

Myth-Busting Government Debt: How deficits and spending foster growth



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In the face of the coronavirus pandemic, governments the world over are investing unprecedented amounts of money in protecting public health and preventing total economic collapse. There is a consensus that this spending is the right response to the pandemic. At the same time, this amount of spending raises many questions from people across the country: Can we afford this? How will we pay it back? When will we have to stop?

In order to address some of these questions, we've put together this handy myth-busting guide to help answer your questions and demystify conversations around government debt, deficit and program spending. It's certainly complicated, but not as complicated as you think!



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Canada is spending way too much on public programs right now. It's just not sustainable, am I right?



Now is exactly the right time for government to be spending extraordinary amounts of money. Canada, and the rest of the world, are currently in the most severe economic downturn since the Great Depression of the 1930s. How did countries recover after that depression? The US government spent enormous amounts on programs, services and infrastructure, implementing The New Deal, to boost employment and economic growth. This crisis also requires an extraordinary response from governments.

The fact is, federal spending has helped keep many workers working and income flowing for those who are jobless. As a result, there has been a smaller drop in GDP (a measure of economic activity) than would have otherwise been the case.

The good news is that Canada entered the crisis with the strongest balance sheet in the G7. Prior to the forced economic shutdown, Canada's debt-to-GDP ratio was just over 30% - the lowest of all G7 nations ^[1]. Even with the deficit topping \$300 billion this year ^[2], Canada's debt-to-GDP ratio will still be much lower than it was in the 1990s when the federal government unnecessarily took a sledgehammer to program spending, leaving millions in dire straights. Slashing budgets is the wrong way to kick-start a recovery.

The size of Canada's debt in comparison to the economy is still far lower than in previous eras of prosperity – including during the rebuilding phase after the Second World War. Let's put debt into proper context instead of losing sleep over big numbers.

Instead of cutting our way to further decline, we need a forward-thinking government that will invest in the future and put us on a path toward a prosperous future for all.



Listen. Governments are like households, OK? Just like mine. We all have to live within our means. We can't just go around buying things we can't afford.



This is a popular viewpoint that has been floating for decades. You should be aware that it is a red herring – an argument designed to be misleading or distracting. Government finances differ from household budgets in many important ways.

For starters, and unlike households, governments can raise money through various instruments, including by raising taxes. The ability to raise revenue is one of the

reasons credit rating agencies give Canada such a high rating – our taxes are low and there is room to grow them without hurting the economy.

It would be wonderful if individuals could, at the snap of a finger, secure better jobs with higher wages and other benefits to increase their income, but sadly we can't - we still need unions to help with that!

Additionally, governments can borrow money in perpetuity – and can renew the debt they take on over and over again. Individuals and households are constrained by their life expectancy; governments are not. Instead, they usually live far longer than any human, which means they can take far longer to pay back their debt.

Government spending will spur economic growth and that growth will minimize the effect of government debt on finances. Certainly there will be a substantial increase in the debt-to-GDP ratio, but over time the size will moderate. The thing about growing our way out of debt is not that the government pays the debt off quickly, but that the economy has gotten so much bigger that the size of the debt is no longer worrisome.

The question is not whether Canada is spending beyond its means (it's not, by the way). The question is what is government spending for?

Right now, government is spending and investing to grow the programs and services that support life and economic activity across the country – things like roads and bridges for sure, but also child care, health care and public transit. These are all important pieces of infrastructure people rely on in order to lead healthy lives and to be able to participate to the fullest in the economy.



Are you kidding!? The Parliamentary Budget Office published a report saying Canada's debt might hit \$1 trillion by the end of the year! That's so big it's almost... well... I don't know, but it's a lot of money!



There is no question \$1 trillion is a lot of money. But, instead of the doomsday scenarios, we need to start thinking about why the debt has grown so quickly and what these new funds are accomplishing.

Without the Canada Emergency Response Benefit (CERB) and the Canada Emergency Wage Subsidy (CEWS), for instance, Canada's workers would have been forced to take on massive debt and face financial ruin – we would be seeing individual and business bankruptcies on a mass scale.

The cost of those two critical stabilization programs alone is expected to top \$160 billion. That represents

nearly one half of the total revenue the federal government generated in fiscal year 2019. Even with all this spending, many individuals and families are barely staying afloat. Increased debt is an inevitable outcome of the response to this pandemic. Without the CERB and the CEWS, individuals, faced with a devastated economy and few job prospects, would be borrowing money at extraordinarily high levels.

The fundamental question is who is best positioned to take on this debt - governments or people?

Government debt is the most secure and the cheapest form of debt in the Canadian economy ^[3]. With federal interest rates sitting at all time lows and many workers sitting idle, government can safely put people back to work and build the infrastructure we need for the future at virtually no additional cost.



Look, someone is going to have to pay for all this. And guess what? It's going to be my kids, and their kids, and their kids' kids, and their kids' kids' ki... you get the picture. That's not fair to them!



In truth, what's less fair to them is leaving future generations with a legacy of structural inequality, an unlivable planet and the severe consequences of a long, drawn out (and entirely avoidable) depression that would be taking hold right now if it weren't for all of this government debt.

In the medium term, we should be talking about investing in the recovery and paying for the new and current programs and infrastructure in the future - not questioning whether or not it is affordable, it is the only option.

If we want to talk about what is fair, we should talk about eliminating tax loopholes and access to offshore tax havens that corporations and wealthy individuals exploit. When we talk about fairness for our children, we should talk about addressing staggering inequality and creating better access to good, family-supporting jobs. We should consider raising taxes and redistributing income from the rich to the rest of us so that we can all live a more balanced life.

By the way, have you even talked to your kids or your grandkids about this lately? I bet they are on board with spending more now to secure a more prosperous, fair and environmentally sustainable society for the future. Thinking only about debt leaves out many, far more important, pieces of the puzzle.



You probably haven't heard, but Fitch Ratings just downgraded Canada's credit rating to AA+. It used to be AAA! We're going down the wrong track. I'm not an economist, but I know three "As" are much better than two.



It's true that Fitch downgraded Canada's credit rating slightly. The move was the equivalent of receiving an A+ grade on a test, just not scoring 100%.

Fitch's own website defines an AA rating as denoting expectations of very low default risk. They indicate very strong capacity for payment of financial commitments ^[4]. This change has not affected Canada's ability to lock in long-term debt at very low interest rates, so no one should be worried



At the same time, S&P and Moody's – two other global credit rating agencies – have recently reaffirmed the Federal government rating at the highest possible level ^[5]. All three agencies point to Canada's diversified economy and ability to raise revenue as important levers in keeping these credit ratings at such a high level. Even with the increased debt, Canada continues to receive the first and second highest possible ratings across ratings agencies.

No reasonable person should be raising any concern about this.



Well, Stephen Harper says that after this pandemic Canada's finances will be "an unholy mess." He helped steer Canada through the last financial crisis, and has the experience. I believe him. The only option is for government to cut spending. It's the responsible thing to do.



In times of severe economic recession, spending cuts and austerity are a self-defeating policy. We know this because we have already lived through it.

In fact, after the 2008-09 financial crisis, economic institutions, including the International Monetary Fund ^[6], found that government stimulus spending was a leading driver in returning our economy back to health. Yet, still some notable voices in Canada, including Mr. Harper, are advocating for budget cuts and belt-tightening as if oblivious to the lessons of the past.

We don't have to listen to the people who created the conditions for this crisis to be worse than it was. Instead of continuing down the path of inequality and greed, we can change course and invest in Canada's future.



Governments can't just print money, you know that right?! That's not how the economy works!



On the contrary, governments like Canada that have their own currency can and do, print money every day! Since moving off the gold standard (a policy that tied the amount of Canadian dollars in circulation to our gold reserves), Canada has had the ability to print money.

The Bank of Canada, which manages Canada's money supply, does not print money willy-nilly. The Bank is required to maintain inflation at 2% (which is a somewhat arbitrary target). It does this by controlling the supply of money flowing through the economy. In essence, Canada is not bound to have only a specific amount of money circulating but only as much as is needed to manage inflation.

Under our current monetary system, economists have learned that when the economy is not operating at full capacity (which is certainly the case during the pandemic) creating more Canadian dollars through government spending and borrowing will NOT lead to runaway inflation. On the contrary, it will lead to a stronger economic recovery^[7].

This does not mean there are no constraints on printing money, only that the constraints are different than previously thought and the more nuanced constraints give more space for fiscal stimulus in times of economic collapse or under-utilization.



All I know is that we can't rebuild Canada's economy with too much government interference. Government is always interfering in things. So many regulations, and taxes... they should just leave economic matters to the private sector. You know, the experts!



We do not know how long the effects of COVID-19 will reverberate through our economy, affecting people's lives and families. The only proven way to prevent further economic decline is for governments to play an active role. When business and consumer spending dries up, government is the only institution left to safely invest in Canada's industries and infrastructure and put people back to work.

What we've seen from the private sector over the last 10 years is a tendency to take advantage of the



low interest rate, low corporate tax environment to invest in share buybacks and hostile takeovers – neither one of those being a job-creating activity. Nor do those activities protect the environment, deal with climate change or move us toward a more just and equitable future.



What I can't stand are all those cheaters milking the system. Always taking money from us taxpayers, and never giving anything back. Why do I have to pay for that?!



No one likes a cheater, that's for sure. And what the research shows us is that the biggest tax cheaters, far and away, live among the rich.

In fact, each year, governments in Canada lose up to \$8 billion in revenue because wealthy individuals and businesses are able to hide their income in offshore tax havens instead of paying their fair share of taxes. That's money that could go towards paying for education and health care, child care and better skills training programs. Instead, government just lets it sit there and does nothing.

According to federal officials, false claimants make up just 0.6% of overall CERB claimants (or approximately \$450 million) – a group disproportionately comprised of low-income, laid-off workers – people who have been working hard and can still barely afford to make ends meet.

We're all for going after cheaters – let's make sure we're going after the ones that will make the biggest difference to Canada's finances and develop a system that ensures people can pay their bills and live a life of dignity.



Whatever you say, one thing is clear: governments must be smaller once we get this pandemic under control. That's the only way! Big government ruins everything.



Government plays an important role in our economy and in our society. Government is actually an incredibly important contributor to Gross Domestic Production, GDP, which is our primary measure of economic activity.

GDP is made up of spending by business, consumers, governments and our international trade activity. If any one of these four numbers contracts (and they inevitably will during a crisis), GDP could contract, driving our economy into recession. Spending by government is one way to shore up GDP, and fuel economic activity, when spending by businesses and consumers wanes – it's simple math.

Furthermore, many government-supported programs actually create well-being for Canada's people. Our medicare system, for instance, funded by public money is designed to ensure adequate health care for everyone, regardless of income. A universal child care system would create more gender equity and is an important economic stabilizer for families during times of crisis – its also proven to more than pay for itself in returns down the road as mothers are able to participate more in the labour force if they chose.

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