The unbalanced thinking behind a balanced budget law

By Andrew Jackson
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The Harper government claim to be paragons of fiscal virtue. They have pledged to balance the federal budget this year, notwithstanding a slowing economy, and are likely set to announce details of the balanced budget legislation promised in the 2013 Speech from the Throne.

The promised legislation will disallow annual deficits in "normal economic times" (whatever they are) and "set concrete targets for returning to balance in the event of an economic crisis."

Balanced budget legislation is a bad idea since it would remove the flexibility that is needed to set fiscal policy in a changing economy, particularly an economy such as Canada's with an exaggerated boom-bust cycle linked to resource prices.

When it comes to balancing the books, the Harper government is seemingly more Catholic than the Pope. Even the International Monetary Fund (IMF), hardly big fans of high government spending, argue in their latest Country Report released in January that the federal government should ease up on fiscal restraint in the near term to the tune of 0.3 per cent of gross domestic product. They say this should fund "targeted measures to support growth."

In effect, the IMF said there is no need to quickly balance the federal budget given that growth will be hit hard by the slump in oil prices. They have not said, as has Prime Minister Harper, that we must fall into a recession before we should run a deficit.

The IMF also argues that Canada would be better off to adopt a medium-term fiscal target of debt relative to GDP, rather than a rule to balance the budget in each and every non-recession year.

For its part, the Parliamentary Budget Office noted that the federal government has a very low level of public debt that is shrinking as a share of the economy and stands to be eliminated entirely over the next thirty years.

There is a strong case for deficits to fund public investments that boost future growth and thus help achieve a debt-to-GDP target by growing the economy rather than by cutting spending on social programs and public services. This is especially true with interest rates now at near record lows, and at a time when monetary policy is not the best instrument to boost spending given already sky-high levels of household debt.

And deficits are friendly to future generations since they will enjoy the long-term benefits of investments in areas such as education, skills, innovation and infrastructure.

While the Conservative goal is ostensibly to balance the books, this is, at best, a secondary goal. Their real priority has to be to cut spending so as to cut taxes, not reduce debt.

When the Harper government was elected back in 2006, the federal books were in surplus. While spending more in 2008 and 2009 to counter the impacts of the recession was amply justified, the real Conservative priority has been to cut taxes. Witness the two-percentage-point cut to the GST rate, deep corporate tax cuts, and a host of boutique tax cuts for the government's electoral targets such as high-income single paycheque families.

When the government took office, federal taxes consumed 16.0 per cent of GDP, which has fallen to a forecast 14.5 per cent of GDP this fiscal year. That seemingly small difference translates into $29.8-billion of forgone revenues, enough to have financed any social activist's dream agenda.

We have thus ended up in a very strange situation. The government made deep and damaging cuts where none needed to be made in order to to finance its tax cut agenda. Now further cuts will be made to eliminate the deficit, even though debt is falling, and even though the IMF is counselling spending more to boost a sagging economy.

And somehow this government has gained the reputation of being good economic managers.

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