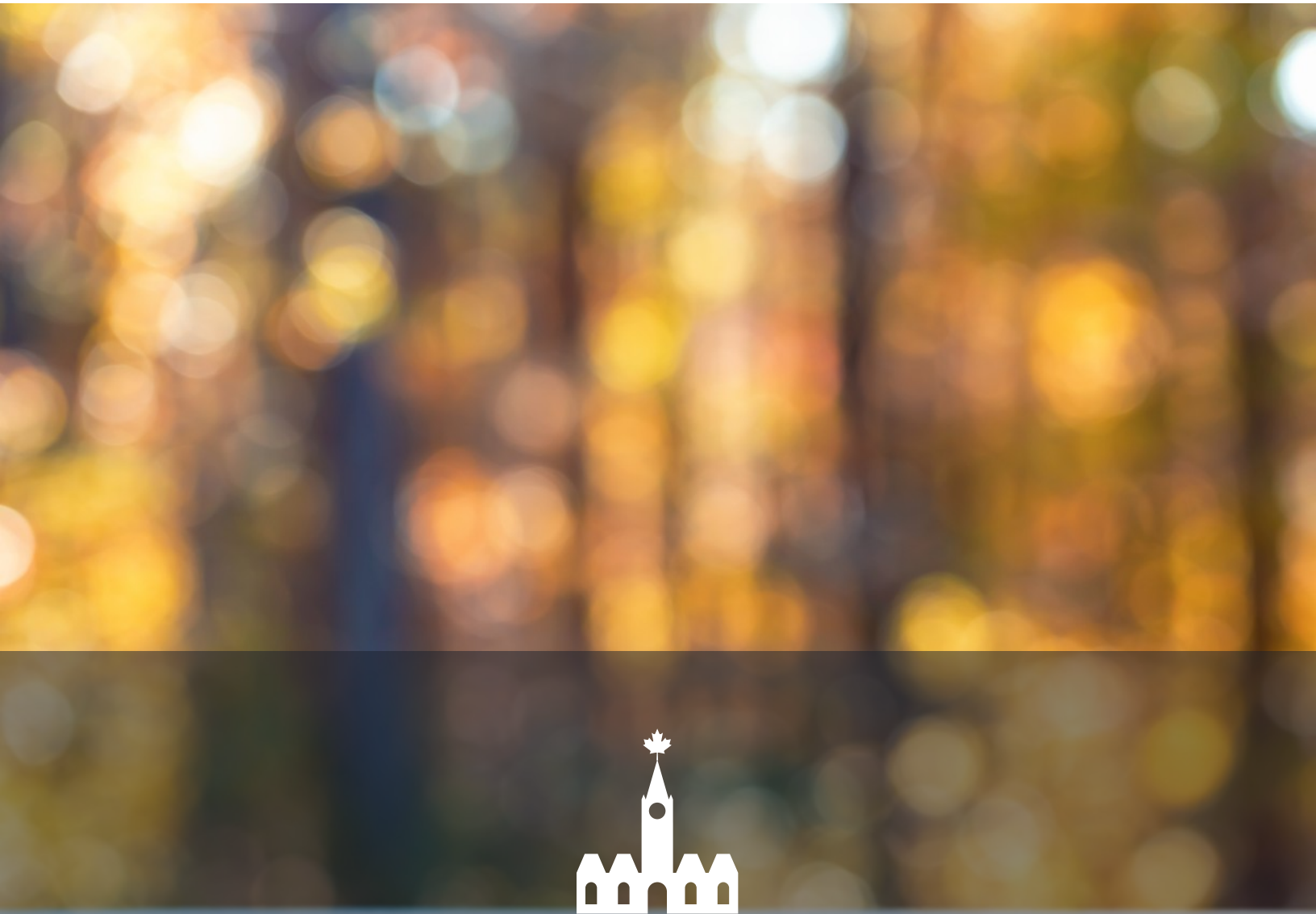
August 14, 2025

Forecasting Federal Capital Expenses



OFFICE OF THE PARLIAMENTARY BUDGET OFFICER
BUREAU DU DIRECTEUR PARLEMENTAIRE DU BUDGET

The Parliamentary Budget Officer (PBO) supports Parliament by providing economic and financial analysis for the purposes of raising the quality of parliamentary debate and promoting greater budget transparency and accountability.

The PBO's fiscal model includes a federal capital spending module. This module has been expanded to more accurately measure federal investments in assets.

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Parliamentary Budget Officer

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Highlights

In Spring 2025, the Government of Canada announced a shift in its fiscal policy to increase the rate of capital investment and place greater emphasis on acquisition of defence-related assets.

The Government has also established a new "Operating Budget" fiscal anchor. At this date, the composition of the "Operating Budget" has not yet been defined.

The Parliamentary Budget Office (PBO) is improving and expanding its modelling of capital spending. These changes are necessary to monitor the new fiscal regime. In addition, understanding non-operating spending is a starting point for measuring the new fiscal anchors.

To this end, the PBO has expanded the capital budget module in its fiscal model. Specifically, the model will now allow us to provide parliamentarians with a five-year projection of federal capital spending, amortization, and the accumulation of assets.

Overall, our new capital budgeting approach better reflects the anticipated increase in federal capital investments. Federal capital amortization expenses are $7.1 billion higher over the next five-years compared to our March 2025 Economic and Fiscal Outlook. This mostly reflects better data shared by National Defence.

For the first time, the PBO is now able to project federal capital spending, on a cash basis, of $128 billion for the next five years. Almost two-thirds ($83 billion) relates to National Defence.

In concert with expansions to the PBO personnel fiscal module, these changes will ensure parliamentarians receive regular updates regarding whether the government is on track to respect its fiscal anchors, as well as the new defence spending targets.

Capital Investment 101

What is capital spending?

In the broadest sense, International Financial Reporting Standards define capital spending as money used to acquire assets - things that provide a continuing economic benefit to an organization.[1] This includes both financial assets (for example, investments and pension plan assets) and non-financial assets (such as equipment used to support ongoing federal program delivery).

PBO analyses both financial and non-financial assets. However, the Government's current policy intent is focussed on the latter, specifically, spending growth in the building or purchase of things used to produce other goods or provide services.

The Public Accounts of Canada organizes non-financial assets into three categories:

- Tangible capital assets (about 90% of the total in 2023-24, such as boats, bullets, and bridges);
- Inventories (about 7% of the total in 2023-24, such as spare parts and supplies); and,
- Prepaid expenses (the remaining 3% in 2023-24).

The Government also holds intangible capital assets, which the Public Accounts deems to be "insignificant."[2]

How much does the Government spend each year on capital?

According to the Public Accounts of Canada, the Government spent $13.6 billion on non-financial assets in 2023-2024, bringing its total holdings to $116.6 billion. As would be expected, almost all this money was allocated toward the stock of tangible capital assets ($104.6 billion as of March 31, 2024).

From one year to the next, the value of capital assets will increase from new investments and decrease primarily due to their use. The latter is also known as *amortization* and is an estimate of how much of the assets' value is "used-up" each year, therefore decreasing their value. In 2023-24 the Government reported an amortization expense of $5.6 billion.

Where does capital appear in the Financial Statements?

Capital is featured throughout the Government's financial statements.

Consolidated Statement of Cash Flows

The most direct place to find capital spending is in the cash flow from investing activities section of the cash flow statement. This line item represents the cash used to acquire or upgrade physical assets like buildings, machinery, and equipment during the year.

Consolidated Statement of Financial Position

While the cash outflow for capital is presented in the cash flow statement, the assets acquired through this spending appear on the balance sheet. Specifically, capital expenditures increase non-financial capital assets, in particular tangible capital assets.

Consolidated Statement of Operations

Capital spending does not appear directly as a single expense on the income statement in the period the asset is purchased. As noted above, the cost of the asset is gradually expensed over its useful life through a process called amortization. This expense is recorded on the income statement, matching the cost of the asset with the activities it supports over time.

Consolidated Statement Net Debt

This statement reconciles how the changes to the stock in tangible capital assets (for example, amortization, acquisition) contribute toward increases (or decreases) in the net federal debt.

What happens if the Government changes its definition of "Capital"?

As noted above, capital spending is a well-defined accounting concept regulated by independent arm's-length experts. That said, the Government may decide to establish its own definition of "capital."

Were this to occur, the PBO would continue to analyse and forecast the commonly accepted measures of capital currently presented in the Public Accounts of Canada (assuming that the Government accounting standards continue to align with international norms).

At the same time, the PBO would also attempt to analyse the Government's alternate "capital" measures as part of its fiscal monitoring.

Motivation

PBO's approach to modelling capital amortization expenses has historically been to assume that the capital assets owned by the Government would remain a constant share of the overall economy and that the same broad categories of items were purchased over time. As such, the amortization rate was stable, and corresponding expenses gradually rose over time in concert with the economy.

Federal fiscal policy announcements over the past six months have highlighted limitations of this approach. Specifically, the Government announced its intention to increase capital spending above its historical trend. As such, the stock of federal assets is likely to grow as a share of the economy. In addition, the composition of federal capital spending will potentially shift over the medium-term with greater emphasis on defence assets.

The Government's new fiscal anchors place greater scrutiny on types of spending, rather than the policy objective of spending. This will require better articulation of operating and capital spending in the PBO fiscal model.

Improving our capital spending model will ensure the PBO is able to provide parliamentarians with timely, accurate assessments of a key Government policy commitment – the NATO spending target. Projecting defence spending separately will more accurately reflect the increase in planned capital spending.

Overall, these changes will improve our understanding of the relationship between planned capital spending by the government, the growth in non-financial assets and corresponding capital amortization costs. In turn, this should allow better measurement of government spending (including "operating") and the new defence spending target.

Approach

PBO's old approach

The capital module of PBO's longstanding fiscal model focused on forecasting the evolution of capital amortization expenses. This involved projecting tangible capital assets and applying an amortization rate to that base. The stock of capital assets was grown at projected nominal GDP growth and the amortization rate was based on an historical moving average.

This methodology implicitly assumed that the stock of federal assets was a constant share of the overall economy, and the composition was consistent over time. While simplistic, it provided strong forecast accuracy for a stable, predictable, small federal expense.

Our new approach

The novel approach places more emphasis on understanding the Government's investment plan and expands the number of things that we project. Most notably, the new projection will *start* with estimating annual cash federal capital spending, comprised of spending on defence assets and other areas of federal capital investment. Projected defence capital acquisitions are based on National Defence's capital investment plan.[3] Capital acquisitions by other federal departments will continue to be grown at our nominal GDP projection.

The current-year estimate

Following the creation of a federal capital spending projection, the next step is to prepare a current year estimate of amortization expenses and net-federal non-financial assets. This estimate begins with the stock of capital assets presented in the most recent Public Accounts.

An amortization cost is imputed by using an average historical depreciation rate for National Defence assets and all "other" assets held by the Government of Canada.[4,5]

The recent non-financial stock is adjusted by amortization and planned capital spending to arrive at the estimated non-financial assets for the current year.

The medium-term projection

Over the remaining five-year horizon, the projection sequentially rolls forward in an analogous manner as the current-year estimate. Each year begins with the final figure for non-financial assets from the previous year. This is then adjusted by forecast federal capital spending and a projected amortization expense, arriving at a new final year-end figure for non-financial assets.

Overall, as presented in Table 1, the new modelling approach incorporates a wider array of relevant data, relies on a more logical accounting structure, and projects a greater range of variables.

Table 1: Comparison of old and new capital modelling methodologies

	Old	New
Data Inputs	• Public accounts aggregates	• Public Accounts Aggregates plus projected microdata for defence
Structure	• Moving average	• Accounting add-up of financial statement data, plus actual government cash spending forecast for defence
Projected Variables	• Three variables: non-financial assets, amortization rate, amortization cost	• All previous, plus federal capital investments

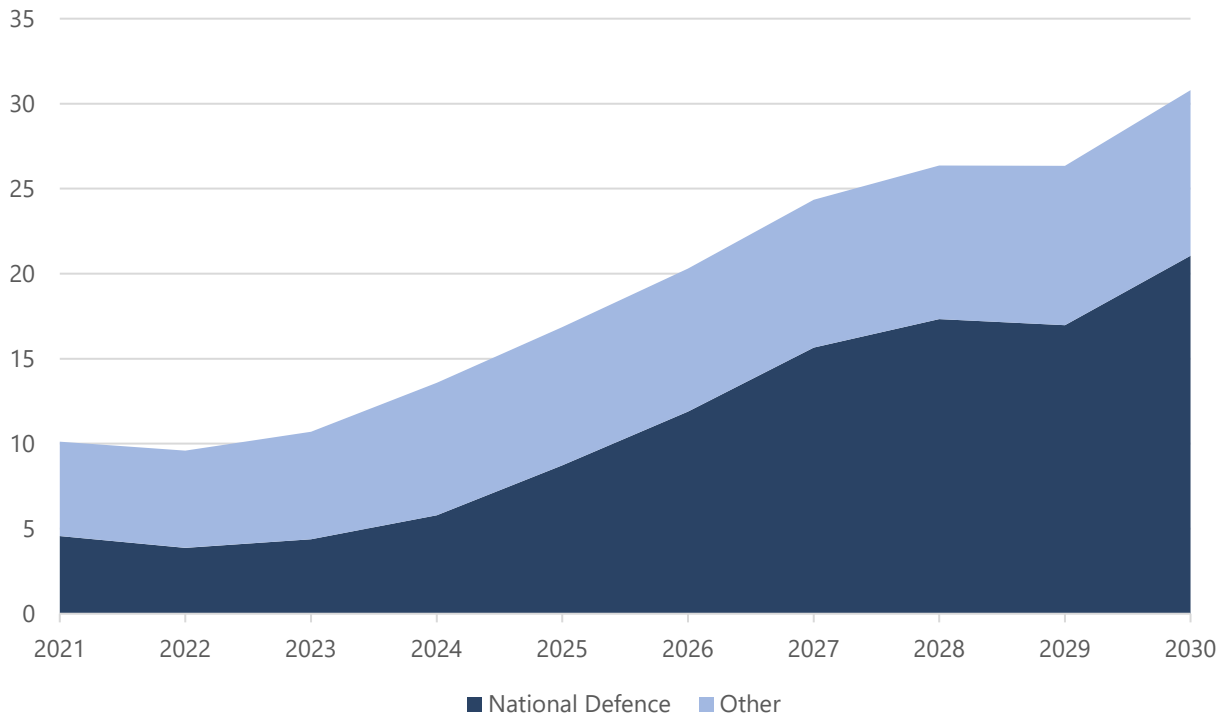
Source:
Office of the Parliamentary Budget Officer.

Results

As depicted in Figure 1, the new capital module projects that federal spending on capital assets will grow to over $30 billion per year over the next five years. Most of the increase reflects planned defence-related acquisitions, but not the recent objective of reaching 5% of GDP devoted to defence.[6] This represents more than a doubling of annual capital investment over the past decade.

Figure 1

Federal capital spending to reach $30 billion by 2030 ($ billions)



Source:
Office of the Parliamentary Budget Officer.
Public Accounts of Canada.

Note:
Spending is presented on a cash accounting basis.

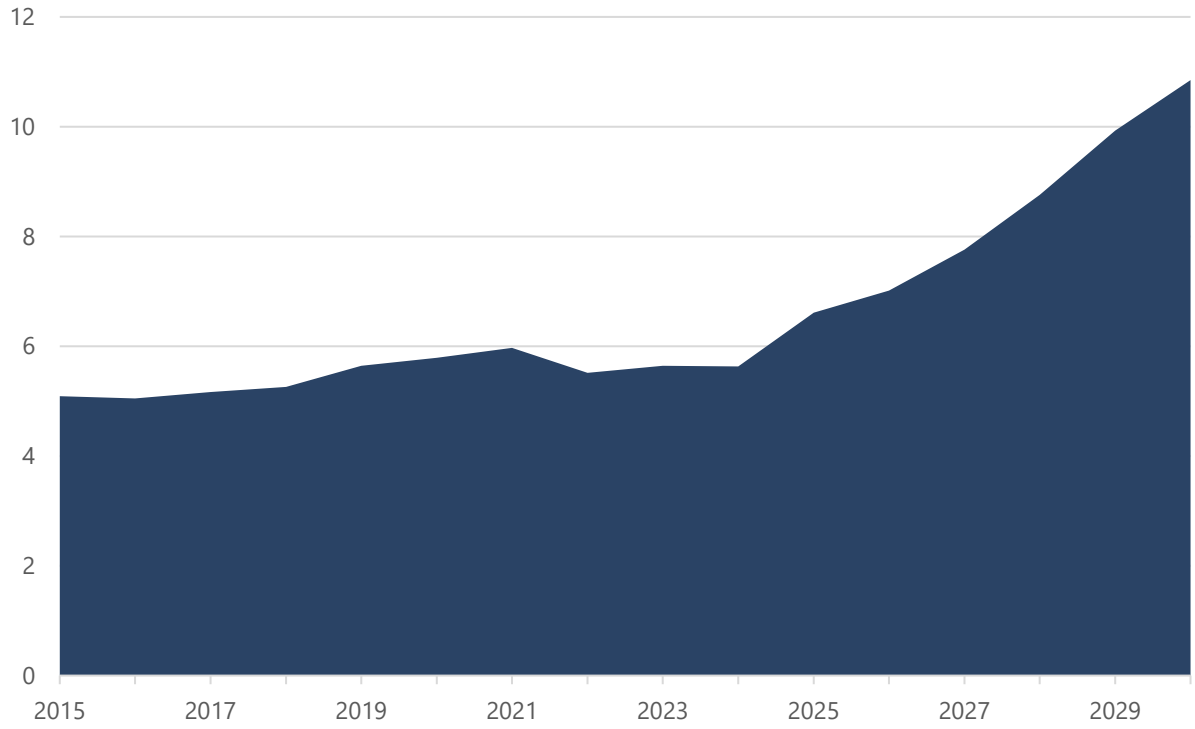
PBO used standard objects 8 and 9 (acquisition of land, buildings and works, and acquisition of machinery and equipment) from Table 3 of Volume II of the Public Accounts to calculate historical cash spending by National Defence. The "Other" category is the residual amount between acquisition of tangible capital assets (as reported in Volume I of the Public Accounts) and the National Defence amount.

Years are presented on a fiscal basis, hence 2030 represents fiscal year 2029-2030.

Commensurate with the increase in federal capital investments, capital amortization expenses are also projected to grow to almost $11 billion by 2029-2030. The growth rate is lower than overall investment due to an initial delay between acquisition and amortization of new assets, and their long useful lives (over 15 years).

Figure 2

Capital amortization expenses will rise to almost $11 billion by 2030 ($ billions)



Source:
Office of the Parliamentary Budget Officer.
Public Accounts of Canada.

Note:
Spending is presented on an accrual basis.

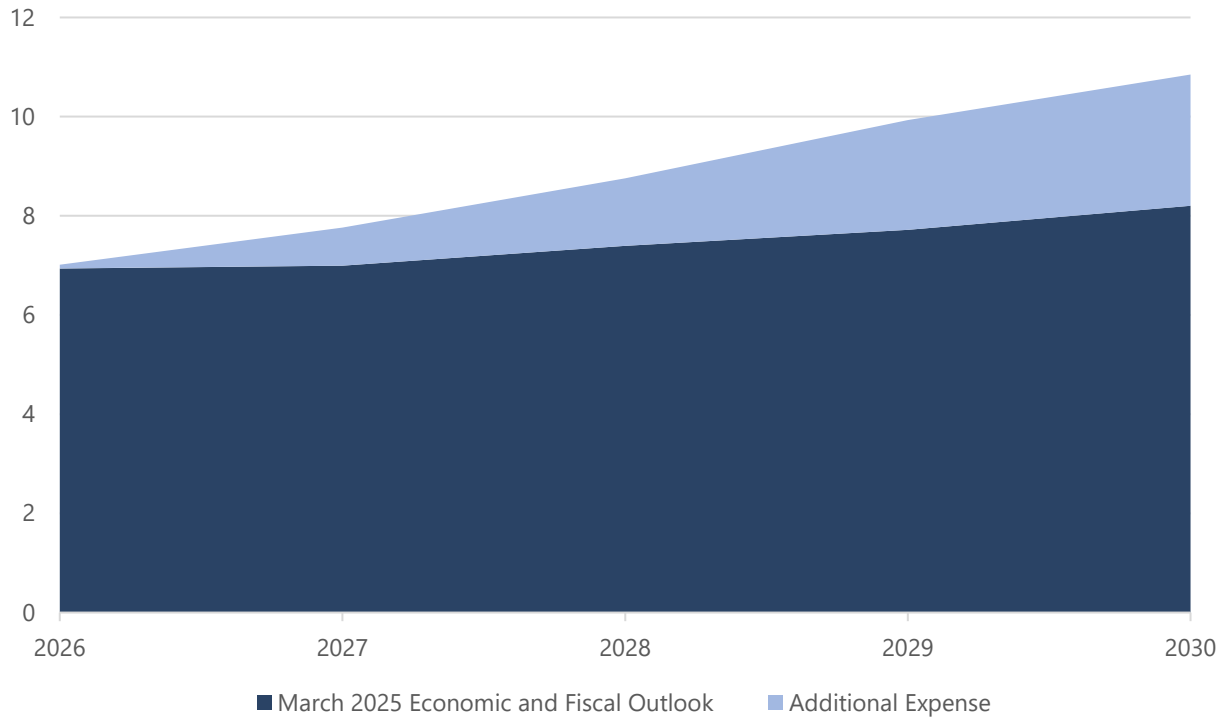
Years are presented on a fiscal basis, hence 2030 represents fiscal year 2029-2030.

Overall, our new capital budgeting approach projects higher annual expenses. Compared to our March 2025 Economic and Fiscal Outlook, capital amortization

expenses are $7.1 billion higher over a five-year period. This mostly reflects new data incorporated from National Defence's capital spending plan. This increase in expenses will, all other things held constant, further increase the deficit.

Figure 3

Capital amortization expenses are over $1 billion higher each year, on average, compared to our March 2025 Economic and Fiscal Outlook ($ billions)



Source:
Office of the Parliamentary Budget Officer.
Public Accounts of Canada.

Note:
Spending is presented on an accrual accounting basis.

Years are presented on a fiscal basis, hence 2030 represents fiscal year 2029-2030.

Notes

[1] International Financial Reporting Standards Conceptual Framework, Chapter 4.

[2] Public Accounts of Canada 2023-2024.

[3] Information Request 0818.

[4] Non-financial assets are also adjusted by changes to inventories, prepaid expenses, and gains/losses on disposal. The first two variables are grown at nominal GDP. Gains/losses on disposal is assumed to be constant.

[5] PBO also models a relationship between the "bottom-up" estimates presented in National Defence's Capital Investment Forecast (CIF) and the audited figures presented in the Public Accounts of Canada (PAC), which are consistently lower. Hence, the microdata-based forecast is adjusted by a constant parameter to arrive at the corresponding PAC-based forecast.

[6] The current version used by PBO is Spring 2025. Hence it pre-dates the revised NATO 5% spending target and the in-year defence spending top-up of $8.3 billion for 2025-26.

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