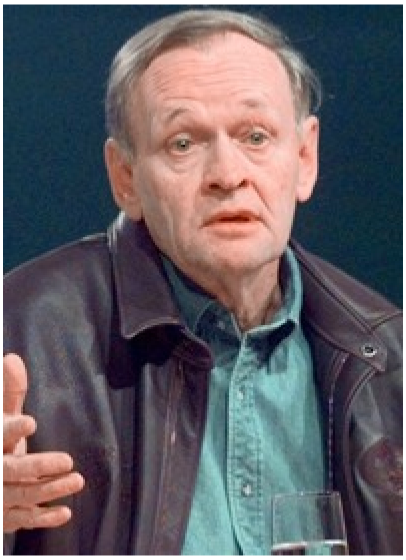
How Canada Cut Spending and Got a "Payoff Decade"



A liberal much in the mold of liberals in the Democrat Party in America, Chretien took over in November 1993 as his country was suffering from high unemployment, a stagnant economy, and increasing interest rates on its national debt. Its ratio of debt-to-GDP was approaching 70 percent while its annual deficits were nearly 6 percent of GDP and increasing. The economy was ranked just above Italy among the Group of Seven, Canada's peers. As Scott Clark, Chretien's Deputy Finance Minister put it: "We used to thank God that Italy was there because we were the second worst in the G7."

In a rare interview, Chretien was forthright about what happened to turn the economy around and set the stage for the country's "Payoff Decade." He said, "There would have been a day when we would have been the Greece of today. I knew we were in a bind and we had to do something. I said to myself, I will do it. I might be Prime Minister for only one term, but I will do it."

Chretien had several initial advantages going into his first term. The spending on welfare by previous administrations was making the people nervous. Budget projections by those previous administrations were based on fatuous assumptions and the people knew it. As Scott put it, "It was hugely frustrating. Every year we put out forecasts showing the deficit going away. We just based every budget on ridiculous assumptions." A Reform Party was beginning to put pressure on Chretien for broad and deep cuts in government spending. And then there was the downgrade by Standard and Poor's the year before from AAA to AA+ which embarrassed and angered the Canadian citizens.

Chretien remembered the first Cabinet meeting when he announced his plan to do some serious cutting of everyone's budget. Lawrence MacAulay, the Minister for Veterans Affairs, called his wife after that first meeting to say, "Darling, I will be back home after the next election. I will be defeated, because the Prime Minister explained to us this morning what he intended to do."

Chretien's first budget included cuts totaling $10 billion over two years, something less than 5 percent of the budget, and the small amount of cuts outraged the citizens who had been forced to cut their personal budgets in reaction to the down economy. Paul DeVries, head of the fiscal policy division under Chretien, remembers hearing people talk about the government's failure to make more significant cuts. He was on a flight to Toronto and said, "The mood was so depressed on that plane that I thought we're never going to get off the ground, and if we did get off the ground we'd crash, because it was just doom and gloom. Everywhere you heard the words, 'They don't get it. They just don't get it.'"

Pressure from the Reform Party began to build, proposing a "zero-in-three" program to balance the budget in three years. Three months after the budget was announced, Moody's Investors Service lowered its rating on Canadian debt. And then the *Wall Street Journal* in January of 1994 called Canada "an honorary member of the Third World," suggesting it might have to turn to the International Monetary Fund for a loan.

A month later Chretien's Finance Minister, Paul Martin, held a Cabinet meeting to announce a spending freeze. Clark remembers Martin as a reluctant budget cutter, especially of Canada's Medicare program, which had been put in place years before by Martin's father. Riding in a taxi in New York with Martin, Clark remembers him saying: "I don't want to do this. I don't want to do this."

> And I said to him, "You don't have any choice because if we don't do it that means you won't be able to keep the programs you've already got. We're going over the cliff and we'll be cutting like you won't even believe."

At that Cabinet meeting when Martin announced the budget freeze, a Minister put forward a proposal that needed funding, but Chretien remembers cutting him off, reminding him of the freeze. A second Minister raised his hand to ask for funding on another project, and Chretien told his Cabinet that "the next minister to ask for new money would see his whole budget cut by 20 percent." Said Chretien, "Everyone knew they had to face the music, and they did it. They had no choice. There was no great debate. I had made my view very clear."

Within four years of cutting the budget by between 12 and 20 percent, the government began to show a surplus. Interest rates dropped by an astonishing 10 percent, the deficit disappeared entirely by 1997, and the next decade enjoyed increased investing, hiring, and economic growth that exceeded that of the United States. As noted by David Lee, writing for Mises.org

> The whole of the fiscal turnaround in Canada … can be quite unambiguously attributed to cuts in government spending. Altogether Chretien and Martin presided over more than $80 billion in surpluses and there is no doubt that this is the single most enduring feature of their legacy.

There are notable differences between the Chretien/Martin administration's results and the current situation in the United States. A look at the numbers shows the federal government in worse shape than Canada's in 1993, but that's where the comparison ends. Chretien "was the man with a steel rod up his spine," according to his Industry Minister John Manley. Where is such fortitude in Washington? The dollar is the world's reserve currency and consequently continues to be considered the ultimate safe haven despite the country's runaway spending and deficits. The bond market continues to oversubscribe every Treasury auction, keeping interest rates at record lows. The media decries any attempt whatsoever to do any cutting, demanding instead that taxes be increased instead. At present the voice of the Tea Party — perhaps the equivalent of the Canadian Reform Party in the 1990s — is muted by the noise from the establishment Republicans unwilling to do any serious cutting or ignoring those who do. Even the recent downgrade of the country's debt by Standard and Poor's appears to be having little effect or impact on the conversation in Washington. The willingness to endure the pain of the necessary cuts is nowhere to be found. The "payoff decade" for the United States appears to be in the distant future.

Photo of Jean Chretien: AP Images