

Canadian government debt and deficit spending: Towards an efficient and equitable economic recovery to the COVID-19 pandemic

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ABSTRACT Since its identification in December of 2019, every nation on this planet has faced a once-in-a-century battle against the coronavirus disease, COVID-19. As countries grappled with their own responses to the pandemic, the Canadian government spent an unprecedented amount of money to provide support to businesses that were forced to close due to lockdowns, as well as citizens who lost their jobs. 2020 saw the largest global economic downturn since the Great Depression because of these emergency measures and similar ones enacted in other countries. Government debt and deficit spending in the Canadian context is increasingly becoming a contentious political issue which warrants an extensive review of literature and past policies to map a path forward. This paper will examine austerity and Keynesianism, two political-economic policy strategies, to address the growing government debt resulting from COVID-19. Given the failures of austerity policies in alleviating economic downturns in recent crises, this paper will argue that the best strategy to address post-COVID government debt is to enact Keynesian stimulatory fiscal policy to produce economic growth. Such a strategy would provide the best economic outcome and avoid the pitfalls of austerity, which often reduces the well-being of society by cutting social programs and promoting class and gendered inequality. The pandemic has exposed shortcomings in the current economic and welfare systems reinforced by neoliberal austerity. These shortcomings have not only been exacerbated by the pandemic, but also risk hindering a more efficient and equitable recovery. This review is aimed at stimulating more research into modern applications of Keynesian fiscal policy to produce better responses to economic crises now and in the future.

INTRODUCTION

The COVID-19 pandemic has been a disruptive force, interrupting the flows of daily life and normalcy. As a dueling public health crisis and economic crisis, the pandemic has exposed many cracks in society's structures, perpetuated by decades of neoliberal capitalism. As economies suffer grave downturns and mounting debt, the actions governments take to address these issues are crucial for the prosperity of the near future and to ensure a more equal society. The most common fiscal strategy to address economic crises in recent years has been policies of austerity, or short periods of economic stimulus followed by austerity policies. Both austerity and Keynesianism promote the idea that governments should run deficits in times of crisis—such as a recession—and run surpluses when the economy is thriving (Alesina et al., 2020; Quiggin, 2012; Russell, 2017). The issue in contention between the two approaches is how governments should fuel a sustainable economic recovery. Austerity policies generally aim to reduce deficit spending and decrease government debt by cutting spending, increasing taxes, or a mixture of both (Alesina et al., 2020). Proponents of austerity posit that its policies can be expansionary, encouraging economic growth by lowering consumer expectations of tax increases in the future and inspiring investment in the economy (Alesina, 2012). On the other hand, Keynesianism endorses considerable government spending through targeted welfare policies and programs to promote increased activity in the economy. (Quiggin, 2012; Russell, 2017). Keynesians also argue for increased control over the financial sector, as well as government intervention in the economy to ensure that economic growth can be sustained (Quiggin, 2012; Russell, 2017).

This paper will provide a historical analysis of both austerity and Keynesian stimulatory fiscal policy, examining the global economic outcomes of such policy applications in the past. It will then shift its focus to the Canadian context to explain how implementing austerity while the country is still in an economic downturn can produce negative consequences, and argue that Canada is in a fiscally stable position to handle the current level of debt and deficit

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spending. Finally, this paper will explain how austerity can have broader repercussions for society, potentially reinforcing or creating class and gendered inequities as well as damaging Canada's potential for a strong economic recovery. It will do so by highlighting examples of the consequences of harsh austerity measures implemented in other countries in the wake of the 2008 Financial Crisis. In sum, Keynesian stimulatory fiscal policy is ultimately the superior policy option to provide an efficient and equitable economic recovery. Such a recovery is essential to the rebounding of the Canadian economy, and with it, sufficient economic growth to reduce the government debt accumulated during this historic crisis.

A HISTORICAL ANALYSIS OF AUSTERITY

Proponents of austerity see government debt as a problem and seek to reduce it through policies that either cut public spending or raise taxes, or both (Quiggin, 2012). These policies are based on the 'Treasury view' of the Great Depression era, which posits that excessive public spending crowds out private investment or private consumption by increasing interest rates, and therefore state budgets should always be balanced (Quiggin, 2012).

Historically, the 'Treasury view' of austerity was utilized to address the Great Depression in most countries during the 1920s and 1930s. Governments of some of the largest economies at the time—the United States, the United Kingdom, and Japan—all enacted cuts to spending in an attempt to stimulate their economies. The results: unemployment soared, debt increased, the growth rate fell, and interest rates increased in these countries (Blyth, 2013a). These effects illustrate how, despite the implementation of austerity to stimulate growth by some of the most immense economic powers, economic woes on the contrary were only exacerbated. Due to these failures, austerity was replaced by Keynesianism as the dominant economic theory for the following 30 years.

Despite the relative success of Keynesian policies in creating economic growth and reducing unemployment, a series of economic crises and events beginning in the 1970s led governments to return to contractionary fiscal policies like austerity (Chick et al., 2016; Domitrovic, 2017; Quiggin, 2012). After the 2008 Financial Crisis in particular, governments responded with austerity measures to address the global economic crisis and growing government debt.

Many governments defended their enactment of austerity, utilizing recent literature on 'expansionary austerity.' This theory emphasizes the effect of expectations related to government finances on the economy. Supporters of expansionary austerity argue that when a government spends excessively and runs budget deficits, it creates an expectation of increased taxes in the future (Russell, 2017). As a result, aggregate demand is diminished, consumer spending drops, and private investment decreases due to weakened private sector confidence (Russell, 2017). On the other hand, implementation of austerity policies would produce an expectation of responsible financing of the economy, and thus consumer and investor confidence would increase domestically and internationally. Such confidence would prompt decreased interest rates, which would in turn further stimulate the economy (Russell, 2017).

The greatest challenge for proponents of expansionary austerity is proving that this concept successfully stimulates economic growth when the economy is in a downturn. A thorough analysis of statistically successful cases suggests that austerity is not conducive to economic growth and can actually hinder it. Advocates for expansionary austerity often point to Canada's policies implemented in response to the recession in the 1980s as an example of austerity succeeding in stimulating the economy. Recent analysis of Canadian economic growth in this period disputes the assertion that austerity measures were responsible for this growth. When the recession began, Canada was coming off a period of high growth, while significant trading partners were still expanding (Blyth, 2013b). Canada's continued economic growth in this period can be correlated with the economic boom in the United States, Canada's largest trading partner, as well as a large currency devaluation of the Canadian dollar (Blyth, 2013b). In other supposed cases of 'expansionary austerity' in this period, economic growth has been connected to similar fiscal and monetary determinants unrelated to austerity measures (Blyth, 2013b). These findings conclude that although there can be a correlation between austerity and economic growth, it does not imply causation as other economic and monetary measures can account for the trend.

THE AUSTERITY ALTERNATIVE: KEYNESIAN STIMULATORY FISCAL POLICY

This paper takes the position that the best strategy to address post-COVID debt is to stimulate the economy to produce economic growth. In response to the shortcomings of the economic responses to the Great Depression, Keynesianism became the dominant alternative to austerity (Quiggin, 2012). In advanced economies, Keynesian fiscal policy produced low unemployment rates, economic growth, and increasing living standards (Chick et al., 2016; Domitrovic, 2017; Quiggin, 2012). This theory posits that, in times of economic downturn, businesses do not have confidence that there will be large aggregate demand from consumers and as a result, investment decreases (Russell, 2017). Reduced investment by private business leads to a vicious cycle in which employment decreases, which in turn diminishes consumption; aggregate demand continues to fall, and business confidence becomes increasingly weaker (Russell, 2017). Keynesianism promotes government intervention within the economy to generate aggregate demand, thereby facilitating the investment of private businesses (Russell, 2017). Stimulative fiscal policy through increased government spending during economic downturns will produce this demand and increase business confidence, thereby generating further investment (Russell, 2017).

Government stimulus measures can be enacted in many ways, including through taxes, direct transfers, and spending. The literature on stimulus lends credence to the Keynesian position, with evidence suggesting that targeted stimulus measures increase economic output and raise gross-domestic-product (GDP) (Coenen et al., 2012). This effect is even more substantial when monetary policy supports the implementation of stimulus by keeping interest rates low (Coenen et al., 2012). Consumers tend to be myopic, ignoring the potential for future inflation or tax hikes (Coenen et al., 2012). Thus, they will generally consume more with their stimulus, increasing aggregate demand (Coenen et al., 2012; Parker et al., 2013). If Keynesian stimulatory fiscal policy is implemented and maintained for a long enough period of time, it

will generate sufficient economic growth to decrease debt in the long run without needing to resort to spending cuts or tax increases.

Canada's current fiscal position strengthens the argument for the government to implement stimulatory fiscal policies in response to the economic crisis of the COVID-19 pandemic. Critical to maintaining a solid fiscal standing is the state's ability and capacity to finance its debt. When government debt grows at a rate that surpasses the growth of the economy, public finances will not be sustainable in the long term (Wherry, 2020a). Markets and creditors to the government debt need to have confidence that the debt and money supply will not produce inflation by weakening the value of fixed-interest investment in state bonds and that government revenue will be able to cover the interest on the debt (Ingham, 2008). The key to maintaining the faith of financial markets and creditors is the debt-to-GDP ratio and the impact of interest rates in financing this debt. There is consensus on the international stage that debts are acceptable within certain limits. The European Union sets a standard maximum acceptable debt-to-GDP ratio at 60% (Ingham, 2008). Even critics of large-state spending posit that there is no consequential negative impact on economic growth in advanced economies until this ratio nears 90% (Reinhart & Rogoff, 2010). Taking into account the economic downturn and massive jump in spending by the government of Canada, the Parliamentary Budget Officer has projected that the debt-to-GDP ratio will only increase to approximately 48.3% (Office of the Parliamentary Budget Officer, 2020). This ratio puts Canada in the most favourable fiscal position of any G7 nation in relation to the federal net debt burden on the economy (Tencer, 2020). The other factor which indicates the ability of a government to deal with debt is the interest rate on the funds the government borrows. The current interest rate stands at a historic low of 0.25%, the lowest cost it has been for the government to borrow money in a century (Wherry, 2020b). As a result, economic growth is projected to overcome costs associated with interest in the future and avoid the factors which led to the Canadian fiscal crises in the 1990s (Wherry, 2020b). For these reasons, Canada is better positioned at this moment to finance the debt it is taking on to implement stimulatory fiscal policies than at any other point in the last 100 years.

AVOIDING THE PITFALLS OF AUSTERITY

Stimulatory fiscal policy helps to avoid many of the pitfalls of austerity, including negative economic consequences and increasing class and gendered inequality in society. In the Canadian context, austerity measures taken in the aftermath of the 2008 Financial Crisis unnecessarily undercut growth and the economy's ability to recover efficiently. Despite maintaining a reasonable debt-to-GDP ratio during the crisis, the government's implementation of austerity measures slowed economic growth and public investment (Dion & Dodge, 2016). Harsh austerity policies were enacted throughout Europe after the 2008 Financial Crisis, which resulted in economies contracting across the region. In fact, for the first time, the entire eurozone contracted in the fourth quarter of 2012 – economies shrank, net debt levels rose, and interest payments increased (Blyth, 2013a).

Austerity measures often result in an uneven recovery from economic crises. The imperative to cut spending can produce a 'wage moderation' effect, where the government reduces the

wages of civil servants (Russell, 2017). This downward pressure on wages can also affect the private sector's wages through direct government intervention or by producing a hostile environment for labour market conditions (Russell, 2017). The impacts of austerity have been theorized to have contributed to the stagnation of wages among the civil service and the working class, thus reinforcing income inequality in society (Russell, 2017). This inequality is also evidenced by the recovery of different classes from economic crises. In the United Kingdom, where severe austerity measures were imposed in the aftermath of the 2008 Financial Crisis, only the top 1% of households (as of 2017) have financially recovered and regained the level of income they had before the crisis (Vassilopoulou et al., 2019). These unequal outcomes between the working class and the more affluent in society can also impact economic growth in the wake of a crisis. When the working class, which makes up most of society, has stagnant or decreased income levels, it harms aggregate demand (Russell, 2017). In the Keynesian logic, without sufficient aggregate demand, there is little hope for economic growth, and thus the inequality of wages and speed of household financial recovery can drag down the speed of the economic recovery as a whole (Russell, 2017).

The pandemic has also exposed dramatic gendered inequalities in the workforce. The areas of the economy in which women make up a more significant percentage of the workforce—healthcare, social care, education, childcare, and the food service sector—have been disproportionately affected by the pandemic. Women in these 'care work' sectors of the economy are generally already overworked and underpaid, and the effects of the pandemic have only placed further strain on their existing working conditions (Thompson, 2020). The pandemic has also forced women into taking on more unpaid duties associated with social reproduction, consisting of the everyday tasks of maintaining and reproducing life (Bakker, 2007). With the closure of schools and other essential services, women are increasingly responsible for more care work for children and elderly relatives. This experience emphasizes the double burden women face – they work in underpaid, more flexible areas of the economy, and then complete unpaid domestic work at home (Thompson, 2020). The social infrastructure around care work, often called the fourth pillar of the welfare state, includes support for children and the elderly through preschools, daycare, nursing homes, and other support programs (Navarro, 2020). It is these social structures that alleviate the costs of social reproductive tasks to women and enables them to participate and fully integrate into the formalized workforce (Picchio, 2015).

To understand the potential detrimental implications of austerity, Greece stands out as a prime example. Greece arguably suffered the most severe impacts of the global economic crisis after 2008 and implemented harsh austerity measures in order to receive a fiscal rescue package. Following these cuts, which impacted many aspects of the welfare state, women's participation in the labour force dropped 14% (Vassilopoulou et al., 2019). This trend indicates that women are not only more disposable in the labour force, but also disproportionately bear the brunt of the impact when austerity measures cut funding to social infrastructure. Such an effect can be seen in the current crisis where, as a result of economic shutdowns affecting social infrastructures, women face the double burden of balancing professional work responsibilities and providing extra unpaid care work to children and the elderly. If Canada wants to avoid the labour market effects on women that

occurred in Greece after their policy response to the 2008 Financial Crisis, the Canadian government needs to avoid imposing stringent austerity measures and instead take a targeted approach towards funding programs that help women re-enter the workforce, thus facilitating a faster and stronger rebound for the Canadian economy.

From these findings, it is apparent that austerity can not only lead to unequal outcomes between women and men in society, but also have negative consequences for economies. There is substantial evidence that diversity of the workforce can create economic advantages through creativity and innovation, stimulating economic growth (Vassilopoulou et al., 2019). Recognizing this fact is crucial to enabling an efficient recovery from the economic crisis caused by the COVID-19 pandemic. It is evident that harsh austerity measures can produce unequal outcomes between men and women in the labour market. Such an impact not only promotes inequality, but it also hinders governments' ability to recover from economic crises efficiently.

CONCLUSION

In conclusion, austerity has been proven throughout history to produce adverse economic outcomes, as exemplified by its impact on economies following the Great Depression and after the 2008 Financial Crisis. Claims of 'expansionary austerity' are overblown by superficial analysis. Keynesian stimulatory fiscal policy is the most effective strategy for reducing government debt, as it avoids the pitfalls of austerity which often undercut growth and can cause economies to contract. Past applications of austerity have also perpetuated systems of inequality along the lines of class and gender. The COVID-19 pandemic is uniquely positioned to expose shortcomings in the current economic and welfare systems perpetuated by neoliberalism and austerity policies. These shortcomings have not only been exacerbated by the pandemic, but also risk hindering a more efficient and fair recovery, as exemplified by the stagnation of working-class income and the disproportional impact of cuts to social infrastructure on women. COVID-19 has exposed flaws in the economic systems which govern the daily lives of people around the world, and it is now up to governments to address these issues in their recovery efforts.

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