

From: Louis Lévesque

To: Canadians Concerned About Debt

Date: June 29, 2021

Re: **PROVINCIAL DEBT LEVELS (II): UNSUSTAINABLE DEBT DYNAMICS**

Growth in healthcare spending consistently higher than growth in total revenues is the main factor since 2007 behind the sustained rise in provincial debt to record levels by 2019, as outlined [yesterday](#).

Canadian Institute of Health Information and fiscal reference tables data show that growth in provincial health expenditures since 2007 has consistently outpaced growth in total provincial revenues, inclusive of federal transfers, creating recurrent and growing annual pressures of over \$30 billion by 2019. Data on provincial deficits after 2007 suggest that about two thirds of this ended up financed through extra debt, or about \$20 billion annually by 2019 as shown in green in the left bar in the Figure.

Infrastructure reinvestment is a less well recognized factor at play that will only grow. The important reinvestment in public infrastructure that started after 2000 following years of neglect is also an important factor pushing provincial debt levels upward. While there are federal infrastructure support programs, the fact remains that provincial and local governments own more than 90 percent of public infrastructure assets in Canada.

Local governments and related entities operate a significant portion of public infrastructure, but it is provinces that have been largely left holding the debt bag. Municipalities are not only required to balance their operating budget, but many also plan their capital spending on a cash basis. For large cities, through grants and other policy instruments, provinces effectively end up assuming financial responsibility for a large portion of big infrastructure assets, including notably transit systems. This is why local government debt levels have not risen to the [same degree](#) as those at the provincial level.

The consistent data required to easily quantify the impacts of infrastructure spending on debt across provinces is not readily available. My preliminary and crude estimate pegs the annual pressure on provincial debt from infrastructure at between \$10-15 billion annually as of 2019 as shown in the Figure. Infrastructure thus represents the remaining one-third of the pre-pandemic annual provincial debt pressure not explained by health.

How did provincial debt pressures change during the pandemic?

A tally of the fiscal tracks projected in 2021-22 provincial budgets shows provincial net debt rising to 38 percent of GDP by March 2022, an increase of about 8 percent from levels at the end of 2019-20, or about \$185 billion over two years. This is illustrated by the middle bar in the Figure, where the yellow portion represents the annual impact of the shock in excess of preexisting pressures from health expenditures growth and infrastructure reinvestment that continued their recurrent and growing pressures on provincial debt.

What is the post-pandemic outlook?

Provincial 2021 budgets also forecast years of further increases in debt with a plateau or the beginning of a decline around 2025. To achieve this however, most forecasts rely on a combination of strong economic growth, unrealistically low spending growth rates, or as yet unidentified restraint measures. Most also assume little or no ongoing spending related to the pandemic. This appears utterly unrealistic given the need to address deficiencies in long-term care, probable ongoing immunization campaigns, massive surgery backlogs and the continuing support needed by COVID patients with long term-symptoms. I estimate the cumulative provincial pressure to be around \$5 billion per year in 2022 and beyond. And \$5 billion likely underestimates many of the post-pandemic burdens.

All the while, both infrastructure and health cost pressures will only grow as Canada's population continue to age and governments continue to increase spending on infrastructure.

What should Ottawa do?

One might have hoped to see more analysis about that the trend deterioration of the fiscal situation of provinces in Ottawa's spring Budget. Canada is, after all, the most fiscally decentralized advanced federation in the world, and provinces spend more on services than the federal government does.

Unsurprisingly, most provincial budgets also called for increases to federal health transfers. Improvements to the fiscal stabilization program will provide some temporary relief for provincial revenue losses, but the federal government's proposal to introduce a new shared-cost program for childcare will add another recurrent and growing upward pressure on provincial debt levels. No permanent transfer increases were announced but the Prime Minister indicated shortly after the Budget his willingness to consider them at a later time.

For now, Canada has collectively decided to punt on the debt dynamics of provinces. But as the above makes clear, this problem is not going away.

Louis Lévesque is a former federal deputy minister whose focus for many years was fiscal federalism.

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Figure:

Upward annual pressures on Provincial debt (\$B)
Pandemic fiscal shock, ongoing costs and new federal programs will add to preexisting pressures

