Getting Canada Back to Fiscal Balance

Issue

The latest federal budget released by the Department of Finance indicates that the federal government plans to run fiscal deficits every year to 2022, while long-term projections carry the deficit trend well into 2055. The largest deficit over the medium term is forecasted for the 2017-2018 fiscal year at $28.5 billion.[1] While Canada holds a strong standing in fiscal management at the federal level compared to its G7 peers, consecutive deficits and an increased debt load is sending Canada down a precarious financial path. With the federal debt currently sitting at approximately $691 billion, the financial burden to Canadians becomes $1.3 trillion once the debt carried by the provinces has been tallied.

More worrisome is the lack of a plan to bring the federal budget back to balance as the proposed investments begin to stimulate economic growth and boost future revenues. It is imperative that the federal government rethink their current fiscal plan and create a clear strategy of targeted results aimed at eliminating deficits, and reducing the debt balance.

Background

While running deficits in years of sluggish growth or recession is considered a reasonable fiscal approach, successive deficits and the lack of a clear strategy for future fiscal balance would be an imprudent fiscal tactic. As it stands, the medium and long-term outlooks released by the federal government forecast deficits - of up to $38.8 billion annually - until 2051. In contrast, the fiscal deficit in 2016 was only $1 billion, and a net surplus of $1.9 billion was generated in the year prior.[2] Should the government follow its current plan, it would make it the longest period of consecutive deficits in Canadian federal fiscal history, followed only by "the period of the Great Depression and the Second World War, and by the period from 1970 to 1996 that saw an oil price shock, two recessions and a stagflation".[3]

Several factors and assumptions come into play to formulate the government's current fiscal plan.

- Global growth is expected to remain sluggish with a growth rate of 3.4% in 2017 as projected by the IMF. (In contrast, global growth during the five years prior to the Great Recession of 2008-2009 was an average of 5.1%.[4])
- Canada's growth rate over the medium term 2017-2021 is expected to average 1.8% (behind the U.S. at 1.9%, but the second highest in the G7 and above its average of 1.4%).
- The decline in crude oil and other commodity prices have had a significant negative impact on Canadian personal income and business investment, particularly in Alberta. And despite the depreciation of the Canadian dollar export growth has been disappointing. Nevertheless, the contraction in investment activity in the oil and gas sector is expected to have run its course in 2017, and gains in jobs in the non-energy markets have surpassed the jobs lost in that sector. Furthermore, the recent increase in the Federal Reserve rate in the U.S. points to signs of growth in the U.S. economy which should benefit Canada.
- Over the long term, Canada's shifting demographics will put further pressure on costs related to supporting an aging baby boomer population while faced with a shrinking labor force.

In response to the new economic reality of slower national and global growth, the government plans to introduce a number of initiatives it hopes will stimulate economic development. One of the largest initiatives is the spending planned on infrastructure projects across Canada. Over the next 11 years the government plans to spend $81 billion

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[1] 2019: $27.4 billion; 2020: $23.4 billion; 2021: $21.7 billion; 2022: $18.8 billion – Department of Finance, Canada, "Budget 2017"
[2] [none]
[3] Fraser Institute, "Why federal deficits to 2055 really matter", https://www.fraserinstitute.org/blogs/why-federal-deficits-to-2055-really-matter
[4] Department of Finance, Canada, "Update of Long-Term Economic and Fiscal Projections"

more than originally planned on projects related to "public transit, green infrastructure, social infrastructure, transportation that supports trade, Canada's rural and northern communities, and smart cities."[5]

Although it may be a while before Canada and the rest of the world return to the pre-recession levels of economic activity, modest levels of growth are still forecasted. The new reality means that we must learn to do more with less. Therefore, it would not be prudent to run large consecutive deficits during periods of positive growth. The government also needs to remain cognizant of the fact that provinces have also been running substantial deficits in recent years. The total debt including federal and provincial is estimated to be around $1.3 trillion, or "$35,827 for every man, woman, and child living in Canada.[6] According to the Fraser Institute, "collectively, the federal and local governments spent $60.8 billion on interest payments in 2014/15, more than what is spent on pension benefits through the Canada and Quebec Pension Plans ($50.9 billion), and approximately equal to Canada's total public spending on primary and secondary education ($62.2 billion, as of 2012/13)".[7] The implications are clear, further increase in debt due to continuous deficits will promulgate the cycle of servicing the debt and divert funds from much needed essential programs such as pension, healthcare, and education. And as the labor force continues to shrink the burden of paying these debt servicing costs in addition to funding essential programs, will fall on the shoulders of fewer Canadians.

The questions that the government needs to thoroughly answer before spending public dollars are: (1) Is it right?; (2) Is it the right thing?; (3) Does it give results?; (4) What are we doing next door?

Recommendations

That the federal government:

1. Maintain a level of debt of no more than 30% debt to the average GDP of the 5 preceding years if GDP is expected to grow over the forecasted period. In years of declining GDP, maintain a Debt/GDP ratio of no more than 30%. This will act to curb future deficits and maintain a much slower increase in the level of debt.
2. Apply more rigor to regularly mandated program reviews across all ministries and departments that re-examine the programs, services, and operations of government, ensuring that these are aligned with citizens' expectations of government. Furthermore, these reviews should begin with the mandatory questions: Should government be engaged in this activity? Is this policy accomplishing what we want? How do we know? Are there other programs across government that are duplicative? The conclusions of such reviews should be tied directly to any continued funding.
3. That the Ministry of Finance implement a cash pooling arrangement within and between all departments and ministries whereby any annual budget surpluses (or unspent money) could be allocated by the Finance Minister to either pay down debt or re-allocated to other departmental/ministerial projects instead of borrowing to finance them. Departments/ministries would then be able to re-apply for that money in the following budget year.

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[5] Department of Finance, Canada, "Update of Long-Term Economic and Fiscal Projections"
[6] Fraser Institute, "The Cost of Government Debt in Canada, 2016", https://www.fraserinstitute.org/sites/default/files/cost-of-government-debt-in-canada-2016.pdf
[7] Ibid.