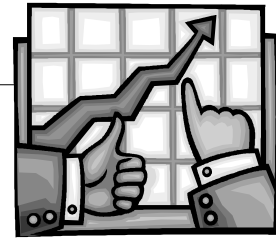
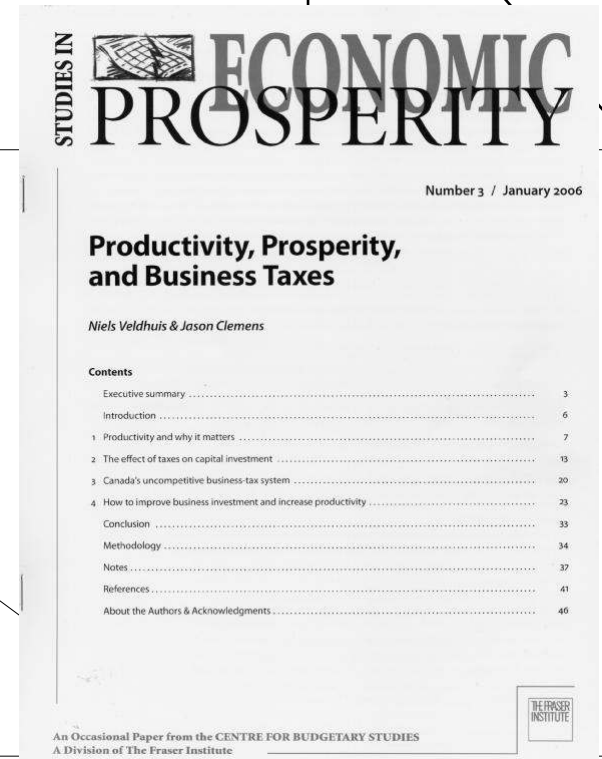


Canada's Productivity Challenge



FEI Canada
February 14th, 2008



Productivity, Prosperity, and Business Taxes

Niels Veldhuis & Jason Clemens

Contents	
Executive summary	3
Introduction	6
1 Productivity and why it matters	7
2 The effect of taxes on capital investment	13
3 Canada's uncompetitive business-tax system	20
4 How to improve business investment and increase productivity	23
Conclusion	33
Methodology	34
Notes	37
References	41
About the Authors & Acknowledgments	46

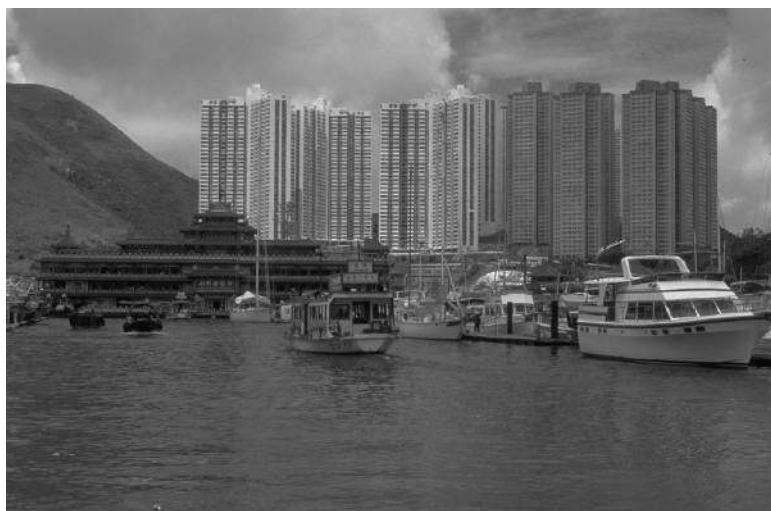
An Occasional Paper from the CENTRE FOR BUDGETARY STUDIES
A Division of The Fraser Institute

Presented By: Niels Veldhuis
Director of Fiscal Studies

Presentation Outline

1. Productivity: what is it and why does it matter?
2. Canada's productivity performance
3. Improving productivity in Canada
4. Questions & hopefully some answers

Productivity and Why It Matters



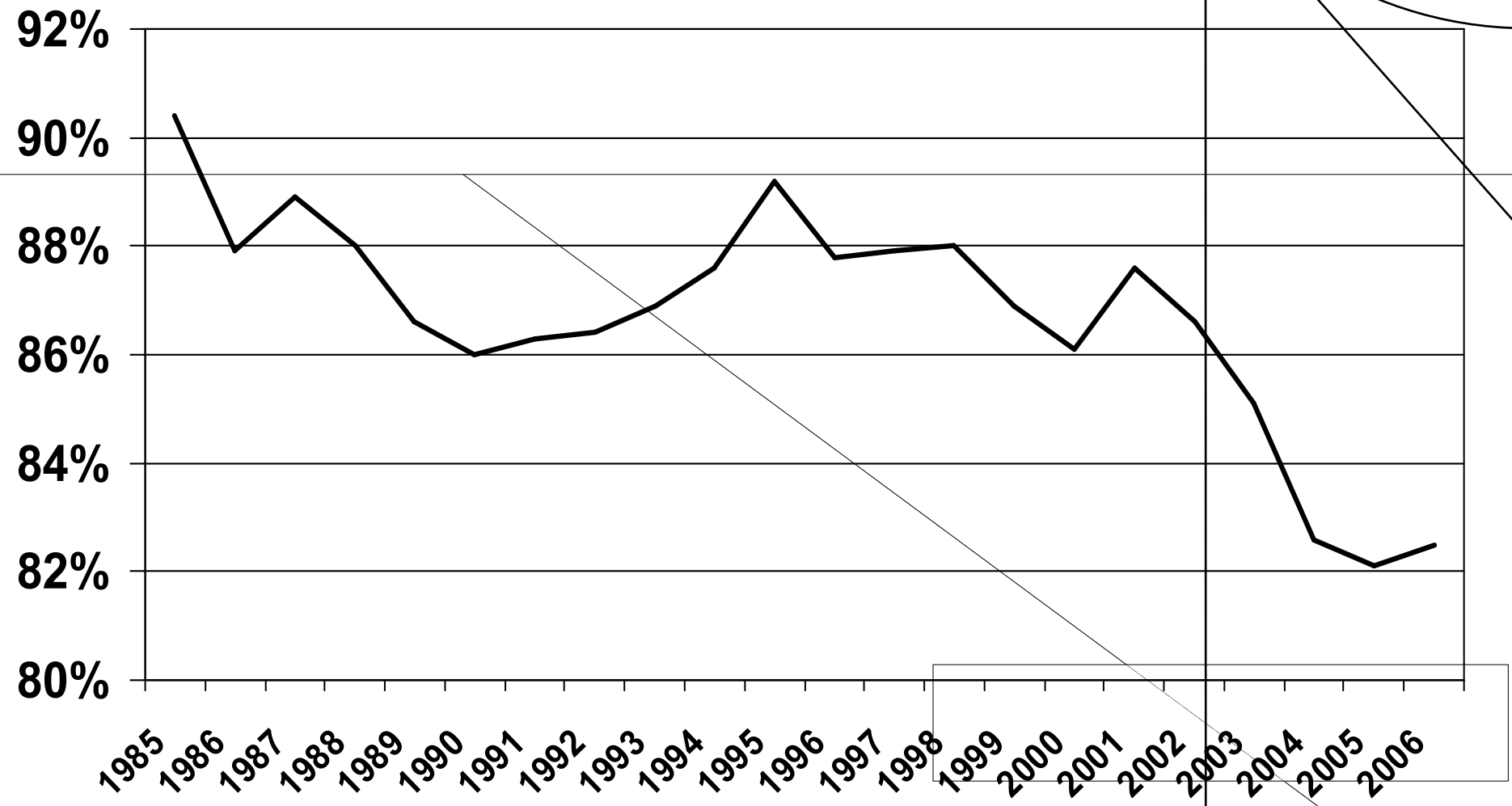
Productivity and Why it Matters?

“Any future increase in the Canadian standard of living will come either from an increase in the average number of hours worked or in the output of our work”

~ Department of Finance, Canada

“The choice is between working longer or working smarter”

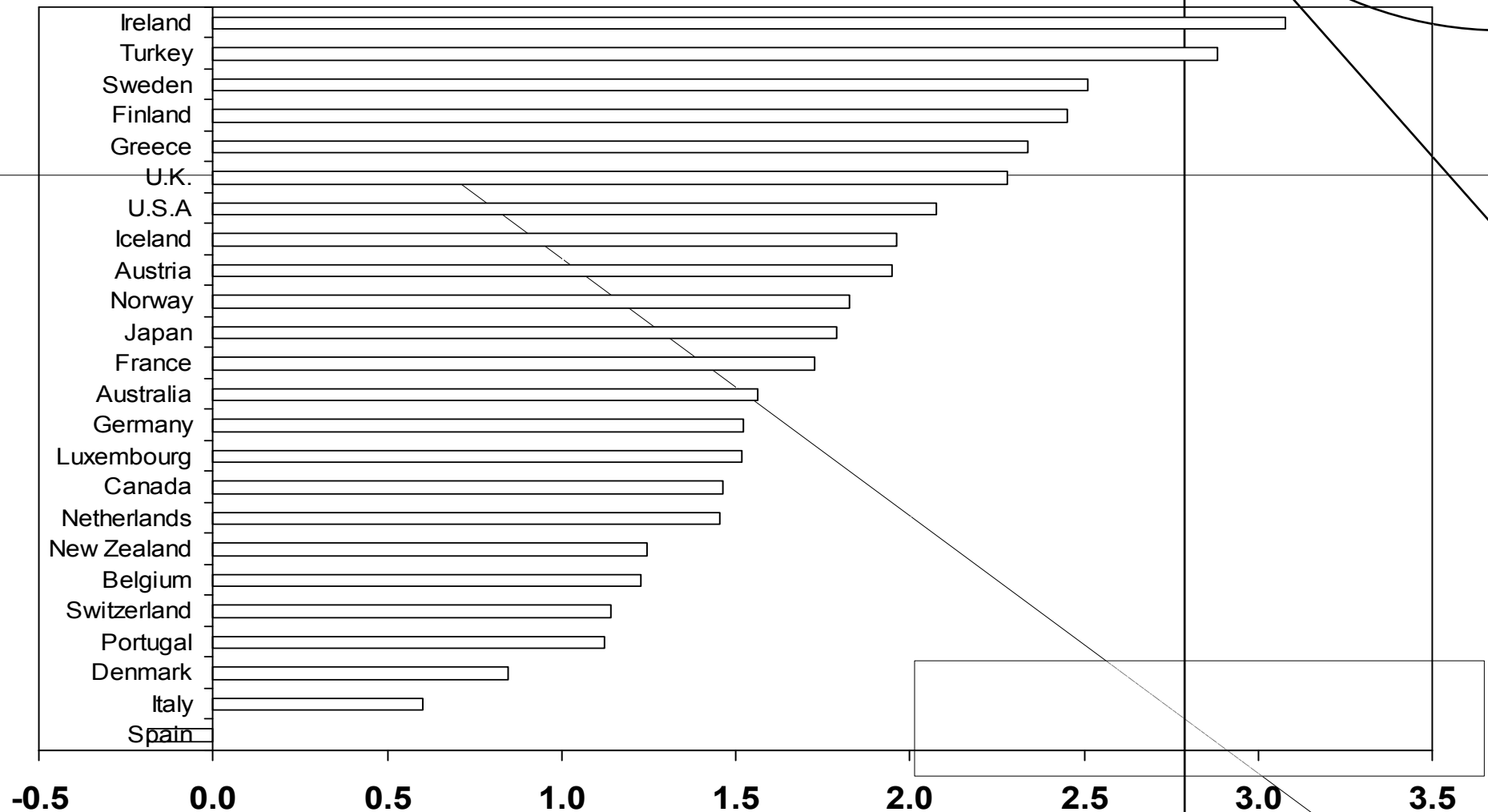
Canada's Productivity Performance: Relative to the United States



Source: Statistics Canada; US Department of Commerce, Bureau of Economic Analysis; calculations by the authors.

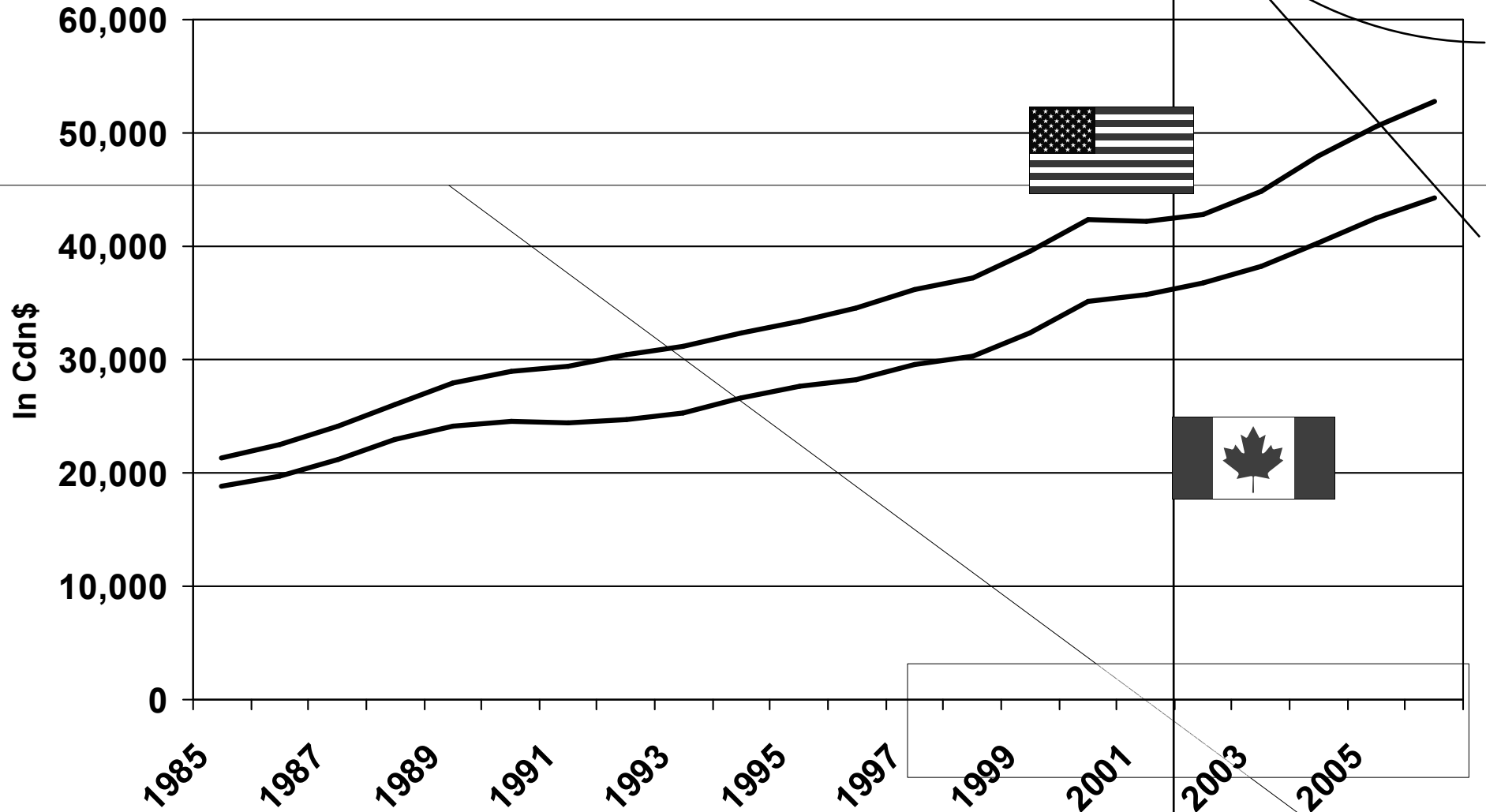
Canada's Productivity Performance:

Average growth: 1998 to 2007



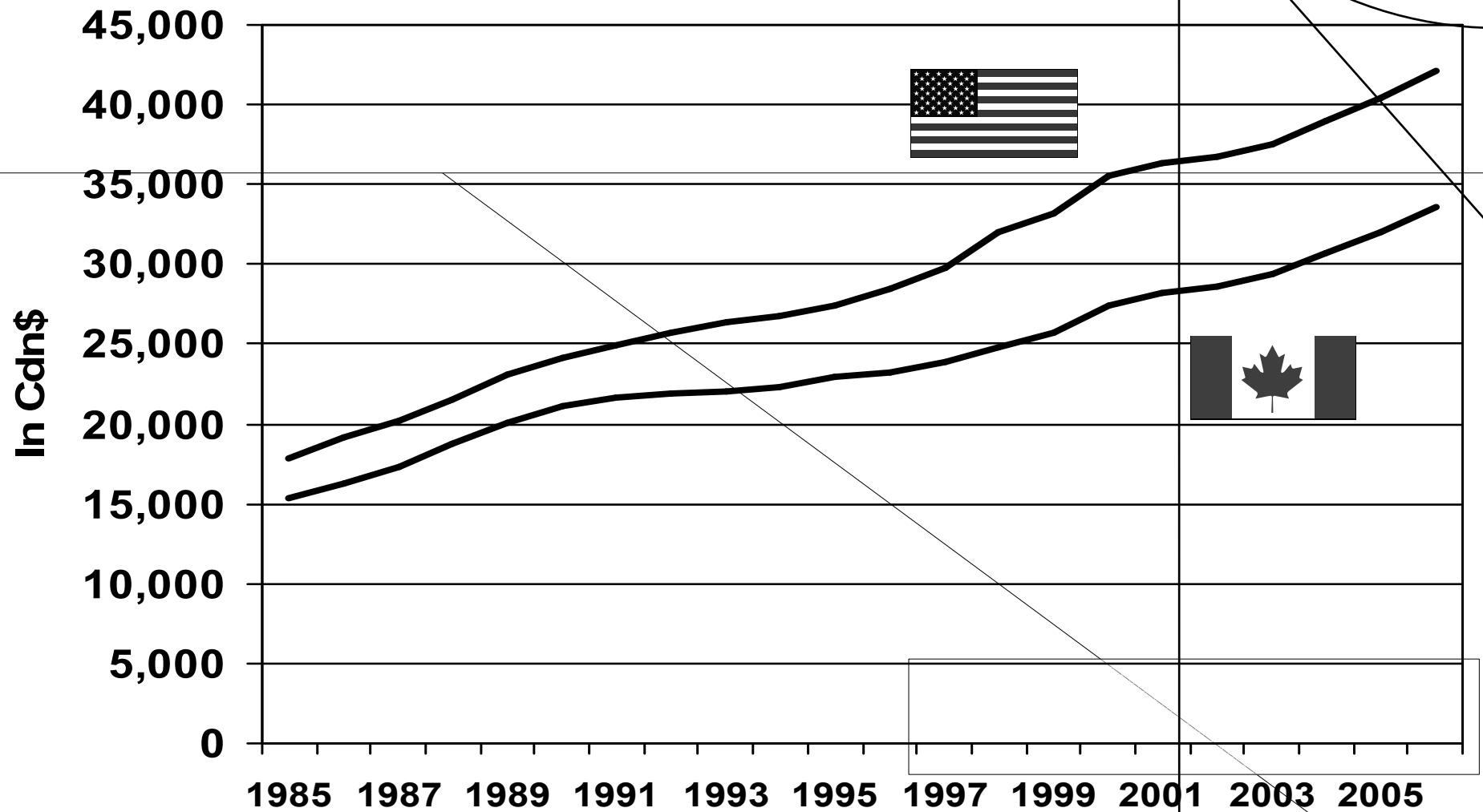
Source: The Conference Board and Groningen Growth and Development Centre, Total Economy Database, January 2008; calculations by the authors.

Impact of Productivity: GDP Per Person



Source: Statistics Canada; US Department of Commerce, Bureau of Economic Analysis; calculations by the authors.

Impact of Productivity: Personal Income Per Person



Source: Statistics Canada; US Department of Commerce, Bureau of Economic Analysis; calculations by the authors.

Supporting Research



Industry Canada:

- US living standards are 10% to 50% higher than Canada

Standard & Poor:

- All provinces below US real disposable income

Statistics Canada:

- US workers earn 29% more than Canadian counterpart on average

TD Economics:

- Average after-tax incomes per worker have increased only 3.6 percent over the past fifteen years

OECD:

- Raising living standards is a key challenge for Canada

Improving Canadian Productivity

Drivers of Productivity:

1. Investment in Physical Capital
Machinery and equipment
2. Investment in Human Capital
Education and skills training
3. Technological progress

Investment in Human Capital

“Canada already has a well educated population, with nine out of ten 25 to 34 year-olds and four out of five 45 to 54 year-olds having at least an upper-secondary qualification”

“Canada has the highest proportion of working aged people with post secondary education and ranks among highest in public expenditures on education as a share of GDP”

Survey of Canada (OECD 2004)

Investment in Physical Capital

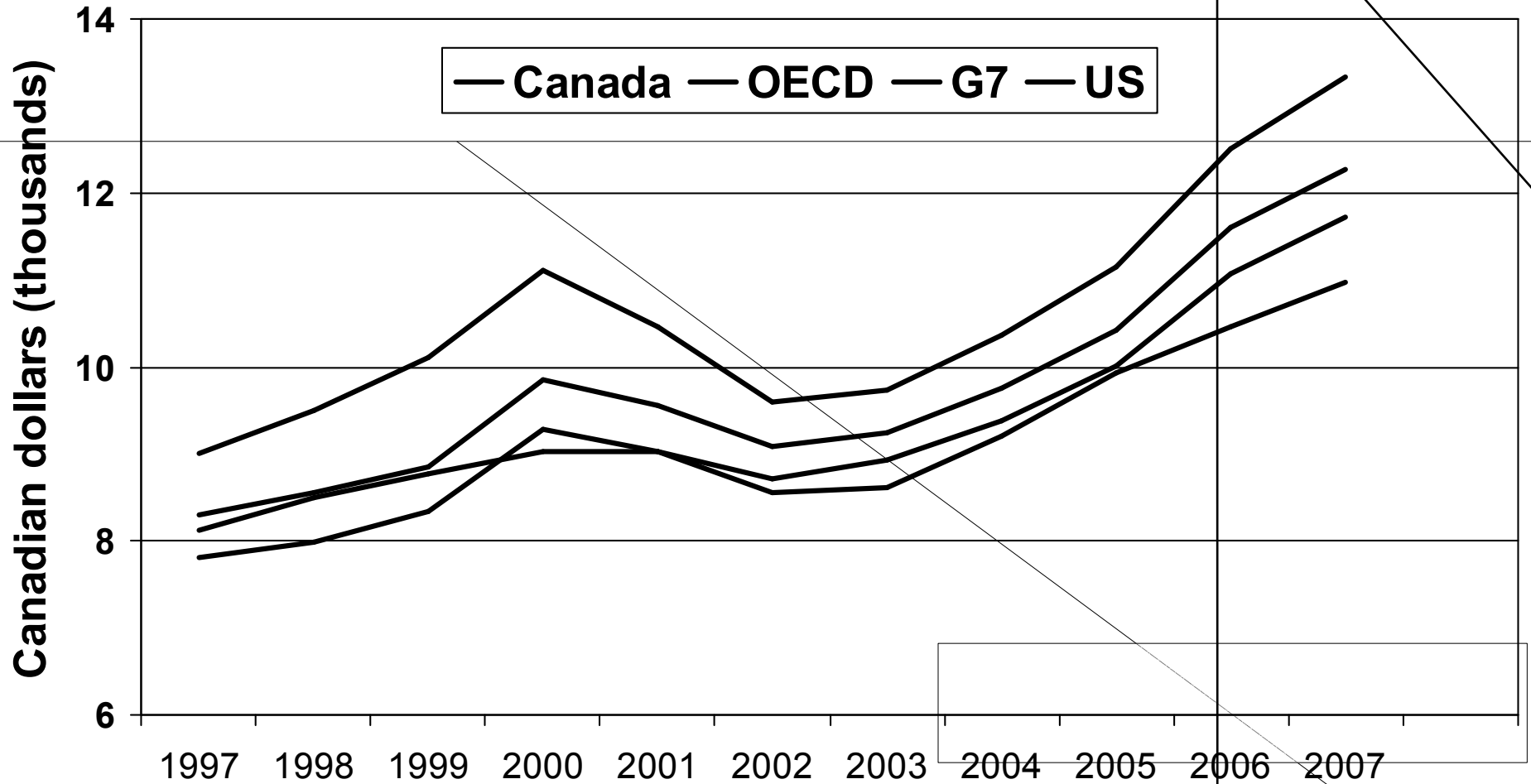
“Canada significantly under-invests in machinery and equipment when compared to other industrialized countries”

~ Mintz and Chen, 2005

“Canadian firms invest less than their peers in the major countries, a pattern that has persisted for at least three decades”

~ Department of Finance, Canada

Business Investment Per Worker 1997-2007

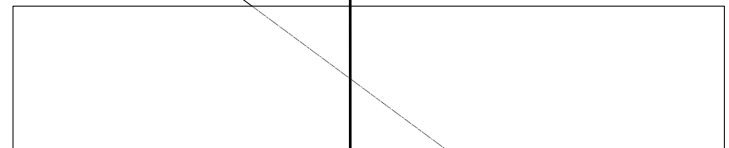


Source: Banerjee and Robson (2007).

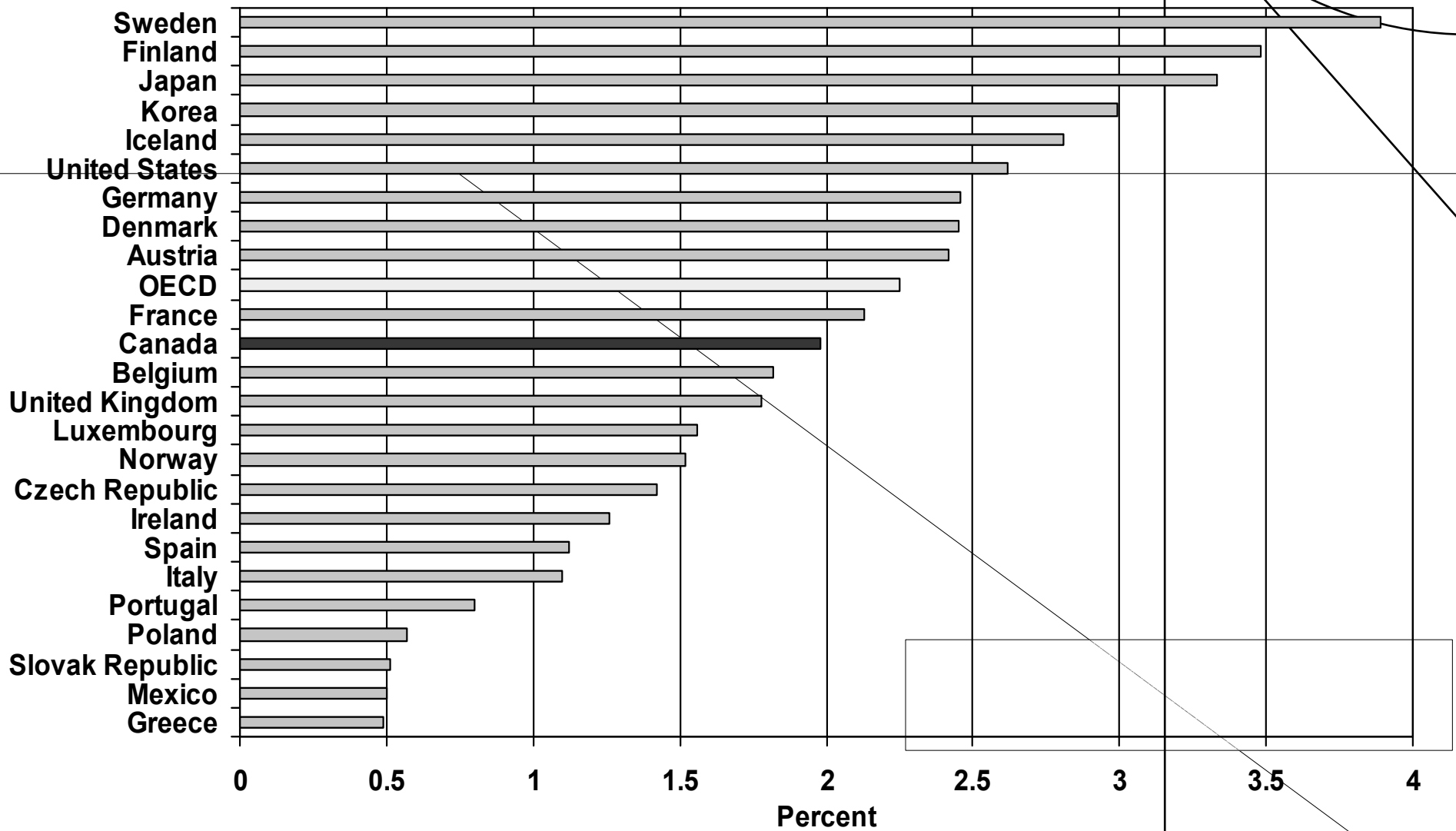
Innovation and Research & Development

“Business innovation truly distinguishes an economy. Yet business research and development (R&D) investments in Canada have been lower than in most OECD countries.”

~ Advantage Canada, Department of Finance

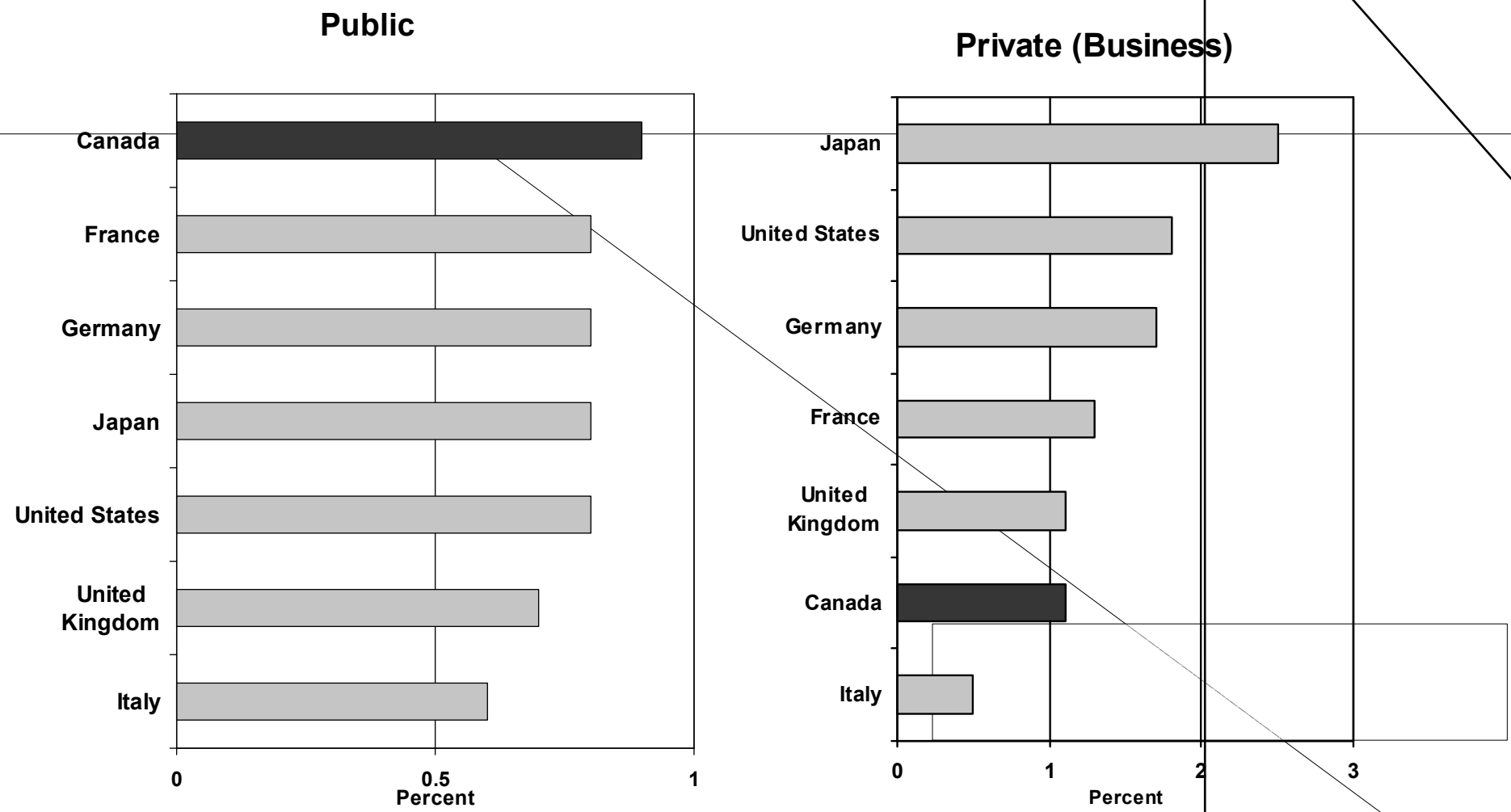


R&D expenditures as a percentage of GDP (2005)



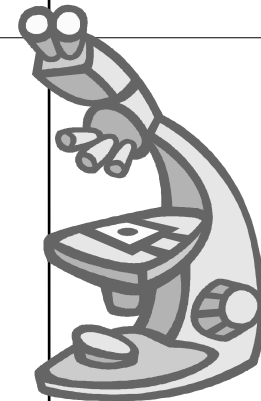
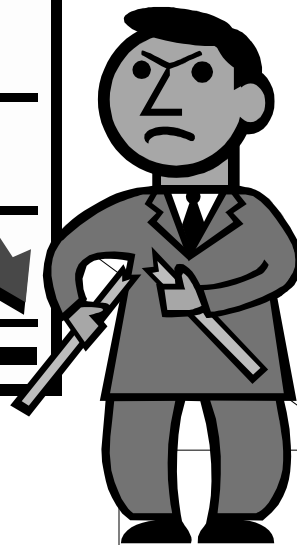
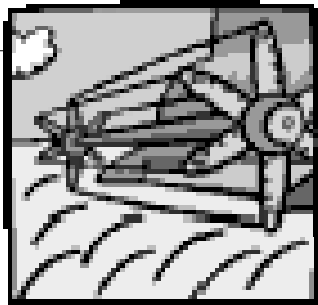
Source: OECD, 2007.

Public and Private R&D Expenditures (2005)



Source: OECD, Main Science and Technology Indicators.

Why does Canada fall behind in Investment and R&D?



Why does Canada fall behind in Investment and R&D?

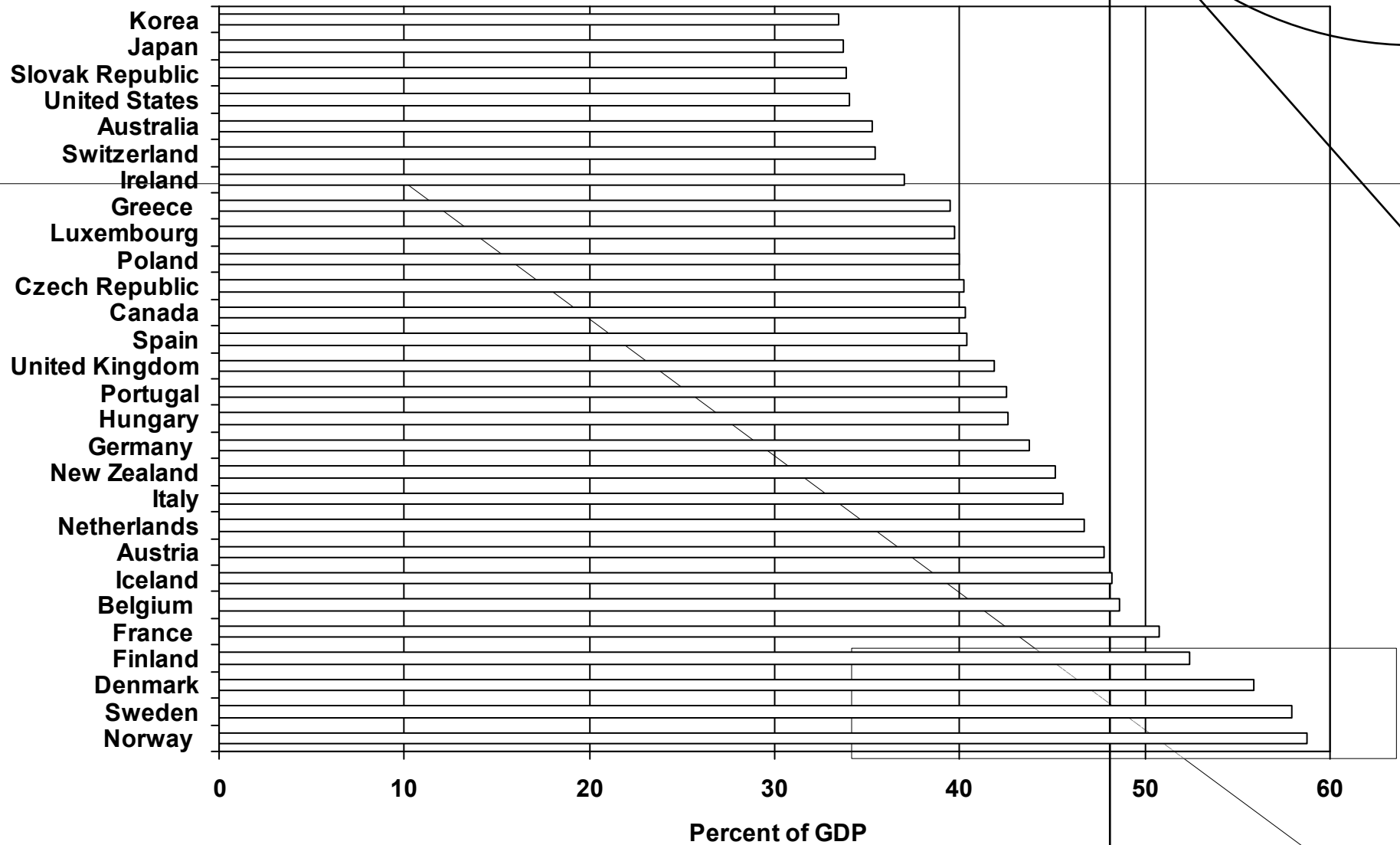
“Capital is highly mobile internationally and a competitive tax system is critical to fostering business investment in capital”

~ Department of Finance, Canada

“Excessive tax and regulatory burdens are holding Canadian businesses back. These burdens have harmed our country’s productivity performance.”

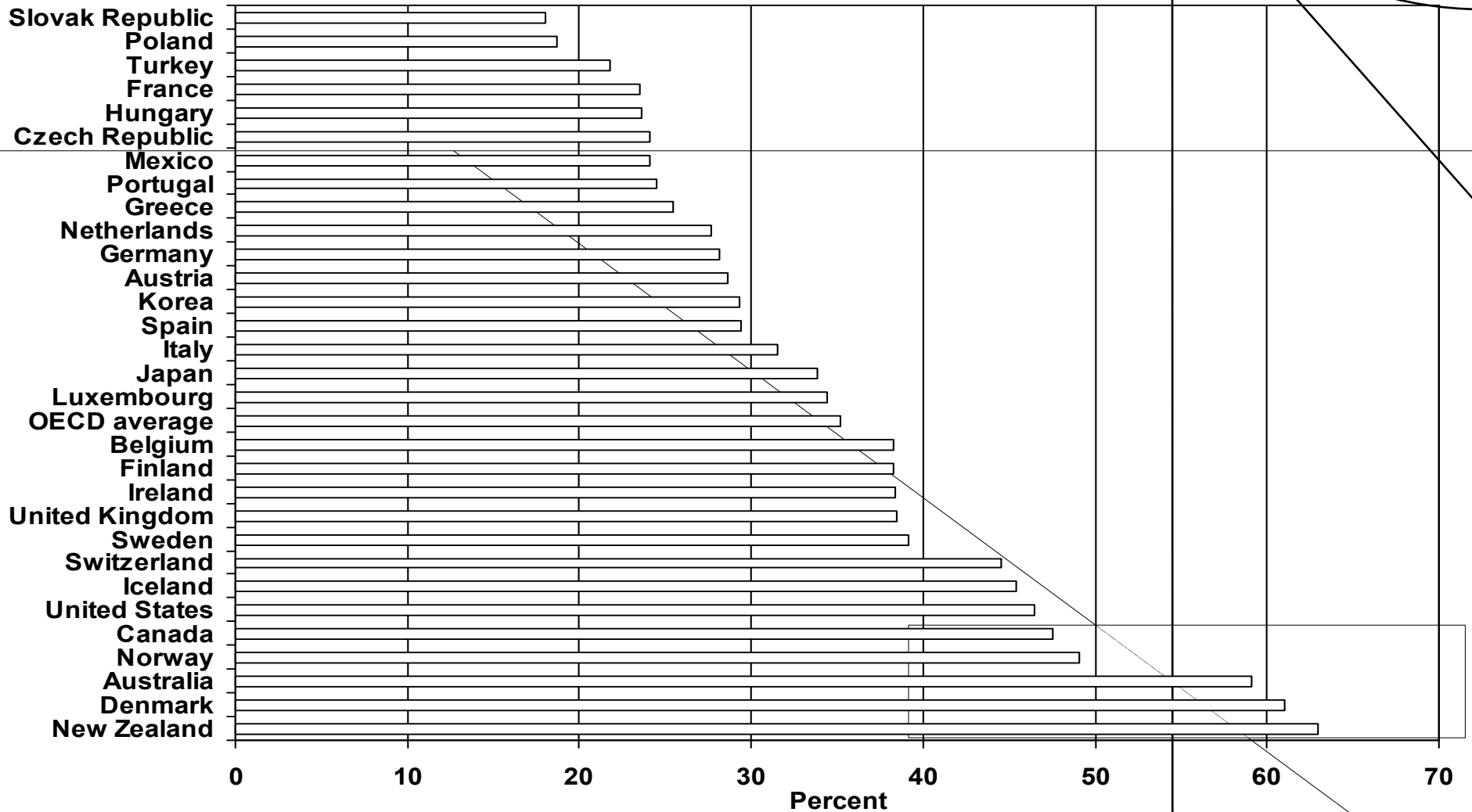
~ Advantage Canada Document

OECD Countries by Revenue Take (2006)



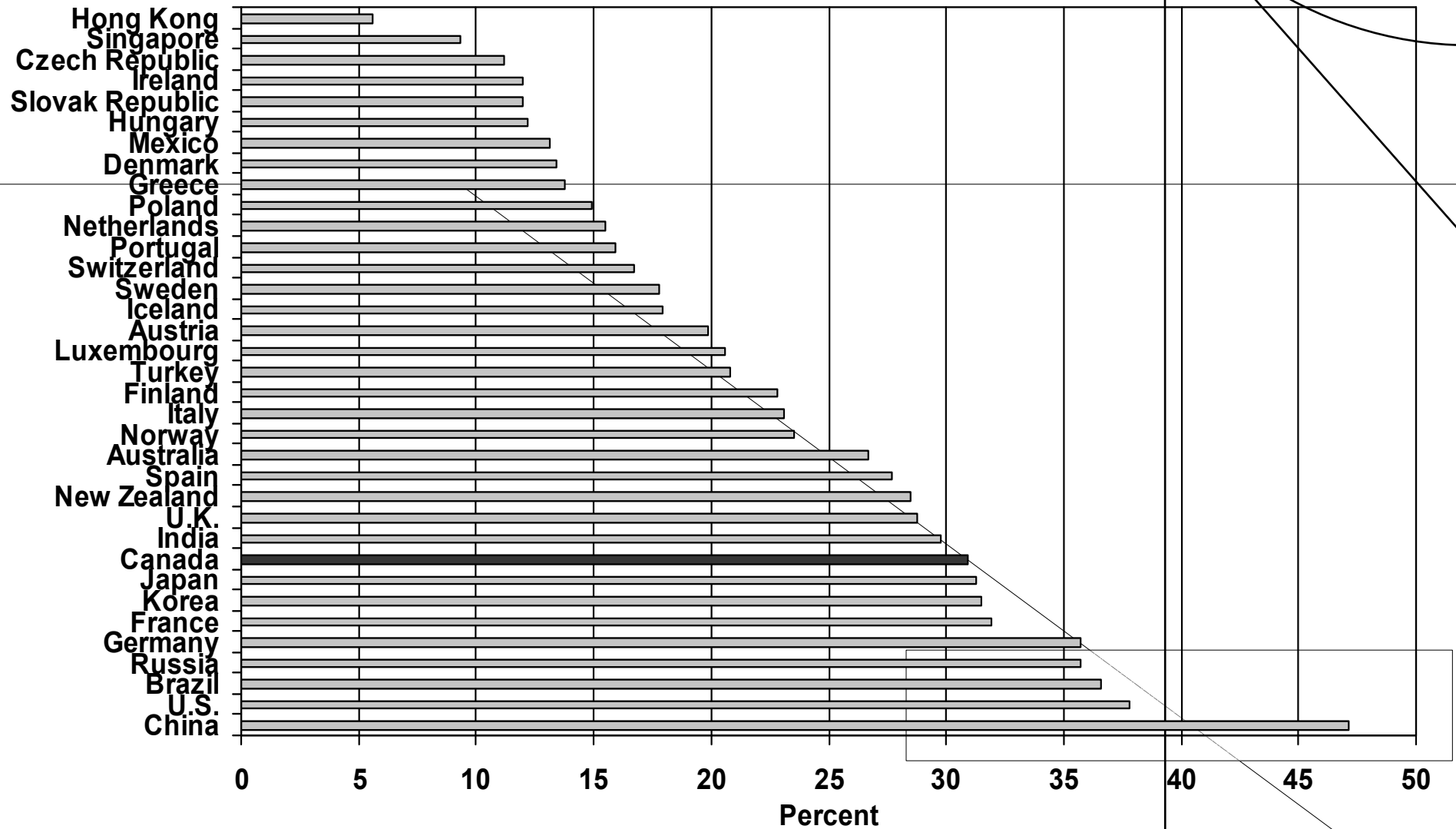
Source: OECD, 2007.

Income and Profit Taxes as a Percentage of Total Tax Revenue, 2005



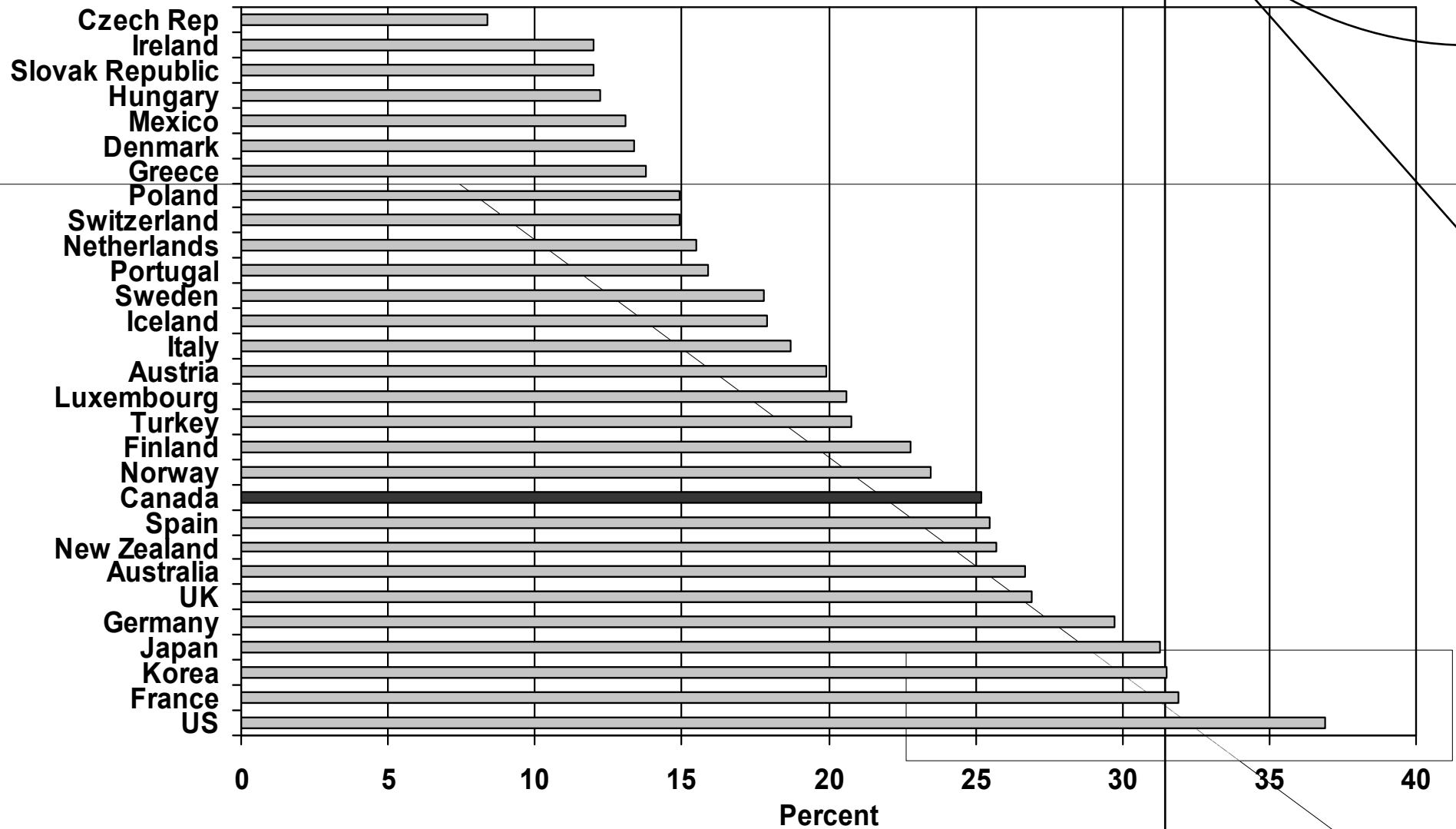
Source: Organization for Economic Cooperation and Development Revenue Statistics 1965-2006.

Effective Tax Rates on Capital, 2007



Source: Mintz, 2007.

Effective Tax Rates on Capital, 2012



Source: Chen, 2007.

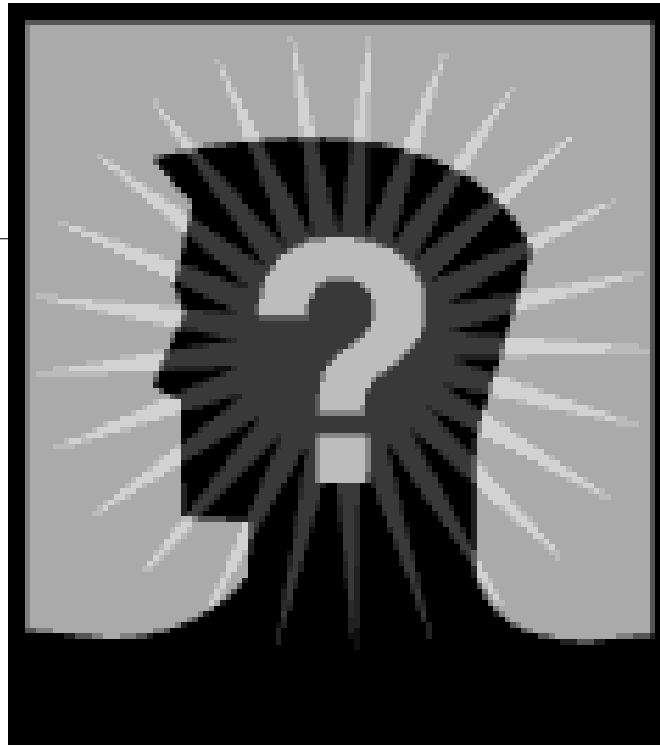
What should be done? Recommendations

- A further reduction of the federal corporate income tax rate to 11 percent by 2012;
- A 30 percent reduction in provincial corporate income tax rates;
- Harmonize with GST to exclude business inputs from provincial sales taxes;
- Reduce personal income tax rates and increase the level of income at which the rates apply for middle and upper income Canadians.

Conclusions

- Canada faces a serious productivity challenge
- Standard of living is falling relative to the United States
- Business taxes are penalizing, rather than promoting investment
- A concerted federal-provincial effort is needed to reduce and reform taxes.

Questions & Answers



**Download our study:
Productivity, Prosperity, and Business Taxes**

www.fraserinstitute.org