Intelligence MEMOS

From: William B.P. Robson

To: Enthusiasts for, and Skeptics about, Federal Government Spending

Date: April 28, 2021

Re: **Budget 2021: Pay Now or Pay Later, but Don't Think We Won't Pay**

In the C.D. Howe Institute's shadow federal budget, released 12 days before Finance Minister Chrystia Freeland delivered the real thing last week, my coauthors, Don Drummond and Alexandre Laurin, and I recommended raising the GST back to seven percent in 2023.

This idea got attention – mostly about how a two-point hike in the GST was too politically painful to be realistic. Over time, though, even in the big-borrowing, low-interest-rate future described in the budget, every dollar spent on programs requires close to 100 cents of revenue. Painful or not, the permanently bigger federal government that this budget anticipates will require Canadians to pay for it.

Since the pandemic struck, the federal government has taken Canada into uncharted fiscal territory. In the fiscal year that ran from April 1, 2020, to March 31, 2021, Ottawa financed more than half its program expense, not by taxing, but by borrowing. Not only did it spend 50-cent dollars on average, its regular announcements of tens of billions more spending left the impression that marginal program dollars cost nothing at all.

In its economic statement last November, the government penciled in $70-100 billion in new stimulus with no associated borrowing costs or revenues whatever. Budget 2021 makes that short-term spending concrete and launches a number of ongoing new programs. The government has also signaled fresh initiatives outside the budget framework, notably on the environment. When new programs look like they cost half-price, or even nothing, why not have more of everything?

But if you look ahead only a few years – no further than the budget projections themselves – the arithmetic changes dramatically. Federal revenue per program dollar rises from 50 cents last year to 93 cents by 2024 and 95 cents by 2025. Over time, the government's own numbers show we will be paying close to full price for our federal government programs. Even slightly slower growth, or higher interest payments on federal debt, and the figure hits $1.00 before we know it.

Where will the money come from? The GST is Ottawa's broadest and most robust tax. Every percentage point of GST yields about $10 billion in revenue. The two-point hike Don, Alex and I recommended would yield about $20 billion annually.

As it happens, that's the right number to use in looking at the spending prefigured in the federal budget. Looking past the COVID-related income supports, which have a clear justification and should wind down, in the medium-term (the 2023/24 fiscal year) the budget gives us a bottom line about $20 billion worse than what the government predicted in November. Filling that gap would require, as it happens, a two-percentage-point increase in the GST.

The fall statement, moreover, already reflected spending beyond that presented in the government's last budget, in 2019. Compare the 2021 budget's projections for 2023/24 with those in the 2019 budget and the bottom line is about $40 billion worse. Filling that gap would require a four-point GST increase.

Needless to say, the government is not talking about raising the GST. Budget 2021 instead contains a number of measures to tax digital services and luxury cars and boats – not politically painful but also not likely to raise much revenue. We may also see proposals for hikes in corporate and personal income taxes before long. But eventually the simple reality that the GST is Ottawa's broadest and most robust tax will reassert itself. If Canadians want a bigger federal government, we have to be ready for some pain. Because, whether sooner or later, we will have to pay for it.

William B.P. Robson is CEO of the C.D. Howe Institute.

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

A version of this Memo was first published in The Financial Post.