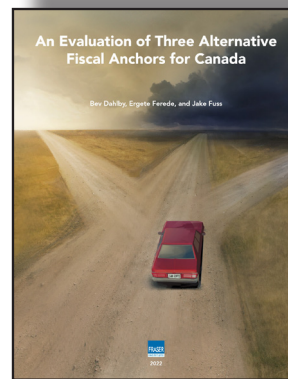


We rank these alternative fiscal anchors based on their potential for providing both public and private goods and services and income transfers over the 25-year time horizon of the models. We find that achieving and then maintaining a primary budget balance through expenditure restraint is the best fiscal anchor because it would allow for both more private consumption and higher public expenditures in present value terms than any of the other fiscal anchors. Similarly, the debt target anchor would be preferred to a ceiling on the ratio of interest payments to revenues, which in turn would be preferred to balancing the primary budget through tax increases. While this ranking of the fiscal anchors is based on the particular scenarios we have investigated, we feel that it would be robust to alternative strategies for implementing these fiscal rules.

We recognize that maintaining a primary balance raises important implementation issues. Strict adherence to a zero primary balance could lead to abrupt and wasteful increases in program spending during an economic boom when there is a surge in government revenues, or abrupt and harmful cuts in current and capital spending with a downturn in the economy and a decline in tax revenues. To avoid pro-cycle spending that would contribute to macroeconomic fluctuations, governments can adopt a rule that places a ceiling on the growth rate of their expenditures. The range of expenditures to be covered by the ceiling should be broad, covering those current and capital expenditures that the government can control in the medium term, but not include expenditures that have a cyclical component, such as unemployment insurance or social assistance payments.

Our main result—that fiscal consolidation based on expenditure restraint provides better economic outcomes than policies that rely on higher taxes—is consistent with the conclusion reached by Alesina, Favero, and Giavazzi in their pioneering study, *Austerity: When It Works and When It Doesn't*, of 200 episodes of fiscal austerity in 16 OECD countries from the 1970s to 2014. They concluded that “on average, expen-

diture-based adjustments have consistently much lower costs than tax-based ones...” This is a lesson that Canadian governments should heed when they consider the fiscal policies that are required to put Canada’s public finances on a sustainable path in the aftermath of the COVID-19 shock.



*An Evaluation of Three
Alternative Fiscal An-
chors for Canada*

By Bev Dahlby,
Ergete Ferede, and
Jake Fuss

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