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The Endgame: Time to Act on Canada's Economic and Fiscal Challenges

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Introduction

A year ago, I spoke to the incoming 2025/26 Master of Public Administration (MPA) class about the economic and fiscal challenges facing Canada and the need for bold action (Drummond 2025). Conditions have not improved. You may think the latest trade friction with the United States suggests they have worsened, but a deterioration in the relationship was highly predictable, and tensions should be expected to continue. While some positive action has been taken, Canada is still not taking the challenges seriously enough. The bold action called for can be postponed no longer.

The Economic and Fiscal Challenges

Over the decade to 2023, gross national income per person grew a meagre 0.5 percent annually in Canada, ranking last in the G7 and 32nd out of 35 Organisation for Economic Co-operation and Development (OECD) countries (Drummond, Laurin and Robson 2026). This weak income growth reflects longstanding productivity underperformance relative to both Canada's own history and other countries.

Canadian economic outcomes fall well short of US standards, and gaps are widening. Some take comfort in the argument that higher US averages are heavily influenced by the disproportionate number of extremely wealthy Americans. Yet the shortfall in Canadian inflation-adjusted median employment income was already substantial at CA$6,126 in 2010 and widened to $8,663 by 2024. From 1999 to 2025, Canadian productivity increased 26.7 percent, while US productivity rose 67.9 percent (Munro, Fuss and Emes 2026).

A severe blow to Canada's most important trading relationship piles on top of the productivity challenge. The two interact in pernicious ways. Weak productivity makes it difficult to trade with other nations. Losing relatively free access to the US market makes it difficult for Canadian firms to build the scale needed to improve productivity.

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Population ageing and climate change make the productivity and trade challenges even more difficult to address. An ageing population reduces the workforce and draws resources into healthcare and pensions. Climate change is exacting billions of dollars a year through infrastructure repairs, health costs, and rising insurance premiums resulting from flooding, wildfires, and extreme weather. The Canadian Climate Institute estimates that climate change will reduce Canada's long-term annual economic growth rate by almost half, compounding into losses of hundreds of billions of dollars or more by the end of the century (Drummond, Philips and Harland 2026).

Canada's fiscal situation acts as a drag on growth and limits our ability to address these challenges. The federal government alone projects deficits exceeding $50 billion a year as far as the eye can see, a net debt-to-GDP ratio staying above 40 percent, and tax and spending parameters that dull incentives to grow. And such dire outcomes do not fully reflect the commitment to massively increase defence spending. At least Canada's fiscal situation and prospects are not as dire as those of the United States and many other countries.

Re-establishing fiscal stability is especially important now to mitigate the contagion from rising global bond yields, driven in good part by growing public debt burdens and a surge in long-term financing needs for artificial intelligence (AI). Canadian bond yields are creeping up but remain about 1 percentage point below US rates. That borrowing advantage is not guaranteed.

Inaction on stabilizing public finances is often justified by the Canadian federal government's lower debt burden compared to other major countries and our own history. But the Canadian debt advantage is much less pronounced when considering all levels of government and using gross debt – which removes the current surpluses from the Canada and Quebec Pension Plans, which are not available to fund public services other than pensions. The current federal net debt burden of just over 40 percent of GDP, with about 13 cents of every revenue dollar going to debt charges, compares favourably with the 66.6 percent net debt-to-GDP ratio of 1995/96, when debt charges absorbed 35.2 cents of every revenue dollar. But it makes no sense to risk following the path of more indebted countries, which face even higher bond yields, or to repeat the worst of our own fiscal history, when Canada struggled to find buyers for its debt.

The only good thing that came out of Canada's dire fiscal situation in the mid-1990s was the acceptance of a crisis and the will to act boldly. Surely, we can have the foresight to act boldly now before again hitting a fiscal wall.

The Status Quo is Unpromising

Drummond and Mahboubi (2026) projected Canada's future economic growth rate assuming productivity continues to grow at its meagre average rate since 2000. Applying this assumption to the demographics resulting from population ageing and the new, lower immigration targets, this "supply-side" perspective on growth yields just 0.5 percent real GDP growth this year and next, and an average of 1.4 percent from 2026 to 2060 if the downward trend in average hours worked is arrested, or 1.2 percent if it is not.

The federal deficit would rise from the $50-billion-plus annual range projected in the 2026 Spring Economic Update, and the debt burden would continue rising as a share of GDP.

The bottom line would be stagnant economic well-being for individuals and a massive transfer of burdens to younger and future generations.

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The Challenges Are Not Being Taken Seriously Enough

Undoubtedly, part of the reason bolder action has not been forthcoming is that many economists, especially forecasters, have put a rather rosy spin on prospects. Typical forecast assumptions include no further increase in the average tariff rate on Canadian exports and diminishing trade uncertainty. In other words, they attach no credibility to the rhetoric of President Donald Trump or the many trade agreements the US has been signing around the world that feature significant base levels of tariffs, with higher rates and quotas on selected products. We continue to see such a spin, with many rushing to predict that the latest round of US tariffs against Canada will only reduce real GDP by 0.4 or 0.5 percent, while assuring us that at least we still have the Canada-United States-Mexico Agreement (CUSMA).

Such analyses of what is taking place at the margins miss the point that the fundamental premise of all free trade agreements struck with the United States over the past few decades – that companies, whether Canadian or foreign, can freely access the US market from a base in Canada – has been broken. It will take a long time, if ever, to restore confidence in that premise. We must ask: if companies were not investing much when they thought they had access to the US market, why would they when such access is threatened?

It is difficult to comprehend the steadfast assurance that average tariff rates will not rise or CUSMA protections will remain. The US has rejected automatic renewal of CUSMA, is breaking its commitments daily, and has made it clear that it expects to extract a fee from all those American firms that buy from outside the United States. The sort of fee it appears to have in mind, and has been extracting from other countries, can make it unprofitable for Canadian exporters and US importers to do business.

Output per hour worked – productivity – has averaged 0.8 percent growth since 2000 and only 0.5 percent over the past four years. Yet most forecasters assume much stronger rates going forward. The Bank of Canada, for example, assumes 1.4 percent average annual growth in productivity through 2028, a pace not seen in decades. It adds 0.2 percentage points per year for the growing application of AI and assumes employers will squeeze more output per worker from the dwindling labour force. These are unproven assumptions and still do not fully explain the optimism. Such forecasts feature much stronger growth than the "supply-side" projections of Drummond and Mahboubi (2026). The latter are not a forecast per se. Productivity could grow more strongly. Demand growth could outstrip supply. But outcomes could just as easily be even weaker. Given global uncertainty and trade tensions with the United States, it would be wise to take such downside risks more seriously.

The Bank of Canada should be given credit for at least thinking about the macroeconomic implications of AI applications. But much more work needs to be done on these issues. And in the meantime, some healthy scepticism about AI's potential benefits for productivity is in order. First, there have been many technological breakthroughs during the period of Canada's declining productivity growth. Second, work by the Future Skills Centre (2024) found that while firms applying AI have higher productivity than those that do not, AI itself did not raise productivity.

If the challenges were being taken seriously enough, the federal government would not have abandoned its promise from five years ago to establish an independent commission on productivity. It also would have followed through on its election promise to establish a group to examine corporate taxation. Clearly, the government understands the problems but has decided not to call upon expert advice or encourage national discussion at this time.

If the challenges were taken more seriously, we would not see federal and provincial politicians uniting in the quest for international free trade while maintaining internal trade barriers. The International Monetary Fund has said these barriers are equivalent to a 9 percent external tariff on all Canadian goods and services, and that removing them could raise real GDP by 7 percent in the long run (Diez and Yang 2026). Some barriers have been reduced since the IMF made these estimates, but they remain substantial.

If the challenges were taken seriously, we would see a concerted national – federal, provincial, territorial, and municipal – effort to streamline regulatory processes. Federal approval alone of projects can easily take more than five years. Add often separate and sequential approval processes at the provincial, territorial, municipal, and Indigenous levels, and the projects being bandied around amid renewed interest in infrastructure may not even start for a long time.

Canada's potential advantage in critical minerals is being cited often of late. But development, if it proves to be economically beneficial, could take decades. The federal government is taking action, including setting up a Major Projects Office and enacting the *Building Canada Act*. It has been noted, however, that the underlying obstacles – "political decision-making over individual projects and open-ended criteria that require regulators to consider broad public policy objectives" remain largely unaffected (Vegh and Koplovich 2026).

If the challenges were taken seriously enough, we would have a comprehensive federal economic plan that realistically lays out the challenges, presents options for national consultation, and sets out a plan for bold action. Instead, we get speeches, webinars, and budget documents that cover the territory only partially and reach relatively few Canadians. The prime minister has said Canadians will be required to make sacrifices. But time after time, the government softens those sacrifices by borrowing more money: to increase the Old Age Security payments for those 75 and over, a cohort with one of the lowest poverty rates; to rename the GST low-income credit the Canada Groceries and Essentials Benefit (CGEB) and increase it; to offer more incentives to first-time home buyers and purchasers of new homes; to suspend the federal gasoline excise tax for six months – and then extend the suspension as gasoline prices failed to decline; and to put still more money into subsidies for childcare.

In all these cases, the federal government addresses affordability issues by borrowing more. That simply transfers the burden forward. Where there is a demand-supply balance, demand is stoked further with much less effort applied to supply enhancement. Affordability challenges would be better met by greater efforts to raise Canadian productivity and incomes. Some of the government's actions, such as more infrastructure spending, will certainly help productivity, but a cohesive plan is not being applied across all spending.

If the challenges were taken seriously enough, we would not see the federal government take the more than $5 billion fiscal windfall from higher oil prices and spend every cent of it in the 2025 budget, mostly to bolster consumption. We would not have seen an 80 percent increase in government operating costs over 10 years, with a 90,000 expansion in the number of federal civil servants – a one-third increase – together with a doubling of contracting costs. Average compensation for full-time equivalent bureaucrats also reached $143,271 (Terrazzano 2026). That is far higher than what is made by the majority of Canadians funding such pay through their taxes. Despite this growth, services do not appear to have improved. The government has cited new programs such as pharmacare and the Canadian Dental Plan, but much of the administrative burden is carried by the provinces and the private sector. Efforts to cut federal spending have been half-hearted, often going little beyond incentivizing civil servants to leave. Even after these so-called cuts, the ratio of program spending to GDP, is projected to reach its highest level since 1994/95 by 2030, outside of the pandemic years.

What Would a Strategy Look Like?

The starting point for a more serious course of action would be to put a comprehensive economic plan to Canadians, realistically depicting the challenges and options for action. If Canadians understand the gravity of the situation, they will give political licence to act, as they did with the initial Free Trade Agreement and the assault on the deficit in 1995.

Governments and private sector agents would cut the wishful thinking from their projections and depict the probable problems under the status quo.

Governments at all levels and in all jurisdictions would unite to finally end internal trade barriers. They would work together to streamline regulatory processes without compromising environmental standards or Indigenous rights. And they would do it soon and quickly.

Governments would radically alter the fiscal landscape with lower deficits and debt burdens and taxation and spending parameters targeted at promoting growth. The focus would be on much lower spending. Restoring the ratio of program spending to GDP that prevailed from 2003/04 to 2019/20 would reduce spending by $66 billion by 2030 and, on its own, bring the budget back close to balance.

The federal government would proceed with the promised review of taxation. The recommendation would inevitably be to shift the composition of Canadian taxation away from the overuse of corporate and personal income taxes, which are the most damaging to economic growth, and toward consumption taxes. The government would cut corporate and personal income tax marginal rates (see Mintz, Laurin, and Dahir 2026). It would also end the steep marginal corporate income tax rate corporations face if they try to grow beyond the definition of a small business.

A federal government plan would feature a comprehensive review of spending with a value-for-money perspective. Programs that could not be reformed to deliver intended outcomes efficiently would be scrapped. The results of the review would be made public to Canadians. The resulting action would need to be sweeping, such as gradually raising the age of entitlement for Old Age Security (OAS) and lowering the income threshold at which OAS payments are clawed back. Programs like $10-a-day childcare would be reformed to recognize that a crisis of affordability has become a crisis of accessibility. Business subsidies should be cut back drastically, as many simply transfer income rather than address market failure. Only about 20 percent of subsidies boost real income (Lester 2026). Supply management in agriculture should be reformed, not to appease the United States, but to raise productivity and lower prices in Canada. Supply management need not be scrapped. The focus should be on greater flexibility in quotas and caps on subsidized prices.

A serious approach would also recommit to environmental objectives, including lower greenhouse gas emissions that contribute to climate change. It is not fashionable of late to speak of environmental objectives, as many countries emphasize economic growth. But the future of the planet and its people depends upon reducing emissions. And this need not come at the expense of economic growth. Putting more emphasis on clean growth would be a start. The focus lately seems to be all on the development of fossil fuels and getting them to markets. But the combined global market value of clean energy technologies has grown about 20 percent per year over the past decade. Ironically, two of the world's largest emitters lead in several dimensions of clean growth. China tops the world in clean energy infrastructure, and the United States invested over US$278 billion in clean energy and transportation in 2025 alone. Canada does not have to match their scale to capture a portion of the prize; it just has to identify and focus on existing competitive advantages (Drummond, Philips and Harland 2026). We now have a National Electricity Strategy. But it does not have nearly the buzz of the attention being given to fossil fuel development.

Government plans would recognize that Canada's post-secondary education system can be a bedrock for people's prosperity and well-being gains. Ontario has finally lifted the freeze on tuition. But by 2025, the initial cut and subsequent freeze had brought real (after-inflation) tuition in Ontario 26.6 percent below the 2018 level. That loss in real value is locked in for the foreseeable future. The February 2026 Ontario announcement raises grants by about $1 billion per year, but by 2027/28, they will still be more than 10 percent below 2015/16 in real terms per eligible student (Drummond 2026).

Institutions should be allowed greater flexibility on tuition. The after-inflation value of Ontario and federal grants for research should be restored and be better aligned with the economic transformation the province and Canada must accomplish. Governments should provide incentives to commercialize university-based research. Universities should be allowed to enrol more foreign students with proper accountability and objectives in place. The recent increase in the income requirements for foreign students is a good first step to curtail abuse, which was never widespread in universities, and should be complemented by ending foreign students' ability to work off campus.

The Endgame and How to Get There

Canada has allowed itself to become too dependent on the United States and has ignored our domestic vulnerabilities for far too long. We are now paying the price. But by addressing the challenges, we can get to an endgame of a new economic and fiscal model that has a stronger, more resilient, and diverse economy with stable finances. The goal should be nothing less than being better off than we have ever been.

What will it take to get to this endgame?

- An honest recognition of the economic and fiscal challenges.
- A comprehensive plan.
- Transparency with Canadians about the problems and the plan, sparking national discussion, debate, and hopefully, consensus on action.
- A willingness to act.
- Speed in acting, but patience with the inevitable lags in realizing improvements.

Conclusion: Let's Act Now

Actions such as those recommended above always meet resistance as too controversial to be supported by the Canadian public and, hence, politicians, or too difficult to pull off within our system of federalism. But that may only be true if Canadians are not fully apprised of the seriousness of Canada's economic and fiscal challenges. With such unfiltered information and a plan to ensure Canada's prosperity, Canadians would likely offer widespread support, as they have in response to previous national challenges.

We must get serious and act now.

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