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# **RIP SSE: What the COVID-19 Pandemic Means for Defence Funding**

by Eugene Lang  
May 2020

# POLICY PERSPECTIVE

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“... as the world economy slumps and debt piles up, guns may lose out to butter”

*The Economist*, April 26, 2020

**T**he pattern is straightforward and has been so for a generation. The economy goes into a recession. The federal deficit balloons due to a corresponding drop in revenue and a short-run increase in government spending to deal with the slump. The economic recovery takes hold. Ottawa begins to bring its finances back into order through cuts to departmental spending. The defence department takes a big hit through this process.

This is the likely fate awaiting *Strong, Secure, Engaged* – the Trudeau government’s defence white paper – and its associated funding.

### **Recessions, Deficits and Defence Funding**

Over the past 30 years, Canada has faced two major recessions and in both cases two different governments followed the basic pattern described.

In 1990, the Canadian economy fell into a slump that lasted about four quarters, with gross domestic product (GDP) shrinking by 2.8 per cent. Going into the downturn, the federal government was running a big deficit, which grew through the recession and peaked at \$39.7 billion – about six per cent of GDP – by 1994-95 when the Liberals under Jean Chrétien were in power. This amounted to a fiscal crisis, with a debt-to-GDP ratio of nearly 70 per cent, interest on the federal debt eating up over 30 cents of every tax dollar, and the *Wall Street Journal* labelling Canada an honorary member of the Third World.

Something had to give. Enter Program Review, the most draconian departmental spending reduction initiative in the history of the Canadian government, the results of which were announced in Budget 1995. The Department of National Defence’s (DND) funding was cut by roughly a third through this process – from \$12 billion in 1993-94 to \$9.4 billion by 1998-99 – with DND capital spending reduced by \$15 billion over 15 years. Years later, Gen. Rick Hillier coined the phrase “decade of darkness” to describe the effect of Program Review and the 1995 budget on the Canadian Forces.

Many at the time claimed this defence austerity was the product of a Liberal government that didn’t care anything about national defence, and that the Conservatives would have acted differently. A decade and a half later, that theory was put to the test.

The second major recession in the past generation to hit Canada was the result of the global economic and financial crisis in 2008, when Stephen Harper’s Conservatives were in office. That slump lasted for just over two quarters, with real GDP dropping by 3.3 per cent. Economic growth returned strongly by the fourth quarter of 2009. Going into the recession, the government was



running a fiscal surplus – owing in part to the structural austerity measures put in place in Budget 1995. As a result of the economic downturn and the associated stimulus spending, however, the fiscal position moved into deficit, peaking at \$55.6 billion, or 3.6 per cent of GDP in 2009-10.

Ottawa was not in a fiscal crisis that time around. The government's debt-to-GDP ratio remained half of what it was in the mid-1990s. And debt-servicing costs were manageable owing to very low interest rates. Nevertheless, the Conservative government attached priority to bringing the deficit down quickly once economic recovery began.

Enter the Deficit Reduction Action Plan (DRAP) and Strategic Reviews, the Harper government's post-recession expenditure restraint initiatives. Budget 2010 announced some of the results of DRAP, which included a reduction in the growth of DND's budget by \$525 million in 2012-13 and \$1 billion annually beginning in 2013-14. (The Conservatives had committed in the 2006 general election to honour the Martin government's five-year, \$12.8 billion planned increase to DND's budget and to add another \$1 billion per annum on top of that, phased in over several years). In addition, through the strategic review process, DND was forced to identify another \$1 billion in departmental savings from 2012-13 and 2013-14.

The lesson from this history is simple. Cutting defence spending in times of austerity is a bipartisan affair in Canada. This is owing less to politics than arithmetic. DND's budget – which typically ranges from 1/5 to 1/4 of total federal departmental discretionary spending – is too big to be excluded from any serious spending restraint initiative. This is well understood by Liberals, Conservatives and the Finance Department.

## The COVID-19 Recession and its Impact

No one knows how deep or how long the COVID-19-induced recession will be. But every serious analyst agrees it will produce the sharpest drop in output since the Great Depression. The International Monetary Fund, for example, projects a 6.2 per cent annualized decline in GDP for Canada,<sup>1</sup> nearly double that of the 2009 recession. And already the government's fiscal response is without precedent and will lead to the largest deficit in postwar Canadian history (at least 10 per cent of GDP, or over \$200 billion).

This does not mean that Ottawa will snap into austerity mode next year. The economy will likely be too weak for that kind of action and cutting government spending is not in the Trudeau government's DNA to begin with. But if history is a guide, by year two or three of the recovery, an effort will be made to bring that deficit down, to try to get back on track toward the government's "fiscal anchor" of a declining debt-to-GDP ratio. This is not likely to be achievable by simply winding down short-run stimulus programs. Government revenues will also have taken a big hit,

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<sup>1</sup> International Monetary Fund, *World Economic Outlook, April 2020: The Great Lockdown*, <https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020>



and they take time to return after a recession. Some of the stimulus measures will also be medium-term in duration.

One big difference between now and the past is that there will be enormous pressure on Ottawa after the recession to boost spending in a wide range of areas which have been exposed in the pandemic. These include public health funding, medical research, pandemic prevention and mitigation, the social safety net, and industries particularly hard hit during the recession. There are also Liberal election campaign commitments from 2019 to honour – almost none of which had been implemented pre-pandemic – of which national defence is conspicuously absent.

Taken together this could produce a perfect storm for *Strong, Secure, Engaged* (SSE). This was always a big risk associated with a defence policy that had its funding ramped up gradually over many years.<sup>2</sup> As the Harper government amply demonstrated, it is relatively easy to reduce or eliminate the rate of planned increases to defence funding – the government took almost no flak for doing so in 2010. Making matters worse, DND has failed to come anywhere near meeting the spending trajectory profiled in SSE, as David Perry has analyzed thoroughly.<sup>3</sup> Which means flattening DND's budget ramp is even more tempting for any government in austerity or even re-prioritization mode.

Would a change in government matter here? Unlikely. While the Conservatives are more committed to national defence and the Canadian Armed Forces than the Liberals, they would likely see deficit reduction as their top priority, and it is virtually impossible to have meaningful expenditure restraint that doesn't involve national defence.

## Conclusion

Over the past generation, recessions and the fiscal consolidation that has followed them have had a seriously negative impact on DND's budget. The COVID-19 recession could be the most severe Canada has faced in at least 40 years. It has already resulted in the largest peacetime deficit in Canadian history. And, because of the pandemic, government priorities have changed radically overnight.

The future for SSE and its associated funding does not look bright. National Defence probably has a year or two before the crunch hits. Now is therefore the time for strategic thinking and serious priority setting among the political, public service and military leadership to ensure that the 2020s don't become another decade of darkness.

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<sup>2</sup> Eugene Lang, "The Shelf Life of Defence White Papers," *Policy Options*, June 23, 2017.

<sup>3</sup> David Perry, "Strong, Secure, Engaged: A Two-Year Review," *Policy Perspective*, Canadian Global Affairs Institute, May 2019.

## ► **About the Author**

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