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Paul Martin's Economic Record:

Living Standards of Working Families and Prospects for Future Prosperity

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Introduction

It is transparently absurd to give all of the credit or blame for Canada's economic performance between 1993 and 2002 to the then incumbent Minister of Finance. Nonetheless, for better or worse, Mr. Martin was the single major architect of economic policy over this period, and the policies for which he was responsible did shape key outcomes.

Mr. Martin had the great good fortune to take over as the Canadian economy was starting to recover from the severe downturn of the late 1980s and early 1990s, and he had the good sense not to re-appoint John Crow as Governor of the central bank. Under the impetus of falling interest rates, a depreciating Canadian dollar, and a booming U.S. economy, economic growth gathered pace after 1992. The strong recovery was dampened through the mid- to late 1990s by the effect of Mr. Martin's deep cuts to public expenditures and, at the end of the decade, by the collapse of the U.S. boom and the impacts of the Asian financial crisis on resource prices. Fortunately, by the late 1990s, the fiscal squeeze had more or less run its course, and rising Canadian family incomes fuelled domestically-driven growth. This compensated for the post-bubble U.S. and global slowdown until 2003, when Mr. Manley saw growth slow to a snail's pace.

Mr. Martin can, and does, point to a record of strong economic growth and rising employment during his watch. Indeed, by the key measure of growth of real GDP per person, Canada put in just about the strongest economic performance of any major industrialized country, including the U.S.

On close examination, the overall economic record is more flawed when viewed from the perspective of working families. As detailed below, the growth of household incomes was not anywhere near as robust as GDP growth, and was fuelled by a growth in jobs rather than by a growth in real wages. In other words, working families have mainly increased their incomes by working longer hours. The quality of jobs has not greatly improved, despite strong employment growth. And income inequality and poverty have both increased when account is taken of the state of the business cycle. Re-distributive economic transfers, economic security, and access to public and social services were all undermined by Mr. Martin's spending cuts, particularly cuts to the Employment Insurance program and transfers to the provinces.

In the famous Liberal *Red Book* of 1993, co-authored by Mr. Martin, and in successive

Budget speeches, strong emphasis was placed upon boosting the new "knowledge-based" economy through strategic investments in innovation, research and development, and skills. The basic argument — which is fundamentally correct — is that Canada's role in the global economy should be as a producer of sophisticated goods and services which can command high prices and support decent jobs. After the deficit was eliminated, Mr. Martin's Budgets made major investments in the "innovation agenda." Disappointingly, however, Canada's productivity and innovation record leaves much to be desired.

Economic Growth and the Well-Being and Incomes of Canadians

The Liberals took office in 1993 just after the Canadian economy began to rebound from the deep slump of 1990-92. From 1993 through 2002, real (inflation-adjusted) annual GDP growth averaged 3.6%, peaking at more than 5% in each of 1999 and 2000. Growth per person in this period exceeded even that of the U.S. Real GDP per capita rose by a cumulative total of 26.9% between 1993 and 2002, compared to 20.9% in the U.S. Canada grew faster than the U.S. in GDP per person terms in every year except 1996 and 1997. As a result, measured at purchasing power parity (which equalizes the buying power of the two currencies), Canadian GDP per capita rose from 81.3% of the U.S. level in 1993 to 86.0% in 2002. (See Statistics Canada data posted at «www.csls.ca».) In short, under Mr. Martin's stewardship, economic growth outpaced even that of the U.S. through the late 1990s boom, and Canada managed to escape the mild U.S. recession which followed.

While real GDP growth figures are the headline numbers for economic performance, it has to be borne in mind that GDP is a very incomplete measure of economic well-being. GDP growth tells us nothing about the extent of economic and social security, though income transfers and public and social services could be improved by higher GDP. Economic growth tells us nothing about the distribution of income, not to mention the quality of life in communities or the state of the environment.

It turns out that, for Canada in recent years, solid GDP growth is also a misleading indicator of the growth of personal and household incomes. While the GDP growth numbers have been impressive, it is striking that income in the hands of households failed to grow at anywhere near the same pace. Real GDP per person grew by 26.9% between 1993 and 2002, but real personal income per person rose by just 11.5% over this period, or by an average of only about 1% per year. Real personal income is the total of all before-tax wage, investment, small business, and government transfer income going to households, adjusted for increases in consumer prices.

There are two major reasons why real income in the hands of Canadian families has failed to grow at anywhere near the same rapid pace as real GDP. (Another reason is that consumer prices rose a bit faster than the all-price measure used to calculate real GDP.) First, government income transfers to households fell sharply as a proportion of national income. Thus, gains in labour income from higher employment were, in the aggregate, offset by lower income transfers to households from all levels of government. Second, corporate pretax profits have grown as a share of national income at the expense of wages and salaries.

Declining Transfers to Working-Age Households

Under Mr. Martin's tenure, the total of all government transfers to persons fell sharply, from 13.5% of GDP to 10.5% of GDP — the equivalent of $35 billion in 2002. Seniors' benefits were largely unaffected by policy changes, and rose due to population ageing. But government transfers to working-age households — mainly EI and social assistance benefits — fell sharply.

Both EI and welfare benefits fell in dollar terms because of falling unemployment, which is a good thing. But the cut to EI benefits, for which Mr. Martin must take direct responsibility, had a big negative impact on spending as well. In 1993, there were 1.6 million unemployed workers on average over the year, 57% of whom collected regular EI benefits. By 2002, the number of unemployed had fallen to 1.3 million, but just 38% of the unemployed now qualified for benefits. The dollar saving was much greater than that justified by the fall in unemployment, and the cost was borne directly by the unemployed (who tend to live in lower and middle-income households).

While changes in the proportion of the unemployed eligible for EI benefits reflected to some degree a change in the make-up of the unemployed population, such as more new entrants to the workforce, the sharp decline in the proportion of the unemployed collecting benefits mainly reflected the shift to an hours-based system with higher qualifying periods of work. This heavily penalized many (mainly women) seasonal, casual, and part-time workers compared to the 1993 system.

Mr. Martin must also take responsibility for changes to federal child benefits. The redesign of the system, notably the introduction of the National Child Benefit, resulted in higher benefits for some low-income working families with children but, by design, did not provide an income supplement for the many low-income families with children on provincial social welfare programs. Mr. Martin cannot, perhaps, be directly blamed for deep welfare cuts in the two richest provinces of Alberta and Ontario, especially since provincial governments here chose to deliver tax cuts. But cuts to provincial transfers and the elimination of 50/50 federal cost-sharing of welfare under the Canada Assistance Plan certainly pushed the costs of social assistance (and related social programs such as child care) onto the provinces, including provinces which had little fiscal room to manoeuvre. No province increased welfare rates at anything near the rate of inflation after the mid-1990s, resulting in deep income cuts to Canada's poorest households. Welfare cuts fell not just on persons and families outside the workforce, but also on the working poor who move between low-wage jobs and social assistance.

To summarize, while GDP growth was strong in the 1990s and did raise incomes from work as unemployment fell, the impact on incomes of working-age households was significantly offset by cuts to EI and social assistance programs. As noted below, this shows up in the very modest income growth of low to modest income families in the Martin era.

Rising Corporate Profits

The second major reason why personal incomes failed to match GDP growth is because

corporate profits (which do not appear in personal income until distributed as investment income) rose sharply as a share of GDP in the Martin era. Between 1993 and 2002, total labour income (all wages and salaries) rose by 50%, while corporate pre-tax profits trebled, rising from $41 billion to $133 billion. As a proportion of GDP, corporate profits peaked in the 1980s' expansion at 10.6% of GDP in 1988. They bottomed out at just 4.7% of GDP in 1992, rose more or less steadily to a new, higher peak of 12.6% in 2000, before falling off a bit to 11.5% in each of 2001 and 2002. This was still well above the peak of the previous period of economic expansion. There has been a significant structural as well as cyclical increase in corporate profitability, which Bay Street seems more than willing to credit in good part to Mr. Martin (who, of course, cut taxes on surging corporate profits, as well).

Soaring Household Debt

The limited growth of personal incomes under Mr. Martin might have held back household spending on consumer goods and on housing had it not been for a very sharp decline in the personal saving rate. Canadian households saved between 10% and 15% of their incomes from the mid-1970s through to the early 1990s, but the savings rate fell from 11.9% in 1993 to historic lows of less than 5% from 1997 on, and fell to a new low of 4.2% in 2002. By 2002, the average Canadian household held consumer and mortgage debt equal to 98% of their after-tax income, up from 85% in 1993. This is an historic high which could prove painful when interest rates rise from current very low levels. Average debt figures conceal the fact that many affluent older households hold little debt, which tends to be concentrated among heavily mortgaged younger families. It is interesting to note that soaring household debt has been the flip side of mounting government surpluses.

Employment, Unemployment and Job Quality

Table 1 provides some basic labour market data for 1989, the lowest unemployment year of the 1980s, for 1993, when Mr. Martin took office, and for 2002. Changes between 1989 and 2002 can be seen as "structural" changes in the job market, as opposed to the cyclical changes which took place between 1993 and 2002.

Under Mr. Martin, the national unemployment rate fell from a 1990s high of 11.4% in 1993, to a low of just 6.8% in 2000, but then bumped back up to 7.7% in 2002. Between 1993 and 2002, the employment rate for all persons aged 15 to 64 rose from 58.0% to 61.8%, and the employment rate for the core working-age population aged 25 to 54 rose sharply, from 74.9% to an all-time high of 80.2%. Between 1993 and 2002, the economy created some 2.5 million new jobs, including many new "blue collar" jobs in manufacturing and construction, which offset the recent tilt of job creation to either well-paid professional/managerial jobs, or low-paid clerical, sales, and services jobs. Women shared fully in the job gains. Clearly, the overall job creation record is very impressive.

That said, there were some flaws in the record. Young people relatively lost out, and, while the youth unemployment rate fell from 1993 to 2002, it remained at 13.6% in 2002, well above the 1989 low. Public sector jobs shrank, from 22.0% to 18.9%, as a propor-

Table 1
Labour Market Trends

	1989	1993	2002
Unemployment Rate			
All	7.5%	11.4%	7.7%
Men	7.4%	12.0%	8.1%
Women	7.8%	10.6%	7.1%
25+	6.7%	10.2%	6.5%
Youth 15-24	11.0%	17.1%	13.6%
Average Number of Weeks Unemployed	18.0	25.1	18.4
Employment Rate			
All	62.1%	58.0%	61.8%
25-54	78.2%	74.9%	80.2%
Part-Time Rate	16.8%	19.3%	18.7%
Composition of Employment			
Public Sector Employees	20.8%	22.0%	18.9%
Private Sector Employees	65.3%	62.3%	65.9%
Self-Employed	13.9%	15.8%	15.2%
"Own Account" Self-employed	7.2%	8.7%	9.8%

tion of all jobs. The proportion of the workforce in part-time jobs fell slightly from 1993 to 2002, but, at 18.7% in 2002, remained significantly above the rate in 1989. At least one in three adult part-time workers, overwhelmingly women, want but cannot find full-time jobs, and part-time jobs are much lower paid on average and provide lower benefits than do full-time jobs. Further, between 1993 and 2002, the proportion of the total workforce in "own account" self-employment rose from 8.7% to 9.8%, even though the overall incidence of self-employment fell slightly. "Own account" self-employed persons employ no other persons, and generally have very low incomes. The incidence of temporary work — seasonal work plus work on short-term contracts — rose from 11.3% in 1997 (no consistent earlier data available) to 13.0% in 2002.

In short, there was a slight tilt towards more precarious and insecure forms of work hidden in the overall job creation record. This had disproportional impacts on women workers and workers of colour, who are much more likely to hold "precarious" jobs. (For details, see *Is Work Working for Women?* and *Is Work Working for Workers of Colour?*, available from «www.clc-ctc.ca».)

While unemployment has fallen, it has to be borne in mind that the average duration of an unemployment spell is about 18 weeks, and that many workers cycle in and out of jobs over the year. In 1999, when the unemployment rate was just over 7%, more than one in eight workers were unemployed at least once in the year. The erosion of EI has made such temporary unemployment relatively more painful.

Union protection for Canadian workers has fallen. Fully consistent data are available only from 1997, but show that private sector union density fell from 21.5% to 19.6% from 1997 to 2002 (from 26.1% to 23.8% for men, and from 16.0% to 14.5% for women), while remaining constant at 75.8% in the shrinking public sector. Union decline was most marked in the expanding manufacturing sector (36.3% to 32.4%). The erosion of union density is associated with shrinking pension and health benefits coverage, a higher incidence of low pay, and larger pay gaps between women and men and between workers of colour and all other workers. (See *"In Solidarity": The Union Advantage*.)

Stagnant Wages

While job growth has been healthy and has certainly benefited working families, it is striking that, on average, there were no real wage gains whatsoever for workers during Mr. Martin's tenure as Minister of Finance. As shown in Table 2, average weekly and average hourly earnings for all workers just about matched the increase in prices, while private sector unionized workers saw a very modest real wage gain of just 3.4% in total over the whole nine years. Real public sector union wages fell, by 1.4%, over the same period. Real median annual earnings did increase — by 10%— between 1993 and 2001 (from $23,028 to $25,387), but this was due to working more hours in the week and weeks in the year, rather than because of higher wages per hour or week.

Data from the *Labour Force Survey* (available only from 1997) show that the boom in job creation had no impact at all on the incidence of low pay. In 1997, 25.0% of all workers — 19.4% of men and 31.1% of women — were low paid, defined as earning less than two-thirds the median (mid-point) hourly wage. In 2002, 25.3% of workers — 19.4% of men and 31.5% of women — were low paid by the same definition. International data show that the incidence of low pay in Canada is, among the advanced industrial countries, second only to the U.S. Just 5% of workers in the Scandinavian countries are low paid by the same definition of earning less than two-thirds of the national median hourly wage.

Table 2
Wages and Prices

% Increase, 1993-2002		
Consumer Price Index	16.9%	
Average Weekly Earnings	16.8%	($583.24 to $681.09)
Average Hourly Earnings	16.2%	($14.70 to $17.08)
Union Wages - Private Sector	20.3%	
Union Wages - Public Sector	15.5%	

Source: Statistics Canada. Canadian Economic Observer Histrocial Statistical Supplement.

Increasing Income Inequality

Mr. Martin's tenure as Minister of Finance was marked by a major increase in income inequality, as the gains of the economic recovery went mainly to higher income families.

Table 3 provides data on income trends in the 1990s for economic families of two persons or more. The data are in constant (inflation- adjusted) dollars. Again, data are shown for 1989, 1993 and 2001 (the most recent available) so as to show the changes when Mr. Martin was Minister of Finance, as well as the longer-term structural trend.

The first part of the Table shows trends in market income, that is, wages and salaries, plus small business and investment income, but not including income from government transfers.

It is clear that the market income gains from 1993 went disproportionately to the high end. The top 20% of families, with average market incomes of $145,580 in 2001, took 45.6% of all market income in that year, up from 44.4% in 1993, and up from 42.4% in 1989. In inflation-adjusted dollar terms (measured in 2001 dollars), the market incomes of the top fifth rose by 23.1% under Mr. Martin, much more than the other income groups with the exception of the bottom 20%. However, the bottom 20%, which is disproportionately made

Table 3
Family Income Trends in the 1990s

	1989	1993	2001	% Change 1989-2001	% Change 1993-2001
Market Income					
Bottom Quintile	$8,969	$5,307	$8,362	-6.8%	57.6%
Second Quintile	$33,729	$29,896	$32,362	-4.1%	8.2%
Middle Quintile	$53,144	$47,235	$54,127	1.8%	14.6%
Fourth Quintile	$73,844	$68,720	$78,389	6.2%	14.1%
Top Quintile	$124,953	$118,241	$145,580	16.5%	23.1%
Shares of Market Income					
Bottom Quintile	3.0%	2.0%	2.6%		
Second Quintile	11.5%	10.1%	10.2%		
Middle Quintile	18.0%	17.7%	17.0%		
Fourth Quintile	25.1%	25.8%	24.6%		
Top Quintile	42.4%	44.4%	45.6%		
After Tax/Transfer Income					
Bottom Quintile	$20,258	$18,891	$20,721	2.3%	9.7%
Second Quintile	$35,979	$32,717	$36,830	2.4%	12.6%
Middle Quintile	$48,064	$44,738	$51,074	6.3%	14.2%
Fourth Quintile	$62,247	$58,886	$67,878	9.0%	15.3%
Top Quintile	$97,242	$91,683	$113,615	16.8%	23.9%
After Tax/Transfer Income Shares					
Bottom Quintile	7.7%	7.7%	7.1%		
Next Quintile	13.6%	13.3%	12.7%		
Middle Quintile	18.2%	18.1%	17.6%		
Next Quintile	23.6%	23.9%	23.4%		
Top Quintile	36.9%	37.1%	39.2%		

(Data are for economic families of two persons or more.) Statistics Canada, Income in Canada CD-Rom. 2001.
(Constant $ 2001)

	1989	1993	2001
Poverty (Post Tax LICO)			
All Persons	10.0%	12.9%	10.4%
Children	11.5%	15.7%	11.4%
18-64	9.3%	12.3%	10.6%
65 plus	10.9%	10.8%	7.3%

Source: Statistics Canada. Income in Canada CD-ROM. Table T802.

up of elderly families and recipients of social assistance, receives very little market income, and is mainly reliant on government transfers.

As also shown in the Table, the top 20% of families also increased their share of after-tax/after-transfer income between 1993 and 2001, from 37.1% to 39.2% of the total. The share of all other income groups, including the bottom 20%, fell. This is unusual in a period of strong economic recovery, which usually provides strong benefits to lower- and middle-income groups because of falling unemployment. In the economic recovery of the 1980s (1982 to 1989), the after-tax income share of the top 20% of families remained the

same, and their share of market income increased only very slightly, from 42.0% to 42.4%. Increasing inequality reflects two broad forces pushing in the same direction. As noted, the increase in market income went mainly to the top, and the cuts in government transfers to non-elderly families fell disproportionately on lower income groups. Tax changes also contributed to greater inequality.

Note that a family in the middle of the income distribution saw only a 14.6% increase in real market income over the eight years from 1993 to 2001, and a 14.1% increase in real after-tax/transfer income. A real income gain of only about 1.5% per year looks very small in comparison to the average real GDP growth rate of over 3.5% per year over the same period. The bottom 40% of families fared even worse in terms of growth of after-tax/transfer incomes. In short, there has been a major disconnect between the statistics of overall economic recovery and the incomes of ordinary working families, explained in significant part by the very unequal distribution of income gains.

The picture is slightly different when it comes to poverty rates, as measured by the after-tax low-income cutoff line. Under Mr. Martin, poverty fell significantly for all age groups, reflecting the fact that the jobs recovery did give a boost to the incomes of those at the bottom, even if their share of the overall income gain was not large and was offset by cuts to transfers. However, poverty rates for the working-age population in 2001 were still well above the level of 1989, when unemployment was at about the same level. The fact that the child poverty rate was about the same in 2001 as in 1989 is no reason for great celebration, given that this was the decade for the elimination of child poverty.

The clear bottom line is that income inequality increased significantly in the Martin years, mainly because the increasingly unequal distribution of market income was not offset to the same extent as in the recent past by government transfers to lower income families. And poverty rates remained disturbingly high.

The Social Wage

It is widely believed — with good reason — that Canadian governments spend significantly more on social programs and public services than do U.S. governments. Redistribution of income through tax-financed income support programs and delivery of services through tax-financed public services reduce reliance on wage income alone and make Canada a more equal and inclusive society. However, the difference shrank remarkably in the Paul Martin era because of spending cuts by all levels of government in the 1990s. While Mr. Martin was directly responsible only for federal spending cuts, lower federal transfers to the provinces certainly played a major role in reduced spending at the sub-national level.

Table 4 — based on data from a research paper from the Department of Finance — details program spending differences between Canada and the U.S. in 1992 and 2001. The data are for all levels of government expressed as a share of GDP. The bottom line is that Canadian governments collectively spent 34.8% of Canadian GDP on programs in 2001, while U.S. governments spent 31.9% of GDP. The difference between the two countries fell from 10.9 percentage points of GDP in 1992 to a remarkably small difference of

Table 4
Canada-US Fiscal Comparisons

	Change in Government Spending as % GDP					
	1992			2001		
	US	Canada	Gap	US	Canada	Gap
Function						
Income Security	7.9	14.3	6.4	7.1	11	3.9
Housing and Community Services	0.7	1.9	1.2	0.5	1.4	0.9
Economic Affairs	3.2	5.8	2.5	3.2	3.5	0.3
Recreation and Culture	0.3	1.3	1	0.3	1	0.7
Education	5.7	7.7	2	6.2	5.9	-0.3
Health	6	7.3	1.2	6.7	7	0.4
General Public Servicer	2	2.4	0.4	1.9	1.9	0
Public Order and Safety	1.9	2.3	0.5	2.2	1.9	-0.2
National Defence	6	1.7	-4.3	4	1.2	-2.8
Total Program Spending	33.7	44.6	10.9	31.9	34.8	2.9
Non-Defence Program Spending	27.7	42.9	15.2	27.9	33.6	5.7

Source: "Government Spending in Canada and the US," Department of Finance Working Paper 2003-05.

just 2.9 percentage points in 2001, as Canadian government spending fell by almost 10 percentage points of GDP. In short, there has been a major convergence of Canada towards the small government/high inequality/high insecurity U.S. social model.

The spending gap between the two countries is greatest for non-defence spending, at a significant 5.7 percentage points of GDP, but this is down from a much greater difference of 15.2 percentage points in 1992. Note that non-defence program spending actually increased in the U.S., while falling by almost 10 percentage points of GDP in Canada. The main differences between Canada and the U.S. are in national defence (where we spend much less), and in income security programs. Here we spend 11.0% of GDP compared to 7.1% in the U.S., but the gap has shrunk greatly since 1992. This reflects cuts to welfare and EI benefits, but also falling unemployment.

Canada now spends relatively less than the U.S. on public education, the result of recent cuts in Canada and increases in the U.S. We spend only a bit more on health (though we spend much more efficiently because of public delivery and a single-payer Medicare system). We also spend relatively more on housing and community services and recreation and culture, though these are relatively small areas of expenditure.

It is important to spend money wisely and efficiently, but the size of spending clearly matters as well. The Canada-U.S. difference has shrunk dramatically in the 1990s because of deep cuts to Canadian spending on social programs and public services.

Good Jobs: Building a More Productive and Innovative Economy

In the famous *Red Book* prepared for the 1993 election by Paul Martin and Chaviva Hosek, the Liberals committed themselves to building an innovative "knowledge-based economy" through higher levels of public and private investment in research and develop-

ment, education, and training. It was recognized that Canadian business performance in terms of investment in innovation and training had been relatively weak. The basic message, repeated in successive government policy documents and Throne speeches, has been that Canada lags too far behind other advanced industrial countries in building the "new economy" which is required to create and sustain well-paid jobs. Ultimately, the argument goes, Canada must create jobs in industries which participate in competitive world markets by producing high-value goods and services which sell because they are unique or sophisticated rather than because they are low cost. In a world of abundant cheap labour, it is indeed true that the long-term prosperity of Canadians depends upon building a much more technologically sophisticated economy.

As Finance Minister, Mr. Martin had a real enthusiasm for innovation policy. While the 1995 Budget cut very deeply into spending by Industry Canada (almost cutting economic development program spending in half over two years), successive Budgets slowly rebuilt from a smaller base. After the deficit was eliminated in 1997, substantial resources were invested in the granting councils which fund university research; in the National Research Council and other federal research agencies; in the Canadian Foundation for Innovation which supports university and other research infrastructure; in the development of the "information highway;" and, in networks of centres of excellence. A new industrial subsidy program, Technology Partnerships Canada, gave direct federal support to research and development in targeted sectors, mainly the aerospace and defence industries. Direct public support for innovation was stacked on top of corporate research and development tax credits which are considered to be the most generous in the world.

On the education and training side of the ledger, the public investment record has been much less impressive, despite the promises of the *Red Book*. Federal transfers to the provinces for post-secondary education were deeply cut, and later increases to research funding failed to undo the damage to instructional programs. Federal expenditures on training for unemployed workers were cut, and responsibility devolved to the provinces. The rhetoric of "lifelong learning" was not translated into coherent programs which would upgrade the skills of already employed workers or promote a genuine training culture in the private sector.

The Martin approach has been a classic "supply side" innovation strategy, designed to give public sector support to Canadian businesses capable of drawing on public sector and university research and education, but doing little to directly build our innovative and productive capacities or to regulate private business investment decisions. The Achilles' heel of the approach has been the underlying weakness of Canadian industry, which has been, and remains, heavily tilted towards the production of resource-based commodities and automotive products. True, Canada has some innovative sectors — such as telecom equipment, aerospace, software, pharmaceuticals and biotech, and aerospace — but the key question is whether this base is adequate for a purely "supply-side" strategy to work.

It is now widely recognized that the apparent boom in Canadian industrial exports, production and jobs, from 1992 to 2002, was based overwhelmingly upon the steady depreciation of the Canadian dollar, rather than

upon rising productivity or higher levels of innovation. Both manufacturing output and employment grew rapidly in the economic recovery between 1992 and 2002. However, manufacturing productivity growth between 1992 and 2002 was much lower than in the U.S., rising by just 17.9% compared to 51.9%. Between 1995 and 2002 — the peak years of the U.S. boom — labour productivity growth in Canadian manufacturing averaged just 0.7% per year compared to 4.2% in the U.S. Despite slower real wage growth, Canada's output share would have deteriorated very seriously had not the dollar depreciated. *(See Andrew Jackson. "Why the Big Idea is a Bad Idea." CCPA. 2003, for extensive documentation.)*

Our poor relative productivity performance is due to the long-standing structural problems of Canadian industry: too many small, undercapitalized plants; relatively low-firm investment in advanced machinery and equipment, R and D, and training; over-dependence on resources and low value-added industrial materials; and, an underdeveloped advanced capital goods sector. *(See OECD Economic Survey of Canada, 2003 and Conference Board of Canada, Performance and Potential, 2003.)* In the 1990s, Canadian industry invested much less than the U.S. in machinery and equipment, especially the new information-based technologies, resulting in large differences in the quality of the capital stock. Business investment in research and development increased a bit in the 1990s, but remained at less than two-thirds the U.S. level. Business investment in worker training similarly continues to lag well behind U.S. and average OECD levels.

Canadian industries in the same sector are often just about as productive as U.S. industries. We are more productive in resources and the auto industry, but we have failed to decisively move up the value-added chain. We have a relatively much smaller and less productive advanced industrial sector than the U.S. or other advanced industrial countries. Capital goods industries — producing electrical and electronic equipment such as computers and telecommunications equipment, and industrial machinery and equipment, including aerospace — account for only about one-sixth of manufacturing production, compared to more than one-third in the U.S. The research and development we perform is very heavily concentrated in these sectors. Indeed, just a handful of companies, such as Bombardier and Northern Telecom, perform most Canadian research and development.

Balanced budgets, tax cuts, deeper integration of the manufacturing sector in the North American economy, and "supply-side" industrial strategies have done little to decisively shift the structure of our industrial economy away from natural resources and relatively unsophisticated manufacturing towards the more dynamic and faster-growing, "knowledge-based" industries. Machinery and equipment exports did grow somewhat more rapidly than total exports in the 1990s because of the growth of the telecom and aerospace sectors, but the energy share of our exports has also been growing fast. Resources, resource-based manufacturing, and crude industrial material production combined (i.e., agriculture and fish products, energy products, forest products, and basic industrial goods, including iron and steel and smelted minerals) still make up about 45% of all exports, down just a little in the 1990s. Resource-based commodities and basic industrial materials, such as wood and paper, minerals, and primary metal products,

still account for over one-third of manufacturing sector value-added, while machinery production (machinery plus aerospace) accounts for just 17.5%, up from 12.5% at the end of the 1980s.

Despite the collapse of the high-tech bubble of the 1990s, the capital goods sector remains hugely important to the long-term economic future of advanced industrial countries, given the ongoing shift of consumer goods production to lower wage-developing countries. A strong resource-based and commodity production sector is no bad thing to the extent that it is an important source of wealth and jobs, and helps sustain regional economies. The distinction between a resource-based economy and a knowledge-based economy glosses over the fact that the resource industries are increasingly technologically sophisticated. Still, the long-standing Canadian structural bias to production of commodities in capital-intensive industries carries important costs. It will be very hard to raise Canadian living standards over the long-term and create well-paid jobs if we do not shift production towards goods and services which command rising rather than falling prices in world markets. That means producing more unique or sophisticated goods and services. Our dependence on large-scale crude energy exports is particularly unwise in a world of finite conventional resources, and is environmentally unsustainable from a global perspective.

In summary, for all of the focus placed by Mr. Martin on building a "knowledge-based economy," Canada has taken only small steps in that direction in recent years. This begs the question of whether much more interventionist policies — such as green industrial strategies based on subsidies, regulation, and direct public investment — are needed in place of a purely "supply-side" strategy.

Conclusions

It would be absurd to argue that the Paul Martin economic record was one of failure. Canada's recent economic performance has been impressive in terms of GDP and job growth. However, it has been less impressive when the focus is upon the living standards of working families. Incomes have improved modestly, but wages have stagnated and income inequality has greatly increased. The social wage has been cut deeply, and insecurity has risen. The Canadian economy remains weak in terms of its ability to support well-paid jobs into the future. Mr. Martin's record needs to be debated rather than uncritically celebrated, and alternative approaches need to be developed if we are to do better.

A Note on Sources:

Except as otherwise indicated, data are taken or calculated from the standard sources as reported in the 2002-03 issue of Statistics Canada's *Canadian Economic Observer Historical Statistical Supplement*.

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