

Quarterly Research Alert

This month we continue our new Fraser Forum feature: the Quarterly Research Alert. Use this Alert to get a quick, accessible look at recent important academic studies that are related to the role of markets and public policy.

Competitiveness and **Productivity**

Competitiveness Challenges Facing **Canadian Industries**

Someshwar Rao and Jianmin Tang Canadian Public Policy, vol. 30, no. 4 (December 2004): 365-380

This study by two Industry Canada analysts assesses the competitive positions of Canadian industries relative to their American counterparts. The authors conclude that the recent strong economic and trade performance of Canada masks its competitiveness problems. Specifically, they find that the export surge and the large increase in the trade surplus are largely a result of a strong US economy and a large real decrease in the value of the Canadian dollar versus the US currency. Further, neither the strong economic or trade performance are due to improvements in underlying competitiveness. In fact, the authors note, Canada has "lost substantial ground to the United States in productivity." They attribute Canada's productivity and competitiveness difficulties to our relatively weak performance in capital accumulation, innovation, skilled labour, greater importance

of small-sized firms to the economy, and a slower shift to new economy industries. They recommend that Canada "create a highly competitive business climate" and suggest that "to improve Canada's investment climate, we must ensure that Canada's tax and

Canada has productivity and competitiveness difficulties that are due to our relatively weak performance in capital accumulation, innovation, and skilled labour...

regulatory burdens on business, universities and individuals, investment incentives, real interest rates, and market framework policies are all highly competitive vis-à-vis the United States."

—Niels Veldhuis and Jason Clemens

Privatization

Water for Life: The Impact of the Privatization of Water Services on **Child Mortality**

Sebastian Galiani, Paul Gertler, and Ernesto Schargrodsky Journal of Political Economy, vol. 113, no. 1 (February 2005): 83-120

The article examines water privatization in Argentina during the 1990s when the country undertook one of the largest privatization initiatives in the world, including local water companies that covered roughly 30 percent of the country's municipalities and 60 percent of the population. The authors indicate that while the need for increasing access to safe water is a near universal goal, there is very little consensus about how best to achieve it. The authors note that a series of case studies had concluded that, "the newly privatized firms were more efficient, invested more in physical infrastructure, and provided better service quality than their public incarnations" (p. 113). The study used variation in ownership of water provision over time and between regions in Argentina to test the effect of privatization. The authors conclude that child mortality declined 8 percent in areas with private water services and the effect was largest (26 percent) in poorer areas. The authors undertook further rigorous examination of the results using causespecific mortality statistics. They found

that privatization was associated with "significant reductions in deaths from infectious and parasitic diseases" (p. 83). In fact, they conclude that "privatization appears to have had a progressive effect on reducing health inequality" (p. 115).

-Ken Green and Jeremy Brown

Health and Pharmaceuticals

Examining the Link between Price Regulation and Pharmaceutical R&D Investment

John A. Vernon Health Economics 14:1-16

This paper looks at the link between price regulation and investment in pharmaceutical research and development (R&D). It identifies two mechanisms through which price regulation may exert an influence on R&D: an expected profit effect and a cash-flow effect. The author uses the fact that relative to the rest of the world, the US pharmaceutical market is largely unregulated with respect to price. This fact allowed him to undertake a controlled comparison with countries that interfere in markets through price regulations. The study finds that introducing pharmaceutical price regulation in the US would lead to a decline in industry R&D investment by between 23.4 percent and 32.7 percent.

-Brett Skinner and Nadeem Esmail

Taxation

Tax Structure and Economic Growth

Young Lee and Roger H. Gordon *Journal of Public Economics* 89, no. 5 (2005): 1027-1043

This study adds to the academic literature documenting the detrimental effects of higher corporate tax rates on economic growth. The authors explore how tax policies affect a country's growth rate using 70 countries from 1970-1997. The authors find that corporate tax rates are significantly negatively correlated with cross-country differences in economic growth, even when controlling for various other determinants and covariates of economic growth. Specifically, the authors' estimates suggest that a reduction in corporate tax rates by 10 percentage points will raise the annual growth rate by one to two percentage points.

-Keith Godin and Niels Veldhuis

Start-ups, Venture Capitalists, and the Capital Gains Tax

Christian Keuschnigg and Soren Bo Nielsen

Journal of Public Economics, vol. 88, no. 5 (April 2004): 1011-1042

The authors discuss the importance of venture capital to the development of young firms. Keuschnigg and Nielsen hypothesize that entrepreneurs have ideas and technical competence, but lack financial resources and commercial experience. Venture capitalists provide start-up finance and managerial support. The authors argue that this two-way relationship requires "high powered financial incentives" such as favourable tax treatment of capital gains. The authors conclude that the

capital gains tax is particularly harmful as it diminishes the financial incentives to provide entrepreneurial effort and managerial support. They find that even the introduction of a small capital gains tax impairs effort and advice and leads to losses. They conclude that, "the capital gains tax could indeed be a major impediment to the development of a high-quality venture capital industry that significantly adds value to young innovative firms" (p. 1033).

—Jason Clemens and Niels Veldhuis

A Theory of the Worst Forms of Child Labour

Sylvain E. Dessy and Stephane Pallage

The Economic Journal, 115 (January 2005): 68-87

This article examines the effects of child labour bans, and in particular bans on physically and psychologically risky employment. The two Canadian researchers conclude that "Although intuitive and morally compelling, a ban on the worst forms of child labour [those that expose children to physical and psychological stress] in poor countries is unlikely to be welfare improving" (p. 68). They show that harmful forms of child labour have an economic role and that it is critical to understand that role. Specifically, wages earned by children increase family income and often allow the accumulation of human capital in poor countries. The authors conclude that unless appropriate mechanisms are designed to mitigate the decline in child labour wages caused by reduced employment options for children, a ban on harmful forms of child labour will likely prove undesirable.

—Amela Karabegović and Jason Clemens 🕮