Executive Summary

A year ago the financial crisis that shocked nations around the world into a global economic recession dragged Canada down with it. In very short order, Canada’s economy deteriorated from a state of robust expansion to a condition of severe crisis. Canada experienced the largest contraction in nominal GDP since the end of World War II, a 50% increase in unemployment within a year, and unprecedented financial instability. Canadians are eagerly awaiting signs of a rebound.

For months, some analysts have been claiming that full-fledged recovery is imminent. Certainly the financial sector is demonstrating considerable optimism: investors have bid up the Canadian stock market by more than 50% since March; bank profits are strong and growing. But a thorough review of Canada’s economic indicators suggests the road to economic recovery will be a long and winding one. It also indicates the need for a firm and steady federal government commitment to actively support Canada’s economic recovery. In a world where business, export, and household spending have all been contracting, government is the only actor left to keep the economic engines running. Despite Harper minority government claims that its January 2009 stimulus plan is working, there is growing evidence that more robust interventions are needed, and soon.

Part one of this study, by CAW Economist and CCPA Research Associate Jim Stanford, examines the state of Canada’s economy and concludes Canada is still far from a genuine economic recovery. Stanford evaluates 10 critical indicators and notices a troubling trend: Canada’s private sector is still contracting. The normal leading engines of economic expansion in Canada’s market economy — business investment, construction, and exports — have not re-established a positive trajectory since last year’s economic shock. Private sector output and job creation is shrinking, not growing. Only the public sector is growing. Exports of goods and services fell by over 8% in the second quarter alone (and by a stunning 27% year over year). Exports fell another 5% in August. Business investment is also still declining rapidly. Substantive injections of spending...
power from the public sector are still required to offset sagging private sector activity in Canada. Yet the Harper minority government is already planning its exit from the world of stimulus, anticipating the phase-out of most of its spending initiatives.

Household incomes are stagnant and without increased government transfers would be falling. Labour force participation is dropping notably. Consumer spending is barely holding its own. Credit conditions continue to tighten for businesses. Prices are falling, a sign of continuing profound weakness in demand. Indeed, if this deflationary pattern becomes rooted, it can create a self-reinforcing contraction in prices and incomes. While the frightening fall in output and employment that occurred in the wake of last fall's financial meltdown has clearly levelled out, on the basis of the full set of economic indicators, Stanford concludes that Canada's economy has not yet turned the corner.

Every Canadian is hoping for economic recovery to arrive sooner rather than later. This evaluation of key economic indicators reveals that Canada's public sector — three levels of government, including public entities financed by government such as education and health care — has become the only engine of growth: the only source of new investment and purchasing power to stimulate the second-order spending and job creation that is a prerequisite for an economic recovery. This public sector rescue effort was not enough to prevent or offset the private sector recession. The traditional engines of private sector expansion — investment, exports, and construction — continue to stall. Public investment has been essential to stabilizing Canada's economy. Without it, Canada would have fallen deeper into recession. More is needed to steer Canada through to recovery.

Part two of this study, by CCPA Alternative Federal Budget Coordinator David Macdonald, evaluates the effectiveness of the Harper minority government’s response to the economic crisis and concludes it was not up to the task.

Ottawa’s rescue of Canadian banks and other financial institutions a year ago was quick and massive. While Prime Minister Stephen Harper was insisting to the world that Canada’s banks were sound, his minority government was busy handing them one of the biggest industry support packages in Canadian history. For example, since October 2008, the Harper minority government purchased $65.5 billion worth of residential mortgages from Canadian banks, and auctions are continuing to a potential promised maximum of $125 billion. Combined with other financial measures, the potential intervention could total $200 billion. The amount of funds marshalled to provide liquidity to the banks is staggering. The Harper minority government has effectively funded all net new mortgages in Canada since August 2008 and the federal government now owns approximately 7% of all Canadian residential mortgages. As a result, highly profitable private financial institutions continued to reap multi-billion dollar profits throughout the duration of Canada’s recession. Yet consumer borrowing has slowed to a snail’s pace and business borrowing continues to contract, weakening the prospects for new business capital spending. This suggests that while the financial rescue package certainly protected the banks, it did not succeed in fully protecting Canadians’ access to credit.

In the fiscal arena, the Harper minority government’s response to the crisis — in contrast to its quick and powerful interventions to support the banks — has been grudging and slow. Harper’s February 2009 stimulus package amounts to $18 billion for 2009–10, paling in comparison to the potential $200 billion financial sector bailout and falling well short of the International Monetary Fund recommendation that governments spend 2% of GDP on stimulus. Yet even this announced spending has been slow to flow, bound up in layers of delays and red tape that may be jeopardizing Canada’s economic recovery. For example, total federal spending during the first half of 2009 increased by only 2.1% compared to a year ago.

To assess the effectiveness of Canada’s stimulus package, Macdonald breaks down the elements of the Harper minority government’s modest spending increase. He isolates spending on infrastructure projects most likely to directly create new jobs and stimulate activity to counteract the 2008–09 recession. Compared to indirect stimulus measures such as tax cuts, loans to auto companies, and pre-announced or automatic increases in federal transfer payments and social programs, Macdonald finds the Harper government’s infrastructure stimulus efforts have fallen short of what’s needed. Federal stimulus spending on infrastructure projects most likely to create new jobs in Canada when it was needed it most — during the first five months of the current fiscal year (from April to August 2009) — went up by only $1.9 billion compared to the same period a year ago. Only 22% of promised budget increases in key job-creating areas had been spent during the first five months of this year. This very small spending increase in infrastructure stimulus that was most likely to directly create new jobs amounts to about one-tenth of one percent of Canada’s GDP.

Chart 1 illustrates just how insignificant the government’s infrastructure stimulus spending has been.
Infrastructure stimulus spending is the most likely of government investments to create jobs during an economic downturn, but actual infrastructure stimulus spending in Canada to date in this recession pales dramatically in comparison to the massive funds marshalled for the financial sector. The scale of the different stimulus interventions speaks volumes of the federal government’s priorities during the economic crisis.

Federal spending in crucial infrastructure budget categories has actually declined since Canada fell into recession. Over the crucial period from October 2008 through August 2009, stimulus program spending in key infrastructure categories that would have directly created new jobs in Canada fell by $1.7 billion, compared to the previous year. Despite the Harper minority government’s pledge to pump direct stimulus into Canada’s beleaguered economy, when we remove tax cuts, corporate loans, and pre-announced or automatic increases in social spending, we conclude its fiscal effort has actually weakened.

The U.S. government, in contrast, has done a far better job of increasing federal government expenditures to combat economic contraction. During the first half of 2009, the U.S. federal government increased its total spending by 14.5% compared to a year ago. Canada’s federal government increased its total spending during the same period by only 2.1%. By this measure, America’s federal stimulus effort is outpacing ours by a ratio of 7 to 1.

Meanwhile, those hit hardest by Canada’s recession—hundreds of thousands of newly unemployed Canadians and millions of fearful pensioners—have been less supported than in any other economic downturn since the Great Depression.
Part One: Recovery? What recovery?

Economists and politicians alike have been watching Canada's economic data very closely in recent weeks, searching for signs (so-called “green shoots”) of imminent economic recovery. After experiencing the largest contraction in nominal GDP since the end of World War II, a 50% increase in unemployment within a year, and unprecedented financial instability, Canadians are eager to see signs of a rebound. Political leaders and economic officials have a special motive to emphasize the bright side of economic affairs, in order to make their government look better and to try to promote confidence among consumers and businesses. To some degree, positive thinking can even become self-fulfilling: if hopes of a stronger economic future spur more spending by consumers and businesses, that sentiment itself can translate into a turnaround.

Some recent economic reports seem to have given support to this growing conviction that recovery has arrived. For example, Canada's GDP grew marginally in June — after 10 consecutive months of decline — but then it shrank marginally again in July. Meanwhile, seasonally adjusted employment grew by over 30,000 jobs in September. No less an authority than Mark Carney, the Governor of Canada’s central bank, declared confidently back in July that the recession was already over, and that the process of re-establishing economic expansion had begun.

Bolstering the illusion of recovery, Canadian financial markets have been in full-fledged expansion mode since March of this year. The Toronto stock exchange index has climbed by over 50% in seven months — its fastest bull market ever, creating about a half-trillion dollars worth of shareholder value in no time flat. Bank profits have recovered strongly (net after-tax income totalled over $14 billion over the past four quarters for the Big Five Canadian banks alone), to the point that the major Canadian banks are already setting aside billions of dollars once again for executive bonuses and other performance-based compensation. However, this renewed financial exuberance should not be mistaken for a recovery in the real economy — where working Canadians produce real goods and services, distinct from the business of trading in financial assets. Beyond Bay Street and the financial industry, Canada's economic indicators are not so positive.

The cold hard economic reality facing most Canadians has not been altered by upbeat financial reports, nor by the hopeful exhortations of political and economic officials that the worst is over. While it is clear that the frightening economic free-fall which occurred in the wake of the most acute phase of the global financial crisis last autumn has levelled off — Canadian employment and output are no longer contracting rapidly — it is not yet evident that a genuine rebound has begun in Canada.

The normal mechanisms of economic expansion in Canada's market economy — where business investment, construction, or exports generate multiplied positive impacts on economic activity through the spending and re-spending of new income — have not been re-established. Available data suggests the underlying drivers of private sector growth, especially exports and business capital investment, are getting weaker, not stronger.

This report card on the economic recovery provides an overview of the evidence regarding Canada’s economic recovery. Work and production are stagnant at best, and still contracting in the private sector. The main drivers of future growth in the private sector are still contracting significantly. Incomes are stagnant; without government transfers they would be falling. Consumer spending is just holding on. Credit conditions continue to tighten, especially for businesses. Prices are falling, a sign of continuing profound weakness in demand conditions. If this deflationary pattern becomes rooted, it can create a self-reinforcing contraction in prices and incomes. On the basis of all these indicators, it would be dangerously premature to conclude that Canada's economy is now poised for recovery.

Increases in public spending by all levels of government have been essential — though not enough — to stabilize the economy. Continued increase in public spending will be essential to stop the economy from shrinking again, and to generate sufficient positive momentum that the economy eventually becomes able to, once again, autonomously create and sustain new jobs and income.

How Economic Expansion Occurs

About 85% of Canada's GDP is attributable to the activity of private, profit-seeking businesses, so trends in aggregate variables such as GDP, employment, and income are dominated by trends in private sector activity and sentiment. Typically, in a market system like Canada’s, injections of initial spending power or investment are required in order to get the economic ball rolling. This could consist of investments by business in new facilities or products, increased demand from abroad for
Canadian-made goods and services or an expansion in consumer spending on an important product such as new housing.

In the word’s most common usage, a recovery has begun once a country’s real GDP has stopped falling and started growing — no matter how quickly or slowly, and no matter what the composition of that growth. But this technical definition of recovery in no way implies that the whole economy is back on track. For a true recovery, other qualitative conditions must also be met. There must be a sustained source of new initial investments or expenditure power to continue stoking the fires of expansion. That resulting expansion must be sufficiently vibrant to more than keep up with population and productivity growth, creating new jobs offsetting the drop in income and living standards that was experienced during the recession.

By these criteria, there is no evidence that Canada’s overall economy is pulling itself out of recession. Without exception, the traditional drivers of private sector expansion (business investment, exports, and construction) continue to weaken, not strengthen. The decline in private sector activity has been partly offset by important and necessary injections of spending power from government. Indeed, at this point in time, Canada’s public sector — three levels of government, including public entities financed by government such as education and health care — has become the only engine of growth. So far it is the only source of new investment and purchasing power to stimulate the second-order spending and job creation needed for an economic recovery. This public sector rescue effort was not enough to prevent or offset the private sector recession. But it has been essential to stabilizing Canada’s economy and, without it, Canada would have fallen deeper into recession.

Yet even this significant growth in public spending has not yet been sufficient to rekindle generalized growth. More backup from the public sector will be required in the months to come, unless and until the traditional drivers of economic growth in a capitalist economy — investment, exports, and construction — start to display vigour again.

**Evaluating Canada’s Economic Recovery**

This section reviews the state of 10 different critical indicators (summarized in Table 1). The goal is to evaluate whether Canada’s economy is recuperating from the recession, on the basis of a snapshot of recent relevant statistical data.

**Real GDP**

This is the conventional, narrowest metric for measuring economic growth, recession, and recovery. If real GDP falls for two quarters, then economists consider the country to have experienced a recession. Once it begins growing again, no matter how fitfully, it is considered to be in recovery. It was on the expectation (still not certain) that Canada’s real GDP would expand slightly in the third quarter of this year that Mr. Carney declared the recession officially over back in July. A tiny uptick in real GDP during the month of June (of 0.1%) was the spur for this optimistic conclusion.

National GDP fell by 0.9% in the second quarter of this year, despite the uptick in June. It then confounded the optimists by falling slightly (by less than a tenth of a percentage point) in July. Excluding the public sector, which has continued to grow throughout the recession, real GDP produced in the private sector has been falling more quickly — by 1.1% in the second quarter and by almost 6% over the past year. Private sector GDP is still falling. Even by this narrowest of measures, therefore, it cannot be said the recession is over.

**Employment**

Total employment in Canada expanded slightly in August, and then more significantly (by over 30,000 jobs) in September. This growth has been due entirely to increased employment in the public sector, including activities such as education and health care. Private sector employment has continued to decline. Growth in total employment did not exceed population growth, Canada’s employment rate, which measures the proportion of working age Canadians who have work, is still at its lowest level of the cycle. The proportion of total employment located in contingent or precarious positions (including part-time work, self-employment, and contract or temporary jobs) has increased notably throughout the recession, indicating that the quality of jobs (not just their quantity) has declined.

**Unemployment**

Unemployment shrank in September and the unemployment rate fell by 0.3 percentage points for the first time in over a year. But this decline in unemployment was mostly due to a significant drop in labour force participation, which declined to 67.1% of the working age population. The fall in the participation rate over the past year is equivalent to the exit of over 200,000 Canadians from the labour force. If labour force participation had remained at its pre-recession levels, Cana-
Canada’s Long Road To Economic Recovery

Monthly export data indicate that the slide in export sales continues. Canada’s merchandise exports fell another 5% in August alone, contributing to the emergence of Canada’s largest monthly trade deficit ever. A combination of deep recession in the key U.S. market, the rocketing takeoff of Canada’s currency (which has soared by 25% against its U.S. counterpart since March) and structural weakness in key export industries such as automotive products is causing an unprecedented contraction in Canadian exports that will certainly continue to drag down Canadian economic activity.

Business Investment and Construction

Despite the boom on Bay Street, real business capital spending continues to decline rapidly, indicating once again that the hyperactive world of finance has very little connection to the real work of investment and capital accumulation. Non-residential fixed capital spending declined 6.6% in the second quarter and has fallen by 11% year over year. For 2009, private sector capital spending is expected to decline by 13% from 2008, according to Statistics Canada’s survey of investment intentions. Residential

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<tr>
<th>Indicator</th>
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<tr>
<td>1. Real GDP</td>
<td>July, 2nd Quarter</td>
<td>Total real GDP stagnant. Private sector real GDP falling.</td>
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<tr>
<td>3. Unemployment</td>
<td>September</td>
<td>Unemployment fell in September, mostly due to falling labour force participation.</td>
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<td>4. Exports</td>
<td>August, 2nd Quarter</td>
<td>Exports declining significantly. Record merchandise trade deficit.</td>
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<tr>
<td>8. Consumer Spending</td>
<td>July, 2nd Quarter</td>
<td>Total consumer spending up slightly in second quarter. Retail sales down in July.</td>
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See text for specific data citations. All data from Statistics Canada CANSIM database.
construction activity has held up better than business investment, but shows no clear signs of recovery either: seasonally adjusted new housing starts fell in September. Even including residential construction, total capital investment fell 3.5% in the second quarter and is still shrinking.

**Personal Income**
To support growing expenditure on the range of goods and services which they purchase, households need growing incomes. Total nominal personal incomes edged up by 0.1% in the second quarter, marking a cumulative year-over-year increase of just 0.3% — the weakest year-over-year growth on record. However, a significant increase in government transfer payments, including EI benefits, welfare, and pensions, was essential to even that miniscule increase in personal income. Excluding government transfer income, total personal income fell in Canada in the second quarter by 0.4%.

**Labour Compensation**
Wages, salaries, and other employment compensation are the most important source of personal income in Canada. Most Canadians depend on employment compensation for the bulk of their income and spending. Total nominal labour compensation has been declining this year, for only the second time in Canada’s postwar history. Labour compensation in the business sector has declined more rapidly, by 1.1% in the second quarter and almost 2% year over year.

**Consumer Spending**
Consumer spending is the largest single component of GDP, accounting for over half of all spending. It is rare that consumer spending actually determines the direction of overall GDP. Consumer spending tends to respond to trends in the underlying engines of growth and job creation — injections of spending like business investment, exports, or construction. But consumer spending is an important indicator of whether strength or weakness in those engines is sufficient to influence the momentum of the overall economy. And on rare occasions, a sudden shock in consumer sentiment can actually cause a recession in its own right. This was not the case with the current recession, in which the downturn in consumer spending lagged visible weakness in other components of GDP — most notably investment and exports.

Consumer spending in Canada has held up more strongly through the current recession than has been the case in the U.S. and some other countries. Perhaps the greater demonstrated stability of Canadian banking institutions, backed by unprecedented government assistance, has been a factor here. At any rate, nominal consumer spending grew during the second quarter by 0.6%. Consumer confidence is still obviously shaky. More recent monthly data on retail sales in Canada indicated a decline in retail spending of 0.6% in July. Even after adjusting for the decline in gasoline prices, an important component of total spending, real retail spending declined in July.

**Credit**
New borrowing by consumers and businesses is essential to the growth of new spending. Credit conditions were very negatively affected by the financial crisis of 2008 and 2009. Since then, reductions in interest rates and active measures to support Canadian bank lending by government have helped to maintain capacity for borrowing by consumers. Consumer borrowing in Canada has continued to increase, albeit at one of the slowest rates in history (by 0.6% in July). Business credit conditions remain very contractionary, however. Total business credit declined by 1.3% in August and has fallen by almost 6% year over year. Credit markets, therefore, currently reveal two personalities: consumer borrowing is more robust than business borrowing. But consumer borrowing and spending alone cannot sustain an entire economy’s growth for long, unless and until the underlying engines of growth (like business investment) also show positive momentum. Without ongoing progress in those core sectors — exports, investment, construction — which traditionally drive private sector economic expansion, continued consumer borrowing and spending will only set the stage for a painful day of reckoning in the future, once it becomes clear that we were driving a car with no engine, fuelled only by continued injections of consumer debt.

**Inflation and Deflation**
Consumer prices in Canada are teetering on the edge of deflation. For four consecutive months, Canada’s consumer price index has registered a year over year decline. This indicates very weak conditions in many consumer markets. Inflation has fallen well below the Bank of Canada’s target band, as desperate businesses in many industries cut prices in order to attract customers. Falling prices are a consequence of serious recession, but in turn they can then make the recession worse by undermining business investment and exacerbating downward pressure on wages and incomes.
Evaluating the Public Sector Economy

The one bright light in Canada’s economic performance over the past year has been a significant and necessary expansion in work, production and investment in Canada’s broader public sector (including the activities of federal, provincial, and municipal governments, and public agencies and services like education and health care). The public sector was relatively immune to the downturn in private sector production and spending. Even better, governments at all levels have, to varying degrees, expanded their own spending and service provision, despite the fall in government revenues that accompanied the recession, in hopes of offsetting the contraction in the rest of the economy.\(^8\)

For several of the indicators reported in Table 1 for the overall Canadian economy, corresponding data is available reporting on their recent trend solely within the public sector of the economy. These performance indicators are summarized in Table 2, and they show that public sector activity, in contrast to the recession-mired private sector, is growing. Indeed, the public sector has become the only driver of underlying economic growth that is presently pushing in a positive direction. This makes it all the more important for the public stimulus effort to be maintained well into the future.

Public sector GDP and employment have increased steadily throughout the last year. Without those public sector gains, total GDP and employment would be continuing to decline. Public purchases of goods and services grew 1.5% in the second quarter and by over 5% year over year. Public sector employment grew another 1.1% in September, reaching over 3.4 million Canadians. Public sector investment spending has also grown strongly: up by 2.1% in the second quarter and by 12.8% year over year. Labour compensation in the government sector is growing (in contrast to shrinking private sector payrolls), up by 1.3% in the second quarter and 5% year over year. Government has also made a crucial contribution to stabilizing personal incomes in Canada through increased transfer payments, which grew 3.1% in the second quarter and 7.6% year over year. Even the government deficits which are associated with this ramp-up of public sector activity (causing consternation among fiscal hawks) play a useful role during economic contractions: new government borrowing is the only source of credit creation to support overall spending power in the economy, when private sector agents (especially businesses) are reducing their own borrowing in the face of the downturn.

In summary, Canada’s broader public sector has provided a welcome and necessary boost of spending over the past year, partly offsetting the profound weakness in the traditional drivers of private sector economic expansion, especially business investment, exports, and construction. Those public injections were not sufficient to prevent recession, but they were essential to level off the downturn. Even more public support will be required in the months and years ahead, however, to offset the continuing contraction in business investment and exports and to fuel a broader, more lasting expansion in the aggregate economy.

The federal government is obviously a crucial player in this important overall expansion of public sector activity, although actions by lower levels of government and by other public agencies and service providers are equally crucial. Part two of this report will now review in detail the federal government’s economic response to the dramatic and painful events of the past year.

### Table 2: Evaluating Canada’s Public Sector Performance: Recent Economic Indicators

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<thead>
<tr>
<th>Indicator</th>
<th>Latest Data</th>
<th>Notes</th>
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<tbody>
<tr>
<td>Work and Production</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real GDP</td>
<td>July, 2(^{nd}) Quarter</td>
<td>Public sector real GDP has grown steadily.</td>
</tr>
<tr>
<td>Employment</td>
<td>September</td>
<td>Public sector employment has grown steadily.</td>
</tr>
<tr>
<td>Drivers of Growth</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment</td>
<td>2(^{nd}) Quarter</td>
<td>Government investment spending up 12.8% year over year.</td>
</tr>
<tr>
<td>Income and Spending</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal Income</td>
<td>2(^{nd}) Quarter</td>
<td>Government transfers grew in second quarter, preventing a decline in total personal income.</td>
</tr>
<tr>
<td>Labour Compensation</td>
<td>2(^{nd}) Quarter</td>
<td>Labour compensation in government sector has grown.</td>
</tr>
<tr>
<td>Credit</td>
<td></td>
<td></td>
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<tr>
<td>Government Borrowing</td>
<td>2(^{nd}) Quarter</td>
<td>Government borrowing helping to offset de-leveraging in private sector.</td>
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8 AFB 2010 Canada’s Long Road To Economic Recovery
Part Two: Not Up To The Task: The Federal Government’s Response to Canada’s Economic Crisis

Like the Great Depression, the worldwide economic crash of 2008 that has thrown Canada into the worst recession since World War II was precipitated by a major crisis in the financial sector. While banks and financial companies were imploding in the U.S. and elsewhere, the contagion effects of globally integrated financial markets were also putting the Canadian financial system under stress. Meanwhile, Prime Minister Stephen Harper was insisting to the world that Canada’s banks were sound, even as his minority government was handing them one of the biggest industry support packages in Canadian history.

Canada’s bank intervention came in mid-October 2008, just as the nation was plunging into recession. Unprecedented in its scale and in its swiftness, this extraordinary intervention provided banks with cash by purchasing their residential mortgages, and finding other ways to provide liquidity. The potential value of the mortgage program alone is $125 billion or 8% of GDP. Together with other initiatives, the potential government support for Canada’s ostensibly sound financial sector totalled $200 billion.

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<tr>
<th>TABLE 3</th>
<th>Evaluating the Federal Government’s Response to the Economic Crisis</th>
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<tbody>
<tr>
<td>Indicator</td>
<td>Description</td>
</tr>
<tr>
<td>1. Bank intervention</td>
<td>Since October 2008 the federal government has funded $65.5 billion worth of residential mortgages, and provided other massive financial support to the banking and financial industries.</td>
</tr>
<tr>
<td>2. Monetary stimulus</td>
<td>The Bank of Canada’s key interest rate is now close to zero and the Bank has taken unconventional measures to expand credit and the money supply.</td>
</tr>
<tr>
<td>3. Fiscal stimulus spending since the financial crisis</td>
<td>Net infrastructure stimulus spending that can directly create jobs contracted by $1.7 billion in the period from October 2008 to August 2009 (compared to year-earlier levels).</td>
</tr>
<tr>
<td>4. Getting stimulus “out the door”</td>
<td>Net infrastructure stimulus program spending grew by only $1.9 billion in the first five months of this fiscal year (from April through August 2009), compared to year-earlier levels. This amounts to only 22% of the $8.4 billion in new spending that was allocated to these expenditure areas in this year’s budget.</td>
</tr>
<tr>
<td>5. Stimulus timing</td>
<td>With so little money spent before the summer, most projects won’t get started until next year.</td>
</tr>
<tr>
<td>6. Keeping pace with U.S. stimulus</td>
<td>U.S. federal spending has increased at seven times the rate of Canadian federal spending during the first half of this year.</td>
</tr>
<tr>
<td>7. Spending all the stimulus money</td>
<td>Green projects don’t even have “committed” status. Projects may run long because of delays and have their funding cut.</td>
</tr>
<tr>
<td>8. Stimulus report transparency</td>
<td>Simple data like total spent, projects funded, and total jobs created to date are not publicly available.</td>
</tr>
<tr>
<td>9. Protecting the unemployed</td>
<td>Government EI changes have had not enough impact in allowing unemployed Canadians to access the EI system; most unemployed Canadians still receive no benefits.</td>
</tr>
<tr>
<td>10. Protecting seniors</td>
<td>Despite significant concern about pension plan viability and lost incomes to pensioners as a result of the financial crisis, no meaningful pension reforms have been implemented.</td>
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</table>

In sharp contrast to this quick and powerful financial rescue, the Harper minority government dragged its heels on a fiscal stimulus intervention for the real economy for four long months after Canada plunged into recession. Even then, the Harper minority government acted only once its back was up against an electoral wall, facing a coalition of opposition parties who had lost confidence in the minority government’s ability to steer the economy through rough waters. Harper’s February 2009 announced stimulus package amounted to $18 billion for 2009–10. This pales in comparison to the potential $200 billion financial sector bailout and falls well short of the International Monetary Fund’s recommendation that governments around the world inject fiscal stimulus equal to at least 2% of GDP to protect their citizens from the worst of the economic crisis. Now, however, it’s not even clear that those announced funds are being spent as quickly, or in as large amounts, as promised. Concrete data on federal spending since the recession hit indicate that federal spending is growing only modestly, especially on infrastructure projects and other direct programs that would provide the most direct and powerful boost to output and employment. By some measures, the Harper minority government’s spending on infrastructure
stimulus most likely to directly create new jobs has actually declined since the onset of the recession last fall.

This section of the report reviews 10 different dimensions of the federal government’s response to the economic crisis (summarized in Table 3). In the financial arena, the government’s response was immediate and powerful — consisting mainly of an unprecedented effort to support Canada’s banks, which remained highly profitable throughout the downturn. But in the real economy, the federal response was much slower and stingier. As a result, Ottawa has not lived up to its responsibility to protect Canadians, to the fullest extent possible, from the ravages of a recession which originated in the irrational and immoral actions of the private financial system.

Canada’s Financial Sector Bailout

Since October 2008, the Harper minority government has purchased $65.5 billion worth of residential mortgages from Canadian banks and auctions are continuing to a promised potential maximum of $125 billion.

The amount of funds marshalled to provide liquidity to the banks is staggering. The intervention is so significant that the Harper minority government has effectively funded all net new mortgages in Canada since August 2008. The federal government now owns approximately 7% of all Canadian residential mortgages.

The public purchasing of bank mortgages started on Oct 16, 2008, within a month of the onset of the financial crisis. By the New Year, the government had already purchased $25 billion worth of mortgages from the banks, which is the equivalent of almost the entire value of the fiscal stimulus package for 2009, including provincial contributions.

The Bank of Canada created several additional loan facilities to channel funds to financial firms, including Term Purchase and Resale Agreements, as well as a Term Loan Facility, which allowed firms to borrow from the Bank using a variety of financial assets as collateral.

The scale of Canada’s financial intervention left no doubt that the Harper minority government had the capacity and will to marshal extraordinary resources to support a financial sector under stress.

Although the government’s purported goal in providing the financial support package was to enable banks to increase lending to households and businesses, virtually no conditions were attached to the assistance. Since no reporting requirements were put into place to ensure that the banks were, in fact, parlaying this assistance into increased lending to households and businesses, it is difficult to know whether this goal was achieved. Business credit has contracted since the financial rescue package was delivered. Consumer credit has continued to grow, but at a historically slow rate.

Monetary Stimulus

Almost immediately after the financial collapse, the Bank of Canada began lowering its key lending rate in order to stimulate the imploding economy. Following the lead of the U.S. Federal Reserve, the Bank cut its rate from 3% to 0.25% between September 2008 and April 2009. This near-zero rate is the lowest in Canadian history.

In an unprecedented move to jawbone down long-term interest rates, it pledged — barring the return of inflation — to keep its main rate at that level until the middle of 2010. (As noted above, the greater threat at the moment is deflation, not inflation.) The Bank has also indicated that it is prepared to employ quantitative easing measures if necessary by increasing the reserve base of the central bank, which leads to an expansion of deposits at the banks and in the money supply.

The Bank of Canada recently raised the possibility of intervening in the foreign exchange market to bring down the dollar which, driven by financial market speculation, has appreciated dramatically relative to the U.S. dollar in recent months (by over 25% since March). Canada’s currency has soared against the U.S. dollar by more than twice as much as the trade-weighted average of all global currencies. The Bank of Canada and the federal government must address the seriously overvalued Canadian dollar, which is threatening economic recovery and causing a further slide in Canadian exports.

Finally, the Bank of Canada’s continued focus solely on a 2% inflation target is too rigid. It should broaden its policy goals to include employment and economic growth along with inflation as near term objectives.

Canada’s Fiscal Stimulus Measures

Not all fiscal stimulus measures are created equal. Some have a more powerful effect on the economy than others.

Tax cuts, especially broad-based tax cuts, have a relatively weak stimulus effect. In bad economic times households are
more likely to save their tax cuts, pay down debts or even buy imports rather than spend that money immediately on goods and services produced in Canada. As a result, the jobs created by tax cut measures are relatively small.

Improved access to Employment Insurance (EI) is a more powerful stimulus because it is directed toward workers who have lost their jobs and are therefore more likely to spend their EI benefits in their local community. It also helps protect households from economic freefall during recession.

When financial markets are contracting, and both businesses and households are clamping down on spending, government is the only actor left to stimulate the economy and prevent a further downslide. The most powerful thing governments can do in the event of a recession is to directly spend money in the Canadian economy by expanding physical or social infrastructure, whether that is by building bridges or expanding staffing at hospitals. This type of spending requires more planning and, if structured poorly, can experience significant lag times. The challenge is to get stimulus money out the door, spending it on real production and employment, in a hurry. If done right, infrastructure stimulus spending is most likely to directly create new jobs and can make a powerful difference at a time when the economy needs it most.

However, when it comes to expediting Canada’s stimulus promises, the Harper minority government has fallen far short. Canada’s recession started a year ago. The Harper minority government’s bank intervention was introduced rapidly, in mid-October 2008, almost a month to the day after the stock market crash. In November, the Harper minority government had an opportunity to introduce fiscal stimulus measures to secure the real economy, through its much anticipated fall economic and fiscal statement. But it did not do so. Once forced by the opposition coalition, the Harper minority government finally introduced its stimulus plan in its 2009 budget, at the end of January. Most measures were to be implemented beginning April 1st, 2009 – nine long months after recession struck home.

The Harper minority government committed to Canadians to stimulate the economy with different types of new spending. In this section, we examine the government’s net new stimulus infrastructure spending — new money that had not previously been committed. For instance, if the government decided to build new affordable housing with one part of its budget but then cancelled community centre construction to save that money on the other, one could hardly call that net new stimulus spending. As well, if the government announced last year that it was going to double the gas tax and then re-announced that doubling later as stimulus spending, that could hardly be called net new stimulus.

In order to determine if the government is in fact spending the stimulus dollars it promised, we look at the net increases in spending to make sure they aren’t cutting elsewhere. We exclude pre-announced spending increases so we are capturing only the net new stimulus spending. We also look for stimulus spending in areas where the government has promised to spend it. If there is a department, like defence, where the government has not announced stimulus spending, we do not count an increase in such spending as net new stimulus spending. We include all program spending, with few exceptions.

Tax cuts and increases in transfers to Canadians through EI and elder benefits can be implemented almost immediately and, for the most part, they were. In fact, tax revenues are down significantly since last year, in part due to changes introduced in Budget 2009.

Infrastructure spending is not an automatic stabilizer like EI that reacts immediately to economic difficulties. Infrastructure spending requires planning but it is the most effective at creating jobs and can be delivered far more quickly than it has been to date.

By infrastructure we mean physical infrastructure (such as building new affordable housing), but also social infrastructure like training for the unemployed. Federal departments are also included, since they make up a critical part of federal social infrastructure in the programs and services they deliver. We include programs like First Nations infrastructure, affordable housing construction, university building rehabilitation and other direct programs as outlined in Table 6.

While Employment Insurance is an automatic stabilizer that kicks in without need for additional planning on the government’s part, the extensive new training programs proposed in Budget 2009 do not commence automatically. Instead, putting these new training programs in place requires planning and getting the $1.3 billion dollars out the door will be challenging. As such, EI training is included as social infrastructure while the EI payments as automatic stabilizers are excluded.

Sectoral financial assistance like the automotive loans and the massive banking intervention are helpful to those industries and likely preserved jobs, however they are not infrastructure related. Such sectoral supports have been excluded to focus more specifically on infrastructure spending both physical and social.11
Canada’s Long Road To Economic Recovery

change in spending is included. After all, federal departments perform a vital role in delivering services to Canadians and make up an important part of Canada’s social infrastructure.

Table 4 examines the net change in infrastructure stimulus spending between the stock market crash (and the beginning of the massive Canadian bank intervention) in October 2008, to the most recently available data from August 2009. Program spending is compared to the same eleven-month period in the previous year.

The change in net Infrastructure Stimulus Spending over the past year — highlighted in Table 4 — is surprising. Net Infrastructure Stimulus Spending from October 2008 to August 2009 declined by $1.652 billion compared to the previous year. The drop reflects reductions in federal department and agency spending starting in October 2008, at the same time the stock market crashed and recession hit home.

The conclusion: during the worst worldwide recession the world has seen since the Second World War, the Harper minority government oversaw an actual net decline in its Infrastructure Stimulus Spending. In terms of recession-fighting expenditures, the Harper government took a troubling procyclical position.

Getting Stimulus Out the Door

The preceding table summarizes the change in net infrastructure stimulus spending from the worst phase of the financial crisis last autumn. Here we examine net infrastructure stimulus

<table>
<thead>
<tr>
<th>Fiscal Monitor Heading ($Mil)</th>
<th>October 07 to August 08</th>
<th>October 08 to August 09</th>
<th>Net Change from previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Program Expenses</td>
<td>185,508</td>
<td>200,717</td>
<td>15,209</td>
</tr>
<tr>
<td>Excluded Items</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Automotive Industry Loans</td>
<td>0</td>
<td>7,567</td>
<td>7,567</td>
</tr>
<tr>
<td>Total Transfers to Persons</td>
<td>54,014</td>
<td>60,508</td>
<td>6,494</td>
</tr>
<tr>
<td>Health and Social Transfers to the Provinces</td>
<td>29,619</td>
<td>31,531</td>
<td>1,912</td>
</tr>
<tr>
<td>Doubling of Gas Tax Transfer to Municipalities</td>
<td>0</td>
<td>677</td>
<td>677</td>
</tr>
<tr>
<td>Transfers to Defence</td>
<td>17,121</td>
<td>17,332</td>
<td>211</td>
</tr>
<tr>
<td>Total Excluded Items</td>
<td>100,754</td>
<td>117,615</td>
<td>16,861</td>
</tr>
<tr>
<td>Net Change in Infrastructure stimulus spending (Total Program Expenses — Excluded Items)</td>
<td>84,754</td>
<td>83,102</td>
<td>-1,652</td>
</tr>
</tbody>
</table>

Source: The Fiscal Monitor
The money may well be allocated in the 2009–10 fiscal year, but the vast majority of the projects will not begin until the 2010 building season. With such a substantial delay, a critical window to offset rising unemployment—at a time when Canada needed it most—was missed. Statistics Canada data indicates that construction employment continued to decline in Canada through July, and only began to rebound modestly in August and September. This indicates the Harper government’s infrastructure stimulus plan missed most of the spring and summer building season.

Canada’s stimulus program needed to get money out the door fast, with as few unnecessary restrictions and hurdles as possible, to ensure shovel-ready projects were breaking ground in the spring rather than late summer—at a time when Canada needed it most—was missed. Statistics Canada data indicates that construction employment continued to decline in Canada through July, and only began to rebound modestly in August and September. This indicates the Harper government’s infrastructure stimulus plan missed most of the spring and summer building season.

Table 5 highlights the same items reported in Table 4. However, the time frame in Table 5 corresponds to the start of the federal government’s fiscal year in April. As Table 5 illustrates, only a net $1.9 billion has been spent in Infrastructure Stimulus Spending since April 2009. This is a better performance than over the longer period (from October to August), when net infrastructure stimulus spending actually declined. However, given the stimulus promises laid out in Budget 2009, the increase in spending since April has been disturbingly small.

As Table 6 illustrates, the Harper government promised to direct $8.4 billion in 2009–10 into the same program spending areas which we included in our measure of Infrastructure Stimulus Spending: the budget areas which have the most powerful job creating effects. However, as Table 7 shows, with net infrastructure stimulus spending of only $1.9 billion by the end of August 2009, only 22% of the $8.4 billion budgeted increase in job creating stimulus dollars for 2009–10 had been spent.

There does not appear to have been a significant push to get job-creating infrastructure stimulus dollars into the hands of provinces and municipalities before the summer construction season. Few projects were even started in summer of 2009.

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Canada’s stimulus program needed to get money out the door fast, with as few unnecessary restrictions and hurdles as possible, to ensure shovel-ready projects were breaking ground in the spring rather than late summer—almost a full year after recession thundered in. But instead of speedy action, job creation spending was initially delayed by the political shenanigans of last fall, and then by an unnecessarily cumbersome bureaucratic structure created to oversee the spending. The Harper government’s infrastructure stimulus plan missed most of the spring and summer building season.

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Keeping Pace With U.S. Stimulus

The American stimulus package was passed within a month of the Canadian budget and within mere weeks of President Barack Obama taking office. It provides a benchmark against which Canadians can evaluate their own stimulus package progress. Tables 4 and 5 focused directly on net Infrastructure Stimulus Spending in Canada (stripping out other forms of government spending that have less impact on actual production and employment). A comparable decomposition of spending in the U.S. is more difficult. While the analysis of Canadian infrastructure stimulus spending excludes specific items like EI, our comparison with the U.S. stimulus effort does not. Instead, in this section all government spending is considered (for both countries) with the exception of tax cuts. To ensure comparability, we use national accounts data from the two countries (rather than official budget reports).

Table 8 illustrates that compared to the U.S. federal government, the Canadian federal government’s effort to increase expenditures and stimulate the economy has been far less ambitious and timely. In terms of the rate of growth of total spending, Americans are outpacing Canadians 7 to 1. In transfers to lower levels of governments (states, provinces and municipalities), they are outpacing Canadians 10 to 1. In the growth of transfers to individuals for programs like EI and seniors programs, U.S. federal spending is growing three times...
faster than Canada. Only in the purchase of goods and services is Canada even in the ballpark, although we are still boosting our spending slower than the Americans as of the middle of 2009.

It is certainly true that America’s recession has been more severe than Canada’s (not surprising given its greater exposure to sub-prime lending problems and other financial problems. As a result, the U.S. needed an especially large and powerful stimulus effort to stem the economic freefall. However, Canada’s government had a responsibility to move as quickly and powerfully as possible to protect Canadian jobs and incomes. This evidence indicates Canada’s federal stimulus effort has been both weak and slow compared to the U.S. effort.

### Stimulus Reporting Transparency

On the issue of transparency, Canada can also learn from its American neighbours. Under the terms of the American Recovery and Reinvestment Act, extremely detailed information is publicly available regarding specific projects that have been supported by the stimulus program, the timing and amounts of spending, and the resulting economic effects, such as job creation. This allows Americans to find out where and how government funds are being spent and to identify the supported projects that could benefit them.13

Unlike the American model, however, Canadians still do not have access to basic information about the government’s stimulus spending, such as how much money has been spent and how many jobs have been created. These simple measures are updated weekly in the U.S. and in other countries. Unfortunately, Canadians are left to guess about how their government’s money is being spent — if, in fact, it is being spent at all.

So far the Harper minority government’s reporting on the roll-out of its stimulus effort has revealed how much of the money has been committed, not what has been spent. Its definition of committed may mean as little as a sign going up or a project being featured in a taxpayer funded television commercial. More information is needed for a complete evaluation.

### Spending All of the Stimulus Money

When it unveiled its economic stimulus budget, the Harper minority government stipulated that any allocated monies not spent within two years would be cut off and recouped. With year-long delays resulting from political shenanigans and unnecessary bureaucratic restrictions, Canadians should be concerned that significant portions of promised stimulus dollars may in fact never be spent. This may be setting the stage for the Harper government to announce a convenient fiscal “surprise” some time in the future: if stimulus funds are delayed and eventually clawed back, then future budget deficits could come in significantly lower than currently anticipated. But this would not be testimony to the virtues of prudent fiscal management. It would represent a phony achievement, attained on the backs of Canadians who remained unemployed as a result of needless delays in delivering necessary stimulus.

As noted above, the Harper government’s definition of which stimulus funds have been actually committed is vague. Worse yet, in one notable area funds have not even been committed: green infrastructure. The two green infrastructure stimulus areas announced in the budget total $400 million. So far only $7 million has actually been committed.14 There appears to be no plan for how to invest in this area that is so critical to sustainable economic growth in the future.

### Protecting the Unemployed15

Much of the debate around the stimulus package and throughout the summer of 2009 centred on how Employment Insur-
Despite the incremental expansion of benefit rules, the grim reality is that half of Canada’s officially unemployed individuals have been left without regular EI protection in the midst of a terrible recession. This compares starkly to unemployment eligibility in previous recessions, before the punitive changes to the system which were implemented in the early 1990s, when 80% or more of unemployed Canadians qualified for benefits.

Protecting Seniors

The stock market crash of September 2008 has highlighted the fragility of the pension system that Canadians rely on. Canadians who are members of pension plans have been put at risk due to last year’s financial meltdown; many defined benefit plans are badly underfunded, and this translates into big cuts in pension income when troubled companies go out of business (as occurred with Nortel, AbitibiPrice, and other failed companies). Canadians who rely on defined contribution or RRSP-style programs face even more severe risks; their pension incomes fell immediately in line with the financial downturn. Meanwhile, the majority of working Canadians simply have no workplace pension benefits at all, and hence must rely solely on public plans and their personal savings. Currently only 38% of employed Canadians have a workplace pension plan, down from 45% in 1992.

Employers are moving away from defined benefit plans and towards defined contribution plans, placing all of the risks for future benefits squarely on the shoulders of employees. For those without a workplace pension plan, government programs such as the Registered Retirement Savings Plan (RRSP) and
the new Tax Free Savings Account (TFSA) further encourage a “do it yourself” approach to retirement savings. With a tight linkage between RRSP values and the general stock market, the September 2008 crash has exposed the fallacy that stock prices always go up. Canadians are expected to be financial wizards: nimbly investing their hard-earned money when even the experts cannot predict or control rapid stock market developments.

To further complicate the situation, Canadians used only 6% of the RRSP room available to them in 2007, with more than two-thirds of Canadians contributing nothing at all to an RRSP. Such a miniscule uptake essentially guarantees that the new Tax Free Savings Account will, with the exception of a wealthy minority, have little effect on Canadians’ retirement savings. It also underscores the inadequacy of pension savings for the majority of Canadians — a problem that will not quietly go away.

The government did increase the Age Credit amount, which will benefit low- and middle-income seniors. However, increasing Old Age Security (OAS) payments and the Guaranteed Income Supplement (GIS), which would have helped low-income seniors, were excluded from the 2009 budget.

**Conclusion**

This report examines key indicators to assess whether Canada has entered a phase of economic recovery and whether the federal government’s efforts to stem the worst of the recession have been effective. Since Canada’s private sector is not bouncing back from last year’s economic shock, it would be more than optimistic to call the nation in recovery yet. In fact, it would be plain wrong. By a broad range of indicators Canada is still in recession, and the only actor able to help pull the nation out of recession at this point continues to be government. The federal government’s actions in the past year were swift and hearty when the financial sector was in need, but they were tepid and tardy when out-of-work Canadians were in need. Promised stimulus spending on the most direct and powerful job creating vehicle available — the expansion of Canada’s physical and social infrastructure — paled dramatically in comparison to the financial sector bailout, and continues to fall far short of what’s needed.

The story doesn’t end there. For Canada to pull itself out of recession and re-emerge into a robust and sustainable economic recovery, the federal government will have to expand its support even further. It will have to increase the amount of infrastructure stimulus spending needed to save and create jobs, and it will have to ensure that stimulus spending gets out the door in a more timely fashion than it has to date. The good news is that if the federal government actually rises to the occasion, Canada will be poised for an economic recovery that could be led by massive investments in valuable public services ranging from roads, bridges, and transit expansion to housing, child care, postsecondary education and health care improvements. In other words, a “silver lining” to this recession could be that it leads to the most substantial investment by one generation in the wellbeing of the next that Canada has seen in decades. Spurred by recession, the government could finally take care of business that has long been neglected but that is essential for Canada to remain economically competitive on an international stage for decades to come. But the federal government needs to act now, and its actions need to be far bolder than it has been to date.
Bank of Canada, Weekly Financial Statistics September 25, 2009 pg. 13. Total residential mortgage credit has expanded from $877,415 million in August 2008 to $935,176 in July 2009. An expansion of $57,761 million or slightly less than the $64.2 billion the federal government has spent purchasing NHA MBS over that period.

Unlike the loans and other forms of assistance provided to financial institutions (which were not included within federal budgetary estimates), the loans to auto companies were booked by the government as a direct program expense—even though some or all of those loans (in principle) will eventually be repaid with interest. This is an odd inconsistency; in practice, the auto loans have a similar economic effect as the (off-budget) assistance to banks: they helped to keep a crucial industry in business, but did not directly finance production or jobs.

The American Recovery and Reinvestment Act of 2009 HR1 was signed by the President on February 17th, 2009 (http://www.opencongress.org/bill/111-h1/show accessed on Oct 1st, 2009)

See www.recovery.gov in the United States.


Figures in this section were calculated by the author using Statistics Canada: Labour Force Survey and Statistics Canada: Employment Insurance figures

Armine Yalnizyan, Exposed: Revealing Truths about Canada’s Recession, Canadian Center for Policy Alternatives, April 2009.

The six largest banks have set aside $6.4 billion for performance bonuses during the first three quarters of the current fiscal year; “What recession? Bonuses swell at Big Six banks,” by Andrew Willis, The Globe and Mail, September 10 2009.

Throughout this report, we refer to statistical data regarding the growth of real GDP as an indicator of whether the economy is expanding or contracting. This is not to imply that growth in itself is the goal of economic policy, nor that the presence of growth indicates a healthy economy. In addition to stimulating new employment and opportunity, economic policy must also strive to regulate economic growth in order to maximize its social benefits and minimize its environmental consequences.

The only other occasion when nominal labour compensation declined was in the third quarter of 1982.

The federal government’s performance in this regard is evaluated in detail below in the second half of this report.

2009 Budget, Pg 30.

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Notes

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2 2009 Budget, Pg 30.

3 Actual employment declined in September, as it does every September when students go back to school. Only by seasonally adjusting the data did the reported increase in employment “appear.” In reality, the data indicates that employment did not decline quite as much in September as it usually does.

4 “Recession is over, Bank of Canada says,” cbcnews.ca, July 23 2009.

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16 Armine Yalnizyan, Exposed: Revealing Truths about Canada’s Recession, Canadian Center for Policy Alternatives, April 2009.

17 Statistics Canada, Proportion of the Labour Force and Paid Workers covered by a Registered Pension Plan (http://www40.statcan.gc.ca/l01/cst01/labor26a-eng.htm accessed on Oct 9, 2009)