Canada's prime minister admits jobs and savings in peril

Wall Street meltdown spreads to Bay Street

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In the wake of the most turbulent week in global financial markets since the Great Depression of the 1930s, Conservative Prime Minister Stephen Harper has grudgingly acknowledged the vulnerability of the Canadian economy to a world recession.

"Look, we're not an island. We can't pretend, and we're not pretending that we will escape effects of world developments," said Harper this past Monday in response to a barrage of reporters' questions prompted by the latest freefall on the Toronto Stock Exchange.

Harper, in the midst of a federal election campaign, has been hoisted on his own petard by the unraveling of the North American and, now, European economies. Only last week, during the French-language party leaders' debate Harper had declared, "Canada is not the United States. The situation is very different. The foundation of our economy is very solid.... .We do not have a crisis."

In truth, Harper and the Conservatives called the election last month with the cynical calculation that a recession could be held at bay until after the October 14 vote.

Thus, the Conservative Party campaign has highlighted the "calm, prudent, stay the course" leadership of the prime minister even whilst things have rapidly spun out of control south of the border. "The economic and financial mess in the United States is disastrous," said Harper in last week's English-language debate. "The policies have been irresponsible. We have made very different choices in Canada. We are not bailing out our companies..."

At the same time, Harper has pilloried the opposition parties, accusing them of "talking up a recession" and "panicking" because they have called for modest "job-creation" schemes and consideration of enhanced regulatory oversight of Canada's financial institutions.

But facts have proven to be stubborn things for the prime minister. Monday, the same morning that the Toronto Stock Exchange nose-dived by almost 1200 points (a loss of 10 percent), Scotiabank's capital market issued a report forecasting recessions in both Canada and the United States. "This is not just made-in-USA weakness as Canada faces its own home-grown recession signals," said the bank's economists. Don Drummond, the chief economist at the Toronto-Dominion Bank, echoed the prediction, saying that not only will the economy shrink until late 2009, the subsequent recovery will be "different," slow, and problematic.

The reality is that the Canadian economy has been contracting in many respects for some time. Since 2002, more than 400,000 manufacturing jobs, or 15 percent of all jobs in the manufacturing sector, have been eliminated. Especially hard-hit have been the auto and forest industries.

While the Canadian economy has been buoyed in recent years by soaring oil and mineral prices, recent weeks have seen a sharp drop in commodity prices triggered by concerns of a world recession.

That Harper is utterly indifferent to working people's fears that the convulsions in the world financial system are wiping out their savings and pensions and will translate into massive job losses was exemplified by the prime minister's retort Tuesday that "there are probably some great buying opportunities emerging in the stock market as a consequence of all this panic."

Canada's principal stock exchange, the Toronto Stock Exchange, has lost more than a third of its value since reaching an all-time high last June, with the lion's share of the losses coming in the last month.

The opposition parties-the Liberals, social-democratic New Democratic Party, the Quebec *indépendantiste* Bloc Québécois, and the Greens- have made hay by linking Harper with the disastrous administration of US President George W. Bush and by painting the Conservatives' laissez-faire, "magic of the market" pronouncements as cold hearted and out-of-touch with the economic pressures being faced by much of the Canadian population.

In reality, the opposition parties are no less subservient to big business than the Conservatives.

Echoing Harper, the Official Opposition Liberals have decried an NDP plan to roll back the corporate tax rate to the level it was in 2007 as a "socialist" scheme that would result in massive job losses.

A measure of the largely cosmetic differences between the Liberal and Conservative plans to deal with the impending recession was provided by Liberal frontbencher and former Ontario Premier Bob Rae Tuesday. In response to a speech by Harper to the blue-chip Canadian Club, Rae eschewed specific recommendations and instead focused his attack on the prime minister's failure to employ Clinton-style "I feel-your-pain" rhetoric. Said Rae, "He doesn't do hope very well; he doesn't do empathy very well; he doesn't do understanding very well and frankly those are all qualities we expect in our leaders, particularly in a time of difficulty."

As for the NDP, its plan to increase public spending by $52 billion over the next four years pales before the impending social catastrophe. Moreover, party leader Jack Layton has repeatedly pledged that all his party's spending promises are conditional on a "balanced budget," meaning that they will be quickly discarded as the economic slump blows a hole in Ottawa's budget.

Opinion polls indicate that the deepening economic crisis and Harper's smug response have had a significant impact on popular consciousness. The Conservatives, who at the beginning of the five-week election campaign appeared on the brink of forming a majority government, will now do well to win a plurality of the seats and form a weak minority administration.

The belated release of the Conservative Party's election platform-less than seven days before voters go to the polls-has done little to reverse the slide in Harper's electoral fortunes. His "stay-the course" policies, with few spending initiatives outside of further handouts to targeted corporate sectors in auto, aerospace and forestry and a commitment to continue his drastic reductions in the corporate tax rate, have provided ample ammunition for the opposition parties. They are portraying Harper as another R.B. Bennett, Canada's prime minister in the early 1930s, fiddling while the economy burns.

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Harper and Finance Minister Jim Flaherty have argued that the sub-prime-mortgage-fueled financial meltdown on Wall Street does not apply to the Canadian situation because of several factors. Household debt stands at 20 percent of total assets in Canada (as opposed to 26 percent in the US), while Canadian homeowners' net equity as a percentage of home value remains, in sharp contrast with the US, stable. Hence, to date, there have been far fewer home foreclosures in Canada. Further, financial analysts have argued that only 5 percent of mortgages in Canada are "sub-prime" compared to 12 percent in the U.S.

But the debt of Canadian households is rapidly growing, as working people use credit to cope with stagnant or declining incomes. By June 2008, household debt in Canada equaled 107 percent of household income, an 11 point increase from January 2006. Home prices are now falling and the sub-prime mortgages from the earlier part of the decade are coming up for renewal under conditions where mortgage rates are unstable. Moreover, even if only 5 percent of mortgages in the country are sub-prime, fully 24 percent of Canadian mortgages have been bundled in the risky "securitized instrument packages" that have been so radioactive for American and European Banks. And new housing starts, which have accounted for a large proportion of the new jobs created over the past several years, have seized up altogether.

Even more importantly, despite the claims of the Tory party brain trust, the Canadian economy does not exist in some hermetically sealed bubble.

The global financial convulsions are, if Harper needs to consult a map, centered in the country immediately to his south-a country that absorbs fully three-quarters of Canada's exports and that for decades has underpinned the world financial system.

Yesterday, Canada's central bank joined with the central banks of the US, Britain, the European Union, Sweden and Switzerland to cut lending rates by half a percentage point. In Canada's case, the central bank's key lending rate is now 2.5 percent

In a statement explaining its actions, the Bank of Canada was forced to concede that Canada is being buffeted by "global financial crisis," the weakening of the US economy, and the abrupt fall of commodity prices. "As a result of these developments," said the bank, "credit conditions in Canada have tightened significantly, despite the relative health of our financial institutions."

On Bay Street, the center of Canada's financial industry, there was concern that this coordinated action was too little to late. "Everybody's throwing everything in the tool box at this problem." Royal Bank of Canada chief economist Craig Wright told the *Globe and Mail.* "I don't know that, given how negative sentiment is, any one event would turn it, but the hope is that the culmination of all these events starts at least to get recognized."

Harper's rosy claims about the fundamental soundness of Canada's economy notwithstanding, Wednesday's bank rate cut is only the latest action taken by the government, the Bank of Canada, and regulatory agencies over the past year to forestall, and now contain, an unprecedented financial crisis.

Only last Friday, the Bank of Canada made its biggest intervention yet in the money markets boosting its initial $8 billion injection up to $20 billion in an effort to unfreeze money markets.

The central bank's liquidity injections, said Merrill Lynch Canada's chief economist, "are telling you that they are alarmed. Canada has looked less and less insulated from global financial stress through this past week."

The central bank's unprecedented effort comes after growing signs that the credit seizure that has convulsed Wall Street is spreading north. Canadian banks have become reluctant to lend cash to each other, causing the spread between the rate at which banks borrow cash from each other and the interest rate paid on government securities to steadily increase.

Small spreads are a barometer gauging a more "healthy' state of affairs for the bottom lines of the banks. In July of 2007, just prior to the Asset Backed Commercial Paper (ABCP) debacle in Canada, the overnight spread stood at just 10 basis points. At that time, the Bank of Canada injected about $23 billion to lubricate the financial system. By November of 2007 the central bank was injecting up to $2 billion per day in liquidity. These developments clearly showed that the liquidity issues facing Canadian financial institutions were no longer an episodic but rather a chronic problem facing the system.

By the time of last Monday's latest stock meltdown, spreads were above 100 points-a level comparable to those in the United States only one month ago. Such is the hyper-volatility of the current situation that one day after the Black Monday (Oct. 6) world stock market crash the spread increased another 25 basis points!

Individual financial institutions have also been hit hard by the crisis. For the past year Canadian banks, investors and other financial institutions have been squabbling over an emergency plan to liquidate $30 billion in so-called Asset-Backed Commercial Paper, whose value collapsed in the wake of the eruption of the sub-prime mortgage crisis south of the border.

The giant insurer Manulife Financial has over $600 million in exposure to the failing Wachovia Bank. The Canadian Imperial Bank of Commerce (CIBC) wrote down $6.8 billion for the nine months ending July 31. Another $3.2 billion has been lost by their banking competitors. In addition, the Royal Bank faces a payout of over a billion dollars from exposure to near worthless "auction rate securities." And the Royal Bank, Toronto-Dominion Bank and the Bank of Montreal own troubled banks in the United States.

Far from Canada's financial institutions being spectators to the financial crisis on Wall Street, they joined other foreign-based banks in mounting a ferocious struggle to be included in the US Treasury's bailout package. Under this package, the bad debts of the major US financial institutions are being bailed out at the expense of working people.

If the Canadian banks have proven more resilient, at least so far, than that their US counterparts, this is very much bound up with their stranglehold over the country's economy. Unlike in the Unites States, where hundreds of banks jockey for market share, the "Big Six" banks in Canada hold over 90 percent of all financial assets. Their combined profits for 2007 reached a record $19.5 billion, even after incurring $2 billion in credit market write-downs as the first signs of the crisis surfaced.

Just as in the United States, the massive deregulation of the banking industry, set in motion by the Conservative Mulroney government in the 1980s and early 1990s and supported by successive Liberal governments, provided the wherewithal for ever-increasing profit margins on Bay Street and huge salaries, bonuses, and stock options for its executives. But these super-profits were more and more based on speculation in derivatives, hedge funds and other complicated and dubious investment vehicles. As Tory Finance Minister Jim Flaherty so erroneously boasted in 2007, "The evidence is clear; economies with the most dynamic capital markets enjoy the strongest growth over the long run."

An economist by training, Harper knows full well that capitalism today confronts its greatest crisis since the Great Depression. But Harper is loath to spell out the implications of this crisis, because he recognizes that to bolster the crumbling position of Canadian big business the next government will be compelled to take draconian, unpopular measures, while businesses themselves slash jobs and wages.