

Can Canada Increase Defence Spending Without Fiscal Fallout?



Canadian Prime Minister Mark Carney, middle, takes part in a meeting of the North Atlantic Council during the NATO Summit in The Hague, Netherlands on June 25, 2025. Sean Kilpatrick/The Canadian Press

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News Analysis

Politicians of different stripes agree that Canada's military has been neglected over the years, but recent pledges from Ottawa to massively increase defence spending are raising questions in some circles about the fiscal feasibility.

The federal government is running sizeable structural deficits that were already expected to increase substantially before the new defence pledges were made.

Those pledges have included Prime Minister Mark Carney announcing earlier this month that Canada would be meeting NATO's 2 percent of GDP spending on defence this year instead of 2030. That represents an additional \$9 billion in defence spending.

This would bring total spending eligible under the NATO definition—which includes spending made by other departments related to defence—to over \$62 billion, [according](#) to the Parliamentary Budget Officer (PBO).

The [last time](#) Canada spent 2 percent of GDP on defence was in 1990 when the Soviet Union was unravelling. In the following years marking the end of the Cold War, spending saw a constant decline to a low of 1.1 percent in the year 2000.

A few weeks after Carney made his historic pledge, the NATO military alliance decided to aim at reaching 3.5 percent of GDP in core defence spending by 2035, with an additional 1.5 percent for defence-related expenditures such as critical infrastructure.

Carney [said](#) this would mean raising Canada's defence spending to \$150 billion, more than triple that of current expenditures.

Ottawa will now have to decide how to go about meeting these defence commitments, whether by raising taxes, cutting programs, or piling on more debt. Massively boosting Canada's economy to increase federal revenues without higher taxes or major cuts is likely the preferred option, but this cannot happen overnight.

Carney commented on the issue after the NATO summit when asked by reporters if he intends to raise taxes or cut social spending to avoid high deficits.

"We'll grow this economy, we'll balance our operational budget in three years, that's our commitment," Carney said on June 25 in The Hague. "But we will also invest in this country, including in our defence industry."

Fiscal Context

Carney and the Liberals ran on a platform in the recent election which predicted running larger deficits than what the previous government under Prime Minister Justin Trudeau had projected.

Trudeau's Fall Economic Statement ([FES](#)) of December 2024 projected a deficit of \$42.2 billion in fiscal year 2025-26, while the Liberal platform has projected a \$62.3 deficit over the same period.

This projection did not account for the \$9 billion in new defence spending announced this month. With the absence of a spring budget, Parliamentary Budget Officer Yves Giroux hasn't been able to project the expected deficit size, but has [pinned](#) it between \$60 and \$70 billion, a sizeable increase over FES predictions.

Those FES predictions suggest that defence spending in line with NATO's 2 percent target at \$62 billion would dwarf what Ottawa spends on other major items such as health and social transfers to provinces and territories, equalization, employment insurance benefits, the Canada Child Benefit, and public debt charges.

The FES projected \$54.7 billion for the Canada Health Transfer in fiscal 2025-26, \$26.2 billion for equalization, and \$54.2 billion to pay interest on the federal debt.

It's in this fiscal context that Ottawa is moving forward with rebuilding Canada's military, which has faced critical personnel shortfalls, aging and non-serviceable equipment, and a bogged-down procurement process.

Carney has suggested Canada won't have to make the tough decisions on other government spending in the short term, and said the increase in spending would be done incrementally.

"The question is—as we move towards later in this decade, and depending on how the threat environment evolves globally—if we are moving to the higher and higher levels of defence spending because that's necessary, then we will have to make considerations about what less the federal government can do in certain cases, and how and how we're going to pay for it," Carney said on June 25.

"Those trade offs happen towards the end of the decade, into the next decade and we will be much, much better informed," he added. NATO countries have said that a review of the new spending target will take place in 2029.

Feasibility

Experts in economics and fiscal policy have started analyzing Ottawa's new defence commitments and have raised a number of concerns.

Jake Fuss, director of fiscal studies with the Fraser Institute, told The Epoch Times in an interview the Carney government deserves credit for seeking to meet NATO's guideline after governments of different stripes failed to do so, but that there will be "major challenges" ahead.

He said that with the higher deficits and increased borrowing, additional spending will lead to a "significant problem for Canada, because we already have an uncompetitive tax environment."

Fuss views the only solution for Ottawa as reducing spending in some areas that are not core functions of the federal government. He noted programs put in place by the Trudeau government such as dental care, pharmacare, and national child care, are fields that fall under provincial jurisdiction.

"So instead of continuing to fund federal overreach, the Carney government could divert spending back to the core function of national defence," Fuss said. "And they could also find savings by reducing the number of bureaucrats, eliminating corporate welfare, dropping electric vehicle subsidies, and many other mechanisms."

The Conference Board of Canada, an economics think tank, has noted in a recent [paper](#) that cutting programs would not be popular. With a \$92 billion increase in defence spending in five years, the board said it would require decreasing other expenses by over 15 percent to avoid adding more debt.

Aside from implementing cuts, raising taxes is another alternative, but it also has its pitfalls, such as stymying investments and growth. The measure could also prove unpopular, especially after the Liberals recently passed measures to reduce the income tax rate and remove the GST on new homes for first-time homebuyers.

"Given the sheer dollar value that needs to be raised, raising taxes alone would cause tax rates to move much higher, and are likely not politically feasible," said the board.

The think tank said the best approach is to try to boost revenue with growth-friendly policies, targeted tax increases, cutting spending in areas such as the public service and foreign aid, and increase the deficit in a "measured, responsible way that maintains Canada's advantage as a country known for fiscal responsibility."

The Fitch Ratings agency had [warned](#) about the fiscal plans of the new government after the April 28 election. It said Canada has a strong credit allowing it to weather a shock, but that “increased structural deficits would pressure its credit profile.”

Stephen Johnston, private equity manager and director at Omnigence Asset Management, told The Epoch Times in an interview he doesn’t see how Canada and other NATO countries will be able to fund their defence commitments without causing economic harm.

“I just view these announcements as highly stagflationary because they can’t be funded,” he said. “And so how will they be funded? They’ll be funded with expansionary monetary policy, and it’s an investment into what effectively is dead capital.”

‘Stagflation’ is the combination of inflation, slow economic growth, and high unemployment. Johnston’s reference to “dead capital” relates to the fact that what the defence industry produces has no downstream benefit and leads to the destruction of capital when it’s put to use.

Johnston said social programs will be very difficult to cut, especially given the aging demographics.

“So they either print the money or they raise taxes to a level that I don’t think are sustainable. It will have very, very negative impacts on their economies,” he said, referencing NATO countries.

As for funding new defence spending through the development of the critical minerals industry, as suggested by Carney, Johnston expressed doubts, saying it would need to generate \$300 billion a year in before tax profits to generate \$100 billion in additional federal tax revenues, an unrealistic amount 10 percent the size of Canada’s GDP.

Johnston said that the United States under the Trump administration is causing this refocus on defence and on rebuilding industrial capacity in allied countries, “because you can’t be a military power, unless you’re an economic power first.”

This requires investments in fixed capital and the “hard economy,” he said, such as mines, oil wells, and hydroelectric.

Johnston said the Liberals now seem to be embracing that idea.

This week Parliament passed the government's Bill C-5 which intends to speed up the development of major projects deemed in the national interest.