Policy Brief

The Forum Presents:

Growth in the Canadian Economy

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Growth in the Canadian Economy

What are the drivers of growth? Can public policy have a positive impact on those drivers? If so, what policies can have the biggest impact? As economists, and a new government, consider these pressing questions a few points are often highlighted. First, there is general consensus that it is the ratio of debt-to-GDP, not the deficit, which is an important indicator of macro stability. Economists caution that, despite the recent election rhetoric, a need for a balanced budget should not be a leading priority for the new government. Second, there is general agreement that investment, whether private and/or the public is a key to growth. Thirdly, many have underlined the high importance of the relationship between the federal government and the provinces. Economists have also highlighted other issues which impact growth such as: the importance of free trade agreements, the significance of rising levels of household debt and what a high wage economy should focus on to stay competitive.

Drawing from the existing literature, this paper will outline three principles that should be part of any Canadian growth strategy. It will suggest policies that best adhere to these principles, incorporating some considerations for fiscal constraints the government may face with respect to implementation.

Principle 1: Establish a true economic union within Canada

In the current global economic climate, where we are experiencing weak international demand, any Canadian growth strategy should focus on first promoting growth from within. The first step to doing this is re-establishing a positive and constructive federal-provincial relationship. This could finally allow for the creation of a true economic union in Canada which is long overdue. The positive impacts this would have on productivity and competitiveness is well documented in the economic literature. To accomplish this, the current Agreement on International Trade needs to be modernized to allow for the free flow of capital, labour and goods within in Canada. Laura Dawson at the Fraser Institute argues the importance of supporting the simple principles that Canadians should be able to work anywhere in Canada in their chosen profession, and that any product produced in one province should be able to be sold in another province.

One modest policy change that would be a step in the right direction and that could have a significant impact on productivity would be moving towards a single mechanism for corporate registration. Currently, businesses register provincially, meaning when they expand across provinces, they incur redundant costs. If businesses could register on a national scale rather than a provincial one, this duplication could be avoided. According to

Dawson, the potential savings from creating a harmonized national system is in the tens of millions of dollars.

Principle 2: The tax system should be aligned to best support growth

The economic literature widely supports a simplified tax system that has a minimally distortionary impact on the economy. Many economists have talked about tax reform as a way to boost productivity and impact growth and therefore they argue that Canada needs to simplify and re-focus the tax mix. Don Drummond at the Center for the Study of Living Standards presents evidence, consistent with the existing economic literature, that the adoption of a tax structure that favours consumption taxes over income taxes would encourage savings and investment, and would support productivity and economic growth. This could be accomplished if the government increased the GST/HST with off-setting increases to the refundable GST credit and reductions to income taxes.

Another change to the tax system that could have a positive impact on growth in Canada is to reform the method of capital taxation. William Robson and Alexandre Laurin at the C.D. Howe Institute argued the merits of introducing an allowance for corporate equity (ACE), which would provide a deduction for taxable profits on a normal return, (on a revenue neutral basis). Currently Canada's corporate income tax system allows businesses to deduct interest related to debt-financed investments but not returns related to equity-financed investments. Experts have argued that this system distorts investment decisions by incentivizing excessive borrowing and encouraging cross border tax planning. According to many experts, ACE would reduce the distortions that exist with corporate income taxes in Canada and make domestic and foreign physical investments in Canada more attractive, which would support economic growth.

Principle 3: Canada needs to tackle its productivity problem

Canada has a productivity problem; this fact is well documented. According to Andrew Sharp at the Centre for the Study of Living Standards, in the 1980s Canada was about 95% of the U.S. in terms of business sector output per hour, but now is about 70%. Despite this gap there is little mention of addressing this productivity problem in the new government's electoral platform. The government needs to focus on implementing policies that can increase Canadian productivity relative to U.S productivity. Such policies would need to target the drivers of productivity such as: investment, innovation, and human capital.

One policy initiative, which has received a lot of attention and would have a positive impact on productivity, is public investment in infrastructure. A report released by the Mowat Center argues that infrastructure spending not only has a high return on investment in the short term, but there is a clear link between infrastructure investment and increased productivity in the long term.

Private sector investment in infrastructure and R&D is also an important way to increase productivity. According to Drummond's study, weakness in Canadian private sector investment has been identified as an important source of weakness in Canada's productivity. Unfortunately, for reasons that are not completely clear, the private sector seems reluctant to invest even in today's very low interest rate environment. Some experts have suggested that corporate tax reform (including creating an allowance for corporate equity) could help address this problem. Drummond's study suggests that the problem may be a lack of information and that the government could help by providing better information through Statistics Canada and by helping businesses analyze the data so they can better identify opportunities to invest.

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