

Government Fiscal Sustainability in Canada After COVID-19

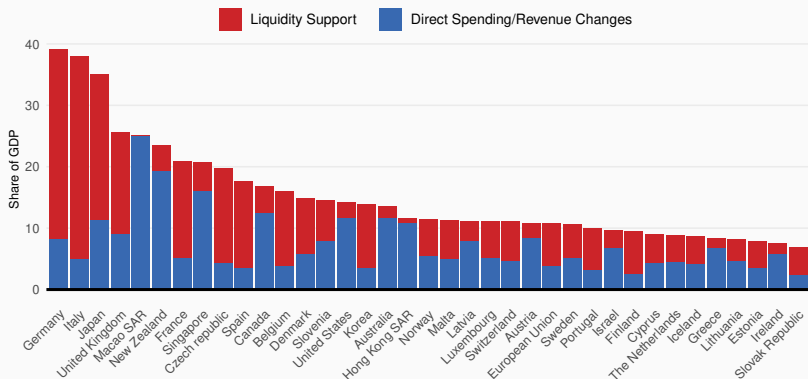
Trevor Tombe (University of Calgary)

December 2020

Economics Society of Northern Alberta, Annual Outlook Conference

Historic Fiscal Responses to COVID-19 Globally

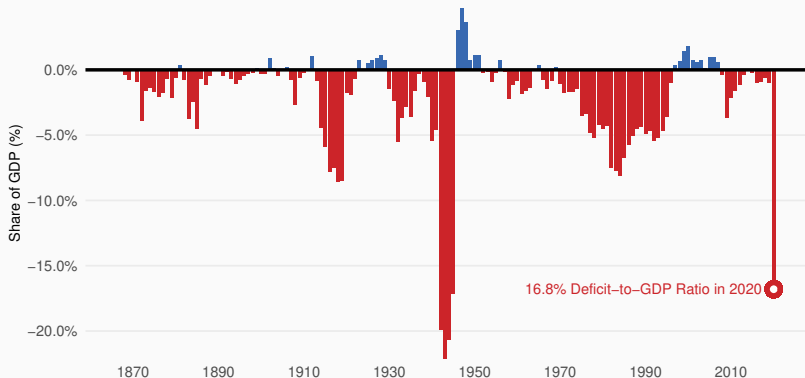
Figure 1: Government Fiscal Responses to COVID-19, Selected Countries



Sources: IMF Fiscal Monitor Database, October 2020.

Historic Peacetime Federal Borrowing

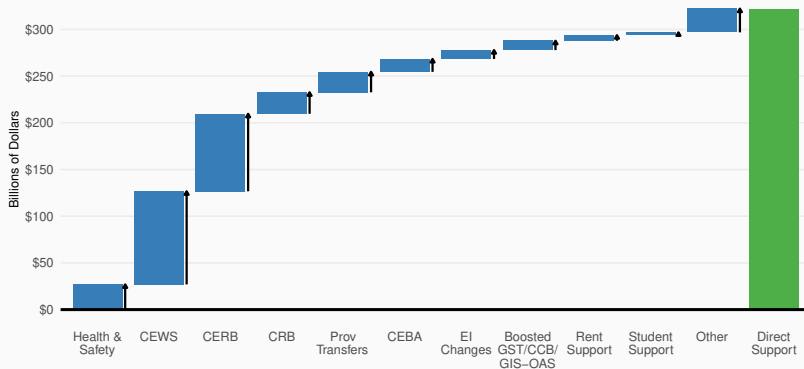
Figure 2: Federal Budget Balances, 1867 to 2020 (F)



Sources: Historical Statistics of Canada, 1867-1965; Fiscal Reference Tables, 1966-2018; Federal Fall Economic Statement, 2019-2020. Excludes net actuarial losses.

Federal Direct Support Programs

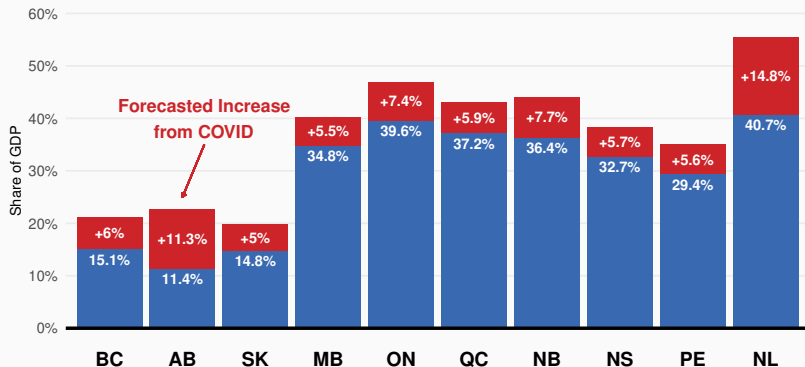
Figure 3: Direct Support Measures for COVID-19 (2019-2022)



Source: Federal Fall Economic Statement 2020. Excludes \$168 billion in tax and liquidity support.

Rising Provincial Debt Levels

Figure 4: Net Provincial Debt by March 2021, as Share of GDP



Source: Various provincial budgets for 2019/20 and fiscal-updates for 2020/21. Based on Scotiabank forecast for New Brunswick.

Debt Sustainability Analysis in Canada

Existing Long-Run Sustainability Analysis

1. Canada: Ontario's FAO, Fed's PBO, Conference Board
2. International: IMF, EU, CBO
3. Academic research: Auerbach (1994) ... Mauro and Zhou (2020), Lian et al. (2020), Mehrotra and Sergeyev (2020)

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The importance of debt sustainability studies for Canada

1. Evaluate long-run implications of COVID-19 debt
2. Inform tax and expenditure policy choices
3. Evaluate changes to federal-provincial transfers
4. Gauge credit risk of public debt

A New Source for Timely Public Finance Analysis

Finances of the Nation

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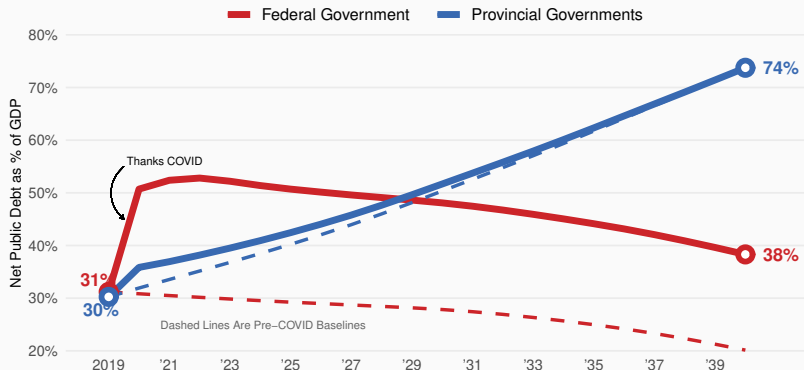
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Today's Talk:

1. Crash course in fiscal sustainability
2. Project where are our public finances are headed
3. (Briefly) Examine various policy options

Result Preview: Feds are Sustainable, Provinces are Not

Figure 5: Net Debt to GDP, 2019 to 2040 (F)



Source: own calculations from Tombe (2020, Canadian Tax Journal). See financesofthenation.ca for details. This scenario incorporates the latest projections from the Fall Economic Statement 2020, along with "scenario 1" stimulus spending.

A Primer on Provincial Debt Sustainability

What does “fiscal sustainability” mean?

Intuition: **No debt bombs!!** 💣

Debt cannot grow beyond your ability to service it

For public debt, this means **debt-to-GDP ratios cannot grow forever**

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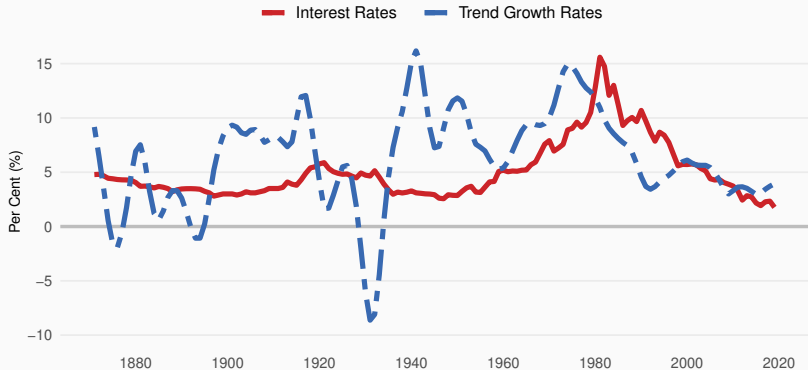
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- **But ... what if interest rates are less than economic growth rates?** It turns out, everything changes

Comparing Borrowing Costs and Growth Rates in Canada

Figure 6: Long-Run Nominal Interest Rates and Economic Growth Rates

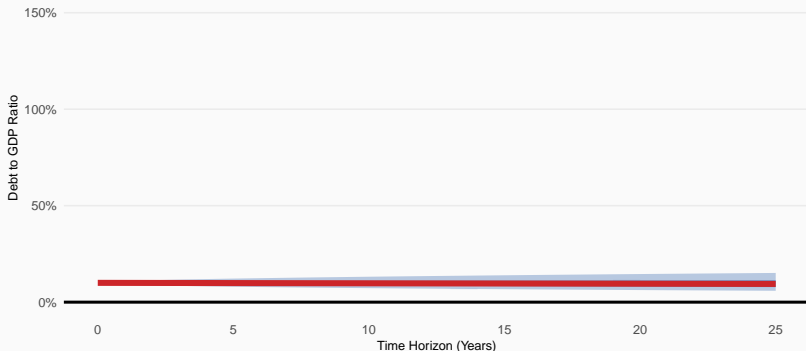


Sources: My own calculations from various Statistics Canada sources for recent decades; historical data from Òscar Jordà, Katharina Knoll, Dmitry Kuvshinov, Moritz Schularick, and Alan M. Taylor, "The Rate of Return on Everything, 1870–2015" (2019) 134:3 Quarterly Journal of Economics 1225–1298 and Òscar Jordà, Moritz Schularick, and Alan M. Taylor, "Macrofinancial History and the New Business Cycle Facts" (2016) 31 NBER Macroeconomics Annual 213 – 263.

Don't Neglect Economic/Fiscal Risks

Figure 7: Debt/GDP If Interest Rates and Economic Growth Are Volatile

Plots the range of future debt ratios. Red line is the median. Dark blue is the 50% range. Light blue is the 90% range.

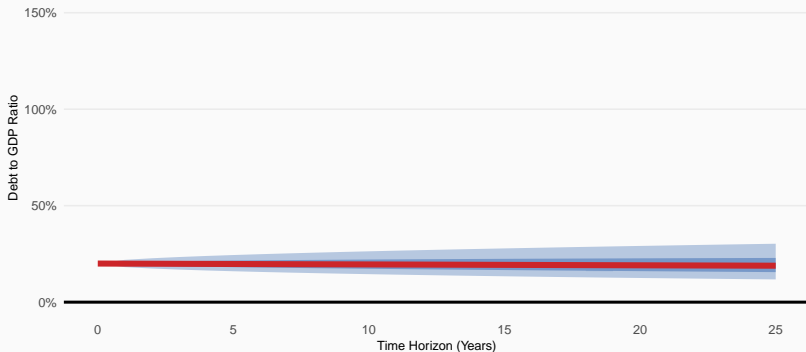


Sources: own calculations based on Hanniman and Tombe (2020), stay tuned on Finances of the Nation for details. Based on the interest rate and growth rate average and volatilities faced by Canada's provinces since 2006. Presumes a fully balanced primary budget in all years.

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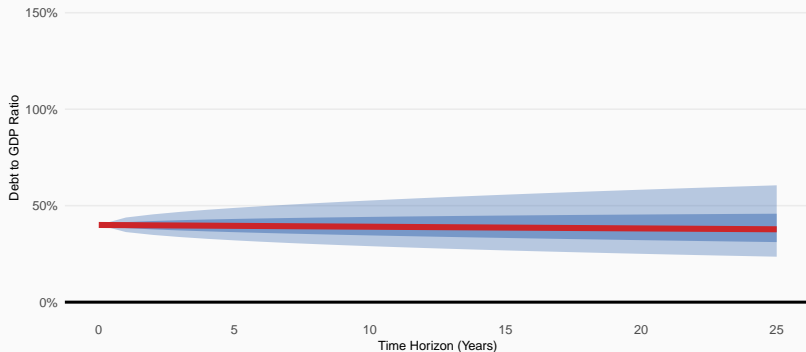


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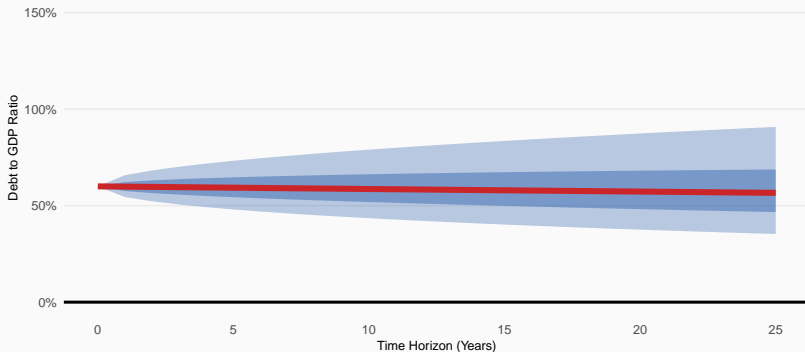


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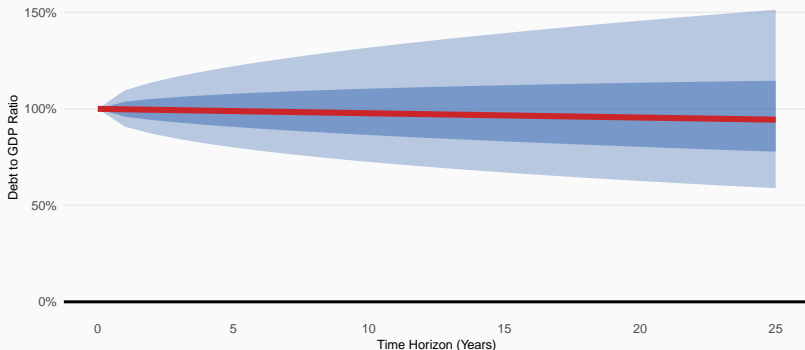


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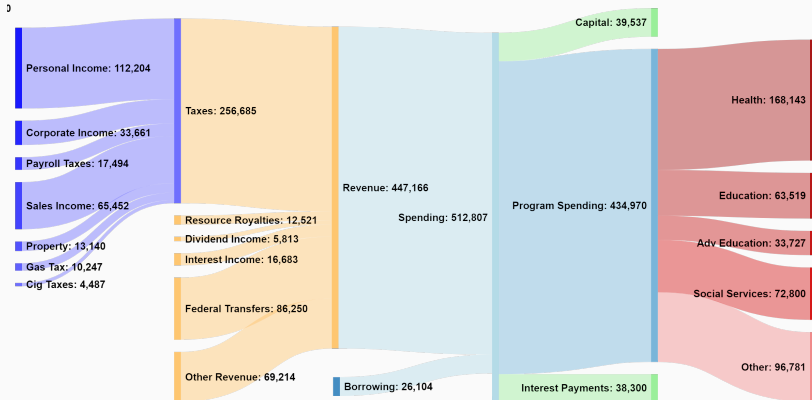


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Projecting Future Primary Balances of Canada's Provinces

The Structure of Canada's Provincial Budgets

Figure 8: Sankey Diagram of Provincial Budgets in 2019

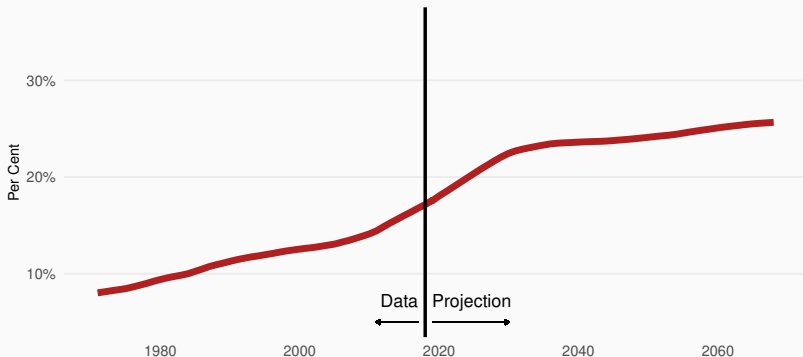


Sources: own calculations from Statistics Canada data tables 10-10-0017, 10-10-0024, and 36-10-0450.

Canada's Ageing Population

Figure 9: Share of Canada's Population 65+

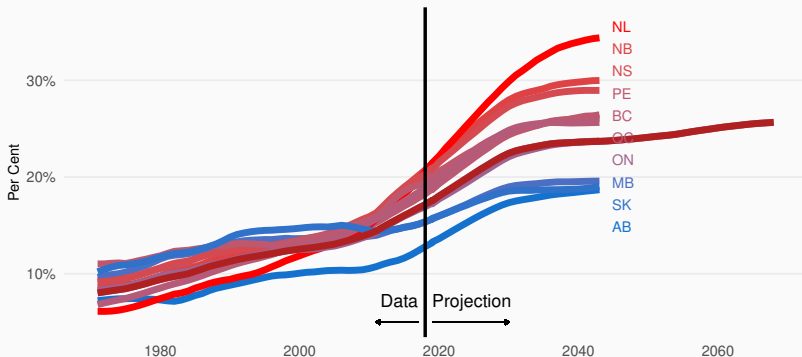
Source: Own calculations from Statistics Canada data table 17-10-0057. M2 scenario.



Canada's Ageing Population

Figure 10: Share of Canada's and Province's Population 65+

Source: Own calculations from Statistics Canada data table 17-10-0057. M2 scenario.



Demographics An Important Factor Behind Healthcare Spending

Figure 11: Per Capita Health Spending by Age

Source: Own calculations from CIHI Health Expenditure Trends 2019

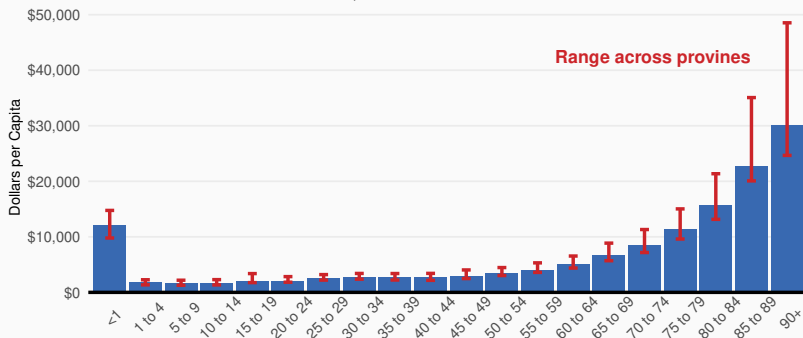
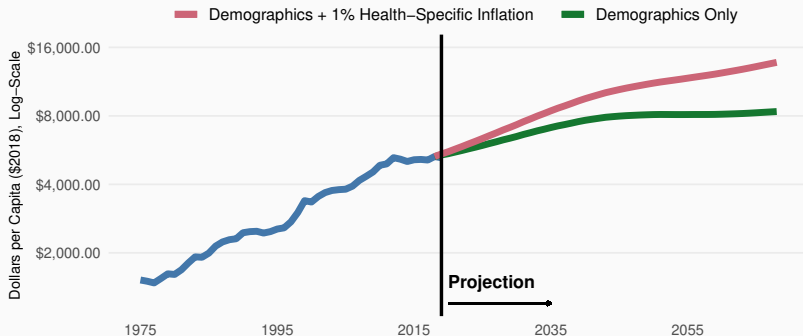


Figure 12: Newfoundland and Labrador Real Per Capita Health Spending

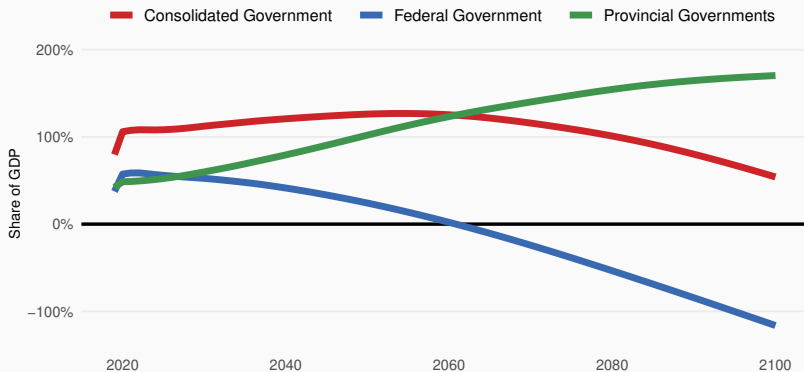
Source: Own calculations from CIHI health spending data and population projections based on provincial projections (Oct 2019) during the period 2018 to 2041 and extrapolated beyond with national StatCan M2 scenario (17-10-0057).



**Are government finances
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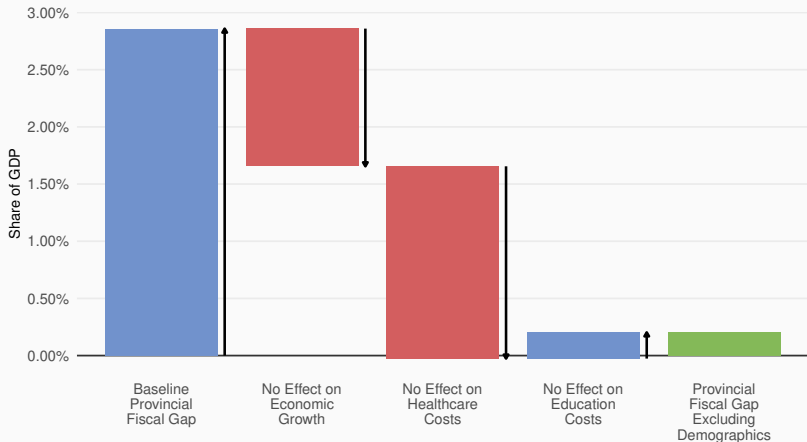
Figure 13: Debt-to-GDP Trajectories of Canada's Governments



Displays the hypothetical debt/GDP for levels of government in Canada over a 80-year horizon.

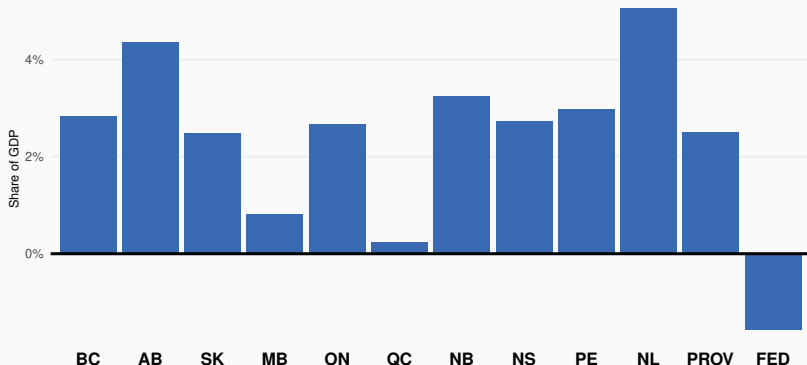
The Role of Demographics

Figure 14: How Demographics Contributes to the Fiscal Gap



How Much Policy Action is Needed to Maintain Debt/GDP?

Figure 15: Fiscal Adjustment to Maintain Debt/GDP Over 50-Year Horizon



Note: Displays the increase in revenue or decrease in spending necessary to achieve the same net debt to GDP ratio in 50 years as each government had in 2019. All as share of GDP.

Policy Options Aplenty!

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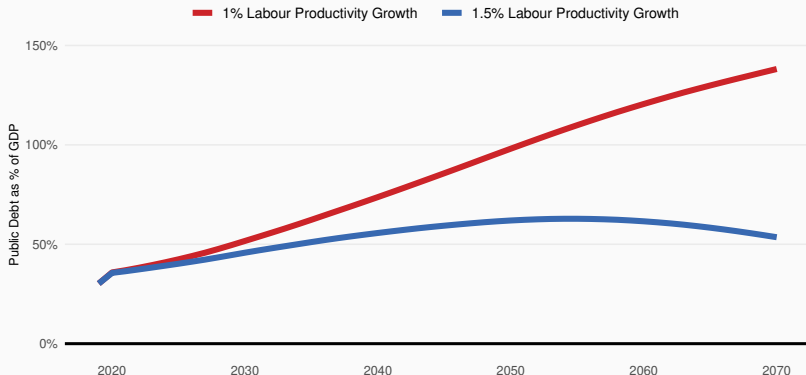
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Lowering health cost growth by 0.5% + provinces ensuring their revenues growth with GDP is the whole ballgame!

- **Important Note:** AB, SK, and NL have unique challenges

Faster Economic Growth Can Ensure Sustainability

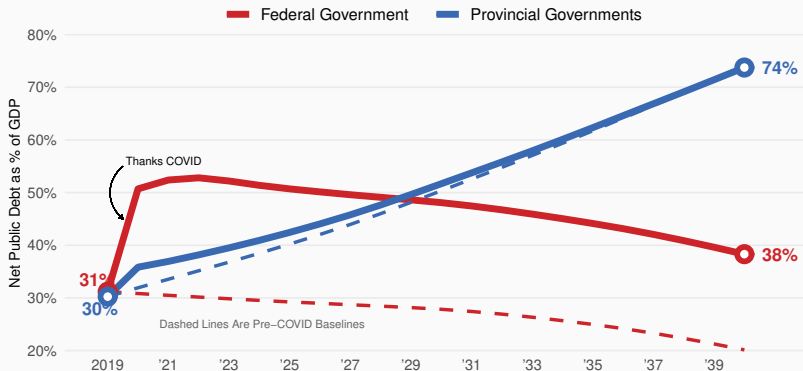
Figure 16: Provincial Debt Ratios with Higher Productivity Growth



Displays the projected level of aggregate provincial debt as a share of GDP with 0.5 percentage points higher annual labour productivity growth than in the baseline projection of 1 percent per year.

Does COVID Matter for Province's Long-Run Sustainability? No.

Figure 17: Net Debt to GDP, 2019 to 2040 (F)



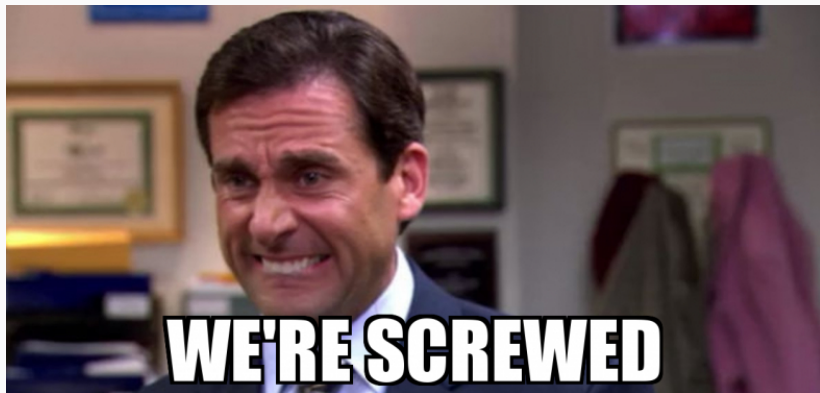
How a Major Recession Can Boost Health Transfers

Table 1: Growth Rates of GDP and the Canada Health Transfer (%)

Year	Nominal GDP Growth				Annual		Cumulative
	Annual		3-Year MA		CHT Growth		Gain from
	Pre	Post	Pre	Post	Pre	Post	Baseline
2019	3.8	3.8	4.4	4.4	4.4	4.4	0.0
2020	3.4	-10.1	3.7	-0.8	3.7	3	-0.6
2021	3.6	8.3	3.6	0.7	3.6	3	-1.2
2022	3.6	7	3.5	1.7	3.5	3	-1.7
2023	3.6	5.8	3.6	7	3.6	7	1.6
2024	3.6	5.2	3.6	6	3.6	6	4.0
2025	3.5	4.6	3.6	5.2	3.6	5.2	5.6
2026	3.5	4.5	3.5	4.8	3.5	4.8	6.9
2027	3.5	4.1	3.5	4.4	3.5	4.4	7.8
2028	3.5	3.5	3.5	4	3.5	4	8.4
2029	3.5	3.5	3.5	3.7	3.5	3.7	8.5

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Alberta's New "Fiscal Anchors"

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Fiscal policy consistent with all three "Fiscal Anchors" involves tax increases (or dumb luck) equivalent to roughly 2% of GDP.

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This merely illustrates magnitudes. Other revenue options exist.

Concluding Thoughts

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Former Premier Klein, 1992 (during leadership race):

"If any discussion about deficit reduction is to be taken seriously, then governments have to be honest with their constituents, and the constituents, the people, have to be honest with their governments."

Thank you!

THANK YOU!

Questions?