TD Asset Management

Investor Knowledge 10 Minutes

Running Hard, Falling Behind:
Canada's Productivity Paradox

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Canada, long celebrated for its natural resources, strong institutions, and social stability, is facing a mounting economic concern that threatens its long-term prosperity: stagnating productivity. For decades, Canadian productivity growth has lagged peer nations, most notably the U.S. While the country has weathered global crises relatively well in terms of stability, its ability to generate real GDP per capita has eroded. This article explores the core reasons behind Canada's productivity gap, the consequences of inaction, and what the future may hold for investors.

Understanding productivity

Productivity is commonly defined as the efficiency with which capital and labour are used to produce goods and services. It is often measured in terms of output per hour worked. High productivity allows economies to grow without simply adding more workers or extending work hours. In practical terms, higher productivity leads to higher wages, stronger economic growth, and improved living standards. For Canada, productivity is not merely an abstract economic metric—it's a direct reflection of national competitiveness and prosperity.

Not a good look

Canada's productivity growth has been stagnating for over a decade. When adjusted for inflation, Canadian Gross Domestic Product (GDP) per capita has remained relatively flat compared to other G7 nations. In fact, Canadians now produce roughly one-third less output per capita than their U.S counterparts. This growing gap reflects systemic inefficiencies, structural misalignments, and underinvestment in key areas of the economy. While Canada has experienced high population growth in recent years—largely through immigration—this has not translated into proportional economic output.

What went wrong?

1 Chronic underinvestment in capital

One of the most persistent contributors to weak productivity growth is Canada's chronic underinvestment in productivity-enhancing capital—machinery, technology, infrastructure, and intellectual property. Canadian businesses have lagged their international peers in adopting new technologies and automating processes. Real Gross Fixed Capital Formation (GFCF) as a percentage of GDP has trailed that of other developed countries. This underinvestment leads to inefficiencies and slower gains in output, which in turn further dis-incentivizes business investment.

2 Rapid population growth dilution

Canada has experienced a demographic boom driven by high immigration levels. While this helps counteract aging demographics and supports labour force growth, it also presents challenges. In the short term, high population growth can dilute capital intensity and suppress per capita output, particularly if infrastructure, housing, and services do not keep pace. Moreover, many newcomers initially work in lower-productivity sectors or require time to integrate fully into the economy, delaying their productivity contributions.

3 Internal trade barriers

Despite being a single country, Canada operates under a patchwork of provincial regulations that create significant internal trade frictions. Differences in product standards, licensing requirements, and procurement preferences act as de facto trade barriers. These inefficiencies restrict competition, reduce economies of scale, and inhibit business expansion across provinces. The result is a fragmented domestic market that limits the full realization of productivity gains from trade.

4 Energy sector constraints

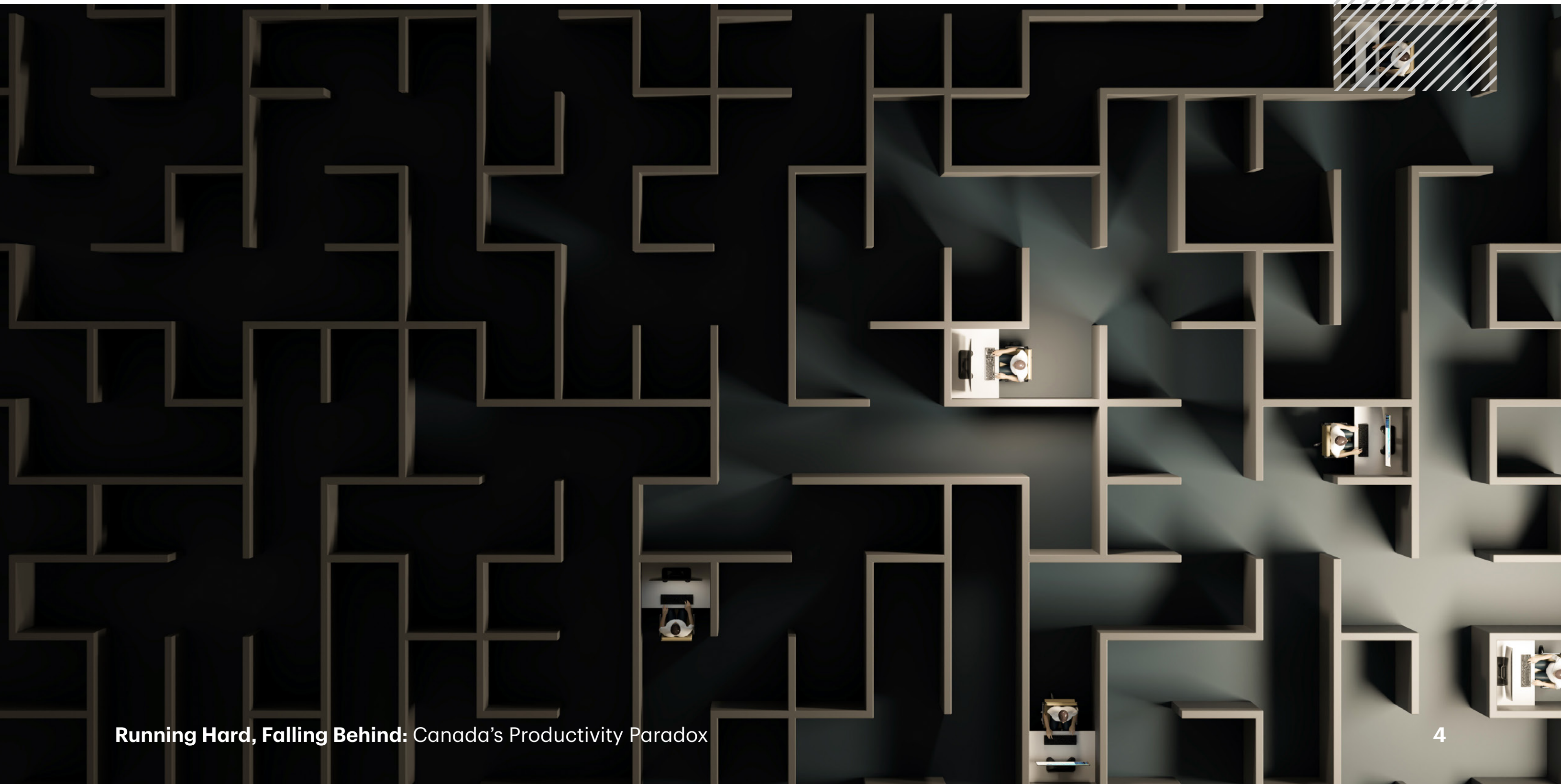
Canada's energy sector, once a cornerstone of national productivity, has faced a series of setbacks. The collapse in oil prices in 2014 led to a wave of project cancellations and the exit of multinationals from the basin. In addition to this, regulatory hurdles, and opposition from political, environmental, and indigenous groups have stifled further pipeline expansion. Decarbonization policies, while necessary, have not been matched with sufficient support for green transition investments like carbon capture and storage (CCS). As a result, capital has exited the sector, and growth has slowed within this high productivity sector.

5 Shift to lower-productivity sectors

Canada's economy is gradually shifting toward service-oriented industries, which are characterized by lower productivity versus goods-producing industries. While these sectors are essential, they typically exhibit slower productivity growth than manufacturing, and oil and gas extraction. Furthermore, within the goods producing segment, labour hours worked have shifted in favour of the construction sector which has suffered from chronic inefficiencies, including regulatory red tape and low technological adoption. This shift in economic composition has contributed to the overall decline in national productivity.

6 Lagging innovation and technology adoption

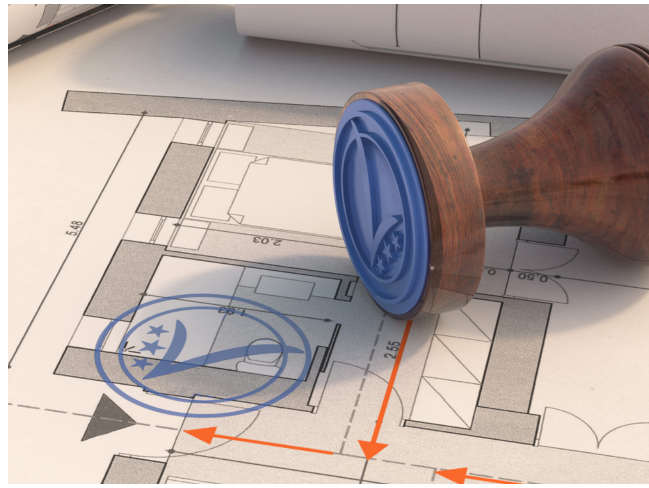
Canada underperforms in translating research into commercially viable products and services. Although the country boasts strong academic institutions and spends significantly on research and development (R&D), it struggles to commercialize innovation. Moreover, adoption of frontier technologies like artificial intelligence (AI), cloud computing, and automation remains uneven, particularly among small and medium-sized enterprises (SMEs). Without faster technological integration, Canada risks falling further behind global leaders.



Reversing the slump

To reverse Canada's productivity slump, the following strategies, if implemented, may steer the country in the right direction:

1 Incentivize investment and streamline regulation



Introduce targeted fiscal incentives, such as accelerated capital cost allowances and investment tax credits, for businesses investing in productivity-enhancing assets like automation, advanced machinery, and digital infrastructure. Simultaneously, reduce regulatory burden and modernize permitting processes to enable faster deployment of infrastructure projects and private capital investment, particularly in sectors like transportation, clean energy, and advanced manufacturing.

2 Reform immigration policy to meet labour market needs

Realign Canada's immigration system to better reflect the evolving demands of the labour market, with a particular focus on skilled trades, science, technology, engineering, and mathematics (STEM) fields, and health care. Expand employer-led immigration streams, prioritize credential recognition and language support, and invest in integration programs to improve the economic outcomes of newcomers. A more agile and responsive immigration system will help close skill gaps and boost overall productivity.

3 Eliminate internal trade barriers

Work with provinces and territories to harmonize standards, recognize professional credentials across jurisdictions, and reduce regulatory duplication. Removing these barriers would enable more seamless interprovincial commerce, enhance labour mobility, reduce business costs, and unlock the full potential of Canada's domestic market—boosting efficiency and scale for firms of all sizes.

Strategy

4 Drive a modern, competitive energy sector

Support the dual goals of energy security and net-zero emissions by encouraging investment in clean energy technologies. Introduce clear, consistent tax incentives for carbon capture, utilization and storage (CCUS), hydrogen, and renewables. Streamline environmental assessments and permitting for major energy projects to attract long-term capital. A revitalized energy sector can drive export growth, especially as global demand for natural gas – an abundant resource in Canada – remains high.

5 Accelerate technology adoption across industries

Promote digital transformation in lagging sectors, particularly SMEs, through targeted grants, matching funds, and support for cloud computing, cybersecurity, and automation tools. Expand public-private partnerships that foster innovation adoption and help companies scale more quickly. Workforce upskilling programs should complement these efforts, ensuring Canadian workers can thrive in a digitally enabled economy.

6 Build world-class AI and data infrastructure

Leverage Canada's clean energy advantage, diverse talent pool, and leading AI research institutions to become a global hub for AI and data-intensive industries. Expand investment in high-capacity data centers, quantum computing, and national AI strategies. Support responsible AI development through ethical frameworks, public R&D funding, and commercialization pathways to strengthen global competitiveness.

Investment Implications

For investors, Canada's productivity challenge presents both risks and opportunities. In a low-productivity environment, returns in traditional sectors like energy and real estate may underperform unless they undergo significant innovation. Conversely, sectors focused on technology, AI, infrastructure, and education could see outsized returns as the country attempts to modernize. Fixed income investors should also monitor government fiscal policy—stimulus measures aimed at boosting productivity may shift the yield curve or increase public debt, altering bond market dynamics.

The time is now

Canada's productivity crisis is not insurmountable - but it is urgent. Years of underinvestment, regulatory complexity, and sectoral shifts have eroded the country's economic edge. Without strategic reforms and targeted investments, the nation risks further divergence from its global peers. However, with smart policy, bold leadership, and a renewed focus on innovation, Canada can revitalize its productivity engine and unlock a new era of sustainable growth. For investors and policymakers alike, the time to act is now. ■

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