As Canadian productivity has increased, workers' pay has stagnated

Ottawa research institute report demonstrates that real wages lag far behind productivity growth

Ottawa, December 11, 2008. A new study by the Ottawa-based Centre for the Study of Living Standards shows that over the past 25 years Canadian workers' pay packets have not kept up with their increased productivity. From 1980 to 2005, Canadian labour productivity increased by 37%. During that same period, median wages in Canada have not increased at all, when adjusted for inflation.

"Economists argue that productivity increases should lead to proportional gains in inflation-adjusted wages," the Centre's Executive Director Andrew Sharpe points out.

"But the figures show that this has not happened in Canada over the past 25 years. This means that gains from productivity advances have not been shared equitably among all members of society."

One of the main reasons for this gap, the study notes, is the growth in "earnings inequality." From 1980 to 2005 the earnings of the highest income workers increased by 16% (when adjusted for inflation) while the lowest income group saw its inflation-adjusted earnings ***drop*** by more than a fifth.

Decreased bargaining power for workers, caused in large measure by the pressures of globalization and declining rates of unionization, has also contributed to the gap between growth in productivity and wages.

"Decreased bargaining power has meant that labour's share of income in Canada's GDP has dropped," Dr Sharpe explains. "When workers cannot exert pressure for pay increases, more of the total income tends to stay in the form of profits."

The study identifies another factor contributing to the gap between income and productivity growth.

There has been a decline in what economists refer to as "workers' terms of trade." That means the prices of goods workers purchase have increased at a greater rate than the prices of goods they produce.

Impact of changing economy and technology

Among other findings of the study are that the shift in Canada's economy from manufacturing to commodities has also shifted income away from workers.

"Because commodity-based industries tend to have larger profit shares and lower labour shares," the study says, "employment shifts towards these industries lead to a decreasing labour share."

Finally, the study shows that the changing nature of technology has also contributed to the productivity-wages gap.

What the study calls "short-lived capital assets," such as computers and other high tech products, must be replaced more frequently than "old" technology products. This means that enterprises must invest an increasing share of their production in replacing these assets.

Effects of current economic crisis

The findings of this study are significant in the context of the current recession.

The report points out that following the recession and the prolonged period of economic stagnation of the first half of the 1990s, inflation-adjusted earnings of Canadian workers never made up the lost ground relative to productivity.

In the current economic crisis, inflation-adjusted wages gains for Canadian workers will be minimal if not negative. Today, most Canadian workers do not have the cushion of the gains they should have made during the good times since 1995, so they will be doubly disadvantaged.

The study was written by Andrew Sharpe, Executive Director of the Centre for the Study of Living Standards, and Jean-François Arsenault and Peter Harrison, who are economists at the Centre.

The study is posted online at www.csls.ca/ipm17/sharpe.pdf

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Backgrounder: Why Have Real Wages Lagged Productivity Growth in Canada?

Statistics Canada reported in May 2008 that median real wages in Canada have been stagnant over the 1980-2005. Yet labour productivity growth advanced 37 per cent over the same period. Economists argue that productivity growth leads to proportional increases in real wages. The more a worker produces, the more output that is available for the worker to consume. But why have the productivity gains of the last 25 years not been equitably shared among the overall population?

In a study entitled “Why Have Real Wages lagged Productivity Growth?” released December 11 and published in the Fall 2008 issue of the International Productivity Monitor, Andrew Sharpe, Jean-Francois Arsenault and Peter Harrison from the Centre for the Study of Living (CSLS), an Ottawa-based non-profit economic research organization, tackle (address) the issue of the disconnect between median real wages and labour productivity. They identify the four factors at play and provide quantitative estimates of their importance. Their key findings are:

- growing earnings inequality accounted for 28 per cent of the gap between the growth rate of median real wages and productivity. The median real earnings of workers in the top quintile increased 16 per cent between 1980 and 2005 while those of the bottom quintile fell 21 per cent. The reasons for this development are poorly understood.

- globalization and falling unionization rates have lead to a decrease in the bargaining power of workers. This decline was reflected in the falling share of labour income in GDP, which explained 20 per cent of the gap.

- a decline in the terms of trade of labour, that is a greater increase in the price of the goods workers purchase, as represented by the Consumer Price Index than in the price of the goods workers produce (the GDP deflator) accounted for 33 per cent of the gap.

- finally, measurement issues, largely associated with the difference between the growth of earnings and a measure of labour income that includes supplementary labour income (employer contributions to social programs), accounted for 20 per cent.

While recognizing that the only way for an economy to enjoy sustainable increases in its standard of living is through productivity growth, the authors caution that it will be difficult to gain wide public support for policies that improve productivity if the gains from productivity advance are not more equitably shared among all members of society.