September 24, 2026

The Government's Operating Budget Fiscal Anchor

OFFICE OF THE PARLIAMENTARY BUDGET OFFICER
BUREAU DE LA DIRECTRICE PARLEMENTAIRE DU BUDGET

The Parliamentary Budget Officer 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.

This note assesses the Government's Operating Budget Fiscal Anchor.

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Highlights

Budget 2025 announced two fiscal anchors – (1) balance operating spending with revenues by 2028-29 and (2) maintain a declining deficit-to-GDP ratio to govern fiscal management decisions within a stated strategy to “spend less to invest more”.

While Budget 2025 described the general components of the operating budget anchor, the lack of specific definitions to the initiative level constrained the ability to assess whether the anchor would function as a binding discipline on overall federal spending in practice or serve more as a directional guide as to high-level values for the government.

The Parliamentary Budget Office (PBO) requested and analyzed the detailed, granular components of the operating budget anchor and found that:

The detailed classification of tax and spending items as operating versus capital within the Framework provides transparency as to how the government views the longer-term economic returns of specific initiatives, which informs the likelihood that they may be subject to future fiscal restraint to meet the anchor target.

Attributions of certain tax or spending initiatives as operating versus capital appear contradictory and would benefit from a more formal methodology motivation.

PBO has released supplementary files with this study of granular attributions of spending items or tax expenditures as operating to inform which items the government may target to balance operating spending and revenues by 2028-29.

Summary

Budget 2025 introduced a new fiscal anchor to balance “day-to-day” operating spending with revenues by 2028-29. Accordingly, the government introduced a new Capital Budgeting Framework that attributes federal spending and revenue items as operating versus capital in nature, as based on two criteria:

(1) *Conditionality* - whether the funding recipient must invest in capital formation to receive the benefit and;
(2) *Linkage* - whether the spending encourages capital investment in identifiable sectors or projects.

It is important to note that the new Capital Budgeting Framework is separate from and does not replace long-standing operating and capital definitions under the Public Sector Accounting Board (PSAB) standards, which remain the basis of federal Public Accounts.

The high-level criteria for the Capital Budgeting Framework provided with Budget 2025 means that classifying any given program depends on judgments that are not easily observable to outside parties. Two similar-looking programs can receive different treatments depending on how closely each satisfies the conditionality and linkage tests, making it difficult to independently replicate government figures or anticipate how future spending will be classified, absent detailed attributions of spending and taxation initiatives as operating or capital – separate from their PSAB treatment.

Finance Canada subsequently provided PBO with granular attributions of spending and taxation items as operating or capital within its Capital Budgeting Framework.

Analysis of the granular attributions are informative as to the potential focus of future fiscal restraint by the government to meet its fiscal anchor goals for 2028-29, in that cutting spending items or tax expenditures tagged as operating will move the government closer to its anchor target. This enhances discipline and transparency of the government’s fiscal stance.

That said, attributions of certain tax or spending initiatives as operating versus capital appear contradictory by title alone in some cases and would benefit from a more formal methodology motivation. For example, film tax credits are included as capital while journalism tax credits are not. Similarly, Agriculture and Agri-Food Canada's Agricultural Clean Technology program is classified as a capital transfer, while the Agricultural Climate Solutions program is classified as day-to-day operating, despite both programs

supporting farm-level investments. As detailed with further examples in this report, technology and innovation grants and tax measures across departments and agencies attract different classifications as operating and capital.

Canada is not the first jurisdiction to tie a fiscal anchor to a capital-versus-operating split. Most notably, the United Kingdom (UK) has a similar framework. However, the UK also pairs it with a debt rule and a capital definition aligned to international national accounts standards. These are two characteristics notably absent from the Canadian approach.

Based on information provided with Budget 2025 and the Spring Economic Update 2026, PBO projects the government to slightly miss its 2028-29 operating balance target by one year, achieving balance in 2029-30. Targeted restraint to operating items of $500 million would allow the government to meet its fiscal anchor in 2028-29. On September 15, 2026, the Prime Minister announced that the government was on track to balance the operating budget in 2027-28, one year ahead of its Budget 2025 commitment. Budget 2026 will allow PBO to assess the main drivers of the improvement in the operating balance.

Overview of the Government’s Operating Fiscal Anchor

Budget 2025 framed the government’s fiscal stance as deliberately intending to shift the composition of its spending, to “spend less to invest more” at a high level and, more specifically, to prioritize capital investments that would increase national economic activity into the medium term over “day-to-day” operational spending.

As part of this priority shift, the government introduced two new fiscal anchors:

- Balance operating spending with revenues by 2028-29; and
- Maintain a declining deficit-to-gross domestic product (GDP) ratio.

To support the first anchor, the government introduced a new Capital Budgeting Framework, designed to delineate operating spending and tax initiatives from those that contribute to capital formation across public and private sectors (also referred to as capital investment). The government motivated this stance to “identify and prioritize initiatives that deliver long-term economic returns” and “increase transparency, allowing Canadians to better understand what funds services today, and what builds future prosperity.”[1]

Canada is not the first jurisdiction to base its fiscal rules or anchors within a capital budgeting framework. The UK’s suite of fiscal anchors requires that day-to-day spending must be paid from revenues, and borrowing is only permitted to fund capital investment.[2]

The new Canadian capital framework broadly defines capital investment as “any government expense or tax expenditure that contributes to public or private sector capital formation, held directly on the government’s balance sheet or on that of a private sector entity, Indigenous community or another level of government.”[3]

Finance Canada further stated that items attributed as capital investment would meet the criteria of:

(1) *Conditionality* - whether the funding recipient must invest in capital formation to receive the benefit and;
(2) *Linkage* - whether the spending encourages capital investment in identifiable sectors or projects.[4]

Based on these criteria, Finance Canada identified 6 high-level categories of federal government spending that are classified as capital investment (Table 1).

Table 1
Finance Canada's Six Capital Investment Categories

Category	Definition
Capital transfers	Transfers to other levels of government and organizations that are expressly intended for the recipient to invest in infrastructure or a productive asset.
Capital-focused corporate income tax incentives	Tax expenditures intended to incentivize new capital formation.
Amortization of federal capital	Expenses recorded to spread the cost of capital assets owned or controlled by the federal government over their useful lives.
Private sector research and development	Direct funding, or tax incentives, for research and development activities that enable commercialization or scale-up and raise future productive capacity.
Support to unlock large-scale private sector capital investment	Contractual agreements with proponents involving exceptional, significant operating subsidies designed to unlock incremental large-scale private capital investments.
Measures to grow the housing stock	Measures that accelerate new housing supply.

Source:
Government of Canada Budget 2025.

The government also stated that this framework is meant to supplement, not replace, existing financial reporting. The Public Accounts will remain fully compliant with PSAB standards, which only allow for the capitalization of costs of assets under the federal government's control.

Benefits and Limitations of the Operating Budget Fiscal Anchor

The government has defined "day-to-day operating spending" as program expenses or tax expenditures that do not meet its criteria to be attributed as capital. As such, assessments of the usefulness of the new Operating Budget Fiscal Anchor to actively constrain federal spending rely heavily on how the new Capital Framework applies in practice to specific spending initiatives and tax expenditures.

Benefits

As noted by both the International Monetary Fund (IMF) and Organisation for Economic Co-operation and Development (OECD), clear and well-defined fiscal rules (or anchors) are widely considered a positive fiscal management practice which promote improved fiscal discipline.[5]

Attributions within the new Capital Framework require a link to capital formation, which is less strong than the capital attribution tests in traditional financial statements. For example, PSAB standards treat transfer payments to provinces for infrastructure investments as a federal expense, even where the intent is to substantively support an investment in long-term productive assets.

As such, the government is bringing transparency to its forward fiscal stance by formally identifying the range of policy instruments that it considers important to encourage capital investment (for example, tax incentives, transfers, loan guarantees) - as separate from their PSAB treatment. This more expansive definition of capital to meet medium term fiscal objectives can alleviate some unintended policy consequences that could occur by basing the operating budget fiscal anchor on PSAB definitions of capital. For example, it may reduce administrative burden as departments don't need to redesign or relabel a program around a particular instrument to make it qualify as capital under PSAB. As above, transfers to provinces for infrastructure are typically recognized as an operating expense. In contrast, under the new Framework, they are recognized as capital investment and precludes pressure to reduce them to meet the operating budget fiscal anchor.

Another potential benefit is that the Framework provides additional information on how government spending supports its investment objectives. It introduces new reporting and data in the fiscal update documents that would not otherwise be publicly available – and so inform debate as to potential forward fiscal restraint. In this way, the Framework provides greater transparency regarding how the government practically weights its internal priority-setting framework for budget decisions.

Limitations

As noted above, fiscal rules or anchors are generally considered a positive fiscal management practice. That said, classification-based fiscal rules like the operating budget fiscal anchor do not limit overall government borrowing, and there is a risk that the classification definition can be arbitrary or change over time.

The UK addresses these issues in two ways. First, additional to its capital investment rule, the UK also follows an investment (debt) rule where Public Sector Net Financial Liabilities as a percentage of GDP must be declining by a specific year. Second, the definition used for capital investment is aligned with international definitions based on the System of National Accounts.

While the Government of Canada did introduce the second fiscal anchor of a declining deficit-to-gross domestic product (GDP) ratio in Budget 2025, it retired the previous anchor of a declining federal debt-to-GDP ratio. Thus, there is not a similar constraint on total debt accumulation – which aligns with the Canadian government's general stance that significant borrowing to finance capital in the short to medium term will generate subsequent economic returns of sufficient magnitude to support declining debt-to-GDP profiles subsequently.

As noted previously by the PBO, the government's capital definition "expands beyond the current treatment in the Public Accounts and international practice based on the System of National Accounts (SNA), such as that adopted by the United Kingdom".[6]

The inclusion of corporate income tax expenditures, investment tax credits and operating (production) subsidies blends policy measures with capital formation. While such measures may influence corporate investment decisions, federal spending on these measures would not be considered capital formation within the SNA or UK frameworks. Nor would they be included in provincial capital budgets or that of Singapore, or additional comparator jurisdictions identified by the Government of Canada.[7] Federal spending under these categories represents their upfront fiscal cost and not necessarily the amount of incremental private sector capital formation that will be undertaken in the economy subsequently because of these measures.

While the government’s general proposition is that additional borrowing to prioritize certain capital investments will drive important forward prosperity, it does not set forth a testable rule as to how specific capital outlays have been or will be assessed to deliver tangible assets in the first instance and longer-term economic returns subsequently. Put differently, it is not clear that all spending and taxation measures do translate into public or private capital assets. Even where they do, those assets do not all generate the same financial return for government or the same contribution to broader economic growth, if any.

Further, in respect of the attribution of what is considered a capital investment, it is critical that definitions underpinning these fiscal anchors are transparent, have consistent rules over time and can be easily replicated by external bodies.

While the government has provided summary lists of measures and programs it considers as capital investment and has communicated the general principles used for the classification, no formal methodology or a mapping framework have been published in respect of the detailed categorizations that yield the aggregate figures cited in Finance Canada calculations of the operating budget fiscal anchor. Moreover, the categorization of capital investment is done at a level more granular than what is usually available regarding fiscal costs of programs and measures. Therefore, based on current public information, it is not possible to independently replicate the classification or anticipate how future spending might be attributed.

Applying the Capital Framework

To generate an independent estimate of the Operating Budget balance, PBO submitted several information requests to Finance Canada, seeking greater detail on how classification decisions were made and exactly which measures will be counted as capital.

While the government previously published financial projections on some detailed items in the Spring Economic Update 2026 (SEU 2026), certain categories lacked specific detail, representing about 20 per cent of the Capital Budgeting Framework. PBO was not able to identify granular financial projections for items in the largest such category, "other provincial, territorial, and municipal infrastructure investments", at roughly 10 per cent of the Framework. Public reporting on the full set of programs and measures included in the Capital Budgeting Framework would enhance transparency and facilitate independent analysis.

Grants and contributions and tax expenditures are the largest spending categories in the Framework, together comprising about 80 per cent of the annual capital budget. Given their size, PBO focused granular financial analysis on these two spending baskets, preparing its own "bottom-up" analysis by applying the Capital Framework to Departmental Plans and the Report on Federal Tax Expenditures. These detailed financial data files are also available on the PBO website.

PBO's analysis draws on both information provided by Finance Canada and publicly available expenditure data. Finance Canada provided a list of detailed measures they classified as capital investments under the Capital Budgeting Framework in response to several PBO information requests.[8] The measures were reviewed and matched to detailed financial information contained in Departmental Plans and the Report on Federal Tax Expenditures. Spending or tax expenditure items not classified by Finance as capital were deemed operational. This exercise enabled PBO to develop a more detailed breakdown of the Framework's components and departmental impact, as well as assess the extent to which publicly available information aligns with the government's capital classifications.

Departmental Plans

Based on detailed capital and operating itemization received from Finance Canada, PBO compiled material financial information on 53 transfer payment initiatives (grants and contributions) that are tagged as capital investments under the Capital Budgeting Framework, as sourced from the 2026-27 Departmental Plans.[9] This financial exercise does not include programs below $5 million that are not publicly listed, which account for $70.5 million of the $97.0 billion in total (representing less than 1 per cent of the total transfer payments). Table 2 presents planned spending amounts for 2026-27 only, as planned spending in subsequent years reported in Departmental Plans often reflects the scheduled sunsetting of funding provided for various programs and measures and may therefore understate expected future spending levels.

As presented in Table 2, most of the identified capital spending rests in three departments – Housing, Infrastructure and Communities Canada; Innovation, Science and Economic Development and Indigenous Services Canada. PBO identified at least 12 other departments and agencies sharing the remaining balance of substantive capital initiatives, which illustrates the complexity involved in tracking detailed capital financial information using publicly available documents, as well as the complexity of the underlying program base.

Table 2
Capital grants and contributions (G&Cs) by department

Departments	Share of total capital G&Cs	2026-2027 Spending ($B)
Housing, Infrastructure and Communities Canada	37.5%	9.3
Innovation Sciences and Economic Development Canada	27.8%	6.9
Indigenous Services Canada	15.2%	3.8
Transport Canada	7.6%	1.9
Natural Resources Canada	3.1%	0.8
Other departments	8.8%	2.2

Sources:

Parliamentary Budget Office.

GC Infobase, Open data, 2026-27 Departmental Plans.

Note:

Totals may not add due to rounding.

Tax expenditures

Reviewing the Federal Tax Expenditures report, PBO identified financial information respecting 22 measures that Finance Canada has designated to be capital investment in calculating the operating budget fiscal anchor (Table 3). These are estimated to comprise $15.2 billion in forgone revenues or additional expenses in 2026-27.[10]

As is the case with transfer payments, most of the federal capital investment is concentrated in a handful of tax expenditures. In particular, the Scientific Research and Development Tax Credit is responsible for almost half of the total amount. An additional 16 smaller measures comprise about one quarter of federal tax expenditures that have been attributed to be capital-related under the Framework.

Table 3
Capital tax expenditures

Tax expenditure	Share of total	2026-2027 Spending ($ B)
Scientific Research and Experimental Development Investment Tax Credit	35.4%	5,385
Accelerated Investment Incentive	16.5%	2,516
Clean Technology Investment Tax Credit	7.2%	1,100
Clean Electricity Investment Tax Credit	8%	1,215
Enhanced rebate for new residential rental property	6.7%	1,021
All others (16 measures)	26.2%	3,980

Sources:
Office of the Parliamentary Budget Officer.
Report on Federal Tax Expenditure – Concepts, Estimates and Evaluations 2026.

Note:
Totals may not add due to rounding.

Capital or Operating? It Depends Who's Asking

Working through the individual transfer payment and tax incentives it becomes evident that applying the new Capital Framework depends on judgments that are not easily observable to outside parties. In particular, the weaker the linkage between spending and capital formation, the more challenging it is to easily anticipate the government's attributions at a granular level.

For example, within Agriculture and Agri-Food Canada, the Agricultural Clean Technology program funds the adoption of on-farm clean technology and is classified as a capital transfer. In contrast, the Agricultural Climate Solutions program is classified as day-to-day operating. Both programs support farm-level investment toward reducing greenhouse gas emissions, but only one is treated as capital formation under the Framework.

Innovation, Sciences and Economic Development Canada (ISED)'s grants and contributions portfolio also illustrates how programs with similar objectives can receive different treatment under the Framework. The *Artificial Intelligence Compute Access Fund* provides affordable compute access to Canadian AI firms and SMEs and is classified as day-to-day operating, while the *AI Compute Infrastructure Program* is classified as a capital transfer. In this situation, the distinction rests on the conditionality criterion: the Infrastructure Program requires recipients to build or expand physical compute and data infrastructure, whereas the Access Fund subsidizes the cost of using existing capacity.

To provide another tax example, the film and journalism tax credits are similar labour-based tax credits but receive different treatment under Finance Canada's Capital Budgeting Framework. Film tax credits are included because the result are film products which are considered intellectual property assets with long-term value. Journalism tax credits are excluded because news content is not considered to have a long enough lifespan to qualify as a capital asset. This demonstrates how small definitional distinctions can lead to different classifications.

More broadly, many grants and contributions programs administered by various departments are designed to support research, commercialization, innovation, and technology adoption activities that may ultimately contribute to the creation of intellectual property assets. However, based on program descriptions alone, it is often unclear whether the government would view the resulting outputs as sufficiently linked to capital formation to qualify under the Capital Budgeting Framework. As a result, external parties may find it difficult to anticipate which innovation programs will be classified as capital measures. For instance, ISED's *Digital Research Infrastructure* program and *Global Innovation Clusters* programs are classified as day-to-day operating, while the *Canada Foundation for Innovation* is classified as a capital transfer.

A similar pattern is evident within Natural Resources Canada (NRCan). Of the department's 27 grants and contributions programs, only three programs are classified as capital transfers under the Framework.[11] The remaining programs, despite often supporting investments, technology deployment, or innovation activities, are classified as operating spending. The rationale for these distinctions is often not readily apparent from publicly available program descriptions. For example, NRCan's *Grants and Contributions in support of the Energy Innovation Program* is classified as day-to-day operating, while *Grants and Contributions in support of Smart Renewables and Electrification Pathways Program* is classified as a capital transfer, despite both programs stated purpose and objectives being to develop innovative energy technologies.

These examples reflect a broader pattern. Programs with similar objectives can receive different treatment depending on how directly they link to asset formation and classifying them can depend on judgments that vary program by program without a consistent, published rationale. This makes it difficult to anticipate how future spending will be sorted. Capital transfers are concentrated in a small number of departments, as shown in Table 2, so these judgments can meaningfully shift how much of a department's overall spending envelope appears on the capital side of the ledger.

Composition of New Measures Since Budget 2025

Using Finance Canada's figures, PBO decomposed the change in the fiscal track since Budget 2025 into economic and fiscal developments and new policy measures (Table 4). Economic and fiscal developments underlying Budget 2025 and SEU 2026 generated cumulative fiscal room of $18.5 billion over 2025-26 to 2029-30. However, the government announced new measures with a total fiscal cost of $173.3 billion over the same period, more than offsetting this fiscal room. Three quarters of this cost, $126.8 billion, was attributable to day-to-day operating spending rather than capital investment ($46.6 billion). The deterioration in the fiscal track therefore reflects the government's own policy choices, concentrated in operating rather than capital spending.[12]

Table 4
Budget 2025 and SEU 2026 measures, 2025-26 to 2029-30

	Fiscal room/deterioration			New measures		
	Revenues	Expenses	Total	Capital investments	All other	Total
Budget 2025	37.5	-79.4	-41.9	-45.1	-80.5	-125.6
SEU 2026	35.9	24.5	60.4	-1.5	-46.2	-47.7
Total	73.4	-54.9	18.5	-46.6	-126.8	-173.3

Source:
Finance Canada

Notes:
Totals are shown for 2025-26 to 2029-30. SEU 2026 also introduced measures for 2030-31 that add $6.8 billion in net spending to deficits.

Impacts of changes in the pollution pricing regime are excluded from the revenues and expenses presented in this table.

Negative amounts represent a deterioration in the budgetary balance.

Assessment of the Operating Balance using PBO Projections

To project the day-to-day operating balance in PBO's outlook, PBO sent an Information Request to the Department of Finance seeking a comprehensive list of all pre-existing programs or measures categorized under each category in the Capital Budgeting Framework.

Using the information received from the Department of Finance and our latest Economic and Fiscal Outlook report (June 2026), PBO projected its own day-to-day operating balance (Table 5). As is consistent with PBO's fiscal projection methodology, the estimates for the capital investment measures are incorporated as provided, unless PBO has its own estimates.[13]

Table 5

Day-to-day operating balance, billions of dollars

	2025-2026	2026-2027	2027-2028	2028-2029	2029-2030	2030-2031
A. Total expenses, including net actuarial losses	580.1	600.1	614.2	626.4	648.1	670.2
B. Capital investments (expenses)	34.5	48.5	53.0	52.9	54.6	55.7
C. Day-to-day operating expenses (A - B)	**545.6**	**551.6**	**561.2**	**573.5**	**593.5**	**614.5**
D. Budgetary revenues	508.1	528.3	546.2	566.1	588.4	612.0
E. Capital investments (revenues)	6.5	7.5	6.7	7.0	6.8	5.2
F. Counterfactual budgetary revenues (D + E)	**514.6**	**535.8**	**552.9**	**573.1**	**595.2**	**617.2**
Day-to-day operating balance (F - C)	**-31.0**	**-15.8**	**-8.3**	**-0.5**	**1.7**	**2.6**

Source:
Parliamentary Budget Office

Based on the PBO-adjusted day-to-day operating balance, the government would not achieve its fiscal anchor of balancing operating spending with revenues by 2028-29, rather in 2029-30. That said, the operating budget deficit is relatively small. This underscores how a subjective “capital” attribution can influence the government’s ability to achieve its fiscal goals. Classifying even a modest amount of spending as capital rather than operating, without any actual change in fiscal policy, may have been relevant to balance the initial operating budget fiscal track.

On September 15, 2026, the Prime Minister announced that the government was on track to balance the operating budget in 2027-28, one year ahead of its Budget 2025 commitment. Budget 2026 will allow PBO to assess the main drivers of the improvement in the operating balance.[14]

Note

[1] Budget 2025. Annex 2: Capital Budgeting Framework.

[2] The UK's current fiscal framework consists of a stability rule and an investment rule. The stability rule requires the current, or day-to-day, budget to be in balance or surplus by 2029-30. The investment rule requires net financial debt to fall as a share of GDP over the same period, with borrowing permitted to fund capital investment.

[3] Modernizing Canada's Budgeting Approach.

[4] Budget 2025.

[5] IMF and OECD reports.

[6] Budget 2025: Issues for Parliamentarians.

[7] Budget 2025. Annex 2: Capital Budgeting Framework.

[8] IR0850, IR0925 and IR0938

[9] PBO identified $24.8 billion of the $38.9 billion total transfer payments reported in Finance's capital investments as grants and contributions, consistent with the $24.9 billion identified in the 2026-27 Departmental Plans. The remaining $14.1 billion cannot be reconciled to a specific grants and contributions program in the Departmental Plans. These amounts reflect measures announced after the publication of the plans, confidential measures, Crown corporation programs, funding embedded in larger undifferentiated authorities, tax expenditures or amounts below $5 million.

[10] PBO identified $15.2 billion in capital tax expenditure in the Federal Tax Expenditures report for 2026-27, compared with $15 billion reported by Finance through IR0938. PBO converted the tax-year cost estimates reported in the Federal Tax Expenditures report to a fiscal-year basis by using 75 per cent of the 2026 estimate and 25 per cent of the 2027 estimate.

[11] The three Natural Resources Canada grants and contribution programs classified as capital investments are: Contributions in support of Zero Emission Vehicle Infrastructure,

Grants and Contributions in support of Home Retrofits, and Grants and Contributions in support of the Smart Renewables and Electrification Pathways Program.

[12] On a cash basis, the composition of new measures is similar, with new measures amounting to a total of $282.2 billion over 2025-26 to 2029-30, of which $88.2 billion, or roughly a third, was attributable to capital investment.

[13] PBO independently projects capital amortization expenses. The outlook for capital amortization expenses is based on projected amortization rates and the government's stock of tangible capital assets. Projected federal government capital asset stocks reflect prior-year balances adjusted for new capital spending and current-year amortization expenses. Additionally, tax expenditures identified as capital investments are adjusted to reflect PBO's GDP growth assumptions.

[14] Prime Minister Carney delivers opening remarks at the Canada Investment Summit

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