

The axeman cometh

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 GLOBE AND MAIL UPDATE
 OCTOBER 30, 2008 AT 6:14 PM EST

OTTAWA — The provinces were the first to hear that they will be helping the federal government avoid a budget deficit, but there will likely be many more Canadians conscripted, willingly or otherwise, in what may prove to be a futile battle.

It did not have to be this way. Had the Harper government been less generous in its spending and more particular about which taxes it cut when times were good, the global economic turmoil would have rocked but not capsized the federal fiscal ship.

Those decisions produced the current razor thin surplus, which could yet turn into a deficit before the fiscal year ends next March. Having left himself nothing in reserve, Prime Minister Stephen Harper now faces an unenviable choice: Increase spending even more to help Canada through the roughest patch it has faced in some time, or slash it to avoid becoming the prime minister whose government went back into deficit after more than a decade of surpluses.

Comments made by Finance Minister Jim Flaherty in Toronto this week indicate the government is leaning toward the latter. Increases in payments to the provinces, promised under a much-ballyhooed plan to “solve” the fiscal imbalance less than two years ago, will not be forthcoming, Mr. Flaherty said.

That's just the start. Federal government departments will be given money for what the Finance Minister termed “essential programs and services” and no more. The usefulness of Crown corporations will be reviewed.

All of these decisions will have knock-on effects in the economy. Without the promised funds, the provinces will have to decide whether they will swallow the difference between what they expected and what they will get, or whether they will pass the problem on to municipalities (as they did in the mid-1990s under the Liberal round of spending cuts designed to vanquish the deficit).

Either way, you will be getting fewer services or paying higher taxes to some level of government.

There may be service or program cuts coming your way as well from the federal government. That won't be clear until Mr. Flaherty defines what he considers “essential,” which he will likely do in the economic update expected some time in the next month. It is safe to assume that no major new spending will be done in the foreseeable future. Industries looking for federal help should not hold their breath.

As for the Crown corporations, which range from Canada Post to Atomic Energy of Canada Ltd., the impact of any government action depends on whether they are put on the block, asked to trim budgets, or simply closed down.

Mr. Harper and Mr. Flaherty are pleading extraordinary economic circumstances for their plans. That's far from the whole story. The government's fiscal problems, like those of the auto and forest industry and indeed much of manufacturing, predate the most recent bout of turmoil. All that has done is made a bad situation worse.

Reputable groups, including the Conference Board of Canada, were warning after the February, 2008, budget that the government had left itself so little fiscal room that a worsening of the economy would risk a return to deficits. With national economic growth now almost at a standstill, that is now the most likely scenario.

The two rounds of cuts to the goods and services tax pushed through by the Conservatives were worth about \$12-billion a year, money that might have come in handy now. Removing the \$3-billion cushion for contingencies that the Liberals routinely put in their budgets further reduced the federal government's room to manoeuvre.

In a way, this is all spilt milk and the more pressing question is what to do next. Mr. Flaherty has indicated there will be spending cuts. An Ipsos-Reid poll out this week suggests an overwhelming majority of Canadians (82 per cent) support that idea and almost 60 per cent do not want to see a deficit.

The poll is testament to the Liberal success of persuading Canadians that all deficits are bad. Whether support would continue once cuts stop being an abstract idea and take the shape of real reductions in services and programs is an open question.

But should Mr. Harper be following a contra-cyclical policy, spending when times are good and then cutting when times are bad? That is a recipe for sapping whatever growth there is left in the national economy.

The Prime Minister was giving little away on Thursday, the day his new cabinet was sworn in. He said his policy would be “prudent” and “pragmatic,” which tells us nothing at all. No government on earth describes its plans as wild and unrealistic.

If the Prime Minister sticks to his stated preference for smaller government and lower taxes, Canadians should prepare themselves for a series of blows. The first will come from federal spending cuts and the rest will result from the knock-on effects of those cuts as they filter through an already weakened economy.

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