

Intelligence MEMOS



From: William B.P. Robson
To: Canada's Voters
Date: October 10, 2019
Re: **CAMPAIGN 2019: DUMB ON DEFICITS**

For Canadians concerned about national finances, the 2019 federal election campaign has been a double whammy. Personal smears and social-media mobbing have mostly eclipsed substance. And any discussion of budgetary policy that has managed to cut through the noise has been discouraging. Especially the commitments for more and bigger deficits: even more red ink in the next four years than was spilled in the past four.

Economists are divided about how much that matters. If the ratio of federal debt to GDP is stable, some say, we are good. Others, like me, don't like how deficits burn up saving, heralding a future with less infrastructure, housing, machinery and technology than we otherwise would have enjoyed. If there's no consensus on those points, let's start with something so basic that it features in first-year textbooks: that smart fiscal policy can help stabilize the economy. What we have seen lately, and what the campaign is amping up, is not smart fiscal policy.

The concept behind smart stabilization is not controversial. Suppose the economy is slowing. Lower incomes and spending reduce revenues, while income supports and stimulus raise spending. Letting the bottom line slip toward deficit avoids disruptive changes in tax rates and programs, maintaining confidence and cushioning the slump. When the economy picks up, the opposite happens. The boom raises revenues and reduces spending. Letting the bottom line rise toward surplus cools off an overheating economy. And prepares government finances to respond with more smart fiscal policy when the next downturn comes.

We have seen this, not just in textbooks, but in the real world — including a decade ago in Ottawa. The federal government's response to the financial crisis of 2008 and the recession of 2009 followed the formula. It budgeted for lower revenue and higher spending in the 2008/09 and 2009/10 fiscal years. Moreover, when the slump turned out deeper than expected, revenue undershot projections in both years, while spending overshot. The bottom line went way south. But in a recession that was smart fiscal policy.

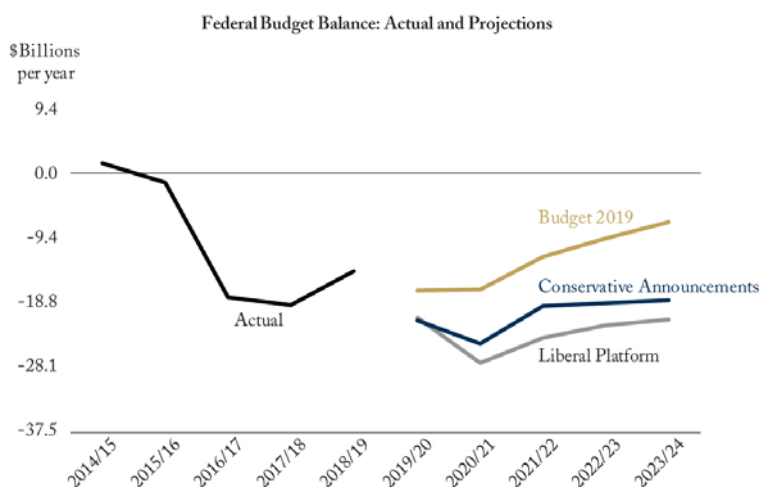
The federal government's record during the recovery was also pretty good. It budgeted for a return to surplus. Moreover, when better-than-expected growth boosted revenue and reduced the need for spending, it let the bottom line recover faster than budgeted. Then, when the oil-price collapse buffeted the economy five years ago, it let the bottom line slip back. Again, smart fiscal policy.

Targeting the ratio of federal debt to GDP would have been less smart. A long-run debt-to-GDP target is not a serious constraint. Even if Statistics Canada did not regularly revise its GDP numbers, which it does, governments can't credibly commit beyond the next election. For its part, a short-run debt-to-GDP target is just silly — it's a promise to make the debt grow as fast as the economy. So a fast-growing economy means a bigger deficit. A slow-growing economy means a smaller deficit. A shrinking economy means a surplus. That would be dumb.

The federal government's record since 2014-15 has been less smart. Over the past four years, the economy surprised to the upside. Federal revenues consistently overshot. But only once did actual spending come in below budget, as ought to happen in a strong economy. The rest of the time, the government boosted spending, keeping the bottom line way in the red. Not smart.

Now the election campaign is moving us further toward dumb. The crisis of 2008-2009, and the oil price collapse of 2014, are well in the past. Revenues have been strong and the federal bottom line should be back in the black. But the 2019 federal budget prefigured a further ramp-up in spending, and the Liberal platform, and the Conservative commitments to this point, augur even more. We need smarter than this.

During the rest of the campaign, we need more substance — and sensible substance — on our national finances. We know what smart fiscal policy looks like. We should not be doubling down on dumb.



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Sources: Federal Public Accounts, 2019 Federal Budget, Tally of platform commitments by Prof. Kevin Milligan, UBC.