
PRESS RELEASE

For immediate publication

THE COMPETITIVENESS OF THE CANADIAN ECONOMY: THE REAL ISSUE IN RENEGOTIATING NAFTA

Montréal, September 11, 2018 – Thus far, negotiations to renew the North American Free Trade Agreement (NAFTA) have focussed mainly on trade disputes between Canada and the United States. But in fact, the concerns in the headlines may be overshadowing a much more fundamental problem: the competitiveness of Canadian firms. This is one of the key findings of the latest report issued by the Centre for Productivity and Prosperity – Walter J. Somers Foundation (CPP).

“In a context where the difficulties surrounding the NAFTA negotiations are giving rise to serious concerns, we have to wonder about Canada’s ability to compete,” explains CPP Director Robert Gagné, co-author of the study. “Is the Canadian economy so fragile that new trade barriers would threaten the survival of some industries? Doesn’t the weakness of the Canadian dollar give them a sufficient trade advantage to offset the impact of such new barriers?”

Paying for their inaction

To better answer these questions, the CPP set out to evaluate the competitiveness of Canadian industries. Using an innovative approach based on the relative evolution of productivity and production costs in Canada and the United States, the authors examined the changes in the relative competitiveness of the 34 main industrial groups making up the Canadian economy.

Generally speaking, the results show that productivity gains in Canada were too weak for industries here to remain competitive when the Canadian dollar began rising in the early 2000s. Many sectors had not invested enough in improving their productivity, and hence now appear vulnerable to new trade barriers, even though the relative weakness of the loonie currently gives them a significant trade advantage.

According to Gagné, for too long Canadian firms took refuge behind a favourable exchange rate when trading with the United States. “Relying on their currency’s relative weakness, Canadian producers saw their exports skyrocket without really having to worry about their productivity or competitiveness. As a result, they have lost more and more ground against the US in terms of productivity and their ability to absorb a trade or monetary shock has gradually declined. In the end, their lack of initiative has caught up with them.”

Instructive results

Combining the results by industry, the authors found that the competitiveness of the Canadian economy as a whole decreased between 2000 and 2014.

“When we ignored the impact of the changing exchange rate, it initially appeared that industries had made significant gains,” explains Gagné. “In many sectors, the pressure on production costs was weaker than in the United States, as the costs of intermediate purchases and capital rose

more slowly. The result was that the nominal competitiveness of the Canadian economy grew by 9.9% in comparison with the United States, although its overall performance in terms of productivity didn't let it make the most of these gains."

The winds shifted, however, when the Canadian dollar began strengthening. "Once production costs were adjusted to take account of the changing exchange rate, the gains turned into losses," he explains. "As it appreciated, the loonie boosted the effective value of goods and services produced in Canada. The nominal gains had not been strong enough, so that the Canadian economy's effective competitiveness plunged." On average, the rise in the Canadian dollar reduced the competitiveness of the Canadian economy by 26.6% between 2000 and 2014, abruptly wiping out the gains made before taking the exchange rate into account. The Canadian economy's effective competitiveness fell by 16.7% during this period, a sign that Canada's competitive position has become much more fragile.

Highlights by industry

- Only the agriculture, paper manufacturing and wood products manufacturing industries improved their effective competitiveness vs their American counterparts. In other words, fewer than 10% of Canadian industries managed to offset the exchange effect with nominal gains.
- The largest gains were in the paper manufacturing sector, where production is actually shrinking. So this positive performance is in fact due to a "skimming-off" effect, as declining business has apparently led to the removal of less-competitive players.
- The heaviest losses were in computer and electronic product manufacturing. Although it had a considerable head start in nominal competitiveness vs its US counterparts, the industry suffered from particularly weak productivity growth.
- Across the country, competitiveness gains before the exchange rate is taken into account come mainly from goods-producing industries, probably reflecting a catch-up effect.

Productivity, key to competitiveness

In the light of these findings, one thing is clear: more than ever, Canadian firms must not hide behind a weak loonie once again. To boost their competitiveness, they must instead focus on productivity, one of the few levers at their disposal to improve their ability to withstand factors that are beyond their control – such as new trade barriers resulting from NAFTA negotiations.

For more information:

- Consult the report, entitled *[The Evolving Comparative Competitiveness of Canadian and American Industries](#)*.
- Téléchargez le communiqué [en français](#).

About the Centre for Productivity and Prosperity – Walter J. Somers Foundation

The Centre for Productivity and Prosperity – Walter J. Somers Foundation has a twofold mission. First of all, it is devoted to research on productivity and prosperity, mainly in Quebec. The Centre then shares its research findings through knowledge transfer and educational activities.

About the Walter J. Somers Foundation

The Somers family established the Walter J. Somers Foundation in tribute to the founder of Walter Surface Technologies. Through different donations, the Foundation pursues the family heritage of commitment to the community and contributes to the prosperity of Quebec society, firstly by helping to improve its productivity but also by supporting excellence in youth education.

For more information on the Centre, visit www.hec.ca/cpp or write us, at info.cpp@hec.ca.

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