ECONOMIC VIEWPOINT

An Oldie but A Goodie: Economic and Fiscal Implications of an Aging Population

By Marc Desormeaux, Principal Economist, and Randall Bartlett, Senior Director of Canadian Economics

Highlights

- Population aging will have profound effects on Canada's economic prosperity, public finances, and the quality of healthcare we can provide. In this note, we discuss some of those impacts and the challenges they will create for the federal and provincial governments.
- The aging of Canada's population is well known and long predicted. Though high immigration levels and skyrocketing non-permanent resident admissions have helped slow the process, alone, they won't be nearly enough to stop the rapid acceleration expected over the next decade.
- Canada's provinces will bear the brunt of the costs of an aging population. Current health spending plans likely won't meet the needs of an aging population, and we estimate that meeting those needs could cost an additional $2.5–5B in each of the four largest provinces by 2030.
- In this challenging environment, governments will need to increase the Canadian economy's productive capacity and find new, more efficient ways to deliver healthcare services. Look for more analysis on healthcare and aging from Desjardins Economic Studies in the coming months.

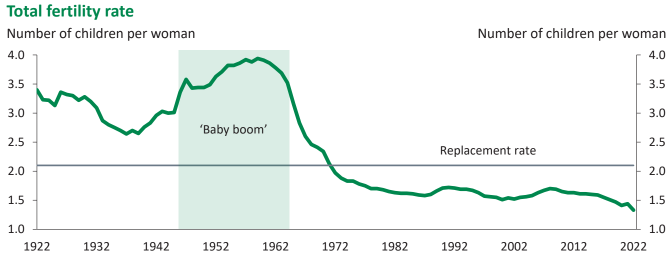
Population aging is sometimes compared to a speeding car approaching in your rearview mirror. For a while, it looks far behind you. But before long it passes you, becomes a speck on the horizon, and you're squinting to see it through the windshield. Amid decades-high population growth, moribund productivity, and a changing budgetary picture at the federal and provincial levels, is Canada cruising at the right speed? Or will our rapid and well-documented rate of population aging soon leave our economy in its dust?

In this note, we update the discussion on population aging in light of recent data and new economic trends. Overall, while many things have changed in the last few years, it's still abundantly clear that aging's impacts and the challenges it will create for the governments over time will be enormous.

Canadians Aren't Getting Any Younger

The aging of Canada's population is well known and long predicted. During the 'Baby Boom' Canadian women gave birth to an average of 3.7 children. But starting in the early 1970s, the fertility rate fell below the replacement rate of 2.1 children (graph 1 on page 2). It has continued to decline gradually since, reaching an all-time low of 1.3 children in 2022, the most recent year for which data is available. Nearly all OECD countries have experienced falling fertility rates over that period, but Canada's ratio is weaker than most others. With all the challenges facing young people today (see here, here and here), it's tough to see why it wouldn't go lower still.

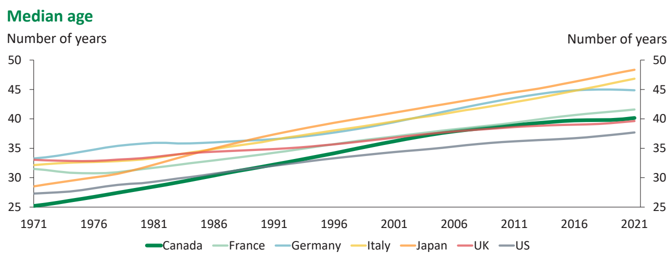
Graph 1
How Low Can Canada's Fertility Rate Go?



Statistics Canada and Desjardins Economic Studies

As the Baby Boomers grew older and had fewer children than their parents while their parents lived longer than ever, the median age of Canadians got older along with them. According to Statistics Canada, it topped 40 years recently, up from 25 years in the early 1970s. But this paled in comparison to the rapid aging that has occurred in some other G7 countries (graph 2).

Graph 2
Canadians are Getting Older but Not as Old as In Some G7 Countries

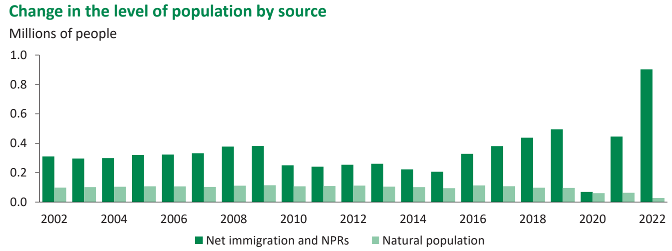


United Nations and Desjardins Economic Studies

While the median age in Canada has continued to climb, the pace of that increase has slowed in the last couple of decades. The primary reason for this deceleration in the aging of Canada's population is immigration (graph 3). Without immigration, Canada's population would be much older and would have grown much more slowly.

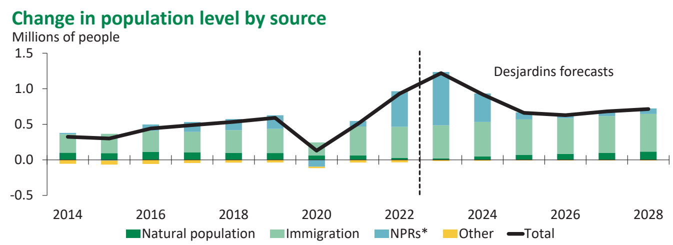
However, the strong pace of immigration and surge in entrants of non-permanent residents (NPRs) (international students, temporary foreign workers, etc.) has recently received pushback from some quarters. This prompted the federal government to cap the number of new study permits issued in 2024 at 65% of 2023 levels. The cap will be revisited for 2025. While we weren't certain which stream of NPRs would see reductions in 2024 and beyond, we included some reduction in NPRs in our population projection (graph 4).

Graph 3
Immigration Has Been the Primary Driver of Population Growth



NPRs: Non-permanent residents
Statistics Canada and Desjardins Economic Studies

Graph 4
Canada's Population Has Boomed Due to Sharply Higher NPRs



NPRs: Non-permanent residents
Statistics Canada and Desjardins Economic Studies

Going forward, there is a real risk that the current and subsequent federal governments aggressively close the door to permanent residents and NPRs. This would cause the Canadian population to age more rapidly, with knock-on consequences for the economy and government finances.

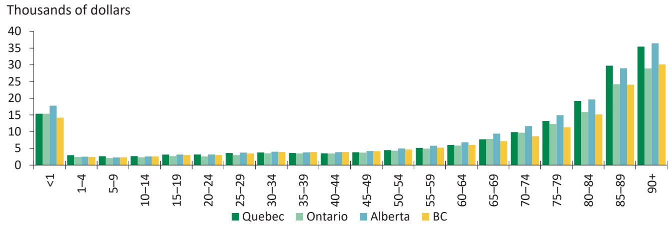
Provincial Governments Are Aging's Frontline

Canada's provinces will bear the brunt of the costs of an aging population. Healthcare is the expenditure category most affected by population aging because providing it is most expensive for older Canadians for whom adverse health conditions are more common (graph 5 on page 3). In Canada, the cost of providing and administering health services is the responsibility of provincial governments and makes up the largest single expenditure category in those governments' budgets.

These fiscal pressures are arguably the most severe on Canada's east coast. The Atlantic Region is home to the oldest populations of any jurisdiction in Canada, as measured by the old-age dependency ratio—the ratio of people ages 65 and over to those ages 15 to 64 (graph 6 on page 3). That said, immigration and mass migration of younger Canadians to the region during the peak pandemic period looks to have slowed the rate of aging. Still, recent population growth has only delayed, not stopped the trend of rapid population aging ongoing across the provinces.

Graph 5
Healthcare Spending Concentrated Among Oldest Canadians

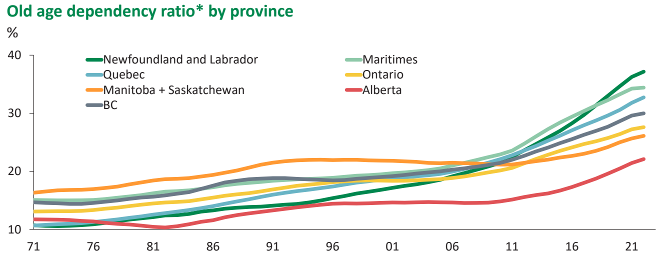
Per capita healthcare spending by age and province, 2021



Canadian Institute for Health Information and Desjardins Economic Studies

Graph 6
Aging Pressures Most Acute on East Coast

Old age dependency ratio* by province



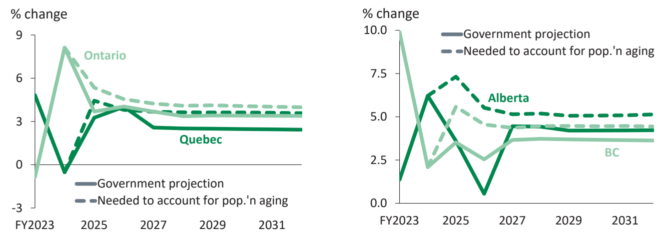
* Population aged 65+ as a share of population aged 15 to 64
Statistics Canada and Desjardins Economic Studies

To quantify the potential fiscal impact of population aging at the provincial level, we made use of government demographic projections and healthcare spending data from the Canadian Institute for Health Information (CIHI). We first assumed that CIHI's estimates of per capita health expenditures—broken down by sex and into five-year age groups—increase at the rate of total inflation. We then applied these anticipated per person figures to the relevant population groups from provincial government demographic projections. The resulting provincial forecasts represent the level of health care spending that would be needed to maintain the current level of service delivery, after accounting for population aging. Finally, we compared these forecasts and government health spending projections.

For two reasons, we limited this approach to the four largest provinces. For one thing, because of skyrocketing net non-permanent resident admissions, Statistics Canada's most recent demographic projections are no longer representative of population growth trends. Against this backdrop, Quebec, Ontario, Alberta, and BC were the only jurisdictions to update their outer-year population and health care expenditure projections in 2023.

The results of our analysis are clear: population aging will prove very costly to Canada's four largest provincial governments. Current health spending plans do not appear sufficient to meet the needs of an aging population (graph 7). And meeting those needs could result in each of the four largest provinces' bottom lines deteriorating by $2.5–5B by the end of this decade.

Graph 7
Current Health Spending Plans Won't Meet the Needs of an Aging Population

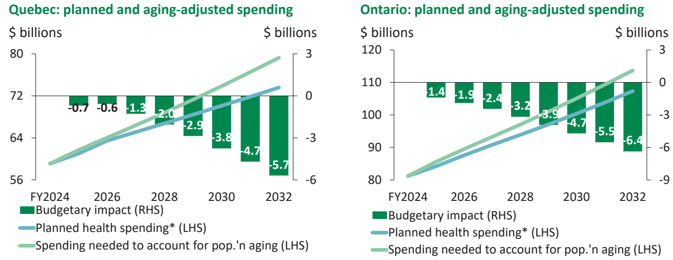


* Health spending assumed to increase according to government forecasts for total consumer price index plus population growth beyond FY2026
Canadian Institute for Health Information, Finances Québec, Ontario Ministry of Finance, Alberta Treasury Board and Finance, British Columbia Ministry of Finance and Desjardins Economic Studies

Based on these results, provinces could soon find themselves between a rock and a hard place. Either they must accept a degree of deterioration in health care service quality or increase spending plans at significant cost (graphs 8 and 9 on page 4). And the spectre of that fiscal impact comes at a time when many provinces are attempting to control spending as part of efforts to balance their budgets over the next few years. That limits the scope for material increases versus current plans in the near future.

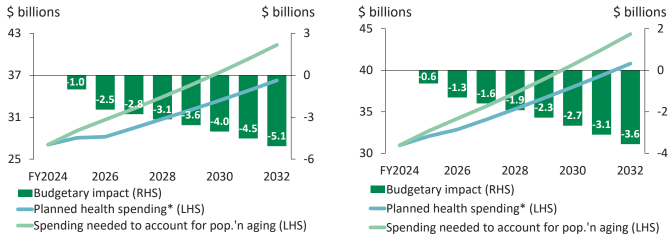
International migration can help mitigate the effects of population aging, though it's not a silver bullet. In our non-permanent resident-driven high population growth scenario, we would expect dependency ratios in the four largest provinces to come in about one percentage point lower than in the base case by 2030. That would bring per-person health care expenditures down and boost the income tax base. But it would also put upward pressure on other spending categories and still leave dependency ratios at all time highs in all four jurisdictions.

Graph 8
Meeting the Needs of an Aging Population Will Be Costly, Part 1



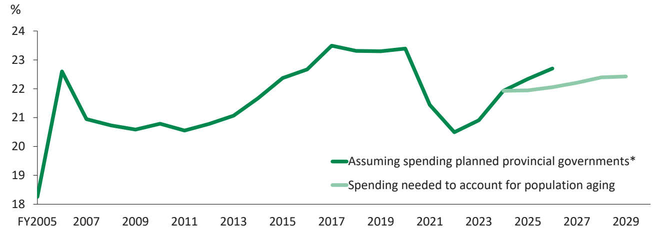
* Health spending assumed to increase according to government forecasts for total consumer price index plus population growth beyond FY2026
Canadian Institute for Health Information, Finances Québec, Ontario Ministry of Finance and Desjardins Economic Studies

Graph 9
Meeting the Needs of an Aging Population Will Be Costly, Part 2



* Health spending assumed to increase according to government forecasts for total consumer price index plus population growth beyond FY2026
Canadian Institute for Health Information, Alberta Treasury Board and Finance, British Columbia Ministry of Finance and Desjardins Economic Studies

Graph 10
Federal Health Contribution Share Will be Lower if Provincial Healthcare Spending Accounts for Population Aging
Canada Health Transfer as a share of provincial health spending



* Forecast based on combined growth rates for the four largest provinces
Finance Canada, Canadian Institute for Health Information and Desjardins Economic Studies

Federal Finances Are Less Vulnerable to Aging

It is a national pastime in Canada to watch the federal budget balance and complain about the level of Government of Canada debt. But when it comes to aging at least, the federal finances are much less vulnerable than those in the provinces. That's because the federal government largely taxes and transfers as opposed to directly delivering the programs most likely to be stretched by an aging population.

Most directly at the federal level, elderly benefits will be pushed higher as Canadians get older, as this major transfer tends to increase with the senior population and inflation. Indeed, this program is indexed to inflation, which has further contributed to the sustained deficits recently in the ongoing high-inflation environment.

More indirectly, the Canada Health Transfer (CHT) is a per capita transfer from the federal to provincial governments in support of their providing more equitable, publicly funded health care services across the country. However, the CHT as a share of provincial health care spending has generally declined over the last few years. This reflects the increase in provincial health spending because of the pandemic. Implementation of a less generous rule that limits CHT increases to the three-year moving average of Canadian nominal GDP growth also contributed to the decline. The recently announced top up to the CHT should help to reverse that somewhat over time. But going forward, we don't expect the transfer's share of provincial health expenditures to reach its late-2010s peak (graph 10).

Other federal spending and revenue categories are more indirectly affected by the impact of aging on the economy. As the population ages, real and nominal GDP growth tend to slow as workers become less engaged in the labour market. This reduces revenues generally and some categories more specifically, like personal income taxes and Employment Insurance premiums. It is difficult to think of a revenue source that won't be adversely impacted by aging. However, spending categories other than elderly benefits and CHT should generally rise more slowly in response to weaker economic and labour market activity.

All told, slower revenue growth combined with modestly higher expenses due to aging should lead federal deficits to be larger and debt higher that would otherwise be the case. That's why immigration plays such an important role in offsetting the slowing in economic growth and fiscal burden posed by aging. As we determined in a report last year, Canada would need to see sustained solid population growth to just stabilize the old-age dependency ratio. But given the constraints in Canada's capacity to welcome newcomers, it means that the economic growth offset will also have to rely on stronger productivity to a meaningful extent.

Conclusion

Population aging will have profound effects on Canada's prosperity, public finances, and the quality of healthcare it can provide. Despite pushback from many stakeholders about the pace of population growth, there's no question that international migration has helped to stem the tide. Getting policy right on this front will be important if we are to keep Canada's economy and fiscal position in good shape. But on its own, that won't be anywhere near enough to stop the rapid pace of population aging expected over the next decade. That means many governments face potentially very large fiscal costs and the possibility of diminished overall healthcare service quality, with the most significant impacts at the provincial level.

In this challenging environment, governments will need to increase the Canadian economy's productive capacity and find new, more efficient ways to deliver healthcare services, as well as use more targeted immigration policy. Look for more analysis on healthcare and aging from Desjardins Economic Studies in the coming months.