1 Key Policy Insights

Canada's economy recovered from the COVID-19 crisis, but new challenges have emerged (Figure 1.1). The rate of unemployment declined rapidly in the aftermath of the pandemic and total output has been running above pre-crisis levels since late 2021. Consumer-price inflation, already rising, was further fuelled by the impact on energy and food prices of Russia's invasion of Ukraine. This has dented household purchasing power and prompted policy measures to address the cost of living. The Bank of Canada has forcefully raised policy interest rates since March 2022 and is pursuing quantitative tightening.

Government policy has been advancing on several of Canada's socio-economic challenges. The federal government's Budget 2022 announced a raft of demand and supply-side measures aiming to reduce housing costs for low-income households. Meanwhile, a major reform to increase access to affordable childcare is underway. This will potentially help reduce gender gaps in employment and earnings. Progress has also been made in expanding the coverage of Canada's public healthcare. Policy continues to prioritise narrowing the wide socio-economic gaps that exist between Indigenous peoples and the rest of the population.

Meanwhile, Canada's GDP per capita has advanced more slowly than leading economies in recent years. It has barely reached pre-COVID levels and the gap with the United States has widened (Figure 1.1). This is linked to relatively weak productivity growth. Policy towards raising productivity is often being combined with climate policy goals. For instance, the federal government has announced a new fund for financing investment in green technology. Considerable other policy work towards lowering greenhouse gas emissions is underway. A steep decline in emissions is needed to reach net zero by 2050 (Figure 1.1).

The key messages of this Economic Survey are:

- Like many economies, Canada faces the difficult challenge of tackling inflation while avoiding a significant downturn in economic activity. Fiscal policy should continue to work in the same direction as monetary policy by tempering excess demand, and to further build fiscal buffers. Measures to address cost-of-living increases should be targeted and temporary.
- Faster progress is required in strengthening incomes and living standards. Successful implementation of recent reforms to make housing and quality childcare affordable is a core challenge. Removing barriers to internal trade and ensuring sound competition policy for big tech companies would help raise investment and productivity, and thus incomes.
- Canada will require strong incentives for abatement to achieve its climate targets. Multiple policies are now in place to decarbonise economic activity. Recent efforts to tighten carbon pricing rules should continue alongside planned increases in the carbon price floor. Subsidies play a role in spurring green technology take-up but should be reined in when cost-effective products emerge. Reform of electricity pricing could encourage energy saving with less need for additional government intervention.

Figure 1.1. Inflation, long-run economic growth and the environment are key issues

Year-on-year % changes

A. Consumer prices

Canada — United States — Euro area 19 — OECD

B. Real GDP per capita, at fixed PPPs and 2015 prices

USD thousand

Canada — United States — Euro area 19 — OECD

C. Total greenhouse gas emissions

Mt CO_2 eq.

Emissions pathway under current policies

2030 target: 40% emission reduction on level in 2005

Net zero

Note: in Panel C, the emission pathway under current polices is from *Greenhouse Gas Emission Projections*, May 2022, Environment and Climate Change Canada.

Source: OECD (2022), Main Economic Indicators (database); Quarterly National Accounts (database); Environment and Climate Change Canada.

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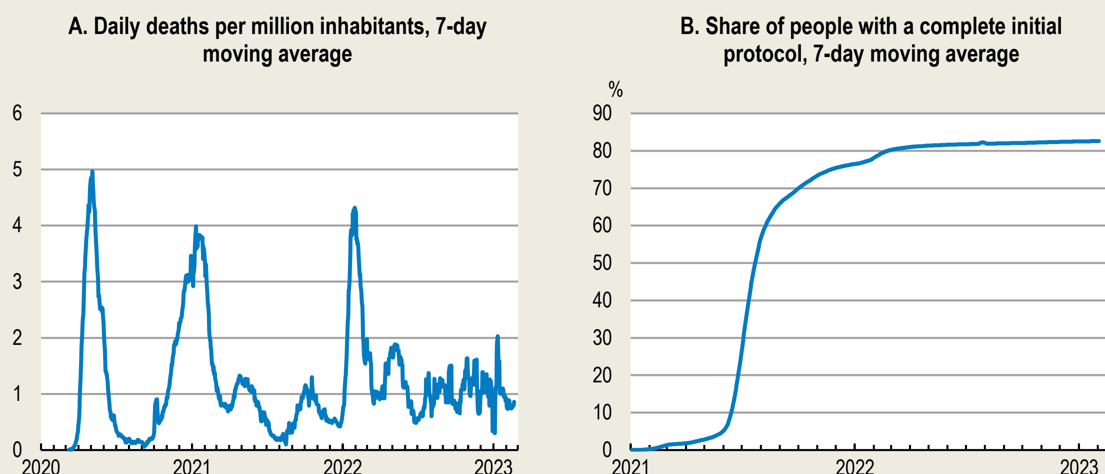
Box 1.1. COVID-19 in Canada and policy responses

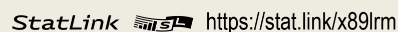
Canada's first cases of COVID-19 appeared in mid-January 2020. A substantial acceleration from early March followed, prompting the introduction of confinement measures. GDP fell by around 15% between February and April 2020. The Bank of Canada responded with policy-rate cuts and measures to bolster liquidity and financial markets. Macroprudential policy was used to help banks absorb potential losses. The federal government provided most of the financial support for households and businesses and imposed restrictions on international travel. The support contributed to limited economic scarring and damage to the labour market. Canada's decentralised system of government meant provincial, territorial and municipal authorities played a core role in tackling COVID-19. Health-care services are run by the provinces and territories, which also have jurisdictional powers to impose containment measures, such as restrictions on businesses and social distancing rules. Outbreaks of COVID-19 continue but related fatalities have stabilised at a comparatively low level (Figure 1.2). Over 80% of the population has a strong level of protection through vaccination.

Figure 1.2. COVID-19: fatalities and vaccination rate in Canada



Note: Panel B: Total number of people who received all doses prescribed by the initial vaccination protocol, divided by the total population of the country.

Source: Johns Hopkins University CSSE COVID-19 Data via Our World in Data.



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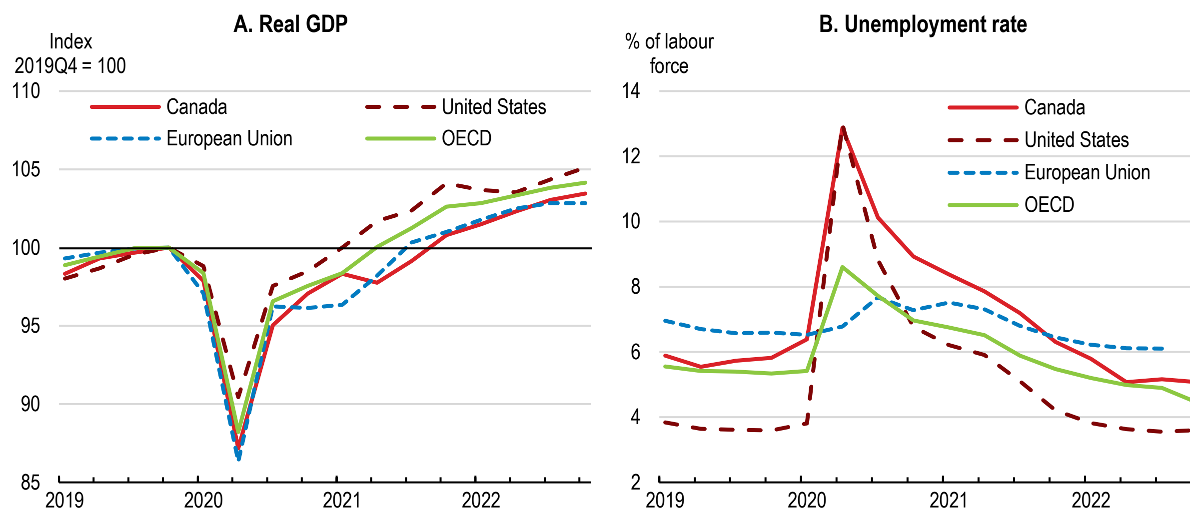
The economic outlook - inflation remains a key issue

Canada's level of economic output has recovered from the sharp dip that occurred during the COVID-19 crisis (Figure 1.3, Box 1.1). Output surpassed pre-pandemic levels in the second half of 2021, somewhat later than in the United States and partly reflecting Canada's relatively prolonged lockdowns. The labour market recovered rapidly. The rate of unemployment dropped from its peak in 2020 and by early 2022 it had hit record low levels. Vacancies have, however, since fallen amid larger-than-usual immigration flows from other countries. Canada ramped up permanent immigration programmes after borders re-opened and has provided a safe haven to a large number of Ukrainians fleeing Russia's invasion (Box 1.2).

Figure 1.3. Recent developments in output and unemployment



Source: OECD Economic Outlook (database).

Box 1.2. Canada's response to Russia's invasion of Ukraine

Sizeable commodity exports and limited direct ties to hard-hit economies have thus far shielded Canada from the worst economic effects of Russia's war against Ukraine. Canada exports commodities – including wheat, oil and natural gas –which rose in price in the initial months of the invasion.

Canada has been active in supporting Ukraine and in campaigning for tough sanctions on Russia. Additionally, it has introduced the Canada-Ukraine Authorization for Emergency Travel, which allows Ukrainians and their immediate family members to stay as temporary residents for up to three years. By November 2022, over 420 000 people (this is equivalent to roughly 1.1% of Canada's population) had received a visa through this pathway. Also as of November 2022, Canada has committed over CAD 5 billion in assistance to Ukraine, including CAD 2 billion in direct financial assistance, an additional CAD 500 million through the Ukraine Sovereignty Bond scheme, and more than CAD 2.5 billion in military, humanitarian, development and other assistance. Among other sanctions, Canada has banned Russian crude oil imports, revoked Russia's Most Favoured Nation trade status, and prohibited exports to Russia of certain goods, technologies and financial services.

Inflation has increased considerably since 2021, though less than in most OECD countries. Headline consumer-price inflation went well above 3% (the upper bound of the Bank of Canada's target range) in April 2021 and peaked at 8.1% in June 2022 (Figure 1.1). Wage growth has picked up, though from a low base (Figure 1.4). The price and wage pressures have prompted monetary tightening and government measures to ease impacts of cost increases on households and businesses (these are discussed in later sections). Initially, some of the price increases reflected bounce backs from very sharp dips in the initial months of the pandemic, notably in gasoline and other fuels. In addition, Canada has been affected by global supply-chain disruptions, including for grains and microchips, which pushed up the price of food and motor vehicles, respectively. China's supply-chain disruptions due to lockdowns also affected Canada. Meanwhile, strong increases in global energy prices linked to Russia's war against Ukraine have passed through to consumer and business costs. Energy price increases have boosted incomes for oil and gas producers.

In spring 2022 the Bank of Canada, operating under its renewed policy framework (Box 1.3), began reducing the monetary stimulus that had been introduced to support the economy during the COVID-19 crisis. In April 2022 the Bank started quantitative tightening, allowing its balance sheet to shrink by not replacing maturing bonds. Increase in policy rates commenced around the same time as in the United States, and earlier than in the euro area. As of January 2023, Canada's policy interest rate was 4.50%. As shown in Figure 1.1, headline inflation has begun to slow (in year-on-year terms), and core inflation has passed its peak (Figure 1.4). Monetary tightening is tempering demand. Survey evidence suggests inflation expectations one year ahead declined recently and those for five years ahead have remained stable and close to the Bank of Canada's target (Figure 1.4). The Bank should continue to shrink its balance sheet and stand ready to raise its policy rate as warranted to bring inflation sustainably back to target.

Figure 1.4. Wage growth has picked up while core inflation has passed its peak

A. Wage growth measures

y-o-y % changes

Fixed-weight measure, LFS
National accounts wage measure
Fixed-weight measure, SEPH

B. Core CPI inflation

%

Canada
United States
Euro area 19

C. Central bank key interest rate

%

Canada
United States
Euro area 17

D. Expected inflation at different horizons

%

1-year-ahead
2-year-ahead
5-year-ahead

Note: Panel A: LFS is the Labour Force Survey; SEPH is the Survey of Employment, Payrolls and Hours. The LFS fixed-weight measure is constructed using 2019 employment weights for wages based on employees' job status (full or part time), job permanency (permanent or temporary), industry of employment and occupation. The national accounts wage measure is constructed as total wages and salaries from the Canadian System of Macroeconomic Accounts divided by total hours worked from SEPH. Panel D: From the Business Leaders' Pulse survey (BLP), businesses are asked "What do you expect the rate of annual inflation to be in about one, two and five years from now?" BLP estimates use the midpoints of multiple-choice buckets, with values assigned to open-ended buckets (-1% and 9% for the "deflation" and "8% or higher" buckets, respectively).
Source: Bank of Canada; OECD (2022), OECD Economic Outlook (database); and OECD (2022), Main Economic Indicators (database).

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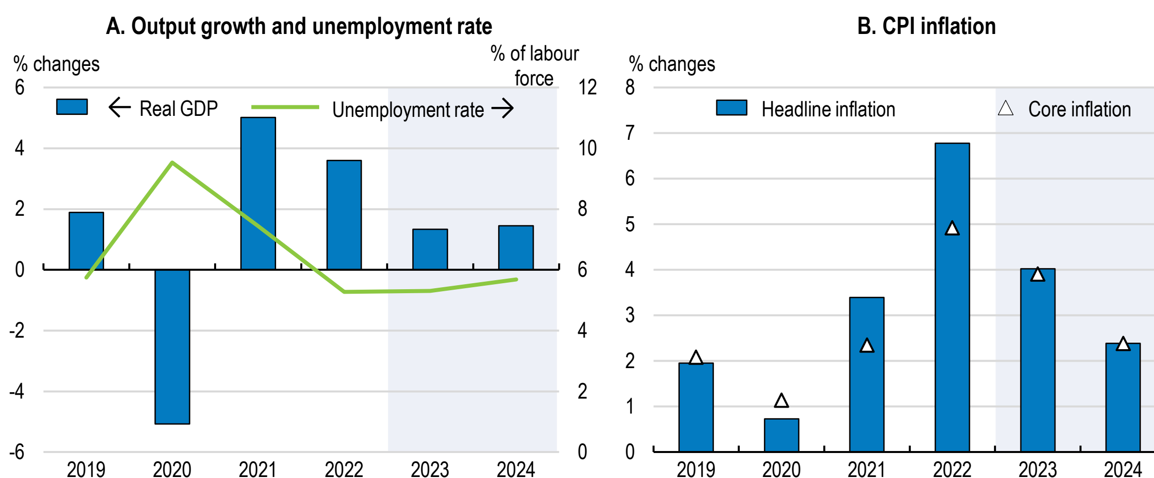
Fiscal policy support (discussed further below) has appropriately been withdrawn as Canada's economy has recovered from the pandemic. The termination of pandemic measures, recovery in tax revenues plus improvements in economic output and the labour market situation have driven substantial drops in the fiscal deficit since 2020, even as governments introduced new living-cost support for households facing high inflation. Deficit reduction is expected to continue in the coming years, which will complement the damping of aggregate demand through tighter monetary policy.

Box 1.3. Renewal of the monetary policy framework

Every five years, the Bank of Canada and the Government of Canada review and renew their agreement on Canada's monetary policy framework (Bank of Canada, 2021[1]). The review process is a strongpoint of Canada's monetary policy. It includes benchmarking the existing framework against alternatives to inflation targeting. The latest review used a combination of economic models, lab experiments and public consultations to evaluate the pros and cons of four alternatives: average inflation targeting; a dual mandate that targets both inflation and employment; targeting nominal gross domestic product - both its level and growth; and price-level targeting. It was concluded that the current system of flexible inflation targeting remained appropriate. The framework for the 2022-26 agreement remains centred on an inflation target of 2% inside a control range of 1 to 3%. However, there is now more emphasis on attaining maximum sustainable employment that is consistent with price stability.

Output growth is expected to continue to slow and then strengthen (Figure 1.5, Table 1.1). Real GDP growth is projected to be 1.3% in 2023 following estimated growth of 3.6% in 2022. Weaker conditions in the United States and other major economies will pull down export growth. Higher interest rates will continue to weigh on growth in housing investment and private consumption, despite support from population increases (Box 1.4). Business investment will continue to recover from low levels during the COVID-19 crisis, aided by expenditure on public transport systems as well as some large energy sector projects. Labour demand will ease with slower growth in production, causing employment growth to slow. GDP is projected to grow by 1.5% in 2024. Subdued domestic demand will be partly offset by strengthening export growth through the year as conditions in Canada's main trading partners improve (Box 1.5). Rising unemployment will check wage growth, helping to alleviate pressure on consumer prices.

Figure 1.5. Growth and inflation are projected to normalise



Note: Provisional economic forecast by the OECD in February 2023.
Source: OECD (2022), OECD Economic Outlook 112 database and OECD calculations.

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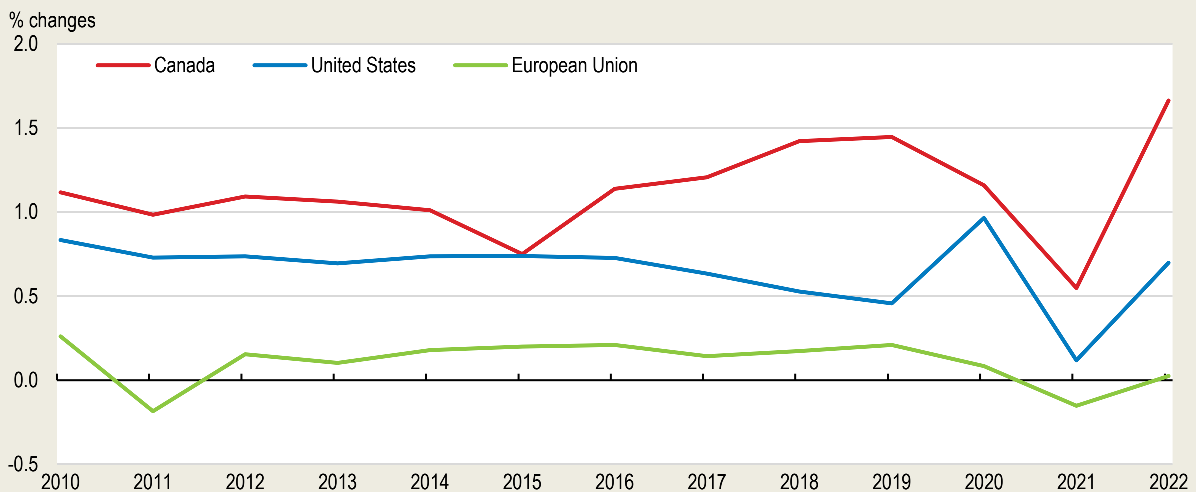
Box 1.4. Canada's population growth dipped during COVID but is set to recover

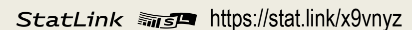
Canada's population continues to grow considerably faster than that of many other OECD countries, particularly those in Europe (Figure 1.6). Canada's pro-active immigration policy accounts for most of the difference. Since 2015, the federal government has significantly increased planned immigration levels. The pandemic brought a pause in migration and there has since been a strong recovery in inflows. In 2022, more than 430 000 immigrants (1.1% of Canada's current population of around 39 million) were expected and there are plans to reach 500 000 immigrants in 2025 (equivalent to 1.3% of today's population) (Government of Canada, 2022[2]). The goal is for the majority to be skilled workers with a view to addressing persistent labour shortages, including in healthcare, manufacturing, and the building trades.

Figure 1.6. Canada's population growth remains high compared with the United States and Europe

Total population



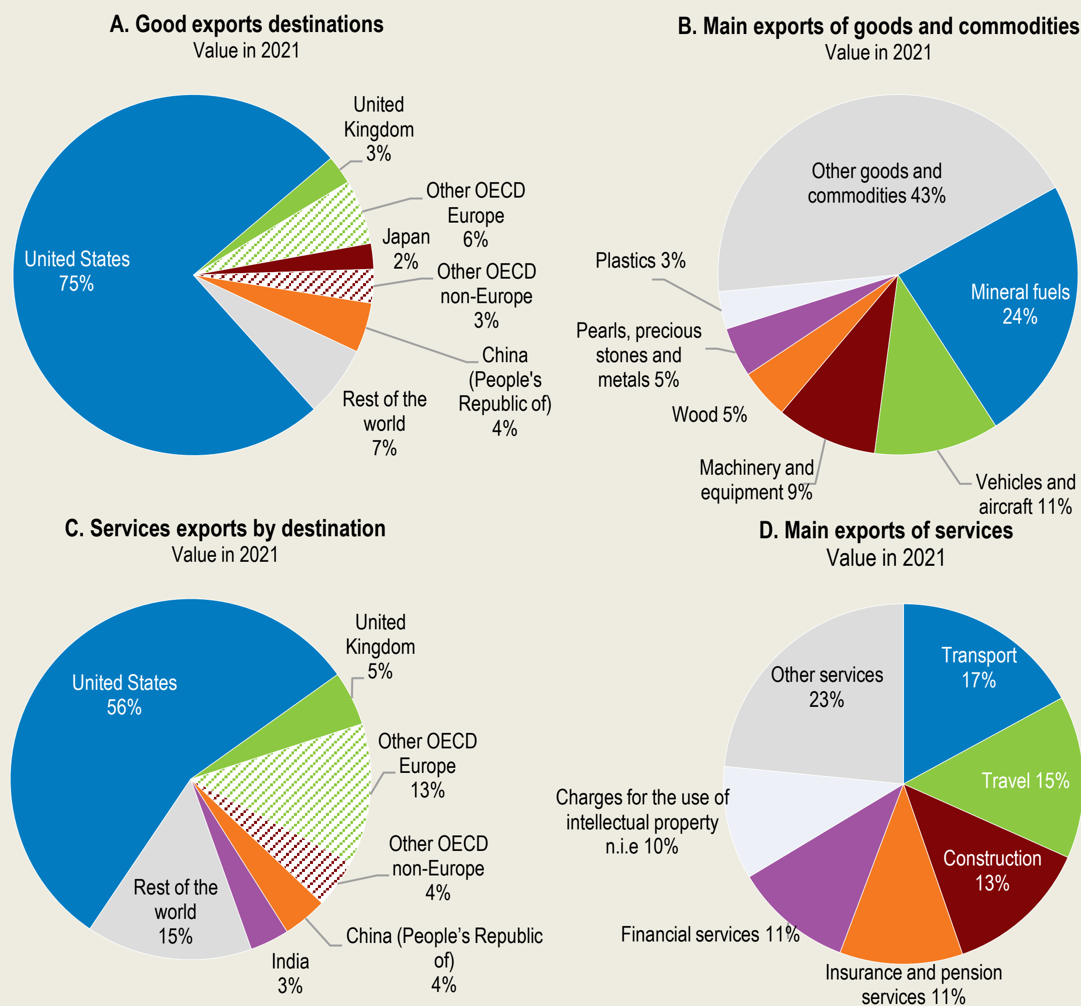
Note: Data for 2022 are estimates.
Source: OECD Population Statistics (database).



Box 1.5. Canada's composition and destination of exports

The United States remains Canada's most important trading partner, accounting for around three quarters of goods exports and around half of services exports as of 2021 (Figure 1.7). Direct exposure to European markets is limited but the influence of developments in Europe on global commodity prices has an indirect impact on Canada's exports. A large share of Canada's merchandise exports benefited from the increases in commodity prices seen in 2021 and 2022. Mineral fuels accounted for about a quarter of the nominal value of goods exports in 2021.

Figure 1.7. Exports by main destinations and types of goods and services



Note: Panel A and B: Data from the ITCS database are collected on the basis of the Harmonised System 2017; Panel C and D: Data from the ITSS database are collected according to the Balance of Payments methodology.
Source: OECD International Trade of Commodity Statistics (ITCS, database) and OECD International Trade in Services Statistics (ITSS, database).

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Table 1.1. Macroeconomic indicators and projections

	2019	2020	2021	2022	2023	2024
	Current prices (CAD billion)	Percentage change, volume (2012 prices)				
Gross domestic product (GDP)	2311	-5.1	5.0	3.6	1.3	1.5
Private consumption	1335	-6.1	5.0	4.7	1.3	1.5
Government consumption	479	1.3	6.4	1.4	1.1	0.7
Gross fixed capital formation	518	-2.4	7.4	-0.8	-1.0	1.5
Housing	175	5.0	14.6	-10.5	-7.6	1.3
Final domestic demand	2332	-3.8	5.8	2.7	0.7	1.3
Stockbuilding[1,2]	16	-1.6	1.1	2.5	0.2	0.0
Total domestic demand	2348	-5.4	7.0	5.2	1.0	1.3
Exports of goods and services	745	-8.9	1.4	2.5	2.5	1.9
Imports of goods and services	782	-9.3	7.8	7.7	1.4	1.4
Net exports[1]		0.3	-2.1	-1.6	-0.4	0.2
Other indicators (growth rates, unless specified)						
Employment	. .	-5.1	4.8	3.7	1.0	0.5
Unemployment rate (% of labour force)	. .	9.5	7.4	5.3	5.3	5.7
GDP deflator	. .	0.6	8.2	7.8	2.5	2.2
Consumer price index	. .	0.7	3.4	6.8	4.0	2.4
Core consumer prices	. .	1.1	2.3	4.9	3.9	2.4
Terms of trade	. .	-3.3	14.2	6.0	-3.1	-0.5
Household saving ratio, net (% of disposable income)	. .	13.9	10.7	6.2	5.4	4.7
Trade balance (% of GDP)	. .	-2.2	0.0	0.2	-0.5	-0.5
Current account balance (% of GDP)	. .	-2.2	0.3	-0.6	-1.5	-1.5
General government fiscal balance (% of GDP)	. .	-10.9	-4.4	-0.6	-0.1	0.1
Underlying general government fiscal balance (% of potential GDP)	. .	-6.1	-2.8	-0.6	-0.3	-0.3
Underlying government primary fiscal balance (% of potential GDP)	. .	-5.7	-3.4	-0.9	-0.1	0.1
General government gross debt (% of GDP)	. .	129.2	120.9	113.2	112.6	111.8
General government net debt (% of GDP)	. .	26.0	21.2	19.6	19.0	18.3
Policy interest rate (end of period)		0.3	0.3	4.3	4.5	3.8
Three-month money market rate, average	. .	0.6	0.2	2.6	4.6	4.3
Ten-year government bond yield, average	. .	0.8	1.4	2.8	3.4	3.1

1. Contributions to changes in real GDP, actual amount in the first column.
2. Including statistical discrepancy.
Note: Provisional economic forecast by the OECD in February 2023.
Source: OECD (2022), OECD Economic Outlook 112 database and OECD calculations.

The risk profile of Canada's economic outlook has changed in recent quarters. As an energy producer, Canada benefits from oil and gas price rises, but is nevertheless subject to inflationary pressures from them. The increase in interest rates in response to high consumer-price inflation has contributed to a softening of the housing market, following the very large price increases in recent years. Higher interest rates also imply a shift in the risk-return trade-off for financial-market portfolios. However, these housing-market and financial-market adjustments may turn sour (Table 1.2). The possibility of new COVID-19 outbreaks leading to widespread lockdowns and a large drop in economic activity has receded considerably, though cannot be discounted completely. The possibility of highly disruptive extreme weather events that have substantial national economic impact represents another risk to the outlook.

The following sections consider uncertainties around household consumption spending, the evolving risks around the housing market and mortgage lending and emerging concerns about fixed-income markets in the financial sector.

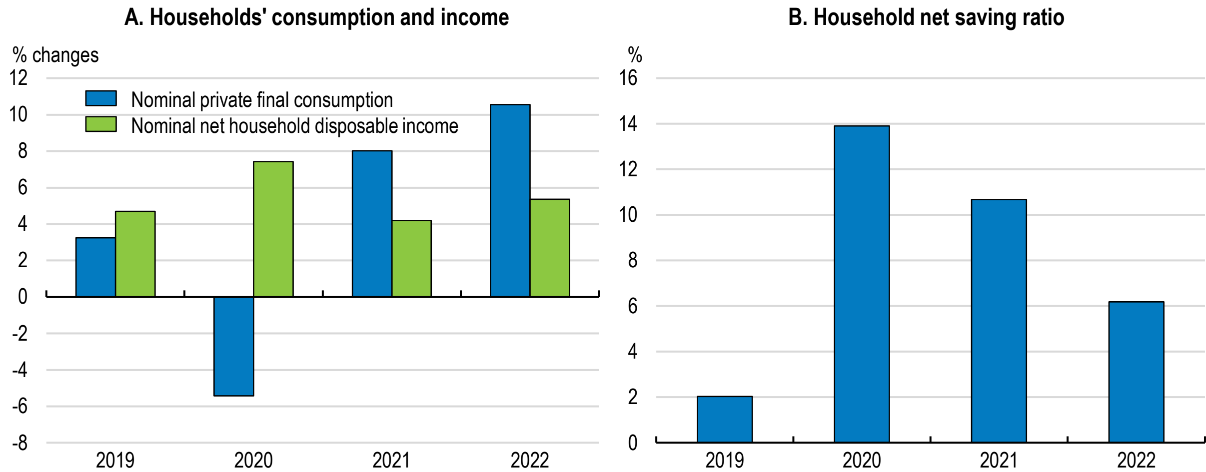
Table 1.2. Events that could entail major changes to the outlook

Shock	Likely impact	Policy response options
Destabilising wage-price spiral; high wage and price growth becomes self-sustaining.	Extremely elevated uncertainty for households and businesses, significant relative price distortions, negative impact on real GDP.	A greater degree of monetary policy tightening.
Further large increase in energy and commodity prices, for instance due to deepening disruptions to supply in Europe.	Additional cost increases for households and energy-intensive businesses. Further gains for energy and commodity producers.	Extension and re-targeting of support schemes. Greater efforts to increase fiscal revenues from the extraordinary rents from those sectors benefitting from the price increases.
The softening of the housing market turns into a hard landing with very sharp declines in prices.	Reduced residential investment and diminished household consumption, inter alia due to wealth effects or reduced equity extraction are the most likely channels.	Central-bank emergency measures to support liquidity and financial markets, especially mortgage markets. Measures to reduce risks of future problems, including macro-prudential measures.
Financial asset price corrections overshoot and destabilise markets.	Deepened economic downturn from negative wealth effects, reduced business confidence and investment, potentially also destabilised financial sector.	Fiscal and monetary measures to support demand.
A return to a prolonged and deep lockdown due to new variants of COVID-19 that, despite vaccination, require dramatic steps to contain contagion.	Renewed containment measures could see substantial fall in economic activity, with deeper scarring in shutdown-vulnerable sectors that could increase risk of a sluggish recovery and prolonged socio-economic damage.	Central bank re-evaluates monetary policy stance. Re-introduction of government support for households and businesses.
Highly disruptive extreme weather events such as flooding or heatwaves associated with climate change.	Disruption to transport linkages, output in agriculture and other industries, and supply of essential goods and services, loss of life.	Greater resources for early warning systems and emergency response services. Improved knowledge informed by climate science and forecasts. Investment in preventative measures.

Uncertainty around consumer spending remains elevated

The evolution of consumer spending remains highly uncertain and important for the overall economic outlook given the substantial weight of household consumption in GDP (around 55%). During the initial phase of COVID-19, consumption shrank, while household incomes rose substantially, largely thanks to transfers from government (Figure 1.8). Consequently, the household saving ratio increased. It later declined with the normalisation of consumption, higher inflation and withdrawal of fiscal support. However, increased interest rates, softening house values, and uncertainty in the outlook for employment will likely cause households to become more cautious. These considerations are factored into this *Survey*'s baseline economic projections (Table 1.1) but the range of plausible outcomes in household consumption growth is wide.

Figure 1.8. The household saving ratio has declined from peak levels



Note: Data for 2022 are estimates.
Source: OECD Economic Outlook (database).

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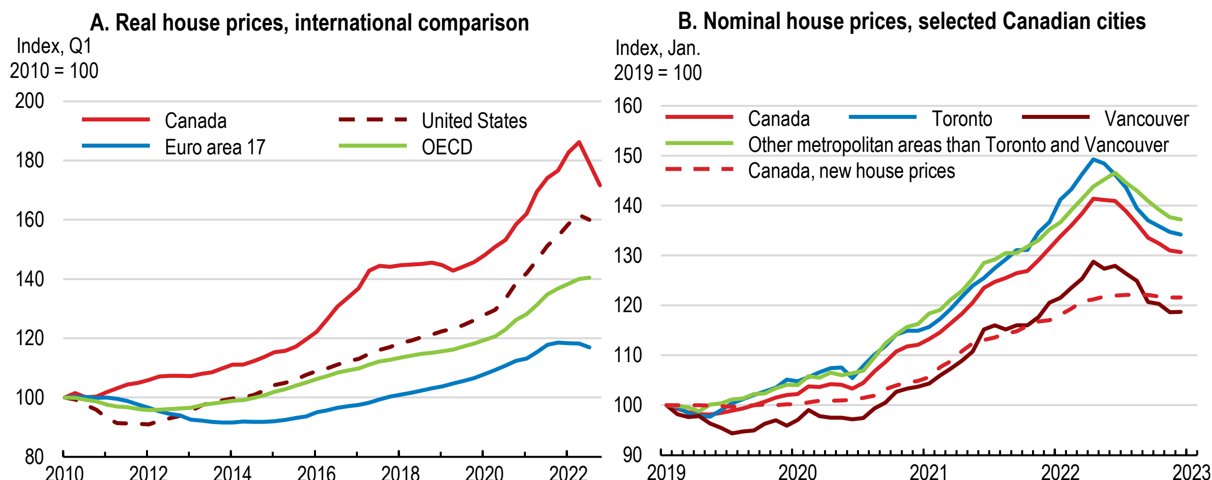
The softening of the housing market brings new risks related to the household sector

The softening of the housing market, prompted by rising interest rates, is welcome and the financial system is expected to remain resilient. That said, rapidly rising house prices and mortgage borrowing during the pandemic further amplified Canada's longstanding vulnerabilities in this domain. Prior to the pandemic, Canada's real house prices had already increased more than in the United States and Europe (Figure 1.9). The softening of prices began in spring 2022 and among Canada's biggest cities has been particularly pronounced in Toronto. Nevertheless, the steep price increases earlier on mean that many homeowners have still seen large gains in the value of their properties. The aggregate household debt burden remains among the highest in the OECD; other countries with substantial burdens include Australia, Denmark, Norway, the Netherlands and Sweden (Figure 1.10). So far, for Canada aggregate-level data indicate no issue with debt servicing. Indeed, the household debt service ratio has notched down post-pandemic (Figure 1.10). Also, limited increase in household financial stress in energy-intensive provinces when the oil price collapsed in 2014 suggests the risk of significant problems from defaults may be low (Box 1.6). However, more granular Bank of Canada data show increasing levels of stretched finances among households. In the years prior to the pandemic, less than 5% of mortgages were issued with the combined characteristics of a loan-to-income ratio of more than 450%, variable interest and an amortisation longer than 25 years. By the first quarter of 2022, 15% of mortgages issued had these features (Bank of Canada, 2022[3]). Also, an increasing number of borrowers on variable-rate mortgages are reaching a point where fixed-payment arrangements could end (the so-called trigger rate, Box 1.7), resulting in an increase in payments.

Figure 1.9. Canada's housing market has softened after steep price increases



Source: Panel A: OECD Economic Outlook database; Panel B: Teranet-National Bank of Canada House Price Index (housepriceindex.ca), except "Canada, new house prices" which are Statistics Canada data.

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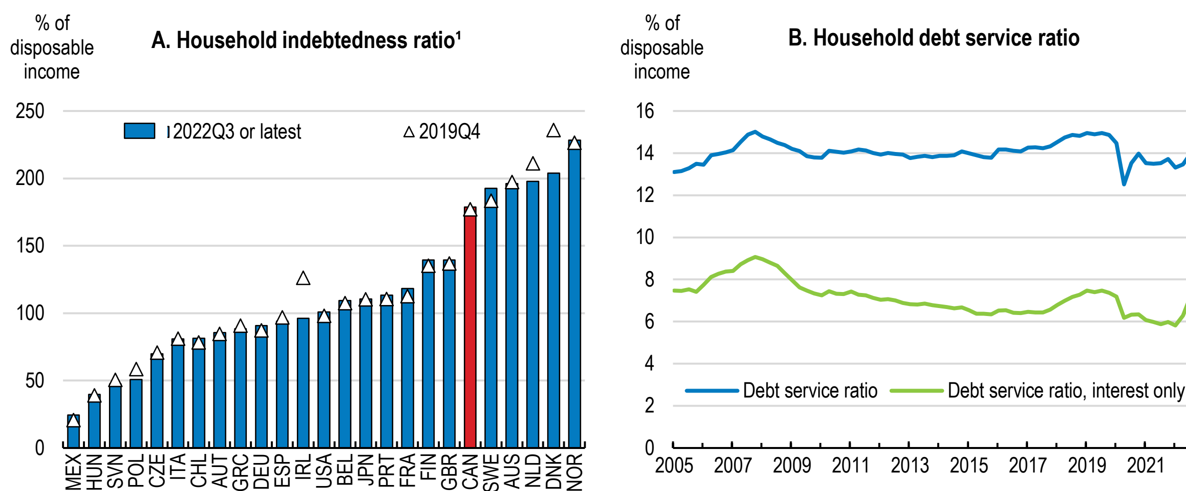
Figure 1.10. Household indebtedness remains high, but debt servicing burdens are stable



1. Total household outstanding debt as a percentage of household gross disposable income.
Source: OECD, National Accounts - Household Dashboard database; and Refinitiv, Datastream.

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Box 1.6. Borrowers' financial stress in the wake of the 2014 oil-price collapse

In 2014 global oil prices collapsed, triggering an economic downturn in the energy-intensive provinces of Alberta, Saskatchewan and Newfoundland and Labrador. For instance, the rate of unemployment in Alberta increased from 4.7% in 2014 to 8.2% in 2016. A Bank of Canada study (Bilyk, Chow and Xu, 2021[4]) using historical banking microdata has explored the impact on households' financial stress following the oil-price collapse in these regions relative to the rest of Canada.

In the study, a household is counted as under stress if it was behind on payments for at least 60 days in any credit category at any point within the first three years of obtaining a mortgage. Prior to the oil-price collapse, around 2.5% of households were in financial stress according to this definition. In the years following the collapse, in the energy intensive regions the share averaged around 3%, while it averaged around 2.3% in the rest of Canada. This suggests that even with a fairly large economic shock, the numbers of those in financial stress remain fairly limited.

The study found that among a number of mortgage characteristics, the loan-to-value (LTV) ratio was the strongest predictor of household financial distress. For instance, in the insured mortgage market, the probability of experiencing stress within the first three years of taking on a mortgage increases by 2.9 percentage points when comparing mortgages that have an LTV ratio of 95% with those that have an LTV ratio above 80 but below 95%.

Box 1.7. Canada's variable-rate mortgages with fixed payments: the trigger rate

According to Bank of Canada research (Murchison and teNyenhuis, 2022[5]) variable-rate mortgages currently account for about one third of total outstanding mortgage debt, up from about 20% at the end of 2019. Around three-quarters of variable-rate mortgages have fixed payments; when interest rates move, the amount of the mortgage payment does not change, but the portion going toward interest (rather than principal) is adjusted. If interest rates increase substantially, these mortgage borrowers can reach a point where their fixed payments cover only interest and not any principal. The interest rate at which this happens is known as the trigger rate. If rates rise above the trigger rate, some borrowers may then need to increase mortgage payments to cover the additional amount of interest. For some households, this payment increase may be unexpected. Of note, most borrowers have been stress tested for higher interest rates via the minimum qualifying rate for both uninsured and insured mortgages. The Bank of Canada research estimates that as of end October 2022 about 50% of variable-rate mortgages—or nearly 13% of all Canadian mortgages—had already reached their trigger rate.

Assessments of financial-sector resilience continue to suggest that banks and other mortgage lenders are in a good position to handle adverse scenarios. According to a stress test conducted in the second half of 2021 by the Bank of Canada, a 5.8% drop in GDP lasting 18 months would bring significant financial losses for the banking sector but would not lead to insolvencies (Bank of Canada, 2022[3]). The sector's resilience has been bolstered by the measures taken in the wake of the global financial crisis, such as increased capitalisation requirements. Also, without the macro-prudential measures of recent years to temper the housing market, such as tighter loan-to-value caps and debt-servicing stress-test requirements, banks' risk exposure would likely have been greater. Recent proposals to tighten such measures, if implemented, suggest further containment of risk for banks, and households (Box 1.8).

Box 1.8. Recent proposals for strengthening residential mortgage underwriting

In January 2023 Canada's *Office of the Superintendent of Financial Institutions* proposed measures for initial public consultation that, if implemented, would strengthen federally regulated lenders' assessments of debt serviceability and residential mortgage risk management. Feedback from this initial consultation (the closing date is April 14, 2023) will inform proposed revisions to Guideline B-20 (*Residential Mortgage Underwriting Practices and Procedures*), which will be issued for public consultation in the form of a draft guideline at a future date.

Federally regulated lenders can operate across provincial jurisdictions and hold nearly 80% of all residential mortgages in Canada. The proposals include:

- A loan-to-income (LTI) restriction. The proposal is for a maximum LTI threshold of 450%, with lenders allowed a 25% quarterly volume limit on originations that exceed this threshold.
- Clearer debt-servicing limits for uninsured mortgages. Establishing clear limits on Gross Debt Service (GDS) (housing debt only) and Total Debt Service (TDS) (all household debt) ratios for the "uninsured" mortgage segment, similar to current limits for the insured segment. As with the LTI proposal, these limits are proposed to apply on aggregate loan volume. (The uninsured segment comprises mortgages for properties costing more than CAD 1 million or with down payments of 20% or above.)
- Expansion of interest-rate affordability stress tests, including an expectation that lenders apply a minimum qualifying rate to a borrower's total debt service, in addition to gross debt service.

Source: Office of the Superintendent of Financial Institutions, *Public consultation on guideline B-20: Residential Mortgage Underwriting,* January 2023.

Nevertheless, the softening of the housing market may have greater negative consequences for the economy than anticipated in projections. Homeowners' consumption expenditure may diminish more than expected in reaction to declining housing prices. The softening itself may prove more severe than projected, with lower prices leading to deeper problems for mortgage holders and financial problems for the construction sector.

Structural improvement to the mortgage market should still be sought. A recent study (Emenogu and Peterson, 2022[6]) underscores that the presence in Canada of unregulated mortgage lending via shadow banks can weaken the impact of the macroprudential and monetary policies on house prices, household debt and output (shadow banks are mortgage investment corporations and other lenders that issue uninsured and non-conforming mortgages that operate outside the purview of any prudential supervision). Model simulations suggest increased demand for unregulated mortgages when monetary policy is tightened, an issue of relevance given the policy-rate increases in recent quarters. Past *Survey* recommendations to closely monitor the unregulated mortgage sector still apply. Even so, the share of the residential mortgage market held by shadow banks remains low. Over 70% of mortgages are issued by federally regulated financial institutions and a large part of the remaining 30% is issued by provincially regulated credit unions. Previous concern about the government-backed Canada Mortgage and Housing Corporation (CMHC) playing an overly large role in the mortgage insurance market has diminished (Table 1.3).

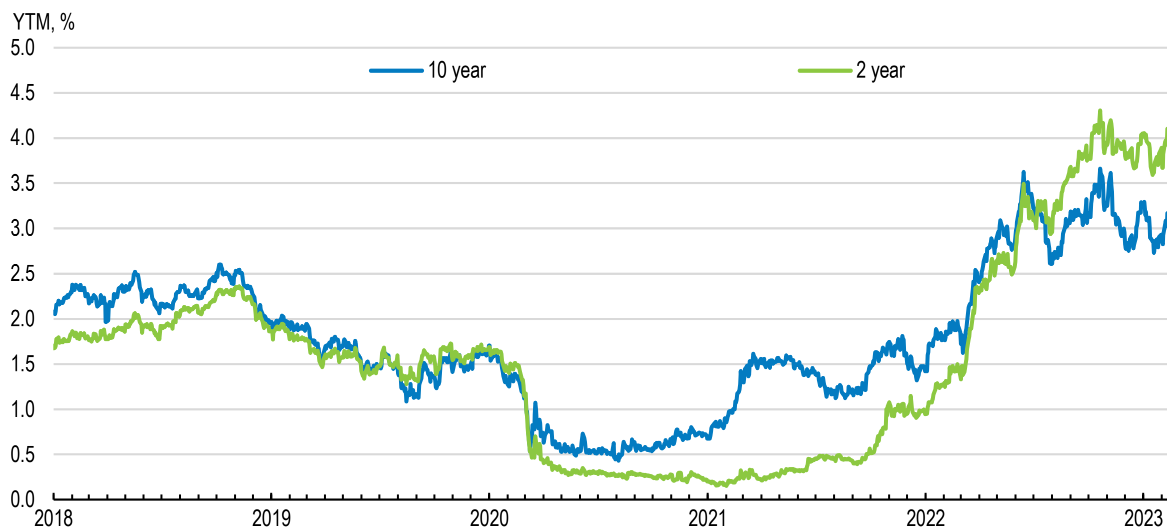
In addition, policymakers should continue working toward greater flexibility of housing supply and actively seek to increase supply for the affordable housing segment. The strong focus on these issues in Budget 2022 (Government of Canada, 2022[7]) is welcome (see discussion on welfare issues below). Effective reform would help avoid the price surges seen in the past and make housing more affordable.

Volatility and high rates in fixed-income markets are of concern

Echoing developments in some other economies, there is growing concern about volatility and reduced liquidity in fixed-income markets (Bank of Canada, 2022[3]). These markets are critical for Canada's asset management sector, which includes investment funds, pension funds and insurance companies. The sector has grown substantially over the past decade or so and portfolio composition typically moved to a greater share of riskier, less-liquid assets. This has raised the importance of trading the liquid end of portfolios, notably fixed-income assets, as a means of meeting cash needs. A sudden demand spike in the demand for cash could entail a destabilising sell-off in fixed-income assets. Exemplifying the volatility concerns around the fixed-income markets, the increase and fluctuation in medium-term bond yields has been especially dramatic in recent months (Figure 1.11). Yields have, at times, exceeded the policy rate by a sizeable margin and have also been greater than those of long-term bonds (thus, the yield curve has been inverted).

Meanwhile, risk associated with financing via high-risk bonds, an issue raised in previous *Surveys,* can be downgraded. The *Surveys* highlighted growth in corporate financing through bonds and leveraged loans, expressing concern that firms relying on these instruments may be vulnerable to sharp repricing of assets resulting in difficulties in debt roll-over. Recent Bank of Canada analysis points to a slowdown in issuance of high-yield bonds by Canadian businesses (Bank of Canada, 2022[3]). This, *inter alia*, may reflect higher borrowing costs with rising interest rates. Also, recent research using firm-level data suggests a diminished need for concern. It appears businesses using high-yield debt markets have wider access to a broader range of alternative financing than previously thought. Many high-yield bonds have several years to maturity and anyway comparatively few firms rely on this type of bonds (10% according to the study) (Bank of Canada, 2022[3]).

Figure 1.11. Short-term bond yields have increased sharply over the past two years



Source: Refinitiv, Datastream.

https://stat.link/ywgpob

Table 1.3. Past OECD recommendations on financial-sector regulation and actions taken

Recommendations in past *Surveys*	Actions taken since the previous *Survey*
Co-ordinating financial regulation	
Extend participation in Cooperative Capital Markets Regulatory System.	The body ceased active operations in January 2022. Membership at this moment comprised: British Columbia, New Brunswick, Ontario, Nova Scotia, Prince Edward Island, Saskatchewan, the Yukon and Canada.
Mortgage-borrowing oversight and regulation	
Tighten mortgage insurance to cover only part of lenders' losses in case of default. Keep increasing the private-sector share of the market by gradually reducing the cap on the Canada Mortgage and Housing Corporation CMHC insured mortgages.	Concern about the extent of federal government involvment in mortgage markets via CMHC has diminished as CMHC's market share of mortgage insurance has fallen considerably following a tightening of rules about eligibility for its insurance in 2020 (other insurers did not follow suit). The size of the insured market has also shrunk over time, in particular due to the maximum insurable house value set at $1 million.
Monitor the unregulated mortgage-lending sector more closely to improve understanding of risk exposures. Bolster cooperation and information sharing between federal and provincial financial regulators.	The Canadian authorities are continuously monitoring shadow-banking entities, including through their participation in the Financial Stability Board's information-sharing exercises.

Rebuilding fiscal buffers

Despite new spending commitments, including financial support for Canadian households in the face of rising living costs, fiscal balances are expected to have improved in 2022 (Figure 1.12, Table 1.5). Playing a key role have been the unwinding of COVID-19 tax and spending measures and the recovery in revenues as lockdowns and other constraints were lifted. Revenue boosts from higher commodity prices have also bolstered fiscal balances, substantially in some provinces. The government of resource-rich Alberta revised up estimates of revenues for budget year 2022-23 by CAD 14.3 billion in their mid-year fiscal update, which is equivalent to around 0.5% of Canada's GDP (Government of Alberta, 2022[8]). Commodity price increases and general high price inflation have also meant more rapid nominal GDP growth, helping drive down deficit and debt burdens. The consolidated fiscal deficit across all levels of government (Figure 1.12), peaked at 11.4% of GDP in 2020 but is estimated at 0.6% for 2022. The expected deficit outturn for 2022 is lower than those of the United States and the European Union and implies reductions in gross and net public debt burdens (Figure 1.13). Net debt is a better measure for assessing long-term fiscal sustainability, especially in the case of Canada, which appropriately recognises and funds most of its public pension future liabilities, in contrast to some other countries (Box 1.9).

Box 1.9. Measuring Canada's public debt

Reporting and policy debate on public debt within Canada typically centres on net debt. Gross debt is a poor metric to compare the long-term fiscal sustainability of countries like Canada, that have well-funded social security schemes and significant financial assets. Canada's debt measures (both gross and net) include assets and liabilities relating to pensions, as appropriate. This reflects good accounting practice and efforts to ensure long-term fiscal sustainability. According to Statistics Canada data (Table 1.4), as of the third quarter of 2022 Canada's consolidated financial assets were equivalent to 98% of GDP while liabilities stood at 120% of GDP, implying a consolidated net debt (negative net financial worth) of 22% of GDP. OECD analysis typically focuses on consolidated gross debt because of a lack of generally accepted and (in some countries) poor practices in valuing assets. To strengthen comparability of gross debt, the unfunded public-sector pension liabilities that appear in some countries' accounts are stripped out. However, this adjustment does not fully resolve the issues affecting international comparisons.

Table 1.4. Canadian government financial assets and liabilities, position as of Q3 2022, % GDP

	Consolidated government	Federal government	Provincial and territorial government	Local government	Canada Pension Plan (CPP) and Quebec Pension Plan (QPP)
Financial assets	98	24	39	7	28
Currency and deposits, financial assets	8	3	2	2	0
Debt securities, financial assets	16	0	8	1	6
Loans, financial assets	22	11	8	0	2
Equity and investment fund shares, financial assets	30	3	10	0	17
Insurance and pension schemes, financial assets	6	2	4	0	0
Other accounts receivable, financial assets	16	5	7	2	3
Liabilities	120	56	49	9	5
Currency and deposits, liabilities	0	0	0	0	0
Debt securities, liabilities	81	43	34	2	2
Loans, liabilities	7	0	3	2	2
Equity and investment fund shares, liabilities	0	0	0	0	0
Insurance and pension schemes, liabilities	12	6	6	0	0
Other accounts payable, liabilities	19	6	7	4	2
Net financial worth	-22	-31	-11	-2	23

Note: Asset and liability values are from Statistics Canada table 10-10-0015-01 (formerly CANSIM 385-0032). A value of CAD 2 812 billion was used as the denominator. The Canada Public Pension Plan (applies across Canada except Quebec) and the Quebec Pension Plan form Canada's first-pillar pension support. The consolidated values in this table equate with the sum of the components (Federal, Provincial and territorial, Local government and pension schemes).
Source: OECD calculation based on Statistics Canada data.

Improving fiscal balances at a continuing rapid pace in the coming years will be more challenging. The elevated economic uncertainties suggest downside risk for revenue growth. Also, there is upside risk to spending. There may be further price shocks that require prolongation of support to households (see welfare section below). New large multi-year reforms, including in childcare and affordable housing measures (discussed further below) have added budgetary pressure. The continued deficit reduction envisaged in the federal government's recent budgets (Budget 2022, published in April 2022 and the Fall Economic Statement, November 2022) relies heavily on offsetting revenue increases and spending savings (Figure 1.14). However, the spending savings have not been detailed in the budgets, making it difficult to assess the challenges in implementation (discussed further below).

Figure 1.12. Canada's general government deficit is unwinding relatively fast

2019 2020 2021 2022

A. Net general government deficit

% of GDP

Canada United States OECD EU22

B. General government spending

% of GDP

Canada United States OECD EU22

C. General government revenue

% of GDP

Canada United States OECD EU22

Note: Data for 2022 are estimates.
Source: OECD Economic Outlook 112 database; and OECD calculations.

https://stat.link/tjku2v

Figure 1.13. Canada's gross and net debt burdens have started to decline

Notes: Panels A and B. Gross debt in these figures is aggregate consolidated debt across federal, provincial and territorial governments (as appearing in the national accounts). Panel C. The baseline assumption of a zero primary fiscal balance is based on the observation that in the five years before the COVID-19 pandemic (2015-2019) the fiscal balance averaged 0.1% of GDP. A downward adjustment is applied in the projections to account for additional costs relating to population ageing. OECD estimates of spending pressure over the long run suggest that by 2060, health, pension and other spending pressures will have added costs equivalent to 5% of GDP, equivalent to 0.125% of GDP per year (Guillemette and Turner, 2021[9]).
Source: OECD Economic Outlook 112 database; Statistics Canada and calculations based on OECD Economic Outlook database.

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Table 1.5. Recent fiscal consolidation reflects an easing of spending growth relative to growth in revenues and nominal GDP

Per cent of GDP

	2019	2020	2021	2022[1]
Total revenue	40.7	41.6	41.0	39.1
Income tax	16.3	17.3	16.7	16.2
Social contributions	4.6	4.8	4.7	4.5
Other receipts	19.7	19.5	19.6	18.3
Total expenditure	40.7	53.0	46.0	40.8
Of which:				
Government consumption	20.7	22.7	21.7	20.7
Social transfers	11.0	17.2	13.7	11.0
Gross fixed capital formation	3.5	4.1	3.6	3.9
Gross interest payments	3.0	3.0	2.7	2.8
Budget balance				
Fiscal balance	0.0	-11.4	-5.0	-1.7
Primary fiscal balance[2]	0.1	-10.9	-5.5	-1.3
Cyclically adjusted fiscal balance[3]	0.0	-6.5	-3.1	-1.2
Underlying primary fiscal balance[3]	0.2	-6.0	-3.5	-0.8
Public debt				
Gross debt (national accounts definition)[4]	92.9	126.9	118.7	111.6
Gross financial assets (CAD tens of billions)	171.2	214.1	238.1	248.2
Net debt	18.8	29.9	23.2	22.5

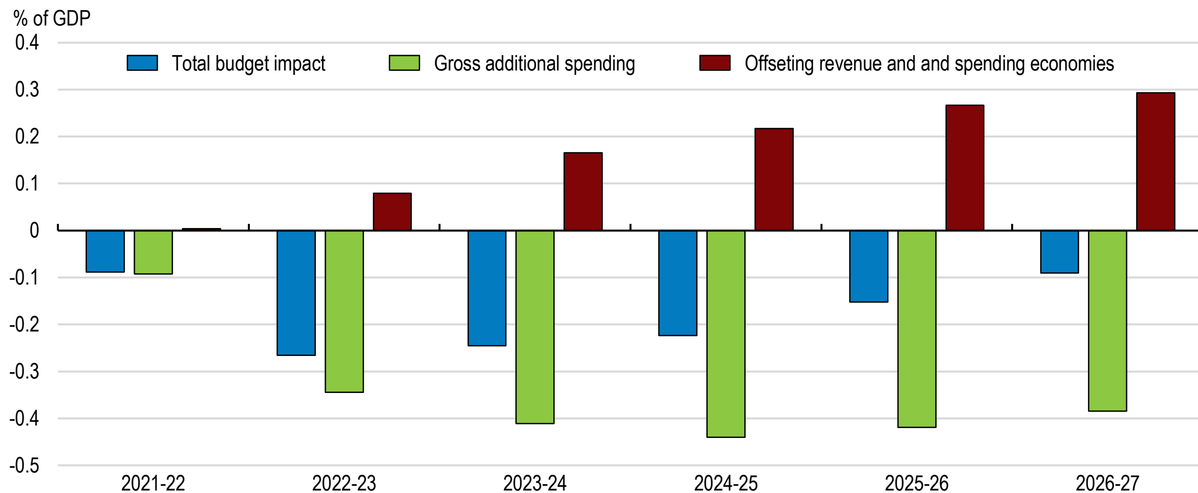
1. OECD estimates unless otherwise stated.
2. The primary balance is the net fiscal balance excluding net interest payments. Other definitions exist, such as the primary balance published by the European Commission, which excludes only interest paid.
3. As a percentage of potential GDP.
4. National Accounts definition includes state guarantees, among other items.
Source: OECD Economic Outlook 112 (database).

Despite these challenges and risks, in the absence of a major downturn, fiscal policy needs to aim for continued improvement in budget balances in the coming years. Deficit reductions mean fiscal policy is working in the same direction as the current contractionary stance of monetary policy. Also, ensuring deficits are sufficiently low to bring reductions in the public debt burden helps rebuild fiscal buffers for future shocks. To this end, maintaining a credible medium-term plan for controlling and lowering federal government debt is important. Specific to the recent macroeconomic context, priority should be given to re-channelling the strong resource revenues toward reducing public debt, or in the case of some provinces, towards stabilisation funds (see below).

Fiscal policy also needs to continue accommodating the long-run fiscal headwinds from population ageing. OECD estimates of spending pressure over the long run suggest that by 2060, health, pension and other spending pressures will have added costs equivalent to 5% of GDP (Guillemette and Turner, 2021[9]). This figure is smaller than those estimated for many other economies and represents a fiscal headwind of around 0.1 percentage points of GDP each year. Pressure for more healthcare spending mainly affects provincial and territorial budgets. Though Canada’s pension system is more self-funding than many, pressures from population ageing on fiscal balances will arise from spending commitments on first-pillar pensions.

Figure 1.14. Measures proposed in Budget 2022 implied increased net public spending

Impact of new measures proposed in Budget 2022, as % of GDP



Note: OECD projections of nominal GDP are used for the denominators.
Source: Based on Table 1 of Budget 2022: A Plan to Grow Our Economy and Make Life More Affordable.

https://stat.link/ix6b41

Long-run scenarios illustrate the sensitivity of the public-debt burden to fiscal strategy and economic conditions. The public debt burden will continue on a downward track if, for instance, output growth trends at 1.7%, a zero primary fiscal balance is maintained and if borrowing costs average 3% and inflation averages 2%. Faster growth and maintenance of a fiscal surplus would see a faster decline in the debt burden. In contrast, with lower average growth and a persistent primary deficit, the public-debt burden could rise. Higher borrowing costs would exacerbate any problems.

Structural reforms to taxation and public spending can help governments continue financing important spending commitments and cope with the long-term pressures on budgets. Reforms can also boost growth potential. Canada's government spending and revenue levels are close to the OECD average. For 2022, the value of total government revenues is estimated to be 39% of GDP, and disbursements are estimated to be around 41% (Figure 1.15). These values are somewhat above those for the United States and Australia, for instance, but well below those of some other OECD economies, including France and the Nordic countries. Canada's relative position suggests an absence of widespread problems relating to under-funding, or excessive resourcing and heavy taxation. Nevertheless, there will be scope to improve tax and spending efficiencies. The following sections examine developments in windfall taxation, scope for tax-mix improvement and measures to improve the efficiency of public spending.

Figure 1.15. Canada's government revenue and spending are similar to the OECD average

2022, % of GDP

A. Government revenues

Income tax and social security | Indirect tax | Other income

B. Government disbursements

Expenditure on goods and services | Expenditure on investment | Social security payments | Other disbursements

Note: For Norway, as % of mainland GDP.

Source: OECD (2022), OECD Economic Outlook 112 (database).

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Windfall revenues could be handled better

Windfall gains in some sectors of the economy have prompted moves to impose additional taxation. The federal government has introduced the temporary Canada Recovery Dividend, a special tax on banks and life insurers groups, on the basis of large profits during COVID-19 (Table 1.7) (the Dividend is a 15% levy on a group's average taxable incomes in 2020 and 2021 above CAD 1 billion). In addition, the federal government is permanently imposing a supplementary rate of corporate tax (16.5% instead of 15%) on these financial institutions when taxable income exceeds CAD 100 million. Although proposed by some, the Canadian government has not moved to impose a windfall tax on the energy sectors in reaction to the high commodity prices experienced in recent quarters.

Provincial jurisdiction over resource and energy-sector royalties and a variety of resource-sector ownership arrangements potentially complicates the imposition of country-wide windfall taxation. In some provinces,

the public ownership of energy or natural resources means windfall revenues are channelled directly into government budgets as well as via taxation. One province, Saskatchewan, made a one-off payment in fall 2022 of CAD 500 to all citizens over 18, passing along some of the provincial government's windfall revenues linked to commodities production (including oil). While being a simple and direct way of channelling extra revenue back to the population, it would be inefficient if intended as a poverty reduction measure.

The large increase in resource revenues experienced in 2021 and 2022 should be a prompt for provinces to check whether their standard royalty regimes appropriately handle such events, and are also fit for purpose on other fronts (including ensuring they are aligned with green transition objectives). Some reforms are already underway. In 2022, British Columbia began a two-year transition to a new royalty regime that includes a windfall mechanism. Once revenues from a production facility exceed its capital costs for development, a price-sensitive royalty rate between 5% and 40%, depending on the commodity type, will apply (Government of British Columbia, 2022[10]).

The strong revenue growth in some provinces serves as a reminder that greater use of stabilisation or wealth funds would be a useful way of smoothing fiscal balances, and act as a check against excessive current spending when revenues surge. Canada is not alone in facing this issue; similar points have been made in *Economic Surveys* of Australia and Ireland, for instance in OECD (2020[11]) and OECD (2021[12]). Both Alberta and Saskatchewan have run stabilisation and wealth funds. Each established "Heritage Funds" in the 1970s, which were aimed to run like wealth funds (wealth funds accumulate over the longer term while stabilisation funds primarily aim to smooth out financing over boom and bust cycles). Saskatchewan's fund was made too easy to access for current spending and it was scrapped in the early 1990s. Alberta's heritage fund is still in operation but has not been consistently inflation proofed, such that withdrawals have eroded the real value of the fund. Both provinces have introduced (and subsequently scrapped) stabilisation-type mechanisms, such as the Alberta Stabilisation Fund that operated from 2003 to 2013 (Fraser Institute (2021[13]), Fraser Institute (2021[14])).

There is scope for improving the tax mix

Tax policy since the previous *Survey* has evolved on several fronts. Tax credits have been employed to counter the cost-of-living increase and to address housing affordability (discussed further below). Also, tax is increasingly being used to further the green transition. For instance, a preferential rate of corporate tax now applies to businesses manufacturing zero-carbon-emission technologies.

The recently announced change to the preferential tax rate mechanism for small businesses will see more businesses paying less than the standard rate. Corporate tax policy measures in Budget 2022 included a more gradual transition from the 9% preferential rate of tax applied to small and medium-sized enterprises (SMEs) to the 15% standard rate of federal corporate tax (see Table 1.7) (Canada's average statutory corporate income tax rate, taking into account federal and provincial taxes, is 26.2%, higher than the minimum rate being targeted for large multinationals in the OECD's Global Minimum Corporate Tax initiative). Transition out of the preferential rate for SMEs will end if a business' working capital reaches CAD 50 million; the cut-off was previously CAD 15 million. The move aims to lower the marginal effective tax rate generated by the phase-out. However, it will also increase the number of businesses paying less than the standard rate of corporate tax. This may improve the preferential tax for SMEs in itself, but blanket preferential tax rates for SMEs are a crude means of supporting business (OECD, 2015[15]). For example, if the goal is to promote productivity growth, a better policy may be to target tax preferences on SMEs most responsive to innovation incentives and that create the most spillover benefits.

While raising rates of indirect taxation, notably consumption tax, would not be timely in the current context of cost-of-living issues, this should remain a policy objective for the longer term. As underscored in previous *Surveys*, international evidence shows that raising indirect taxation is less damaging to economic growth than higher income tax (Johansson, 2016[16]). Shifting to more indirect taxation can therefore make the tax

mix more growth friendly. Similar to Australia (OECD, 2021[12]), Canada has more headroom for increasing consumption tax than many other countries. The combined rates of federal Goods and Services Tax (GST) and provincial equivalents are low compared with many other OECD countries. According to the OECD Revenue Statistics, revenues from VAT/GST represent about 13% of total tax revenues in Canada, compared to an OECD average of around 20%. Raising the rate of federal GST would be the most practical approach, given the challenges in coordinating an increase in provincial rates. Previous *Surveys* have also underscored scope to broaden GST bases through the scaling back of zero-rated items among basic groceries. This would reduce the economic distortion from the tax but, again, is a move best implemented once the cost-of-living crisis has subsided. Reform could envisage combining scaling back of zero-rating with increased income support payments.

Increasing public spending efficiency would create more fiscal space

Opportunities for improving public-spending efficiency should be identified and exploited as a means of funding increased resource allocations and reducing pressure on revenue-raising and public borrowing. There is scope to better target provincial energy cost support schemes. Also, solutions to cost-of-living relief that avoid need for such support in the future should be explored (see discussion below on welfare issues). In addition, ensuring that new spending initiatives deliver the desired outcomes is important. This applies especially to the significant federal funds that will be provided to provinces for improving childcare services (see discussion on welfare issues).

Promised campaigns by federal government to improve public spending efficiency need to be more concretely detailed. As mentioned above, recent federal budgets have factored in spending reductions attributed to efficiency gains. Budget 2022 announced a review of spending plans with a view to reducing spending by up to CAD 3 billion over the next four years (i.e., around 0.025% of GDP each year). However, in the Fall Economic Statement 2022 it was revealed that these savings originate in lower-than-expected demand for certain COVID-19 programmes. As underscored by the Parliamentary Budget Officer, this would not usually be assessed as active policy to increase public spending efficiency (Parliamentary Budget Officer, 2022[17]). Budget 2022 also announced the launch of a Strategic Policy Review. The Review would assess programme effectiveness in meeting the government’s key priorities and identify opportunities to save and reallocate resources. Savings of CAD 6 billion over five years are aimed for (i.e., in total about 0.04% of GDP each year). Budget 2023 will provide further details on how the savings target will be achieved. Expenditure reviews can identify large inefficiencies. For example, in the Slovak Republic, spending reviews completed in 2020 detailed potential savings amounting to 1.2% of GDP in public employment and wages, defence and IT spending (OECD, 2022[18]).

Box 1.10. Quantifying the fiscal impact of structural reforms

The following estimates roughly quantify the fiscal impact of ambitious medium-term reforms and are illustrative.

Table 1.6. Illustrative fiscal impact of structural reforms

Policy	Scenario	Additional fiscal cost/revenue, percentage points of GDP
Structural reform		**0.0**
More timely adjustment of welfare benefits	One-off budget cost of payments equivalent to 5% of welfare spending being advanced by six months.	-0.1
Helping with delivery of childcare	A 10% supplement in the total estimated cost of financing the childcare deals between the federal government and provinces (the total estimated cost is around CAD 30 billion).	-0.1
Introduction of Pharmacare	The figure is an estimated gross cost by 2027. Note, however, some researchers suggest cost reduction through increased bargaining power would mean net savings.	-0.4
Increased environmental taxation	Increase in environmental taxation as a share of GDP to the level of the OECD median. This scenario does not factor in any recycling of revenues to households and businesses.	1.1
Retrofitting	Incentives for deep retrofits of homes and other buildings.	-0.3
EV charging infrastructure	Incentives for zero-emission vehicle purchases and charging infrastructure.	-0.1
Options for creating more fiscal space (if required)		
Increase in the federal rate of GST	Two-percentage-point increase in the rate of federal goods and services tax. As indicated in the main text, this measure could be used towards improving the tax mix as well as to finance additional spending measures.	0.8

Source: OECD calculations.

Table 1.7. Past OECD recommendations on fiscal budgeting, tax and spending and actions taken

Recommendations in past *Surveys*	Actions taken since the previous *Survey*
Fiscal rules and budgeting	
Establish provincial budget agencies, as in Ontario, or, better still, an agency reporting to the Council of the Federation that analyses fiscal forecasts and cost estimates for policy proposals.	No action taken.
Taxation	
Consider an increase in the rate of the federal goods and services tax as a means of either raising overall revenue or improving the tax mix. Eliminate GST zero rating for basic groceries.	No action taken.
Make more use of property taxes and user fees by municipalities, while easing the property tax burden on firms.	No action taken.
Review small business taxation to identify clear market failures and the policy instruments best suited to addressing them.	Budget 2022 extended preferential rates of corporate tax by more gradually transitioning from the 9% rate to the 15% rate. Transition will end when a business' working capital reaches CAD 50 million (previously the cut-off was CAD 15 million).
Reduce personal income tax expenditures not warranted on economic or equity grounds, notably the non-taxation of private health plan benefits, capital gains on principal residences and some small business shares.	No progress on major issues.

Strengthening the business environment

Canada's productivity and investment performance has weakened in recent years, notably relative to the United States (Figure.1.16). A slump in Canada's resource-sector investment following the 2014 oil-price collapse has been particularly influential. Weakening productivity and investment performance echoes longstanding concern that Canada is not tapping as successfully as some other economies into opportunities to increase output through capital deepening and innovation in products and processes. A wide range of policy actions can potentially increase business-sector productivity. There are proximate policy levers, such as tax breaks on investment and R&D that deepen capital and technological progress. In addition, there are less direct instruments, such as improvements to infrastructure and market efficiency, and reforms that strengthen vocational education and skills. Influences on market efficiency include competition policy, red tape in setting up businesses and bankruptcy processes. Policies in other economies, especially those that produce similar tradable goods and services, can also affect cost competitiveness and the capacity to attract and grow high-productivity businesses and industries. To respond to financial support in the U.S. Inflation Reduction Act, Canada indicated in the Fall Economic Statement 2022 that it would expand technology support (Government of Canada, 2022[2]). As well as launching the Canada Growth Fund, the government has promised to announce additional actions in Budget 2023.

There has been some welcome progress in policy measures past *Surveys* have identified as levers for strengthening Canada's business environment. In particular, a review of competition legislation is underway (Table 1.8). Past *Surveys* have picked up on scope for improving critical network sectors as a route to better conditions for business (typically with benefits for households too). Among the key network sectors, the potential gains from expanding the electricity grid through more east-west interconnectors, (as underscored in previous *Surveys*, and in the in-depth chapter on green transition) are particularly relevant at the present time. Meanwhile, the government's efforts towards strengthening competition in telecommunications markets are welcome (Table 1.8).

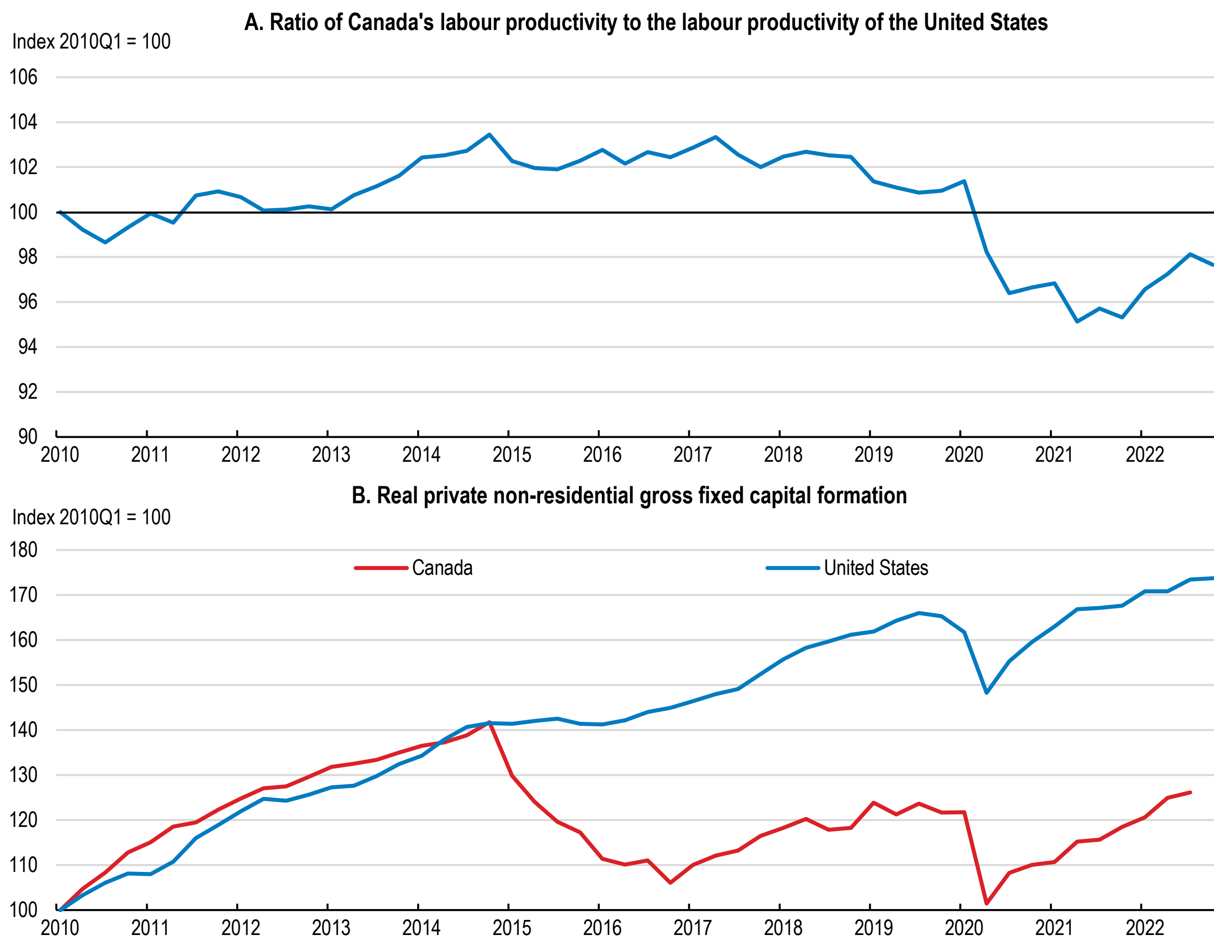
Barriers to foreign direct investment via foreign ownership restrictions continue to be high in Canada relative to those in other OECD countries, particularly in network sectors. For instance, in telecommunications rules state that both ownership and board composition must be at least 80% Canadian in operators with more than a 10% share of the market. The need for such restrictions should be evaluated as part of the ongoing review of the sector (Table 1.8). Rules applying to the aviation sector should also be reconsidered. These issues have been underscored in previous *Surveys* but no action has been taken since 2018. A renewed push for reform is overdue.

Though it has not yet created significant policy issues, teleworking should remain on watch for policymakers. According to Canada's Labour Force Survey data, as of October 2022 9% of workers reported that they usually worked both at home and at locations other than home (hybrid working) while 15.8% were usually working exclusively from home. A priori, teleworking has widened labour markets and options on where to live. There may also be productivity gains; one survey of Canadian employees has found that 63% of respondents felt they are more productive working from home (Benefits Canada, 2022[19]). However, there are potential downsides. For instance, there may be losses in productivity from reduced in-person contact. A permanent shift to teleworking may need to be considered in some areas of policy, for instance in transport planning. Google Mobility data continue to show that movement through transit stations in Canada remains below pre-COVID levels.

The remainder of this section looks in greater depth at three additional policy dimensions to the business environment and productivity:

- *Barriers to improved business-sector efficiency.* Barriers to internal trade remain an important constraint on the efficiency of Canada's economy. This *Survey* underscores the potential returns from reform and elaborates on avenues for making progress.
- *Competition policy.* The presence of dominant internet platform companies raises important competition issues.
- *Corruption and economic crime.* Review of challenges linked to corruption and money laundering reveals a slip in Canada's standing. Efforts to tackle money laundering continue, but ensuring they are effective remains a challenge.

Figure.1.16. Canada's productivity and investment performance has deteriorated relative to the United States



Source: OECD Economic Outlook (database).

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Table 1.8. Past OECD recommendations on business policy and actions taken

Recommendations in past *Surveys*	Actions taken since the previous *Survey*
A. Business efficiency and competition	
Internal trade. Expedite the removal of non-tariff barriers to internal trade (see main text).	Budget 2021 announced CAD 21 million funding over three years towards advancing the lowering of internal trade barriers (see main text).
Insolvency. Augment the insolvency system with an early-warning mechanism and a pre-insolvency regime for businesses in difficulty.	No substantial action taken on insolvency since legislative changes in 2019.
Competition legislation. Grant the Competition Bureau powers to require provision of relevant information in the context of conducting market studies and advocacy activities. Require federal government agencies to "comply or explain" in response to the Bureau's recommendations.	Amendments to the Competition Act that take effect June 2023 include provisions that expand the evidence-gathering powers of the Competition Bureau. In November 2022 a wide-ranging review of the competition act was launched that aims to improve all key areas of the competition framework, including the scope of the Act; enforcement methods and corrective measures; and the improvement or reinforcement of competition policy in increasingly digital and data-driven markets.
Foreign ownership. Reduce foreign ownership restrictions in air transportation on a reciprocal basis and in telecoms and broadcasting, where cultural objectives could be achieved by other means.	No new measures since amendment of the Canada Transportation Act in 2018 which increased the maximum percentage of foreign voting interests in Canadian air carriers, subject to restrictions.
B. Critical network sectors	
Telecommunications. Reduce the cost and improve the quality of telecommunications services, including broadband to rural and remote communities. Continue to widen market access for mobile virtual network operators.	The federal government announced a new policy direction on telecommunications services in May 2022. Goals include strengthening of third-party access to wholesale markets, increased competition in the market for cell phone plans and improved consumer rights (Government of Canada, 2022[20]).
Energy. Develop more east-west electricity interconnections. Liberalise the generation and distribution segments in jurisdictions that have not done so yet. (*This issue is elaborated on the Climate change chapter of this Survey.)*	No action taken.
C. Innovation	
Small-and-medium enterprises. Shift away from tax-subsidies by lowering the small firm tax-credit rate toward the large firm rate in the Scientific Research and Experimental Development (SR&ED) Program. Use the savings from this move to reinstate capital costs in the base for the credit and to scale up direct grants.	Budget 2022 announced a review of the SR&ED Program.
D. Corruption and economic crime	
Money laundering. Tackle money laundering via the property market by tightening property registration rules to prevent the creation of opaque business structures. Consider limits on cash transactions to shut down money laundering.	British Columbia has introduced a new public land registry that aims to increase the transparency of transactions (see main text). The federal government is extending anti-money laundering and anti-terrorist financing requirements to all businesses (mortgage brokers, lenders, and administrators) involved in the mortgage lending process to mitigate the risks of these businesses being misused for money laundering/terrorist financing.

Faster progress on lowering inter-provincial trade barriers is needed

Lowering internal trade barriers remains one of the most fruitful avenues through which policy can help boost Canada's productivity and living standards. As previous *Surveys* have underscored, Canada appears unusual in the extent to which differences in regulations and technical standards across sub-national jurisdictions hamper the flow of goods and services and compromise the labour market. Perhaps the most well-known example is restriction on the movement of alcohol and tobacco products between provinces. The barriers extend across many activities, including the dairy sector and legal and accounting services. The non-recognition of qualifications remains an issue notably in some areas of the healthcare sector and compulsory trades (those where only those with the relevant official qualifications (or apprentices) can legally be employed, such as electricians, plumbers and crane operators). Evidence continues to mount on the economic cost of internal trade barriers. For instance, Deloitte (2021[21]) estimates point to large province-by-province economic impact of the barriers, echoing the findings of previous studies (Table 1.9).

A stronger push to remove the trade barriers is needed. Current instruments to tackle them include the Canadian Free Trade Agreement (CFTA) plus some additional agreements between subsets of provinces and territories. The CFTA builds on a previous agreement (the Agreement on Internal Trade) and includes a mechanism for reconciling regulations across provinces and territories (the Regulatory and Cooperation Table). Past OECD analysis, plus other reports, point to several ways forward in removing barriers faster, including:

- Greater use of mutual recognition agreements between sub-sets of provinces.
- Wider scope for the CFTA, notably using it to tackle agricultural supply management regimes.
- More "teeth" for the CFTA. A detailed assessment in C.D. Howe (2020[22]) suggests strengthening the Agreement's dispute resolution mechanism, which provides a channel for launching legal claims that a province's regulations in a particular area are discriminatory. The mechanism can thus potentially provide a route to dismantling the barriers. The C.D. Howe analysis suggests that introducing a loser-pays principle (i.e., legal costs are borne by the unsuccessful participant) would prompt more claims and help force change in the provinces.
- Incentivising barrier reduction through conditional federal funding. One study (Scotiabank, 2022[23]) suggests that resistance to lowering barriers arising from localised vested interests could be overcome by the federal government offering financial inducements to provinces. There has been some welcome progress in this direction. Budget 2021 announced CAD 21 million of funding over three years, to, inter alia, enhance the capacity of the Internal Trade Secretariat that supports the Canadian Free Trade Agreement. The funding also aims to pursue internal trade objectives through new or renewed discretionary federal transfers to provinces and territories.
- Raising awareness through an easily accessible public database documenting internal trade barriers. Again, there has been some welcome progress in this direction. The funding announced in Budget 2021 also aimed to advance work with willing partners towards creating a repository of open and accessible pan-Canadian internal trade data.

Table 1.9. Studies on the economic impact of Canada's internal trade barriers

Study	Scenario	Impact
Deloitte (2021[21])	Gains from removal of (non-geographic) trade barriers (the study combines (IMF, 2019[24]) with Deloitte modelling).	The study reports province-by-province gains from trade-barrier removal. Smaller provinces typically have (relatively) greater gains than larger provinces. For instance, it is estimated that barrier removal would increase the GDP of Ontario by 2.9% while that of Saskatchewan would increase by 5.1%.
IMF (2019[24])	Gains from removal of (non-geographic) trade barriers.	3.8% increase in Canada-wide GDP.
Bank of Canada (2017[25])	10% reduction in interprovincial trade barriers.	0.6% level increase in GDP over three years.
Albrecht and Tombe (2019[26])	One scenario describes the elimination of trade-cost asymmetries (these arise, for example, if one province allows for larger truck loads than another province), another analyses the effects of removing all trade costs unrelated to distance.	3% increase in real GDP (elimination of trade-cost asymmetries), 7% increase (removal of all costs).

Source: OECD based on Scotiabank (2022).

Competition policy needs to be better tuned to issues around Big Tech

Digital technologies have given rise to new competition issues. The challenges include barriers to entry linked to data access, abusive and exclusionary practices related to dominant platforms, and low competitive pressures due to lock-in of consumers and businesses to service providers. Canada has been a somewhat late starter in ensuring competition laws and regulations are well tuned to handle these issues. A report released by the United Kingdom's competition authority in late 2021 noted that Canada was the only country in their review that had not introduced any legislative reforms to better address digital competition issues and where no proposed reforms were pending before national legislative or regulatory bodies (Competition and Markets Authority, United Kingdom, 2021[27]).

Progress in better tailoring Canada's competition policy to accommodate big tech issues is now underway. In June 2022, a first round of amendments to the Competition Act included measures that widen the scope of business conducts that fall under the Act's abuse of dominance provisions. Now included are conducts intended to "have a selective or discriminatory response to an actual or potential competitor", including nascent competitors. Conducts that negatively affect non-price variables are also explicitly captured, such as the effect on barriers to entry (including network effects), quality, choice and consumer privacy. Also, private parties can now bring abuse-of-dominance cases before the Competition Tribunal. To further deter abuse of dominant provision, fines have been increased. Financial penalties have increased, from CAD 10 million (for a first violation by a corporation) to up to three times the value of the benefit derived from the conduct or, if the value of such benefit cannot be reasonably determined, up to 3% of a party's annual worldwide gross revenues (Government of Canada, 2022[28]). The ongoing review of the competition legislation (Table 1.8) includes measures aiming to increase competition in digital and data driven markets.

"Ex ante" regulation around digital platforms needs greater consideration. A recent report (OECD, 2022[29]) underscores that, across the OECD, policy work has started on measures to reduce the risk of anti-competitive behaviour arising in relation to large digital platforms (ex ante regulation). The Council of the European Union recently adopted the Digital Markets Act (European Council, 2022[30]). Similar regulatory frameworks are being discussed in the United States and the United Kingdom. In essence, the frameworks envisage special fair trade and contestability obligations on large digital platforms aimed at ensuring strong competition. As described above, Canada's policy measures have so far concentrated on improving the handling of anti-competitive behaviours (ex post regulation). Serious consideration should be given to an ex-ante framework. Compatibility with frameworks introduced elsewhere, especially that in the United States, will be important given digital markets are usually transnational.

Box 1.11. Potential impact of structural reforms on GDP

The following elaborate on the potential impact of reforms aimed at improving GDP performance.

Table 1.10. Illustrative GDP impact of selected recommendations

Policy	Scenario	Impact
Expediting the removal of non-tariff barriers.	Impact of a 10 percent reduction in interprovincial trade barriers (Bank of Canada, 2017[25]), percentage points. IMF (2019[24]) estimates a total boost to GDP per capita of 4% from the removal of barriers.	0.2 percentage-point increase in potential GDP growth.
Stronger competition policy on big tech	Higher gross domestic income in real terms through reduced IT service charges. Productivity gains through faster and more reliable internet.	Not available.
Increase in the federal rate of GST channeled into reducing income tax.	As underscored in the main text, international evidence (Johansson, 2016[16]) suggests that raising indirect taxation is less damaging to economic growth than higher income tax A two-percentage-point increase in the rate of federal GST could, for instance, finance a 7% fall in income tax across households and businesses. Uncertainties in the response elasticities make it challenging to estimate a growth impact.	Not available.

Source: OECD calculations.

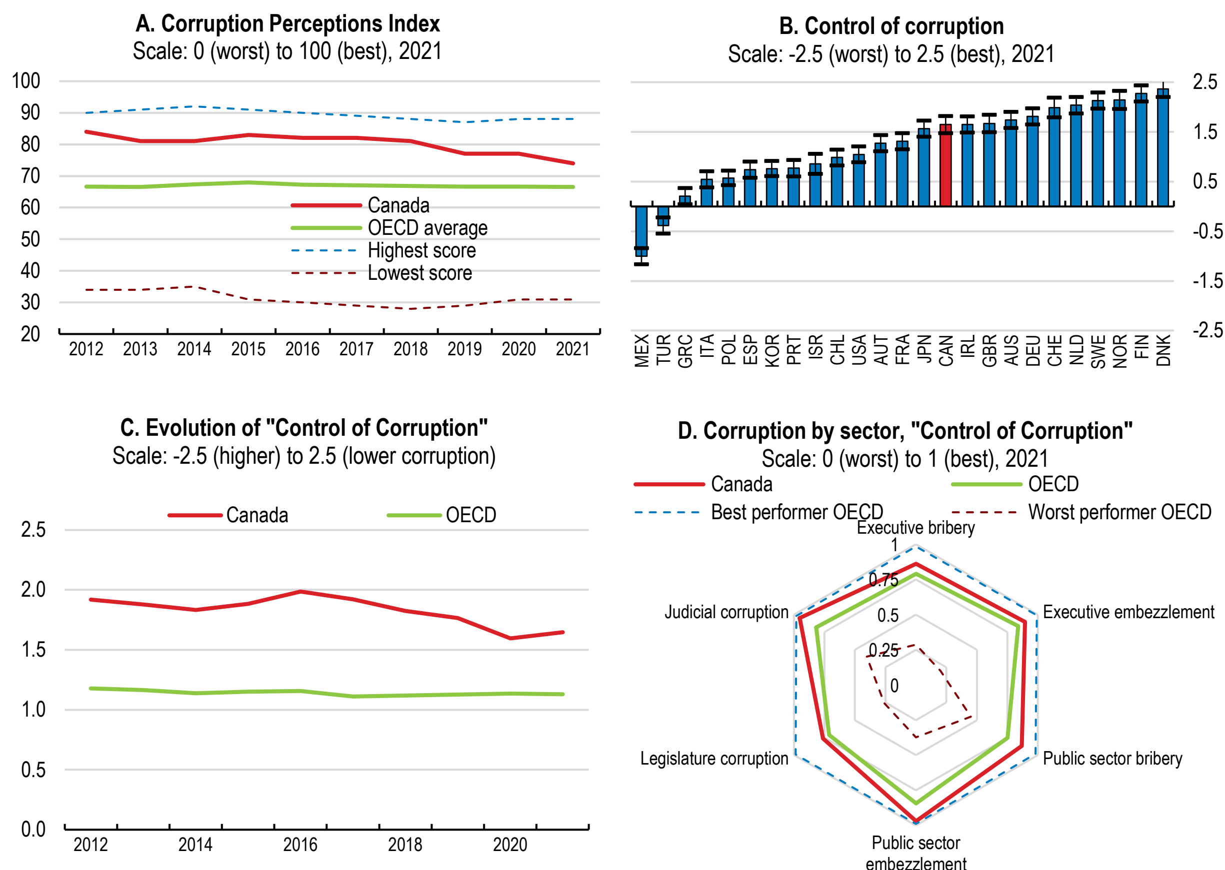
Measures combatting corruption and money laundering are ongoing

Though Canada still ranks well in indicators of domestic corruption, there are signs of slipping performance. Notably, the country's score in Transparency International's corruption perception index shows a trend decline (Figure 1.17). Corrupt practices have been alleged involving governments, municipalities, corporations and senators (Rotberg and Carment, 2018[31]). Notable cases of enforcement actions by authorities to combat corruption include that relating to the engineering company, SNC-Lavalin, and military electronics company, Ultra Electronics (RCMP (2022[32]) and RCMP (2022[33])). Corruption linked to public construction contracts in Québec has long drawn attention. Recent OECD reports on this issue (OECD (2020[34]) and OECD (2022[35])) acknowledge the substantial policy efforts but underscore need for further action, including greater co-ordination between the province's authorities and legislation to cover grassroots lobbying (i.e., lobbying through motivating the general public to advocate issues). A recently developed OECD indicator database assesses the strength of countries' strategic frameworks for strengthening public integrity (Smidova, Cavaciuti and Johnson, 2022[36]). The data suggest Canada's strategic framework could potentially be improved through a wider scope and increased consultation practices.

Canada's anti-money laundering system scores similarly to the OECD average according to a range of characteristics (Figure 1.18). Russia's war against Ukraine has increased attention to Russia-linked money laundering and sanctions evasion. Canada's Financial Transaction and Reports Analysis Centre (FINTRAC) published a bulletin describing the likely laundering techniques (FINTRAC, 2022[37]). These include use of intermediary jurisdictions to create networks of shell and front companies (often registered in offshore financial centres or tax havens) and non-resident bank accounts (generally located in jurisdictions known to cater to Russian-speaking customers). Canada is a founding member of the Russian, Elites, Proxies and Oligarchs Task Force and supports global efforts to have the Russian Federation comply with international law, including the identification of assets generated through corruption and money laundering. To support these efforts Canada has legislated a framework that could expose these assets to forfeiture. The federal government's aim to establish by the end of 2023 a public and searchable registry that requires more details of the beneficial owners of corporations. This will also support countering sanctions evasion. This is a welcome move that has long been called for (Transparency

International, 2022[38]). Efforts to shut down channels for money laundering need ramping up, including by following through on the establishment of the new federal beneficial ownership registry and promoting a similar approach by provinces. Canada is also working on developing a Canadian Financial Crimes Agency, which will be the lead federal enforcement agency for criminal offences related to financial crimes.

Figure 1.17. A widening gap from the best scores in perceived corruption

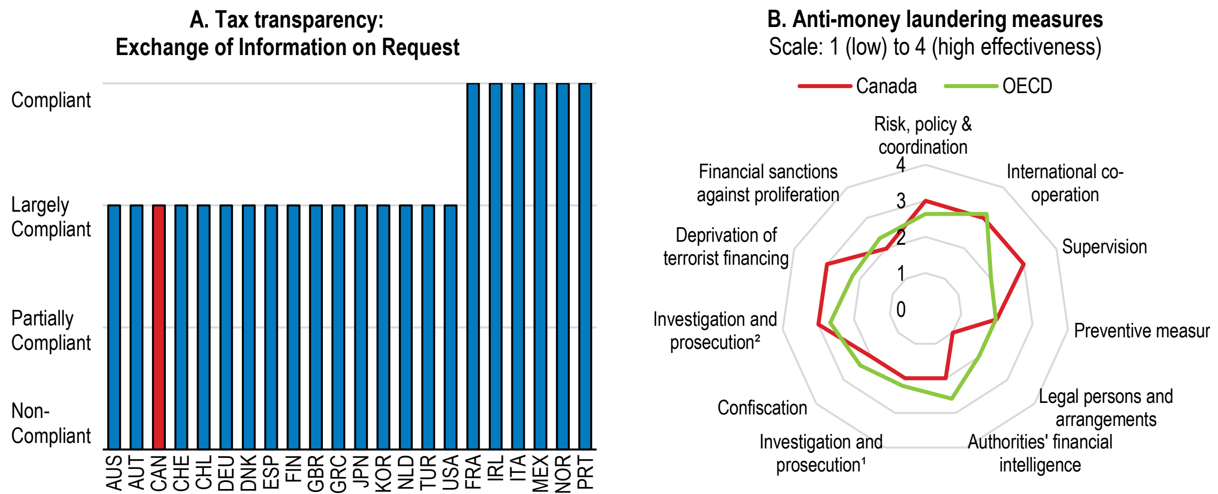


Note: Panel A shows the Corruption Perception Index (CPI) which originally scores from 0 (worse) to 100 (best) on an inverted scale (i.e., 100 – CPI); Panel B shows the point estimate and the margin of error. Panel D shows sector-based subcomponents of the “Control of Corruption” indicator by the Varieties of Democracy Project.

Source: Panel A: Transparency International; Panels B & C: World Bank, Worldwide Governance Indicators; Panel D: Varieties of Democracy Institute; University of Gothenburg; and University of Notre Dame.

Money laundering via real-estate transactions remains an issue in some provinces. Previous *Surveys* have recommended further attention to property registration, and limits to cash transactions. Some governments are progressing with reform. British Columbia has a new public land registry aimed at increasing the transparency of transactions (though some claim the registry could be more effective in this role (C.D. Howe, 2020[39])). British Columbia’s Cullen commission (Cullen, 2022[40]) on money laundering (not only in real estate), while welcoming the policy steps taken, recommended further measures including the establishment an anti-money laundering commissioner and a money laundering unit. In addition, the federal government is extending anti-money laundering regulation around mortgage lending (Table 1.8).

Figure 1.18. Canada scores similarly to other countries in frameworks to fight economic crimes



Source: OECD Secretariat's own calculation based on the materials from the Global Forum on Transparency and Exchange of Information for Tax Purposes; and OECD, Financial Action Task Force (FATF).

Supporting the vulnerable and raising labour force participation

Canada is generally well placed to support low-income households when they come under strain. Capacity for rapid and effective policy response in this regard was demonstrated during the COVID-19 crisis (see Box 1.1). Also, Canada is among the few countries that is developing a well-being framework for use in government indicators (see the 2021 *Survey* for an in-depth assessment). In addition, progress is being made in implementing reforms in two of Canada's most important and longstanding welfare issues (Table 1.11), deprivation among Indigenous peoples (Box 1.12) and healthcare coverage (see the 2021 *Survey* for in-depth assessments):

- Federal policy continues to expand efforts to advance reconciliation and improve the living standards of Indigenous peoples. In 2021 substantial funds were provisioned to compensate First Nations children and families for past harms incurred due to underfunding of the First Nations Child and Family Services Program and delays in services. Enabling the transfer of powers to Indigenous communities (self-determination), including through capacity building in community government as well as co-development of policy that reflects Indigenous-led priorities, needs to remain at the core of reconciliation efforts. Also important is maintaining the distinctions-based approach (i.e., policies that are more tailored to the three Indigenous peoples of Canada: First Nations, Métis and Inuit). Focus is also needed on ensuring adequate funding and support to close the wide socio-economic gaps with other Canadians, including in health outcomes, employment and incomes.
- In healthcare, provisions in Budget 2022 to cover dental treatment for households are welcome. However, Canada remains an outlier in having a national public universal healthcare scheme that does not cover drug treatment. Progress on this front remains intended but has slowed. Improvements are being made on some other healthcare issues, including addressing post-COVID treatment backlogs, shortages of long-term care spaces and the resourcing of mental health care.

Canada continues to perform comparatively well in narrowing gender gaps. In 2022 the G7 countries established annual monitoring of gender equality and the first dashboard of indicators provides an informative update. The data suggest Canada is in reasonable standing as regards some aspects of education. The gap between girls' and boys' PISA scores in mathematics is now small. Also, Canada's share of women among tertiary graduates in Science, Technology, Engineering and Mathematics is above the OECD and G7 average. The situation regarding employment and earnings remains mixed. The gap in the labour force participation rate between women and men is relatively narrow. However, the gender wage gap (discussed in detail in the 2021 *Survey*) is comparatively wide. Meanwhile, the gender difference in pension income is relatively small. In terms of gender gaps in leadership positions, the G7 indicators point to progress, but also a long way to go. The share of women in board seats of the largest publicly-listed companies has increased in recent years and stands at around one third (which is the average of the G7). The share of women holding parliamentary seats is of a similar magnitude. The "Gender-based Analysis Plus" assessment included in the Fall Economic Statement of 2022 (Government of Canada, 2022[2]) noted a number of recent policy actions that have positive implications for women, notably the temporary support to help households address the rising cost of living (discussed further below).

Box 1.12. Policies addressing long-standing disadvantage among Indigenous peoples in Canada

Indigenous peoples in Canada continue to suffer deep disadvantages, despite substantial policy attention and many programmes providing targeted support. A majority of Indigenous communities are worse off than the rest of Canada's population in many dimensions including income, employment, security, housing, life expectancy and physical and mental health. Progress has been made toward recognizing and empowering Indigenous governments, for instance by expanding the number of communities actively negotiating how to exercise their Indigenous rights and by providing flexible ten-year funding for eligible First Nation communities to invest based on their own priorities. Also, in recent years federal government policy has pursued a "distinctions based" approach that makes greater efforts to tailor policy to each of the three Indigenous peoples: First Nations, Métis and Inuit. The 2021 *Survey* underscores the importance of maintaining a focus on self-determination, improving labour-market outcomes through better education and support for Indigenous entrepreneurship, ensuring adequate housing, providing more infrastructure and boosting access to high-speed broadband in remote communities.

Source: OECD (2021[41]).

The remainder of this section examines two further issues in greater depth:

- *Cost-of-living challenges.* For many years the most prominent cost-of-living issue was worsening affordability stemming from rapidly rising housing costs. Though the housing market has cooled somewhat (see macroeconomic section above), house prices remain elevated. The increase in price inflation across a wide range of consumer goods and services that began in 2021 has prompted wider concern for the cost of living.
- *Affordable quality childcare*. Limited access to affordable childcare in many provinces has long been compromising parents' ability to combine work and family life. This has meant difficult choices for families and sub-optimal labour force participation for the economy, especially among women. Implementation of a major drive to increase access to affordable childcare is underway.

Table 1.11. Past OECD recommendations on social, labour and welfare policy and actions taken

Recommendations in past *Surveys*	Actions taken since the previous *Survey*
Well-being among Indigenous peoples and the wider population	
Enhance self-determination among Indigenous peoples. Maintain the distinctions-based approach to policy and ensure adequate funding to eliminate gaps with other Canadians.	Following additional funds for compensation for past harms in Budget 2021 (CAD 40 billion), Budget 2022 committed to further legislative change and funding to support Indigenous children, address the legacy of residential schools, and improve health care and water quality. Commitment to legislative changes to support self-determination was also made in Budget 2022. These include new legislation that will better facilitate First Nations to opt out of the Indian Act legislation and replace it with their own laws. Work is underway to advance tax jurisdiction for Indigenous governments, including creating the option of a sales tax on fuel, alcohol, cannabis and tobacco. A push to improve the registration process for Indian status by First Nations women is underway with a Senate report making several recommendations (Standing Senate Committee on Aboriginal Peoples, 2022[42]).
Develop a well-being framework including a dashboard of indicators for use in government decision making. Use the well-being dashboard initially to identify policy challenges and to measure progress in outcomes.	A well-being framework was published in Budget 2021 (Government of Canada, 2021[43]), with a dashboard of indicators which are used in the annual budget process. Work continues on refining the indicators.
Childcare and early education	
Boost childcare provision through increased subsidies of services, tougher quality control, and more support for families to pay for these services.	Implementation of a major reform is now underway (see main text).
Support take-up of parental leave by fathers through information provision and, if necessary, higher payment rates.	In 2019, the federal government introduced extra benefits when parents share parental leave (Parent Sharing Benefit).
Affordable housing	
Improve housing supply by ensuring a competitive construction sector, reducing rent controls and relaxing strict zoning and land-use regulations and urban containment policies. Put more resources into social housing and encourage alternative ownership arrangements.	Budget 2022 proposed a raft of measures including a fund to help municipalities speed up housing development by improving zoning, land-use regulations, etc. (the Housing Accelerator Fund), more funds for repairing low-cost housing, building more affordable housing and new tax support for first-time buyers. Proposals were also made to curb foreign investment and speculation, including through restrictions on who can acquire property. See main text.
Improving health and long-term care	
Seek efficiency gains and reduced waiting times in health care through better patient prioritisation, improved co-ordination between primary-care providers and specialists, greater use of telemedicine and the reallocation of some tasks from physicians to nurses. Increase support for high-quality institutional and home-based long-term care. Shift more resources towards mental health and public health.	Additional funding has been provided to reduce backlogs in surgeries and procedures in the wake of COVID-19 (Budget 2022). Implementation of "Motion 77", a federally funded programme for increasing the number of long-term care spaces, is now underway. Increased funding has been announced for mental health care (Budget 2021) and to address the opioid crisis (Budget 2022).
Follow through with the plan to negotiate with the provinces and territories the gradual adoption of universal drug coverage ("Pharmacare").	A plan to expand public healthcare to cover dental care was announced in Budget 2022. The programme started in 2022 with coverage of under 12-year-olds.
Employment of older workers	
Index the eligibility age for public pensions to life expectancy, supported by encouraging flexibility in working hours and skill development for older workers.	No action taken on indexing the eligibility ages. There is considerable flexibility in the current pension system as regards continued working and the retirement age. For instance, workers can access Canada Pension Plan retirement benefits at any time between the ages of 60 and 70, with corresponding actuarial adjustments.

High inflation raises further concern about the cost of living

The rapid rise in consumer prices in recent quarters has generated concern about the cost of living. Comparing across Canada, Europe and the United States, although rates of increase and turning points in price inflation differ somewhat (Figure 1.1, above), the broad increase in the price of representative households' consumption baskets has been similar (Figure 1.19). The price rises have impacted real

disposable income among households and the volume of spending on consumer goods and services. The average effect across all households is likely to understate the increasing difficulties for low-income households, which face tighter margins in finances and spend a comparatively large share of their income on energy, food and housing – items that have experienced especially steep cost increases. Such households may face limited scope for economising on household spending, few savings to dip into, and challenges in accessing credit.

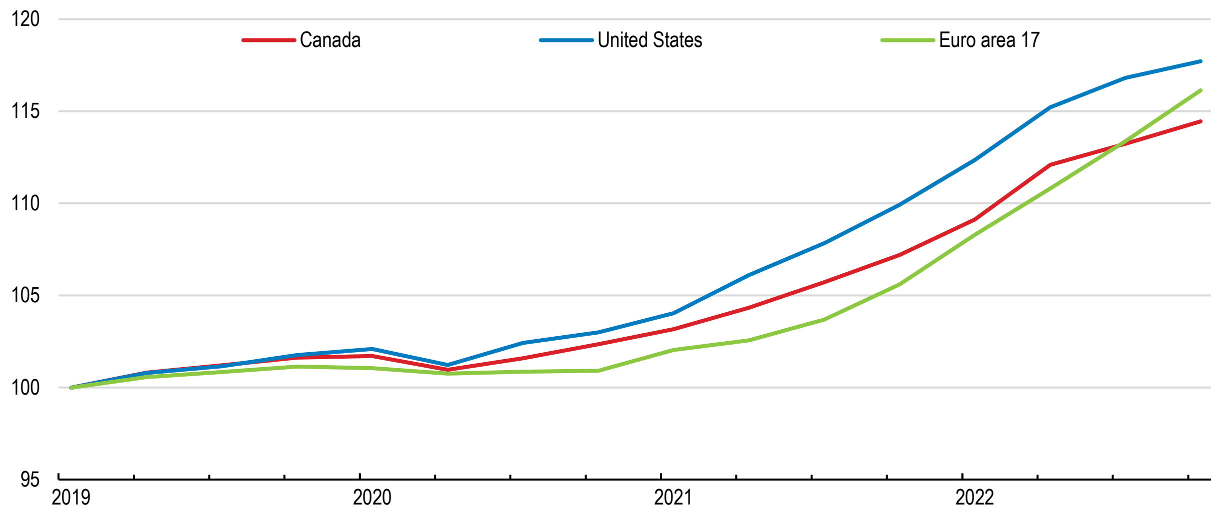
Provincial and federal governments have been responding to the cost-of-living increase with various measures (Table 1.12), including steps reducing the cost of fuels and utility bills. As emphasised in OECD analysis (OECD, 2022[44]), while relatively simple to introduce and communicate, across-the-board measures that lower energy costs are costly and fail to target the most vulnerable, while also weakening incentives to reduce energy use when supply is tight. Especially if prices remain elevated for a prolonged period, governments should better target support to households most in need of relief on living costs, including through increased use of income support. From this perspective, the measures introduced in Canada have been mixed. Direct support for motorists (for instance, cuts in gasoline taxation by Ontario and Alberta) has typically benefitted all motorists, including the well-off. Meanwhile, examples of targeted support include the federal government's goods and services tax credit hike and Quebec's one-time payments to lower-income households. Much of the targeted support has potential downsides if sustained for a prolonged period. For instance, British Columbia has introduced a cap on housing rentals, that if sustained for the longer term could dissuade rental supply, creating a shortage of rental properties.

Table 1.12. Measures taken by the federal government and provinces to alleviate the cost of living increase: selected examples

Jurisdiction	Measure
Federal government	Announced September 2022: -Doubling of Goods and Services Tax Credit for six months (among families with children, around half will receive the benefit and similar for seniors). The increase, for instance implies an extra CAD 467 over the fiscal year for a couple with two children. The scheme began operating in November 2022. -One-time CAD 500 top-up to the Canada Housing Benefit for low-income households in rental accommodation (around 1.8 million renters are expected to receive the benefit). (The federal government also underscores that various measures already in the pipeline are set to help with the cost of living, such as the reductions in childcare costs and expanded dental care coverage.)
Ontario	-Cut in gas tax by 5.7 cents per litre and the fuel tax by 5.3 cents per litre for six months, beginning July 2022 and effective until the end of December 2023. -Refunding licence plate sticker renewal fees paid since March 2020 and eliminating license plate renewal fees and plate stickers on a go-forward basis, saving vehicle owners CAD 120 a year in southern Ontario and CAD 60 a year in Northern Ontario for passenger and light commercial vehicles. -Permanently removing tolls on Highways 412 and 418.
Quebec	-Nearly CAD 3.2 billion for a one-time payment of CAD 500 in 2022 to 6.4 million people earning CAD 100 000 (implying a large majority of households will receive the payment). An additional payment of up to CAD 600 to 6.5 million people was announced in late 2022, worth CAD 3.5 billion.
British Columbia	-British Columbia's public auto insurer is providing a one-time relief rebate of CAD 110 to customers (estimated cost CAD 395 million). -A package of measures was announced in September 2022, estimated to be worth up to CAD 1 500 in total for a family of four. The measures included: increase in Climate Action Tax Credit payment, boost to the British Columbia Family Benefit and capping rent increases below inflation. - One-off electricity bill credits for families (CAD 100) and small and medium businesses (CAD 500) available in the Fall of 2022. - Lower-income households also get an Affordability Credit to be paid through the tax system in January 2023. The credit is indexed to income. The maximum Affordability Credit is CAD 410.
Alberta	- Electricity rebates: the scheme provides a total of up to CAD 500 in monthly energy rebates to households and businesses whose electricity use is under 250 thousand kilowatt hours per year (started July 2022, currently extended to April 2023). - Fuel tax relief. Relief on Alberta's fuel tax, normally 13 cents per litre, has been in place since April 2022. The latest update announced a zero rate from January to June 2023 (the fuel tax had previously been partially reinstated). -- Transfers to seniors, families with children as part of a package of measures reportedly worth CAD 2.4 billion.

Figure 1.19. Canada's cost of living has increased by a similar amount to the United States and the Euro area since the pandemic

Consumer prices, index 2019Q1 = 100



Source: OECD Economic Outlook database.

StatLink https://stat.link/lymdoi

There has been a welcome acceleration of efforts to address housing affordability. The federal government's Budget 2022 announced a raft of measures with net budgeted spend of around CAD 10 billion over five years (0.3% of annual GDP spread over the five years). The measures are under four themes:

- "Building Affordable Homes". Steps include the New Housing Accelerator Fund which aims to provide CAD 4 billion to help municipalities speed up housing development. Other measures comprise funds for the construction and repair of affordable housing, and steps towards greener housing (see in-depth chapter).
- "Helping Canadians buy their first home". Measures include further tax breaks for first-time buyers and support for rent-to-own projects.
- "Protecting Buyers and Renters". Among the measures are a home buyers' bill of rights and steps to dissuade large-scale corporate ownership of housing.
- "Curbing Foreign Investment and Speculation". Proposals include a ban on foreign investment in Canadian housing, and higher costs for property flippers and assignment sales (resale of a property before it has been constructed).

At this juncture, given the large number of announced supply- and demand-side measures it would be appropriate for policy to enter a phase of implementation and evaluation.

Other measures can permanently help households cope with cost-of-living squeezes. For instance, the federal government has made welcome progress in making tax filing easier; many of Canada's poorer households have been missing out on benefits because they were not filing tax returns. Other permanent changes that could help reduce cost-of-living squeezes are:

- Timelier adjustment of benefits. As pointed out in recent cross-country OECD analysis (OECD, 2022[45]) most transfers are not immediately responsive to price shocks as experienced by individual households. Automatic or regular price adjustments are not universal and where some form of indexation does exist, the additional support is typically subject to significant delays because benefit amounts are typically uprated annually or at less frequent intervals. Delays between 12 and 24 months are typical. The result is that transfer recipients experience declining purchasing power during periods when inflation accelerates. A welcome feature of Canada's federal-government adjustment is that two major benefits are adjusted on a quarterly basis (Table 1.13), which implies a reasonably timely update for recipients. However, other federal benefits along with provincial benefits are generally updated once a year. The federal government's standard annual updating (which is based upon past inflation) saw an increase in income-tested benefits (such as the goods and services tax credit) of 2.4% in July 2022). The annual increase in CPI inflation from July 2021 to July 2022 was, in contrast, 7.6%. Federal and provincial governments should explore whether more timely updating could be applied more widely.
- Improving minimum-wage updating. Canada has a mix of regular minimum wage indexation and discretionary adjustment by government decision. For instance, in Ontario the minimum wage is currently updated every October in line with changes in the province's consumer-price index. Meanwhile, minimum-wage updating in Quebec and Alberta is discretionary (Table 1.13). The process through which minimum wage increases, or indexing rules, are determined is important to how well the system works. Regular review of minimum wages by an independent body can help ensure appropriate balance between compensating for cost-of-living increase and the risk of undesirable consequences for employment and inflation.
- Further work to improve financial literacy and the quality of financial advice. Financial literacy can help households cope when budgets come under stress, such as when prices and interest rates rise. According to analysis of financial literacy using data from the OECD's Programme for International Student Assessment (PISA) (OECD, 2020[46]), Canada's school students, on average, fare better than those in many other countries. Nevertheless, a sizeable proportion of students score poorly, and this almost certainly would apply to older cohorts too. The federal government has been campaigning to improve individuals' understanding of finance and the quality of financial decisions through its National Strategies on Financial Literacy. The first of these ran from 2015 to 2020 and the second covers the period 2021 to 2026. The current strategy aims to work further on both improving access to information on finance and on ensuring good use of that information to make decisions (Financial Consumer Agency of Canada, 2021[47]). The approach aligns closely with OECD recommendations on financial literacy policy (OECD, 2022[48]). Thus overall, policy on financial literacy in Canada appears on the right track. Nevertheless, bringing about widespread improvement on education requires sustained policy campaigns. Exemplifying the challenge, Australia has had a financial literacy strategy since 2011, yet according to OECD *Surveys*, many Australians still lack sufficient financial knowledge and capability (OECD, 2021[12]).

Table 1.13. Lags in adjustment to inflation mean only modest increases in some benefits and minimum wages in 2022

Federal-government benefit adjustment and minimum wage updating arrangements in federal government and in the four most populous provinces

	Updating approach	Increase in in 2022
	Federal updating of benefit amounts	
Quarterly indexing	Two key benefits, the Old Age Security (OAS) and Guaranteed Income Supplement (GIS) are indexed on a quarterly basis. For instance, the October 2022 update that increased benefits for the fourth quarter (Q4) 2022 was based average CPI for May, June and July 2022 divided by the average CPI for February, March and April 2022.	OAS and GIS benefits were 7.9% higher in Q4 2022 compared to Q4 2021.
Annual indexing	Other benefits (along with benefits via the tax system) are adjusted every year (generally 1 July). For benefits such as Goods and Services Tax Credit and Canada Child Benefit, indexation for July 2022 was based on average CPI over October 2020-September 2021 period divided by average CPI over October 2019-September 2020 period (same factor as was used for indexing personal income tax system parameters as of January 2022).	Annually indexed benefits increased by 2.4% in July 2022.
	Minimum wage updating	
Federal (applies to federal-government employees)	Indexed to CPI. Adjusted 1 April every year. Current rate (hourly): CAD 15.55 (since April 2022).	3.4%
Ontario	Indexed to provincial CPI. Updated 1 October every year. Current rate: CAD 15.50 (announced April 2022, applied from October 2022).	3.3%
Quebec	Government decision. Current rate: CAD 14.25 (since May 2022).	5.6%
British Columbia	Indexed to provincial CPI, Adjusted 1 June every year. Current rate: CAD 15.65 (since June 2022)	3.0%
Alberta	Government decision. CAD 15 (since October 2018)	0.0%

Source: OECD.

Reform towards increasing access to affordable childcare is underway

Undersupply of reasonably priced childcare has long been an issue in much of Canada. As indicated above, the supply shortfall implies difficult choices for families and sub-optimal labour force participation for the economy, especially among women. Women's employment rate in Canada compares favourably to many other countries (the rate was 70.2% in 2021 compared with an OECD average of 60.4%, according to OECD Labour Force Statistics). Nevertheless, a higher rate would lift the economy's productive capacity and support higher living standards. Undersupply of childcare is a challenge also faced by some other OECD countries (Box 1.13). In Canada much of the policy momentum has been spurred by studies that found introduction of low-cost childcare in Quebec in the late 1990s led to an increase in the employment rate of women in that province. A recent paper by Statistics Canada estimates that by 2015 Quebec's reform had added 7 percentage points to the employment rate of women with children (Gu, 2022[49]). The number of families that could benefit from increased access to affordable childcare is large; across Canada as a whole, there are around 1.7 million households with children aged under 5. A major federal-provincial initiative is now underway that should see substantial progress towards increasing access to affordable childcare. The federal government has struck deals with each province to ramp up the number of childcare spaces and to reduce the median cost of childcare. The deals vary in detail across provinces (Table 1.14). The gross additional federal funding commitment is substantial, equivalent to around 0.2% of GDP every year over a five-year period. A report by the Parliamentary Budget Officer (PBO) concludes that cost recovery (for instance through additional tax revenues through increased labour supply) will help offset the fiscal cost but not dramatically reduce it (Parliamentary Budget Officer, 2022[50]).

Box 1.13. Childcare provision issues in other countries

Countries facing similar challenges in childcare provision to Canada include Austria and the Netherlands. In Austria, the shortcomings of the childcare infrastructure became more visible during the pandemic according to the 2022 *Economic Survey.* These shortcomings contribute to Austria having one of the lowest full-time participation rates among women among comparable countries and one of the highest part-time employment rates. Similarly, in the Netherlands, relatively high out-of-pocket cost of centre-based childcare plays a role in the country's relatively large share of part-time working among women. Women's overall labour participation is high, but nearly 60% of women work part-time. This is roughly three times the rate for men. Widespread part-time working represents an inefficient use of human capital and leads to large gender gaps in earnings, wealth and pensions. *Surveys* of the Netherlands (OECD, 2021) have recommended reducing the user cost of childcare.

Norway and Sweden have been cited as cases of effective reform. A reform expanding access and reducing the cost of childcare in Norway in the 2000s facilitated the increased uptake of one- and two-year-olds from 40% in 2002 to 80% in 2012. The reform boosted women's employment and earnings and enabled more women living in couples to move into full-time work. Attitudes vis-à-vis early childcare changed also since the start of the reform, with the share of mothers estimating that full-time centre-based childcare is the best type of care for three-year-olds increasing from 41% in 2002 to 72% in 2010. Sweden is another country where centre-based childcare expanded in tandem with both an increase in women's employment and a steady increase in the share of women working full-time.

Sources: OECD Economic Surveys: Austria 2022, the Netherlands, 2021.

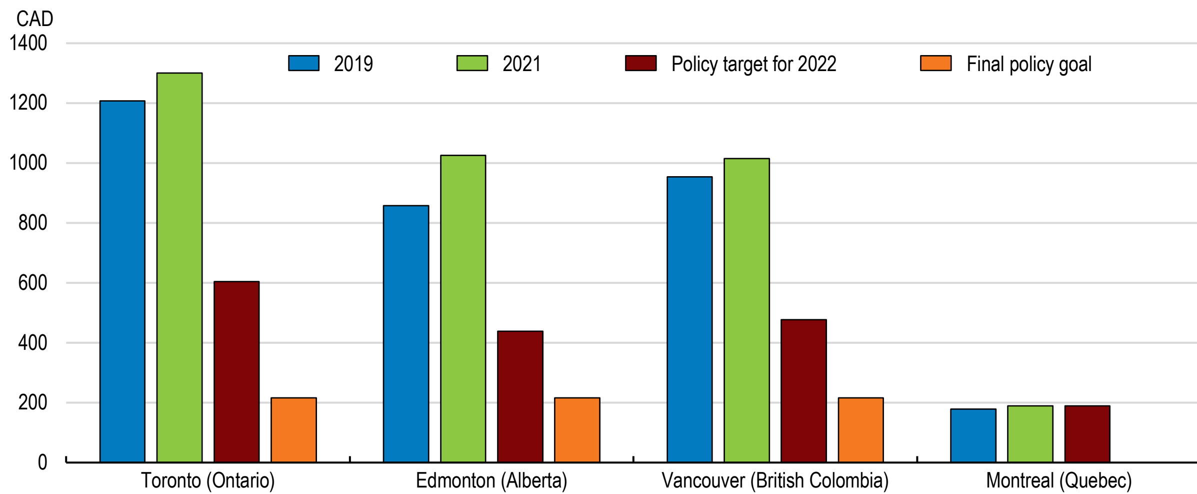
If the provinces successfully deliver, the impact on childcare costs could potentially be profound. There is an intermediate goal for fees for regulated childcare spaces to be reduced to half of 2019 values by end 2022 and for the cost to eventually reach CAD 10 per day. For instance, if fully executed, Toronto should see the median childcare cost fall from CAD 1 300 per month in 2021 to just over CAD 600 dollars by end 2022 and eventually CAD 216 dollars (Figure 1.20). The costs will be closer to those in Quebec, where subsidised day-care has long been in place and averages around CAD 8.50 per day.

The impact on households' choices around work and childcare may be significant. The large fall in childcare costs implied by the reform will widen the scope for parents to combine work and family life. The reform will bring financial benefits to households, boost labour supply (especially that of women) and broadly raise living standards. OECD microsimulations suggest that pre-reform a couple earning two-thirds of the average wage was paying just under 15% of their wage income on childcare, a relatively high share compared with other OECD countries (Figure 1.21). Reducing the share by half – as roughly aimed for by the end of 2022 – would bring the cost well within the lower half of the distribution. If the goal of CAD 10 per day can be attained, Canada's childcare costs would be among the lowest in the OECD area.

Policy now needs to focus on monitoring and assisting implementation, and on anticipating the need for further action. Substantial reduction in childcare costs and boosting the number of childcare spaces is a complex task. So far, the evidence suggests all provinces and territories have been on track for a 50% reduction in childcare costs, or better, by the end of 2022. The federal government can help further with implementation, for instance through the dissemination of information on progress towards lower costs and more childcare spaces. Exchange of experiences across provinces should be encouraged. Policymakers also need to ensure that the creation of new childcare spaces keeps pace with new demand generated by the reduction in childcare costs, which could be substantial. Importantly, policymakers also need to start developing policy for the delivery of low-cost childcare when the current five-year deals expire.

Figure 1.20. Substantial reduction in childcare costs is in the pipeline, if provinces can deliver

Median monthly childcare fees, selected major cities

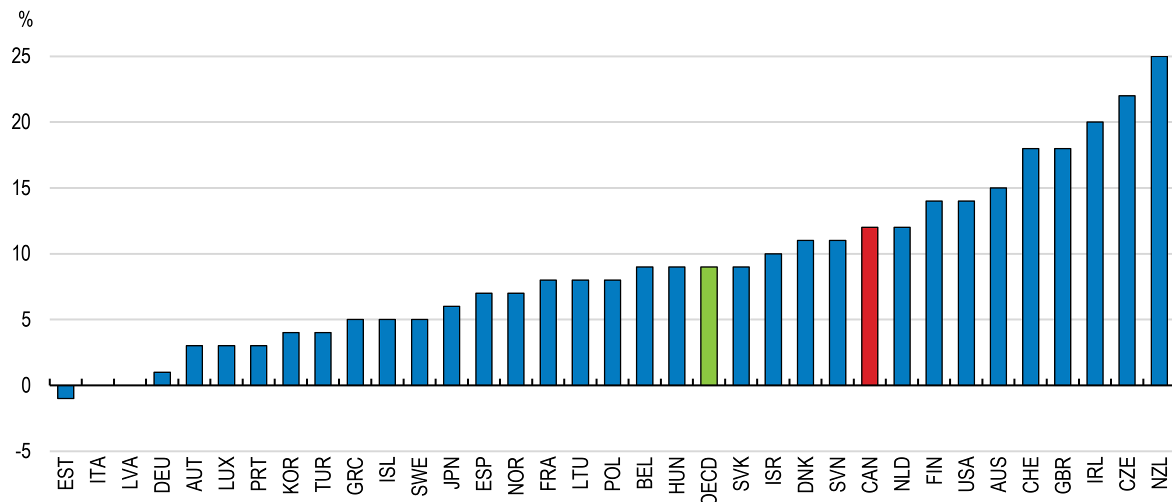


Note: the childcare fees are based on a survey of households across 37 cities in Canada. This chart shows the results for the major cities in the four most populous provinces. The policy target is for a 50% reduction in the 2019 childcare costs by end 2022. The "final policy" goal is based on the stated policy goal of CAD 10 per day (it assumes 20 days childcare per month).
Source: Centre for Policy Alternatives.

StatLink https://stat.link/shkryn

Figure 1.21. Lower childcare fees will help make work pay

Net childcare cost for parents using childcare facilities, % of household income, 2021 or latest available year



Note: This indicator measures the net childcare costs for parents using full-time centre-based childcare, after any benefits designed to reduce the gross childcare fees. Childcare benefits can be received in the form of childcare allowances, tax concessions, fee rebates and increases in other benefit entitlements. Net childcare costs shown here are calculated for couples assuming two children aged 2 and 3. Both parents earn 67% of the average.
Source: OECD (2022), Benefits and wages: Net childcare cost for parents using childcare (database).

StatLink https://stat.link/l37axj

Table 1.14. The federal-provincial childcare reform deals

Selected details of the deals with the four most populous provinces

	Cost-cutting objectives	Supply increase commitments	Federal funding commitment
Ontario	Cut child-care fees in the province in half by the end of 2022. Further cuts are slated for September 2024 to bring Ontario to an average of CAD 10 a day by September 2025.	The creation of 86 000 child-care spaces, though that number includes more than 15 000 spaces already created since 2019.	CAD 10.2 billion over five years
Quebec	The federal deal with Quebec does not involve specific commitments as the province already provides low-cost childcare. Ottawa agreed to transfer funds to the Quebec government, partially to support the current system. The province spends about CAD 2.7 billion annually on its daycare program, which costs parents CAD 8.50 a day per child.		CAD 6 billion over five years
Alberta	Child-care fees to be halved by the end of 2022 and reduced to an average of CAD 10 a day by 2026.	Alberta is also to create 42 500 new regulated early learning and childcare spaces by the end of March 2026.	CAD 3.8 billion over five years
British Columbia	Reduce childcare fees by half by the end of 2022. An average of CAD 10-per-day childcare in regulated spaces for children under six before 2026.	30 000 new spaces over five years.	CAD 3.2 billion over five years
Memorandum: total federal government funding commitment			Approximately CAD 30 billion over five years, equivalent to approximately 1% of annual GDP (0.2% each year).

MAIN FINDINGS	RECOMMENDATIONS (key ones in bold)
Ensuring macroeconomic stability	
High inflation is widespread and reflects the cost of energy, food and housing. With capacity strained in a tight domestic labour market, there is risk of a destabilising wage-price spiral.	**Continue to shrink the central bank's balance sheet and stand ready to raise the policy rate further as warranted to bring inflation sustainably back to target.**
Interest rate rises are increasing financial stress on some households, many of which have high debt. Concern around the liquidity of fixed-income asset markets has grown.	**Maintain a close watch on housing debt and on fixed-income markets. If necessary, take further steps to relieve household financial stress.**
The fiscal deficit has declined rapidly. Continued improvement would help rebuild fiscal buffers.	**Ensure that fiscal policy continues to work in the same direction as monetary policy by tempering excess demand.** **Maintain a credible medium-term plan for lowering federal government debt. This should include the detailing of spending efficiency plans.**
Some windfall gains from high commodity prices are being spent while fiscal buffers for future shocks are thin.	**Rechannel strong resource revenues towards reducing public debt and/or towards stabilisation funds.** Provinces should review royalty regimes in light of recent high commodity prices to ensure they can appropriately handle future surges in commodity prices.
The federal government has broadened the scope of the preferential tax regime for small businesses. There are more efficient ways of targeting support to overcome market failures.	Reconsider preferential tax rates for small businesses.
Taxation on consumption spending remains underutilised. The combined value of federal and provincial value-added/goods and services taxation is typically low in international comparison.	Maintain shift towards more indirect taxation through higher rates of goods-and-services tax as a policy objective for the longer term.
Lifting productivity growth	
Canada's productivity growth and investment continues to underperform relative to leading OECD countries. Internal barriers to trade have large economic costs and limit the efficiency and scope of labour markets.	**Accelerate reduction in internal barriers to trade, including through widening the scope and powers of the Canadian Free Trade Agreement.** Make tackling barriers around the recognition of qualifications a key element of reform.
Competition in some sectors is hampered by limits on foreign ownership and board membership of Canadian companies.	**Evaluate, with a view to removing, foreign ownership restrictions in network sectors.**
Canada has lagged in adjusting competition laws to a more digital world.	**Strengthen instruments in competition law and regulation that prevent the emergence of anti-competitive behaviour around large digital enterprises ("ex ante" regulation).**
Russia's war against Ukraine has increased attention to Russia-linked money laundering and sanctions evasion.	**Ramp up efforts to shut down channels for money laundering, including by following through on the proposed establishment of a new beneficial ownership registry by the federal government.**
Ensuring support for the most vulnerable and improving childcare	
Federal and provincial governments have brought in a wide range of temporary measures to help households cope with rising living costs. Some provincial measures are not well targeted.	**Better target provincial temporary support to households most in need of relief on living costs.** Consider widening the use of quarterly updating in benefits to households, especially in the event of future surges in the cost of living. Ensure minimum wage setting processes have the capacity to deliver timely increases that strike an appropriate balance between compensating for cost-of-living increase and the risk of undesirable consequences for employment and inflation.
The major initiative underway to lower the cost of childcare and increase the number of childcare spaces will mitigate cost-of-living pressures and support female employment and gender equality.	**Monitor and, where necessary, support the provinces' and territories' delivery of lower cost childcare and the creation of additional childcare spaces.** Begin working on policy solutions for the delivery of low-cost childcare after the current five-year deals between federal and provincial governments expire.
Significant socio-economic gaps between Indigenous people and the rest of Canada's population remain. Large multi-year investments are underway to advance reconciliation.	**Support self-determination among Indigenous peoples through further transfer of powers to communities, including through capacity building in Indigenous governments, and co-developing policy.** Maintain the distinctions-based approach to policy and ensure adequate funding to eliminate gaps with other Canadians.
There has been a welcome acceleration of efforts to address housing affordability. The federal government's Budget 2022 announced a raft of measures with net budgeted spend of around CAD 10 billion over five years.	Look toward evaluating the effectiveness of the large number of announced measures.

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