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Ottawa and the provinces are enjoying a revenue windfall. But it's almost over

Before the pandemic, the annual release of Ottawa's public accounts was a humdrum affair.

Each fall, the federal government closes its books on the previous fiscal year, which ends in March. The public accounts land in three volumes, at more than 1,200 pages. Its rear-view mirror perspective, at a time when everyone is looking ahead, usually meant the tomes attracted little attention.

The pandemic's fiscal upheaval changed all that. The virus forced Ottawa to deploy a firehose of umpteen billions of dollars in emergency spending. That unprecedented outlay to support idle workers and shuttered businesses was largely a success: the downturn was severe but relatively brief; the recovery more supercharged than expected. The economy surged back at an unprecedented pace, which is what's behind current inflation. But it also sent unemployment to record lows, and government revenues to new highs.

Together, these factors are delivering a windfall to the provincial and federal treasuries, in the form of personal and corporate earnings yielding higher tax revenues. Forecasts of massive deficits turned into much smaller shortfalls or, in several provinces, surprise surpluses. For more than a year, the fiscal headline has been: not yet perfect, but so much better than expected.

Ottawa's 2021-22 public accounts arrived last Thursday. Compared with the 2021-22 budget's expectations, revenue came in 16 per cent higher, and the deficit was almost halved. Compared with 2020-21, the first year of the pandemic, the deficit was more than 70 per cent lower.

How did this happen? An economic rebound that delivered lots of extra revenue. Ottawa is not yet in perfect fiscal condition, but it's in much less bad shape than anyone expected even a few months ago. The evolving picture of the current fiscal year, 2022-23, will be revealed on Thursday, in the fall economic update.

When the 2021-22 federal budget was tabled, a year and a half ago, the Liberals predicted revenue of $355-billion, program spending of $476-billion, debt charges of $22-billion, and a deficit (excluding actuarial losses) of $143-billion.

The final accounting released last week had revenue $58-billion higher, program spending slightly lower, debt charges a bit higher, and a deficit (again not including actuarial losses) of $80-billion.

As a result, instead of federal debt at 51.2 per cent of GDP, it instead ended the fiscal year at 45.5 per cent of GDP. That's higher than before the pandemic, when net debt was barely above 30 per cent of GDP. But running up debt was what Ottawa was supposed to do during a recession, and over the past year the weight of that debt has been falling much faster than expected.

Ahead of the fall economic update on Thursday, the picture of Ottawa's 2022-23 fiscal situation also looks better than expected. The difference so far is the Liberals have leaned to extra spending. In last April's 2022-23 budget, revenue was forecast at $408-billion, program spending at $425-billion, debt charges at $27-billion, and the deficit (excluding actuarial losses) at $44-billion. Compared with earlier estimates, there was $30-billion of extra revenue – of which the Liberals planned to spend $22-billion.

Over the two fiscal years combined – albeit in the middle of the current one – the Liberals have seen $88-billion in surprise revenue. Of that, $70-billion went to the deficit, $15-billion to spending, and $3-billion to debt charges.

What Finance Minister Chrystia Freeland announces in terms of new spending commitments in Thursday's economic update will be key – because while revenues rose rapidly last year, and will again this year, that trend won't last much longer. Higher revenues were powered by fast economic growth – too fast, in fact, which is why the Bank of Canada is trying to slow the economy.

The Parliamentary Budget Officer and private-sector economists expect that the 2022-23 deficit will be even smaller than forecast in April – down to a comfortable 1 per cent of GDP, where it resided during the Trudeau government's first term. But a slowdown, maybe even a recession, looms. In the Bank of Canada's monetary policy report last week, 2023 GDP growth is forecast at just 0.9 per cent. Tax revenue growth will moderate accordingly.

Ottawa and the provinces got a record tax windfall, thanks to a record economic rebound. It's already fading in the rear-view mirror.