

Intelligence MEMOS



From: Don Drummond

To: Finance Minister Chrystia Freeland

Date: December 2, 2021

Re: **UPCOMING FALL FISCAL UPDATE MUST ANSWER QUESTIONS ABOUT GROWTH STRATEGY**

Fiscal Updates were created to support a national dialogue on the solutions to challenges without the pressure of immediate policy action as attends a budget.

There has never been a greater need for such a dialogue. Budget 2021 gave a perspective on long-term economic and fiscal prospects while glossing over the challenges and how they might be addressed.

It implied that technological change, including policy action to spur clean growth, would raise economic growth sufficiently to ensure a steadily declining debt burden. Little was said on how such growth would be achieved and there was almost no acknowledgement of downside risks.

The Fall Update is a good opportunity to rectify this, starting with addressing the following assumptions:

- We can clearly expect more frequent and costly natural disasters.
- Shifting to a neutral monetary policy stance is made more difficult by inflation minefields
- Government debt burdens are at dangerously high levels (although the Update may show the fiscal track beating the Budget projection as a result of inflated revenues).
- Households are deeply indebted.
- The labour market has high job vacancies co-existing with high long-term unemployment.
- The housing market has been wild across much of the country.
- And COVID and its variants are not likely to disappear any time soon.

All these are superimposed on the still widely unrecognized reality that the aging population, combined with modest growth in productivity, means the economy is shifting to a lower, sustainable rate of growth. None of this was contained in the slight glimpse of the long-term provided in Budget 2021.

Instead, that Budget started with the Finance Department's previous long-term real GDP growth rate of 1.7 percent with 0.2 added to arrive at 1.9 for a base case. The increment, it was explained, was attributable to technological developments such as artificial intelligence. But we've had digital developments for many years now and Canada's productivity growth rate has remained below 1 percent. Then, another 0.2 percentage points were added for the measures in the 2021 Budget. It seems mildly preposterous that they would have that large an impact and for that long. Will Budget 2021 raise not only the level of productivity but the growth rate for 34 years? Really?

Let us hope the Update considers some of the downside risks and contemplates how they might be addressed.

A good place to start is how the economic/environment plan is integrated in budgeting. In December 2020, the Government of Canada released what might be the clearest environment plan ever – clear but light on the economy. In contrast, the 2021 Budget was light on the environment. It is time to join them. How is the economy going to make the transition to net zero? Nowhere has there been acknowledgement this could be tough. High emitting sectors weigh heavily in the Canadian economy whereas new growth sectors are light. We have long been laggards on research and development, innovation, technological adaptation, and in directing financial flows to these areas.

The point of raising these challenges is not to be pessimistic nor to suggest abandoning the net-zero goal. The point is the required transformation could be difficult, and a clear, integrated plan is required. A key element is the reduction of policy uncertainty and here the Update could help.

The current stated objective is to get the price on carbon to \$170 a tonne. What's the timetable? Firms need to know. Now.

Will the current approach of recognizing comparable provincial approaches stand up? If the carbon price is to do much of the heavy lifting, why raise other potentially inferior substitute policies? And why get stuck in the middle of an unproductive debate whether the energy sector must be defended at all costs or cease to exist. Now is the time to shift support to transformation rather than perpetuating subsidization of past practice.

There are many questions and many loose ends that the Fall Update could and should discuss. Conversation about whether the deficit is on or a bit better than the Budget track seems relatively trivial. Even in the fiscal sphere, the more important question is what to do about the very high debt burden and the fiscal shocks clearly coming.

One big example: How and when will the promise to increase the Canada Health Transfer be enacted, how will it be funded and will there be any assurance it will deliver improved health outcomes?

The upcoming Economic and Fiscal Update owes us some answers, or at least the raw material for a national dialogue on solutions to the challenges upon us.

Don Drummond is a Stauffer-Dunning Fellow and Adjunct Professor at the School of Policy Studies at Queen's University, and is a Fellow-in-Residence at the C.D. Howe Institute.

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