# Productivity

## BACKGROUNDER

Productivity is a measure of how efficiently an economy transforms its labour, capital, and raw materials into goods and services.

One common measure of productivity is labour productivity, or the output per worker in the economy. This is not merely a measure of how hard people work but how "smart" they work. It is a measure of the extent to which Canadian businesses and industries take advantage of better education, training, management, equipment and technology to increase the production per worker.

Economists do not fully understand what the driving forces are behind productivity growth. Many of the things that increase productivity are things over which we have very little influence or control. The invention of the transistor and the growth of the Internet are examples.

**Productivity and the standard of living**

Labour productivity plays the dominant role in how fast the incomes of workers improve. Productivity growth allows real wages to increase, by lowering prices, and real improvements to occur in our standard of living.

Productivity, which means reduced real costs to producers, is often confused in public discussions with two other related but very different concepts—competitiveness, which means lower costs than your competitors, and profitability, which means low cost relative to the selling price.

**Growth good in post-war years**

Productivity growth in Canada, like that in other major industrial countries, was exceptionally strong during the post-war years until the early 1970s. In the past two decades, productivity growth has been weaker. As a result, growth in per capita real income has also slowed remarkably during this period. The reasons for the decline are still not clear. Many explanations have been advanced, but none is completely satisfactory.

Past experience has been that, when periods of dramatic technological change occur, it takes a fairly long time for productivity to increase. There have been many changes in the Canadian economy over the past 10 years—large investments made in equipment and information technology driven by new information technology and changes that governments have made, such as deregulation and the free trade agreement. The productivity dividends that should result from all this change have not been fully realized.

The best contribution that the Bank of Canada can make to increase Canadian productivity is to provide a stable *monetary policy*. A high and unstable *inflation* rate is detrimental to productivity growth because it makes it more difficult to make sound investment decisions; it encourages investment in inflation protection rather than investment in productivity improvement. Low and stable inflation reduces uncertainty and encourages the investment necessary to become more productive and competitive and to keep the economy growing.