TRANSITIONING FROM THE PANDEMIC:

Towards a More Balanced Fiscal Policy

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EXECUTIVE SUMMARY

As Canada's COVID-19 vaccination rates achieve critical thresholds in mid 2021, fundamental changes in fiscal policy are recommended to boost the Canadian economy's supply side and make governments' demand-side support more effective. A more balanced fiscal policy would help achieve greater economic resilience and robustness, and foster more broadly-based growth and sustainable prosperity. A fiscal pivot is also timely given the economic risks and health uncertainties of the Delta variant in H2, 2021.

This paper builds upon the methodology and frameworks of Stewart & O'Reilly's 2020[1] and our 2021[2] *Long-Term Thinking in Extraordinary Times* GRI articles. It assesses fiscal policy-making needs with a **three-phase lens** reflecting successes, challenges and risks from the pandemic, while focusing upon the needs of the transition and sustainability phases. Effective fiscal policy requires consideration of the potential impacts of key **known unknowns**, and preservation of the flexibility to respond to **unknown unknowns** in 2021 and 2022.

The pandemic-driven surge in Canada's government deficits and debt makes greater supply-side support and better-targeted consumption-related expenditures crucial to minimize the future risk of major tax hikes and spending restraint. More inclusive growth will decrease future deficits, improve policy options and reduce social inequities given the "Great Divide"[3] between the pandemic-driven income/job losses of many workers in the traditional economy and the success of financial markets and the technology sector.

Hindsight enables Canada's fiscal policy in mid-2021 to reflect the lessons learned from policy errors during and after the Great Financial Crisis (GFC) of 2007-09 while adapting to the unique features of COVID-19. Canada's massive fiscal (and monetary) demand-side support was crucial during the early pandemic stage to address the economy-wide need for cash flow, income and confidence. Huge fiscal support was key for firms and workers in the close/high contact industries hit hard by lockdowns and other activity restrictions from the pandemic's onset through mid 2021.

Yet, Canada's fiscal approach to the pandemic should adjust to core differences in H2, 2021, versus after the GFC. They include the more durable economic rebound from the fall 2020 onward, the surge in household and business incomes from fiscal stimulus, and geometric increase in technology adoption and usage. In our view, fiscal policy should have shifted by the fall 2020 and especially by mid 2021 to a supply-side emphasis and better-targeted demand stimulus.

Effective risk management of Canada's fiscal policy requires boosting investment, innovation, productivity and wages. **Improving Canada's supply side is important** to reduce the economic risks of lower growth, higher inflation and increased interest rates to government deficits and debt. Building resiliency and robustness will help address the major structural needs of funding climate change mitigation and adaptation as well as healthcare. Enhancing resiliency and robustness will also increase the policy room needed to address unanticipated budget requirements including those arising from future crises with their serious fiscal risks and economic repercussions.

While the Delta variant poses major risks and uncertainties in H2, 2021, forward-looking policy should begin with addressing the challenges in the transition phase from the pandemic. These start with an effective exit strategy from emergency programs, and implementing more targeted demand support. Better fiscal balance involves addressing a broad range of supply-side policy areas to raise Canada's economic growth and productivity. Each of these supply-side areas is important on their own. They are also interdependent in their effects. Better policies and more support for business investment, infrastructure, reskilling and retraining should be core fiscal priorities. Investment-supporting policies include fostering capital spending on intangibles as well as plant, machinery and equipment to boost worker productivity and wages. Increased government investments in better digital networks and improved policies to address data and innovation opportunities are recommended, as are greater outlays on transportation, utilities and water grids.

Achieving stronger GDP growth and rising productivity will drive better wage growth and higher standards of living. Better supply-side policies would support increased robustness through a more durable expansion and increased social inclusiveness, and boost resilience with a greater capacity to absorb the next shock.

A strong commitment to a medium and long-term fiscal anchor is also important. Economies are complex, adaptive systems, and sound fiscal policy includes reflecting the limits to forecasting accuracy. Prudent fiscal policy for Canada would include flexibility and buffers given the potential risks of known unknowns (inflation and interest rates) and the inevitable occurrence of unknown unknowns.

ENDNOTES

1. https://globalriskinstitute.org/publications/long-term-thinking-in-extraordinary-times/
2. https://globalriskinstitute.org/publications/long-term-thinking-in-extraordinary-times-macroeconomic-lessons-from-the-pandemic/
3. https://globalriskinstitute.org/publications/fiscal-policy-and-the-economys-great-divide-addressing-the-income-and-jobs-gap-in-the-traditional-economy-2/