

Intelligence MEMOS



From: John Lester
To: Economy Watchers
Date: April 30, 2025
Re: CANADA'S NEXT GOVERNMENT MUST FIND ADDITIONAL FIXES FOR THE PRODUCTIVITY PROBLEM

About a year ago, Carolyn Rogers, senior Deputy Governor of the Bank of Canada, declared Canada's productivity problem a national emergency.

Judging from their election platforms, Canada's major political parties did not get the message. Job one is clearly responding to Donald Trump's tariff tantrum, but the Conservative and NDP platforms were silent on productivity, and the Liberal platform fell well short of the full court press required to fix Canada's productivity problem.

As discussed in a recent C.D. Howe Institute [special report](#), Canada's productivity problem is the result of low investment, particularly in machinery and equipment, and a low propensity to innovate relative to our peers. Canada spends less on tangible capital per worker than in the US and other countries, in large part because the cost of capital is high relative to the cost of labour. To fix this problem Canada's next government must lower the tax burden on tangible capital and reform immigration to focus on attracting and employing highly skilled newcomers.

The Liberals did propose reducing the tax burden on investment by extending immediate expensing for machinery and equipment used in manufacturing and processing and for clean energy investments. However, the targeted investment incentive should be accompanied by a reduction in the corporate income tax rate.

And while the Liberals offered limiting immigration and improving recognition of foreign credentials, their platform was light on details. We must stop filling lower-skilled job openings through immigration, which keeps productivity and wages low by discouraging investment in new equipment and technologies. We must also end the tragic waste caused by accepting newcomers before confirming that their credentials meet our standards.

The provinces hold most of the cards in credential recognition, but the federal government could break the logjam by financing the systematic assessment of foreign accreditation agencies. Canada should start by identifying foreign agencies that meet or exceed provincial standards and give priority to applicants certified by them. We should follow up with a case-by-case evaluation of accreditation agencies, and specific educational institutions and programs, in other countries.

Much of Canada's innovation problem can be traced to low spending on R&D, a low propensity to patent the inventions flowing from this R&D, and an unexpectedly low impact on productivity from the inventions that are patented.

The Liberal measures miss the mark by enriching incentives for R&D performed by small firms. The incentives for small firms to perform R&D are already too high relative to the spillover benefits created while the incentives for larger firms are too low by the same metric. A better approach would therefore be to reduce the small firm subsidy rate and increase it for large firms. Small firms would benefit greatly from increasing the timeliness of SR&ED incentives by delivering assistance independently of filing a tax return.

The low propensity to patent is acute for academic research. A [recent study](#) found that Canada produces just over half the patents that would be predicted based on the quality and quantity of its academic research. We could make some progress here if federal funding for patentable academic research were conditional on developing plans for commercializing the resulting inventions.

The weaker link than in other countries between patents and productivity growth arises because a low share of our inventions is brought to market in Canada, not because of lower quality patents. The key reason for this outcome is that too many small, innovative firms sell their intellectual property to foreign firms rather than commercialize it themselves.

Several policy changes would tilt the calculus in favour of commercialization in Canada. The Liberal proposal to increase funding for venture capital financing will help if it is structured to reduce reliance on foreign sources, which encourages selling to these suppliers. Shifting some support for R&D to commercialization would also help. The Industrial Research Assistance Program should get a new mandate to support commercialization of inventions rather than R&D. Eliminating capital gains taxation on the sale of qualifying small business shares to a Canadian resident would strengthen the incentive and ability to scale up in Canada.

Small and medium-sized firms employ about 64 percent of private sector workers in Canada, compared to 46 percent in the United States. Small firms are much less productive and pay lower wages than large firms, so firm size is contributing to the productivity gap. We should therefore review small business policies to ensure they do not encourage more small-scale production than necessary. In addition to reducing the generosity of the SR&ED incentive for small firms, we should eliminate the preferential income tax rate for small business. Both measures encourage entry by firms that are not growth oriented.

And while the Liberals did propose measures, such as working with the provinces to reduce interprovincial barriers to trade and mobility, that will make the Canadian economy more productive, they don't yet have a comprehensive plan for raising productivity growth to match the performance of our peers.

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