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Canadian Lessons on Fiscal Policy

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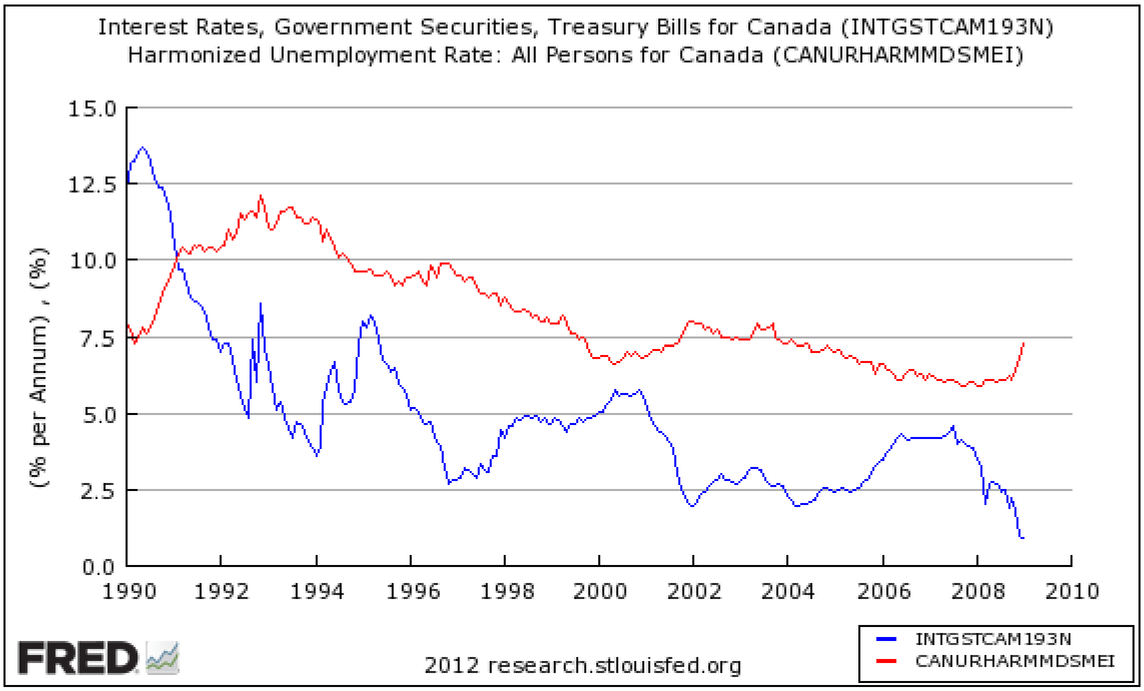

The Cato Institute's Chris Edwards touts Canada in the 1990s as a refutation of "the Keynesian notion that cutting government spending harms economic growth" arguing that "Canada's spending cuts of the 1990s were coincident with the beginning of a 15-year economic boom" and "its experience shows that even a modest dose of public sector austerity combined with pro-market reforms can lead to substantial gains in private-sector prosperity."

Arguing about what is and isn't Keynesian gets a bit tiresome, but I think that what Canada in the 1990s shows is the same as what the United States in the 1990s—namely that when your country is suffering from high interest rates, that deficit reduction paired with loose money can bring rates down and boost employment in a non-inflationary way. That was the premise under which a lot of center-left governments—led by figures like Bill Clinton, Göran Perrson, Wim Kok, and Jean Crétien—operated and it worked pretty well. It's a bit strange that Cato would reach to *Canada* for an example of this strategy when the exact same strategy was applied in the

USA at the exact same time. The problem, perhaps, is that it's too well-known that Clinton raised taxes (Cato doesn't mention Canada's tax hikes) along with cutting spending.

But the question for today is what should a country do when nominal interest rates are as low as they can go and the economy is still depressed. Deficit reduction can't make U.S. interest rates go lower. What you could do instead is make the deficit *bigger* and count on the Fed to keep rates low, or else you could have the Fed take "unorthodox" measures to goose the economy. But you can't re-run Clinton policies in a totally different situation and expect the same result.