

Six lessons from Canada's path to fiscal virtuoso

The Canadian Liberal Party's experience of battling fiscal crises in the 1990s offers some key lessons for centre-left parties today

BY EUGENE LANG & FRANK GRAVES

Imagine an advanced Western country with a budget deficit of nearly 7% of GDP and a debt to GDP ratio of over 70%. The country has run deficits consistently for a quarter century and its gold plated credit rating is at risk. Its government nearly fails to roll over debt in a bond auction, coming dangerously close to hitting the fiscal wall. A full 32% of tax revenue is going towards paying the interest on the national debt. *The Wall Street Journal* labels the country a “banana republic”.

The country has emerged from a brutal recession, yet three years on, its unemployment rate is stuck in double digits. Growth prospects appear bleak. The citizenry has lost faith in politicians, governing institutions and the economy. It is fertile ground for radical right-wing and ethno-nationalist political parties, who are having unprecedented success challenging half a century of economic, social and political consensus.

You would be forgiven for concluding that this sounds like any number of European countries or even the United States today. But it isn't. The country in question is Canada in 1994-95.

At the time, the Canadian federal government was piloted by the Liberals, a centre-left party which had taken office after a decade in the political wilderness. Yet, within three years, this government – which many thought congenitally incapable of managing the nation's books due to its previous governing record in the 1970s and 1980s – had eliminated the deficit and begun paying down debt with alacrity. So much so that by 1997 *The Economist* labelled Canada a “fiscal virtuoso”. By the mid-2000s, Canada's federal debt to GDP ratio had plummeted to under 30%. And today, despite running big deficits for the past five years (under a Conservative government), Canada remains one of the most fiscally solid countries in the developed world.

What policy and political lessons might progressives in Europe, America and other countries that are battling fiscal crises today take from the Canadian experience of 15 years ago? Six spring to mind.

1. The public might be more willing to support austerity than is thought.

In Canada, by the mid 1990s, the media, economists and some political leaders had been warning of the perils of deficits for years and these warnings had taken root in the public consciousness. Canadians were better conditioned towards austerity than many assumed when the government took drastic anti-deficit measures in their watershed 1995 Budget. Polls suggested 90% of Canadians ranked fiscal issues in their top three priorities. The Liberal government was re-elected three times following that austerity budget.

2. Act quickly and decisively on the fiscal problem, not incrementally.

This approach, taken by the Liberals, re-assured markets (and led to lower government borrowing costs) and resulted in the elimination of the deficit in three years. This is not to say that all austerity measures should be enacted immediately. This was not done in Canada and would be inappropriate in Europe or the US today given the anaemic state of the economy.

Rather, it is to say: develop the fiscal strategy and announce a detailed plan immediately, with appropriate phasing of specific initiatives.

3. Use the austerity agenda to re-engineer government towards a progressive state designed for the challenges of the 21st century.

Do not make across-the-board cuts to ministries, programmes and initiatives, “sharing the pain” equally, as it were. The pain should be shared unequally, based on a rigorous analysis of what a modern progressive state really needs and must do, and what it no longer needs to do. Anachronistic sacred cows – which persist mainly due to sectional interests and nostalgia – should be slaughtered on the altar of austerity.

The Liberals, for example, had established a litany of state-owned enterprises, yet they came to the conclusion that many of these “crown corporations” no longer had a compelling public interest or policy rationale and should be privatised. A money-losing, debt-laden and uncompetitive government-owned freight railway – Canadian National – was sold, resulting in the largest public offering in Canadian history and yielding the government C\$2.16bn. Today, Canadian National is one of the most competitive and successful railways in North America.

4. Don’t rely heavily on downloading to lower levels of government.

The Liberals made a big mistake in their austerity drive when they radically cut fiscal transfers to provinces that were used to fund health, education and social welfare services. The provinces, also experiencing fiscal crises at the time, were even less capable of managing these cost pressures than the federal government, so they further devolved fiscally to municipal governments and citizens, creating a regressive cascade of passing the buck. Ottawa’s downloading poisoned federal-provincial relations and ushered in more than a decade of intergovernmental wrangling over money that still hasn’t fully worked itself out.

5. Never rest on past fiscal laurels.

Do not allow success in eliminating a deficit to weaken the heart and soul – the core goals and orientation – of a progressive political party or government. And do not assume that because a progressive government succeeds in regaining a nation’s fiscal sovereignty – where conservatives had failed – that translates into the public seeing progressives as having the best credentials on fiscal and economic matters.

Canada’s federal Liberals were the most successful and competent fiscal managers of any Canadian government in 40 years. Nevertheless, it didn’t take long for public images to revert to type, with the Conservatives seen as the more competent party fiscally, their governing record notwithstanding. For their part, the Liberals were, in the minds of most Canadians, the party of social policy.

6. Invest in a modern welfare state as soon as the fiscal crisis is under control.

The Liberals took this path as soon as the Budget was balanced, with a new child income support programme in 1997 and numerous post-secondary education measures that same year. The message was clear – the age of austerity in Canada would not lead to a night watchman state. Rather, a modernised, activist welfare state was taking shape.

The Liberals further enhanced their progressive credentials at this time through non-budgetary measures, notably legislation on same-sex marriage, the decriminalisation of small quantities of marijuana and a Canadian-led effort to ban land mines globally. These post-

deficit initiatives served to undercut significantly the notion that there was little difference between Liberals and Conservatives, given both parties seemed indistinguishable on fiscal policy.

The ultimate compliment for this pragmatic progressivism came in 2000 when *The Economist* labelled Canada “cool”, devoting a cover to what some were starting to call a Northern Tiger.

Know who you are.

In the final analysis, the biggest lesson of all from Canada is know who you are as a political party when you embark on an aggressive austerity agenda, never lose sight of your values, and never see deficit reduction as anything more than a means to an end of regaining fiscal sovereignty – a detour on the road of government’s role in advancing social and economic progress.

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This article forms part of a series of international responses to Policy Network’s discussion paper *In the black Labour: Why fiscal conservatism and social justice go hand-in-hand*