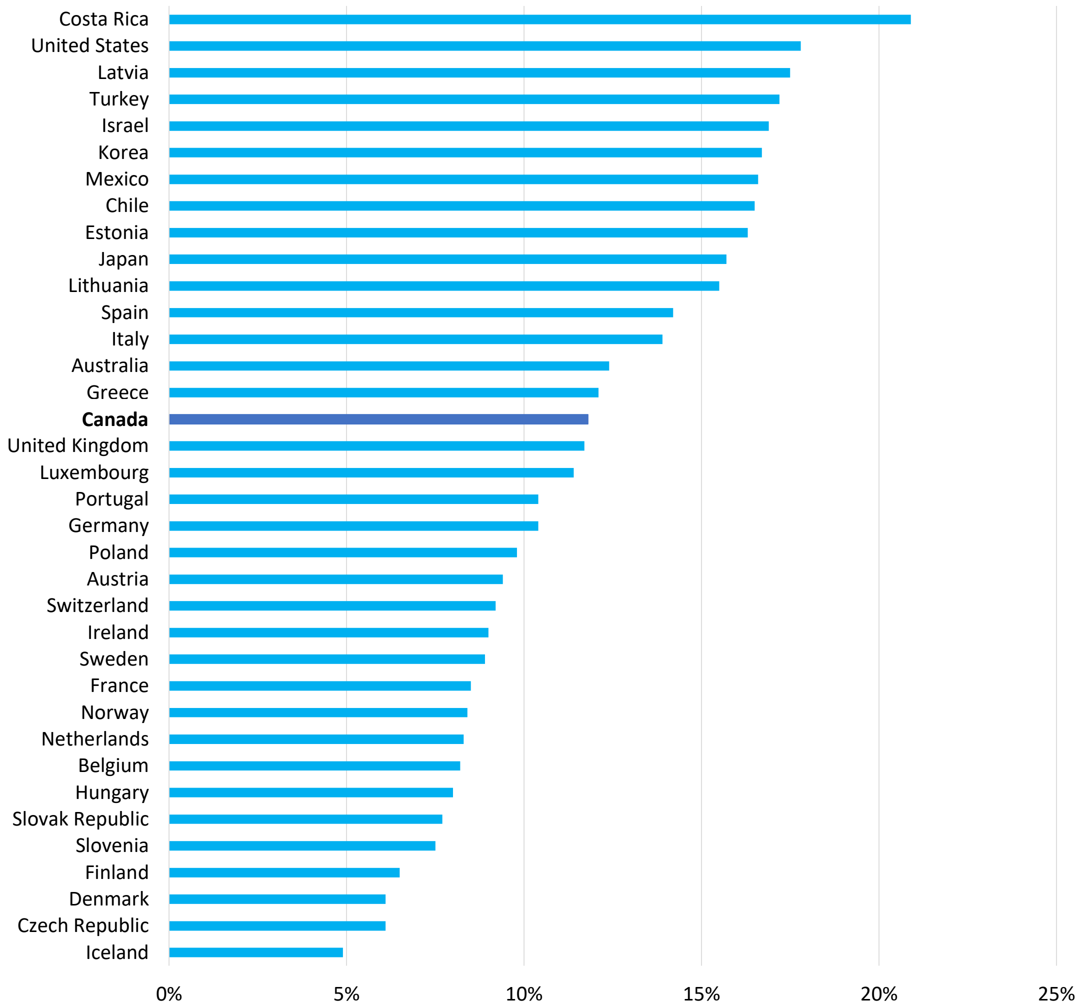


Note: Data for Chile, Denmark, Germany, Greece, Hungary, Iceland, Ireland, Italy, Switzerland and United States are for 2017. Data for Japan and Turkey are for 2015. Data for New Zealand is for 2014
Source: https://stats.oecd.org/Index.aspx?DataSetCode=IDD#.

tinues, Indigenous people will contribute more than one-fifth of all the labour force growth in Canada through 2036 (Drummond, Sharpe, Murray and Mask, 2017). The COVID-19 experience has heightened attention to the effect of childcare on female labour force participation. Immigration to Canada cratered during the pandemic. It will return on its own accord once travel and other restrictions ease, but rebuilding must address pre-pandemic challenges. While immigrants had been faring better in the labour market on the basis of several indicators from 2006 to 2019, the unemployment rates of new immigrants were persistently above those of other Canadians and their average hourly wages persistently lower (Wong, 2020). On the wage front, it is particularly troubling that highly educated recent immigrants fared worst in terms of the gap with respect to the Canadian-born.

The participation rate of persons with disabilities is 55 per cent in the prime working-age group 25-54 compared to 84 per cent for persons without disabilities (Turcotte, 2014). Higher participation of persons with disabilities could add hun-

Chart 6: Poverty Rates in OECD Countries, 2018



Notes:

1. Data for Denmark, Germany, Hungary, Iceland, Ireland, Italy, Switzerland, United States and Chile are for 2017. Data for Mexico and Netherlands are for 2016. Data for Turkey and Japan are for 2015.
2. The poverty rate is the proportion of the population whose income falls below the poverty line, which is defined as half the median household income of the total population. The poverty rate is measured after taxes and transfers, and income is adjusted for household size.

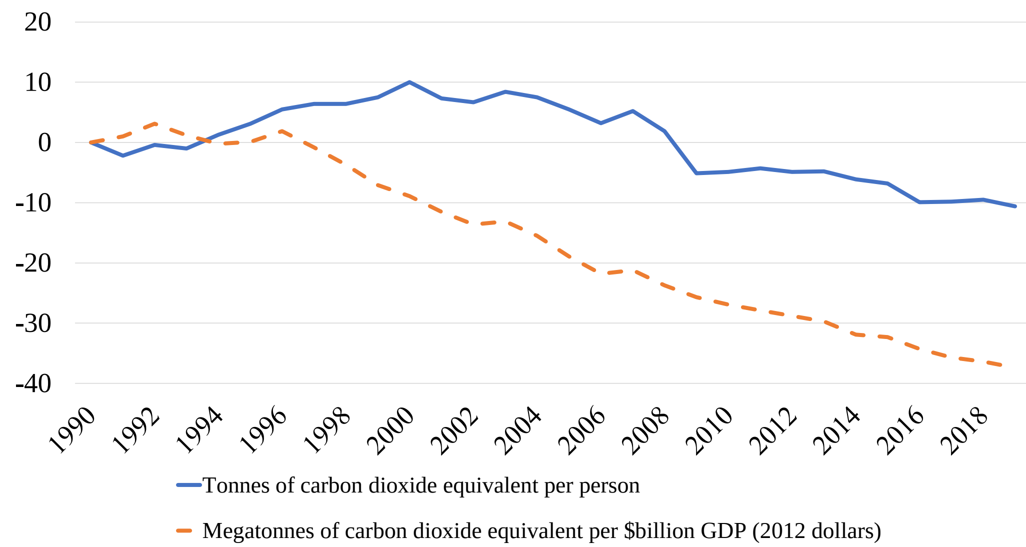
Source: https://data.oecd.org/inequality/poverty-rate.htm#indicator-chart.

dreds of thousands to the total labour force and be critical to improving their well-being.

Surveys suggest many older Canadians wish to continue working in some fashion, but not necessarily full-time. The participation rate for those 55 and over has risen from 23.8 per cent in 1996 to 37.9 per cent in 2019, but still, it is less than half the 87.3 per cent rate for Canadians 25-54. Labour market obstacles to the aspirations of older people should be examined, including inflexibility of pension and work arrangements.

Canada's business investment is weak with per worker spending on new capital in Canada lower than the average figure among reporting countries in the OECD (Robson, 2019). The Canadian context therefore demands that all sources of growth be examined: labour force, capital, and productivity.

Chart 7: Percentage Change from the 1990 Levels of per Capita and per Dollar GDP Emissions in Canada, 1990-2019



Source: Environment and Climate Change Canada (2021)

Concern over income inequality has grown in recent years in Canada and improving income distribution is a major focus of the current government. So too should it be a focus of an institute. Interestingly, the concern with inequality has coincided with rough stability in the key measures as noted earlier (Chart 4). Nonetheless, international comparisons show there are grounds for improvement. Using the Gini coefficient to measure income inequality, of the 37 countries analyzed by the OECD, Canada is close to the middle with 17 countries having more equal distributions and 19 worse (Chart 5). Canada is also in the middle of the poverty rankings with 20 countries having lower poverty and 15 higher (Chart 6). Canada should aspire for better.

Concern over income inequality often focuses upon re-distributing a given amount of income. An Institute could certainly look into this. But as well it should examine how growth and income are created. If a more representational group of Canadians were involved in the generation of growth and income, there would be less need for re-distribution. In a common vernacular, this is growing the pie rather than slicing it differently. But it is growing the pie from all dimensions.

An Institute could take a broader focus on inequality than simply income. Inequality can be found in many facets of life including access and affordability of health services, educational opportunities, legal services, financial advice, broadband, access to affordable housing and safety of neighbourhoods.

The Government of Canada has targeted net zero emissions by 2050. The environmental objective should not and must not compromise economic growth or, more generally, the well-being of Canadians. And it need not. But strategies will need to be set out to ensure this result. The focus must be on reducing the emissions intensity of GDP. The progress made since the late 1990s (Chart 7) must accelerate. This will certainly entail the development and absorption of new technologies. It will involve changes in production processes. It will likely involve shifts in resources across sectors and firms with substantial implications for workers.

Fitting the Canadian Context on Governance

Of the 10 pro-productivity institutions analyzed by Dougherty and Renda, four are housed at the centre of government (European Political Strategy Centre, France Strategie, Mexican Productivity Commission and U.S. Council of Economic Advisors) and six are independent. Of the independents, four report to the Prime Minister and two to Parliament. As the Economic Council of Canada, existing from 1963 to 1992, had some similarities to what is proposed here for an Equitable Growth Institute, it is worth noting it reported to the Prime Minister of Canada but had a Board of Directors drawn from a variety of backgrounds.

The governance of an Equitable Growth Institute in Canada must also fit the Canadian context. It should be an agency of the federal government. It would only be effective if the government recognizes there is an economic problem and is committed to finding solutions. That would require some foresight because the benefits tend to flow over a long period, whereas controversy can arise in the nearer term. For example, such bodies tend to recommend more competition and better regulation but those with vested interests in protected markets resist.

An Institute must have sufficient independence to challenge the status quo without the government feeling the need to be defensive. But it must be sufficiently connected to government that it has internal champions and is taken seriously. Yet even with considerable independence, a reporting structure would be required. Possibilities for reporting include the Prime Minister, the Minister of Finance, Parliament, or a Board of Directors established by the Government. Or, as in the case of the Economic Council of Canada, it could have dual reporting such as to the Prime Minister and a Board.

A particular feature of the Canadian context is the large importance of provinces and territories in the Canadian economy and policy. They should be involved, too. Formal representation of provincial/territorial governments may make the governance unwieldly, but there could be representation on a Board by individuals representing provincial/territorial perspectives. There could also be an advisory body to the institute with members connected to the other levels of government as well as business, labour and other stakeholders, including those dedicated to equity and sustainability of growth. The advisory body could also have direct discussions with the government.

Fitting the Canadian Context on Structure

The Canadian Equitable Growth Institute should be headed by someone with credibility in economic and policy matters. There should be an internal research staff, but it should also connect and foster existing research networks and create new ones where needed. Such connections should include other government entities including the recently established Future Skills Council, the Labour Market Information

Council and the Canadian Institute for Climate Choices.

An Equitable Growth Institute Must Delve into All Corners of the Economy and Policy

The Institute must have the authority and capacity to delve into all aspects of the economy and the policies that influence it. There was a time when much of the attention to economic growth and productivity in particular focused on "macroeconomic factors and policies". In the 1980s and 1990s that made sense in the Canadian context because macroeconomic policies were growth inhibiting with high government debt, high marginal tax rates, high tariff barriers and high inflation, to mention just some of the weaknesses. But many of these policy deficiencies were addressed at least in part, yet productivity growth did not improve.

That is not to suggest it was not worthwhile making the policy improvements. No doubt things would have been worse had policy remained on its prior course. But the record does suggest other factors have to be looked at. Analysis must reach into sectoral detail. Many sectors have productivity even lower than the 70 per cent average of that in the United States. At the other extreme, we have a number of firms that are world class, but few industries at the global productivity frontier. A thorough sectoral review of productivity levels relative to U.S. counterparts has not been done in almost two decades (Rao, Tang and Wang, 2004). Going a step further, the behavior of firms must be studied and how that is influenced by policies, both macroeconomic and microeconomic such as regulation and legal framework. Drummond (2011) provides a personal and somewhat broader account of this journey from the macro to more micro foundations of economic growth.

Internationally there is also some redirection happening in productivity research. To a degree the catalyst is observations of the failure of productivity to converge more across countries and the striking and persistent productivity gaps across sectors and across firms within sectors. This has led the World Bank to label some of its recent work "the second wave of productivity research". The approach is based on firm-level data disaggregating productivity into gains within firms, across firms through resource allocation and through market entry and exit. Drummond (2020) provides an analysis of this approach.

Fortunately, in Canada firm-level data have recently become more available with growing capacity to link to other data bases. Firm-level data along with detailed industry data could be fertile ground for an Equitable Growth Institute and take it into the world of regulation, competition policy, and intellectual property rights. It could take the Institute into investigating what is often called the "Valley of Death" in firm growth in Canada. This refers to the observation that firms are created at a fair clip in Canada, they tend to grow fairly rapidly at first, but then they stall or sell out once reaching a modest size. This is anti-growth and anti-productivity as productivity tends to be higher with larger firms.

An Institute should study who benefits from productivity gains. It was conventionally thought that productivity growth was fairly fully reflected in real wages. However, the link has come into question, not only in Canada, but in many countries, over recent decades as growth from productivity appears to largely accrue to higher-income individuals. For the United States, Mishel and Bivens (2021) identify excessive unemployment, eroded collective bargaining, and corporate globalization as factors that explain why median wages have not kept pace with productivity growth. Research should determine if such factors, or others, are at play in Canada.

An Equitable Growth Institute Should Address Some Big Questions

There are many big questions in the areas of economic growth, its distribution and its environmental effects. We address but three here.[3]

First, should Canada move beyond a fairly singular focus on Gross Domestic Product (GDP) as the metric of the economy? There is an international movement questioning how GDP represents an economy as it does not fully capture well-being or social welfare. Upon research, the Institute could recommend modifications within the existing structure, such as incorporating shadow prices of "free" goods and prices of difficult-to-measure products, or satellite accounts that connect specific economic, social and welfare domains such as health, human capital or the environment to the core GDP concepts.

Or the Institute could play a broader role in advancing the federal government's interest in a Quality of Life Index. In December 2019, the Minister of Middle Class Prosperity and Associate Minister of Finance was tasked with better integrating quality of life measurements into decision-making and budgeting. Since then, Finance Canada has done consultations and research leading to a report (Finance Canada, 2021b). The architecture of the index includes health, prosperity, society, environment and good governance, all viewed through the lenses of fairness and inclusion and sustainability and resilience. The Institute could help bring the Quality of Life Index into prime time. It could advise on what to measure and how. It could be the body to publish regular reports, thus providing a more objective perspective than might be the case as a government publication. It could draw together inputs from outside government, including academic researchers, think tanks and others. It could help formulate objectives for a higher quality of life for Canadians and recommends means to achieve that.

Second, the Institute could examine a conventional view that there is a trade-off between a strong economy and equity. In this view, measures to reduce inequality such as tax and transfer programs to redistribute income, reduce economic growth through channels such as work disincentive effects. But counter arguments can be made whereby reduced inequality could enhance economic growth and over time reduce fiscal burdens. For example, a more equal income distribution could improve access to education and training for those in the bottom half of the income distribu-

3 For a more comprehensive discussion of an equitable growth agenda for Canada, see Sharpe (2021).

tion.

Third, the Institute could look at the commonly expressed view that there is a trade-off between a strong economy and sound environment. The key is achieving smart or clean growth and facilitating adjustments throughout the economy.

An Equitable Growth Institute is Key to Advancing Canada's Goals on the Economy, Inclusiveness and Environment

Canada has a strong research community in government, academia and think tanks. This community could no doubt continue playing a valuable role in advancing Canada's interests. But the research and researchers tend to concentrate on particular pieces of the puzzle whereas the issues are broad and cross-cutting. An entity charged with taking a broad perspective and bringing together and facilitating efforts of others would be a valuable addition to what is in place now.

A Modest Cost for a Large, Potential Gain

There would be some cost associated with establishing an Institute, but the bar seems low for realizing a net gain. Raising the rate of productivity growth just 0.1 percentage points a year over the next 10 years, leading to an increase in economic growth from 1.5 per cent to 1.6 per cent, would boost the level of output in 2030 by $23 billion and the cumulative output over the decade by $121 billion. Between 30 per cent and 40 per cent of that gain would flow to the total government sector through existing tax provisions.

Those revenues are desperately needed by Canadian governments given the battering their fiscal positions have taken because of COVID-19 as well as future pressures on health care and pensions from the aging population.

Conclusion

The federal government could announce in short order its intent to establish a Canadian Equitable Growth Institute and begin consultations immediately thereafter.

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