

Post-Stimulus Spending Trends in Canada

by Sean Speer and Joel Emes

QUICK SUMMARY

Canadian governments enacted Keynesian-inspired fiscal stimulus plans in 2009. These plans were to be a temporary response to the global economic recession. The stimulus spending was to be withdrawn after two years and program spending was then to be brought under control and returned to pre-stimulus trends.

However, Canadian governments did not withdraw their stimulus spending as quickly as promised and as a result have run budgetary deficits for longer and accumulated more public debt than they would otherwise have.

This research, which focuses on the post-stimulus spending trends for the federal government, Alberta, British Columbia, and Ontario, finds that these governments have delayed withdrawing their stimulus spending and pushed back initial projections for eliminating their budgetary deficits by at least two years.

These four governments have run larger and more protracted budgetary deficits than they would have if they withdrew stimulus spending and returned to pre-stimulus spending trends. The result is \$63.5 billion in higher cumulative deficits and \$2.9 billion in additional annual debt service costs that could have been avoided.

Introduction

The global economy began to decline in 2007 and took a sharp downward turn in September 2008. Canada was not immune from this worldwide slowdown. Output in Canada started to decline in the third quarter of 2008 and reached a low point in the second quarter of 2009. Overall the economy contracted by 3.3 percent. Employment declined by 431,000, or 2.5 percent, from October 2008 to July 2009 (Uppal and Larochelle-Côté, 2013).

In response, Canadian governments enacted fiscal stimulus plans to help boost economic activity. The federal government's two-year stimulus package was \$45.4 billion and comprised a mixture of tax relief, expanded benefits and training for unemployed workers, and infrastructure spending. The provinces followed suit with matching funding for infrastructure and new programs in their own priority areas.¹ The Ontario government, for instance, provided direct subsidies to pulp and paper mills, farmers, and the auto sector. The Alberta government provided subsidies for carbon capture and storage and other environment-related projects. Each Canadian government implemented some level of fiscal stimulus and overall the composition was heavily weighted towards spending rather than tax reductions.

This paper will not assess the economic impact of the stimulus packages put in place by Canadian governments. Past research published by the Fraser Institute has estimated that stimulus spending had a negligible effect on Canada's economic recovery (Karabegovic, Lammam, and Veldhuis, 2010). A subsequent commentary

1 According to federal estimates, provincial and territorial stimulus spending totaled \$18.4 billion between 2009-10 and 2011-12 (Canada, Department of Finance, 2012: 290).

published by the Institute found that this experience is consistent with empirical research on the general efficacy of fiscal stimulus (Veldhuis and Lammam, 2010).

Instead, this paper focuses on government spending trends post-stimulus, and the extent to which temporary increases have become permanent and the base from which future program spending will grow. In particular, the analysis focuses on the federal government, Ontario, Alberta, and British Columbia.

At the time the stimulus plans were enacted, these governments touted them as temporary measures to "protect and create jobs" in the short-term (Canada, Department of Finance, 2009). The stimulus spending was supposed to be "timely, temporary, and targeted" (Canada, Department of Finance, 2009: 10; Ontario, Ministry of Finance, 2009: 7). The governments were clear that the fiscal stimulus would be withdrawn and program spending would be brought under control and returned to pre-stimulus trends.

As this paper will show, these governments did not withdraw their stimulus spending as quickly as promised and as a result have run budgetary deficits longer and accumulated more public debt than they otherwise would have. All four governments have delayed their initial projections for eliminating their budgetary deficits by at least two years and in some cases the return to a balanced budget remains precarious. Many of these governments have attributed revenue shortfalls as the source of ongoing deficit spending. But the real cause of their current deficits and debt accumulation is high spending.

The concept of short-term fiscal stimulus finds its intellectual basis in the work of John Maynard Keynes. Writing in the 1930s, Keynes pos-

tulated that during periods of economic downturn governments should (i) not try to balance their budgets in the face of falling revenues and (ii) borrow to fund temporary tax cuts or temporary increases in government spending (transfers or purchases) to increase aggregate demand. His work was premised on the assumption that deficit-financed spending would have a multiplier effect represented by the ratio of the increase in real output to the increase in government spending or tax cut that generates it. Put differently: government spending could help to stimulate investment and employment, and in turn have a net positive effect on economic output. This thinking underpinned the fiscal policies of Canadian governments in response to the global economic recession.

The empirical foundation of Keynes's multiplier effect remains a point of contention among economists and in any case is outside the scope of this paper. What is important, however, is the corollary of Keynes's prescription, which is that fiscal stimulus should be temporary and governments should retrench once the recession is over in order to pay down debt accumulated due to lower revenues and higher spending. As one commentator has put it: "Real Keynesianism swims against the economic current all the time—borrowing and spending when times are bad, running surpluses and paying down debt when times are good" (Crowley, 2013, March 2).

This often overlooked aspect of Keynes's thinking is relevant to our analysis. Canadian governments that engaged in stimulus spending committed at the time to adhere to his theory by withdrawing the stimulus after two years. The record of the four governments covered in this paper, however, shows that there were delays in fully withdrawing so-called "temporary spending," which has led to protracted deficits and a greater accumulation of debt than would

have otherwise happened had they followed Keynes's prescription more closely.

The purpose of this analysis, then, is to evaluate the extent to which fiscal stimulus was temporary by showing the difference between actual (and projected) program spending and the amount these governments would have spent if they had grown expenditures according to the pre-recessionary trend. The pre-recessionary trend level of spending is estimated by taking the level of spending prior to stimulus and increasing it by the rate of population growth and the rate of inflation to maintain constant real per capita program spending.

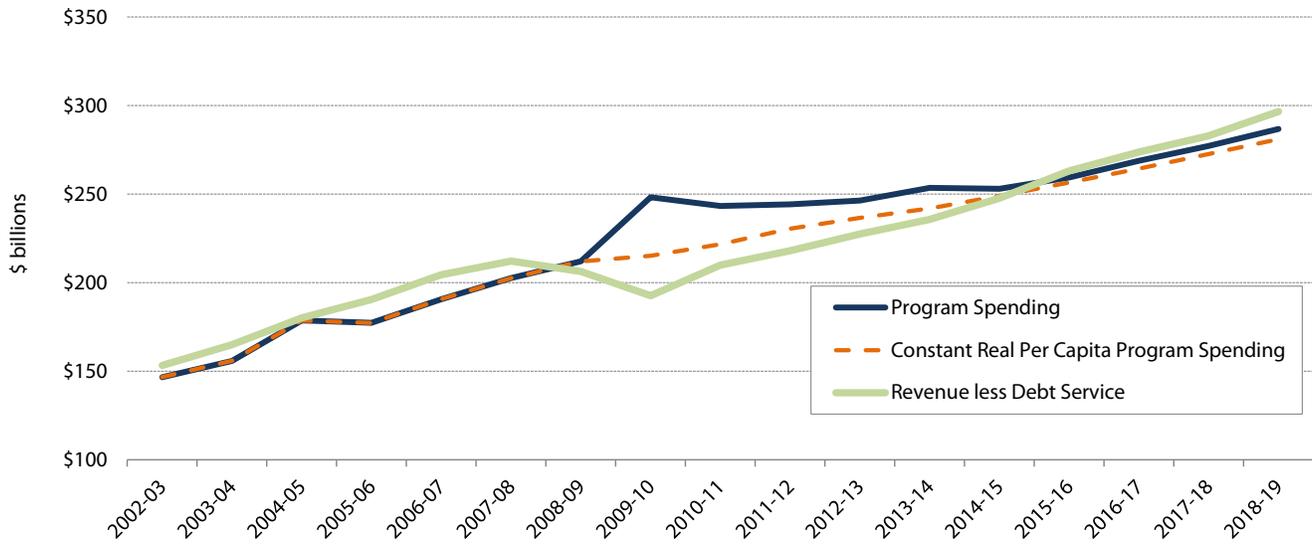
We show this pre-recessionary trend as a red line in the figures. Thus, our calculations for the amount of the deficit that could have been avoided are based on the amount by which the blue exceed the red lines in the post-stimulus period. The green line shows revenue less debt servicing costs to illustrate when these governments would return to budgetary balance.

This is important because if temporary spending increases become permanent, they will entail a higher debt and greater future tax burden and possibly affect the fiscal sustainability of government programs. It is important to note that total government spending also includes debt servicing costs, and debt service costs with larger deficits means more overall spending than when those deficits are smaller. For the Canadian governments examined here, these higher short-term deficits have led, and will continue to lead, to higher government spending over the long-term.

The federal government

The federal government launched its stimulus plan—politically branded as *Canada's Economic Action Plan*—in Budget 2009. The two-year plan

Figure 1: Federal—Program Spending vs. Constant Real per Capita Program Spending



Sources: Canada, Department of Finance (2013a); Canada, Department of Finance (2013b); Statistics Canada (2013a); Statistics Canada (2013b); Statistics Canada (2013c).

covering fiscal years 2009-10 and 2010-11² contained \$45.4 billion in new spending and tax relief initiatives.³

As a result of its plan, federal government program spending spiked in 2009-10, increasing by \$36.2 billion in year one and remaining elevated in year two. This 17.1 percent increase in program spending was supposed to be temporary and withdrawn at the end of the second year of the stimulus plan.

2 A small portion of federal stimulus spending on infrastructure projects (a total of \$1.3 billion) was expensed in 2011-12 (Canada, Department of Finance, 2012: 290).

3 Of the total federal stimulus, the government estimates that \$6.2 billion (14 percent) was delivered in the form of tax relief (Canada, Department of Finance, 2012: 290).

Indeed, the government’s 2009 budget was clear that the stimulus measures were focused in these two years in order to allow for an early return to balanced budgets. As it stated:

The Government has designed its Economic Action Plan to concentrate new spending in 2009-10 and 2010-11, when the economy is expected to be weak. Starting in 2011-12, the fiscal position of the Government is projected to improve rapidly, as the time-limited stimulus measures expire and the economy recovers. By 2013-14, the budget is projected to be in a small surplus (Canada, Department of Finance, 2009, 28).

However, the government deviated from this plan in subsequent years and has since pushed back its timeline for eliminating the deficit by two more years. The key to understanding the current deficit lies in spending trends following 2010-11.

Post-Stimulus Spending Trends in Canada

Constraining post-stimulus spending growth to align with population growth and increases in prices based on a 2008-09, pre-stimulus baseline would have been consistent with Keynes's prescription for fiscal stimulus and the government's communications in the 2009 budget.

Yet instead of withdrawing stimulus spending and adopting a low-growth expenditure trend, the government pursued a less ambitious course that has led to larger and more protracted budgetary deficits, and in turn higher public debt than it initially projected.

The government now estimates that it will have accumulated \$68.5 billion in deficits from 2011-12—the first post-stimulus year—to 2015-16—the year in which it currently expects to eliminate the deficit.

Had it lowered spending growth beginning in 2011-12, it would have been in a position to balance the budget a year earlier—in 2014-15—and would have accumulated \$29.2 billion in deficits during this period.

If the current plan holds, the government will have ran deficits longer and accumulated \$39.4 billion more in debt than it needed to because it did not return program spending to a pre-stimulus trend. The annual increase in debt service cost from these additional accumulated deficits is \$1.9 billion.⁴

Ontario

The Ontario government also launched a fiscal stimulus plan as part of its 2009 budget. It was designed to match temporary federal spending on infrastructure and subsidize student jobs

and support sectors affected by the economic downturn such as agriculture, mining, and forestry.

The two-year plan covering fiscal years 2009-10 and 2010-11 contained significant new spending and tax relief measures, including \$32.5 billion in infrastructure spending.

As a result of its plan, program spending spiked in 2009-10, increasing by \$11.5 billion in year one and by another \$4.9 billion in year two, or by 17.1 billion for the two years.

The government's stimulus-induced increases in program spending were supposed to be temporary and withdrawn from the government's spending trajectory allowing for a balanced budget by 2015-16.

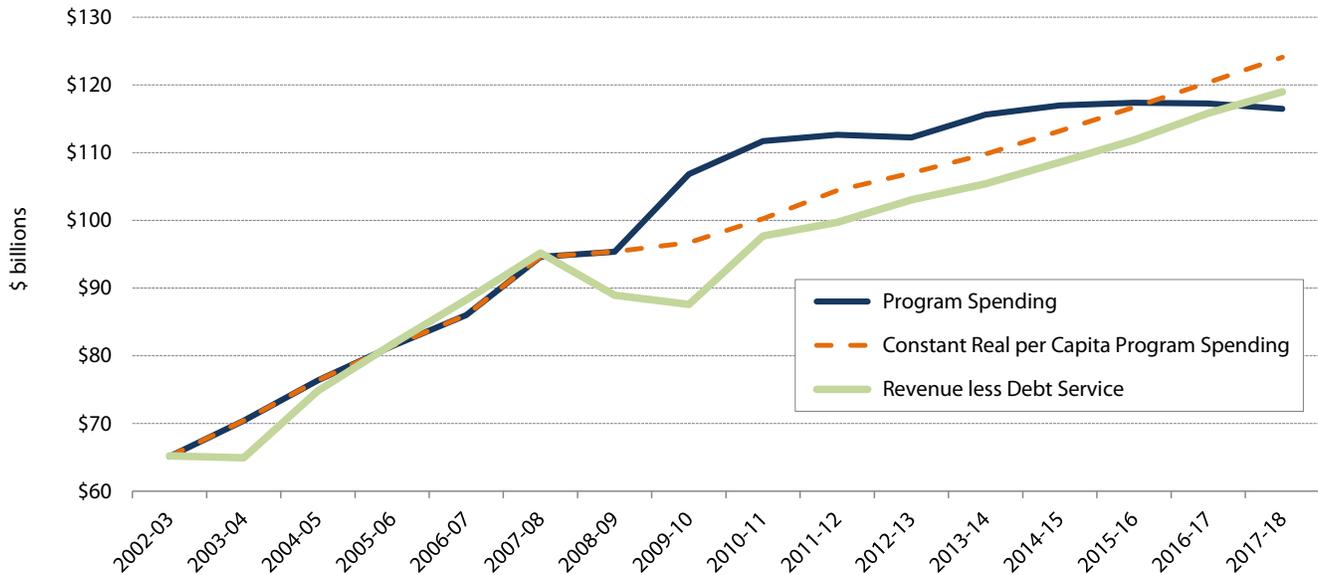
As the Ontario budget stated:

The government's plan consists largely of short-term strategic investments that will preserve and create jobs today, while preserving future fiscal flexibility... The short-term nature of a large majority of the government's new capital investments allows for a prudent, realistic plan to return to balance by 2015-16 (Ontario, Ministry of Finance, 2009: 7).

However, the government has revised downward its fiscal projections in the intervening years and is now planning to remain in deficit for two more years. Its latest economic and fiscal update showing lower-than-expected economic growth and a renewed focus on short-term spending, what the finance minister described in his speech to the legislature as a "new direction," suggests that even this delayed target may be at risk (Sousa, 2013). Budget 2014 will provide Ontarians with a better sense of whether the current timeline is credible or if the government will remain in deficit even

4 Based on 2012-13 public debt charges and accumulated deficit in the 2013 *Fiscal Reference Tables* (Canada, Department of Finance, 2013a).

Figure 2: Ontario—Program Spending vs. Constant Real per Capita Program Spending



Sources: Ontario, Ministry of Finance (2013); Canada, Department of Finance (2013a); TD Economics (2013); Statistics Canada (2013a); Statistics Canada (2013b); Statistics Canada (2013c).

longer, leading to higher debt levels for the province.

The source of these revisions to Ontario’s fiscal plan stem from its post-stimulus spending trajectory. The government has put off any significant spending reductions, which means Ontario will not return to trend until 2015-16, resulting in larger and more protracted budgetary deficits and greater public debt than it projected in 2009.

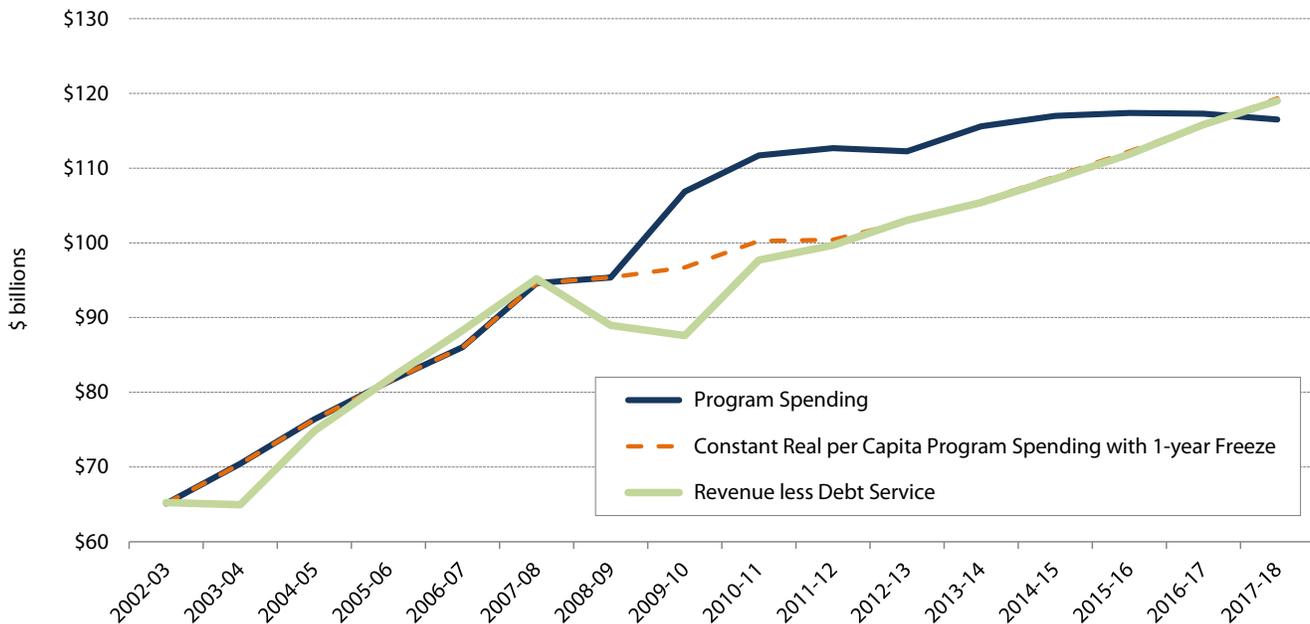
Current projections show that Ontario will have accumulated \$47.8 billion in deficits from 2011-12 (the first post-stimulus year) and 2017-18 (the year in which it currently projects to eliminate the deficit). Had it constrained program spending growth to population plus inflation, beginning in 2011-12 it would have run smaller annual deficits during this period and accumulated \$27.1 billion rather than \$47.8 billion in total deficits. This \$20.7 billion difference will add roughly \$850 million to Ontario’s annual debt service costs.

Alternatively, had it fully withdrawn its stimulus spending and frozen program spending for one year in 2011-12 and maintained spending growth equal to population plus inflation thereafter, its projected deficit for 2011-12 through 2016-17 would be only \$1.3 billion.

However, the government’s current plan to achieve budget balance is for a slight spending decline over 2015-16 through 2017-18. This would represent a significant departure from recent trends and the government’s overall record on program spending. To put this in perspective, the Ontario government grew program spending, on average, by 7.4 percent per year between 2002-03 and 2007-08 and 3.6 percent between 2008-09 and 2012-13.

Of course it would represent significant progress were the government to be able to hold spending growth to its projected levels for the next four years. Still, had the Ontario government better controlled spending following its

Figure 3: Ontario—Program Spending vs. 1-year Spending Freeze and Constant Real per Capita Program Spending



Sources: Ontario, Ministry of Finance (2013); Canada, Department of Finance (2013a); TD Economics (2013); Statistics Canada (2013a); Statistics Canada (2013b); Statistics Canada (2013c).

stimulus plan, the province would have avoided tens of billions of dollars in deficits.

Alberta

The Alberta government also engaged in stimulus spending in response to the global recession. Its 2009 budget relaxed the province's balanced budget legislation in order to permit deficit spending and outlined \$23.2 billion in infrastructure spending (over three years) along with other measures to stimulate economic activity.

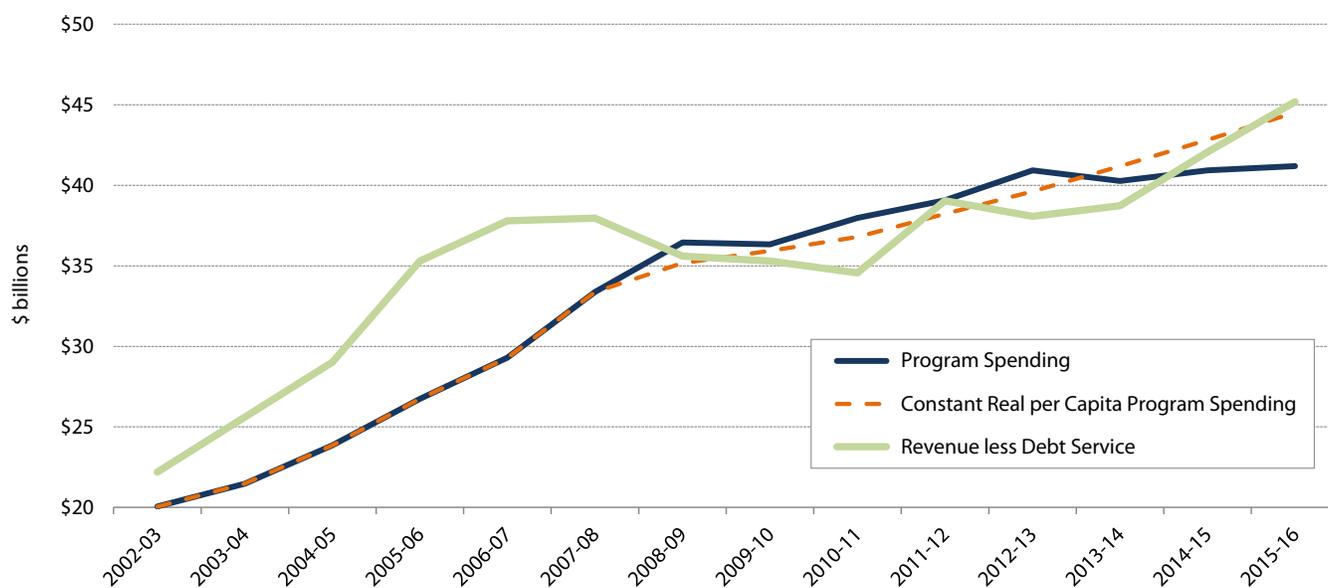
Our analysis for Alberta differs from that for the other provinces because it had been recording multi-billion dollar surpluses and had more than \$30 billion in net financial assets in the years prior to the economic downturn.

In other words, Alberta entered the recession with no net provincial debt.

Because Alberta's revenue dropped from an average growth of nearly 12 percent a year to close to zero, we take our trend line from 2007-08 rather than 2008-09. We also highlight the accelerated asset drawdown that started with the stimulus plan. Although the other jurisdictions covered in this analysis increased capital spending, their non-deficit debt accumulations were largely unchanged before and during the stimulus period. Alberta, by contrast, saw its debt excluding deficits grow significantly in the stimulus years.

The government's original plan was to run budgetary deficits for four years before returning to balance in 2012-13. Changes to its balanced budget legislation authorized the government

Figure 4: Alberta—Program Spending vs. Constant Real per Capita Program Spending



Sources: Alberta, Treasury Board and Finance (2013a); Alberta, Treasury Board and Finance (2013b); Canada, Department of Finance (2013a); TD Economics (2014); Statistics Canada (2013a); Statistics Canada (2013b); Statistics Canada (2013c).

to offset these deficits from its net financial assets held in the Alberta Sustainability Fund.

As the budget document explained:

Alberta's forecast 2008-09 financial results, as reported in the 2008-09 *Third Quarter Fiscal Update* and presented in *Budget 2009* documents, reflect a \$1.4 billion deficit. This is the first deficit in 15 years.

Budget 2009 also projects a deficit for 2009-10, of \$4.7 billion, and deficits for the following two years. By 2012-13 a return to surpluses is forecast. The deficits will be offset by transfers from the expanded Alberta Sustainability Fund, as permitted under the new Fiscal Responsibility Act. The new Act changes the fiscal framework for 2009-10 and future years. (Alberta, Ministry of Finance, 2009: 10).

Alberta's Keynes-inspired stimulus plan was not so much an increase in program spending as it was a lack of program spending reduction in response to a significant decline in revenue. Its program spending contracted by 0.4 percent in 2009-10, but this was not enough to bring it down to trend or to match its revenue decline. Spending growth then resumed to 4.5 percent in 2010-11 and has remained above 4 percent, on average, up to the current year. This has contributed to a delay in the government's plan to eliminate the deficit.

Current projections anticipate that Alberta will have accumulated \$4.4 billion in deficits between 2011-12 and 2014-15 when it now expects to record a small budgetary surplus.

Had the Alberta government taken more aggressive steps beginning in 2011-12, including bringing its program spending to a pre-stimu-

lus trend, it would have run smaller deficits and accumulated \$1.2 billion less in deficits during this period.

In addition to this deficit spending, projections show Alberta adding \$7 billion in debt and continuing to reduce its net financial assets. Changes in net assets show Alberta spent roughly \$600 million per year between 2002-03 and 2006-07 outside of program spending and interest costs. When its large surpluses ceased, this spending not only continued, but increased—to \$3.5 billion in 2007-08 and \$2.6 billion per year for the three years of capital spending in the stimulus plan.

While the government has identified volatile revenue growth as the primary driver of its ongoing deficits, the real problem in Alberta is high program spending. If the Alberta government had exercised greater spending restraint following its stimulus plan, it would have run smaller deficits and would not have drawn down its financial assets as much as it has.

British Columbia

British Columbia's government introduced stimulus spending in its 2009 budget. In particular, its stimulus plan included \$2 billion in new capital spending (over three years) to match federal spending on infrastructure, increases for post-secondary and training, and new programs for communities affected by the economic downturn.

As a result of declining revenues and its increase in program spending, the government anticipated deficits in 2009-10 and 2010-11 and projected a return to a balanced budget in 2011-12.

As the province's then-finance minister said in his budget speech:

... the budget includes a temporary deficit. Weighed against the risks to our economy, our communities and our future—it is, quite simply, the right thing to do. I want to be clear that this is not the same kind of deficit we saw seven years ago—the kind that persists, year over year, even in times of strong economic growth. What we will have for the next two years is a short-term deficit, one that results from a downturn in projected revenues (Hansen, 2009).

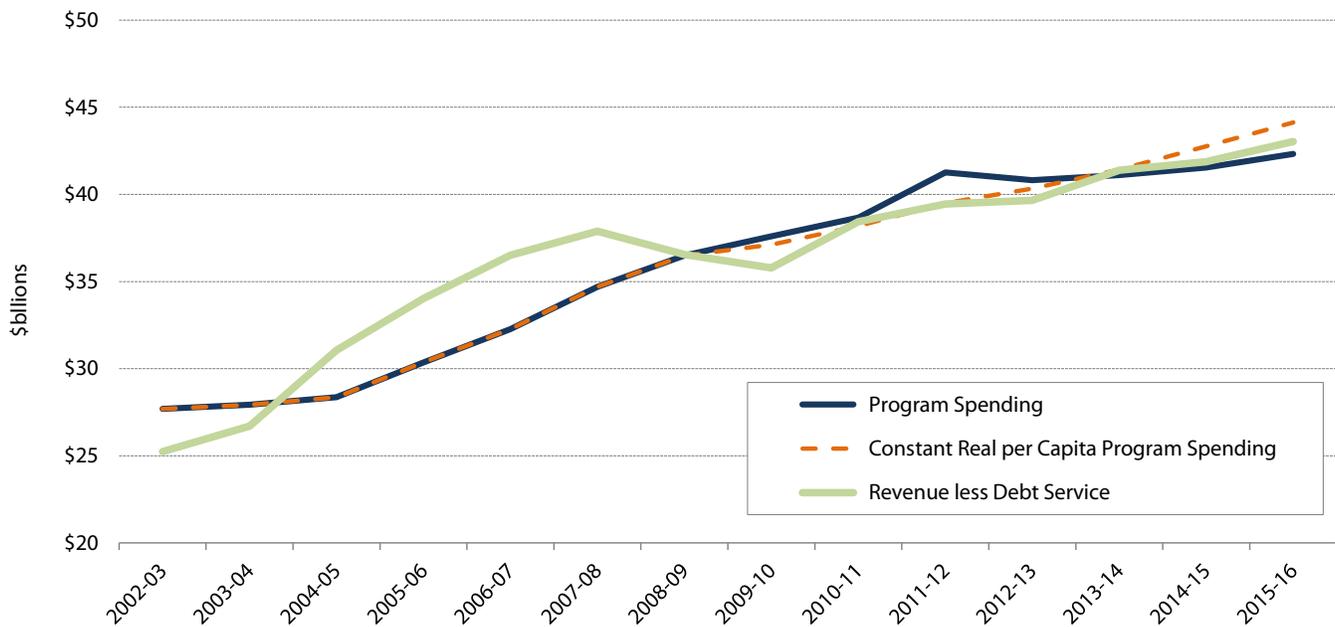
The government's 2009 plan to eliminate the deficit in two years has not come to fruition. In fact, it has since delayed the return to a balanced budget by two years to 2013-14. Budget 2014 will give British Columbians an opportunity to see whether the government delivers on this new target or if deficit spending will be prolonged further.

This two-year delay can be mostly attributed to a large spending increase after a single year of strong revenue growth in 2010-11. In fact, program spending grew by 6.7 percent in 2011-12—the year in which the government initially planned to return to balance. The government's current plan has spending growing slower than population plus inflation, but it will not return to trend until 2013-14.

Current projections anticipate that BC will have accumulated \$3 billion in deficits between 2011-12 and 2013-14 when it expects to record a small budgetary surplus.

Had the BC government taken more aggressive steps beginning in 2011-12—by returning spending to a pre-stimulus baseline trend—it would have run smaller deficits and accumulated \$2.3 billion less in deficits during this period. This \$2.3 billion difference adds roughly \$140 million to BC's annual debt service costs.

Figure 5: BC—Program Spending vs. Constant Real per Capita Program Spending



Sources: British Columbia, Ministry of Finance (2013); Canada, Department of Finance (2013a); Statistics Canada (2013a); Statistics Canada (2013b); Statistics Canada (2013c).

BC’s current plan now envisions a greater degree of spending restraint going forward. Projections for 2013-14 to 2015-16 anticipate that program spending will grow below that for population plus inflation. The province’s average annual spending growth for these three years is projected to be 1.2 percent. This would represent a departure from recent trends and the government’s overall record on program spending. To put this in perspective, the BC government grew program spending, on average, by 4.0 percent per year between 2002-03 and 2007-08 and 3.3 percent between 2008-09 and 2012-13.

Conclusion

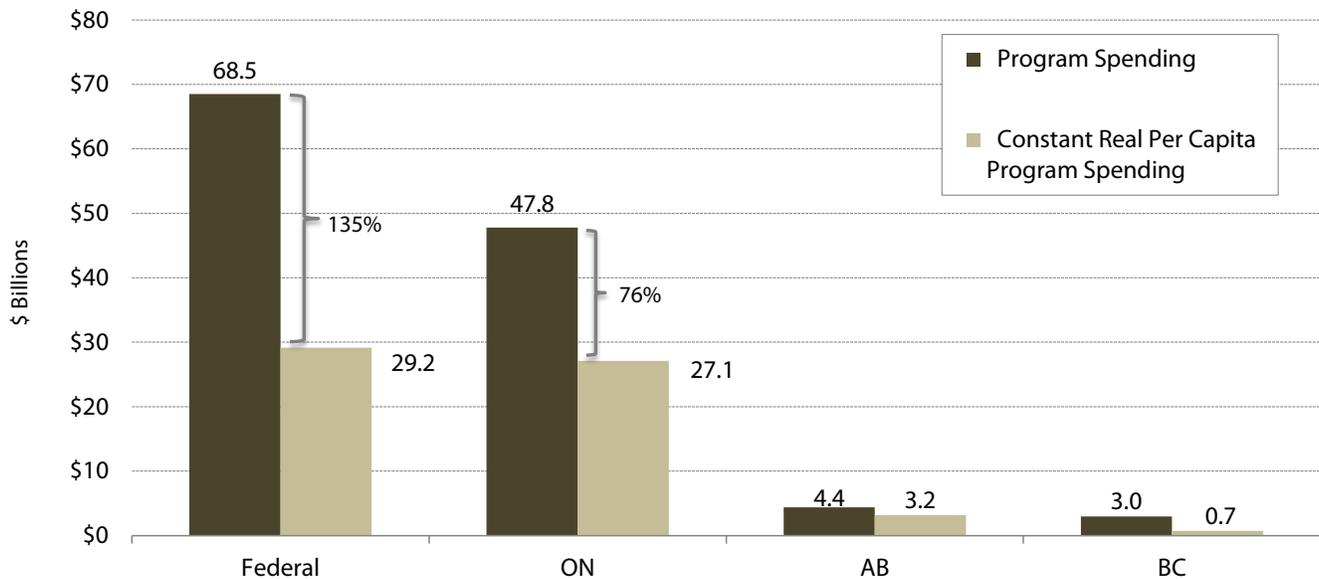
Canadian governments adopted fiscal stimulus plans in response to the global economic recession as part of their 2009 budgets.

Inspired by Keynes’s theory of deficit-financed fiscal stimulus, governments were prepared to run short-term budgetary deficits and incur debt increases in order to fund infrastructure programs and other initiatives to encourage investment and job creation.

But the governments were also clear that they intended to withdraw the temporary stimulus spending after two to three years, and to eliminate their deficits over the short- and medium-term.

This analysis has examined the experiences of four Canadian governments—the federal government, Ontario, Alberta, and British Columbia—in order to measure their post-stimulus spending patterns and their records on withdrawing stimulus spending and eliminating their budgetary deficits.

Figure 6: Deficits—Program Spending vs. Constant Real per Capita Program Spending



Sources: Figures 1 to 5.

These governments did not withdraw their stimulus spending as quickly as promised and instead maintained program spending at elevated levels. This decision has contributed to ongoing budgetary deficits and more public debt (or, in Alberta’s case, lower financial assets). All four governments have delayed their initial projections for eliminating their budgetary deficits by at least two years.

Figure 6 shows the projected deficits from 2011-12—the first post-stimulus year—to the final year in which these governments are currently projecting that they will record budgetary deficits. The figure also shows what the deficits would have been if these governments had withdrawn their stimulus spending and returned to pre-stimulus trends. As illustrated, the consequence is that these governments have run larger deficits and accumulated more debt in the years following the scheduled expiration of their stimulus plans than they and tax-

payers had been led to believe they would. The result is \$63.5 billion in higher cumulative deficits that could have been avoided if these four governments had taken action to return spending to regular, pre-stimulus levels.

These avoidable accumulated deficits will contribute to higher debt servicing costs and therefore higher overall government spending in future. We estimate that these deficits will lead to \$2.9 billion in additional annual debt servicing costs distributed among the four governments. This represents the yearly financial cost of their failure to end temporary stimulus spending and return to pre-stimulus trends.

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