POLICY *Brief*

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The Provinces Need Help. Time to Put the Bank of Canada to Work

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The provinces are in trouble. Revenue is collapsing. Expenses are skyrocketing. And fiscal capacity is limited.

Even before the COVID 19 crisis, resource-dependent provinces like Newfoundland and Labrador, and New Brunswick had net debts for 2018-19 in excess of 46% of GDP and 37% respectively, while more diversified provinces like Ontario, Quebec and Manitoba were groaning under (respectively) the weight of ratios of 39.5%, 39.3% and 34.3%.[1]

It is true that other provinces like Alberta (8%), British Columbia (14.4%) and Saskatchewan (14.7%) had lower ratios but with COVID-19, all bets are off (Nova Scotia and PEI were at 33.8% and 30.4% respectively). At some point soon, the provinces may find themselves unable to sell debt to finance the spending they and their municipalities *must* undertake on services like health, education and social assistance because they alone have that jurisdictional responsibility. They need the federal government's support.

It is likely the federal government will soon make announcements that beef up the Canada Health and Social Transfers (CHST), offer one-off equalization transfers, and even offer military assistance. And the provinces will also benefit from sales and income tax revenue arising from the already-announced stimulus measures that transfer funding directly to households.

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But that is not enough. The Bank of Canada, whose sole shareholder is the federal government, should immediately announce that it will buy zero interest rate short-term treasury bills issued by the provinces and their municipalities until the crisis is over.

Can it do that? The *Bank of Canada Act* says it can. Section 18 provides sweeping powers to the Bank of Canada to buy federal and provincial debt as well as debt issued by institutions guaranteed by either. The

Bank can even make direct, short term loans to the provinces. These could be rolled over as needed.

But where will the money come from? The same place it always does, by keystrokes into a computer, as former Chair of the U.S. Federal Reserve Ben Bernanke famously remarked in the midst of the (last) financial crisis when central banks engaged in trillions of dollars of "quantitative easing."

But won't that be inflationary? Maybe. Supply has been crimped. But we think a bout of inflation is highly unlikely given the precipitous drop in energy costs, disappearing effective demand and related idle capacity in the form of unemployment and silent factories. And if it does lead to inflation, we can manage that problem later. Right now, the provinces need help because many of us need help to put food on the table, pay rents and pay our debts.

Some policymakers will undoubtedly object that this would create a moral hazard problem. Why don't we force Alberta to impose a sales tax like everyone else? And how can we know the provinces will spend the money wisely and not blow it on "white elephant" projects?

There are two responses to this kind of argument. First, this is the worst possible time to introduce a sales tax in Alberta or for other provinces to increase theirs. Second, there is no guarantee that bad investments won't be made, but the level of scrutiny and monitoring over government action is such that politicians know that bad decisions will incur swift social sanction. The electorate is awake. Politicians beware.

If federal policymakers aren't convinced, and if somehow the provinces resist the idea because they worry about giving up too much power to the federal government, then the federal government through the Bank of Canada can consider two other options.

The Bank could buy provincial debt at market rates (a "traditional" form of quantitative easing) and the federal government could flow the resulting interest payments back to the provinces. Or the Bank could issue a blanket guarantee for all provincial debt and drive yields down to federal levels.

There is another more simple and effective option. The Bank of Canada could buy all new short-term federal debt—zero interest or prevailing rates, it doesn't matter—and let the federal government transfer funds to the provinces at almost no net cost. Consider it a COVID-19 grant.

Won't these ideas impinge on central bank independence? Maybe, but probably not in a way that would cause the governor to resign, which has been the real independence threshold since the Coyne controversy of the Diefenbaker era.

The Bank of Canada was born of the Great Depression to deal precisely with the kind of systemic event we now confront. But even facing a Depression, policymakers let moral hazard worries keep them on the sidelines, causing one province (Alberta) to default on its debt. This cannot happen again. The human cost is too great, the stress on our federation too irreversible. The federal government needs to live up to Prime Minister Trudeau's promise to "do what it takes" to get Canada through this crisis. The provinces need the federal government to put the Bank of Canada to work. We all do.

Reference

[1] Candian Federal and Provincial Fiscal Tables. RBC Economics. March 20,2020. http://www.rbc.com/economics/economic-reports/pdf/canadian-fiscal/prov_fiscal.pdf

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Murray Fulton is the Director of JSGS's University of Saskatchewan campus, and a Co-operative Retailing System Chair in Co-operative Governance and a Fellow in Co-operatives and Public Policy in the Canadian Centre for the Study of Co-operatives. His research and teaching interests are focused in a number of areas, including industrial organization, agricultural and rural policy, and public sector and co-operative governance. He is the co-author of a number of books and reports, including Canadian Agricultural Policy and Prairie Agriculture and Co-operatives and Canadian Society. Fulton has also written many articles and papers on industrial organization, agricultural policy, and co-operatives.

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People who are passionate about public policy know that the Province of Saskatchewan has pioneered some of Canada's major policy innovations. The two distinguished public servants after whom the school is named, Albert W. Johnson and Thomas K. Shoyama, used their practical and theoretical knowledge to challenge existing policies and practices, as well as to explore new policies and organizational forms. Earning the label, "the Greatest Generation," they and their colleagues became part of a group of modernizers who saw government as a positive catalyst of change in post-war Canada. They created a legacy of achievement in public administration and professionalism in public service that remains a continuing inspiration for public servants in Saskatchewan and across the country. The Johnson Shoyama Graduate School of Public Policy is proud to carry on the tradition by educating students interested in and devoted to advancing public value.

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