Intelligence MEMOS

From: Don Drummond

To: Economy Observers

Date: September 15, 2025

Re: **Canada's New Economic Model Should Begin with the Budget**

A trading nation, Canada lives next to what has long been a big welcoming market in a generally competitive free-trading world. That once free American market is fast being restricted by tariffs, for now made passably permeable by the United States-Mexico-Canada Agreement, which is likely to be made more U.S.-protectionist in 2026.

Our free-trading world has shrunk, and, in response, Canada is desperately seeking to strengthen its domestic market and diversify trade. Success will require producing goods and services of the highest quality at competitive prices, something Canada is ill-prepared to do because of our failure to tackle long-standing economic and fiscal problems – weak productivity, a growth-inhibiting tax structure, domestic trade barriers, high public debt and mounting spending pressures.

Now, simultaneously, we must find new markets, strengthen the domestic market and rid the economy of old baggage.

In 1960, Canada had the third-highest level of labour productivity among the then 24 members of the Organisation for Economic Co-operation and Development; now we stand 18th of 38.

With growth in output per hour worked ranked as 31st in the OECD from 2000 to 2022, our slide is likely to continue. Multifactor productivity, which is the efficiency with which capital and labour are used, has been declining since 2000. Business investment is weak; investment in machinery and equipment per worker was only 41 percent of that in the United States in 2023. Weak innovation feeds poor productivity through low research and development spending. Canada has few patents and limited commercialization flows from those that do exist.

Taxes on income and profits depress economic output much more than consumption-based taxes do. Yet Canada relies heavily on the former (51.6 percent of total revenue compared to the OECD average of 36.5 percent) and less on goods and services taxes (21.7 percent versus 31.5 percent). Canadian corporate taxation, subsidies and regulation favour small over large businesses, but the latter have higher productivity, export more and do more research and development.

Federal and provincial governments are making some progress in striking down domestic trade barriers, but serious restrictions remain on labour mobility, professional credentialing, trucking and incompatible regulations.

High debt burdens and a federal net-debt-to-gross-domestic-product ratio of more than 40 percent will handicap both levels of government in offering fiscal support to address tariff damage, encourage economic transformation and deal with mounting age-related spending pressures, as well as the federal commitment to much higher defence spending.

In its economic plan of support for the tariff-stricken steel industry, the Prime Minister's Office described four planks. Each will have economic and fiscal problems.

First, investing in domestic production, essential to satisfy all markets, will require higher productivity, competitiveness and freer trade within Canada.

Second, developing Canadian expertise requires redressing the financial crisis in Canadian postsecondary education and an immigration system that in recent years has tilted toward filling low-paying jobs rather than raising skill levels.

Third, supporting companies to retool and reinvest will depend on reversing direction by elevating private business. This may require major revamping of taxes and subsidies.

Fourth, both helping industries pivot to a growing Canadian market and supplying new, reliable trading partners come down to reversing Canada's long slide in productivity.

The Carney government has promised a budget this fall. While an economic and fiscal accounting is long overdue, what's vital is to engage the public and get its buy-in to the government's proposals. What is needed is an early parliamentary economic and fiscal statement that sets out the accounts, provides context for the challenges, and puts proposals before the public for consultation and debate. A budget should follow.

For instance, the current economic model was heavily shaped by the Canada-US Free-Trade Agreement of 1989 and the North American Free-Trade Agreement of 1994, to which the Canadian public was conditioned by the Donald MacDonald Royal Commission, a Finance Canada discussion paper, a vigorous public debate and a federal election largely over trade issues.

The US tariff threat deprives us of a comparable timeline but expedited ways must be found to engage experts and to consult with the public. Had former prime minister Justin Trudeau's government followed through on its promise to establish a productivity commission and had the review of corporation taxation promised in the 2025 Liberal election platform been established, we would have been better prepared.

It is time to reject complacency, regain inventiveness and the reputation for producing goods and services of high quality and competitive pricing throughout the new trading worlds. New economic and fiscal models are imperative, and the Canadian public must be extensively involved in their creation and adoption.

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