ECONOMIC VIEWPOINT

Facts and Fictions about Government Finance in Canada

By Randall Bartlett, Senior Director of Canadian Economics

Highlights

- Nearly a year ago, we published a report digging into the facts and fictions about government finance in Canada. In it, we concluded that "Canada is in a very enviable fiscal position globally and is not on the brink of experiencing a debt sustainability crisis."
- Since then, we have received new estimates and forecasts of government fiscal circumstances here and around the world. But the conclusion we reached in 2023 hasn't changed. As we've said in the past, Canada remains one of the cleanest dirty shirts in the fiscal laundry basket.
- On a total government basis, the IMF expects Canada to run the smallest average annual deficits in the G7 plus Australia, New Zealand and Spain over the next 5 years. The same is true for the federal government for at least the current fiscal year, although the latest monthly numbers from the Fiscal Monitor suggest that top ranking could be at risk. (See our recent note on the in-year federal deficit tracking.) Keep in mind this is just a comparison of actual and projected budget balances, and isn't an endorsement of any specific fiscal policies.
- Looking to gross total government debt to GDP, Canada is middle of the pack. But on a net debt basis, Canada leads most advanced economies, in large part due to financial assets held by public pension plans. When drilling down to just central governments, Canada's net debt as a share of GDP is broadly in line with other top-ranked countries like Australia, Germany and New Zealand.
- Canada's relative fiscal outperformance is not a new story. But it's one that is seldom told at home despite being widely recognized internationally. However, this is an important story that more Canadians should be aware of. Indeed, a common understanding of a shared set of facts will help them to better decide whether fiscal policy in Canada is heading in the right direction. Otherwise, they risk basing their views and decisions on works of fiction.

Nearly a year ago, we published a report digging into the facts and fictions around government finance in Canada. In it, we concluded that "Canada is in a very enviable fiscal position globally and is not on the brink of experiencing a debt sustainability crisis." Since then, we have received new estimates and forecasts of government fiscal circumstances here and around the world. As such, we thought it useful to give a brief update of what the latest fiscal figures tell us about how governments in Canada stack up against comparable fiscal authorities around the world.

Deficits Here, There and Everywhere

Budget balances give a sense of how governments plan to tax, spend and strike a balance between these two sides of the ledger. Starting at the highest level of aggregation, one can look at the total government budget balance, which includes central, state/provincial and local governments as well as public pension plans. According to the International Monetary Fund (IMF), Canadian governments are collectively expected to run the smallest average annual consolidated deficit among the Group of Seven (G7) plus Australia, New Zealand and Spain over the next

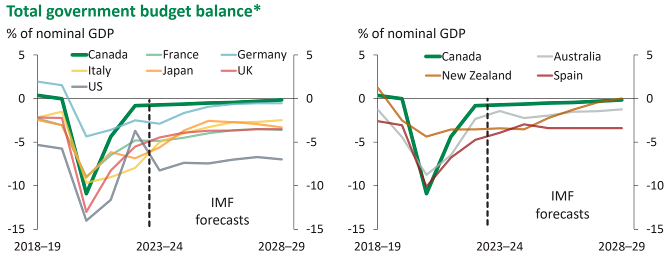
5 years (graph 1).[1] Among this group, the US is expected to run by far the largest total government deficits over that period.

But this doesn't provide an accurate view of government finances in Canada. For instance, taxing and spending decisions in the provinces often don't have material impacts on similar decisions made at the federal level. As such, those levels of government make decisions somewhat independently of one another. They also play in different sandboxes, with the provinces providing many of the public services Canadians enjoy. In contrast, the federal government largely taxes and transfers.

Given that, it's important to examine these different levels of government separately. And when we do, it's clear that federal government deficits have shrunk significantly since the dark days of the COVID-19 pandemic. According to Statistics Canada, they are now broadly similar in size to the aggregated budget deficits of their provincial counterparts (graph 2). On the whole, the total government budget balance would have been in a deficit again last year if it weren't for municipalities and, to a larger extent, pension plans running sustained surpluses.

Graph 1
Canada's Total Government Deficits Should Be Comparatively Small

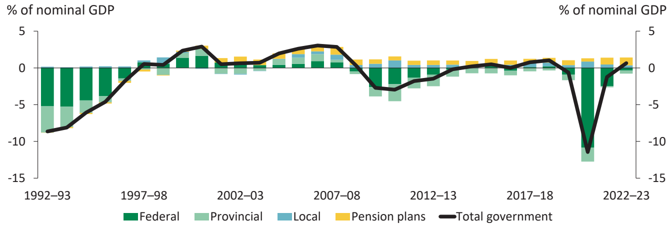
Total government budget balance*



*The estimate of total government budget balance includes the budget balance of public pension plans.
International Monetary Fund (IMF) and Desjardins Economic Studies

Graph 2
Federal and Provincial Government Deficits Have Persisted …

Government net operating balance in Canada

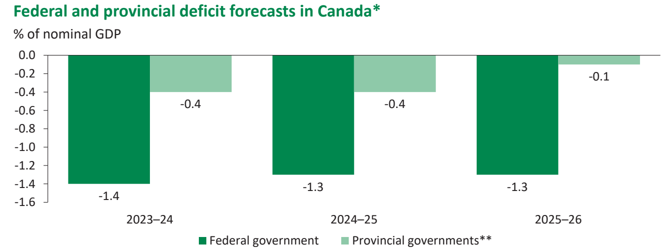


This analysis uses the Government Financial Statistics, not Public Accounts data.
Statistics Canada and Desjardins Economic Studies

Looking ahead, federal deficits are expected to outpace their provincial counterparts over the next few years (graph 3). However, at least at the federal level, even those dour deficit outlooks are starting to look optimistic. As we discussed in a note recently, in-year tracking of the federal deficit based on the monthly Fiscal Monitor suggests that it will be larger in the 2023–24 fiscal year than projected in the Fall Economic Statement (FES) 2023. Indeed, it could reach 2.2% of GDP in the current fiscal year as opposed to the prior fiscal projection of 1.4%. And it is likely to be larger because of greater-than-planned spending, mostly on operating expenses and the like, and in spite of higher-than-expected revenues. As such, the federal government's larger deficit doesn't solely reflect weak economic conditions but also underscores challenges in managing expenditures. However, while we think the federal deficit is likely to be larger than in the FES 2023, it should be smaller than suggested by the Fiscal Monitor for reasons outlined in the aforementioned note.

Graph 3
… And Are Expected to Continue to Persist Going Forward

Federal and provincial deficit forecasts in Canada*



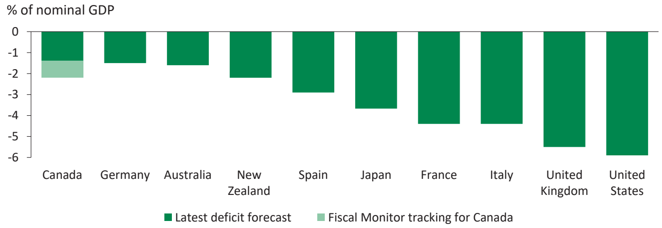
*All numbers are on a Public Accounts basis; **Sum of provincial fiscal forecasts, excluding Newfoundland and Labrador after 2023–24.
Official government sources and Desjardins Economic Studies

But these deficits pale in comparison to those run by other comparable advanced economy central governments. The fiscal forecast published in the FES 2023 put the Government of Canada's deficit at the lowest level among the G7 plus Australia, New Zealand and Spain as a share of GDP in the 2023–24 fiscal year (graph 4 on page 3). If the Fiscal Monitor-implied forecast proves correct, the deficit would be larger than the official forecast for Germany and Australia and in line with New Zealand. But it would still be smaller than in the rest of the G7 plus Spain. Keep in mind this is just a comparison of actual and projected budget balances, and isn't an endorsement of any specific fiscal policies.

[1] We use this group of countries because the G7 is the most common comparator to Canada; Australia and New Zealand are small open economies with independent monetary policy and flexible exchange rates; and Spain's economy is a similar size to Canada's.

Graph 4
Canada's Federal Deficit Remains Small Compared to Other Countries

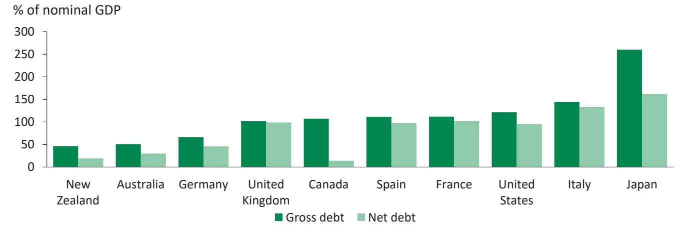
Central government deficit, 2023–24 fiscal year forecast*



*Countries use different approaches to public accounting.
Country ministries of finance, Congressional Budget Office, Office for Budget Responsibility, Australian Parliamentary Budget Office and Desjardins Economic Studies

Graph 6
Canada's Net Total Government Debt Is Very Low by Comparison

Gross and net total government debt, 2022*



*The estimate of total government budget balance includes the assets and liabilities of public pension plans; values for Australia and Japan are forecasts.
International Monetary Fund and Desjardins Economic Studies

Is It Time to Fret over Government Debt?

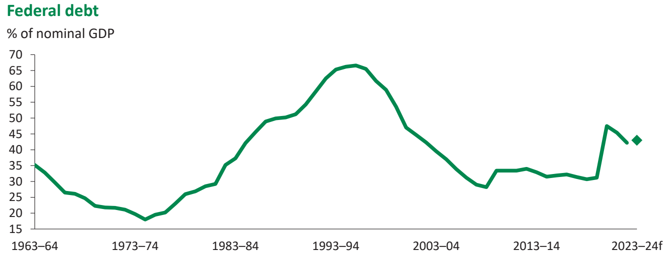
The larger-than-expected federal deficit this year should put similar upward pressure on the debt-to-GDP ratio. Our estimates suggest the federal debt (also known as "accumulated deficit") could rise to about 43% of GDP from 41.7% last year (graph 5). That's also higher than the 42.4% projected in the FES 2023.

However, this measure of debt is not particularly useful. That because it's measured as gross debt less both financial and non-financial assets, the latter of which are illiquid and infrequently valued. Consequently, it provides a poor representation of the risks posed by outstanding government obligations.

That helps to explain why organizations like the IMF instead look at gross and net debt, net debt being gross liabilities minus financial assets. And when comparing these measures of debt across countries, Canada's total government debt moves from middle to leader of the pack when financial assets are accounted for (graph 6). Japan also sees a notable improvement in net relative to gross debt, albeit to still the highest level among advanced economies.

Graph 5
Federal Debt Should Rise Modestly This Year as a Share of GDP

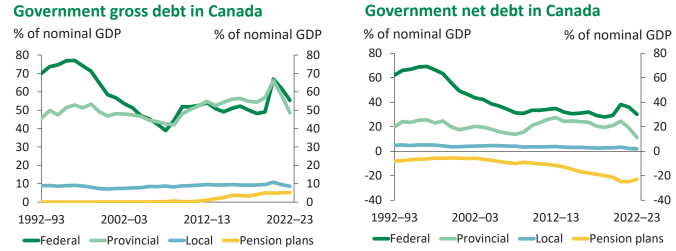
Federal debt



The forecast for the 2023–24 fiscal year is based on the in-year tracking from the federal Fiscal Monitor for November 2023.
Government of Canada and Desjardins Economic Studies

But, again, this refers to total government debt. As such, it includes the debt of all levels of government, including public pension plans. And it's the mass of financial assets held by the Canada Pension Plan (CPP) and Quebec Pension Plan (QPP) that give this distorted picture of Canada's net debt position (graph 7). That said, federal and provincial government debt still improve substantially after their respective financial assets are considered.

Graph 7
Pension Plan Assets Substantially Offset Other Government Debt

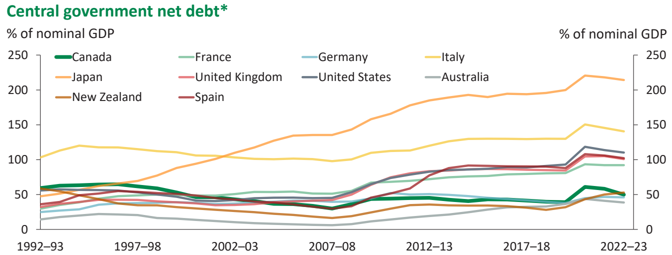


This analysis uses the Government Financial Statistics, not Public Accounts data.
Statistics Canada and Desjardins Economic Studies

According to the IMF (2016), net debt is more appropriate than gross debt when evaluating the impact of indebtedness on the yield spreads of sovereign bonds. And while this finding is more robust for emerging market than advanced economies, it makes sense that we would focus on this same measure of debt for cross-country comparisons.

Isolating just central government net debt, Canada continues to perform well when compared to similar advanced economies (graph 8 on page 4). It is in the illustrious company of countries like Australia, Germany and New Zealand, all of which have a central government net debt-to-GDP ratio in the range of around 40% to 50%. That stands in contrast to the next best performing group, where the central government has a net debt-to-GDP ratio of 90% to 110%. This group includes France, Spain, the United Kingdom and the United States. And finally, there are the

Graph 8
Canada's Central Government Net Debt Is Comparatively Low

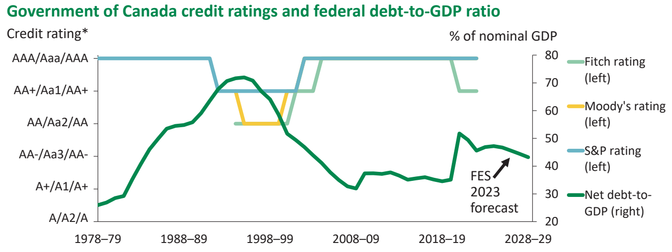


*The estimate of central government net debt does not include the assets and liabilities of public pension plans.
International Monetary Fund (IMF) and Desjardins Economic Studies

outliers. Italy has had high net debt for many years, which has topped 130% of GDP since the start of the COVID-19 pandemic. Japan's central government net debt is even more eyepopping, having remained above 200% of GDP since the 2019–20 fiscal year.

However, this fiscal outperformance can't be taken for granted. In 2020, Fitch Ratings downgraded Canada's federal government debt to "AA+" from "AAA" due to "the deterioration of Canada's public finances in 2020 resulting from the coronavirus pandemic." (Fitch Ratings, 2020) No other rating agency has yet followed suit (graph 9). But it doesn't mean they won't. As such, the federal government must credibly commit to reducing its net debt-to-GDP ratio by reining in its spending, particularly on things like operating expenses that are within its control. And policy initiatives should give high priority to boosting productivity and generating wealth in order to keep public finances on a sustainable long-term path.

Graph 9
The Government of Canada's Credit Quality Remains High for Now



*End of fiscal year; FES: Fall Economic Statement; Net debt is gross liabilities minus financial assets.
Bloomberg, Government of Canada and Desjardins Economic Studies

Conclusion

Canada's relative fiscal outperformance is not a new story. But it's one that is seldom told at home despite being widely recognized internationally. That may be because good news doesn't sell newspapers. It could also be because very few pundits take the time to dig into comparable international data, which is often difficult to find and hard to work with. As we've said in the past, Canada remains one of the cleanest dirty shirts in the fiscal laundry basket.

However, this is an important story that more Canadians should be aware of. Everyone should be able to agree on a shared set of facts regarding measures of deficits and debt as published by international financial institutions like the IMF and World Bank. Canadians can then engage in a more informed conversation about how governments are spending, taxing, borrowing and, ultimately, whether fiscal policy in Canada is heading in the right direction. Otherwise, taxpayers risk basing their views and decisions on works of fiction.