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SPECIAL POLICY REPORT

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An Economic Strategy for Canada's Next Government

By John Lester*

This Special Policy Report addresses Canada's pressing need to strengthen its economy and reduce its reliance on the US market for economic growth. It was crafted by John Lester, Fellow-in-Residence, in collaboration with the Institute's senior staff. The strategy takes its inspiration from the Institute's recently published work in the areas of economic growth and innovation, tax policy, climate change policy, immigration policy, fiscal policy, and trade policy.

Introduction

Canada is facing an unprecedented threat to its economic security and territorial integrity from US President Donald Trump. Canada's next government will necessarily devote time and energy early in its mandate to these threats. Canada must continue trying to convince Americans that tariffs are a lose-lose proposition and develop a calibrated response to the threats. Our next government must also stabilize the economy and provide support for those hardest hit by Trump's tariffs.

Despite these immediate pressures, Canada's next government must not lose sight of the longer-term need to reduce our dependence on the US market, raise Canada's prosperity through faster productivity growth, increase defence spending to meet our NATO commitment and defend our sovereignty, and put debt on a sustainable path once the after-effects of Trump's economic assault subside. The decision to eliminate the federal fuel charge makes it imperative to reassess Canada's carbon emissions reduction strategy.

Reducing our dependence on the US market requires acting on multiple fronts, including negotiating trade liberalization agreements with other nations and removing internal barriers to trade. Improving Canada's productivity performance requires reducing the tax burden on tangible capital, reforming immigration to attract highly skilled newcomers, and improving the environment for innovation. Putting debt on a sustainable path requires returning to a budget surplus over the five-year planning horizon. Canada's next government should also adopt a new fiscal governance approach that will increase the odds of meeting its targets for deficits and debt.

A Prudent Approach To Deficits and Debt

Canada's next government should adopt the C.D. Howe Institute's 2025 Shadow Budget (Robson, Drummond and Laurin 2025). Its central objective is to put debt on a sustainable path by returning to a budget surplus by 2028/29. The fiscal consolidation is achieved primarily by restraining expenditure growth

so that federal spending as a share of GDP returns to its pre-pandemic level by 2029/30. Within this constraint, defence spending reaches NATO's 2 percent of GDP target by 2029/30, which requires cutting non-defence spending by $44 billion from projected levels in that year. The Shadow Budget realizes savings of $32 billion by reducing direct operating costs by $15 billion, trimming $9 billion from transfers to provinces, cutting business subsidies by almost $5 billion, and rescinding the increase in Old Age Security payments to recipients 75 and older to save almost $4 billion. A spending review will identify the remaining $12 billion in savings. With these reductions, non-defence spending will rise 1.1 percent annually until 2029/30.

On the revenue side, the Shadow Budget proposes a near revenue-neutral shift from taxing investment and incomes to taxing consumption, which will enhance prospects for economic growth and productivity improvements. Eliminating several ineffective tax credits and rationalizing the age credit yields a net revenue increase of $5 billion by 2029/30.

A New Fiscal Governance Framework

Canada's next government should commit to a new governance framework that will increase the odds of meeting its fiscal targets. This framework rests on legislation that sets out guiding principles for fiscal policy and complementary policies to ensure adherence. These principles require the government to manage debt prudently, considering sustainability, generational fairness, and the need to stabilize the economy (Lester and Laurin 2023).

Other jurisdictions have adopted rules-based fiscal governance with less than satisfactory results. Formulating rules that capture the nuanced demands on fiscal policy is hard. Simple rules are too rigid and get abandoned in a crisis. More flexible, complex rules still cannot account for every contingency, which reduces their usefulness as a framework for policymaking.

Canada's next government should bolster the principles approach with a legislated multiyear ceiling on non-cyclical spending. Although budgets announce five-year spending plans each year, these plans do not bind the government. A spending cap prevents governments from spending revenue windfalls and from indulging in pre-election spending hikes. The cap will not prevent governments from responding to economic downturns, natural disasters, or other shocks that significantly affect the economy.

The new framework should revamp program evaluation to put value for money front and centre (Lester 2024b). The scope of the government's performance evaluation would expand to include programs delivered through the tax system, such as the Canada Child Benefit, the special low tax rate for small businesses, and the Scientific Research and Experimental Development (SR&ED) investment tax credit. The government would subject new spending proposals to simplified value-for-money assessments, and make ex-post evaluations and the ex-ante appraisals public.

To improve election campaigns, the Parliamentary Budget Officer should publish a pre-election economic and fiscal update, giving all political parties a clear picture of the economic

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and fiscal situation. Canada's next government should also legislate that all political parties publish five-year plans for non-cyclical spending in their election platforms.

This report proposes a strategy to defend Canada against Trump's tariffs, expands on the Shadow Budget's productivity agenda, sets out policies for reducing the cost of living for Canadians, and recommends a fundamental reassessment of carbon emission reduction targets and the supporting policy framework.

Summary of the Strategy

Defending Canada Against Trump's Tariffs

Canada's next government must develop a carefully calibrated response to Trump's tariffs. Our retaliatory tariffs should be structured to inflict pain on Trump supporters so they will pressure the President to abandon his destructive policies, while minimizing the impact on production costs in Canada. The tariff revenue collected should be used to compensate those directly affected by Canadian and US tariffs through enhanced Employment Insurance benefits, training, and increased transfers to low-income households to mitigate the impact of tariffs on food costs and provide limited support for industry restructuring.

Canada's next government must reduce our dependence on the United States by:

- Diversifying our trade relationships by concluding trade agreements with the United Kingdom and the Association of Southeast Asian Nations (ASEAN).
- Working within its jurisdiction to make it easier to undertake major energy and mineral projects that reduce our dependence on the US market.
- Upgrading and rejuvenating trade-related infrastructure.
- Working with provinces to reduce barriers to internal trade and mobility.

Improving Canada's Productivity

Improving Canada's dismal productivity performance has become even more important given the threat to our prosperity from Trump's economic assault. Some of the measures intended to reduce our dependence on the United States – reducing internal trade barriers and investing in trade-related infrastructure – will also boost productivity. In addition, Canada's next government must implement policies that incent productivity-enhancing investments and innovation and reduce the bias in favour of small-scale production.

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. Fixing this problem requires lowering the tax burden on tangible capital, raising the quality of labour through better education and training, and reforming immigration to focus on attracting, and effectively employing, highly skilled newcomers. Filling shortages of lower-skilled labour through immigration harms productivity and innovation by reducing the incentive to adopt more efficient production methods. Low-skill labour shortages would be better dealt with by investing in new equipment and technology.

- To boost investment, Canada's next government should reduce the corporate income tax rate by 2 percentage points and set the stage for a fundamental reform of the tax system that will make it more competitive and supportive of investment.
- To improve the quality of immigrants accepted, Canada's next government should establish a minimum points threshold for acceptance, raise language proficiency standards, and incorporate pre-admission earnings as a selection factor.
- To ensure the credentials used in immigration applications are equivalent to Canadian credentials, Canada's next government should, in collaboration with the provinces, set up an agency to systematically assess the quality of educational institutions and programs in source countries.

Canada's innovation problem has multiple dimensions. Our spending on research and development (R&D) as a share of output is low relative to comparator countries. For both overall and business R&D spending, we rank sixth in the G7 and slightly below the median for all Organisation for Economic Co-operation and Development (OECD) member countries. Further, the patents arising from R&D performed in Canada have a smaller impact on productivity growth than expected, given the relationship between patenting and productivity in other countries. This patent-productivity paradox reflects the low share of inventions developed in Canada that are commercialized here. Finally, the patenting activity arising from R&D performed in Canada's higher education institutes is lower than expected, given the quantity and quality of the research undertaken.

To create a more innovative economy, Canada's next government must:

- Improve the effectiveness of SR&ED incentives by reducing the small firm subsidy rate and increasing it for large firms, making the subsidies refundable for all firms, and delivering assistance independently of filing a tax return.
- Make some federal funding for research by higher education institutions conditional on plans for commercializing the inventions resulting from the research.
- Reduce the reliance of small innovative firms on foreign risk capital, which favours selling to foreign suppliers instead of scaling up in Canada.
- Give the Industrial Research Assistance Program (IRAP) a new mandate to support the commercialization of inventions rather than R&D.
- Eliminate the tax on capital gains realized from the sale of shares of qualified small and medium-sized enterprises (SMEs), provided that the shares are sold to a resident of Canada.

Small, innovative firms that perform R&D need access to external financing at every step of the way to commercializing an invention at scale. While Canada's risk capital market has improved over the last 15 years, more progress is needed. There is a gap at the seed stage and the low tier of venture capital (VC), which covers funding for deals worth up to $5 million. At the high tier of venture capital financing, which covers deals of $20 million and up, the dominance of foreign suppliers affects the decision of many smaller firms to commercialize and scaleup in the US instead of Canada.

To mitigate these problems, Canada's next government should:

- Offer a 15 percent seed or angel investor tax credit rate and a 10 percent credit for other early-stage financing of deals from $2 to $5 million.
- Mandate the Business Development Bank of Canada (BDC) to increase its investing activity in the high-tier segment by reducing its private sector leverage requirement from $2 per $1 invested by the BDC to $1.33.

Canada's next government must address at least three structural issues that harm productivity. Two items on our action list are well known: reducing barriers to internal trade and mobility, and speeding up approval of major resource projects. Less well known is the harm caused by a policy bias in favour of small firms. Small firms are less productive than larger firms, so Canada's next government should review all policy measures supporting small businesses to ensure that they help, not harm, productivity in Canada.

The preferential income tax rate for small firms, like the more generous SR&ED incentive for small firms, reduces the cost of entry into small business for firms that are not growth-oriented. The incentive and capacity of small firms to grow would be substantially strengthened by eliminating taxation of capital gains realized from the sale of qualifying SME shares. Canada's next government must also refocus small business loan programs and do more to encourage the development of the strong management skills required for business growth.

There is now considerable momentum in favour of reducing internal barriers to trade and mobility. The rewards to success are high: removing policy-induced internal barriers to trade in goods alone would measurably raise Canada's GDP. Securing a robust agreement will require offering

compensation to those hurt by dismantling trade and mobility barriers. Canada's next government should provide this compensation.

The state of Canada's infrastructure, particularly trade-related, is holding back economic growth and productivity. Governments have underinvested in public infrastructure and delayed major private sector projects, leading to higher costs and less infrastructure investment. Canada's next government must develop, over its first mandate, a national plan to upgrade and rejuvenate Canada's trade-related and other major infrastructure. In the first year of the new mandate, the federal government should act within its jurisdiction to reform the regulatory approval process to speed up decisions on major projects while ensuring projects continue to pass a public interest test.

To promote the development of Canada's infrastructure, Canada's next government should:

- Extend funding for the National Trade Corridors Fund beyond its scheduled expiry date in 2027/28, with an allotment of at least $500 million a year.
- Set up a process to privatize federal airports, emphasizing participation by private equity investors, including pension funds.
- Accelerate approval of major private infrastructure projects by:
    - Strictly defining federal jurisdiction to ensure that one public interest test applies in most cases.
    - Restricting federal environmental assessments to situations in which decisions from the federal government are required to allow the activity to proceed.
    - Encouraging Indigenous communities' economic participation through appropriate federal regulatory consultation and greater availability of financing.

Reducing the Cost of Living

Canadians' living standards will rise as productivity, and hence incomes, increase with lower taxes on business investment and with measures to promote a more innovative economy. The boost to productivity from the elimination of barriers to internal trade in goods alone would reduce consumer costs by as much as $2,900 per person. Policies that directly lower prices for Canadians will also raise living standards. Canada's next government should:

- Phase out supply management of dairy products, eggs, and poultry to reduce food prices.
- Reduce population growth and hence price pressures on housing by:
    - Setting a target for permanent immigrants of about 300,000 persons a year.
    - Substantially reducing the inflow of temporary residents.
    - Speeding up the processing of refugee claims to reduce the stock of non-permanent residents.

Meeting Canada's Greenhouse Gas Emissions Reduction Targets

The previous government eliminated the fuel charge, which would have contributed almost 10 percent to projected emissions reductions by 2030. Even with the fuel charge, Canada's emissions reduction targets were at risk. Canada's next government must confirm its commitment to carbon pricing for large emitters while undertaking to rigorously assess the policies in place to eliminate redundancies and ensure a minimum level of cost-effectiveness.

Some measures can be taken before the policy assessment is complete. Canada's next government should:

- Drop plans to impose an oil and gas sector emissions cap and the Clean Electricity Regulations. These measures are redundant in a well-designed carbon pricing policy for large emitters.
- Change the zero-emissions vehicle mandate to include the sale of hybrid vehicles, plug-in hybrid electric vehicles, and internal combustion engine vehicles that are powered by renewable fuels after 2035.
- Announce a five-year extension of the carbon capture, utilization, and storage tax credit.

1 – Defending Canada against Trump's tariffs

Retaliation against US tariffs is an essential part of Canada's arsenal. However, Canada should only retaliate when the additional pain for the US economy – beyond the self-inflicted damage from tariffs on Canadian imports – is likely to prompt them to rethink their protectionist approach and will not unduly raise costs in Canada.

One of Canada's strongest defences is to reduce our economic vulnerability to US threats by lowering our reliance on the US economy, thereby strengthening our negotiating position. Canada's next government must act in five areas.

First, Canada's next government should restart and quickly finalize trade negotiations with the United Kingdom, which ran aground over access for UK cheese to the Canadian market and access for Canadian beef to the United Kingdom. Building on the recently concluded Comprehensive Economic Partnership Agreement (CEPA) with Indonesia, Canada should also seek to finalize free trade negotiations with ASEAN and support the admission of new members in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) (Schwanen 2025).

Second, for public procurement not covered by the World Trade Organization's (WTO) General Procurement Agreement, foreign companies should be allowed to participate only if they have a substantial presence in Canada or if their home country broadly maintains tariff-free trade with Canada, subject to the availability of alternate supplies. Similarly, foreign direct investment in restricted sectors, such as telecommunications, should be allowed only for countries maintaining broad tariff-free arrangements with Canada (Schwanen 2025).

Third, Canada's next government must ensure that the momentum for reducing internal trade barriers is sustained. Increased internal trade will effectively increase the size of the domestic market (Schwanen 2025).

Fourth, as discussed in "Improving Canada's Infrastructure," Canada's next government must collaborate with provinces and territories to make it easier to undertake major energy and mineral projects in Canada. This will reduce our dependence on the United States for natural resource exports. Projects like the Energy East pipeline and liquefied natural gas exports should be re-examined (Schwanen 2025).

Fifth, Canada's next government must enhance supply chain security and resilience. We should identify vital strategic sectors, monitor potential chokepoints in their supply chains, and decide on risk mitigation strategies. Similarly, Canada's next government should leverage Canada's key strengths in critical minerals, energy resources, medical technology, and automotive components within the critical supply chains that support major trading partners to better withstand tariff threats and shape our strategic engagement with these partners (Van Assche and Schwanen 2025).

2 – Improving Canada's productivity

"Productivity isn't everything, but in the long run, it's almost everything." This quote, attributed to Nobel Laureate Paul Krugman, highlights that productivity is the key determinant of a country's standard of living. Although we have roughly maintained our productivity ranking among all OECD countries and in the G7 since 2000, recent trends are troubling. From 2014 to 2023, Canada's output per hour worked rose just under 3 percent, beating only five other OECD countries, and was stagnant from 2019 to 2023. Like most high-income OECD nations, we have not kept up with the United States. Productivity in Canada fell from 81 percent of US levels in 2000 to 68 percent in 2023, with the rate of deterioration accelerating since 2014.[1]

Part of this gap stems from lower investment in tangible capital and intellectual property. Canada has long lagged the US in investment in machinery and equipment (M&E) and intellectual property (IP) products, but invests relatively more in structures. From 2008 to 2023, Canadian M&E investment per worker tumbled from nearly 60 percent of the US level to 41 percent, while IP

investment per worker fell from around half of US levels to roughly 30 percent (Bafale and Robson 2024). There is a well-documented link between M&E investment and productivity growth, and IP investment is a critical driver of innovation, so this shortfall is worrying.[2]

Canada invests less in tangible capital per worker, largely because the cost of capital is high relative to labour. Fixing this means reducing the tax burden on tangible capital, improving labour quality through better education and training, and reforming immigration to attract highly skilled newcomers.

Fixing Canada's underinvestment in intellectual property (mainly R&D and software) will help create ideas that fuel innovation. But we also must improve the overall environment for innovation. Achieving these objectives requires improving the SR&ED program, encouraging more commercialization of Canadian inventions here, and enhancing access to risk capital.

2.1 Reducing the Tax Burden on Investment in Tangibles and Intangibles

Canada is stuck in a cycle of low investment, low productivity, and low wages, in part because we have lost our corporate tax advantage by not reacting to initiatives in the US and elsewhere. A comprehensive review of the corporate tax system is overdue. An ideal corporate tax system would minimize distortions so that all investments – regardless of business size, industry, region, or asset type – receive equal treatment. It would offer clarity, predictability, and simplicity, reducing the soaring compliance costs that weigh on the economy (Oakey 2024).

Only a full overhaul can achieve these goals. Fundamental reform of the corporate income tax could move toward a cash-flow-like base that does less harm to investment, while recognizing potential implications for personal income taxes (Boadway and Tremblay 2016).

The harmful effects of taxation on incentives for individuals to work, save, and invest must be as low as possible. Canada's next government should therefore establish a national tax commission to review taxes from all sources to make our tax system more competitive and pro-investment, and reduce the overall cost of taxation. Part of the commission's corporate income tax mandate should be to review options for eliminating the preferential tax treatment of SMEs and using some of the proceeds to finance the elimination of capital gains taxes on qualified small business shares. Another part of the mandate would be to recommend ways to reduce the very high effective tax rates on middle-income families arising from the clawback of benefits.

The commission should deliver a comprehensive reform report by the end of August 2026, with practical solutions for the government to implement. Before the report is received, Canada's next government should adopt several growth-oriented tax changes (Robson, Drummond and Laurin 2025):

- Lowering the tax rate for the second personal income tax bracket from 20.5 to 15 percent by 2028 (thus going from five brackets to four);
- Cutting the general corporate income tax rate by two percentage points by 2027;
- Rescinding the planned capital gains inclusion rate increase;
- Withdrawing the surtax on financial institutions and the tax on share buybacks; and
- Funding the revenue shortfall with a two-point GST increase by 2027.

This shift away from investment, savings, and income taxes and toward consumption taxes will raise productivity. While all taxes have some

1 OECD data on GDP per hour worked, 2015 prices, converted to US dollars at PPPs. See: https://data-explorer.oecd.org/vis?df[ds]=DisseminateFinalDMZ&df[id]=DSD_PDB%40DF_PDB_LV&df[ag]=OECD.SDD.TPS&dq=.A.GDPHRS..USD_PPP_H.Q...&pd=2000%2C&to[TIME_PERIOD]=false&vw=tb

2 See: The Centre for Spatial Economics (2004) for a short summary of the literature.

economic cost, corporate and personal income taxes do more damage than consumption taxes (Baylor and Beauséjour 2004). Corporate taxes dampen investment, giving workers less capital to work with and putting downward pressure on wages. High personal income taxes discourage saving, harm work incentives, and spur tax avoidance efforts.

Canada's next government should also ask the national tax commission for advice on how to mitigate the impact of a higher GST rate on individuals who would not get any offsetting benefit from the recommended reduction in personal income taxes.

2.2 A More Innovative Economy

Innovation drives productivity growth. It happens when a new idea is used in a commercially significant way. Innovation therefore requires generating new ideas, or inventions, converting them into marketable products, and persuading businesses to adopt them. Canada's weak productivity growth, even after accounting for the contribution of capital investment and improvements in the quality of labour, shows that Canada has an innovation problem.

Canada's innovation problem has several dimensions. First, we underinvest in R&D relative to many comparator countries: for both total and business R&D, we rank sixth in the G7 and slightly below the OECD median.[3] Second, patents stemming from R&D performed in Canada have less impact on productivity growth than they typically would elsewhere (Cockburn, MacGarvie and McKeon 2023). This "patent-productivity paradox" reflects the low share of Canadian inventions commercialized here. Third, patenting from universities and other higher education institutions also lags expectations, given Canada's leading research (World Intellectual Property Organization 2024).

To fix these problems, Canada must increase R&D spending while ensuring more of the resulting benefits stay in Canada, which requires making the SR&ED incentive more effective, addressing the patent-productivity paradox, and encouraging more commercialization of Canadian inventions. The benefits to Canada from R&D performed here may be affected by foreign ownership, which is an issue warranting investigation (Box 1).

2.2.1 Increasing the Effectiveness of SR&ED Incentives

Reforms to the SR&ED program should keep it focused on supporting R&D. Separate programs should be used to support other activities on the innovation continuum. The raison d'être of the SR&ED program is to encourage R&D, which benefits society through knowledge spillovers. SR&ED reforms should therefore focus on increasing its effectiveness and on maximizing the net social benefit from knowledge spillovers (Lester 2024b).

The first step is rebalancing support by reducing it for small firms and raising it for large firms. The small firm subsidy rate is 35 percent, while larger firms get 15 percent. This gap might be justified if small firms create much higher spillovers per dollar of R&D, but the limited evidence available suggests the opposite (Kim and Lester 2019).

Some argue that small firms deserve higher rates because they struggle to secure risk capital. But supporting all small-firm R&D to address a narrower financing gap is wasteful. Financing problems are concentrated in a subset of SR&ED recipients: young firms that are most frequently pre-

3 Based on OECD data for 2021, the latest year estimates are available for 36 of the 38 countries.

Box 1: Does Foreign Ownership Matter?

More than 40 percent of Canadian inventions are owned by foreign firms (Cockburn, MacGarvie and McKeon 2023, p. 145).[a] In many cases, Canada supplies R&D services to foreign firms. For example, employees of Google in Kitchener (or Ubisoft in Montreal, and many others) perform R&D that generates IP that is owned by these multinational companies and used in their worldwide operations.

Allowing foreign-controlled firms to benefit from SR&ED subsidies on an equal footing with domestic firms may not be in Canada's interest, for two reasons. First, spillovers from foreign-controlled firms would be smaller if these firms typically move the Canadian inventor along with the patent to the home country (Cockburn, MacGarvie and McKeon 2023). On the other hand, spillovers could be larger if foreign firms performing R&D in Canada act as conduits for global ideas, allowing Canada to benefit from foreign R&D without paying for it. There is no empirical evidence on this issue, so Canada's next government should undertake a comprehensive benefit-cost analysis before making any changes. If the benefit-cost relationship is substantially different for foreign firms, the subsidy rates should be adjusted.

Second, little or no commercialization of inventions owned by foreign firms occurs in Canada. This issue is taken up in "More commercialization of Canadian inventions."

a The estimate is based on filings with the US Patent and Trademark Office from 2004 to 2018.

revenue. These firms already receive support from the BDC. Canada's next government should review the BDC's $4 billion allotment for risk capital financing to determine if it is still adequate after rebalancing SR&ED rates.

Canada's next government should reduce the small firm rate to 25 percent and raise the large firm rate to 20 percent. These adjustments would have roughly offsetting effects on overall program costs. Small firms have higher compliance costs, so a somewhat higher subsidy rate for them is reasonable.

A refundable credit delivered independently of the tax system

Canada's next government should improve SR&ED's effectiveness by making the regular credit refundable and delivering it outside the tax system. Refundability ensures the credit has the same value for taxable and non-taxable firms, providing a more predictable incentive. Further, since the US considers refundable tax credits to be grants rather than deductions from income, US-controlled firms operating in Canada will not be subject to a clawback of the benefit under the US Global Intangible Low-Taxed Income (GILTI) regime (Lester 2024c).

Refundability will raise program costs because firms do not always have enough tax payable to claim the credit as it is earned. Large firm refundability should therefore be phased in over 10 years. Delivering SR&ED as a statutory program (like the Small Business Financing Program) would reduce the delay between R&D performance and subsidy receipt, boosting the incentive to perform R&D (Lester 2024c).

2.2.2 More Commercialization of Canadian Inventions

A major factor in Canada's patent productivity paradox is the low commercialization rate of Canadian inventions. Foreign ownership of Canadian inventions contributes to the low commercialization rate, but the key issue is that too many small, innovative firms sell their IP to US firms rather than commercialize it themselves (Carpentier and Suret 2014; Gallini and Hollis 2019). This hurts Canada's economic performance because innovative firms, by implementing new processes or bringing new products to market, earn above-normal profits, or economic rents, that can be shared by investors, workers, and the broader economy through higher tax revenue. Further, the growth of small, innovative firms into successful multi-national enterprises creates a favourable environment for other innovative startups.

The benefits are greater when inventions are commercialized in Canada, but IP ownership benefits Canada even if it is commercialized abroad. Canadian IP that is exploited abroad, either directly by the owner or by licensing, results in higher tax revenue in Canada. Ownership also makes it easier for firms to expand and develop new inventions by building on their expertise.

Incentives for small innovative firms

In large measure, the decision of small firms to sell their IP reflects a rational calculation by entrepreneurs that they can maximize the value of their inventions by selling to a foreign firm. Canada's next government should implement four targeted measures to tilt this calculation in favour of continued Canadian ownership.

First, reduce the reliance of small innovative firms on foreign risk capital, which favours selling to foreign suppliers. These measures are discussed in "Improved Access to Risk Capital."

Second, shift some support from R&D to commercialization and scaleup. About a dozen programs top up SR&ED benefits, which raises the issue of excessive subsidization. The largest of these programs supporting small firms is the IRAP, which has a budget of about $400 million a year compared to about $1.3 billion for the small firm SR&ED credit. IRAP should support the commercialization of inventions rather than R&D (Box 2). The other programs should eliminate overlaps with SR&ED. The Strategic Innovation Fund, costing about $2.4 billion in 2024/25, should not support R&D, leaving SR&ED as the single channel for R&D subsidies.

Third, make the tax policy environment more friendly to entrepreneurs by eliminating capital gains taxation on qualifying SME shares sold to Canadian buyers. This change will encourage commercialization and scaleup in Canada, promote entry into entrepreneurship, reduce net emigration of inventors, and increase the supply of risk capital.

Fourth, Canada's next government should do more to support the development of management talent and expand the provision of business advice to small firms (Plant 2023). These measures are discussed in "Growing Canada's SMEs."

Foreign ownership of Canadian inventions also contributes to a low commercialization rate in Canada because few foreign-owned patents are commercialized here. An IP Box incentive, discussed below, would encourage both domestic and foreign-controlled firms to commercialize Canadian inventions here and to book the resulting profits in Canada.

More patenting and commercialization of academic research

Universities and other higher education institutions account for about a third of the R&D performed in Canada, compared to a 60 percent share for business.[4] Academic researchers in Canada rank highly in terms of scientific publications and are

4 Statistics Canada. Table 27-10-0273-01 Gross domestic expenditures on research and development, by science type and by funder and performer sector (x 1,000,000). See: https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=2710027301.

Box 2: Focusing the IRAP on Commercialization

Support for R&D is tilted in favour of small firms and will remain so after SR&ED rate rebalancing. About one in six SR&ED beneficiaries also receive financial assistance from IRAP, which would raise the average subsidy rate for these firms to about 60 percent after SR&ED rate rebalancing (Lester 2024c). Such a high subsidy rate lowers the hurdle rate for investing in R&D and hence its quality. If private investors have more skin in the game, the quality of R&D projects will increase, making it more likely that they will be commercialized. To achieve this result, IRAP should have a new mandate to support the commercialization of inventions rather than subsidizing R&D (Lester 2025 forthcoming).

Since most of the benefits from commercializing an invention are reaped by investors, the assistance should be repayable as successful projects generate profits. In effect, the government will be providing risk capital, but since its return is capped, private investors will have a leveraged return: they face the same risk of loss as the government but have a higher upside. Limiting government assistance to no more than 25 percent of the project costs will ensure that only relatively high-quality projects receive assistance. Assistance should be fully repayable with interest at the time of sale of subsidized IP to a foreign entity, unless the IP is commercialized in Canada.

IRAP now has a budget of approximately $400 million a year for non-repayable assistance to firms performing R&D. This cost will fall substantially with the shift to repayable assistance for commercialization.

at the leading edge of knowledge in several fields, including quantum computing, AI, and machine learning.[5] However, this academic success is not reflected in patenting activity: Canada produces just over half the patents that would be predicted based on the quality and quantity of its academic research (World Intellectual Property Organization 2024).[6]

The federal government spends over $4 billion annually funding academic research,[7] overseen by three funding agencies and a new coordinating "capstone" agency. Canada's next government should build on this initiative by making fundamental changes to federal funding agreements, drawing from the US *Bayh-Dole Act*. For protectable research, Canada's next government should:

- Require the originating institution, or any employee of the organization with whom it shares in the ownership, to retain ownership of the IP or cede it to the capstone agency.
- Impose a requirement that commercialization in Canada of owned IP be attempted, or that commercialization rights be ceded to the capstone agency.

5 National Research Council 2024-29 Strategic Plan (https://nrc.canada.ca/en/corporate/planning-reporting/research-powering-innovation-canada-nrc-2024-2029-strategic-plan).

6 Based on international "patent family" data obtained by combining WIPO patent databases and the European Patent Office's (EPO) PATSTAT.

7 In 2022/23 federal support for R&D performed in higher education institutions amounted to $4.2 billion. Source: Statistics Canada. Table 27-10-0025-01 Higher Education Research and Development Estimates, by funding sector and type of science (x 1,000,000). See: https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=2710002501.

Box 3: Design Features of an Effective IP Box

The tax preference should be a deduction from income that will reduce the combined federal-provincial effective tax rate on income from IP assets to just over 15 percent, the global minimum tax rate. An IP Box will encourage firms to retain ownership of the resulting IP in Canada and to commercialize more of it here. Since Canada benefits when IP income is taxed in Canada rather than abroad, the benefits of the IP Box must be available when Canadian firms license their IP to foreign entities.

To maximize the impact of a preferential IP regime on R&D and the retention of IP profits in Canada, income qualifying for preferential treatment must include income from all assets developed from R&D performed in Canada, not just patents. This must include assets developed from R&D and protected by trade secrecy. To ensure there is an incentive to repatriate IP income from tax havens, the preferential rate must apply to existing IP assets that have been developed from R&D performed in Canada.

- Include extra funding for developing an IP management/commercialization plan.

Implement an IP Box[8]

The previous government committed to implementing an IP Box. This is good public policy. Appropriately designed, an IP Box is a cost-effective way to encourage both R&D and commercialization of the resulting IP (Box 3). In addition, an IP Box will not only remove the incentive for domestic firms to shift IP income to tax havens but also encourage the "repatriation" of IP assets now held in tax havens. As a result, the net fiscal cost of an IP Box will be small.

Other measures

Access to receptive markets is a key factor in successful commercialization. The tariff threats against Canada made by US President Trump will reduce access to the US market, making it more likely that Canadian firms will sell their IP or commercialize it in the US. As discussed, Canada's next government must seek to reverse the recent increase in barriers, reduce the uncertainty created by Trump's protectionist trade policy and expand access to other markets through trade agreements. A reduction in internal barriers to trade, discussed below, will also make it more attractive to commercialize inventions in Canada by increasing the effective size of the Canadian market.

2.2.3 Improved Access to Risk Capital

Canada's risk capital market has improved over the last 15 years in part due to additional government support. A higher volume of activity has been accompanied by rising rates of return, which is a sign of a healthy market (BDC 2024b). Nevertheless, gaps remain.

One gap occurs at the seed stage and the low tier of venture capital, which covers funding for deals worth up to $5 million (Nitani and Nusrat 2023). Firms seeking funding in this range must offer higher returns to investors for three reasons

8 This section is based on the discussion in Lester (2022).

(Lester 2017). First, investor costs for assessing projects, providing advice, and monitoring their investment are high relative to the amount invested. Second, the small scale of seed investments reduces the scope for risk-pooling. Third, concerns about potential losses result in too little investment by startup entrepreneurs, which increases the demand for outside funding and drives up its price.

The BDC runs two seed programs: the $50 million Seed Venture Fund and the $500 million Thrive Fund that targets women entrepreneurs. In the absence of evidence of discrimination against women in venture capital (Huang and Rivard 2021), the BDC should shift the combined $550 million budget to gender-neutral seed financing.

Foreign VC investors account for almost half of risk capital funding in Canada and dominate the high tier of VC funding, which covers deals of $20 million and up (Nitani and Nusrat 2023). The importance of foreign investors, particularly from the United States, affects the decision of many small firms to commercialize and scaleup in the United States instead of Canada (Bradley et al. 2019, p. 10). To mitigate this problem, Canada's next government should mandate the BDC to invest more in high-tier VC deals by lowering its private-sector leverage ratio from 2:1 to 1.33:1. Funding for this initiative should come from a reduction in the BDC's conventional loan program, which offers loans to SMEs that are less knowledge-intensive.

2.3 Reforming Immigration

Canada should refocus immigration on attracting individuals with high human capital. Filling lower-skilled labour shortages through immigration undermines productivity and innovation by discouraging the adoption of more efficient production processes.

To ensure immigration supports productivity growth, Canada's next government must:

- Establish a minimum points threshold within the Express Entry (EE) system.
- Raise language proficiency standards and use pre-admission earnings as a selection factor (Mahboubi 2024).
- Modify the Provincial Nominee Program (PNP) to align it better with the EE system.
- Ensure that foreign credentials are valid and recognized as such in Canada (Mahboubi and Zhang 2024).

Setting a points threshold of 480 (about 40 percent of total points) would align Canada with competitor systems. Applicants should demonstrate a minimum of intermediate-level language proficiency (i.e., Canadian Language Benchmark 6), with extra points for higher language skills. People with pre-admission Canadian work experience should gain extra points if their most recent annual income exceeds the local median wage by 20 percentage points.

A significant share of immigrants admitted through the Provincial Nominee Program do not meet EE requirements and have weaker earnings outcomes. To address this, Canada should align PNP criteria with EE eligibility criteria.

Improving Recognition of Foreign Credentials

Credential recognition is crucial to a system intended to attract and integrate skilled immigrants. Canada must ensure that foreign qualifications meet national standards and that valid foreign credentials are recognized by employers and licensing bodies within a reasonable time frame. The current system falls short on both fronts.

Canada's next government should collaborate with provinces and territories to set up and operate a National Office for Credential Recognition (NOCR), which would systematically evaluate foreign institutions and programs using a tiered approach like Australia's "competent authority" model (Li 2017). The NOCR would identify and automatically recognize credentials from trusted institutions and specific programs that meet Canadian standards, while credentials from other institutions would undergo a more rigorous evaluation process to ensure alignment with Canadian requirements.

The NOCR would provide financial support for the development of national standards for licensing and language proficiency in regulated professions and skilled trades. It would also facilitate public-private partnerships with employers, industries, and educational institutions to develop streamlined recognition pathways that align with national standards (Mahboubi and Zhang 2024). Further, the NOCR would support prospective immigrants in regulated occupations by providing pre-arrival resources and guidance on licensing processes, enabling them to begin their licensing process before arriving in Canada. The NOCR would publish its credential assessments to give employers confidence that the credentials claimed by immigrants are valid.

Canada's next government must set immigration targets based on housing availability and healthcare capacity. Subject to further study, Canada's next government should target permanent immigration of 0.6 to 0.8 percent of the population (250,000–330,000 people), about 20 percent below the current objective.[9] The previous government planned to reduce the share of non-permanent residents from 7 to 5 percent of the population by the end of 2026 by admitting fewer temporary residents and converting some to permanent status.[10] Canada's next government should adopt this ambitious target and continue towards a 3.5 percent share by 2030, reversing the sharp increase in non-permanent residents seen in recent years.

Reaching these targets could save around $200 million on settlement services by 2029/30.[11] That would be enough to fund NOCR, credential assessments for immigrants now in Canada who are underemployed, and additional employment-related programs, such as training and internships, to help immigrants meet Canadian standards.

2.4 Structural Changes to Boost Productivity

The measures above will raise Canada's long-term productivity growth. Resolving several structural issues will raise the level of productivity in Canada, which will show up in a temporary, but relatively long-lasting, rise in productivity growth as the reforms take hold.

2.4.1 Growing Canada's SMEs

Growing Canada's SMEs requires two sets of policies. One set, discussed earlier, tackles Canada's well-known problem of bringing ideas to market and scaling up production so that small, innovative firms that perform R&D grow into large, profitable enterprises that pay high wages. Another set of policies is needed to facilitate the growth of small, growth-oriented firms not on the cutting edge of technology.

SMEs employ about 64 percent of private sector workers in Canada, compared to 46 percent in the US.[12] Since small firms are less productive and pay lower wages than large firms, encouraging more small firms to grow into large firms will give productivity a boost. While a smaller economy with greater geographical dispersion means we cannot eliminate the firm size gap with the US, policy changes can make a difference. Canada's

9 See the statement by the C.D. Howe Institute Advisory Group on Immigration Targets 2024: https://cdhowe.org/publication/canada-must-focus-highly-skilled-immigrants-and-reduce-overall-immigration-intake/.

10 The government assumes that more than 40 percent of overall permanent resident admissions in 2025 will be students or workers already in Canada. See: "Supplementary Information for the 2025-2027 Immigration Levels Plan" (https://www.canada.ca/en/immigration-refugees-citizenship/news/notices/supplementary-immigration-levels-2025-2027.html).

11 Canada now spends approximately $1.2 billion on settlement services for economic immigrants, excluding payments for settlement services to Quebec as part of the funding for the Canada-Québec Accord on Immigration and Temporary Admission of Aliens.

12 Based on enterprise data. For Canada, see: https://ised-isde.canada.ca/site/sme-research-statistics/en/key-small-business-statistics/key-small-business-statistics-2023#s2.2; and for the US, see: https://advocacy.sba.gov/wp-content/uploads/2024/11/United_States.pdf.

next government must end policies that encourage small-scale production and adopt measures that support entrepreneurship in a more focused way.

Access to financing is critical for growth. Knowledge-intensive SMEs need risk capital, while other growth-oriented SMEs rely more on loans. Partly because of federal programs, Canadian SMEs generally have good access to debt financing. Less than 9 percent of their loan applications are rejected,[13] and SMEs rank financing as their least important obstacle to growth (Nitani and Nusrat 2023).

Government support for SME debt financing is focused on high-risk borrowers. This is good public policy. Assessing the quality of riskier loans is expensive, and in a competitive market, it is not possible to allocate these costs to higher-risk borrowers.[14] To cover the cost of assessing risky loans, lenders will either increase interest rates on all loans, penalizing low-risk borrowers, or refuse loans to higher-risk borrowers. To address this problem, the government supports direct lending to SMEs through the BDC. The government also has a guarantee program for private sector lenders, the Canadian Small Business Financing Program (CSBFP).

The loan guarantee program partially compensates banks and other lending institutions for losses on high-risk loans.[15] Borrowers pay interest to lenders and fees to the government. The high effective interest rate on loans screens out low-risk borrowers. The program is approximately self-financing, which means that loans are being priced to risk, including the extra cost of assessing riskier loans. This program is working as intended by servicing only high-risk borrowers.

Direct lending by the BDC is also intended to separate the loan market by servicing higher-risk borrowers. The BDC should subsidize these clients only to the extent of absorbing the higher cost of assessing riskier loans. Productivity will suffer if high-risk projects are financed at below market interest rates. The BDC appears to be failing on both counts. About 15 percent of the BDC's loans are to low-risk, investment-grade borrowers (BDC 2024a), and the subsidy offered to borrowers is more substantial than could be justified by the extra cost of assessing riskier loans (Lester 2017).

Canada's next government should instruct the BDC to stop lending to investment-grade borrowers. The savings should fund increased activity in high-tier venture deals noted above and expand their portfolio of high-risk loans. The BDC should also rely more on guarantees. Guarantee programs for SMEs should be consolidated under the BDC or the CSBFP, whichever is more efficient. Canada's next government should mandate a thorough review of lending activities by the BDC to ensure that they are not offering excessive subsidies to high-risk borrowers and to determine the optimal role of loan guarantees.

More competition among lenders would also lower interest costs for all borrowers, so Canada's next government must finalize the legislative framework to implement open banking as soon as possible.

The federal government also supports SMEs with a preferential corporate tax rate intended to make it easier for firms to finance capacity-expanding investment with internal funds. Unlike the targeted support provided by the BDC and the CSBFP, the preferential tax rate applies to

13 The average rejection rate over the 10 years ending in 2022 was 8.56 percent (Organisation for Economic Cooperation and Development 2024, Table 7.1)

14 See (Lester 2017) for a review of this literature.

15 For an overview of the program, see Canada Small Business Financing Program: Cost-Benefit Analysis (https://ised-isde.canada.ca/site/sme-research-statistics/en/research-reports/canada-small-business-financing-program-cost-benefit-analysis#s2).

all SMEs. Not all SMEs experience financing difficulties, so this measure is more generous than it needs to be. This measure is often criticized for creating a barrier to firm growth because the preference is phased out as active business income and capital stock reach certain thresholds. Bunching of firms at the capital stock threshold would be convincing evidence that the preference is encouraging firms to forgo growth opportunities. However, there is no evidence of such bunching (Dachis and Lester 2015). Nevertheless, the preferential rate for small businesses adversely affects the Canadian economy because it reduces the cost of entry into small business by firms that are not growth-oriented (Lester 2017).

A more efficient policy would focus support on high-growth firms, which account for about 3 percent of SMEs (Canadian Chamber of Commerce 2024).[16] Canada's next government should phase out the preferential rate and use some of the savings to support high-growth SMEs by eliminating taxation of capital gains for qualifying SMEs. With a two-percentage-point reduction in the general corporate income tax rate, an eight-year phase-out of the preferential income tax starting in 2026 would raise revenues about $2.7 billion by 2029/30.

The tax treatment of capital gains affects the incentive and the capacity for firms to grow. Canadian SMEs now benefit from three federal policies that reduce the tax burden on capital gains. A rollover provision allows the capital gain on the sale of certain small business shares to be deferred if the proceeds are invested in other qualified small business shares. If the investment is not rolled over, entrepreneurs benefit from a lifetime exemption that eliminates the tax on $2.5 million in capital gains. Finally, under the Canadian Entrepreneurs' Incentive (CEI), the inclusion rate will be reduced to one-third for lifetime capital gains above $2.5 million with a lifetime cap of $2 million in 2025, rising to $6.5 million by 2029.

These are sound policies, but don't go far enough. Taxation of capital gains earned on the sale of shares in a business generating active business income amounts to double taxation (Lester 2017). Expected profits raise the market value of an enterprise, which gives rise to a capital gain on the sale of shares. But these profits are also subject to tax when distributed as dividends. Canada's next government should therefore reduce the CEI rate to zero over five years while gradually lifting the lifetime cap, so the total cost does not exceed the revenue gain from phasing out the SME tax preference.

Differences in management skills explain some of the productivity gap between SMEs and large firms (Bloom, Sadun and Van Reenen 2016, Table 8). SMEs now benefit from subsidized advisory services provided through several programs, most of which focus on technology rather than general management skills. Programs delivered by the BDC are an exception. Canada's next government should mandate the BDC to increase its activity in advisory services. Subsidized advisory services should not be limited to management skills. SMEs would also benefit from advice on adopting new technologies. Somewhat more than a quarter of SMEs for whom adoption of advanced or emerging technologies is relevant fail to do so because of a lack of technical skills or a lack of information about these technologies.[17]

2.4.2 Lower, More Effective Business Subsidies[18]

Business subsidies have increased 125 percent since 2015, rising from $17 billion to $37.4 billion.

16 High growth is defined as annual growth of 20 percent or more.

17 Survey of Innovation and Business Strategy, 2022. Statistics Canada. Table 27-10-0368-01. Reasons for not adopting or using advanced technologies, by industry and enterprise size. See: https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=2710036801. Around 35 percent of SMEs consider the adoption or use of advanced technologies applicable to their business, and approximately 10 percent of these firms cite a lack of technical skills and a lack of information as reasons for not adopting advanced technologies.

18 This section is based on the discussion in Lester (2024a).

That is much faster than overall federal spending on programs, which rose 86 percent. Measures to create "good" jobs – industrial policies – were the most important source of growth, rising from 2 percent of subsidies in 2015 to 21 percent in the current fiscal year. Measures to mitigate the effects of climate change also rose sharply, increasing their share of subsidies from 2 to 10 percent.

Under current plans, business subsidies will rise another 20 percent by 2028/29, assuming $2.9 billion lapses as scheduled. Industrial policies will continue to be the main source of growth, accounting for almost 65 percent of the total increase. On current plans, industrial policy measures will rise from $8 billion in the current fiscal year to $12.5 billion by 2028/29. Robust growth will continue after 2028/29.

Such a high level of subsidies, heavily weighted toward industrial policies, is worrisome. Business subsidies override the market-determined distribution of economic activity, which is a big decision to make because market prices generally allocate society's scarce resources to their best uses. If markets are functioning properly, subsidies harm productivity, making Canadians poorer, not richer.

About one-third of subsidies do not address any clear market failure, acting instead as income transfers that reduce real income. Canada's next government should carefully review these subsidies, which include general business support programs, regional initiatives, and agricultural income support to determine if their redistribution effects are justified, given the real income loss they cause. Immediate candidates for elimination include subsidies for supply managed industries and the Atlantic Investment Tax Credit (Mintz and Smart 2003).

Roughly two-fifths of subsidies address recognized market failures and therefore have the potential to make Canadians richer. However, well over half of this spending does not realize its potential because the cost of providing support exceeds the benefits. Key examples are the preferential income tax rate for SMEs, discussed in the previous section, and the enhanced SR&ED tax credit for SMEs. The enhanced SR&ED tax credit fails a benefit-cost test primarily because it is too generous, particularly in the context of provincial support for SR&ED.

Around 10 percent of business subsidies target climate change mitigation, primarily by reducing CO_2 emissions. The role of subsidies is to complement carbon pricing at an acceptable cost. Complementary measures fill gaps in the coverage of the pricing regime and accelerate the adoption of low-carbon alternatives by demonstrating the feasibility of new technologies and by creating network effects. Canada's next government should rank these programs by cost-effectiveness and eliminate any programs falling significantly below the cost-effectiveness of the large emitters trading systems.

Roughly 20 percent of business subsidies in 2024/25 aim to create "good" jobs by subsidizing high-productivity, high-wage industries. Under current plans, they will reach 28 percent of subsidies by 2028/29. However, almost a quarter of these subsidies are tied to production levels of electric vehicle batteries, which will fall well short of projections if Trump's tariffs on the automobile industry are maintained.

Industrial policies can shift the Canadian economy's structure, but do not necessarily make Canadians richer. A policy that creates jobs in a "high-wage" sector only benefits workers if they earn more than their skills would command elsewhere. A key issue here is that the ability to pay a wage premium varies more by firm than by industry. As a result, broad-based subsidies, such as the tax credits for investment in clean technology manufacturing and the production of hydrogen, may not result in more workers earning wage premiums. And subsidizing specific firms is fraught.

On the other hand, industrial policy measures may maintain high-paying jobs in Canada in the face of subsidies or protectionist policies by Canada's competitors. This has the advantage of avoiding potentially substantial adjustment costs as displaced workers experience temporary unemployment and incur costs to relocate.

Given the uncertain net benefits of industrial policies, Canada's next government should cap their growth. Instead of rising more than three times faster than GDP, they should rise half as fast as GDP from 2024/25 to 2029/30. The lower level of spending would be achieved by eliminating some programs and scaling back others. This would reduce projected spending on subsidies by $3.3 billion in 2029/30. There is solid evidence that one industrial policy measure – subsidizing foreign firms to shoot films and videos in Canada – imposes an economic cost (Lester 2013). Elimination of the refundable Film or Video Production Services Tax Credit would leave savings of about $2.9 billion from capping the growth in industrial policy measures.

Overall, the changes to business subsidies discussed in this section, excluding the phased elimination of the preferential tax rate for small businesses, would reduce spending by about $3.7 billion in 2029/30 and raise around $600 million in tax revenue. Value-for-money and cost-effectiveness assessments of the remaining business subsidies will substantially increase these impacts.

2.4.3 Reducing Internal Barriers to Trade and Mobility

Eliminating barriers in Canada's internal market has long been good policy, but is now urgent given Trump's tariffs, Canada's distressingly poor productivity, and high living costs. While there are no tariffs on goods and services flowing between provinces, differences in regulations, licensing and certification of professionals and tradespeople, and preferences for within-province suppliers in government procurement contracts substantially shrink the effective size of Canada's internal market.

Removing policy-relevant internal barriers to trade in goods alone would raise Canada's GDP by as much as 4 percent (Alvarez, Krznar and Tombe 2019). In 2025, that would mean an increase of $120 billion in output, or up to $2,900 per person.[19] Eliminating barriers to trade in services would provide a further benefit of unknown magnitude.

There is now considerable momentum in favour of reducing interprovincial barriers to trade and mobility. Provincial and territorial ministers responsible for internal trade have agreed, at least in principle, to mutually recognize their regulations and their professional and skilled trades certifications, and to reduce the number of exceptions to the Canada Free Trade Agreement.

These developments are unambiguously good news. Nevertheless, progress may founder because of the Achilles heel of free trade agreements: they raise overall income, but some participants end up worse off, at least temporarily. Securing a robust agreement will require offering compensation to those hurt by dismantling trade and mobility barriers. Canada's next government should provide this compensation. For example, the Regulatory Reconciliation and Cooperation Table (RCT) mandate should be strengthened to include commissioning studies of the impacts of the reduced interprovincial barriers to trade and mobility, which would help identify those who need adjustment assistance, such as training and income support (Manucha 2025).

2.5 Improving Canada's Infrastructure

Canada's ageing infrastructure, particularly trade-related, is holding back growth and productivity. Governments have underinvested in public infrastructure and delayed approval of major private projects, driving up costs and discouraging investment. Canada's next government should upgrade major infrastructure, particularly trade-related, while ensuring timely approvals of private projects that meet a clear public interest test.

19 Canada's population was estimated at 41.5 million in October 2024.

Upgrading and rejuvenating trade-related infrastructure

Canada's National Trade Corridors Fund (NTCF) supports infrastructure investment that facilitates internal trade and international exports. Total funding for the NCTF is $4.6 billion over the 11 years ending in 2027/28. Canada's next government should extend funding for the NCTF to 2028/29 and beyond, with at least $500 million per year earmarked to alleviate bottlenecks, build resilience against climate risks, and diversify trade. In addition, existing subsidy programs should be used to support private sector investments in advanced tracing and logistics technology for use in supply chain management (Supply Chain Working Group 2024).

Airport privatization

Canada is the only country in the world that has transferred its largest airports to non-profit, non-share capital airport authorities, with the federal government owning and leasing land to the airport authorities. There is solid evidence that private ownership of airports, particularly by private equity funds, results in improved performance (Howell et al. 2022). Airport efficiency and overall capacity rise substantially after purchase by a private equity fund. Canada's next government should privatize federal airports, emphasizing participation by private equity investors, including pension funds. Following the Australian example, conditions of sale should include price monitoring to ensure responsible conduct.

Faster approval of major private infrastructure projects[20]

A key change required to promote timeliness in project approval is to eliminate parallel federal and provincial public interest tests. Consistent with the recent Supreme Court of Canada ruling,[21] but going beyond the response of the previous government, Canada's next government must ensure that the jurisdiction that has the primary role in approving a project also has broad authority to decide whether it is in the public interest. Canada's next government should strictly define federal jurisdiction, ensuring that one public interest test applies in most cases.

Similarly, federal environmental assessments should only happen when federal decisions are necessary for the project to proceed. To expedite approvals, the government should clarify submission requirements and limit hearing participants to those directly affected. A possible alternative is to shift from consultations to standards as the basis for approval (Box 4).

To further increase timeliness and certainty, Canada's next government should significantly limit the federal cabinet's power to veto projects that have been approved by independent and expert regulatory agencies, tribunals and authorities.

Encouraging Indigenous communities' economic participation in major projects must be part of any reform. Doing so is fundamental to the success of any major infrastructure project affecting Indigenous communities (DeLand and Gilmour 2024). There remains a significant gap between identified demand and available financing. While establishing the Canada Indigenous Loan Guarantee Corporation is a welcome step, it must be effective and active. In addition, Canada's next government should consider establishing an Indigenous Development Bank (Hodgson and Smallridge 2024).

3 – Reducing the Cost of Living

Canada's next government has the opportunity to raise living standards by increasing incomes and cutting the cost of living. Productivity growth, and hence incomes, will pick up with lower taxes on business investment and measures to promote a

20 This section is based on the discussion in DeLand and Gilmour (2024).

21 Reference re *Impact Assessment Act*, 2023 SCC 23.

Box 4: The World Bank Approach to Project Approval

In addition to adopting administrative efficiencies, the Canadian regulatory approval process could be reformed by making use of high environmental and social standards for regulatory approval, instead of relying on stakeholder consultations as it does now. This approach is used by the World Bank, the leading global development financial institution of which Canada is a founding member.

The World Bank uses an environmental and social framework for the approval and support of the many projects it finances around the globe (World Bank 2016). These standards focus on identifying and assessing environmental and social risks and impacts associated with projects supported by the Bank. They are expected to reflect good international practice relating to environmental and social sustainability, assist borrowers in fulfilling their national and international environmental and social obligations, and enhance transparency and accountability.

more innovative economy. To reduce living costs, Canada's next government should also:

- Phase out supply management of dairy products, eggs, and poultry to reduce food prices.
- Take measures to reduce the pressure on house prices.
- Work with provinces to dismantle interprovincial barriers to trade and mobility that are keeping prices too high, as previously mentioned.

3.1 Phasing Out Supply Management

Canada's supply management system limits the production of dairy, egg, and poultry to control their prices. Production quotas limit what leaves farm gates, and huge tariffs limit imports to a tiny share of the market. This government-mandated cartel raises the price paid by consumers for supply-managed products, without providing substantial benefits to farmers.[22] The explanation for this paradoxical result is that while the initial allocation of quota in the early 1970s was free, farmers who now wish to start or expand production of supply-managed products must purchase quota, which drives up their costs. Farmers receiving the initial allocation of quota reaped a large windfall gain, but for subsequent purchasers, the quota is simply another cost of doing business.

Restricting imports also weakens Canada's ability to negotiate trade deals that benefit bigger exporting industries. For example, trade talks with the UK stalled partly due to Canada's refusal to accept more cheese imports (Schwanen 2024).

Ending supply management will make Canadians richer without harming farmers if done carefully. The first step is to ensure that trade negotiators do not have their hands tied by legislation like Bill C-282, which would have

22 In 2021, after adjusting for capital cost allowances and amortization, the net operating income of dairy, egg, and poultry farm families was $71,813. Economy-wide average family income was $106,300 in 2021. Dairy, egg, and poultry farmers had off-farm family income of $93,976, giving total family income of $165,788. Sources: Statistics Canada tables 32-10-0213-01 and 98-10-0060-01.

banned market-access concessions for supply-managed goods. This legislation died with prorogation. Canada's next government must not resurrect it.

The second step is to phase out production quotas. Canada's next government should implement a phased reduction of import tariffs, combined with the sale of additional quotas (Robson and Busby 2010). A consultation process should be set up to determine the length of the phase-out period, which would be chosen to balance the benefits for consumers and the transition costs for producers. The phase-out should be long enough for farmers to recoup quota value, while gradually reducing domestic producer prices to world levels, benefiting consumers.

3.2 Making Housing More Affordable

Soaring prices, rents, and a growing mismatch between housing supply and population needs have created a housing crisis that challenges all levels of government. Major urban centres have seen housing costs outpace income growth, pushing homeownership beyond the reach of many middle-class Canadians and creating significant barriers for first-time buyers. The Canada Mortgage and Housing Corporation projects that Canada must build an additional 3.5 million housing units by 2030 to restore affordability in the sector (Canada Mortgage and Housing Corporation 2023).

In response to this crisis, the current federal government has announced almost $13 billion in new spending programs and approximately $70 billion in subsidized lending programs since 2023 (Box 5). These programs are intended to increase the supply of housing, boost the productivity of the residential construction industry, which has lagged other sectors for decades, and make housing more affordable for selected groups.

Canada's next government must undertake a thorough review of these initiatives to assess their effectiveness, identify gaps, and eliminate programs that duplicate efforts by other levels of government (C.D. Howe Institute 2025). Coordination of policies across levels of government poses an issue, and creating a National Housing Secretariat could improve the situation. In most cases, federal housing policies align with federal responsibilities. However, one exception is federal intervention in municipal zoning regulation through the Housing Accelerator Fund. While Canada's next government should continue to encourage cities to improve building processes and lower development costs to speed up housing development, it must avoid micromanaging the process (Dachis 2023). Canada's next government should offer lump sum transfers to provinces and/or municipalities in exchange for following best practices for permitting, zoning, and development charges.

Canada's next government should phase out the tax credit for first-time homebuyers and the First Home Savings Account. These measures stimulate demand, which leads to higher housing prices. The First Home Savings Account violates basic tax principles by providing deductions on contributions yet allowing tax-free withdrawals.

4 – Greenhouse Gas Reduction

Canada's greenhouse gas emission policies suffer from a fundamental disconnect between ambitious targets and practical implementation. Despite introducing more than 70 federal emission reduction initiatives, Canada risks failing to meet its climate commitments. The risk of failure has increased with the elimination of the fuel charge. Canada's next government must acknowledge this risk and launch a reassessment of emission targets and their supporting policy framework to determine what needs to be done to achieve the targets. If a careful assessment reveals that the benefits of emissions reduction exceed the costs, the targets should be maintained or strengthened. If not, Canada should adopt a policy framework that passes a benefit-cost test.

4.1 Pricing Carbon

A broad-based and consistent carbon pricing

Box 5: Federal Housing Initiatives[a]

Key federal measures to increase the supply of rental housing are subsidized loans, exemption from GST, and accelerated deduction of capital costs for tax purposes. The supply of affordable housing is being supported by subsidized loans and a program to purchase affordable rental units to prevent them from being repriced. Further cost reductions and hence additional supply are expected from programs that support the development of housing infrastructure, particularly public transit and water and sewage management facilities. The Canada Infrastructure Bank has been given a mandate to support the financing of these housing infrastructure initiatives. The federal government also provides financial incentives to local governments to increase the supply of housing by easing zoning restrictions and streamlining permitting processes.

New federal programs support innovation in homebuilding, such as more intensive use of prefabricated housing factories, mass timber production, panelization,[b] 3D printing, and pre-approved home design catalogues. A small-scale Regional Homebuilding Technology and Innovation Fund (RHII) has been set up to encourage the scaleup, commercialization, and adoption of innovative housing technologies and materials in the residential construction industry. RHII will be complemented by additional support for the regional development agencies.

The housing initiative includes measures to increase the supply of skilled trades workers. Efforts are being made to expedite foreign credential recognition and to implement mutual recognition of trade certification standards by provincial licensing bodies.

The federal government also implemented a tax credit for first-time homebuyers and a First Home Savings Account to make housing more affordable for first-time buyers.

a. Source: Housing, Infrastructure and Communities Canada – Canada's Housing Plan: Programs and initiatives. The loan programs consist of the Apartment Construction Loan Program ($55 billion) and the Affordable Housing Fund ($15.2 billion).
b. Construction of walls, floors, and ceilings in a factory, which are installed on site.

system incorporating inter-sector trading can minimize the cost of achieving an emissions reduction target and ensure that the burden is distributed fairly across sectors. The previous government has dropped the fuel charge and the associated rebate, leaving the large-emitter trading systems (LETS) as the only carbon pricing policy instrument. The fuel charge would have accounted for 8 to 9 percent of the emissions reduction projected to occur by 2030 because of legislated policies, while LETS are expected to contribute between 23 and 39 percent (Beugin et al. 2024).

Canada's next government must continue providing consistent price signals for heavy emitters, like those in oil and gas, implemented by each province, and paired with output-based allowances to preserve competitiveness. The price and allowance levels should be reviewed to ensure they provide incentives to reduce marginal emissions at a technically and economically feasible rate compared to export market competitors.

4.2 Streamlining the Policy Framework

While pricing carbon emissions can be the most cost-effective way to reduce them, there are reasons to support carbon pricing with other policies. For example, subsidies or regulations can fill gaps in the coverage of carbon pricing, or they may help generate scale economies and network effects that will reduce the cost of transitioning to a low-carbon economy. Complementary policies can also help overcome barriers caused by unusually high implementation costs or technological uncertainty.

However, Canada would get more satisfactory results with fewer and better-designed policies, which would increase private sector investment confidence and clarity, and reduce the administrative burden on the public sector (DeLand 2024a). The first step in streamlining the policy framework is to stop adding new policy layers and drop proposed programs and regulations not yet enacted, such as the proposed oil and gas sector emissions cap and Clean Electricity Regulations. These measures are redundant in a well-designed carbon pricing regime for large emitters (DeLand 2024b). The next step is to rigorously assess the plethora of programs intended to reduce emissions. Programs should be ranked by cost-effectiveness, and those that fall below a minimum threshold should be modified or eliminated. This assessment should be made public.

Canada's next government should make changes to two programs before the results from the comprehensive policy review are available.

The zero-emission vehicle (ZEV) mandate sends a strong signal to vehicle manufacturers that there will be a large market for ZEVs, so they can make the required investments with confidence. However, the existing mandate, which requires 100 percent ZEV sales by 2035, is not achievable (Livingston 2024). The mandate should be modified to allow the sale of hybrid vehicles, plug-in hybrid electric vehicles, and internal combustion engine vehicles that are powered by renewable fuels after 2035. All other vehicles sold would be battery-electric vehicles. The subsidies for buying ZEVs should expire as planned in 2025/26.

To complement LETS, Canada's next government should help build scale in nascent carbon capture, utilization, and storage (CCUS) investments (DeLand 2023). This should be achieved by maintaining the existing tax credit at its full value until 2035 and providing a reduced credit until 2046, representing a five-year extension from the current policy. Removing the exclusion of emissions sequestered in enhanced oil recovery operations and the "prevailing wage" requirements would enhance the credit's effectiveness.

5 – Costing summary of productivity-related initiatives

The productivity-related initiatives presented in this document are included in the fiscal framework set out in the Institute's latest Shadow Budget (Robson, Drummond and Laurin 2025). Additional detail on their cost is provided in the following table. The measures contribute almost $5 billion to the $11 billion budget surplus projected for 2029/30 in the Shadow Budget, with almost 90 percent of the contribution coming from lower business subsidies.

Table 1: Detailed Costing of the Productivity-related Initiatives in this Document* ($ millions)

	2029/30 Change In:	
	Program Spending	**Revenues**
Restructuring support for R&D		
SR&ED rate rebalancing	Cost neutral	
SR&ED regular credit refundable	-410	
All R&D support delivered via SR&ED		
Eliminate other programs supporting R&D	380	
Eliminate Canada Innovation Corporation	200	
Eliminate program streams supporting R&D	210	
Subtotal	380	
Increased support for commercialization		
IRAP provides repayable support for commercialization	110	
Implement an IP Box	Small	
Improved access to loans for SMEs		
Change the Business Development Bank's portfolio	Note 1	
Modify the small business financing program	Note 1	
Improved access to risk capital		
Enrichment of Canadian Entrepreneurs Incentive		-2700
Phased elimination of SME preferential rate		2700
Tax credits for investment in early stage ventures		100
Increased support for high-tier VC funding	Note 1	
Lower, more effective subsidies		
Eliminate support for supply managed industries	300	
Eliminate Atlantic Investment Tax Credit	30	360
Eliminate Labour Sponsored Venture Capital Corporations		210
Eliminate Film or Video Production Services Tax Credit	440	
Cap on other industrial policy measures	2900	
Subtotal	3670	570

* Excluding corporate income tax rate reductions.

Table 1: Continued

Immigration		
Credential assessment (NOCR)	-50	
Labour market integration	-150	
Reduced funding for settlement programs	200	
Subtotal	0	
Upgrade and rejuvenate trade-related infrastructure		
Extend funding for the National Trade Corridors Fund	500	
Total	**4170**	**670**

Note 1: The Business Development Bank would stop lending to investment grade borrowers, increase lending to higher risk borrowers, shift some of its portfolio to loan guarantees, and expand risk capital activity in the high-tier VC funding. The changes woud be constrained to be cost-neutral.

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