

Intelligence MEMOS



From: Christian Leuprecht

To: Canadians Concerned about the Deficit

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Re: **BY GAMBLING ON A FREE LUNCH, THE FEDERAL GOVERNMENT IS MAKING A DARING FISCAL BET**

The economic statement last week projects the [largest single-year budgetary deficit](#) since Canada began keeping track in 1966-67: \$381.6 billion. That deficit is greater than the total federal spending of \$375 billion in the previous fiscal year.

Yet Canada's economic fundamentals were already weak before COVID-19 and the collapse of fossil fuel prices, with lagging productivity, a current account deficit for 11 years running, and demographic growth masking sluggish economic growth. A major global credit rating agency recently downgraded the national credit rating over "[the deterioration of Canada's public finances](#)." The risk is that growth may continue to lag, compounded by the economic drag from an aging population, while mounting regulatory burdens stifle investment, productivity and exports.

The short-term payoffs of democratic electoral cycles discourage fiscal discipline at the best of times. The temptation for a minority government is to curry electoral favour by over-investing, not in job retention and creation, but in partisan policy priorities and income support.

The fiscal news may be giving older generations in particular a flashback to the '70s. Canada's debt was comparatively low and manageable until the early 1970s. Significant spending from then led to interest expenses eating ever larger shares of budgets through the early 1990s. The Chrétien government that took power in 1993 was forced to [reduce spending to fight the national debt](#).

It took more than a generation to pay for previous excess spending. Under successive governments from the 1990s to 2015, federal spending averaged 13 percent of GDP. Yet in recent years, federal spending that initially grew to 15 percent of GDP – double that for this fiscal year – and is now projected to hover around [one fifth of GDP](#) for the foreseeable future. In other words, government revenues are at best staying constant at 2019 levels at significantly higher levels of federal spending.

The federal balance sheet is now well over \$1 trillion in the red – \$2 trillion when provincial and municipal debt is factored in. The federal debt-to-GDP ratio has ballooned by an unprecedented two-thirds year-over-year, [from 31 percent in 2019](#) to 50.7 percent today.

That's approaching the debt-to-GDP ratio of 66.6 per cent last seen during the 1990s era, but back then hard political decisions sent the deficit on a downward trajectory. By contrast, under the current government, gross federal debt had already been trending upward before the pandemic. And with the government's announcement of up to \$100 billion in additional post-pandemic spending, the debt-to-GDP ratio is projected to climb further. Canada's [deficit growth](#) is now comparatively larger than that of any other G20 country by a significant margin. The International Monetary Fund [estimates](#) that Canada's deficit will continue to outpace all other G20 nations.

Canadians are told that such aggressive debt expansion is readily sustainable, provided [GDP growth exceeds interest rates](#) and debt servicing charges remain low.

With that claim, however, the government is living on a prayer: upward pressure on interest rates would [precipitate positive fiscal and higher welfare costs](#). Post-COVID-19, short-term GDP growth in countries with sounder economic fundamentals could surpass normal GDP growth in Canada, or inflation could force the Bank of Canada to wind down its holding of federal debt.

These risks and associated costs are shouldered disproportionately by younger generations. Not only do they lose out the most as their education and entry into the job market are disrupted, but they are also overrepresented among the service and gig workers whose jobs have been lost. As Canadian society [ages rapidly](#), the government is [effectively saddling](#) them with public debt for decades into the future.

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