

No to Balanced-Budget Laws, Yes to Sound Budgeting

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The Globe and Mail
October 29, 2013

The federal government has recently announced its intention to legislate a requirement for balanced budgets. Hard-core fiscal conservatives love this idea because they believe it is desirable to restrict the spending powers, and thus the size, of government. Unfortunately, such legislation is either ineffective or ends up creating bigger problems than it solves. Genuine fiscal responsibility cannot be achieved through simple legislation.

I share the belief of many fiscal conservatives that large and persistent budget deficits can be a serious problem, and that genuine troubles are created when governments become highly indebted. Public debt is not always and everywhere a concern, but when it gets out of hand it can become a real threat to the economy. One needs only glance at Europe to see some of the problems created when governments for too many years paid too little attention to their mounting debts. I feel some of the pain of those fiscal conservatives who long for a world in which governments are serious about fiscal responsibility.

The main problem with balanced-budget legislation, however, is that it forces governments to make destabilizing policy adjustments. When the economy is booming, tax revenues naturally rise quickly and the government spends less on things like Employment Insurance. A legal requirement to balance the budget would then force the government to either reduce its tax rates or increase its spending, but both of these actions would stimulate a fast-growing economy when a little slowing would be preferable. Conversely, if the economy is slumping, the natural decline in tax revenues would force the government to either increase tax rates or reduce spending, thus exacerbating the economic slowdown. Balanced-budget legislation thus worsens economic instability.

To be fair, the Conservative government is not proposing balanced budgets for each and every year. Instead, the Throne Speech says that the legislation “will require balanced budgets during normal economic times, and concrete timelines for returning to balance in the event of an economic crisis”. This statement embodies a very sound principle for fiscal policy. It is sensible to run large budget deficits during recessions, as the government did in 2009 and 2010; the dramatic economic plunge provided a clear rationale for both modest tax breaks and large increases in government expenditure, both designed to dampen the severity of the recession.

Despite the sensibility of this principle, embedding it in legislation is a real problem. The weasel words of “normal”, “concrete” and “crisis” are impossible to define with any precision, and this makes the associated legislation almost meaningless. After a law is written and passed, the government of the day – of whatever political stripe – can easily make the case that times are not “normal” and so the budget deficit will be large, or that its intention to return to balance is “concrete” when in fact it is quite flimsy. Budget legislation created by one government can be side-stepped, modified, or eliminated by the next

one – or even by the same one just a little later. And for political actions as central as taxing and spending, no self-respecting government would miss the chance to modify a budget law to make it consistent with favoured policies.

So where does this leave us? If large and persistent budget deficits truly are a problem, and if significant costs of high government debt really do exist, we need to avoid these situations. But if balanced-budget legislation is such a bad idea, how do we stay out of fiscal trouble?

The answer is simple, at least conceptually. What we need is governments – one after the other – that truly understand the advantages of using the power of the public purse to dampen the largest swings in the business cycle while simultaneously recognizing the problems associated with very high public indebtedness. And we need the voters to choose these kinds of governments. In short, we need governments – and electorates – that resist the simplistic and often ideological prescriptions heard from both sides of the political spectrum, and instead take a nuanced approach to fiscal policy.

The federal Conservatives have actually demonstrated this kind of understanding over the past five years. The 2009 and 2010 budgets showed a clear commitment to using significant fiscal stimulus as a means of dampening the worst effects of the financial crisis; but the fiscal path since then has revealed an equally serious commitment to getting back to balance and to returning to more acceptable levels of the debt-to-GDP ratio. I can quibble with some details, but overall this has been pretty responsible fiscal policy.

Balanced-budget legislation hasn't been needed for the past five years, it's not needed now, and it won't help us with our coming challenges. Having a sensible fiscal view and being willing to make tough choices when necessary is far more valuable than passing simplistic legislation.

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