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Canada's budget

Joining the stimulating party

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A pragmatic budget has given Stephen Harper's government a new lease of life—but not necessarily a long one

Illustration by David Simonds

MORE than in many countries, in Canada the question of how to respond to the world recession has become muddied by party politics. During the campaign for last autumn's general election, Stephen Harper, the Conservative prime minister, ridiculed the opposition for daring to suggest that his government might post a budget deficit in a country that has come to prize fiscal virtue. Having won a second term, though once again without a parliamentary majority, Mr Harper promptly almost lost it over a government economic statement in late November. In this his finance minister, Jim Flaherty, again rejected the need for fiscal stimulus but threw in some partisan measures. That prompted the disparate opposition to gang up to try to oust Mr Harper—a fate he evaded only by persuading the governor-general, who acts as Canada's head of state, to shut down parliament for seven weeks.

In that period the economy has slithered towards recession. So this week's budget was of more than usual interest. In the event, Mr Flaherty showed a surer touch than in November. Jettisoning his party's ideological commitment to small government, he came up with new spending and tax breaks worth C$40 billion ($33 billion) over the next two years. Much of the money will go on maintaining roads, railways and ports and in encouraging home improvements. The government is also adding C$50 billion to its C$75 billion fund to buy mortgage-backed securities from banks, to encourage them to lend. For the first time since 1996 the federal budget will move into deficit, with a shortfall of C$34 billion in the fiscal year starting in April. Deficits will total some C$85 billion before the federal finances return to the black in four years time, Mr Flaherty forecasts.

Previous Liberal governments worked hard to cure Canada of an addiction to deficit financing. In losing his fiscal virginity, Mr Flaherty blamed "the synchronised global recession". Certainly Canada is vulnerable: it has been hurt by recession in the United States, which buys three-quarters of its exports, and by falls in the prices of its commodities. Private-sector economists consulted by the government expect the economy to contract by 0.8% this year, bouncing back to growth of 2.4% in 2010. The darkening economic outlook, especially in Ontario where the car industry is concentrated, has softened public opposition to deficits.

But has Mr Flaherty got the dose right? The economy remains relatively strong. Canada's banks are much better regulated, and sounder, than their American counterparts. The central bank began to inject liquidity into the banking system a year ago, and has slashed its benchmark interest rate to just 1%. A weaker currency (see chart) will help exporters. Mark Carney, the central bank's governor, expects the economy to start to recover late this year (though he says this may not be apparent until early 2010). If so, monetary policy may deserve more of the credit than fiscal stimulus.

The government's more immediate concern is survival. On this it may have little to fear for now. The separatist Bloc Québécois and the leftist New Democrats (with 86 seats between them) both said they would vote against the budget. But Michael Ignatieff, the new leader of the Liberals, whose 77 of the 308 seats in the House of Commons are vital, said he would back the budget, provided Mr Flaherty offers quarterly reports on how the extra money is being spent. "We're putting the government on probation," he said.

Mr Ignatieff is unenthusiastic about his predecessor's idea of an opposition coalition. It suits the Liberals better to let the Conservatives take the blame for the recession while rebuilding their own finances, organisation and ideas. As for Mr Harper, while the budget shows that he is a pragmatist, it is not popular with some in his own party. Since November, his authority is no longer unassailable. He is living on borrowed time as well as money.