

ECONOMIC  
NOTES

TAXATION SERIES

# Paths to Balancing the Federal Budget by 2035

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Canada’s federal government has experienced significant fiscal challenges in recent years. The COVID-19 pandemic saw revenues decline and expenditures rise dramatically. Prior to that, the 2009 financial crisis had brought similar shifts, albeit on a smaller scale. But even outside of these extraordinary events, expenditures have consistently exceeded revenues, with the federal government running a budget deficit in each of the past 18 years.<sup>1</sup>

One might naturally wonder what potential paths lie ahead for returning to balance. The present study describes the current state of the federal budget and explores possible paths to balance by 2035. If the budget is balanced at that point, then the string of deficits that began in 2008 would be tied for the longest stretch of deficits ever recorded since 1867.<sup>2</sup>

The scale of the challenge is beyond what many Canadians may appreciate. Returning to balance over this relatively prudent time horizon, while fulfilling Canada’s new international commitments to increase military spending, requires large and fundamentally new approaches to major areas of federal finances that have been mostly absent from public debate. Considering available options sooner rather than later is



important, as the longer that fiscal adjustments are delayed, the larger and more difficult they will need to be to ensure the long-run sustainability of federal finances.

**THE LOOMING RISK OF A 1990s RERUN**

While the long-running nature of Canada’s fiscal deficits is itself a source of concern, federal finances are currently in a stronger position than they were in the early 1990s. At that time, debt-servicing costs consumed roughly one-third of federal revenues, and overall public net debt—net of the federal government’s financial assets—was both high and rising, at roughly two-thirds of GDP.<sup>3</sup> Without adjustments, however, we will soon reach that point again.

**The longer that fiscal adjustments are delayed, the larger and more difficult they will need to be to ensure the long-run sustainability of federal finances.**

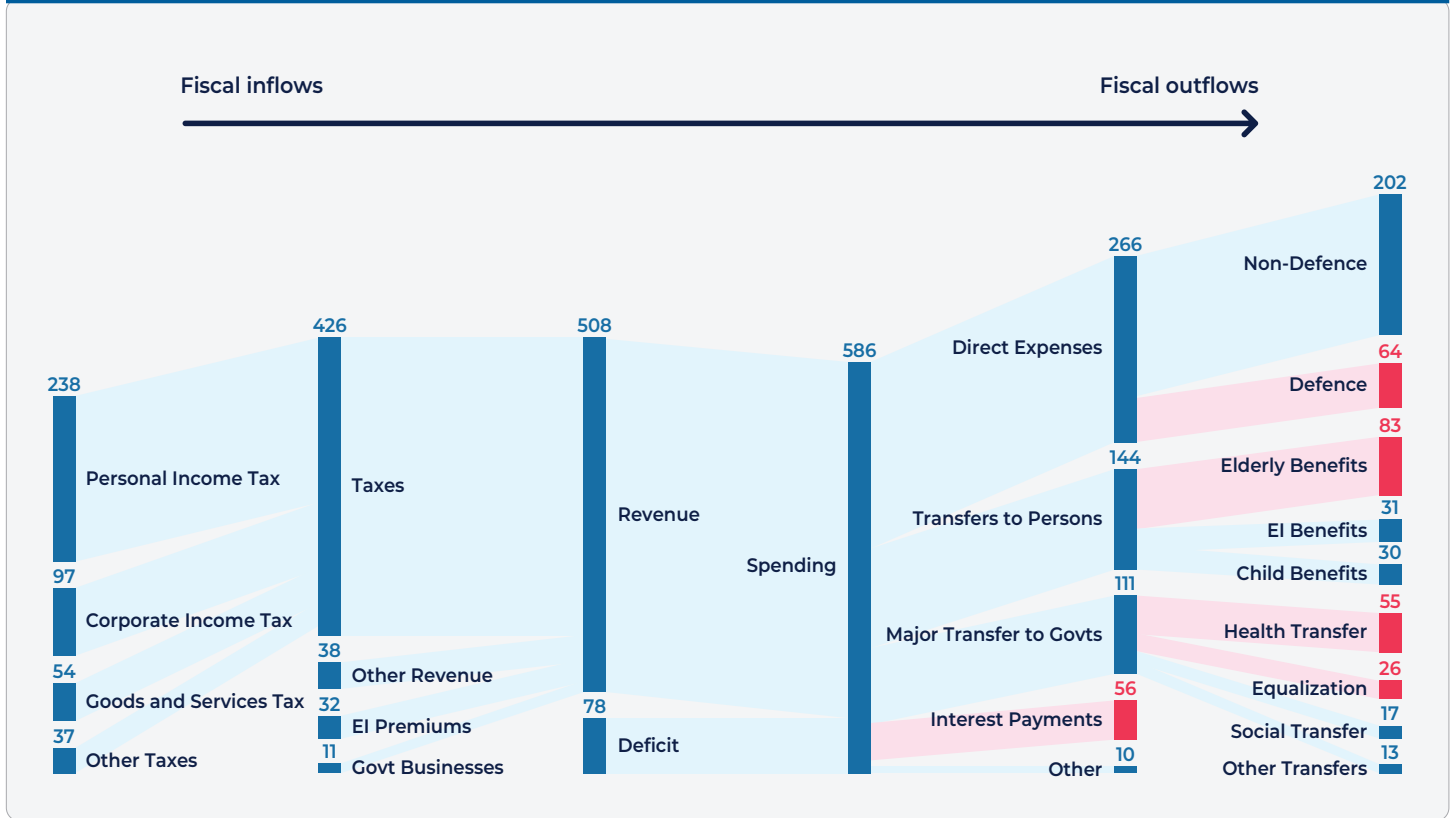
In its projections of net debt-to-GDP out to 2055, the government anticipates a relatively flat trajectory for the coming decade or so, followed by a modest decline.<sup>4</sup> But critically, that projection does not include the planned increase in military spending. That omission is significant and dramatically changes the future debt trajectory. By the middle of the next decade, if current fiscal policy holds and military spending increases as per our new NATO target, overall federal net debt relative to GDP is projected to exceed 50%.<sup>5</sup> Beyond that point, again assuming no change in federal fiscal policy, federal net debt-to-GDP is expected to continue rising for decades.

That trajectory is not sustainable. It is therefore important to start considering what might be required to avert such a situation.

**THE CURRENT STATE OF FEDERAL FINANCES**

The broad categories of federal revenues and expenditures can be represented in a relatively simple way. Figure 1 provides such an illustration for the fiscal year ending April 1, 2026. Federal revenues for that year were projected to total \$508 billion, with most of that coming from

**FIGURE 1**  
**Federal budget flows, 2025–2026 (billions of \$)**



**Note:** Author's calculations, assuming defence-related spending is 2% of GDP. Expenditure categories that are projected to grow faster than revenue are shaded in red.  
**Source:** Government of Canada, *Budget 2025 – Canada Strong*, November 2025, p. 69.

various sources of taxation revenue, principally personal and corporate income taxes, as well as taxes on products such as the GST, customs duties, other excise taxes, and the like. Other minor taxes and profits from government business enterprises make up the remainder.

On the spending side, the government anticipated spending approximately \$586 billion, \$78 billion more than projected revenues, which is represented as the deficit for the year. This spending can be grouped into four main categories.

First are the direct expenses of government, which can be separated into defence and non-defence-related expenditures, assuming the government's stated 2% of GDP projection for defence spending this year holds. Second are transfers to persons, most of which are in the form of elderly benefits such as Old Age Security and the Guaranteed Income Supplement. Third

are major transfers to provincial and territorial governments, largely through programs such as the Canada Health Transfer and the Canada Social Transfer, which are allocated on an equal per capita basis, and Equalization, which provides support to provinces with below-average measured fiscal capacity. Finally, interest payments are the cost of servicing accumulated debt from the government's past borrowing.

**By the middle of the next decade, if current fiscal policy holds, overall federal net debt relative to GDP is projected to exceed 50%.**

FIGURE 2

Illustrating various options to achieve federal fiscal balance by 2035



Source: Author's calculations.

Expenditure categories that will grow faster than revenues are shaded in red. These represent the principal sources of expenditure pressure on the federal government, which are the categories of primary interest. To hit the defence spending target of 3.5% of GDP by 2035, this spending must increase from just over \$60 billion now to just over \$160 billion by then, implying a cumulative growth rate of nearly 10% per year.

Elderly benefits are also a considerable source of expenditure pressure as the population ages and more individuals become eligible for benefits, which have also been made increasingly generous in recent years. Finally, health transfers and equalization are projected to grow faster than revenues, as are interest payments. Together, these pressures will cause overall federal spending to grow faster than revenues in the years ahead unless policy adjustments are made.

**RETURN TO BALANCE SCENARIOS**

To achieve balance by 2035, the growth rate of federal spending must slow relative to revenue. Federal revenue tends to grow with the overall pace of economic growth. Canada's economy is

projected to grow beyond 2029 at an average nominal (including inflation) rate of approximately 3.8% per year, roughly in line with the growth in total federal revenue between 2028 and 2029 projected in the latest budget. Going forward, it is therefore presumed that federal revenue will increase at a rate of 3.8% per year.<sup>6</sup>

**The baseline federal deficit in 2035 will grow to \$117 billion, up from the government's projected deficit of \$57 billion in 2029.**

On the spending side, elderly benefits are projected to grow at a rate of 4.9% per year, again consistent with the latest budget. Major transfers to provinces are projected to grow at a rate of 3.6% per year, while non-defence-related direct expenses are projected to shrink by 1.2% per year by 2029 although this returns to a baseline path that maintains the inflation-adjusted, per-person level of such spending afterwards. The restraint the government hopes to achieve by 2029 would

amount to a reduction of roughly 13% in non-defence-related direct expenses relative to 2025, due to its efforts to review and trim operating spending across government.

If the growth rates of all these items continue along these lines, the baseline federal deficit in 2035 will grow to \$117 billion, up from the government's projected deficit of \$57 billion in 2029. The entire increase is accounted for by higher defence spending. To return to balance, the following measures should be considered. (Their effect on the projected federal deficit by 2035 is illustrated in Figure 2.)

- **Maintain the pace of non-defence direct expenditure reductions until 2035.** Extending the government's current spending restraint beyond 2029 would reduce the projected 2035 deficit by nearly \$51 billion. This is equivalent to a reduction of roughly one-fifth in the real per capita level of such spending by 2035 compared to 2025.
- **Slow the growth of elderly benefits.** Elderly benefits are projected to rise from approximately 2.6% of GDP in 2025 to roughly 3% by 2035. Reducing their growth rate to about 2.5% per year beyond 2029 would keep them at 2.6% of GDP by 2035 and lower the projected deficit by just over \$19 billion. This could take many forms, such as increasing the age of eligibility for Old Age Security or tightening income thresholds. For context, the increase in the age of eligibility to 67 by the Harper government in 2014 (reversed shortly afterwards by the Trudeau government) was roughly equivalent to one-third of 1% of GDP. A reform of only slightly greater magnitude (say, an increase in the eligibility age to 68) would be required in this scenario.
- **Moderate growth in provincial transfers.** Provincial transfers are projected to grow at

3.6% per year, matching the government's anticipated growth between 2028 and 2029. Reducing this to approximately 3% per year thereafter, in line with the current Canada Social Transfer, would reduce the deficit by nearly \$6 billion. This would primarily affect the Canada Health Transfer and Equalization.

- **Accelerate reductions in non-defence direct expenses.** Increasing the pace at which non-defence direct expenses decline to 3.6% per year, triple the previously assumed rate, would reduce the 2035 deficit by approximately \$24 billion. This would represent a nominal reduction of roughly 30% by 2035 relative to 2025 levels, and nearly 50% in inflation-adjusted, per-person terms. This would be a significant contraction in federal government spending.

Even combined, these measures would be insufficient to achieve balance by 2035. The remaining gap could be closed if Canada's economic growth rate were boosted by half a percentage point per year. Measures to achieve faster growth might include adopting revenue-neutral tax reforms to improve investment incentives, reducing regulatory burdens on businesses, and increasing labour force participation rates among older Canadians, for instance.

**Without faster economic growth, the required spending reductions elsewhere would need to be larger.**

Without faster economic growth, the required spending reductions elsewhere would need to be larger. Reducing the average growth rate of transfers to provincial and territorial governments

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to 1% per year after 2029, for example, would effectively lower such transfers from their current level of 3.5% of GDP to 2.9% by 2035. That would be sufficient to achieve balance when combined with the other spending measures identified above, even without an increase in the rate of economic growth.

## CONCLUSION

There are no easy options for balancing the federal budget by 2035. Tax increases alone are certainly not a credible option. To balance by 2035 with no changes in federal spending, and assuming currently planned spending restraint ended

in 2029, the GST would need to gradually rise to 12.5% from its current rate of 5%. That is far beyond a reasonable policy option.

Some combination of faster economic growth, revenue changes, substantial reforms to major transfers to persons, and reductions in non-defence direct expenditures will therefore need to be considered in order to correct the current, unsustainable trajectory of the federal debt. The sooner these difficult conversations begin, and the sooner the public understands the challenge and buys into potential options, the lower the cost of those adjustments will be.

## REFERENCES

1. Government of Canada, Department of Finance Canada, Publications and Reports, Fiscal Reference Tables, November 2025, Table 1.
2. For pre-1966 data on federal revenue and expenditures, see Statistics Canada, Historical Statistics of Canada tables H1-34, July 2, 2014.
3. Government of Canada, *Public Account 1995 – Volume 1*, pp. 2.3-2.4.
4. Government of Canada, *Budget 2025 – Canada Strong*, November 2025, p. 69.
5. All results in the present study are from a budget projection model that takes *Budget 2025's* projection through to 2029 as given. Later years are forecast using assumed growth rates described in the text.
6. One exception is Employment Insurance premiums, which are currently somewhat higher than EI benefits as the EI fund deficit is repaid. This is projected to be completed by 2031, at which point EI premiums are assumed to equal EI benefits in this scenario.

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