Intelligence MEMOS

From: Don Drummond

To: Canadian Debt Watchers

Date: April 20, 2021

Re: **Budget 2021 Leaves Canada Awash in Debt for More than a Generation**

The C.D. Howe Institute 2021 Shadow Budget recommended the federal government return to around the pre-pandemic 30 percent of GDP net debt burden within two decades. Yesterday's Budget shows that marker of fiscal stability not being attained until 2055.

In the meantime, the debt burden is depicted as ever so slightly and gradually declining from the current 50-percent mark. This signifies this government's acceptance of a heavy debt burden and hence considerable risk for more than a generation.

The gradual decline in the debt burden, depicted in a single graph in the Budget with no accompanying detail, is presumably based upon an assumption of no further major shocks to the economy. Economic growth would be steady and interest rates, even if they increase somewhat, would remain modest.

Such an outcome would defy the history of the past five decades over which we have had double-digit inflation and interest rates, two major recessions, a fiscal crisis, a financial crisis, several natural disasters and now a public health crisis. It would be an unlikely outcome to not have another shock to the economy over the next 30 years. Canada would be less well placed to deal with it than it was when the pandemic broke out in 2020. Public policy is in good part an exercise in managing risk. The Budget does not provide an insurance policy for the very substantial risk it puts Canada in for a long time.

Large spending increases during and after the pandemic are a major cause of the high and lingering debt burden. So too is only moderate economic growth. The third critical dimension is an explicit decision to not ask Canadians to pay for the higher spending through taxation. That, too, is a major departure from the Shadow Budget where a 2 percentage point increase in the GST is recommended. Instead the government is passing the bill forward to other generations. Those generations already have a lot on their plates: a rapidly changing economy and job market, climate change – with its $170 a tonne carbon levy – and higher costs of education and CPP/QPP pension contributions. Now it must carry the burden of the response to COVID-19 and the cost of many new programs.

Many of those new programs are valuable. The problem is they are not being funded but instead carried by debt. The pandemic has largely been a shock to the economy's supply capacity. Household income has increased in aggregate and households have demonstrated an interest in spending where and when they have been able to.

Many argued the Budget should not use the $70 to $100 billion of "fiscal stimulus" set aside in the 2020 Economic Statement. Instead, the Budget appears to go further and allocates $101.4 billion in measures over the 2021-22 to 2023-24 period. But that is not really the case. This whole issue has been clouded over semantics.

"Fiscal stimulus" is generally interpreted as measures to encourage economic agents, especially households, to spend. The economy does not appear to need that. And in fairness to the government and the Budget, that is not what the $101.4 billion does for the most part. About one-third of the $101.4 billion is extending the pandemic-related supports to households and businesses. That is appropriate given that the public health crisis continues and in many parts of the country lockdowns have become stricter.

Much of the rest is to increase Canada's growth capacity rather than merely raise aggregate demand. As such, as in the Budget's language, they are more "investments" than "stimulus." Included in this category would be childcare support, which should increase the labour force participation rate, measures to better match labour demand and supply and incentives to increase business investment. Due in part to such measures, the Budget estimates that the economy's potential growth rate 2000-2029 should return to the pre-pandemic estimate of 1.7 percent annual real GDP growth from the extended hit predicted in the Economic Statement.

While there should be concern over the lingering high debt burden, it should be acknowledged that it might have been worse. Some very expensive spending proposals have been bandied about for some time by the Liberals. The budget does not advance a National Pharmaceutical Plan, instead suggesting the problems would be dealt with in a more strategic fashion. Gone are references to broad, expensive basic income schemes. And while there are some enrichments to Employment Insurance benefits, they are more modest than had been suggested.

The 2021 Budget may appear to lock Canada into a fiscal course for more than a generation. But it should be considered a first volley only. Once the pandemic settles, the country must come back to how to fund the higher spending so that Canadians in future do not drown in debt.

Don Drummond is the Stauffer-Dunning Fellow in Global Public Policy and Adjunct Professor at the School of Policy Studies at Queen's University and a Senior Fellow at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

A version of this Memo first appeared in iPolitics.