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Sinking loonie masking the dire state of Canada's competitiveness

The upsurge in Canadian manufacturing exports resulting from cheaper loonie is a welcome sign but it will take more than currency movements to make sure that Canada's competitiveness remains afloat in the long run

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In the spring of 2013, when the Canadian dollar was trading at parity, we might have surprised some investors by claiming that Canada's loss of competitiveness and fading sentiment on commodities would eventually catch up and start pressuring the loonie down.

This scenario came to fruition in the past year, in part a result of the change of tone from the Bank of Canada, which removed its tightening bias that indicated interest rates could rise sooner than expected and moved to a more dovish stance, signalling that interest rates could now be lowered if need be.

The loonie's fall from parity to around 90 cents (U.S.) has been directly helping Canada's exporters, as manufacturing shipments have been accelerating sharply in the past few months. In short, some constructive progress has been made, but is a cheaper dollar enough to make Canada regain its competitive edge?

The obvious answer is no, and the latest **Global Competitiveness Report** from the World Economic Forum illustrates why. Canada ranks 15th among the world's most competitive countries, one rank lower than last year and five lower than in 2008. The country performs admirably well with regards to health, education, and the efficiency of its labour market and financial system, but other aspects are deteriorating quickly.

First and foremost is "technological readiness," where Canada has slipped to 22nd place from 9th since 2008, which shows that our industries are losing some capacity to adopt existing technologies in order to enhance their productivity. In other words, Canadian businesses underinvested in the past decade and are now having difficulty catching up and integrating the latest technologies in their production processes.

The second most critical factor is "innovation," where Canada has fallen nine ranks since 2008 and now sits in 22nd place. Here again, underinvestment (this time in research and development) is the main culprit. Both of these factors result in our businesses lagging their international competition, which is captured by the "business sophistication" factor that fell five ranks, to 23 in 2014 from 18 in 2008. The same can also be said about our public infrastructures, which now rank 14th in the world.

In other words, Canada's competitiveness has been eroding in the past few years. Everyone agrees that it is a very welcome sign to see Canada's non-energy exports post some gains in the past few months, although it remains to be seen if the trend is definitely changing.

But Canada's woes do not end with a lower loonie; the key to returning among the top 10 most competitive countries on the planet is investment in both R&D and productive capacities. The cyclical factors are a welcome sign in helping to keep the boat from sinking further, but it will take more than a cheaper loonie to make sure that Canada's competitiveness remains afloat in the long run.

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