



Missed Opportunity: Federal Spending Increases Prevent Real Tax Relief for Canadians

Grady Munro and Jake Fuss

Summary

- Federal per-person program spending has reached unprecedented levels in recent years, which puts a heavy burden on Canadian taxpayers who are ultimately responsible for footing the bill either through taxes today, or taxes tomorrow if the government allows debt to accumulate.
- This bulletin calculates an alternative fiscal path by assuming that the federal government exercised spending restraint starting in 2015/16.
- Program spending is currently projected to reach \$453.0 billion in 2023/24. The alternative scenario includes program spending of only \$399.4 billion for that same year—a difference of \$53.6 billion.
- Budget 2023 projects the federal government will run a \$40.1 billion deficit for the 2023/24 fiscal year. The alternative scenario projects that the federal government would have run a \$23.3 billion surplus.
- The surplus in the alternative scenario is such that the federal government could have eliminated the second lowest personal income tax bracket, thereby providing \$18.7 billion of tax relief, while still running a surplus of \$4.6 billion in 2023/24.

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Introduction

Canada's federal government has increased spending significantly since 2015, to the point that Prime Minister Justin Trudeau is on track to oversee the five highest years (2018 to 2022) of per-person spending (inflation-adjusted) in Canadian history (Fuss, 2023b). Inflation-adjusted, per-person program spending¹ since 2018 has surpassed levels seen during both World Wars and the 2009 recession (Fuss, 2023b). Even excluding COVID-related spending, the Trudeau government has overseen the highest spending year in Canadian history: 2020 (Fuss, 2023b). The government has funded its high spending largely by borrowing.

An alternative to the fiscal path that the Trudeau government has chosen could have entailed less spending and instead offered tax relief. Families could have then decided what to do with that money, and addressed their needs as they saw fit. Additionally, the federal government would have accumulated less debt, thereby reducing debt interest costs and freeing up even more fiscal room. To that end, this paper explores an alternative—it calculates where federal finances could have been today had there been more spending restraint starting in 2015/16. The alternative scenario shows the size of tax reductions that Canadians could have enjoyed in 2023/24. Simply put, this bulletin outlines one of the main opportunity costs of high federal spending, namely, less tax relief.

Methodology

The alternative fiscal scenario that this bulletin analyzes was calculated by applying three assumptions to Canada's public finances following the 2014/15 fiscal year.

The first is that program spending grew by inflation plus population growth from 2015/16 to 2021/22. In other words, per-person spending adjusted for inflation was held constant starting in 2015/16. Second, it assumed that COVID-19 emergency spending in 2020 and 2021 remained the same as was reported in Budget 2022. Finally, we assumed that program spending in 2022/23 and 2023/24 returned to the per-person levels previously forecasted in Budget 2019 (which are adjusted for inflation). Applying these assumptions to the actual fiscal data generated an alternative scenario that shows the outcome had the federal government exercised more fiscal restraint.

There are several reasons why we chose these assumptions. We chose population plus inflation as the calculus for growing spending because it represents the amount that program spending must increase to maintain the same level of government services over time as the population grows and prices of goods and services increase. We kept COVID-19 emergency spending the same in 2020 (\$261.8 billion) and 2021 (\$90.7 billion) to reflect the costs of that emergency, but grew non-COVID-related program spending in those years by inflation plus population growth (Canada, Department of Finance, 2022a). It's important to note that we made no assumptions about whether the level of emergency spending was necessary or not—we simply took it as given.² Finally, we used forecasts from Budget 2019 because that was the final pre-COVID budget and the estimates it contains represent a good indication of where per-person spending should have been in 2022 and 2023 based on the expectations and information available in 2019. Combined, these assumptions show how a government acting with fiscal restraint might have handled public finances over the past decade or so.

1 Program spending encompasses all government expenditures except for the interest paid on government debt.

2 See Fuss and Hill (2023) for a discussion of federal spending during the COVID-19 pandemic.

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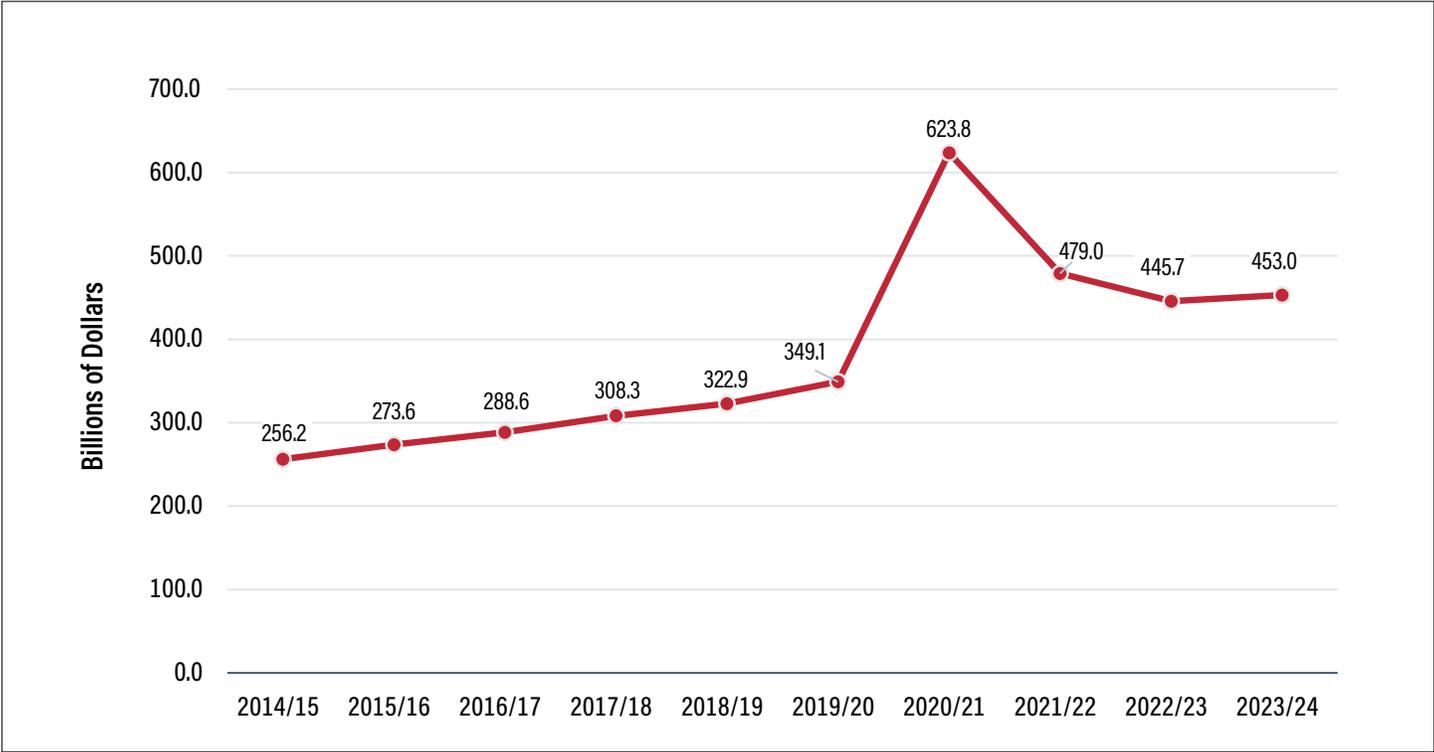
Current fiscal situation

Canada’s current fiscal situation can be determined using the following fiscal measures: program spending, budgetary balance, federal debt, federal debt-to-GDP (gross domestic product) ratio, and debt interest charges. Program spending shows the choices government is making regarding the level of services it provides, while budgetary balances show the extent to which revenues and expenditures align with one another. Federal debt conveys the accumulation of debt over time, which is a direct consequence of the budgetary balances.³ The federal debt-to-GDP ratio measures the size of federal debt

relative to the economy. Finally, debt interest charges show the burden that accumulated debt places on government finances. Taken together these measures present a good summary of the state of government finances in a given year.

Figure 1 displays actual or projected⁴ federal program spending from 2014/15 to 2023/24. Nominal program spending starts at \$256.2 billion in 2014/15 and grows steadily to \$349.1 billion in 2019/20. Five spending categories drove this increase: Canada Child Benefits, Elderly Benefits, National Defence, Indigenous and Northern Affairs, and the Canada Health Transfer (Hill et al., 2020). There is a spike in spending in

Figure 1: Actual and Projected Program Spending, 2014/15 to 2023/24



Note: Program spending includes net actuarial losses. Values for 2022/23 and 2023/24 are estimates based on Budget 2023. Sources: Canada, Department of Finance (2022a; 2022b; 2023); Statistics Canada (2023b; 2023c; 2023d); authors' calculations.

3 Federal debt is the accumulated deficit, which is defined as net debt minus non-financial assets. We chose this measure of debt because it is the one that the federal government most frequently uses.
4 Data for 2014/15 to 2021/22 use the confirmed values while data for 2022/23 and 2023/24 rely on the latest projections from Budget 2023.

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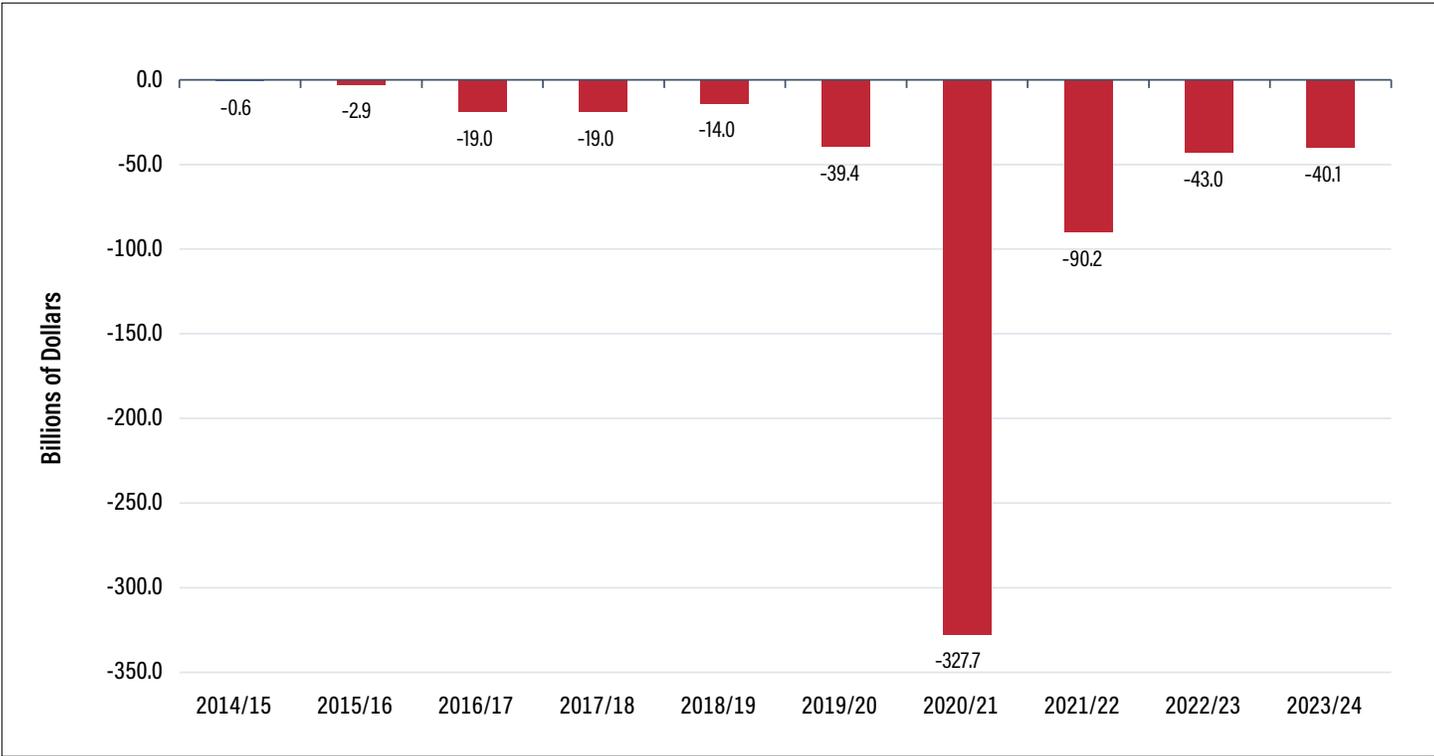
2020/21, corresponding with the start of the COVID-19 pandemic, before spending falls and levels out over the following years. This fluctuation corresponds with the implementation, and subsequent removal, of spending on CERB, CEWS, and other COVID-19 relief (Canada, Department of Finance, 2021).

Unrelated to COVID-19, the federal government also increased program spending during the pandemic by expanding elderly benefits, introducing national child care and dental care, and doubling international climate financing⁵ (Canada, Department of Finance, 2021; 2022a). Due to these increases, program spending in 2023/24 is projected to be \$453.0 billion, more than

\$100.0 billion higher than annual spending immediately prior to the pandemic.

Figure 2 displays the actual and projected nominal federal budgetary balances from 2014/15 to 2023/24. It shows that the current federal government has run deficits every year since it was first elected in 2015. The deficit started off being relatively small at \$2.9 billion in 2015/16, but quickly grew and by the following year, 2016/17, was \$19.0 billion. Deficits in subsequent years showed small fluctuations but then doubled to \$39.4 billion in 2019/20, before the onset of the COVID pandemic. The next two years saw historically large deficits—\$327.7 billion in 2020/21 and \$90.2 billion in 2021/22 and \$43.0 billion in 2022/23 and \$40.1 billion in 2023/24.

Figure 2: Actual and Projected Budgetary Balance, 2014/15 to 2023/24

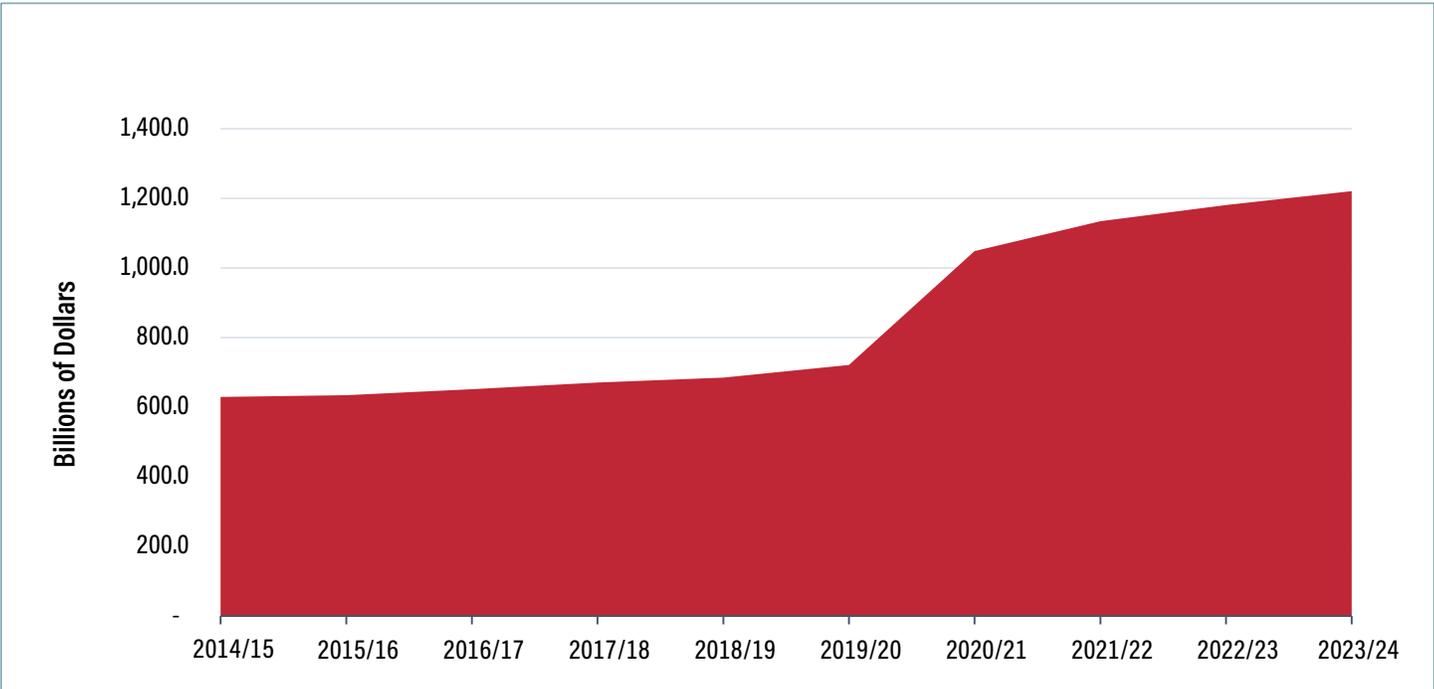


Note: Values for 2022/23 and 2023/24 are estimates based on Budget 2023.
 Sources: Canada, Department of Finance (2022a; 2022b; 2023); Statistics Canada (2023b; 2023c; 2023d); authors' calculations.

5 Budget 2022 included \$5.3 billion over five years to help developing countries tackle climate change (Canada, Department of Finance, 2022a: 132).

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Figure 3: Actual and Projected Federal Debt, 2014/15 to 2023/24



Note: Values for 2022/23 and 2023/24 are estimates based on Budget 2023.
Sources: Canada, Department of Finance (2022a; 2022b; 2023); Statistics Canada (2023b; 2023c; 2023d); authors' calculations.

in 2021/22—primarily due to the pandemic, before decreasing and leveling off to a \$40.1 billion deficit in 2023/24. Roughly 80 percent of the 2020/21 deficit can be attributed to COVID-19 emergency spending (Canada, Department of Finance, 2022a).

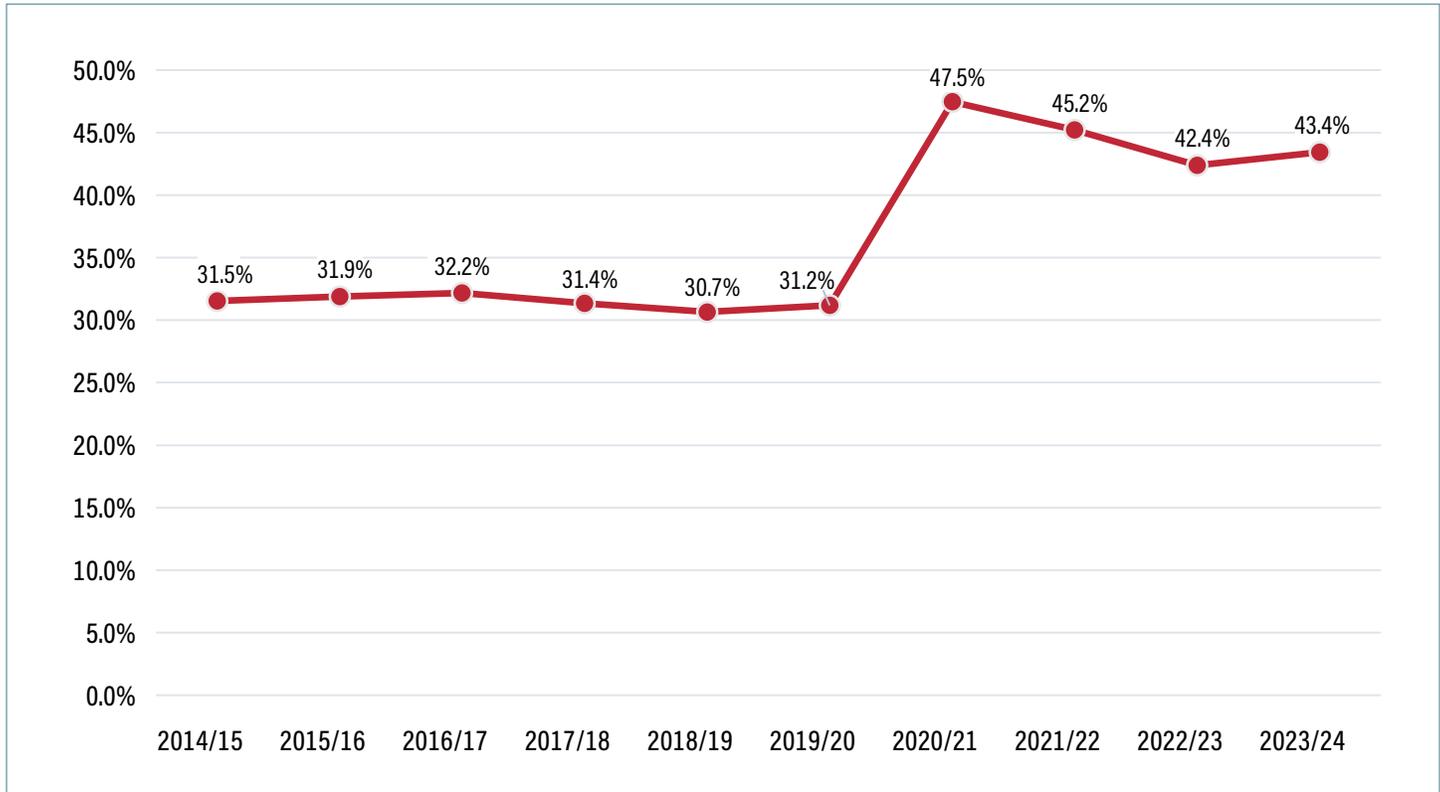
Ten consecutive years of deficits translates to a significant amount of accumulated debt as figure 3 shows. It indicates the levels of actual and projected nominal federal debt. Federal debt started at \$628.9 billion in 2014/15 and rose steadily to \$721.4 billion in 2019/20. Due to record-breaking spending during the pandemic, 2020/21 to 2021/22 stand out as the period with the sharpest increase in the level of federal debt. During those two years, nominal federal debt rose by \$413.1 billion and reached \$1.13 trillion by the end of 2021/22. Following the pandemic, growth in debt slowed and federal debt is now projected to reach roughly \$1.22

trillion in 2023/24. Over the entire period from 2014/15 to 2023/24, nominal federal debt is projected to nearly double, increasing by \$591.9 billion.

Figure 4 displays the federal debt-to-GDP ratio from 2014/15 to 2023/24. The years leading up to the pandemic show essentially unchanging levels of federal debt as a proportion of GDP. From 2014/15 to 2019/20, the ratio changed only slightly—from 31.5 percent to 31.2 percent. However, significant debt accumulation combined with a decline in GDP meant the federal debt-to-GDP ratio jumped during COVID to reach 47.5 percent in 2020/21. As the economy rebounded, debt-to-GDP declined slightly to 45.2 percent in 2021/22, and following the pandemic is projected to level off to 43.4 percent in 2023/24. By the end of the current fiscal year, the federal debt-to-GDP ratio is projected to be more than 12 percentage points higher than its pre-COVID levels.

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Figure 4: Actual and Projected Federal Debt-to-GDP Ratio, 2014/15 to 2023/24



Note: Values for 2022/23 and 2023/24 are estimates based on Budget 2023.

Sources: Canada, Department of Finance (2022a; 2022b; 2023); Statistics Canada (2023b; 2023c; 2023d; 2023e); authors' calculations.

Finally, figure 5 shows the actual and projected nominal debt interest charges from 2014/15 to 2023/24. Debt charges start at \$24.2 billion in 2014/15, decline slightly until 2016/17, before rising back up to \$24.4 billion in 2019/20. Debt interest costs fall slightly in 2020/21, and then increase sharply over the next three years. During this short period, debt charges more than double, rising from \$20.4 billion in 2020/21 up to a projected \$43.9 billion in 2023/24. The small observed fluctuations in debt charges from 2014/15 to 2020/21 were primarily due to changes in interest rates. The substantial increase in debt charges from 2020/21 onward can be attributed partly to the effects of the increase in accumulated debt during the pandemic and partly to significant increases in interest rates (Bank of Canada, 2023).

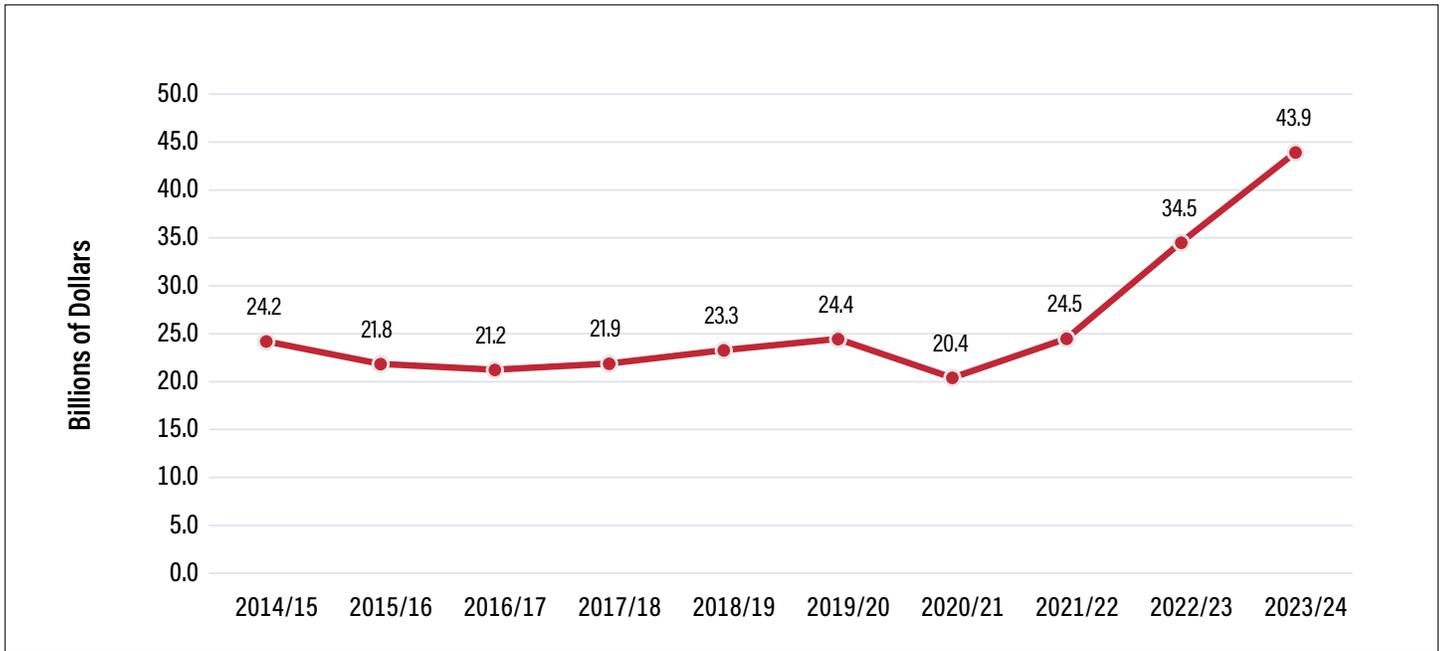
Alternative fiscal situation

Overall, Canada's fiscal situation in 2023 can be summarized as having relatively high program spending, a larger deficit than the ones recorded immediately before the pandemic, a significant accumulation of debt, and rising debt interest charges.

This section analyzes the same five measures, but compares the actual and projected values with those calculated in an alternative fiscal scenario (see figure 6, which displays actual and projected values from 2014/15 to 2023/24 with those associated with alternative program spending). The figure shows that both spending paths follow the same general trend, but that alternative program spending grows more slowly (notwithstanding

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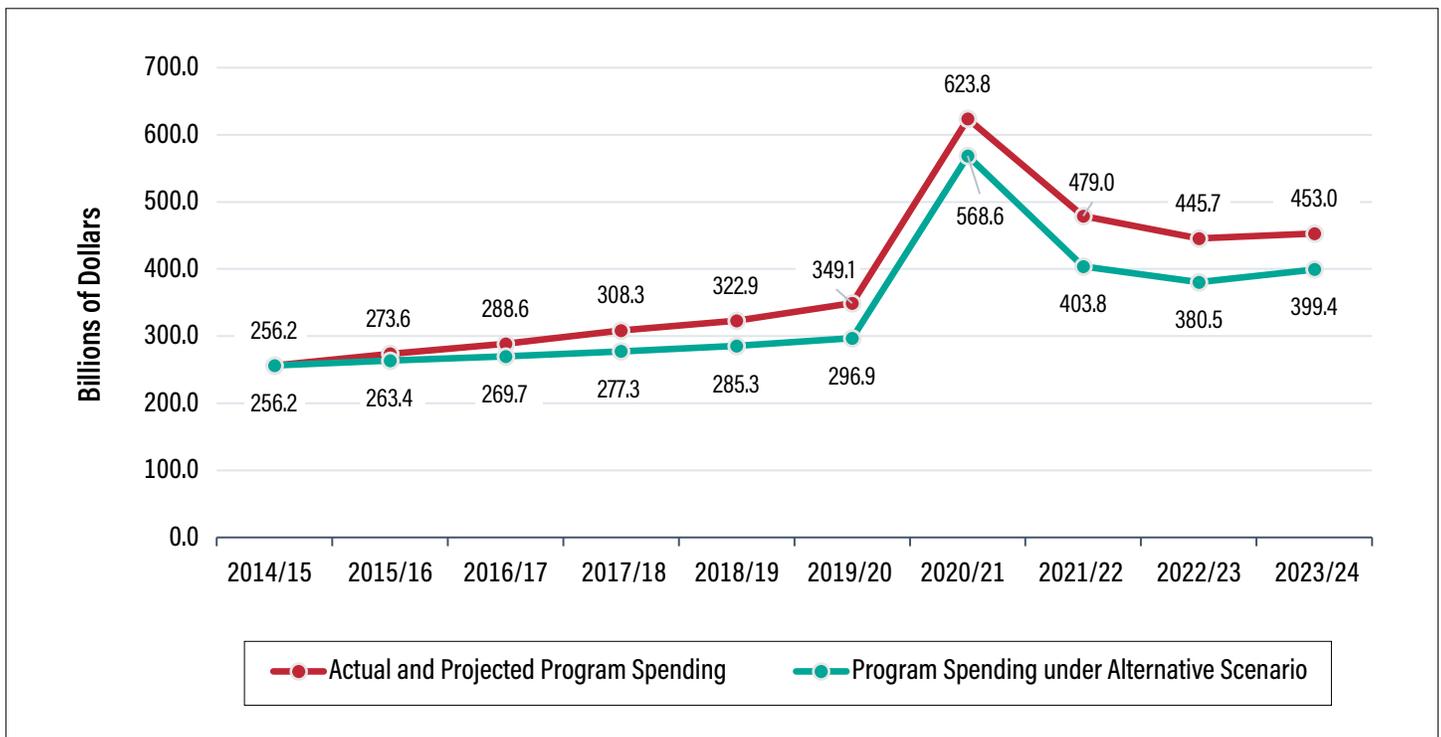
Figure 5: Actual and Projected Debt Interest Charges, 2014/15 to 2023/24



Note: Values for 2022/23 and 2023/24 are estimates based on Budget 2023.

Sources: Canada, Department of Finance (2022a; 2022b; 2023); Statistics Canada (2023b; 2023c; 2023d); authors' calculations.

Figure 6: Actual and Projected Program Spending versus Spending under Alternative Scenario, 2014/15 to 2023/24



Note: Program spending includes net actuarial losses. Actual and projected values for 2022/23 and 2023/24 are estimates based on Budget 2023.

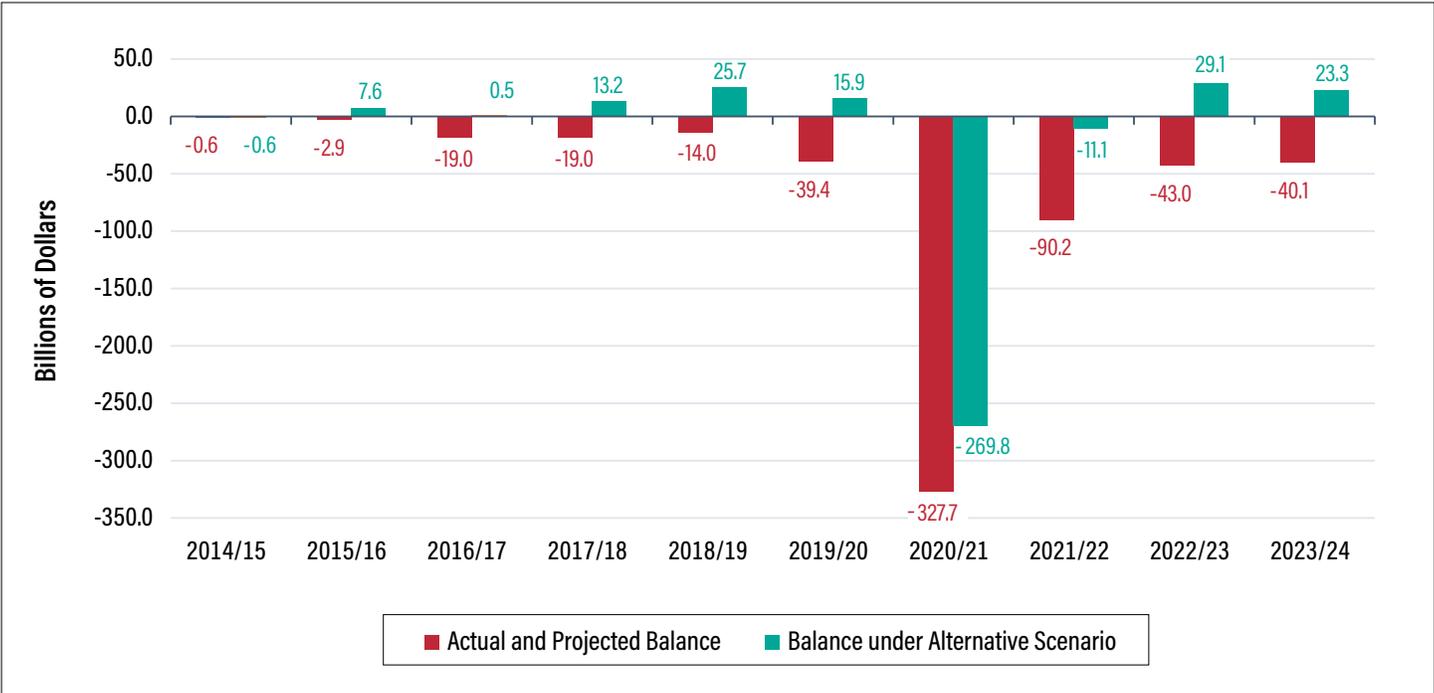
Sources: Canada, Department of Finance (2019; 2022a; 2022b; 2023); Statistics Canada (2023b; 2023c; 2023d); authors' calculations.

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the COVID spike). Had the federal government simply increased program spending by population growth plus inflation, by 2019/20 the government would have spent just \$296.9 billion annually, \$52.2 billion less than what it actually spent during that fiscal year. In 2020/21, program spending in both the actual and alternative scenarios spikes due to emergency spending related to the COVID pandemic, but under that alternative scenario reaches only \$568.6 billion instead of the \$623.8 billion that was actually spent. Spending falls faster in the alternative scenario, decreasing \$20.0 billion more than spending actually did in 2021/22, before leveling off to \$380.5 billion in 2022/23 and \$399.4 billion in 2023/24. Comparing the situations in 2023/24 alone shows that the federal government would be spending \$53.6 billion less annually had it cut per-person spending back to what was forecasted in Budget 2019.

Comparing budgetary balances between the actual and projected and the alternative scenarios shows two very different borrowing paths (see figure 7). Instead of nine consecutive years of budgetary deficits, the alternative scenario shows that the federal government could have achieved budgetary surpluses in seven of the nine years. In 2019/20 the federal government would have enjoyed a \$15.9 billion surplus rather than the \$39.4 billion deficit it actually incurred—a difference of \$55.3 billion. During the pandemic the federal government would have run deficits in both scenarios, but the deficits under the alternative scenario were much smaller. Indeed, the deficit in 2021/22 under the alternative plan would have been \$79.1 billion smaller than it actually was. There are similarly large differences between the two spending paths in the years following the pandemic. The alternative situation shows surpluses of \$29.1 billion

Figure 7: Actual and Projected Budgetary Balance versus Balance under Alternative Scenario, 2014/15 to 2023/24



Note: Actual and projected values for 2022/23 and 2023/24 are estimates based on Budget 2023.
 Sources: Canada, Department of Finance (2019; 2022a; 2022b; 2023); Statistics Canada (2023b; 2023c; 2023d); authors' calculations.

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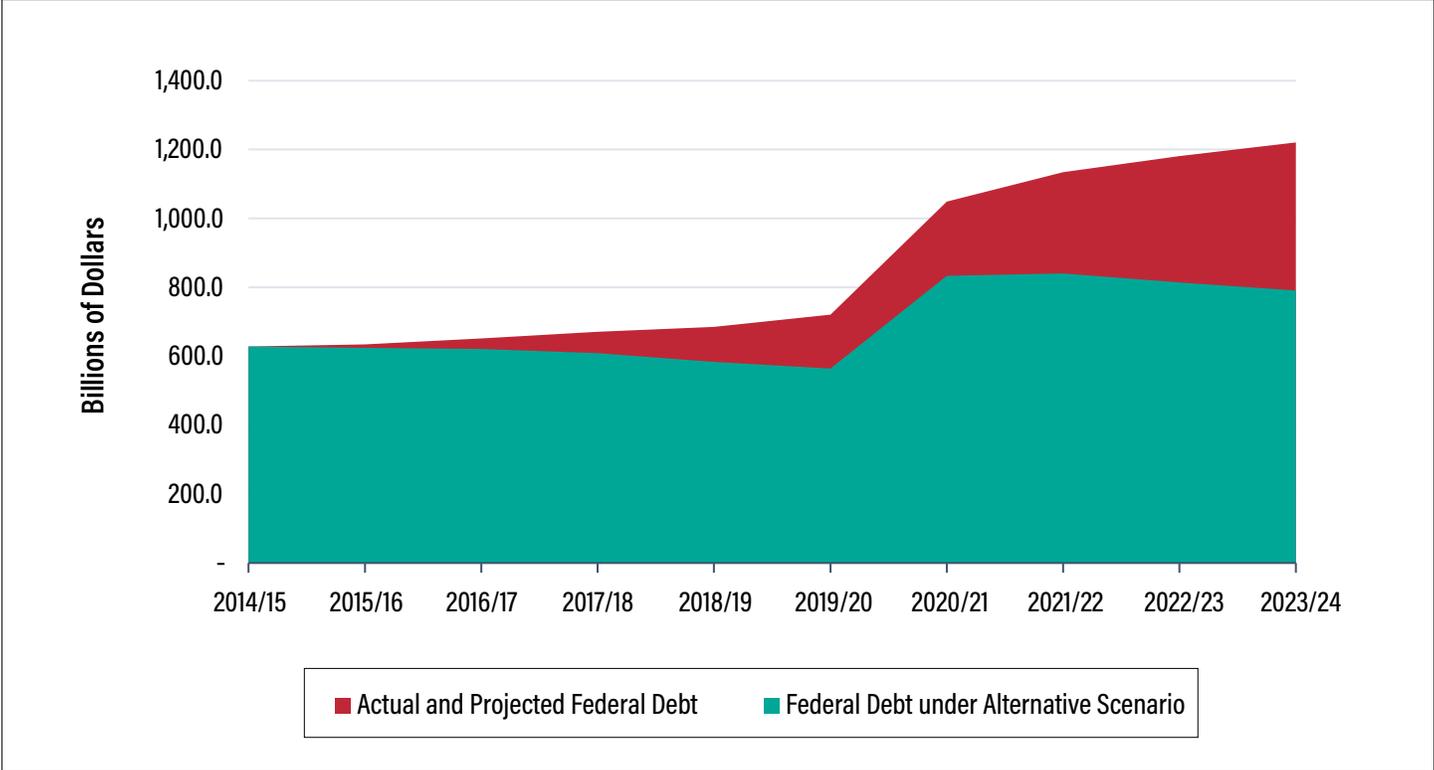
in 2022/23 and \$23.3 billion in 2023/24, while the government actually projects deficits of \$43.0 billion and \$40.1 billion respectively. This difference amounts to \$63.4 billion in 2023/24 alone.

Figure 8 displays the actual and projected federal debt from 2014/15 to 2023/24 versus the federal debt accumulated in the alternative scenario. As the figure shows, the differences in federal debt between the two scenarios closely reflects the differences in budgetary balances. From 2014/15 to 2019/20, instead of growing by \$92.5 billion, federal debt actually falls by \$64.6 billion in the alternative scenario. This is due to the string of surpluses the government would have achieved had it followed the alternative scenario. As a result of the large deficits the government incurred during the COVID-19

pandemic, federal debt jumps significantly in both scenarios in 2020/21 and 2021/22. However, federal debt only reaches \$840.5 billion by 2021/22 in the alternative scenario, instead of \$1.13 trillion. The alternative scenario shows federal debt decreasing again in 2022/23 and 2023/24. Instead of rising by \$86.3 billion from 2021/22 to 2023/24, the alternative scenario shows federal debt would have decreased by \$49.1 billion, again due to budgetary surpluses. Overall, federal debt would have been \$429.4 billion smaller in 2023/24 had the government shown restraint in its spending.

To further explore the differences in federal debt accumulation between the scenarios, figure 9 shows the actual and projected federal debt-to-GDP ratio versus the ratio in the alternative scenario from 2014/15

Figure 8: Actual and Projected Federal Debt versus Debt under Alternative Scenario, 2014/15 to 2023/24



Note: Actual and projected values for 2022/23 and 2023/24 are estimates based on Budget 2023.
Sources: Canada, Department of Finance (2019; 2022a; 2022b; 2023); Statistics Canada (2023b; 2023c; 2023d); authors' calculations.

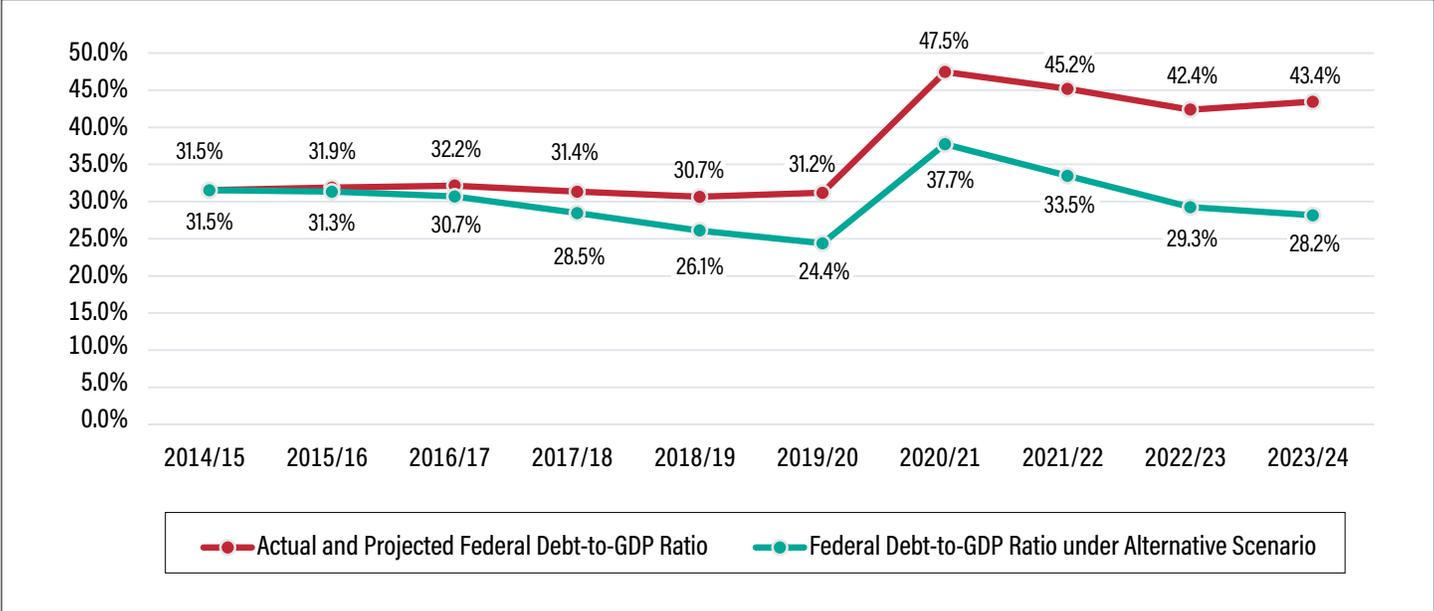
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to 2023/24.⁶ From 2014/15 to 2019/20, the alternative debt-to-GDP ratio falls from 31.5 percent to 24.4 percent. Both scenarios see a sharp increase in the debt-to-GDP ratio in 2020/21, corresponding to the large deficit and faltering economy brought about by the response to the pandemic. However, the ratio under the alternative scenario falls more quickly following 2020/21 and is projected to reach 28.2 percent in 2023/24. Considering the change across the entire period, the actual and projected federal debt-to-GDP ratio increases by nearly 12 percentage points while under the alternative it falls by more than three percentage points. On aggregate, the federal debt-to-GDP ratio in the alternative scenario is more than 15 percentage points lower than what Budget 2023 currently forecasts for 2023/24.

To show the benefits of accumulating less debt, figure 10 displays the actual and projected debt charges from 2014/15 to 2023/24 versus those calculated in the alternative scenario. Figure 10 clearly demonstrates that accumulating less debt translates to lower debt charges. It is important to note, however, that these calculations do not assume a lower effective interest rate on the debt incurred by the federal government during this period; they just show that the government’s interest payments are reduced as a result of less debt accumulation (Dahlby et al., 2022).⁷

Initially, the actual and projected and the alternative debt charges diverge slowly, staying within \$3 billion of each other from 2014/15 to 2020/21. From 2021/22 onwards, however, debt charges for the alternative

Figure 9: Actual and Projected Federal Debt-to-GDP Ratio versus Ratio under Alternative Scenario, 2014/15 to 2023/24

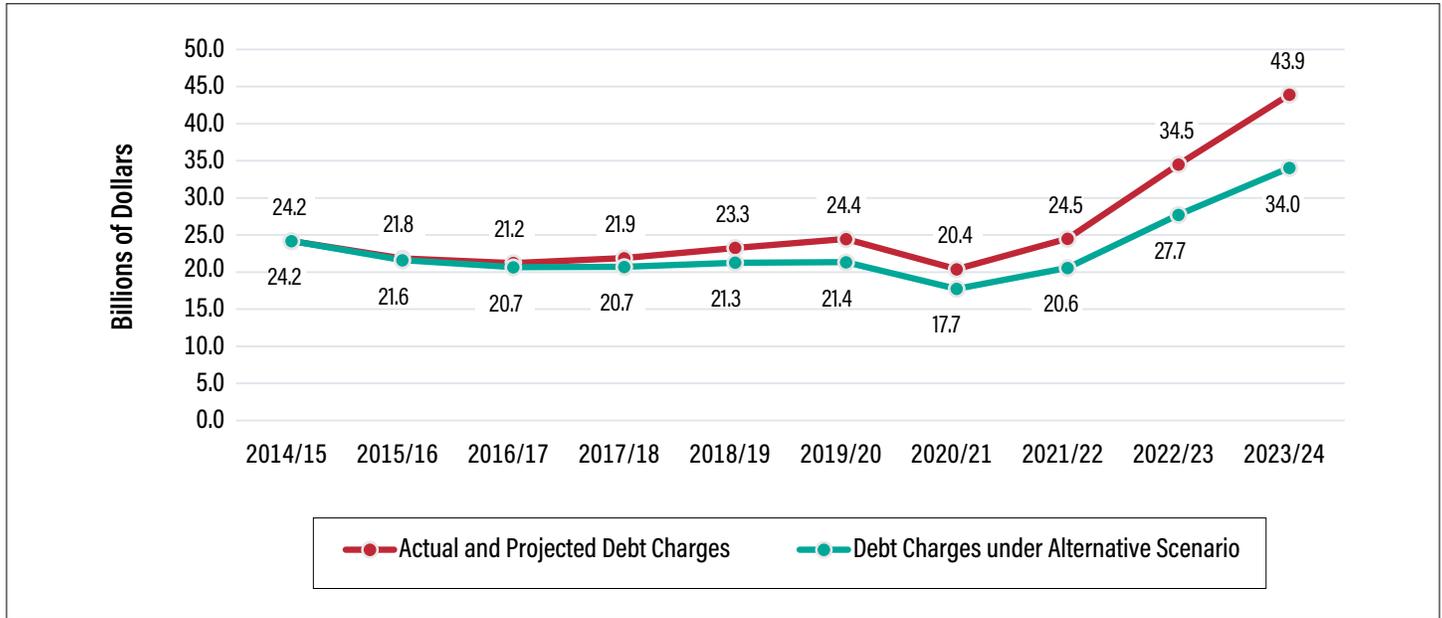


Note: Actual and projected values for 2022/23 and 2023/24 are estimates based on Budget 2023. Sources: Canada, Department of Finance (2019; 2022a; 2022b; 2023); Statistics Canada (2023b; 2023c; 2023d; 2023e); authors' calculations.

6 Both scenarios use GDP estimates from Budget 2023 so as to provide a proper apples-to-apples comparison.
 7 Another potential impact of reduced spending is reduced inflation, something not factored into this analysis. Cross (2023) explains how high spending and large deficits starting in 2015 helped fuel the inflation experienced during the pandemic, suggesting that inflation may not have been as substantial with spending restraint.

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Figure 10: Actual and Projected Debt Interest Charges versus Interest Charges under Alternative Scenario, 2014/15 to 2023/24



Note: Actual and projected values for 2022/23 and 2023/24 are estimates based on Budget 2023.

Sources: Canada, Department of Finance (2019; 2022a; 2022b; 2023); Statistics Canada (2023b; 2023c; 2023d); authors' calculations.

scenario are significantly less than the actual and projected debt charges. The gap between the two series grows to \$6.8 billion in 2022/23, and \$9.9 billion by 2023/24. In other words, instead of paying \$43.9 billion in debt interest charges in 2023/24, the federal government would only be spending \$34.0 billion had it shown fiscal restraint.

Tax reductions

A comparison of the two scenarios provides a key takeaway: Canada could be projecting a \$23.3 billion surplus for this year, rather than a \$40.1 billion deficit, had it limited spending increases since 2015/16. This is the

case even if we assume that COVID emergency spending remained the same in both cases. This surplus is \$23.3 billion of fiscal room the government could have used while still maintaining a balanced budget and avoiding debt accumulation. One option for this fiscal space could have been to provide Canadians with tax relief.⁸ In 2015 the Trudeau government reduced the federal personal income tax rate for income in the second lowest bracket from 22.0 percent down to 20.5 percent (Canada, Canada Revenue Agency, 2015). If the government were to target this rate again, it could lower the rate from 20.5 percent down to 15.0 percent (eliminating the second bracket) and provide \$18.7 billion in tax relief for Canadians.⁹ This would still leave a \$4.6

8 If taxes had been reduced, federal debt in 2023/24 would be higher than the \$791.4 billion that is currently projected in the alternative scenario. This is because not all of the \$23.3 billion surplus would go towards debt reduction. Additionally, depending on the type of tax relief introduced, federal revenues may not have fallen by the full amount of the tax reduction. Ferede and Dahlby (2012) show empirically that reducing corporate income tax rates can increase economic growth rates, which would mitigate the reduction in revenues stemming from reduced taxes.

9 This tax reduction was calculated using Statistics Canada's Social Policy Simulation Database and Model (SPSD/M), which allows researchers to simulate different tax and transfer policies in Canada. For more information see Statistics Canada (2023f).

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billion surplus with which the government could provide further tax relief, or reduce public debt. Simply put, had the federal government shown spending restraint it could have put \$18.7 billion back into Canadians' pockets while still enjoying a budgetary surplus.

Conclusion

As Canadians continue to see high federal spending and significant debt accumulation, it's important to recognize what the fiscal situation could have looked like had the government shown more spending restraint and factored in the opportunity cost of higher spending,

namely, a dearth of meaningful tax relief. The alternative situation we have presented in this bulletin shows that 2023/24 program spending could have been \$399.4 billion, \$53.6 billion less than what is projected. A more fiscally disciplined government would have accumulated \$429.4 billion less in federal debt by 2023/24, translating to a federal debt-to-GDP ratio that is more than 15 percentage points lower than currently forecasted and debt interest charges that are \$9.9 billion lower. Combined, these effects would have enabled the federal government to achieve a budgetary surplus of \$23.3 billion for 2023/24, which would have opened up fiscal room for meaningful tax relief for Canadians.

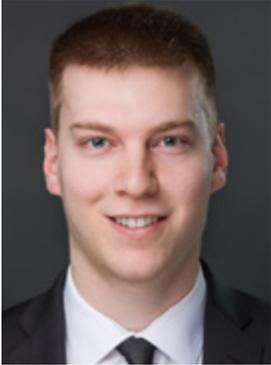
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Missed Opportunity: Federal Spending Increases Prevent Real Tax Relief for Canadians



Jake Fuss

Jake Fuss is director of Fiscal Studies for the Fraser Institute. He holds a Bachelor of Commerce and a Master's Degree in Public Policy from the University of Calgary. Mr. Fuss has written commentaries appearing in major Canadian newspapers including the *Globe and Mail*, *Toronto Sun*, and *National Post*. His research covers a wide range of policy issues including government spending, debt, taxation, labour policy, and charitable giving.



Grady Munro

Grady Munro is a research intern with the Centre for Fiscal Studies at the Fraser Institute. He holds a Bachelor of Arts in Economics from Macalester College in Minnesota, and is currently completing a Master's Degree in Public Policy at the University of Calgary.

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