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# Questioning the Success of Canada's 1995-2005 Austerity Measures

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**Abstract:** Much has been written about how Canada successfully conquered its budgetary crisis in the 1990s. Indeed, significant deficits and mounting debt quickly turned into large budgetary surpluses and a reduction in debt within a few short years. Missing in these accounts are the factors that led to the federal government implementing an austerity agenda and the impact the austerity agenda had on Canada's subnational governments—provinces and local governments. Our objective is to examine these factors. In doing so, we argue that Canada faced a critical juncture in the 1990s when a window of opportunity presented itself for action to be taken. As we find, this was due to the confluence of three factors: agreement in problem definition, agreement in policies for what to do, and the desire of decision makers to respond to the fiscal situation. Yet, the federal government's success at taming its deficit and debt subsequently hampered the ability of subnational governments to act and placed the non-profit sector in a precarious position. We conclude that ideas, individuals, and institutions matter, and the historical context largely dictates how they matter. Insights for the current financial challenges as we emerge from the COVID-19 pandemic are offered.

**Keywords:** Economic Federalism, Austerity Measures, Canada, Critical Juncture, Economic History, Non-profit Sector

## 1. Introduction

By most accounts, Canada conquered its chronic budget deficits in the mid-1990s. Within a few short years, its deficits turned into large surpluses which were heralded by many [20, 30, 38, 39, 41]. But how did Canada achieve these budgetary surpluses? The short answer is by implementing significant austerity measures, some tax increases and by being somewhat lucky. Austerity measures included departmental program cuts on average of 20% ranging from a low of 5% to the Health Department to a high of 50% to the Transport and Natural Resources Departments [14]. Similarly, some tax increases occurred and included reducing deductions for meals and entertainment expenses for businesses and eliminating the individual capital gains tax exemption. All told, six to seven dollars in spending cuts were made for every dollar of tax increase [26]. At the same time, luck in terms of low interest rates played a role in re-establishing fiscal prudence.

Canada won its budget battle. Or had it? Arguably, the Canadian federal government's efforts at eliminating its deficit and reducing its debt from 1995-2005 was successful. After all, significant cuts and some tax increases introduced in the 1995 budget year along with a bit of luck with interest rates, contributed to budgetary surpluses beginning in 1998. Yet, such a narrow interpretation is only one part of the story. Often lost in translation are two parallel government initiatives. The first is its embrace of neoliberal ideas surrounding privatization and deregulation in its pursuance of a smaller federal state presence. The second is its devolution of various programs to provinces through their defunding which led to significant resistance from the provinces to limit the federal spending power, both for enhanced funding but also especially in times of retrenchment.

What can we make of these developments? First, these developments question the success of the federal government's deficit reduction results with success largely depending on where one sits in the federation. From the federal perspective and in nominal terms, the federal deficit was eliminated within a few short years (only to return in 2008 and also recently in response to the recent COVID-19 pandemic) and thus can be deemed somewhat successful. For the provinces and local governments, federal cutbacks and program devolution left them scrambling to fill the funding void from own source revenues which exacerbated their own deficits and debt problems, especially after the 2008 recession. It also underscores the need to examine vertical and horizontal fiscal imbalances in the federation. Lastly, for the non-profit sector, a smaller federal state has meant an increased role in program delivery yet one that came with minimal, if any, core funding limiting their effectiveness.

Second, institutions matter, especially when conceived in broad terms. At their core, institutions mediate the speed, frequency, and type of changes in public policy. But, which and how do institutions matter? Cast narrowly, government departments and the courts, for example, have long been studied and have offered mechanical explanations of how or why certain policies have or have not been enacted [19, 45, 63]. In this process, policy changes are often path dependent, that is, the range of options considered is often conditioned by the legacy of previous policies [47, 49]. Ideas remain marginalized or are static during much of this process yet may increase in importance at critical junctures as do champions for policy changes [13]. It is here at critical junctures that a broad interpretation of institutions, one that encompasses the multitude of constraints decision-makers face that includes institutions, ideas and individuals, can offer a richer understanding of policy changes [24, 43].

This article posits that Canada faced such a critical juncture in the mid-1990s. It argues that a window of opportunity opened for the federal government to address its budgetary deficits. To understand this opportunity, the resulting policy changes and whether or not the results are deemed a success, a multilevel analysis (e.g., federal, provincial, local) from 1990-2010 is used to reveal the interactions between the prevailing ideas, key individuals and institutions. The article concludes that while the convergence of ideas, individuals and institutions may expedite policy changes, success at any one level may come to the detriment of others at other governance levels thus aggravating the fiscal (im)balance. For those reviewing the Canadian experiment, this suggests the need to carefully consider the type of policy changes contemplated, the institutional mechanisms by which change is enacted, the range of actors involved, and at what level of governance to ensure a country's long-term economic health.

## 2. A Window of Opportunity

A window of opportunity opened for Canada to address its fiscal situation in the 1990s. For a window of opportunity to open, three processes needed to come together as Kingdon (1984) points out [31, 67]. First, problems need to come into focus based on indicators that measure conditions, focusing events or the continued study of issues. Second, ideas (policies) for how to address the problems need to be identified. These also have to be affordable, feasible and acceptable to decision makers. Lastly, the politics of the situation has to be "right" for problems and policies to come together. This refers to those involved in the policy process and the guiding ideology at the time. When problems, ideas (policies) and politics come together, that is, are coupled, progress on an issue can be made.

Canada faced such a situation in the 1990s. The federal government was keenly aware of repeated deficits and mounting debt while neoliberal ideology became the dominant paradigm with decisionmakers searching for what to do readily accepting its prescription—austerity measures. The fact interest rates from 1995 to 2005 were very low averaging 3.95% when compared to those of the previous 25 years (which averaged 9.24% as shown in Figure 1; although this does not compare to the low rates from 2012-2021 where they ranged from 0.25 – 1% [5]) facilitated program savings and interest payments [27]. However, the window of opportunity did not open quickly as is suggested by the focus of the literature on the 1995 federal budget cutbacks [25]. Rather, the window of opportunity had gradually opened since the late 1970s and early 1980s to the point that by 1995, the window was fully open from which the federal government could and did fully capitalize. It is this narrative that is reconstructed below before turning to an assessment of the federal government's efforts.

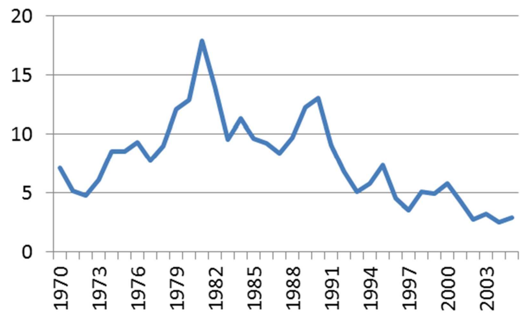


***Figure 1.*** *Canadian Bank Rate, 1970-2004 (%) [55].*

### *2.1. Problems*

Canada's fiscal position was in a state of crisis in the early 1990s. But how did the crisis develop and what was the depth of the crisis? To answer these questions, one needs to first examine Canada's constitutional division of powers. Canada is a federal country with legislative powers divided between federal and provincial governments, yet these powers are not divided equally between them. While originally desiring a highly centralized federal system of government, Canada has nevertheless evolved into one of the most decentralized nations [28]. At Canada's founding in 1867, the most important powers were preserved for the federal government and largely enumerated in s. 91 of the Constitution. These included powers over national defence, banking, currency, trade and commerce and taxation (by any means). Residual powers are also the purview of the federal government. As noted in s. 92 of the Constitution, the provinces have exclusive powers over property and civil rights, education, health care and limited taxing powers among other things. Responsibility over local governments was also assigned to provincial governments [21]. The net effect of this division of powers was that provinces were assigned powers deemed to be less important in 1867. However, as time passed, provincial responsibilities increased in importance to the point that they lack the resources to address them on their own thus necessitating federal-provincial interactions [18].

It is this situation that came to a head in the Great Depression of the 1930s. With unemployment nearing 30% in 1933 and with one fifth of the population on poor relief (e.g., soup kitchens) along with several provinces on the brink of bankruptcy [54], Conservative Prime Minister Bennett initiated a plan to introduce unemployment insurance, health insurance and to improve old age pensions. These were all items of provincial responsibility to which provinces objected to in the courts. Arguments by the federal government that the provinces were unable to address the dire economic circumstances fell on deaf ears with members of the Judicial Committee of the Privy Council (JCPC) who deemed the federal initiatives unconstitutional (the JCPC was Canada's last court of appeal until 1949). A crisis ensued and the Royal Commission on Dominion–Provincial Relations (the Rowell-Sirois Commission) was established to investigate the distribution of federal provincial powers. Their report in 1940 along with events surrounding the Second World War paved the way for the federal government to assume a greater role in Canada's social fabric [1, 62].

It is here, post-World War II that we see the Keynesian welfare state develop in Canada. Decisionmakers learned from government management of the war effort that governments could successfully direct the economy. As such, attention then focused on directing the economy and using the state to help address economic and social ills. In response, Unemployment Insurance and Family Allowances were initiated in the 1940s. The 1950s saw a system of Old Age Security established which was followed by national health care in the 1960s. The welfare state grew rapidly in the 1970s with many new programs introduced including an expanded unemployment insurance program, family allowance, spouse's allowance, and child tax credits. The 1980s saw enhanced child and elderly benefits introduced. Such program growth brought with it significant costs (from $40B in 1970 to over $150B in 1990). As social spending increased post 1970, so did government deficits to where it came to a head in the late 1980s and early 1990s [9]. Any effects of the 1973 world oil crisis and price shocks in exacerbating these deficits, as well as any impact on deficits due to the high inflation of the time period is unclear. While social spending consistently increased, it was the 1973 world oil crisis and price shocks that seemingly triggered significant deficits beginning in 1975 which was exacerbated with the hyperinflation of the late 1970s and early 1980s. The result of these focusing events combined with rapidly rising costs was that by 1985, Canada was approaching a deficit of $50 billion, a substantial amount at the time and a significant percentage of its GDP [9].

The extent of the problem on Canada's debt is shown in Figure 2. Here we find that Canada's debt was rapidly rising in the in the early 1990s going from just under $400 billion in 1990-1991 to $550 billion in 1995-1996. As a share of the GDP, Canada's debt topped off at 70% in the early 1990s. A similar situation is depicted in Figures 3 and 4 which narrowly focus on social spending. Figure 3 shows social spending in Canada quadrupling from 1970 to the early 1990s. As a result, social spending as a percent of the GDP doubled over the same time frame (see Figure 4). Such growth was unsustainable as evidenced by Canada's mounting deficits and debt, and action was needed.

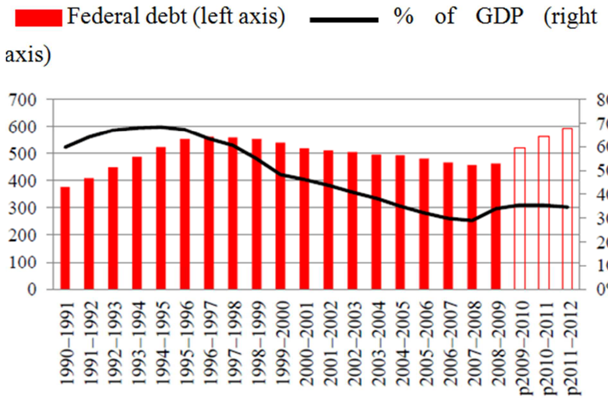


***Figure 2.*** *Changes in the Federal Debt, 1990–2011 ($B) [50].*

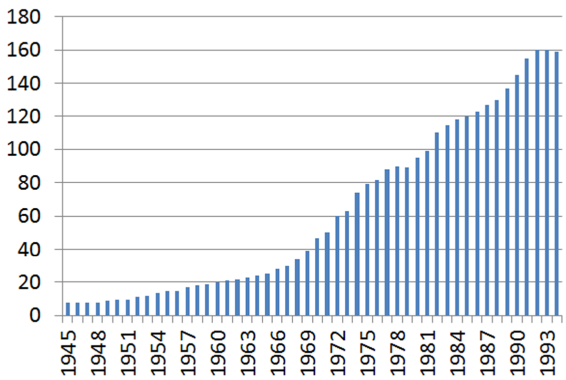


***Figure 3.*** *Total public social spending in Canada 1945/6-1994-5 (billions, constant $ 1998) [8].*

Undermining Canada's fiscal challenges was its lack of international competitiveness which came to light in the late 1970s and early 1980s. This was largely due to its focus since 1879 on developing a strong domestic economy thus protecting many sectors from international competition in the process. By the late 1970s, it became clear that such an approach limited Canada's future and that North American economic integration was in Canada's best interests [66]. Sensing change was required and searching for answers (during a period of record interest rates as shown in Figure 1), in 1982 the Trudeau Liberal government formed the Royal Commission on Economic Union and Development Prospects for Canada (known as the Macdonald Commission) to investigate and to make recommendations. Reporting in 1985, one year after the Mulroney Conservatives had replaced the Trudeau Liberals, the Commission recommended freer trade with the United States and a revamping of the unemployment insurance system among other things [15]. The Mulroney Conservative federal government subsequently negotiated the Canada-US Free Trade Agreement in 1989 and began negotiations leading to the 1994 North American Free Trade Agreement with the US and Mexico (renegotiated in 2020 and renamed the United States-Mexico-Canada Agreement). While opening up trade prospects, these agreements nevertheless increased pressure for the federal government to address its fiscal issues in the early 1990s [7].

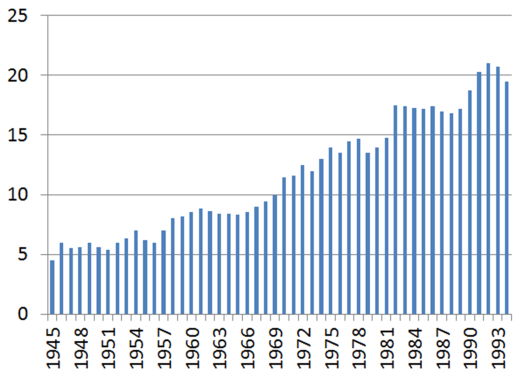


***Figure 4.*** *Total social spending in Canada as percentage (%) of GDP, 1945/6 - 1994/5 [8].*

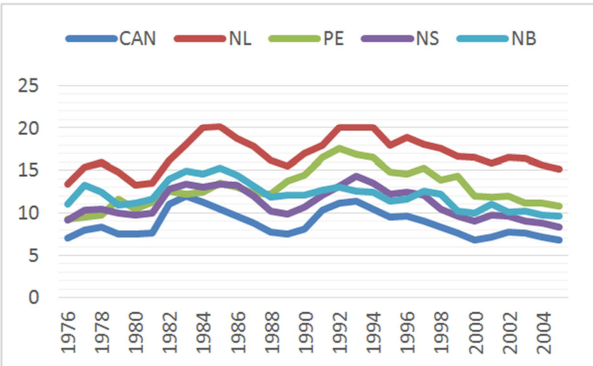


***Figure 5.*** *Unemployment Rate (%), Canada, Atlantic Provinces, 1976 – 2005 [56].*

Mirroring Canada's lack of international competitiveness was an increasingly high unemployment rate and the growth of precarious employment. Canada's unemployment rate seemed to grow in line with the growth of the Keynesian welfare state. In the 1950s, the unemployment rate was in the 4% range which grew to the 10% range in the 1990s [8]. Of concern to governments was the unevenness of the rate across Canada with the Atlantic provinces consistently facing significantly higher than average unemployment rates (compare and contrast Figures 5, 6, 7). Complicating matters was the high out migration from the Atlantic provinces where 25% of those born in the region lived elsewhere in the country [3]. Nor did it help that Atlantic Canada faced the highest poverty and tax rates in the country along with the highest deficits and debt per capita [37]. The net effect was to contribute to mounting pressures the federal government was facing on its federal transfers thus calling into question its fiscal capacity. Undermining its efforts was the growth of precarious employment. That is, many of the new jobs created were of the low wage type offering few, if any, benefits contributing to the strain on social programs [8]. This trend continues to this day [48].

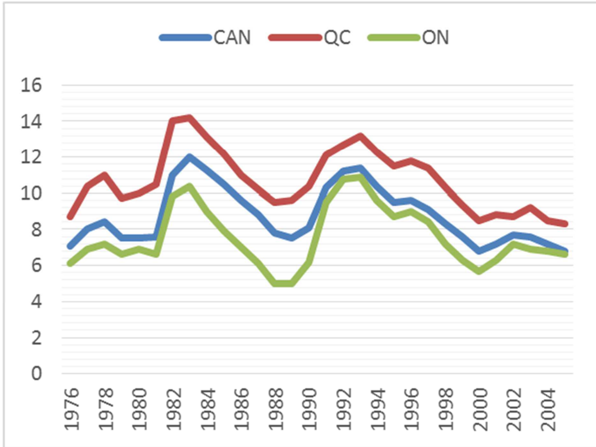


***Figure 6.*** *Unemployment Rate (%), Canada, Central Provinces, 1976 – 2005 [56].*

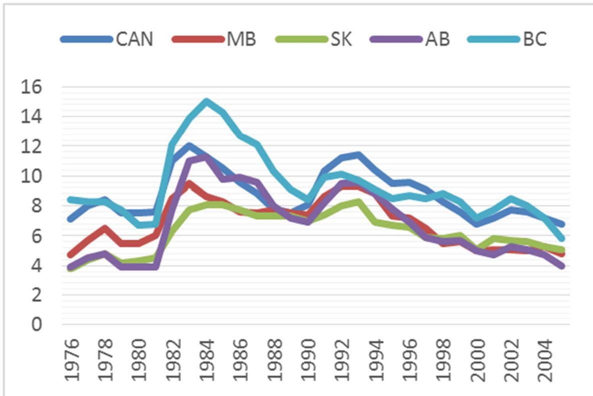


***Figure 7.*** *Unemployment Rate (%), Canada, Western Provinces, 1976 – 2005 [56].*

As the foregoing overview demonstrates, the federal government came to realize its fiscal house was not in order. It was facing rapidly increasing expenditures (and debt) made worse during a time it experienced economic shocks (1970s oil crisis, hyperinflation) and became increasingly uncompetitive internationally and regionally. This led to higher unemployment rates and the growth of precarious employment, the effects of which were felt unevenly across the country. Fiscal problems were identified and intensified when the federal government's debt rating was downgraded by Standard & Poor and Moody's [36] yet addressing these problems required the alignment of "politics" and "policies" to which we now turn.

### *2.2. Politics*

In order for Canada to address its identified problems, the politics also needed to be in "alignment". Politics refers to the stakeholders and guiding ideology of the time. For Canada, this involved the transition from the Keynesian welfare state to the neo-liberal state which occurred under three successive federal governments—the last few years of the Pierre Trudeau Liberals (1980-1984), the Brian Mulroney Progressive Conservatives (1984-1993) and the Jean Chrétien Liberals (1993-2003).

It is true that significant growth in social spending occurred during the Trudeau era.[1] The above discussion documents that fact. It would be wrong however to argue that his policies are to blame for such growth. Rather, a nuanced interpretation is required. Trudeau came into office in 1968 when Keynesian economics was in its glory days. This meshed well with his ambivalent quest for power. I say ambivalent because Trudeau was initially ambivalent to enter the political arena. His overriding reason to enter politics was to combat Québec nationalism by carving out a place for French Canadians and indeed all Canadians within one Canada [17, 33]. This was at the heart of his "Just Society" which saw an active role for the state. As Trudeau said in 1990 reflecting back on his tenure,

> "Canada seemed to me to be an ideal country for a policy of greater equality of opportunity. A young country, a rich country, a country of two languages, of ethnic and religious plurality and of federative structure, Canada also possessed a political tradition that was neither entirely libertarian no entirely socialist, but rested on an indispensable partnership between the government and the private sector, and on direct action by the state to protect the weak from the strong, the disadvantaged from the well-heeled" [61].

His idea of a "Just Society" was activated in two goals: linguistic equality between French and English and equality of economic opportunity. The "Just Society" was based on a participatory democracy with a strong role for the state to support those who could not support themselves in order to level the playing field [42]. Hence universal health care and universality in social programming was paramount, as well as regional economic development (leaving aside Trudeau's quest for patriation of Canada's Constitution with a Charter of Rights and Freedoms). One sees a strong role for the state in this process and there is little question that Keynesianism was embraced by the Trudeau Liberals during its tenure [53].

The point is that as Trudeau's "Just Society" was rolling out, it was met with a changing world economic order. Increasing globalization and international trade undermined Canada's (as well as other countries) competitiveness in world markets.

Oil and price shocks of the 1970s further taxed the federal government's ability to "level the playing field" and led to a period of stagflation— high unemployment, slow economic growth and high inflation. The Keynesian welfare state was no longer working as it should [51, 60]. A search for ideas ensued. In Canada, this culminated in 1982 when the Trudeau Liberal government formed the Macdonald Commission, previously discussed.

The main beneficiary of the Macdonald Commission which reported in 1985 was the Mulroney Conservative government which had assumed office in 1984. The Mulroney Conservatives were preoccupied with deficits, debt and restructuring the public service (setting aside their efforts to bring Quebec into the constitutional fold). They fully embraced the neo-conservative agenda that had taken root in the UK under Thatcher (1979-1990) and the US under Reagan (1981-1989) which espoused a smaller, leaner government where government retained responsibility for broad policy direction while allowing civil society actors to carry out much of the implementation [11, 44]. Upon assuming office, the Mulroney Conservatives did a sweeping program review and set out to reform social programs [37]. Deregulation and privatization were also the order of the day. For example, the Mulroney Conservatives privatized nine Crown corporations including Air Canada, Canadian National Railway and laid the foundation for the gradual privatization of Petro-Canada, the state-owned oil company [6, 32]. Two notable changes under the Mulroney Conservatives were the introduction of the Goods and Services Tax (GST) and the two free-trade agreements with the US, and the US and Mexico (previously noted) all of which were highly controversial.

After two terms in office, the Mulroney Conservatives had worn out their welcome and were replaced by the Chrétien Liberals. By this time the Canadian state had firmly shifted to the centre-right and neo-liberal orthodoxy was firmly rooted. In fact, the Chrétien Liberals governed more in line with Conservative ideology then the Mulroney government for both ideological and pragmatic reasons (elections) [7].

Ideologically, Chrétien is no stranger to centre-right politics [40] having served as parliamentary secretary to Mitchell Sharp, the Minister of Finance in the mid-1960s who became his mentor, and who had long been associated with the Liberal party's right-wing [52]. Chrétien drifted centre-left as his roles in government changed over the years including Minister of Indian and Northern Affairs, Minister of Justice and Minister of Finance. A move back to centre-right politics in the early 1990s was easily accommodated. Pragmatically, one can argue that Chrétien had no choice. Keynesian welfare economics had long been discredited and neo-liberalism was the new "game" in town. As such, Chrétien espoused decentralist tendencies and worked to control spending to eliminate deficits and reduce the debt. This was a conscious move to push individuals towards greater self-reliance [7].

But the Chrétien Liberals faced something that his predecessors did not—a fragmented political landscape. The federal election of 1993 was a reflection of the implosion of the Progressive Conservative Party of Canada (PC) which was reduced to two seats. The former PC party was an amalgam of moderate conservatives (Red Tories), the ultra-right-wing conservatives concerned with deficits, debt and small government largely located in Western Canada, and the left leaning Québec nationalists who desired a

[1]References to Trudeau are to Pierre Trudeau, Canada's Prime Minister from 1968-1984 and not Justin Trudeau, the current Prime Minister of Canada, and Pierre's son.

decentralized state [9]. Given the failure of two rounds of constitutional negotiations to address Québec's demands, which the right-wing elements of the party opposed, the PC party imploded with members defecting to new parties. The Reform Party of Canada absorbed the former ultra-right-wing members whereas the Bloc Québécois, a regional party centred in Québec, was formed to press Québec's demands. The result was that in 1993, the right fragmented thus allowing the Chrétien Liberals to win a majority government with the separatist Bloc Québécois forming the official opposition. In addition to facing elevated expenditures, and rapidly rising debt, Chrétien was confronted with pressures from the Reform Party to do more to address the deficit and debt and decentralization pressures from the Bloc Québécois [10]. In other words, the window of opportunity was wide open for the Chrétien Liberals to act. This fragmented right continued throughout Chrétien's tenure as Prime Minister.

### *2.3. Policies*

Affordable, feasible and acceptable polices to address Canada's fiscal problems given the politics of the situation were plentiful. Retrenchment began with the Mulroney Conservatives. For example, the Conservatives disliked the fact that federal transfers to the provinces were unconditional, and cost shared on a 50/50 basis thus exposing them to significant expenditure growth especially during times of economic hardship (e.g., recessions). In order to control these costs, in 1986, federal transfers were indexed. The 1990 Conservative budget went further and froze federal transfers to the provinces thus saving the federal government an estimated $98 billion by 1999-2000. The 1990 federal budget also saw federal transfers to provinces through the Canada Assistance Plan for welfare and social services capped for wealthy provinces (Ontario, Alberta, British Columbia) generating another $8 billion of savings [8]. In addition, the Mulroney Conservatives moved to targeted social policy with the universal family allowances in 1988 and clawed back old age benefits by moving to a means tested system [37].

The effects of the cuts were significant and not evenly felt across Canada. While federal largesse since the 1950s had allowed the provinces to develop an integrated health care system, a robust education system and expansive welfare system, the 1980s and 1990s were not kind to them. For Atlantic Canada, matters were worse given cuts to it were occurring at twice the rate of other regions [2]. The hardest hit sectors were health care and education where the federal portion of funding went from 38% of net expenditures in the four Atlantic provinces to 19% from 1980 to 1995. The problem is magnified when one considers the fact that most people (50%) in the Atlantic provinces live in rural areas. Federal retrenchment led to user fees for many services including road and bridge tolls to be implemented which were previously unheard of in Canada [37].

Austerity and retrenchment accelerated under the Chrétien Liberals revealing a right of centre repositioning of the party. Financing for social programs was restructured under the new Canada Health and Social Transfer which terminated the Canada Assistance Plan and the Established Programs Financing. The problem was that in the restructuring, funding was cut by $7 billion from 1996-1998. Similarly, and picking up on the recommendations of the 1985 Macdonald Royal Commission, the Chrétien Liberals revamped the unemployment system which became Employment Insurance with individuals having to work longer in order to claim far fewer benefits. At the same time, the federal contribution to Employment Insurance was terminated with businesses and employees now having to shoulder the full costs of the program [7]. These cuts were in addition to reductions in departmental spending of up to 50% previously mentioned. The result was a weakening of the bonds of the Canadian social safety net begun under the Mulroney Conservatives which accelerated under the Chrétien Liberals [7].

### *2.4. Problems, Politics, Policies and the Non-profit Sector*

The effect of the hard neo-liberal turn on the non-profit sector was devastating. Over the past hundred years a close relationship between the state and non-profit groups (e.g., disability, anti-poverty, social service) developed in Canada for the co-delivery of programs and services [23]. Successive Liberal governments over the course of the 20th century were friendly to non-profit groups and increased funding in some cases while creating groups where none existed in other cases such as to promote citizen participation in government programs under the Pearson administration [42]. Trudeau's "Just Society" expanded this relationship to fund rights seeking groups to challenge the state that would otherwise be unable to do so by establishing the Court Challenges Program. Non-profits proliferated with a tripling in their number from 1960-1990. For the state, this made sense in that they viewed non-profits as an important part of social democracy, showed its neutrality, was an effective way to deliver services to citizens, and was an important source of information [42].

Non-profits suffered in the 1980s and 1990s with many closing down [16] while others were forced into "service contracts" with governments [35]. This was the result of a number of factors including some organizations coming under scrutiny for financial irregularities and the discontinuance of federal operational grants to organizations [65]. In the 1990s, their funding was cut by 20% in 1995-1996 with an additional cut of 10-25% per year in each of the next three years. The problem was that non-profits had become too dependent on the federal government for their source of funding with 41% of their funding coming from governments in the mid-1990s (11% from federal and 70% from provincial governments). The situation was worse for health and social services charities where 60% of their revenues came from governments [42].

This crisis in the voluntary sector led to the Chrétien Liberal government's 1999–2004 Voluntary Sector Initiative (VSI). This initiative minimized or dismissed funding issues [64] and tried to legitimize the federal government's policy direction by committing it to consider the impact of its actions on voluntary community organizations [22]. This recognition was a hollow victory at best, given the lack of funding discussions and that the process was captured by elite organizations—on the ground organizations that provided services were not involved in the process [12, 46].

Canada faced a fiscal crisis in the late 1980s and early 1990s. Spending was plentiful and so were deficits and debt which challenged the country's international competitiveness. The problem was identified. The politics of the day facilitated the advancement of solutions to address the fiscal crisis. Neo-liberalism was in full swing though the switch had occurred over a decade and a half (1980-1995). Moreover, the federal government faced an opposition that desired austerity and retrenchment policies which is what ensued in the 1980s and accelerated in the 1990s. By 1998, Canada had tamed its deficit but at a great cost to its regions and non-profit sector. Annual federal multi-billion-dollar surpluses ensued until 2007, some of which was "re-invested" in social services. It appears that Canada was successful in taming its spending, but was it?

# 3. Assessing Success

## *3.1. Assessing Performance*

How successful was Canada's efforts to address the fiscal crisis it faced in the late 1980s and early 1990s? The answer is that it depends on where one sits in the Canadian federation. For the federal government, its efforts to move from Keynesianism to embracing the neoliberal state were successful. Large budget deficits of $40 billion+ in the early 1990s (which pale in comparison to the deficits incurred in response to COVID-19) turned into surpluses beginning in 1998 and continued until the economic recession of 2008 as Figure 8 shows. Canada's total debt also fell from a high of $550 billion in 1996-1997 to approximately $450 billion in 2007-2008 (see Figure 2). Figure 2 and Figure 9 show that the federal government's debt to GDP also fell from a high approaching 70% in 1996 to a low of under 40% in 2007. As a result of its belt tightening, Canada's federal government was in a better financial position going forward and its efforts were successful.

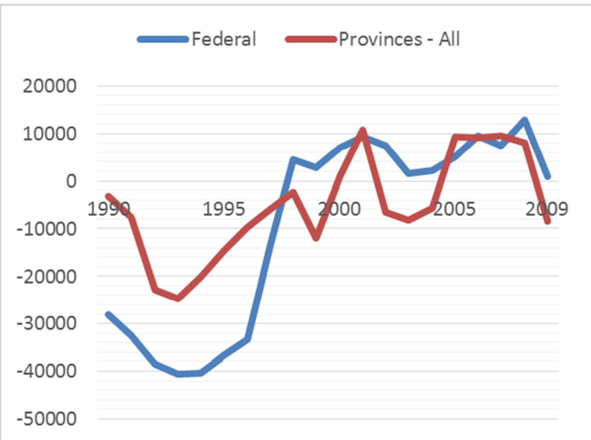


***Figure 8.*** *Canada, Surpluses, Deficits by Type of Government [58].*

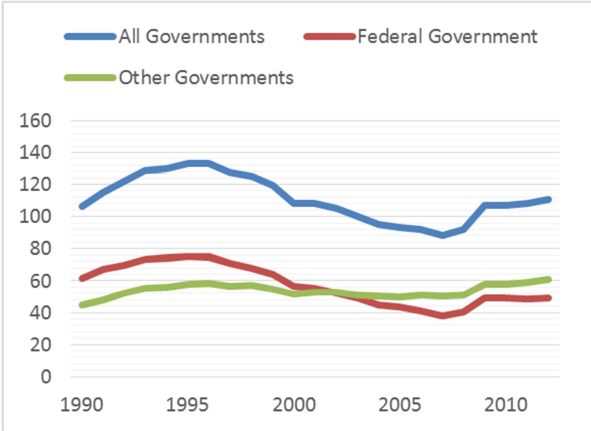


***Figure 9.*** *Canada, Gross Debt to Gross GDP, % [57].*

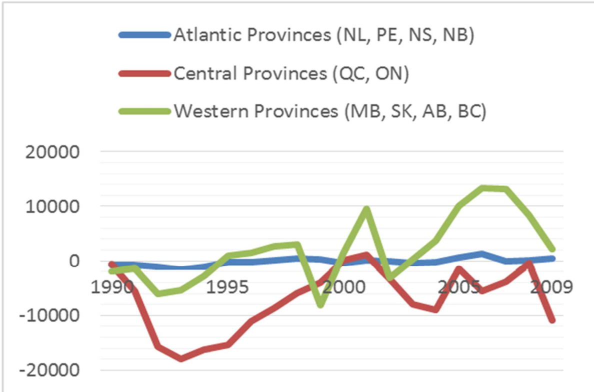


***Figure 10.*** *Canada, Surpluses, Deficits by Region [58].*

At the provincial level, mixed results emerge. Figure 8 shows that provinces were also collectively running significant deficits in the early 1990s much like their federal counterparts (not including Canada's three territorial governments—Yukon, Northwest Territories, Nunavut). However, Canada's provinces were quicker to respond [41] to the fiscal challenges yet sustained surpluses proved to be elusive. What explains this "roller coaster" effect the provinces were experiencing? A closer examination, as shown in Figure 10, reveals significant differences among Canada's regions. For example, the Atlantic provinces fared reasonably well in experiencing the least amount of volatility in deficits. This is in stark contrast to the central Canadian provinces of Québec and Ontario which had significant deficits in the early to mid-1990s which has since moderated. In only two years, 2000 and 2001, did Ontario and Québec post surpluses. One answer lies in the fact the region, Canada's manufacturing heartland, was hard hit by the 1990-1995 economic recession. If the recession was not enough, it also had to adjust to increased competitiveness through new free trade agreements (US, North American). This was challenging and coupled with mounting cuts from successive federal governments in the mid-1990s, the region struggled to address its fiscal capacity, even with the election of the right-wing Mike Harris Progressive Conservative government (1995-2002) in Ontario. Canada's western provinces show the same volatility as its central Canadian counterparts except without the significant deficits in the early 1990s. The volatility in this case is partly explained in the region's recent political culture given it was the Reform Party's stronghold which was preoccupied with debts and deficits and small government. Note its strong showing in the 1993 federal election where it won 51 of its 52 seats west of Ontario. In addition, in Alberta, the Ralph Klein Progressive Conservative government came to power in 1992 on a right-wing platform (and governed until 2006) that mirrored the Reform Party and proceeded to make significant cuts to government expenditures and to restructure the province [29]. This contributed to less volatile conditions, yet efforts were skewed by the volatility in natural resource prices related to oil which primarily affected Alberta (but also Saskatchewan) and potash prices which affected Saskatchewan [34].

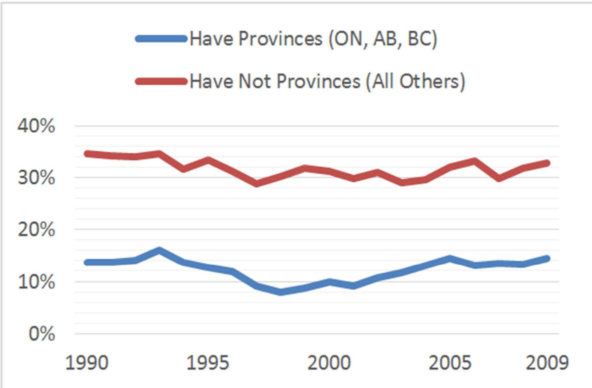


***Figure 11.*** *Canada, General, Specific Purpose Transfers to Have, Have Not Provinces, % [58].*

The above situation underscores the fact that Canada's provinces do not all have the same financial capacities with provinces divided into *have* and *have not* provinces. A province is labelled as being *have* or *have not* depending on whether or not it receives federal equalization payments. These payments are made to provinces whose fiscal capacity is under the national average in order to bring them up to a standard whereby they may then deliver similar services at similar levels of taxation [4]. A province that receives equalization payments is considered to be a *have not* province, while a province that does not receive equalization payments is termed a *have* province. Figure 11 shows the same pattern of volatility between *have* and *have not* provinces. However, *have not* provinces are less extreme in their troughs and peaks underscoring the effects of natural resources revenues and the manufacturing sector (largely located in Central Canada) among other things. Equalization payments seem to have a moderating effect to a degree on the *have not* provinces which is not felt by the *have* provinces (given their lack of equalization payments). Federal retrenchment efforts contributed to this volatility in the *have* provinces. For the *have not* provinces and in particular the Atlantic provinces, federal retrenchment which was occurring at twice the rate in the Atlantic region was partially offset by federal equalization payments they received thus reducing the volatility. This suggests that the federal government can have an important mediating role in fiscal restructuring activities and needs to carefully consider subnational units of government.

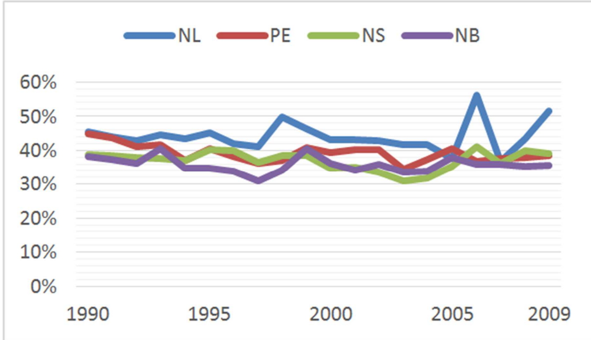


***Figure 12.*** *Canada, General, Specific Purpose Transfers to Atlantic Provinces, % [58].*

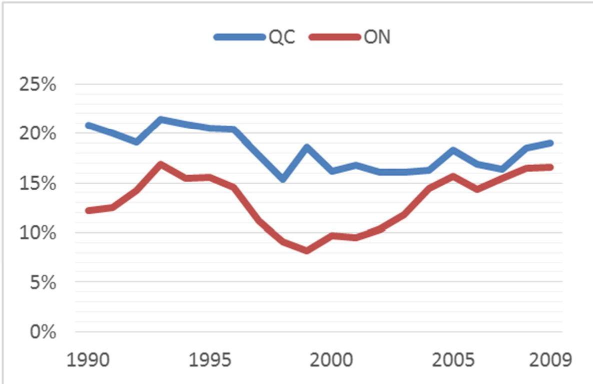


***Figure 13.*** *Canada, General, Specific Purpose Transfers to Central Canadian Provinces, % [58].*

The importance of equalization payments and other federal government transfers to the provinces should not be minimized. *Have not* provinces are 2-3 times more dependent on federal transfers than *have* provinces as shown in Figure 11. It shows that transfers to *have not* provinces consistently make up 30% to 35% of provincial revenues whereas transfers to *have* provinces make up between 8% to 15% of provincial revenues. Yet even this masks the wide variation that exists among provinces. Broken down on a regional basis as shown in Figures 12-14, we find that federal transfers make up between 31% to 45% of revenues for the Atlantic provinces, 8% to 21% of Central Canadian provincial revenues and between 6% to 30% of Western Canadian provincial revenues. Of note is the little variation that exists among Atlantic Canadian provinces, a wide disparity between Central Canadian provinces which is now converging, and the wide variation among Western Canadian provinces with three provinces converging (Manitoba is the outlier). The point is that differences between and among the regions are significant resulting in different effects to federal retrenchment efforts.

In terms of debt to GDP, collectively, the provinces were able to reduce their debt to GDP on a similar pace as the federal government as shown in Figure 15.

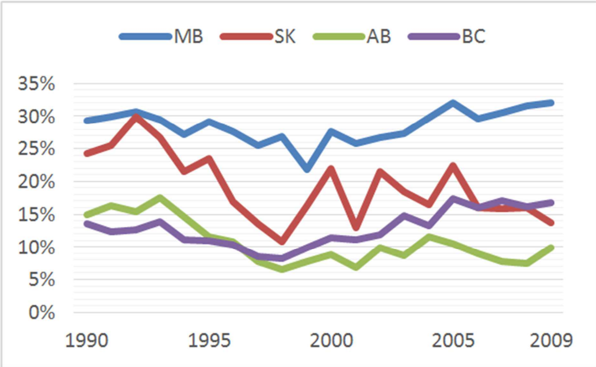


*Figure 14.* *Canada, General, Specific Purpose Transfers to Western Central Canadian Provinces, % [58].*

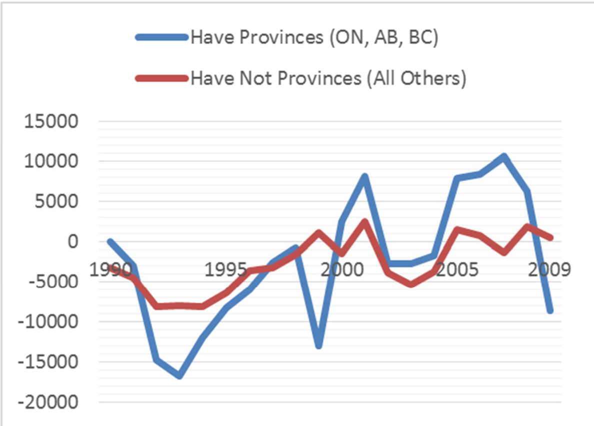


*Figure 15.* *Canada, Surpluses, Deficits by Have/Have Not Provinces [58].*

### *3.2. Impact on Local Governments*

Missing in this analysis to date has been the effect on Canada's municipalities—local governments. What was their experience with federal retrenchment efforts? It is important to recall that in Canada's constitution local governments are assigned as a provincial responsibility, that is, local governments remain creatures of the provinces. Much like provinces affected by what the federal government does, local governments are also largely affected by what their masters do, the provinces. As Figure 16 shows, the effect of federal retrenchment efforts on local governments is negligible. However, a more nuanced interpretation is required to tease out potential differences. A closer examination finds that while the pattern of *have* and *have not* provincial debt levels increased similarly from 1990 to 2005, *have* and *have not* local government debt levels differed with *have* local governments running surpluses beginning in 1999 (see Figure 17). This is confirmed in an examination of regional variations as shown in Figures 18-20. Of note are the gradually increasing debt levels of local governments in Atlantic Canada, the flat lining of local government debt levels in Central Canada (with a slight decrease in Ontario) and a slight decrease in local government debt levels in Western Canada. This is interesting given local governments share costs for welfare provision with provinces and cannot be explained away by the fact that in some provinces (e.g., Ontario), local governments cannot run deficits. Hence their debt levels largely reflect borrowing costs for capital projects. This suggests that Canada's provinces did much to absorb the effects of federal retrenchment efforts, thus shielding local governments. Alternatively, it could be argued that additional time is required to ferret out the effects given much time is required for federal changes to filter down through the provinces to the local governments, if at all.

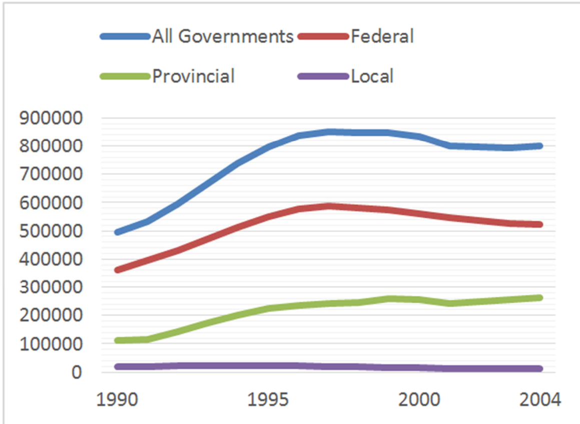


*Figure 16.* *Canada, Net Financial Debt, By Level of Government [59].*

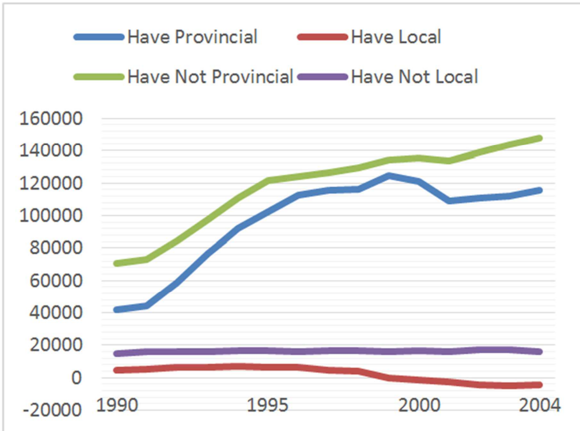


*Figure 17.* *Canada Net Financial Debt, Provincial, Local Governments, Have, Have Not Provinces [59].*

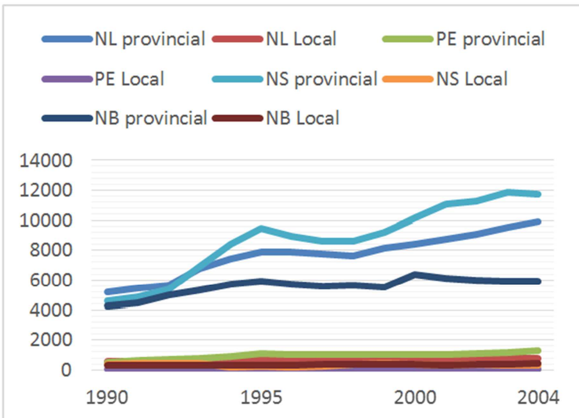


*Figure 18.* *Canada Net Financial Debt, Provincial, Local Governments, Atlantic Canada [59].*

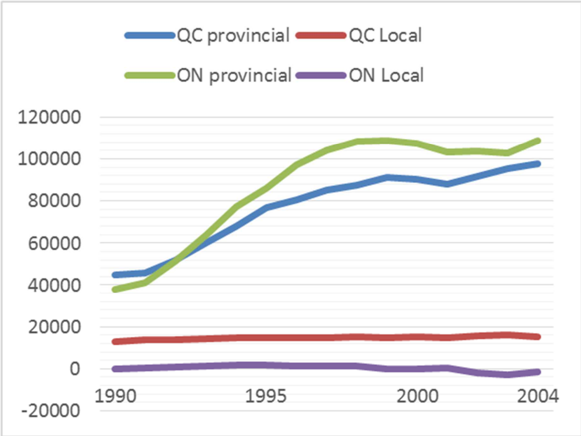


***Figure 19.*** *Canada Net Financial Debt, Provincial, Local Governments, Central Provinces [59].*

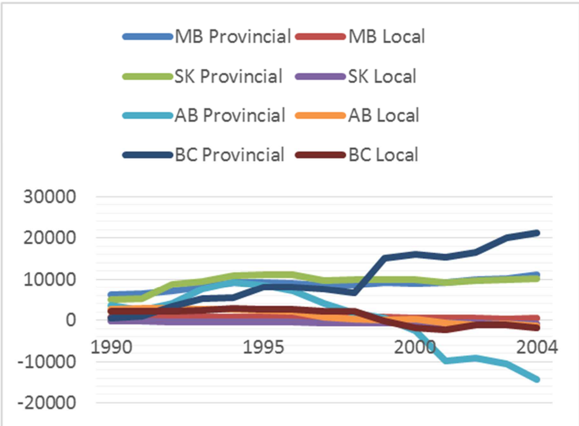


***Figure 20.*** *Canada Net Financial Debt, Provincial, Local Governments, Western Provinces [59].*

## 4. Conclusion

What can one make of Canada's experience with fiscal austerity in the 1990s? First, fiscal changes had long been under way. Canada's fiscal challenges can be traced back to the 1970s when Keynesian economics was unable to adequately address challenges posed by oil and price shocks resulting in a period of stagflation. High unemployment, rising social costs, globalization and less than desired international competitiveness led to the formation of the Macdonald Commission to study the problems. Capitalizing on the neoliberal wave begun in the UK and the US, the 1980s saw a period of initial efforts at federal retrenchment yet Canada's mounting deficits and debt continued leading to credit downgrades in the early 1990s thus setting the stage for the watershed 1995 federal budget for extensive state restructuring. Within three years, surpluses emerged and continued until 2008. Deficits were tamed and the debt was decreasing overall and as a percent of GDP.

Second, a confluence of factors is required to focus government's attention on fiscal realities. While much is made of the success of the 1995 fiscal reforms and subsequent surpluses, the reality is that the "right conditions" are required before substantive reforms are made. This requires the coupling of problems, politics and policies. In Canada, economic problems had long been identified going back to the 1970s yet were unable to be sufficiently addressed by then current economic thinking, Keynesianism. Alternative ideas were needed such as fiscal austerity but for them to emerge, a favourable political environment was required. This occurred in the shift to embrace neoliberal's tenets of a reductionist state in a market-based economy. Neoliberal seeds were planted elsewhere and imported to Canada in the 1980s when rooting began only to fully take hold in the mid-1990s with the Chrétien Liberal federal government. Time is needed for new ideas to root before their rapid growth can take hold.

Third, political ideology is subservient to economic ideology. Economic ideology dominates, that is, if it works for the economy, it will work for political parties. Note the shift in the Liberal Party of Canada's ideology from centre-left to centre-right from the 1970s to the 1990s. The party came to realize that if it wants to govern, then it must adopt the new "economic game" in town which it did. One can also trace a similar change in the Progressive Conservatives from a centre-right party to its current hard-right orientations demonstrating a belief in and the depths to which neoliberal ideology has been adopted.[2]

Fourth, in federal states, when the national government sneezes, subnational governments often come down with the flu. In other words, federal retrenchment efforts have impacts and consequences for provinces and local governments which are not equally felt across the country. In Canada, federal retrenchment efforts were mediated in the Atlantic provinces due to equalization payments. A much more volatile situation was experienced in Central and Western Canadian provinces. Need also exists to take into consideration other economic restructuring events, if any, that are underway such as free trade agreements that were then recently implemented, and the structure of the economy. Natural resource revenues in Canada's case contributed greatly to the volatility in austerity measures as experienced by Western Canadian provinces.

Similarly, local governments need to be considered. Federal retrenchment efforts on Canada's local governments were negligible thus suggesting that provinces acted as a shield absorbing the brunt of the costs while protecting local governments. It also suggests that more time may be required for the full effect to work its way down to local governments. If a decade or more is required to examine the effects on the provinces, then similarly two plus decades is required to examine the effects of federal retrenchment efforts on local governments thus giving provinces sufficient time to absorb the austerity measure and figure out a plan to address their own affairs. It is important to recall that in Canada, local governments are creatures of the provinces.

Fifth, collateral damage may occur to civil society actors. This was the case in Canada where the non-profit sector was devastated with federal retrenchment efforts in the 1980s and

[2] Recognition is made of the fact that the Progressive Conservative Party of the 1980s is not the same party as the current Conservative Party, which is an amalgam of the former Reform/Canadian Alliance party (and more right-wing) and the remnants of the Progressive Conservatives.

1990s. Many ceased to exist when their state funding was reduced or terminated with others left in a precarious position. The need exists to carefully consider the role of civil society actors in state activities when governments contemplate austerity measures.

Canada's federal austerity measures have been a success for its federal government. By 2005, its economic house was in much better shape yet the effects on the provinces was mixed. For local governments, only time will tell how they may be impacted.

Given these "lessons", what can be applied to the current situation? The response to COVID-19 has resulted in significant (historic) deficits and debt. Yet there are some important differences. Interest rates were at an historic low from 2012-2021 (0.25-1%) but are now rising to tame runaway inflation (6-7%). Furthermore, provinces are in no position to absorb another round of austerity given past federal cutbacks and increased program and services delivered. It is likely local governments will be greatly impacted in the process. Yet, corrective actions may take longer to be enacted given the asymmetry between problems, policies, and politics. That is, while deficit and debt problems are well known and while there appears to be agreement on the need to act (politics), the lack of agreement for what to do (which policies to implement) will prevent a window of opportunity from opening from which action may be taken. This suggests that matters may get worse (e.g., a deep economic recession) before they get better.

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