

Canada's deficit miracle could be a tough act for Osborne to follow

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ECONOMIC ANALYSIS

CAN the UK do a Canada? The man who wrote the book on the nation's deficit-busting miracle of the 1990s has been in town to offer some pointers and on the latest evidence of our public finances, it can't come soon enough.

Chancellor George Osborne has draped himself in the maple leaf flag in his bid to emulate Canada's swingeing cuts, but things aren't going to plan so far after a record £10 billion borrowing bill in April.

It's understandable how the Canadian example must appeal when the public accounts are drenched in red ink. At a recent lecture, one of the nation's foremost economists, Brian Lee Crowley, described an apparently stirring story of fiscal redemption to tackle out-of-control public spending, which saw Canada's federal debt balloon to 68% of GDP by 1993.

The nation's politicians were finally shamed into action by a stinging Wall Street Journal leader that said its dire public finances made it an "honorary member of the Third World". Moves included a Canadian version of VAT and swingeing spending cuts for state budgets as well as reform of public pensions.

Every single piece of spending was scrutinised, and some departments were cut by up to 70%.

One Canadian listener in the audience – now living in London but a regular visitor home – called the

slashing "horrible", but the results were spectacular: it achieved the first balanced budget in a generation in 1997 – and followed it with a decade of surpluses which stripped debt down to just 30% of GDP.

Osborne is looking to copy Canada's 80%-20% split between spending cuts and tax rises, but how well the UK can follow the nation's overall example is another matter. According to Crowley, the UK is already going awry on deficit cutbacks by refusing to put everything on the table like the Canadians did, such as the NHS.

But apart from failing to appreciate the quasi-religious fervour with which the health service is regarded in this country – putting it virtually off-limits to all but the most foolhardy of politicians – the vastly different circumstances make it tougher to pull off a repeat.

For one thing, Canada's politicians were cutting against a backdrop of a strong bounceback from a much shallower recession than the one we have just experienced. Canada's economy roared ahead at a pace of 4.8% in 1994

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before the cuts began, far stronger than the measly 1.3% managed by the UK last year.

As Canadian economist Michael Mendelson puts it, "it was economic growth that created the room for cuts", rather than cuts creating growth. In Canada, US exports compensated for weaker consumers at home, and there was also plenty of room for the country's central bank lower cut interest rates to support the economy. And all this took back against a backdrop of steady global growth.

Over here, rates have only got one direction of travel – and that's up. The UK may also struggle to maintain the encouraging trade revival seen so far this year if the economic plight of some of our biggest export markets in the eurozone such as Ireland and Spain worsen.

Canada – also blessed with a much stronger banking regulation system that helped it dodge most of the bullets from the latest financial crisis – was holding a much better hand on deficit cuts than the one dealt to the Chancellor 15 years later. Osborne has minimal growth, a health service budget to protect which accounts for around a fifth of the Government's £710 billion annual spending, and a weak banking sector dribbling credit out to businesses. Rising inflation also means any further steroids from the Bank of England to ease the pain will be in short supply.

Rock-bottom interest rates in the long term offers the best chance of pushing through cuts against the backdrop of anaemic growth but hopes for the drastic improvement seen by our North American cousins may be optimistic. The two situations are chalk and cheese: copying Canada is easier said than done.