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PBO Perspectives on Budget 2009

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Section 1: Introduction

The Parliamentary Budget Officer (PBO) began operations in March 2008 with a mandate to provide independent analysis to Parliament on the Canadian economy and federal budget issues. This note provides analysis and observations from the PBO on Budget 2009. We begin with some brief background on the situation leading up to the budget,[1] then address specific budget issues, discuss developments and the revised outlook since the budget, and conclude by highlighting some longer-term considerations.

Brief Background

After several years of strong growth, the global economy began to slow at the end of 2007, with the U.S. economy entering recession in December and global growth weakening significantly throughout 2008 (Figure 1). While real growth in the Canadian economy was sluggish throughout the first half of 2008, record-high commodity prices that peaked in July helped partially insulate the purchasing power of households and firms in Canada.

In September 2008, global credit market strain turned into a global financial crisis with the failure of a major U.S. investment bank.. This major financial shock amplified the existing weakness in the Canadian economy, and resulted in a large and rapid stock market reversal, compounding the impacts of the on-going commodity price correction. Sharp declines in output and employment quickly followed. Consumer and business confidence collapsed owing to worsening wealth and income prospects and increased uncertainty. Overall, the deterioration in the financial and economic environment was rapid, significant and not well-anticipated. As a result, these developments led to a further downgrading of Canadian economic growth forecasts for 2009 (Figure 2).

[1] For additional background see the MacKinnon, Ragan, and Harris papers in these conference proceeding.

Figure 1: World and U.S. GDP Growth 2004-2009

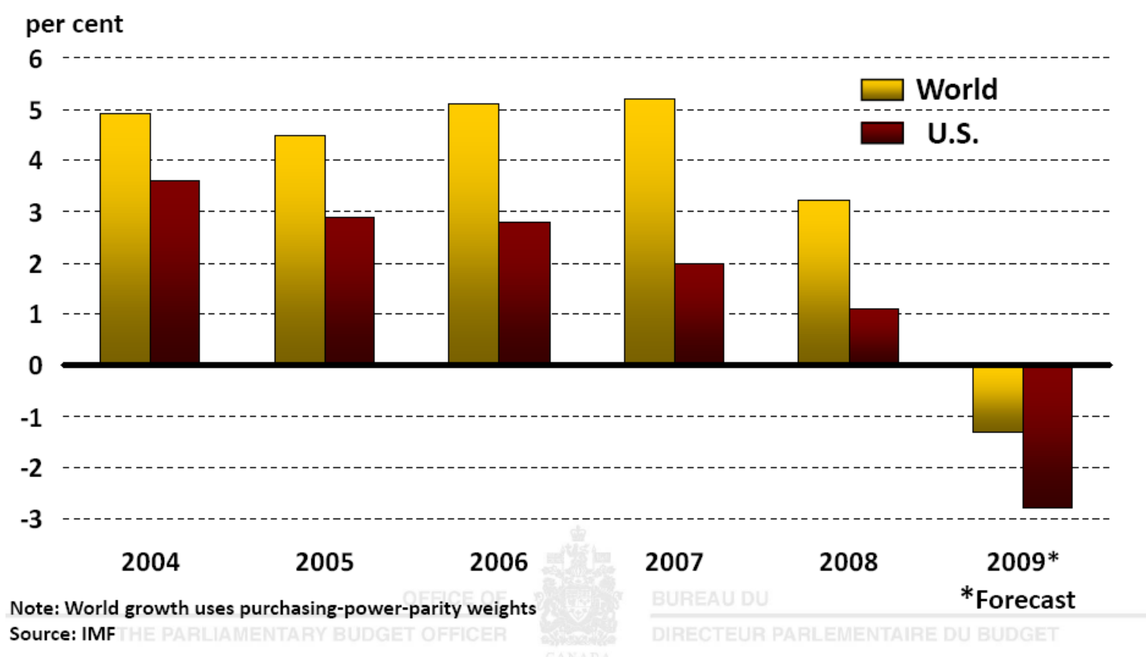
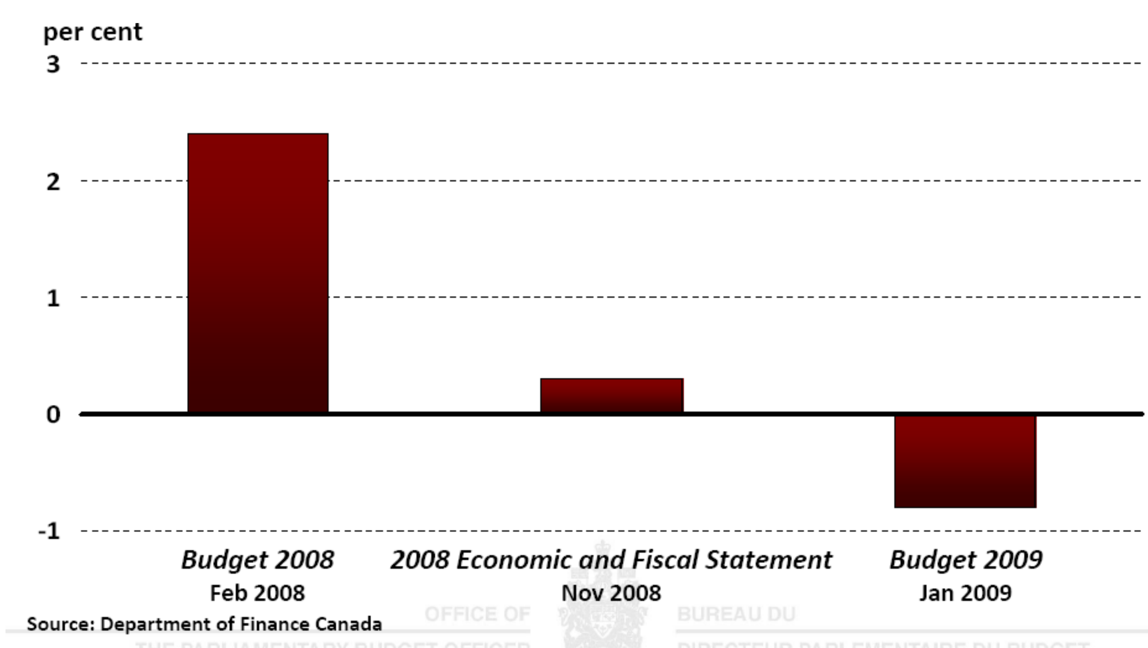


Figure 2: Canadian Average Private Sector Real GDP Growth Forecasts for 2009



The size of the shocks, their global nature, and the limited scope for additional conventional monetary stimulus put the onus on discretionary fiscal policy to help stabilize the Canadian economy.[2] Initially, in November 2008 the Government's *Economic and Fiscal Statement* proposed mildly contractionary spending restraint aimed at achieving modest surpluses in each year of the five-year fiscal planning horizon. These policy actions were criticised by opposition parties and ultimately led to the formation of a coalition in December 2008 that threatened to defeat the minority Conservative government. This defeat was avoided by proroguing Parliament, which allowed the Government time to conclude its stakeholder consultations and bring forward an early budget in January 2009.

Section 2: PBO Budget 2009 Analysis

Budget 2009 was designed largely as an economic stimulus package, based on the guiding principles that its measures be: timely; targeted; and temporary. The budget not only aimed to fulfill Canada's November 2008 G20 commitment to provide timely stimulus, but also to improve the availability of credit and restore the functioning of impaired financial markets. The budget reported total incremental measures at $51.6 billion (3.2% of GDP) over 2009 and 2010, based on $39.9 billion in federal stimulus and an expected $11.7 billion in provincial and municipal 'leveraged' contributions.[3] The budget's stimulus impacts on the Canadian economy were estimated to increase real GDP (by 1.9%) and employment (by 189,000 jobs) by the end of 2010.

Also noteworthy was that the budget projected a return to a surplus position by the end of the forecast horizon in 2013-14. This result relied on the time-limited nature of the

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[2] Monetary policy was thought to be constrained because the Bank of Canada had substantially reduced its policy interest rate during the preceding year (from 4.5% in November 2007 to 2.25% in November 2008), and the financial nature of the downturn had impaired the monetary policy transmission mechanism.

[3] While Budget 2009 included important measures to improve access to financing and strengthen the financial system, the Government's total stimulus estimate did not include these measures.

stimulus spending and overall spending management as well as an optimistic rebound in tax revenues toward the end of the projection period as the economy recovered.

The following sections summarize PBO analysis from pre- and post-budget reports (PBO 2009a and PBO2009b) and include expanded analysis and subsequent results. The issues covered in these sections are the fiscal projections and planning assumptions; the Government's measurement of the stimulus; an assessment of budget measures relative to its guiding principles; and the quarterly budget progress reports.

2A. Fiscal Planning Assumptions and Projection Results

In January 2009 the PBO's pre-budget briefing presented a status quo fiscal projection that relied on a similar economic outlook used for fiscal planning in Budget 2009.[4] Despite these similar economic outlooks, a key difference between the two projections was the budget balance in the outer years, where Budget 2009 featured a return to surplus by 2013-14, while the PBO's analysis projected a deficit (Table 1).[5] The difference between the two status quo projections was roughly $5 billion in 2012-13 and more than $10 billion in 2013-14.

Table 1: Status Quo Budget Balance Comparison ($billions)

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Status Quo Budgetary Balance ($ billions)						
Budget 2009 (risk-adjusted)	0.2	-15.7	-14.3	-8.3	-2.3	5.5
PBO January 2009 (not risk-adjusted)	0.2	-13.0	-11.6	-8.6	-7.4	-5.3
PBO January 2009 minus Budget 2009	**0.0**	**2.7**	**2.7**	**-0.3**	**-5.1**	**-10.8**

Source: Budget 2009, Office of the Parliamentary Budget Officer

[4] Both the Budget 2009 and PBO status quo fiscal projections were based on surveys of private sector forecasters conducted in January 2009. PBO's projection of nominal GDP was marginally higher (+$6B) than Budget 2009's risk-adjusted forecast in 2011 but marginally lower in 2012 and 2013 (-$3B and -$7B).
[5] The differences in the near-term results is partially explained by the fact that the budget risk-adjusted its near-term nominal GDP projection, while the PBO did not risk-adjust its average scenario, instead assessing risk through an additional low growth scenario.

Budget 2009 cited downside risks to the economic outlook that were concentrated in 2009 and 2010, owing to the possibility of more prolonged financial market problems and a weaker outlook for commodity prices. As a result, the budget prudently adjusted downward the near-term private sector forecast of nominal GDP, but returned the level of nominal GDP used for planning purposes to the private sector average by 2014 (Table 2).

There are two implications of this adjustment. First, this risk adjustment to the fiscal projection is front-end loaded — largely affecting the near-term budget balance while having little impact on the medium term. This front-end-loaded risk adjustment differs from the treatment of economic forecast uncertainty in past budgets (prepared in the context of surpluses which grew over the projection horizon). In those budgets 'economic prudence' was back-end-loaded and grew over the projection horizon, rather than shrinking, and thereby increasingly worsened the budget balance over the projection. Second, returning to the *level* of nominal GDP in 2014 forecast average implies that nominal GDP *growth* exceeds the private sector survey average in each year after 2009 — indicating an upside risk to the private sector outlook for growth after this year.

In the PBO's view, incorporating larger downward adjustments to nominal GDP (or explicitly to the budget balance) in the outer years might be a more appropriate way to address the possibility that the downturn could be deeper and/or longer than private sector forecasters anticipated at the time of the budget — particularly given the global and financial nature of the recession.[6]

[6] Recent research by Claessens et al (2008) and Reinhart and Rogoff (2009) analyze cross-country data and find evidence that financial, credit and housing related recessions tend to be longer and more severe.

Table 2: Budget 2009 Nominal GDP Outlook ($ billions)

	2008	2009	2010	2011	2012	2013	2014
Nominal GDP (billions of dollars)							
January 2009 Finance survey							
Level	1,609	1,590	1,657	1,751	1,848	1,940	2,031
Growth		-1.2	4.2	5.7	5.5	5.0	4.7
Budget 2009 fiscal planning assumption							
Level	1,604	1,560	1,627	1,731	1,838	1,935	2,031
Growth		-2.7	4.3	6.4	6.2	5.3	5.0
Level Adjustment for risk	**-5**	**-30**	**-30**	**-20**	**-10**	**-5**	**0**
	2008-09	**2009-10**	**2010-11**	**2011-12**	**2012-13**	**2013-14**	
Revenue Effect of Risk Adjustment	-0.8	-4.5	-4.5	-3.0	-1.5	-0.8	

Source: Budget 2009

Notwithstanding the risk adjustment to nominal GDP, the budget's projected return to surplus was based on relatively optimistic assumptions underlying revenues in 2012-13 and 2013-14. Indeed, the different fiscal projection results between the PBO and Budget 2009 are due mainly to differences in revenue projections ($4.5 billion in 2012-13 and $9.5 billion in 2013-14), primarily reflecting differences in corporate income tax revenues (Table 3). While Budget 2009 did not present its underlying assumptions about corporate profits, it appears to rely on a more optimistic assumption for the outer years — corporate profits as a share of nominal GDP were likely projected to remain well above their long-term historical average.[7] Other revenues, which include Employment Insurance premiums, also contributed to the differences in 2012-13 and 2013-14.

[7] PBO requested projection details for corporate profits and other economic variables underlying Budget 2009 but was not provided with this information because the Privy Council Office deemed it a Cabinet confidence.

Table 3: Status Quo Revenue Comparison (Budget 2009 minus PBO January 2009)

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Revenues (Budget 2009 minus PBO January 2009, $ billions)						
Personal Income Taxes	0.7	-3.1	-5.6	-6.0	-4.1	-1.8
Corporate Income Taxes	-3.5	-1.7	2.0	5.8	6.6	7.1
Goods and Services Tax	-0.5	-1.5	-1.4	-0.7	-0.3	-0.1
Other Revenues	1.5	-1.9	0.1	0.9	2.4	4.3
Budget 2009 minus PBO January 2009 (total revenues)	-1.8	-8.3	-4.9	0.1	4.5	9.5

Source: Budget 2009, Office of the Parliamentary Budget Officer

2B. Measuring the Size of the Fiscal Stimulus

Budget 2009 estimated the federal fiscal stimulus measures at $39.9 billion over 2009-10 to 2010-11. In the PBO's view, this estimate may be overstated. First, the budget estimate of federal fiscal stimulus simply offsets $5.7 billion in contractionary fiscal actions for 2009-10 and 2010-11 which were proposed only two months earlier in the November 2008 *Economic and Fiscal Statement*. Second, the budget estimate includes stimulus of $2.4 billion in 2010 from maintaining Employment Insurance (EI) premiums at 2009 levels in 2010. The estimate is calculated relative to a benchmark case in which EI premiums in 2010 would have been increased to their break-even level, representing a contractionary policy response in the context of rising unemployment. Adjusting for these two considerations, results in a 'net' federal stimulus of $31.8 billion, 20% smaller than reported in Budget 2009 over 2009-10 and 2010-11 (Table 4). Finally, a significant part of the Government's stimulus estimate (approximately $10 billion) is contingent on matching contributions from other levels of government. If these other governments do not participate in these programs, the size of the federal stimulus falls further to $21.9 billion, 45% smaller than the Budget 2009 estimate.

Table 4: Estimates of the Federal Fiscal Stimulus ($ billions)

	2009-10	2010-11	Total
Budget 2009 reported federal stimulus measures (billions of dollars)	**22.7**	**17.2**	**39.9**
Spending reductions in the November 2008 Economic and Fiscal Statement	2.9	2.8	5.7
Budget 2009 estimated cost of maintaining EI premiums at 2009 levels in 2010	0.8	1.6	2.4
Net federal stimulus	**19.0**	**12.8**	**31.8**

Source: Budget 2009

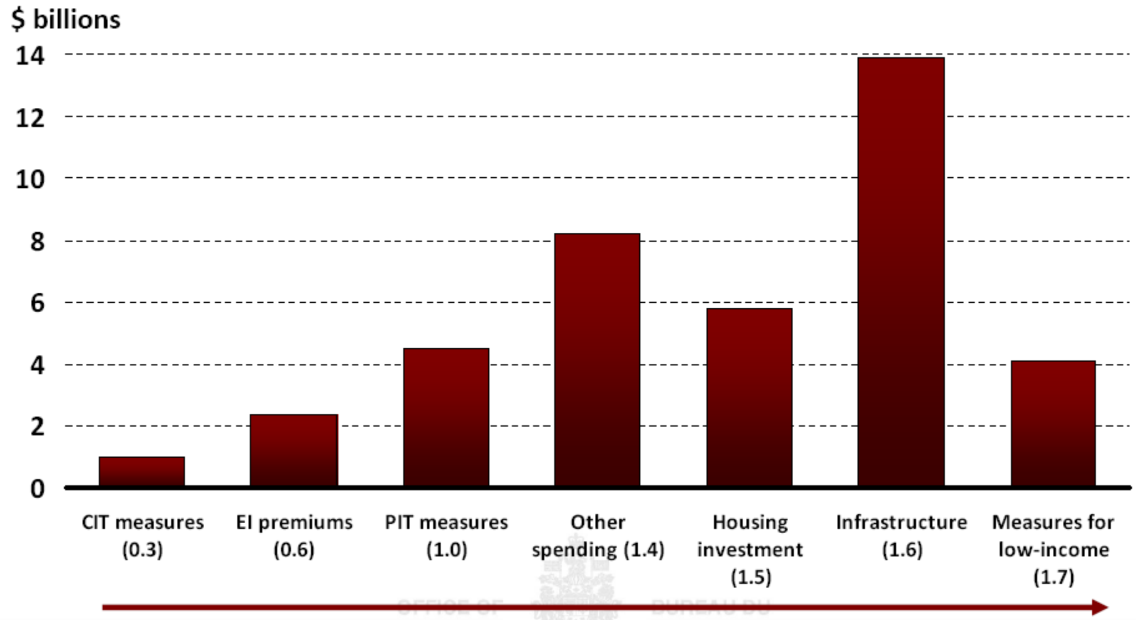
2C. Assessing Stimulus Measures Against the Budget's Guiding Principles

Budget 2009 states that the stimulus measures are based on three guiding principles — that the stimulus measures should be: targeted (to trigger the largest increase in Canadian jobs and output); timely (begin by the end of May 2009); and temporary (phased out when the economy recovers to avoid long-term structural deficits). In general, Budget 2009 stimulus measures appear broadly consistent with the Government's guiding principles, though there may be some challenges to fully achieve all these aims given that there may be trade-offs between these three objectives.[8]

Targeted: Based on Department of Finance Canada estimates of fiscal multipliers (i.e., the short-run increase in economic activity per dollar allocated to a particular policy action), Budget 2009 measures are generally targeted. The majority of the measures are allocated to 'high' impact categories with over 40% ($13.9 billion) of total federal stimulus allocated to infrastructure spending with a multiplier of 1.6 over eight quarters – the second highest multiplier according to Department of Finance estimates (Figure 3). That said, the highest multiplier – and possibly one of the more timely actions – measures for low-income Canadians (1.7), was allocated with fewer resources than many other categories.

[8] For example, infrastructure spending may be targeted, but not timely. Measures for low-income may be timely but difficult to enact temporarily; and some temporary, targeted measures may prove to be permanent.

Figure 3: Federal Measures 2009-2010 by Multiplier Impact ($ billions)



Source: Budget 2009
*Budget 2009 estimated multipliers shown in parentheses

Timely: Budget 2009 also strives to be timely, "measures to support the economy must begin within the next 120 days". Recalling that a key, long-standing argument against the use of discretionary fiscal policy is its long time lags, implementing measures this quickly will be a significant challenge. The Government's first progress report in March 2009 described some of the extraordinary measures taken to accelerate spending appropriations. However, there are some key areas of concern – particularly with respect to infrastructure funding, which accounts for the largest portion of stimulus spending. Based on recent performance, the Government's infrastructure funding has lapsed (i.e., not spent) approximately one of every three dollars planned over the past two fiscal years (Table 5). Given this track record, the doubling of Infrastructure Canada appropriations in 2009-10 poses a key risk to the timely implementation of a major component of the budget.

Table 5: Infrastructure Canada Spending Planned and Actual Spending ($ billions)

	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Infrastructure Canada Spending ($ billions)						
Planned	2.1	3.1	3.4	7.3	7.0	4.1
Actual	1.5	2.0	-	-	-	-

Source: Public Accounts of Canada and Infrastructure Canada's 2009-10 Report on Plans and Priorities

Temporary: On a Public Accounts basis, the fiscal costs to the federal government of Budget 2009 measures over 2008-09 to 2013-14 total $49.4 billion (Table 6). While there may be political pressure to maintain some short-term actions, the majority of budget measures are planned to be temporary, with 70% of the fiscal cost incurred by 2010-11. The fiscal cost of measures is almost equally split between spending and revenue categories over the projection horizon. Spending measures are planned to be mostly temporary with about 90% dispensed by 2010-11 ($21.6 billion). On the tax side, personal income tax cuts contribute about $4 billion to permanent fiscal costs beyond 2010-11, representing almost half of total tax measures ($11.6 billion).

Table 6: Fiscal Costs of Budget 2009 Measures (Public Accounts basis, $ billions)

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	Total
Budget 2009 measures ($ billions)							
Revenue measures	1.2	6.8	5.2	3.7	4.0	3.9	**24.8**
Spending measures	0.1	11.2	10.3	1.0	1.0	1.0	**24.6**
Total measures in Budget 2009	**1.3**	**18.0**	**15.5**	**4.7**	**5.0**	**4.9**	**49.4**

Source: Budget 2009, Office of the Parliamentary Budget Officer

2D. Budget Progress Reports

Implementing a large-scale spending acceleration in a parliamentary system in both a timely and effective manner is a difficult task. To address these concerns, a key requirement for parliamentary approval of Budget 2009 was that quarterly progress reports be provided to Parliament.

In late-February 2009, prior to the release of the Government's first progress report, the PBO published a discussion paper that suggested key information to be included in these reports (PBO 2009c). In the PBO's view, the central goal of these reports should be to provide Parliament with accurate, timely and easily understood information on three key issues: 1) the implementation and progress of budget measures; 2) recent economic and fiscal developments and prospects; and 3) assessing budget results relative to its guiding principles.

The Government's first report in March 2009 focused largely on the first of these three issues, namely on setting up the necessary authorizations to ensure stimulus measures could begin quickly. In the first report there was limited information provided on: expected outputs and outcomes of budget measures; implementation benchmarks and time lines for specific programs; or an updated outlook for the Canadian economy and budget projection. However, if this information is provided in future reports, this may allow for a real-time assessment of program implementation and tracking of results relative to program objectives.

Section 3: Tracking Stimulus Impacts and Recent Economic Developments

Budget 2009 provided detailed estimates and analysis of the short-run economic impacts of stimulus measures over 2009 and 2010. By the end of 2010, the Department of Finance estimates that the total stimulus of $51.6 billion (including leverage)[9] will increase real GDP by 1.9% and will create or maintain 189,000 jobs – equivalent to a 1.1% increase in employment, relative to an unobservable baseline scenario which does not include stimulus measures. Based on this analysis, the PBO has reconstructed a baseline scenario

[9] The total stimulus impact assumes full take-up by other levels of government and that they do not simply divert resources away from other spending priorities to take advantage of matching federal contributions.

projection (i.e., the outlook based on the January 2009 private sector survey which does not likely reflect significant stimulus measures) with estimates of the quarterly impacts of the stimulus measures consistent with the annual and endpoint estimates provided in Budget 2009. This baseline scenario also serves as a useful reference point since it reflects the projected weakness in output and employment that helped prompt Budget 2009 stimulus initiatives.

The data releases to-date suggest that the economy's starting point, prior to the stimulus measures, is considerably weaker than anticipated at the time of Budget 2009. With the larger-than-expected declines in the fourth quarter of 2008 and first quarter of 2009, the level of real GDP is now 1.6% lower than the baseline projection in the first quarter of 2009 (Table 7).

Table 7: Real GDP With and Without Budget 2009 Stimulus (index, 2008Q4 = 100)

	08Q4	09Q1	09Q2	09Q3	09Q4	10Q1	10Q2	10Q3	10Q4
Real GDP (index, Budget 2009 2008Q4 = 100)									
With Budget 2009 stimulus	100.0	100.9	100.6	101.1	101.7	102.4	103.2	104.1	105.1
Without Budget 2009 stimulus	100.0	99.3	99.0	99.5	100.0	100.7	101.4	102.2	103.1
2008Q4 and 2009Q1 actuals	99.1	97.7							

Source: Office of the Parliamentary Budget Officer

Regarding labour market impacts, the level of employment is 0.7% (112,000 jobs) lower than the baseline projection, based on Labour Force Survey data through March 2009 (Table 8).

Table 8: Employment With and Without Budget 2009 Stimulus

	08Q4	09Q1	09Q2	09Q3	09Q4	10Q1	10Q2	10Q3	10Q4
Employment (thousands)									
With Budget 2009 stimulus	17,157	17,073	17,088	17,126	17,169	17,237	17,304	17,382	17,470
Without Budget 2009 stimulus	17,157	17,018	17,014	17,033	17,057	17,106	17,154	17,213	17,281
2008Q4 and 2009Q1 actual	17,146	16,907							

Source: Office of the Parliamentary Budget Officer

Looking ahead, the outlook for the Canadian economy has worsened significantly since Budget 2009 was tabled in January. Indeed, with weaker-than-expected real GDP growth in the final quarter of 2008 and first quarter of 2009 (relative to Budget 2009), private sector forecasters now expect[10] real GDP to decline by 2.7% in 2009 and rise by 2.0% in 2010 (versus the Budget 2009 expectations of -0.8% and 2.4%). Moreover, the current private sector outlook reflects expectations of the impact on real GDP growth of Budget 2009 stimulus measures, which implies that the downward revisions to the baseline outlook were substantial, more than offsetting any of the estimated positive impacts of the stimulus measures.

As a small open economy and commodity exporter, Canada's recovery will depend crucially on global economic and financial developments — particularly those in the U.S.[11] While stimuluative monetary and fiscal policies, both in Canada and abroad, will support growth, history suggests that financial-led recessions are deeper and their subsequent recoveries are slower than in average recessions. These factors suggest that the global and Canadian economies could remain well below their potential production capacity for an extended period. Overall, the revised economic forecasts also imply that the current recession is expected to be more severe than recent recessions in terms of the overall amount of unrealized output (Table 9).

[10] Based on the May 2009 PBO survey of private sector forecasters.
[11] Vector autoregression analysis suggests that shocks to U.S. growth are particularly important for Canada's growth through financial and trade linkages. See e.g. Swiston and Bayoumi (2008).

Table 9: Estimated Output Gap in Recessions (% of potential GDP)

	0	year 1	year 2	year 3	year 4	year 5	year 6	year 7
Output Gap (% of potential GDP)								
1981 to 1988	0.6	-5.1	-4.9	-1.8	0.5	0.6	2.4	4.7
1990 to 1997	1.6	-3.0	-4.1	-3.9	-1.7	-1.9	-3.1	-2.0
2007 to 2014*	0.0	-1.9	-6.7	-7.1	-6.1	-5.1	-4.4	-3.9

* May 2009 PBO Survey for real GDP growth. Potential output growth assumed to be 2.4%; lower potential output growth would result in smaller estimates of excess capacity.
Source: Department of Finance Canada, Office of the Parliamentary Budget Officer

Section 4: Longer-Term Considerations

In the current environment with the intense focus on near-term challenges, it is easy to over-look important longer-term issues. This section highlights some outstanding issues by posing three questions that may be relevant for the Canadian economy and policymakers after the recovery takes hold — and as such, are issues worth raising now. We conclude with three takeaway observations.

Q1) Will the current downturn have longer-term impacts on potential output?

The first outstanding issue that is not well understood at the current time is the possible impacts of the current recession on potential output growth in Canada. One concern is that a severe cyclical downturn and associated restructuring of key industries could have persistent impacts on the economy's production capacity going forward. For example, in its most recent projection in April 2009, the Bank of Canada significantly revised down its estimate of Canada's potential output growth.[12] The Bank cited capital obsolescence and labour reallocation costs resulting from structural adjustments in industries such as the automotive and forestry sectors as well as weak business investment which would lower capital per worker. Looking forward, if these developments proved to be persistent, they could matter not only for fiscal policymakers if they restrain tax collections

[12] Revised down from 2.4% to 1.2% in 2009, from 2.5% to 1.5% in 2010, and from 2.5% to 1.9% in 2011.

or increase spending requirements in programs such as Employment Insurance, but could also have material impacts on Canadian living standards.

Q2) Is there a risk of structural deficits?

Budget 2009 states a principle that stimulus measures should be phased out when the economy recovers to avoid long-term structural deficits. In practice, avoiding structural deficits may ultimately require political will and solid economic performance. Political will is required to ensure that temporary measures are in fact phased out as the economy recovers. It also means that spending remains disciplined over the medium term because after the short-term spike in program spending, Budget 2009 plans to significantly restrain program spending so that it does not grow faster than GDP over the planning horizon. In addition, a sustained rebound in the global economy and commodity prices and maintaining Canada's potential production capacity at high levels will also help avoid structural deficits.

Although there is a high degree of uncertainty surrounding estimates of potential output, and therefore, structural budget balances, rough PBO calculations based on Budget 2009 projections suggest a small structural surplus position over the medium-term through 2013-14 (Table 10).[13]

Table 10: Budgetary Balance Projections ($ billions)

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Budgetary Balance ($ billions)							
Structural balance	9.6	3.7	-1.7	0.4	1.5	1.6	5.0
Cyclical balance	0.0	-4.8	-32.0	-30.2	-14.5	-8.9	-4.3
Budget 2009 Budgetary Balance	**9.6**	**-1.1**	**-33.7**	**-29.8**	**-13.0**	**-7.3**	**0.7**

Source: Budget 2009, Office of the Parliamentary Budget Officer

Table 11 shows the impact of slower potential GDP growth on the structural budget balance estimates by assuming potential growth of 1.9% versus 2.4% annually. Lower

[13] Despite the Government's stated fiscal objective of avoiding structural deficits, it has not yet provided estimates of structural budget balances over the projection horizon.

potential growth would reduce structural revenue growth and lead to small structural deficits, equal to less than 1% of GDP through 2013-14. Overall, the downward revisions to potential output by the Bank of Canada and private sector forecasters suggest downside risks to structural balance estimates over the medium term.

Table 11: PBO Estimates of Structural Budget Balances ($ billions)

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Structural Budgetary Balance ($ billions)							
2.4% potential GDP growth	9.6	3.7	-1.7	0.4	1.5	1.6	5.0
1.9% potential GDP growth	9.6	2.5	-4.2	-3.5	-3.8	-5.2	-3.6

Source: Office of the Parliamentary Budget Officer

Q3) Will policymakers need to re-examine Canada's fiscal policy framework?

In a previous JDI Budget conference, Rick Harris (2003) made the following prediction:

> I am skeptical this Canadian value (of balanced budgets) will endure beyond the current business cycle... Eventually a large recession will occur in Canada, a deficit will result and there will be calls for fiscal stimulus. This is inevitable. Not *if*, but only *when*… The whole framework for fiscal policy will be revisited.

Professor Harris was right. Re-thinking the fiscal policy framework and objectives will be a key issue going forward. One aspect of this is the macroeconomic stabilization provided by fiscal policy. Internationally, the current global recession has led to a strong resurgence in support for discretionary fiscal policy among policymakers (as part of an even broader re-examination of the role of government in the economy more generally). At the current time, it is unclear whether this support will continue or whether this response was specific to the nature of the current recession. In Canada there may be additional forces at play rather than simply the large economic shocks and the perceived limitations of additional monetary stabilization. There is a sense that automatic stabilizers at the federal level have possibly become less countercyclical in the past decade, due to personal and corporate income tax rate reductions and policy changes to the Employment Insurance and Equalization programs.[14] If automatic stabilizers are indeed less effective, then other things equal, that could imply an increasing reliance on discretionary fiscal stabilization measures in future recessions.

Regarding the fiscal policy framework more generally, prior to this recession Canadian fiscal policy operated under a combination of several stated fiscal targets over differing time horizons. There was a short-term objective of paying down debt by $3 billion annually; the medium-term objectives of achieving a 25% federal debt-to-GDP ratio by 2011-12, and to keep program spending growth below that of nominal GDP growth on average; and a longer-tem goal of eliminating net total government debt by 2021 (which includes the balances of the public CPP/QPP pension plans as well as other levels of government).

As Harris predicted, a rethinking of fiscal priorities is underway, and indeed there already appears to be a subtle adjustment of fiscal policy objectives. Budget 2009 did not re-affirm its prior specific policy targets. Instead, the budget reiterated the general goal of reducing the debt burden, stating that "as a first priority, surpluses should be dedicated to repay the deficits expected over the next four years". Also, in addition to its economic stimulus objectives, the budget appeared to suggest a new fiscal policy goal of maintaining a structural surplus/avoiding a structural deficit. This may be viewed as a move from aiming to balance the budget each year, towards balancing the budget over the economic cycle — an approach generally supported by O'Neill (2005) and Dodge (1998).

[14] In fact, changes to the latter two programs may have potentially added procyclical elements that could effectively amplify booms and downturns. For example, the overall size of Equalization payments is tied to GDP growth, and for EI in this recession, premiums were set to rise going forward to balance the EI account and explicit policy actions were necessary in Budget 2009 to over-ride this feature of the program.

Concluding Observations

With a few months passed since Budget 2009, the JDI Budget conference provides the opportunity to reflect on recent developments. First, there are some important reminders on timeless issues that are easily forgotten:

1. ***In policymaking discussions and for policy decisions, it is important to address near-term demands, while maintaining focus on long-term policy challenges and preserving policy credibility.***

One component of this is debating and articulating clearly-defined exit strategies for fiscal and monetary policy for the post-recovery period. Focusing on fiscal policy, credibility was hard earned in 1990s as many governments in Canada made great progress in reversing rising debt burdens. This required not only educating the public about the debt problem, but also making difficult policy decisions — particularly to cut spending. This progress must not be undone in the current downturn. Preserving fiscal sustainability is particularly important in anticipation of several long-run challenges, including:

- *Future demographic pressures*. Population ageing will slow labour force growth dramatically and without stronger productivity performance, living standards and public finances will come under pressure.
- *Weak productivity performance*. Canada's recent productivity performance has been weak both historically and compared to the U.S.
- *Environmental problems*. Strong policy actions will be required in this area.
- *Regional and industrial adjustments,* including the downward trend of manufacturing employment in advanced industrialized economies will require policies that cushion these impacts while facilitating a necessary reallocation of labour from slowing regions and industries to growing regions and industries.

Overall, then policy decisions today should attempt to clearly identify these and other key challenges and make long-term investments to address them.

2. The global financial crisis underscores the importance of transparency in financial reporting and decision-making.

One key contributor to the financial market crisis was a lack of transparency regarding financial assets on the part of borrowers, investors, credit rating agencies, etc. Related problems also arose in the past decade from accounting scandals in various countries in both the public and private sectors. While improving transparency in financial decision-making is not sufficient on its own to ensure sensible decision-making, improving transparency has the potential to raise warning signs sooner and possibly prevent increased speculation or poor financial management. This leads to a view of how recent developments present a unique opportunity:

3. The heightened scrutiny of budget stimulus measures provides a unique opportunity to improve budget transparency, oversight and reporting to Parliament for Budget 2009 and beyond.

The PBO views the introduction of quarterly budget progress reports as a welcome development. These progress reports represent an historic opportunity to strengthen budget transparency regarding the implementation, oversight and effectiveness of Government budgets. The Government's first report represents an important first step towards improving interim reporting to Parliament and will ultimately strengthen Parliament's budgetary oversight role. Therefore, the PBO encourages Parliament to consider making permanent some type of progress reporting requirement to ensure this increased level of transparency remains for future budgets.

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