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Canada’s middle power moment: An industrial comeback?

By Matthieu Arseneau, Alexandra Ducharme and Évelyne Gosselin

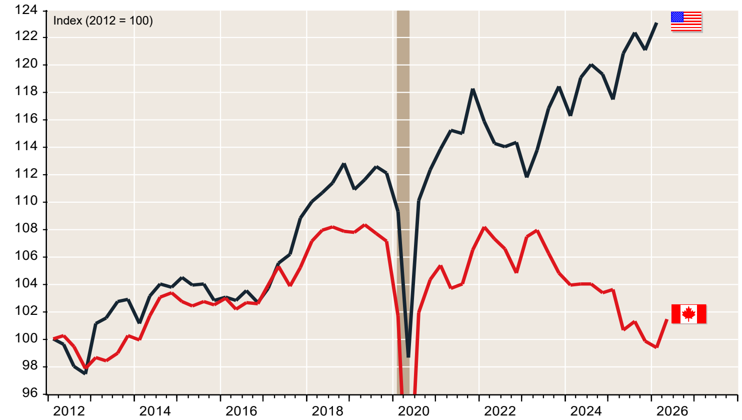
Summary

- Canada’s manufacturing decline is not simply the natural evolution of an advanced economy. Manufacturing now represents just 8% of GDP, while Canada has suffered one of the sharpest declines among advanced economies and has fallen markedly in global industrial competitiveness.
- The problem is not only that Canada produces less, but also what it produces. Contrary to expectations that globalization would push advanced economies toward more sophisticated activities, low-value-added industries now account for more than two-thirds of Canadian manufacturing output, versus roughly half in other G7 countries.
- A widening productivity and investment gap has eroded competitiveness. Since 2000, Canadian manufacturing wages have risen faster than in the U.S., while productivity gains have been less than one-third as large, driving a much steeper increase in unit labour costs. At the same time, Canada’s real manufacturing capital stock has contracted while the U.S. stock has continued its upward trend.
- A stronger domestic manufacturing base would improve supply and national security, strengthen Canada’s leverage as a middle power, capitalize on Canada’s relatively clean electricity and stronger environmental and labour standards, and support social cohesion by preserving opportunities for less-educated workers.
- We welcome Ottawa’s policy shift, which is creating much more favorable conditions for reindustrialization. Building on recent regulatory, energy and defence initiatives, the new tax measures significantly improve Canada’s investment competitiveness. Accelerating deregulation at all levels of government, together with a de-escalation in trade tensions with the United States, may now represent the final pieces of the puzzle needed to fully unlock that potential.

A continuing downward trend

In late 2024, we highlighted in a **Special Report** that the decline of the manufacturing sector was a cause for concern for the Canadian economy. Recently, this trend has been exacerbated by Washington’s imposition of tariffs on certain Canadian exports. Data available for the first half of 2026 suggests that the sector is on track to experience a third consecutive annual contraction in economic activity. The labour market has also lost jobs since the first rounds of tariffs (-1.0%) and could be further affected if the new tariffs imposed by Washington remain in place (**link**).

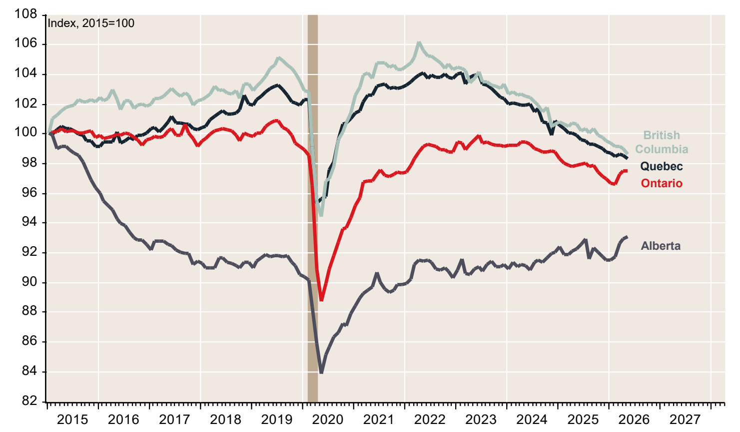
Canada: Manufacturing recession enters its third year
Real manufacturing GDP* : Canada vs US.



* Chained-weighted dollars
NBC Economics and Strategy (data via Statistics Canada and Fred)

This weakness in the manufacturing sector is reflected in the fact that more companies are closing than opening. This is leading to a steady decline in the number of operating factories in the country’s three largest provinces.

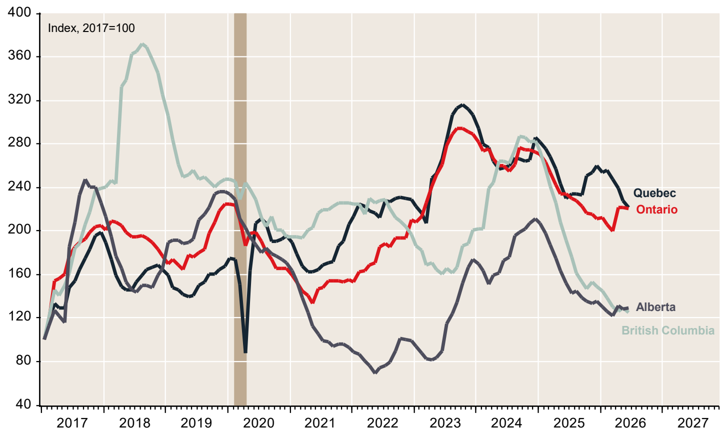
Canada: Number of factories in a downward trend
Number of active businesses in the manufacturing sector, main provinces, seasonally adjusted by NBC



NBC Economics and Strategy (data via Statistics Canada table 33-10-0270-01)

While tariffs have a direct impact on economic activity in specific sectors, manufacturers across the board remain on guard and fear losing their privileged access to the U.S. market. Admittedly, the White House has not announced its withdrawal from the USMCA, but the recent tariffs on products previously exempt under the free trade agreement are cause for concern among all exporting companies. This confidence has already been shaken, as evidenced by the downward trend in factory construction in the country’s four largest provinces since the onset of trade tensions. This slowdown in the expansion of production capacity could weigh on output in the medium term.

Canada: No signs of a recovery in factory construction
Investment in factories and plants. Main provinces, constant dollars, seasonally adjusted by NBC



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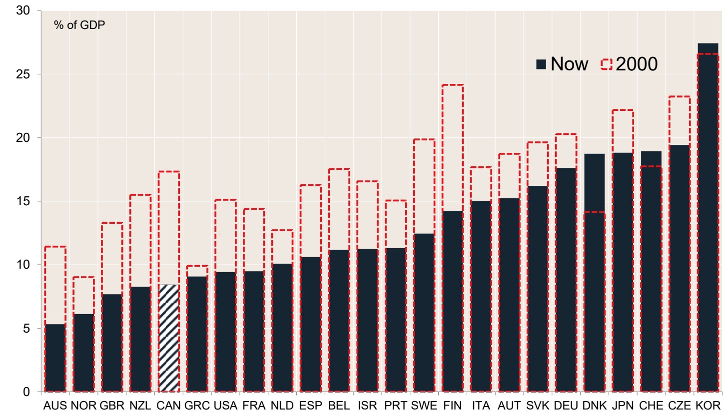
Canada: From average to bottom of the class
Manufacturing value added as a share of GDP



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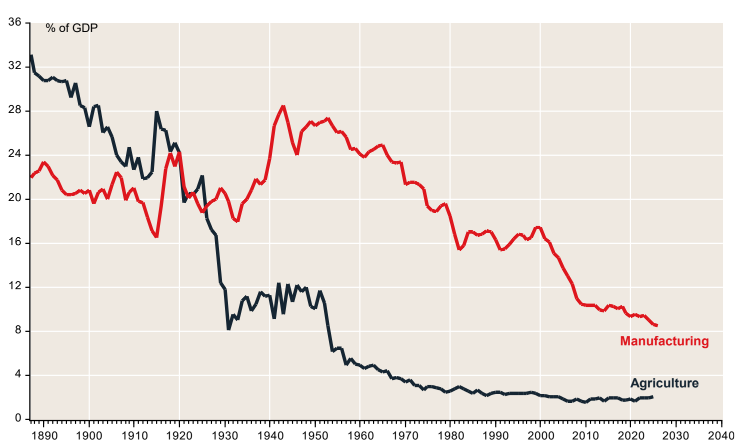
Less manufacturing, a sign of progress?

This weakness would be less concerning if it could be attributed solely to trade tensions, a factor that may prove to be temporary, at least at its current intensity. However, the problem is that the Canadian manufacturing sector's difficulties are not a recent phenomenon. While its share of the economy never fell below 15% between 1890 and 2000, it has declined sharply since then and now accounts for only 8.0% of economic activity. For some, this decline is part of a long-term trend that began after World War II and should not necessarily be a cause for concern, as it represents a natural evolution of advanced economies. As the manufacturing sector achieves productivity gains, it can produce more with proportionally fewer workers. At the same time, rising household incomes drive growing demand for services, which consequently account for an increasing share of economic activity and employment. The parallel is often drawn with the agricultural sector, whose share of the economy and employment has shrunk considerably over time due to dramatic productivity gains.

Canada: Is the manufacturing sector decline a sign of progress?
Manufacturing and agriculture, forestry, fishing and hunting as a % of gross domestic product

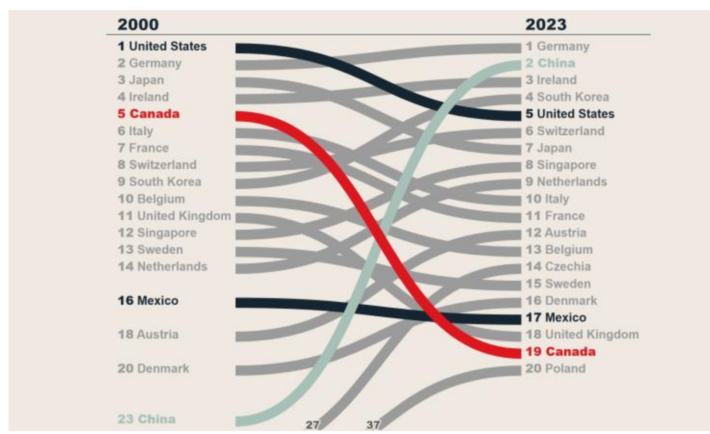


NBC Economics and Strategy (data via Statistics Canada and World Bank)

We believe, however, that the recent downward trend is largely due to competitiveness issues. In fact, the magnitude of Canada's decline is striking. Among advanced economies, Canada has experienced one of the sharpest contraction in the share of its manufacturing sector since China joined the World Trade Organization (WTO).

This marked decline is also evident in the United Nations Competitive Industrial Performance (CIP) Index, which compares countries' ability to produce and export manufactured goods competitively. Canada shows the sharpest deterioration among comparable advanced economies. Ranked 5th in the world in 2000, it now ranks only 19th—a drop of 15 places.

Canada: From 5th place in 2000 to 19th for industrial competitiveness
Change in Competitive Industrial Performance (CIP) index rank: 2000 vs 2023



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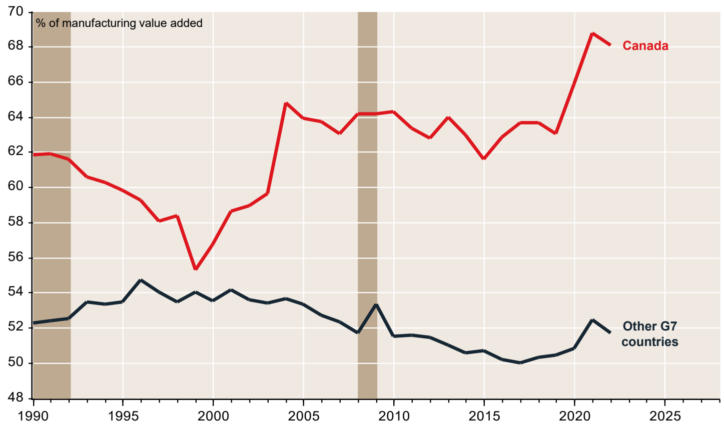
During the first decade following China's accession to the WTO, many observers argued that Chinese competition posed a threat primarily to labour-intensive, low-value-added industries. Advanced economies such as Canada could thus gradually move away from these activities and specialize in segments with higher value-added and greater technology intensity. However, Canada's experience has turned out to be quite different. Not only has the manufacturing sector's share of the economy declined sharply, but its composition has also shifted toward lower-value-added activities. These now account for more than two-thirds of Canadian manufacturing output, compared with about half, on average, in other G7 countries.

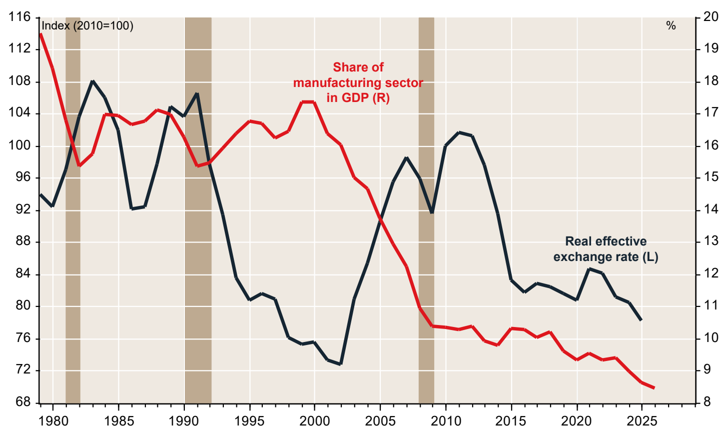
Canada and G7: Low tech manufacturing value added
% of manufacturing value added



NBC Economics and Strategy (data via World Bank)

What explains this underperformance? Between 2005 and 2015, several observers attributed part of the manufacturing sector's difficulties to the strength of the Canadian dollar. However, the significantly weaker real effective exchange rate observed over the past 10 years has not been enough to halt the sector's decline. The contrast is striking compared to the 1990s, when a weaker dollar coincided with a significant expansion in manufacturing activity.

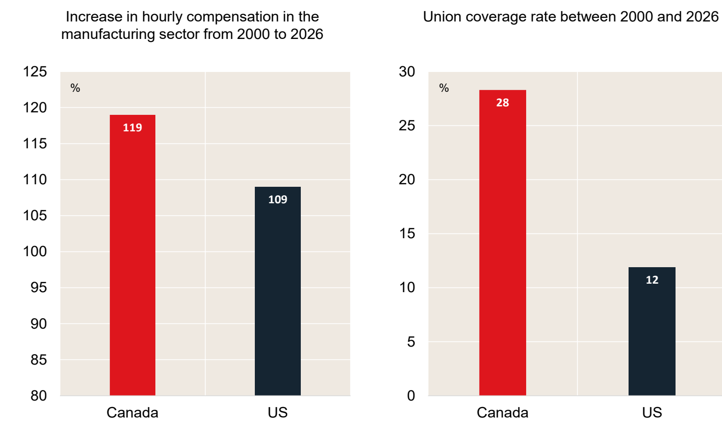
Canada: The weak currency no longer supports manufacturing
Share of manufacturing sector in GDP and real effective exchange rate



NBC Economics and Strategy (data via Statistics Canada)

Could trends in labour costs offer a possible explanation for the lack of competitiveness among Canadian firms? Between 2000 and 2026, average hourly wages in the Canadian manufacturing sector rose by 119%, compared with 109% in the United States. The Canadian manufacturing sector is also characterized by a unionization rate significantly higher than that observed in its southern neighbor. This difference may have contributed to the faster growth in wages, though it is not sufficient on its own to explain the deterioration in competitiveness regarding the cost of doing business in Canada.

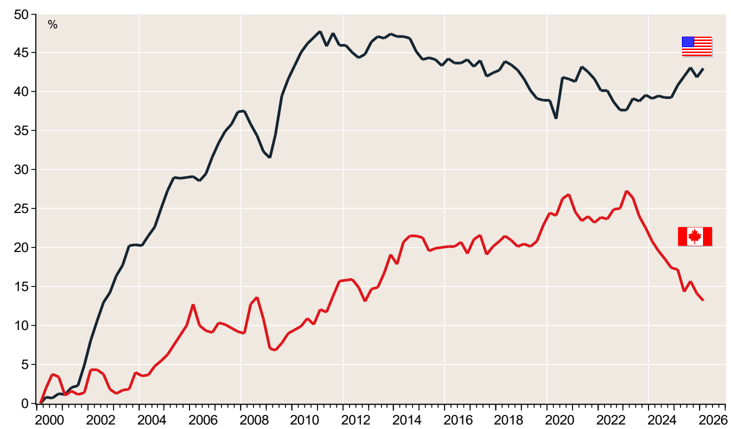
Canada: Larger increase in wages for factories workers



NBC Economics and Strategy (data via Statistics Canada and BLS)

In fact, faster wage growth would not be a problem if it were accompanied by greater productivity gains. However, precisely the opposite occurred during the first quarter of the century. In the manufacturing sector, productivity gains south of the border were more than three times higher than those observed in Canada.

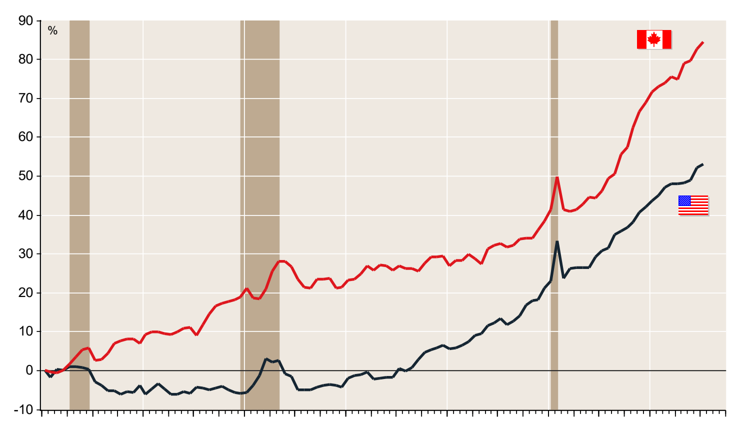
Canada: The productivity gap with our neighbors is widening
Manufacturing labour productivity cumulative gains since 2000



NBC Economics and Strategy (data via Statistics Canada and BLS)

Wages therefore rose more in Canada while productivity increased at a much slower pace, a combination that is particularly detrimental to competitiveness. As a result, unit labour costs rose 59% more in Canada than in the United States over the period.

Canada: Higher unit labour costs weigh on competitiveness
Manufacturing unit labor cost cumulative increase since 2000



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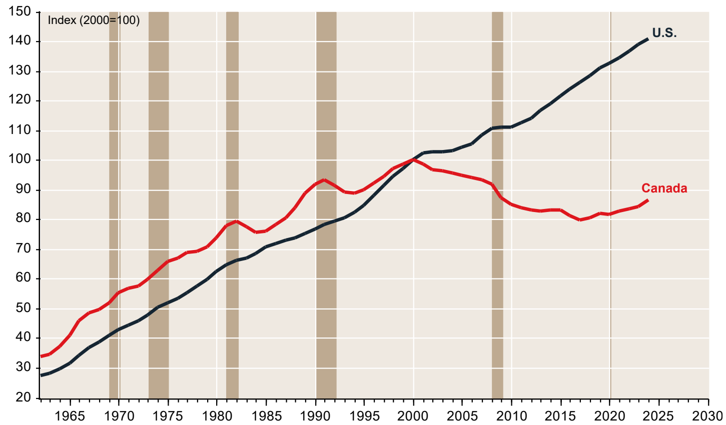
It must be acknowledged that it is very difficult to achieve productivity gains in the sector when the stock of real capital is shrinking. Yet this is precisely what happened in Canada after 2000, while the United States followed a diametrically opposite trajectory. Such a disparity inevitably raises questions about the investment environment in Canada. That is why we have repeatedly called on governments to examine the barriers that may be discouraging investment, including overregulation, taxation, and uncertainty surrounding energy supply.

Canada and U.S.: Perspective on manufacturing stock of capital
Real stock of capital in the manufacturing sector (indexed chained 2017 dollars)

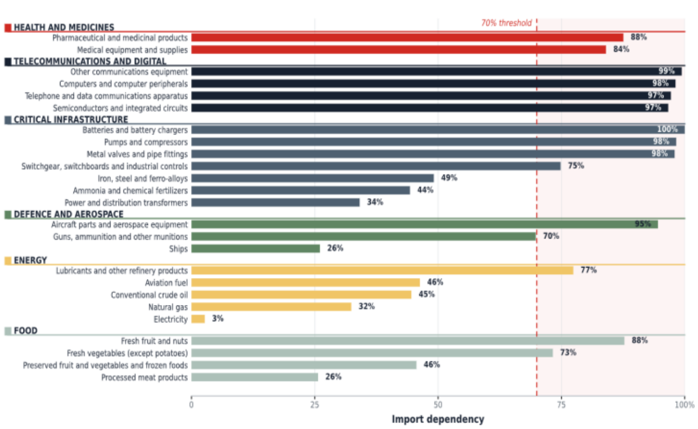


NBC Economics and Strategy (data via Statistics Canada table 36-10-0097-01 and BEA table 3.2ESI)

Why is it important to reverse this trend?

While there are likely many reasons for the manufacturing sector's lack of competitiveness, the sector's decline can no longer be ignored in several respects. The **first reason relates to national security**. The pandemic has highlighted the vulnerabilities associated with overreliance on foreign supply chains, particularly for medical equipment and essential medications. When a crisis disrupts these chains, access to international markets is no longer necessarily sufficient to guarantee security of supply, underscoring the importance of maintaining a certain level of domestic production capacity. The same logic applies to several other essential goods and sectors, including food, energy, defense, telecommunications, and critical infrastructure. An economy does not need to produce everything it consumes, but it must consider the consequences of a supply disruption for goods it cannot do without.

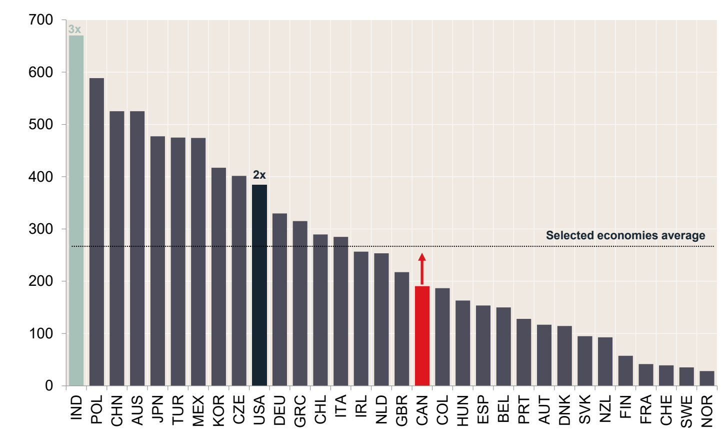
Canada: Dependence on imports
Share of Imports in Domestic Consumption, 2022



NBC Economics and Strategy (data via Statistics Canada table 36-10-0478-01)

The **second reason relates to environmental, social, and governance (ESG) criteria**. From an environmental perspective, deindustrialization can create the illusion of an improvement in a country's carbon footprint. When production is offshored, the emissions associated with it disappear from the national inventory, even though the goods continue to be consumed domestically. The emissions are not necessarily eliminated but simply shifted overseas. This phenomenon is more concerning in Canada's case, as the country has a significant environmental advantage when it comes to hosting manufacturing activities. Thanks to electricity generation that is much lower in carbon emissions than that of many of its competitors, certain goods can be produced here with a smaller carbon footprint. Shifting this production to economies more dependent on fossil fuels—including coal—can therefore, paradoxically, reduce Canadian emissions while increasing global emissions. From this perspective, promoting production in Canada—particularly in energy-intensive industries—can serve not only as an industrial strategy but also as a contribution to reducing global emissions. In addition to this energy advantage, Canada has a regulatory framework that better addresses the externalities associated with industrial production. Canadian standards regarding pollution, health and safety, and working conditions offer safeguards that are not always equivalent in the countries to which production is offshored. Manufacturing abroad therefore does not necessarily eliminate these environmental and social costs; it may simply shift them to jurisdictions where they are less regulated or less visible to Canadian consumers.

World: Canada's electricity grid is one of most resilient and cleanest
2025 carbon intensity of electricity (gCO2/kWh), selected OECD economies + China and India



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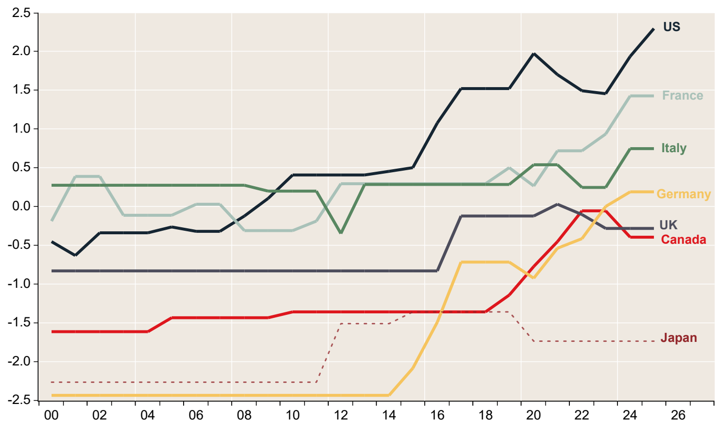
Finally, **the third reason relates to social cohesion**. The offshoring of production has certainly brought benefits, notably by allowing consumers to enjoy lower-cost goods and, consequently, lower inflationary pressures. However, we must not forget that deindustrialization has also imposed significant costs on certain segments of the population and regional economies. Several studies have shown that in the United States, the labour market situation for men without a college degree has deteriorated (**link**) and that communities most exposed to competition from imports have been particularly affected (**link**). The consequences have, in fact, extended beyond the labour market: some studies show that the states most exposed to trade shocks have also experienced increased political polarization and a shift in electoral support toward more ideologically driven candidates (**link**).

Canada: Political polarization of G7 countries
Central estimate of the extent to which society is divided into hostile political camps



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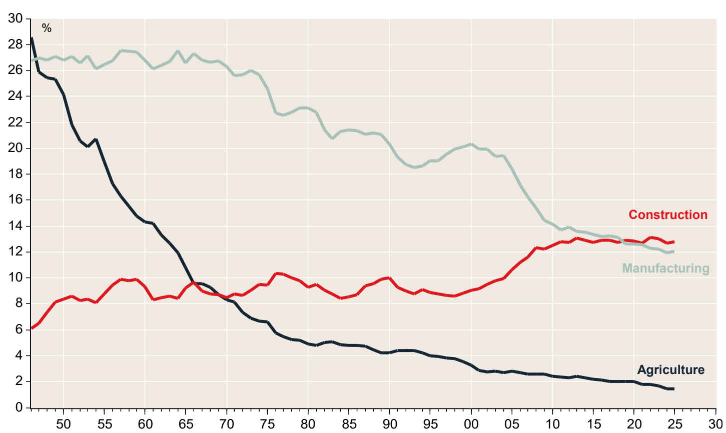
In Canada, the repercussions of deindustrialization on certain segments of the population have also been observed. Statistics Canada has also shown that the decline in manufacturing activity has had significant negative effects on labour market conditions for men, particularly those without a college or university degree (**link**). There is reason to believe that the boom in the construction sector may have mitigated the negative impact on the labour market for men over the past 25 years. Indeed, while the proportion of men working in the manufacturing sector fell from 20% to 12%, the proportion of those in construction rose from 8% to 13%. This offsetting effect did not occur in the United States.

Canada: Employment by industry - men
Share of total employment for the manufacturing, construction and agriculture industry for males



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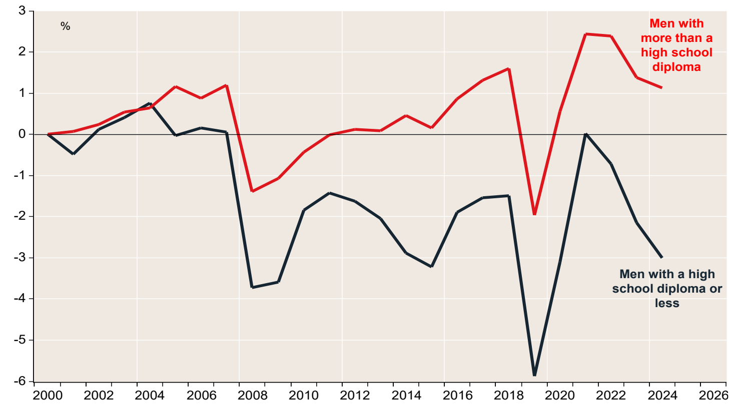
Nevertheless, the relative situation of men aged 25 to 54 without a postsecondary degree has clearly deteriorated in the labour market. The gap in employment rates between this group and other men of the same age has widened by 4 percentage points since the start of the century. Far from benefiting equally from the general improvement in the labour market, this group has thus lost ground.

Canada: Less educated men struggling on the labour market
Change in employment rate of men with more or less education since 2000, 25-54 years



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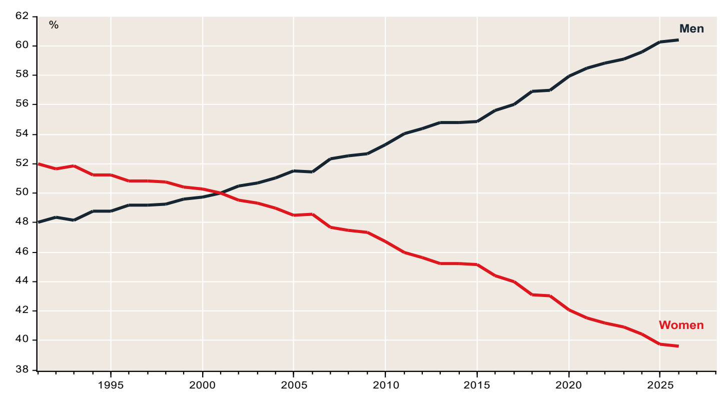
Although the population's educational attainment has increased considerably over time, a significant proportion of men of prime working age still have a high school diploma or less as their highest level of education. This proportion stands at 24% among men, compared to only 16% among women. Men now account for nearly 60% of the less-educated population, a proportion that has risen sharply since the turn of the 2000s.

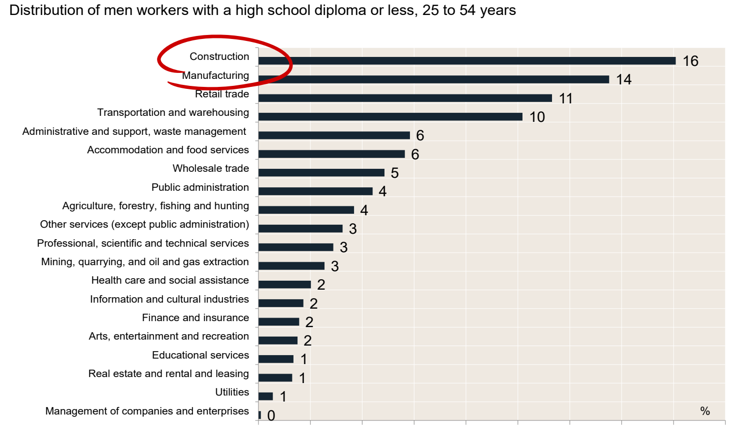
Canada: More men than women stop at high school
Percentage of men and women in the total population with a high school diploma or less, 25-54 years



NBC Economics and Strategy (data via Statistics Canada)

For this population, the construction and manufacturing sectors are therefore of critical importance, together employing nearly one-third of these workers. However, the proportion of men working in construction has already reached an all-time high. Given that short-term demographic outlooks remain bleak, which affects housing demand, it would be risky to rely too heavily on this sector to offset a persistent decline in manufacturing employment.

Canada: Some sectors more crucial for less educated men
Distribution of men workers with a high school diploma or less, 25 to 54 years



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Conclusion

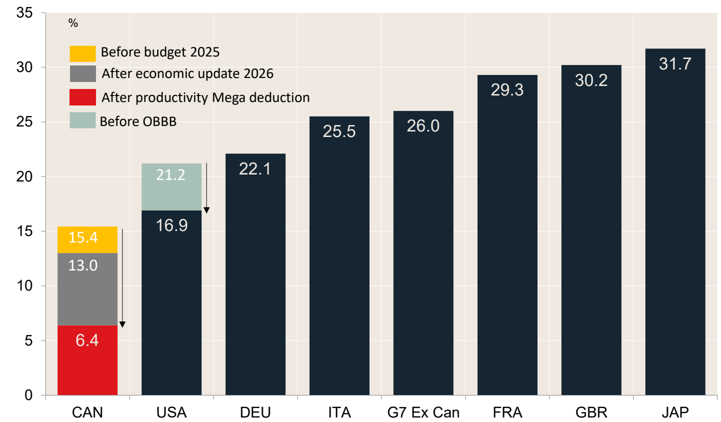
While the manufacturing sector's share of the economy naturally tends to decline as advanced economies develop, industrial atrophy is not inevitable. In our view, the scale of the deterioration observed in Canada since 2000 goes well beyond what can be explained by this structural trend alone. On the one hand, the decline in its share of the Canadian economy has not been accompanied by a shift toward manufacturing activities with higher value added. On the other hand, the sector's fundamentals, particularly unit labour costs and productivity, have evolved in a way that has undermined its competitiveness.

While there are likely multiple causes for the manufacturing sector's lack of competitiveness, the fact remains that the sector's decline poses a challenge in several respects. As we have shown, maintaining a competitive manufacturing base involves issues that go far beyond economic growth alone and touch on national security and security of supply, ESG criteria, and social cohesion.

We therefore welcome Ottawa's recent shift in policy aimed at stimulating investment and reindustrialization across the country. The streamlining of the regulatory framework and greater development of natural resources—including various energy sources—are steps in the right direction toward making Canada more attractive for industrial investment. The increase in military spending, which should particularly benefit domestic manufacturers, further reinforces this shift.

It was also necessary to address the loss of tax competitiveness relative to the United States. The September 15 **announcement** introducing the immediate deduction for a wide range of investments helps correct this imbalance by significantly improving their after-tax returns. As a result, Canada's effective marginal tax rate on investment is now, by a wide margin, the lowest in the G7. Most of the conditions therefore now appear to be in place to foster Canada's reindustrialization. Accelerating deregulation at all levels of government, together with a de-escalation in trade tensions with the United States, may now represent the final pieces of the puzzle needed to fully unlock that potential.

Canada: A very attractive tax environment for investment
Effective marginal tax rate on investment, 2026



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