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From small credit card draws to massive corporate refinancing, our relationship with debt is complicated. But what is the ultimate cost of all that borrowing?

BY JOHN LORINC

IN THE MONTHS leading up to the COP27 climate summit in Sharm El-Sheikh, Egypt, Mia Mottley, the prime minister of Barbados, began talking up a radically new approach to global debt and the enormous costs incurred by low-lying nations that are facing the brunt of climate change.

After climate-related disasters, she argued, the World Bank Group and the International Monetary Fund (IMF) should suspend debt repayment plans for the affected nations, enabling their governments to direct funds to reconstruction and also attract global capital to build up the resilience of these vulnerable places with investments in clean energy, flood protection, and so on. Many are developing nations that already carry ruinously high national debt. “We were the ones whose blood, sweat, and tears financed the Industrial Revolution,” Mottley said in a much-watched address at the COP27

conference. “Are we now to ... pay the cost as a result of those greenhouse gases from the Industrial Revolution?” During the summit, Mottley’s plan rapidly garnered international support and became one of the cornerstones of the summit’s final resolution.

Mottley’s high-wire campaign to link debt and climate change can be seen as yet another reminder that the financial relationships between borrowers and lenders are never just about the numbers on balance sheets. The twinned conditions of owing money or being owed money create power dynamics, political and economic tensions, harsh moral judgments, investment instruments, and entrepreneurial action. The vocabulary of debt is woven as deeply in our language and thinking as it is in our most ordinary commercial transactions. And, as Mottley argues, a new understanding of debt could even shift the way the world confronts an accelerating environmental catastrophe that burdens some societies more than others.

Debt and the proliferation of credit instruments have played a starring role in some of the worst economic disasters in the past two generations, including the Savings and Loan scandal of the late 1980s, junk bond scandals, the collapse of Enron, sub-prime mortgages, the 2008 credit crisis, and the geopolitical instability caused by the rigid repayment policies the IMF imposed on developing nations.

The pandemic and its aftermath have added a new chapter in the complicated history of debt dynamics. “In the decade or so prior to COVID and [the] post-financial crisis, interest rates in North America were pretty suppressed,” observes Robert Kavcic, a senior economist with BMO Capital Markets. “So there was a lot of borrowing and leveraging going on in the household sector and you can [also] see it in the housing industry.” He points out that, in recent years, there’s also been

a surge in the use of home-equity lines of credit (HELOC) to finance the purchase of second or third properties, such as condos, for income purposes.

After March 2020, and the imposition of lockdowns in so many countries, many governments took on huge debt burdens to ensure that the sharp decline in economic activity didn’t cause undue suffering. (As of mid-2021, Canada’s national debt hit \$1.6 trillion.)

In Canada and elsewhere, many people couldn’t spend money on activities like travel or eating in restaurants so they began saving at unprecedented rates. But, as the world re-opened, pent-up demand and historically low interest rates produced a surge of consumer spending and a run on housing, and thus a sharp upswing in new consumer and mortgage borrowing, supply chain bottlenecks, and, finally, inflation at rates not seen since the 1980s.

The pandemic led to pent-up demand in consumer spending, particularly in housing



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growth, he says, and it becomes clear that today’s figure is “massively lower.”

Explaining the underlying dynamics, Hoyes rhymes off a list of factors: a reasonably strong labour market, new federal rules enacted after the 2009 recession that enabled individuals to more easily make consumer proposals (an alternative to filing for bankruptcy), and demographics. The insolvency wave after the credit crisis, Hoyes says, was driven in part because so many Canadians were in their mid-40s, an expensive time of life. Today, there are a lot more people retiring, and they tend to be less leveraged. “You’ve kind of aged out of the system,” he says.

Hoyes is also quick to point out that no one should sit in judgment of people who get trapped in a debt spiral. In the go-go years prior to the pandemic,

DOUg HOYES, a CPA and licensed insolvency trustee based in Kitchener, Ont., knows first-hand from his clients what happens when household and consumer debt become overwhelming. But he also keeps close tabs on economic trends and has arrived at some revealing conclusions about where Canada is, as a society, when it comes to owing money. Insolvency rates, he says, “crashed” during the pandemic and remained at or near a 25-year-low in late 2022. “That’s what doesn’t get reported in the media,” he observes archly. “It’s not a very interesting story, but those are the facts.”

On a recent Zoom call, he shared a chart showing that the absolute number of insolvencies per month in Canada in fall 2022 was roughly the same as 25 years earlier. Adjust for population

he may have seen more personal bankruptcies or consumer proposals from people who’d given their credit cards too much of a workout. The current environment couldn’t be more different. After household savings rates shot up in the spring of 2020 to 26.5 per cent (“the highest level in my lifetime,” Hoyes says), they’ve gradually come back down. But, due to soaring inflation, rents, and interest rate spikes designed to contain the inflation, some household budgets are generating red ink. “My average client last year had income of around \$2,400 a month,” he says. “But if you live in Toronto, your rent is \$2,000 a month.” Hoyes adds that many people now also carry tax debt.

CPA Canada’s director of finance, Michael Massoud, points out that the pandemic also produced a sharp divide between those who benefitted financially and those who did not. He says non-profit

credit counselling agencies have seen an uptick in people who are grappling with mounting debt and increases in the prices of all manner of household expenditures. “People are starting to struggle with debt,” he says. “I think there is an uptick in individuals [who] might be struggling with maintaining a proper credit rating.”

The range of options has broadened because of the changes in the rules governing consumer proposals, but Massoud, like Hoyes,

stresses that it’s important to confront a worsening debt crisis without shame—a piece of advice he also directs at CPAs whose clients might be in a tough spot. “The most important thing is really to encourage your clients, or even yourself, to not be afraid to ask for help,” he says. “People confuse net worth with self-worth.” One very straightforward piece of advice: “Ask your bank or creditor to reduce the interest rates on outstanding debt. The worst they can say is ‘no.’ But, if you don’t ask, you’ll never know.”

Not-for-profit credit counselling agencies have long been a source of advice for consumers, with the costs covered by creditors. But, Hoyes points out, the business of debt counselling for profit has picked up steam as consumers turn to these companies for debt relief.

URSULA WEGEN, a Calgary small business owner, knows precisely how swirling global forces can turn into a debt squeeze that poses a direct threat to the viability of a store she's owned and operated for almost 20 years. Wegen and her daughter started UtB Specialty and Fashion Shop in 2003, first selling T-shirts and later branching out into designer fashions and crafts made by local artisans. But, in the late 2010s, she realized she'd have to downsize and relocate from her downtown location because depressed oil and gas prices had emptied out the Calgary office buildings that delivered customers to her doorstep.

"We thought we did the right thing," she says, but then the pandemic hit. They started selling online, and were able to rely on a loyal customer base, which worked for a while, until the more global imponderables washed over UtB: inflation that further eroded her customer base, economic uncertainty because of the war in Ukraine, and, finally, the Bank of Canada's inflation-busting interest rate spikes. Wegen has had to load up her line of credit, max out her credit cards, and slash prices to stay afloat. She's determined to stay open, pay her suppliers, retire a loan from an angel investor, and eventually hand over the business to her daughter.

Wegen is by no means the only small business owner struggling with debt as the economy whipsawed through the past year. As the world began to open up in 2021 and interest rates were at historic lows, many small businesses hustled to take advantage of the economic resurgence, but then found themselves stuck in the jaws of inflation, supply chain nightmares, and steep increases in their borrowing costs in 2022.

According to the Canadian Federation of Independent Business, fully a third of small business owners reported that borrowing costs had become a major concern, up from just 16 per cent the year previous. More than half are also relying on lines of credit or loans with variable interest rates, and about 62 per cent are still carrying unpaid debt taken on during the pandemic.

Taylor Matchett, a senior CFIB research analyst, says the average member firm is carrying more than \$114,000 in debt, and cites a November 2022 survey that showed that insolvencies reached a two-year high in mid-2022. One in 10 Canadian small business owners would opt to file for bankruptcy if they couldn't keep their doors open, the survey found, while 46 per cent of businesses at risk of closure would simply stop operating rather than go through the bankruptcy process. "The situation, when it

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comes to pandemic debt, is still really widely felt by a majority of small business owners," she says, "and it's pretty top of mind."

Massoud agrees: "As interest rates continue to rise and wage pressures continue to increase, I think there's a lot of uncertainty out there that's causing businesses to rethink their plans and their expenditures over the coming years." He points out that some businesses may have had the foresight to lock in lower-cost loans last year, when interest rates were low. But, he adds, "if you've actually had to access debt in the last couple of months, you might be starting to feel that squeeze."

Matchett points out that increasing debt overhangs carry opportunity costs for small businesses and can lead to tough situations, such as not being able to increase wages and benefits or finance strategic investments, such as tapping online markets. "The takeaway is that this is going to continue to be an issue for the foreseeable future," she says. "It's going to be really important that government tries to lower costs for businesses."

With dwindling sales and increasingly cautious consumers, Wegen has been living this reality for almost a year. "That's where we're sitting," she says with a shrug. "It's month to month to month." But, she adds quickly, closing her doors or declaring bankruptcy is not on the table. "We've gotten through many tough times before and we'll get through this."



"Quantitative easing" by central banks led to the purchase of corporate bonds, which, in turn, fuelled inflation, critics say

THE PROSPECTS for Canada's heavily leveraged small businesses seem worrisome. According to Statistics Canada, small businesses (businesses with fewer than 100 employees) in 2021 accounted for 98 per cent of all employers, almost two-thirds (63.8 per cent) of the entire labour force, and the near-term outlook wasn't especially positive.

But their activities and contributions to the economy are often overshadowed not just by very large or publicly traded companies but also the roiling world of international corporate bond markets that account for a lion's share of business borrowing. A Statistics Canada study on business borrowing before and after the pandemic found that Canadian companies have become increasingly leveraged in the past decade, and that rate of growth has exceeded those of countries like the U.S., Japan, and Germany. When the pandemic hit, corporate borrowing from banks in Canada not only spiked but surpassed all previous records. As the study pointed out, "short-term financing now dominates new lending," and the resulting exposure to the Bank of Canada's interest rate hikes is clear.

These pandemic-fuelled swings in corporate bond markets are playing out against yet another new dynamic in the way our society thinks about debt. During the pandemic, as in the 2008 credit crisis, central banks, in order to prevent deflation, implemented aggressive "quantitative easing" policies that led to the purchase of hundreds of billions of dollars of corporate bonds by institutions like the Bank of Canada and the U.S. Federal Reserve.

Critics contend these money-printing policies fuelled inflation, and some, including the Conservative Party leader Pierre Poilievre, have attacked central bankers, claiming they've mismanaged the economy. While there's a robust policy debate about those arguments, one point is abundantly clear: that debt—from modest draws on a credit card to a central bank's unprecedented purchase of corporate bonds—exerts an extraordinarily powerful and possibly increasing influence on modern society and, if you listen to Mia Mottley, the planet as a whole.

We owe it to ourselves to pay attention to what all that borrowing has wrought. ♦