



Higher taxes and inflation are coming. This is how investors should prepare for it

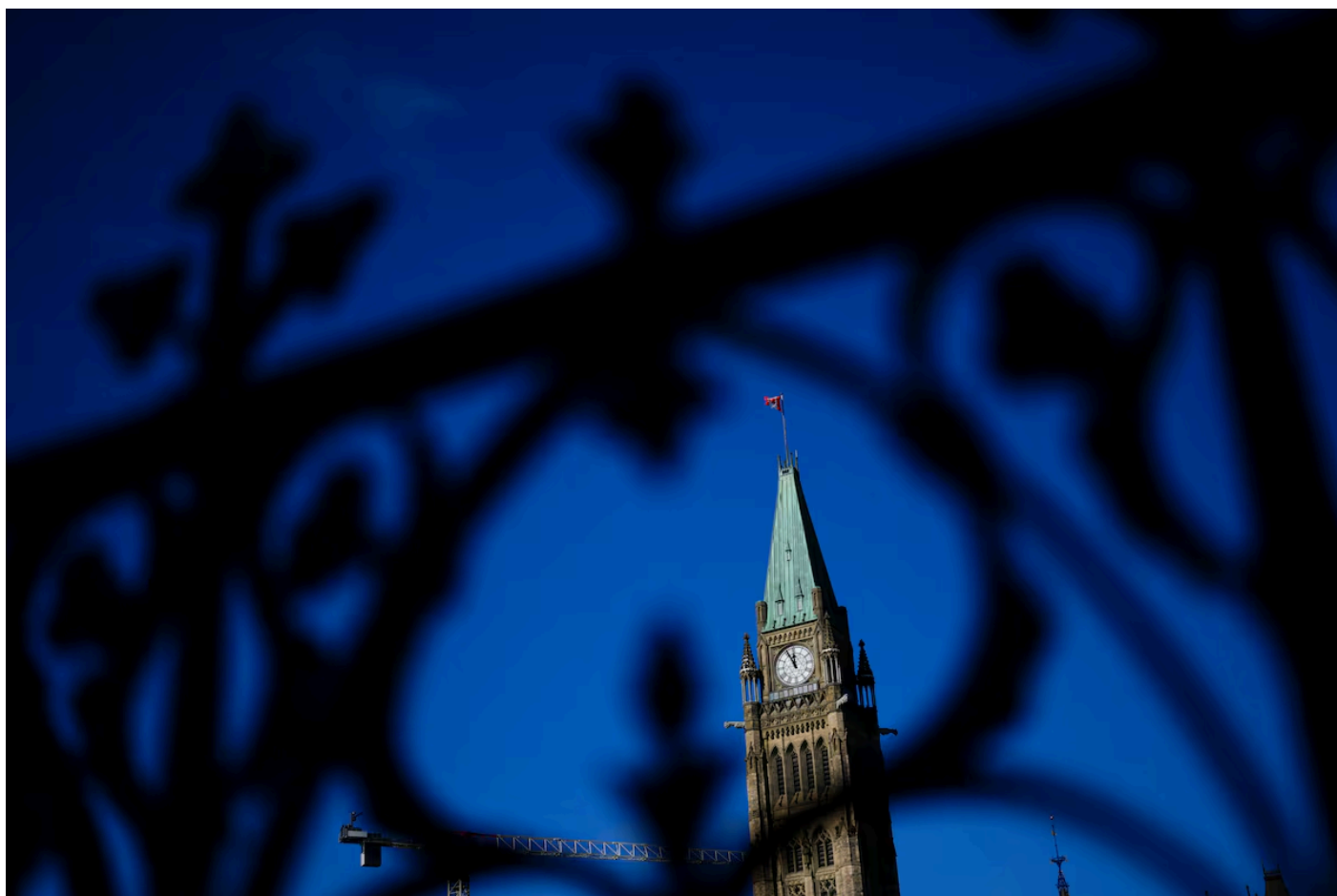


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The number of high-net-worth individuals globally continues to rise. Meanwhile, countries are taking on ever-larger amounts of debt.

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Free trade and globalization over the 30 years prior to 2022 made citizens of every nation around the world richer, particularly those in advanced economies. A report by Credit Suisse Research Institute indicated that there were 59.4 million high-net-worth individuals in the world in 2022 (namely, those with wealth between US\$1-million and US\$50-million), up from 29.6 million in 2011. North America accounted for 42 per cent of the total, while Europe accounted for 27 per cent.

In the process, and driven by low interest rates, consumer borrowing increased to record levels. Governments around the globe also borrowed extensively to pay handsome wages and rich benefits and other support or transfer payments. In addition to record borrowing, the 2008 credit crisis hit advanced economies hard with huge amounts of debt transferred from overleveraged individuals and businesses to the government. Public debt expanded further through the various stimulus programs during COVID.

Some figures from Canadian and U.S. government sources help put this into perspective. In 2000, Canada's public debt was US\$426-billion, public debt per person was US\$13,948 and public debt-to-GDP was 59 per cent. The corresponding figures for the United States were US\$5.7-trillion, US\$20,836 and 31.2 per cent, respectively.

Fast forward to 2022. Canada's public debt had risen to US\$1.67-trillion, public debt per person had more than doubled to US\$41,794, and public debt-to-GDP stood at 86 per cent. The picture in the U.S. was staggering, with public debt at US\$30.27-trillion, US\$93,518 in public debt per person and public debt-to-GDP at 112 per cent. And public debt outstanding has risen further since then in the U.S., while it has improved somewhat in Canada, but still remains at historically high levels.

No matter how you look at it, public debt and public debt per person have skyrocketed around the globe, particularly in advanced economies – this does not include private debt, which has also exploded. And all this is happening while luxury home and luxury car sales are booming, according to recent reports by The Agency and Scotiabank, respectively. Result: wealthy citizens, but not-so-wealthy countries.

Economies and countries around the world have now reached a wall. Public debt cannot continue to climb in this fashion – especially in times of economic prosperity.

Governments know this. But does it matter that governments have too much debt on their balance sheets? Yes, it does. Higher debt levels increase the risk of fiscal crises (what if there is a recession?) and hurt economic growth. Public debt must be paid down.

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But how? One option is by raising taxes – thus transferring wealth from rich citizens to poor governments. We have heard a lot around this issue recently in the U.S., and Canada, but in the opposite direction, namely, governments have promised to reduce taxes rather than raise them.

Another option to rein in debt is to cut spending. And finally, another option is to fire up the money-printing presses and, in the process, create inflation and reduce public debt in real terms. In my opinion, governments will try to tax to the max, either directly via income tax changes or indirectly via tariff increases or via increasing consumption taxes. And all this at a time when non-payment of taxes has become a continuing problem around the globe.

While Greece has received most of the negative publicity about its inability to collect taxes, wealthy people in Germany and Britain hide much greater sums from tax authorities, according to the Boston Consulting Group. But it seems that baby boomers want to hold on to what they have, and they do not want to share it with others in their societies. Our mistrust of the government may have to do with efforts to hide taxes from the taxman. Will higher taxes (direct or indirect) achieve the necessary increase in revenues to balance budgets and start reducing debt levels? There are many views on that, but no consensus.

Governments will also try to cut spending. Good luck with this, too. Looking around the world, the U.S. and Canada included, one can see how resistant people are to cuts to their entitlements and how difficult it is to cut the bloated public sector – and military spending is set to jump around the world rather than decline. We are seeing daily the kind of social upheaval that attempts to cut spending in “sensitive” areas can lead to.

For political reasons, the option that may be the most viable and the solution of least resistance, is starting up the money printing presses and inflating the debt away. This fits well with my recent writings on the increasing possibility of a world with slow growth and higher inflation.

For investors, this has serious implications. The value of paper currencies will be worth less and holding cash and bonds (except for real return bonds) in one's portfolio will not make one secure and wealthy. Stocks will do better, particularly those of companies in good businesses with global reach that have pricing power. And so will investing in gold. Moreover, the possibility of higher taxes is also inflationary. They are inflationary as investors demand higher before-tax returns in their bond portfolios and workers demand higher before-tax wages to make up for the higher taxes.

So, get used to it and get ready. Higher taxes and higher inflation will be the name of the game in the future. Both are unavoidable and are the effect of rich citizens and poor countries.

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