

THE COST OF GOVERNMENT DEBT IN CANADA

2014-15
\$60.8
BILLION
combined government
debt interest



What's Inside

How to Make Vancouver
More Affordable? Look
to Texas

Liberal Spending Increases
Drive Big Deficits, Not a
Weak Economy

Essential
Hayek



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Our mission is to improve the quality of life for Canadians, their families and future generations by studying, measuring and broadly communicating the effects of government policies, entrepreneurship and choice on their well-being.

WELCOME!



Dear Readers,

The toughest part of the year is finally done—exams are over and summer is here! To our graduating students, be it high school or university, we want to extend our deepest congratulations for finishing your schooling. We wish you all the best in your future endeavors. This summer issue of the *Canadian Student Review* highlights two key policy issues raised in the Fraser Institute’s *Troubled Water* series: how the cost of government debt is going to have long term implications for students and how Alberta’s budget could have been a surplus instead of a serious deficit. Check out this issue’s *Hot Topics* section to learn more.

Other articles include an analysis of the recent federal Liberal government’s budget, ideas on how to improve housing affordability in Vancouver, and a video on income mobility in Canada. In addition, this issue includes a fascinating excerpt from *Essential Hayek*, a recent Fraser Institute publication that provides an overview of Nobel Laureate Friedrich Hayek’s most famous economic principles.

We hope you enjoy this issue and the rest of your summer!

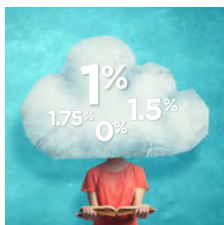
Lisa-Diane Fortier

Editor, *Canadian Student Review*



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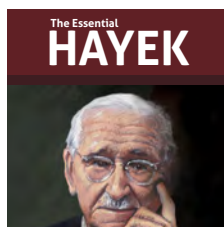
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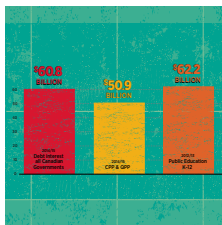
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OUR INTEREST FANTASY

Brennan Sorge



1%
1.75% 0% 1.5%

Today's interest rates are of historical significance. Until very recently, the idea of 0% interest rates, or as some nations have now experienced, negative interest rates, seemed, at best, a theoretical idea. Many interest rates in the developed world, especially in Europe, are now consistently below 1%.¹ Such an experiment has never been tried previously, and we are, as of yet, uncertain what the results of this experiment will be. Even though the results remain uncertain, we can gain some insight into how this might play out based on more general economic concepts.

For Canada, it will be very important to have some indication of which direction interest rates are likely to move.

There is a well understood relationship between cost and how much a good and service is demanded by consumers. All else being equal, if something is inexpensive, there will be a higher

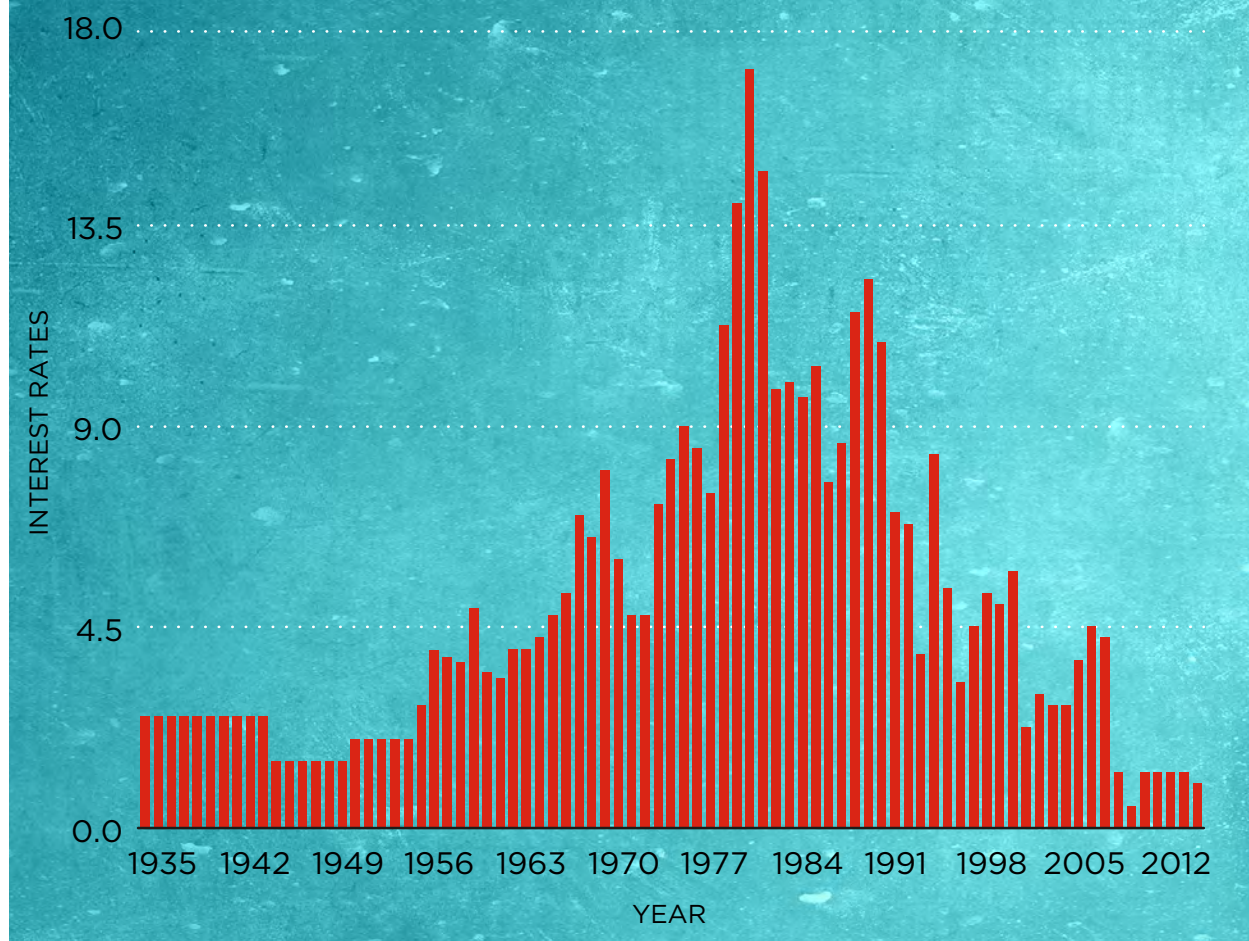
quantity demanded than if it were more expensive. If this rather simple idea is applied to our current interest environment, there are a few things that we would expect. Interest is the cost of borrowing money, so if our rule holds, it would be expected that in a low interest environment people would borrow in larger amounts than they might in a high interest environment. This expectation has so far been correct for households, and for governments at both the provincial and federal levels.^{2 3}

Debt is unlike most other goods or services, even though it seems to follow the cost-demand relationship. After the initial purchase, debt is paid over a long period of time. The cost of that debt is dependent on interest rates, and unless interest rates are locked, a change in the interest rate can affect the cost of previously accumulated debts. For Canada, it will be very important to have some indication of which direction are interest rates likely to move. Information from past periods of low interest could potentially be used as this indicator.

There have only been a few other instances during which interest



Canadian Interest Rates (From 1935 to 2015)




rates remained at extreme lows for multi-year periods, the most recent of these having been the Second World War. By looking at changes in interest rates following the war, it may be possible to draw conclusions about our future rates. At wars end in 1945, interest rates remained suppressed at 1.5% for 5 years. In 1950, rates grew slightly, up to 2%. In October of 1955, interest rates began a steady increase, which, except for a few brief periods, kept interest rates above 3.5% until November of 1996. During this time, rates rose to highs above 10% for multi-year periods, reaching a

peak of 21% in August 1981.⁴ If current trends are even somewhat similar to those following World War 2, higher rates should be expected, with the real possibility of large increases in the long term.

This leads to another important question: what will the results be if interest rates increase? On a household level, many Canadians hold large amounts of debt, which will quickly become increasingly expensive given the realization of this trend.⁵ In terms of home ownership it will become more difficult to borrow

for a new house. For existing home owners, many will face increased difficulty paying back their existing mortgages (if these mortgages haven't locked in low rates), some of whom will find this an impossible task, and will default.

Worst of all, we will be tasked with paying back the debt we are currently expanding, and shouldering the immense costs that entails.

However, public debt will also be a great concern. In order to pay for the rising cost of debt servicing, we will soon require new tax increases, and/or significant cutbacks to government services. Our economy will grow very slowly, if at all, with larger amounts of revenue being diverted to interest payments. This will hurt all of us, we will be faced with a heavy tax burden, few job opportunities, and severely diminished government assistance. Worst of all, we will be tasked with paying back the debt we are currently expanding, and shouldering the immense costs that entails. If Canadians wish to avoid this future, then it is time that we start paying our debts. 



Brennan Sorge is graduating this summer from Sun Peaks Secondary Academy and is starting at Thompson Rivers University in the fall. Having taken an interest in politics and economic policy, he hopes to earn a degree in economics as well as law, and then continue into the political arena.

Endnotes

- 1 Trading Economics, retrieved April 20 2016 from <http://www.tradingeconomics.com/country-list/interest-rate>, Interest rates by country.
- 2 Stats Can, retrieved April 13 2016 from <http://www.statcan.gc.ca/pub/75-001-x/2011002/article/11429-eng.htm#a1>, Trends in household debt.
- 3 RBC, retrieved April 13 2016 from http://www.rbc.com/economics/economic-reports/pdf/provincial-forecasts/prov_fiscal.pdf, Canadian Federal and Provincial Fiscal Tables.
- 4 Bank of Canada, retrieved from April 20 2016. http://www.bankofcanada.ca/wp-content/uploads/2010/09/selected_historical_v122530.pdf, Bank rates. Chart data reflects the interest rate for each years January value.
- 5 Stats Can, retrieved April 13 2016 from <http://www.statcan.gc.ca/pub/75-001-x/2011002/article/11429-eng.htm#a1>, Trends in household debt.

“ QUOTE WALL ”

“The first lesson of economics is scarcity: there is never enough of anything to satisfy all those who want it. The first lesson of politics is to disregard the first lesson of economics.”

—Thomas Sowell (1930 -)



Image courtesy YouTube

HOW TO MAKE VANCOUVER MORE AFFORDABLE? LOOK TO TEXAS

Kenneth P. Green, Ian Herzog, and Josef Filipowicz

Vancouver's growing housing costs are outstripping income increases in the city.

There's no single, easy to spot cause for Vancouver's growing housing costs. Low interest rates, population growth, and the region's liveability encourage demand. But one factor—constraints on the housing supply—is often overlooked. Vancouver's geography and a substantial amount of protected agricultural land stop the city from growing out, while red tape at city hall makes growing up difficult as well.

In Vancouver, it takes an average of 15 months to get a residential development approved—nearly five months longer than in neighbouring Burnaby. The costs of complying with regulations and development fees add up to an average of more than \$37,000 per new home in Vancouver, while in Burnaby this cost averages at \$17,500. Opposition to new housing

from local council and community groups also deters homebuilders, raising questions about the city hall's priorities as housing affordability is a growing concern.

So what's to be done?

Other growing cities offer important lessons for Vancouver. Houston, one of the fastest growing cities in the United States, issued more building permits between 2010 and 2014 than any other metro area in America. As a result, the region remained affordable to middle-class families during its oil-fuelled growth spurt.


Houston's loose land-use policies and absence of traditional zoning allow the city to grow rapidly as its economy evolves. Houston developers can add density to inner-city neighbourhoods without facing a long and costly rezoning process. Meanwhile, more than two-thirds of new housing in Vancouver requires rezoning, which adds an average of



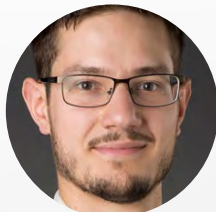
THIS ARTICLE APPEARED IN THE FRASER FORUM ON MAY 4, 2016

6.5 months to the approval process. Doing without this layer of regulation creates a capacity for growth that helps maintain Houston’s affordability, and offers lessons for any city expecting to grow.

Vancouver is internationally known for two things: world-class quality of life and unaffordable housing.

Vancouver is internationally known for two things: world-class quality of life and unaffordable housing. Municipal policies play a role in maintaining both of these titles. Vancouver can learn from its peers on the world stage who benefit from reduced red tape, which ultimately lowers housing costs. That would be good news for many Vancouver-area families. 

Read the blog post here [»»](#)

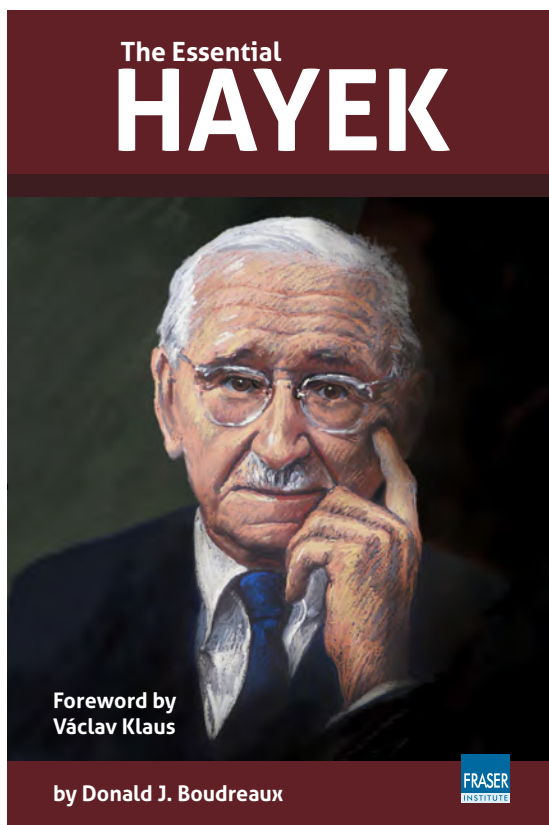


Kenneth P. Green is the Senior Director of Natural Resource Studies at the Fraser Institute. Ian Herzog is an Economist at the Fraser Institute. Josef Filipowicz is a Policy Analyst at the Fraser Institute.



THE ESSENTIAL HAYEK

Donald J. Boudreaux



Nobel laureate economist Friedrich Hayek (1899 – 1992) is one of the most influential thinkers of the 20th century and his work still resonates with economists and scholars around the world today. Two decades after Hayek’s death, his ideas are increasingly relevant in an era where governments grow ever larger and more interventionist. Written by Fraser Institute Senior Fellow Donald J. Boudreaux, *Essential Hayek* is a project of the Fraser Institute, comprised of a book, website, and videos that aim to explain Hayek’s ideas in common, every-day language.

Donald J. Boudreaux is Chairman of the Department of Economics at George Mason University in Fairfax, Virginia, a Fraser Institute Senior Fellow, and creator of Café Hayek. 

Learn more about *Essential Hayek* [»»](#)

To read an excerpt from *The Essential Hayek* turn to the next page

ESSENTIAL HAYEK

Nobel laureate economist Friedrich Hayek (1899 – 1992) is one of the most influential thinkers of the 20th century and his work still resonates with economists and scholars around the world today. Two decades after Hayek’s death, his ideas are increasingly relevant in an era where governments grow ever larger and more interventionist. Written by Fraser Institute Senior Fellow Donald J. Boudreaux, *Essential Hayek* is a project of the Fraser Institute, comprised of a book, website, and videos that aim to explain Hayek’s ideas in common, every-day language. Here is an excerpt of Chapter 9: *The Challenge of Living Successfully in Modern Society*.

Part of our present difficulty is that we must constantly adjust our lives, our thoughts and our emotions, in order to live simultaneously within the different kinds of orders according to different rules. If we were to apply the unmodified, uncurbed, rules of the micro-cosmos (i.e., of the small band or troop, or of, say, our families) to the macro-cosmos (our wider civilization), as our instincts and sentimental yearnings often make us wish to do, we would destroy it. Yet if we were always to apply the rules of the extended order to our more intimate groupings, we would crush them. So we must learn to live in two sorts of worlds at once.

—Friedrich Hayek (1988).
The Fatal Conceit. In W.W. Bartley III (ed.), *The Fatal Conceit, I* (Liberty Fund Library, 1988): 18.

As emphasized throughout this volume, modern prosperity is produced through an astonishingly complex web of human cooperation. This web of cooperation is vast. It spans the globe. Nearly every individual in the modern world is part of it, both as a consumer and as a producer. And so almost all of this productive cooperation is among strangers.

This fact is highly significant for the rules that guide us in our daily activities.

Every day, each of us participates in two very different kinds of productive and valuable social arrangements. One of these arrangements involves interactions with people who we know and care about—our parents, siblings, spouses, children, friends, close neighbours. Call these arrangements “small group arrangements.”

The other arrangements are with multitudes of strangers—the millions of people in the great global web of economic cooperation. A small handful of these strangers you see face-to-face, such as the cashier



at the supermarket and the flight attendants on your most recent flight. But the bulk of these strangers—such as the person who sewed the shirt you’re now wearing, and the person who designed the shoes now on your feet—are people you’ll never lay eyes on. All of these strangers are people you know nothing about. Call arrangements with these multitudes of strangers “large-group arrangements.”

One of the greatest challenges to those of us who live in modern society is to be able to function comfortably within *both* types of arrangements. The challenge lies in the fact that behaviours that are appropriate in one of these arrangements are often inappropriate in the other, and vice-versa.

Consider the ultimate small-group arrangement: the immediate family. As in the larger society, within families economic decisions must be made. What’s on the menu for tonight’s dinner? Who’ll cook that dinner and who’ll wash the dishes? (Such decisions allocate the family’s labour resources.) Where will the family vacation this summer? Should money be spent to remodel the kitchen or

should that money be saved for the kids’ college education?

Within families, even such “economic” decisions are not made commercially among the members of the family. Perhaps family decisions are made by mutual agreement; perhaps mom and dad alone make all decisions. But regardless of the details of the rules or habits that any particular family uses to reach decisions, normal families do *not* make decisions by using “arms-length” formal contracting, market prices, competitive bidding, or any of the other impersonal procedures that characterize most of our economic relationships with strangers.

The same holds true for decision-making within other small-group settings, such as when friends decide which movie to watch together. The decision is typically reached by informal discussion leading to mutual consent, rather than through bargaining in which the highest monetary bidder gets to choose.

Also within families and many small groups we typically apply egalitarian norms of distribution. The portion of the family’s budget that mom has, the portion that dad has, and the portion that each of the kids has is not determined by impersonal market forces. It is instead determined by a strong sharing norm. Within families, income is distributed not only consciously (usually by the heads of the household) but also more or less equally. This sharing norm within families and most other small groups is, of course, praiseworthy.

That we use informal, non-commercial decision-making procedures and norms in small-group settings is a

good thing. First, the formalities and competitiveness of commercial procedures are unnecessary in small-group settings. Family members and friends genuinely care about each other and they know each other personally and with a depth of detail that simply cannot exist among strangers. So not only can people in small-group settings rely upon love or mutual concern to prevent cheating; people in these settings also know a great deal about each other. This mutual, detailed, and deep knowledge enables each person to be trusted to act wisely with respect to each other. Parents, for example, generally do not need to be forced by the police to treat their children well. Also, as parents they know their children's desires and abilities well enough that they do not need to learn this information through market competition and prices.

Not only can people in small-group settings rely upon love or mutual concern to prevent cheating; people in these settings also know a great deal about each other... [which] enables each person to be trusted to act wisely with respect to each other.

The close personal connections, the on-going face-to-face communications, and the mutual affections that bind together members of families and other small groups give each member of these small groups such deep knowledge of the other members that no

impersonal means of dealing with each other are required.

Second and more importantly, using the formalities and competitiveness of commercial procedures in small-group settings would undermine all that is valuable about those settings. Central to our human nature is our longing and our ability to interact with loved ones and with friends on personal terms—to interact in ways that are built upon particular feelings and expressions of sentiment, caring, and love. Each of us wants to have people to personally care for and to care about, and each of us wants to be loved and cared for personally by other flesh-and-blood individuals. Attempts by parents, say, to charge their children for home-cooked meals, for the time that parents spend nursing their children through illnesses, or for any other benefits and care-giving that parents extend to children would rip from family interactions all that makes those interactions worthwhile and satisfying. Children growing up in such “families” would likely become, at best, social misfits as adults.

With the exception of giving young children an allowance as a way to help them begin to understand how to manage money, the money nexus has little or no place within a healthy family unit. A household run like a business would crush rather than nurture those familial bonds and personal sentiments that are so deeply important to us as human beings. In a world run *only* by arms-length contracting, market competition, money prices, and the formal “thou-shalt-not” rules that we follow when dealing with strangers,

intimate relationships, loving families, and close friendships would not exist. Such a world would be worse than cold; it would be inhuman.

Everyone understands the value of personal relationships governed by love and sentiment. Not only are such relationships part of everyone's daily lives, we as a species are also evolved to treasure such relationships and to *know how to engage in them*. Again, parents naturally care for their children; they do not have to be instructed to do so or about how to do so. Likewise, because we humans spent most of our evolutionary history living in small bands of individuals who were known face-to-face to each other—and interacting only relatively rarely with strangers—nearly all of our successful *personal* connections continue to be with the individuals in our small groups.

The sentiments and emotions that bound members of small groups together and best enabled them to survive and to reproduce became encoded in our genes. These sentiments and emotions, therefore, are inextricably part of who we are. They are part of what it means to be human. And although human society in modern times has grown in size far larger than the small groups in which most of our ancestors lived, these small-group sentiments and emotions remain important “guides” to us in our dealings with our loved ones and friends.

As valuable and agreeable as these small-group sentiments and emotions are, however, they are poorly suited to guide us in our connections with the larger society. We cannot possibly

know enough about strangers to be able to interact in their lives as intimately as we interact in the lives of people whom we know personally. Also, we cannot possibly care as deeply about the wellbeing of strangers as we care about the wellbeing of our family and friends.

And yet, to flourish in modern society requires our almost-constant interaction with countless strangers.

And yet, to flourish in modern society requires our almost-constant interaction with countless strangers. To be productive for everyone involved, these interactions must be based on mutual consent and governed by an ethic of kept promises. But these interactions need not be based on feelings of love, caring, and concern. This fact is fortunate because, as just noted, no one is capable of knowing about and caring about more than a tiny number of the individuals with whom he or she interacts daily.

Being guided in our interactions with millions of strangers by impersonal rules and market forces, our capacity for love and concern for others isn't over-taxed. Nor are we called upon to learn the details of the lives of these strangers. When you want to buy, say, a new car, you need to know only some information about the quality of the car and its price in comparison with other cars. The only personal information you need to know when deciding whether or not to buy the car is information about

yourself. What are *your* tastes and preferences in automobiles? What is *your* price range? What financial arrangements to pay for a car work best for you? You do not have to know—and you cannot possibly know—any such personal information about the millions of individuals whose efforts contributed to the production of the car.



The rules for interacting with strangers overlap with, but are much “thinner” than, the rules for interacting with people whom we know personally. Treat strangers with respect and do not presume that you are a better judge than they are of what is best for them; do not steal from strangers; do not cheat them; initiate no violence against them; keep your promises to them; respect their property rights. To follow these rules requires no personal knowledge of strangers. When people follow these impersonal rules when dealing with strangers in the economy, “arms-length” exchange and contracting occur. These exchanges and contracts give rise to market prices. These prices, in turn, guide each of us to interact productively—as both consumers and as producers—with

the increasingly large numbers of strangers who make our modern lives possible.

The success and sustainability of modern society, therefore, requires that each of us be guided by our small-group norms when interacting with people we know personally, yet also to put those norms aside when interacting with strangers.

Switching back and forth between these two sets of very different norms is difficult, especially because we are genetically hard-wired to follow small-group norms. When we see on television or in Internet clips the faces of strangers who are suffering job losses or some other economic misfortune, our small-group norms trigger within us sympathies for these strangers (especially if they share our political nationality). So when government officials promise to “do something” to relieve the suffering, we are inclined to support those efforts, even if we suspect that those efforts will cost us something.

Intellectual reasoning might convince us that the government’s proposed efforts won’t work, are too costly, or are otherwise unjustified. But insofar as we think of our nation as our extended family, the planned efforts of the government tap into our small-group norms. These norms, thus activated, are often difficult to overcome by those who wish to make unbiased (“rational”) evaluations of government policies. For better or worse, even the best rational evaluation is often inadequate to overcome the emotional impulse to consciously tend to those among us who we perceive as suffering.

The power of these small-group norms is especially intense when government presents itself—and is portrayed by the media, by academics, and by popular culture—as being the caring and wise leader of our national “family.” In the same way that we would make personal sacrifices to save our children or siblings from economic hardship, “we” as members of the national family, applaud efforts by the leaders of our national family to rescue those among us who have fallen on hard times.

But government policies springing from these small-group norms can be counterproductive. If, for example, government raises tariffs to protect the jobs of domestic wheat farmers, workers in other industries suffer. The reason is that higher tariffs on wheat—by reducing the number of dollars that foreigners earn by selling wheat to us—mean that foreigners will have fewer dollars to use to buy other goods from us (or to invest in our economy). But because these negative effects of the tariff are spread over a large and very diverse number of people, they are more difficult to see than are the benefits of the tariff, which are concentrated on a relatively small, uniform, and easily identified group of people. Being more difficult to see, these negative effects of the tariff don’t trigger our small-group sentiments. Those sentiments, in short, bias us toward supporting policies whose beneficiaries are easily seen and whose victims remain cloaked in the complexities of reality.

Similarly, small-group norms of fairness that work well for determining the distribution of

goods and resources within families and among friends are inappropriate for judging the distribution of goods and resources in the larger society. The forces that determine the relative sizes of people’s bundles of material possessions in market economies are far more complex than are the forces that determine the sizes of people’s bundles of resources within small groups.

In small groups, each person’s effort, intent, and simple luck (good and bad) can be observed and taken accurately into account.

In small groups, each person’s effort, intent, and simple luck (good and bad) can be observed and taken accurately into account. You know, for example, if your brother’s low income is the result of his bad luck or of his choices. (His low income, incidentally, might be the result of his *poor* choices—say, he drinks excessively—or the result of choices that are unobjectionable yet that yield only a low income—say, he chooses to earn his living as a street mime because he enjoys that line of work.) And you and others who know your brother can adjust how you treat him based upon your intimate knowledge of his particular circumstances.

In the larger society, in contrast, such personal observation and knowledge are impossible. No one can know every person’s particular circumstances. Nor can we directly observe every person’s contributions to the economy as a whole. The best

available means of gauging the size of each person's contribution to the economy is to measure the monetary earnings he or she amasses in dealing peacefully in the market with customers, suppliers, and competitors.

The norms that we use in small groups are inappropriate for assessing the merits of the size of strangers' monetary earnings. What *appear* to us to be this stranger's unjustly high income and that stranger's unjustly low income in fact have layers of complex causes that cannot be observed and assessed with the sort of accuracy that we can attain when we observe and assess the justness of how much of a small-group's resources are claimed by each member of that group.

Another difference between small groups and large groups is important here. In small groups we can know with confidence most of the effects on our small group if we redistribute resources from one person to another—say, if mom and dad give Jane a bigger allowance and Joe a smaller allowance. In large groups, in contrast, we cannot trace out the full effects of redistribution. Because we can't comprehend all of the countless unseen interconnections and feedback loops that tie together the choices of millions of individuals from around the globe into the particular outcomes in which some individuals' annual incomes are relatively low while others' incomes are relatively high, we can't know the full effects of redistribution policies. Attempts to redistribute incomes in such complex settings risk triggering many negative feedback loops and upsetting productive arrangements that make

even poorer those people with the lowest incomes.

Higher income taxes on the rich... might diminish private investment so much that over time the resulting loss in economic opportunities for the poorest citizens swamp whatever extra income they receive from government's redistribution policies.

Higher income taxes on the rich, for instance, might diminish private investment so much that over time the resulting loss in economic opportunities for the poorest citizens swamp whatever extra income they receive from government's redistribution policies. Likewise, redistribution might so stymie the incentives of today's poor people to stay in school or to find and keep jobs that the economic well-being of these people is actually worsened over time by the redistribution policies that are meant to help them.


The argument here is not that these particular negative effects will occur. Rather, the argument is that *some* unanticipated negative effects will occur if we try to make outcomes of the large group satisfy the sense of justice and fairness that are appropriate for our small groups. The reason is that our knowledge of the relevant details of the large group—our knowledge of the details of what Hayek called “the extended order”—is puny compared to our knowledge of the relevant details of our small

groups. If we try to make the outcomes of the large group satisfy the notions of fairness and justice that are appropriate for small groups, we will dampen and distort the impersonal forces of competition and of profit and loss that are necessary in a large economy to allocate resources to uses that are of maximum value to multitudes of people. We will also weaken the obligation people feel to change their jobs and businesses if consumers no longer value the outputs of these jobs and businesses.



Switching back and forth between small-group norms and large-group norms isn't easy. It's understandable that many people feel a strong desire to apply small-group norms to the large group. Fortunately, however, for the past two or three centuries enough people in many parts of the world have avoided applying their small-group norms to the larger society and economy—or have avoided doing so at least enough to allow global, industrial, bourgeois capitalism to take root and spread. So it *can* be done. People *can* switch back and forth appropriately between small-group norms and large-group

norms. Yet media and political commentary daily compound the difficulty of doing so.

In the next and final chapter of this book, we will explore the role of ideas and their inevitably dominant role in determining public policies. If our ideas are “good,” they will overcome any sentiments we might have that are destructive to “the extended order.” But if our ideas are “bad,” the consequence will be policies that undermine and destroy the extended order and, along with it, our civilization. 

Learn more about Essential Hayek here [»](#)

Extracted from Donald J. Boudreaux's The Essential Hayek, published by the Fraser Institute.



Donald J. Boudreaux is a Professor of Economics and former Economics Department Chair at George Mason University and a Senior Fellow with the Fraser Institute. He is also a Senior Fellow with the F.A.

Hayek Program for Advanced Study in Philosophy, Politics, and Economics at the Mercatus Center at George Mason University



THIS ARTICLE APPEARED IN THE *FINANCIAL POST*

\$113.2 billion
increase to the
federal debt in
just five years

\$29.4 billion
projected budget
deficit in 2016/17

2016/17, elderly
benefits will
be up by
\$2.8 billion

2016/17,
government
proposes
to increase
program
spending by
**\$20.5
billion**

2016/17,
childrens
benefits
increase
by **\$3.8
billion**

2020/21,
projected
deficit of
**\$14.3
billion**

2016/17,
EI benefits
increase
by **\$1.7
billion**



LIBERAL SPENDING INCREASES DRIVE BIG DEFICITS, NOT A WEAK ECONOMY

Charles Lammam and Ben Eisen

In advance of tabling their first budget, the Liberals conveyed a message that deteriorating government finances were the result of a weak economy. The reality of the budget is quite different from the rhetoric; the source of the large and sustained deficits is a marked increase in spending.

Before analyzing the numbers, we should pause and note how much the Liberals have diverged from their election promise to run deficits of no more than \$10 billion with a return to budget balance before the end of their mandate.

At \$29.4 billion, the projected budget deficit in 2016/17 alone is larger than the cumulative budget deficits projected for the entire mandate in the Liberals platform. And the deficit is not a one-off; the government is planning deficits as far as the eye can see. In total, the string of deficits is expected to add \$113.2 billion to the federal debt in just five years—approximately four times as much debt as the Liberals said that they would add.

Both in the lead up to the budget and in the budget document itself, the Liberals tried to establish that a weak economy is the reason why they couldn't keep their election promises of "modest" and temporary deficits. The data don't support this. The big deficits are driven by spending.

According to the government's revenue projections, \$2.7 billion (or nearly 80%) of the \$3.5 billion revenue reduction is due to a one-time reduction in revenues from Crown corporations, not a weak economy.

First, consider revenues, which is where a weak economy would materialize most in the budget. In 2016/17, federal revenues are projected to be \$3.5 billion lower than in the previous year. That's a drop of only 1.2 per cent. For perspective, federal revenues fell \$15.2 billion (or 6.4 per cent) in 2009/10 when the economy was actually in recession.

According to the government's revenue projections, \$2.7 billion (or nearly 80 per cent) of the \$3.5 billion revenue reduction is due to a one-time reduction in revenues from Crown corporations, not a weak economy. Revenues from EI premiums, which are particularly sensitive to the state of the economy, are budgeted to decline by a meagre 2.6 per cent.

As troubling as this is, it's made worse by the fact that the government has no plan to return to a balanced budget.

The real culprit of the deficit is a dramatic increase in spending. In 2016/17, the government proposes to increase program spending by \$20.5 billion—a 7.6 per cent jump. This increase is even more dramatic considering that program spending in 2015/16 is now anticipated to be up 6.7 per cent from the previous year. That means program spending is projected to increase 14.8 per cent in just two years.

The budget shows the Liberals are planning to increase spending in virtually all areas. For example, in 2016/17, elderly benefits will be up by \$2.8 billion (6.1 per cent), children benefits by \$3.8 billion (21.0 per cent), and EI benefits by \$1.7 billion (8.8 per cent).

The predictable consequence of the dramatic run-up in spending is an increase in the size of the federal deficit and the related growth in federal government debt.

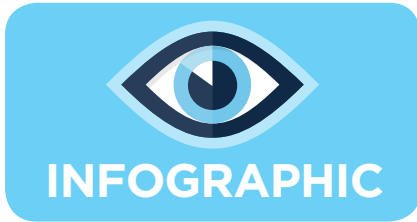
As troubling as this is, it's made worse by the fact that the government has no plan to return to a balanced budget. In fact, the government is projecting a deficit of \$14.3 billion in 2020/21—a year after its current mandate is over. In other words, the budget leaves the task of balancing the books to the next government.

Make no mistake—despite the rhetoric on a weak economy, the government's decision to dramatically increase spending is why Canada's budget is now soaked in red ink. [C](#)

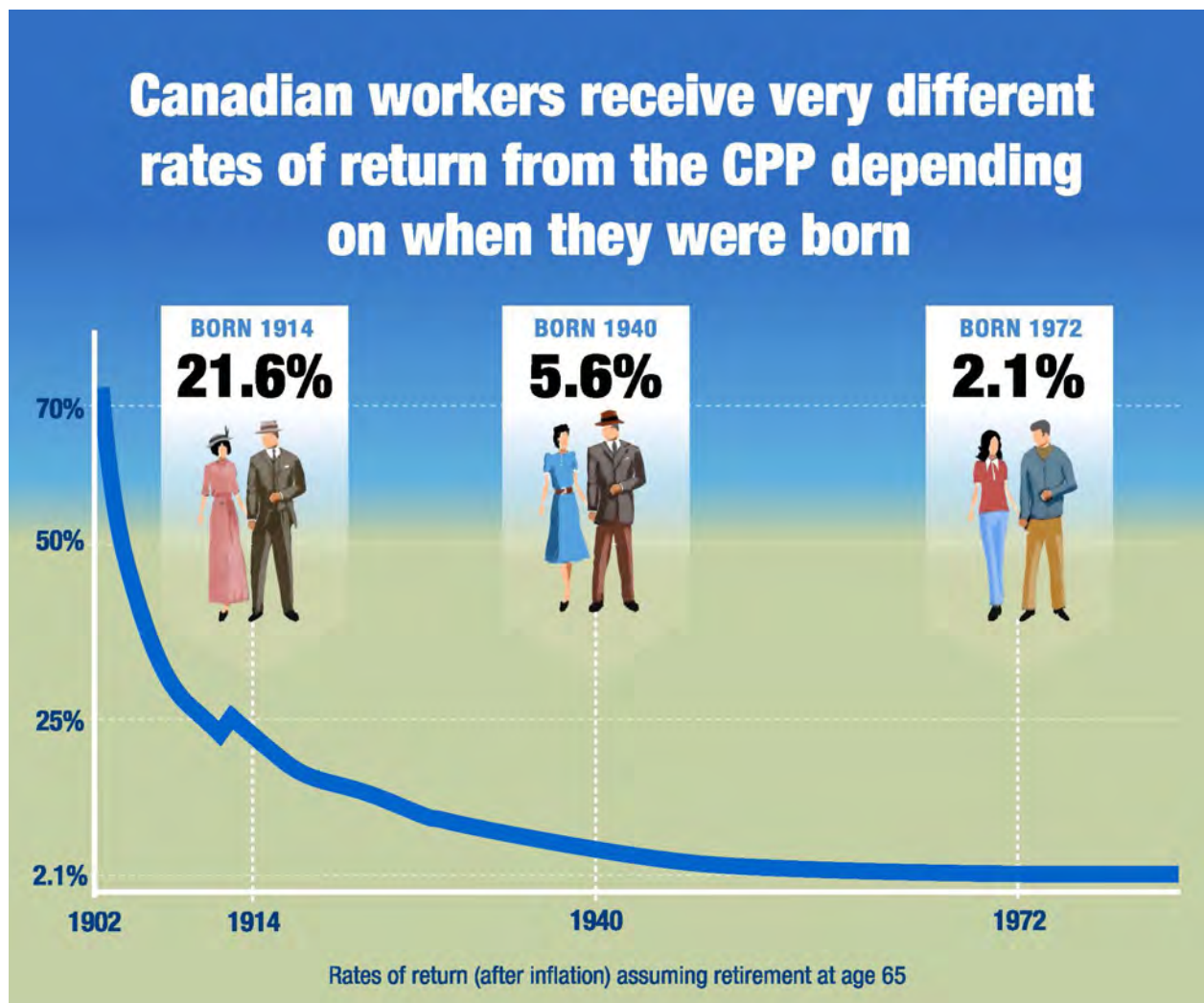
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Charles Lammam is director of fiscal studies and Ben Eisen is associate director of provincial prosperity studies at the Fraser Institute.



RATES OF RETURN FOR THE CANADA PENSION PLAN



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**FROM THE
ARCHIVES**

THE ECONOMIC COSTS OF VANCOUVER'S ELECTORAL REFORM

Niels Veldhuis and Jason Clemens

In June, Vancouver's Electoral Reform Commission, headed by former BC Supreme Court Judge Thomas Berger, made its recommendation for electoral changes at the municipal level. Specifically, Mr. Berger recommended moving from an at-large system of electing city councillors to a ward system with district representation. Unfortunately, the municipal commission and its subsequent recommendation seem to have ignored, or at the very least neglected, the economic costs of electoral reform.

Under Vancouver's current at-large electoral system, voters choose the city's councillors and mayor from an exhaustive list of candidates. The top vote-getters are elected to the 10 seats available on city council. Under a ward system, the city would be divided into smaller voting areas (wards) and citizens would vote for candidates in their geographic area.

Essentially, the ward system is similar

to the current provincial electoral system in which each MLA is elected by, and represents, a specific riding.

There are, of course, benefits to moving to a ward system; the Berger Report points to greater representation for geographical areas (specifically the East side), improved opportunities for smaller parties and independents, and a simplified ballot. That said, economic theory and empirical research indicate that such a transition will be accompanied by significant economic costs.

ECONOMIC THEORY

Economic theory, developed largely by the public choice school of economics, suggests that the ward system will produce two main changes.

First, district councillors elected under the ward system will face incentives very different from those of councillors elected at-large. Specifically, councillors elected at-large will promote policies generally in line

with the average voter's preferences, whereas policies advocated by district councillors will be more closely tied with particular interest groups in their respective districts. As a result, councillors elected under the ward system will focus more on their districts, whereas at-large representatives will be more attuned to the general interests of the city.

Such trade-offs lead to increased spending on projects that are mainly of interest to a limited constituency.

In addition, vote trading (where councillors support measures in order to receive commensurate support for their own district projects, or “logrolling” in economic language) will increase. For example, Councillor A supports a new community centre in East Vancouver for the sole purpose of securing Councillor B's support for a road project in his own Point Grey district. Such trade-offs lead to increased spending on projects that are mainly of interest to a limited constituency.

Both changed incentives and increased logrolling will lead to more spending, more taxes, and ultimately, more debt.

EMPIRICAL EVIDENCE

Unfortunately, Vancouver's Electoral Reform Commission, which cost taxpayers an estimated \$300,000, failed to adequately review the academic literature on the economic costs of moving to a ward system. In fact, all told, the 158-page report mentions only two studies of the economic costs of different election systems.

The first “study” is actually a memo from the Vancouver Economic Development Commission (VEDC), an organization funded by the City of Vancouver, whose mandate is to promote economic development in the city.¹ Unfortunately, VEDC's memo relies solely on anecdotal evidence collected through conversations with city administrators, elected officials, and two political scientists. In fact, the survey contains no data, no empirical analysis, and no review of existing academic research. Using



anecdotal evidence, the Vancouver Economic Development Commission concludes, without due diligence, that economic development would not be affected by a move to a ward electoral system.

Unfortunately, Vancouver's Electoral Reform Commission, which cost taxpayers an estimated \$300,000, failed to adequately review the academic literature on the economic costs of moving to a ward system.

The second and only academic study referenced by the Berger Report analyzed the impact of ward systems on government spending and taxation. The study, published some 24 years ago (1980), analyzed a mere 22 US cities, using only 11 years of data from the mid 1940s to the early 1950s (see Morgan and Pelissero, 1980). In fact, the authors themselves point out the limitations of their analysis in the conclusion of their study: “the time span is somewhat limited, and a relatively small number of cities are involved.”

Citing these two references, the Berger Report concludes that, “the cries of alarm about the impact that representation of neighbourhoods [a ward system] would have on economic progress seem to be without real justification” (Berger, 2004).

Several other studies published in respected academic journals however, directly contradict the Berger Report's conclusions regarding the economic costs of electoral reform. For example, DalenBerg and Duffy-Deno (1991) assess differences in public infrastructure spending between at-large and ward electoral systems. They conclude that if other demand and supply factors are constant, ward systems result in higher public capital stocks. In plain English, “ward councilors are biased toward large capital projects which are visible and have concentrated neighbourhood benefits” (DalenBerg and Duffy-Deno, 1991).


The most comprehensive study, written by Professor Lawrence Southwick and published in 1997 in *Economics and Politics*, empirically tested whether or not ward systems

**THIS ARTICLE APPEARED IN THE
FRASER FORUM IN OCTOBER 2004**

lead to higher local government taxes, spending, and debt in over 630 US cities.² The results show that a purely at-large council spends 17.6 percent less than an all-ward council. On the tax side, an all at-large council taxes 16.3 percent less than an all-ward council. Finally, per person local government debt is 68.5 percent lower in an all at-large council than in an all-ward council. In other words, ward systems result in higher levels of government spending, higher levels of taxation, and higher levels of debt.

A purely at-large council spends 17.6 % less and taxes 16.3 % less than an all-ward council.

CONCLUSION

While electoral change is in the air, it will ultimately be Vancouverites who, through a referendum to be held in October, will decide whether or not to move to a ward system for electing their local politicians. While there are some benefits to a ward system, Vancouverites must decide if paying higher taxes and accumulating more debt in order to finance more municipal spending are worth these benefits. 



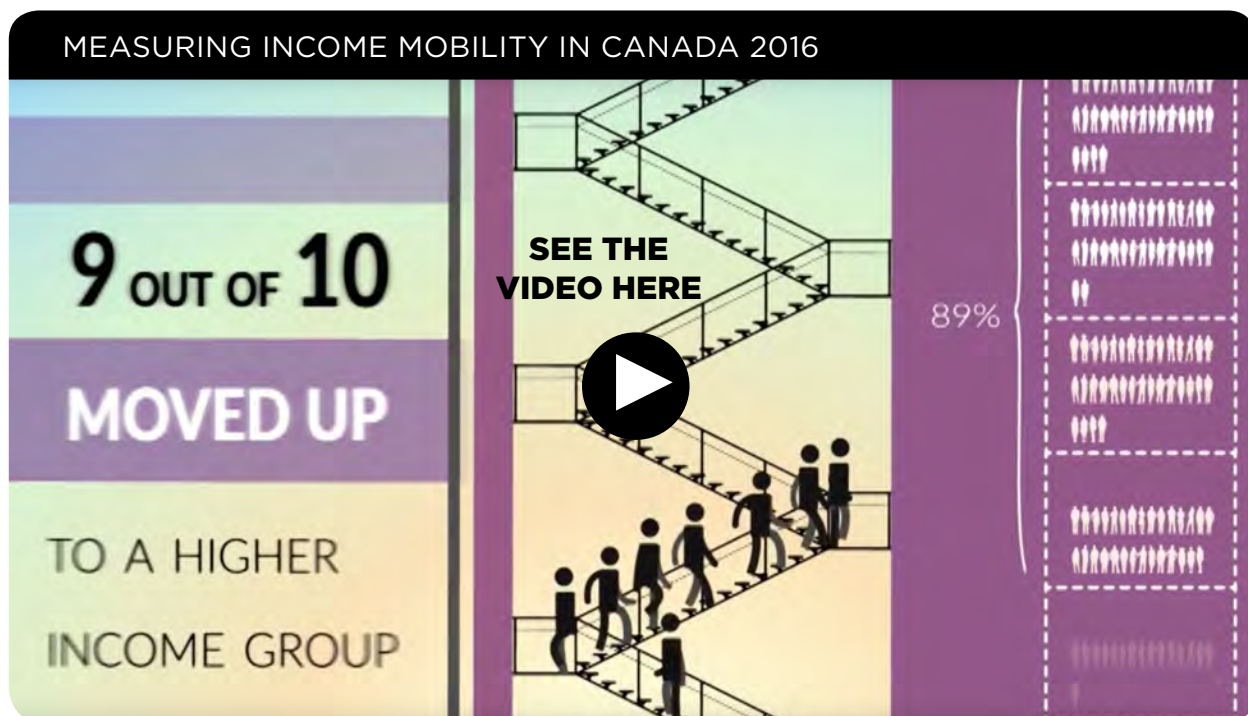
Niels Veldhuis is now the President of the Fraser Institute. He has an MA in Economics from Simon Fraser University. Jason Clemens is now the Executive Vice President of the Fraser Institute. He has an MBA from the University of Windsor and a Post Baccalaureate Degree in Economics from Simon Fraser University.

Notes

- 1 The Vancouver Economic Development Commission's memo can be obtained by contacting the VEDC's Director of Communications.
- 2 Southwick criticizes Morgan and Pelissero's study (cited by the Berger Report) for using statistics that were "very limited."

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MEASURING INCOME MOBILITY IN CANADA 2016

Too often, an underlying assumption in the income inequality debate is that low- and high-income Canadians are the same people year in and year out. In reality, however, Canadians are not permanently stuck in certain income groups. Over the course of their lives, the overwhelming majority move up and down the income ladder.” [C](#)

View the video *Measuring Income Mobility in Canada 2016* here [»](#)

THE CASE AGAINST COMPULSORY VOTING: WHY CONSCRIPT THE UNINFORMED?

William Watson

I've been a fan of U.S. politics since 1965 or 1966 when, shortly after it came out in paperback, my father gave me Ted Sorensen's JFK biography, *Kennedy*, for Christmas or my birthday. (That was the complete title: Books didn't have baroque subtitles in those days.) A quarter century or so later one of the great thrills of my life was meeting Sorensen at a dinner party in New York.

The length and expense of the modern U.S. presidential campaign come in for lots of criticism from foreigners, including Canadians.

I've followed U.S. politics pretty closely ever since reading that very inspiring book. Several years after we were married my wife confided that she'd thought it strange on first meeting me that my Sunday morning devotional was to watch the political interview shows, *Meet the Press*, *Face the Nation*, and the like—the ones

Donald Trump says he gets many of his policy ideas from.

When kids came along I gave up that habit but with them off to university I'm getting back to my old habit and I have certainly been watching the candidate debates pretty faithfully, including healthy (or maybe unhealthy!) chunks of all 36—yes, 36!—Republican and Democratic debates and town halls.

The length and expense of the modern U.S. presidential campaign come in for lots of criticism from foreigners, including Canadians. For that matter, they come in for lots of criticism from Americans, too. One obvious drawback is that a candidate has to start running at least two years before the final vote and then campaign and fundraise more or less flat-out, full-time.

On the other hand, a very big benefit is that voters get to know the candidates and see how they behave



during the little crises that come up from time to time during the course of a campaign. And though it doesn't necessarily follow that a candidate that can't run a successful campaign couldn't run a successful government, it doesn't necessarily not.

Part of being free is being free not to participate in the democratic process if you don't want to.

There have been problems with the debate structures and rules and, this year in particular, with the comportment of the debaters, at least on the Republican side. But there has also been considerable variety in the debates, which are

organized in a decentralized way we Canadians experienced for the first time during the last federal election but which congenital centralizers seem likely to outlaw in favour of much more heavily regulated procedures, as is too frequently our national instinct. All that aside, any American who doesn't by now have a reasonably clear opinion of the five surviving major party candidates just hasn't been paying attention.

The funny thing about my great interest in U.S. politics is that I don't vote. Every four years I invest tens, maybe even hundreds of hours watching and reading even though, not being American, I don't have a ballot to cast. I suspect lots of Canadians are like me. By contrast,

tens of millions of Americans, the surveys and vote-counts demonstrate, don't pay attention, aren't very well-informed about the candidates or issues, and in the end don't vote.

And yet you regularly hear people recommend that democracies in which voter turnout is low, such as the U.S., such as Canada, should institute compulsory voting, which would require people to either show up at their polling station and cast or spoil a ballot, or instead pay a fine of \$20 or \$25.

I've never understood why we would want to do this. If people prefer not to vote or just can't be bothered, why is that not their right? Part of being free is being free not to participate in the democratic process if you



don't want to. Those of us who stay away in our droves from the public consultations on this project or that, which now run almost 24/7, exercise a similar right of non-participation. In the case of voting, you might think not participating is in bad taste, given the effort many of our forebears put into acquiring the vote for us. But freedom isn't worth much if you can only exercise it in ways none of your peers objects to.

More fundamentally, why would we want to force people who are disinclined to vote to come out to the polling station and record some sort of preference? A stock person-in-the-street interview around voting time is to ask people about who's running or what the issues are. No doubt many people answer sensibly. They don't get broadcast, of course. Who does get broadcast are the alarming number of people who betray almost complete ignorance about even the most basic facts of the campaign or our electoral system.

My guess is that such people are disproportionately non-voters. Why we should seek out their participation in a process many of us do see as consequential I'm afraid I will never understand. [C](#)

Read the blog post here [»»](#)

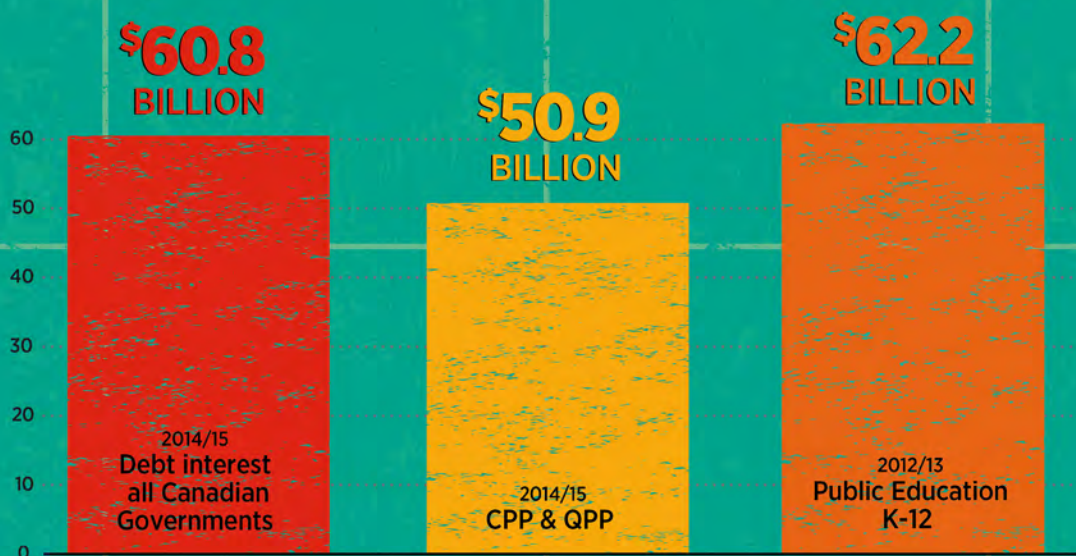


William Watson is a Professor of Economics at McGill and Senior Fellow with the Fraser Institute.



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matter most Visit: www.fraserforum.org





Recently, the Fraser Institute released *Troubled Waters*, a series on current public policy issues plaguing Canadians. Here are two key issues chosen for this edition of Hot Topics:

THE COST OF GOVERNMENT DEBT IN CANADA, 2016

Charles Lammam, Milagros Palacios, Hugh MacIntyre, Feixue Ren

The *Cost of Government Debt in Canada, 2016* examines how interest payments governments' owe on the debt they have accumulated over the years has started to consume government revenue. As a result, this leaves less money to spend on important programs pertaining to health care and education. To put into

context, Canadian governments spent \$60.8 billion on debt interest payments in 2014/15 while Canada's total primary and secondary education spending equaled \$62.2 billion in 2012/13, highlighting the increasing burden that government debt has on young people.

Read the study here [»](#)



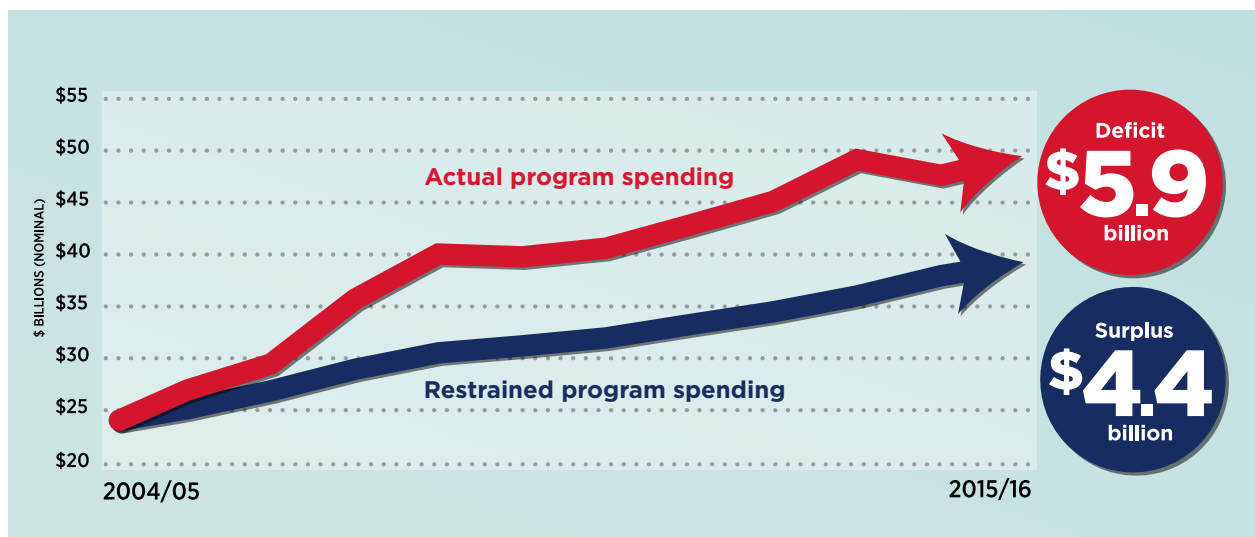
ALBERTA'S BUDGET DEFICIT: WHY SPENDING IS TO BLAME

Steve Lafleur, Milagros Palacios, Ben Eisen, Charles Lammam

Contrary to the claim that falling oil prices are to blame for Alberta's poor economic situation, program spending is, in reality, a key reason why Alberta is running its seventh deficit in eight years. The study *Alberta's Budget Deficit: Why Spending is to Blame* argues that Alberta could have had a \$4.4 billion surplus this year had program spending not outpaced the rate of inflation, population growth, and economic growth. Instead, program spending increased by 98.3%

from 2004/05-2014/15 leaving the province with a deficit of \$5.9 billion for the 2015/16 fiscal year. [C](#)

Read the study here [»»](#)



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