THE CANADIAN CHAMBER OF COMMERCE
LA CHAMBRE DE COMMERCE DU CANADA

The Voice of Canadian Business™
CONNECT! BRANCHÉ!
Le porte-parole des entreprises canadiennes MD

5 Minutes for Business

Back in Black: What's so great about a surplus anyway?

May 5, 2015

With the tabling of the federal budget, the curtain falls on the best spectacle we've seen for a while–the government's fight to rescue its carefully orchestrated plan to balance the budget in time for the election. This pledge has been the long-standing centerpiece of the Conservative economic platform. Last year's estimates even gave them a $1.9 billion in surplus to play with, even with huge promises on income splitting and family benefits.

But, you know, stuff happens. Specifically, that lovely surplus disappeared as oil prices tumbled more than 50%. The first quarter of 2015 would be "atrocious" according to the Governor of the Bank of Canada. Suddenly, a party running on fiscal prudence might have to face the voters without a single balanced budget in its nine-year record.

In the end, they pulled it off, of course. The budget was delayed, the government's shares of GM stock were sold, the contingency reserve was emptied. The government will go into the election with its image of sound economics intact.

The whole show raises the important question: "Do balanced budgets matter?" And if they do, is it always appropriate to cut your way to them?

Spending cuts are painful, but the IMF showed that economic impacts are usually modest. A spending cut of 1% of GDP typically shrinks the economy (GDP) by about 0.5% within two years–short-term pain for long-term gain.

But what if the economy is already in recession? This is very different because "automatic stabilizers" kick in. A recession causes tax collections to fall because business revenues plummet and people buy fewer things while government spending rises because more folks are dependent on employment insurance and social assistance programs. Deficits soar, and it becomes difficult to cut spending in the midst of a downturn. If government and the private sector are both in cut-back mode at the same time, then unemployment can soar in a manner that is terribly damaging.

The two-year recession in Europe is the best example of self-defeating austerity. In a follow-up report, the IMF said that for economies in recession, the hit to GDP from spending cuts can be up to four times greater, resulting in a much more severe hit to the economy that actually increases debt levels. This means a tough recession can result in years of deficits no matter what the government does.

And that's why surpluses are important, so that governments have room to maneuver in a downturn and don't have to layer public cuts on top of private sector cuts à la Greece and Spain, which are struggling with 25% unemployment.

Canada's debt levels are certainly manageable, and the provinces can borrow 10-year money at an interest cost of 2-2.5% per year–which is just above "zero-risk" U.S. treasuries, so clearly markets aren't worried.

Let's remember that a $1.4 billion surplus on a $280 billion budget is 0.5%, barely a rounding error from a business perspective. More important is to have responsible spending and the type of investments in infrastructure and skills that will generate future prosperity. Surpluses make us much more comfortable so that we can cope with a storm, but let's also build a speed boat so that we can race ahead.

For more information, please contact :

Hendrik Brakel
Senior Director, Economic, Financial & Tax Policy
613.238.4000 (284) | hbrakel@chamber.ca