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Austerity isn't working: Europe in recession, deficits rising



Evidence is piling up that austerity budgets and public spending cuts aren't working—even for reducing deficits.

Europe has been thrust back into recession, led by those countries where spending cuts have been most severe, including Greece, Ireland, Portugal, Spain, Italy and the United Kingdom.

Instead of rapidly reducing deficits, deep spending cuts have slowed the economy, increased unemployment, reduced revenues and prolonged deficits. The U.K.'s deficit is actually higher this year than last because revenues have declined.

U.K. Prime Minister David Cameron is being abandoned by many who supported his austerity measures. A majority of the prominent economists who publicly supported his austerity budgets are now urging the government to slow

the cuts and increase public spending with stimulus. Even the British Chamber of Commerce is now calling for the government to stimulate the economy. Unemployment has doubled in many countries, with youth unemployment above 20 per cent in all these austerity cases and now above 50 per cent in Spain and Greece.

The situation in the United States could become even more of a concern. While the U.S. was at the epicentre of the financial crisis, it has fared better than Europe because the federal government continued to stimulate the economy. But with temporary stimulus measures set to expire at the end of this year and Republicans preaching deep spending cuts, the U.S. could fall off a "fiscal cliff" that would plunge the country back into recession.

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ECONOMIC SHORTS

HIGHLIGHTING RECENT ECONOMIC STUDIES AND DEVELOPMENTS



WAGES The union advantage

Analysis by the Canadian Labour Congress shows being a union member provides workers with an average of \$5.11 per hour more compared to non-unionized workers. With over 4.5 million union members in Canada, this translates to about \$793 million more pumped into workers' pockets and Canadian communities every week. Unions also increase productivity and help equalize wages by achieving higher wages for the lowest paid and less excessive compensation for CEOs, improving the economy for other workers as well.

CHILDCARE Public childcare more than pays for itself

A study by Pierre Fortin—Quebec's most prominent economist—and his colleagues has demonstrated that the province's \$7-per-day public childcare program more than pays for itself. Every dollar of public spending returns \$1.05 in higher revenues and lower spending for the province, and an extra 44 cent windfall to

Ottawa for a total of \$1.49 to federal and provincial governments. These immediate fiscal benefits are on top of short-term economic benefits and the extensive long-term educational, social and health benefits provided by quality public childcare.

BUDGETS Cut wages of lowest paid, CEOs tell Flaherty

At last year's exclusive pre-budget retreat, hosted by Finance Minister Jim Flaherty at an Ottawa-area spa-resort, his selected guests—almost all CEOs—urged him to reduce workers wages, particularly of the lowest paid. They also asked him to layoff public sector workers, extend the retirement age, introduce right-to-work legislation, privatize public services and bring in two-tier health care, according to minutes of last year's meeting. Flaherty's 2012 budget followed much of their direction on reducing workers' wages. With another exclusive list of CEOs at this year's gathering, he's likely to accelerate privatization in the 2013 budget.

HIRING Pay more, get less with external promotions

Research from the top-ranked Wharton Business School found when employers hire externally, they generally pay more and get less than if they promote internal workers into similar jobs. The study found external hires perform significantly worse in their first two years on the job, but are paid about 20 per cent more than existing employees.

ECONOMICS Drummond admits he was wrong

In a remarkable "confession," Don Drummond, former chief economist for TD Bank and head of the Ontario government's cost-cutting Drummond Commission, admitted the policies he's advocated and implemented for decades—tax cuts for business, deficit deregulation, free trade—had failed to improve economic productivity and are a "dead-end." He says he doesn't know what the answers are, but the private sector is more to blame. Despite this, Ontario and other governments haven't demonstrated a similar degree of courage and honesty—instead implementing more of the same.

Economy at Work is published four times a year by the Canadian Union of Public Employees to provide workers and their representatives with accessible information and analysis of relevant economic developments and to assist in bargaining. It replaces CUPE's previous *Economic Climate for Bargaining* publication.

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Please email Toby Sanger at research@cupe.ca with corrections, questions, suggestions, or contributions.

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ECONOMIC DIRECTIONS

Latest economic trends at a glance

Economic Growth	Growth is far slower than usual for an economic recovery. Held back by public spending cuts, economic uncertainty, high household debt and half a trillion in corporate cash surpluses, GDP is expected to increase by about two per cent this year and next. A housing bust could tip the scales and cause a recession.
Employment	Job growth slowed over the summer. With jobs growing little faster than population and the labour force, the unemployment rate is declining very slowly.
Inflation	Inflation slowed over the summer and averaged 1.9 per cent so far this year. Bank economists expect it to average 1.7 per cent this year and rise slightly in 2013, but higher gas prices will bring it up.
Wages	Wages increased by an average of two per cent in major collective agreements signed in the first half of this year, similar to the increase in average hourly wages. Wage hikes are higher in the private than public sectors. Public sector wage suppression in B.C. and Ontario will bring averages down (<i>see more, page 7</i>).
Interest Rates	Rates are expected to stay superlow until the end of next year, particularly short-term rates. Long-term rates will rise more gradually from their current record lows. Low inflation and slow economic growth mean the Bank of Canada has little reason to hike rates anytime soon.



SPOTLIGHT JOBS

Golden age no more: Seniors at your service

Employment growth in Canada has been mediocre so far this year, barely keeping up with population growth. But below the surface of this slow moving recovery, dramatic demographic changes are happening in the workforce.

There's been an extraordinary increase in the number of seniors working—up by 69 per cent in the past five years—far faster than their population growth of 17 per cent. At the same time, there's been an absolute decline in the number of youth with jobs, while their population has continued to grow.

Seniors aren't necessarily choosing to work past age 65 because they want to. A CIBC survey found 59 per cent of retired Canadians are in debt while more than half of those now in their 50s plan to work into retirement. Unemployment of those aged 65+

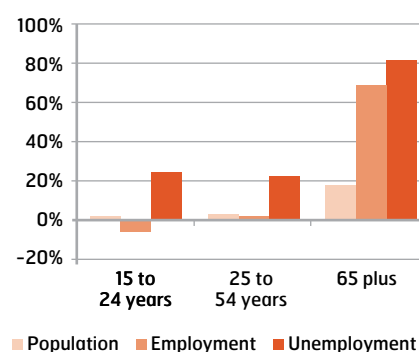
has increased at a faster rate than any other age group, almost doubling over the past five years. Seniors are increasingly moving into lower-paid “entry-level” jobs that young workers used to fill, increasing most rapidly in two of the lowest paid industries: retail trade and accommodation and food services.

With inadequate pensions forcing older workers to work longer, often in lower paid jobs, the progress Canada made reducing seniors poverty is in danger of being reversed while also depriving a generation of young workers of jobs they've traditionally filled.

Governments are doing little to solve the growing crisis of youth unemployment. Instead many are making it worse, by extending the retirement age and not improving public pensions. The International Labour Organization has called for

governments to introduce targeted employment measures to address the youth employment crisis, including public employment programs and job guarantee schemes.

LABOUR FORCE CHANGES BY AGE GROUP
2007 to 2012 (Jan to Aug)



Source: Statistics Canada Labour Force Survey, Cansim Table 282-0087

Housing bust could plunge Canada into recession

House prices in Canada have escalated to record levels, far outstripping increases in wages and other consumer prices over the past decade.

While other countries have gone through housing busts in recent years, prices in Canada declined briefly in 2009 before climbing upwards again. It was fortunate we didn't have a housing bust coincide with the stock market crash and financial crisis, but it's been a waiting game before that other shoe drops. An increasing number of experts now think housing prices are set to decline. The only difference of opinion is when it will happen, how much prices will fall and how it will affect the economy.

The issue is vitally important because a home is by far the most valuable asset most families have: house price changes have major impacts not just on family finances, but also on the entire economy.

Accurately predicting when the market will turn is always difficult. We warned about the economic impacts of a housing bust five years ago in 2007, but low interest rates, tax incentives and more lenient rules helped keep prices rising—and allowed house buyers to go deeper in debt for longer. Since then many others have warned about impending housing busts, but now it appears house prices are deflating. With mortgage rates still at rock bottom, prices haven't declined much so far, but when rates start to rise, house prices will go downhill faster.

How much house prices will fall by is anyone's guess. It depends on a host of factors: individual markets, housing supply, household income and finances, mortgage conditions, broader economic conditions, behavioral responses, and how governments respond. An International Monetary Fund (IMF) report from last year estimated house prices were overvalued by about 10 per cent in Ontario and Quebec, and by 30 per cent in B.C. based on economic fundamentals. A number of Canadian banks are predicting price declines of 10 per cent nationally over the next 2-3 years, with sharper declines in Toronto and Vancouver.

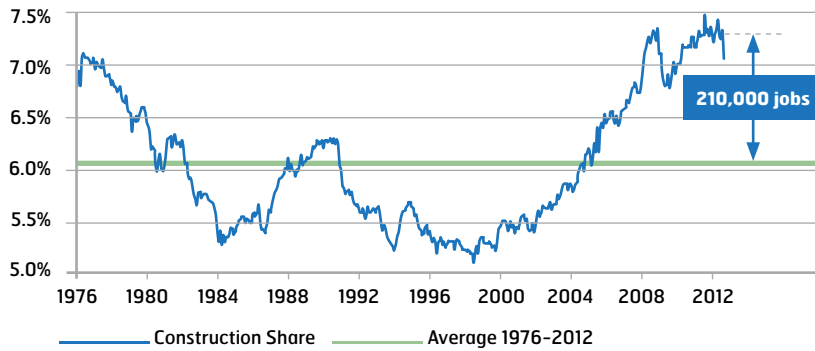
These forecasts of moderate price declines may be hopeful. The higher prices rise, the harder they fall. Analysis of housing busts around the world suggests real housing prices after adjusting for inflation will decline by an average of 23 per cent in affected countries and be spread over four years. Canadian housing prices declined by close to this amount in real dollar terms during previous contractions in the 1980s and 1990s. These were triggered by high interest rates, which won't be replicated, but prices have also risen higher this time.

The other big question is how a housing bust will affect the economy and employment. Just as the housing and construction boom added a lot to Canada's economic growth over the past decade, a housing bust will also subtract from it.

The most direct impact will be on those employed in the industry. Construction employment recently reached 1.3 million, or 7.4 per cent of total employment: both record highs since 1976. If industry employment declines to its average share of six per cent, this will mean 220,000 fewer jobs; if it falls to the recent minimum of 5.2 per cent, job losses will amount to 360,000. These levels of job losses on their own would lead to a hike in the unemployment rate to 8.5 or 10.4 per cent: higher than the 9.1 per cent high it reached in the recent recession. This doesn't



CONSTRUCTION INDUSTRY SHARE OF TOTAL EMPLOYMENT Canada 1976-2012



Source: Statscan Labour Force Survey, Cansim Table 282-0088

include jobs losses from related industries, such as real estate, finance, professional services and retail, which could double the total.

This potential impact on the construction and related employment is significant. Equally troubling is the impact of declining house prices on consumer spending and the broader economy through what is called the “wealth effect.” As the value of real estate increases, consumer spending rises because homeowners are—or at least feel—wealthier, because they have greater access to credit through home equity loans and because related spending in other areas also increases.

The Bank of Canada estimates every dollar of increased housing

wealth leads to six cents more in consumer spending per year, which is in the range of other international estimates. Depending on conditions and responses, we can expect a similar reduction in consumer spending from declines in house prices. However, analysis by the IMF shows when housing busts are preceded by large increases in household debt, the economic impacts tend to be much more severe. In these high debt situations, consumer spending falls by an average of more than four per cent, economic output falls by 2.5 to four per cent and the unemployment rate rises by an average of one to two percentage points—all of which would thrust Canada back into recession.

No one knows exactly what the impact will be because we don’t know how people, markets—and especially governments—will respond. But this is certainly no time to be complacent. There are some clear things governments should be doing to reduce the potential negative impact.

One is to maintain monetary stimulus and relatively low interest rates—something the Bank of Canada has shown strong commitment to.

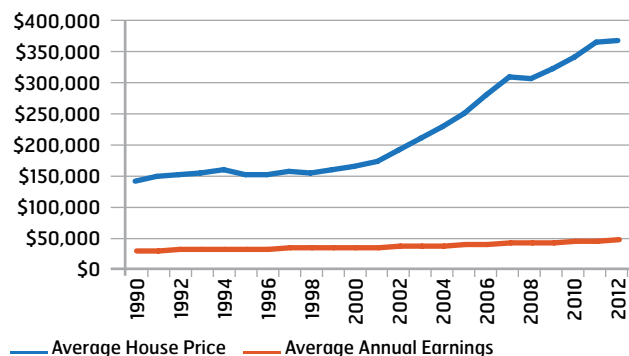
Our governments need to join this monetary stimulus with fiscal stimulus, instead of squeezing public spending, which will slow down the economy and make the situation worse. Investment in public infrastructure and affordable housing should be increased, which will help the construction sector. Financially constrained households should also be supported by improving the social safety net and maintaining wage growth, financed if required by progressive taxes. Debt restructuring programs for households may also be necessary.

Canadian governments focused on fiscal austerity, cutting public spending and suppressing wages need to take heed: they have more than enough fiscal capacity and still have the time to prevent another damaging recession. They must use it.

The Big Picture Housing prices outpace wage growth

Until a decade ago, house prices in Canada increased at roughly the same rate as average earnings and were equal to about five times average workers annual earnings. After 2000 house prices soared in Canada and around the world. While they’ve plummeted to earth in many other countries, house prices are still sky-high in Canada. Average house prices are expected to average \$365,000 this year, equal to almost eight times the average annual earnings of \$46,700.

HOUSE PRICES AND AVERAGE ANNUAL EARNINGS



Source: CMHC Canadian Housing Observer for MLS® housing prices and Statistics Canada for average earnings (Cansim table 281-0027)

Lower interest rates save governments big bucks

Record-low interest rates are saving federal and provincial governments billions more than forecasted. This will result in lower deficits than projected and provide good opportunities for increased public investment to stimulate the economy.

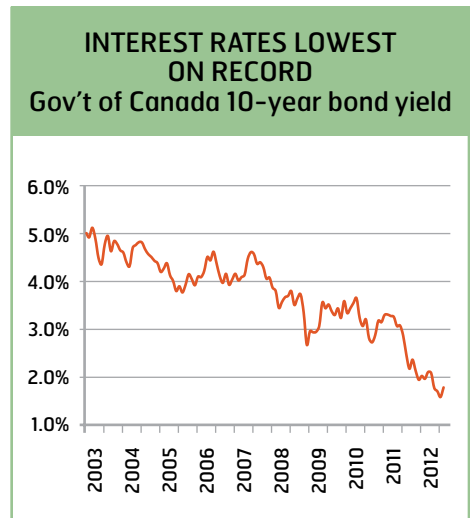
The federal government's long-term borrowing rate dropped to 2.14 per cent in July: the absolute lowest rate on record. Its ten-year borrowing rate dropped as low as 1.58 per cent and has averaged 1.92 per cent so far this year: less than half the four per cent rate projected in the 2011 budget and below the 2.2 per cent rate projected in this year's budget. Meanwhile short-term borrowing rates have dropped below one per cent—well below the rate of inflation. Costs of borrowing have also plummeted for provincial and municipal governments.

Low interest rates are yielding major cost savings for governments. CIBC economists calculate lower interest rates since 2007 have already saved federal and provincial governments \$80 billion in lower debt charges, including \$25 billion this year alone. These savings will grow in coming years. Ten-year borrowing rates are now expected to rise to only 3.5 per

cent by 2016, at least 100 basis points below what recent federal and provincial budgets projected. Ontario's recent \$1 billion bond issue allows it to borrow over 10 years at less than 2.5 per cent: well below the rate projected in its budget.

The federal government should save an extra \$300 million from lower long-term interest rates this year, rising to \$2 billion in 2016 as more debt rolls over, and totaling \$6 billion during the next five years. Estimated interest savings in 2014 will amount to more than the \$1.3 billion deficit. The federal government could achieve higher savings in future years by accelerating its shift from short-term borrowing into long-term bonds.

Ontario should realize at least \$200 million in interest savings this year compared to its budget estimates, rising to \$1.7 billion in 2015 as more debt rolls over, and approximately \$5 billion during the next five years. These savings could be increased if the province retires debt at a faster pace. These savings are in addition to the \$3.3 billion lower deficit the province recently reported in its public accounts for 2011/12, which was largely due to lower program spending.



Source: Bank of Canada

It's time to invest

At these rock-bottom interest rates and with the economy in the doldrums, governments should invest more to stimulate economic growth, as a number of traditionally fiscally conservative and bank economists have argued. While this will increase deficits over the short-term, higher economic growth will more than compensate for these interest payments, reducing deficits and debt-financing ratios over the longer term.

This applies not only to growth enhancing public infrastructure investments, but also to spending on public services. The biggest threats to Canada's economy now are record levels of household debt and the impact a housing bust could have on the entire economy. Increased spending on key public services can relieve the rise in household debt and reduce these threats to our economy. Low public borrowing rates also mean governments have even less justification for privatizing public services and public-private partnerships, which rely on much more expensive private financing.

SAVINGS FROM LOWER INTEREST RATES				
	10-year bond rate		Estimated interest savings (\$ millions)	
	2012 Budget forecast	Current forecast (CIBC, TD)	Federal government	Ontario
2012	2.20%	1.80%	\$270	\$200
2013	2.80%	2.40%	\$740	\$520
2014	3.60%	2.90%	\$1,340	\$840
2015	4.30%	3.10%	\$1,840	\$1,730
2016	4.50%	3.50%	\$2,120	\$1,670

Source: CUPE calculations, based on federal and provincial budgets, and other financial information

Freezes will stifle overall wage growth

Average base wage increases in settlements of 500+ members negotiated in the second quarter of this year increased to 2.1 per cent from 1.7 per cent in the first quarter, in both the public and private sectors. This was below the 2.8 per cent average wage increase these workers achieved in their previous settlements.

Other wage measures have shown similar trends. Statistics Canada's

payroll survey shows industry-wide hourly wages increased at an average of two per cent in the first six months of 2012, rising faster in goods industries than in services. Private sector wage adjustments have risen faster in the year so far, increasing at an average of 2.4 per cent compared to 1.9 per cent for public sector agreements.

Public sector wage increases in the second quarter were lowest in B.C.,

with the province in the third year of a wage freeze, followed by Saskatchewan at one per cent as a result of the SAHO agreement with nurses (see table). The strongest gains were in Alberta and Manitoba. Average base wage increases in Ontario settlements in the second quarter were 1.7 per cent.

The Ontario government's move to legislate wage freezes and concessions against public sector workers will undoubtedly diminish wage average increases for Ontario, the public sector and the country over the next year. Cuts to starting wages demanded by auto companies in their bargaining with the CAW will also suppress wages in Ontario's manufacturing sector.

CONSUMER PRICE INDEX

Inflation down but food prices rising

Consumer price inflation has retreated slightly this year, with July's rate of 1.3 per cent down from the 2.5 per cent recorded in January and the average so far this year at 1.9 per cent. Inflation is higher in Atlantic Canada and Quebec because households there haven't benefitted as much from lower prices for natural gas, as it isn't widely available for home heating.

Food prices are expected to rise further this year by 3.5 per cent following the summer of drought, hurting those with lower incomes while lower prices for natural gas and a cooling of housing prices are expected to keep overall inflation moderate. Canadian and U.S. government requirements for gasoline to contain corn-based ethanol, which has risen in price, are both increasing the price of food and driving up prices at the pump.

Bank economists expect national consumer price inflation to average 1.7 per cent this year, rising towards two per cent in 2013—but the recent spurt in gas prices could drive it higher.

MORE INFORMATION including an inflation calculator at cupe.ca/cpicalculator

CONSUMER PRICE INFLATION

	Average 2012 Jan to July	Average 2013 Forecast
Canada	1.9%	1.8%
Newfoundland and Labrador	2.5%	2.0%
Prince Edward Island	2.3%	1.8%
Nova Scotia	2.3%	2.2%
New Brunswick	2.1%	1.8%
Quebec	2.3%	1.8%
Ontario	1.8%	2.0%
Manitoba	1.6%	1.9%
Saskatchewan	1.9%	2.3%
Alberta	1.4%	2.1%
British Columbia	1.5%	1.3%

Sources: Statistics Canada Cansim table 326-0020 and recent forecasts by TD, RBC and BMO Banks

AVERAGE WAGE INCREASES IN RECENT SETTLEMENTS

Sector and Jurisdiction	2012 2 nd quarter
National Total	2.1%
Public	2.1%
Private	2.1%
Newfoundland and Labrador	-
Prince Edward Island	-
Nova Scotia	2.4
New Brunswick	-
Quebec	2.0%
Ontario	1.7%
Manitoba	2.8%
Saskatchewan	1.0%
Alberta	2.9%
British Columbia	0.5%

Source: Labour Canada Wage Adjustments 31 August 2012

Salary budget surveys forecast increases of three per cent in 2013

Surveys of Canadian employers conducted by WorldatWork suggest they will increase salaries by an average of three per cent in 2013, up fractionally from this year's wage increases. According to the HayGroup, wage increases will be highest in oil and gas (3.9 per cent), mining (3.6 per cent) and lowest in health care, media, and government—all at close to two per cent.

MORE DETAILS on wage increases and recent settlements at cupe.ca/bargaining

**ECONOMY AT WORK
ONLINE**

**WHAT IS GDP?
HOW DO WE MEASURE INFLATION?**
Measuring overall economic growth can be broken down into a few major indicators.

LEARN ABOUT economic fundamentals
cupe.ca/economyatwork/fundamentals

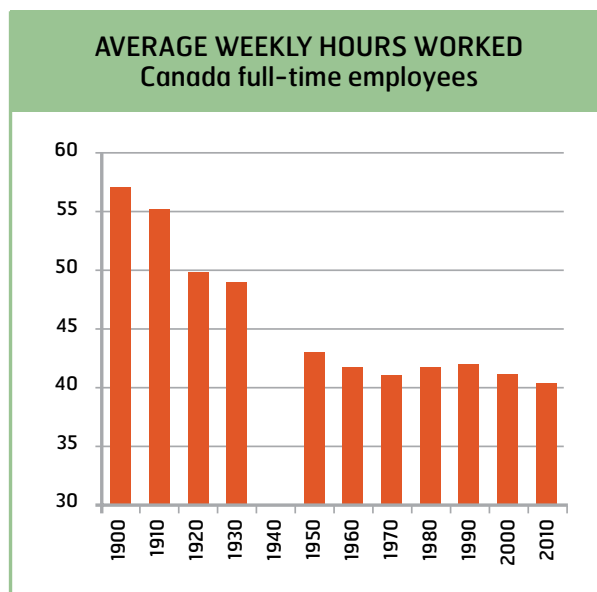
OUT OF THE BOX **HOURS OF WORK**

Whatever happened to the 15 hour workweek?

Eighty years ago in the Great Depression, economist John Maynard Keynes looked optimistically towards a world where progress would allow people to work an average of just 15 hours a week, or three hours a day by 2030.

Sounds crazy now? It didn't then. The average manufacturing workweek then was 50 hours, down from almost 60 in 1900. With decent economic growth (which was achieved), output per person would expand six times and working hours could be reduced to that rate, if people chose.

What happened? Labour's long-time goal of a 40 hour workweek was largely attained by the 1960s, but there's been little improvement since. With slow wage growth and dual income families now the norm, household working hours have increased. Rising inequality is one culprit. Vastly expanded consumption opportunities, even for "leisure activities" are another.



Source: Altman (1999), *Historical Statistics of Canada, Labour Force Survey*

**PUBLIC FINANCES
SPENDING CUTS**

continued from page 1

The Bank of Canada estimates U.S. growth could drop by four per cent with negative repercussions on Canada and the rest of the world.

Canada also has rising risks of its own. Household debt has escalated to record rates and a housing bust would take a whack out of the economy (see more on page 4).

With these menacing clouds on the horizon, public spending cuts make even less economic sense. Still the federal government's budget is cutting direct program spending to a 50-year low as a share of the economy according to Canada's Parliamentary Budget Officer (PBO). The PBO and private bank economists estimate federal and provincial cuts will reduce economic growth by about one percentage point a year and result in more than 100,000 job losses.

Instead of cutting spending, it makes far more sense for governments to stimulate the economy, especially with today's record-low interest rates. Even fiscally conservative and bank economists have urged this approach. Investing more in infrastructure and social protection spending and allowing wages to rise will lead to stronger economic growth—and also lower deficits in the future.

SEE ALSO *Lower interest rates save governments big bucks, on page 6.*