Unfunded liabilities dwarf public debt and are growing

How would you feel if the Canadian government sent you a letter suggesting you owe an extra $150,000?

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How would you feel if the Canadian government sent you a letter suggesting you owe an extra $150,000?

No doubt few, if any, Canadians would welcome that news. But that's the situation facing Canadian taxpayers as each of us is on the hook for another $150,211 in liabilities that our governments have racked up in debt and unfunded program obligations.

Unless immediate action is taken to reduce Canada's liabilities, young Canadians will be hit with a significantly larger tax bill in the future.

The good news is that Canadians have largely come to realize the seriousness of continually increasing government debt.

Indeed most governments are making an effort to balance their books and some are paying down debt. At the federal level, many consider running a deficit (increasing the debt) a sure way to commit political suicide.

Across all Canadian governments -- the sum of federal, provincial and local -- net direct debt declined from $800 billion to $791 billion between 2000-01 and 2004-05. While $791 billion ($48,922 per taxpayer) is not exactly insignificant, it is not the greatest liability concern for Canadians.

In addition to the national debt, Canadian governments have committed themselves to providing programs that are not fully funded. That is, we've collectively promised to provide a host of programs which current tax rates leave unfunded.

Consider the Old Age Security (OAS) program, the "cornerstone" of Canada's retirement income system. Old Age Security pensions are available to all Canadian citizens and legal residents 65 years and older, providing they have lived in Canada for a minimum of 10 years of their adult lives.

The problem with Old Age Security benefits is they are paid for out of current federal tax revenue.

At their inception, programs like OAS were based on the assumption that the demographics prevailing in the 1960s would persist. It was considered favourable social and economic policy to transfer a small amount of money from a large group of younger workers to benefit a small group of relatively poor retirees.

Unfortunately, demographic assumptions have proven false.

In 1956, only 7.7 per cent of Canadians were over 65 years old. That proportion increased to 13.3 per cent in 2006 and is expected to rise to 26.5 per cent by 2040.

This change in Canada's demographic makeup has and will continue to increase the portion of federal revenues needed to fund OAS benefits. We estimate that the difference between the stream of promised benefits and the expected future stream of revenues -- the unfunded liability of the OAS program -- currently stands at $356 billion.

Canada's Medicare obligations suffer the same ills.

In 2006-07, Medicare consumed 19.1 per cent of total federal, provincial and local government revenue. Given that those over 65 years old account for approximately 44 per cent of all health spending, and the fact that the percentage of the population over 65 years old will increase dramatically, the portion of revenue currently used to fund Medicare will not be sufficient to deliver future medical expenses. As such, Medicare's unfunded liability stands at $364 billion.

Adding the unfunded liabilities of the Old Age Security program and Medicare to that of the Canada Pension Plan ($538 billion) puts total Canadian unfunded liabilities at $1.3 trillion.

Further, these unfunded liabilities have increased by more than 20 per cent over the most recent five years for which data are available (2000-2004).

Unfunded liabilities, coupled with the national debt, put Canadians on the hook for liabilities totalling $2.4 trillion or approximately $150,000 per taxpayer.

Our hope is that the massive fiscal hole created by the unfunded liabilities of government programs begins to receive the same attention as Canada's debt.

Awareness of the debt on the part of the public helped push federal and provincial governments to stop using deficit financing and to begin decreasing Canada's debt burden. Given the magnitude of the unfunded liabilities, Canadians have little choice. Without fundamental reform of government programs such as Medicare and OAS, young Canadians will be digging much deeper into their pockets to pay their future tax bill.

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