RBC Economics & Thought Leadership

Canada's Growth Challenge:

Why the economy is stuck in neutral

Canada has a growth problem. The economic momentum that propelled the country through the 20th century has faded in the 21st, and appears to have worsened since the pandemic. Higher interest rates have slowed per-capita output since 2019, but the problems run deeper than that. Our economy is now smaller than it was in 2019 when adjusted for inflation and immigration, and pretty much in the same place it was a decade ago.

Globally, we've fallen behind most major economies since 2000. At the turn of the century, the economic output of the average Canadian was on par with Australia. Today, Australians are almost 10% more productive, while their economy has grown 50% per person faster than Canada's over the quarter century. We're further behind the United States. Canada is 30% less productive than the U.S. and closer to lower-income states like Alabama in terms of economic performance than tech-rich California or New York. The result: We've fallen from the 6th most productive economy in the Organisation for Economic Co-operation and Development in 1970 to the 18th as of 2022.

Pretty much every Canadian has something at stake. The productivity gap with the U.S. stands at about $20,000 per person a year, putting Canadians' wages roughly 8% below their U.S. counterparts. The gap has been even more taxing for capital. Anyone who invested $1,000 in Canada's main stock index in 2000 would have $4,400 today; the same investment in the U.S. S&P 500 index would be worth $6000—a more than 35% difference.

Our relatively low productivity —the amount of production and income generated per hour worked in the economy—has been held back by a shortfall in investment, especially outside real estate, construction and public services like hospitals. As a result, we've not been able to capitalize on the immigration boom that has added seven million people—most of them working-age and well-educated—since the turn of the century and offset the retirement wave of baby boomers.

The deindustrialization of many parts of Canada has cut into the country's overall prosperity. Manufacturing is half what it was to the economy in 2000, while mining has also shrunk. Oil and gas—once powerhouses of investment and growth—are showing signs of renewed strength, but investment levels remain far below what they were a decade ago. Agriculture has been a rare standout, as we'll explore later in this report.

A positive change in productivity could be the most significant factor in lifting economic growth, and the prosperity that goes with it. We have the natural and human resources that much of the world is looking for, and our access to major markets—Europe, Asia, and critically, the U.S.—is the envy of the world. With those strengths, Canada's growth challenge can quickly become a growth opportunity, with significant benefits for Canadians. Simply closing the productivity gap with the U.S. would add roughly $20,000 of GDP per person per year.

Boosting productivity is not simple, of course. Canada is a large, geographically diverse, resource-rich country with a dispersed population, and that creates unique infrastructure, regulatory and investment challenges. Administrative burdens across multiple levels of government have created inefficiencies and increased internal trade barriers. Infrastructure chokepoints and red tape make international trade more difficult than it should be. Even the mobility of skilled workers—hard enough given our geographic expanse—can be limited by the way provinces, industries and professional groups try to control labour supplies.

Those issues all contribute to lower Canadian business investment and with that, lower growth. Moreover, in recent economic cycles, a growing share of savings and investment has flowed to real estate and construction, which, while needed and beneficial for many reasons, are both relatively inefficient and can hold back the overall productive growth of an economy. The same can be true for small businesses, which account for 98% of total businesses and historically have been less productive. Those businesses are foundational to the country and are part of many Canadian' communities, but if they're not growing and becoming more competitive, they can limit the overall economy's potential.

It wasn't always this way. Canada's productivity growth averaged 5% per year in the 1950s as wartime technologies were adapted for civilian use—powering virtually all GDP growth that decade. Productivity growth stayed strong (3.5% per year) in the 1960s as automation of the manufacturing sector continued, along with a boost from the 1965 Auto Pact between Canada and the U.S. that opened a new door to freer trade. That trajectory faded during the turbulent economic times of the 1970s and 1980s, although innovations like container shipping and expanding global trade led to further gains in growth and productivity in the 1990s.

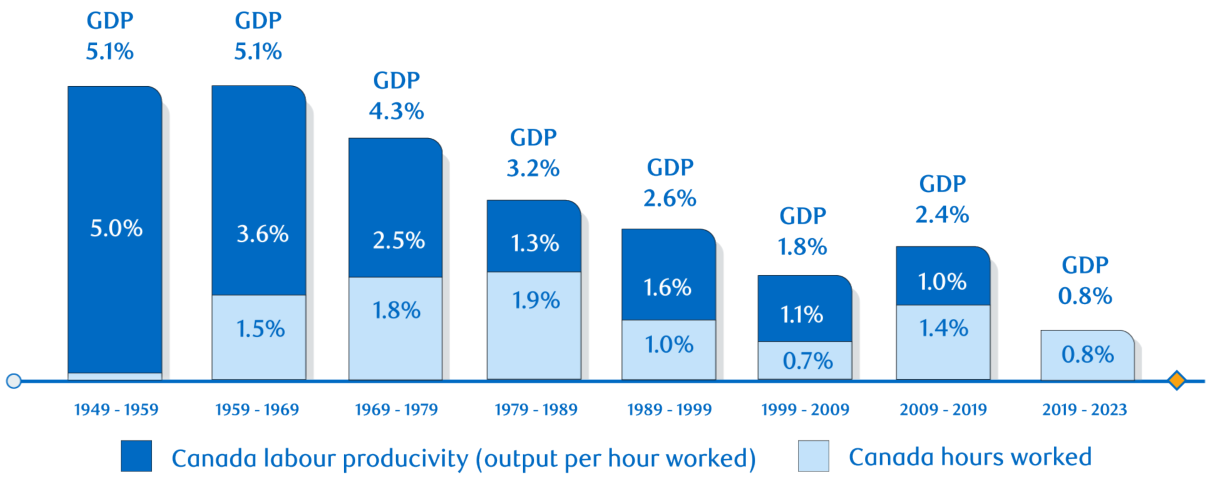
Many of those tides that helped lift the Canadian economy were global ones, most notably trade, technology and education. But many positive forces were also driven by Canada, including the rapid rise of female participation in the workforce, better health conditions for the vast majority of people and increases in education access and quality at all levels.

Even with those investments, productivity growth has stagnated at less than 1% per year on average since the turn of the century. These challenges are not unique to Canada—they are mirrored broadly across other advanced economies. But the slowing here has been more significant than elsewhere. The transformation of every sector by digital technologies, the rapid expansion of robotics and advanced manufacturing, and significant economic gains from life sciences—the forces that accelerated economic growth in other countries did not materialize to the same effect in Canada.

Looking ahead, another challenge for Canada is the services sector, which is the biggest part of the economy. Productivity in service sectors is rising, but not as quickly as it should, given the significant investments made in education. About 80% of the workforce is now in the services sector. That includes all of those food counter workers and hotel staff, who provide real value to their customers and employers, but also professional services where productivity and wages depend more on investments in human capital than machinery and equipment. Simply put, Canada's investments in education and training, and our efforts to attract skilled immigrants, are not generating the expected economic returns.

Slowing Canadian GDP growth led by softening productivity gains

Average annual percent change, business sector (sum of bars equals per-year GDP growth)



Source: Statistics Canada, RBC Economics

These challenges can seem daunting. But the solutions are also clear and attainable and don't require many trade-offs. Growth-minded policies can benefit all parts of society including both investors and workers.

Among the most compelling options for governments, businesses, unions and industry groups are:

Cutting red tape and reducing internal trade barriers. This doesn't have to mean lowering standards but rather improving consistency and rules across jurisdictions to make project approval times and costs more predictable.

Better utilization of immigrant skills. All population and workforce growth is going to come from immigration, and we need a better system to match education and skills with jobs.

Improving tax competitiveness. Canada's tax competitiveness has been slipping. Our level of taxation overall is lower than other more productive economies, but broader reforms to reduce complexity and the cost of tax compliance could help to attract more investment.

Adopting new technologies. "Smarter" investments like artificial intelligence can help but adoption rates are low in Canada. Making it easier to invest in new technologies is critical to maintaining global competitiveness.

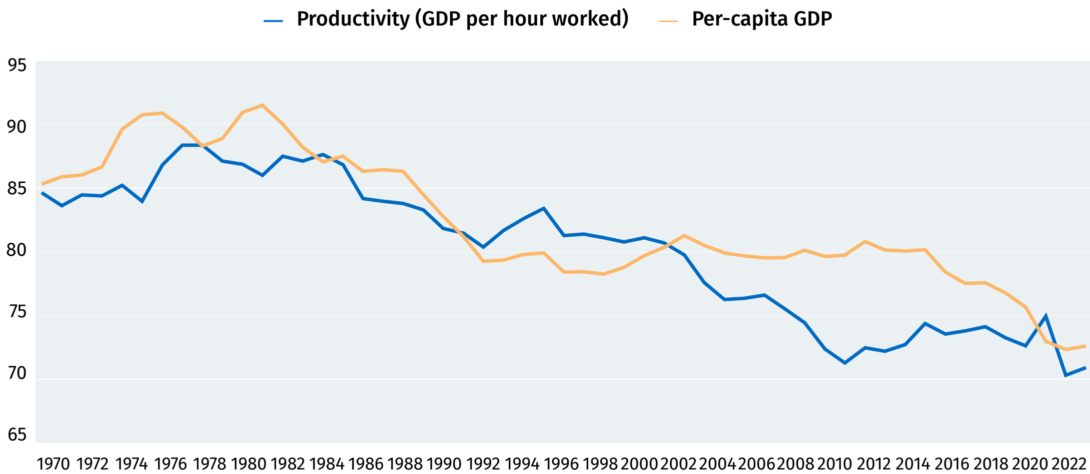
Capitalizing on a highly educated workforce. Canada's highly educated workforce is uniquely positioned to benefit from a global shift to a more services-based economy. Canada needs to ensure investments in education are generating a return.

Every federal government over the last quarter-century, and many of the provinces have studied the challenges of competitiveness, growth and productivity. And they've each discovered, sometimes in hindsight, that there's no simple policy playbook. This report examines some of the steps that can be taken to enhance growth, but one of the most powerful tools is not a tool at all; it's a mindset.

If Canadians developed a collective focus on the economy of the future—one that rewards innovation, celebrates competitiveness, invests in both people and technology, and efficiently delivers returns—the productivity puzzle may become easier to solve. And with it, growth will return.

Canada's productivity vs. the U.S. has been sliding since 1980s

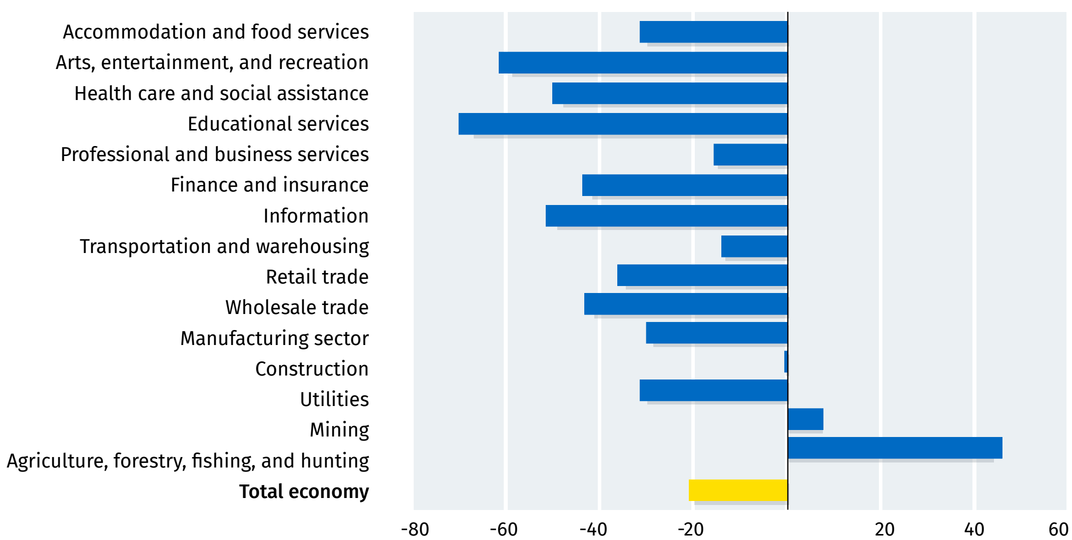
Canada % of U.S., PPP adjusted, 2015 USD



Source: OECD, RBC Economics Research

Natural resources lead Canada's productivity gains vs. U.S.

Canadian GDP per hour worked % difference from U.S. equivalent, USD PPP adjusted, 5 year average ending 2019



Source: Statistics Canada, RBC Economics Research

What you need to know about productivity

What is productivity?

Productivity is a measure of economic output per hour worked. Economic growth depends on many factors—the price of goods and services, and the value of exports, for instance. But, the most important factor over time is the efficiency of an economy at generating additional income from each hour worked.

Can an economy grow without productivity?

It's possible. You just need to add more hours worked. To some degree, high rates of immigration have done that in Canada in recent years. But an economy can't become more vibrant and competitive unless productivity improves.

Does more productivity mean fewer jobs?

It's not about replacing workers with machines. It's about working more efficiently, which is the most reliable way to increase wages and living standards. New technologies like AI have the potential to be disruptive, but for specific tasks and jobs, they can equally allow a wide range of people to create more value with what they do. Technological advancements change the way we work, but historically, have allowed the creation of more jobs than they displace.

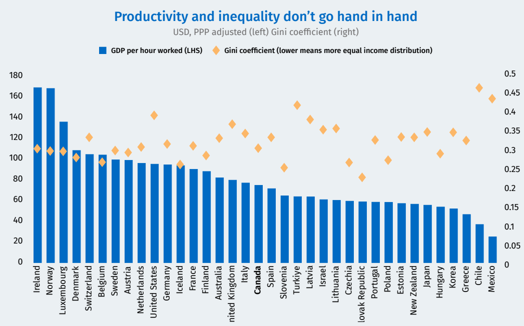
Do we need lower taxes to raise productivity?

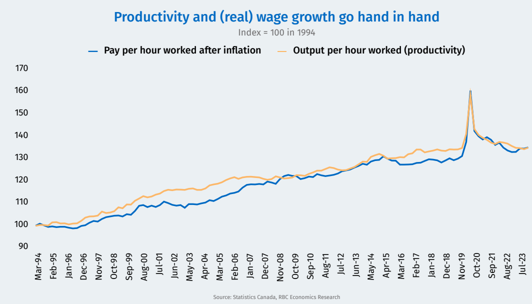
Some taxes impact productivity; others don't. Worldwide, private-sector investment does not require a race to the bottom on corporate tax rates. Other economies with higher productivity levels have higher taxation rates overall than Canada, but the mix of taxes is different and there are benefits to be had from making the tax system less complex.

Does higher productivity mean higher income inequality?

No. Most countries with higher productivity levels than Canada have lower levels of income inequality. Global comparisons in productivity are often complicated by the fact that the U.S. outperforms most other advanced economies in total production per hour worked, but those gains are not evenly spread across the population and between workers and business owners.

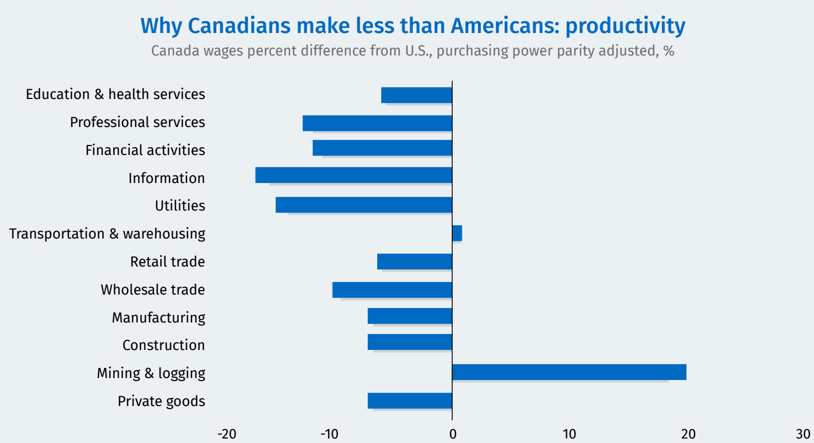
There is no rule that productivity gains will necessarily be evenly distributed between workers and business profits. However, the U.S. experience—where both productivity and income inequality are high—is more an exception than a rule. Of the 17 economies in the OECD with stronger productivity levels than Canada, nine also have lower levels of income inequality. The Nordic countries of Norway, Denmark, Sweden, Finland, and Iceland all have both higher productivity levels than Canada and lower income inequality. After inflation, wage growth in Canada has increased largely in lockstep with productivity over the last 30 years.





Does productivity operate the same across economies?

There are significant geographical and structural economic differences that lead to different productivity outcomes. Norway benefits from large oil and gas resources that are mostly publicly owned or controlled. Canada's widely dispersed population and rich resource base create some unique challenges. But, some of those challenges are also human-made and tied to a lack of cooperation and consistency in rules and regulations across different levels of government.

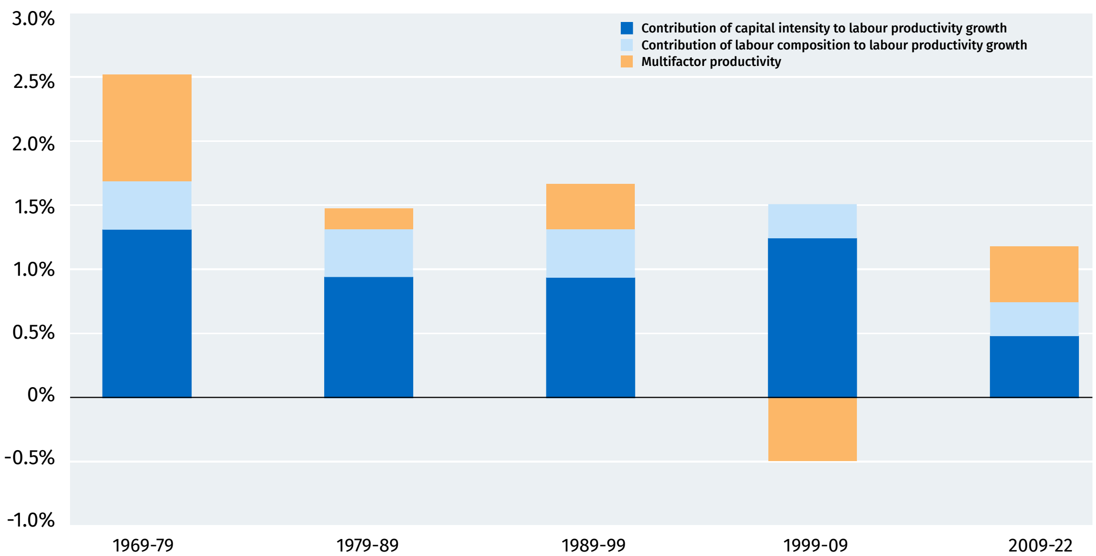


How we got here: Canada's journey to low productivity

Some of the causes of Canada's long-term slowdown in economic growth are well-known and clear. Let's start with an inefficient regulatory and administrative approval system at all levels of government, which has unintentionally increased internal barriers to trade and growth. Infrastructure chokepoints and red tape further make international trade more difficult than it should be. Those have contributed to lower Canadian business investment, and with that, an overweight of capital going to buildings and construction, which, while valuable to the economy, don't do as much for growth as machinery and intellectual property do. Moreover, many policies have favoured small businesses over growth companies and large enterprises, which, in turn, limits our overall productivity growth.

Slow investment is the biggest cause of low productivity

Percentage point contribution to growth in Canadian GDP per hour worked



Source: Statistics Canada, RBC Economics Research

Canadian businesses invest less

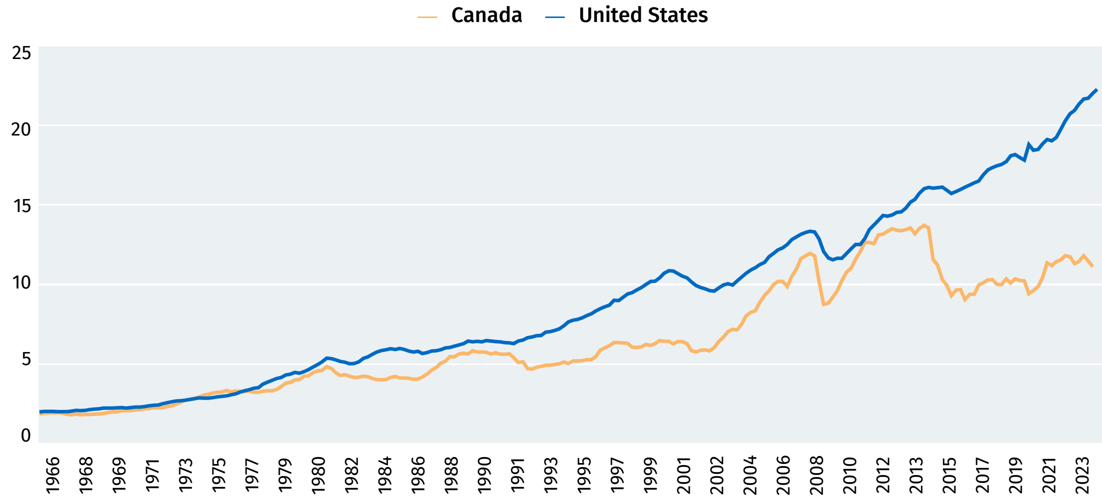
Canadian businesses invest substantially less than in the U.S.—about half as much per worker in aggregate. That underperformance intensified following the 2008-09 global financial crisis and through the oil price collapse of 2015, and worsened following the pandemic as higher interest rates hit the Canadian economy harder than the U.S. In sum, the contribution to productivity growth from capital investment in Canada since the 2008/09 financial crisis has been less than half the average over the decade before. Added to this, weak recent investment trends suggest further underperformance in the decade ahead.

Of course, part of the slowing in investment has been from a pullback in investment in the Canadian oil and gas sector that is tied more to the ongoing energy transition globally away from fossil fuels. But, businesses have also invested a substantially smaller share of GDP in the manufacturing sector in Canada than in the U.S. over the last decade.

The issue does not appear to be a lack of available funding. Central banks have pushed interest rates higher, but businesses are still sitting on a large cash stockpile worth almost a third of GDP. Businesses have long argued that an inefficient project approvals backdrop is making investing in Canada relatively expensive. Lack of investment also keeps Canadian businesses smaller (98% of businesses in Canada have fewer than 100 employees) and smaller businesses are typically, on average, less productive.

Canada severely lags the U.S. in capital investment

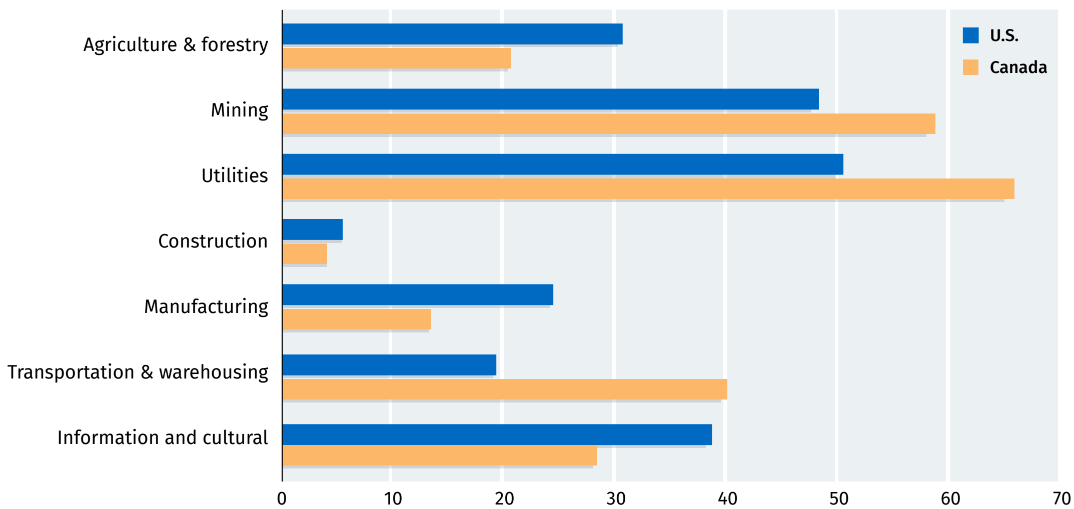
US$ per employed worker (at market exchange rates)



Source: Statistics Canada, Bureau of Economics Analysis, RBC Economics Research

Utilities and mining draw most investment both sides of the border

Total investment to GDP ratio by industry, 10 year average ending in 2022



Source: Statistics Canada, Bureau of Economics Analysis, RBC Economics Research

Regulation is a tax on investment and growth

A patchwork of regulatory and administrative rules across different municipalities and provinces is complicated and unintentionally restricts trade within Canada.

The International Monetary Fund has estimated that internal trade barriers (for example, regulatory differences across regions, paperwork requirements for businesses in multiple jurisdictions, and certification differences that limit labour mobility) cost the equivalent of a 20% average tariff between provinces. By comparison, the effective tariff rate collected on international imports from abroad in Canada is less than 1%.

In 2020, Canada ranked 188th out of 208 economies tracked by the World Bank on the number of days businesses spent dealing with construction permits for new projects. That is three times longer than time spent in the U.S.

Red tape also makes it more expensive for companies to trade across international borders. Actual tariff rates on international trade in Canada are low, but Canada ranks poorly (51st globally) in the ease of trading across borders in large part due to high administrative costs associated with importing and exporting.

Our tax system is losing its competitive edge

A decade ago, Canada had the second lowest corporate tax rate among G7 economies. That gap has narrowed, particularly, after a sharp drop in U.S. corporate tax rates in 2018.

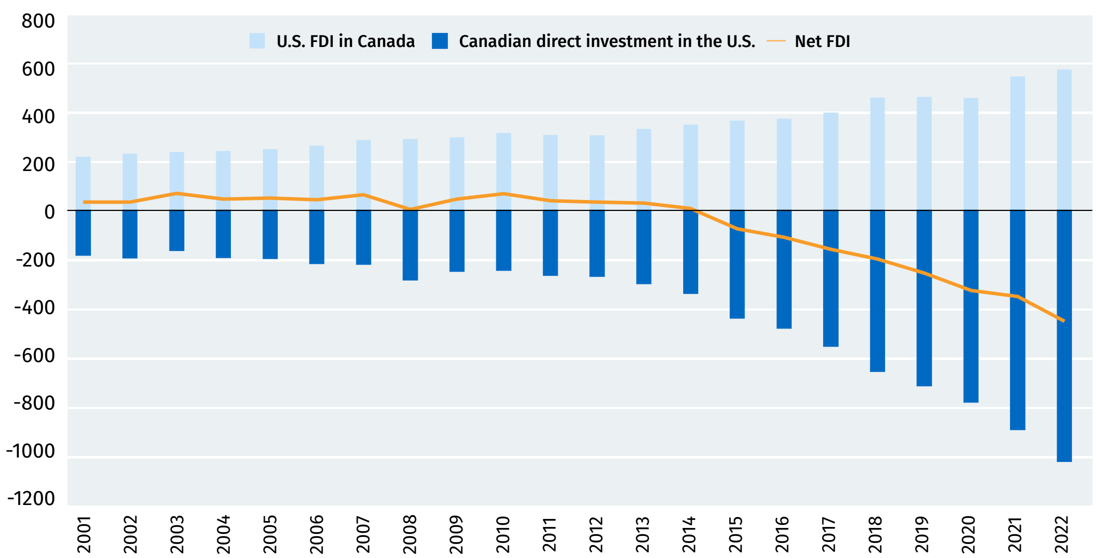
Canadian corporate tax rates are still comparable to other advanced economies. But taking into account the tax on company dividends at the personal income tax level, the total tax on distributed profits from Canadian companies is the highest in the G7, according to the OECD.

Added to this, governments in Canada have been running larger budget deficits after decades of fiscal responsibility. That raises the risk of further tax increases in the future, which increases uncertainty for businesses thinking about coming to and expanding in Canada.

At the same time, while foreign direct investment in Canada has remained firm, investment by Canadians abroad has grown substantially, leading to a large net outflow of investment abroad. The investments abroad are valuable. Canada's stock of net assets held abroad has increased to about $1.7 trillion (57% of GDP)—but they are adding to productivity growth outside of Canada, rather than within.

Canada's net investment outflow to U.S. intensified after 2014

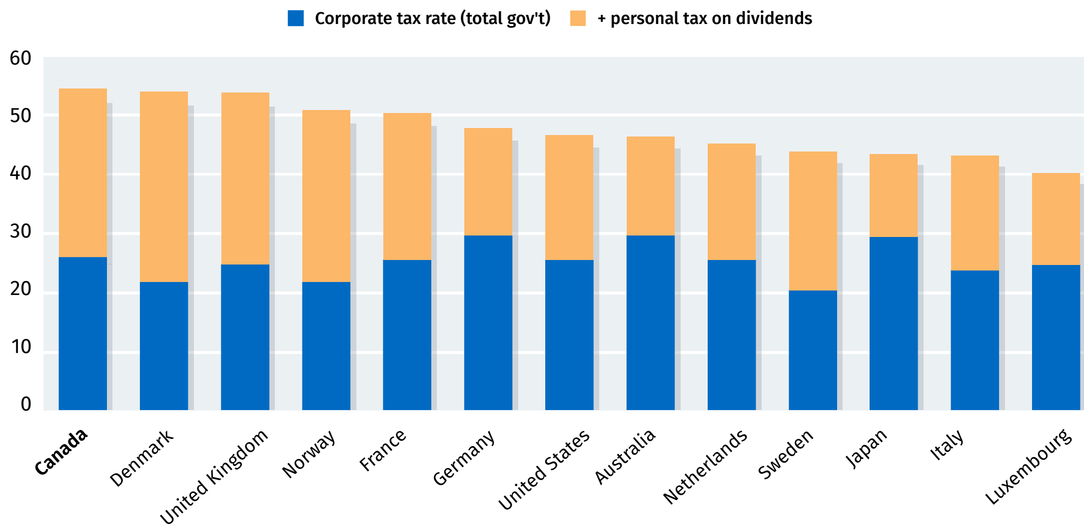
Billions of Canadian dollar, book value



Source: Statistics Canada, RBC Economics

Canada's corporate profit taxes are highest among developed nations

%, sum of bars is total effective tax rate on distributed corporate profits



Source: Statistics Canada, RBC Economics Research

Infrastructure challenges—some natural, some self-created

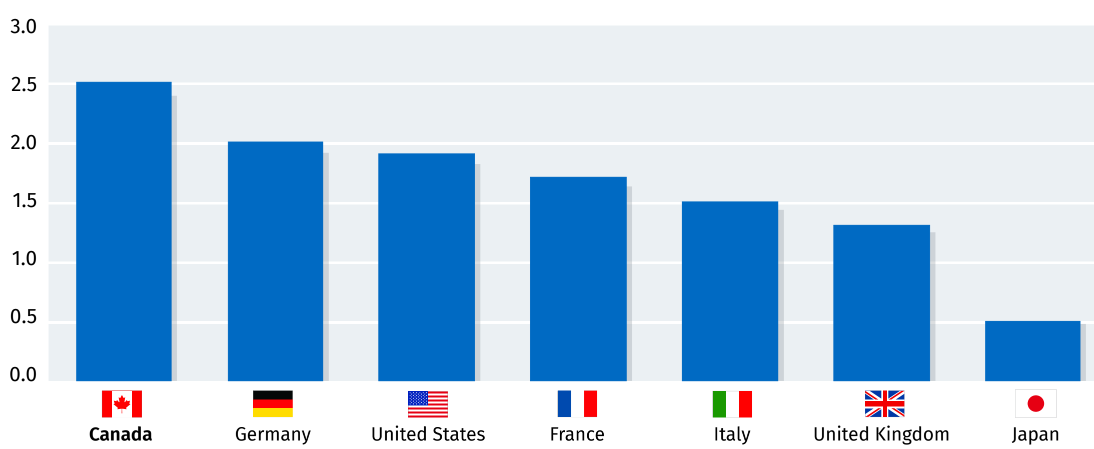
Canada has a small population spread across a large land area with abundant natural resources that need to be exported. That generates some unique challenges compared to other countries.

The good news is Canada has a strong infrastructure overall, ranking at the top of the G7 in World Bank rankings. Transportation and warehousing are the few industries where Canadian business investment is a larger share of industry GDP than in the U.S. It is one of the industries where Canada's productivity underperformance relative to the U.S. is the smallest.

However, there remain significant bottlenecks where Canadian infrastructure significantly underperforms. The country's turnaround times at ports are among the longest in the world, ranking 103rd out of 113 countries tracked by the World Bank in 2023 with a median of two and a half days. Canada also ranks poorly on "ease of exporting" in global rankings by the World Bank largely due to high document and paperwork costs.

Chokepoints at Canadian ports are delaying trade

Weighted turnaround time at ports in days



Source: World Bank, RBC Economics Research

Overweight in construction, light on intellectual property

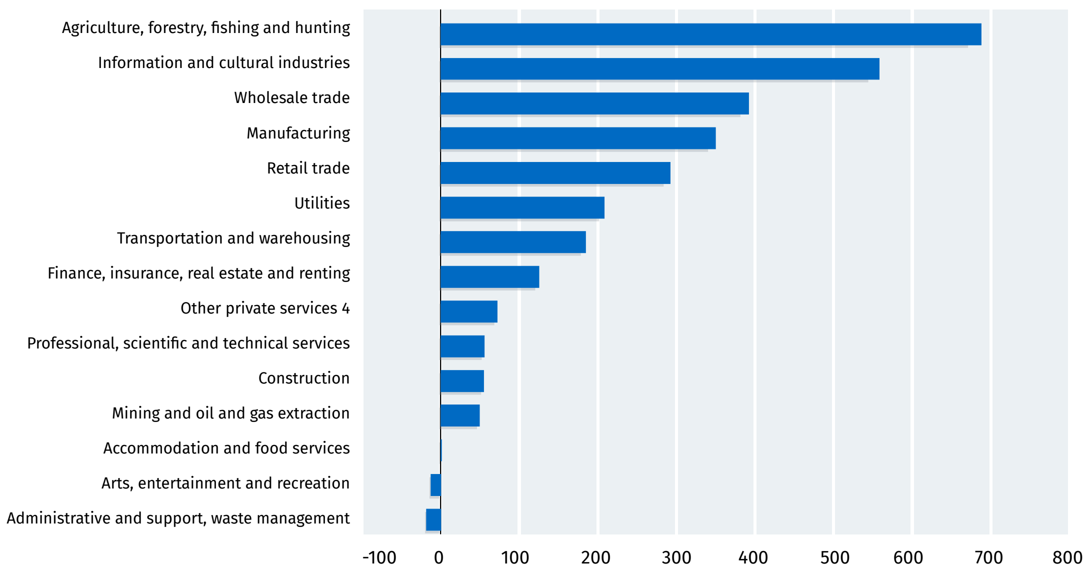
Productivity in Canada lags in most industries versus the U.S., but the Canadian economy is also overweight in construction, where productivity growth has been slower.

Investment in residential structures accounts for twice the share of GDP in Canada (6%) than in the U.S. (3%). Businesses in Canada invest more in nonresidential structures and less in intellectual property products. Canada invests about 40% less (as a share of GDP) in intellectual property products (IPP) overall—with a larger weighting towards mining exploration activity. The manufacturing sector invests about just a quarter of what the U.S. invests in IPP relative to the industry's GDP footprint.

As a result, construction accounts for about twice the share of total hours worked in Canada (8%) as it does in the U.S. (4%). Construction is one of the industries that has struggled the most to boost productivity over time. Indeed, looking back decades, productivity in the Canadian construction sector as of 2022 was 54% above levels in 1961—which is just a fourth of the broader increase in business sector output per hour worked over that period.

How Canada's productivity grew by sector over the last six decades

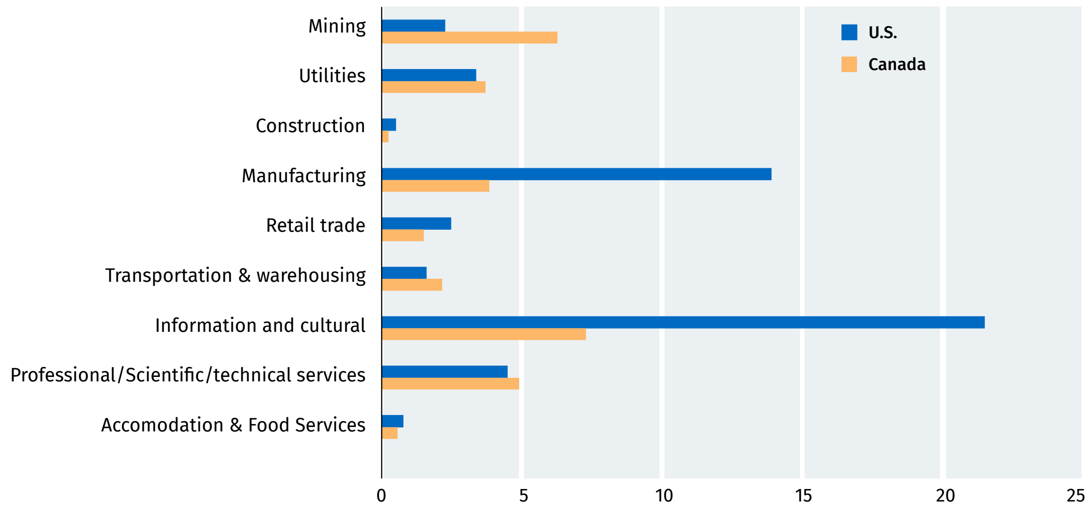
Percent change



Source: Statistics Canada, RBC Economics Research

U.S. outpaces Canada in intellectual property investment in key sectors

Industry investment to GDP ratio, percent, 10-year average ending in 2022



Source: Statistics Canada, Bureau of Economics Analysis, RBC Economics Research

A growing services sector isn't helping productivity

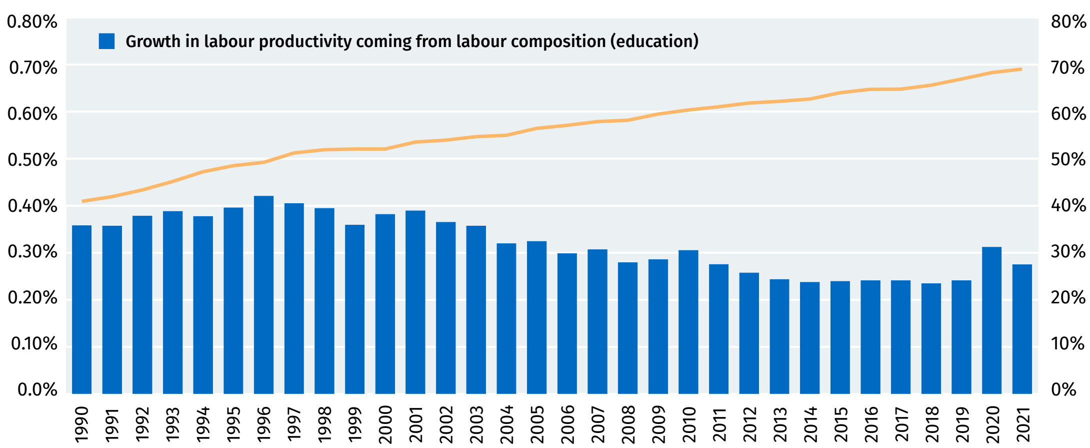
The reasons for Canada's decades-long productivity challenge on the goods-producing side of the economy are well known, if not easily solved. The service sector (home to 80% of Canadian workers) must also be part of any solution to productivity challenges.

It's concerning that high levels of investment in human capital aren't paying higher dividends in terms of productivity growth. Canada has a highly educated and skilled workforce that should be well-positioned to take advantage of the ongoing shift in the global economy from goods to service-producing industries. However, there hasn't been a corresponding acceleration in productivity growth from the quality of labour as education outcomes have improved.

The share of the Canadian workforce with completed post-secondary education has increased from 41% in 1990 to 70% in 2023, but growth in measured productivity from labour composition (skill upgrading as measured by increases in the experience and education composition of the workforce) has been running at about half its pace in the 1990s.

A more educated workforce isn't resulting in higher productivity

ten-year average of y-o-y % change



Source: Statistics Canada, RBC Economics

A large and growing public sector is less productive

Canada's large public sector education and healthcare industries are much less productive than in the U.S. by 70% and 50%, respectively. and accounting for a fifth of the total economy productivity gap despite only accounting for 14% of the economy.

However, it is also notoriously difficult to measure productivity in the public sector, where there are often no market transactions. Much of Canada's underperformance in measured productivity in healthcare and education (essentially the market value of services over the number of hours worked) versus the U.S. disappears when broader outcomes of those systems are considered. Life expectancies in Canada are longer, and preventable deaths are lower. A larger share of the population over the age of 65 is in good health. And the Canadian healthcare system costs just over half as much as the U.S. on a per-capita basis to achieve those outcomes. In education, Canadian students (15 year-olds) rank close to the top of the OECD (and above the U.S.) in math, science, and reading scores.

But that doesn't mean there is no room for improvement. The public sector will need to get more productive to meet the needs of a rapidly growing population. While Canadian health outcomes rank better than measured productivity, the speed and availability of services have long been an issue.

Satisfaction with health coverage has been slipping. Canada has a shortage of doctors and nurses, and a poor record of utilizing the skills of new arrivals, particularly, in the healthcare sector at a time when demands are increasing due to rapid population growth. In Canada, public-sector employment has accounted for more than a third of total job growth over the last decade.

Canadian agricultural output:

Lessons for the future

Agriculture isn't always top of mind in conversations about technological innovation. But no industry in Canada has seen more disruptive technological advancement over the last century (or two) than food production. Those advances have led to massive productivity gains—even in recent decades. New techniques and products have increased crop yields. Advanced machinery has dramatically reduced the number of people needed to work the land. Forget about the tractors and combines of a generation ago—the technology in modern farm equipment more closely resembles that found in a spaceship. By our count, agricultural production per farm acre in 2016 was three and a half times the level in 1941. Per-worker production gains have been even stronger. Output per agricultural worker is about 12 times what it was in 1941.

Fewer farmers but multiple times more productive

All of those productivity gains have led to dramatic structural changes. Farms have gotten much bigger. The average Canadian farm size in 2021 was about 800 acres—twice as big as an average farm 50 years ago and four times the average size in 1921. Larger machinery means fewer workers are needed. In 1921, about a third of Canadian jobs, or one million workers were in the agriculture industry. Today, agriculture accounts for about 1.5% of jobs or less than 300,000 workers. About 700,000 fewer people currently farm land, which is about 12% larger than it was a century ago.

Automation—this is not our first rodeo

There's a lesson in agriculture for those who fear that automation could make large swaths of the current workforce obsolete. Historical trends in agriculture show us technology can be massively disruptive but also welfare-improving on the same scale. The prospect of losing almost a third of jobs to technological innovation in agriculture would have sounded terrifying in 1921. There have been negative consequences for rural communities that depended on all of those agricultural jobs. The flip side of that equation, though, is that all of those agricultural productivity improvements freed up almost a third of the workforce to focus on something other than food production. New industries developed, and people found other jobs. Advancements in medical research, a widely expanded social safety net, new innovations that have boosted output in other industries, all owe part of their success to the fact that farmers got really good at producing food.

What needs to be done to improve productivity

Most of what should be done to address Canada's productivity challenges is not controversial. The changes required are growth-positive policies that would benefit business owners and workers even if Canada were starting from the highest productivity levels in the world. That does not mean they are not easy to implement. But if they're not addressed, Canada will enter the 2030s with an even greater economic challenge than we face today.

1. Lower interprovincial trade barriers and cut red tape

Lowering trade barriers within Canada doesn't have to mean lower standards. It implies improving consistency and rules across jurisdictions to increase the speed and predictability of project approval times and lower potential holding costs for businesses planning new investments in Canada. In a lot of our conversations with businesses, an unpredictable project approval timeline is flagged as an issue that raises costs in Canada versus other regions like the U.S.

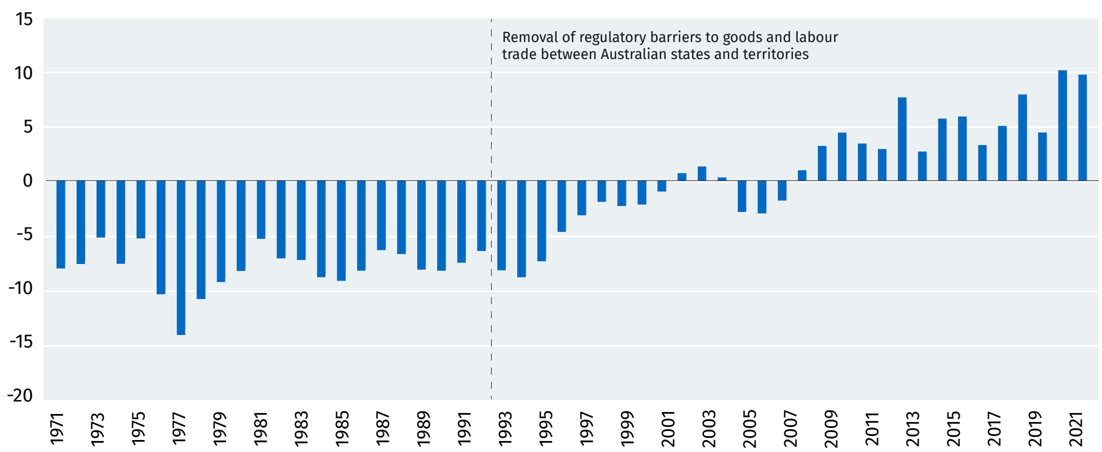
Attempts have been made over decades to try and better harmonize the regulatory backdrop across the provinces. The latest was the 2017 Canadian Free Trade Agreement. But progress is slow and lists of exemptions to free trade across provinces are long. Not all of the challenges are interprovincial, either. Rules, regulations, and project approval times also vary across municipal governments.

Other countries that have been able to reduce internal trade barriers have had success in boosting productivity levels.

Australia also struggled with internal trade barriers but had more success eliminating them in the 1990s. Other factors at play in Australia included the emergence of China as a major global economic power. The result: Australia's productivity levels swung from 8% below Canada's in the early 1990s to 8% above Canada's before the pandemic.

Reducing trade barriers improved Australia's productivity

Percent difference between Australian and Canadian GDP per hour worked, USD PPP adjusted



Source: OECD, RBC Economics Research

2. Better utilize immigrant skills

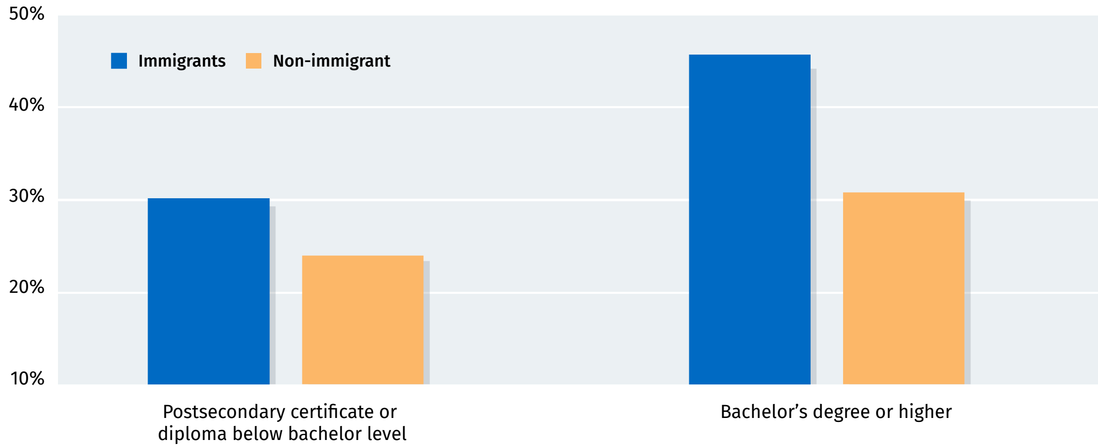
All population and workforce growth is going to come from immigration in the decade ahead, and Canada has a bad track record at utilizing the skills of new arrivals. Canada leads the G7 in attracting immigrants with newcomers now driving population growth.

Those immigrants are, on average, better educated and younger than the domestic workforce and more likely to have majored in STEM-related fields (science, technology, engineering, and math) than their Canadian-born peers. But they are also more likely to work in jobs that don't fully utilize those skills.

Canada has had more success at utilizing the skills of new arrivals among international students who choose to stay in Canada. Labour market underutilization of immigrant skills versus the Canadian-born population largely disappears among immigrants that studied in Canada. But simply recognizing the credentials of foreign-trained professionals in fields like healthcare would also increase the productivity and earnings of those workers and help address the chronic undersupply of those workers in the labour market.

Immigrant skills are underutilized in Canada

%, population under-utilized in the labour force*



Source: StatCan 2021 Census, RBC Economics | *measured as working in occupations that require less education

3. Focus again on tax competitiveness

Canada's effective economy-wide tax rate doesn't appear to be a problem. Of the 17 OECD economies that outrank Canada's productivity, 13 have higher total tax burdens (all taxes, including corporate and personal, combined).

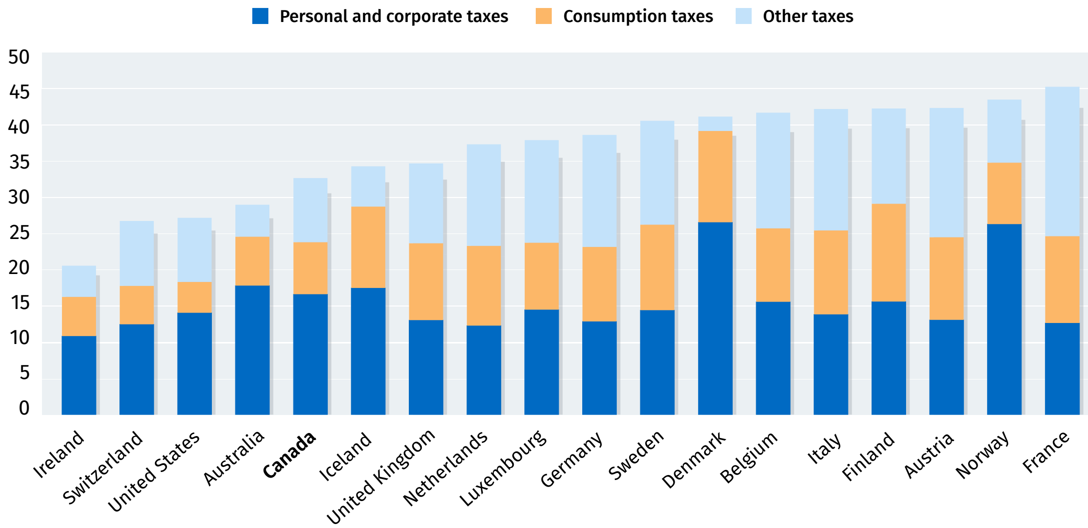
But the way that tax revenues are collected also matters. Canada relies more heavily on income taxes and less on consumption taxes like the GST/HST compared to more productive economies. Tax rates on corporate profits (including taxes on dividend payments) are also high.

The tax system is also overly complex with a long list of exceptions, deductions, credits, etc. They increase the costs of compliance, often without clear results in terms of increasing tax fairness across the income distribution. Policymakers should aim to make sure tax rules can be easily understood to encourage compliance, especially among those that are most in need of the benefits, i.e., new businesses and lower-income households. Proper assistance from the government with tax filing and document gathering should also be available and accessible to all with the help of digitization.

The harmonization of the tax rules, tax bases and defined terms between the federal government and provinces can also be improved to increase efficiency. Canada could also consider the creation of an independent, impartial body or mechanism for regular tax policy and complexity reviews. Canada's last thorough review of the tax system happened in 1967.

Productivity is higher outside of Canada despite higher tax rates

% of GDP, 2022 or last available. Countries selected are Canada and those with higher productivity levels than Canada



Source: Statistics Canada, RBC Economics Research

4. Invest in new technologies

“Smarter” investments like AI can help but adoption rates are low in Canada. New disruptive technologies also don’t always translate into productivity gains. Productivity gains have been slower in the decades following the widespread adoption of the Internet than in the 1990s, for example. However, the consequences of falling behind emerging trends can be significant, and Canadian businesses have been underinvesting in new technologies.

Canada is already a leader in generating new ideas, but has been slower to adopt new technologies among businesses. Canada ranks fifth in the OECD in research and development at universities and only 22nd in those investments among businesses.

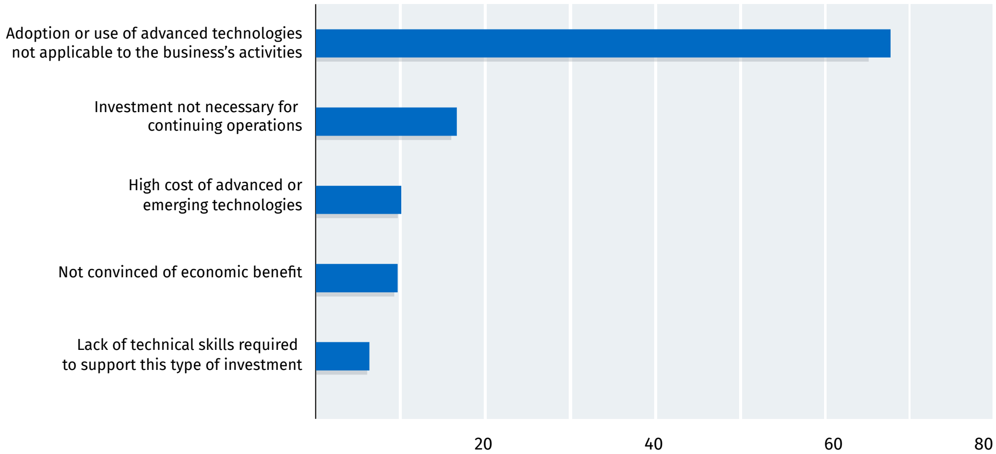
The problem does not appear to be a lack of capital. The Canadian venture capital market is much smaller than in the U.S., but is easily the second largest in the G7.

Improving the broader competitive backdrop and predictability of the policy environment can help. Canada ranks relatively high in R&D subsidies for small and medium-sized businesses, but much smaller for larger businesses, according to the OECD. Still, R&D tax incentives will only help in a predictable policy environment and projects often have long time horizons. Therefore, improving the efficiency and predictability of Canada’s complicated project approvals system and simplifying the tax system would benefit these investments.

The OECD has also found that bankruptcy regimes that are less punishing to debtors can help spur investments and productivity growth. Canada ranks well on measures of ideas generation and perceived opportunities, but entrepreneurs have a high fear of failure.

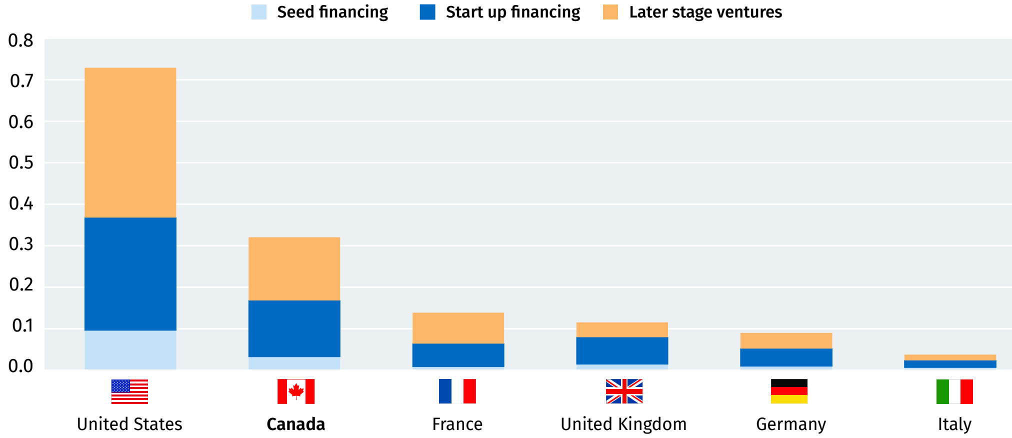
Top reasons why companies don't use advanced technology to innovate

Percent of all surveryed industries



Canada's (relatively) large venture capital funding

% of GDP



Source: RBC Economics Research

5. Capitalize on Canadian strengths

Canada is uniquely positioned to capitalize on a global shift to a more services-based economy. Automation is shrinking the share of the workforce that is needed to produce goods globally, and that has meant that the services sector is growing.

Canada's highly educated workforce should benefit from that shift—with the largest share of university and college graduates in the G7. Some of the natural challenges to productivity growth in the goods-producing side of the economy, like the geographically dispersed population, are less of an issue in services, where high-value outputs can be exchanged electronically around the world almost instantly.

Indeed, size and scale have long been a challenge for a dispersed population in Canada with a larger share of smaller and less productive businesses than in the U.S. But those challenges are smaller in the service sector where productivity levels are tied less to business size. The professional services sector has been among the fastest growing in recent years. It is a productive and high-wage industry, relies heavily on human capital versus machinery and equipment investments, and is less dependent on economies of scale. The average professional services business in Canada had six workers versus 29 in the manufacturing sector as of 2019.

In Canada, the challenge has long been converting those positive education outcomes into increased income. We have long argued that a focus on skills over degrees, increasing emphasis on career planning in high school programs, and increasing the utilization of work-integrated learning placements (co-ops and internships) would help to better match the developments of skills in the economy with current and future labour market needs.

Productivity will not fix itself

Canada's productivity problems could take years, if not decades, to fix. But if action isn't taken to address why people are working more and producing less—resulting in lower wages— then the growing discontent among workers and businesses could set the economy back even further than where we are today.

The skyrocketing cost of living has put lagging productivity more in focus because lower wages play a big role in the affordability crisis. The challenge for Canada is how can the economy reverse decades of underinvestment by businesses, slow and low adoption of new technologies, and remove complex regulatory and tax hurdles. It also comes down to what are the tools and measures needed to get a highly educated workforce to fully utilize their skills.

The massive gains in agricultural productivity over the last century show Canada has the capability to turn things around, as disruptive as it may be. There is a role for governments, businesses and industry groups to implement and support the transition to becoming more efficient. After all, if we don't improve productivity in Canada, living standards will not improve.

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Recommended Reading

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Humans Wanted: How Canadian Youth Can Thrive in the Age of Disruption

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