FRASER RESEARCH BULLETIN

FRASER INSTITUTE

2022

Ottawa's Pattern of Excessive Spending and Persistent Deficits

by Jake Fuss and Tegan Hill

MAIN CONCLUSIONS

■ While the federal government significantly increased its debt in 2020 and 2021, the pandemic exacerbated Canada's pre-existing fiscal challenges rather than created them.

■ Between 2015/16 and 2019/20, the federal government ran five consecutive deficits, causing nominal federal net debt to rise by $112.2 billion.

■ During this period, growth in federal program spending was far more rapid than growth in revenues. In fact, the Trudeau government boosted nominal federal program spending by 36.1%, from $248.7 billion in 2014/15 to $338.5 billion in 2019/20.

■ Average annual growth in federal program spending over this five-year period (6.4%) outpaced both the average annual rate of nominal GDP growth (3.0%) and also inflation plus population growth (2.9%). This led to persistent budget deficits and debt accumulation before COVID-19.

■ If the growth of federal program spending had been moderately restrained to match either inflation plus population growth or nominal GDP growth from 2015/16 to 2019/20, the federal government would have recorded surpluses nearly every year over the period and avoided taking on approximately $150 billion to $160 billion in debt.

■ Holding growth in spending to either the rate of nominal GDP growth or inflation plus population growth would have put federal finances on stronger footing to take on the additional fiscal burden stemming from COVID-19. Even under conservative estimates, our analysis shows the federal net debt-to-GDP ratio would be between 45.6% to 46.0% in 2021/22 rather than the projected 52.1%.

Introduction

Recently, the Canadian federal government has increased debt levels at a significant pace and indications suggest this will continue for the foreseeable future. In 2021/22, federal net debt (total debt minus financial assets) is projected to reach nearly $1.3 trillion, which equals approximately $33,750 per Canadian (DOF, 2021a). While the federal government significantly increased its debt in 2020 and 2021, the pandemic exacerbated Canada's pre-existing fiscal challenges rather than created them.

There was an increase in federal debt for more than a decade prior to the onset of COVID-19 because the government consistently ran budget deficits following the 2008–2009 recession. In fact, Ottawa recorded 12 consecutive deficits between 2008/09 and 2019/20 (DOF, 2021b). Notably, however, the annual deficit was gradually declining after the 2008/09 recession, dropping to $550 million in 2014/15. A year later, the Trudeau government took office and reversed this trend by immediately increasing the deficit, largely through higher spending. Between 2015/16 and 2019/20, the Trudeau government ran five successive budget deficits that ranged from $2.9 billion to $39.4 billion (DOF, 2021b). The result was a $112.2 billion cumulative increase in federal net debt over a five-year period of tepid economic growth. Simply put, Canada was already running continuous budget deficits and had elevated its nominal debt levels before the COVID-19 pandemic.

This brief report illustrates the scale of the debt accumulated since 2015/16. It shows that increased spending by the federal government is the primary reason that Canada faced a rising nominal federal debt burden before 2020—a situation that serves to compound our fiscal challenges today. Specifically, we compare the growth in federal program spending to other metrics including economic growth and the combined effects of inflation and population growth from 2015/16 to 2019/20. Lastly, the report projects where nominal federal net debt and the debt-to-GDP ratio would be today had the government done more to restrain its spending prior to COVID-19.

Ottawa's persistent deficits and the accumulation of debt

Federal debt has increased in recent years. This has created an ongoing cost for Canadian taxpayers. Even with interest rates near historic lows, the federal government will spend a projected $24.5 billion on interest payments to service its debt in 2021/22 (DOF, 2021a). This represents nearly 7 cents out of every dollar collected by the federal government in revenue.

Further, federal finances are exposed to significant risk as interest payments could increase substantially if interest rates rise in the years ahead—as financial markets and economic forecasters expect (Nair and Ganguly, 2021). For instance, the federal government projects it could spend 8.5 cents out of every dollar in revenue on interest payments by 2026/27 (DOF, 2021a). The actual interest cost could be greater if deficits and/or interest rates are higher than the government assumes. Either way, this is money that is unavailable for programs such as health care or social services.[1]

1 Another problem is that there is no return to balanced budgets forecast in the latest projections from the federal government. In fact, the Parliamentary Budget Officer projects there will be a budget shortfall every year until 2070 (MacPhee, Bergeron, Busby, and Nicol, 2021).

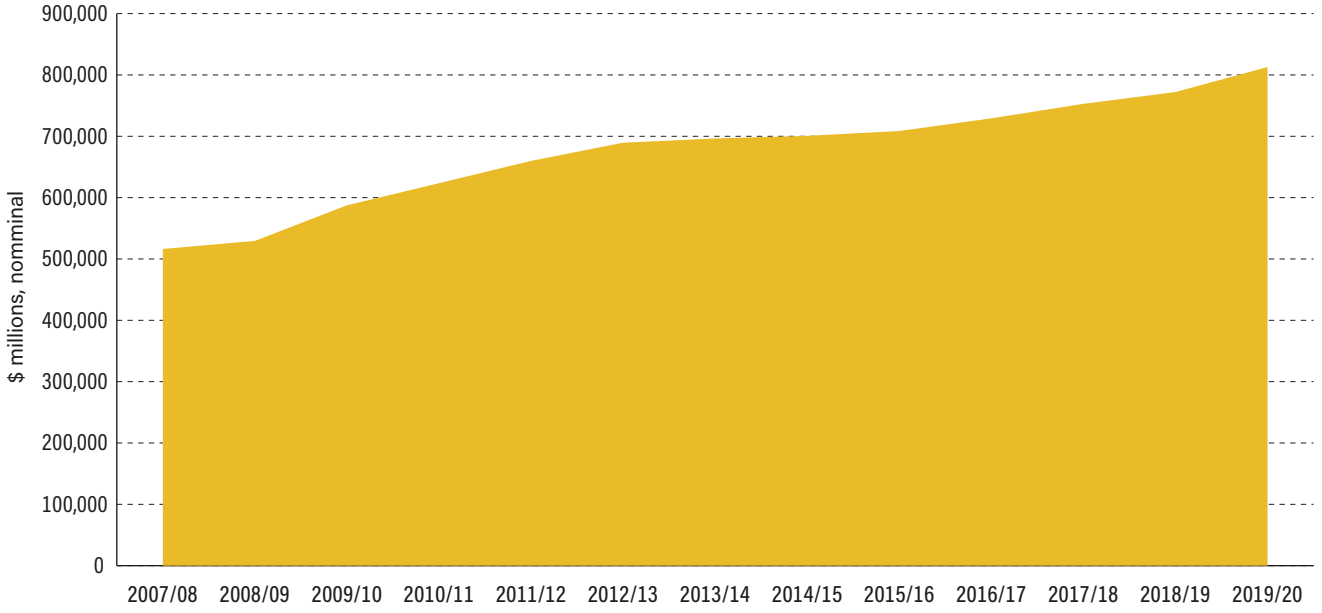
Prior to the 2008/09 recession, the federal net debt totaled $516.3 billion and the net debt-to-GDP ratio stood at 32.7% (DOF, 2021b; Statistics Canada, 2021c). Once the financial crisis hit, net debt levels began to climb higher. In 2009/10, the federal government ran a budget deficit of $56.4 billion and net debt levels increased by 11.0% in just one year (DOF, 2021b). The Harper government continued to run budget deficits for the next five years, causing net debt to rise over time. However, the annual deficit was gradually declining during this period and the annual budget deficit was essentially eliminated by 2014/15, shrinking to just $550 million (DOF, 2021b).

The autumn of 2015, however, saw the election of Justin Trudeau's Liberal government, which presided over a new period of loosened fiscal policy. Deficits re-emerged despite a growing economy, the government ditched the target of a balanced budget shortly into their tenure, and created a soft fiscal target of a steady or declining debt-to-GDP ratio.

In 2015/16, the Trudeau government immediately increased spending and turned a small projected surplus into a $2.9 billion deficit (DOF, 2021b). Over the next four years, Ottawa continued to run multi-billion-dollar deficits, causing federal net debt to rise quickly. By 2019/20, federal net debt had climbed to $812.9 billion, an increase of $112.2 billion from the debt level in 2014/15—the last full fiscal year under the Harper government (DOF, 2021b). Over just five years, the level of nominal federal net debt had increased by 16.0%. ***Figure 1*** shows the increase in the federal net debt burden between 2007/08 and 2019/20, measured in nominal dollars.

The COVID-19 pandemic hit Canada in early 2020 and exacerbated the existing fiscal problems. Higher spending and lower revenues caused the federal budget deficit to rise to $327.7 billion in 2020/21 and the government expects another $144.5 billion shortfall in 2021/22 (DOF, 2021a). As a result of these large budget deficits, federal net debt increased

Figure 1: Federal net debt ($ millions, nominal), 2007/08–2019/20



Source: DOF, 2021b.

dramatically once again. In 2021/22, net debt will reach nearly $1.3 trillion, equal to 52.1% of GDP (DOF, 2021a; Statistics Canada, 2021c).

In recent years, budget deficits and increasing debt became a serious fiscal challenge for many provincial governments as well. Combined federal and provincial net debt reached 65.7% of the Canadian economy in 2019/20 (Fuss and Lafleur, 2021; RBC Economics, 2021). As it did at the federal level, the pandemic took a heavy toll on provincial balance sheets. In both 2020/21 and 2021/22, every province except New Brunswick is expected to record a budget deficit (RBC Economics, 2021). Correspondingly, net debt-to-GDP ratios are projected to rise from pre-pandemic values in each province (except, again, New Brunswick), ranging from 19.6% in Alberta and British Columbia to 47.0% in Newfoundland & Labrador by 2021/22 (RBC Economics, 2021).

In the other large provinces—Ontario and Quebec—net debt-to-GDP ratios are projected to reach 43.4% and 45.5%, respectively in 2021/22. Combined federal and provincial net debt is projected to reach $2.1 trillion by 2021/22, or 86.3% of the Canadian economy (RBC economics, 2021; Statistics Canada, 2021c). In other words, combined net debt as a share of the economy is set to be more than a third higher than it was before the pandemic.

Although the increase in provincial debt is noteworthy, subsequent sections will focus only on the increase in federal debt. Furthermore, while the accumulation of federal debt between 2019/20 and 2021/22 is stark, it is clear the run-up in debt had begun well before the pandemic. In the next section, we explore what caused the federal debt to accumulate before 2020 to demonstrate how Ottawa's current fiscal challenges should not be viewed simply as a crisis brought about by COVID-19.

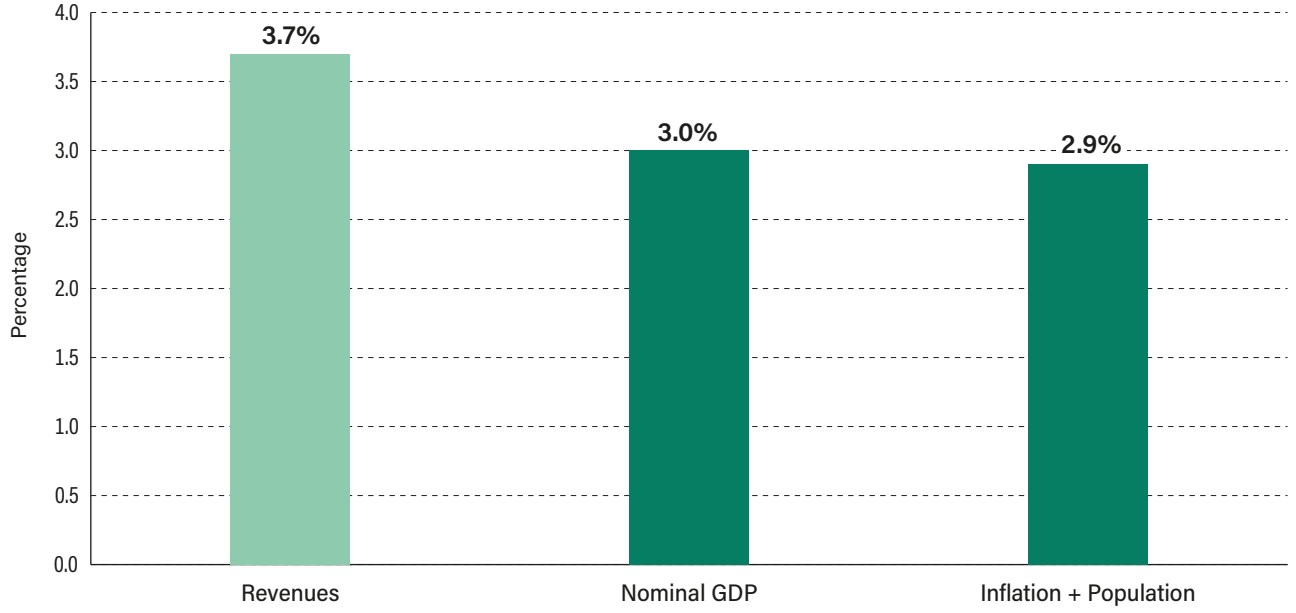
The pattern—rapid growth in federal spending

Federal debt was rising for more than a decade prior to the pandemic as a result of persistent budget deficits. It is important to understand the root cause of these deficits. Some pundits have suggested that the national government has a shortfall in revenue and should increase taxes, particularly on higher-income earners, to generate additional revenue (Lim, 2021). This opinion ignores important evidence.

Between 2015/16 and 2019/20, average annual growth in federal revenues exceeded combined inflation and population growth (***figure 2***). In fact, total federal government revenues increased by an average of 3.7% per year over this period (DOF, 2021b) while on average inflation plus population growth was 2.9% (Statistics Canada, 2021a; 2021b). Revenues also grew faster than the economy—Canada's nominal GDP increased at about 3.0% annually between 2015 and 2019. In other words, government revenues grew at an average annual rate approximately 27.6% greater than would have been necessary to offset the pressure placed on government finances by inflation and population growth, and 21.6% greater than the growth in GDP over the period.

As slow growth of revenue was not the root cause of the accumulation of federal debt in the years leading up to the pandemic, it makes sense to examine the other side of the ledger—spending. The period between 2014/15 and 2019/20 saw rapid growth in spending—growth that outstripped the growth in revenue. During this period, the Trudeau government boosted nominal federal program spending by

Figure 2: Annual average growth rate (%) in federal revenues compared to growth in GDP and growth of inflation plus population, 2015/16–2019/20



Sources: DOF, 2021b; Statistics Canada, 2021a, 2021b, 2021c; calculations by authors.

36.1%, from $248.7 billion in 2014/15 to $338.5 billion in 2019/20 (DOF, 2021b).[2] To put this growth in spending into context, we compare increases in program spending to two other economic indicators—nominal GDP growth and the combined effects of inflation and population growth.

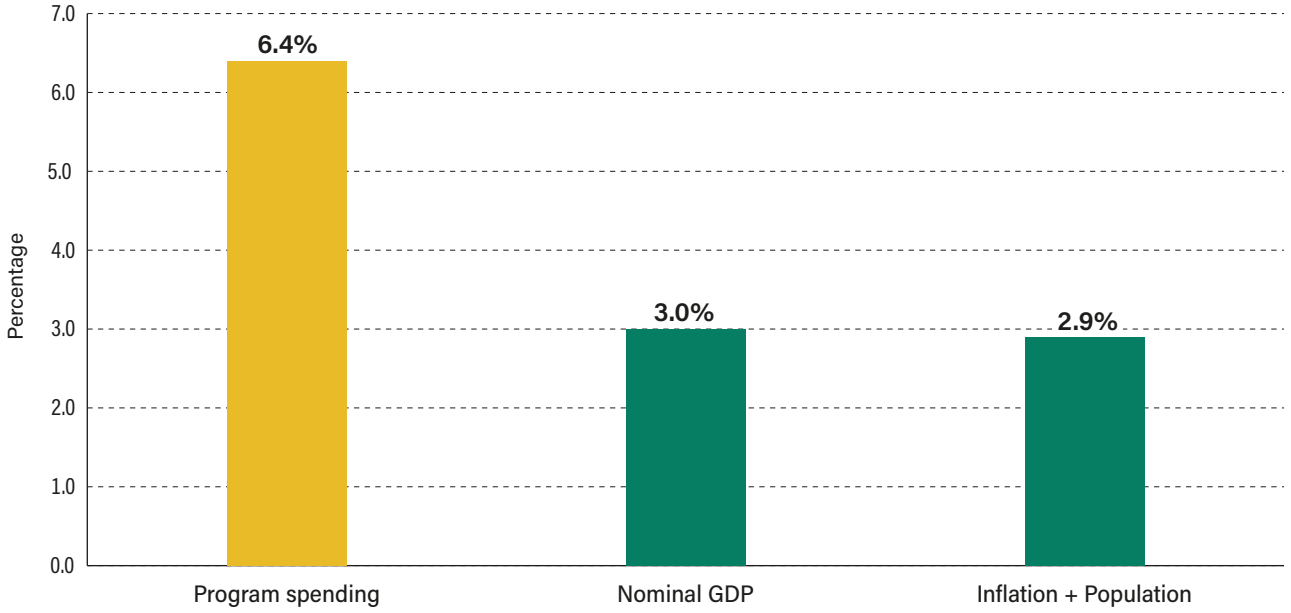
As mentioned previously, Canada's nominal GDP grew by an annual average rate of 3.0% during this period. Inflation and population combined grew slightly less at an average annual rate of 2.9%. But, growth in federal program spending outpaced both of these indicators considerably, averaging 6.4% annually between 2015/16 and 2019/20 (DOF, 2021b). ***Figure 3*** compares the growth rate for program spending against the two economic indicators.

Moreover, growth in nominal program spending during Prime Minister Justin Trudeau's first term in office exceeded growth in nominal GDP and in inflation plus population in each of the five fiscal years from 2015/16 to 2019/20 (***figure 4***). To put this into historical context: Prime Minister Trudeau broke the record for the highest level of per-person federal spending in Canada's history at $9,224 per person in 2018/19 and again at $9,671 in 2019/20 (all figures are adjusted for inflation so they are comparable over time).[3] This was before the COVID-19 pandemic hit the country. In other words, Canada entered the pandemic with spending levels that were already at record highs. Our conclusion is that the federal government was spending excessively prior to COVID-19, which exacerbated the fiscal challenges that emerged during 2020 and 2021.

2 For details on the increase in each area of federal spending, see Hill, Li, Palacios, and Clemens, 2020.

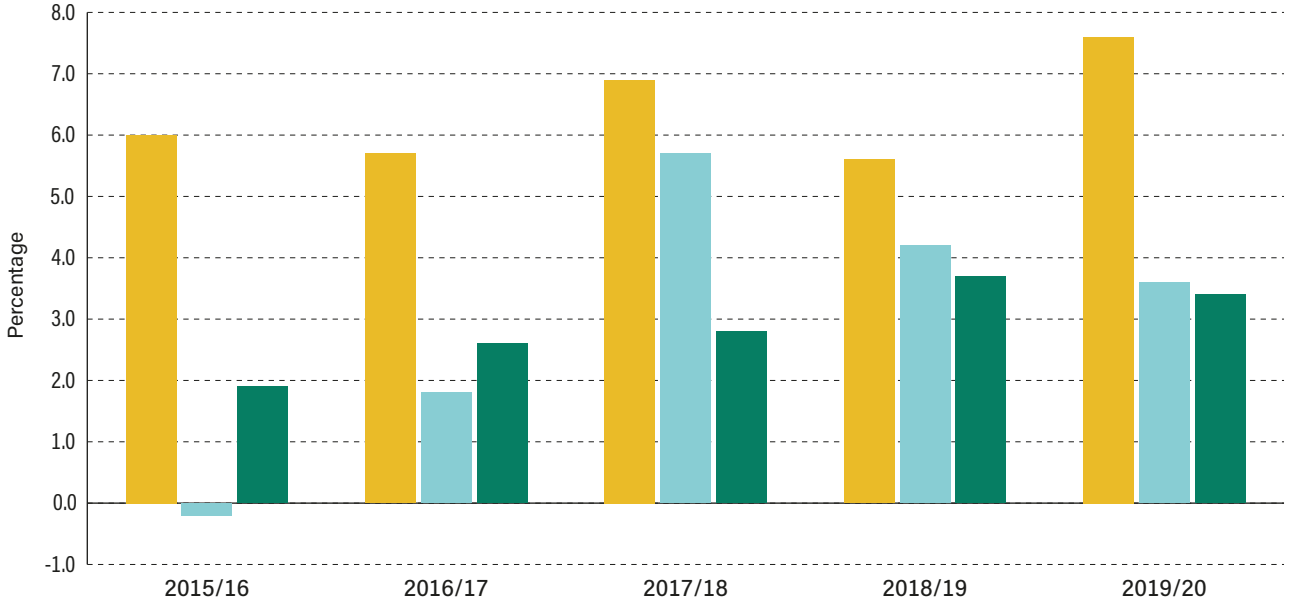
3 The per-person spending record was broken again in 2020/21 during COVID-19. See Fuss, Palacios, Li, and Hill, 2021 for more information about per-person spending levels in Canadian history.

Figure 3: Annual average growth rate (%) in program spending compared to growth in GDP and growth of inflation plus population, 2015/16–2019/20



Sources: DOF, 2021b; Statistics Canada, 2021a, 2021b, 2021c; calculations by authors.

Figure 4: Growth (%) in federal program spending compared to growth in nominal GDP and growth of inflation plus population, by year, 2015/16–2019/20



Sources: DOF, 2021b; Statistics Canada, 2021a, 2021b, 2021c; calculations by authors.

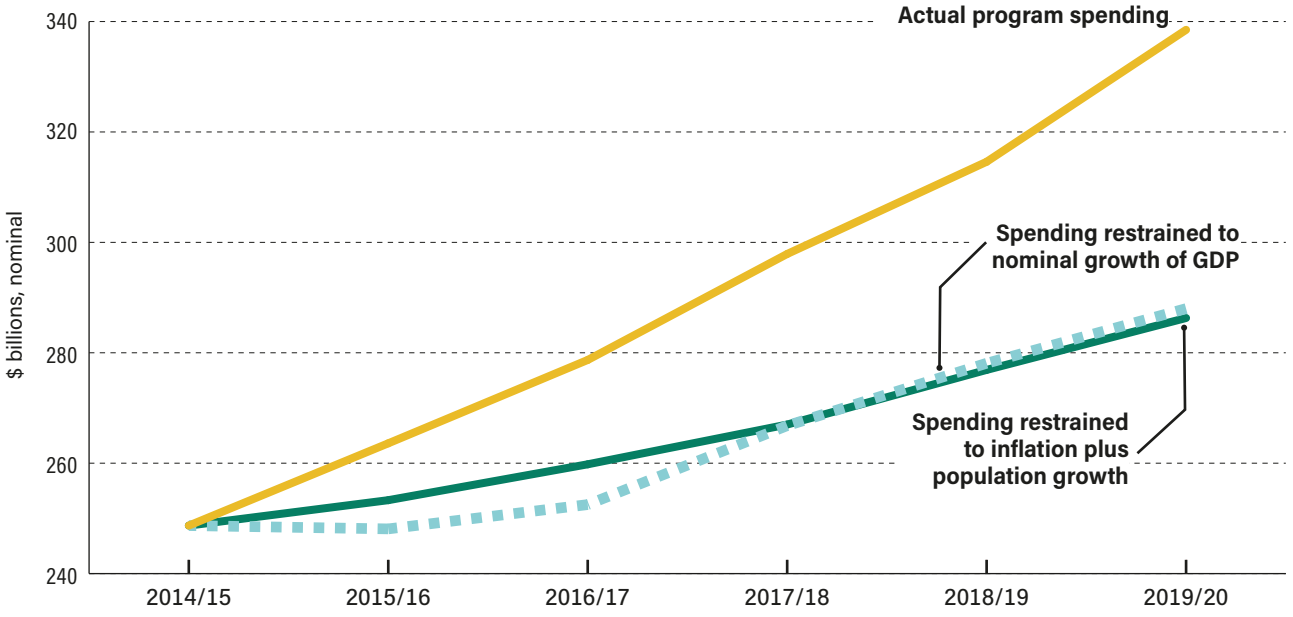
A scenario—federal finances with spending restraint before COVID-19

The increase in federal program spending from 2015/16 to 2019/20 outpaced both inflation plus population growth and also nominal GDP growth. This led to large budget deficits and an accumulation of considerable debt before COVID-19 appeared. To demonstrate the significance of the federal government's spending choices, this section compares Ottawa's actual fiscal position to the position the country could have been in a scenario of moderate spending restraint before the pandemic.

Figure 5 compares Ottawa's actual program spending to the level of program spending that would have been necessary to match either growth in nominal GDP and in inflation plus population from 2014/15 to 2019/20. As indicated in the previous section, program spending would have been lower in every fiscal year had the federal government restrained growth in program spending to equal either of these metrics. By 2019/20, annual program spending would have been $50.4 billion lower had it matched nominal GDP growth, and $52.1 billion lower had spending kept pace with inflation-plus-population growth.

If the federal government had shown a greater discipline in spending, it would have significantly improved Ottawa's annual budgetary balance by the time COVID-19 arrived. As shown in ***figure 6***, the federal government would have run surpluses almost every year under either alternative scenario, as opposed to incurring persistent deficits.[4]

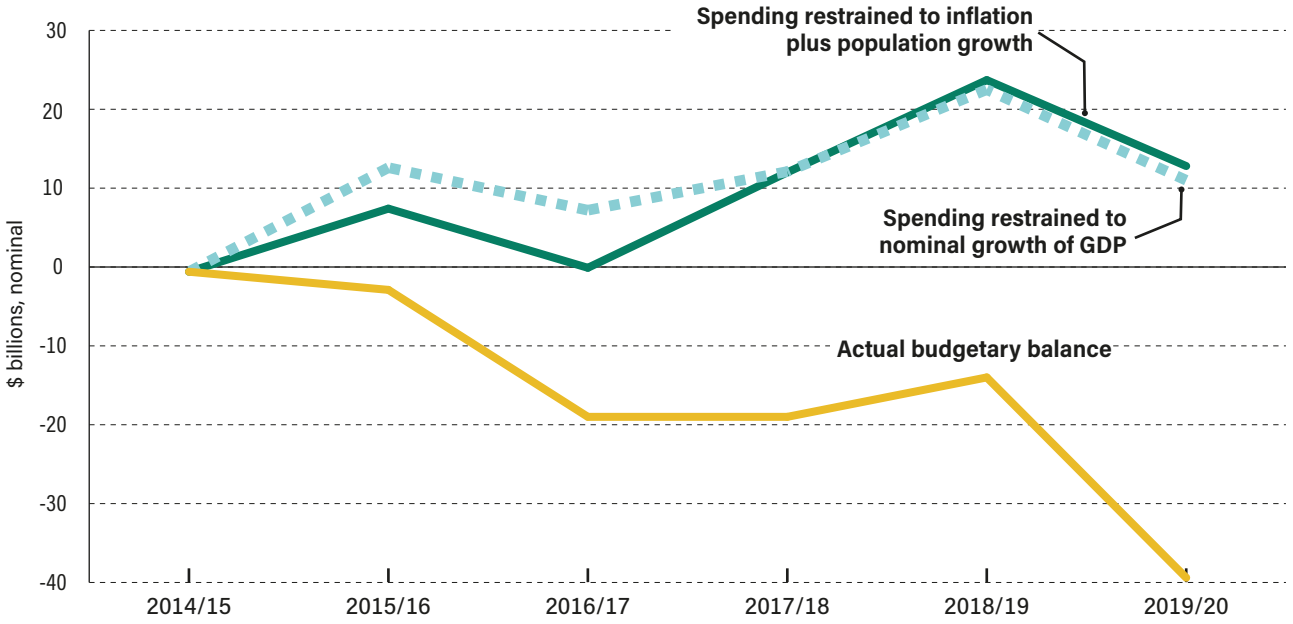
Figure 5: Actual federal program spending compared to program spending with restraint ($ billions, nominal), 2014/15–2019/20



Sources: DOF, 2021b; Statistics Canada, 2021a, 2021b, 2021c; calculations by authors.

4 This analysis makes two simplifying assumptions. First, it makes no adjustment for the reduced debt servicing costs that would result from lower program spending. Second, it makes no adjustment for the impact of lower program spending on economic growth or government revenue.

Figure 6: Actual budgetary balance compared to budgetary balance with spending restraint ($ billions, nominal), 2014/15–2019/20



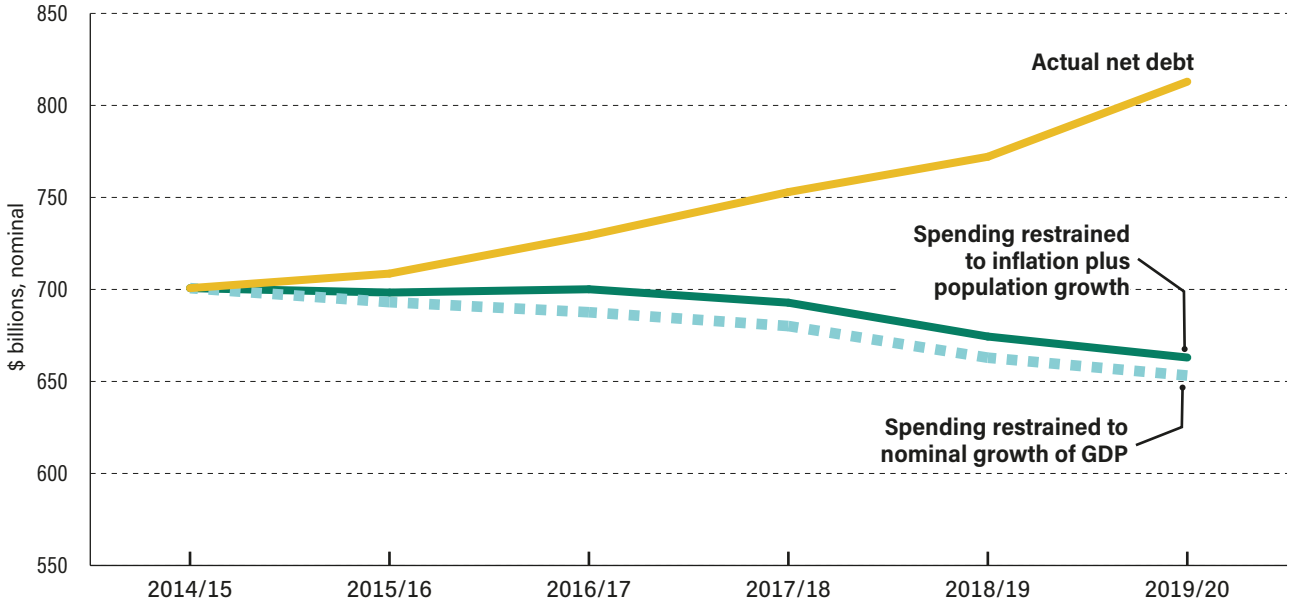
Sources: DOF, 2021b; Statistics Canada, 2021a, 2021b, 2021c; calculations by authors.

If program spending had been held to the rate of nominal GDP growth, Ottawa's average annual budget balance would have been a $13.1 billion surplus over the period, compared to a $18.8 billion deficit. If program spending had been restrained to the rate of growth of inflation plus population, the average annual budget balance would have been a $11.2 billion surplus. By 2019/20, the difference between the actual budget balance and the budget balance with moderate spending restraint is particularly marked. Specifically, Ottawa would have had a $11.0 billion surplus in 2019/20 if increases in program spending had matched nominal GDP growth, compared to the actual $39.4 billion deficit. If it had increased spending at a rate consistent with the inflation-plus-population growth, the federal government would have posted an even larger surplus of $12.8 billion in 2019/20.

Had it had these surpluses, the federal government would have been able to reduce its net debt burden, as opposed to increasing it, before COVID-19. ***Figure 7*** compares actual federal net debt to the level that would have been accumulated had the government moderately restrained spending over the five-year period from 2014/15 to 2019/20.[5] As shown, the net debt was $700.7 billion in 2014/15. Had the federal government increased annual spending to match nominal GDP growth, the net debt would have been reduced to $653.2 billion by 2019/20, instead of increasing to $812.9 billion. Similarly, net debt would have been reduced to $663.0 billion in 2019/20 had the government held spending growth equal to inflation-plus-population growth. Put differently, the federal government could have avoided between $149.9 billion and $159.6 billion in net debt prior to the

5 This analysis assumes no change in financial assets. For simplicity, the change in net debt is simply calculated as the difference in the accumulated deficit/surplus from 2015/16 to 2019/20.

Figure 7: Actual net debt compared to net debt with spending restraint ($ billions, nominal), 2014/15–2019/20



Sources: DOF, 2021b; Statistics Canada, 2021a, 2021b, 2021c; calculations by authors.

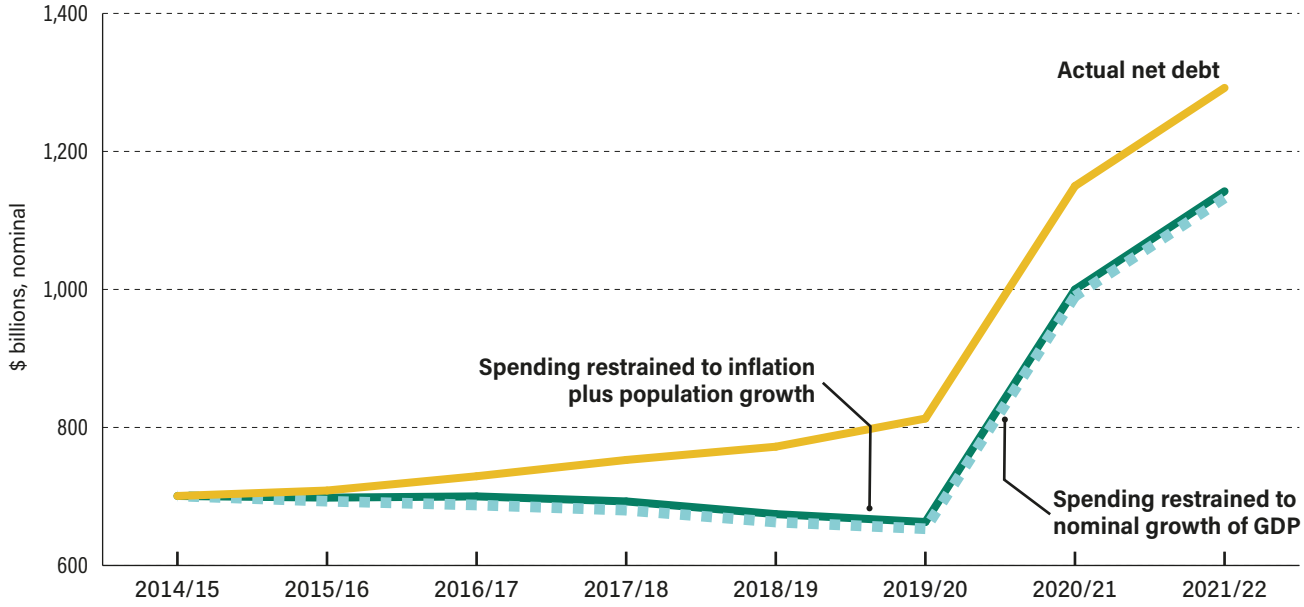
pandemic through moderate spending restraint. This would have put federal finances on a stronger footing to take on the additional fiscal burden stemming from COVID-19.

To illustrate this, ***figure 8*** compares actual federal net debt to the level of net debt that would have been accumulated by 2021/22 under a scenario of moderate spending growth in the five years leading up to the pandemic. For simplicity, no change is made to actual government spending or revenue during the pandemic years from 2020/21 to 2021/22. Even under our conservative estimates, Ottawa's net debt would be approximately $1.1 trillion in 2021/22, compared to the projected $1.3 trillion. As a share of the economy (nominal GDP), net debt would be between 45.6% to 46.0%, compared to the projected 52.1% in 2021/22.

Conclusion

Nominal federal debt was already increasing well before COVID-19. As we have shown, this was not the result of insufficient revenue growth, but rather of a pattern of escalating spending and deficits in the five years before 2020. If growth in federal program spending had been moderately restrained to match inflation-plus-population growth or nominal GDP growth from 2015/16 to 2019/20, the federal government would have recorded surpluses nearly every year over the period and avoided taking on approximately $150 billion to $160 billion in additional debt. Moreover, the federal net debt-to-GDP ratio could have been lower than it is today, at roughly 46% rather than the current 52.1%. Put simply, federal finances could be in a better position today had the government exercised greater restraint in spending.

Figure 8: Actual net debt compared to net debt with spending restraint ($ billions, nominal), 2014/15–2021/22



Sources: DOF, 2021a, 2021b; Statistics Canada, 2021a, 2021b, 2021c; calculations by authors.

References

Canada, Department of Finance [DOF] (2021a). *Economic and Fiscal Update 2021*. Government of Canada. <https://www.budget.gc.ca/efu-meb/2021/report-rapport/EFU-MEB-2021-EN.pdf>, as of December 16, 2021.

Canada, Department of Finance [DOF] (2021b). *Fiscal Reference Tables December 2021*. Government of Canada. <https://www.canada.ca/content/dam/fin/publications/frt-trf/2021/frt-trf-21-eng.pdf>, as of December 30, 2021.

Fuss, Jake, and Steve Lafleur (2021). *The Growing Debt Burden for Canadians: 2021 Edition*. Fraser Institute. <https://www.fraserinstitute.org/sites/default/files/growing-debt-burden-for-canadians-2021.pdf>, as of January 17, 2022.

Fuss, Jake, Milagros Palacios, Nathaniel Li, and Tegan Hill (2021). *Prime Ministers and Government Spending, Updated 2021 Edition*. Fraser Institute. <https://www.fraserinstitute.org/sites/default/files/prime-ministers-and-government-spending-updated-2021-edition.pdf>, as of November 23, 2021.

Lim, Jolson (2021). A Wealth Tax in Canada Could Net More Revenues than Expected. *iPolitics*. <https://ipolitics.ca/2021/03/11/for-thursday-a-wealth-tax-in-canada-could-net-more-revenues-than-expected/>, as of November 23, 2021.

MacPhee, Sarah, Etienne Bergeron, Carleigh Busby, and Caroline Nicol (2021). *Fiscal Sustainability Report 2021*. Parliamentary Budget Officer. <https://www.pbo-dpb.gc.ca/en/blog/news/RP-2122-010-S--fiscal-sustainability-report-2021--rapport-viabilite-financiere-2021>, as of January 17, 2022.

Nair, Swathi, and Sarupya Ganguly (2021). Bank of Canada Q3 2022 Rate Hike Expected, Q2 Rise Possible. *Reuters*. <https://www.reuters.com/world/americas/bank-canada-q3-2022-rate-hike-expected-q2-rise-possible-2021-12-03/>, as of January 17, 2022.

RBC Economics (2021). Canadian Federal and Provincial Fiscal Tables. <http://www.rbc.com/economics/economic-reports/pdf/canadian-fiscal/prov_fiscal.pdf>, as of January 17, 2022.

Statistics Canada (2021a). Table 17-10-0005-01: Population estimates on July 1st, by age and sex. Statistics Canada. <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1710000501>, as of November 23, 2021.

Statistics Canada (2021b). Table 18-10-0005-01: Consumer Price Index, annual average, not seasonally adjusted. Statistics Canada. <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1810000501> as of November 23, 2021.

Statistics Canada (2021c). Table 36-10-0221-01: Gross domestic product, income-based, provincial and territorial, annual (x 1,000,000). Statistics Canada. <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3610022101> as of November 23, 2021.

Acknowledgments

The authors would like to acknowledge the anonymous reviewers for their helpful insights and suggestions. The authors, however, are alone responsible for the report itself, its conclusions, and recommendations. Any remaining errors or oversights are the sole responsibility of the authors.

As the researchers have worked independently, the views and conclusions expressed in this paper do not necessarily reflect those of the Board of Directors of the Fraser Institute, the staff, or supporters. This publication in no way implies that the Fraser Institute, its directors, or staff are in favour of, or oppose the passage of, any bill; or that they support or oppose any particular political party or candidate.

About this publication

ISSN 2291-8620

Media queries: call 604.714.4582 or e-mail: communications@fraserinstitute.org

Support the Institute: call 1.800.665.3558, ext. 586 or e-mail: development@fraserinstitute.org

Visit our website: www.fraserinstitute.org

About the authors

Jake Fuss is a Senior Economist at 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.

Tegan Hill is an Economist at the Fraser Institute. She holds a Bachelor of Economics and a Master's Degree in Public Policy from the University of Calgary. She specializes in government spending, taxation, and debt, with a focus on the policies of Alberta and the federal government. Ms. Hill's articles have appeared in major Canadian newspapers including the *Globe and Mail*, *National Post*, and *Toronto Star*; and she has co-authored more than 150 studies and commentaries, including *Prime Ministers and Government Spending: 2020 Edition*, *Examining Federal Debt in Canada by Prime Ministers since Confederation 2020*, and *Alberta's Lost Advantage on Personal Income Tax Rates*.