



## Canada's Redemptive Decade - Lessons for the United States

At times the U.S. government's fiscal situation seems hopeless. Deficits are projected to continue as far as the eye can see, adding to our sky-high debt. Politicians seem unwilling to make the tough choices needed. In the book *The Canadian Century*, the authors describe how Canada went through a similar financial crisis 15 years ago. Decades of government deficits led to a mountain of debt, the loss of Canada's AAA credit rating, and rising interest rates on government bonds. A 1995 *Wall Street Journal* editorial named Canada "an honorary member of the Third World in the unmanageability of its debt problem" and warned that Canada was "flirting with the financial abyss." Canadian politicians heeded the warning and took action to address their dire fiscal situation. Today, Canada is in better fiscal condition than most other developed countries. How did Canada do it, and what can the United States learn from our northern neighbor's experiences?

Canada ran a budget deficit every year from 1975 to 1996. At its peak, Canada's federal and provincial debt to GDP was over 120 percent and the second highest in the developed world. Out of control government spending on a bloated welfare state consumed half of the country's GDP. Interest payments on the debt ate up nearly a third of the budget (compared to about 6 percent for the United States today).

The Canadian dollar was mocked as the "Northern Peso." Yields on Canadian government bonds rose as investors feared Canada might require a bailout from the International Monetary Fund (similar to the PIIGS today).



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With their backs against the debt wall, Canadian politicians got serious about solving their fiscal crisis. Paul Martin, Canada's Liberal party finance minister said, "Debt and deficits are not inventions of ideology. They are facts of arithmetic." In 1995, Martin's national Liberal party unveiled a budget that cut spending dramatically. Over the next two years, it cut program spending 9 percent, reduced government employment 14 percent, and cut grants to the provinces by 14 percent.

It cut spending on the military and unemployment insurance. As part of the cuts, Canada's federal government significantly reduced its involvement in the transportation, agriculture, and business sectors of the economy. Tax increases played a role as well, although spending cuts were four and a half times larger than tax increases. The success of these changes emboldened Canadian politicians to take on even greater reforms in the years that followed. Canada reformed their welfare system to bring capable individuals back into the workforce. They reformed the Canadian Pension Plan (their version of Social Security) putting it back on sound financial footing. They also significantly reformed their tax system to encourage businesses and entrepreneurs

to work hard, take risks, and create jobs by reducing corporate and personal income taxes. To offset these tax cuts a consumption tax was added, which was less of a disincentive to businesses and entrepreneurs.

As a result, Canada balanced their Federal budget in just three years. Most of the provinces balanced their budgets in three years as well. After balancing the Federal budget in 1997 for the first time in 23 years, Canada went on to run 11 straight annual budget surpluses. This slashed Canada's federal debt from 80 percent of GDP in 1997 to just 45 percent 10 years later. Canada's return to sound fiscal disciplines paid off big in their economic performance versus other developed countries. From 1997 to 2007, Canada led the G7 (France, Germany, Italy, Japan, U.K., U.S., and Canada) in economic growth, job formation, and investment. Their sound fiscal policies and strengthened financial position helped Canada to weather the 2008 recession better than many industrial countries and to rebound more strongly.

What lessons can the United States learn from Canada's experience of wandering into the fiscal wilderness and then returning to fiscal responsibility?

1. Canada didn't grow their way out of their debt problem through massive spending in an attempt to stimulate growth. They tightened their belts, making hard choices and real spending cuts to achieve a smaller but smarter government.
2. Although it almost took a crisis, their politicians finally got serious about getting their fiscal house in order.
3. Once their politicians were serious, Canada's turnaround was fast. They balanced their federal budget in just three years.

4. Canada reaped benefits, including strong economic growth, job growth, and investment from getting their fiscal house in order.

Up to this point, the U.S. government has borrowed and spent more in an attempt to stimulate the economy and grow our way out of our deficits and debt. Needless to say, it hasn't worked very well. Hopefully the downgrade of America's credit rating will serve as a wake-up call for American politicians to get serious about getting our financial house in order. The debt and deficit issue is now a big concern for U.S. voters across the political spectrum, so expect American politicians to someday start getting the message. Eventually our politicians will put aside their ideological differences to address our deficits and burdensome national debt. While some will warn that cutting government spending will throw the United States back into recession, Canada's experience demonstrates that is not necessarily the case. Following sound fiscal policies at the Federal, State, and local levels will increase the confidence of U.S. consumers.

These changes will put in place a solid foundation for strong economic growth for America in the years ahead. Our politicians should learn from Canada's experience and emulate it. The situation is not hopeless. With the right policies we can turn our country around.

Source: *The Canadian Century: Moving out of America's Shadow* by Crowley, Clemens, & Veldhuis