



# A Case for Spending Restraint in Canada

## How the Federal Government Can Balance the Budget

by Grady Munro and Jake Fuss

Since 2015, there has been a deterioration in the federal government's fiscal situation. Annual nominal program spending has increased an estimated \$193.6 billion since 2014/15; adjusted for inflation and population growth this represents an extra \$2,330 per person. Prior to the COVID pandemic, spending increased faster than population, inflation, and other relevant economic indicators. These spending increases have resulted in a string of large budgetary deficits that have contributed to an estimated \$941.9 billion increase in gross federal debt from 2014/15 to 2023/24. This accumulation of debt, along with recent hikes in interest rates, has raised the cost of interest on the federal debt to one of the largest budget expense items.

Moving forward, the federal government plans to slow nominal spending growth, which will keep inflation-adjusted, per-person spending relatively constant to 2026/27. Despite this, the federal government will continue running budget deficits and accumulating debt. It is also uncertain whether the federal government's current estimates are truly reliable as the estimates do not incorporate expected spending on pharmacare or the level of defence spending to meet Canada's NATO commitment. Moreover, the federal government's track record of exceeding previous spending commitments calls into question the reliability of the current spending targets. Therefore, it is clear the federal government is not implementing the level of spending restraint necessary to reverse course towards a stable fiscal situation.

An approach to federal finances that continues to run budget deficits and accumulate debt is economically harmful to both current and future generations of

Canadians. Research shows that significant increases in debt-financed spending harm economic growth by reducing capital accumulation and labour productivity. Furthermore, accumulating debt today increases the tax burden on future generations of Canadians, as they will be responsible for paying off this debt. Despite these effects, the federal government plans to continue running deficits and accumulating debt for the foreseeable future.

This need not be the case. The federal government can undertake decisive spending reform starting in 2024—similar to the reform by the Chrétien government in the 1990s—that balances the budget within a year or two. The federal government could balance the budget in 2026/27 by limiting annual growth in nominal program spending to 0.3% for two years. This would result in a 5.9% reduction in real per-person spending. Alternatively, the budget could be balanced in 2025/26 if the federal government reduces spending 4.3% for one year; the next

year, 2026/27, would see a budgetary surplus. In this scenario, inflation-adjusted per-person spending would decline by 7.5%. Key trade-offs between the two approaches include the extent of the spending reform and the speed of the return to balanced budgets. Balancing the budget in one year, as opposed to two years, would result in \$30.0 billion less debt accumulated by 2026/27.

Though it is beyond the scope of this study to discuss how such spending reforms should be implemented, there are three areas that might be considered for reform. Business subsidies are a significant expense, yet research suggests they have little if any economic benefit, and may actually harm economic growth when governments pick winners and losers in a free market. Reviewing business subsidies might provide opportunities to find savings. Aligning government-sector wages with those in the private sector would also provide savings, as government workers in Canada currently enjoy

an 8.5% wage premium (on average) relative to comparable private-sector workers. Finally, studies show that government fiscal waste can be significant. From 1988 to 2013, more than 600 government failures cost the federal government between \$158.3 billion and \$197.1 billion. Moreover, more than 25% of all federal COVID spending was wasteful. Addressing inefficiencies within government might also reveal savings.



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