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Op-ed: A federal fiscal façade?

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At long last, Canada's federal government will present a *Fall Economic Statement*. This influential document—used to quantify the policy direction and underlying health of the most important government in the land—will be tabled Monday, the penultimate day of the legislative session and the fifth-last day of Fall. Down to the wire then, although this may not be a case of 'better late than never'. Rather, from a purely budgetary perspective, it's likely the nation's finances will be revealed to be worse off given the underperformance of the Canadian economy.

When it comes to expectations management, the Deputy Prime Minister and Finance Minister has been choosing her words carefully. We're told that Ottawa's so-called 'fiscal anchor'—that of a declining federal debt-to-GDP ratio over the medium term—will be respected. (That's not the most binding constraint as we explore below.) At the same time, the government has been deliberately silent/vague/non-committal on other previously stated fiscal targets.

Recall: Back in Budget 2024, the feds re-upped on three fiscal objectives. These are numbered below (in our slightly modified order):

1. *Maintaining the 2023-24 deficit at or below the Budget 2023 projection of $40.1 billion;*
2. *Maintaining a declining deficit-to-GDP ratio in 2024-25 and keeping deficits below 1 per cent in 2026-27 and future years;*
3. *Lowering the debt-to-GDP ratio in 2024-25, relative to the 2023 Fall Economic Statement, and keeping it on a declining track thereafter.*

We should have dispensed with uncertainty regarding objective #1 some time ago. Budget 2024 was presented after the 2023-24 fiscal year was over, which should have dampened the threat of end-of-year budgetary re-jigging. But even though that fiscal year ended eight and a half months ago, we've been left to guess. Never mind that every province has managed to release audited financial statements in a timely manner. In Ottawa, the public accounts have been held up, adding a degree of fiscal uncertainty we could do without. What's the big deal you ask? Yes, we're talking about a prior fiscal year. But public sector analysts know there are potentially important base effects at play. Of note, more timely analysis by the non-partisan Parliamentary Budget Officer sees objective #1 having been breached. Let's see.

That brings us to objective #2, which may be a promise Ottawa now regrets. Still, is it too much to ask the nation's treasurer for clear and unambiguous commitments on the budget balance? Not really. It's a fundamental part of the job when interacting with investors and credit rating agencies. Moreover, is relative deficit reduction not appropriate when the consensus forecast is characterized by sustained, positive growth? We think so. We'd hope to see a fresh commitment to smaller deficits (in absolute and relative terms) in Monday's update. While reserving judgement, we're prepared to be disappointed.

Instead, we're asked to focus attention on the federal debt-to-GDP ratio. Not coincidentally, a declining debt burden during an economic expansion is about the least binding constraint one could muster. Although commonly referenced at varying levels of government, the debt ratio is an arguably imperfect tool. Not for nothing, this metric is vulnerable to a recasting of the GDP profile (i.e., the denominator).

Which brings us to recent economic revisions. With the release of Canada's Q3 GDP, StatCan boosted—by a material degree—the level of nominal national output vs. prior estimates. As things stand, the new and upwardly revised profile suggests nominal output in 2024 will be 2% above the planning assumption used in Budget 2024. That's a potentially big development for a government focused on relative fiscal metrics, perhaps enabling/encouraging larger deficits.

An example may help illustrate the magnitude of the 'gift' StatCan may have just handed the feds. Based on the ~42% debt-to-GDP pledge for 2024-25 from April's budget, the new, higher level of nominal GDP (vs. the budget plan) would theoretically allow almost $25 billion to be added to this year's deficit. It's by this 'logic' that some have reverse-engineered a budget shortfall exceeding $60 billion.

But come now; the materialization of 'bonus' GDP by the waving of StatCan's revisionary wand can't honestly justify that much extra red ink. If anything, a higher plane for nominal output—a portion of which the feds presumably tax—should be consistent with *smaller*, not *larger*, deficits. Just think of the alternative scenario. You know, the one where nominal GDP gets revised *lower*. Would an evaporation of nominal output via normal-course statistical revisions warrant, in isolation, federal government layoffs, or reduced supports for the jobless and elderly, or some other serious cutbacks? Surely not.

So let us be clear: Positive nominal GDP revisions *should not* be treated as a real/genuine fiscal dividend to be deployed … spent… committed. The onus for thoughtful and sustainable fiscal policy must rest with finance ministers not public sector statisticians.

While yet to be confirmed, the federal debt burden almost certainly increased in 2023-24 vs. the prior year. What's done is done. But prudent risk management, respect for taxpayers and inter-generational equity considerations argue against setting the 2024-25 debt burden any higher than it otherwise needs to be. If GDP revisions create scope to lower the debt burden, it should be seized not surrendered. We now estimate a federal debt ratio of 41.6% for 2023-24 or half a percentage point below the government's prior estimate. The feds were originally prepared to tilt the debt burden a touch lower in 2024-25 and we see no reason to push indebtedness higher for a second straight year.

GDP revisions should invalidate the 'old' targets for the debt burden. Instead, we argue for treating the 2023-24 debt burden (assumed to be 41½%) as the new, binding debt limit. Of course, the government may have a different view on the matter. Just how much of a 'sacrifice' would our preferred debt limit entail? Not a whole lot really. It would mean 'limiting' the deficit to roughly $50 billion vs. the $40 billion originally planned for. Relative to the $60 billion-plus deficit tallies we've heard tossed around, you might label that damage limitation. Wild but true.

Beyond more-timely updates, the elevated fiscal uncertainty we now contend with could be reduced. Rather than the current, somewhat ambiguous and purely qualitative 'fiscal anchor', we favour quantifiable and time-dependent targets for the budget balance and the debt burden. These lend added weight to the favourable international comparisons Ottawa ceaselessly trots out. As an aside: When it comes to this fiscal chest-thumping, let's not forget that Canada's much-heralded general government net debt edge was borne of real sacrifice years ago and is increasingly dependent on net asset accumulation in our social security system. Judging from current fiscal performance, the feds may be a weak(er) link in Canada's broad government sector.

Finally, as should be apparent to all, we face no little amount of uncertainty in Canada. The global backdrop is fragile; our largest trading partner has threatened tariffs. Is this then not a time to keep some fiscal powder dry? Seems so to us.

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