From: Alexandre Laurin and William B.P. Robson
To: Canadians Concerned about Government Debt
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Re: The Federal Fiscal Snapshot Has Shown Us the Problem. So What’s the Plan?

Last week’s fiscal “snapshot” from Finance Minister Bill Morneau was, as its name implied, a static picture—leaving us hanging about what comes next. Like the basketball caught on camera in mid-air as it bounces from rim to rim: will it go in or stay out? Or a person teetering on a cliff’s edge: will she pull back safely or fall? Likewise our fiscally overextended federal government: will it return to sustainable levels of spending and borrowing, or are Canada’s public finances out of control?

Previous forecasts from the Parliamentary Budget Officer and other projections had muted the shock value of the snapshot’s numbers, but they are alarming. Federal spending in the current fiscal year (2020/21) is now projected to be $612 billion, which would be $235 billion above the level prefigured in the fall 2019 fiscal update. With revenue projected at $269 billion—$84 billion below what the update prefigured—the deficit would come in at $343 billion, which would be $319 billion worse than in the fall update.

Before the year is done, the federal government’s net debt will surpass the previously unimaginable mark of $1 trillion. Relative to Canada’s economy, it will grow from 31 percent of GDP to 49 percent. This is an unprecedented peacetime deterioration in an indicator the Finance Minister has repeatedly assured us was the government’s fundamental guide to responsible fiscal policy.

The size of the federal government’s debt, in absolute terms and relative to the economy, matters for many reasons.

Federal borrowing absorbs saving otherwise available for investments that will make us better off in the future, such as housing, technology and infrastructure—and the healthcare we need for COVID-19. It erodes Ottawa’s future capacity to deliver services. Federal spending and borrowing also crowd the provinces, which are on the front line when it comes to current and future demands for healthcare. Canada’s ability to service all its debts is already a concern: one of the major credit rating agencies downgraded the federal government just last month.

We need to get beyond the static snapshot. Now, what comes next?

It is possible to project, assuming a robust economic recovery and the ending of emergency support payments, that deficits could shrink to an average close to $50 billion annually from 2022/23 to 2024/25. This is a remarkable amount of red ink for a government to be spilling while the economy is expending. It could, however, stabilize the debt ratio around 50 percent of GDP. As long as interest rates remain low, we could avoid tax hikes, and leave room for Canada’s provinces, businesses and households to finance their own needs in the medium term.

But the document released by the Finance Minister does not show the way to that happy outcome. Should the government continue to extend income supports and introduce new stimulus packages, the debt could be $100 billion or even $200 billion higher, and the ratio of debt to GDP would keep climbing.

Ottawa would keep competing with other borrowers to fuel its own operations and transfer payments, depriving provinces and the private sector of the funds they need to rebuild the economy. Pressure will mount for tax hikes, the mere threat of which would further depress business and consumer confidence.

What Canada needs is a timely wind-down of federal emergency measures and restraint in Ottawa’s own operating costs. Even before the pandemic, deficits that Canadians understood would be modest and temporary had become large and chronic. From 2015/16 to 2018/19, actual expenses exceeded the already rapid growth prefigured in annual budget projections by a cumulative $13.2 billion.

The July 8 snapshot shows Ottawa’s operating expenses—not the transfer payments, just the payroll, employee benefit, capital and other internal costs of the federal government—running $14 billion ahead of the projections in last fall’s update. More discipline would help the deficit shrink, making more room for other borrowers, while reducing the likelihood of additional credit downgrades and tax hikes, which could further damage an economy that will struggle to grow and create jobs in the difficult years ahead.

The Finance Minister’s snapshot showed us the static problem. We see the ball in the air—the person teetering at the edge of the cliff. What we need now is a dynamic plan that takes us forward to a sustainable fiscal future.

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