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Counter-Cyclical Fiscal Measures In Canada
During The 1957-58 Recession

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Introduction

The relations between the Canadian and United States economies are such that a cyclical downturn in this country is almost inevitably associated with a corresponding downturn in Canada. The relative extent and duration of a particular recession in the two countries is determined by differences in their economic structure and in their economic policies. This paper considers some of the structural differences between the Canadian and United States economies, compares the actual course of the 1957-58 recession in the two countries, and then describes in some detail the fiscal measures taken by the Canadian Government to offset the decline in demand in the private sector. These measures were numerous and diverse, and add up to a much more intensive anti-recession program than was carried out in the United States.

Some theoretical considerations

Many observers believed late last year that the developing Canadian recession was apt to be more severe than the recession in the United States, assuming that the scale of government intervention would be roughly the same in the two countries. For one thing, private investment expenditure, the demand component of Gross National Product most sensitive to an economic decline, was relatively more important in Canada than in the United States. In the second place, investment in new production facilities for petroleum, iron ore, and nonferrous metals had been especially intensive during the preceding boom in Canada and the demand for each of these products was very vulnerable to a leveling off in world economic activity. Finally, the Canadian boom had been more intensive than the boom in this country so that the chances of "misdirected investment" had probably been greater.

On the other hand, several sustaining elements were evident. Most important, perhaps, was the fact that a big share of Canada's investment goods are imported, mostly from the United States. Consequently, a lower demand for capital equipment in Canada was likely to mean a large reduction in imported machinery rather than a cutback in the demand for domestically produced capital goods. To put it another way, Canada's imports are cyclically quite sensitive, so that she has an automatic tendency to shift the burden of both excess and deficient demand to foreign countries, especially the United States, her major source of imports.

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Another potentially strengthening factor for the Canadian economy in the current recession was the existence of a flexible exchange rate. During the recent boom, capital inflows into Canada, largely for expansion of productive capacity in Canadian export industries, tended to exceed the surplus of Canadian imports over exports. The result was an appreciation of the price of the Canadian dollar from U.S. $1.00 in June 1956 to $1.06 in August 1957. This appreciation cut into export receipts and reduced the cost to Canadians of imports, a desirable anti-inflationary effect during a boom. With the boom at an end it was expected that this capital inflow would tend to decrease very sharply — even more sharply than the expected shrinkage of the current account deficit.. If this occurred, the result to be expected would be a depreciation of the exchange rate. This would encourage Canadian exorts and discourage Canadian imports and thus help to sustain internal production and incomes.1/

Extent of the current recession: Canada and the United States

The expectation that the recession in Canada would be more severe than the recession in this country has not been realized. While the downturn in economic activity occurred somewhat earlier there than here, the extent of the decline seems to have been much less when account is taken of the greater seasonal reduction in economic activity in Canada during the winter. Furthermore, the Canadian recession appears to have been decisively checked during the first three months of 1958, whereas indicators of economic performance in this country continued to decline through April. Thus, in Canada, the seasonally adjusted index of industrial production reached its low point in December 1957, declining to 6.9 per cent below the peak of February 1957. In the United States, the low point was not reached until April and was 13.1 per cent below the mark attained in August 1957.

1/ The rate, in fact, did decline from $1.06 in August 1957 to $1.01 in January 1958. But since January, it has once again appreciated at a more or less steady rate to reach $1.04 by the end of June 1958. In part, this renewed appreciation of the Canadian dollar has been due to the large reduction in the Canadian current account deficit as a result of sharply reduced imports and well maintained exports; it has also been due to the continuance of higher interest rates in Canada than in the United States. The margin by which Canadian interest rates exceeded rates in the United States decreased perceptibly last October and November but since then the margin for most maturities has increased to as large a differential as existed during most of 1957. This has encouraged renewed Canadian municipal, provincial and corporate borrowing in the cheaper New York capital market. The conversion of these funds raised in New York has been a second major cause of the renewed appreciation of the Canadian dollar during the past five months.

In both Canada and the United States, Gross National Product, seasonally adjusted, reached its pre-recession peak in the third quarter of 1957 and, apparently, its recession low in the first quarter of 1958. Percentage changes in expenditure between these quarters are shown in Table 1.

Table 1

Gross National Product Components; Canada and United States
(Per cent change from 3rd qtr. '57 to 1st qtr. '58)

(Seasonally adjusted)

	Canada	U.S.
Gross National Product 1/	- 0.8	- 4.4
Personal consumption	+ 2.7	- 0.7
Government	0.0	+ 2.9
Residential construction	+19.2	+ 1.2
Nonresidential construction	-10.3	- 2.5
Producers durable equipment	- 9.2	-18.2
Exports 2/	- 2.9	-15.0
Imports 2/	- 7.7	- 3.6
Change in nonfarm inventory flow as per cent of GNP in 3rd qtr. '57	- 2.2	- 2.4

1/ For Canada, excludes accrued net income of farm operators, for which the seasonal adjustment is somewhat arbitrary.
2/ Computed from seasonally adjusted balance-of-payments data, for the U.S. Imports include goods and services, remittances and pensions, and nonmilitary government grants.

As price movements have been very similar in the two countries, the table probably gives a fairly accurate comparison of the relative changes in economic activity in particular sectors of the two economies. On the basis of the figures in Table 1, several comparisons can be made concerning the recent economic behavior of the two countries. (a) The total Gross National Product figures support the conclusion reached from the industrial production indices that the recession in Canada was less severe than in the United States. (b) Residential construction was a major anti-recession force in Canada, but little more than a neutral element in the United States. (c) Movement in the balance of payments was another important strengthening factor for Canada as her exports of goods and services held up fairly well while her imports fell. The balance of payments was a weakening factor for the United States as our imports weakened only slightly and our exports declined dramatically. (d) Consumption outlays, while a sustaining element in both countries, held up much better in Canada than in this country. (e) The over-all decline in private fixed investment, excluding residential construction, was relatively less in Canada. In addition, there was a large reduction in imports of investment goods. Consequently, the impact of lower rates of fixed investment on domestic employment and production was partially shifted abroad, especially to the United States, Canada's most important external supplier of machinery and construction materials.

Other data supporting the judgment that the contraction in Canada was less than in the United States include labor incomes, retail sales and employment. From the first quarter of 1957 to the first quarter of 1958, each of these economic indicators showed a considerably greater decline in the United States than in Canada. The difference in retail sales was especially sharp; in Canada, retail sales actually rose by 6.9 per cent from the third quarter of 1957 to the first quarter of 1958 while in this country, in the same interval, retail sales fell by 4.1 per cent.

During the boom year, 1956, the demand for labor in Canada was even more acute than in this country and seasonally adjusted unemployment averaged 3.1 per cent of the labor force there compared to 3.8 per cent in the United States. Subsequently, as the 1957-58 recession developed, unemployment in both countries rose to the same peak percentage level -- 7-1/2 per cent of the labor force. This peak was reached in March in Canada and in April in the United States. The lower pre-recession unemployment level in Canada meant that a sharper rise in unemployment, on a seasonally adjusted basis, had occurred there than here. But this is only an apparent contradiction to the generalization that the recession has been deeper in the United States and it is explained by the much larger percentage growth of the Canadian labor force during 1957 as a result of record immigration.

We have already mentioned that movements in exports and imports helped compensate for the decline in internal demand in Canada but aggravated the decline in this country. The second major reason for the stronger economic performance in Canada seems to lie in the large number and variety of important anti-recession actions taken by the Canadian Government, in contrast to the more delayed and moderate steps taken in the United States. It is true that these various anti-recession measures in Canada -- especially the earlier ones -- represented the fulfillment of a hodge-podge of election promises rather than a deliberate program to offset developing recessionary tendencies. Nevertheless, they comprised and impressive program.

The 1957 election

In the election campaign, prior to their surprise victory in June 1957, the Conservatives made a number of promises to increase federal spending and cut taxes, which if carried out would materially reduce the budget surplus then being generated. At the time they were made, these election promises appeared to be somewhat irresponsible since Canada apparently was still riding the crest of a huge investment boom. Increased government spending, not offset by increased taxes, promised only to intensify the inflationary pressures already straining the economy.

These pressures eased noticably in the second half of 1957, however, so that in translating its campaign promises into legislation the Conservative Government, in fact, acted to offset the decline in economic activity.1/

Fiscal actions of the new Government

The following table summarizes the various fiscal measures passed by Parilament or invoked by the Canadian Government under already existing legislation since the 1957-58 budget was presented in Arpil 1957.

1/ In passing, it might be noted that the Liberal Opposition, as well as most members of the two lesser parties in Parliament, voted for nearly all the measures proposed by the Conservatives despite strenuous objections in Parliamentary debates over details.

Table 2

Fiscal Measures taken in Canada since April 1957

Measure	Date passed by House of Commons or invoked by administrative order	Date effective	Fiscal impact in Fiscal 1957-58 1/ (In millions of dollars)	Fiscal impact in Fiscal 1958-59 (In millions of dollars)
A. Pay increases				
1. For civil servants and armed forces	6/14/57	Retroactive to 5/1/57	100	110
B. Tax cuts				
1. Reduced auto excise tax	12/13/57	Retroactive to 12/7/57	8	20
2. Lower income tax rates	12/14/57	1/1/58	10	86
3. Larger dependent exemptions	12/14/57	"	7	60
4. Corporate income tax cut	12/14/57	"	1	12
5. Promised increased deductions for provincial tax payments	Current session	4/1/58	--	(10) 2/
6. Miscellaneous adjustments in various rates and exemptions in new budget	6/19/58	6/19/58	--	8
Subtotal			26	196
C. Direct housing loans				
1. Release of appropriated funds	8/21/57	9/1/57	150	--
2. Further appropriations	12/18/57	1/1/58	150	--
3. Further appropriations	5/16/58	5/17/58	--	350
Subtotal			300	350
D. Increased transfer payments				
1. Increased pensions and disability benefits	11/5/57	11/1/57	42	103
2. Extnesion of unemployment insurance benefits	11/28/57	12/1/57	13	13
3. Interest free advances on farm-stored grain	10/31/57	11/57	(50)	100-150

1/ The fiscal year in Canada runs from April 1 through March 31.
2/ Figures in parentheses are particularly uncertain estimates.

Table 2 (cont.)

Measure	Data passed by House of Commons or invoked by administrative order	Date effective	Fiscal impact in Fiscal 1957-58	Fiscal impact in Fiscal 1958-59
			(In millions	of dollars)
D. Increased transfer payments (cont.)				
4. New agricultural price supports measure	1/25/58	3/31/58	--	(10)
5. Grants and loans to Colombo Plan countries	1/8/58	1/8/58	50	(?)
6. Further extension of unemployment benefits	5/15/58	5/18/58	--	14
Subtotal			155	240-290
E. Increased grants to Provinces				
1. As percentage of tax receipts	1/29/58	4/1/58	--	87
2. Contributions to Provincial Health Insurance Plans1/	11/27/57	7/1/58	--	(70)
3. Subsidy for maritime coal	1/15/58	1/15/58	--	2
Subtotal			--	159
F. Public works				
1. $30 million maximum loan to New Brunswick	1/13/58	at discretion of Govt.	--	(30)
2. Thermal projects for Atlantic Provinces2/	1/15/58	(?)	--	(12)
3. Acceleration of programmed public works	--	--	--	61
Subtotal			--	103
Fiscal year totals			581	1039-1089

1/ Under an act passed in 1957 which provided for federal contributions when agreements were reached with provinces covering over 50 per cent of Canada's population. The Prime Minister's announcement on November 27, 1957 pushed forward the anticipated date of the program's commencement to July 1, 1958.

2/ Enabling legislation only, appropriations are to come later. It is proposed that $25 million be spent in the 2 years beginning April 1958. The program may be extended later.

A. Pay increases -- Salary increases for 7,000 professional and scientific civil servants were announced on May 10, 1957, retroactive to May 1. Similar increases for more than 200,000 nonprofessional civil servants, members of the armed forces, and mounted police were announced on June 14. The increases ranged from 4.5 to 12 per cent, with the average increase amounting to 6 per cent. These pay increases were effected by the outgoing Liberal Government through an administrative order of the Finance Minister. They resulted in large retroactive payments in August covering pay for May, June, and July, which contributed to an increase in consumer spending in the third quarter of 1957.

B. Tax cuts -- The impact during the fiscal year ending this past March of the tax cuts passed in December was quite small compared with the impact of other anti-recessionary measures in Canada. The cuts amounted to an estimated $28 million -- only 5 per cent of the estimated fiscal impact of all measures put into effect. In the current fiscal year, however, the December tax cuts plus further small tax reductions contained in the budget presented in June will amount to an estimated $196 million. This would be equivalent, in relation to Gross National Product, to tax cuts of about $2-1/2 billion in the United States, and is 18 per cent of the estimated fiscal impact of all measures so far put into effect for the fiscal year ending next March.

All major categories of domestic taxes were affected. Personal income taxes were cut by about 9 per cent, corporate taxes by about one per cent, and the auto excise tax was reduced from 10 to 7-1/2 per cent of the manufacturer's price. The income tax cut was achieved by lowering the tax rate applicable to the first $1,000 of taxable income from 13 to 11 per cent, lowering the rate applicable to the second $1,000 of income from 15 to 14 per cent, and increasing the allowable exemption for child dependents by $100. The increased exemptions removed 100,000 tax payers from the rolls. Similar changes in income tax rates and exemptions in the United States would have had a greater impact since in this country a larger share of total tax receipts are generated by the personal income tax.

It is impossible to isolate the specific effects of these tax cuts. They must have played a significant part in sustaining consumer expenditures in Canada in recent months. However, the effects of increased transfer payments and especially of the massive injection of low cost government mortgage loans have been of considerably greater importance in slowing the economic downturn and promoting economic recovery.

C. Housing -- Housing starts in Canada, seasonally adjusted, rose to record levels in the second half of 1955 under the stimulus of rising personal incomes and family formation. Due to a developing shortage of land provided with community facilities in several large metropolitan areas and a growing shortage of mortgage funds, housing starts slackened in the first part of 1956. This decline became much sharper in the second half of 1957, and starts fell to a seasonally adjusted five-year low rate in January and February 1957.

Believing that its credit policies were having too severe an effect on residential construction, the Bank of Canada met with the Chartered Banks in March 1957. At this meeting, it induced them to agree to expand their mortgage lending on the condition that such an expansion would not force them to reduce their total volume of other loans. As a result of increased mortgage lending by the banks, some recovery in housing starts followed, but the rate of starts remained well below the level of 1955 and 1956.

Beginning September 1, 1957, the Government made available \$150 million of "direct" government loans to builders and prospective home buyers under the National Housing Act of 1954 (NHA). These loans were "direct" in the sense that the money loaned was appropriated by the Government out of general revenues for use by the Central Mortgage Housing Administration (CMHA). Although the CMHA inspected the borrowers' building plans to insure conformity with NHA regulations, it did not negotiate the loans itself but instead had banks and insurance companies act as its agent. For handling the financial part of the lending transaction and for administering the loan repayments, these "approved lenders" received a fee ranging from \$80 to \$300 a loan, plus a collection fee of one-half of one per cent of the principal outstanding for home-ownership loans and one-fourth of one per cent of the principal outstanding for loans on rental property. An "approved lender" had the option of purchasing from the Government any loan which it had granted within one to two years after the loan was made, at a price which reflected the maximum rate of interest on NHA guaranteed loans at the time of purchase.

By the end of November, \$135 million of these funds had been committed and housing starts had shown a strong upsurge. In December, a second \$150 million of direct loan funds was made available. At the same time downpayment requirements were substantially lowered and this greatly increased the number of loan applicants. Impelled by these NHA loans and the easier borrowing requirements the rate of starts rose to record levels in the first quarter of 1958.

By the end of March, nearly all of the \$300 million of direct mortgage money was loaned out. In relation to Gross National Product, this would be equivalent to loans of about \$4 billion in the United States. In May, immediately after convening the current session of Parliament, the Government rushed through the appropriation of an additional \$350 million for further direct housing loans. However, very little of these additional funds are currently being expended, since with the drop in interest rates banks and insurance companies once again became large-scale lenders on government guaranteed mortgages. The Government has indicated that as long as these private funds are made available in sufficient quantities it will hold off making further direct loans. From the Minister of Finance's recent budget speech it seems likely, however, that the additional $350 million, recently appropriated, will be expended some time during the 1958-59 fiscal year. In any case, it seems almost certain that outlays for housing during the current year will exceed the record levels of 1956 largely as a result of the injection of government funds which has already taken place.

D. Transfer payments -- Six of the fiscal measures listed in Table 2 are classified as increased transfer payments. The combined fiscal impact of these measures for fiscal year 1957-58 is estimated at between $229 million and $279 million, equivalent to between $3 and $4 billion in the United States. Largely as a result of these transfers, nonfarm personal income rose by 1.3 per cent from the third quarter of 1957 to the first quarter of 1958 while nonfarm National Income declined by 1.1 per cent.

Old age pensions were increased from $46 to $55 a month and larger benefits to blind and other disabled persons were made effective starting November 1, 1957. For the fiscal year beginning April 1, 1958, the cost of these measures is estimated at $106 million.

Special seasonal payments to unemployed workers in the winter months have been a feature of the Canadian unemployment insurance program since 1950. Many unemployed workers who are not covered by regular unemployment insurance or who have exhausted their eligibility for regular unemployment benefits may receive these special seasonal payments. The period during which special seasonal unemployment benefits could be made was lengthened by two months by Act of Parliament in November 1957. This extended the eligibility period to run from mid-March to mid-May. The cost of this extension was estimated at $13 million. In May of this year, immediately after the new Parliament convened, the period was again extended, this time for six weeks, through June 28. This second extension, however, applies only to the current year. It will cost an estimated $14 million.

A program of interest-free advances for currently produced farm-stored grain was put into effect by the Advance Payments Act passed October 31, 1957. This act resulted from the inability of the Canadian Wheat Board, the sole purchaser of wheat in Canada, to buy currently produced wheat from farmers because of full government granaries and large quantities of grain stored on farms awaiting government purchase. Because payments to farmers could not legally be made until their grain was actually delivered into government storage, some scheme to provide advance payments or loans was necessary if farm disposable income was to be maintained. Estimates of total advances for the 1958-59 fiscal year range from $100 to $150 million.

Existing farm price-support legislation has been replaced by a more liberal support bill designed to assure the farmer "greater stability of income." The bill provides discretionary flexible supports for all agricultural products and sets minimum price levels on key products in relation to prices in a moving base period. The actual extent to which farm incomes will be increased depends on the manner in which the new legislation is administered. It seems likely, however, that Canadian farmers will continue to receive much less subsidized support than farmers in the United States. (But there are indications that imports of competitive fruits and vegetables from the United States may be confronted by a more intensive use of tariffs and quotas this summer.)

The sale of some $50 million in wheat and flour to Colombo Plan countries to be shipped during the winter and spring months of 1957-58 was announced by the Government on January 8, 1957. These shipments were financed by long-term loans of $30 million and grants of $15 million. The short-run economic effect of this measure was to increase the ability of the Canadian Wheat Board to maintain purchases of grain from Canadian farmers by increasing the rate of outflow from full government granaries.

E. Grants to provinces -- The Federal-Provincial tax sharing arrangements act was amended on January 29, 1958, so as to increase by $87 million the amount of federal tax revenues to be given the provinces in the fiscal year beginning April 1, 1958.

Another measure which will increase federal transfers to the provincial governments are the promised federal contributions to the various Provincial Health Insurance plans. In fiscal year 1957-58, these will probably total $70 million.

F. Public works -- A major issue in the recent Canadian election campaign was whether the Federal Government should rely more on further tax cuts or on an expanded public works program to promote economic recovery. The Liberals espoused additional tax cuts totaling $400 million (roughly equivalent to a cut of $5 billion in the United States on a Gross National Product basis) as a recession remedy. The Conservatives did not promise further specific tax cuts, but proposed instead a "great national program of public works" including a highway program to open the Yukon and Northwest Territories.

Since the Conservatives won the March 31 national election in overwhelming fashion they are in a position to carry out their promised public works program as they please. The presentation of the annual budget on June 17 has resolved speculation concerning the size and impact of their program. It appears to amount to no more than a modest acceleration of projects either already begun or already on the list of scheduled public works. Thus, public works outlays by the Federal Government during the current year are scheduled to rise by only about $103 million, equivalent to about $1.4 billion in the United States. While large, this increase in public projects has not had and will not have an economic impact of the same order of magnitude as the increase in transfer payments or the injection of funds for residential construction.

Summary

The various measures put into effect by the Canadian Government during the past year add up to a major anticyclical effort. In terms of relative economic impact, the program for direct housing loans has probably been the most important measure, followed by increased transfer payments and tax reductions. In the current fiscal year, larger provincial grants and expanded public works will increase in relative importance.

As a result of these measures and the automatic decline in government revenues because of the decline in national income, the federal budget for fiscal year 1958-59 contains a cash deficit of $1.4 billion, equivalent to about $20 billion in the United States. And this estimate assumes that the beginning of an economic recovery, now discernable in Canada, will continue so that real output in 1958 will be 2 per cent higher than in 1957. If a more limited recovery or a renewed decline occurs, the deficit will undoubtedly be greater.

Due to the Government's energetic program, together with the great improvement in its balance of trade as a result of sharply reduced imports and well maintained exports, the Canadian recession has been considerably more limited than the recession in the United States and a definite economic recovery in Canada appears to have begun in the first quarter of this year.