Productivity, Innovation and How Canada's Tax System Can Help

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Canada and its new government find themselves at a crossroads in the summer of 2025. The Trump administration's first six months have changed (likely forever) Canada's relationship with its closest neighbour and largest trading partner. While the Canada-United States-Mexico Free Trade Agreement has cushioned most of the impact to date, we still face considerable economic headwinds from threatened tariffs (both general and sectoral) and the prospect of CUSMA being renegotiated in 2026. The resulting uncertainty creates a drag on the economy, as businesses hesitate to expand or modernize at a time when important parameters are changing weekly.

Moreover, the "One Big Beautiful Bill Act" enacted in July 2025 includes a host of highly stimulative tax changes designed to super-charge the American economy. These include faster tax write-offs of business expenditures, export subsidies, expanded investor-level tax relief, and the extension of reduced income tax rates, all financed by substantial deficit spending. When combined with the highly distortive and inefficient *de facto* consumption taxes that America's new tariffs represent, these tax changes constitute a major shift in U.S. fiscal policy and a substantial incentive to attractive business investment into the U.S. from other countries.

All of this is occurring at a time when the Canadian economy continues to experience a general malaise, essentially stalling or even experiencing a modest contraction. In particular, Canada's performance on productivity continues to languish, falling further behind not only America's but also that of many of its own OECD counterparts. On innovation, our persistent aversion to risk limits our willingness to fully participate in the innovation economy of tomorrow. For example, one report identifies Canada as "trail[ing] every other G7 nation in AI computing infrastructure." We continue to underperform in business innovation at the risk of missing out on the high-value sectors of the global economy that are becoming increasingly important, as other countries move to create critical mass and resulting gravitational attraction in the innovation economy.

Addressing these issues must be foremost on our new government's agenda. While tax policy is not the entire solution, it is certainly part of it. This paper discusses what levers within the tax system might be employed to address these challenges and respond to initiatives in the U.S., hopefully providing a useful basis for further discussion as to which ones are best suited to create the right incentives and achieve the desired

results. Typical Canadian wait-and-see incrementalism is not the answer when events are moving with such force and celerity. Canada needs to act now to invest in its economy in a major way so as to protect its long-term tax base and the social programs it funds.

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