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Healthcare costs: Still ailing provincial budgets

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The pandemic may be distant in the rearview mirror, but healthcare costs are continuing to have an outsized impact on provincial finances. At just over 40% of total expenses in aggregate, healthcare is always the single biggest line item. But its recent impact has been even greater than that, as it has contributed more than half of the increases in spending seen in the past five years. Moreover, these cost increases haven't always been easy to predict, with healthcare also contributing more than 50% of recent spending overshoots relative to initial budget estimates (Chart 1).

Increased health spending needs have often been blamed on inflation (including pay increases for medical staff) and population growth. While concerns about inflationary pressures are resurfacing again due to the Middle East conflict, the sharp deceleration in population growth should, in theory, ease the strain on healthcare costs. Unfortunately, however, there is another and potentially larger factor driving costs upwards — one that will get worse before it gets better.

That's the increase in healthcare costs that comes from an aging population, as per capita health spending rises

exponentially for age brackets above 65 (Chart 2). If the population continues to age as expected, then healthcare costs could continue to rise more than provinces, on aggregate, are currently projecting.

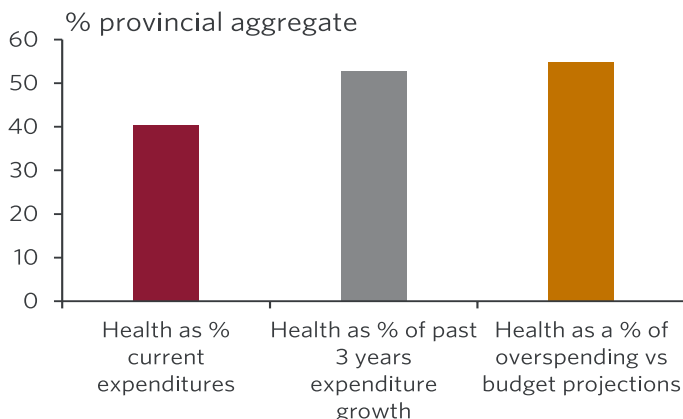
A problem as old as...

A decomposition of the increase in healthcare costs since 2019 illustrates that the surge hasn't been wholly driven by population growth and inflation (Chart 3). Indeed, for some provinces (BC, NS and NL) almost half of the cumulative increase appears to be due to other factors.

These "other factors" may not solely be related to population aging. It is possible, for example, that productivity has differed across the country in the healthcare sector. We have also seen many provinces trying to improve the quality of healthcare, after the pandemic revealed flaws within the system.

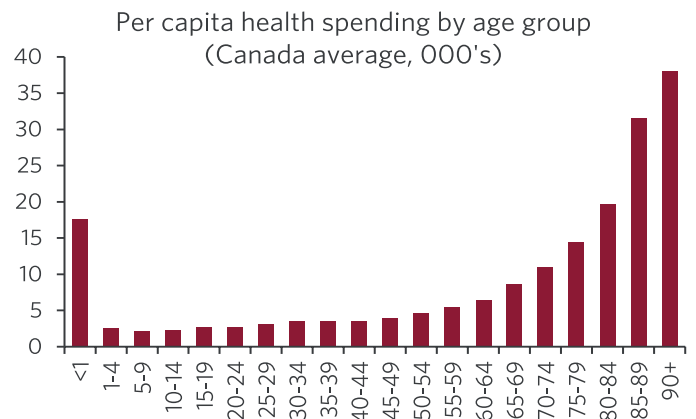
As macroeconomists, we're not well positioned to judge where improvements in the standard of care are necessary, or the

Chart 1: Health costs an important driver of budgetary performance



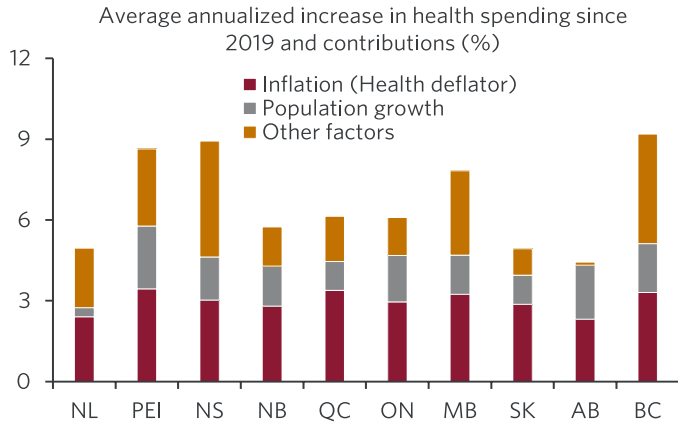
Source: Provincial budgets, CIBC

Chart 2: Per capita health spending rises exponentially for age groups above 65



Source: Canadian Institute for Health Information, CIBC

Chart 3: Inflation and population growth only partly explain higher health spending

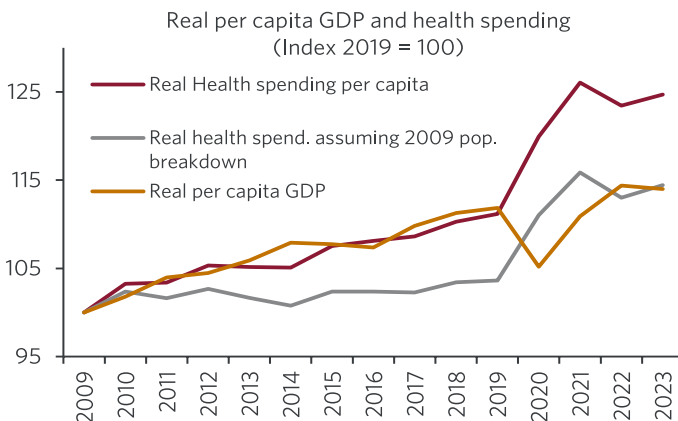


Source: Canadian Institute for Health Information, CIBC

magnitude of spending increases needed to achieve them. However, it does appear that the healthcare shortcomings exposed by the pandemic also stemmed indirectly from the aging population, and the failure to provide sufficient funds to address their needs in the years before the pandemic struck. While inflation-adjusted healthcare spending broadly kept pace with real GDP on a per capita basis between 2010 and 2019, it actually flat-lined if you adjust for the aging population (Chart 4). In other words, healthcare spending was falling as a percentage of the overall economy once you adjusted for the needs of an ageing population.

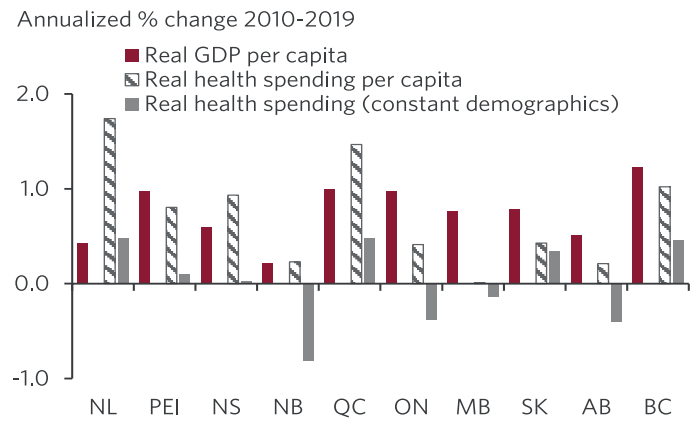
That was the case, to varying degrees, across most of the country (Chart 5). Even in Quebec, where inflation-adjusted per capita health spending rose quickly in the decade that preceded the pandemic, after adjusting for the aging population, that increase was much more modest and below the pace of per-capita GDP growth. In some provinces, including Ontario,

Chart 4: Real per capita health spending flatlined pre-pandemic after adjusting for population ageing



Source: Canadian Institute for Health Information, Statistics Canada, CIBC

Chart 5: Age-adjusted real per capita health spending was falling in some provinces prior to the pandemic



Source: Canadian Institute for Health Information, Statistics Canada, CIBC

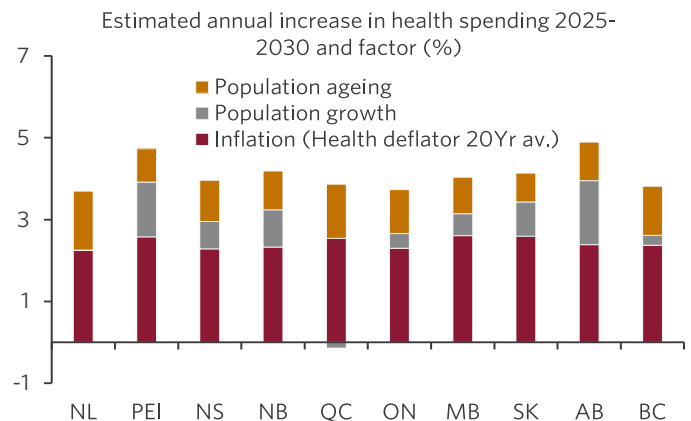
age-adjusted health spending was actually falling in real terms.

Not getting any easier

A further ageing of the population ahead will continue to put upward pressure on healthcare costs. Indeed, with growth in aggregate populations slowing dramatically (and stalling in some provinces), population ageing will likely be the second largest driver of increases in healthcare costs over the next five years, assuming an average trend in inflation. That's particularly the case in Quebec, BC and Newfoundland & Labrador, where we project that average annual increases in healthcare costs could still be close to 4% even with little (or no) population growth (Chart 6).

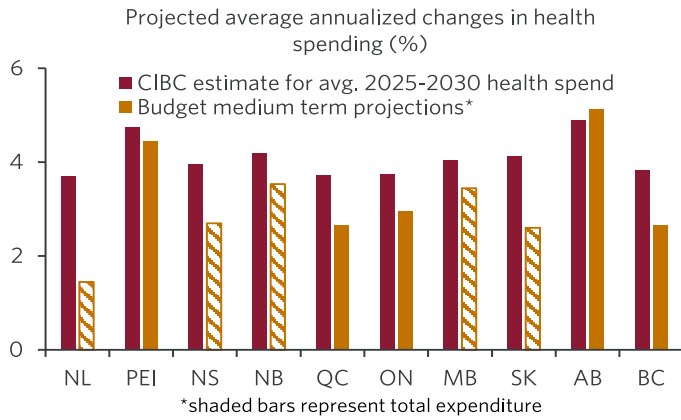
While provincial governments have generally been raising health spending within budget plans, these increases may still

Chart 6: Population ageing, rather than population growth, will be a bigger driver of health costs in most provinces



Source: Canadian Institute for Health Information, Statistics Canada, CIBC

Chart 7: Provinces are planning for high health costs, but maybe not quite enough in most cases

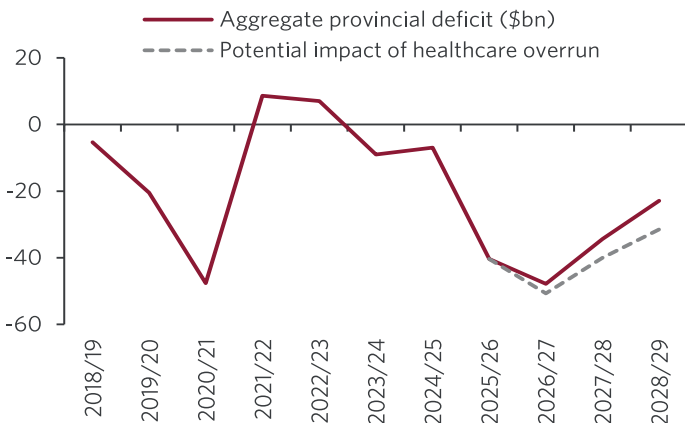


Source: Canadian Institute for Health Information, Provincial budgets, CIBC

not be quite strong enough to keep up with the demands of an ageing population. Medium-term projections for health spending, where provided, are often still slightly lower than our estimate of what's needed to cover inflation and population ageing (Chart 7). Where specific medium-term projections for health spending are not available, it is clear that provinces could see upward pressure on their total expenditure estimates ahead, unless cutbacks were made in other areas.

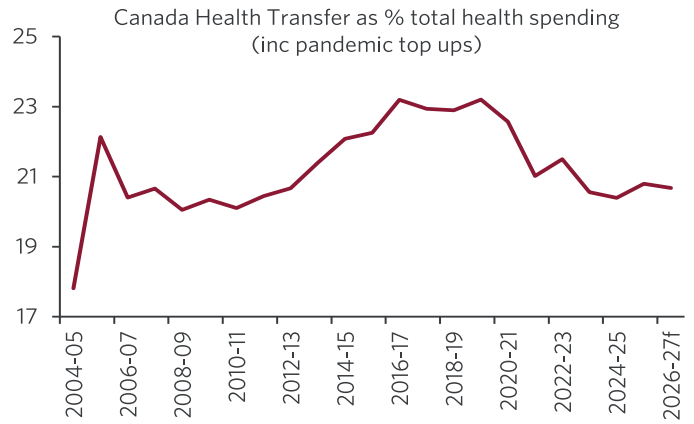
The potential for health spending to continue rising quicker than provincial forecasts would have an obvious negative impact on overall budget projection. If healthcare costs rise by an additional 1% a year between now and fiscal 2028/29 (the year most province's medium-term projections end), the aggregate deficit would be roughly \$9bn wider without new revenue sources or savings in other expenditure areas (Chart 8). Note that these projections do not account for any other changes, such as commodity price and interest rate assumptions, relative

Chart 8: Further increases in healthcare costs would limit any improvement in budget deficits after this year



Source: Provincial budgets, CIBC

Chart 9: Federal government transfers cover only a small proportion of health costs



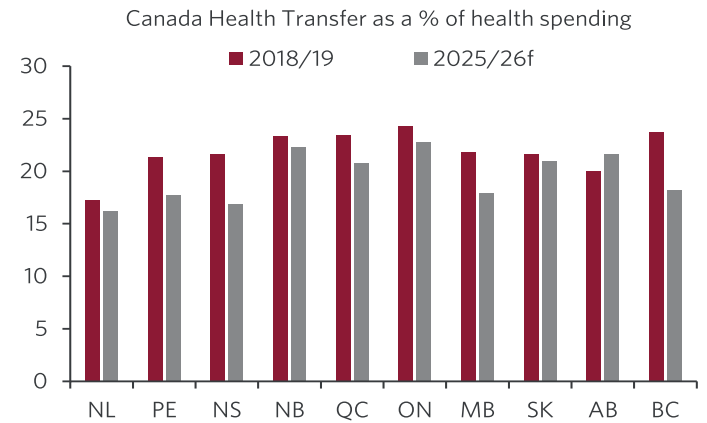
Source: Canadian Institute for Health Information, Federal government, CIBC

to what was included in recent provincial budgets.

And it's important to remember that provinces bear most of the cost for healthcare. Transfers from the federal government under the Canada Health Transfer account for around 21% of health spending, with this figure down from a peak of roughly 23% pre-pandemic. Top-up payment increase to that transfer in fiscal years 2025/26 and 2026/27 have only partly reversed the downward trend in the proportion covered, thanks to the sharp increases in overall health spending seen last year and budgeted for this year (Chart 9).

However, that trend to a smaller percentage contribution from the federal government relative to pre-pandemic peaks isn't consistent across provinces, because the transfer is based on a calculation using nominal GDP and doesn't account for population ageing. BC, Nova Scotia and PEI have seen the largest declines in the proportion of health spending covered by federal transfers (Chart 10). In contrast, Alberta and

Chart 10: Federal transfers for health costs vary slightly across provinces



Source: Canadian Institute for Health Information, Federal government, CIBC

Saskatchewan, where populations may not be ageing as quickly and nominal GDP growth has recently been stronger, have seen little change or even a slight increase in the proportion covered.

Health costs still ailing provincial finances

Overall, it's very likely that rising healthcare costs continue to put strain on provincial budgets in the medium term, with increases driven not just by inflation and population growth, but also by the needs of an ageing population. While most provinces are budgeting for large increases this year, medium-term projections may still be too low. If healthcare costs remain higher than current projections, that will make it harder for provincial governments to make progress in narrowing the aggregate deficit that is currently projected.

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