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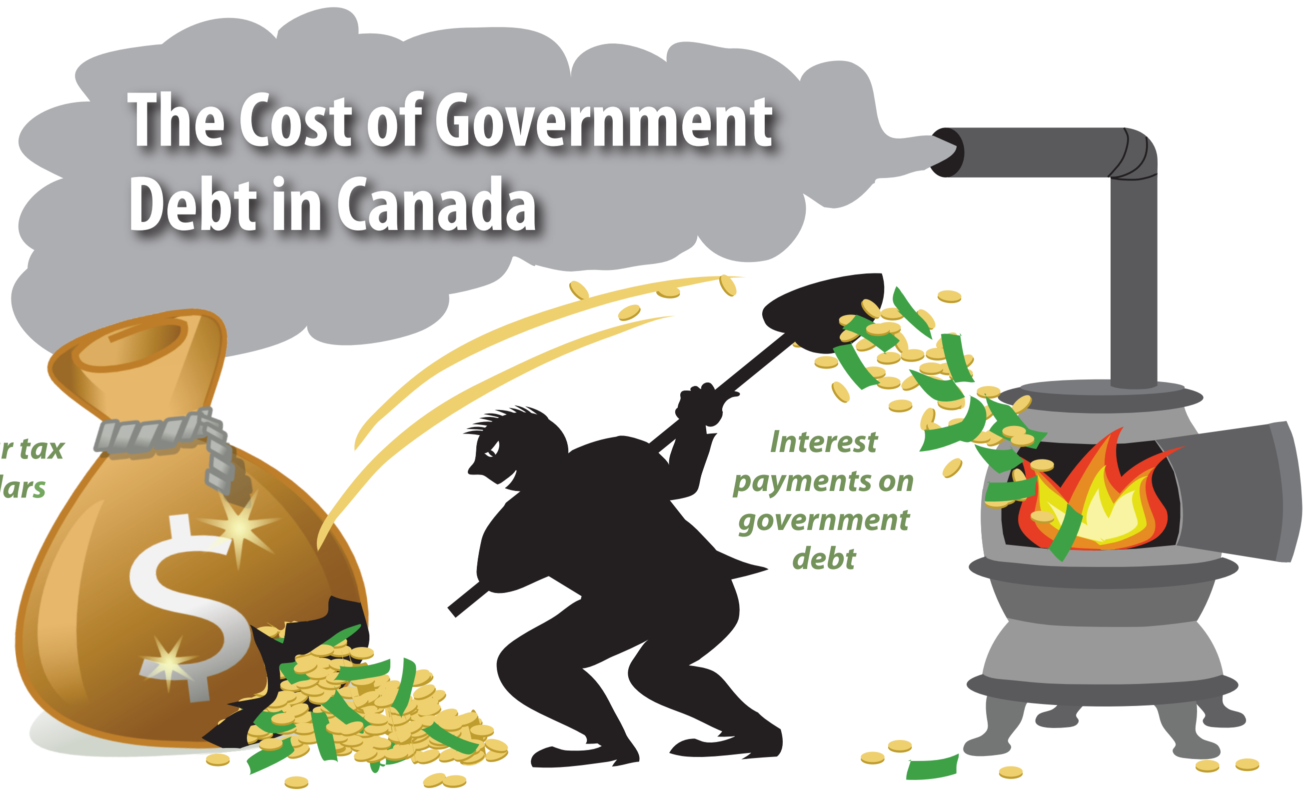
The Cost of Government Debt in Canada



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Summary

■ A major theme of this year's federal and various provincial budgets is continuing deficit spending and growing government debt. The result of recent deficits and debt accumulation is that the combined federal and provincial net debt has increased from $823 billion in 2007/08 to over $1.2 trillion (or $34,905 for every man, woman, and child living in Canada) in 2013/14.

■ This type of debt accumulation has costs. One major consequence is that governments must make interest payments on their debt similar to households who pay interest on borrowing related to mortgages, vehicles, or credit card spending. Spending on interest payments consumes government revenues and leaves less money available for other important priorities such as spending on health care and education or tax relief.

■ Canadian governments (including local governments) collectively spent an estimated $61.7 billion on interest payments in 2013/14.

■ To put that in perspective, it is more than Canada's public spending on primary and secondary education ($61.0 billion, as of 2011/12, the last year for which we have finalized data), or more than the three major federal-to-provincial government transfer programs comprising Equalization, the Canada Health Transfer and Canada Social Transfer ($58.6 billion).

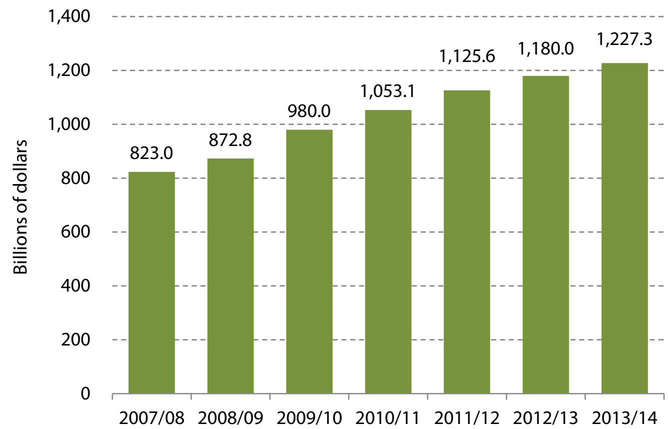
Introduction

The federal government's mid-February 2014 budget launched the year's budget season, which stretched for six months and ended with the tabling of Ontario's budget in mid-July.

The federal and seven of 10 provincial governments are projecting deficits in the 2014/15 year, and all governments are estimating that their debt levels will grow.[1] In fact, rising debt loads in some provinces such as Ontario have attracted attention from international credit agencies. Put simply: this year's budget season was generally characterized by the continuing trend of deficit spending, growing government debt, and substantial interest costs for many Canadian governments. This path carries short- and long-term consequences for the country and its citizens.

This research bulletin examines the growth in government debt in Canada since the 2008/09 recession and the immediate consequences of that debt, specifically, higher government spending on interest payments to service past debt.[2]

Figure 1: Combined federal and provincial net debt, 2007/08 – 2013/14



Sources: Federal and Provincial Public Accounts (various years).

Trend reversal: Growing government debt

The growth in government debt over the past six years reversed a positive trend in the mid-1990s to late-2000s when Canada's federal and provincial governments made considerable progress in reducing their debt burdens (Palacios et al., 2014). After a period of debt reduction, the combined federal and provincial debt reached a recent low of $823.0 billion in 2007/08.

However, the global economic recession in 2008/09, combined with significant increases in government spending that took place in 2009/10, meant that every government with the exception of Saskatchewan fell into deficit in either 2008/09 or 2009/10. This started Canada's governments down their current path of deficits and debt, which has largely persisted through the latest round of federal and provincial budgets. Figure 1 illustrates total combined federal and provincial debt (excluding local governments) from 2007/08 to 2013/14. Total debt in 2013/14 is estimated to be over $1.2 trillion.

[1] Debt is defined in this research bulletin as net direct debt. Net debt is the amount of total (gross) debt (including pension liabilities) minus financial assets. "Direct debt" refers to debt that has been directly borrowed by government. This is in contrast to indirect debt which is other liabilities that represent a future claim on government resources and could become direct debt. For more discussion on measures of debt, see Palacios et al., 2014. The authors use "debt" throughout the rest of the paper to mean "net direct debt."

[2] Canadian governments use different descriptors for interest payments on past debt. "Debt-service costs," "public debt charges," and "interest on debt" can be found in different budgets or other financial reporting documents. This bulletin uses these different terms interchangeably.

Table 1: Federal and provincial net debt in 2007/08 compared to 2013/14 ($ millions)

	Net Debt 2007/08	Net Debt 2013/14	Change ($ millions)	Change (%)
BC	23,899	39,220	15,321	64.1%
AB	(31,527)	(9,956)	21,571	68.4%
SK	6,049	4,213	(1,836)	-30.4%
MB	10,561	17,288	6,727	63.7%
ON	142,418	269,155	126,737	89.0%
QC	124,681	181,965	57,284	45.9%
NB	6,943	11,661	4,718	68.0%
NS	12,115	14,609	2,494	20.6%
PEI	1,347	2,120	773	57.4%
NL	10,188	9,018	(1,170)	-11.5%
FED	516,281	687,963	171,682	33.3%
FED + PROV	822,954	1,227,256	404,302	49.1%

Source: Federal and Provincial Public Accounts, 2008; Alberta, Ministry of Finance, 2014; Federal and Provincial budgets, 2014; calculation by authors.

This growth in combined federal and provincial debt was not limited to just a few jurisdictions. The federal and every provincial government with the exception of Saskatchewan and Newfoundland & Labrador increased their debt levels between 2007/08 and 2013/14. Table 1 shows the change in debt for the federal and provincial governments over this period. The combined federal and provincial debt increased by $404.3 billion, or nearly 50%, over these seven years.

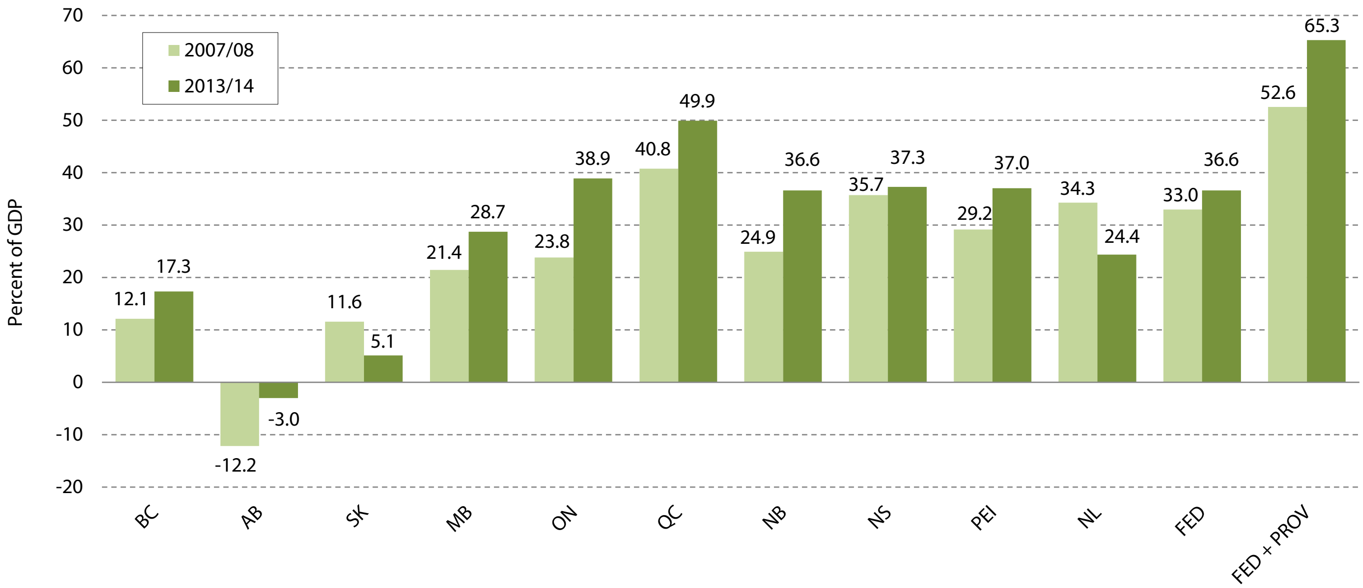
To put this in perspective, the federal government reduced its absolute debt level by $92.7 billion between 1996/97 and 2007/08. Since it began running a deficit in 2008/09 and as of 2013/14, $171.7 billion has been added to the debt. According to the federal government's own estimates, it will have added a further $2.9 billion on top of this amount by the time it returns to a balanced budget in 2015/16 (Canada, Ministry of Finance, 2013a; Canada, Ministry of Finance, 2014). In other words, the federal government paid off debt for 11 years, but in just seven years has accumulated nearly double the amount of debt previously repaid.

Figure 2: Combined federal and provincial net debt as a percentage of GDP, 2007/08 - 2013/14

Sources: Federal and Provincial Public Accounts (various years); Statistics Canada (2013b); calculations by authors.

A common measure of government debt is as a share of the economy using Gross Domestic Product (GDP). The ratio between debt and GDP can be used to compare government debt between different jurisdictions and to assess the sustainability of debt accumulation. Figure 2 shows the increase of combined federal and provincial debt as a share of GDP between 2007/08 and 2013/14. From its peak in the mid-1990s (99.6% in 1995/96), combined federal and provincial debt as a share of GDP fell to 52.6% in 2007/08. It began to climb thereafter as governments started to run budgetary deficits

Figure 3: Net Debt as a percentage of GDP, 2007/08 – 2013/14



Sources: Figure 1; Statistics Canada, 2014b; calculations by authors.

in 2008/09 and 2009/10 and is estimated to reach 65.3% in 2013/14.

Most Canadian governments recorded an increase in their debt-to-GDP ratio between 2007/08 and 2013/14. Figure 3 shows the change in debt as a share of the economy for the federal and provincial governments over this period. Only Saskatchewan and Newfoundland & Labrador saw their debt-to-GDP ratio decline. The largest percentage-point increase was in Ontario where the ratio climbed from 23.8% to 38.9%. Quebec's debt-to-GDP ratio is the highest at nearly 50%.

Another way to evaluate government debt is on a per capita basis. This is a useful measure because ultimately debt needs to be repaid and using a per-person calculation shows how much government debt each Canadian is ultimately responsible for on average. Table 2 shows the estimated debt per capita for the federal and provincial governments in 2013/14.

Table 2: Federal and provincial net debt per capita, 2013/14

	Net debt per capita ($)
BC	8,563
AB	(2,470)
SK	3,795
MB	13,613
ON	19,879
QC	22,300
NB	15,344
NS	15,541
PEI	14,133
NL	17,015
FED	19,567
FED + PROV	34,905

Source: Table 1; Statistics Canada, 2014a; calculations by authors.

Quebec has the highest debt per person at $22,300, while Ontario has the second highest with $19,879 per person, followed closely by the federal government at $19,567 per person. The combined federal and provincial debt is $34,905 for every man, woman, and child living in Canada.

This six-year growth in government debt in Canada is staggering but, according to the latest federal and provincial budget, it is far from over. It is poised to continue for the foreseeable future as several governments continue to project budgetary deficits. Table 3 summarizes the expected year that the federal and provincial governments will eliminate their deficits as well as the number of years of projected deficits since 2008/09.

The timelines for a balanced budget in Ontario and Quebec, for instance, have been delayed and still remain precarious (Speer and Emes, 2014). This means that the total amount of debt that will be accumulated before federal and provincial governments ultimately return to surplus is still uncertain. However, one thing is sure: Canadian governments have collectively increased debt since 2007/08 and eroded the progress made from the mid-1990s through to the late-2000s. The sooner governments return to balanced budgets, the sooner they can begin restoring the long-run health of Canada's public finances.

Table 3: Expected year of deficit elimination, federal and provincial governments (as of July 23, 2014)

	Expected year of deficit elimination	Expected number of years in deficit since 2008/09
BC	Already in surplus	4
AB	Already in surplus	6
SK	Already in surplus	0
MB	2016/17	7
ON	2017/18	9
QC	2015/16	7
NB	2017/18	9
NS	2017/18	7
PEI	2015/16	7
NL	2015/16	4
FED	2015/16	7

Sources: Alberta, Ministry of Finance, 2014; Palacios et al., 2014; Provincial and Federal Budgets, 2014; calculations by authors.

Note: Provinces that have eliminated their deficit may still be accumulating debt due to debt-financed capital spending (Wen, 2014). For example, despite having a balanced operating budget, British Columbia projects that its net debt will increase by $1.9 billion in 2014/15 (British Columbia, Ministry of Finance, 2014).

Why is growing government debt important?

Empirical research has found that a negative relationship exists between debt and economic growth (Reinhart and Rogoff, 2010; Égert, 2012; Cecchetti et al., 2011; Kumar and Woo, 2010; and Checherita and Rother, 2010). This negative relationship can be explained in different ways but one of the more important ways relates to the effect of government debt on private investment. When government debt expands, it can cause long-term interest rates to rise, which in turn increases the cost of private-sector borrowing. Higher borrowing costs can then discourage private capital investment, which is a key driver of long-term economic growth.

There are also immediate consequences from government debt in the form of interest payments, or what are called debt servicing costs. Governments must maintain interest payments on their debt similar to households which pay interest on borrowing related to mortgages, vehicles, or credit card spending. Government

Table 4: Federal and provincial debt servicing costs, 2013/14

	Debt servicing costs (in millions of $)	Debt servicing costs as percent of revenue (%)
BC	2,539	5.8
AB	590	1.3
SK	585	5.1
MB	836	5.8
ON	10,556	9.1
QC	10,608	11.3
NB	685	8.9
NS	856	9.3
PEI	113	7.1
NL	841	11.9
FED	29,300	11.1

Sources: Alberta, Ministry of Finance, 2014; Provincial and Federal Budgets, 2014; calculations by authors.

spending on debt servicing costs results in less revenue available for important priorities such as tax relief and spending on public programs like health care, education, and social services.

Debt servicing costs have become a considerable expenditure for a number of Canadian governments. Table 4 shows the amount that Canadian governments are estimated to have dedicated to interest payments in 2013/14. It also measures these costs as a share of total government revenues for the federal and provincial governments. This provides a measure of the percentage of government resources directed to interest payments and gives a sense of the potential displacement effect on other spending priorities.

Newfoundland & Labrador, Quebec, and the federal government are now spending more than 11% of their total revenues on debt servicing costs. The Nova Scotia and Ontario governments estimate that their debt servicing costs now exceed 9% of total revenues. This means that a number of Canadian governments are now dedicating nearly 10 cents or more of every dollar in revenue simply to service past debt obligations.

It is important to note that these figures exclude debt servicing costs incurred by local governments. Incorporating these latter expenditures increases total debt servicing costs in Canada to an estimated $61.7 billion in 2013/14 or 10.8% of total revenue (Statistics Canada, 2014c).

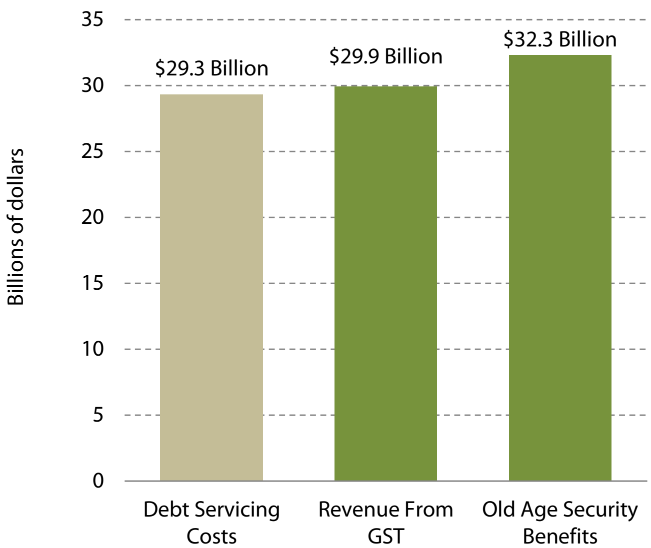
Debt accumulation is a significant driver of debt servicing costs. But debt levels alone do not determine the magnitude of interest payments. The interest rate, or the cost of borrowing, also has a significant impact. Governments have been borrowing at historically low rates. If interest rates rise, borrowing costs will rise accordingly and result in even more resources being directed to debt servicing costs. Governments that maintain relatively high and growing debt levels, such as Ontario and Quebec, are especially vulnerable to interest rate increases.

More spending on debt servicing costs invariably means that fewer resources are available for public priorities. To put debt servicing costs into perspective, consider the following illustrations from Canada's three largest governments.

Federal debt servicing costs

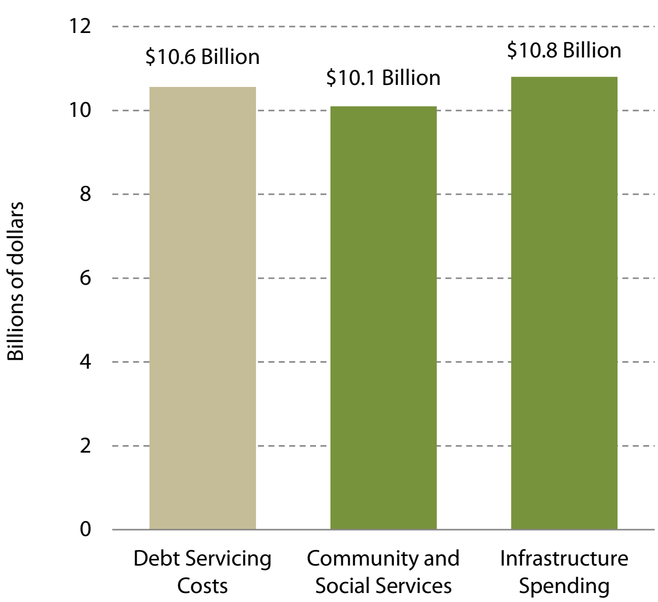
At the federal level, debt servicing costs are projected to be $29.3 billion, or 11.1% of revenues in 2013/14. This is similar to the $29.9 billion in revenues from the GST, and the $32.3 billion it is estimated to have spent on Old Age Security for Canadian seniors in 2013/14 (see figure 4). Indeed, debt servicing costs now consume considerable resources compared to

Figure 4: Federal debt servicing costs compared to other expenditure or revenue sources, 2013/14



Sources: Canada, Ministry of Finance, 2014; Canada, Ministry of Human Resources and Skills Development, 2012.

Figure 5: Ontario's debt servicing costs compared to other expenditures, 2013/14



Source: Ontario, Ministry of Finance, 2014.

some of the federal government's main revenue sources and largest and most important spending programs.

Debt servicing costs in Ontario

In Ontario, where growing government indebtedness is a well-documented problem,[3] the province estimates debt servicing costs in 2013/14 at $10.6 billion or 9.1% of overall revenue. This means that over 9 cents of every dollar in revenue that the government collects will go to paying interest on the provincial debt. It is greater than the entire $10.1 billion budget for the ministry of community and social services and slightly less than $10.8 billion for total infrastructure spending in 2013/14 (see figure 5).

The share of revenues consumed by interest payments is projected to grow. The government's own estimates anticipate that debt servicing costs will rise, on average, by 7.9% between 2013/14 and 2016/17, making it by far the government's fastest-growing expenditure (health care and education will increase annually by 2.2% and 2.3% over the same period, respectively). The result is that the government will be spending nearly 11% of its total revenue on interest payments by 2017/18 (Ontario, Ministry of Finance, 2014).

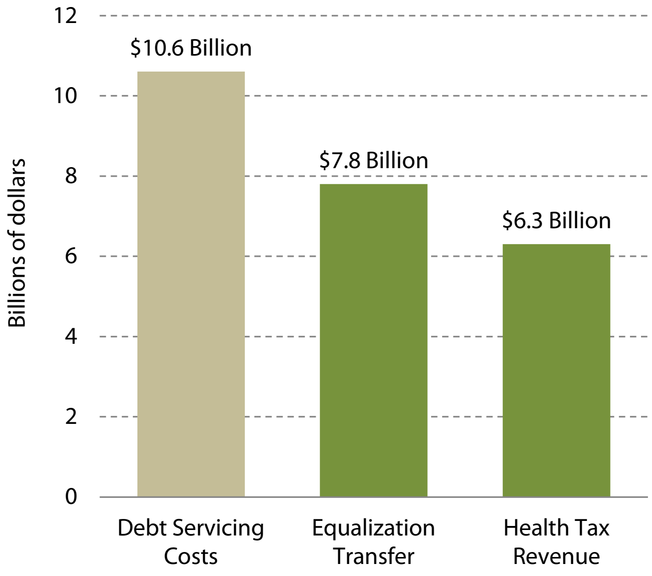
Debt servicing costs in Quebec

In Quebec, Canada's second most populous province and the most indebted relatively to the size of its economy, government interest costs are projected to consume 11.3% of total revenue in 2013/14.[4] In fact, its 2013/14 inter-

[3] For a discussion on Ontario's growing debt problem, see: Murphy et al., 2014.

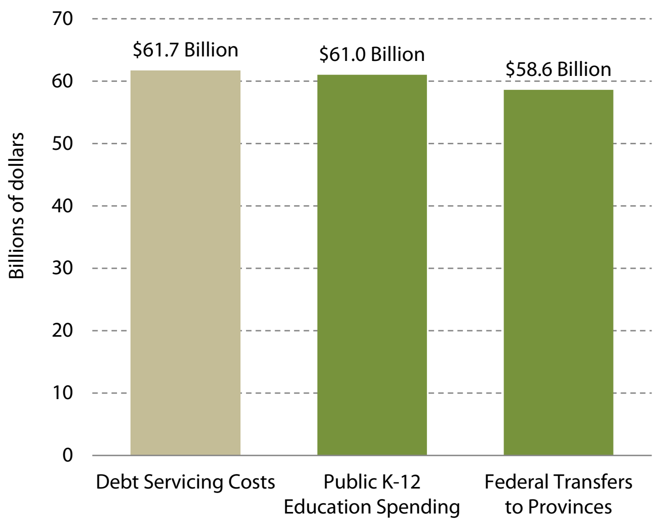
[4] For a discussion on the state of Quebec's debt, see Speer, 2014.

Figure 6: Quebec's debt servicing costs compared to revenue sources, 2013/14



Source: Quebec, Ministère des of Finances, 2014.

Figure 7: Consolidated government debt servicing costs compared to other expenditure or revenue sources, 2013/14



Sources: Canada, Ministry of Finance, 2013b; Statistics Canada, 2014c; Statistics Canada, 2014d.

Note: Public Elementary and Secondary School Education Expenditures in 2011-2012, the most recent year available.

est payment of $10.6 billion is greater than the $7.8 billion transfer the province received from the federal government for equalization and $6.3 billion it collected in health premiums (see figure 6).

Overall debt servicing costs

In aggregate terms, this type of comparison can be staggering. The $61.7 billion spent on debt servicing costs in 2013/14 is more than Canada's public spending by all Canadian governments on primary and secondary education ($61.0 billion in 2011/12, the latest year of available data) and more than the three major federal-to-provincial government transfer programs comprising Equalization, the Canada Health Transfer and Canada Social Transfer ($58.6 billion).

Taken together, these comparisons provide a sense of the magnitude of the interest payments for which Canadian governments are responsible and the extent to which growing government debt can displace resources for important priorities.

Conclusion

This bulletin's key point is that deficit spending and growing government debt is not without costs. Rising government debt can mean more resources are directed to interest payments and away from public priorities that help families or improve Canada's economic competitiveness. This year's round of federal and provincial government budgets did little to reverse the trend of growing debt and debt servicing costs. This path of persistent deficits, growing debt, and rising interests costs for Canadian governments has consequences.

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