THE NATIONAL INTEREST

The Problem with Canada's Economy

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September 4, 2026

At a news conference with Canadian Prime Minister Mackinzie King some 80 years ago, President Harry Truman declared "Canada and the United States have reached the points where we no longer think of each other as 'foreign countries. We think of each other as friends, as peaceful and cooperative neighbors on a spacious and fruitful continent".

Since that press conference, US-Canadian relations have taken a quantum leap backward and. are now at their lowest ebb since Canada burned down the White House in 1814 during the War of 1812.

Today's conflict between the two neighbors is all about trade, not territorial acquisition despite President Trump's rhetoric about wanting to make Canada the 51st state and renaming Lake Ontario "Lake America".

While the conflict may be widely perceived as a David vs. Goliath match, Canada has only itself to blame for its weakness and vulnerability in trade. The reason? Canada has failed for decades to take sweeping measures to improve *competitiveness* and *diversify exports*.

In the first instance, competitiveness, Canada's key sectors comprise energy, metals and mining, agribusiness, forestry, major manufacturing, technology and commercial services. These sectors also account for more than 90% of Canada's exports. The nation supports five Global Innovation Clusters, including digital technology, advanced manufacturing, and AI (formerly called the Innovation Superclusters Initiative). These are industry-led economic networks designed to boost research, technology commercialization, and business growth.

Nevertheless, Canada does not rank among the top 15 countries in the world, according to IMD's *World Competitiveness Ranking*. Canada suffers from low labor productivity, internal trade fragmentation, weak business investment, and a lack of robust market competition. Specifically, labor productivity growth has failed to keep pace with the U.S. for decades; and while U.S. companies invest roughly twice as much into R&D relative to GDP compared to Canadian firms, it is internal (provincial) trade barriers that are most detrimental. According to IMF calculations, fully eliminating these domestic trade barriers could expand Canada's long-term GDP by roughly

7%, unlocking approximately $210 billion in additional economic output without spending a single taxpayer dollar. Other competitiveness impediments are Canada's taxes--higher than the average among wealthy nations--and federal regulatory compliance costs that exceed $18 billion per year

Export diversification, is another arena where Canada comes up short, as 72% of the nation's merchandise exports go to the U.S. Only 10% goes to the Indo-Pacific region Asia and less than that to Europe and Central Asia. Reaching new buyers in Asia and Europe could generate an additional $146 billion in additional export growth by 2035.

Canada has 15 active FTAs covering 51 countries outside of the USMCA/CUSMA. Canada uses a multi-layered network of federal departments collectively known as Canada's Trade Team to promote exports and help domestic businesses expand globally. The country's Trade Commissioner Service (TCS) has offices in over 160 cities worldwide. Canada also provides direct financial support to SMEs, export credit and sector specific assistance.

Canada has a significant opportunity to diversify exports beyond its historical reliance on the United States, according to a new PwC Canada report, *New markets, new routes for Canadian logistics*. A new report from the Fraser Institute argues that China and India represent Canada's most promising markets for reducing its economic reliance on the United States. The Carney government itself has a stated goal of doubling Canadian exports to non-US markets by 2035.

Yet, when it comes to exporting, Canada is practically joined at the hip to the U.S. Take civil flight simulators, engines, and aircraft. Canada is a top five global player with firms like Bombardier, CAE, De Havilland and Pratt & Whitney, however 75% of its export go to the U.S. with *only 20.6% to Europe and 10.5% Asia.*

Stepping back and observing the current US-Canada trade conflict, one can speculate as to the U.S. reason, such as President Trump's need for distraction from his increasingly abysmal poll numbers. For a Canadian explanation, it can best be explained as the "comfort trap"--an economic concept describing how a high baseline of national wealth and past success have created complacency, hiding weak productivity growth and delaying necessary structural reforms.

Writing in the digital magazine *Policy Options,* strategy consultant Qi Wu, argues that Canada's "comfort trap" is stalling long-term economic growth and competitiveness. Impediments to competitiveness and failure to diversify exports are manifestations of that diagnosis. As Canada remains wealthy, stable and livable, according to Mr. Wu, what's the problem? For an Ontario producer of spark plugs, why bother exporting to Toledo, Spain, even where demand for product is increasing when Toledo, Ohio, is 4.5 hours away?

Co-dependent relationships, whether personal or commercial, are not healthy. The $27 billion US-Canada trade relationship is case in point where targeted goods on each side directly drive up costs for everyday consumer products, manufacturing inputs, and business.

Canada's competitiveness issue must be addressed at 80 Wellington Street, Ottawa—not 1600 Pennsylvania Avenue, Washington, DC. The current roller coaster relationship between the U.S.

and Canada will stabilize and hopefully improve. So, the key question remains: will Canada's competitiveness and export diversification follow as well?

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