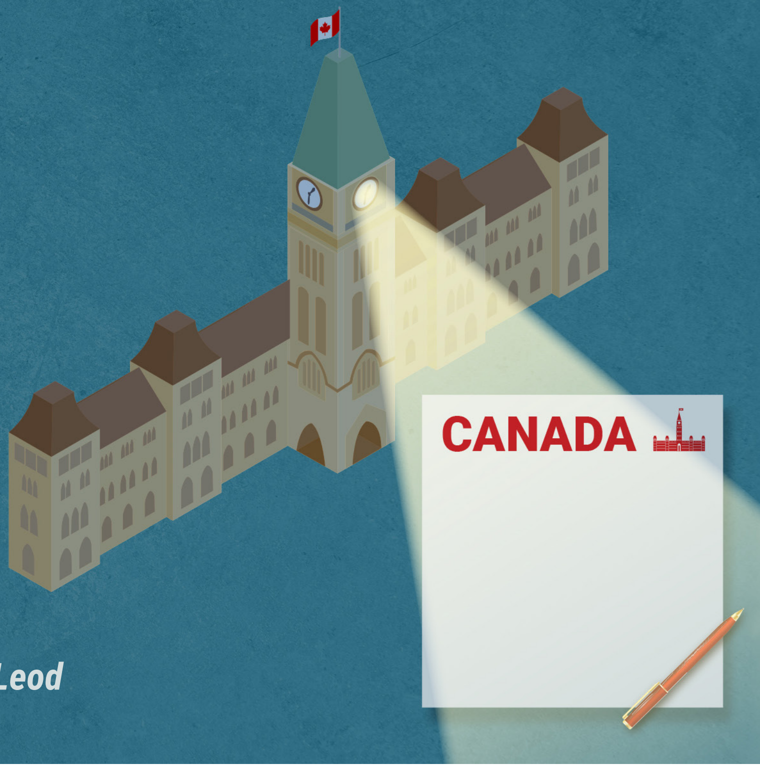
FRASER RESEARCH BULLETIN

FRASER INSTITUTE

August 2024

Caution Required When Comparing Canada's Debt to that of Other Countries, 2024 Edition



by Jake Fuss, Milagros Palacios, and Callum MacLeod

Summary

- The federal government continues to rationalize its debt-financed spending based on international comparisons showing Canada with the lowest level of debt in the G7.
- Of the two broad measures of debt, gross debt includes most forms of debt while net debt is a narrower measure that accounts for financial assets held by governments.
- By using net debt as a share of the economy (GDP), Canada ranks 5th lowest of 32 countries and lowest amongst the G7. By using gross debt as a share of the economy, Canada falls to 26th of 32 countries and 3rd lowest in the G7.
- Canada experiences the largest change in its indebtedness ranking—falling 21 places—when the measure shifts from net debt to gross debt.
- One reason for this pronounced change in ranking is that net debt includes the assets of the Canada and Quebec Pension Plans, which have unique approaches to funding public retirement plans: unlike most other industrialized countries, the CPP and QPP invest in non-government assets including equities and corporate bonds.
- As of December 31, 2023, according to Statistics Canada data, there were net assets in the combined CPP and QPP of $716.7 billion.
- According to IMF data, the difference between Canada's gross and net debt was approximately $2.7 trillion at the end of 2023, which means the assets of CPP and QPP explain more than one-quarter of the difference.

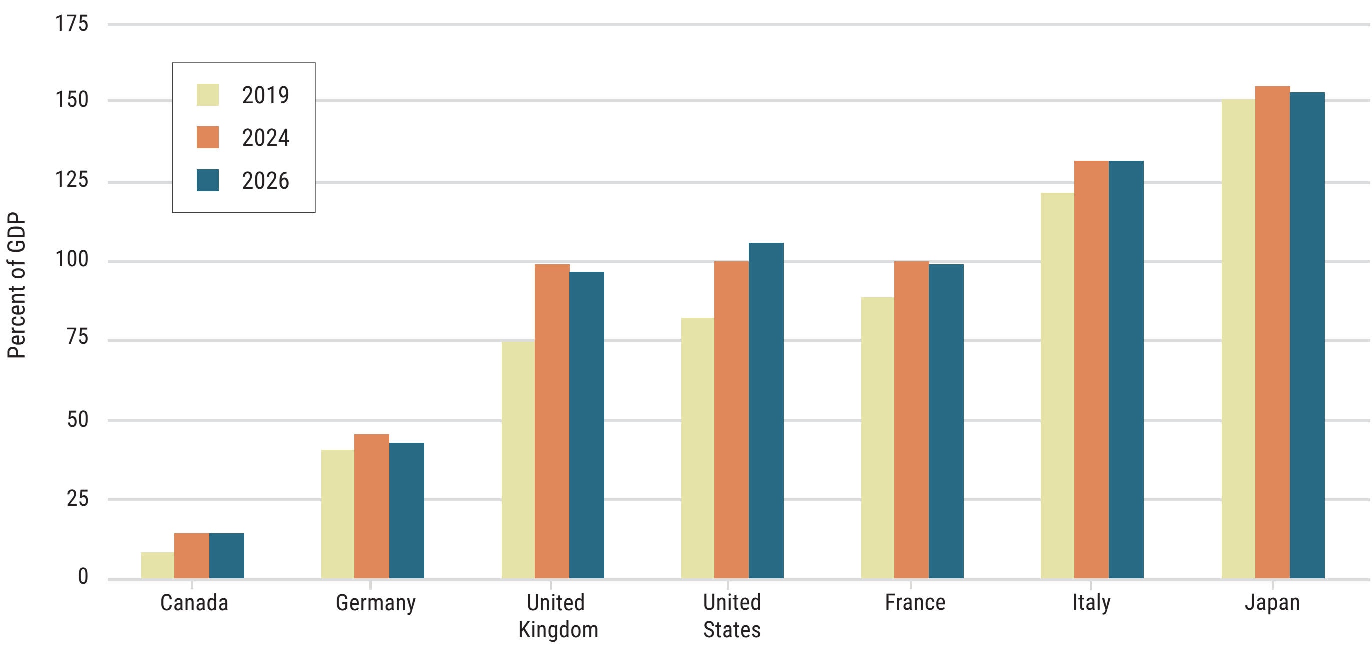
Introduction

Since the height of the COVID pandemic, a similar graph has appeared in every federal budget. The graph shows Canada's international advantage in terms of its net debt-to-GDP ratio, specifically in comparison with other G7 countries (Charts 26 and 27, pictured below). This statistic has continually been used as a rationalization by the federal government to justify continued deficits. When Minister Freeland presented the 2024 budget in April, she stated that "Canada has the lowest deficit- and net debt-to-GDP ratios in the G7, as recognized in our triple-A credit rating" (Canada, Department of Finance, 2024a).

This line of thinking summarizes the wider argument contained within the 2024 budget (Canada, Department of Finance, 2024b). On page 25, under a section about preserving Canada's fiscal advantage on the international stage, the budget highlights Canada's low net debt:

> Canada's net debt as a share of the economy remains lower today than in any other G7 country—an advantage that Canada is expected to maintain (Chart 26). Canada's responsible economic plan has also delivered the fastest fiscal consolidation in the G7 since the depths of the pandemic, resulting in Canada having the smallest net debt and deficit in the G7 as a share of the economy over the current and next two years (Chart 27).

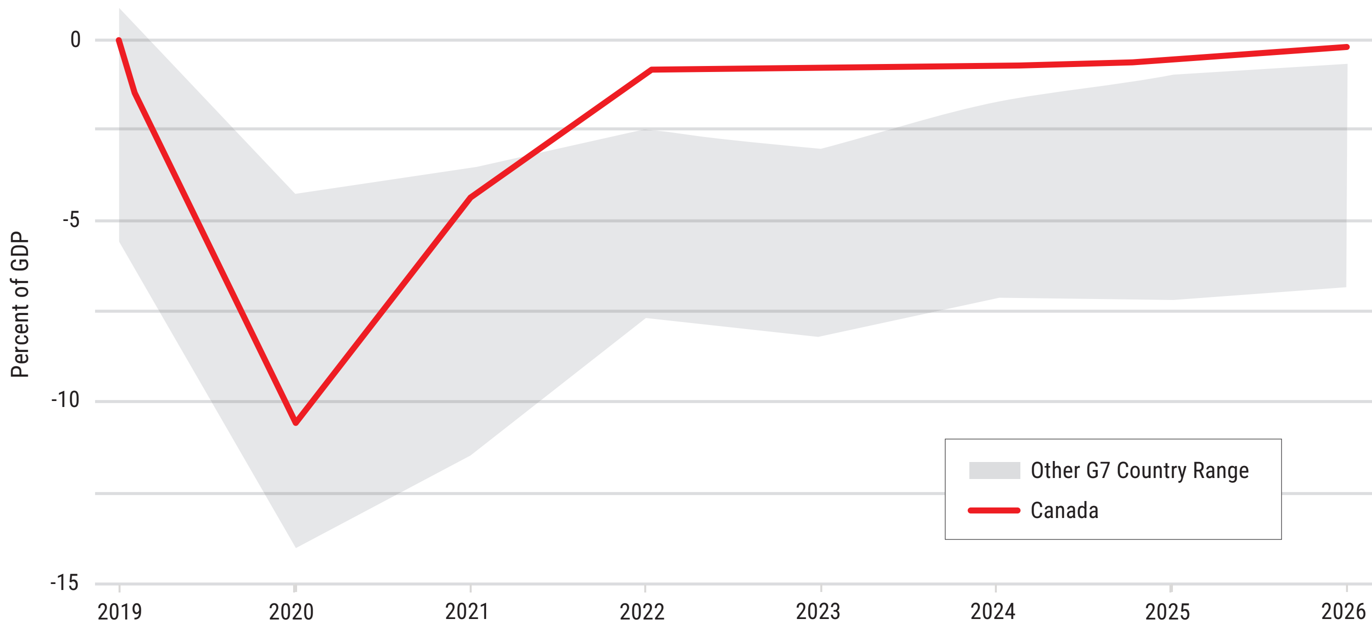
Chart 26: IMF General Government Net Debt Projections, G7 Economies



Note: The Internationally comparable definition of "general government" includes the central, state, and local orders of government, as well as social security funds. For Canada, this includes the federal, provincial/territorial, and local and Indigenous government sectors, as well as the Canada Pension Plan and the Quebec Pension Plan.

Source: International Monetary Fund, October 2023 *Fiscal Monitor*.

Chart 27: IMF General Government Budgetary Balance Projections, G7 Economies



Note: The Internationally comparable definition of "general government" includes the central, state, and local orders of government, as well as social security funds. For Canada, this includes the federal, provincial/territorial, and local and Indigenous government sectors, as well as the Canada Pension Plan and the Quebec Pension Plan.

Source: International Monetary Fund, October 2023 *Fiscal Monitor*.

> By meeting the additional fiscal objectives introduced in the 2023 Fall Economic Statement, Budget 2024 maintains a long Canadian tradition of fiscal responsibility, which is a pillar of Canada's excellent credit ratings from Moody's (Aaa), S&P (AAA), Fitch (AA+), as well as DBRS Morningstar (AAA). Along with Germany, Canada is one of only two G7 economies to have a AAA rating from at least two of the three major global credit rating agencies.

This line of reasoning by the federal government is flawed for a number of reasons. For instance, the government fails to account for the complexities of various debt-associated metrics and the different stories those metrics tell of Canadian public debt.

Gross debt versus net debt

The International Monetary Fund (IMF), which is the source of the chart and statement by the federal government above, defines *gross debt* as "All liabilities that require future payment of interest and/or principal by the debtor to the creditor" (International Monetary Fund, 2024a).[1] In other words, gross debt is a broad measure of the liabilities and indebtedness of a country, and it tends to include almost all government liabilities. On the other hand, net debt is a narrower measure of indebtedness. Net debt refers to the indebtedness

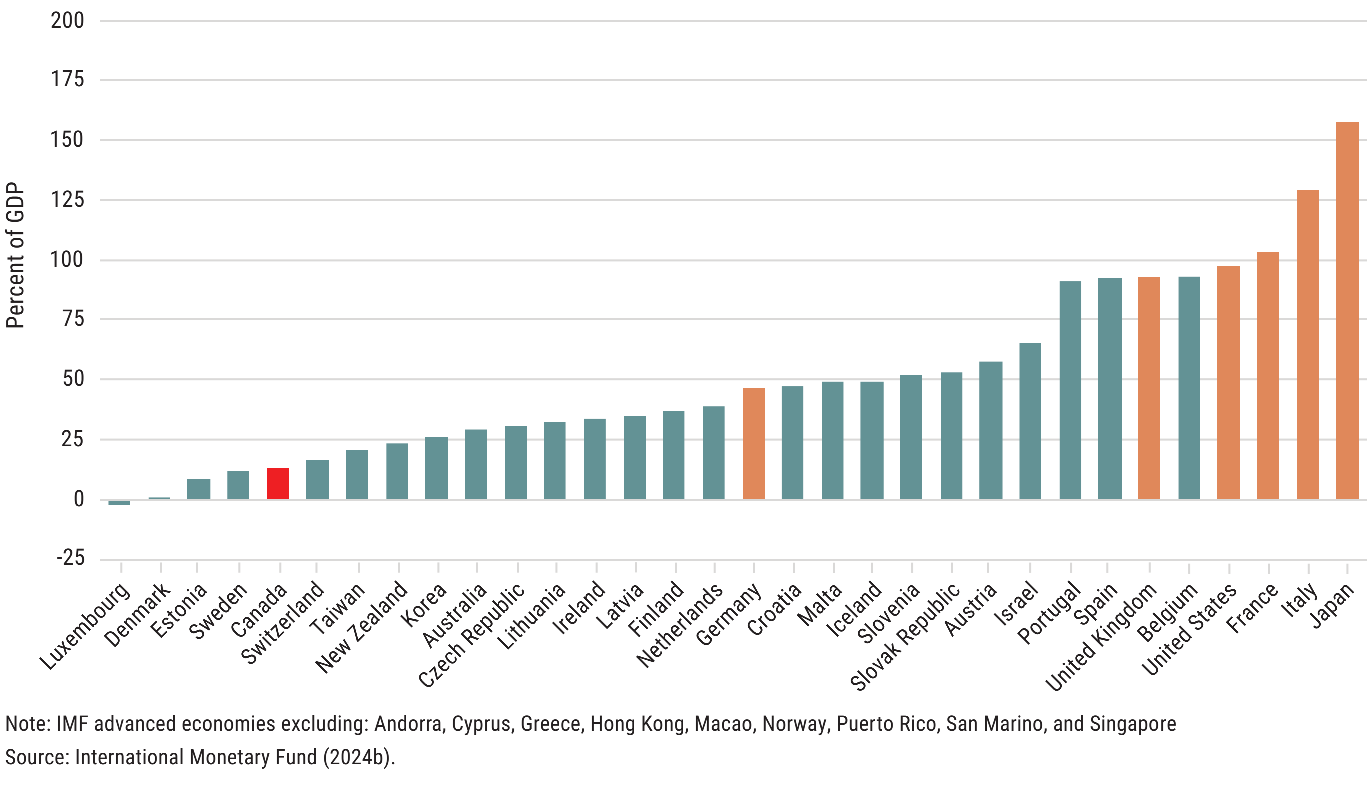
1 See also the IMF's e-learning video on gross and net debt at <https:// www.youtube.com/watch?v=LAD1oCHCibI&list=PLmYAE4wV1YQzimXjDWMQ-4GwConTsP7-a>.

of a jurisdiction after financial assets such as currency deposits, gold, and debt securities have been subtracted from gross debt.

The minister's speech and the 2024 federal budget both refer to the IMF's measure of net debt. Figure 1 illustrates the net debt to-GDP percentages for the advanced (i.e., developed) countries covered by the IMF.[2] Canada performs well on this metric, ranking 5th out of 32 countries in terms of its net debt-to-GDP ratio (13.3 percent) for 2024. This places Canada first among the G7 countries (shaded green) for its net debt-to-GDP ratio. Canada is well ahead of second-placed Germany (46.4 percent) and far outpaces last-place Japan (157.7 percent).

The federal government is correct to commend Canada's advantage in terms of net debt, but this one metric fails to give a holistic view of Canada's public debt. A different assessment of Canada's comparative indebtedness occurs if gross debt statistics are used. Figure 2 illustrates the gross debt-to-GDP percentages for the same group of countries presented in Figure 1. Japan is still the most indebted (254.6 percent), with Italy the second most indebted in both cases as well. Canada, however, falls from 5th place when net debt is measured

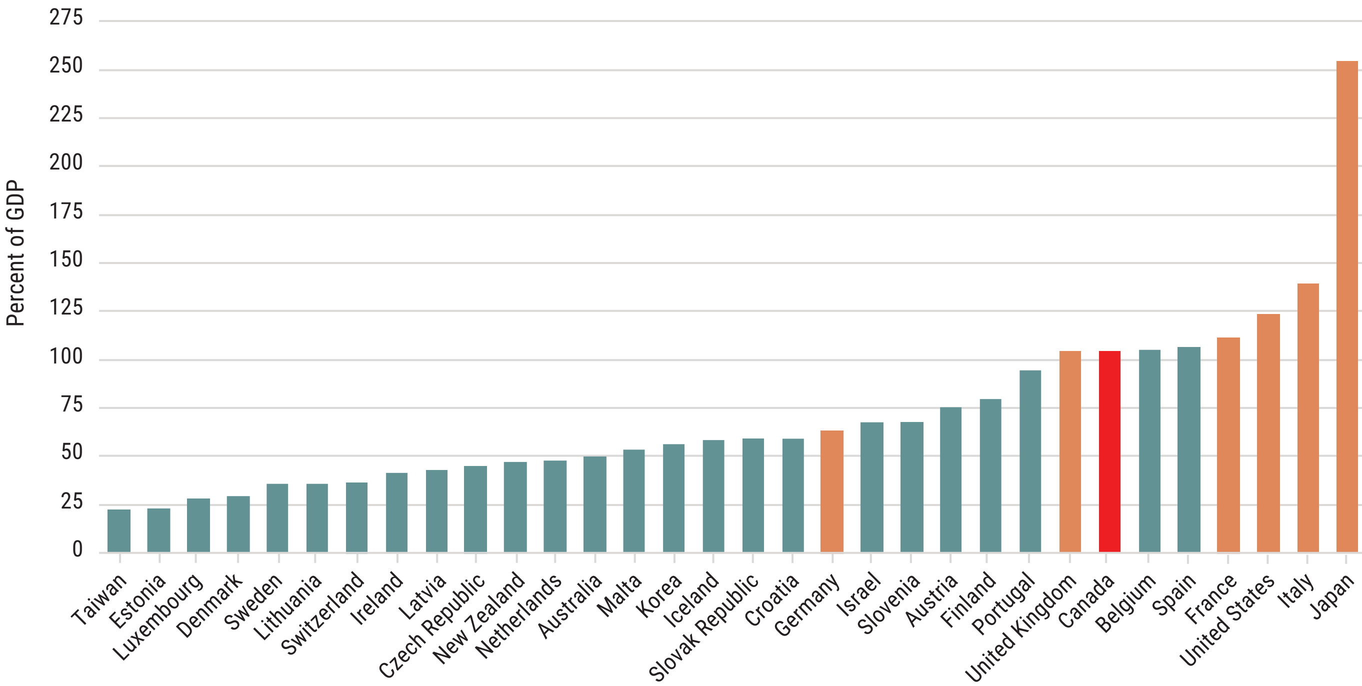
Figure 1: Net Debt as a Share of GDP (2024) for Select Advanced Countries



Note: IMF advanced economies excluding: Andorra, Cyprus, Greece, Hong Kong, Macao, Norway, Puerto Rico, San Marino, and Singapore
Source: International Monetary Fund (2024b).

2 The analysis includes 32 advanced countries for which comparable data are available from the IMF. Cyprus, Greece, Hong Kong, Puerto Rico, San Marino, and Singapore were excluded for a lack of data for both gross and net debt. Norway was also excluded since its net debt statistic, which is largely based on the treatment of its oil reserves and Sovereign Wealth Fund, results in a net debt position of -103.2% of GDP—a significant outlier within the IMF data.

Figure 2: Gross Debt as a Share of GDP (2024) for Select Advanced Countries



Note: IMF advanced economies excluding: Andorra, Cyprus, Greece, Hong Kong, Macao, Norway, Puerto Rico, San Marino, and Singapore
Source: International Monetary Fund (2024b).

to 26th when gross debt is used. Moreover, Canada switches from having the lowest net debt-to-GDP ratio in the G7 to the third lowest gross debt-to-GDP, outperformed by both the United Kingdom and Germany.

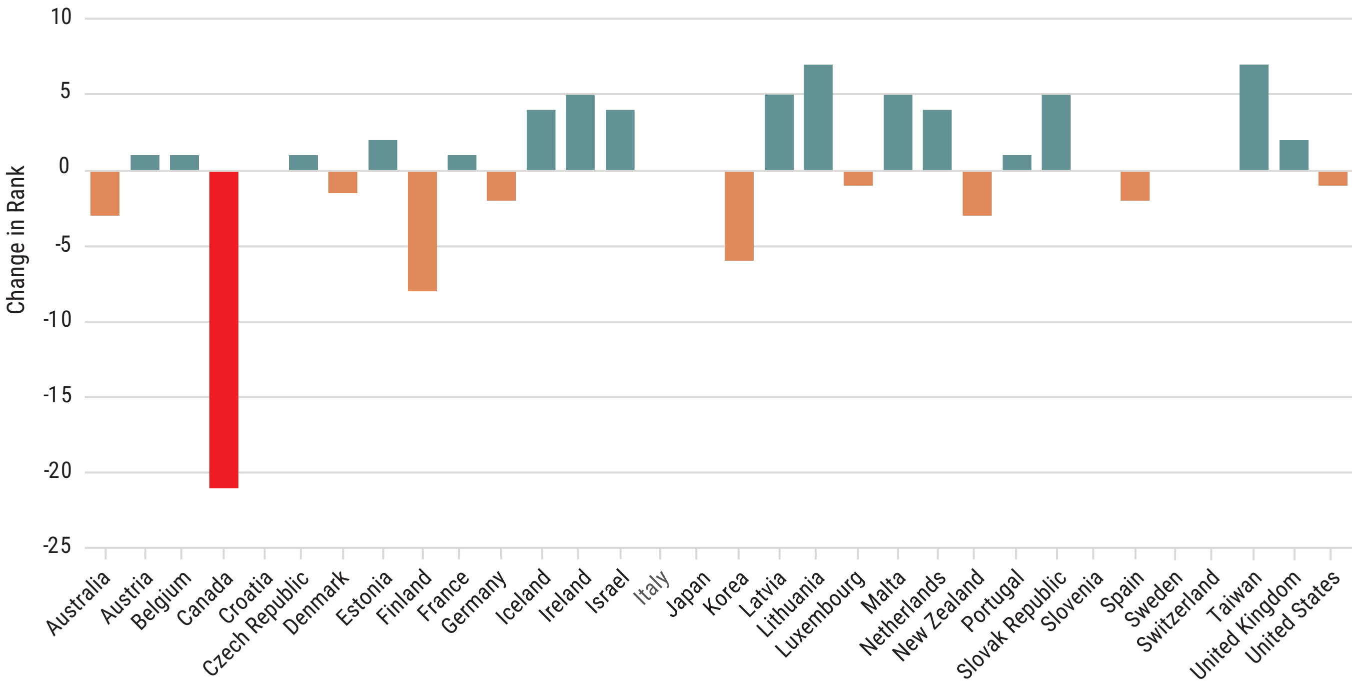
Figure 3 illustrates the change in the rankings for the 32 countries included in Figures 1 and 2. Specifically, it depicts the change in the rank moving from net debt to gross debt. Canada's rank falls 21 positions, by far the largest change of any country. The next largest change is Finland, which falls by 8 positions. The countries with the greatest improvements in ranking are Taiwan and Lithuania, who both improve by 7 places, roughly a third of the change experienced by Canada.

A key explanation for this marked difference between the two measures of indebtedness relates to the definition of net debt. Budget 2024 includes the following:

> Note: The general government definition includes the central, state, and local levels of government, as well as 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.

The last phrase in the note above is key—the financial assets used to adjust gross debt to calculate net debt include the Canada Pension Plan and the Quebec Pension Plan. The unique approaches to funding public retiree benefits are critical in understanding the differences between the two measures

Figure 3: Change in Rank from Net Debt to Gross Debt (2024)



Note: IMF advanced economies excluding: Andorra, Cyprus, Greece, Hong Kong, Macao, Norway, Puerto Rico, San Marino, and Singapore
Source: International Monetary Fund (2024b).

of debt, and more importantly why caution should be used in relying solely on net debt to assess Canada's comparative indebtedness.

Understanding accounting for public pensions and indebtedness

Under the leadership of then Prime Minister Jean Chretien and Finance Minister Paul Martin, the nine participating provinces and the federal government agreed to historic changes to the Canada Pension Plan (CPP) in 1996, which took effect in 1997 (OSFI, 1997a; 1997b). These effectively ensured the solvency of the CPP for the long term through the pressures of the retiring baby boomers.[3] Amongst several reforms, the increase in the contribution rate to the CPP was accelerated to 9.9 percent by 2003,[4] the exemption value was frozen,[5] a host of small changes were made to certain

3 For simplicity this essay focuses on the reforms to the Canada Pension Plan, but reforms were also introduced to the Quebec Pension Plan, a summary of which is available in National Assembly (1997).

4 The actuarial evaluation of the CPP prior to the reforms estimated that the contribution rate would have to increase to 10.1% by 2016, ultimately reaching 14.2% by 2030. The reforms meant that the rate increases were accelerated such that the contribution rate reached 9.9% by 2003 but was thereafter capped. For a succinct summary of the reforms, see Section II: The Canada Pension Plan: Provisions and Issues, in Kramer and Li (1997).

5 One of the largest sources of savings in the reforms was the freezing of the exemption at $3,500. The result is that inflation and wage growth have reduced the real value of the exemption over time and allowed for larger contributions from lower-income workers as well as increasing the value of income subject to the CPP contribution rate. See OSFI (1997a) for more information.

benefits,[6] and most importantly for this essay, the surplus funds of the CPP were transitioned to an active investment strategy. The Canada Pension Plan Investment Board (CPPIB)[7] was created to actively invest the surplus funds from the CPP in a broad portfolio of market instruments including bonds, equities, private placements, and other investments. The investment board has seen great success in their investment returns. As of December 31, 2023, the CPPIB's net assets were $570.3 billion (CPPIB, 2024).

The reason this reform is so important is because it is unique amongst almost all industrialized countries.[8] Before the reform, the CPP, like the public pension plans of most other industrialized countries, invested the surplus funds in provincial bonds. The 1996–97 reforms ended this practice and transitioned to an active investment strategy to increase the returns earned on the CPP assets.

This reform has major implications for Canada's measure of net debt. Consider the old rules, which exist for most industrialized countries. The old rules require excess funds from government-mandated retirement plans like the CPP in Canada or Social Security in the US to be invested in government debt. In the case of Canada, the funds were invested in provincial bonds while the United States invested in federal treasury securities.

The result of such an investment strategy has important implications for the measure of gross and net debt. Every dollar of debt issued by a government that is financed by its retirement plan (i.e., the CPP or the US Social Security) results in both an asset and liability, meaning no net change in its *net* indebtedness. For instance, let us assume that the CPP purchased $1 billion in Government of Canada bonds. The federal government has a liability of $1 billion and the CPP has an asset of $1 billion in bonds.

The *gross* debt for the federal government would have increased by $1 billion but its *net* debt position, which includes the assets of the retirement plan (CPP) would have an offsetting $1 billion in assets.

The reforms to the Canada Pension Plan in 1997 have a profound effect on the measurement of Canada's net debt relative to other countries. Specifically, the accumulated assets, and more importantly the net asset position of both the CPP and CPPIB post-1997 do not have a corresponding liability on the books of the federal or provincial governments. After adding the QPP's net worth to the CPP's, Statistics Canada records a combined worth of $716.7 billion as of December 31, 2023 (Statistics Canada, 2024). These net assets of the CPP and QPP, which are substantial, reduce the *net* debt of Canada.

6 A number of CPP-related benefits were adjusted, which provided substantial savings as part of the overall set of reforms. For instance, more stringent work requirements were introduced for disability benefits, changes to how benefits were calculated were introduced, and the value of the death benefit ($2,500) was reduced and frozen. See OSFI (1997a).

7 For a review of the creation and history of the Canada Pension Plan Investment Board (CPPIB), see https://www.cppinvestments.com/.

8 It's also worth noting that many of the other countries included in this analysis are unitary states, meaning that they do not have sub-national governments such as provinces in Canada or states in the United States. Moreover, Canadian provinces do not have legal limits imposed on the level of debt they can incur as almost all US states do in the form of constitutional balanced budget requirements.

This is particularly important in reference to the statistics presented by the federal government in its recent budget given that the difference between gross debt and net debt, according to the IMF, was approximately $2.7 trillion at the end of 2023 (International Monetary Fund, 2024b). In other words, more than one-quarter of the difference in Canada's gross and net debt could be explained by the value of net assets held in the CPP and QPP.

In contrast, consider Social Security in the US. The financial statements for the Social Security Administration (SSA) for 2023 (fiscal year ending September 30th) shows investment assets of just over $2.8 trillion, all of which were invested in federal government debt (SSA, 2024). As explained previously, this means the $2.8 trillion in debt is included in the US gross debt statistic but has no effect on its net debt since there is both an asset from the SSA and a liability held by the federal government. Recall that the assets from the CPP (and QPP) reduce Canada's net debt because there is no corresponding liability held by the government to the degree the assets are invested in non-government financial instruments.

To be clear, the earnings of the CPPIB (and the equivalent in Quebec) are not available to the federal or provincial governments and are specifically retained within the CPP. The assets of the CPP are similarly not available to the federal or provincial governments for use outside of funding the retirement and related benefits provided by the CPP. Indeed, as noted in the reform-era actuarial evaluation, the introduction of the CPP's active investment strategy was one of the single largest sources of savings from the reforms (OSFI, 1997a). Allowing the federal and/or provincial governments to have access to either the earnings of the CPP or its assets would necessitate an increase in the required contribution rate for the CPP to be sustainable.

The specific instructions governing how much can be pulled from the CPP and QPP contradict how the financial assets from the net debt calculation are meant to be represented. The financial assets from net debt are supposed to show the government's ability to pay back its debts, but the CPP's and QPP's assets cannot contribute to these payments. The IMF understands the outsized effect that sovereign wealth funds or social security funds, such as the CPP and QPP, can have on net debt. Their database allows for a function that excludes social security funds from the balance sheet—making net debt more accurate in terms of what it aims to study. The academic literature also affirms this distinction. Reinhart et al. (2012) state:

> The fact that net public debt today tends to be significantly lower than gross public debt would do little to reverse our conclusions since by and large the trust funds are woefully underfunded, and implicit tax liabilities in most pension systems are hugely positive. In other words, these trust funds are hardly a source of future revenues to offset gross government deficits.

The inclusion of the assets of the CPP (and QPP) in the country's net debt statistics overestimates the value of available financial assets to Canadian governments and in doing so provides an underestimate of the indebtedness of Canada, particularly when compared to other industrialized countries.

Conclusion

Comparing countries' finances is always difficult. Debt statistics in particular have a broad range of metrics that describe a country's indebtedness.

The federal government has consistently rationalized continued debt-financed spending through claims of international advantage from Canada's net debt-to-GDP ratio. However, the government fails to recognize the role that the net assets of the CPP and QPP play in reducing Canada's overall net debt position. They similarly fail to account for Canada's debt position using any other metrics, especially gross debt, where Canada's international advantage is muted. In an era of higher interest rates, the recent downgrade of BC's credit rating (Seal, 2024), and RBC encouraging the federal government not to take Canada's credit ratings for granted (Battaglia, 2024), Canada should be wary of both gross and net debt before continuing down a fiscally negligent path.

References

Battaglia, Rachel (2024). *Governments face higher interest costs when straying from fiscal anchors*. RBC. <https://thoughtleadership.rbc.com/governments-face-higher-interest-costs-when-straying-from-fiscal-anchors/>, as of May 16, 2024.

Canada, Department of Finance (2024a). *Remarks by Deputy Prime Minister and Minister of Finance*. Government of Canada. <https://www.canada.ca/en/department-finance/news/2024/04/budget-2024-remarks-by-the-deputy-prime-minister-and-minister-of-finance.html>, as of May 16, 2024.

Canada, Department of Finance (2024b), *Federal Budget 2024*. Government of Canada. <https://www.budget.canada.ca/2024/report-rapport/budget-2024.pdf>, as of May 16, 2024.

CPPIB (2024). 2023 Annual Report, CPPIB. <https://www.cppinvestments.com/the-fund/f2023-annual-report/>, as of May 21, 2024.

International Monetary Fund (2024a). *Fiscal Monitor, April 2016*. Glossary.

International Monetary Fund (2024b). *World Economic Outlook Database* (April). <https://www.imf.org/en/Publications/WEO/weo-database/2024/April>, as of May 21, 2024.

Kramer, Charles and Yutong Li (1997). *Reform of the Canada Pension Plan: Analytical Considerations,* International Monetary Fund. <https:// www.imf.org/external/pubs/ft/wp/wp97141>, as of May 21, 2024.

National Assembly (1997). *Bill 149 (1997, chapter 73): An Act to Reform the Quebec Pension Plan and to Amend Various Legislative Provisions.* Quebec Official Publisher. <http://www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge. php?type=5&file=1997C73A.PDF>, as of May 16, 2024.

Office of the Superintendent of Financial Institutions [OSFI] (1997a). *CPP Sixteenth Statutory Actuarial Report*, OSFI. <https://www. osfi-bsif.gc.ca/Eng/Docs/cpp16.pdf>, as of May 16, 2024.

Office of the Superintendent of Financial Institutions [OSFI] (1997b). *Canada Pension Plan, Seventeenth Actuarial Report as at December 31, 1997,* OSFI. <http://www.osfi-bsif. gc.ca/eng/docs/cpp17.pdf>, as of May 16, 2024.

Reinhart, Carmen, Vincent Reinhart, and Kenneth Rogoff. *Public Debt Overhangs: Advanced-Economy Episodes Since 1800.* The Journal of Economic Perspectives, vol. 26, pp. 69–86. <http://www.jstor.org/stable/41581132>, as of May 16, 2024.

Seal, Thomas (2024). *B.C. Gets third credit downgrade in 3 years*. Financial Post. <https://financialpost.com/news/economy/bc-third-credit-downgrade-3-years>, as of May 16, 2024.

Social Security Administration [SSA] (2024). *Social Security Administration's Agency Financial Report for Fiscal Year 2023,* United States, SSA. <https://www.ssa.gov/finance/2023/Full%20FY%202023%20AFR.pdf>, as of May 16, 2024.

Statistics Canada (2024). National Balance Sheet Accounts (Table 10-10-0015-01). Government of Canada. <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=1010001501>, as of July 4, 2024.

Jake Fuss

Jake Fuss is Director of Fiscal Studies for the Fraser Institute. He holds a Bachelor of Commerce and a Master's Degree in Public Policy from the University of Calgary. Mr. Fuss has written commentaries appearing in major Canadian newspapers including the *Globe and Mail, Toronto Sun,* and *National Post.* His research covers a wide range of policy issues including government spending, debt, taxation, labour policy, and charitable giving.

Milagros Palacios

Milagros Palacios is the director for the Addington Centre for Measurement at the Fraser Institute. She holds a B.S. in Industrial Engineering from the Pontifical Catholic University of Peru and a M.Sc. in Economics from the University of Concepcion, Chile. Ms. Palacios has studied public policy involving taxation, government finances, investment, productivity, labour markets, and charitable giving for over 15 years. Since joining the Fraser Institute, Ms. Palacios has authored or co-authored over 150 comprehensive research studies, 100 commentaries, and four books. Her recent commentaries have appeared in major Canadian newspapers such as the *National Post*, *Toronto Sun*, *Windsor Star*, and *Vancouver Sun*.

Callum McLeod

Callum McLeod is a research intern in the Fiscal Studies Department. He is finishing a Combined Honours BA in Economics and Political Science at McMaster University.

Acknowledgments

The authors would like to express appreciation to the anonymous reviewers of this bulletin. Any remaining errors or omissions are the sole responsibility of the authors. As the researchers have worked independently, the views and conclusions expressed in this paper do not necessarily reflect those of the Board of Directors of the Fraser Institute, the staff, or supporters.

ISSN 2291-8620

Media queries: For media enquiries, please contact our communications department via e-mail: communications@fraserinstitute.org; Telephone: 604.714.4582.

Support the Institute: call 1.800.665.3558, ext. 574 or e-mail: development@fraserinstitute.org. Visit our **website:** www.fraserinstitute.org