Government Support Is Shielding Canadians from COVID-19, but Can We Finance It?

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The World Health Organization announced the pandemic on March 11, 2020. Everyone wonders how long COVID-19 will impact their daily lives and the implications the virus has for the provincial and broader Canadian economy. The track and ultimate severity of COVID-19's impact on the economy are as yet unknown; however, it is already clear it is having a significant impact that will reverberate through the economy for a long time. Since the pandemic was announced, the Government of Canada has allocated more than one trillion dollars towards Canada's COVID-19 Response Plan, an amount that will likely increase until the pandemic runs its course. Provincial governments are supplementing the federal response with billions of dollars of additional spending. However, existing fiscal constraints, variations in the severity of COVID-19 experience, and differing priorities have resulted in substantial differences in the amounts and focus of funding allocated to COVID-19 relief across the provinces.

To understand the likely fiscal impacts and related economic effects of COVID-19 spending, there are some major questions that need answering, including:

1. Ontario represents approximately 38% of the Canadian economy and was badly damaged by the pandemic in its early phase. What has been its response? How much has the provincial debt increased due to COVID-19 relief and support funding? How would a second wave impact provincial reserves and finances?
2. How have other provinces approached the pandemic? What can be learned from the mitigation initiatives of other provincial governments?
3. How has COVID-19 impacted the Canadian economy and sovereign debt position? How will the resulting increase in national and provincial debt be financed? Does the Canadian public have the appetite to make the necessary payments, especially if further waves of COVID-19 cause today's deficits to skyrocket or if there are substantial differences in pandemic severity across regions? At what point does the taxpayer start digging in?
4. How does Canada's emergency fiscal response to the pandemic shape up against other G7 nations? What does the expected "road to recovery" portend for future taxation levels as well as Canada's (and the provinces') fiscal and debt standing?

This four-part series will look at the provincial and federal responses to COVID - 19, scrutinizing their fiscal approaches, the assumptions on which these were based, and make some informed guesses as to the fiscal implications of Canadian governments' efforts to mitigate the economic consequences of the pandemic.

Section 1: Ontario's Fiscal Response to COVID-19

The Government of Ontario postponed releasing its 2020 budget, instead issuing their response to the coronavirus pandemic[1]. On March 25, 2020, a COVID-19 Response Plan was released in which $17 billion dollars of additional provincial funding was allocated to supporting the health care system, individuals, and businesses[2]. Given that a pandemic-induced economic contraction would be accompanied by a decline in tax revenue, the combination of higher spending and falling revenue led the Government of Ontario to more than triple their 2021 deficit projection to $20.5 billion[3].

COVID-19 Response Plan (March 25, 2020)	**$ millions**
Additional Funding	
Health	
Reserve	2,500
Contingency Fund	1,300
Additional Resources	3,300
Total Health Spending	7,000
Direct Support for Individuals and Businesses	10,000
Total Support	**17,000**
Interim Update on 2020 Budget Deficit (1)	9,200
Projected 2020 Budget Deficit (2)	10,300
Improvement from the 2019 Projected Budget Deficit	**1,100**
Forecasted 2020-2021 Budget Deficit (2)	6,800
Updated Projection 2020-21 Budget Deficit (1)	20,500
Change in Fiscal Position from the 2021 Forecast	**13,700**

Notes

(1) Interim update provided on March 25, 2020 Re: COVID-19 Response Plan

(2) Taken from the 2019 Budget Forecast, page 45.

Ontario's job outlook and unemployment statistics were early victims of the coronavirus. Ontario's unemployment rate exploded to 11.3% in April 2020, the highest level since 1993[4]. Employment has steadily recovered since initial lockdown restrictions were lifted in late May and early June[5]. Despite this, the sharp economic contraction experienced in the first two quarters of 2020 have forced the Government of Ontario to slash their 2021 revenue projection by half a billion dollars from the 2019-2020 interim estimate[6]. Should the recovery remain anemic, tax receipts may take even longer to recover. At the same time, additional emergency provincial support may be required, worsening the deficit picture even more. In addition to the COVID-19 related support detailed in the table above, the Government of Ontario has already suggested the possible need for an additional expenditure of $8 billion dollars to support "critical programs and services"[7]. The proposed allocation of these funds awaits the multi-year provincial budget, which is to be released on November 15, 2020[8].

Despite the economic hardships faced by Ontario, the provincial government is projecting an *improvement of $1.1 billion* in the 2020 budget deficit as compared to initial 2019 projections[9]. While the national and Ontario economy is slowly recovering, it is hard to imagine a financial forecast in which declining government revenues and increased spending on COVID-19 relief measures will result in a smaller 2020 budget deficit than what was forecasted in 2019. This gives rise to the questions of what underlies the government's optimism, and whether forecasted results are achievable given the recovery's trajectory? As well, how would this optimistic forecast be affected should the province be faced with a second wave of the virus?

Details of Ontario's Fiscal Plan

	Initial Forecast	**March 25, 2020 Interim Update**	
	2019-20	**2019–20**	**2020–21**
		$millions	
Revenue			
Personal Income Tax	36,550	37,600	37,300
Sales Tax	28,080	29,100	29,100
Corporations Tax	15,200	15,400	15,200
Ontario Health Premium	4,000	4,100	4,100
Education Property Tax	6,100	6,200	6,300
All Other Taxes	16,200	16,200	16,300
Total Taxation Revenue	**106,130**	**108,700**	**108,200**
Government of Canada	25,500	25,400	26,300
Income from Government Businesses	5,800	5,700	4,100
Other Non-Tax Revenue	16,800	16,900	17,600
Total Revenue	**154,230**	**156,700**	**156,300**
Total Programs	150,100	153,100	161,100
Interest on Debt	13,300	12,600	13,200
Total Expense	**163,400**	**165,700**	**174,300**
Surplus/(Deficit) Before Reserve	(9,300)	(9,000)	(18,000)
Reserve	1,000	200	2,500
Surplus/(Deficit)	**(10,300)**	**(9,200)**	**(20,500)**
Net Debt as a Per Cent of Ontario's GDP	40.70%	39.90%	41.70%

Compared with its initial 2019-2020 estimates, the March Interim Update contemplated a $2.57 billion[10] rise in tax revenues of which more than 40%[11] are expected to come from an increase in personal tax revenues. This is a particularly surprising proposition based on the province's bleak economic outlook at the end of March as much of Ontario went into 'lockdown'. The May 2020 Labour Force Survey corroborated a negative correlation between public health restrictions and employment (hence tax receipt) levels[12]. As public health restrictions ease and the economy re-opens, provincial employment levels should increase, a trend seen in British Columbia and Quebec as early as May 2020, while Ontario and Alberta continued to be severely impacted by the COVID-19 economic shutdown[13]. The July 2020 Labour Force Survey indicates that Ontario appeared to have effectively rebounded from most of the economic impacts of the pandemic, reporting employment at "…91.7% of its pre-pandemic February level"[14].

While Ontario's economy has displayed some resilience, it may take some time to regain pre-pandemic levels of employment, let alone employment above the initially projected 2020 levels. Growing revenue through higher tax rates would be a challenge since the 2020 provincial and federal tax rates have already been published[15] and increasing them while the economy is so fragile would pose a major political challenge. This suggests the government's expectation of increased personal income tax revenues by the end of fiscal 2020 errs more on the side of optimism than plausibility. It is also important to note that while Federal Government CESB and CERB income support payments are taxable, they were not announced until April 2020, after the March Update was released by the Government of Ontario. These federal transfers will need to be extended well past their original termination dates to form part of the Ontario Government's calculation of larger 2020-2021 tax revenues.

Another notable item is the provincial reserve which has been reduced by $800 million for the 2019-2020 fiscal period as compared to the initial budget projection. This reserve is meant to, "…protect against unexpected adverse changes in revenue and expense…"[16] for the period in question. If the reserve is not needed in a particular fiscal period and remains unused at year-end, it can be drawn down, together with any contingency funds allocated, to reduce the debt level at year-end[17]. In July 2018, the Independent Financial Commission of Inquiry (Commission) was established to restore accountability and trust in Ontario's public finances[18]. As part of their initial involvement with the fiscal budget, the Commission recommended that, from 2019 onwards, the annual reserve is restored to at least the historical level of $1 billion[19].

The $800 million reduction in the reserve suggests the Ontario Government already views COVID-19 as an unexpected and material adverse economic event. A second effect of running down the reserve is that Ontario has few funds available to respond to a resurgence of COVID-19 cases. The occurrence of further waves of COVID-19 is challenging to predict in terms of both timing and severity, thereby making it difficult to plan for how/if this affects the budget. The March Update featured a planned reserve of $2.5 billion in the 2020-2021 fiscal year which is perhaps meant to cover future waves of COVID-19. Given spending to date and the possibility of a further $8 billion of spending this year, this planned reserve would cover only a very modest resurgence of COVID-19 economic dislocation.

Ontario's substantial increase in contingency reserve and forecasted deficit levels for 2021 indicates that the next fiscal year may offer more challenges than 2020 has presented thus far. With this in mind, it is important to be aware of the following:

- Ontario is already undertaking significant debt to support the provincial economy through the pandemic. The $17 billion allocated to the COVID-19 relief fund represents 5% of Ontario's 2019 net debt level and approximately 2% of Ontario's 2019 Nominal GDP[20];

- The provincial government has made some brave assumptions regarding recovery and the rebound in employment and tax revenues. Although federal initiatives may help to support the rebound on the personal tax front, other sources of income such as corporate and sales tax are going to stay flat, at best, absent a full and robust recovery;

- The province has already suggested that a further $8 billion spending is being considered. How is it going to be paid for and what if subsequent pandemic waves require more than one round of funding? The Provincial Premiers are already demanding more funds from Ottawa and if they succeed, what will this do to the fiscal position at the Federal level?

Ontario's historic debt position is also worth considering, particularly, before the domino-effect impact of the initial $17 billion relief spend are felt on its economy. In recent years, Ontario's net debt level has been the highest of the provinces[21] as the province has consistently increased spending without a proportionate increase in revenue[22]. Ontario generates relatively high per capita income tax revenues due to its strong economic base. However, Ontario's total revenues per capita are relatively low when compared to the other provinces[23]. This is partially explained by the fact that Ontario generates comparatively little resource royalties and federal transfers[24]. Over time, this has resulted in a growing gap between Ontario's government spending and its revenues which has contributed to steady growth in its net borrowings[25].

Upon its election in 2018, the Ford Government vowed to control government spending[26] and, to this end, several budget cuts were made in fiscal 2019, particularly in the healthcare sector[27]. Of its $17 billion in COVID-19 relief funding, Ontario has allocated $7 billion dollars towards health support[28]. This comes out to approximately $480 per capita in health spending, making Ontario's COVID-19 related health expenditure, the highest of the provinces on both an aggregate and per capita basis[29]. Before the pandemic, Ontario had the third lowest health spend per capita amongst the provinces[30] which suggests that there may be an element of catch-up underlying the province's pandemic health support allocation. It is also worth noting that Ontario's total program spending[31] is the lowest of the provinces on a per capita basis, approximately $2,000 less than the average per capita program spends of other provinces as of 2017[32]. This puts Ontario in a precarious position when dealing with the adverse effects of the pandemic, especially as it puts pressure on Ontario's already weakened health resource base.

Ontario's approach to pandemic recovery and its fiscal position is especially important as Ontario's economy accounts for close to 40% of the national GDP. Section 2 will examine the COVID-19 responses of some of the other larger provinces responsible for much of the remaining 60% of the economy.

Section 2: Provincial Approaches to the Pandemic

Each province has responded differently to the pandemic but what assumptions and concerns have driven these various approaches? Is their projected spending sustainable if the pandemic continues for an extended period? How do differing assumptions alter recovery timelines and projected expenditure plans?[33]

The lack of standardization in budgetary components and measures makes inter-provincial comparison challenging. In addition, the evolving state of the economy and pandemic within each province and region means that what appears to be the optimal solution today may be short-lived as the situation evolves. Only the lasting economic impact of the pandemic and its related funding will enable, in hindsight, a determination of which province made the right series of decisions in terms of the effectiveness of their response efforts.

The following discussion examines the fiscal responses of the four provinces that make up approximately 87% of Canada's GDP[34].

Province	**ON**	**QC**	**AB**	**BC**
	$millions			
Projected 2021 Budget Surplus/(Deficit) - Note 1	(6,800)	nil	(5,883)	227
Updated Budget Surplus / (Deficit) - Note 2	(20,500)	(14,900)	(7,310)	(12,524)
Excess Deficit Over Projected	(13,700)	(14,900)	(1,427)	(12,751)
COVID-19 Response Plan Expenditure				
Health	7,000	3,706	573	3,500
Direct Support to Individuals and Businesses	10,000	2,963	8,599	6,260
Total COVID-19 Relief Funds	17,000	6,669	9,172	9,760

Notes

(1) Forecast of 2020-2021 Budget, published 2019 (Except BC, published Feb 18, 2020).

(2) Fiscal 2020-2021 Budget Updated in March 2020 or later

(3) Health spending is included in Total Support Funds allocated by the British Columbia government.

The first line of the table above summarizes fiscal 2020-2021 budgets as published and updated by the various provinces before the coronavirus pandemic was announced by the World Health Organization. The second line summarizes each provinces' update to the 2020-2021 fiscal budget post-announcement to illustrate the drastic impact that COVID-19 has had on provincial governments' expectations of future revenues and expenses.

Each province has altered their fiscal 2021 projections to reflect a higher net debt position but there is significant variation between approaches in how much and on what the stimulus is being spent on. This may be partially due to differences in the severity of COVID-19 amongst the provinces as well as the structure of their individual demographics, economies and fiscal positions pre-pandemic.

	ON	QC	AB	BC	Notes
Total Population	14,566,547	8,484,965	4,371,316	5,071,336	2
Population Aged 65+	17.2%	19.3%	13.3%	18.7%	
COVID-19 Health Spend Per Capita	$481	$437	$131	$690	3
Net Debt-to-GDP Ratio	39.5%	39.3%	8.0%	14.6%	
Historical Debt Level (2000-2015)	high	high	surplus	steady	4
Debt Level Movement (since 2016)	increasing	declining	major increases	increasing	

Notes

(1) Note that all of the above statistics are as at 2019, unless otherwise stated.

(2) Statistics Canada, *Population estimates on July 1st, by age and sex,* 2019 Statistics

(3) Calculated as COVID-19 Health Spending ÷ Total Population

(4) RBC Economics, *Canadian Federal and Provincial Fiscal Tables*, 2019 Statistics

a. Ontario

Ontario is spending the most on COVID-19 relief programs and is projecting the highest budget deficit for the fiscal year ended 2021. Some of Ontario's funding allocation can be attributed to a need to catch up to other provinces in terms of their healthcare program spending. It remains to be seen if significant additional investment will be required. A second characteristic of Ontario's approach is the seeming assumption of a sharp 'V'-shaped recovery that will sharply improve employment and tax receipts.

Section 1 offers a more detailed analysis of Ontario's COVID-19 Response Plan.

b. Quebec

The Government of Quebec's forecast for a balanced budget in fiscal 2021 was replaced by a budget deficit of close to $15 billion due to the economic impacts of COVID-19. This is a marked change from the tight spending control and increasing tax receipts that characterized Quebec's fiscal position since it started running budgetary surpluses in 2016[35]. Quebec has budgeted a contingency reserve of $100 million for the next three years[36] which is significantly smaller than Ontario's allocation, even after Ontario drew down its reserve by $800 million in March 2020. This may be due to a different budget approach. Recently, the Government of Quebec has focused on paying down the provincial debt while concurrently making significant investments in healthcare and other support programs, rather than putting money aside for unspecified contingencies. Over the last decade, Quebec has increased health-care spending by an average of 4-5% per annum since fiscal 2011[37]. In the initial 2021 projection, the Government of Quebec expected a balanced budget instead of a surplus since they planned on allocating 'additional' surplus funds to the debt stabilization reserve, per the Balanced Budget Act[38]. Since 2006, Quebec has been making considerable progress in reducing its debt burden, even going so far to propose an accelerated debt repayment program which started in fiscal 2018[39].

Quebec's relatively elderly population may help to explain why almost half of the cases in Canada have been reported in Quebec[40], since almost a third of its COVID-19 cases impacted residents over the age of 60[41]. As such, it might be expected that Quebec's emergency healthcare and business support spending would be higher especially since Quebec's pre-pandemic health care spend per capita is below that of Ontario[42] despite the latter having a slightly younger population. Quebec's relatively less aggressive COVID-19 healthcare relief spending is possibly due to the fiscal and infrastructure benefits that Quebec's Generation Fund has provided since its inception in 2006[43]. The Generation Fund is allocated a certain amount of government revenue on an annual basis that is invested to generate returns which are further used to *indirectly* pay down the provincial debt[44]. The excess of investment returns over the cost of new borrowings represent direct gains which are then re-invested into the fund to reduce the government's future debt burden and help limit the growth in indebtedness[45]. Between fiscal 2010 and fiscal 2015, the Generations Fund mitigated the growth in government debt by approximately $6 billion while also helping the Government of Quebec continue investing in crucial programs such as healthcare and infrastructure[46].

Such efforts to support its health care system seem to have paid off since the province's emergency COVID-19 health funding is only $206 million over that projected by British Columbia, despite having a population more than 60% larger. Quebec's pre-pandemic health spending may have created an infrastructure that was well prepared to handle initial and ongoing health challenges brought on by the pandemic. Despite a well-funded health system, Quebec has still allocated a significant portion of their COVID-19 support funding to supporting additional health resources. As part of their health spend, the province has committed approximately $900 million towards increasing COVID-19 testing, providing mental health services to the general population, supporting community organizations focused on helping people[47], and ensuring that service workers have adequate personal protective equipment to safely meet their employment responsibilities[48]. Quebec's Finance Minister, Eric Girard, has stated that their COVID-19 Response Plan will also focus on supporting sectors hardest hit in their economy such as tourism, culture and public transit in an effort to mitigate the long-term economic impacts of the pandemic's economic setbacks[49].

The nature of Quebec's budget forecast updates indicates that Quebec is taking a similar approach to Ontario in that they are expecting a fairly sharp and sustained 'V'-shaped recovery. Premier Francois Legault has assured residents that the government will continue to support provincial programs without increasing taxes[50]. Instead, the Premier is relying on an economic revival to curtail additional pandemic spending and get back to balanced budgets and deficit reduction once the pandemic ends[51]. This reliance on an economic recovery to mitigate the impact of the additional spending necessitated by the pandemic is concerning on two fronts.

First, the Premier's assurance indicates that the Government of Quebec has a timeline in place for when economic revival is expected to begin. What happens if this timeline is extended due to a second wave or a slower than expected pace of economic recovery once the pandemic eventually passes? The second concern relates to whether Quebec is prepared for a second wave or for future economic disruptions from the pandemic or from what follows. As an unexpected economic shock, the pandemic should have inspired provinces to put additional contingency measures and funds in place to help provide financial support in times of economic turmoil.

These concerns around Quebec's recovery forecast are further aggravated by the fact that all of the provinces have suffered a steep decline in tax revenues[52] due to decreased consumer spending and export demand as well as lost incomes in the wake of the pandemic. In particular, Quebec lost almost 600,000 jobs between February and May of this year but has made a rapid recovery, reporting employment at almost 96% of its pre-pandemic level as of the August Labour Force Survey[53]. While Quebec was able to recover from the drastic drop in employment levels suffered at the start of the pandemic, will this recovery be enough to substantially increase Quebec's revenue base? It is also important to consider that Quebec' employment level recovery is offset by continuing to lead the country in infections, mortality, and active cases which, if the situation persists, will necessitate additional support funding.

While Quebec's overall fiscal position is similar to that of Ontario, its emergency pandemic relief spending will place a much larger per capita debt burden[54] on its inhabitants than that of Ontario whose population is 70% larger. At prevailing interest rates, the additional spending should not be too difficult to finance, but if interest rates move back towards historical norms, Quebec's debt service burden could once again place a heavy burden on provincial finances. These assumptions and approaches will need to be addressed in future fiscal updates provided by the Government of Quebec.

c. Alberta

In their March 20th Fiscal Plan Update, Alberta *increased* their projected income tax revenues for the 2020 fiscal period[55]. As a resource-based economy, Alberta's government revenues at the margin depend on the price of oil and demand from the U.S., by far the largest customer. The price of Canadian crude oil has declined significantly in the last half of this decade and remains extremely volatile[56]. Energy-related royalties constituted approximately 13% of government revenues in the most recent fiscal year[57], even as energy prices were relatively depressed. The fiscal effect is magnified by fluctuations in personal and corporate income taxes that tend to move roughly in step with energy prices[58], reflecting the importance of the energy sector to Alberta's economy.

Economic Recovery

The initial budget included conservative estimates for real GDP and employment level recovery, stating that, "Real GDP is not expected to return to 2014 levels until 2020 and the economy is not assumed to reach full employment until 2023"[59]. Alberta's forecast of not returning to 2014 Real GDP levels refers to the peak of economic activity that Alberta experienced during a very prosperous oil boom from 2007 to mid-2015. Since 2015, oil prices have been generally declining[60] which, when coupled with reduced industry growth expectations, suggests that Alberta's recovery forecast was overly optimistic even in 2019 when this initial 2020 budget forecast was published. Alberta's extended period of lower oil prices and supressed economic activity helps to explain why Alberta has recently gone from a net creditor to a net debtor. Alberta also entered the pandemic with approximately 180,000 unemployed Albertans in the service sector[61], raising questions about what underlies the pre-pandemic forecast of a revenue increase for fiscal 2020. Perhaps one reason for the optimism underlying Alberta's 2020 budget update was its attempt to lift public health restrictions and reopen its economy faster than any other province[62].

The Price of Oil

Due to a reduction in production and exploration spend, many projections foresee significantly increased oil prices in the "12-18 months following the return to global demand"[63] which will help bolster Alberta's economy. The pandemic has significantly decreased global travel and other economic activity which has caused a decline in demand for crude oil and has subsequently repressed oil prices. As the pandemic continues, or worsens with a second wave, oil prices could stagnate or experience another sharp decline. If the oil price recovery forecasted by the Government of Alberta takes longer to materialize than originally expected, Alberta's recovery timeline would be significantly extended.

Alberta's updated budget also expects oil prices to rise when the global economy reopens but what happens if pandemic-induced lifestyle changes lead to a long-term decline in demand? For example, if firms want to continue the reduced overhead costs enjoyed during the pandemic and allow more employees to work from home, this could significantly reduce the amount of commuting necessitated, thereby potentially causing a lasting reduction in the demand for oil when compared to pre-pandemic levels.

It is also important to note that this expected "return to global demand" may not have the positive economic impact that the Government of Alberta is expecting. The limitations in transporting Canadian oil to anywhere but the United States crowds out Alberta from a large part of the international oil market, limiting its potential customer base. If the United States' economy enters further or extended downturn, Alberta can expect a significant decline in oil demand which will suppress the price of Canadian oil and gas. This will lead to a decline in royalty revenues and has a likelihood of significantly extending Alberta's recovery timeline.

Historic Positioning

Alberta entered the pandemic with an unemployment rate of 8.7%, the highest it has been in the past three years. To make matters worse, Alberta suffered record-high unemployment rates throughout the pandemic, rising to 15.5% in May and sustaining this level of unemployment through the month of June. As of August, Alberta's seasonally adjusted unemployment rate fell to 11.8% which is still almost 5% higher than it was in the comparable August 2019 period[64]. While Alberta's pre-pandemic government support payments were high, the ongoing health crisis continues to necessitate increasingly higher amounts of direct support payments to individuals and businesses. In particular, Alberta's direct support funding to individuals and business is only $1.4 billion less than Ontario's allocation despite having a population one-third the size.

Given its historically non-existent debt servicing costs and extremely low net debt-to-GDP ratio[65], Alberta has more borrowing room than other provinces to support their COVID-19 spending. Despite Alberta's ability to borrow more than the other provinces, its emergency relief spending has been relatively low. In particular, Alberta's COVID-19 health spend is the lowest of the provinces, coming out to about $131 per capita. This may be due, in part, to having a younger population with an average age of 37 and only 13% of its population aged over 65[66]. Alberta's relatively small increase in spending may also be explained by the economic challenges that the province is still facing with respect to volatile energy prices and uncertainty regarding demand in North America.

Before the pandemic, Alberta's total health spend per capita was the highest of the provinces (with the exception of Newfoundland), well above the Canadian average[67]. Population and economic growth during energy boom years has provided Alberta with a newer healthcare system that may have been better-positioned to deal with the health-related challenges brought on by the pandemic. But will this be enough? Alberta's COVID-19 cases are currently more than double that of British Columbia[68] which is concerning given than Alberta's population is approximately 700 thousand people fewer and suggests that more aggressive spending or mitigation plans may be necessary.

d. British Columbia

Unlike other provinces, British Columbia has not released a formal budget update relating to measures to deal with COVID-19. Instead, the Government of British Columbia has issued a news release[69] and presentation[70] explaining the allocation of COVID-19 response funds and their expected economic impact.

The fiscal impact of the pandemic and its related social and health support payments caused British Columbia to update their 2021 forecast in July to reflect a budget deficit of $12.5 billion[71]. This contrasts original budgetary estimates in which British Columbia forecasted three-consecutive surplus years beginning in fiscal 2021[72]. Additional program funding coupled with lower forecasted revenues and operating results for the 2021 fiscal period[73] have contributed to this update, as well as the general uncertainty surrounding the magnitude and timing of a global recovery[74]. Of the four provinces discussed, British Columbia has committed the highest per capital health spend which makes sense given that this metric was the lowest of the provinces in 2019[75], perhaps necessitating a greater 'catch-up' effort than even Ontario despite having a population almost three times smaller.

British Columbia entered the pandemic with a small forecast budget surplus, a AAA credit rating from three major agencies, and a very affordable debt-servicing cost with a net debt-to-GDP ratio of approximately 16%[76]. While the province has been steadily increasing their net debt over the past several decades[77], it has benefited from low interest rates, a generally strong provincial economy and a provincial debt level that is mainly supported by taxpayers[78]. These are all factors which help to reduce the revenue volatility faced by other provinces such as Alberta, thereby positioning British Columbia reasonably well to weather the economic implications of the pandemic. In particular, this provides the Government of British Columbia with significant borrowing capacity to fund the immediate pandemic relief effort and potentially mitigate several more waves of the virus.

Since British Columbia's health system started treating COVID-19 cases in late January[79], the province was impacted early and severely by COVID-19. British Columbia also has the second-highest percentage of elderly, at-risk residents, surpassed only marginally by Quebec which may have also contributed to its significant per capita health spend in the initial stages of the pandemic.

British Columbia expects a deterioration of approximately $12.8 billion in their 2021 fiscal budget projection which is approximately $2,514 of additional debt per capita. This is almost three times the COVID-19 related deficit per capita in Ontario (approximately $941). This may be due to a decision by the Government of British Columbia to factor in several waves of the virus in their fiscal update, expecting a longer recovery period than the other provinces. If the economy recovers slower than expected, British Columbia has capacity to sustain future rounds of funding. On the other hand, if the economy makes a 'V'-shaped recovery, British Columbia's fiscal position will significantly improve.

Once a formal budget update is released, some of the assumptions underlying British Columbia's fiscal adjustment will likely be explained. The October election is expected to provide some much-needed clarity as the government defends its spending policies.

e. Key Observations

Some things stand out from the provincial budget spend and deficit summary provided:

1. Ontario's highest health sector spend amongst the provinces suggests that there is an element of catch-up underlying its COVID-19 relief spending. Ontario's inadequate contingency reserve for the remainder of fiscal 2020 may signal problems ahead if the recovery is not rapid or sustained.

2. Significant investments made by Quebec in healthcare over the past decade, a key government priority even before the pandemic, may have allowed it to restrain emergency health spending despite having higher infection rate and a population with comparatively more senior citizens.

3. Quebec and Ontario's government policies are implicitly anticipating a 'V' shaped recovery. Alberta is not as specific in their recovery timeline; however, low and volatile energy prices as well as an economy that was depressed even before the pandemic have inspired a cautious approach in Alberta's COVID-19 related spending despite the borrowing room made available by its low accumulated deficits.

4. British Columbia is forecasting the highest per capita budget deterioration of the provinces and anticipates record support spending during the pandemic, a contrast for the province given its historically steady debt and spending levels. British Columbia's 2020 budget update does not offer much insight in terms of understanding fund allocations and economic expectations other than an implicit prediction there will be several waves of the pandemic and/or recovery will be slow. This will likely be addressed in the weeks leading up to the upcoming election.

Section 3: Canada's National COVID-19 Response Plan

a. The federal debt

The Canadian government established a COVID-19 Economic Response Plan on March 18, 2020 to help stabilize the economy and mitigate the effects of a significant financial downturn[80]. This plan has since been further revised to provide additional support as the severity of the pandemic's effects on the economy have been reassessed. The government initially projected direct support to Canadian individuals and business of up to $27 billion dollars[81]; however, in the revised estimate made on July 8, total direct support payments to individuals and businesses are projected to cost approximately $214 billion[82]. Of these payments, the largest components are expected to be the Canada Emergency Response Benefit (CERB) and the Canada Emergency Wage Subsidy (CEWS), together forecast at just over $160 billion[83] of the available COVID-19 response funds.

The following table highlights the allocation of the most significant of these support payments.

COVID-19 Economic Response Plan - Financial Overview	$ millions
Subtotal - Protecting Health and Safety	25,617
Direct Support Measures – Support for Individuals	
Canada Emergency Response Benefit (CERB)	80,473
Canada Emergency Wage Subsidy (CEWS)	83,600
10% Temporary Business Wage Subsidy	2,080
Canada Emergency Student Benefit	5,250
Businesses, Sector Specific Supports	
Canada Emergency Business Account (CEBA) - 25% incentive	13,750
Canada Emergency Commercial Rent Assistance	2,974
Subtotal - Direct Support Measures	214,255
Total - Health & Safety + Direct Support	**239,872**
Tax Liquidity Support	
Income Tax payment deferral until after August	55,000
Subtotal – Tax Liquidity Support	85,050
Total – Health, Direct Support Measures and Tax Liquidity	**324,922**
As Percentage of Canadian GDP	**14.10%**

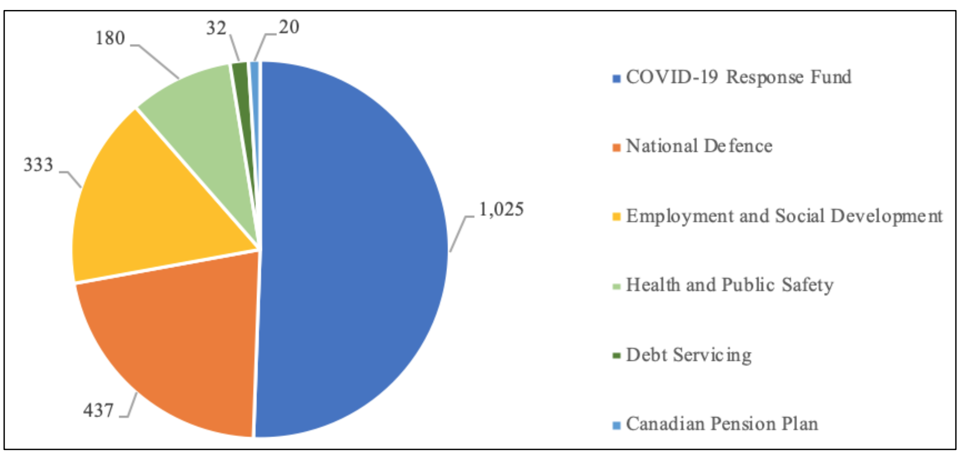
See the COVID-19 Response Plan Fiscal Summary for the full fiscal budget:
https://www.canada.ca/en/department-finance/economic-response-plan/fiscal-summary.html

In addition, the federal government is providing approximately $413 billion in funding to support the Canada Emergency Business Account (CEBA)[84]. This program was created to aid small businesses and non-for-profit organizations in obtaining financing for non-avoidable and non-deferrable expenses in an effort to help position them favourably for economic reopening[85]. Programs like CEBA and CEWS provide support to struggling businesses to aid them in sustaining some level of economic activity from the start of the pandemic and as economic reopening continues. The criteria required for companies to be eligible for CEBA and CEWS effectively targets businesses who have seen a significant drop in revenues and are having trouble supporting their mandatory expenditures. Essentially, these are business that are not faring well in the face of the pandemic's economic effects.

An interesting question becomes to what extent were some of these businesses struggling before COVID-19 struck and would they have survived absent the emergency support provided by programs such as CEBA, CEWS and their provincial counterparts? Furthermore, will these struggling companies eventually recover together with the general economy or become zombie enterprises, reliant on the government for support and for stifling the growth of companies and businesses with better prospects? Studying companies that benefited from CEBA and CEWS may provide interesting insights into the efficacy of these government programs once the country has reached a 'new normal'. The counter, and very valid, argument is the speed and severity of COVID-19's impact on the economy was such that without emergency government support, the entire economy, employment levels, and companies both strong and weak would have collapsed. In addition to taking much longer to recover, the very few large companies in protected or growing industries may have taken the opportunity to snap up real assets and businesses, entrenching oligopolies.

b. COVID-19 Spending Comparisons

In the *2020 Fiscal Budget*, the Government of Canada set aside approximately $1 trillion for COVID-19 relief (see *Section 4: Comparison to the Rest of the G7* for an expenditure breakdown). This represents an unprecedented sum of money compared to the resources that the federal government generally commits to support programs on an annual basis. To put pandemic-related spending into perspective, the following graphic compares the immediate COVID-19 Response Fund of $1,025 million[86] to some key government-funded programs. As the graphic below indicates, this immediate COVID-19 response necessitated more than 50 times the funding allocated to the Canada Pension Plan and more than national defence, employment, health, pension funding, and debt servicing combined.



All numbers presented are in $millions. ***Source:*** *2019 Budget and Canada's COVID-19 Response Plan*[87].

The most striking part of this analysis is the question of how Canada plans to finance this COVID-19 relief effort, especially since this budget allocation was made at the pandemic's inception and will unlikely reflect the total spending required to defeat the pandemic. To put things in perspective, the Government of Canada's COVID-19 Response Plan was first published in March and was further updated to reflect a greater need for spending efforts once the situation was reassessed in July. Since then, no further updates have been provided; however, it is safe to assume that future waves of the pandemic or anything but a sharp and robust 'V-shaped' recovery will require funding set aside for COVID relief to be significantly increased.

In the initial 2020 Fiscal Budget Projection, personal income tax revenues were forecasted to bring in approximately $163 billion[88]. This would represent approximately 16% of the funding required to support Canada's *current* total projected COVID-19 fund allocation, before considering the long-term impact of COVID-19 on employment and tax revenue. The big question is how will this trillion-dollar debt be financed? In the short to medium term, the obvious answer for this and any future pandemic-related stimulus will be through borrowing. But, eventually, there are limits to what even sovereign nation-states can borrow before becoming caught in a debt spiral or facing constrained access to international capital markets. Since COVID-19 is a global phenomenon, it may be instructive to compare Canada's response and fiscal position with that of other countries.

Section 4: Government Debt and the Canadian Economy

Temporary COVID-19 response measures are expected to have a significant impact on Canada's debt level, with the 2020-2021 deficit projected at $343.2 billion[89]. This is a significant increase over the $19.7 billion deficit forecast for the same period in the 2019 Federal Budget[90]. Despite the net $324 billion dollar increase in the projected budget deficit, Bill Morneau, Canada's former Finance Minister, stated that this spending increase is an appropriate response to the estimated 40% decline in Canada's real GDP[91] and is proportionate to the response of other advanced economies as they attempt to rebound from the pandemic's initial economic shock[92]. He assured Canadians that despite massive spending to mitigate the economic consequences of the pandemic, Canada remains well positioned to "…maintain its 'low debt advantage' among G7 countries"[93]. This 'low debt advantage' refers to Canada's net debt-to-GDP ratio.

The 2019 Federal Budget Overview forecast debt-to-GDP of 30.5% for the 2020-2021 period based on an expected federal debt level of $725 billion[94]. Projected COVID-19 spending as of July 8, 2020 would increase 2019 federal expenditure (and therefore debt levels) by around $1 trillion. This would push the national net debt-to-GDP ratio to approximately 75%, an increase of 44% from pre-pandemic estimates when holding government revenues at their projected 2019 levels (Appendix 2: Nominal GDP Projections and Assumptions). Even this approximation may understate borrowing given federal tax revenues will drop significantly due to the pandemic-induced contraction of the Canadian economy[95].

	$billions
2021 Federal Debt, per 2019 Federal Budget[96]	**725**
Additional Program Expenses Related to COVID-19	
Health and Safety Measures	26
Direct Support Measures	214
Tax Liquidity Support	85
Total Health, Direct Support and Tax Liquidity	325
BCAP, Other Credit and Liquidity Support	386
Capital Relief (OSFI Domestic Stability Buffer)	300
Total BCAP, Other Credit and Liquidity + Capital Relief	686
Total COVID-19 Relief Payments at the Federal Level	**1,011**
2021 Federal Debt Adjusted from 2019 Budget Estimate (1)	**1,736**
2019 Nominal GDP	
Projected Nominal GDP (2), per the 2019 Federal Budget	2,298
Actual Nominal GDP, per COVID-19 Economic Response Plan (3)	2,304
Change in Real GDP from the 2019 Projection	(6)

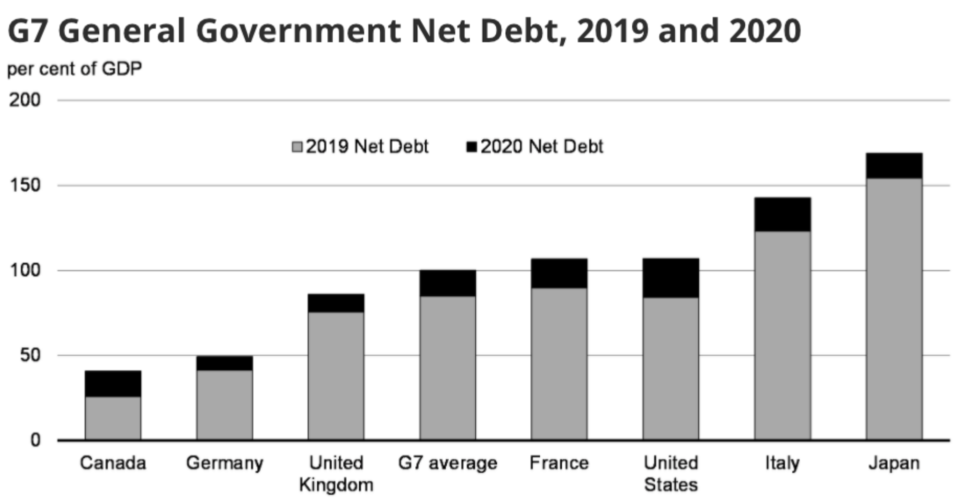
(1) Holding all else constant, including budgetary revenues, public debt service, and the overall financial position of the federal government.

(2) *Nominal GDP is considered the broadest measure of the tax base[97]. 2019 Nominal GDP is used here since it is the most recently available fiscal year-end Nominal GDP as per data employed in Federal Government budgets and estimates.*
(3) *$325bn in total health, direct support and tax liquidity payments represents approximately 14.1% of Canada's 2019 Nominal GDP, therefore $325bn/14.1% solves for actual Nominal GDP for 2019 of $2,304bn.*

It is important to note that this debt estimation assumes a 'worst-case' scenario in which all COVID-19 expenditures are financed through debt, without any source of revenue support. The Federal Government's Debt Management Strategy for 2020-2021(DMS) expects the national borrowing level to rise to $1.2 trillion by March 2021 which only accounts for the adverse economic events that could occur by the end of fiscal 2021[98] based on *current* COVID-19 spending allocations. The above federal debt level adjustment is approximately $500 billion higher than current government borrowing estimates[99] because it also incorporates additional funding that will likely be required to mitigate any adverse economic effects resulting from additional waves of COVID-19 which are not explicitly included in the DMS.

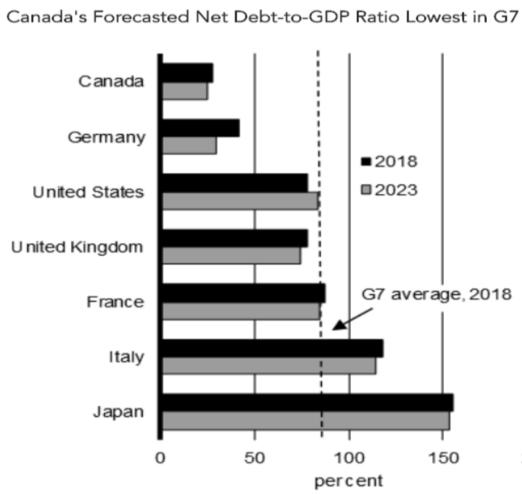
Since March 2020, the COVID-19 relief fund has already necessitated $713 billions of additional borrowing[100], making it plausible that federal borrowings may increase by an additional $500 billion or more by the time the pandemic runs its course. This includes estimated supplemental transfer payments to the provinces to help them cope with sustained economic dislocation should further waves of the pandemic occur. In April 2020, the International Monetary Fund (IMF) made an upward adjustment of 18% to the projected Canadian debt-to-GDP ratio, estimating that it will rise to 49% by the end of fiscal 2021. The IMF uses the aggregate of federal and provincial debt in its calculation. Given that such a drastic adjustment was made just one month into the pandemic, even this degree of increase may severely underestimate the ultimate impact of the pandemic on Canada's sovereign debt-to-GDP positions in the long term.

The following graph illustrates the IMF's adjusted net debt-to GDP ratios for the G7 per the April 2020 Fiscal Monitor:



These projections significantly reduce the gap between Canada and the other G7 nations with respect to Canada's perceived 'low debt advantage', particularly with respect to Germany whose 2020 net debt-to-GDP ratio is only 8% higher than Canada's[101]. Comparing 2019 Federal debt projections to the adjusted projection of the 2020-2021 Federal debt level, it is apparent that without sources of revenue to support COVID-19 relief spending, Canada's net debt-to-GDP ratio could more than double by the end of fiscal 2021. Morneau's assurance that Canada is expected to maintain its 'low debt advantage' is contingent on the assumption that the net debt-to-GDP position of other G7 nations will significantly deteriorate, possibly to an even greater degree than Canada.

The following bar graph compares Canada's actual 2018 net debt-to-GDP ratio to 2019 projections of where this metric was expected to be in 2023, based on an aggregate of federal and provincial borrowing.



Source: Government of Canada, *2019 Budget.*

Across all G7 counties, the government net debt-to-GDP ratio is the ratio of total liabilities, net of financial assets of the central, state and local levels of government, as well as those in social security funds. For Canada, this includes the federal, provincial/territorial and local government sectors, as well as the Canada Pension Plan and the Quebec Pension Plan. (Source: International Monetary Fund, October 2018 *Fiscal Monitor*).

The IMF's initial forecasts indicated an improvement in Canada's net debt-to-GDP ratio by fiscal 2023. These estimates were made in 2018 and are based on underlying economic assumptions that are no longer relevant in current circumstances. When looking at the adjusted projection for Canada's 2021 net debt-to GDP ratio (Appendix 2), it is important to note that this amount is approximately three times Canada's initial projection for fiscal 2023.

Perhaps what is most striking when comparing Canada's initially forecasted net debt-to-GDP ratio[102] to the IMF's recently published update is the change in Canada's positioning relative to Germany. While Germany's debt level has remained somewhat stable, especially compared to actual 2018 levels, Canada's projected net debt-to-GDP ratio for fiscal 2020 has skyrocketed relative to initial estimates. It is also worth mentioning that the adjusted projections for the 2020-2021 fiscal period were based on the assumption that required COVID-19 relief will not amount to more than one trillion dollars. Should this assumption prove inaccurate, the severity and duration of the pandemic on the Canadian economy would require additional borrowing at the federal and/or provincial level, further worsening the projected net debt-to-GDP ratio. A sharp economic rebound and/or reduction in COVID-19 relief payments would also mitigate the severity of the projected impact on Canada's net debt-to-GDP ratio.

The assumptions used, and the economic scenarios anticipated by Canadian governments may not eventually be reflected by reality. Here are a few examples:

- The emergency spending initiatives by the federal and provincial governments, referenced above and in previous sections, have a contemplated run-off date. The amount and duration of emergency stimulus spending will be largely determined by how soon the population emerges from the health threat posed by the pandemic. Will the resulting deficits be sustainable if spending remains at current levels in six months? Two years from now?

- Government fiscal projections assume a sharp 'V'-shaped (or, in the worst case, a 'U'-shaped) economic recovery. If recovery is slower or less than complete, government revenues and GDP projections may prove overly optimistic. This could radically alter Canada's net debt-to-GDP ratio.

- Canada is a trading nation, with international trade comprising about a third of GDP[103]. Three-quarters of this is with the U.S.[104], which has been experiencing significant difficulties with COVID-19, both medically and politically. The medium-term prospects for the U.S. economy may be challenging and any such difficulties will undoubtedly delay a Canadian recovery.

Ultimately, debt incurred today must be repaid tomorrow. The question is always how and by whom? The traditional government response is to reduce expenditure or increase taxation. Implementing either of these measures will not be easy, but the likely response points to increased taxation since reducing COVID-19 funding seems especially unlikely as the situation continues to progress. With taxation, the perennial necessity of maintaining competitive corporate and personal tax rates will remain. Canadian businesses and some of our most educated and talented citizens have a long tradition of voting with their feet should tax rates move too far away from those in other jurisdictions.

The DMS illustrates the Government's plan to keep debt accumulated in relation to COVID-19 spending under control. In an effort to help retain Canada's 'low debt advantage', the Government is issuing, "… an unprecedented level of long-term bonds in order to lock in funding at historically low interest rates"[105] which may prove problematic if refinancing occurs at higher rates in the future, as discussed in the "Cost of Debt" section below. The DMS also does not mention the debt that is being accumulated by the provinces in the wake of COVID-19. Over time, provincial debt levels have grown and constitute a large part of Canada's combined net debt position. On an aggregate basis, Canada's Federal COVID-19 related debt financing in fiscal 2021 is expected to be $713 billion which is $437 higher than the pre-pandemic financing expected to be required for this fiscal year[106]. When coupled with the $43 billion *additional* deficit taken on by Canada's four largest provinces to support provincial relief efforts[107], this would indicate Canada's aggregate debt outlook is darker than the Federal Government has considered and addressed in the DMS.

Unlike many other countries, Canadian provinces have both taxation and spending power which puts Canada in a unique position to shift the national debt burden around, placing it on provinces in an effort to sustain a perceived debt advantage at the national level. The relative ratios of federal versus provincial debt have changed over time which means that solely looking at federal debt and budgets severely understates the country's actual sovereign debt position. At the end of fiscal 2019, the combined net debt levels of the four largest provinces were equivalent to approximately 75% of the total federal net debt level[108]. The federal government has not yet released estimates of the net debt level expected in fiscal 2020 and 2021, instead focusing on presenting net debt solely as a percentage of GDP. However, the Federal Government's COVID-19 announced expenditure might bring this ratio down to the high 50% range as the federal net debt level continues to rise at a much faster pace than the provinces. With this said, most estimates indicate it is still the provinces that will owe a majority of Canada's aggregate debt.

Other considerations that might have an impact on Federal Government economic assumptions and borrowing decisions include:

- Two enduring Canadian political problems need to be managed. The first is the demand for federal financial help as the burden on spending and debt at the provincial level grows. These will be difficult to resist given the likely nature of the requests (for healthcare, education, protective and testing equipment) as well as the high levels of provincial borrowing that already requires servicing. Any additional revenue transfers will not help the Federal fiscal balance. The second problem is potential revival of regional tensions within the federation, particularly if provinces and regions that have escaped relatively unscathed (the North, the Maritimes, Saskatchewan, Manitoba) resent the attention and funding 'less careful' provinces are receiving.

- Canada is reliant on immigration to maintain the working-age labour force and attract highly skilled workers. COVID-19 has already significantly disrupted this essential flow, with net immigration currently running about one-third of target levels[109]. This will dampen economic growth potential and tax revenues in the mid-long term.

- Inflation can help shrink the impact on of any given amount of public debt on long-term government finances. This is because while debt levels are fixed, prices are not. Put differently, as inflation rises and inflation-indexed salaries adjust to this higher price level (at least partially), corporate, individual, and consumption tax bases will increase. Thus, an increased revenue basis makes debt levels less worrisome. Even a CPI of 3% per year[110] reduces the 'value' of a dollar in debt by around 20% after six years. The Federal Government appears to be acting on the assumption that inflation, and by extension interest rates, will remain low for a very long time.

Having a real or imagined 'low debt advantage' may not matter very much, especially when almost every government around the world is spending freely to mitigate the economic effects of COVID-19. However, a national government's fiscal position can powerfully shape its economic prospects and performance. Here are some reasons why:

- The most obvious is opportunity cost. Money spent on supporting incomes or commercial rent is money not available to refurbish or build new infrastructure, fund education and research or other investments that can improve a country's economic competitiveness

- Not all countries are being equally affected by the pandemic. For example, if Germany makes faster progress in its “new normal” and continues to operate in a “90% economy”[111] state, they will see the benefits of recovering government revenues, less need for extraordinary fiscal support system and consequently, a lower debt level compared to countries who move at a slower pace.

The Cost of Debt

Absolute and relative sovereign debt levels are a key metric that rating agencies use to assign their credit ratings. For example, 10-year U.K. sovereign debt currently yields about 0.18%[112]. The equivalent yield for Portugal is 0.32%[113] which means that a dollar of debt for the Portuguese government costs almost twice as much as a dollar of borrowing by the U.K government. One of the main drivers of this difference is the fact the U.K. is rated AA/Aa2//AA-[114] by the three main rating agencies[115] while Portugal’s debt is rated two ‘notches’ lower at BBB/Baa3/BBB[116]. Canada has traditionally enjoyed the top rating available, but on June 24, 2020 one agency, Fitch, downgraded Canadian sovereign debt one notch[117] reflecting, amongst other concerns, Canada’s growing debt levels.

Since borrowing costs are very low by historical standards, even slight changes in credit perception and economic prospects can have major impacts on the nation’s finances. For example, even a slight increase in borrowing rates from 1% to 1.5% which does not seem like much at first glance, can exacerbate Canada’s debt servicing cost. This interest rate change represents a 50% increase in borrowing costs which, on an increased debt level of $1.7 trillion, amounts to approximately $8.7 billion annually in additional interest expense[118].

An increase in debt levels such as that already incurred by federal and provincial governments will probably take years to pay down, which means that a significant portion may have to be refinanced with new borrowings at rates prevailing at the time. What if, in 10 years’ time, $736 billion of the adjusted $1.7 trillion is due to be refinanced, but at the 3% sovereign borrowing rate then possibly prevailing? The annual debt service of this remaining principal amount would then be $18.4 billion higher than before[119]. This is especially concerning since a significant portion of the Government’s COVID-19 borrowings consist of short-term instruments[120] which will need to be refinanced even sooner than the 10-year horizon illustrated above in the event that they are not repaid before maturity. Since the cumulative principal amount that the Government expects to borrow in fiscal 2021 is $713 billion[121], the associated costs and likelihood of refinancing quickly increase.

A formal economic update by both the Federal and Ontario governments is expected in the latter part of this year. These may yield some answers and provide revised fiscal and economic forecasts based on the two quarters of COVID-19 induced pandemonium we have just lived through. As such, it is important that all of us are well informed about the government’s COVID-19 remedial actions and what they could have in store for our economy moving forward. We will likely have to live with the consequences for a long, long time.

Appendix 1: Comparisons of Provincial GDP levels (2019)

	In millions	As a % of GDP	
Canadian GDP 2019, expressed in Real Dollars		**100.00%**	
Ontario	744.44	37.80%	
Quebec	377.04	19.14%	
Alberta	334.17	16.97%	86.76%
British Columbia	253.05	12.85%	
Saskatchewan	81.54	4.14%	
Manitoba	63.49	3.22%	
Nova Scotia	37.44	1.90%	
Newfoundland and Labrador	31.59	1.60%	
New Brunswick	30.75	1.56%	
P.E.I.	6.05	0.31%	
Northwest Territories	4.30	0.22%	
Nunavut	3.16	0.16%	
Yukon	2.62	0.13%	

Appendix 2: Nominal GDP Projections and Adjustments, in billions

2019 Projection of 2020-2021 Federal Debt		$725

	2019 Budget	2019 Actual
Nominal GDP	$2,298	$2,304
Net Debt-to-GDP	31.5%	31.5%

Adjusted 2020-2021 Federal Debt		$1,736

	Per 2019 Budget	2019 Actual
Nominal GDP	$2,298	$2,304
Net Debt-to-GDP	75.5%	75.3%
Change	**43.99%**	**43.87%**

Endnotes

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[31] I.e. on healthcare, education, social services, public transit, etc.

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[96] Government of Canada (2020, March 19). *Investing in the Middle Class: Budget 2019*, page 284.
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[98] Note that the government fiscal year end is from April 1st to March 31st.
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[118] $1,736bn x 0.5% = $8,680mn in additional interest expense.
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