Escaping Austerity: Embracing the Shift to a Caring and Green Future

By Brigitte Kitchen and David Thornley September 6, 2021

The Weathervane of Government Spending Policy

To build a better world for all in the post-pandemic era, we have to understand that the world around us is largely shaped by the federal government's tax and spending policies.

In the past these policies have been full of competing, often contradictory ideas that gained or lost favour depending on the weathervane political climate of their time. Where to focus spending and how much to spend has always been a challenging task.

Looking back at the post-war years, **Susan George** observes "…the idea that the market should be allowed to make major social and political decisions…that the State should voluntarily reduce its role in the economy…and citizens given much less rather than more social protection – such ideas were utterly foreign to the spirit of the time." There was both a greater sense of solidarity, and a recognition that significant government investments were essential, after the sacrifices of war, to give Canadians a fair chance to succeed. Special attention was given to the re-integration of returning veterans, starting with training, education and decent affordable housing.

By the early 1990s, these ideas had become foreign as Canada was deemed to have descended into a fiscal death spiral with a federal debt-to GDP ratio close to 80%. Such debt was seen as unsustainable during the transition to a global economy based on free trade agreements that shifted power from governments to multi-national corporations and contributed to the deindustrialization of many Canadian cities and towns. In the context of a global capitalist economy Canada's fiscal health had raised serious concerns. When the Wall Street Journal disdainfully dismissed Canada as an honorary member of the Third World, the reductions in social benefits and deep cuts to government programs seemed unavoidable and cheered on by the corporate sector.

Finance Minister Paul Martin, introducing his brutal 1995 federal austerity budget, assured the country, that he was opening 'a new road of fundamental reform, of renewal – of hope" To pull the economy back from financial disaster he chose to drastically slash government spending. He insisted that previous governments had been spending beyond their means and engaged in excessive borrowing at high interest rates, causing both higher inflation and unacceptable levels of unemployment. Later research documented that reduced taxation levels for businesses coupled with the high interest rates of borrowing from private banks explained between 90% and 95% of deficit growth between 1980 and 1995.

The new approach of austerity policies proved to be both popular and remarkably successful. Within six years, Canada was alone among the G-20 to record budgetary surpluses which resulted in having its former AAA credit rating restored.

On the human side, the impact of Martin's road back to balanced budgets had devastating consequences. Literally hundreds of thousands of Canadians were made poorer. They either lost their job or found themselves locked into precarious, part-time jobs without benefits and only limited chances for advancement. The primacy of business profits overrode the needs of ordinary people for a decent standard of living. The massive retreat from the redistributive goals of government income support programs and services had a profoundly negative effect, making Canada an increasingly inequitable society. Governments of all political stripes closely adhered to the neo-liberal orthodoxy of fiscal austerity measures for almost two decades.

The Winds of Change

The twin shocks of the 2008 financial crisis and the 2020 Covid pandemic have led many to seriously question the foundations of current fiscal and monetary policy. The 2008 financial crisis and shifts in public opinion led the Harper government to introduce an approximately $30 billion economic stimulus package to be repaid within five years.

Change came with the election of the first Justin Trudeau Government. Its economic stimulus funding in its first budget in the Spring of 2016 was to be financed by budgetary deficits over the next four fiscal years. This was not seen as a problem by voters but widely interpreted as marking the end of austerity politics.

Surprisingly, Paul Martin supported the return to budgetary deficits. He considered them justified as long as they paid for long-term investments, such as in infrastructure, but not for income support programs, covering immediate consumption needs, as if their beneficiaries did not re-spend the monies received and thus contribute to economic growth.

What happened to overcome the fear that budgetary deficits would bring about a return of the fiscal abyss of earlier years? Around 2018, a new way of economic thinking, Modern Monetary Theory (MMT) began its push from the fringe towards the mainstream. It took, first of all, issue with the popular but mistaken notion of equating governments with individual households, which MMT proponents dismissed as the 'household fallacy.' The crucial difference between the two entities is that government unlike households have the power to issue and designate their own money and under-write and guarantee its value in their currency, i.e., the Canadian dollar. Secondly, governments cannot go broke since there is no upper limit to their ability to print money. Households, on the other hand, are not issuers and guarantors but users of currency and cannot create money. If they do, it is called counterfeiting, and the perpetrators go to jail.

Also, behavioural outcomes of individual households have quite different effects from the actions of government. Financially challenged households are often advised to trim their expenses and live more parsimoniously. If they do, they only cut back on their own living standards. Government spending cuts, on the other hand, reverberate through the whole economy. Employment opportunities may vanish, wages stagnate or fall and needs for public services go unmet or their quality and safety put at risk. A third, less radical aspect of MMT is that governments can easily afford new and increased social spending without raising or introducing new taxes by rolling over their accumulated debts by issuing new bonds. The austerity agenda, supported by fiscal hawks in business and politics, aided by a compliant media, successfully suppressed discussion of such budgetary possibilities for years, dismissing them as fiscal profligacy.

Most recently, the average citizen saw only too clearly that hundreds of billions in funding could be found to provide liquidity to the financial system and underwrite loans and investors. The claims that there isn't enough money to fund health care, to ensure everyone has food to eat and a safe and secure home, and to invest in community infrastructure was exposed as a political choice and one that puts corporate and financial interests ahead of the needs of the population and the health of the planet.

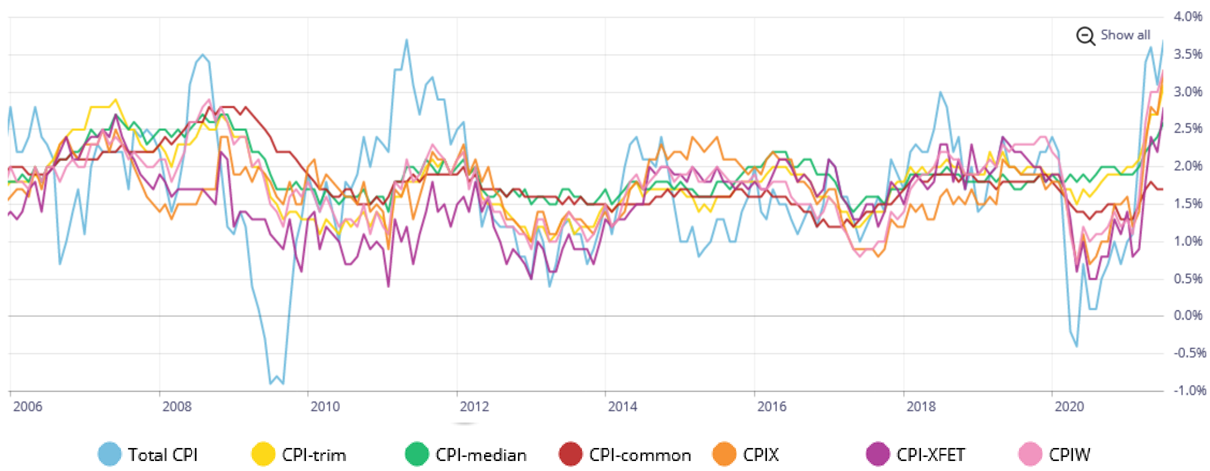
Debt That Makes Sense: Funding a Caring and Green Economy

It took the Covid-19 pandemic and its ravages on all aspects of private and social lives to open up the faucets of unprecedented government spending. The federal government spent hundreds of billion of dollars on income support programs and wage subsidies for businesses as well as emergency benefits for unemployed and underpaid workers. These measures were criticized by some as overly generous and by others, as too little. The World Bank and International Monetary Fund, however, approved, favouring spending on fighting the pandemic and to protect individual living standards and keeping business operations going.

The accumulated federal debt is by now substantial. It has been estimated to reach $1trillion for the fiscal year 2020-2021, according to the last federal budget and is expected to climb even higher in future years. This prospect led one fierce opponent of federal debts and deficits to declare that the Bank of Canada was turning into an ATM for reckless federal spending. The Canadian Taxpayers Federation also denounced debts and deficits, warning of imminent ruin and bankruptcy. This amounts to fear-mongering and lacks any credible evidence.

As MMT points out, deficits can be managed successfully within a fiscal and monetary policy framework that focuses on maintaining low interest rates. , The IMF, the US Federal Reserve and the European Central Bank are now all targeting their monetary policies on anchoring inflation at 2% over the medium and long-term. Although inflation appears to be spiking slightly as we enter the COVID recovery phase, a longer term view reveals a very different picture. With the exception of the two upheavals, the 2008 to 2010 financial crisis and the current economic downturn caused by COVID, the trend line of inflation has rarely been outside the range of 1% to 2.5% as this fifteen year graph below from the Bank of Canada demonstrates.

Changes In Living Costs: 2006 to 2021



> "This is instructive, as the World Bank, the IMF, the US Federal Reserve and the European Central Bank are all targeting their monetary policies on anchoring inflation at 2% over the medium and long-term."

Since 1990, we watched governments continue to shrink their fiscal capacity. More of the same would be a recipe for disaster. The challenges facing us over the next decade include boldly rebuilding our badly neglected public infrastructure and to move forward without hesitation towards shaping the economy of the Commons.

Moving forward, it is therefore essential that governments are able to borrow money under similar terms and conditions to those afforded to Canada's private banks. They can increase the money supply independent of government. They can also secure access to credit through the Bank of Canada at interest rates that are well below the prevailing rate of inflation. This change would ensure both ready access to essential infrastructure investments and that the size of the deficit will shrink over time with the proportionate growth in GDP.

So far, the doomsday prognosis of fiscal hawks has found little resonance among the Canadian public. The focus has remained on overcoming the pandemic and repairing the damages it has left behind. Whether the debt and deficit will matter in future depends very much on both the expected economic growth and the methods of debt financing. Monies wisely invested can lay a new, equitable foundation for a socially, ecologically sustainable future.

The crucial lesson learnt from the pandemic and the incisive paradigm shift in reshaping fiscal policies offered by MMT is the re-newed recognition of the foundational role of government as guarantors of decent living standards and working conditions as well as supporting activities that foster community building and entrepreneurial initiatives. A new and better world cannot happen without government and its willingness to re-align with and enable communities, businesses and all of civil society to aim higher and manage the transition to both a secure and sustainable future for all of us.