

## **Canada 2015: A Remarkable Economic Transformation**

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It's natural for public discussion to focus on today's problems and how to best solve them. But it's also worthwhile to remind ourselves what past challenges we've already come together to solve. In comparison with only a few decades ago, things look remarkably good today.

Quebec had its first referendum on separation in 1980. Not only did this create much angst across Canada, it led Pierre Trudeau's federal government to devote enormous energy to constitutional negotiations. Quebec never signed on, and this eventually led to more angst surrounding Meech Lake and Charlottetown. Today there is much less angst, and we have a strong and smart Quebec premier who is constructively engaged with the other provinces, discussing issues that matter for all Canadians.

The year 1980 also saw the creation of the National Energy Program. Designed to promote energy independence for the country, and also to redistribute resources from the oil-producing provinces to the others, the NEP generated a political firestorm that still singses the federal Liberals whenever they visit the West. Fortunately the NEP is now ancient history, being terminated in 1985.

By the mid 1980s, Canada's tax system had high marginal rates, too many brackets, an excessive reliance on income taxation, and a badly designed Manufacturers Sales Tax (MST). The tax reform of the late 1980s cleaned up the system massively, reduced the number of personal brackets, better integrated the corporate and personal sides of the system, and replaced the MST with the Goods and Services Tax, which has now been harmonized with the sales taxes in most provinces. Many Canadians still hate the GST, and probably always will, but there's no question that our tax system is far more efficient today than back then.

Since Confederation Canadians had debated the merits of freer trade with the United States, but the idea was simply too much for too many to bear. It took the Macdonald Commission to resurrect the issue and the government of Brian Mulroney to have both the vision and the courage to make it the centerpiece of a federal election. The rest is history, with the Canada-US Free Trade Agreement beginning in 1989 and its expansion into NAFTA five years later. Trade flows have sharply increased, supply chains have never been more integrated, and Canadians have finally come to embrace both the opportunities and challenges that free trade brings.

After the OPEC-induced oil shocks of the 1970s, and with less than stellar monetary policy, the Canadian rate of inflation by 1980 was over 12 percent and the prime interest rate was almost 22 percent. The Bank of Canada didn't adopt its formal inflation-targeting regime until 1991, but when it did it proved to be a huge success. For the past 20 years, inflation

has averaged almost exactly 2 percent annually, and its volatility has been trivial compared to that in the 1970s. The high and costly inflation of our past is all but unthinkable today.

Government finances have also turned around remarkably. In 1984, the federal budget deficit was over 8 percent of gross domestic product (GDP) – roughly \$145 billion in terms of today's economy. This year, the federal government is wondering whether its deficit will be a few billion dollars or whether it will actually balance its budget, or maybe even post a small surplus. But it almost doesn't matter – any reasonable forecast shows a number (positive or negative) far less than 1 percent of GDP.

Those large 1980s budget deficits lasted for a decade, and led to the accumulation of an enormous public debt. The federal debt-to-GDP ratio was about 40 percent in 1985 and rose steadily to its peak at 68 percent a decade later. Paul Martin then became the G7 poster boy for fiscal responsibility, and the large budget deficits turned into balanced budgets and then surpluses. Today's federal debt-to-GDP ratio is roughly 30 percent. In international circles, fiscal prudence has become nearly as Canadian as the maple leaf.

Despite the remarkable improvement in many parts of Canadian economic life, we still have our share of challenges. Rising health costs from an aging population, a shortage of critical infrastructure, increasing costs from climate change, and rising income inequality are four big ones. And there are others. But our history proves that we have the ability to come together as a country to solve these problems. Let's hope we keep rising to the occasion.

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