



Paul Martin, as federal finance minister, celebrates balanced budget in 1998.

TOM HANSON / THE CANADIAN PRESS ARCHIVES

# Break out the red ink

*Turns out we didn't slay the deficit; it's just been asleep for awhile*

**O**TTAWA — It was Oct. 14, 1998. Finance minister Paul Martin was practically bursting with pride and excitement as he stood up before Canadians to tell them the country had done something it hadn't done for 28 years: balance a budget.

The 1997-98 budget recorded a \$3.5-billion surplus, marking the end of decades of government deficit financing that left Canada's fiscal picture in tatters.

By the mid 1990s, the federal government was being crushed under the weight of an enormous debt and ballooning deficits. Between 1979 and 1998, the amount of money Canada owed jumped from \$65 billion to \$609 billion. The government was spending almost one in every three dollars just on interest payments.

And each year the debt got worse. In 1993-94, Canada's deficit hit \$42 billion — meaning the country spent \$42 billion more than it took in.

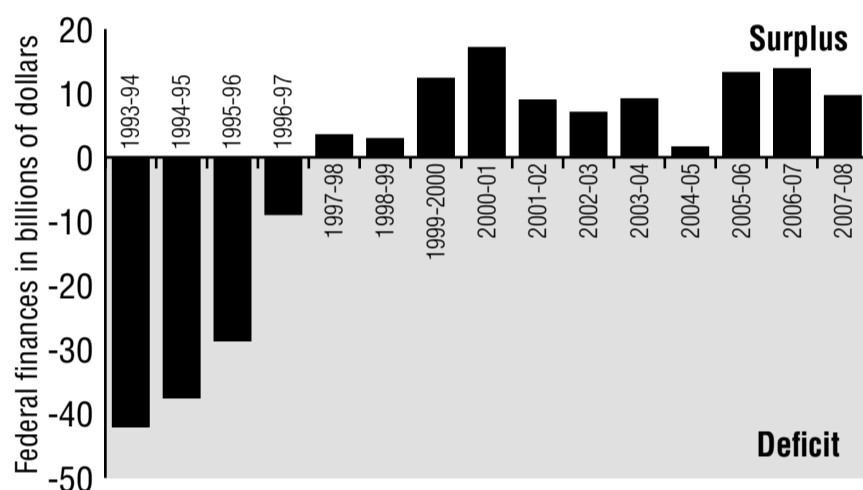
Among the world's largest industrialized nations, only Italy had a poorer fiscal picture than Canada.

The world's economic experts were issuing dire warnings for Canada and the government realized something had to change.

So Martin and the Liberals slashed spending, offloaded costs to the provinces and forced the country to suffer through extremely lean budget years. Over the course of four budgets, the government went from a \$42-billion deficit to a \$3.5-billion surplus.

Since then, the idea of budget deficits has become such anathema that most politicians would probably prefer to get caught in their office in a compromising situation with an intern than admit to having to run one.

But with the country facing its first recession since 1991, Finance Minister Jim Flaherty is going to be the unlucky man who has to announce to



the country on Jan. 26 that the deficit is back.

"Canadians are justifiably concerned about it," said Don Drummond, senior vice-president of TD Bank Financial Group. "Your antennas do go up. The country paid a heavy price to get rid of it."

It is perhaps hard to believe the country is going back into deficit after 11 straight years of surplus budgets. Just two years ago, the surplus exceeded \$13 billion.

But Drummond said the fiscal policies of the governments since 2000 meant even without a recession the government was going to run a deficit at some point.

"The recession accelerated it, but it would have happened anyway," Drummond said.

Since 2000, the Liberal and Conservative governments have slashed taxes and ramped up spending. You can't cut your revenues and spend more year after year without at some point forcing your budget into a collision course with a deficit.

To get the budget balanced again, Martin slashed program spending by \$15.2 billion between 1994 and 1997. But once the books were back into alignment, the government began moving in the other direction. Between 2000 and 2006, the Liberals bumped up program spending by \$57 billion, an average of \$8 billion in new spending every year.

Since taking office in 2006, the Conservatives continued on the same path, but increased spending at an even faster rate. Program spending jumped by \$33 billion in the last three budgets, or about \$11 billion more per year.

Billions more were taken out of the

government's revenue side through tax cuts. The two-point cut to the GST took \$5 billion or more out of government coffers alone.

The Conservatives have taken a lot of heat for the GST cut. Drummond said it was "not the tax I would have cut," because it's the most neutral tax in terms of whom it applies to, and it also is inefficient to cut because the cost of collecting the tax to business and government is fixed regardless of the amount.

Drummond notes if the GST had not been cut, the government "probably would not have a deficit."

"They claim it was cut to dent the economic downturn, but that's wrong," said Drummond, noting they announced the cut in the 2006 election, long before there was any suggestion Canada's economy was going to need some help.

Exactly what kind of deficit we are likely to run is unknown. It depends on how the government decides to stimulate the economy, be it with one-time spending commitments for infrastructure or industry bailouts, or even some form of tax relief.

It also depends just how bad the recession gets and how much government revenues drop.

Parliamentary Budget Officer Kevin Page, who was appointed to the job in March by the Conservative government, predicted a few weeks ago the deficit for 2009-10 will range between \$3.9 billion and \$14 billion, depending on the scope of the economic downturn.

Once a fiscal stimulus package is agreed upon, the next couple of years could see the country rack up a deficit topping \$30 billion. It could mean all

the money paid on the debt in the last three years is racked up again.

Conservative MP Ted Menzies, the parliamentary secretary for the minister of finance, said he hopes that doesn't happen.

"That is not our intention," he said. But he is also quick to point out a short-term deficit to address economic weakness is not the end of the world.

Though his Liberal opponents disagree and accuse the Conservatives of ruining the balanced budget in just three years, most economists think it's time Canadians stopped thinking of a deficit as a four-letter word.

"It has to lose that reputation," said Glen Hodgson, chief economist at the Conference Board of Canada. "Thirteen years ago, that was totally relevant. But the government got its act together. We fixed it."

In 1994, when the budget deficit peaked at \$42 billion, the country's debt-to-GDP ratio exceeded 70 per cent, up from 12.5 per cent in 1979, when the years of deficit financing began.

But after 11 years of surpluses, the government's fiscal picture has improved dramatically. The overall debt went down \$93 billion between 1996-97 and 2007-08. The debt-to-GDP ratio is down to about 28.5 per cent now. Canada is being held up internationally as an example of fiscal prudence.

Canada was the only G8 nation to record a surplus in 2007-08. Debt interest charges, while still a significant portion of spending, are down to \$26 billion, representing 14.3 per cent of overall government expenditures. In 1995-96, interest charges were \$44 billion, or 30 per cent of government spending.

So, says Hodgson, running a deficit now is not the same as running a deficit a decade ago, and Canadians need to "grow up a little" about the idea of running a deficit.

"When your economy is in the tank, fiscal stimulus is necessary," he said. But both Drummond and Hodgson agree the deficit can never become a regular occurrence.

Drummond says to get back into balance, there are two options: Raise taxes or cut spending. Since no government is likely to do the former, they have to at the very least bring spending down. If they can not actually cut spending, they must at least curb the rate at which it increases.

mia.rabson@freepress.mb.ca

## We've seen worse

As bad as the current economic downturn seems, it bears little or no resemblance to the Great Depression of the 1930s.

Here's a list of key indicators from today and the depths of the mid-1930s.

### Unemployment (nationally)

**NOW:** About six per cent  
**THEN:** 33 per cent

### GDP

**NOW:** Hovering barely above zero per cent growth  
**THEN:** Lost 40 per cent

### Canadian exports

**TODAY:** Still growing  
**THEN:** Fell by 50 per cent

### Stock market

**TODAY:** Down 45 per cent  
**THEN:** Down 90 per cent

### Monetary policy stimulus (the availability and cost of money)

**TODAY:** Trillions of dollars worldwide  
**THEN:** Virtually nothing

### Fiscal policy stimulus (spending by the government)

**TODAY:** Absolutely massive  
**THEN:** Modest

### Trade

**TODAY:** Free trade continues unabated  
**THEN:** Smoot-Hawley Tariff Act in the U.S. fractured world trade

### Taxes

**TODAY:** Flat or going down  
**THEN:** Higher taxes

Source: John McCallum, I.H. Asper School of Business at the University of Manitoba

## Where we are and where we're going

According to Statistics Canada and RBC Economics Research, here's a snapshot of the Manitoba economy for 2008 and 2009.

	2008	2009
<b>Unemployment rate:</b>	4.0 %	4.5 %
<b>Employment:</b>	607,200 (up 1.8 %)	616,300 (up 1.5 %)
<b>Retail sales:</b>	\$15.1 billion (up 8.0 %)	\$16.0 billion (up 5.5 %)
<b>Housing starts (units):</b>	5,400 (down 5.9 %)	5,400 (flat)
<b>Personal disposable income:</b>	\$31,860 (up 8.0 %)	\$33,453 (up 5.0 %)
<b>Consumer Price Index (inflation):</b>	2.5 %	2.6 %

## Fortress

Continued from B1

Marie-Christine Bernard, associate director of its provincial forecast, said if she was a betting woman, she'd put her money on Manitoba staying out of recession.

"We feel Manitoba will be one of the strongest provinces in 2009, probably just behind Saskatchewan," she said. "It's one of the few provinces that will do relatively well (next year)."

Projects scheduled to put a shovel into the ground next year, most notably the Canadian Museum for Human Rights, will continue to fuel the construction industry, while heavy order books for buses mean the province's manufacturing sector will see positive returns next year, too, she said.

RBC Royal Bank's most recent provincial outlook, which was released in October, called for GDP growth of 3.1 per cent in Manitoba next year. But Kirk Dudschak, the bank's regional president, said considering the economic turmoil of the past two months, that number will be revised downward to about 2.0 per cent or slightly higher in its next report.

He said both Manitoba and Canada are relatively insulated from the carnage happening south of the border, but not everybody is going to escape scot-free.

"When you step back, we've got a really diverse economy, yet there are some employers, largely those that are heavily dependent on U.S. consumers, that are experiencing some tougher times. We haven't seen the upward pressure on residential real estate to the same extent as other parts of the country have, we haven't had the huge pressures on inflation that Alberta has, and we don't have the dependency on the automotive market that Ontario has. We have a more balanced growth and less consumer leverage," he said.

Business sentiment is, for the moment, relatively positive. When Jim Carr, CEO of the Business Council of Manitoba, a group of CEOs representing some of the province's largest companies, went around the table soliciting opinions at a recent meeting, most of them said things were stable.

"The biggest threat is the anticipation of recession and the fear that consumer behaviour will respond to the anxiety of what is anticipated rather than the reality of the moment," he said.

Carr said in an interconnected economy, there is no immunization against a recession, but "Manitoba is better positioned than most to withstand the prevailing winds."

He said Manitoba companies are doing better thus far than their counterparts in many other jurisdictions because they are more diversified, less dependent on individual sectors and their exports are being helped by the lower value of the Canadian dollar.

McCallum said he's amazed by the many people who compare the current economic environment with the Great Depression of the 1930s "with a straight face."

"We're looking possibly at a recession or puttering around zero (growth) for awhile. In 1929 in the U.S., the unemployment rate got into the 20s and the economy lost one-third of its income. We're not even remotely in that league," he said.

McCallum said people grasp at these incredible comparisons because they have no reference point. With just 16 months of recession over the last 25 years, they simply can't remember a prolonged negative economic period.

geoff.kirbyson@freepress.mb.ca