

# CANADA'S CHALLENGE IN MEETING NATO'S DEFENCE SPENDING TARGET

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## Introduction

Canada has long been critiqued for its lackluster defence spending. Multiple US presidents, ambassadors, and most recently a senator, have called out Canada's "feeble commitment" to defence spending (McCarten, 2023). Much of this criticism centres around Canada's failure to meet its long-standing NATO pledge to spend at least 2.0 percent of gross domestic product (GDP) each year on defence. Most NATO countries do not meet this benchmark, but with the war in Ukraine, NATO's Secretary General is putting pressure on members to treat the target "as a floor, not as a ceiling" (NATO, 2023d: 50). In response to mounting pressure from its allies, Canada reaffirmed its pledge to reach the 2.0 percent target at NATO's latest summit in Vilnius (NATO, 2023e).

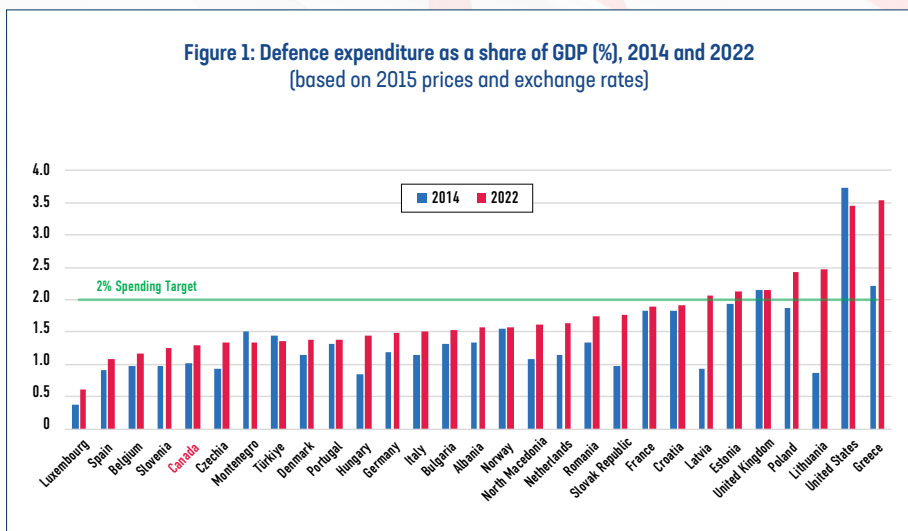
The problem is Canada is not in a position to come up with the billions of dollars needed to meet the benchmark, and the federal government appears to lack the desire to reach it. Reports suggest that just weeks after reaffirming its pledge, the federal government looked to cut defence spending by \$1 billion (Brewster, 2023). Without significant adjustments to planned spending, Canada is stuck in a lose-lose situation: accumulate billions more in debt to reach the target or further disappoint its allies by failing to uphold the renewed pledge.

## NATO's Spending Target

In 2006, NATO members agreed to commit a minimum of 2.0 percent of GDP towards defence spending (NATO, 2023c). At the 2014 Wales Summit, in response to Russia's annexation of Crimea and continued defence spending cuts, NATO countries formally pledged to reverse cuts and meet the spending target by 2024 (NATO, 2023b). Although European members and Canada have since increased military spending by a cumulative US\$350 billion (inflation-adjusted) since 2014, few members have been able to follow through on this pledge (NATO, 2023d). In fact, only seven countries met the 2.0 percent target in 2022 (see Figure 1).

While Canada is not alone in missing the target, it still lags behind other NATO members in defence spending. In 2022, Canada spent 1.29 percent of GDP on defence, ranking it fifth lowest compared to 28 other members. While some progress has been made since 2014, when Canada spent just 1.0 percent of GDP on defence, a significant portion of this growth (as measured by NATO) can be attributed to a 2017 change to NATO's definition of what constitutes defence spending (PBO, 2022). NATO expanded the definition to include some measures previously not considered defence, such as veteran's benefits, which served to artificially inflate Canada's defence spending figures (PBO, 2022).

**Figure 1: Defence expenditure as a share of GDP (%), 2014 and 2022**  
(based on 2015 prices and exchange rates)



## Canada's Current Fiscal Position

Increased spending and significant debt accumulation during recent years have left Canada in a weak fiscal position. In 2023/24, annual federal program spending<sup>1</sup> is projected to be \$449.8 billion (Canada, Department of Finance, 2023). Adjusted for inflation and population growth, this represents \$11,395 per person. Program spending rose and fell significantly during the pandemic, but 2023/24 inflation-adjusted, per-person spending is still projected to be \$681 higher than 2019/20, and \$2,330 higher than 2014/15 (Canada, Department of Finance, 2022b, 2023). Most of this has gone towards expanding or implementing new programs such as the Canada Child Benefit, national child care and

dental care, or expanded elderly benefits, rather than towards core government functions such as national defence or justice (Canada, Department of Finance, 2021, 2022a; Hill et al., 2020). Furthermore, recently reported spending cuts appear as though they will reduce annual defence spending and leave programs such as national child care and dental care untouched (Brewster, 2023).

This increased spending has been financed primarily through public debt. The Trudeau government has run deficits every year since first being elected, and recent deficits have been relatively large. This year's (2023/24) annual deficit is projected at \$40.0 billion (Canada, Department of Finance, 2022b, 2023). Overall, Canada is projected to have added \$721.6 billion in gross debt since 2019/20 (Canada, Department of Finance, 2022b, 2023).

### Meeting the Target

Canada and the rest of NATO reaffirmed the pledge to spend 2.0 percent of GDP on defence at the 2023 Vilnius Summit. To meet this target over the next few years, the Parliamentary Budget Officer (PBO, 2022) estimates the federal government will have to increase forecasted defence spending by \$57.1 billion over four years.<sup>2</sup> The government will be hard-pressed to take on this spending without adding significantly to future deficits.

For 2023/24 to 2026/27, the federal government forecasts a string of annual deficits totaling \$143.8 billion in additional debt (Canada, Department of Finance, 2023). To incorporate additional defence spending into these forecasted budgets, assuming revenues do not rise substantially, the government will need to divert funding away from other programs and/or take on further debt. The former is unlikely; past spending shows the Trudeau government consistently prioritizes social programs over core government functions such as defence. For example, though Budget 2022 announced investments into defence totaling more than \$55 billion over 20 years (an average of \$2.75 billion per year), the previous year the federal government announced \$30 billion over 5 years (an average of \$6.0 billion per year)

to implement \$10-a-day child care (Canada, Department of Finance, 2022a, 2023). Assuming these priorities remain unchanged, Canada would need to finance the additional defence spending primarily through debt.

To show the costs of meeting the target, Figure 2 displays forecasted federal budgetary balances from 2023/24 to 2026/27, versus the balances that would occur if the federal government used debt to meet its NATO commitment. If Canada spent 2.0 percent of its GDP on defence, the federal deficit in 2023/24 would increase by \$15.5 billion, from \$40.0 billion to \$55.5 billion. To maintain this target over the next three years, the deficit would increase \$14.5 billion in 2024/25, \$14.1 billion in 2025/26, and \$13.0 billion in 2026/27. Attempting to meet the defence spending target by 2026/27 would

increase federal debt accumulation by \$200.9 billion—a \$57.1 billion increase compared to current projections. This would also increase debt interest costs and likely raise the deficits past what is presented in Figure 2.

### Conclusion

Canada has yet again pledged to spend 2.0 percent of GDP on national defence. This comes without any plan of how to reach the goal given Canada's weak fiscal position. To uphold its pledge without seriously weakening an already tenuous fiscal position, Canada would need to shift spending away from new and expanded programs, and towards defence. This is unlikely to happen given expected defence spending cuts, meaning the federal government is left in a lose-lose situation: add debt or disappoint allies.

