

Intelligence MEMOS



From: Paul Jenkins
To: Canada's Economic Policymakers
Date: September 11, 2020
Re: **THE LONG ... AND THE SHORT OF FINDING EQUILIBRIUM**

Macroeconomics is about optimizing long-run equilibrium conditions (e.g., full employment), and re-establishing those conditions as quickly as possible through short-run stabilization policies in response to unanticipated shocks.

From this perspective, where are we today in our coronavirus battle, and what are some of the issues still facing us?

Given the progress we have made in controlling the spread of COVID-19 and the associated re-engagement in economic activity, the Canadian economy has snapped back. But activity remains well below pre-COVID-19 levels, largely reflecting depressed demand.

At this juncture, there are, broadly speaking, three challenges before us:

- i) the need to remain vigilant on the health front and stay focused on the intersection of health and economy through an optimal [policy mix](#);
- ii) the need to transition from initial support policies to policies promoting recovery back to full production and employment; and
- iii) the need to look long term to take advantage of the opportunity we have to restructure the Canadian economy.

In tackling these challenges, sequencing matters from both an economic and a political perspective.

First off, maintaining confidence that the virus is under control boosts our confidence to re-engage in the economy and begin spending. In turn, confidence in employment and income strengthens the resolve to stay the course with responsible behavior. [Using a range of COVID interventions](#), which can vary by age, economic sector and location, we can both beat the virus and stay on the path of economic recovery.

Today, as we look ahead to coming out the other side, the government has called for us to think big and think differently.

A consensus seems to be developing across Canada that two of the most critical issues we need to address are equality of opportunity, and sustainable economic growth.

Progress on both these fronts will be a multi-year undertaking, requiring a substantial reallocation of resources, with significant relative price adjustments to bring it all about. Past experience tells us that this is not a smooth path. And we also know that how we fund both the transition and the desired endpoint matters – budget constraints remain a fundamental principle of economics. In other words, [managing the debt level](#) matters.

Another fundamental principle is the imperative of economic growth to provide equal opportunities for all Canadians and to pay for the type of nation we wish to be. While interest rates are currently historically low, it is interest rates that connect the present to the future. The most durable source of funding is sustained economic growth, not a reliance on low interest rates.

What does this mean in terms of challenges (ii) and (iii) above?

The government has correctly begun the move away from the initial support policies to ones that are cast more in the vein of traditional stabilization policies. For example, the shift from the Canadian Emergency Response Benefit (CERB) to the Canadian Recovery Benefit and an expanded Employment Insurance program will both provide ongoing support where needed and self-unwind as the recovery matures. Combined with other traditional stabilization policies, especially accommodative monetary policy, the goal is to absorb the remaining slack in labour and product markets over the next 12 to 24 months, and in doing so to put the economy on a solid growth footing.

As these short-term stabilization policies bring us back to full resource utilization, policies of long-term structural reform can confidently begin to take hold. These would include policies to bring about the relative price changes needed to encourage the reallocation of resources and changes in behaviour. It would also include pro-growth policies to promote investment (over consumption) in our human and physical capital consistent with our long-run goals as a nation.

We can and should think big. But we cannot jump to a desired endpoint. The sequencing of policies is critical if we are to achieve and fund that outcome through sustained (in every sense of the word) growth.

One Final Thought

Canada has grown and developed as an active member of an integrated global economy – history of punching above our weight. Unfortunately, the world lost much of the spirit of co-operation and multilateralism in recent years.

Now, more than ever, how we all fare in a globalized economy rests on having global governance that works. This, too is critical to Canada's future successes, and thus a goal for Canada to re-commit.

Paul Jenkins is a former senior deputy governor of the Bank of Canada and a senior fellow at the C.D. Howe Institute.

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