State of the Economy

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What's Inside:

1. The Economy in 2000

Although symptoms of a slowing economy began to appear by the end of 2000, economic growth in Canada continued to post impressive gains through the first three quarters of the year, led by rising consumer spending and business investment. Real GDP expanded by a healthy 5% on an annualized basis in the third quarter of the year.

The good news for working people is that robust growth has finally begun to reverse the decline in living standards and incomes that characterized the Canadian economy in the 1990s. Real GDP per capita was up 4.1% in the third quarter of 2000 over the same period in 1999, and real personal disposable income per capita rose 4.2%.

Employment Growth Rebounds From Mid-Year Lull

Following strong gains in 1999 and in the first two months of 2000, employment growth in the middle of 2000 was surprisingly sluggish. Between March and July, there was virtually no net growth in employment. This slack in the job market, coupled with an increase in the active labour force, helped push the unemployment rate up from 6.6% in April to 7.1% in August.

In the last four months of the year, however, stronger employment growth made up for the slower gains in previous months. Overall, between December 1999 and December 2000, employment rose by 2.2%. This was strong growth, but lower than the average employment increases of the previous three years. By the end of 2000, the unemployment rate fell to 6.8%, the same level as in December 1999.

While the overall labour market in Canada has improved considerably, the bulk of job growth has been heavily concentrated geo-

National Accounts

	1997	1998	1999	2000 QIII
GDP $1992 (millions)	815,013	842,002	880,254	930,252
GDP per capita $1992	27,179	27,838	28,869	30,252
Personal disposable income per capita ($1992)	16,946	17,290	17,528	17,685
Corporate Profits (% of GDP)	9.9%	9.1%	10.6%	11.9%

graphically. Ontario accounted for nearly 60% of total employment growth in the country in 2000. Employment rose 3.2% in Ontario, 2.8% in Nova Scotia, 2.7% in New Brunswick, 2.6% in Alberta, 2.5% in Prince Edward Island, 2.3% in British Columbia, and 1.9% in Manitoba. By contrast, employment advanced just 0.8% in Quebec, and declined in Saskatchewan (-1.0%) and Newfoundland (-3.1%).

In terms of job quality, there has been a real improvement over the past year, with most job growth tilted towards full-time employment. Of the 319,000 new jobs created in 2000, more than 80% were full-time. Both the part-time and self-employed rates have continued their downward trend.

As job prospects have improved, participation in the labour market climbed from 65.6% in December 1999 to 66.2% in December 2000. However, this is still well below the pre-recession peak of 67.1% recorded in 1989.

The rapid decline in self-employment over the past year is particularly notable, since it reverses a trend that dominated the labour market of the 1990s. Many economists argued that the growth in self-employment over the past decade was part of a structural change linked to the emergence of the so-called knowledge-based economy. Others suggested the rise in self-employment was an indication of weakness in the labour market as working people, unable to find full-time paid work, were forced to eke out a living as self-employed "consultants." The dramatic drop in the self-employed rate in 2000 tends to support the latter view that, as the labour market improved, many self-employed Canadians would prefer to take up more stable and secure jobs as employees.

A Recession for 2001?

While only a few months ago economists were warning of a dangerously overheated economy and emerging inflationary pressures, the talk today has turned to the possibility of a full-blown recession in 2001. There are indeed some worrying signals that the economy will weaken this year. Over the last quarter of 2000, corporate profit growth remained flat and earnings projections were downgraded. This led to volatility and heavy losses on stock

Key Labour Market Indicators (%)				
	1998	**1999**	**Dec. 1999**	**Dec. 2000**
Unemployment Rate	9.1	7.6	6.8	6.8
Men	8.6	7.8	7.0	--
Women	7.9	6.3	6.6	--
15-24 year-olds	15.1	14.0	13.1	12.5
Participation Rate	65.1	65.6	65.6	66.2
Part-time Rate	18.9	18.5	18.1	18.0
Self-employed rate	17.1	16.9	17.0	15.7
Unemployment Rate by Province				
Newfoundland	18.0	16.9	14.1	17.7
PEI	13.8	14.4	12.7	11.8
Nova Scotia	10.5	9.6	9.6	8.9
New Brunswick	12.2	10.2	10.2	10.0
Quebec	10.3	9.3	8.1	8.0
Ontario	7.2	6.3	5.5	6.0
Manitoba	5.5	5.6	5.2	4.9
Saskatchewan	5.7	6.1	5.3	5.3
Alberta	5.6	5.7	5.4	4.8
British Columbia	8.8	8.3	7.8	7.1

markets, which could weaken business investment in the coming year. As well, exports have fallen, with the critical auto sector hit particularly hard on the tail of slower growth in the United States.

South of the border, weakening economic indicators have led many to sound the alarm bells that the US economy is heading into a recession. There is no doubt that both the US and Canadian economies are slowing down, but claims such as those made by Vice-President Dick Cheney that the US is on "the front edge of recession" are likely more political spin than economic reality. The new administration of George W. Bush is clearly raising the spectre of recession in an effort to push through its otherwise indefensible plans for a massive $1.2 trillion in tax cuts. Private sector economists, largely supportive of the President's tax cut plan, have only been too happy to bolster the administration's case by revising their economic forecasts lower. Still, most economists in the United States are predicting growth of between 1.5% and 2.5% for 2001 — a slowdown, yes, but hardly a recession.

The anticipated weaker growth in the US has inevitably led economists in Canada to downgrade their expectations for the country's performance in 2001. Most forecasters are predicting slower US growth will quickly spill over into Canada, with expectations for an increase in real GDP ranging from 1.6% to 3.0%.

The full impact of the US slowdown on Canada has been the subject of some debate. Pessimists point to the increasing share of Canada's GDP accounted for by total trade with the US — a figure that has risen from 31% in 1990 to over 58% in 1999 — as evidence of Canada's extreme vulnerability to a US downturn at this time. Others, however, have rightly pointed out that this figure can be misleading because it includes a lot of back-and-forth importing and re-exporting of goods and services that are counted each time they cross the border. This suggests that Canada is not as dependent upon the US market as commonly thought and that the federal government could, if it adopts the proper monetary and fiscal policies, largely insulate our economy. While the sting of a US slowdown will definitely be felt, it does not have to be as serious as many assume.

Why Not Tax Cuts?

For his part, Finance Minister Paul Martin, who has built a reputation for being overly prudent and bearish, is uncharacteristically upbeat about the prospects for 2001. Much of his optimism rests on the faith that domestic consumer demand will pick up the slack in weakening exports over the months ahead as the massive $100 billion in tax cuts announced in the February budget and October mini-budget take effect.

However, the reduction in personal and corporate income tax could actually create further imbalances in the economy. The cuts mainly benefit the wealthy, will exacerbate income inequality, and will delay urgently needed investments in health, education, income assistance, and other social programs that bore the brunt of deficit reduction measures in the 1990s. The worry is that, if growth is lower than expected, federal and provincial finance ministers will find that the commitment to planned tax cuts will further preempt any new social spending and may, in fact, lead to further spending restraint at the same time demand for public services will be rising.

As well, the Finance Minister would be wise not to put too much faith in the stimulative impact of his announced tax cuts. Tax cuts generally don't provide the same bang for the buck as equivalent increases in spending, either in terms of boosting GDP or creating jobs. Given the urgent need to rebuild our public programs and services after years of cutbacks, now would be a good time for the government to make some strategic investments.

Wages Remain Flat

A further imbalance and potential problem in the Canadian economy is that economic growth has not yet fully spilled over to working people in the form of wage gains. Pre-tax corporate profits have soared to new heights, reaching a decade-high 12% of GDP in the third quarter of 2000. By contrast, real average hourly wages are virtually unchanged since 1997 and real average weekly earnings remain below their 1997 levels, although there has been some modest gain in manufacturing.

The stagnation in real earnings, of course, has been a long-term feature of the Canadian economy since at least the mid-1970s. In fact, as of May 2000, real hourly earnings had finally recovered to roughly the same levels they were in 1985.

Core Inflation Remains Low ... For Now

A further problem may arise as a result of skyrocketing energy prices that pushed the year-over-year inflation rate to 3.2% in December 2000. Thus far, higher energy prices have not yet translated into generalized price increases for other goods and services. Consequently, the core inflation index for all items excluding food and energy rose just 1.9% in December 2000, well within the Bank of Canada's strict anti-inflation targets. The danger, however, is that if energy prices remain high, costs will eventually be passed on to consumers in the form of higher prices for goods and services. This could very well push up the inflation rate and delay needed interest rate cuts.

Real Average Hourly and Weekly Earnings ($1999)

	1997	**1998**	**1999**	**2000***
Average Hourly Earnings				
Industrial aggregate	15.27	15.38	15.33	15.40
Manufacturing	17.30	17.51	17.23	17.48
Average Weekly Earnings				
Industrial Aggregate	614.38	616.92	610.40	610.91
Manufacturing	756.55	769.15	755.86	762.48

*January to September average.

In fact, despite no evidence of "overheating" in the Canadian economy, the Bank of Canada nevertheless did match several interest rate hikes by the US Federal Reserve over the course of the year. The bank rate rose from 5% in January to 6% in May where it has remained into 2001. Recent indications that growth is slowing suggest these rate hikes are now working through the economy. Fearing the US economy may be slowing too quickly, the Federal Reserve cut its benchmark rate by a half point early in 2001, but the Bank of Canada has yet to follow the lead. This is a mistake. Clearly, without an easing of monetary policy by the Bank the immediate danger is that the Canadian economy may be dragged down more quickly by a slowdown in the US long before Canadian workers begin to win any real wage gains.

Overall, despite evidence of some downside risks from slower US growth and weaknesses in specific sectors, it is extremely unlikely the Canadian economy will slip into recession this year. Employment growth in both the US and Canada remained strong in December, with about 30,000 net jobs created in Canada and 350,000 in the US. Such numbers are simply inconsistent with a recession. Real GDP will not match the estimated 5% rate of growth in 2000, and will fall to just under 3%. Barring a significant reduction in interest rates or unforeseen fiscal stimulus, employment growth will slow sharply in 2001, but the slower growth in the labour force will likely keep the unemployment rate hovering near 7%.

2. Income Inequality in Canada

Statistics Canada has released detailed income data covering the years 1989 to 1998 which reveal an alarming trend toward greater inequality. If families are ranked by their income level from lowest to highest, the top 20% of families earned 45.2% of all market income in 1998, against 3.1% for the bottom 20%. Looked at another way, for every dollar earned by the least well-off families, 14

Average after-tax family income, 1989-1998 ($1998)			
	1989	**1998**	**% change**
Lowest quintile	18,624	17,662	-5.2
Second quintile	33,188	31,754	-4.3
Middle quintile	44,447	44,019	-1.0
Fourth quintile	57,605	58,533	1.6
Highest quintile	90,189	96,175	6.6

dollars were earned by the wealthiest. By contrast, in 1989 the top 20% of families received 41.9% of market income (compared to 3.8% for the lowest quintile) and earned 11 dollars for every dollar earned by the bottom 20%.

Despite the impact of government transfers and taxes in reducing market inequality, the disparity in after-tax income also rose throughout the 1990s. Families in the lowest income quintile saw their share of after-tax income fall from 7.6% to 7.1%. The second and middle-income quintiles also experienced drops.

Moreover, families in the lowest income quintile sustained a substantial drop in real after-tax income. Between 1989 and 1998, the average after-tax income of these families fell by 5.2%. Average after-tax income of families in the second and middle quintiles also fell by 4.3% and 1.0%, respectively.

In fact, only the top two quintiles experienced any real after-tax income gains over this period. Those in the top quintile posted the largest gain of 6.6%, while families in the 4th quintile increased their after-tax incomes by 1.6%.

3. Low Income in Canada

An estimated 725,000 Canadian families fell below Statistics Canada's low-income cut-off line in 1998, down from 852,000 in 1997. The low-income rate fell from 10.8% in 1997 to 9.3% in 1998, the lowest rate since 1990.

Although the low-income rate fell in 1998, the depth of poverty for those families falling below the low-income cut-off showed signs of further deterioration. These families had incomes that on

Prevalence of Low Income (%)

	1990	1992	1994	1996	1998
All Persons	11.0	12.2	12.5	14.2	12.2
Males	9.7	11.2	11.3	13.5	11.4
Females	12.4	13.2	13.7	15.0	13.0
Families	8.5	9.5	9.8	11.4	9.3
Persons under 18	13.2	14.3	15.0	17.2	13.8
Unattached individuals	28.2	30.5	30.4	32.5	30.3
Males	24.9	28.5	27.5	30.9	28.3
Females	31.3	32.6	33.4	34.1	32.2

average were 32.1% below the low-income cut-off. They would have needed an average of $6,638 additional after-tax dollars just to reach the cut-off. In 1997, the income gap for these families was $6,404 or 30.5%.

Among unattached individuals, 1,288,000 or 30.3% were in low income in 1998, down slightly from 32% in 1997. In relative terms, their low-income gap was 37% in 1998, virtually unchanged from 1997. Poverty rates for unattached women have remained stubbornly high throughout the 1990s while the rate climbed noticeably for unattached men.

Child poverty, while dropping significantly since 1996, remains very high in Canada at 13.8%. Among children living in lone female households, the low-income rate is an astounding 45.6%.

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