Keynes comes to Canada

By Paul Krugman
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Canada has a reputation for dullness. Back in the 1980s The New Republic famously declared “Worthwhile Canadian Initiative” the world’s most boring headline. Yet when it comes to economic policy the reputation is undeserved: Canada has surprisingly often been the place where the future happens first.

And it’s happening again. On Monday, Canadian voters swept the ruling Conservatives out of power, delivering a stunning victory to the center-left Liberals. And while there are many interesting things about the Liberal platform, what strikes me most is its clear rejection of the deficit-obsessed austerity orthodoxy that has dominated political discourse across the Western world. The Liberals ran on a frankly, openly Keynesian vision, and won big.

Before I get into the implications, let’s talk about Canada’s long history of quiet economic unorthodoxy, especially on currency policy.

In the 1950s, everyone considered it essential to peg their currency to the U.S. dollar, at whatever cost — everyone except Canada, which let its own dollar fluctuate, and discovered that a floating exchange rate actually worked pretty well. Later, when European nations were scrambling to join the euro — amid predictions that any country refusing to adopt the common currency would pay a severe price — Canada showed that it’s feasible to keep your own money despite close economic ties to a giant neighbor.

Oh, and Canadians were less caught up than the rest of us in the ideology of bank deregulation. As a result, Canada was spared the worst of the 2008 financial crisis.

Which brings us to the issue of deficits and public investment. Here’s what the Liberal Party of Canada platform had to say on the subject: “Interest rates are at historic lows, our current infrastructure is aging rapidly, and our economy is stuck in neutral. Now is the time to invest.”

Does that sound reasonable? It should, because it is. We’re living in a world awash with savings that the private sector doesn’t want to invest, and is eager to lend to governments at very low interest rates. It’s obviously a good idea to borrow at those low, low rates, putting those excess savings, not to mention the workers unemployed due to weak demand, to use building things that will improve our future.

Strange to say, however, that hasn’t been happening. Across the advanced world, the modest-size fiscal stimulus programs introduced in 2009 have long since faded away. Since 2010 public investment has been falling as a share of G.D.P. in both Europe and the United States, and it’s now well below pre-crisis levels. Why?

The answer is that in 2010 elite opinion somehow coalesced around the view that deficits, not high unemployment and weak growth, were the great problem facing policy makers. There was never any evidence for this view; after all, those low interest rates showed that markets weren’t at all worried about debt. But never mind — it was what all the important people were saying, and all that you read in much of the financial press. And few politicians were willing to challenge this orthodoxy.

Most notably, those who should have stood up for public spending suffered a striking failure of nerve. Britain’s Labour Party, in particular, essentially accepted Conservative claims that the nation was facing a fiscal crisis, and was reduced to arguing at the margin about what form austerity should take. Even President Obama temporarily began echoing Republican rhetoric about the need to tighten the government's belt.

And having bought into deficit panic, center-left parties found themselves in an extremely weak position. Austerity rhetoric comes naturally to right-wing politicians, who are always arguing that we can't afford to help the poor and unlucky (although somehow we're able to afford tax cuts for the rich). Center-left politicians who endorse austerity, however, find themselves reduced to arguing that they won't inflict quite as much pain. It's a losing proposition, politically as well as economically.

Now come Justin Trudeau's Liberals, who are finally willing to say what sensible economists (even at places like the International Monetary Fund) have been saying all along. And they weren't punished politically — on the contrary, they won a stunning victory.

So will the Liberals put their platform into practice? They should. Interest rates remain incredibly low: Canada can borrow for 10 years at only 1½ percent, and its 30-year inflation-protected bonds yield less than 1 percent. Furthermore, Canada is probably facing an extended period of weak private demand, thanks to low oil prices and the likely deflation of a housing bubble.

Let's hope, then, that Mr. Trudeau stays with the program. He has an opportunity to show the world what truly responsible fiscal policy looks like.