Canada's Unusually Bad Situation

by Allison Fedirka - January 13, 2025

From a geopolitical perspective, the U.S.-Canadian relationship is enviable. The two countries lack the dramatic historical, cultural and religious differences that often lead to conflict between neighbors – especially prosperous ones. Relative to most other countries, they both enjoy a high degree of physical protection from potential enemies, thanks to the Pacific and Atlantic oceans, and have managed to maintain, by global standards, a peaceful, secure border.

Through treaties and trade agreements, they have avoided conflict and have integrated their economies such that stability for one is stability for both. For example, Canada provides just over half of petroleum imports to the U.S., and since imports account for 37 percent of total U.S. petroleum consumption (as of 2023), Canada is responsible for nearly 20 percent of total U.S. consumption. The U.S. also relies on Canada to supply critical materials such as potash, uranium and lumber, and the two share highly integrated production chains in major economic sectors such as the automotive industry – all of which reduces vulnerabilities within the U.S. economy.

Put simply, Canada is crucial to the United States' ability to project power, because when Washington doesn't have to attend to its own backyard, it has more time and resources to spend elsewhere.

But even under ideal circumstances, stability is never guaranteed. The government in Ottawa is in the throes of a political crisis brought on by economic and social pressure. Early last week, Prime Minister Justin Trudeau announced his resignation from an office he held for nearly a decade. His departure comes alongside a dramatic rise in the Conservative Party's popularity. By all accounts, the ruling Liberal Party is poised to lose power in the upcoming federal election, with polls showing the Conservatives with a strong lead. Elections were initially slated for Oct. 20, but Trudeau's resignation will likely result in an earlier date as the opposition is expected to call for a confidence vote shortly after the resumption of Parliament on March 24.

The crisis was long in the making. The rising cost of living, labor shortages, immigration tensions and an affordable housing crisis have compelled the government to engage in major policy overhauls. Many of these changes have yet to yield the desired results. Canada's inflation peaked at 8.1 percent in June 2022 and trended downward to 1.9 percent in November 2024. Though inflation has slowed, the price of essential goods remains high for consumers. Community Food Centers Canada estimates one in four Canadians face some level of food insecurity. These numbers started to climb in 2019, impacting not only those living in poverty but also some 15 percent of people not living in poverty. Wages initially lagged behind inflation after the pandemic but have since recovered. But higher wages drive up the cost of services and labor at a time when economic growth lags slightly behind inflation.

The government has struggled to design a policy that allows it to successfully address labor shortages in critical areas without relying too much on immigration. Since the pandemic, Canada has experienced major demographic shifts. Fertility rates are at record lows (1.33 births per woman in 2022), and millennials now outnumber baby boomers. Population movement between provinces has increased to its highest levels since the 1990s, resulting, broadly speaking, in people leaving urban areas for more rural settings. In recent years, the government has relied on immigration to compensate for Canada’s population problems. Last year, the country’s total population stood at 40 million, and population growth was the highest it had been in almost 70 years (3.2 percent). Immigration now accounts for nearly all (97.6 percent) population growth in the country, with temporary residents accounting for 6.2 percent of the total population.

Canada uses a points system to award immigration status that, in the past, rewarded white-collar, highly educated individuals. However, many of those who gained entrance to Canada could not find jobs consistent with their skill sets. This was due to a mismatch of skills in the labor force and jobs and the economy failing to create jobs at pace with population growth. In 2021, the government loosened immigration measures to make working-class jobs more attractive. Two years later, the government loosened regulations to allow more immigrants to work in the country. This included increased immigrant quotas, requirements to apply for work permits once already in the country and allowing international students to work up to 20 hours a week.

These measures failed to offset the labor shortages. Demand for skilled work still outpaces the available supply of tradespeople and blue-collar workers, especially in construction, trades, agriculture, transportation and health care. In turn, this has increased the cost of labor, created delays in services and strained quality control standards. There are concerns that the shortages will persist: Some 700,000 of Canada’s 4 million trade workers are set to retire by 2030, putting even more pressure on labor scarcity.

Socio-economic pressures have forced the government to change course on how it plans to deal with immigration. Unemployment slowly began to rise in 2024. Immigrants living in Canada for less than five years had nearly double the unemployment rate (12.6 percent) in July as the national average (6.4 percent). The uptick in joblessness has made social welfare services both more expensive and less able to meet the population's growing needs. In late 2024, the government announced it would reduce the annual allotment of permanent residents, which came to 500,000 in 2024, to 365,000 by 2027. It also removed some of the looser regulations introduced in 2023. The moves aim to reduce the share of temporary residents to 5 percent of Canada's population by the end of 2026. (In theory, the measures will still allow for workers to participate in key labor markets such as health care and trades.)

Labor shortages, slow economic recovery and the government's immigration policy are seen as major contributors to Canada's housing crisis. From 2000 to 2021, housing prices in Canada rose by 355 percent while median nominal income rose by only 113 percent. Lower inflation and lower interest rates have failed to reverse the trend. Increased immigration and labor shortages in construction and trades have put upward pressure on prices and slowed growth in supply of available homes. Market indicators such as pre-construction sales and new condo sales continued to fall in 2024, suggesting the problem will persist in the near term. Market analysts estimate that, in the best-case scenario, it will take at least five or six years for supply to catch up with demand.

Academics and some market analysts have also noted structural shifts in homeownership as part of the problem. Fifty or so years ago, Canada had more government programs in place to fund social housing programs. These programs were reduced or eliminated in the 1990s. Experts also point out that housing financialization intensified after the Canada Mortgage and Housing Corporation shifted from building homes to insuring mortgages. As a consequence, they argue, housing came to be seen more as a wealth-building tool rather than a basic social need. The rise in prominence of short-term rentals, like Airbnbs, has also contributed to the problem. Approximately 20 percent of residential properties in British Columbia and Ontario (two provinces with some of the most severe affordability problems) are owned by investors.

Government efforts to ease pressure on housing prices seem to have failed. More than 50 percent of Canadians worry about their ability to pay their mortgage or rent, and a similar number say they could lose their homes if their financial situation were to worsen. Two-thirds of Canadians with mortgages reportedly already have trouble meeting their financial commitments. In the spring of 2024, a new housing plan was launched to "unlock" 3.87 million new homes by 2031. The challenge here will once again be the strain of having to fund such extensive federal programs to meet the population's socio-economic needs.

Unsurprisingly these economic problems have created social unrest. Citizens and longer-term permanent residents find themselves competing with new immigrants and temporary residents for government funds. The influx of immigrants has also been difficult for Canadian society to absorb, resulting in a lack of assimilation among the different immigrant groups that often remain concentrated in semi-isolated communities and more marginal positions, similar to what we see in many European countries.

All this is to say that Canada is not as socially or economically stable as it was during President-elect Donald Trump's first presidency. Some warn that Canada's slow economic growth and structural issues leave it ill-suited to absorb shocks such as new tariffs from the United States. Economists estimate that, if Trump were to follow through with his blanket 25 percent tariffs, it would reduce the size of the Canadian economy by 2.6-3.8 percent. Retaliatory measures from Canada could push that figure as high as 5.6 percent, according to economists from Scotiabank. That kind of decline would trigger greater instability in Canada and could have knock-on effects for the U.S. This could easily result in greater undocumented migration, more cross-border smuggling of goods and other security concerns. In this sense, when the U.S. designs trade policy for Canada, it must consider how it would affect U.S. consumers.

Author: Allison Fedirka
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