Making Public Services a Priority

How Canada Can Beat Tough Times

National Union of Public and General Employees

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Making Public Services a Priority

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QUALITY OF LIFE MATTERS a lot to Canadians. In tough economic times it is important to talk and reflect about how our quality of life can be maintained and improved. The National Union represents government and general service providers across Canada. Our members work in hospitals, community colleges, social services, child care centres and thousands of other workplaces to improve the Canadian quality of life. Economic well-being depends on people working together to meet each other's needs. The desire to help others is an important part of what motivates our members.

The contribution public services make to our prosperity should be obvious, but it is not always properly appreciated. It is generally agreed that public services such as health care and education need to be properly funded and widely available. It should be better known that our public sector service providers are concerned that public money be spent carefully. Public employees work to protect against waste, and to improve the quality of care and attention given to the needs of our fellow citizens.

At this time, Canada faces serious concerns about our economy and finances. A worldwide slump is on the horizon. We hear lots of different advice about what needs to be done. At times like this it is important to look to governments and the public sector for leadership. The way to deal with the threat of recession is through common action. As Canadians, it is important to consider together carefully the situation we face, and then support and take decisive action. As we shall see below, the public sector in all its dimensions, federal, municipal and provincial has the potential to carry us through tough times, and bring us out on the other side well prepared for what the future holds.

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I Tough Times

LOTS OF PEOPLE talk about economic problems. They do not usually agree about what to do next. The reason is understandable. Different interests are in conflict. We should not be surprised when this produces different views of what is best.

Despite the raised voices we can find a starting point. The Canadian economy picks up and slows with changes in spending. You might say spending is the economic motor. When the economy declines, it is because spending is slowing.

The spenders are governments, business, individuals and their families, and foreign buyers of Canadian products and services. When all this spending is added together, the total equals what we produce. Technically we call this the GDP or gross domestic product.

What kinds of spending we do matters a great deal. Purchasing equipment made abroad can improve our capacity to produce. However, spending that leaks abroad does not have the same positive secondary effects as spending in our communities. Money spent in Canada is received by other Canadians and may be spent again at home.

Economists measure the impact of different types of spending on overall economic growth. What we have learned is that government spending on income support, social services, and infrastructure raises national income by more than the dollar amount spent. The consulting firm, Moody's, estimates that one dollar spent on infrastructure adds one dollar and then another 59 cents more to GDP in the same 12 months. The reason is that government spending has a multiplied impact, it gets passed on to others, and spent again rapidly. For example, every dollar in increased Employment Insurance payments creates 69 cents in GDP growth above the dollar received. On the other hand corporate tax breaks return less than their dollar value to the Canadian economy. Cuts to corporate income tax amount to only 30 cents in increased spending for each tax dollar not collected over 12 months.

Spending is linked to production by contracts signed across the economy. For instance, workers sign collective agreements with employers. When wages go up, more money is available to be spread throughout the economy. But, if workers are fearful for their jobs they may save, rather than spend.

In fact, recessions occur because overall spending slows. For families and individuals, saving makes sense in tough times. But, if overall savings increase faster than overall spending, then the economy slows. Slowed spending, by governments, businesses, and foreign buyers of Canadian products, as well as families and individuals, can only have a recession as the inevitable outcome. Governments trying to run surpluses and businesses reducing investment are important contributors to reductions in overall spending.

The Canadian government has a strong fiscal position and is well placed to contribute to economic growth in tough times. Federal authorities working closely with provincial governments can together provide leadership in fighting recession, by investing more in public services.

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II Inflation Is Not the Worry

CONTRACTS TO MAKE and ship goods, and put them on shelves, are signed across the world economy. Prices for goods are set through these negotiated deals. Similarly, contracts are signed for rental accommodation, car leases or purchase, home improvement, or mortgages.

When attempts to spend exceed capacity to produce goods, prices go up. This is what economists call consumer price inflation. The consumer price index or CPI measures the increase in the general level of prices for everything we buy. We deduct the CPI to get an idea of the real value of a paycheck, pension, student bursary, welfare, or employment insurance benefit. When the CPI goes up, but wages, pensions, bursaries, or benefits do not, their real value goes down.

Recently we have seen steep upward movements in energy and food prices. These were followed by rapid falls. Quick changes in food and energy prices are due to changes in capacity to produce. They should not be confused with excess spending. When the overall level of food prices falls, it is not because people decide to eat

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less, then reduce their food purchases. Food prices fall when food becomes abundant, thanks perhaps to good weather, and good crop conditions overall.

Price inflation has been an important issue for everybody. As recently as the 1970s, price increases in the industrialized countries went above 10 percent. Price inflation has not disappeared as an issue, but it is not a worry today. Why? Largely because the shift in manufacturing to places such as China has reduced consumer prices, magnifying buying power.

When the Canadian dollar rises in value, Canadian purchasing power goes up as well. But a higher Canadian dollar puts pressure on workers in industries that can move production to lower cost sites such as China.

With a stable value for the Canadian dollar, incomes are protected from increases in prices for imported goods. Dollar stability also allows for investment in Canada. Businesses can plan ahead with some confidence when the foreign exchange rate is stable.

When the value of the Canadian dollar falls, prices set internationally (usually in U.S. dollars) for our raw material exports go up. The domestic producers get a windfall income. But a falling dollar only works to increase overall spending when the rest of the world economy is growing.

The Bank of Canada has a price inflation target (a one to three percent band). It also has a hammer it uses to control overall spending: interest rate increases. When it thinks inflation is pressing up against the inflation target, the Bank of Canada tries to make spending more expensive. The way it does this is through increasing interest rates. By increasing the cost of borrowing money, the Bank tries to slow spending.

Far and away the best policy for interest rates is stability. When the Bank of Canada raises interest rates, this pulls money into Canada, and causes the Canadian dollar to go up. When the Bank lowers rates, it causes the Canadian dollar to drop. Rapid changes in the international value of the Canadian dollar make planning investment very difficult. Business spending to create jobs becomes next to impossible.

Lower interest rates are welcome but do not translate automatically into increased spending. When people fear the future they do not spend, and businesses often decide to pay down their debt. At this juncture the issue that concerns Canadians is the safety of their economy from worldwide credit difficulties. No one wants to see credit, and then spending dry up. Ensuring that the economy does not go into reverse, and suffer from what economists call deflation or a decline in activity, including the opposite of inflation – falling prices, means looking to our public authorities to do their job on behalf of all Canadians.

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III

Protecting Financial Services

The severe international financial crisis reveals the importance of regulating financial institutions very closely. Strict rules about lending practices are always needed. Bank service charges need to be set by law. A healthy financial environment means services are widely available at low cost, and deposits are properly insured. It does not mean financial deregulation. Bank mergers and increased foreign competition have no role to play in ensuring a stable financial system.

Proper bank lending practices are important for spending and investment decisions by families, individuals, and businesses. The money deposited at the end of a pay period goes quickly back into the economy as spending on housing, food, energy, goods and services, sports, recreation, and cultural products, allowing others to get on making a livelihood as well. Bank loans go directly into new deposits. The capacity to make loans was granted Canadian banks through bank charters approved by parliament. Banking services are government regulated, and need to be supervised by public authorities.

When difficulties arise, governments do not hesitate to take ownership and control over banking and finance. The reason is simple: ensuring that citizens can spend to meet their daily needs, without having to worry about the safety of their money, is an essential part of overall security. Governments are expected to provide security to Canadians.

In recent years, waves of international speculation have spread across the world economy. Banks have taken liberties they were never granted. Public authorities looked the other way as this occurred. Loans were routinely

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extended for what are known as derivative products. So-called investors could bet on increases in the price of financial products or hedge bets on credit defaults. In the meantime, banks bundled loans for house or car purchases, and sold them to unwary purchasers: pension funds, insurance companies, and other financial institutions. Bankers may have believed they had passed on risk to securities markets. It turned out financial markets are so intertwined, that when the music stopped, the institutions that could not find a chair, owed money to the ones that were supposedly safely seated.

A sound financial system requires every participant to be able to meet its obligations. Banks remain solvent when they make prudent lending decisions. Public regulation helps to protect banking and finance from the instinct to go too far in search of extra profit.

IV Current Dangers

When overall spending, and production of goods and services go up together, we have the best of both worlds. The economy grows, and prices do not increase. Unfortunately, the Canadian economy has slowed, and there is a need to do better. In 2008, spending declined overall in the first six months of the year. The official GDP measurement was a decline of .3 percent in the first quarter of the year, followed by an increase of .1 percent in the second three months. The technical measure of a recession is a decline in GDP over two consecutive quarters. Canada just missed this because of the slight increase in the second quarter.

What is going on? Much of what we read suggests that Canada is vulnerable to a slowdown in the U.S. This is no doubt true. Exports to the U.S. bear watching. But bad times in the U.S. do not explain what made Canada slow down in 2008. Professor Stephen Gordon of Laval University has been monitoring the two economies closely, and his research (http://worthwhile.typepad.com/worthwhile_canadian_initi) shows that overall Canadian exports to the U.S. did not slump in the early part of the year.

Canadian business has been making record profits. Corporate income taxes have been reduced substantially. From the 40 percent range, successive cuts are expected to lower business taxes on profits to around 20 percent. Despite making a lot of money in Canada, few economists expect business spending to continue. Businesses only spend and invest when they *expect* to make profits. They do not invest because they have *made* record profits and have lots of extra cash on hand.

One way to activate business spending is for governments to work with companies and trade unions to develop local and regional industrial strategies. Instead of cutting taxes, government could offer support to those companies which create jobs, undertake research and development, and generally invest in Canadian communities. Other countries have used public investment to lever more business investment. Unlike corporate tax cuts, these programs work in tough times as well as good times. However, very aggressive government subsidy programs for business investment around the world have not been matched in Canada.

Without a coherent manufacturing strategy Canada has become dependent on commodity exports to sustain economic growth. The Canadian economy is vulnerable to the world slowdown triggered by the U.S. subprime mortgage debacle. Commodity prices have fallen considerably, leading to lay-offs and distress in resource communities. It is imperative that workers be protected from these cyclical downturns through access to Employment Insurance so that they can continue to make mortgage payments, and stay in their communities.

Governments continue to spend, though often on the wrong things. The military budget has been pumped up like a balloon. Spending has not increased to meet needs for health care, post-secondary education, social services infrastructure, public transit, and environmental improvements. Instead of investing in improved access to public services, the federal government reduced the GST.

Household spending cannot be expected to carry Canada forward. Individuals and their families are strapped. Recent research from the CCPA shows us where the problem lies. In the first thirty years after World War II, national spending increased fairly rapidly. As well,

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family income grew at much the same pace across the different income groups. Then things changed dramatically. According to CCPA author Lars Osberg, since 1979 average real wages have been frozen.

When we take all the families in Canada, and rank them from highest income to lowest, the lower 90 percent have not seen any improvement since 1980. Unlike post-war Canada, where median income (50 percent above it earn more and 50 percent below it earn less) kept up to national income, since 1980 family income has been stagnant while national income has grown. It turns out that since the 1990s most of the gains have gone to the top one percent of income earners, and indeed the top one percent *within the top one percent*. What the CCPA numbers tell us is that Canadian families are not able to keep up.

Businesses watch household spending closely, and monitor planned family spending. When households are not increasing their spending, businesses do not invest.

To summarize, our current situation is worrisome. As we saw at the outset, times get tough when new spending evaporates. Businesses do not spend more, households do not spend more, and foreigners do not spend more. A contraction of overall spending equals a recession. When a recession deepens and persists it is called a depression. As new spending dries up people get thrown out of work. Unemployment can mean families not able to make house payments. Falling house prices drive spending lower, as people judge they have less wealth to fall back on.

Job searches force people to move, leaving hardship behind. The cumulative impact of a decline in business, household, and foreign spending can be severe, and take the economy a long way down.

Financial markets are supposed to match savers and investors. But, the investment spending comes first, and the savings are mobilized only later. Worldwide credit is tight because of huge losses sustained by financial institutions that purchased U.S. securities made up of bundled mortgages, including poor risk “subprime” mortgages. Bad lending practices, and bad management practices, including wasteful executive compensation in the hundreds of millions of dollars have devastated the once proud investment banks of Wall Street. Working out how to apportion the blame and limit the damages will take years.

Canada has escaped the worst features of the world financial crisis, so far at least. But it is important that intelligent policy decisions be taken to protect past gains and ensure a better future.

Looking at the options, investing in public services makes the most sense for Canada at this time.

V
The Way Ahead

WHAT DO WE DO, what is the best way forward?

1. We can wait for the rest-of-the-world to bail us out, for new spending to start flowing in from abroad.
2. We can wait for businesses to discover new profitable endeavours.
3. We can wait for consumers to start to borrow and spend again.
4. We can ask governments to borrow and invest in our future, cover our collective risks through common action, and to provide Canadians with safe, secure returns on financial instruments – government bonds – paying competitive rates, with no service charges.

Looking at the options, investing in public services makes the most sense for Canada at this time. What is needed is a coordinated approach bringing together all levels of government.

With financial markets in disarray, Canadians desperately need new sound financial instruments for their savings. Government bonds provide the highest degree of safety of any investment instrument. Unlike mutual funds, government bonds do not charge management expense fees. Instead of paying as much as two to three percent per year – to watch your fund decline in value – purchasers of government bonds pay only a one-time, modest sales commission. It is reasonable to expect a four percent interest rate to be paid to holders of government bonds. With a new tax free savings account available to Canadians, it makes sense for citizens to buy government bonds to place in the accounts. Investors in government bonds are putting their money to work in building needed infrastructures for their communities. Governments could clearly label their bonds (for instance as education bonds, green

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- PEI Union of Public Sector Employees
- Newfoundland & Labrador Association of Public and Private Employees

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bonds, or health bonds) giving citizens a choice as to where they want to see their support directed. Savings mobilized by government bonds are redirected into spending to revive local economies. Bond funded investment fights recession directly.

A national public services investment plan funded by bond initiatives and coordinated between levels of government is what we should be working to achieve. Lets put all the best ideas on the table, and ensure that we pick alternatives that lead to more spending for public services to protect our communities from recession. The great advantage of investing in public services is that governments are accountable to citizens for spending the money properly, and public employees work on our behalf to protect the integrity of public projects.