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The Promise of Productivity

Delivering Shared Growth to Canadians

April 2026



CSA Public Policy Centre

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Acknowledgements

The author would like to thank the reviewers for their insightful comments.

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Contents

Introduction 6

The Productivity Crisis 7

The Anatomy of Productivity Growth and Performance in Canada 7

Solutions 8

The Limits of the Grow-and-Redistribute Approach 8

Who Gains from Productivity Growth? 8

The Role of Redistribution 9

Redistribution as a Crutch 10

Diffusion: Canada's Untapped Potential 11

Policies That Foster Productivity Diffusion 11

Competition – The Central Pillar of Productivity Diffusion 12

Policy Solutions to Improve Competition 12

Complementary Reforms to Strengthen Productivity Diffusion 13

Conclusion 13

Endnotes 13

Executive Summary

Canada is in a self-proclaimed productivity crisis that threatens to cripple growth in the country's living standards. Furthermore, Canada faces profound threats to economic wellbeing from unstable US–Canadian relations and a shifting global order. This uncertainty makes it critical for Canada to improve productivity and self-sufficiency.

That said, the promise that productivity will improve Canadian living standards depends on who ultimately enjoys the wealth and income that come from boosting productivity. If gains from productivity only go to those who already have the most, then Canada fails to deliver on the promise that greater productivity can improve everyone's living standards.

Today, Canada works to deliver on the promise of productivity by following a *grow-and-redistribute* policy logic. Policymakers focus on growing the proverbial "economic pie" without regard for who profits from that growth. Governments then "split the pie" through taxation and redistribution in a way that is politically palatable. This approach is framed as a sensible market-driven, hands-off strategy. But the irony is that it forces Canadians to rely more heavily on social welfare systems and large interventionist governments to improve their economic wellbeing. This approach is not sustainable and does not lead to real economic opportunities that empower Canadians.

This paper puts forward the *diffusion* approach as an alternative. The goal is to close the gap in productivity growth between the most productive frontier firms in Canada and the non-frontier businesses by enhancing domestic competition. Closing the productivity gap by helping non-frontier firms become more productive will enhance the productivity of the Canadian economy while reducing reliance on the tax-and-transfer system to improve living standards.

Competition is the cornerstone of the diffusion approach to boosting productivity. Stronger competition in Canadian markets motivates both frontier and non-frontier firms to adopt new technologies and business practices that enhance efficiency and performance. It also helps ensure that the gains from productivity growth are shared more widely through fairer prices for consumers and better wages for workers. To advance this agenda, governments should continue strengthening Canada's competition policy regime by enforcing competition law in labour markets, revitalizing the Competition Tribunal, and appointing a Prime Ministerial lead to coordinate pro-competitive reforms across ministries. Competition should also be a guiding principle in the design of regulations and tax policy.

Introduction

In her remarks *Time to break the glass: Fixing Canada's productivity problem*, Senior Deputy Governor of the Bank of Canada Carolyn Rogers outlined the "pressing need for Canada to increase productivity."[1] Commentators, bankers, and economists have long discussed Canada's weak productivity performance. Due to US policy actions like import tariffs, improving Canada's economic performance is now even more urgent.

The "promise of productivity" is this: investing time and money into businesses to make them more productive and therefore more profitable means more Canadians can enjoy a better quality of life. When Canadian businesses are more productive, people will not have to work as hard to enjoy the same or better quality of life they have today.

For the promise to be true, the profit created from higher productivity needs to be shared broadly across society, not just with the small handful of investors, business owners, and elite workers. This paper explores how Canada delivers on the promise of productivity today and more coherent ways to deliver on that promise tomorrow.

Policymakers should revaluate their approach given that many Canadians are skeptical of the very idea that economic growth and productivity lead to higher standards of living. In a survey from the Boston Consulting Group in the spring of 2024, 72% of respondents believed that more economic growth means a higher cost of living. Only 22% of respondents believed that economic growth would lead to a more equal Canada, and 40% disagreed.[2]

The first section of this paper presents information about the current state of productivity and its growth in Canada, including a summary and insights into solutions that have been proposed. The second section explores how the Canadian economy currently translates productivity gains into higher living standards, presenting data that outlines the structure of these systems and deficiencies in the current approach. The last section lays out an alternative, yet complementary, approach to addressing gaps in Canada's current productivity and living standards processes.



The Productivity Crisis

Canada's productivity issues are not new. Since 2000, Canada's labour productivity growth has been anemic. From 1973 to 2000, labour productivity in the business sector grew by 1.74% per year on average.[3] That growth fell to 0.86% per year on average from 2000 to 2022.[4]

Canada's productivity growth lags that of international peers. As of 2023, Canada's labour productivity growth ranked 32nd out of 41 OECD nations.[5] However, Canada's is not the only mature economy that is grappling with declining productivity growth. Furthermore, in 2023 its slowdown is less pronounced than in other mature economies such as the Netherlands, New Zealand, and Italy.[6]

Canadian policymakers and commentators frequently compare the country's labour productivity with that of the US, but it is important to note that the US surpasses most nations in both productivity levels and productivity growth. That said, Canada's overall productivity levels in 2022 remained below the OECD average and much behind many G7 nations.[7]

The Anatomy of Productivity Growth and Performance in Canada

Growth of labour productivity has three sources: labour composition, capital intensity, and multifactor (or total factor) productivity. *Labour composition* reflects human capital and is influenced by experience and education. C*apital intensity* reflects the quality of capital, and it grows when people make investments in better, more productive equipment and technologies.[8]

Multifactor productivity growth is the most ethereal component of labour productivity growth. Think of it as the "everything-else" bucket of productivity. The term captures all other forms of productivity that are not measured through labour composition and capital intensity growth, or what some call *disembodied* types of productivity.[9] It includes know-how, new business processes that result from bringing new technologies into a firm, good management, culture, trust, economies of scale, government regulation, and others.[10] For mature economies like Canada's, multifactor productivity growth is a core driver of national economic growth.



Research attributes Canada's slowing productivity growth since 2000 to diminished effects from earlier IT adoption and liberalization.[11] Recent declines in multifactor productivity growth, and even some years of full-on decline,[12] have significantly reduced overall productivity gains, but specific causes are difficult to assess because multifactor productivity is broad and ambiguous.[13] More specifically, some research has pointed to less investment in machinery and equipment[14] and information technologies as causes of low productivity growth.[15] On a more structural level, researchers have pointed to the geographic dispersion of markets across Canada, regulations that inhibit competition, a relatively large number of small firms, the rising prevalence of zombie firms (i.e., persistently unproductive businesses that survive without contributing to national growth), skills mismatch in labour markets, an already high degree of market-oriented economic policy,[16] poor business management,[17] and low levels of R&D investment as some of the reasons for Canada's poor performance.[18]

Overall, researchers have attributed Canada's low productivity growth to problems in business investment, business practices, and other disembodied forms of productivity reflected in multifactor productivity. Gaps or deficiencies in human capital are not a major driver of Canada's low productivity growth. A review of the drivers of productivity performance for other economies similar to Canada's is outside the scope of this study. However, it is worth noting that Canada's challenges mirror those of other OECD nations.[19]



Solutions

There are a number of possible solutions that have been put forward to improve Canada's productivity. They include increasing competition in Canadian marketplaces, revising the tax system to incentivize saving,[20] bolstering Canada's R&D ecosystem,[21] encouraging AI adoption,[22] increasing national pride[23] — the list goes on. Some have argued that there is no silver-bullet solution to lagging productivity, and that fixing Canada's weak productivity growth will take a suite of interventions.[24] No matter how governments aim to boost productivity, two key principles should be considered.

First, improving productivity now and in the future requires new approaches—past causes of low growth may not be relevant. Innovations like AI and the green transition offer fresh opportunities for productivity growth not seen in historical trends.[25] The digital economy relies more on intangible assets such as patents and intellectual property and less on physical capital like machinery. Governments should focus on prospects instead of past models.

The second principle is policy coherence. Professor Barry Cross at Queen's University notes that while large businesses may boost productivity through economies of scale and scope, reduced competition can lessen their motivation for ongoing productivity improvement.[26] To navigate these potential contradictions, policymakers need to be clear about their ultimate policy objective—improve productivity at any cost or improve productivity to enhance living standards?

The Limits of the Grow-and-Redistribute Approach

Productivity fulfills its promise only when its gains translate into higher living standards across society, not just for a select few. In other words, the rising tides must lift *all* boats.

Canadians benefit from productivity growth through two channels: higher wages and higher returns for business owners and investors.[27] The tax system redistributes productivity gains accrued to workers, business owners, and investors at the top end of the income distribution to those at the low end so that productivity growth leads to higher living standards for more people. The tax-and-transfer system drives Canada's grow-and-redistribute approach to economic policy.

Who Gains from Productivity Growth?

Canada's labour share of income shows how economic gains, including productivity growth, are divided between workers and business owners (investors). From 1998 to 2020, the labour share ranged from 55.8% to 59.7%, indicating that more than half of all income in the economy went to workers.[28] Canadian macro-level data show that wage growth tracks productivity growth, meaning workers generally earn more as productivity rises.[29] However, there is evidence that this connection has weakened over time, with workers now receiving less benefit from productivity gains compared to business owners.[30]

Examining market income by income decile provides a more detailed perspective of who gains from higher productivity. Since the mid-1970s, the share of market income held by most deciles has stayed stable, except for the top decile, which rose from 26.2% in 1976 to 29.4% in 2023. The third, fourth, and fifth deciles have seen a subtle and gradual decline in their share.

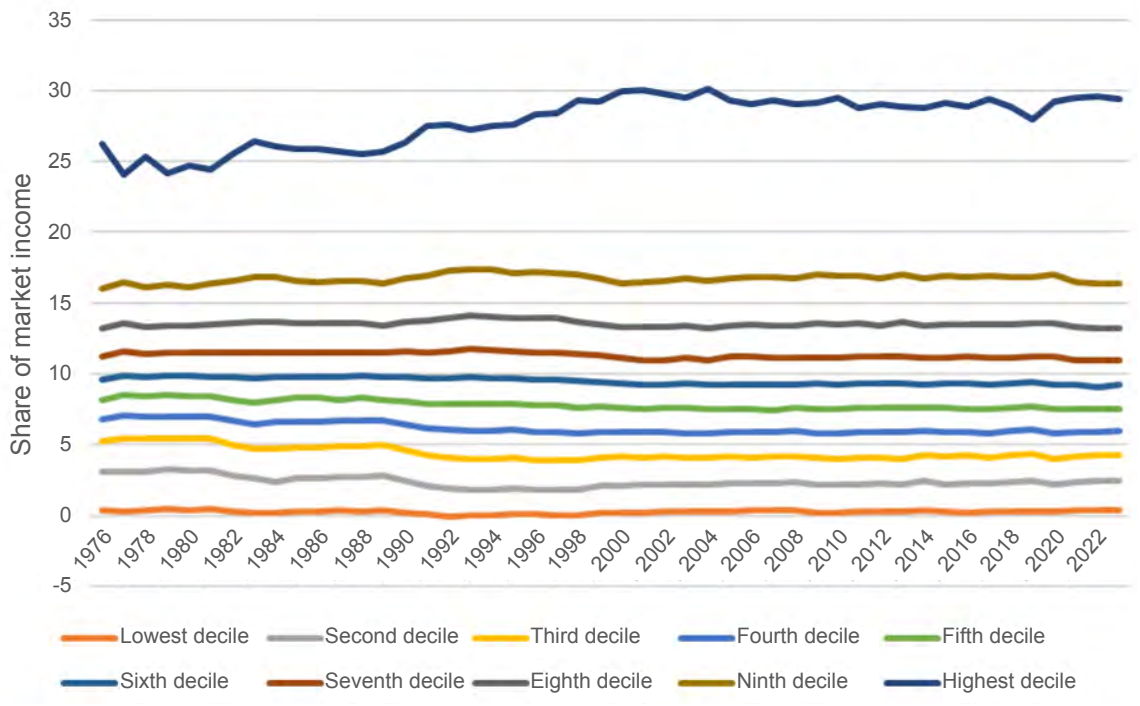
The rise in top earners' income share aligns with the connection between wages and firm productivity. Statistics Canada reports that employees at Canada's top 10% most productive businesses earn, on average, 3.9 times more than those at other companies.[31] Additionally, research shows that frontier firms (top 10% in productivity) consistently outpace non-frontier firms in productivity growth across nearly all industries.[32] This pattern reflects market income distribution, with the incomes of top earners increasingly outpacing incomes of most other workers.

As shown, under the current system, productivity growth does not raise all boats. Instead, Canada's labour markets combine with skewed wealth distribution (the top 1.0% hold 24.8% of all wealth in Canada)[33] to create the conditions where productivity growth raises some boats higher than others.

The Role of Redistribution

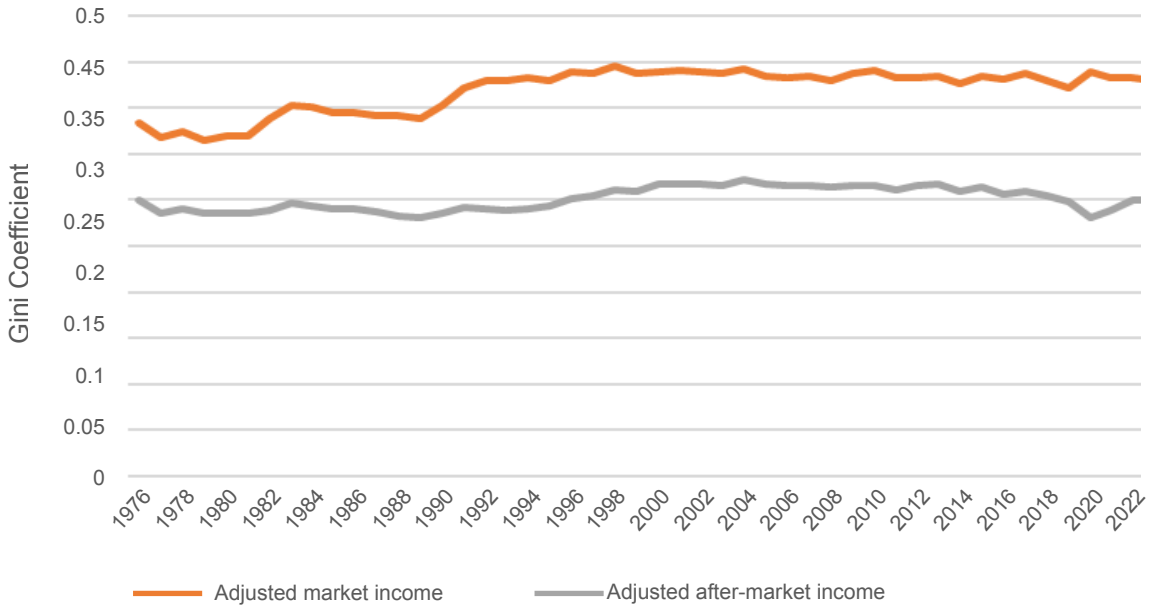
Governments play a substantial role in reallocating the gains from productivity by taxing high-income earners with progressive marginal tax rates and redistributing some of that income to lower-income tax filers. The differences between the Gini coefficients—a statistical measure of inequality—based on market and after-tax income show this impact.

Figure 1: *Percentage share of total market income by adjusted income decile, 1976 to 2023*



Source: Statistics Canada. (2025). *Table: 11-10-0193-01: Upper income limit, income share and average of adjusted market, total and after-tax income by income decile.* https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1110019301

Figure 2: *The Gini coefficients by adjusted market income and adjusted after-tax income, 1976 to 2023*



Source: Statistics Canada. (2024). Table 11-10-0134-01: *High income trends of tax filers in Canada*. https://www150.statcan.gc.ca/t1/tbl1/en/cv.action?pid=1110013401

The spread between the Gini coefficients of market and after-tax income has increased over time, meaning that the tax-and-transfer system must take on an increasingly larger role in redistributing income across people in Canada. In 1976, the difference between the two Gini coefficients was 0.084; in 2022 that difference increased to 0.132.

Defining the appropriate level of economic inequality is a complex economic and moral challenge. While some inequality rewards innovation and risk-taking, excessive inequality can cause poverty, limit human potential, increase public costs, and can be a drag on productivity. Even moderate income gaps can restrict opportunities to build skills or start businesses, ultimately reducing society's overall prosperity. While recognizing that this relationship is complex, empirical research has found that higher levels of inequality can undermine economic growth.[34] Economic policymakers should address income and wealth inequality as economic, not just social, issues when working to improve Canada's economy.

Redistribution as a Crutch

In his 2022 keynote address to the C.D. Howe Institute's Annual Director's Dinner, Bill Morneau, former Liberal finance minister, expressed his disappointment at how his government spent "[s]o much time and energy [...] finding ways to redistribute Canada's wealth that there was little attention given to the importance of increasing our collective prosperity—let alone developing a disciplined way of thinking and acting on the problem." He went on to say that Canada's lack of competitiveness is "not [...] *one* of the big problems facing Canada's economy, it's that this is our *fundamental* problem. Nothing else is solvable if we don't put this issue first."[35]

This perspective on economic growth and its distribution is not exclusive to Morneau. Jason Clemens and Tegan Hill of the Fraser Institute express a similar sentiment when they say, "we must grow the economic pie before slicing it up and distributing (or redistributing) it."[36]



This *grow-and-redistribute* approach drives Canada's current economic policy, which is designed to address growing inequality shown in the figures above. Most productivity growth has occurred in a few leading firms, while the productivity growth of other companies advanced more slowly.[37] As leading firms pull further ahead, their workers and owners earn significantly more than their peers in lagging firms. To share economic growth more broadly, governments tax these higher profits and incomes and redistribute the revenue to lower-income individuals.

However, the grow-and-redistribute model is a negative feedback loop and fundamentally unsustainable. As top firms continue to become more productive and out-earn the rest, Canadians increasingly depend on taxes instead of markets to distribute productivity gains of the top firms. This greater reliance on income and profit taxes discourages investment in productivity.[38] It also reinforces disempowerment and a lack of agency. As well-paid jobs and business opportunities become less accessible to those in the mainstream economy, redistribution programs increasingly serve as a core income source for many, papering over the underlying issue of limited opportunities.[39]

To enhance productivity growth in Canada and transform that growth into higher living standards, Canada needs an alternative approach to economic policy.

Diffusion: Canada's Untapped Potential

To raise living standards without increasing reliance on the tax system, the productivity gap between leading firms and others must be narrowed. The goal is to enhance the productivity of the 90% of Canadian businesses not at the productivity frontier by diffusing technologies, innovations, and know-how from leading firms as quickly and broadly as possible. Through diffusion, Canada can increase wages and profits for broad segments of the population, improving living standards for many people and delivering fully on the promise of productivity growth.[40]

The traditional grow-and-redistribute approach centres on developing a few highly productive national champions that make up the productivity frontier and drive productivity growth in Canada's economy. In contrast, the diffusion approach maximises productivity across many firms. These two approaches can work together. Spreading the technology, knowledge, and business practices of leading firms boosts productivity across the economy and helps Canada make the most of both private and government investments in national champions.

Policies That Foster Productivity Diffusion

A recent report by Andrew Sharpe and Stephen Tapp of the Centre for the Study of Living Standards, *Can a Lack of Pro-Productivity Policies Explain the Secular Decline in Canada's Productivity Growth?*, offers important context.[41] The authors review decades of productivity-oriented policy in Canada and highlight a paradox: despite extensive pro-productivity initiatives since the 1960s, national productivity growth continues to decline.

A major factor is weak private-sector investment in machinery and equipment. Canadian firms invest heavily abroad—possibly at the expense of domestic investment. Sharpe and Tapp conclude that while government policy can support productivity growth, real progress depends on business leaders choosing to invest in innovation and efficiency. Despite numerous government incentives, including tax credits, many firms have not acted on them. As the authors note "[o]ne can lead a horse to water, but one cannot make him drink."[42]

Still, there are clear steps policymakers can take to support widespread productivity growth. Chief among them is strengthening competition in Canadian markets.

Competition – The Central Pillar of Productivity Diffusion

Numerous experts have stressed that competition is vital for growing productivity and that Canada needs more of it.[43] A Competition Bureau study found that competitive intensity in Canada declined from 2000 to 2020 across several measures.[44] What makes competition a particularly effective solution is its ability to both enhance productivity and ensure that the gains from that productivity growth are shared more evenly across society.

Competition drives productivity by motivating firms to adopt new technologies and processes that improve efficiency and profitability.[45] It also weeds out zombie firms, freeing up labour and capital for more productive use elsewhere.[46]

Just as importantly, competition ensures that the gains from productivity are distributed more equitably. When firms lack competitors, they charge higher prices and suppress wages because workers and consumers have limited alternatives. Stronger competition reduces this market power, pushing firms to share productivity gains with consumers through lower prices and with workers through higher pay and better conditions.[47]

Embracing greater competition also means that Canadian policymakers commit to fostering many efficient, profitable firms rather than just a few dominant ones. Market leaders' positions must remain contestable so other companies can overtake them through effort and investment. This environment not only spreads best practices but also motivates all firms to innovate and improve.

Supporting greater competition does not mean avoiding business growth by building large companies. Certain businesses increase productivity with scale, and policies should support their growth.[48] Rather, committing to competition requires rejecting the idea that large companies are always more productive than small ones or that increased scale always leads to higher productivity. Canada's top 10% most productive firms employ under 10% of Canada's workers since they need fewer employees to produce equal or greater output than less-productive companies.[49] Economies of scale are not the only type of productivity, and competition-focused economic policy recognises this.

> **"Competition drives productivity by motivating firms to adopt new technologies and processes that improve efficiency and profitability."**

Policy Solutions to Improve Competition

Evidence shows that Canada's markets have become less dynamic and competitive. While recent amendments to the *Competition Act* may improve market conditions, their impact depends on modern, rigorous enforcement. Canada's labour markets also require stronger enforcement of the *Competition Act*. Recent updates to the Act make wage-fixing and no-poach agreements between employers a criminal offense. However, there is no public record of the Bureau enforcing the law against harmful labour market mergers or dominance abuses, despite having the authority to do so.[50] Overlooking pressures on labour markets harms both workers and competition in Canada's economy.

Revitalization of the Competition Tribunal, which enforces the *Competition Act*, is also needed. The Tribunal is a quasi-judicial body that hears cases presented by the Commissioner of Competition. The rationale behind creating a specialized body to hear competition cases was the belief that competition law issues were exceptionally complex, requiring an expert panel to adjudicate them. Due to this specialization, only a few judges sit on the Tribunal; over the past decade, only two judges have handled almost all competition rulings.[51] This has limited diverse viewpoints in caselaw and hindered the development of jurisprudence that incorporates current economic theories. To strengthen enforcement of the *Competition Act*, the Competition Tribunal should include more judges for competition cases.



Policymakers can also strengthen competition in Canada by adopting an all-of-government approach, as suggested by Denise Hearn and Vass Bednar in their book *The Big Fix: How companies capture markets and harm Canadians*.[52] They propose that the federal government make a Prime Ministerial appointee responsible for working across ministries and the Competition Bureau to identify and coordinate opportunities for pro-competitive policy reforms. To help policymakers across government promote more competition, the appointee should follow the policy best practices outlined in the OECD's Competition Assessment Toolkit.[53]

Complementary Reforms to Strengthen Productivity Diffusion

Enhancing competition is essential to productivity growth but not sufficient. Sharpe and Tapp highlight other priorities, including reducing regulatory barriers to investment (such as interprovincial trade barriers) and reforming taxation. These should be pursued within a diffusion framework, not a grow-and-redistribute one.

For example, the federal Scientific Research & Experimental Development (SR&ED) tax credit has long aimed to spur innovation by subsidizing R&D, treating it as a public good. While effective for frontier firms, these programs benefit non-frontier firms less.[54] Reforms that make SR&ED tax credits more accessible and useful to smaller and mid-tier firms could significantly boost diffusion.

Similarly, Michael Wolfson's *Notes on Corporate Concentration and Canada's Income Tax* shows that while Canada's tax system lacks an explicit bias toward large firms, effective tax rates are often lower for the biggest (and smallest) businesses.[55] This structure inadvertently encourages consolidation and reinforces a grow-and-redistribute logic. Policymakers should assess how tax programs collectively influence market concentration and competition.

Finally, as noted, the OECD's Competition Assessment Toolkit is a valuable guide for reviewing regulations and taxes through a competition lens. Anchoring reform efforts in the goal of promoting and protecting competition not only strengthens productivity growth—it ensures that the benefits of that growth are broadly shared across the Canadian economy.

Conclusion

Recent US efforts to economically separate from Canada pose significant risks to Canada's economy, which has been built for integration. Improving weak productivity is essential to ensure that business gains lead to better living standards for everyone, especially in light of current challenges.

Canada's current approach to improving productivity misses the mark. The grow-and-redistribute approach that guides economic policy today relies heavily on promoting a few champion firms, taxing the profits and wages that they generate, and distributing those tax gains to people with lower incomes. It means that governments help only top firms become highly productive market leaders and then spread the wealth.

This approach reinforces the concentration of profits from productivity growth in frontier firms. Further, the current way those profits are shared across the economy is not equitable or sustainable. As Canada's top firms

grow more productive, the economy relies more on taxes to share gains rather than a higher concentration of productive firms would. Higher income taxes create inefficiencies and distort markets, while the best-paying jobs pull further away from the mainstream economy. Overall, the grow-and-redistribute strategy has failed to improve growth in productivity while it has expanded government reach.

This paper proposes an additional option: the *diffusion* approach. Its goal is to narrow the productivity gap between Canada's top firms and the rest by enabling productivity knowledge, technologies, and processes to diffuse from leading firms to others. Boosting Canadian business productivity through productivity diffusion can raise incomes across Canada's economy without increasing dependence on government for economic redistribution.

Focusing on diffusing productivity throughout the economy allows Canada's economy to generate the greatest returns from innovation possible because it mobilizes large segments of the economy. It also spreads prosperity and success, empowering people and creating opportunities for them to actively participate in creating prosperity, not just be recipients of it through tax credits.

Competition is central to making the diffusion approach work in practice. A more competitive economy pushes both leading and lagging firms to adopt new technologies, better management practices, and innovations that raise performance and productivity. It also ensures that the gains from productivity growth are shared more evenly, leading to fairer prices for consumers and better wages for workers. To advance this agenda, governments should strengthen Canada's competition policy regime—enforcing competition law in labour markets, revitalizing the Competition Tribunal, and appointing a Prime Ministerial lead to coordinate pro-competition reforms across ministries. Embedding competition as a guiding principle in regulation and tax policy would translate productivity gains into broadly shared prosperity.

Further research is needed on frontier versus non-frontier firms and how productivity spreads. Identifying Canada's frontier firms and understanding their productivity drivers can help policymakers design targeted interventions to boost productivity growth across other businesses in the country. Devoting public funds to this type of research would generate outsized returns.

Ultimately, with the economic disruption coming from geopolitical shifts and an evolving economic world order, Canada needs to turn inward and find new pathways for creating prosperity. The productivity growth approach suggested here, which seeks to mobilize as many Canadian firms as possible, provides a roadmap for doing just that.

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