



Center for Canada's Future

Prosperity@150

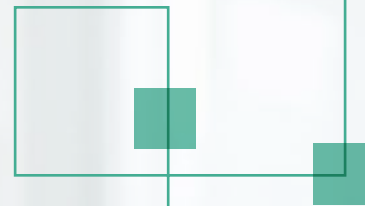
Delivering big ideas for growth

Our intent

To celebrate **Canada's 150th anniversary**, we at BCG in Canada decided to take a step back and think about where we stand today.

Canada has been enormously successful and has a bright future. **We also have major challenges**, some of which have been partly hidden by our successes and the **last 20 years of strong growth**.

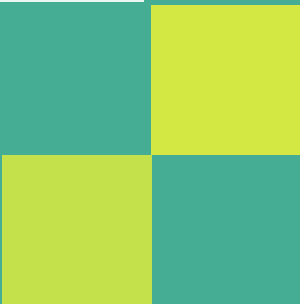
We've decided to contribute a series of **studies** to the national conversation about Canada's future. This is our first one. It's about Canada's prosperity, today and in the future.



Where Canada stands

A STRONG HISTORY

1. CANADA IS A WORLD LEADER WHEN IT COMES TO QUALITY OF LIFE. THIS WAS ENABLED BY OUR ECONOMIC GROWTH, WHICH WAS THE FASTEST AMONG G7 PEERS OVER THE LAST 20 YEARS.



Low productivity growth

2. Most of Canada's economic successes have been the result of "working harder" (adding labour and capital) rather than "working smarter" (how productively those inputs are used).

High consumer debt

3. Growth was driven by ballooning consumer spending on the back of record growth in consumer debt.



Real estate boom

4. A robust real estate market has fueled growth further, but ever-higher prices will be difficult to sustain.



Reliance on energy

5. Much of Canada's recent growth came from our now-challenged energy sector.



Future workforce gap

6. We face an impending workforce gap that will be nearly impossible to bridge through traditional means (e.g., immigration).



A CALL TO ACTION

7. TOGETHER, THESE CHALLENGES COULD LEAD TO A >50% DROP IN FUTURE ECONOMIC GROWTH.



Twin paths forward

8. Maintaining strong growth will require action in two areas:
- Completing unfinished reforms to unlock productivity
 - Delivering on a set of big ideas to drive long-term growth

Introduction

How do we continue the path of prosperity that Canada has enjoyed over the past 20 years?

The Canada at 150 celebrations are a welcome reminder that we are all incredibly fortunate to call Canada home. This isn't just a nice thing to say. It's backed up by facts. If you look at the OECD Better Life Index, which measures well-being across 38 OECD countries, Canada scores in the top quartile in 8 of the 11 dimensions surveyed. This is an impressive feat. Our OECD peers are among the most admired countries in the world. We have thrived over the last 20 years thanks to our talented workforce, stable economic and political environment, and openness to trade and investment, among other things. This helps us afford the education, health, social and infrastructure benefits that give us the quality of life that is the envy of so many people around the world.

As we at BCG celebrate Canada 150, we asked ourselves a key question: Can Canadians expect the economic growth we have enjoyed over the last 20 years to continue in coming decades?

The following pages have our answer. We hope you find the analysis engaging, and that you discuss and debate it with your colleagues, friends and children.



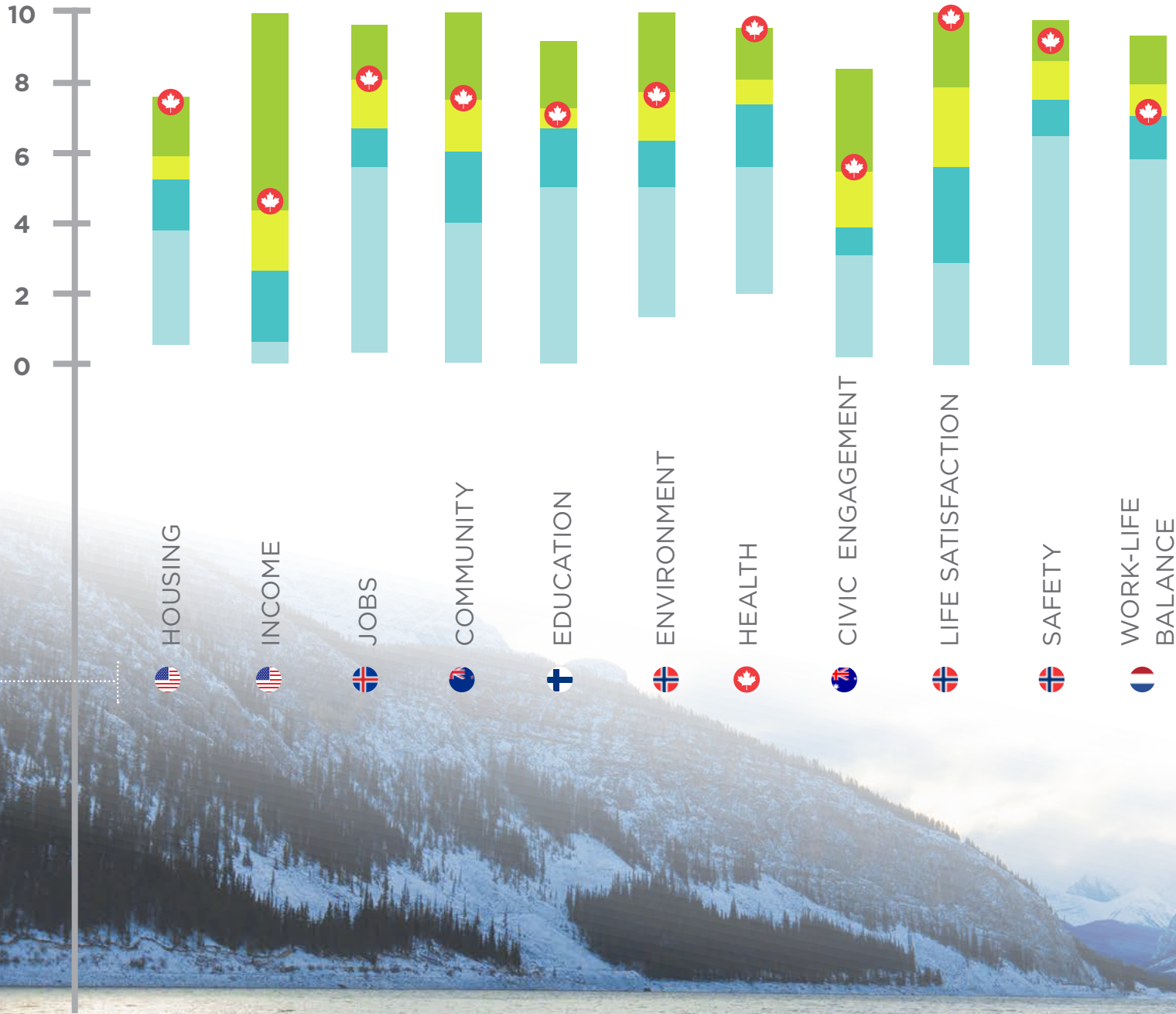
Kilian Berz

BCG, Toronto
Chair of Centre for
Canada's Future

Canada's relative position on OECD Better Life Index

OECD country results by quartile

- 1st quartile
- 2nd quartile
- 3rd quartile
- 4th quartile
- Canada's position



Leading score across dimension

SOURCE: OECD Better Life Index (2016), BCG Analysis

Prosperity matters

We have become used to growth that is the envy of some of the world's most advanced economies.

The Canadian economy grew faster than that of any other G7 country over the last 20 years. On a per capita basis—a key dimension since it reflects the benefits to individual Canadians—Canada and the UK led the G7.

A few decimal places in GDP growth may not seem significant, but those incremental gains make a big difference when compounded over decades. An economy growing at 2.4% per year like ours has done since 1996 doubles in size every 30 years. By contrast, economies that grow at just 1%, like some other countries, take 70 years to double.

The rate of economic growth has big implications. It affects the personal incomes of Canadians, the business opportunities of our entrepreneurs, and the tax revenues that pay for social services, infrastructure and other important functions.

It is worth remembering, however, that Canada benefited from some major tailwinds in recent decades. Those winds may change. As we look ahead, there are a few ‘buts’ that threaten our growth potential.



Keith Halliday

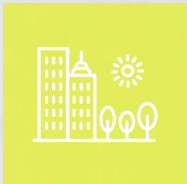
Director of BCG Centre
for Canada's Future



One more thing:

Even though Canada was less affected by the global financial crisis than other countries were, that doesn't explain all of our strong relative performance. We were already performing well against other advanced economies in the decade before the crisis and in more recent years.

SOURCE: Conference Board; BCG analysis



Stagnant productivity

Growth has come on the back of “working harder,” not “working smarter.”

In order to drive growth, Canada has historically relied on increasing the amount of labour and capital rather than increasing the quality and productivity of those resources. You might call this “working harder” instead of “working smarter.”

When we look at multi-factor productivity and measures of labour quality, Canada lags productivity champions like Germany and the US and every other G7 country with one exception—Italy. This should be a wake up call.

One aspect of “working smarter” is grooming talent in science, technology, engineering and math (STEM). Canada has a strong base of STEM talent, but has lots of room to do better. Only 21% of Canadian students graduate with STEM-related degrees. That’s 2% fewer than in the UK, 8% below the Nordics and more than 10% below Germany and Japan. That skill base deficit is compounded by the fact many of our most gifted leave for Silicon Valley.



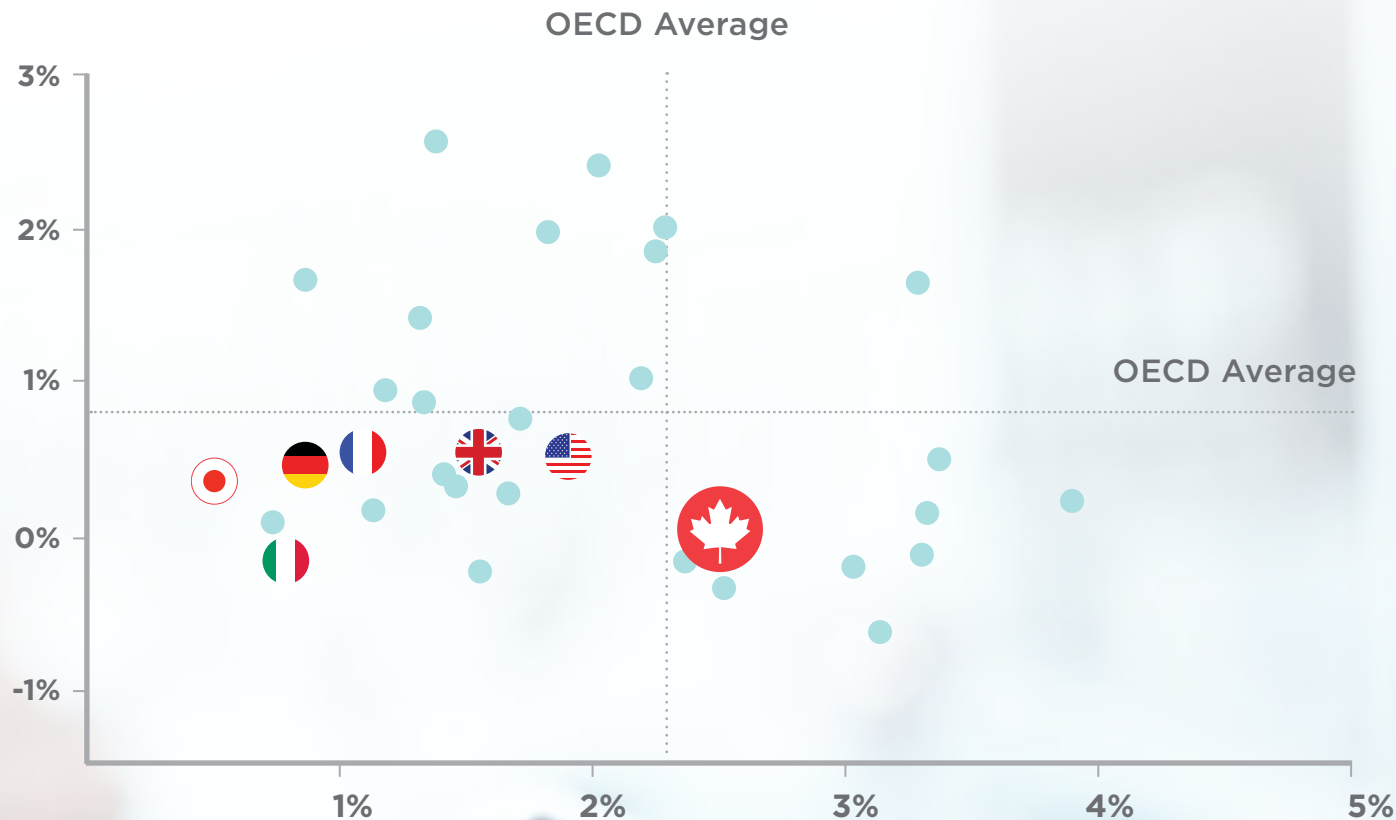
Nina Abdelmessih

BCG, Toronto



Working Smarter

% of growth driven by multi-factor productivity and labour quality (1995–2015)



Working Harder

% of GDP growth driven by labour and capital growth (1995–2015)

Technical note:

Multi-factor productivity is a measure that accounts for growth in total economic output compared to traditional “inputs” such as labour and capital. In a way, it is a proxy for innovation, technological change and productivity improvement.

SOURCE: Conference Board; BCG analysis



Consumer debt

Debt-fuelled consumer spending contributed strongly to economic growth, but this isn't sustainable.

Consumer spending has been a major force among many G7 economies over the last couple of decades. In this area, too, Canada has led the pack. Household spending as a share of GDP rose by 7 percentage points from 2000-16, more than double the change of any other G7 nation.

Though good for Canada on the surface, a deeper look reveals that much of that spending was fueled by sky high (and growing) levels of household debt. For instance, during the same 16-year period while consumers in Germany, Japan and the US cut their borrowing, household debt as a share of GDP surged by 39 percentage points in Canada, much of it to fuel consumption. Indeed, by some indicators, our debt levels are higher than those in the US prior to the housing crisis.

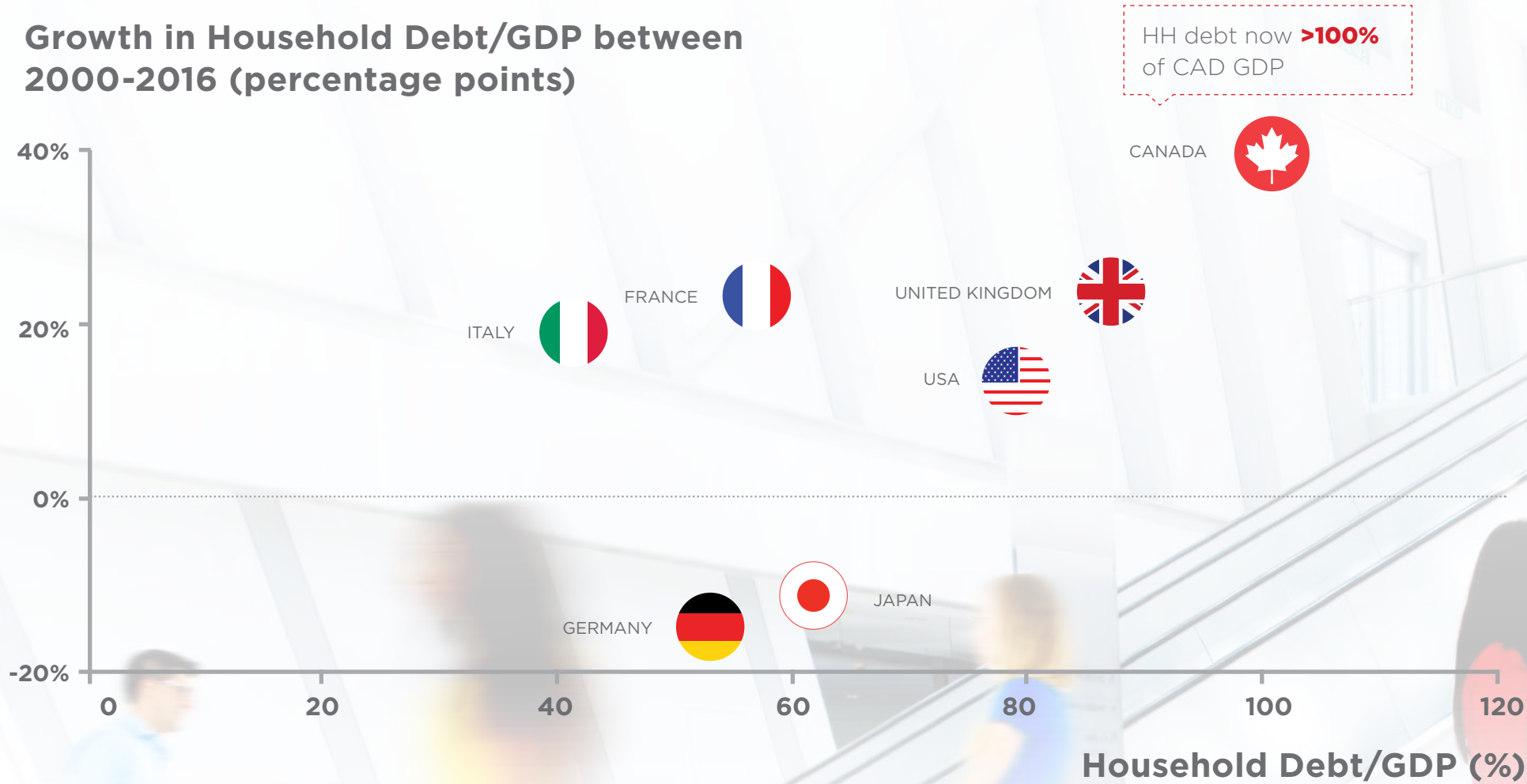
We don't need to have a major debt crisis to cut economic growth. Even a minor slowdown in borrowing that reduces consumer spending will substantially curtail our economic growth rate.



Matt Mackenzie

BCG, Toronto

Growth in Household Debt/GDP between 2000-2016 (percentage points)



One more thing:

The net worth of many households has been trending upwards as a result of rising real estate values and a market fueled by steady borrowing. While positive in aggregate, debt-fueled asset growth leaves households more exposed to pricing corrections in which asset values fall but debt requirements remain the same.

SOURCES: Trading Economics; BCG analysis.




Real estate boom

Growth has benefited from a real estate boom that will be difficult to sustain.

Canada is the only G7 nation to see real estate and construction-related GDP growth rise from 2008 to 2015. In our case, such economic activity not only rose, it soared to more than 10 percent of GDP in 2015.

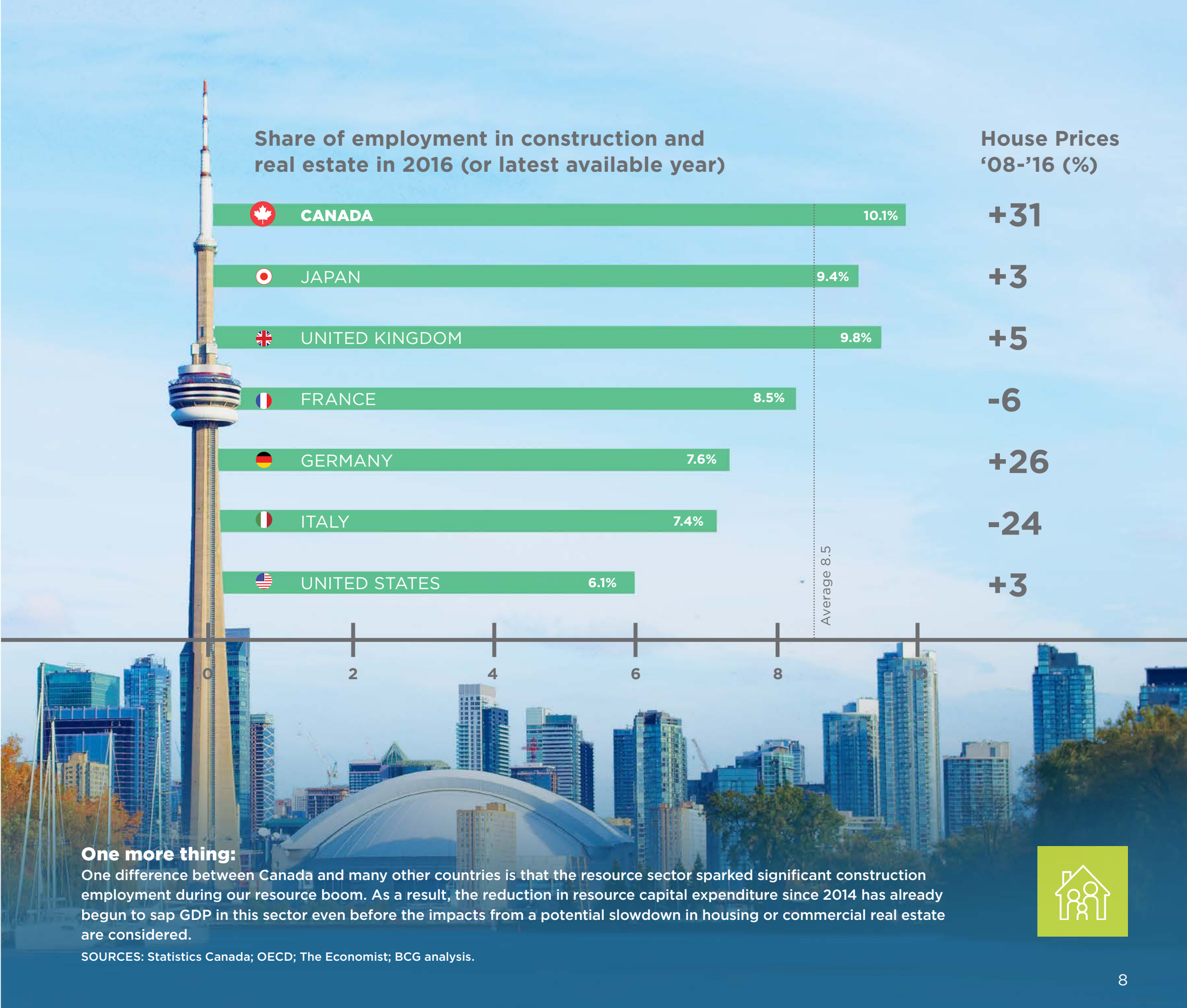
All this while housing prices have ballooned—growing at the fastest rate of any G7 country since 2008. The price growth has been especially pronounced in Toronto and Vancouver over the last two to three years.

Such heady growth rates are likely to taper in the face of regulatory guidance, rising interest rates and tapped out consumer budgets. Whether this is manifested in a sharp correction or in a more gradual slowdown is hard to say. What is clear is that housing is unlikely to be as strong a contributor to growth going forward as it has been in the last decade.



Vinay Shandal

BCG, Toronto



Energy reliance

Much of our growth came from our now-struggling energy sector.

Even some in the energy sector have been surprised to learn just how much their industry has contributed to Canadian investment, jobs, profits and tax revenues over the last 20 years.

Nor was it an all-Alberta story. Gas in BC. Thousands of workers from the Maritimes. Steel and manufactured goods from Ontario and Quebec. The cumulative value from across the country has been immense.

As a result, the fall in world oil prices since 2014 has been a major shock. Oil prices have fallen to half of what they were a few years ago. Although Canadian innovation and productivity have enabled our industry to keep producing at these lower prices, the energy slump has stunted billions of dollars in potential capital investment, and resulted in thousands of jobs being lost.

As you can see from the chart, CapEx plummeted after the oil shock. With a rebound in oil prices hard to predict, the Canadian economy has lost a major driver of future growth.



Darwin Smith

BCG, Calgary

Oil and mining make up a lot of Canada's economy...

- 18% of GDP
- 12% of Jobs
- 26% of CapEx
- 37% of Exports
- 29% of FDI

WTI Price (US\$)
CapEx Investment C\$B



One more thing:

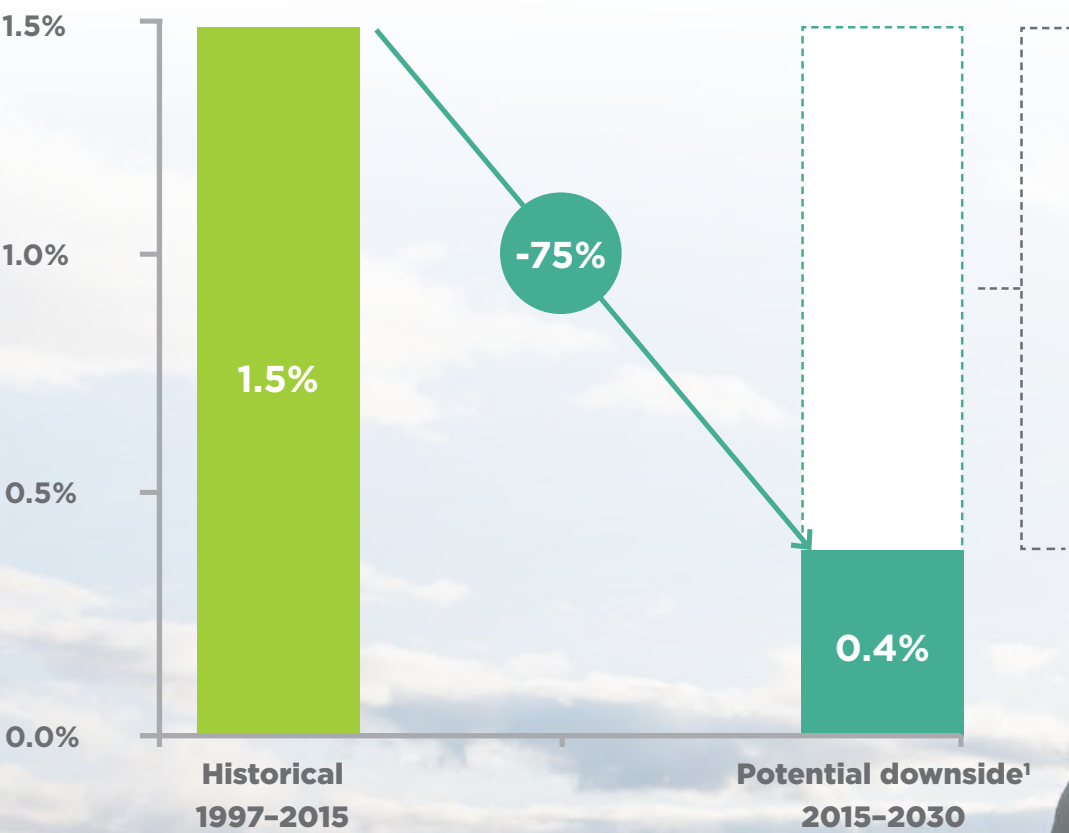
No matter how you slice it, the energy and mining sector makes up a significant portion of economic activity in Canada. This is especially true when we look at the percentage of capital expenditure, exports and FDI where natural resources make up nearly 1/3 of economic activity.

SOURCES: Statistics Canada; Bloomberg; BCG analysis.



Workforce gap

Workforce growth (%)



All of this would be needed to close the gap

- 2.0x** **Increase** immigration/capita from '15-'25²
- +**
- 100%** **Reduction** female employment gap³
- +**
- 2YR** **Increase** average retirement age
- +**
- 100%** **Reduction** immigrant employment gap
- +**
- 100%** **Reduction** aboriginal employment gap

Notes and sources:

- 1. Assumes Statistics Canada medium case population growth.
- 2. Assumes linear rise up to 1.5%pa immigration by 2025.
- 3. Assumes full 2015 male vs. female employment gap closed.

SOURCE: Statistics Canada, OECD, BCG Analysis



Canada has an impending workforce gap that will be hard to bridge using traditional measures.

Workforce expansion has been an especially strong driver of growth in Canada. But with twice as many employees aged 55+ today as in 1997, this will change in coming decades.

To grow our workforce at the same rate moving forward, we'd have to: double our immigration rate (despite already sitting near the top when it comes to new immigrants per capita), eliminate the 7.5% female to male employment gap, raise the average retirement age to 67, and more.

It is hard to imagine Canada solving all these problems simultaneously in the near future. But if we don't, labour growth could fall to just 25% the rate of the last 15 years.

Meanwhile, each member of our workforce will also need to support more dependents. The ratio of non-workers to workers in our economy is expected to increase from 0.95 to 1.12 over the next 15 years, a shift that will have deep and costly consequences.



Nan Dasgupta

BCG, Toronto

A call to action

Potential downsides combined could spell a greater than 50% reduction in GDP growth moving forward.

So yes, Canadian prosperity has surged over the last 20 years. But we are faced with some challenges. The concerns discussed on previous pages could deal a significant blow to Canada’s GDP outlook.

For example, If Canadian consumers draw down their spending, the housing market softens, and oil-related capital expenditures decline further, Canada’s GDP growth rate could be cut in half over the next 15 years—falling from an average of 2.4% since 1997 to 1.2% by 2030.

A 1.2 percentage point decline may strike some as small, but the toll when compounded over even just 10 or 15 years would be significant. Today, GDP per capita is about \$50K. By 2030, 2.4% growth combined with Statistics Canada population forecasts would get us to around \$60K while 1.2% growth would only keep us at \$50K. It’s a big gap, and should be a call to action for Canadian leaders.

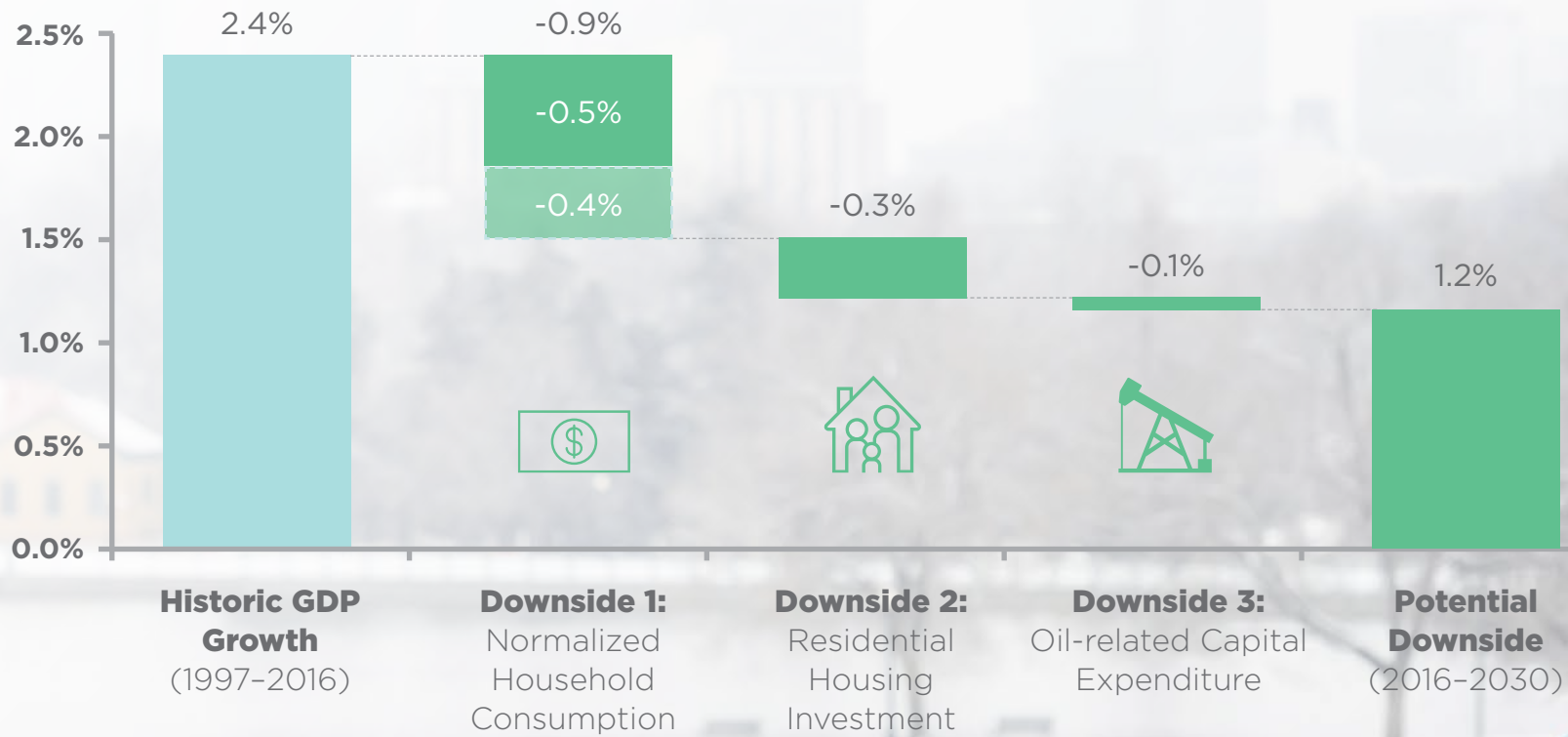


Marc Gilbert

BCG, Montreal



GDP growth (%)



Technical note:

Because these variables interact with each other, the analysis above should be considered directional, since a shift in one factor will invariably alter others. Still, the overall takeaway is that we face a major downside risk to economic growth.

SOURCES: Statistics Canada; Conference Board; BCG analysis

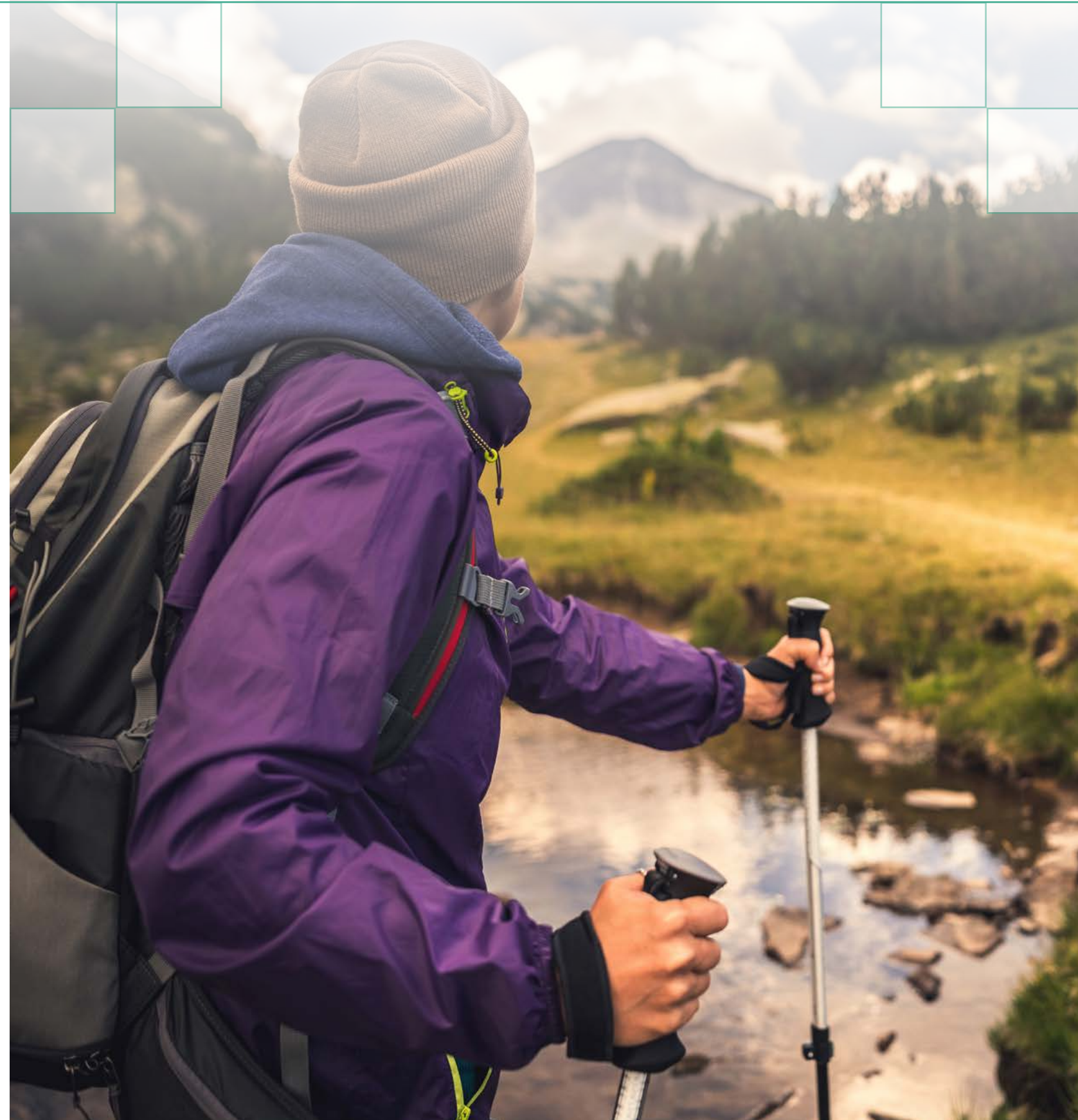
Twin paths forward



Complete unfinished reforms and unlock productivity growth

Canada's strong economic performance over the last few decades has allowed us to put off addressing growth and productivity inhibitors that many less fortunate countries have been forced to tackle head on. But the significant headwinds outlined earlier will likely force more concerted action.

Issues like barriers to internal trade, low competition in protected industries, underperforming business expenditure on research and development, and others have been studied for decades by Canadian commissions, task forces and working groups (see the deeper dive on page 13). They will continue to weigh down the country's growth until reforms are made, as painful as those changes may be for many firms and workers. Properly orchestrated, such reforms have the potential to unleash billions of dollars in productivity-enhancing investment. This investment, from both Canadian and foreign sources, is critical to achieving the growth goals that we as a nation aspire to. It is also critical to enabling us to think more boldly about our long-term future.



Deliver on a set of big ideas to drive long-term growth

While important, and in some cases long overdue, simply completing Canada's unfinished reforms is not enough. Securing our future prosperity also requires advancing a fundamentally new set of ideas that will drive the next wave of growth, whether that is turning Canada's world-leading metropolitan areas into "Smart Cities" that provide greater integration, mobility and connectivity, or capitalizing on emerging high-growth fields such as artificial intelligence (AI) and robotics, in addition to other possibilities we haven't even thought of yet.

Delivering on these ambitions will require Canadian leaders to partner and organize in new ways. Many of the most promising ideas require collaboration between businesses, non-profits and with multiple levels of government—a type of close cooperation that Canada has not practiced as effectively as other countries.

Completing unfinished reforms



Stop perpetuating productivity inhibitors that prevent growth

Newsworthy innovations such as self-driving cars and artificial intelligence have a tendency to stir up lots of conversation. But we need to step back and address why a taxi in our national capital can drop off a passenger on the Quebec side of the river, but not pick one up. Some rules are plain silly—do we really need different provincial standards for the size and shape of milk containers? While it's important—and often less politically fraught—to look at the big new ideas that can drive growth, it's urgent to stop perpetuating practices that hold us back.

Interprovincial trade

The best way to dive deeper into this issue is through an example, such as interprovincial trade. It's widely accepted that trade barriers between provinces could cost Canada anywhere up to 7% of GDP per year. That's huge.

Progress as well as leadership is needed

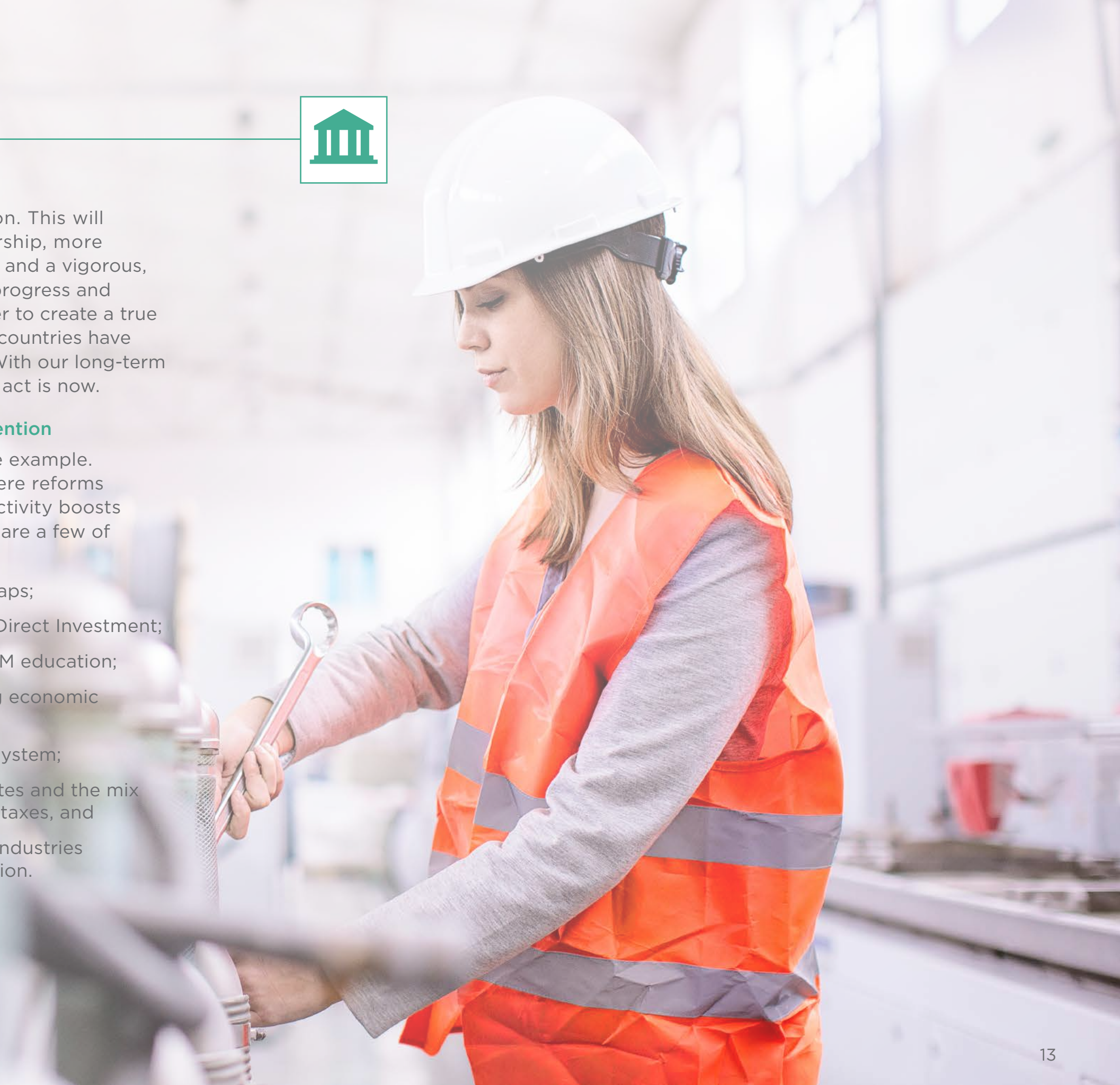
The new Canadian Free Trade Agreement made some welcome progress, but hundreds of exemptions remain and these affect vast swathes of the economy. The problem has certainly not been a lack of research! We found so many studies examining seemingly every angle it was hard to catalog them all. It's time for Canadians to put the binders

away and take concerted action. This will require greater political leadership, more support from business leaders, and a vigorous, national approach to tracking progress and enforcing commitments in order to create a true single Canadian market. Other countries have cracked equally tough issues. With our long-term prosperity at stake, the time to act is now.

Reforms that require more attention

Interprovincial trade is just one example. The number of other areas where reforms could unblock or enable productivity boosts is too long to list. Instead, here are a few of the most important:

- Labour force participation gaps;
- Too many limits on Foreign Direct Investment;
- Need for more focus on STEM education;
- Barriers blocking or delaying economic infrastructure;
- Gaps in our innovation eco-system;
- High marginal income tax rates and the mix of income and consumption taxes, and
- Low productivity growth in industries protected from full competition.



Delivering big ideas for growth



A big theme that came out of our conversations with Canadian leaders was genuine excitement about the opportunities ahead. Many we spoke to are passionate about truly “big ideas” that can transform our economy and society. But, as many interviewees noted, delivering on them will require us to organize in a more concerted and strategic fashion.

1. Shape Canadian cities as economic drivers: Our cities are already the envy of the world. Many of our most innovative companies and workers are based there. Growing these cities further without losing what makes them great places to live will not be easy. Achieving what some call the “Smart Cities” agenda requires

a shared vision, integrated planning and sustained cooperation between all levels of government, academia and the private sector.

2. Leverage resource advantage and future-proof the energy sector: The resource industry provides many high-value-add jobs and still has major growth opportunities—particularly in energy. In recent years, we have been beaten to market in areas like natural gas. Our endowment advantage won’t last forever; we must improve how we reinvest benefits for the future. It’s time for a strategic refresh.

3. Bring marginalized communities into the economic mainstream: Aboriginal people and newly arrived immigrants continue to face wide earnings and employment gaps. Those gaps run counter to our values and are also enormously costly. We need to invest in new approaches that champion social innovation and support much broader economic mobility.

4. Maximize global flows of investments, goods and talent: At a time when anti-globalist sentiment is convulsing the world, Canada has an opportunity to press home its advantages as an open trading partner and welcome destination for businesses and talented immigrants from all over the world.

5. Lead the digital and AI revolution: AI, robotics, smart manufacturing and biotech show particular promise for Canadian researchers and companies. We have an opportunity to build world-class leadership in these domains through committed, focused investment and greater public-private partnership.



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