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From: Don Drummond and Nicholas Dahir
To: Defence Spending Observers
Re: SOMETHING BIG HAPPENED TO DEFENCE IN THE BUDGET: WHAT IT IS
ISN'T EXACTLY CLEAR

A few defence matters were made clear in the last month's federal budget.

First, the injection of new funding is very large. Second, the incremental money still leaves Canada short of its recent commitment to NATO's 3.5 percent of GDP target. And third, plans are incomplete as to how to use the new funds. This raises an assortment of questions the budget should have addressed.

1. How much new money is being injected?

The budget says \$81.8 billion is being allocated over five years on a cash basis, starting in 2025/26. That has been widely reported as the increase in defence spending, although a Globe and Mail article talks about \$84 billion. Oddly, there is no table in the budget that shows either \$81.8 or \$84 billion. According to the Department of National Defence, the five-year cumulative total of \$56.6 billion shown in the budget is the equivalent on an accrual accounting basis to the \$81.8 billion cash injection. It is understandable the budget would include a table with accrual accounting as that is the accounting convention underlying the budget. But NATO spending is reported on a cash basis. Not showing the details on an annual cash basis forces guesswork.

Furthermore, the cash figure of \$81.8 billion does not include all defence spending initiatives in the budget. Adding those, the largest of which is \$2.7 billion over three years for the **renewal** of Operation REASSURANCE, gives a five-year total increase of \$84.9 billion on a cash basis.

2. Where does the budget leave defence spending as a percentage of GDP?

Since we don't know how much money is actually going to flow on a cash basis, we cannot calculate defence spending as a percentage of GDP.

We do know that of the \$84.9 billion announced, \$9.2 billion had already been allocated for this fiscal year. If we assume the remaining \$75.7 billion is distributed evenly over the forecast period – about \$18.9 billion per year – then, combined with a pre-budget defence baseline of \$57.4 billion for 2029/30, total spending for that year would yield a defence-to-GDP ratio of approximately 2.06 percent, based on the budget's nominal GDP projection of \$3.7 trillion.

There may be additional amounts that should be added to for purposes of this calculation. If so, what are they?

Here too, it is murky, but the broader point is clear: despite a massive injection of new funds, Canada is not on track to reach 3.5 percent by 2035.

If we use a pre-budget defence baseline of \$52.3 billion for 2025/26 and add the \$9.2 billion in additional spending announced last June, dividing by the budget's projection of nominal GDP at \$3.2 trillion gives a defence-to-GDP ratio of roughly 1.9 percent this year. Assuming a linear rise in the defence-to-GDP ratio to 3.5 percent by 2034/35, spending in 2029/30 would need to reach about 2.6 percent of GDP by that time – almost halfway to the target. On that path, total additional defence spending from 2025/26 to 2029/30 would need to exceed \$120 billion.

3. Where does Canada stand on the commitment to NATO to spend 1.5 percent of GDP on matters supporting defence?

What qualifies for NATO's defence-supporting spending target is broad and open to interpretation. Canada and several allies are declaring projects like roads, ports, airports, telecommunications networks, and other civilian infrastructure can support military readiness and are therefore eligible. On numerous occasions the government has insisted that Canada is already, and will remain, in compliance. Presumably it will be found in the tens of billions being spent on infrastructure projects and the renewal of existing ones.

4. Will the money actually go out the door?

The defence department has a history of underspending even its traditional smaller budgets. The Parliamentary Budget Office revealed an \$18.5 billion shortfall of budgeted capital spending over fiscal 2017/18 to 2023/24. The PBO expected the pattern of lapses to continue.

5. Are there plans for the new spending?

The budget announces in very general terms how some of the new money will be employed. In 2024, Our North, Strong and Free **set out** an incomplete plan for the future of defence. As David Perry **noted**, the budget provides 80 percent of the new funding referenced in that plan. But that 2024 plan was already incomplete and is now irrelevant in the context of much higher spending over the next few years. When will a more complete, and up-to-date plan be released?

The budget references keeping much of the new spending in Canada to bolster the economy. A more comprehensive and detailed economic plan is needed and it needs to look beyond simply spending at home, but intelligently assessing what makes sense to manufacture in Canada, and how defence research can create spin-offs for other sectors. Further, we'll still be importing a lot of gear from the United States, no matter how well we do at increasing our production, and we should leverage that to achieve a better trade arrangement.

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