Why the Canadian economy needs a new public investment boost

By Andrew Jackson
December 12, 2016 – *The Globe and Mail*

The Liberal federal government took office just over one year ago, not least because Justin Trudeau promised to boost the economy and help the middle class through a major increase to public investment. Economists and the public generally endorsed running modest deficits at a time of very low interest rates in order to spark a stronger recovery.

As 2016 draws to a close, the economy continues to limp along and there is a growing case for further fiscal stimulus in 2017.

It is clear that 2016 has been an economic bust. Over the year from November, 2015, to November, 2016, we lost 30,000 full-time jobs; the proportion of part-time jobs jumped to 19.7 per cent from 18.7 per cent; and the unemployment rate would have risen if the number of Canadians seeking work had not fallen.

Middle-class living standards are stuck in the mud. The average hourly wage has increased by just 1.4 per cent over the past year and average weekly earnings have risen by just 1.1 per cent. Meanwhile, inflation is running at a projected 1.6 per cent for 2016.

Growth for 2016 is expected by private forecasters to come in at just 1.2 per cent. Non-residential business investment has been dismal, falling by 5.4 per cent between the third quarters of 2015 and 2016. Exports were flat over the same period, meaning that growth essentially came from the continuing housing boom and consumer spending based on rising debt.

This dismal record is, of course, mainly a result of global economic forces that governments cannot control. But the promised fiscal boost was modest and has not made much of a difference.

Between the third quarters of 2015 and 2016, capital investments by all levels of government rose by just 0.8 per cent, even less than the very weak overall growth rate. And the Bank of Canada noted in the Dec. 7 media release announcing no change to interest rates that "the effects of federal infrastructure investment are not yet evident in the GDP data."

The bank judges that the contribution of government spending to growth will increase a little bit in 2017, but they and private sector economists still expect growth of only about 2 per cent in 2017. This is not enough to put much of a dent in unemployment and underemployment and stagnant wage growth.

There is a widespread misconception that all government deficits are stimulative. In fact, an increase in the deficit because of slow growth that lowers revenues does not boost the economy. Changes in budget balances are best calculated on a "cyclically adjusted" basis, as is done by the International Monetary Fund in the Fiscal Monitor publication.

Stimulus comes about from changes to the overall budget balance that arise from discretionary spending or tax measures. In 2016-17, the federal government boosted program spending to 14.4 per cent from 13.7 per cent of GDP, but spending is projected to rise only marginally to 14.6 per cent of GDP in 2017-18.

As made clear in the recent Fall Economic Update, the federal deficit will remain at about $28-billion next year mainly as a result of a very weak economy, as opposed to any net new spending or tax measures.

Total Canadian government spending as a share of GDP is not forecast by the International Monetary Fund to increase at all in 2017 as many provinces impose austerity programs. And the IMF calculates that, while there was a modest stimulus to growth in Canada in 2016 from discretionary fiscal policy at the government level, this will not be the case in 2017 when fiscal policy will become modestly contractionary.

The Trudeau government's first budget essentially delivered a modest one-time boost to Canadian growth that has marginally helped to offset slumping private investment and the impacts of provincial spending cuts. But this stimulus will very soon run out of steam. In putting together the 2017 budget, Finance Minister Bill Morneau will have to seriously consider a further boost to public investment if exports and private investment continue to disappoint, and if we continue to have a very weak job market.

Andrew Jackson is an adjunct research professor in the Institute of Political Economy at Carleton University in Ottawa and senior policy adviser to the Broadbent Institute.