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Understanding the Scale of Canada's Federal Deficit

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MAIN CONCLUSIONS

- For many years the federal government's approach to government finances has relied on spending-driven deficits and a growing debt burden, causing a deterioration in the state of federal finances.
- While deficits can sometimes be justified in certain circumstances, perpetual spending-driven deficits have become the norm rather than a temporary exception for the federal government. The $39.8 billion deficit expected in 2024/25 is the 17th consecutive annual deficit, and deficits are expected to continue into the foreseeable future.
- Deficits have helped drive federal gross debt from 53.0% of the economy ($1.1 trillion) in 2014/15 up to an expected 69.8% ($2.1 trillion) in 2024/25.
- This increase in the level of federal debt comes with costs and will result in higher taxes on Canadians.
- It may be hard to comprehend the scale of the deficits and debt, so to contextualize the current state of federal finances this bulletin provides an example of what a median family's household budget would look like in 2024 if it managed its finances the way the federal government does.
- The median family earning $101,821 in 2024 would be spending $109,982 if it spent the way the federal government does. To cover the difference, it would put $8,161 on a credit card, despite already being $427,759 in debt.
- Of the total amount spent, $11,066 would go towards interest on the debt this year. Simply put, a Canadian family that chose to spend like the federal government would be in financial trouble.

Introduction

Over the last two decades, Canada has seen a shift in the approach to public finances that has seen the federal and most provincial governments move away from balanced budgets, declining government debt, and smaller and smarter government spending (Clemens, Lau, Palacios, and Veldhuis, 2017). Instead, governments across the country (led by the federal government) have chosen to consistently run budget deficits and increase the level of government debt, ultimately held by Canadians.[1] Unchecked debt and deficits have contributed to a deterioration in the state of public finances but, given the sheer scale of the numbers involved, it may be difficult to understand the extent of this problem.

To help Canadians understand the scale of debt and deficits at the federal level, and underscore the severity of the problem, this analysis puts the federal deficit into a more personal context using a comparison with the median Canadian family's household budget.[2] The following sections begin with a discussion of deficits and spending, then provide a discussion of the consequences of deficits (namely debt accumulation), and end with the presentation of a Canadian household budget modeled after the federal plan for 2024.

Deficits and spending

Governments operate at a deficit when they spend more than they receive in revenues and therefore must borrow money to cover the difference. In certain situations, deficits can be a useful or even necessary tool for governments. For instance, deficits allow governments to maintain consistent levels of taxation during periods when revenues temporarily decline and spending grows—such as during a recession or economic shock (Lau, 2022). Using deficits to smooth taxes over time is economically beneficial, since frequent tax changes create uncertainty that inhibits economic activity. However, deficits must be balanced out by surpluses, when revenues exceed spending. Tax-smoothing only works when over the long run governments run surpluses in the good times to balance out deficits accumulated during the bad times; otherwise deficits are simply a higher tax burden in the future.

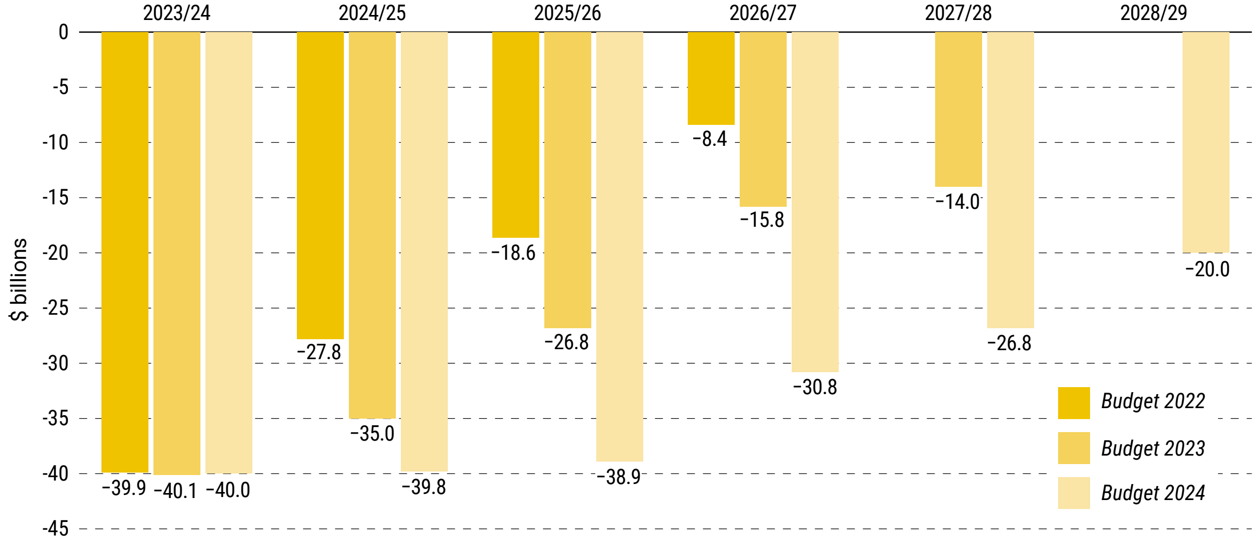
This is the situation of the federal government currently as budget deficits have been the norm for many years and the government has not budgeted for surpluses to balance them out. Indeed, the last time the federal government ran a surplus was in 2007/08, and every year since then the government has operated at a deficit (Canada, Department of Finance, 2023b). Furthermore, under the Trudeau government deficits have grown larger and persisted. From 2015/16 (the Trudeau government's first partial year in office) to 2024/25, the annual deficit as a share of the economy has grown from 0.1% to 1.3% (Canada, Department of Finance, 2023b, 2024; Statistics Canada, 2023). In nominal dollars, this is a rise from \$2.9 billion in 2015/16 to \$39.8 billion in 2024/25. Moreover, recent deficits from 2019/20 to 2024/25 have been relatively large—exceeding 1.2% of GDP in every year, a cumulative shortfall of \$572.6 billion.

Any plans to reduce the deficit have been consistently delayed by the government. **Figure 1** displays projected federal deficits for 2023/24 to 2028/29 from the last three federal budgets. It shows that the

1 For example, Fuss, Hill, and Whalen (2024) provide an overview of the federal and provincial 2024 budgets and conclude that, with few exceptions, governments by and large demonstrated irresponsible fiscal management through their reliance on deficit spending, inability to limit debt accumulation, and unwillingness to provide meaningful tax relief for Canadians.

2 The authors acknowledge that government and household finances and debt are not the same, and this report makes no assertion to the contrary. Rather, inspired by the work of Ditch (2022), our purpose is to present the current state of the federal budget in a context that is familiar and understandable to Canadians.

Figure 1: Projections of the federal deficit ($ billions) from *Budget 2022*, *Budget 2023*, and *Budget 2024*, 2023/24–2028/29



Note: *Budget 2022* did not have projections for 2027/28 or 2028/29, while *Budget 2023* did not make projections for 2028/29.
Sources: Canada, Department of Finance, 2022, 2023a, 2024.

Trudeau government has continually delayed meaningful deficit reduction. Instead, estimates for future deficits have consistently been revised upwards, and there are apparently no plans to balance the budget in the foreseeable future.

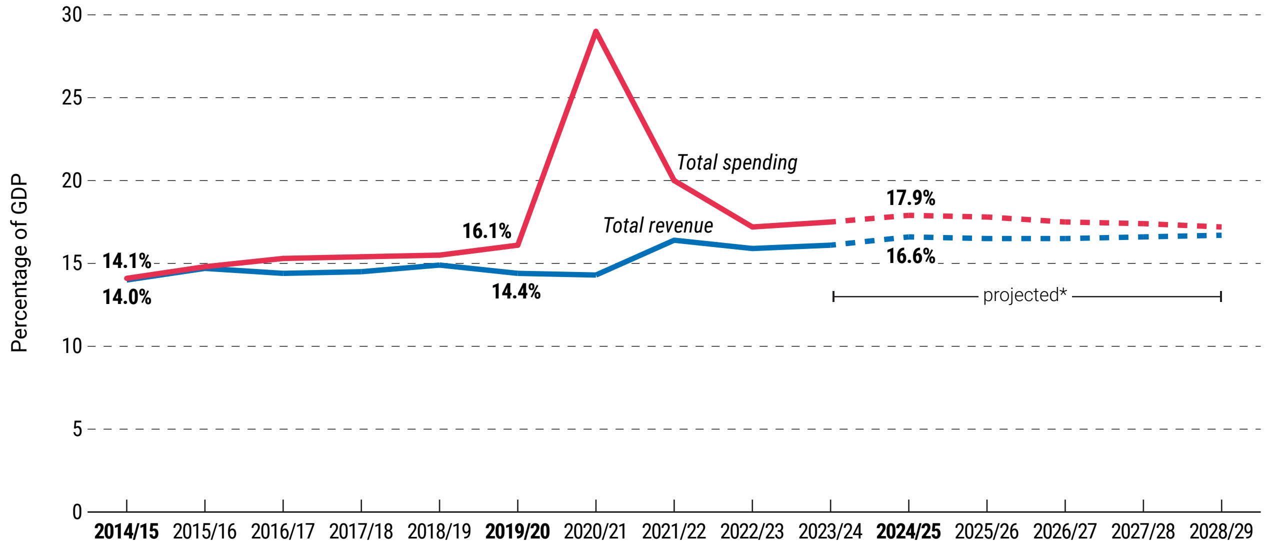
The root cause of these deficits has been not a decline in federal revenues but the federal government's unwillingness to limit growth in spending (**figure 2**). In 2014/15, total annual spending and total annual revenues were nearly equal: spending was 14.1% of GDP while revenue equaled 14.0%. Since then, annual revenues have grown to reach an expected 16.6% of GDP in 2024/25 (a $217.9 billion nominal increase). However, total annual spending grew even faster and is expected to reach 17.9% of GDP in 2024/25 (a $257.2 billion nominal increase). While some of the spending increase is the result of the rising cost of interest on debt, annual program spending (total spending minus debt interest) is still expected to grow faster (88.7%) than annual revenues (77.8%) from 2014/15 to 2024/25 (Canada, Department of Finance, 2023b, 2024). Figure 2 displays the explicit choice by the federal government to continually spend outside its means and run budgetary deficits.

Deficits contribute to the accumulation of debt

Since deficits represent borrowed money (except when financed by asset sales), the primary consequence of allowing extended periods of consecutive deficits is the rapid accumulation of government debt. **Figure 3** displays federal gross debt[3] from 2014/15 to 2028/29, and shows that Canada is indeed experiencing a substantial increase in the total amount of debt issued by the government. Federal gross debt is expected to have nearly doubled from $1.1 trillion (53.0% of GDP) in 2014/15

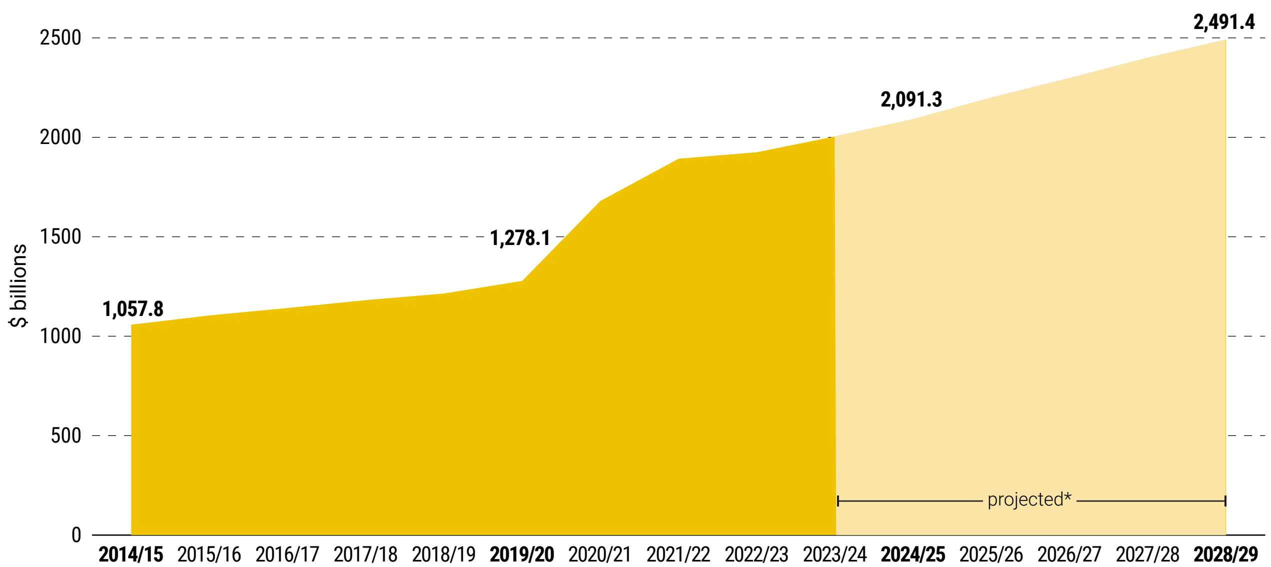
3 Federal gross debt refers to total federal liabilities and is used instead of net debt (total liabilities minus financial assets) because the inclusion of CPP and QPP assets in financial assets means net debt underestimates Canada's level of indebtedness (Clemens and Palacios, 2021). The interest that governments pay on liabilities is also determined by gross debt rather than net debt.

Figure 2: Annual federal spending compared to revenue (percentage of GDP), 2014/15–2028/29



Note: * as reported in Canada, Department of Finance, 2024.
Sources: Canada, Department of Finance, 2023b, 2024; Statistics Canada, 2023.

Figure 3: Federal gross debt ($ billions), 2014/15–2028/29



Note: * as reported in Canada, Department of Finance, 2024.
Sources: Canada, Department of Finance, 2023b, 2024.

to $2.1 trillion (69.8% of GDP) in 2024/25 (Canada, Department of Finance, 2024; Statistics Canada, 2023). For perspective, during the previous ten years, federal gross debt as a percentage of GDP declined slightly from 53.6% in 2004/05 to 53.0% in 2014/15 (Canada, Department of Finance, 2023b). Over the next four years, the federal government plans to add another $400.1 billion in debt, meaning that by 2028/29 the federal government plans to hold approximately 71 cents of debt for every dollar in the Canadian economy.

Government debt always comes at a cost, and Canadians will need to pay higher taxes as a result of accumulated debt. Debt represents an obligation to pay in the future, so future generations of Canadians are ultimately on the hook for paying interest on debt and repaying it as well. Cross (2022) warned that a significant accumulation of debt during periods of relatively low interest rates (as has happened under the Trudeau government) risks rapid increases in interest costs once interest rates rise. Indeed, as interest rates have risen in recent years, the federal government expects its debt charges to have more than doubled in the last three years from $24.5 billion in 2021/22 to $54.1 billion in 2024/25 (Canada, Department of Finance, 2023b, 2024). This means the federal government has gone from spending 5.9% of total revenues on debt charges in 2021/22 to 10.9% in 2024/25. When interest costs rise as a share of revenues, governments have less money available to fund other programs, and therefore face pressure to either raise taxes higher or cut spending elsewhere.

Research by Ferede and Dahlby (2024) examined how Canadian federal governments since Confederation have responded to deficits. They found that higher spending and deficits result in higher taxes on Canadians. Specifically, 70% of debt reduction typically has been accomplished through reduced program spending, while 30% is achieved through higher taxes. Simply put, empirical data analyzing the entirety of Canada's federal fiscal history shows that deficit spending results in higher taxes on Canadians even as government programs are being cut.

What if a family managed its finances the way the federal government does?

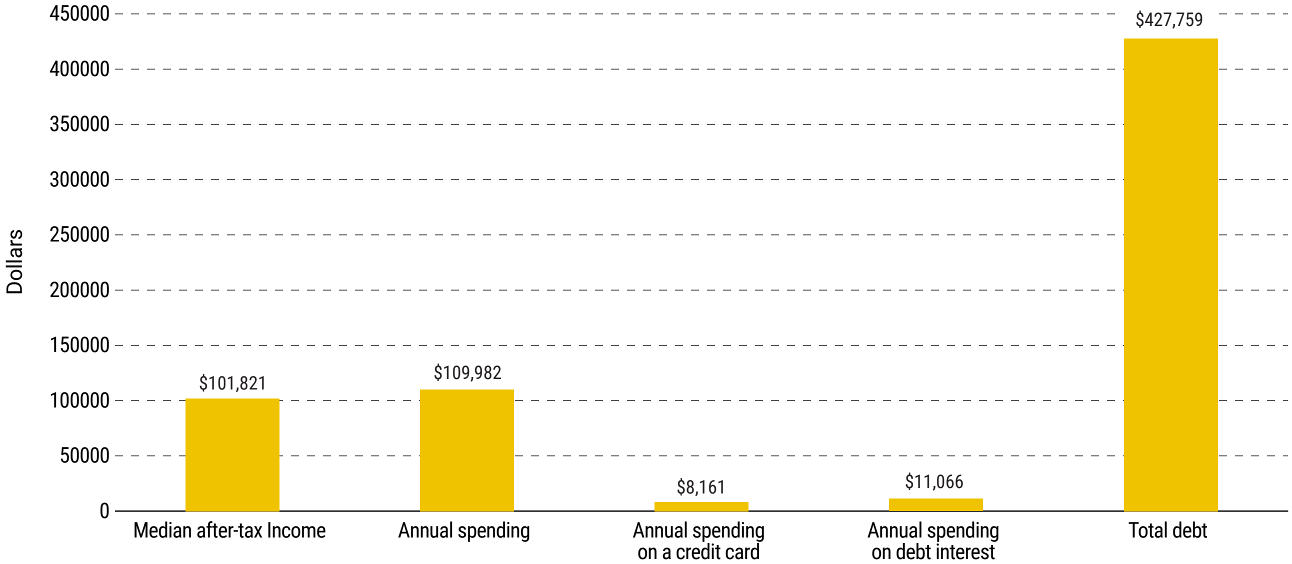
Continued reliance on deficit spending at the federal level has contributed to a substantial increase in the total amount of debt held by the federal government. This has led to a deterioration in the state of Canada's finances, but it can be difficult for Canadians to comprehend the scale of the fiscal mismanagement. Therefore, to put federal finances in a context familiar to Canadians, **figure 4** shows what the household budget of a Canadian famiy[4] would look like in 2024 if it managed its finances the way the federal government does. It should be noted that, apart from the median after-tax income for families, the values presented in figure 4 are calculated by applying the ratios of total federal revenue to total federal spending, to the deficit, to federal debt charges, and to gross debt.

Based on data from Statistics Canada (2024), figure 4 shows the median after-tax income for families in 2024 is estimated to be $101,821.[5] If that family decided to spend as the federal government does, it would spend $109,982 this year. To cover the difference between its income and spending, the family would put $8,161 on a credit card in 2024. This additional credit-card debt would be taken on despite the family already being $427,759 in debt. As a consequence of this debt, $11,066 of the $109,982 this family spends would go towards paying interest. This means approximately 11 cents of every dollar of income would go towards debt interest, rather than towards groceries, heating, or other necessities. While it is important to remember

4 The family budget is based on median after-tax income for economic families from Statistics Canada (2024). The latest year available is 2022, so the authors use the five-year pre-COVID average growth rate (2015–2019) to calculate the median after-tax income in 2024. Using the median after-tax income for families in 2024, annual spending, spending on the credit card, total debt, and debt interest costs, are calculated by using the ratios of total federal revenues to total spending, to the deficit, to gross debt, and to federal debt charges as reported in Canada, Department of Finance, 2024.

5 Our chosen value for median after-tax income for families is likely a conservative estimate. Using private-sector forecasts of growth in real disposable income from Daly (2024) and Porter (2024), we calculate the values for median after-tax family income in 2024 would be $103,951 and $104,239, respectively.

Figure 4: If a Canadian family managed its finances in 2024 the way the federal government does



Sources: Canada, Department of Finance, 2024; Statistics Canada, 2024; calculations by the authors.

that government and family budgets are not the same, it is clear that a family that managed their household budget as the federal government does would be in financial trouble.

Conclusion

By the end of the 2024/25 fiscal year, it is expected the federal government will have recorded its 17th consecutive budget deficit. While deficits can be justified in certain circumstances, the federal government's explicit choice to continually run deficits to finance ever-growing spending commitments represents a problem. The resulting increase in the level of federal debt imposes costs on Canadians, primarily in the form of higher taxes, yet the federal government appears to have little desire to change course.

To illustrate the scope of the degree to which federal finances have declined, this analysis shows the median Canadian family's budget in 2024 if it managed its finances as the federal government does. Like the financial troubles that would face such a family, continued deficits add to a large and growing debt burden with severe consequences for Canadians. The federal government must change its approach to fiscal policy in order to avoid such an outcome.

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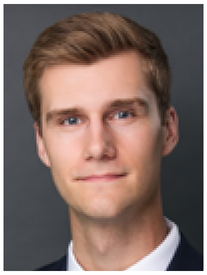

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