Economic growth tops the priority list for Canadian policymakers: Here's why

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Canada is currently experiencing anemic economic growth, meaning there is a slowdown in the total production of goods and services per capita. The real GDP growth forecast for 2024 is 0.7 percent.

Despite this, American economist Tyler Cowen recently wrote that Canadians have nothing to worry about when it comes to the economy. While the Canadian economy is not growing as rapidly as the United States, he argued, few are. "Yes, Canadian performance could be better," he wrote, "but there's no reason to be pressing the panic button."

This is not an opinion shared by Canadian policymakers. In our recent book, Fiscal Choices: Canada After the Pandemic, we explain why Canada's anemic growth rate is worrying and why politicians and their advisors believe, almost unanimously, that economic growth is a policy imperative.

Their reasoning boils down to this: in an economy that isn't growing—one in which per capita incomes are stagnant in real terms—any budgetary adjustments to meet emerging priorities are zero-sum.

The requirement that Canada increase its commitment to NATO, for example, cannot be achieved without raising taxes or removing some $18 billion from elsewhere in the budget.

When it comes to reallocating what we already spend, most federal government spending is assembled under the heading "transfers to individuals," and much of this spending is statutory, which means it can't be reduced simply by adjusting the annual budget.

Spending on employment insurance and pensions is required. Similarly, transfers to other governments—the Canada Health Transfer and Equalization payments, for example—are legal requirements.

While legislative changes are possible, they come with political risks and uncertain economic payoffs. The age of eligibility for the Canada Pension Plan could be increased and Old Age Security could be clawed back at a lower level of income.

Reducing transfers or increasing taxes might improve the government's balance sheet, but whether these changes will have a positive effect on the economy is another matter. Reductions in spending or increases in taxes are austerity measures and austerity has so far produced limited, if any, payoffs in terms of economic growth.

Interest rates are outpacing growth rates

One possible solution is for Canada to simply borrow more. Debt is not an inherently bad thing. Short-term debt to manage cyclical downturns is better than raising taxes to balance budgets and long-term debt has a Keynesian logic to it.

When growth is strong and interest rates are low, debt is manageable. As long as the social rate of return from government spending is greater than the real interest rate, fiscal deficits help maintain output at potential.

But right now, interest rates are higher than growth rates. As recently as 2017, interest on 10-year government bonds was 1.8 percent, while the economy was growing at a rate of 3.1 percent per year. At the time, interest payments on the debt consumed 7.04 percent of the federal budget.

In 2023, by contrast, the interest rate on bonds had climbed to 3.3 percent and growth had declined to 1.1 percent nationally. Meanwhile, just over 10 percent of the federal budget was devoted to debt servicing costs. Public debt charges will amount to $54.1 billion in 2024–25, or 10.9 percent of the federal budget.

Worse, there is no budgetary relief on the horizon. The Parliamentary Budget Office estimates that the debt service ratio will peak at 12 percent in 2023–24 and decline to 11 percent in 2028–29—well above its pre-pandemic low of 8.3 percent in 2018–19. The decline, such as it is, assumes a status quo policy that will include no major increases to the debt we already have.

Even when borrowing conditions are favorable, the social rate of return on government spending should be positive. To ensure spending is productive, many academics support periodic reviews of government programming. In theory, this involves getting rid of programs that aren't working and replacing them with ones that will, all while saving money in the process.

Government review processes

In the 2022 budget, the federal government announced a review of programs to realize savings in the order of $6 billion over five years. The 2023 budget and the 2023 Fall Economic Statement doubled down on this initiative, requiring savings in the order of $15.8 billion.

The politicians and public servants we spoke to while preparing our book were strongly in favor of periodic reviews, but they acknowledged that reviews to save money seldom work.

With the exception of the review process undertaken by the federal government under Jean Chrétien in 1994, program reviews have yielded very little in long term savings.

One reason is conceptual. Program evaluation, which practitioners argued should be an ongoing project, is typically aimed at improving outcomes, such as shorter wait times or better math scores, not saving money. Sometimes it's possible to do both, but these two objectives do not naturally line up.

Fiscal choices are always difficult, but they are especially problematic for an economy that is not growing. A small but resolute group of economists wonder whether economic growth really is an imperative and whether the level of aggregate economic activity (GDP, in other words) should be the holy grail of fiscal policy.

There are other economic goals with intuitive appeal, including price stability, lower levels of inequality and happiness. Some (non-economists typically) have gone as far as to argue that we should welcome degrowth —the shrinkage of our collective economic footprint to better serve other species and the environment as a whole.

Economic progress

There is nothing wrong with reviewing our assumptions about what economic progress looks like and who benefits from a bigger economy. We should be making room for measures of personal and collective well-being other than GDP.

But we also need economic growth—not just so we can consume more, or generate more revenue for governments, but so we can take better care of one another. Consider the possibilities: growth could include better housing, better food and better health care, or even a better defense posture. And it need not require consuming more natural resources.

Technological innovation has a major role to play in helping us shift to an economy built more on providing better services than on producing more things. This shift to a knowledge-based service economy is already well underway and it should be welcomed. But we can't benefit from this transition without becoming more productive. That means, as the saying goes, doing things better and doing better things.

Short-term quarrels over carbon taxes, for example, detract from long-term questions of economic sustainability. We need to produce what the world needs and do it efficiently. Improved productivity, in both the public and private sectors, is another way of saying more sustainable economic growth. Without it we are standing still while our needs increase and our neighbors—not just the United States—leave us behind.

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