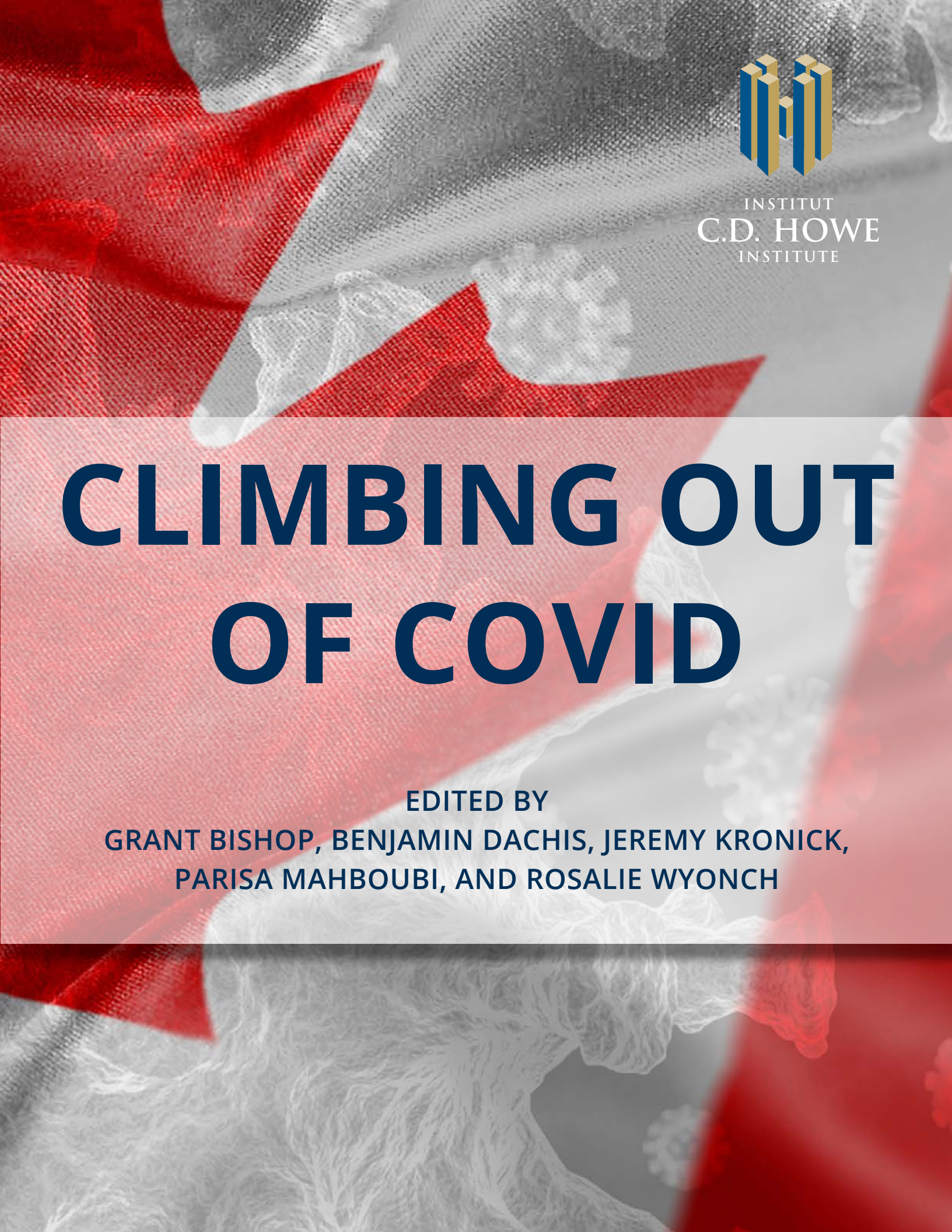

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CLIMBING OUT OF COVID

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Preface

by Benjamin Dachis

2020 will go down as one of the most pivotal in Canadian economic policy history. The year began focused on the usual slate of policy issues. Debates about corporate tax deductions on interest expenses. Finalizing a trade deal with the United States. Then the world changed. And fast. As the world shifted its focus to COVID-19, so did the C.D. Howe Institute and much of the field of Canadian policy experts.

Starting in March 2020, the C.D. Howe Institute devoted much of its research efforts towards addressing the consequences of COVID-19, which we summarize here. Given the pace of change, the Institute rapidly focused its efforts through two main routes.

First, we formed crisis working groups of academics, business leaders, and policymakers to tackle the biggest policy problems of the day. The Institute started with four such groups, forming a fifth in the fall:

- Our Public Health and Emergency Measures group (chaired by Janet Davidson and Tom Closson) made recommendations ranging from addressing the acute public health and long-term care emergencies to laying out the critical path for creating a vaccine.
- The Business Continuity and Trade group (chaired by Dwight Duncan and Jeanette Patell) focused on policies to ensure businesses that needed to stay running had the workers, supplies, and financial support needed to survive. It also focused on how to support those sectors most affected by the pandemic.
- Our Household Income and Credit Support group (chaired by Katie Taylor and Mike Horgan) pointed out the lack of data that policymakers had in making many labour market decisions, while also showing the way towards improvements to the income supports available for Canadians.
- The Monetary and Financial Measures group (chaired by David Dodge and Mark Zelmer) advised on ways to ensure stable financial markets and access to capital while considering the medium- to long-run impact on Canada's inflation target.
- Starting in the fall of 2020, the Institute launched a working group (chaired by Janice MacKinnon and John Manley) dedicated to fiscal and tax policy to begin tackling the mounting fiscal cost of, and how to pay for, COVID-19 measures.

Second, the Institute ramped up its Intelligence Memo series and op-ed publishing, covering the full spectrum of policy issues governments faced. Canada's economics community responded with a flood of submissions. The Institute's Intelligence Memos have a wide readership among Canadian policymakers and experts. These became the go-to source for rapid policy advice. The Institute led the policy debate with Institute staff and fellows publishing 43 Op-Eds in the *Globe and Mail* and *National Post* between March and the end of September. We reproduce most of these contributions here, either in op-ed form or when republished as an Intelligence Memo.

Meanwhile, our research team also continued to produce timely Commentaries and E-Briefs on important policy issues for the country, whether or not related to COVID-19.

We at the C.D. Howe Institute hope this compilation of the policy advice during this period serves a few goals.

Preface

First, it can light a path forward on future policy. As I write this introduction in October 2020, it is unclear what path the spread of the virus will take. It may continue to grow exponentially. Or we may flatten the curve once again. Many of the conversations at this moment are similar to those from the spring of 2020. What parts of the economy should be shut down? How do we ramp up testing? And how do we support those sectors and workers most hurt? to name just a few current problems. Many of Canada's top policy minds turned their attention to these questions earlier in 2020. This book contains a deep well of ideas that policymakers can quickly turn to when the need for quick decision-making arises in the near future. Who knows what future decisions lie ahead?

Second, it can give future generations of policymakers and policy analysts a window into the policy debates of the time and the totality of the policy challenge. We have organized the book by theme, but also by date within each theme. There is a good reason for that. Readers can see the evolution of policy changes and the thinking of policy writers at the time. What may look obvious to readers years after the pandemic is over was not as apparent in the fog of war against the virus and subsequent economic carnage. A good example of this was the policy debate over the ideal form of income support during the pandemic. At the end of March, there was an intense debate over whether the ideal way to support workers was via direct payments to those who lost their jobs or via wage subsidies paid via their employers. For months, a debate raged over the effect these policies had on the labour market. Economists had few ways to be truly able to tell. Readers of these sections will see the policy debate between those advocating various approaches and how best to measure the policy impact. The timing of policy pieces also shows when a matter showed up in the policy debate. For example, the fiscal cost of many of the COVID-19 measures wasn't a priority until well into the summer of 2020. Future readers may also come to appreciate how many policy battlefronts there were in the spring of 2020 based on the wide range of entries from that time.

Third, it is a celebration of the work economists and policymakers took on during the pandemic. For all the lost livelihoods, all the losses in our lifestyles, and – most importantly – all the lost lives, things in Canada could have been so much worse. Good policy, and good policy advice such as that encapsulated here, played a role in Canada weathering the COVID-19 storm better than some countries. From March of 2020 onwards, Canada's greatest policy minds tackled the problems caused by COVID-19 with an exceptional level of focus. We at the C.D. Howe Institute were proud to be one of the main – if not the main – forums for independent economic policy advice to governments during the pandemic. This book is a record of the achievement of Canadian economists and policy analysts.

Fourth, despite the success of some parts of Canada's policy response, we could have done better in many areas. Governments had to make decisions very quickly and often with little time for advice. Our compilation can help governments gauge their reactions against the thinking from experts.

This effort is a team collaboration. Grant Bishop, Jeremy Kronick, Parisa Mahboubi, and Rosalie Wyonch supported the working groups, and contributed their own pieces, as you will read more about below. Their work also covered editing and reviewing the many memos and op-eds that came across their inboxes. They were aided by many other C.D. Howe Institute staff, including Bill Robson, Duncan Munn, Daniel Schwanen, and Alex Laurin in setting the tone and tenor. Farah Omran, Miles Wu, and Mariam Ragab provided enormous help on multiple products throughout the way. Colin MacKenzie was indispensable with his eyes on every single Intelligence Memo. James Fleming copy-edited much of the material that went out, and Yang Zhao gorgeously designed the submissions and did the majority of the work in compiling them for this book. Laura Bouchard, David Blackwood, and Nancy Schlömer took on an enormous task in writing up the media notifications for much of our expanded products and getting

the word out of their publication. The Institute's events team did an enormous amount of work in ensuring that working groups functioned smoothly with all the rest of the Institute staff keeping the Institute operating during tumultuous times of getting everyone set to work from home.

Not least, a huge thank you to all the people who contributed their time and brainpower to the ideas pulled together here. Our crisis working group members devoted countless hours to the meetings of these groups, not to mention the preparation for the meetings. This is especially true for the co-chairs of the groups. Many, many experts submitted Intelligence Memos and op-eds that we reproduce here. We especially value the time they put into their analysis while they juggled the threat of the virus in their daily lives, children at home and in the background of Zoom calls, and everything else 2020 threw at them.

This book is dedicated to all the experts who did what they could to help Canada get through the COVID-19 crisis.

Benjamin Dachis
October 26, 2020

Part 1

Protecting Canadians from the COVID-19 Outbreak

by Rosalie Wyonch

Unlike previous disease outbreaks, particularly the SARS outbreak in 2003, COVID-19 has had broader community transmission resulting in more extensive public health measures being needed to combat its spread. The need to physically distance resulted in significant disruptions to almost all sectors of the economy. The presence of COVID-19 in communities meant that managing its spread involved a broad range of health professionals and institutions. The first wave of COVID-19 and the extensive policy and public health measures taken in response illuminated gaps in health system preparedness and Canada's social safety net.

Due to the complexity of the current crisis and the time required to implement broad health system changes, there are challenges in addressing short-term needs and the longer-term changes required to improve our capacity to respond to infectious disease outbreaks in future. Following the SARS outbreak, numerous reports related to disease outbreak preparedness and management were written. Analysis of the recommendations in these reports as well as their implementation is needed to gauge whether we were adequately prepared for COVID-19.

In the early days of the pandemic, the top priorities for analysis were access to testing and personal protective equipment, timely access to comprehensive health information, and intergovernmental and health system collaboration to manage the challenges. To maintain some continuity of care in the midst of restrictions, significant progress was made in the adoption of virtual care delivery. In some cases, however, delays in urgent and non-urgent surgeries have added to backlogs that pose a significant challenge in the midst of continuing COVID-19 risk. The initial wave of the pandemic also highlighted the cracks in the system; mortality and infection rates in retirement and long-term care homes in particular.

There is a need to determine the allocation of scarce resources towards applications with the highest impact on disease spread. Shortages of primary care providers, physicians, nurses, personal support workers, and other care providers that were manageable before the crisis became acute as some healthcare providers were exposed to COVID-19. The consequent isolation and restrictions on health workers reduced the flexibility of part-time workers. Concerns about consistent and adequate access to medicines, testing reagents and other inputs were compounded by border and airport closures that disrupted commercial shipping routes.

In the medium-term, policymakers and health administrators require accurate and up-to-date information about the epidemic to be able to respond effectively to it. Currently, electronic medical records do not allow for rapid aggregation and anonymization that would make data useful for comprehensive analysis of the ongoing epidemic, as well as measuring the effectiveness of policy interventions. In addition, it is important to evaluate social policies that are not directly related to the healthcare system but relevant to disease spread and the ability to practically implement physical distancing. Examples include homelessness, the availability of sick-leave pay, and gaps in access to employment or supplementary health insurance.

Retirement residences and long-term care facilities were the center of the first wave of the COVID-19 epidemic in Canada. As of September 29, 1,306 outbreaks had been reported at such facilities accounting for more than three-quarters of COVID-19 deaths (Table 1). Provinces have implemented different policies related to long-term care and retirement homes, which has resulted in some faring much better than others. In general, however, Canada has not done well at protecting

Table 1: Institutional Care COVID-19 Outbreaks and Mortality

	% of homes affected	% of cases	% of deaths
Alberta	27	8	70
British Columbia	14	8	57
Manitoba	5	2	31
New Brunswick	0.43	13	100
Nova Scotia	10	36	88
Ontario	36	21	73
Prince Edward Island	3	2	0
Quebec	28	25	80
Saskatchewan	1	0.44	8
Canada	23	20	77

Note: Newfoundland and Labrador has zero recorded deaths institutional care related cases of COVID-19, with 1 resident case. The territories have zero COVID-19 cases related to long-term care or retirement facilities.
Source: https://ltc-covid19-tracker.ca/ (September 29, 2020).

the elderly population living in an institutional care setting from COVID-19 infection and mortality compared to many other countries. Residential care facility outbreaks of COVID-19 have been centered in five provinces: Nova Scotia, where one home experienced a particularly severe outbreak, and the four most populous provinces (BC, Alberta, Ontario, and Quebec). The outcomes are particularly bad in Quebec, where more than 60 percent of Canada's COVID-19 deaths have occurred. Ontario continues to struggle to manage institutional outbreaks as well; 36 percent of facilities are experiencing or have experienced an outbreak at time of writing.

The elderly population receiving care in the community is at a much lower risk of infection than those in residential care facilities. However, they are also generally less medically complex cases than long-term care residents. That said, the severity of outbreaks at residential care facilities varies across provinces, as does the proportion of seniors living in residential care facilities. About 90 percent of funding for seniors' care in Canada is directed to institutional care with only 10 percent directed to home- and community-based long-term care. Canada falls well below the OECD average of 35 percent of long-term care expenditures being directed to home and community care. Generally, the countries that have a higher proportion of seniors receiving care at home are also the ones that direct a higher proportion of long-term care expenditure to such care and also spend a larger proportion of all health expenditures on seniors' care. Canada has invested in residential long-term care at similar levels to other countries. But, comparatively under-invests in elderly care overall and particularly in home- and community-based care.

Although media outlets, governments, and academics hope that a vaccine for COVID-19 will be developed within 12-18 months, the C.D. Howe Institute's Public Health and Emergency Measures Working Group recommends preparing for a less optimistic timeline: novel vaccines usually take 10-15 years to develop. The fastest vaccine development was for Mumps at four years while the Ebola

vaccine took five years.[1] Under normal circumstances, the vaccine development process is slow because (i) development is carried out sequentially, (ii) significant investment is required related to research and development, and (iii) there is a need to establish oversight on these investments to ensure a collaborative approach is taken.

Normally, vaccine development is carried out in sequential stages: drug discovery, pre-clinical testing, three-phase clinical testing, regulatory approval, and follow-up monitoring of safety and efficacy. Most candidates fail to pass the drug discovery and pre-clinical phases and many more are eliminated in subsequent phases. Throughout the process, vaccine development requires significant academic, industry, and government collaboration. The factors that would normally slow the vaccine development process are less of a hindrance in developing the vaccine for COVID-19. First, the pandemic affected almost the entire world, which means that there is significant ongoing and recurrent demand for the vaccine, depending on the length of time that the approved vaccine confers immunity and whether COVID-19 is seasonal. Globally, governments have made significant investments to develop the vaccine for COVID-19 and there is a significant level of collaboration between academics, clinicians, industry, and governments to achieve the goal. Nevertheless, there is a need to consider the possibility that a vaccine will not be sufficiently developed within the next 12-18 months. It is important that governments' investment strategies incorporate a longer development scenario.

Much of the initial attention, particularly from the media and public, to COVID-19 has been on the disease and its consequences. It is clearly a disease with devastating potential as witnessed in the early months in jurisdictions such as Italy and New York State. As a result, in the absence of proven preventive and therapeutic agents, a drastic series of public health measures were taken in order to control spread of the virus globally. These measures have been successful in Canada, but they have come at a tremendous cost.

These costs are most often considered in terms of the economic burden, which is clearly substantial. Canadians' adherence to the public health measures has been facilitated by generous interventions, such as the Canada Emergency Response Benefit. While this has eased impact on individuals, it has resulted in our governments incurring significant debt (see discussion below).

However, there is a much more significant set of costs that appear to be less often discussed and considered in public policy. These are the very significant social and health consequences of the public health measures. Some examples of these consequences include:

- Delayed medical visits and surgical procedures – for example, data are emerging that delays in diagnosis and treatment for cancer patients is leading to worse outcomes.
- Delayed immunization programs – as medical offices closed, children missed scheduled appointments.
- Domestic violence and child abuse – as families were together at home for a prolonged period of time this created unsafe conditions for many individuals.
- Mental health effects of isolation – survey data show increased levels of anxiety and depression in the population.
- Delayed early childhood development – the early years are one of the strongest predictors of lifelong health and social outcomes.

1 In the case of the Ebola vaccine, five years refers to the time taken to conduct clinical testing and gain market approval. The chemical entity that eventually became the vaccine was identified in 2004 and initially licensed in 2010. Merck purchased the commercial rights to it in 2014, following the Ebola outbreak in West Africa and the appearance of a small number of cases in the US; the Public Health Agency of Canada maintains ownership of non-commercial rights.

- Physical inactivity – lockdowns and closure of gyms has led to decreased levels of exercise, a strong predictor of health status.
- Increased drug and alcohol consumption – for example, opioid deaths are increasing.
- Food insecurity – visits to food banks have increased.

And this list is by no means complete. As well, it is important to bear in mind that the economic consequences themselves will result in further health consequences. For example, unemployment has been shown consistently to result in poorer health outcomes and increased mortality.

While we cannot stop our focus on controlling COVID-19, we must do so in a manner that accounts for these adverse consequences. We know much more about the disease and how to control and treat it than we did in March. We have much greater capacity for testing and contact tracing as well as more resiliency in our health system. As we move forward, we need to ensure that critical societal functions, such as education, are restored. We need to ensure the appropriate precautions are in place so in the case of resurgence of disease we can control the cases without having to resort to lockdowns again.

As case numbers rise across the country over the fall of 2020, the healthcare system is bracing for the second wave of COVID-19 and also preparing for the annual challenge of managing flu season. Information about the virus and its effects continues to evolve, as does policy to combat its spread. In the short term, there are a number of priorities for governments and the healthcare system to address to improve outcomes for the second wave of COVID-19:

- Adapt economic and healthcare restrictions to reduce the extent of disruption while achieving similar or better outcomes related to COVID-19. Different provinces prioritized continuation of different areas of care in the midst of the initial disruptions caused by the first wave, with Alberta maintaining surgeries throughout and Saskatchewan focussing on continuity of primary care services. Provinces that had more stringent restrictions on access to medical care during the first wave have the opportunity to learn from the provinces that have successfully continued most healthcare services.
- Develop public health and policy plans for multiple infection scenarios and communicate them with the public. As case numbers rise, governments should be proactive in setting public expectations to align with the imposing of further restrictions, how long they will be in place and the possibility of further government support in the form of subsidies, cash transfers, and tax and loan payment deferrals.
- Ensure preparedness:
    - Maintain excess hospital bed capacity for COVID-19 patients and adapt healthcare and clinical practices to maintain continuity of access as much as possible.
    - Secure sufficient supplies of personal protective equipment and other medical supplies such as ventilators and testing materials to minimize the risk of healthcare providers and workers being exposed or infected.
    - Actively engage in ongoing clinical trials of promising potential therapies and vaccines to contribute to their development and provide early access to Canadians.

Overall, the issues that we are facing today in terms of the health system's ability to manage a crisis are also important in improving the quality and condition of healthcare when the system is not in acute crisis.

Theme 1:

A Crisis in and of Public Health

Crisis Working Group Report
Public Health and Emergency Measures

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. The complexity of the current crisis and its far-reaching effects have necessitated across-the-board policy responses. Accordingly, the C.D. Howe Institute has convened specialized groups to discuss the ongoing policy issues in the following areas:

- Public Health and Emergency Measures
- Household Income and Credit Support
- Business Continuity and Trade
- Monetary and Financial Measures

The Public Health and Emergency Measures working group is Chaired by Janet Davidson, Chair of the Board of the Canadian Institute for Health Information, former Deputy Minister of Health (AB) and C.D. Howe Institute Senior Fellow, and is supported by a group of health academics, professionals and business leaders. Meeting weekly, this group will examine policy ideas, and publicly communicate the results of its discussions via Communiqués. The Working Group's first meeting was March 27, 2020. The purpose of the initial meeting was to discuss and prioritize key policy issues that affect the healthcare system's capacity and ability to effectively respond to the COVID 19 pandemic.

The working group noted that the COVID-19 pandemic contains echoes of the SARS outbreak in 2003 but COVID-19 is notably distinct from a public health perspective. One notable distinction was that the effects of COVID 19 are much broader from a societal perspective – the need to physically distance due to the number of cases and community spread has resulted in significant disruption to almost all sectors of the economy. A group participant noted that the effects of the SARS outbreak were much more concentrated in the hospital setting, and while it was disruptive, the presence of COVID-19 in communities broadens the range of health professionals and institutions directly involved in treating patients and managing the spread of disease.

Following the SARS outbreak, numerous reports related to disease outbreak preparedness and management were written (Naylor 2003, Walker 2004, Campbell 2006). Several members of the group

noted that analysis of the recommendations in these reports as well as their implementation is needed to gauge whether we were adequately prepared for COVID-19.

Due to the complexity of the current crisis and the time required to implement broad health system changes, the group discussed challenges in addressing short-term needs and longer-term changes required to improve our capacity to respond to infectious disease outbreaks in future.

Intergovernmental Collaboration

A Federal/Provincial/Territorial Public Health Response Plan for Biological Events has been activated to enable a more consistent and collaborative approach to disease management across the country. Group members pointed to the variability of testing strategies across provinces, noting Ontario is only testing vulnerable populations while Alberta and British Columbia are conducting tests on a more widespread basis. This was seen by group members as an indicator that collaboration could improve. And even at the highest level, provincial testing falls far below that seen in jurisdictions such as Taiwan and South Korean. The group noted that since each province manages and administers its own healthcare system, some variability is expected. However, where policies fall below an objective measure of what is required from a public health perspective, this raises the issue of whether the federal government could (both legally and practically) invoke the Emergencies Act to address deficient testing and contact tracing across provinces.

Allocating Scarce Resources – Medical Staff and Supply Shortages

The current pandemic is illuminating the cracks in Canada's healthcare system and specifically the relatively low rates of hospital beds and medical personnel per capita. Concerns about consistent and adequate access to medicines, testing reagents and other inputs are compounded by border and airport closures that are disrupting commercial shipping routes. Shortages of primary care providers, physicians, nurses, personal support workers and other care providers that were manageable prior to the crisis have become acute as demand surges and some health providers themselves are exposed to COVID-19 and require isolation.

The group discussed the need for strategies to allocate scarce resources to the applications where they will have the highest impact on disease spread. Addressing shortages of personal protective equipment, ventilators and other equipment should be of paramount concern, as the healthcare system cannot run at full capacity if many health workers are unable to work due to COVID 19 exposure. Further, there is a desperate need to ensure that all medical personnel (whether in hospitals, in long-term care homes or in home care settings) are regularly tested for COVID-19 to ensure their safety and the safety of the patients they treat. Strategies for addressing acute capacity constraints – labour and supply shortages – are a priority for discussion in future Working Group meetings.

Medium-Term Agenda

Policymakers and health administrators require accurate and up-to-date information about the epidemic to be able to respond effectively to it. The current state of electronic medical records across Canada, however, does not allow for the rapid aggregation and anonymization that would make the data useful for comprehensive analysis of the ongoing epidemic, as well as measuring the effectiveness of policy interventions. Better standardization of electronic health data and medical records would enhance the government's capacity to track and manage public health crises.

The group also discussed aspects of social policies not directly related to healthcare but relevant to disease spread and ability to practically implement physical distancing measures. One particular example was homelessness – the lack of affordable housing, combined with an at-capacity shelter system in some cities makes physical distancing a practical challenge for the vulnerable homeless population and those working to support them. More generally, the current crisis situation is exhibiting gaps in the social support systems for vulnerable populations across the country. Addressing existing gaps has necessitated extensive emergency support from government.

Finally, the group noted that many of the issues we are facing today in terms of the health system's ability to manage a crisis are also important to improving the quality and coordination of healthcare when the system is not in acute crisis. Group members said it is important to address forward-looking issues, those pressures that may arise in future, and policy actions that could be taken now to address them.

The members of the Public Health and Emergency Measures Crisis Working Group Include:

Dr. Sacha Bahtia, Director of Institute for Health Systems Solutions and Virtual Care, Women's College Hospital.

Åke Blomqvist, Health Fellow-in-residence C.D. Howe Institute; Adjunct Research Professor, Carleton University.

Tom Closson, Co-Chair Health Policy Council C.D. Howe Institute.

Janet Davidson (Chair), Senior Fellow C.D. Howe Institute; Chair of the Board Canadian Institute for Health Information.

Duncan Sinclair, Emeritus Professor, Queens University.

Colleen Flood, Professor & Director, uOttawa Centre for Health Law, Policy & Ethics University Research Chair in Health Law & Policy.

Catharine Whiteside, Executive Director, SPOR Network in Diabetes, Emerita Professor and Former Dean of Medicine.

Rosalie Wyonch, Policy Analyst and Research Lead, Health Policy Council C.D. Howe Institute.

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Public Health and Emergency Measures

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. The complexity of the current crisis and its far-reaching effects have necessitated across-the-board policy responses. Accordingly, the C.D. Howe Institute has convened specialized groups to discuss the ongoing policy issues in the following areas:

- Public Health and Emergency Measures
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The Public Health and Emergency Measures working group is Chaired by Janet Davidson, Chair of the Board of the Canadian Institute for Health Information, former Deputy Minister of Health (AB) and C.D. Howe Institute Senior Fellow, and is supported by a group of health academics, professionals and business leaders. Meeting weekly, this group discusses policy ideas for addressing various aspects of the COVID 19 crisis, and publicly communicate the results of its discussions via Communiqués.

The most recent meeting of the Public Health and Emergency Measures Working Group was on April 3, 2020. The discussion focussed on addressing supply shortages of critical medical equipment and inputs. In particular, the group discussed way to mitigate shortages of personal protective equipment (PPE) and strategies for directing limited supplies to where they will have the maximal public health benefit. In addition, the group discussed different testing and diagnostic strategies used internationally and across Canadian provinces. Since testing strategies and the availability and timeliness of public health data varies across provinces, the group discussed some of the reasons that Canada's public health data collection and dissemination lacks coordination with reference to recommendations made for improvement of laboratory infra- and infostructure post-SARS and current legislative hurdles.

Personal Protective Equipment

Shortages of face masks, gloves, and other personal protective equipment (PPE) are putting health care workers at higher risks of exposure to COVID 19 in health care facilities battling the pandemic across the world. Meanwhile, pharmacy and hardware store inventories are running low or completely depleted as individuals purchase protective equipment for themselves and their families. Governments and companies have warned against excessive price gouging for personal protective equipment. But when global supplies run short in a high demand situation, paying a high price for supplies might become a necessity if Canadian health care workers and the public are to be able to access critical personal protective equipment.

Recently, two separate shipments of KN95 masks manufactured in China were rerouted from their original destination to the United States. French officials have said that supplies bound for France were re-routed to the US "on the runway" after the US offered "3 to 4 times the price in cash." A similar situation has occurred in Quebec, where the owner of a manufacturing company has reported that a shipment of KN95 masks arrived at a DHL shipping centre in Quebec on Sunday, but the shipment was redirected to Ohio (the masks have since been rerouted back to Quebec). China has also changed the rules for exporting PPE and diagnostic testing supplies to limit the scope of companies allowed to export supplies to Europe following complaints of substandard products. 3M has reported that the US Administration has requested it cease exporting N95 face masks to Canada and Latin America.

Guidance from public health authorities has been that members of the public shouldn't wear a protective mask unless they are sick or caring for those who are sick. But the WHO has convened an expert panel to reassess that guidance. Similarly, the CDC in the US, and European health authorities are considering the question of whether or not to recommend the public wear face masks to prevent COVID 19 spread. Health and economics commentators have indicated encouraging the public to wear masks preventatively as a factor in controlling disease spread.

Meanwhile, public health officials in Quebec have asked the public to avoid preventative use of face masks in an effort to reserve dwindling supplies for health care workers and sick people. Ensuring that Canada's health care workers have access to high quality PPE is critical to managing the crisis. The healthcare system cannot run at full capacity when workers are exposed to COVID-19 and need to isolate to reduce the spread of infection.

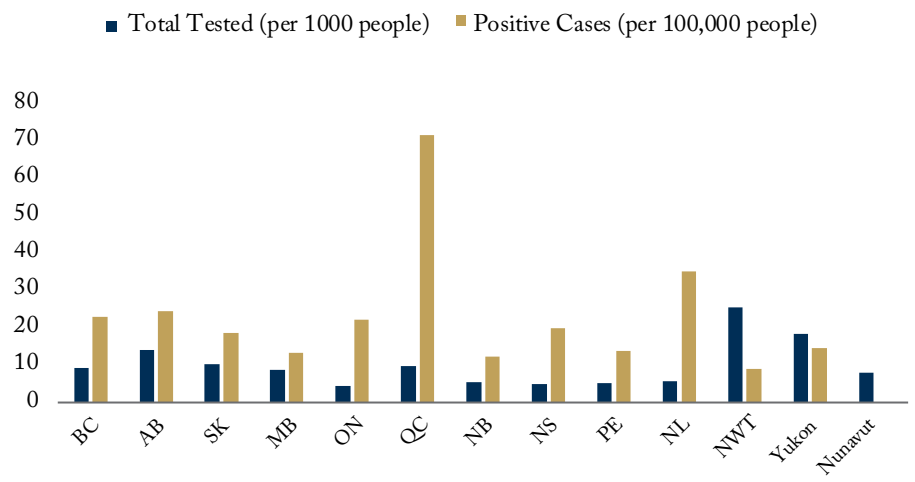
There are many stories of hospitals running low on PPE supplies in Canada and internationally. When critical supplies are rerouted mid-shipment and prices climb by hundreds of percent, it's a strong indicator of a global shortage. The efficient use of these limited supplies is critical to minimizing the

health and economic effects of the pandemic. Health care systems are under strain with the surge of people requiring hospitalization and the presence of disease spread in communities. Encouraging the public to preventatively use face masks would increase demand for them, further increasing prices and exacerbating the existing global shortage. If there were no shortage in personal protective equipment, however, recommending preventative use would be a practical step towards limiting disease spread in the community.

The working group discussed strategies to increase the supply of face masks and other PPE in Canada and strategies for directing limited supplies to highest affect in mitigating disease spread and had the following observations:

- Health Canada should develop and issue guidance on sterilizing and reusing masks and other PPE, where possible.
  - Researchers at the University of Manitoba have tested various types of face masks for functionality following autoclave or aerosol hydrogen peroxide sterilization. The results show that some masks can be sterilized with autoclaving – equipment that is widespread throughout medical facilities.
  - The FDA has issues Guidance for reprocessing N95 respirators using STERRAD Sterilization systems under the "Enforcement Policy for Sterilizers, Disinfectant Devices and Air Purifiers During the Coronavirus Disease 2019 (COVID-19) Public Health Emergency"
  - The British Columbia Interior Health Authority confirmed it will collect used disposable N95 masks to be sterilized and stored as an emergency back-up supply.
- Since shortages of PPE are occurring, guidance for the public should continue to discourage personal use of N95 face masks and maintain its current focus on physical distancing, hand and respiratory hygiene measures as the best way for individuals to protect themselves from infection. The recent shift to recommending personal use of non-medical masks as an additional measure to protect those around you further promotes containment of the spread of infection and aligns with guidance issued by the CDC.
- Where shortages occur, reserve higher level PPE for highest risk of exposure situations and use lower-grade PPE for other applications. In an acute shortage scenario, public health authorities should discourage the use of such equipment by the public in an effort to reserve necessary supplies for health care workers and patients in areas that are at higher risks of exposure.

COVID 19 Testing and Case Rates, by Province



Source: xx

Laboratory Testing, Public Health Data and Contact Tracing

A major factor in successfully containing the spread of infectious disease is the ability to quickly identify new cases and trace contacts so that other who may have been exposed can self-isolate or be tested. As of April 5, 323,297 people had been tested for COVID19 in Canada. Canada is neither a leader nor particularly a laggard when compared to other countries. In Germany, about 350,000 tests are preformed per week and are carried out in hospitals, doctors' practices and special drive-in test stations. The UK is targeting 100,000 tests per day, though as of March 21, was testing at a rate of 10,412 per day.

Within Canada, both the rate of COVID testing and testing strategies vary (Figure). Ontario lags most other provinces in testing rates – despite similar case numbers to Alberta and British Columbia, Ontario has performed about half as many tests per capita, meaning there are likely many positive cases not included in official counts due to individuals not receiving tests. The Working Groups discussed possible reasons that Alberta and British Columbia were more successful in testing larger portions of their population more quickly than elsewhere in the country and why Ontario, in particular, did not achieve similar results.

In the case of Ontario, group members discussed a lack of preparedness to scale up coordinated testing in the province. Initially, testing strategy in Ontario relied only on the Public Health Lab for testing; neither private labs nor hospital labs were involved in sample collection or testing. Now public, private and hospital labs are doing testing, hospitals are involved in sample collection but private labs are not. Not involving private and hospital labs early on in testing along with the Public Health Lab caused backlogs and negatively impacted Ontario's attempt at containment. Group members also discussed whether the regional organization of health care in Alberta and British Columbia affected their ability to rapidly scale up and coordinate testing relative to Ontario.

While more rapid and widespread testing could have affected provinces' ability to contain the spread of COVID 19 early on in the epidemic, there was some debate amongst group members about whether broad population testing would be appropriate at this stage of the outbreak. The presence of community spread, limited testing capacity, and the presence of asymptomatic positive cases[1] suggests that testing should be done strategically. At this point in time there are still places and populations where rapid testing, widely deployed, with rigorous contact tracing and isolation could keep the virus at bay. Priority should be given to testing members of the public in relatively isolated communities (indigenous, rural communities, etc.) in which the concentration of infected people (symptomatic or not) would be low. In areas that already have significant community spread of infection, however, broad population testing is of limited use in managing it. In these areas, the priority for testing should be front-line health care workers and vulnerable populations; population at the highest risk of exposure and those at the highest risk for transmission.

Once the outbreak is under control or there is appropriate testing capacity, however, the use of testing should be evaluated and shifted to managing and preventing further community spread. Similarly, new testing procedures are being developed constantly, and should be individually evaluated for appropriate use and deployed as quickly as possible. More accurate and timely information about COVID cases would be incredibly valuable to informing policies to contain the infection and to ensure that loosening of restrictions won't inadvertently lead to a resurgence of cases.

1 If individuals can infect other people, but themselves do not have symptoms, they are unlikely to receive testing. So, testing symptomatic patients in the community is likely to be of limited value in managing disease spread, as long as those who have symptoms are directed to self-isolate. With limited testing capacity, it is not currently feasible to test the entire population.

Since there is significant disparity between provinces in testing rates and ability to trace contacts in the community, the group discussed legislative and policy tools that could have improved coordination between provinces in gathering and disseminating new information.

- The Emergencies Act does not appear useful in these circumstances to impose testing protocols, or obligations to report comprehensive information and data related to disease tracking. It could possibly be used to increase testing capacity via emergency laboratory and hospital facilities or in accessing individuals' personal data to facilitate improved contact tracing.
- Part of the current problem with collecting and disseminating diagnostic data is a lack of coordinated laboratory infrastructure across the country. The group referenced recommendations made following the SARS outbreak and noted that many recommendations for renewing laboratory infrastructure and surveillance/data gathering and dissemination were only partially implemented or remain to be addressed.[2] In particular, while a national public health information system exists, it does not reliably contain all relevant information and lacks a compulsion mechanism to address the incomplete nature of reporting. Having an integrated, well-resourced public health lab system is critical but so is having an accessible reporting system using common case definitions that can reliably and rapidly share surveillance data between jurisdictions.

In the current public health crisis, a major priority for governments should be addressing shortages of personal protective equipment, and other supplies necessary to protect frontline workers from infection. In addition, proactive guidance for health care providers and institutions about appropriate practices for directing limited supplies and their reuse, would reduce the negative effects of shortages in critical supplies where they arise.

Once the immediate threat of the pandemic has passed, governments should address preparedness gaps in coordinating and scaling epidemic response in the future. Shortages of PPE occurred during the SARS crisis. The importance of emergency supplies of PPE and practices for managing infectious disease outbreaks in Canada were highlighted when Ebola surfaced in a US hospital in 2014. When crisis strikes, ensuring a coordinated and timely approach to managing it across the country helps to minimize health and economic damage.

2 See Learning from SARS for list of recommendations considered during this discussion.

Working Group Participants

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Åke Blomqvist, Health Fellow-in-residence C.D. Howe Institute; Adjunct Research Professor, Carleton University

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Janet Davidson (Chair), Senior Fellow C.D. Howe Institute; Chair of the Board Canadian Institute for Health Information

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Duncan Sinclair, Emeritus Professor, Queens University

Colleen Flood, Professor & Director, uOttawa Centre for Health Law, Policy & Ethics University Research Chair in Health Law & Policy

Catharine Whiteside, Executive Director, SPOR Network in Diabetes, Emerita Professor and Former Dean of Medicine

Rosalie Wyonch, Policy Analyst and Research Lead, Health Policy Council C.D. Howe Institute

From: Don Drummond, Duncan G. Sinclair, David Walker, and Chris Simpson

To: Canadians Concerned about Public Health

Date: May 1, 2020

Re: **PUBLIC HEALTH, FROM LAST TO FIRST**

Since the plague of Athens in 430 BC, our world has known many crises, many of them caused by epidemic illnesses of which COVID-19 is but the latest.

In the interim, particularly in the 20th and current century, humankind's understanding, scientific and otherwise, of the many factors that determine the health and wellness of individuals and populations increased by leaps and bounds. The causes of the world's previous epidemics are now well known. And so are the ways and means that were discovered, improved upon, and continue to be applied both to treat and reduce mortality among those affected and, most importantly, to prevent their recurrence.

With respect to the latter, from John Snow's 1534 removal of the handle from the Broad Street pump to fight cholera in London, to the use of vaccines to create 'herd immunity' against many infectious diseases, the principles and practitioners of public health have been front and centre.

Based on its historical role in the prevention and foreshortening of the spread and duration of pandemics, you would think that public health would be king of the hill among all health professions and first in line for public respect, approbation, and support. That it is not explains to a considerable extent why the current COVID-19 crisis constitutes such a grave threat to people's health and their countries' economies throughout the world.

We were poorly prepared when SARS-CoV-2 infected its first human host in 2019. Thanks to our current scientific expertise we knew very quickly the structure and composition of the virus and developed tests to detect its presence in infected individuals in respiratory distress.

But even now, months later, we lack the capacity to test for its spread within populations or the immune status of survivors, information key to the creation of epidemiological models on which to build the most effective public health strategies to contain the virus and minimize its twin health and economic impacts.

Despite being forewarned by SARS at the turn of the century (and the threat of Ebola in 2014), Canada, together with virtually every other country worldwide, has found itself again massively short of the masks, gowns, face shields, etcetera, needed to protect a host of caregivers, from doctors to cleaners, from being infected by the sick people for whom they were caring in hospitals, long-term care, care homes, home care, or wherever.

The world's dominating focus was on those caring for those affected, particularly those in hospitals and their intensive care units where beds and mechanical ventilators to oxygenate those in respiratory failure were in short supply.

In contrast, past mandated disaster planning exercises, religiously and rigorously conducted with public health professionals in the lead, were taken much less seriously; for the most part, their reports went on dusty shelves with their recommendations relating to preparedness for future pandemics not implemented. Again, the short term trumped the long. Now we are paying the price.

"(T)he primary objective of Canadian health care policy is to protect, promote and restore the physical and mental well-being of residents of Canada…," reads the *Canada Health Act*.

Frustratingly, common practice continues to put them in reversed and dramatically imbalanced priority order. Compassion dictates that we pay the close attention we do to hospitals, other organizations, and individuals that provide healthcare, working to restore to good health those affected by illness, injury, or disability. But the short shrift we give to optimizing the health of Canadians and to the public health professionals and bodies dedicated to health's protection and promotion is at our peril.

The high price we are paying, and will continue to pay for years to come after this COVID-19 crisis is over, is a measure of that peril's magnitude.

Don Drummond, Duncan G. Sinclair, David Walker and Chris Simpson are all members of the health policy council at Queen's University.

To send a comment or leave feedback, email us at blog@cdhowe.org.

From: Konrad von Finckenstein

To: All Provincial Governments except Alberta

Date: May 14, 2020

Re: **Balancing Privacy and Cellphone Tracing to Fight COVID-19**

It has widely been reported that South Korea used cellphone tracing in its largely successful efforts to control the pandemic.

This raises important questions of privacy, and forces governments into the difficult task of reconciling public health concerns with the protection of privacy.

Alberta last week introduced an app called *ABTrace Together* that it urges all Albertans to download and install on their IOS or Android mobile devices. These are mostly cellphones and hence we will use that term broadly speaking.

In doing so, Alberta had to find a tradeoff between protecting the public from health risk and not violating privacy.

The Alberta approach is as follows:

- Downloading the app is voluntary;
- It can be uninstalled by the user at any time;
- Once the app is installed, the device is Bluetooth enabled and therefore will register any other cellphone (which has the same app installed) within two meters and log the length of time of that proximity;
- The app on each cellphone will store this data on that cellphone;
- If an Albertan has a positive test result for COVID-19, a contact tracer from Alberta Health Services (AHS) will ask them to upload their cellphone data collected by the app;
- Using this data, the contact tracer can find out with whom the infected has been in near contact, notify such person(s) and give guidance as to self-isolation and/or testing.

Given that the data is stored on a cellphone user's app, AHS does not have access to it. It can only be uploaded with the device user's consent. The app also does not collect geolocation data, so AHS does not know where the contact occurred.

The app does, however, collect anonymized app utilization data. This anonymized data will be used to understand app adoption, engineer app improvement, develop public health policy and analyze emergencies.

Download and installation are free, simple and very quick. A user must agree to the usual terms and conditions before the app becomes effective. This is written in heavy legalese and is difficult to comprehend. However, the site has an excellent FAQ page that covers, in simple and user-friendly fashion, how the app works, who gets access to the data, when and where it is stored and how it can be used by the AHS in anonymized form.

The app's design would appear to have addressed the principal concerns of privacy advocates, namely use of personal data for purposes other than disease prevention, control of the data by internet access providers, access to the data by third parties or other government agencies.

Alberta has to be commended for developing this app. If widely adopted by Albertans, it will be successful in combating COVID-19.

Employing cellphones for contact tracing is inevitable, and one can only hope other provinces will follow Alberta's carefully balanced lead.

The Hon. Konrad W. von Finckenstein, Q.C., was Chair of the Canadian Radio and Telecommunications Commission, a Federal Justice and Commissioner of Competition.
To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Rosalie Wyonch

To: Canadians Concerned about Healthcare

Date: May 14, 2020

Re: **COVID-19 Immunity: What We Don't Know But Can Now Test for**

With the COVID-19 curve flattened and loosening of restrictions now underway in many jurisdictions, Canadian healthcare providers require new tools to continue to study and understand the virus. Health Canada recently approved the first test for COVID-19 immunity in Canada.

Information about immunity is critical to continuing efforts to contain the epidemic, particularly as restrictions are loosened, potentially increasing transmission risk. Without it, it is impossible to know how many people may have been exposed but never developed symptoms (estimates suggest up to one quarter of infections are asymptomatic). An unknown asymptomatic rate affects the accuracy of epidemiological models and makes projections less certain. In particular, the fatality rate is based on the number of known cases: we can't know how deadly COVID-19 is without knowing the true infection rate.

The C.D. Howe Institute's Public Health and Emergency Measures Working Group recently discussed testing for immunity and concluded that it would provide valuable information about the epidemic and could be used directly or indirectly in developing policies to transition to the "new normal."

It is currently unknown how long antibodies are present after infection has subsided or how effective antibodies are in preventing reinfection or further transmission of the virus – critical information for vaccine development and public policy. There are also clinical results showing plasma transfusion of antibodies could be an effective treatment for critically ill COVID-19 patients.

Tests for COVID-19 related antibodies could also have applications in contact tracing and identifying immune or at-risk clusters (within households, businesses or geographic regions). Some governments have suggested that the detection of antibodies to the SARS-CoV-2, the virus that causes COVID-19, could serve as the basis for an "immunity passport" or "risk-free certificate" that would enable individuals to travel or to return to work assuming that they are protected against re-infection.

At the moment, however, there is not enough known about the possibility of re-infection or the length of time a recovered patient might be immune to be able to formulate labour market policies. In addition, there are serious ethical questions about allowing some people to be less restricted than others based on biological considerations – in this case the presence of a particular antibody.

Health Canada has recently authorized the first serological test for the Canadian market and plans to test 1 million Canadians over the next two years. Meanwhile, the FDA granted Emergency Use Authorization to the first serological test on April 1. As of May 4, 170 manufacturers were selling serologic tests that had not received FDA authorization, but can be used (with restrictions on their use for the purposes of diagnosis). In Australia, serologic tests have contributed to findings that children are at low risk of transmitting the infection in a school environment.

The authorization of a test for COVID-19 antibodies is a good first step towards better understanding of the epidemic in Canada. Initial access to testing should prioritize the most at-risk populations, health care workers and elderly Canadians residing in institutional settings in particular. However, efforts to broaden access and scale up testing volumes should not wait until the initial crisis has passed. Tests for the presence of the virus use different laboratory resources than those that test for antibodies: increasing testing volumes for antibodies shouldn't affect the volume of diagnostic COVID-19 tests that are performed.

As provinces begin to loosen restrictions imposed to flatten the curve and reduce the spread of COVID-19, continued monitoring through extensive testing and contact tracing is required to prevent a second wave of infection. Market authorization of an immunity test is a good first step, but without test results Canadian health care providers and policy makers lack a complete picture of the epidemic.

Rosalie Wyonch is a Policy Analyst at the C.D. Howe Institute.
To send a comment or leave feedback, email us at blog@cdhowe.org.

From: Vivek Goel

To: Canada's Health Policy Planners

Date: August 28, 2020

Re: **A Population Health Approach to COVID-19**

Much of the initial attention, particularly from the media and public, to COVID-19 has been on the disease and its consequences. It is clearly a disease with devastating potential, as seen in Italy and New York in the early months. As a result, in the absence of proven preventive and therapeutic agents, a drastic series of public health measures were taken in order to control spread of the virus globally. These measures have been successful in Canada, but they have come at a tremendous cost.

These costs are most often considered in terms of the economic burden, which is clearly substantial. Canadians' adherence to the public health measures has been helped by generous interventions, such as the CERB. While this has eased impact on individuals, it has resulted in our governments incurring significant debt.

However, there is a much more significant set of costs that appear to be less often discussed and considered in public policy. These are the very significant social and health consequences of the public health measures. Some examples of these consequences include:

- Delayed medical visits and surgical procedures – for example, data is emerging that delays in diagnosis and treatment for cancer patients is leading to worse outcomes.
- Visits to emergency rooms declined – even for the most critical conditions, as shown in data from the Canadian Institute for Health Information.
- Delayed immunization programs – as medical offices and schools closed, children missed scheduled appointments or public health vaccination programs were delayed.
- Domestic violence and child abuse – families were together at home for a prolonged period of time, which was an unsafe condition for many individuals. Government consultations showed increases in gender-based and domestic violence of 20 to 30 percent in some regions.
- Mental health effects of isolation – survey data shows increased levels of anxiety and depression in the population.
- Delayed early childhood development – the early years are one of the strongest predictors of lifelong health and social outcomes.
- Physical inactivity – lockdowns and closure of gyms has led to decreased levels of exercise, a strong predictor of health status.
- Increased drug and alcohol consumption – for example, opioid deaths are increasing.
- Food insecurity – visits to food banks have increased likely as a result of lost income and increasing food costs associated with COVID-19 related economic restrictions.

And this list is by no means complete. As well, it is important to bear in mind that the economic consequences themselves will result in further health consequences. For example, unemployment has been shown consistently to result in poorer health outcomes and increased mortality.

While we cannot stop our focus on controlling COVID-19, we must do so in a manner that accounts for these adverse consequences. We know much more about the disease and how to control and treat it than we did in March. We have much greater capacity for testing and contact tracing as well as more resiliency in our health system. As we move forward, we need to ensure that critical societal functions such as education are restored. We need to ensure the appropriate precautions are in place so that when the second wave arrives, we can control it without resorting again to lockdowns.

Most significantly, we need to deal with the fear that has developed in Canadians.

In order to obtain compliance with the public health measures, we allowed a level of fear to develop which is inhibiting the return to activities such as schooling. We have to reassure Canadians that the disease is being controlled, and they need to understand the full range of health and social consequences if we do not restore those activities.

Vivek Goel is a Professor at the Institute of Health Policy Management, and Evaluation, Dalla Lana School of Public Health, University of Toronto.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Theme 2:

Vaccine Development

Crisis Working Group Report: Crisis Working Group on Public Health and Emergency Measures

Communique #3: National Process Needed to Hasten Vaccine Development

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. The Working Group on Public Health and Emergency Measures is Co-Chaired by Janet Davidson, Chair of the Board of the Canadian Institute for Health Information and former Deputy Minister of Health (AB) and Tom Closson, Co-Chair of the C.D. Howe Institute Health Policy Council. The membership of the group includes health academics, professionals and business leaders. Meeting weekly, this group discusses policy ideas for addressing various aspects of the COVID 19 crisis, and publicly communicate the results of its discussions via Communiqués.

The most recent meeting of the Public Health and Emergency Measures Working Group was on April 24, 2020. The discussion focussed on vaccines for COVID-19. In particular, the group discussed the time and resources required to develop a new vaccine, strategies for ensuring access for Canadians, domestic production and distribution capacity, and how to encourage efficient and coordinated use of recently announced federal funding for vaccines.

From R&D to Injection: Vaccine Development

Media outlets, governments and some academics have been suggesting hopefully that a vaccine for COVID-19 could be available in 12 to 18 months. While not impossible, it would be quite a remarkable feat to achieve, considering that it normally takes about 10-15 years to develop a novel vaccine. As Dr. Natasha Crowcroft, Director of the Centre for Vaccine Preventable Diseases and a Professor at the Dalla Lana School of Public Health said, 12 to 18 months is an "incredibly optimistic timeline. Nobody has done this before." The fastest vaccine developed was for Mumps at four years and the Ebola vaccine took five years.[1]

1 In the case of the Ebola vaccine, five years refers to the time taken to conduct clinical testing and gain market approval. The chemical entity that eventually became the vaccine was identified in 2004 and initially licensed in 2010. Merck purchased the commercial rights to it in 2014, following the Ebola outbreak in West Africa and the appearance of a small number of cases in the US; the Public Health Agency of Canada maintains ownership of non-commercial rights.

A vaccine being developed in 12 to 18 months would be a world first. The group discussed some of the reasons the development process is long under normal circumstances and why this time might be different.

Normally, vaccine development proceeds through stages of development in a sequential order: drug discovery, pre-clinical testing, three-phase clinical testing, regulatory approval, and follow-up monitoring for long-term safety and efficacy. Many possible candidates will not pass the drug discovery and pre-clinical phases, more will be eliminated at each phase of clinical trials. Vaccines are also subject to strict safety standards: since they are administered to healthy people, the tolerance for negative side effects is low. As of April 21, there were 93 vaccine candidates in development but only five in the clinical testing phase; all others were in pre-clinical testing.

Vaccine development requires significant academic, industry and government collaboration. It takes significant resources and investment to orchestrate and run adequate clinical trials. Many promising treatments or vaccines identified by researchers don't proceed beyond initial discovery to development into marketable medical products. There are many reasons for this, but the most common is simply that many contenders are eliminated in the clinical or pre-clinical testing phases; when experimental results are not favourable. Once clinical trials are complete, a vaccine must also receive regulatory approval before being made available to the public.

Some of the factors that contribute to long vaccine development times under normal circumstances are not likely to delay development of a vaccine for COVID-19. There is significant demand so pharmaceutical companies have a strong incentive to invest in the development of promising candidates. Governments around the world are investing in research, development and testing of possible treatments, vaccines and diagnostics for COVID-19. For example, the federal government announced $1 billion "in support of a national medical research strategy to fight COVID-19" on April 23, in addition to the $275 million previously announced in March. Also, the scale of COVID-19's spread, unfortunately, means that there is no shortage of patients or healthy volunteers to participate in clinical trials. Despite these factors, however, unprecedented collaboration will still be required if a vaccine is to be approved and available to the public within the 18-month timeframe some have optimistically been predicting.[2]

2 For an example of rather unprecedented collaboration between industry competitors and with governments and academics, see the International Federation of Pharmaceutical Manufacturers and Association statement on global collaboration to accelerate development.

The Working Group discussed the already impressive industry, government and academic collaboration occurring around treatments and vaccines for COVID-19 and also some factors that remain a cause for concern, or could be improved to further expedite the development process. In particular, it was unclear to the group how the significant government investments would be distributed and some concern about efficient use of those funds. The group agreed that it is important to remain focussed on the goal of applicable research and not allow the process to become political or allow significant portions to be invested in research that is peripheral to the current crisis.[3] The group also discussed the need to consider the possibility that a vaccine will not be developed within 18 months and necessitate investment strategies for a longer development scenario.

Securing Canadian Supply

Once a vaccine is developed, there will be massive demand for it since the COVID-19 pandemic has affected almost the entire world. There might also be significant ongoing or recurrent demand, depending on the length of time over which an approved vaccine confers immunity and whether COVID-19 is seasonal. With large global demand and an initially limited supply of vaccine, ensuring that Canadians have access to it as early as possible should be a priority for government. The Working Group discussed strategies related to domestic manufacturing capacity, intellectual property licensing and international clinical trials.

Canada already has extensive vaccine manufacturing capacity, an advantage that should be leveraged for COVID-19 vaccine production. In 2019, Canada exported $453 million worth of human vaccines to the US and had a positive trade balance of $253 million (global trade balance was -$252 million). There is not sufficient excess domestic manufacturing capacity, however, to manufacture efficiently the required volume of a new vaccines. Redeploying the current domestic manufacturing capacity for COVID-19 vaccines would likely result in significant opportunity cost in the form of shortages of other vaccines. Nevertheless, the group concluded that there is significant opportunity for Canada to manufacture an approved vaccine and could likely do so in quantities sufficient to exceed Canadian demand. To do so, however, increases to vaccine manufacturing capacity will need to begin as soon as possible. The group discussed building new manufacturing facilities on existing sites and the possibility of building entirely new facilities. Both appear to be viable options, but building new facilities on existing sites might avoid some regulatory or licencing approvals required for an entirely new one.

3 A participant noted that there has been a significant decrease in non-COVID-related research funding, so there is likely a perverse incentive for some researchers to apply to COVID-related research funds even if their research is unlikely to significantly contribute to the current crisis or is only tangentially related.

Once a vaccine has been developed and is being manufactured in significant volumes, the group discussed options for distribution. Relative to development and scaling of manufacturing, the group agreed that distribution is likely the easiest piece of the puzzle. When quantities are limited, targeting the most at-risk populations should be the priority – elderly populations, healthcare workers, for example. If supplies of the vaccine are not limited, then everyone should be able to access it, similar to other population-wide vaccination programs. There was consensus among the group on two particular points. First, access to the vaccine should be as convenient as possible and involve limiting physical contact to the extent possible. While already allowed in some provinces, the scope of practice for pharmacists should be expanded to allow them to administer vaccines to provide convenient access within communities. Second, since comorbidities are a significant factor in the severity of a COVID-19 infection, public health should issue guidance encouraging people to ensure their vaccinations are up-to-date. In particular, since a vaccine is unlikely to be available within the year, encouraging people to get their annual influenza vaccine in higher proportions could contribute to decreasing the severity and mortality of COVID-19.

Summary and Conclusion

It will likely be quite some time before a COVID-19 vaccine is fully tested, approved, manufactured at scale and available to the public. Significant industry, government and academic collaboration to accelerate the process is already underway, but more will be needed.

One of the factors that contributes to the slow development of new medical treatments and vaccines is that the process normally proceeds sequentially. Given the speed of development and the scale of demand, there is a need to proactively develop standards for evaluation, increase manufacturing capacity, and establish distribution strategies simultaneously. There may be opportunities to use novel approaches to regulatory cooperation and intellectual property licensing given the level of international collaboration among different groups to accelerate development of a vaccine and subsequently manufacture and distribute it at scale as quickly as possible.

Significant investments have been announced related to research and development. There is a need to establish oversight of those investments to ensure a collaborated approach to achieving the goal. A national decision-making process should be established as soon as possible to review on-going research and international experience and, on the basis of evolving evidence, advise governments on the best course of action. Next steps should include (i) establishing the process for evaluating successful trials; (ii) selecting the vaccines for Canadian market approval; and (iii) expanding domestic manufacturing capacity. Canada should leverage its existing advantage in vaccine manufacturing and begin expanding domestic capacity to ensure access for Canadians and the potential to contribute to the global supply through exports.

Members of the Public Health and Emergency Measures Working Group

Dr. R. Sacha Bahtia, Director of Institute for Health Systems Solutions and Virtual Care, Women's College Hospital.

Åke Blomqvist, Health Fellow-in-residence, C.D. Howe Institute; Adjunct Research Professor, Carleton University.

Tom Closson (Co-Chair), Health Policy Council, C.D. Howe Institute.

Janet Davidson (Co-Chair), Senior Fellow C.D. Howe Institute; Chair of the Board Canadian Institute for Health Information.

Perry Kendall, Co-Interim Executive Director at the BC Centre on Substance Use; BC Provincial Health Officer (former).

Christopher Naugler, Professor, Department of Pathology and Laboratory Medicine, University of Calgary; Associate Dean Undergraduate Medical Education, Cumming School of Medicine

Duncan Sinclair, Emeritus Professor, Queens University.

Colleen Flood, Professor & Director, uOttawa Centre for Health Law, Policy & Ethics University Research Chair in Health Law & Policy.

Catharine Whiteside, Executive Director, SPOR Network in Diabetes, Emerita Professor and Former Dean of Medicine, University of Toronto.

Rosalie Wyonch, Policy Analyst and Research Lead, Health Policy Council, C.D. Howe Institute.

Special Guests

Mark Lievonen, President (former), Sanofi Pasteur Canada.

Kevin Tuer, Vice President Strategic Initiatives, Communitech.

Amanda Green, MedTech Programs Lead; Academic Connections and Research Funding, Communitech.

Joseph Berger, Director, Public Policy and Research, McKesson Canada.

Theme 3:

Long-term Care

COVID-19 Crisis Public Health and Emergency Measures Working Group

Communique #4: A Tale of Two Epidemics: Why Seniors' Care in Canada was So Hard Hit

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. The Working Group on Public Health and Emergency Measures is Co-Chaired by Janet Davidson, Chair of the Board of the Canadian Institute for Health Information and former Deputy Minister of Health (AB) and Tom Closson, Co-Chair of the C.D. Howe Institute Health Policy Council. The membership of the group includes health academics, professionals and business leaders. Meeting weekly, this group discusses policy ideas for addressing various aspects of the COVID-19 crisis, and publicly communicates the results of its discussions via Communiqués.

The most recent meetings of the Public Health and Emergency Measures Working Group have focussed on healthcare for the elderly population in the context of COVID-19. In particular, the group discussed high mortality rates in institutional care settings and some of the underlying causes. Provinces have implemented different policies related to long-term care and retirement homes which has resulted in some faring much better than others. In general, however, Canada has not done well at protecting the elderly population living in an institutional care setting from COVID-19 infection and mortality compared to many other countries.

Canada: A Tale of Two Epidemics

Working group members noted that, overall, Canada has been successful in flattening the curve with physical distancing and other public-health measures. Quick action, relatively consistent messaging from politicians reaffirming evidence-based recommendations from subject-matter experts and scientists, and generally broad public cooperation with restrictions have resulted in many regions of Canada achieving better outcomes than the US, Italy, the UK. As a result, COVID-related mortality in the community has been limited to about 1,000 deaths (of which about 600 were senior citizens). By contrast, in the institutional settings of long-term care and retirement homes, there have been about 5,000 deaths.

Members observed that long-term care and retirement homes are the center of the epidemic in Canada. About 80 percent of deaths have occurred in residential care facilities; a poorer outcome than most other nations. Residential care facility outbreaks of COVID-19 have been centered in five provinces: Nova Scotia, where one home experienced a particularly severe outbreak, and the four most populous provinces (BC, AB, ON, QC). The outcomes are particularly bad in Quebec, where 60 percent of Canada's COVID-19 deaths have occurred. Ontario continues to struggle to manage institutional outbreaks as well; more than 25 percent of facilities are experiencing or have experienced an outbreak. British Columbia, the first province to experience a COVID-19 outbreak in a residential care facility, has since controlled outbreaks sufficiently enough for possible reopening to visitors beginning in June.[1] Abroad, Hong Kong is an example of successful containment and prevention, noted some members. Hong Kong has achieved zero deaths in care homes by employing rapid and rigid isolation protocols. In addition, every care home has trained infection control staff that regularly conduct simulation drills of an infectious outbreak. This practice is common in Canadian hospitals, but not in residential care facilities.

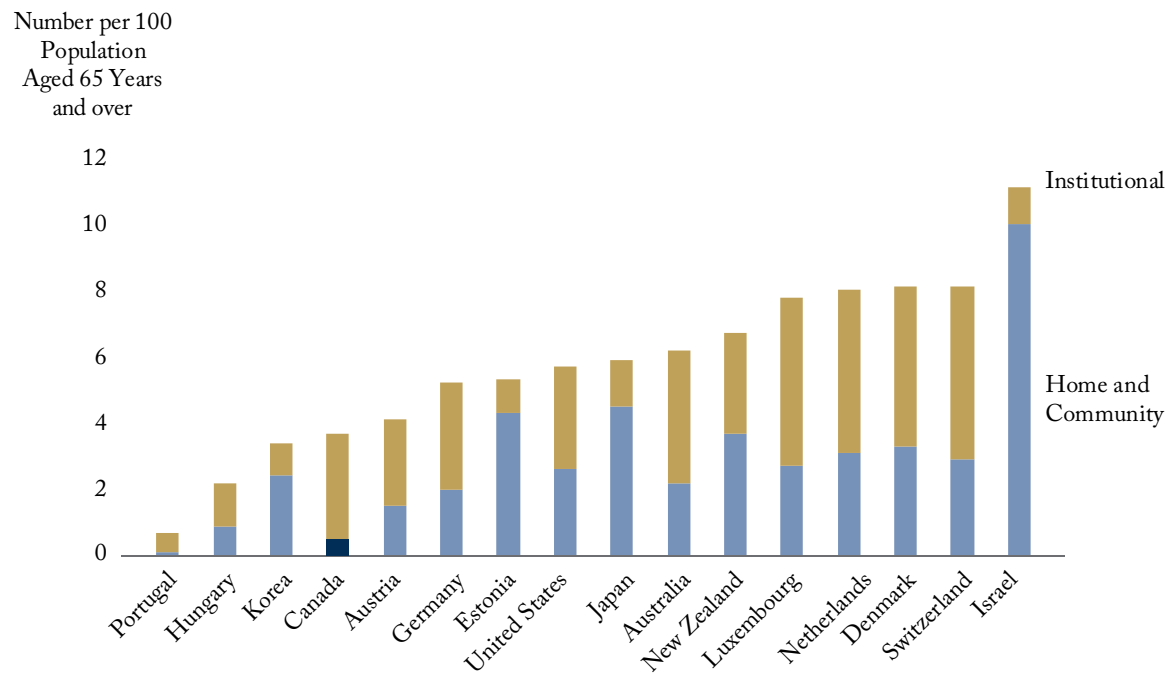
Residential care facilities are not included in the *Canada Health Act* and systems, subsidies and policies vary significantly across the country, as do the structures governing funding, ownership, and staffing. Members noted that regional variation results in the quality of care, price of accommodation and access to facilities also varying. There are also significant variations in testing and tracing strategies across provinces. Initial access to testing for staff and residents was deployed under different accessibility criteria and varying comprehensiveness, thereby affecting the speed at which new outbreaks in residential care facilities could be identified and contained.

Funding and Wages

The working group discussed the issue of funding and wages, noting that all provinces fund long-term care residences (nursing homes) at a lower rate per diem than they fund hospitals to provide care to a person with similar needs who is awaiting transfer to a long-term care residence. Differences in funding between hospitals and long-term care residences for serving post-acute patients are due to differences in hours of care provided per diem, staffing mix and wage and benefit levels for each staff type (RNs,

1 To prevent and address outbreaks in residential care facilities, every day matters. British Columbia has achieved better containment in community COVID-19 spread and generally has better outcomes than other provinces. The more positive results from residential care homes should be considered within the context of better outcomes throughout the population.

Figure 1: Nurses and Personal Care Workers by Setting



Source: OECD Long-Term Care Utilization and Resources, 2016 or most recent available year.

RPNs and personal support workers and other staff). Members believed this makes staff recruitment and retention a challenge for long-term care residences. For example, in a 2018 survey of Ontario's long-term care homes, 80 percent of respondents said they had difficulty filling shifts, and 90 percent experienced challenges recruiting staff. In addition, long-term care residences often use more part-time labour to reduce costs. Significant reliance on part-time workers, however, means that many work at multiple facilities and do not have sick leave or other health benefits.

Group members suggested that an appropriate comparison of staffing levels and wages would be international examples. Among OECD countries for which recent data are available, Canada has fewer nurses and personal support workers per senior citizen than most (Figure 1). In addition, the proportion of workers in the institutional setting, as opposed to the community or home-care settings,

is much higher in Canada than most other countries. This suggests, members noted, that there is a relative shortage of personal support workers and nursing staff providing care to Canadian seniors, particularly in the community and home-care setting.

The current system creates a perfect petri dish to spread uncontrolled infection, in the view of some members. The working group noted the system depends on relatively low-paid workers, many without sick leave benefits, possibly with limited access to personal protective equipment, working in multiple facilities with immunocompromised and vulnerable populations. Group members also noted that limited job security, retirement benefits and other factors contribute to the generally lower quality of employment in the residential care sector, relative to hospitals. Rather than blame long-term care residence operators, group members noted that contract rates paid to these providers by government have not kept pace with increases in case complexity and inflation. Group members pointed out that long-term care operators have been unable to increase staffing levels and augment staff mix sufficiently given the limited funding increases they have received. Addressing the needs of the residents of long-term care facilities needs to be done as a partnership between operators and government. Some group members argued, however, that there is little incentive for for-profit providers to pass funding increases on to staff through wage increases or to invest in facility improvements to improve quality of life and care for residents when they are successful in keeping beds occupied without such changes. Neither the government nor the operators are entirely faultless for the current situation in these residential care facilities. Both government and operators have a significant role to play in addressing the problems that resulted in the spread of infection in some residential care facilities, in the view of working group members.

They observed that staff working at multiple facilities are more likely to be exposed to and to expose others to infection simply due to a higher volume of close contacts with both residents and other staff. There is a need to limit foot traffic in residential care facilities and especially limit staff contact between facilities. A critical step is to provide low-wage and part-time workers, currently without sick-leave benefits, the support they need to be able to take time off work if they have been exposed. British Columbia has done just that, said members.

The British Columbia government took over as the employer of all long-term care staff for six months as of April 1, 2020 to ensure that they are made full-time employees and are paid at standardized rates which are the same as the health authority rates. This move, costing the province about $10 million per month, has many benefits in the context of controlling the spread of COVID-19, noted some members. In particular, it helps maintain a stable workforce and it streamlines communication of infection control procedures and education among staff. Since all staff are public employees, the government can directly communicate new or changed infection control guidelines and other procedures with all of them at the

same time. One aspect of the policy that remains unclear is how the new wage arrangements affect sick leave and other benefits for newly publicized residential care staff. Increases in the wage rate encourage staff to continue to work. Access to paid sick leave would encourage them not to work following possible exposure or infection.

Other provinces have also increased wages but many have yet to make sick pay available for workers who are part-time or have multiple employers. The federal government reached a cost-sharing arrangement with most provinces for temporary increases in wages for front-line workers in early May. Quebec increased hourly wages for workers in private long-term care homes by $4 and offered a $24.28-per-hour salary to attract new workers to fill in as attendants at the facilities. Ontario, British Columbia and Saskatchewan have since followed suit with similar programs.

Unfortunately, the extent of residential care outbreaks in Ontario and Quebec have exceeded the level where providing benefits and additional pay is sufficient to address the ongoing staffing crisis situation, in the view of members. In Quebec, for example, 9,500 health workers were absent from work in late April (about 4,000 were diagnosed with COVID). Since many workers and facilities have been exposed, and many staff are off sick, hospitals and the military have been compelled to make up the shortfall. However, the extent of the outbreaks has many hospital staff not wanting to work on COVID floors or go to residential care homes. Health workers are losing faith in the system and its capacity to protect them, noted some members. There is a need to rebuild the trust and capacity.

Overall, underfunding of residential care facilities and the sector's resultant reliance on part-time and low-wage staff has been an ongoing problem across the country for many years, in the view of the working group. These pressures existed in British Columbia as well; however early action by public health authorities and better outcomes with regard to community spread and containment contributed to less severe or widespread outbreaks in residential care facilities compared to other provinces. Challenges in seniors' care existed before COVID-19, but the crisis is highlighting the ongoing issues related to care for elderly people.

Private Ownership: Not as Simple As It Seems

Early analysis has shown that the severity and mortality of COVID-19 outbreaks are higher at privately run, for-profit facilities than in non-profit or publicly operated facilities. In Ontario, for-profit nursing homes have four times as many deaths as municipally run homes. In British Columbia, about 2.7 percent of publicly managed homes experienced an outbreak, compared to about 12 percent of contracted (privately run) facilities and about 6 times as many patients were infected in privately run

facilities. Worse outcomes at privately operated facilities are not particularly surprising, as pre-crisis research across many countries and populations consistently finds that private, for-profit providers generally perform worse than not-for-profit providers. Privately operated facilities receive the same funding envelope as non-profits and are required to provide a similar level of care, said working group members, meaning that they are subject to all the same pressures as non-profit facilities plus the additional pressure of generating profit.

The situation is more complicated than simply concluding public administration equals better outcomes, however, and there is a need to understand the underlying reasons for worse outcomes at privately run facilities in relation to COVID-19. The working group agreed there is a need to research the differences in privately run (for-profit and non-profit) and publicly funded, privately run and privately funded, and publicly run and publicly funded residential care facilities. Factors that could have significant effects on the severity of outbreaks include:

- Staffing levels, their disciplines and working conditions: patterns in ratios of professionals, the effects of particular employment arrangements, and appropriate staffing levels (staff: patients).
- Size and configuration of rooms and facility layout: the majority of rooms in BC are single occupancy, but publicly operated homes have a higher proportion of shared occupancy. Single occupancy is likely to reduce the spread of infection, but privately operated homes have had more frequent and severe outbreaks. The reasons for these differences and the effects of the physical layout of facilities needs to be better understood.
- Patient complexity: residents of long-term care facilities, by definition, have pre-existing health conditions that require significant personal care. Facilities with particularly complex resident populations have more difficulty controlling an outbreak and are also more likely to have high mortality in the event of an outbreak, due to the vulnerability of their resident population. The relationship between outbreak severity and the case mix index of facilities is not well understood in the context of infectious disease.

While privately managed long-term care and retirement facilities have had more outbreaks and higher mortality when outbreaks occur, it is likely that a better understanding of some of the underlying patterns would explain a significant portion of the worse results, members cautioned. There are significant challenges in the effective management of residential care facilities regardless of the type of ownership. Better understanding of which factors play the most important role in reducing the spread of infection would inform policies to improve outcomes at all facilities. Addressing the issues that resulted in 4 out of 5 COVID-19 deaths occurring in residential care facilities is not as simple as shifting ownership or management. It will require significant change to the funding and management structures currently in place to determine: appropriate funding levels; best practices for delivery of care to minimize the potential for infectious disease outbreaks; and ways of addressing perverse incentives to improve health outcomes for Canadian seniors in residential care.

Where to Care: Keeping People in the Community

The elderly population receiving care in the community is at a much lower risk of infection than those in residential care facilities. However, they are also generally less medically complex cases than long-term care residents. That said, the severity of outbreaks at residential care facilities varies across provinces, as does the proportion of seniors living in residential care facilities. Each province has different policies and funding mechanisms that create varying incentives and affect where seniors receive care and how much it costs.

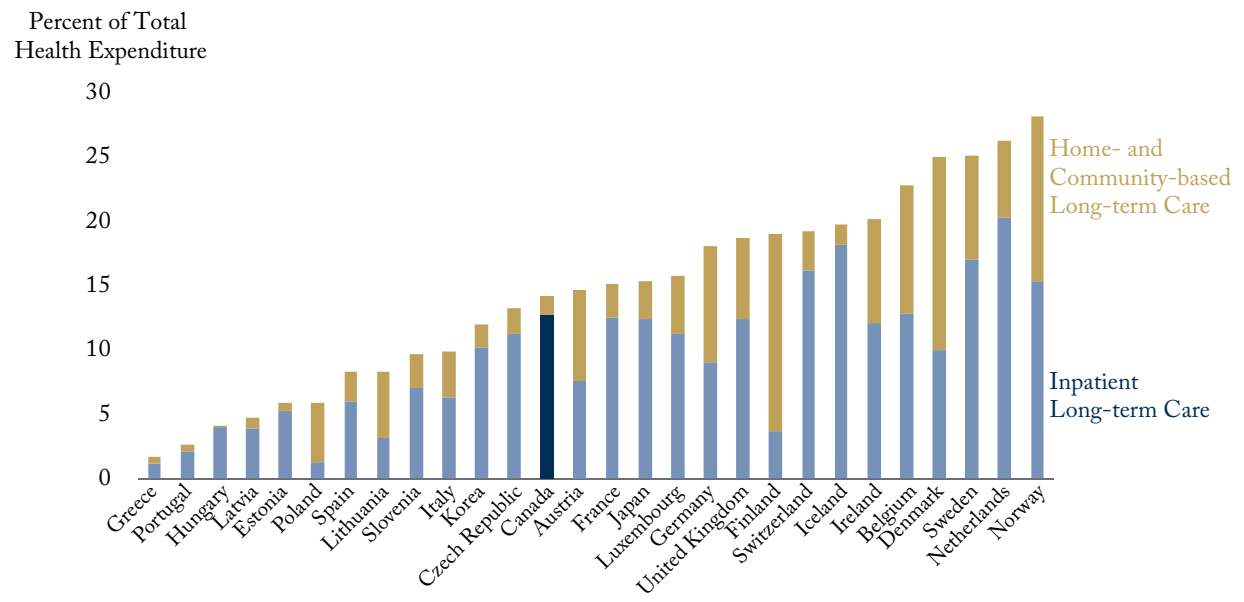
An important factor affecting the severity of COVID-19 in the senior population is simply the proportion of elderly people living in residential care facilities and the proportion living in the community, in the view of working group members.

In Canada, about 12.7 percent of the population over 65 years of age receives ongoing care and more than two-thirds is delivered at home or in the community – similar to many peer countries.[2] Those over 80 years of age, however, are more likely to be receiving care in an institutional setting, like a nursing home or hospital than at home, relative to other countries. About 42 percent of those requiring ongoing care and over 80 years of age in Canada reside in a care facility, compared to about 30 percent in Switzerland, the US, New Zealand, Norway, Germany and Denmark, for example. The differences in the proportion of the institutionalized elderly population across countries and the relatively high utilization of long-term care relative to home and community care in Canada suggest that some of the people residing in institutional care facilities could receive effective care in a non-institutional setting, observed members.

Significant changes to the location of care delivery for the elderly population are not likely to occur during the current crisis situation in residential care facilities. Canada has not performed well relative to other countries, however, in protecting the senior population from COVID-19 exposure and high mortality rates. The results might have been more favourable if a lower proportion of seniors were living in residential care facilities prior to the crisis.

2 OECD Long-Term Care Utilization Database, 2017 or most recent available year.

Figure 2: Long Term Care Funding by Country (2017)



Source: OECD Health Expenditure Database.

About 90 percent of funding for seniors' care in Canada is directed to institutional care with only 10 percent directed to home- and community-based long-term care (Figure 2).[3] Canada falls well below the OECD average of 35 percent of long-term care expenditures being directed to home and community care. Generally, the countries that have a higher proportion of seniors receiving care at home are also the ones that direct a higher proportion of long-term care expenditure to such care and also spend a larger proportion of all health expenditures on seniors' care.

To understand the current crisis scenario presented by severe outbreaks in residential care facilities across the country, and why many other countries have so far have fared better than Canada in

3 Among OECD countries (for which data are available) only Hungary, Estonia and Iceland direct a larger proportion of long term care expenditures to inpatient settings than Canada.

protecting their senior populations, it is important to understand the differences in setting and funding pre-crisis, in the view of the working group. Canada invested in residential long-term care at similar levels to other countries. But, comparatively under-invests in elderly care overall and particularly in home- and community-based care. To address the ongoing challenges in Canada's residential care sector and prevent such disastrous outcomes from infectious disease outbreaks in the future, significant investment will be needed.

Across provinces, the investment in institutional or community-based care significantly varies; as does the proportion of the senior population residing in institutional settings. Overall, Canada underinvests in seniors care relative to other countries, meaning that all provinces likely have significant room for improvement. But some are much closer to the international average than others. In particular, Ontario is the only province to invest more in home and community care than residential care: there are about 90,000 people eligible for nursing home care but are still at home (up from about 40,000 ten years ago). Those 90,000 people are less likely to be exposed to COVID-19 simply because they don't live in an institutional setting, said members. They are also less physically restricted, as they aren't subject to entry and exit restrictions that have been necessary to prevent and control facility outbreaks. Quebec, by comparison, has the largest proportion of its senior population living in a residential care facility.

Members believed each province should revisit their seniors' healthcare policies and evaluate how incentives affect where people receive care, as well as the role clinical thresholds can play in admission to institutional care settings. Those requiring 24-hour, intensive-care services undoubtedly need to be accommodated in long-term care facilities but many others are best and more happily accommodated at home and in their own communities with home care and other appropriate service supports. The former are also at a higher risk of exposure to infectious disease than they would be if living elsewhere. Addressing underinvestment in home and community care along with reforming subsidy and funding mechanisms to improve the allocation of health services would likely prevent future waves of COVID-19 or other infectious diseases from having such negative consequences for Canada's senior population.

Policy Discussion

Overall, Canada has been successful in flattening the curve with physical distancing and other public health measures, in the view of the working group. In the institutional settings of long-term care and retirement homes, however, there have been about 5,000 deaths. About 80 percent of deaths have occurred in residential care facilities; a poorer outcome than most other nations. Residential long-term care is the center of the epidemic in Canada.

Since each province is at different stages of infection control and the loosening of restrictions, there is not a "one size fits all" solution to dealing with COVID-19 outbreaks in residential care facilities. There are, however, common challenges in providing residential care across the country that should be addressed over the long term: the dependence on part-time workers, lower wage rates, and other factors.

Some provinces, Ontario and Quebec in particular, are still struggling to control active outbreaks at residential care facilities. They are implementing emergency policies to address the spread of infection and the shortage of staff resulting from work/location restrictions and exposure/infection of residential care staff. Hospitals and local health authorities are being compelled to help address outbreaks in residential care facilities in their regions. A lack of agreement persists, however, about joint management between long-term care facilities and hospitals. For the duration of the epidemic, joint management protocols should be formalized. Given differential funding arrangements, staff compensation rates, protocols regarding use of PPE and many other details, between hospitals and individual residential care facilities, the lack of a formalized arrangement can delay effective action as details are negotiated and sorted out.

British Columbia provides an example of quick action and a combination of measures that has resulted in better outcomes than other provinces, in the view of working group members. One of the major factors in the success of BC in containing residential care facility outbreaks was making all staff of such facilities public employees. Providing full time jobs, sick leave benefits and comparative pay rates prevents sick workers from choosing between income and protecting residents. In addition, it streamlines communication of public health information and procedures.

Once the initial crisis has passed, all provincial governments must work to address the ongoing challenges in the residential care sector. Consistent under-investment in home and community care has resulted in a higher proportion of Canadians living in an institutional care setting than in many other nations. Seniors living in the community are at much lower risk of exposure, infection and death from COVID-19 than those in institutional settings. Provinces should increase investment in home and community care and develop policies that increase the freedom of choice for senior Canadians with respect to where and how they receive care services. Incentives should be designed to encourage those who can receive appropriate care in a non-institutional setting to do so. France, Germany and Australia, for example, have implemented self-directed models of care delivery that support greater independence among the elderly while improving patient satisfaction (Blomqvist and Busby 2014).

The working group concluded there are many challenges to providing high quality and accessible elderly care services. From effective primary care and access to expertise in managing chronic

conditions, to adult day programs and recreational physical activities to maintain health, caring for an elderly individual takes a team. While not directly related to the current crisis in residential care facilities, addressing underlying challenges and improving coordination of health and other care services would reduce the baseline risk to the senior population in the event of a COVID-19 second wave or a different infectious disease in the future.

Members of the Public Health and Emergency Measures Working Group

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Christopher Naugler, Professor, Department of Pathology and Laboratory Medicine, University of Calgary; Associate Dean Undergraduate Medical Education, Cumming School of Medicine.

Duncan Sinclair, Emeritus Professor, Queens University.

Colleen Flood, Professor & Director, uOttawa Centre for Health Law, Policy & Ethics University Research Chair in Health Law & Policy.

Catharine Whiteside, Executive Director, SPOR Network in Diabetes, Emerita Professor and Former Dean of Medicine, University of Toronto.

Rosalie Wyonch, Policy Analyst and Research Lead, Health Policy Council, C.D. Howe Institute.

Special Guests

Dr. Samir Sinha, Director of Geriatrics, Sinai Health System and the University Health Network; Associate Professor of Medicine, Health Policy, Management and Evaluation, University of Toronto and Assistant Professor of Medicine Johns Hopkins University School of Medicine.

Isobel Mackenzie, Seniors' Advocate, British Columbia.

Vivek Goel, Vice-President, Research and Innovation, and Strategic Initiatives at the University of Toronto and a Professor in the Institute of Health Policy, Management and Evaluation at the Dalla Lana School of Public Health.

Christian Ouellette, Head of Government Relations and Public Affairs, Novartis Canada.

Theme 4:

The Rise of Virtual Care and Overdue Health Reforms

From: R. Sacha Bhatia, Will Falk, Janine McCready, and Joshua Tepper

To: Canadians Concerned about Coronavirus

Date: January 28, 2020

Re: **Responding to the Coronavirus: Building Capacity through Virtual Care**

In 2020, Canada's health systems are better prepared to respond to the Novel Coronavirus than they were 17 years ago during the SARS outbreaks.

We have learned the lessons from SARS, and those at the front lines of the healthcare system are better prepared and better protected.

But we remain concerned about the system's overall capacity to absorb the impact. That will come from the – likely small – number of infected but also from the far larger number of people who will seek care because they are concerned they may be infected.

And virtual care can help ease the burden on already overcrowded hospitals and phone lines across the country.

Ontario's hospitals are already chronically operating above capacity, some every day of year, according to a CBC review of six months of data from 162 sites. Further, Canada remains in peak flu season, unlike the SARS outbreak. The province is addressing the chronic overcapacity, but in the short term, many hospitals have little wiggle room.

China, meanwhile, is building a 1,000-bed hospital in 10 days, with a 1,500-bed facility to follow by the end of February. Fortunately, there are other ways of creating capacity and responding to patient need.

Virtual care, with its video visits, email or text messages between patients and providers is essential. This would increase capacity and could improve safety, as we outlined in a C.D. Howe Institute paper.

The overwhelming majority of those concerned they have the coronavirus will not have it. This can often be assessed and the patient reassured with precisely the same few questions now being asked thousands of times a day in person at emergency departments, out-patient clinics and primary care clinics across Canada as part of screening protocols.

Among the very small number who might be infected, the vast majority seem likely to get mild cases that do not need hospital admission. However, those infected do need to self-isolate to prevent spread. Virtual home visits would improve triage, provide reassurance, prevent spread of the virus and free capacity of the health system to treat those who are acutely ill.

Virtual care can also help those who are already sick with other ailments, and do not want to risk being exposed. It can also be used for patients needing care, but too fearful to come to an office, a widespread phenomenon during the SARS period.

Virtual care has been used for more than two decades in Ontario and around the world. The Ontario Telemedicine Network schedules hundreds of thousands of visits a year, many primary care practices routinely use virtual care with their patients, private companies have emerged to supplement the public system because of the convenience. Its potential has been routinely cited in several Ontario reports seeking to reduce "hallway medicine."

There are barriers to widespread adoption of virtual care, such as privacy concerns and funding. But with a health system at capacity and a population anxious about both the flu virus and a new virus, this could be the time to thoughtfully unleash the potential of virtual care.

Dr. R. Sacha Bhatia is chief medical innovation officer at Women's College Hospital in Toronto, Will Falk is a senior fellow at the C.D. Howe Institute, Dr. Janine McCready is an infection prevention and control officer at Michael Garron Hospital, and Dr. Joshua Tepper is President and CEO North York General Hospital and associate professor at the University of Toronto.

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From: R. Sacha Bhatia, Will Falk, Trevor Jamieson, Carole Piovesan and James Shaw

To: Healthcare Policymakers

Date: April 7, 2020

Re: **VIRTUAL HEALTHCARE IS HAVING ITS MOMENT. RULES WILL BE NEEDED**

The global COVID pandemic has forced health systems to innovate quickly to protect patients and providers. The first priority has been to diagnose and treat the virus to control its spread and fury, while providing high-quality care to others in need.

A huge shift to virtual ambulatory visits has occurred for COVID and non-COVID cases alike, key to reducing exposure for both patients and providers.

Ontario has created virtual care billing codes that allow the use of any technology clinicians deem appropriate, including phone and commercial videoconference services, with a dramatic and immediate shift to virtual.

At Women's College Hospital and Unity Health in Toronto, virtual visits now represent a majority of hospital ambulatory services. Test results are delivered online. Prescriptions are delivered electronically.

Decades of prediction have come true in a single month.

This situation will continue while the "Risks of Physical Contact" (RoPC) remain high. Experience from Asia suggests this will last months after control is established. It may be mid-2021 before RoPC lowers enough to make in-person healthcare visits viable and attractive again.

Urgent clinical needs have required flexibility around privacy and security with virtual. Bodies like the Information and Privacy Commissioner of Ontario are acknowledging that in this unprecedented situation, decision-making around privacy issues is necessarily different.

British Columbia issued a ministerial order, easing certain personal health disclosure rules to communicate, support and respond to COVID-19. The best decisions today may differ from decisions six or 12 months from now as technology matures and RoPC drops.

Care delivery has already been permanently changed. Policymakers need to shape both the urgent control period and the post-COVID world. New standards are needed that mix both physical and virtual delivery, equitably available. We need modernized standards of care for population health that seek to achieve the IHI's Quadruple Aim using both physical and virtual means. This will require addressing five issues:

1. **Patient Safety and Quality**: What healthcare issues can/should be addressed virtually, and when is in-person care required? Who decides? Each set of medical and social services should undergo a systematic review to determine the appropriateness and desirability of a virtual service option.
2. **Privacy and Security**: In the rush to meet physical distancing requirements, governments have promoted virtual with no specific standards or guidance for digitally securing sessions or protecting patient privacy. How should a provider verify identity, capture consent and ensure understanding virtually? How do these measures not compromise equitable access? Should a secure email address be a requirement to practice? Is it time for cross-provincial licences/standards?
3. **Integrated Population Health Approach:** How do we build a virtual system to ensure robust care continuity, including strong links back to primary care and needed ancillary services? How can we facilitate remote ordering and reviewing of diagnostic tests, simple referrals and even basic daily activities like nutrition and transportation? In short, how does a mixed virtual/physical system achieve high-quality population health?
4. **Billing considerations**: Ontario made a bold move by reimbursing virtual visits equally. This drives rapid adoption, but also embeds many undesirable aspects of fee-for-service medicine, including rewards for overtreatment and episodic discontinuity. Strong economic analysis and thoughtful payment reform will be critical to building systems of care that allow continued innovation.
5. **Utilization impact and outcomes**: Additional fundamental questions remain. These include chronic disease outcomes, appropriate use of diagnostic tests and prescriptions, clinical outcomes for COVID and non-COVID patients alike. A very large, and unexpected, natural health system experiment is occurring. Future research needs to examine these impacts so that we can modify practices to maximize patient and system benefit.

The pandemic is massive disruption for healthcare and society. Virtual and online delivery of services is now both expected and likely life-saving. Now that we have a virtual care system, we need to marry it with our fundamental goals for population health: quality, cost effectiveness, provider and patient experience, and risk mitigation. The IHI Quadruple Aim provides an excellent framework to do so. Our forthcoming C.D. Howe Institute paper will discuss these five areas and how to ensure the Quadruple Aim through a thoughtful system design for permanently mixed virtual-physical healthcare.

Dr. R. Sacha Bhatia is chief medical innovation officer at Women's College Hospital in Toronto, Will Falk is a senior fellow at the C.D. Howe Institute, Dr. Trevor Jamieson, is chief medical information officer at Unity Health, Carole Piovesan is a partner at INQ Data Law and James Shaw is research director of artificial intelligence, ethics and health at the University of Toronto Joint Centre for Bioethics.

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From: Åke Blomqvist and Rosalie Wyonch

To: Provincial Ministers of Health and Long-Term Care

Date: April 16, 2020

Re: **COVID and Professional Scopes of Practice**

The recent changes to allow doctors to bill provincial insurance plans for virtual consultations are a welcome innovation that will help in the fight against the COVID virus. Relaxing the current rules regarding scopes of practice, who can prescribe and administer various kinds of medication, or decide how to treat certain patients, would also help.

The COVID-19 crisis is threatening to stretch healthcare systems beyond the limits of their capacity. Addressing both the pandemic and regular healthcare needs, while attempting to minimize exposure risk for health professionals, vulnerable populations and the public, poses a daunting challenge.

Meanwhile, some healthcare professionals need to self-isolate and cannot provide care due to being exposed or infected themselves. In addition, protecting the public and vulnerable population, in particular, from exposure requires minimizing physical interactions.

Allowing health professionals like pharmacists and nurse practitioners broader authority to diagnose and prescribe for patients with relatively uncomplicated health problems would leave physicians more time to deal with COVID patients. The scopes of practice of pharmacists and nurse practitioners have been expanding for years prior to the current crisis – allowing these professionals to deliver more routine care, such as administering flu vaccines for example.

Some provinces have already taken the additional step in expanding scope of practice to ensure continuity of care by relaxing restrictions on pharmacists for renewing prescriptions.

A particularly important issue is to ensure that there are enough doctors to treat elderly COVID-19 patients not only in hospitals but also in nursing homes and retirement residences, or those cared for by family members in their own homes. Elderly patients are at greater risk of becoming seriously ill if they get infected; if they live in institutions, they are also at greater risk of becoming infected since the virus spreads more easily in institutional environments.

In the coming days, there will be a growing need for care provision in these institutions, not only to resident COVID patients who cannot be transferred to hospitals, but also to patients with other health problems.

Currently, most medical services for institutionalized elderly people are supplied by doctors who make regular visits to where they reside. If these doctors fall ill or have to spend more of their time with hospitalized patients, those who live in nursing homes or retirement residences may risk having to wait a long time before they can be seen.

Giving other health professionals – nurses and pharmacists in particular – more authority to prescribe drugs and make certain treatment decisions could alleviate the consequences of such delays. For example, it could give terminally ill COVID patients faster access to palliative care if they and their families have opted to forgo more aggressive interventions.

Rules with respect to scope of practice are controversial, both because it is important to ensure that treatment decisions are made by properly trained professionals, and because they can affect expected incomes in the different professions. For now, these issues should not be allowed to stand in the way of measures that could reduce the likelihood of elderly patients dying while gasping for air. To make the new rules less controversial, they could be made temporary and reviewed at regular intervals as the current crisis proceeds.

Relaxing restrictions on scope of practice aligns with temporary/emergency licensing of medical graduates and retired physicians and other actions already taken to increase the system's surge capacity. If provinces do decide to proceed further along these lines, they should do so quickly, so that the new rules are operationally effective in time to help expand surge capacity in the current crisis.

Åke Blomqvist is Adjunct Research Professor at Carleton University and Health Policy Scholar at the C.D. Howe Institute; Rosalie Wyonch is a Policy Analyst at the C.D. Howe Institute.

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What Happens to the Health System after COVID-19?

By Will Falk and Dr. R. Sacha Bhatia

The weekend brought good news and early signs the COVID-19 curve may be flattening. The number of new cases has slowed and the numbers of COVID-19 patients hospitalized and in the ICU have stabilized.

Current ICU utilization remains well under the best-case scenario projections, and while it's still early, it appears likely that we will not have the same surge that overwhelmed New York and Italy.

Canada has avoided the fate of other jurisdictions through strong public health measures and physical distancing. Flattening the curve has involved shutting down or moving large portions of our society online: schools, universities, retail, and the justice system.

In the healthcare sector non-emergency ambulatory care was halted for two weeks and has now moved to virtual care. Ontario's hospitals have reduced non-COVID volume, including elective visits, procedures and surgeries to create capacity for a potential surge in COVID-19 patients.

Historically these hospitals run occupancy rates over 95 per cent, many are now operating at occupancy rates of 65-70 per cent. Thirty per cent of hospital beds are held open and thousands of people who would "normally" be in an Ontario hospital today are somewhere else.

Creating this surge capacity was the right thing for the health system to do, but it has come at a cost.

Hip replacements, cataract removals, aneurysm repairs, and even some cancer surgeries are all postponed. The same is true for patients with mental health challenges and other patients suffering from chronic diseases.

Virtual care is now the norm for these chronic conditions and will be for many months to come. After SARS, research studies did not suggest an adverse impact when hospital services were substantially reduced. But public health projections and international experience suggest a much longer time horizon for COVID-19.

While it may be early to ask, there is a real question for decision makers about when we open up the healthcare system again. And how do we reorganize it for the long interim "second-wave" period?

This will force a conversation about tradeoffs. The clear peak of the surge remains in doubt, and the lack of population-based testing in Ontario leaves us with no clear view of disease activity. Yet, remaining closed has real risks for the thousands of Ontarians with active medical conditions or aggravated chronic diseases. The choices are not easy, but we would like to offer several preliminary suggestions.

First, continue to defer care of questionable benefit. Choosing to not overtreat has never been more important, as the risks of in-person contact with our healthcare system are now very clear.

Second, providers should offer as many services virtually as possible. By continuing the billing codes for virtual services, doctors are encouraged to provide services virtually, reducing the risk of transmission. Refining the virtual system for stable chronic care management, mental health and primary care will add capacity and maintain physical distancing.

Third, government should take a coordinated and prescriptive approach towards hospital utilization. An average of 800 beds is two to three moderate size hospitals. We should consider designating some hospitals COVID-only, where we can develop expertise in treating these complex patients, with the appropriate levels of PPE, trained staff and ICU capacity.

This would allow other hospitals to resume full services to non-COVID patients. Meanwhile, another tier of hospitals should be designated and organized to become COVID-19 institutions in the event they are needed. This approach is taking shape in different jurisdictions from Wuhan to New York. While we support independent hospital governance, some designations should be made for COVID-19 specialty care facilities. Some semblance of normalcy could then return to clinical care for patient groups whose care cannot be deferred.

Finally, we need to put real community care into action. This requirement has become distressingly clear in long-term care and nursing homes over the past few weeks. The homeless and prison populations are also at risk.

Taking care of the social needs of vulnerable populations and protecting them from COVID-19 has always been the right thing to do. The pandemic has shown us it is also in society's interest in order to stop further spread. We need to reorganize our resources so that we can and manage outbreaks in these vulnerable sectors. This will require a thoughtful population health approach over the next year.

Will Falk is a senior fellow at the C.D. Howe Institute. Dr. R. Sacha Bhatia is chief medical innovation officer at Women's College Hospital in Toronto.

Published in the Toronto Star.

From: Rosalie Wyonch

To: Healthcare Policymakers and Managers

Date: June 16, 2020

Re: **Low-Value Care: Re-opening the healthcare system and living with COVID-19**

Canadian provinces are in the midst of re-opening their economies and healthcare systems following the restrictions imposed to fight the COVID-19 pandemic.

The shutdown came fast, but the recovery is slow. This gives the healthcare system an opportunity to avoid re-introducing unnecessary services that add no clinical value to patients and divert resources from better uses.

The first meeting of the Policy Forum on COVID-19 and Low-Value Care discussed some of these critical issues. The Forum, hosted weekly by Choosing Wisely Canada, brings together dozens of policymakers and subject matter experts.

So far, the suspension or delay of most health services has not resulted in a spike of negative health outcomes for the majority of patients.

This suggests that a significant number of missed tests and treatments might be of the low-value variety, and that there is significant opportunity to constrain low-value care as the systems re-open.

In particular, Forum members urged implementation of the more than 400 Choosing Wisely recommendations put forward by 80 clinician groups on separate low-value health services.

COVID-19 necessitated drastic changes in physician-patient interactions and resulted in unprecedented progress on previously intractable issues, notably virtual care. There has been a significant increase in virtual delivery of healthcare services due to the physical distancing measures and the activation of new billing codes for virtual care.

The natural experiment is ongoing, and the effects of expanded virtual care for patients, clinicians and healthcare spending should be closely monitored. The increase of virtual care has ambiguous potential effects on low-value care. For example, it could contribute to declines in low-value laboratory testing, but increases in inappropriate antibiotic prescriptions because of added diagnostic uncertainty from the inability to physically examine patients.

The pandemic experience across Canadian provinces has differed, and these differences are reflected in various approaches to prioritization and re-opening of healthcare services.

In Alberta, for example, urgent surgeries continued throughout, and some elective surgeries have resumed, but only for patients not requiring post-operative care in order to reserve hospital bed space for COVID-19 patients.

In Ontario, health services are being progressively re-opened on a regional basis, and guided by provincial parameters. In Saskatchewan, a major priority of the re-opening is primary care services to prevent illnesses from progressing to the point of requiring acute care: a policy focus on prevention to ensure the acute care capacity necessary to manage a COVID-19 second surge. A temporary Pandemic Physician Services Agreement has been established to facilitate redeployment of physicians to high-need services, and to achieve some measure of income stabilization.

Provincialized systems such as those managed by Alberta Health Services and Saskatchewan Health Authority are able to quickly implement a unified approach to prioritizing services. For example, Saskatchewan was able to restrict its laboratory services menu in order to free up resources to support more urgent COVID-19 related testing.

Similarly, there were discussions about the employment of a single queue / single entry model for certain services, a more consistent and efficient method of matching highest-need patients with soonest available resources. A number of tensions would have to be resolved, including how to balance efficiency objectives with the importance of maintaining patient-provider relationships.

Strategies to limit the growth of low-value services would need to also consider public education and expectation-setting. For example, increasing the percentage of Canadians who have advanced care directives will help reduce the need for end-of-life care.

Regardless of the current pandemic situation in a particular province, ensuring that people can access necessary healthcare services is critical to re-opening. With the unprecedented shut down and restriction of many healthcare services, governments and healthcare managers should prioritize the highest value services and look for opportunities to reduce low-value or unnecessary healthcare. From particular services or supplies to total system efficiency, the COVID-19 pandemic presents a unique opportunity for systemic change as healthcare in Canada transitions to a new normal.

Rosalie Wyonch is a Policy Analyst at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Rosalie Wyonch

To: Canadians Concerned about Healthcare

Date: June 22, 2020

Re: **Low-Value Care and COVID-19**

Low-value healthcare provides little to no benefit to patients and can cause harm.

Previous research has shown that there is much low-value care in Canada. The OECD estimates that about 20 percent of health spending is directed to activities that do not add value. The COVID-19 pandemic has put significant strain on healthcare system resources across the world. Cost pressures on the health system are only going to increase, so reducing low-value care is an important part of maintaining and improving the quality of healthcare.

Patients, clinicians and the system itself are all drivers of low-value care. There is no single factor responsible for low-value care, and it has many complex drivers.

Patients can seek unnecessary treatments, or might not feel they have received adequate services if they leave an appointment "empty handed" (action bias). Clinicians might over-prescribe or order unnecessary tests and treatments due to risk aversion, both personally and for patients, with respect to meeting patients' needs and personal fear of lawsuits. Inadequate training or outdated habits also contribute to low-value care.

Systemic factors also contribute to perpetuating low-value care. In many provinces, physician remuneration often doesn't encourage appropriate resource stewardship. Passive mechanisms, such as default-listed items on standardized order forms, affect the number and frequency of services that physicians request. In some cases, low-value procedures might be required by existing policy or legislation for certain healthcare procedures. For example, the *Public Hospitals Act* in Ontario requires pathological tests for tissue removed during uncomplicated hip and knee replacement surgeries, even though research shows that it does not alter patient management or outcomes.

Part of the challenge in addressing low-value care is that it can be difficult to measure. It is easy to observe what has been ordered and with what frequency, but in many cases, determining appropriateness requires information about individual patient complexity. For many common interventions, however, a physician's practice and ordering patterns could be compared to objective clinical standards, to other physicians' behaviour or assessed based on patient outcomes. Administrative data can also contribute to assessments of appropriateness, for example through comparing mean abnormal results rate to volume of diagnostic test orders.

The response to COVID-19 has driven rapid and unprecedented restrictions in access and changes to the delivery of healthcare. The silver lining to this disruption is that it is a wide-scale, ongoing natural experiment that will likely change prevailing views about what is low-value and how care is prioritized. The waitlists for surgeries and other services have grown as a result of COVID-related cancellations. With constrained resources, there is a renewed focus on improving triage procedures – methods of matching highest need patients with soonest available resources. This renewed focus and the crisis itself have highlighted data and information gaps that could facilitate more efficient management of health resources.

COVID-19 has put significant strain on already scarce resources for healthcare. Before the current crisis, there were concerns about the fiscal sustainability of increases in healthcare spending. The economic consequences of the pandemic, associated restrictions and significant government spending to moderate the negative effects mean that public spending will need to be constrained in the future. Healthcare represents more than a third of provincial program spending across the country and it will not be immune from the fiscal pressure.

To maintain a high quality and accessible healthcare system, policymakers, managers and clinicians will need to evaluate the effects of the recent restrictions and ruthlessly determine value for patients. The combined pressures of the pandemic and its associated economic damage require decision-makers to address the complex drivers of low-value care. The sustainability of the healthcare system depends on it.

Rosalie Wyonch is a Policy Analyst at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Rosalie Wyonch and Shivani Maharishi

To: Health Policymakers and Managers

Date: July 3, 2020

Re: **Low-Value Care: Health's Future and Fiscal Reckoning**

The COVID-19 pandemic has created a backlog of delayed health services and lower government revenues resulting in turbulence for Canada's healthcare sector. These changes and uncertainty are anticipated to continue for some time until the system settles into its new normal.

Canada, like most countries, has spent the past four months implementing change as it adapts to pandemic-driven restrictions and safety precautions. As a result, many healthcare services across the country have been suspended. This pause has offered a unique opportunity for professionals to reflect and prioritize high-value care, and for decision-makers to emphasize the need to avoid low-value care as the system attempts to bring back suspended or delayed services.

In the third and final meeting of the Policy Forum on COVID-19 and Low-Value Care, dozens of policymakers, clinicians and subject matter experts discussed the effects of the pandemic for health system reforms and funding over the longer term. In particular, participants discussed changes to the delivery of care related to the shift to virtual service delivery, the costs and intensity of acute care for end-of-life care, and models of physician remuneration, all of which have significant implications for driving low-value healthcare.

These critical issues were discussed in the context of the fiscal policy environment. Current emergency government spending is not sustainable. Further, government revenues will remain constrained as the economic slowdown persists. Even before the pandemic, healthcare spending was straining budgets as its growth outpaced GDP, so system reform has been a longstanding concern for many decision-makers and healthcare providers long before COVID-19.

The need to promote physical distancing, alongside the suspension of non-urgent medical services, has resulted in a significant increase in the use of virtual care services.

Forum participants discussed how the balance of the "cost of contact" for patient interactions with the healthcare system has changed. Prior to the pandemic, almost all costs were borne by patients – taking time off work or arranging childcare to attend appointments, for instance. The risk of COVID-19 infection, however, increased the "cost of contact" for both providers and patients resulting in the rapid mass shift to virtual care/treatment whenever possible.

Given the continuing risk of COVID-19, avoiding unnecessary contact between patients and providers protects the capacity of the healthcare system in the event of a second wave. Virtual care, however, has the potential to reduce patient costs of contact, protect healthcare workers and can enable more efficient healthcare delivery across many treatments and procedures. For example, remote monitoring of patients with chronic conditions or in post-op recovery could maintain much-needed hospital bed capacity for other purposes while also benefitting patients. Determining which services should continue to be delivered virtually, those where physical interactions provide added value, and how service providers should be remunerated are critical questions for the post-pandemic recovery period.

The participants discussed the challenging fiscal position of governments, and how it could affect healthcare in the post-pandemic recovery period.

For example, the social determinants of health have been long known, yet progress to addressing these has been slow. Large increases in government spending combined with the slowdown of economic activity mean that austerity is inevitable in the coming years, especially when considering the pre-pandemic fiscal position of some provincial governments.

But the pandemic has also shown that Canada's government can move with astonishing speed to address long-standing challenges: the creation of the Canada Emergency Response Benefit to address existing gaps in employment insurance coverage or the activation of virtual service billing codes being prime examples.

With fewer resources and higher need for services, policymakers and health system managers must face the daunting challenge of adapting to the "new normal." Efforts to focus on outcomes for patients and maximizing value is needed to ensure sustainability and innovation. The broader context of the fiscal environment demands taking a bold new approach to health system management.

Rosalie Wyonch is a Policy Analyst, and Shivani Maharishi is an intern at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Part 2

Supporting Canadian Businesses through Shutdown, Restart, and Recovery

by Grant Bishop

The pandemic and the ensuing shutdown delivered an unprecedented shock to demand and supply across the Canadian economy. The challenges for businesses and policy responses to support business continuity through the pandemic can broadly be divided into three phases: an initial "shutdown" phase, a "restart" phase and a (still ongoing and tentative) "recovery" phase.

In brief, during the "shutdown" phase, businesses faced incredible challenges to manage and preserve operations and maintain supply chains. Governments rapidly innovated on measures to backstop businesses and limit long-term scarring. For "restart," governments required a "playbook" approach to anchor expectations and communicate the staging for reopening and the balance between risk and economic cost. To this end, rapid ramp-up of testing and contact tracing, as well as transparency around data and models, was essential to manage public health risks during restart. While a cause for some optimism, the ongoing "recovery" presents significant risks and headwinds, and Canadian businesses and policymakers will face a long, hard road – particularly as long as the pandemic persists. Stimulus measures may become increasingly necessary as activity in many key sectors remains depressed.

During the "shutdown" phase of the crisis, self-isolation and "social distancing" measures effectively shut down major segments of Canada's economy. With impaired supply chains and the impact of public health measures, production by many businesses halted. In the face of cash flow constraints, many businesses and not-for-profits faced inability to meet payroll and fixed costs (e.g., rent and debt servicing obligations). The wave of layoffs of workers and business closures threatened families' abilities to meet immediate needs. Simultaneously, employers in many "critical" sectors (e.g., agriculture, food distribution and grocery retail, manufacturing of medical equipment) faced workforce challenges and confusion about the applicability of shutdown measures to their operations. Governments faced incredible uncertainty and rapidly changing conditions, but also needed to act to "stop the bleeding." Without expeditious (and admittedly imperfect) measures, permanent scarring of businesses would have been even more widespread, further hindering economic recovery once public health measures are eased.

This unprecedented crisis demanded a scale, scope and speed for support measures by governments to households, businesses, not-for-profits and financial institutions beyond anything in any previous economic crisis. Governments were forced to rapidly shift to an execution mindset and adjust risk tolerances with a view that "the perfect must not be the enemy of the urgent." Through the "shutdown phase" of the crisis, expert viewpoints and communiques from the C.D. Howe Institute's Working Group on Business Continuity and Trade recommended policy support to ensure business continuity in the following "buckets":

1. preserving people (i.e., preventing layoffs and safeguarding mobility for critical labour);
2. backstopping credit/liquidity (i.e., cash to cover fixed costs); and
3. safeguarding production/supply chains (i.e., flow of inputs and critical goods).

The subsidization of wages through the Canadian Emergency Wage Benefit (CEWS) was a particularly important measure to abate economic damage threatened by the cascading layoffs from shut down and its potential knock-on effects. For many Canadian workers, this helped stem the impact of layoffs on lost income and psychological toll for families.

In formulating support for business, policymakers rightly distinguished between "backstops" and "bailouts." Businesses could not self-insure for this "black swan" event. Providing temporary "bridge" financing for immediate liquidity needs is distinct from government participation in long-term support for the restructuring of distressed companies. While governments must be conscious of taxpayer exposure, ensuring access to near-term credit is essential for businesses to be able to cover fixed costs.

Restarting the economy required transparent, locally calibrated approaches for staging and managing the reopening of the economy in each province. Provincial governments led development of "playbooks," which each identified the principles, processes, metrics and milestones for staging a gradual return to work. The C.D. Howe Institute's working group on business continuity and trade proposed the aim for such "playbooks" should be to anchor expectations and planning by businesses and families – analogous to forward guidance and "contingent commitments" by central banks. Recommended principles for such playbooks were:

1. Transparent pre-conditions for each stage of easing economy-wide restrictions.
2. Pan-Canadian consistency in principles, decision-making criteria and data.
3. Sector-level staging for restart based on workplace transmission risks and economic impacts.
4. Safeguarding access to essential goods and services.
5. Synchronized re-opening of enabling public services and infrastructure.
6. Clear off-ramps for government-provided temporary income supports.

The working group recommended that pre-conditions for economy-wide re-opening of the economy should be based on public health expert judgment and modelling and informed by monitoring. In particular, a playbook should identify the acceptable thresholds for (i) virus spread and (ii) health system capacity at which governments will plan to ease restrictions.

Managing the economic impact and successfully reopening the economy also required an accurate picture of the extent of the pandemic and transparent, high frequency reporting. To this end, governments faced a need to increase widespread testing and robust contact tracing to support the reopening of the economy. Widely available testing and effective tracing are essential to manage risks for health system capacity and workplace transmission.

Through the summer of 2020, Canada has moved into a "recovery" phase and witnessed a rapid resumption of activity in many sectors. Nonetheless, overall demand and employment remains depressed – and Canada is certainly not out of the woods. Economic recovery faces significant risks and headwinds, with continued support necessary to prevent long-term scarring in key economic sectors.

The private sector must remain the primary source of credit; however, governments should identify where impaired access to liquidity could disrupt key productive capacity, as well as complement private lending where credit access is bottlenecked and disorderly insolvencies would hinder medium-term production capacity. The air travel, agrifood, petroleum, tourism and accommodation sectors represent significant shares of the Canadian economy and each face a likely protracted plunge in demand. Nonetheless, governments must clearly identify the particular market failures that policy is targeted to address, and interventions should not displace market forces. Government backstops should not displace private creditors, impair efficient, pro-competitive consolidation or forestall restructuring of distressed companies.

As well, such a protracted period of depressed demand – particularly in many export-oriented sectors – presents a case for fiscal stimulus. Canada could leverage this opportunity to address its maintenance backlog for aging public infrastructure assets – for example, repairing bridges, roads and linear water

infrastructure. In addition, broadband connectivity is a critical "backbone" for long-term national prosperity. To guide future national infrastructure priorities, Canada needs a national strategic assessment initiative to identify those infrastructure investments that would boost long-run economic growth, enhance social wellbeing and enhance resilience – particularly in response to risks from climate change.

Finally, the pandemic witnessed a worrisome tide of export restrictions on critical goods internationally. Experts emphasize that open international trade is essential to Canada – both in the immediate crisis and for the long term. From the ingredients in hamburger buns to motor vehicle production, Canada's economy depends on integrated production across borders. With increasing risk of a shift towards protectionist policies internationally, Canada must remain a champion of open borders and integrated trade. However, Canada may need an "elbows up" defence to ensure key Canadian industries survive amid restructuring of global value chains.

Theme 1:

How to Safely Restart the Economy, and How to Measure it

Intelligence MEMOS

From: Grant Bishop and Mariam Ragab

To: Canadian Businesses and Governments

Date: April 15, 2020

Re: **In A Pandemic, Canada Needs Faster Economic Data: Here's Our New Tracker**

The shutdown of much of Canada's economy has exposed gaps in the availability and frequency of data about Canada's economy.

Statistics Canada has peerless rigour for its officially released statistics. However, during this crisis, the duration between the collection and release of data creates a rear-view mirror look. Without a daily or weekly line-of-sight on Canada's economy, businesses and policymakers are flying blind.

The gap and lag in official data motivated the C.D. Howe Institute to establish a dashboard for impacts on Canada's economy. Deloitte has also compiled daily metrics, like geospatial data on commercial and commuter vehicles and pedestrians.

The aim is to provide high-frequency and current indicators of changing economic conditions. These indicators are the start of showing the slowing pace of Canada's economy. Additional datasets would help track our economic trajectory.

Governments should also publish administrative datasets. Ottawa should publish data on claims for Employment Insurance (EI) and the new Canada Emergency Response benefit. Officials have leaked the number of EI weekly claims, but have not actually published statistics. The US publishes weekly last week's claims for Unemployment Insurance. In Canada, the last official release of monthly EI claims is for December 2019. The C.D. Howe Institute's Crisis Working Groups have repeatedly recommended weekly release.

Businesses could help publish data: banks on aggregated credit card transactions, categorized by different merchants; courier companies on shipments; ISPs on internet traffic volumes; and transit authorities and ride-sharing firms on daily ridership.

For the moment, the most immediate publicly-available aggregate indicator of economic activity in Canada is electricity demand (see similar US data here).

Hourly power demand data is available on the next day in Alberta and Ontario, and with a lag of several days in British Columbia, but not elsewhere.

For the week ending April 11, Ontario power demand was 12 percent lower than the same week in 2019. Interestingly, in Alberta and BC, power demand is not yet significantly below the same week last year (cold weather may be to blame).

Power demand by certain large industrial users recently appeared lower in the past weeks relative to the same week in 2019. This would be consistent with reduced petroleum sector activity.

This crisis has also exposed Canada's lack of near-term metrics for activity in our petroleum sector. Despite a recent initiative by the Canadian Energy Regulator to identify data gaps, real-time energy information is missing.

Canada lacks up-to-date official data on petroleum storage. With anecdotal reports of oil inventories at risk of "tank topping," it is embarrassing that Canada lacks such information. The US reports petroleum stocks weekly.

Our dashboard includes the most recent data published on Canadian refinery output, which has a two-week lag. In contrast, the US numbers come after five days.

Canada's last reported week (ending March 31) showed refinery runs down from a year earlier by 17 percent in Western Canada, 15 percent in Ontario and 17 percent in Quebec and Eastern Canada. US crude oil demand at refineries in the Midwest market (PADD 2) was down 11 percent for the week ending April 3.

For other industrial products, shipments by Canadian railways yield a window into the pace of output. For the week ending March 29, total carloads were down by 17 percent relative to the same week last year. Motor vehicles and parts shipments were 80 percent lower than a year earlier. This corresponds with the plunge in domestic motor vehicle sales in March. Slowed vehicle shipments by rail indicate reduced output by car manufacturers – and likely Canada's wider manufacturing sector.

Railway shipments of intermodal units, mainly containers, were also down 13 percent year-over-year. Reduced container shipments highlight possible risks to Canadian supply chains as bottlenecks overseas inhibit import of intermediate inputs. For February 2020, container imports at the Port of Vancouver had already fallen by 16 percent year-over-year. Data for March will be available in the coming week.

Finally, setting an example to other businesses in publishing their data, OpenTable data shows a 100 percent decline in restaurant reservations. Food services and accommodation represent 2 percent of GDP but around 7 percent of employment. The economic cost from the near-total restaurant shutdowns cannot be overstated.

Our dashboard provides real-time insight on the economic impacts of the crisis on Canada's economy. To effectively manage through this crisis, Canadians should have better information. Governments and businesses should step up to deliver the data we need.

Grant Bishop is Associate Director, Research, and Mariam Ragab is a researcher at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

COVID-19 Crisis Working Group: Business Continuity and Trade

Communique #4: Canada Needs "Playbook" For Restarting Economy

In order to help Canadian governments confront the public health and economic crisis resulting from the spread of COVID-19, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The working group on business continuity and trade is co-chaired by Dwight Duncan (Senior Strategic Advisor at McMillan LLP and former Ontario Minister of Finance) and Jeanette Patell (Vice-President of Government Affairs and Policy for GE Canada). Its membership includes industry experts and economists. Meeting weekly, it identifies and prioritizes policy challenges and communicates members' views in published communiques. The group's fourth meeting was held on Tuesday, April 14, 2020.

At this meeting, the working group discussed the need for a roadmap to restart Canada's economy, the implementation of supports for businesses to "bridge" the present shutdown, and the importance of continued investment in robust telecommunications infrastructure to meet the current surge in demand.

Working group members believe Canada's governments should provide a "playbook" for the restart of the economy. Such a framework would outline principles, processes, metrics and milestones for a graduated return to work at the industry and workplace level. As elements of a framework, working group members recommended:

- Transparent principles for managing risks of transmissions and impacts on economic activity;
- Federal-provincial collaboration on pan-Canadian principles with continuing responsibility for emergency measures by provincial and municipal governments;
- Collaboration with industry (e.g., through task forces) to develop workplace-level standards and protocols to mitigate transmission risks;
- Thresholds for public health indicators at which certain restrictions can be lifted; and
- Timely tracking for epidemiological indicators and pressures on the healthcare system.

For supports to "bridge" the crisis, the working group commended the federal government's initiative in so quickly establishing various new and urgently needed programs. Nonetheless, members urged:

- Simplification of criteria to address confusion by workers and businesses – in particular, guidance around qualifying conditions for the wage subsidy;
- Tailored industry-specific support measures for hard-hit sectors; and
- Design of support as temporary, rather than permanent, measures and careful weighing of trade-offs for new, targeted supports.

Finally, the working group emphasized the important enabling role of Canada's resilient telecommunications services during this crisis. The working group acknowledged the challenges facing telecommunications providers to maintain network reliability amid record usage levels when "every day is Superbowl Sunday." Looking ahead, the roll-out of next generation networks will be essential for helping Canadians to adjust in a "new normal" (e.g., sustained "work from home") for Canada's economy post-crisis.

Governments could ensure ongoing network resilience post-crisis by providing incentives to accelerating capital outlays by telecom providers.

Formulate and Communicate the "Back to Work" Playbook

As soon as possible, governments must also provide line-of-sight on conditions for easing "shut down" measures. Businesses presently face paralyzing uncertainty about the duration and scope of measures. Accordingly, without guidance to anchor expectations, businesses may reduce output more drastically than is optimal in order to avoid commercial downside. Forecasts now project a sizable reduction on economic output globally: the International Monetary Fund's most recent economic outlook projects a 3 percent contraction of the global economy in 2020, including a 6 percent decline of real GDP in Canada.[1] Members highlighted recent economic research that, beyond the direct impacts of shut-down, the present levels of forward-looking uncertainty facing businesses as a result of COVID-19 may inflict a sizable contraction on economic output.[2]

While recognizing the inherent uncertainty around the rapidly evolving public health crisis, governments should outline the principles and milestones that will guide the return to work. A principled framework

1 International Monetary Fund. 2020. *World Economic Outlook*. April. Available online: https://www.imf.org/en/Publications/WEO/Issues/2020/04/14/weo-april-2020

2 Baker, Scott, Nick Bloom, Steven J. Davis and Stephen J. Terry. 2020. *COVID-Induced Economic Uncertainty*. April 4. Available online: https://www.policyuncertainty.com/media/COVID-Induced%20Economic%20Uncertainty.pdf

for restart would be rooted in public health advice and conditions (e.g., "slack" within the current healthcare system). The aim should be to manage risks around workplace transmission and minimize exposure of vulnerable individuals. Principles and contingent timelines will help manage expectations and address current commercial paralysis.

Echoing recent proposals,[3] the working group recommends governments actively leverage industry working groups with knowledge of frontline operations and expertise on occupational health and safety. By collaborating with industry, governments can formulate appropriate standards and protocols that safeguard employees and facilitate a graduated return to work.

As emphasized in an earlier communique,[4] the working group continues to believe that provincial governments are best situated to manage emergency measures, given their capacity for service delivery and information to calibrate measures to local conditions. Nonetheless, the federal government can play an important facilitating role by working with provinces to develop pan-Canadian principles and guidelines.

Simplify Criteria for Existing Programs and Target Sector-specific Supports

Members emphasized the importance of support programs for workers and businesses to "bridge" income loss during this crisis and commended the federal government for its rapid creation of the wage subsidy, lending programs for businesses, and direct supports for workers.

Nonetheless, members expressed concern that complex qualifying criteria prevent businesses from accessing these programs. For example, members highlighted the confusing rules about how a company's subsidiaries should assign revenues to determine whether the company meets the 30 percent revenue reduction requirement and so qualifies for the wage subsidy.
Certain members noted that take-up of certain federal loan programs has been slow – in particular, the BDC co-lending program for small and medium-sized enterprises – and hypothesized that this is a result of the complex requirements to qualify.

3 See: Robson, Bill. 2020. "Governments should rely on industry task forces to advise on restarting the economy," Globe & Mail. March 13. Available online: https://www.theglobeandmail.com/business/commentary/article-governments-should-rely-on-industry-task-forces-to-advise-on/

4 Business Continuity and Trade Crisis Working Group. 2020. *Safeguard Critical Supply Chains by Addressing Weak Links: Crisis Working Group on Business Continuity and Trade*. C.D. Howe Institute. April 2. Available online: https://www.cdhowe.org/council-reports/safeguard-critical-supply-chains-addressing-weak-links-crisis-working-group-business-continuity-and

Looking forward, the next stage of business support will involve targeted backstops for hard-hit sectors – for example, airlines, tourism, petroleum producers and oil field services companies. Members highlighted that other countries are ahead of Canada on rolling out support for sectors like airlines. While the shock to global petroleum demand, many of Canada's oil producers will be shutting in production and could face insolvency. While the federal government pledged imminent support for the oil sector weeks ago, it has yet to deliver.

Nonetheless, members stressed that governments must weigh trade-offs and design "bridges" rather than permanent subsidy programs. While urgency has motivated large spending commitments, government should keep its eye on its objective to "turn off the taps" on the temporary measures that have been created to confront this emergency.

Telecommunications Critical for Connectivity during Crisis

The working group noted that Canada's telecommunications infrastructure has remained remarkably resilient during a period of intensified usage. Members particularly emphasized that Canada's telecommunications services have sustained economic activity as many Canadians switch to working by remote connection at home. The resilience of telecommunications networks today is a result of past investments and current efforts in the field to maintain infrastructure. Network providers are also rapidly building new facilities where these are needed – for example, to service remote learning for students and temporary medical facilities.

Nonetheless, members are cognizant of the challenge for continued investment outlays by telecommunications providers during a period of constrained revenues – for example, as small businesses pause or cancel services to conserve cash flow. Governments could incent the acceleration of investments by telecommunications providers through such measures as acceleration of Capital Cost Allowances (CCA). As well, government policies directed at reducing prices for telecommunications services (such as low rates for mandated access by resellers to telecommunications facilities) may discourage future investment.[5]

Looking ahead, the roll-out of next generation networks will likely be necessary in a "new normal" for Canada's economy post-crisis. "Work from home" is likely to be sustained until the COVID-19 virus is fully contained. Fast and reliable telecommunications services will be essential for helping Canadians to adjust.

5 For elaboration, see: Competition Policy Council. 2020. *Mandated Competition or Free Ride? Mandated Access to Telecommunications Facilities Risks Impairing Canada's Next Generation of Digital Infrastructure*. C.D. Howe Institute. March 19. Available online: https://www.cdhowe.org/sites/default/files/attachments/other-research/pdf/Communique_2020_0319_CPC.pdf

The Members of the Business Continuity and Trade Working Group Include:

Dr. Sylvain Charlebois, Professor, Senior Director, Agri-Food Analytics Lab, Dalhousie University

Dwight Duncan (Working Group Co-Chair), Senior Strategic Advisor McMillan LLP

Rick Ekstein, President & CEO, Phaze 3 Management

Glen Hodgson, Fellow-in-Residence, C.D. Howe Institute

Keith Halliday*, Director of Centre for Canada's Future, Boston Consulting Group

Caroline Hughes*, Vice-President of Government Relations, Ford Motor Company of Canada

Jeanette Patell (Working Group Co-Chair), Vice-President of Government Affairs and Policy, GE Canada

Geoff Smith*, President & CEO, EllisDon

John Stackhouse, Senior Vice-President, Office of the CEO, Royal Bank of Canada

Trevor Tombe, Associate Professor of Economics and Public Policy, University of Calgary

* denotes not in attendance at April 14th meeting.

Intelligence MEMOS

From: Glen Hodgson and William B.P. Robson

To: Canadians Concerned about COVID-19's Economic Impact

Date: April 21, 2020

Re: **Some Principles for An Economic Restart**

We have learned a great deal over the past month about the interaction between the coronavirus pandemic and the economy. This is a recession unlike any other, driven by a forced supply-side shutdown of many business sectors and firms, in the global effort to contain the pandemic.

The required shutdown has focused on sectors that rely on direct contact with and among consumers and clients, such as hospitality, retail, accommodation, and entertainment. Despite massive government supports, its impact on Canada's economy will be dire, with soaring unemployment and GDP projected to fall by six percent or more in 2020.

The recovery will also differ from the past. It will likely be step-by-step, extended, and prone to setbacks – notably the risk of additional pandemic waves until a vaccine is widely available.

How can the economy be reopened while containing the threat of later waves? It will require a shift in mindset, strategy, and tactics, from broad intervention to more targeted action. The first phase has been about widespread containment by shutting large portions of the economy. It is beginning to flatten the curve, but with huge economic and fiscal costs.

The next phase of policy response should be about risk management. It will require a combination of phased reopening, smart public health practices in the workplace and specific locations, testing as much as possible, and constantly assessing the possible risks and the impacts on containment. Successful implementation of phase two will require more granular local and workplace data on the rate of spread and the risk of severe cases to calibrate the speed and nature of the path to a new normal.

At this point, it would helpful to have close alignment around a few principles that could help guide policy and business decision-making in the months ahead. We suggest the following.

Public transparency: Canadian leaders have largely been open and transparent about how the pandemic has progressed, and how the public health and economic policy response is evolving. Even more transparency during the recovery phase would help to reduce uncertainty and encourage buy-in from both the public and business.

Pan-Canadian principles with provincial implementation. The best approach for moving forward would be to develop principles that apply across the country, providing a consistent operating platform for business and the public. Each province and territory would then implement a recovery plan that reflects local conditions and expectations.

Be clear on the conditions: A key element of transparency would be to provide clarity on conditions for reopening the economy. Each province would be progressively reopening as its case curve declines, drawing on lessons from other jurisdictions, and ensuring the provincial healthcare system's ability to manage severe cases.

Consider business attributes that would promote a quick restart: A number of business attributes could be considered, such as the ability to start up quickly, notably by firms that retained access to their core workforce; ability to limit the number of employees in a workspace and the number of customers served at a time; the ability to shift business to a virtual platform; meeting market gaps where there are few substitutes; and the reliability of supply chains and access to key inputs.

Meet demand for the basics: While there will be pent-up demand from consumers who have maintained their jobs and income streams, it should be recognized that many Canadians continue to face heightened insecurity. Meeting the demand for basic goods and services from all consumers, by ensuring adequate supply is available, should be a priority.

Reopen public institutions: Other segments of the economy, notably our education and childcare systems, can prepare for reopening by defining the right conditions and timing. Susceptibility to the virus, ability to respect some degree of personal distance, and ability to test for the virus, are key criteria.

The next stage in managing the coronavirus will require a careful balancing act, aiming to restart the economy without sacrificing containment and population health. The principles and conditions suggested here would help to provide a foundation for sustained recovery.

Glen Hodgson is a senior fellow at the C.D. Howe Institute where William B.P. Robson is president and CEO.
To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Scott Baker, Nick Bloom, Steven J. Davis and Stephen J. Terry

To: Canadians Concerned about COVID-19's Economic Impact

Date: April 22, 2020

Re: **COVID-Induced Economic Uncertainty**

Major uncertainties surround almost every aspect of the COVID-19 pandemic from the virus itself to the human toll to the economic recovery.

The tremendous speed of the shock makes assessing the macro-economic uncertainty challenging. There are also problems of a lack of recent historic parallels. While the influenza pandemic a century ago offers a reasonable point of comparison in terms of mortality, it took place in a very different social, political and economic context.

To project the potential impact of the pandemic on economic outcomes, we need forward-looking uncertainty measures that are available in real time, or nearly so. No matter how good the model linking uncertainty to GDP growth, for example, we can't expect the model to give useful answers without sensible inputs. Thus, we need timely, forward-looking measures.

Consider five measures of uncertainty and how they stack up:

Stock Market Volatility: The VIX, which reflects the forward-looking volatility implied by options on the S&P 500 index, rose by about 500 percent from mid-January to the end of March. This forward-looking measure starts in 1990 and is available daily in real time.

Newspaper-Based Measures: Examples include the Economic Policy Uncertainty (EPU) indices available here. These indices reflect the frequency of articles with one or more terms about "economics," "policy" and "uncertainty" in leading national newspapers. The figure below displays monthly indices for Canada and the United States. Each index is normalized to 100 from 1985 to 2010, so values above 100 reflect higher-than-average uncertainty. Each country experienced extremely large EPU jumps from February to March. Canada's index stands at 553 in March 2020, the highest in the history of the series back to 1985. The US index stands at 427, also the highest ever.

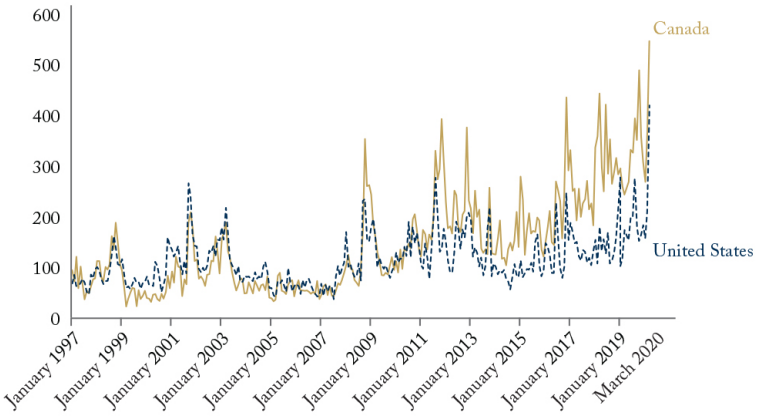
Newspaper-based measures of uncertainty are forward looking in that they reflect the real-time uncertainty perceived and expressed by journalists. They also offer a ready ability to drill down into the sources of economic uncertainty and its movements over time, as contemporaneously perceived. More than 90 percent of newspaper articles about economic policy uncertainty in March mention some pandemic related term.

Business Expectation Surveys: These surveys elicit forecast distributions over each firm's own future sales growth rates at a one-year look-ahead horizon. By calculating each firm's subjective standard deviation about its own future growth rate forecast in a given month, and aggregating over firms in that month, we obtain an aggregate measure of subjective uncertainty about future sales growth rates (see the early March US and UK data). Developing a similar survey for Canada would give policymakers and business leaders a useful new source of information about the economic outlook.

Forecaster Disagreement: Examples include the dispersion of point forecasts about macroeconomic outcomes among participants in the Survey of Professional Forecasters (SPF). The typical disagreement measure is the standard deviation of point forecasts across the 50 odd forecasters that provide regular forecasts. There is a long history of using such disagreement measures to proxy for uncertainty (and a long history of disagreement about their suitability for that purpose). For our present purpose, there is a practical issue: The most recent SPF data are from mid-February, the COVID spread beyond China, and its quarterly frequency results in a data lag too long for periods of rapid change.

Statistical Forecast Uncertainty: Examples include models that predict uncertainty from past volatility or the forecast uncertainty implied by a large statistical model, as in prominent research by Kyle Jurado, Sydney Ludvigson and Serena Ng. These approaches can be used to generate time-varying measures of forecast uncertainty for GDP growth, industrial production, employment, trade, and other standard measures. They capture recurring relationships in the data – for example, the strong propensity for the volatility of many economic measures to rise in recessions – but their backward-looking character makes them less useful in the wake of abrupt shifts and once-in-a-century shocks. Long lags in the availability of key data inputs into statistical models of this type, 60 days or so, are another serious limitation for real-time uncertainty measurement, especially in the wake of sudden and unusual shocks.

Economic Policy Uncertainty Index Values, Canada and the United States.
January 1997 to March 2020.



To summarize: The COVID-19 pandemic created an enormous uncertainty shock – larger than the financial crisis of 2008-09 and more similar in magnitude to the rise in uncertainty during the Great Depression of 1929-1933. We need real-time, forward-looking uncertainty measures to project the full impact of the pandemic on the economy. Some of our recent research illustrates how to make such projections. Using stock-market measures as inputs, we project that the COVID-19 shock will cause US real GDP to contract 11 percent in the fourth quarter of 2020 on a year-on-year basis.

Scott Baker is associate professor of finance at the Kellogg School of Management, Nick Bloom is professor of economics at Stanford University, Steven J. Davis is professor of economics at Chicago Booth and senior fellow at the Hoover Institution, and Stephen J. Terry is assistant professor of economics at Boston University.

To send a comment or leave feedback, email us at blog@cdhowe.org.

COVID-19 Crisis Business Continuity and Trade Working Group

Communique #5: Restart Playbook Must Balance Risks with Economic Costs

To help Canadian governments confront the public health and economic crisis resulting from COVID-19, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The Working Group on Business Continuity and Trade is co-chaired by Dwight Duncan (Senior Strategic Advisor at McMillan LLP and former Ontario Minister of Finance) and Jeanette Patell (Vice-President of Government Affairs and Policy for GE Canada). Its membership includes industry experts and economists. Support from the C.D. Howe Institute is provided by Daniel Schwanen (Vice-President, Research) and Grant Bishop (Associate Director, Research). Meeting weekly, it identifies and prioritizes policy challenges and communicates members' views in published communiques. The group's fifth meeting was held on Tuesday, April 21, 2020.

The working group recommends a transparent, pan-Canadian framework for staging and managing the restart of the Canadian economy. Federal and provincial governments should collaborate to develop this "playbook," which should identify the principles, processes, metrics and milestones for staging a gradual return to work. This should be a "living" framework, with transparent communication of decision-making criteria and relevant data. The aim should be to anchor expectations and planning by businesses and families – analogous to forward guidance and "contingent commitments" by central banks.

As recently outlined by Glen Hodgson and Bill Robson, governments should apply a principled risk management approach to formulating this playbook.[1] Recommended principles for this playbook are:

1. Transparent pre-conditions for each stage of easing economy-wide restrictions.
2. Pan-Canadian consistency in principles, decision-making criteria and data.
3. Sector-level staging for restart based on workplace transmission risks and economic impacts.
4. Safeguarding access to essential goods and services.
5. Synchronized re-opening of enabling public services and infrastructure.
6. Clear off-ramp for government-provided temporary income supports.

1 Glen Hodgson and William B.P. Robson. 2020. "Some principles for an economic restart." C.D. Howe Institute Intelligence Memo. April 21. Available online: https://www.cdhowe.org/intelligence-memos/hodgson-robson-%E2%80%93-some-principles-economic-restart

Pre-conditions for economy-wide re-opening of the economy should be based on public health expert judgment and modelling and informed by monitoring. Based on epidemiological modelling, a playbook should identify the acceptable thresholds for (1) virus spread and (2) health system capacity at which governments will plan to ease restrictions. The sequence for easing sector-level restrictions should be based on the:

- potential extent of population exposure from the activity;
- probability of transmission in the sector/workplace;
- workplace-level protocols for health and safety practices required to mitigate transmission; and
- balance between risk tolerance and economic costs from restrictions on the activity.

While provincial governments should continue to make decisions about local emergency measures, federal coordination can reduce fragmentation in decision-making and protocols. In particular, the federal government should identify appropriate pre-conditions, monitor and report key public health indicators, and standardize health & safety guidance and risk-rating for specific sectors.

While governments should now plan for restart, working group members also stressed that "we are not out of the woods." The magnitude of the economic contraction means that many sectors and companies will continue to face unprecedented commercial challenges and looming financial distress. Although federal and provincial governments have established various credit supports for businesses, companies continue to face fixed costs and other financial obligations. With the likelihood of a protracted downturn in demand for exports and continuing restrictions on workplace activities, this will place unprecedented stress on company balance sheets. Governments will need to make and communicate difficult decisions about which sectors and companies receive direct financial support.

Pan-Canadian "Restart Playbook" with Provincial Implementation

The working group notes that provincial governments are best situated to manage emergency measures, given their capacity for service delivery and information to calibrate measures to local conditions. The federal government can play a facilitating role by working with provinces and industry leaders to develop pan-Canadian principles and guidelines.

Working group members highlighted the example of Australia, where the federal government has assembled a national coordination committee, leveraging industry leadership and sector-level task forces.[2]

2 See: Australian Government. 2020. "NCCC sets up expert group to help keep workplaces safe through COVID-19." April 21. Available online: https://pmc.gov.au/nccc/news/nccc-sets-expert-group-help-keep-workplaces-safe-through-covid-19

Provinces have jurisdiction for public health measures and will ease restrictions at different times. However, federal coordination can help reduce fragmentation and provide some consistency.

Echoing recent proposals,[3] the working group recommends governments actively leverage industry working groups with knowledge of frontline operations and expertise on occupational health and safety. By collaborating with industry, governments can formulate appropriate standards and protocols that safeguard employees and facilitate a graduated return to work.

"Restart Playbook" with Metrics and Milestones to Manage Risks and Anchor Expectations

The restart playbook should address uncertainty and provide anchors for expectations by businesses and families. This involves specifying the pre-conditions and sequencing for easing restrictions on different activities and workplaces. Governments should equip families and households to make contingent plans and anticipate how public health measures would change in response to evolving conditions.

Political decision-makers would need to define the acceptable level of risk; however, modeling of the probability of virus spread, disease severity and health system capacity would provide estimates for risk levels. For example, at a current rate of virus spread and hospital admissions, epidemiological models could be applied to estimate probabilities or the number of days until cases exceed local health system capacity. Using these estimates for risk, governments could specify pre-conditions or milestones for each stage of restart readiness.

Governments' playbook should also provide a framework for assessing the workplace-level risks of transmission of the virus and balancing this against the economic impact on different sectors/activities. Health and safety standards for individual workplaces should be calibrated based on input from experts on operations and health and safety. The aim should be to implement an appropriate level of control to minimize exposure and transmission risks for those in the given workplace.

Off-ramp for Temporary Emergency Income Support

The federal government must also outline the off-ramp for its temporary income supports under the Canada Emergency Response Benefit (CERB) and Canada Emergency Wage Subsidy (CEWS).

3 See: Robson, William. 2020. "Governments should rely on industry task forces to advise on restarting the economy," Globe & Mail. March 13. Available online: https://www.theglobeandmail.com/business/commentary/article-governments-should-rely-on-industry-task-forces-to-advise-on/

CERB and CEWS were established as necessary emergency measures during the unprecedented shutdown of the Canadian economy.

However, the federal government must be conscious of the fiscal cost and the incentive effects from the programs. While both programs are essential to preserve families through the crisis and prevent permanent destruction of household net worth, they must be ramped down as the economy restarts.

For example, working group members pointed to anecdotal evidence that CERB has reduced certain workers' willingness to accept work – particularly where workers perceive a risk of exposure to transmission. Working group members emphasized that the federal government should not phase out CERB until workers have available options for safely returning to work and that financial circumstances should not compel workers to accept work with high risk of exposure to the virus.

To this end, ahead of the phase-out of CERB, governments must ensure that appropriate workplace-level health and safety measures are in place. To address workers' risk perceptions, governments and employers will need to be actively communicating information about the risks of transmission and the effectiveness of workplace mitigation measures.

Assess and Address Systemic Risk in Enabling Sectors

While the "restart playbook" should be the immediate priority, governments must also identify and address sources of "systemic risk" to the economy and potential "scarring" that could impair economic recovery. Governments must assess the risk of financial distress in sectors that play an enabling role for wider economic activity. The financial distress of certain companies may have knock-on effects throughout supply chains or for other sectors.
For example, the steep plunge in demand will likely drive significant financial distress in the energy and aviation sectors. Canadian banks may have significant exposure to these industries and governments must assess the potential for systemic risk from these sectors.

Certain companies will face insolvency and financial restructuring, and governments cannot backstop every business. Governments will face difficult decisions about which companies or industries will receive targeted financial assistance – and which do not. For example, during the 2008-09 financial crisis, the federal and Ontario governments provided financial support to certain large automakers but not others and also did not provide similar direct aid to auto-parts suppliers. These decisions were based on the central role of those certain large automakers in the industry and the risk of systemic risk to the entire industry and wider economy if they failed.

Governments should formulate a principled framework to make and communicate these difficult decisions regarding targeting financial support to specific sectors and companies. Such a framework should focus on: maintaining business continuity for operations that are integral to the wider economy; risk-sharing by existing creditors and shareholders; limiting financial exposure for governments; a coherent path to commercial viability post-crisis; and a clear "exit plan" for public financial support.

Working Group Members

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Caroline Hughes*, Vice-President of Government Relations, Ford Motor Company of Canada

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Elise Maheu, Director, Government Affairs and Markets. 3M Canada

Geoff Smith, President & CEO, EllisDon

John Stackhouse, Senior Vice-President, Office of the CEO, Royal Bank of Canada

Trevor Tombe, Associate Professor of Economics and Public Policy, University of Calgary

* Denotes not in attendance at April 21st meeting.

From: Daniel Schwanen and William B.P. Robson

To: Canadians Concerned about Reopening the Economy

Date: April 29, 2020

Re: **Our lessons in loosening lie in Europe**

With encouraging signs on the COVID-19 health front, and mounting evidence of the costs of containing it, attention has shifted to the world's economies. This is a global pandemic, and many countries have begun to reopen on their own terms. Here in Canada, governments in Ontario, Saskatchewan, Prince Edward Island and New Brunswick have announced plans for lifting some constraints.

What can we learn from progress elsewhere?

Many jurisdictions we would like to imitate – Taiwan, South Korea, Hong Kong – are in a class of their own. They imposed targeted travel checks and restrictions early, built more testing capacity, produced more protective equipment, and implemented electronic monitoring or tracing to a degree that – even if we could – we would hesitate to use. Plus, their main supplier and market, China, restarted manufacturing weeks ago.

Two other countries we often look at, Australia and New Zealand, are also in the unattainable group. They are island countries that clamped down on travel and domestic activity early and hard. We can look to them, like their Asian neighbours, for hopes about where we may be by fall, but we cannot jump immediately from here to there.

We don't want to end up among a second group of countries where restrictions on activity were later, fewer and milder. Some, such as Singapore and Japan, had reassuringly few cases early on, but more recently reacted to increases with clampdowns. Sweden, another country with a less restrictive approach, has so far stayed the course, but Britain, which also started easier, tightened up as cases and deaths mounted.

Canadian provinces that got off to a bad start – notably Quebec and Ontario, and seemingly Nova Scotia – have paid a heavy economic price to bend the COVID-19 curve. We want to build on that progress, not slip back.

Then there's a third group abroad, which has the most relevant lessons for Canada. Mainly in Europe, some of these countries suffered worse ravages early on, imposed heavy restrictions and are now relaxing them.

Denmark and Israel, for example, clamped down quickly after confirming their first cases and also did well in ramping up testing. Italy and Spain suffered horrendous outbreaks, but have contained them with physical-distancing measures, restrictions on movement, and business and institutional closings like ours. Italy imposed penalties for breaking movement restrictions, including between municipalities. In addition to closings, Austria made face masks mandatory early on. Germany forbade more than minimal public gatherings.

This third group, which is ahead of us in containing the virus, will teach us a great deal as we approach the next stage. Many are reopening schools and daycares, so that education resumes and people with children can get back to work. They are reopening businesses, prioritizing urgent services and those small enough or otherwise configured to minimize health risks to employees and customers. All continue to impose or urge physical distancing and, for the time being, restrictions on gatherings. Many have layered on restrictions such as compulsory face masks on public transit. They are all stepping up testing, monitoring and electronic tracing. They are all wrestling with the balance between intrusive surveillance and contact tracing and civil liberties – the same tensions Canada must deal with in the weeks and months ahead.

Then there is the United States – geographically close by and vitally important as Canada seeks to return to full production. As in Canada, COVID-19 has affected different US regions differently. Late in reacting in many ways, the US is nevertheless flattening its curve. Even hard-hit New York and Michigan are seeing progress and taking small steps toward lifting restrictions. That is good news for us – we want them to be physically and economically healthy, for their sake and ours.

As with the struggle on the health front, a key looming challenge will be sorting out information that is reliable and relevant. We cannot get to where the leaders are right away. But we are in better shape than the laggards. Let's look to countries such as Denmark, Israel and Austria, which are ahead in containing the disease and getting back to work – just as we hope to do soon.

Daniel Schwanen is vice-president, research, and William B.P. Robson is president and chief executive officer, at the C.D. Howe Institute.
To send a comment or leave feedback, email us at blog@cdhowe.org.

From: Daniel Schwanen and Rosalie Wyonch

To: Policymakers for The Economic Reopening

Date: April 29, 2020

Re: **Local Removal of Restrictions Imposed to Fight the Spread of COVID-19**

As jurisdictions plan the dismantling of pandemic inspired restrictions on economic and social life, they need to ensure that new cases of COVID-19, and the urgent caseload, are firmly under control, and that remaining or newly emergent cases can more easily be identified and isolated.

Gaining this assurance depends on accurate surveillance, through access to testing and rapid response to cases and contacts. Indeed, some jurisdictions around the world with these capacities were able to impose fewer restrictions to begin with.

Some jurisdictions, such as New York State, explicitly contemplate lifting restrictions in some areas, while leaving in place more stringent ones in areas where the caseload remains problematic. US federal guidelines for removing restrictions even mention a "county-by-county" approach, where it makes sense.

The very success of maintaining such differentiated measures in otherwise neighbouring jurisdictions has depended crucially on limiting mobility between regions where infection risk is high, and others where it is manageable.

If there is no mobility of people between regions, the lifting of restrictions first in areas where the disease appears well contained, does not pose a policy problem from a containment perspective, though some additional protective measures for vulnerable population groups within regions are advisable.

Indeed, some Canadian provinces are already policed as to severely limit travel between more and less vulnerable regions, for example between the Far North public health region of Saskatchewan, home to 42 of the province's 72 active cases, and the rest of the province, or even between rural areas and main centres within Quebec administrative regions.

What about eventually lifting travel restrictions between areas where the disease appears well under control and are reopening some activities and others where the disease is still at large, permitting family visits and even some tourism?

The main international cautionary tale in this respect is Hokkaido, Japan, both an island and distinct administrative prefecture. Hokkaido had managed to reduce the spread of the disease by mid-March that it lifted its school closures, stay-at-home advisories and other measures imposed after its first case emerged in February. But it did not restrict travel to and from other regions of Japan, and is now dealing with a deadly flare-up of the disease and was forced to reinstate its lockdown last week.

According to Professor Kenji Shibuya of King's College London: "The major lesson to take from Hokkaido is that even if you are successful in the containment the first time around, it's difficult to isolate and maintain the containment for a long period. Unless you expand the testing capacity, it's difficult to identify community transmission and hospital transmission."

Here, the "layering" of other measures that would minimize the likelihood of people in more restricted areas visiting areas with fewer restrictions, provides important context.

"Stay-at-home" recommendations, if followed, would prevent people in one area of a province in which hair salons and restaurants remain closed, from seeking to visit such businesses in a part of the province where they would be open.

Loosening the public health guidance that discourages non-essential or recreational travel between regions in different phases of reopening would be very risky without some way of tracing such movements. It would at a minimum require beefed up testing in areas deemed less risky, in order to be able to identify quickly the source of a resurgence of the disease in those areas, and the application of quarantines where necessary in the latter case.

Ultimately, as suggested by Shibuya, testing and tracing capacity and proper quarantine policies is key to restoring mobility between areas that may or may not be at higher risk of the disease flaring up, as well as simply the key to the gradual lifting of restrictions everywhere.

We are seeing this in other countries, such as Taiwan, where restrictions are locally precise – the closing of a school for 14 days rather than closing the entire school system for months – because of the ability and willingness to identify, trace, and quarantine problem persons or groups quickly, and where mobility is not otherwise restricted.

Provinces should issue guidelines, accompanied by any necessary legislative change, addressing the ability to identify and trace the movements of infected persons, and alert those with whom they might have been in contact, if they wish to enable the lifting of current restrictions at significantly different speeds in different areas of their province, while restoring greater mobility between these areas.

Daniel Schwanen is vice-president, research, and Rosalie Wyonch is a policy analyst at the C.D. Howe Institute.
To send a comment or leave feedback, email us at blog@cdhowe.org.

COVID-19 Crisis Business Continuity and Trade Working Group

Communique #6: For resilient re-opening, test, trace and target support

To help Canadian governments confront the public health and economic crisis resulting from COVID-19, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The Working Group on Business Continuity and Trade is co-chaired by Dwight Duncan (Senior Strategic Advisor at McMillan LLP and former Ontario Minister of Finance) and Jeanette Patell (Vice-President of Government Affairs and Policy for GE Canada). Its membership includes industry experts and economists. Daniel Schwanen, Vice-President, Research, and Grant Bishop, Associate Director, Research, at the Institute support the group. Meeting weekly, it identifies and prioritizes policy challenges and communicates members' views in published communiques. The group's sixth meeting was held on Tuesday, April 28, 2020.

At this meeting, the working group emphasized the need for:

- Greater detail in provinces' restart/recovery playbooks, including clear thresholds and indicators for decision-making about the easing of restrictions;
- Rapid ramp-up of testing and contact tracing, as well as transparency around data and models, to manage public health risks during restart;
- Modification of rules for federal wage and commercial rental support to include businesses that may otherwise face layoffs and closure;
- Targeted business credit to "bridge" companies over immediate liquidity needs; and
- A principled approach for government support for long-term restructuring of key distressed sectors and companies.

The working group noted that a growing list of provinces are publishing frameworks and roadmaps for easing restrictions and re-opening their economies. While still requiring more detail and target dates, such frameworks help anchor expectations for businesses and households.

Based on international experience, governments must increase widespread testing and robust contact tracing to support the reopening of the economy. Widely available testing and effective tracing are essential to manage risks for health system capacity and workplace transmission. While balancing individuals' privacy rights, employers and governments must be able to rapidly identify risks to specific workplaces and public health. Governments should regularly publish granular epidemiological data

and modeling so that the civil society can participate in informed discussions about the pace of restart, easing of restrictions and the balance of risks.

The re-opening is likely to be gradual and many headwinds may slow the pace of economic recovery. Businesses' revenues have plunged as the crisis has inflicted an unprecedented shock to demand for consumption, exports and capital investment. No business could self-insure against this present shock, and imminent failure of many businesses – particularly small and medium-sized enterprises – could severely impair the pace of recovery.

The working group recommends that policymakers distinguish between "backstops" and "bailouts." Providing temporary "bridge" financing for immediate liquidity needs is distinct from government participation in long-term support for the restructuring of distressed companies. While governments must be conscious of taxpayer exposure, ensuring access to near-term credit is essential for businesses to be able to cover fixed costs. Widespread business failures would "scar" the economy and substantially impair the pace of recovery. As an option for rapid financial support, certain members recommend expanded use of partial guarantees for credit through commercial banks and other lenders. This would allow governments to leverage the existing credit infrastructure to channel the necessary financing.

The federal government should also address rules around the Canadian Emergency Wage Subsidy (CEWS) and the recently announced (but not yet detailed) Canada Emergency Commercial Rent Assistance (CECRA) program. For CEWS, rules on revenue recognition from non-arm's length corporate affiliates risk excluding domestic employers that are integrated in multinational enterprises' production chains. For CECRA, the requirement for landlord consent to rent reduction is likely to exclude many commercial tenants.

Even with near-term credit support, governments should expect a wave of corporate distress. For certain sectors, the downturn in demand is likely to be protracted. Governments will face political pressure to support specific failing companies and distressed sectors. Although the present crisis is distinct from the 2008-09 "credit crunch," governments should draw on past experience (e.g., restructuring of major auto-manufacturers) to define rigorous and principled criteria for decision-making and design of long-term, company-specific support. In the present crisis, governments lack internal capability for adequate due diligence in the face of the likely scale of impending corporate distress and restructuring. Therefore, governments should leverage due diligence by the private sector and should not let politics supersede objective evaluations of companies' long-term commercial viability. The working group agreed that bailouts should be a last resort and have strict conditions, including a clear plan for long-term viability and an exit for taxpayers.

Ramp Up Widespread Testing and Contact Tracing

Countries are now publishing plans for the graduated easing of restrictions and re-opening of activities. These plans provide examples that Canada can leverage.[1] From a survey of restart frameworks internationally, a series of common practices emerge (Table 1).

Table 1: Common Practices for Restart

Common Practices	Observed Application
Clear pre-conditions for restart staging based on four principles	1. Spread under control: trend of declining new cases over two weeks, or very low and manageable numbers, typical before reopening
	2. Health system "buffer" capacity: Indicators include sufficient ICU beds for COVID-19 cases (bed utilization now low in parts of EU and Canada); health system can meet non-COVID needs (e.g., surgeries) even with surge
	3. Ramp up of testing and contact tracing capabilities to identify new clusters/spread and contain transmission
	4. Confirmation of "steady state" for each stage before further easing
New or continuing restrictions during restart	• Required social distancing in public places and shops (occupancy limits) • Facemasks required where crowding unavoidable (e.g., public transit) • Limits/screening for contact with vulnerable populations (e.g., elderly)
Regional and local calibration	• Maintenance of local quarantines on specific regions or cities while gradually easing for regions where local risk meets pre-conditions • Differential pace of easing between regions requires limits on individual movement between different regions
Complementary measures	• Opening of daycares and elementary and secondary schools to enable parents to attend work
	• Electronic tracking (generally non-compulsory) integral to many countries re-opening plans • Anonymity and eventual data destruction is key to public acceptance.
	• Coordination with border and immigration officials for mobility and isolation controls for foreign workers in essential sectors
Activity- and workplace-specific health and safety measures	• Employers required to take specific workplace measures based on character of work • Staggering of shifts and rotation of employees in office to minimize exposure
Protocol for rapid response to new cases	• Quarantine for individuals with probable or confirmed infection • Workplace and school closure when a case is confirmed

1 Schwanen, Daniel, and Bill Robson. 2020. "The best lessons from abroad about reopening our economies are in Europe." Globe & Mail. April 27. Available online: https://www.theglobeandmail.com/opinion/article-the-best-lessons-from-abroad-about-reopening-our-economies-are-in/

This working group has recommended that government prescribe transparent pre-conditions for each stage of re-opening – in particular, specifying the thresholds for spread of the virus and health system capacity for each stage of easing restrictions.[2] As regions and cities re-open to differing degrees, international experience also highlights the need to calibrate restrictions locally and consider inter-regional mobility restrictions to prevent spread.[3]

As an immediate priority, the working group emphasized the need to expand testing and tracing to improve data on caseload across the population. Without a sufficient sample of the population, the confirmed caseload will understate the extent of transmission. From data as of April 23rd, Ontario and Quebec continued to lag peers, having relatively high ratios of confirmed cases to testing and relatively low per capita testing (Figure 1).

The ramp-up of testing and contact tracing must engage employers – particularly those with large workplaces that could be settings for transmission. As part of the return to work, employers must have clarity on pathways and procedures for screening employees and ensuring that employees are not exposed in the workplace. This will be essential for worker confidence for a safe return to work. Governments should consider what access employers should have to private testing to safeguard workplaces. Working group members also highlighted that workplace-level health and safety measures and clear protocols for addressing new cases will be critical for resilient reopening.

Distinguish "Backstops" from "Bailouts"

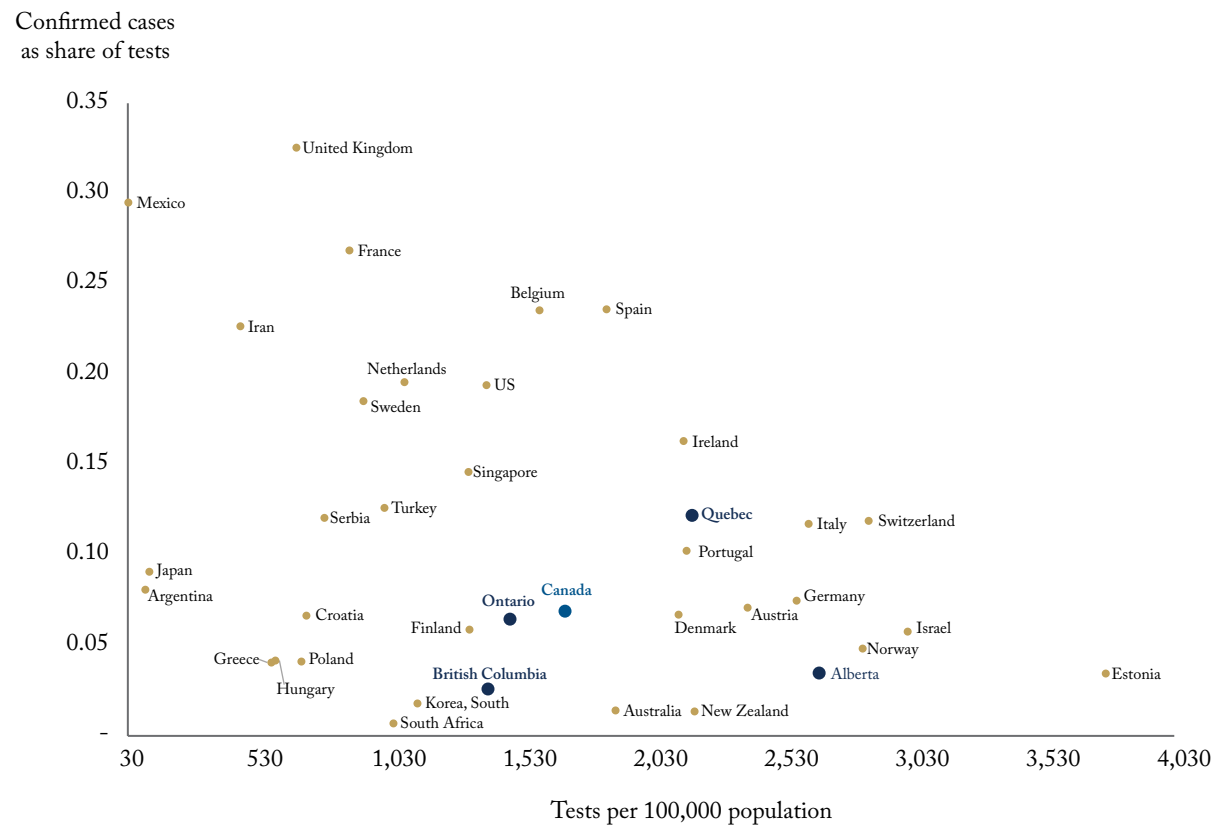
Working group members emphasized the magnitude of revenue downturn for many businesses and, without access to credit, the likelihood of financial distress and business failure for many businesses – in particular, small and medium-sized enterprises.

Members believe governments should distinguish between categories and staging of support for companies. Specifically, response to financial constraints from the crisis will involve two distinct stages:

2 Business Continuity and Trade Crisis Working Group. 2020. Restart Playbook Must Balance Risk with Economic Cost. Available online: https://www.cdhowe.org/council-reports/restart-playbook-must-balance-risk-economic-cost-crisis-working-group-business-continuity-and-trade

3 Schwanen, Daniel, and Rosalie Wyonch. 2020. *Local Removal of Restrictions Imposed to Fight the Spread of COVID-19*. C.D. Howe Institute Intelligence Memo. April 29. Available online: https://www.cdhowe.org/intelligence-memos/schwanen-wyonch-%E2%80%93-local-removal-restrictions-imposed-fight-spread-covid-19

Figure 1: Comparative Extent of Testing (as of April 23, 2020)



Sources: John Hopkins, provincial governments, Statistics Canada, CIA World Factbook.

(1) "Bridge" financing to support many businesses over the next 60 to 90 days; and
(2) Restructuring of an impending wave of financially distressed companies.

For the first stage, government must continue to leverage existing commercial banks and other lenders, supplemented by credit through agencies like Export Development Canada (EDC) and the Business Development Bank of Canada (BDC). Governments can further leverage private lending channels by expanding guarantees or interest payment support.

For the second stage, governments must define a principled framework for selecting companies and designing support. Such a framework will be critical to de-politicize the selection of support for particular companies and sectors.

Bailouts Should be a Last Resort and Have Strict Conditions

Working group members emphasized that governments lack institutional capability for due diligence of individual companies. Private investors have greater expertise for evaluating companies' long-term viability and creating restructuring plans. Moreover, a government could confuse its own role and displace private-sector discipline by providing at-risk capital to specific companies. Certain sectors face great uncertainty about future market conditions, and Working Group members believe that governments are generally poorly equipped to assess long-term commercial risks.

Group members stressed the differences between the 2008-09 "credit crunch" and the current crisis. In particular, during the credit crunch, financial institutions faced paralyzed financial markets and wholesale funding constraints. Additionally, the focus of government support during the credit crunch involved a relatively small number of large companies. In contrast, the present crisis is likely to trigger widespread insolvency and the restructuring of potentially hundreds of significantly sized firms.

Experience during the 2008-09 financial crisis – specifically, support for certain auto manufacturers – provides some lessons for criteria and design of government support.[4] Requirements for support would be:

- Systemic impact from failure on the wider economy – for example, an operator of a critical network or a lynchpin customer/supplier for a given sector.
- Market failure in the availability of financing on the required scale – for example, an impairment in financial markets or institutions that inhibits the availability of credit.
- Rigorous, commercially driven evaluation of a company's long-term viability.
- Capability for effective due diligence by government or commercial partners.
- Clear and robust plan for viability post-restructuring.
- Appropriate loss-sharing by existing equity-holders and creditors.
- Rigorous limits on management (e.g., pay and perquisites).
- Clear "exit plan" and limits on taxpayer exposure.

Members emphasized that government should only intervene where and to the extent that an identifiable market failure would hinder private investors and regular restructuring processes (e.g., through the *Companies Creditors Arrangement Act*) from operating effectively.

4 For example, see: Paul Boothe 2020. "Taxpayer bailouts for big corporations should be a last resort." Maclean's. April 27. Available online: https://www.macleans.ca/economy/economicanalysis/taxpayer-bailouts-for-big-corporations-should-be-a-last-resort/

Refine Support Measures Based on Business Feedback

Working Group members expressed appreciation for the unprecedented pace at which the federal government has established important new measures to support businesses and workers through the crisis. However, they emphasized unintended consequences – particularly where rules unintentionally or irrationally exclude certain businesses or workers.

For example, members highlighted rules concerning the treatment of sales to non-arm's length foreign affiliates in determining whether an employer had experienced the required decline in revenue to qualify for the wage subsidy under CEWS. Specifically, under the legislation for CEWS, revenue from non-arm's length affiliates may be excluded when determining whether a Canadian employer has experienced the required decline in revenue of 15 percent for March and 30 percent for April and May. This can result in excluding Canadian employers from the wage subsidy who both sell finished products and are also part of internationally integrated manufacturing operations.

Many Canadian manufacturers sell all production to foreign affiliates, which then integrate the parts or finish the given product. However, these Canadian companies often also sell finished goods to non-arm's length customers. Such Canadian employers will be ineligible for CEWS even though their recognition of revenue from their non-arm's length affiliates must meet rigorous transfer pricing requirements for other tax purposes. Excluding such major employers from the wage subsidy is likely an unintended consequence of the legislation. Working group members recommend that the federal government rectify the exclusion in order to safeguard employment by these companies.

As well, while the federal government announced assistance for commercial rent, many businesses are confused about the qualifying criteria and concerned about the requirement for a landlord's consent to rent reduction in order to qualify for the support. Businesses fear that failure to negotiate the required rent reduction will exclude them from support.

Members of the Business Continuity and Trade Working Group

Dr. Sylvain Charlebois*, Professor, Senior Director, Agri-Food Analytics Lab, Dalhousie University

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Elise Maheu*, Director, Government Affairs and Markets. 3M Canada

Geoff Smith, President & CEO, EllisDon

John Stackhouse, Senior Vice-President, Office of the CEO, Royal Bank of Canada

Trevor Tombe, Associate Professor of Economics and Public Policy, University of Calgary

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* denotes not in attendance at April 28st meeting.

From: Daniel Schwanen and William B.P. Robson

To: Canadians Concerned about Re-opening the Economy

Date: May 27, 2020

Re: **ONTARIO NEEDS MORE CLARITY ON ITS RE-OPENING PROCESS**

Re-opening locked-down economies is not easy. Because governments did the locking down, governments are key to the re-opening. How Ontario's government manages it, given the province's demographic and economic weight, will have consequences across the country.

Ontarians and Canadians could do better if the province followed the example of other jurisdictions and published a clearer and more comprehensive re-opening plan.

Where can Ontario look for ideas? Its immediate Canadian neighbours, Manitoba and Quebec, are not very helpful examples. Manitoba re-opened earlier but never had a per capita caseload anything like Ontario's. Quebec still has a worse caseload and had to backtrack on relatively aggressive early re-opening plans when its numbers refused to improve.

More relevant examples for Ontario are New York state, Alberta and France. All have had alarming numbers. All have phased plans for re-opening. But they are moving more decisively than Ontario, including dealing with such fraught issues as regional differentiation, testing and contact tracing.

Like Ontario, New York has a phased plan, but it is clearer both about what happens in each phase and what criteria allow a move to the next phase. Five regions of the state met the criteria and went to phase 1 on May 15; two more regions just followed.

Along with criteria such as a declining number of new cases and hospital capacity, New York's conditions for re-opening include requirements both for the availability of tests and for having sufficient contact tracing teams up and running within a region. The state stepped up testing weeks ago – including antibody testing, which is only just getting underway in Canada. So far it has conducted more than twice as many tests per capita as Ontario.

On May 14, following plans announced two weeks earlier, Alberta re-opened everywhere for dentists, other medical professionals, some retail stores, museums, art galleries and daycares. Bars and restaurants (table service only), hair salons and barbershops could also re-open as of that date, except in Calgary and Brooks, where they remained closed until this week. Alberta has not announced a date for its second or third phases of re-opening but it has specified a number of businesses that will be allowed to re-open when these take effect.

With a slightly lower per capita caseload than Ontario's, Alberta has conducted 20 percent more tests per person. On May 1, it made an encrypted tracing app available and recommended that people download it to their phones and use it when in public. Teams of contact tracers will get back to those who test positive and, if they consent, to anyone they have had contact with.

COVID-19 hit France much harder than Ontario. But with France's per capita rate of new cases now a quarter of Ontario's, it has been lifting its lockdown. On May 11, shops, parks, small museums and libraries and some schools re-opened in many parts of the country. Markets and malls could also re-open, subject to local authorities' approval. France has also announced which businesses and activities can operate in subsequent phases and when that's likely to be – cinemas and theatres on June 2, restaurants and bars on June 15.

France is re-opening more slowly in regions where risk of resurgence is higher, as defined by the number of new cases, the capacity of the health system and the ability to meet testing targets. This multi-speed approach is possible because travel across departmental lines will be restricted to a 100-kilometre radius. France has an aggressive testing strategy with the goal of testing just over one per cent of its population – 700,000 people – every week. Tracing "brigades" will hone in on the previous contacts of any new case.

Ontarians in general, and Ontario businesses in particular, would be better able to plan if – like New York, Alberta and France – the province published a clear list of activities and dates for the next phases of re-opening, along with a more precise idea of what will guide it in allowing each next step. Such information would make everyone's stake in keeping the relevant numbers low more obvious.

Robust testing and tracing let governments offer such clarity, especially for regionally differentiated re-opening. Ontario has accelerated its testing this month but remains noticeably behind Canadian leaders Alberta and Quebec on that score. And we don't yet know the details of a tracing plan.

We are all in this together. Ontario can help both itself and the rest of Canada by being more specific about the phases of, and conditions for, its re-opening.

Daniel Schwanen is vice-president, research, and William B.P. Robson is president and chief executive officer, at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

A version of this memo first appeared in The Financial Post.

Intelligence MEMOS

From: David A. Green, Gaëlle Simard-Duplain, and Henry E. Siu

To: Policymakers across Canada

Date: June 2, 2020

Re: **A COVID Assessment Tool to Guide the Opening and Closing of Sectors**

Since early May, the number of new Canadian COVID cases and – importantly – the number of COVID-related deaths, is on a downward trajectory. Now, public attention and policy concern has turned to the relaxation of public health measures, and the staged renormalization of economic activity.

The VSE COVID Risk/Reward Assessment Tool fills the void in information and analysis needed for evidence-based economic re-opening strategies. Based on 300 occupations across 100 industries, it can also serve as a common knowledge base upon which federal and provincial guidelines are formulated.

The tool is constructed at the provincial level. It allows policymakers to see the risks and benefits of re-starting various sectors of a province's economy (or, if needed, re-introduction of closures or restrictions if a second wave emerges.) In addition, it lets policymakers compare occupations in terms of viral transmission risk, allowing the identification, within sectors, of areas that require particular attention.

In terms of benefits to re-opening, sectors can be compared along three dimensions.

The first is simply the size, in terms of employment or GDP.

The second is sectoral employment losses from February to April. (The tool also allows users to focus on job loss in the bottom quartile of the wage distribution where the effects of recessions, this one included, are disproportionately borne.)

Finally, sectors can be organized by their centrality: how essential they are to the functioning of all other sectors of the economy.

The VSE Risk Index captures the risk of viral transmission faced by returning workers in a given occupation. The risk scores of individual occupations can then be aggregated to produce the risk score of various sectors.

But the index also captures life outside of work.

This unique and important feature combines occupational characteristics – proximity or close contact with others, frequency of personal contacts, exposure to diseases or infections, interaction with the public, and outdoor work – and worker characteristics – commuting on public transit, working from home, living in a crowded dwelling, and living with a health care worker – to form a comprehensive measure of risk.

The variables included in the index were determined through discussions with experts at the BC Centre for Disease Control and the Institut national de santé publique du Québec (INSPQ). Since currently available data does not allow us to directly observe SARS-CoV-2 transmission risk, a key issue is determining how to aggregate the various occupational and worker characteristics into a single index. To the extent that these characteristic measures vary together, they can be thought of as capturing changes in an underlying risk of transmission index. We exploit this intuition to weigh occupational and worker characteristics in the construction of the VSE Risk Index, via a statistical technique called factor analysis. To validate our approach, we use a decades worth of flu data to confirm that our index is related to influenza viral illness, though a different virus from SARS-CoV-2.

As an example of how the assessment tool can be used, a sector with high reward to re-opening is accommodation and food services. Hotels and restaurants have suffered large losses. Within restaurants and food service establishments, the riskiest job is perhaps easily overlooked: supervisors/managers. That is because this person is in constant, close contact with kitchen staff, wait staff, and customers.

Another example worth noting: hairstylists/barbers. Hair salons and personal services are being re-opened in many jurisdictions. But the nature of their work makes this occupation among the riskiest outside of those in healthcare. This is further amplified because, at least in BC, hairstylists and barbers are more likely than others to live with someone over the age of 60; the consequences of COVID are more severe for the aged. Such considerations can only be learned through evidence-based analysis, such as that provided by the VSE COVID Risk/Reward Assessment Tool.

David A. Green is Professor, Vancouver School of Economics, UBC, Gaëlle Simard-Duplain is Researcher, Research Chair in Intergenerational Economics, HEC Montréal, and Henry E. Siu, is Professor, Vancouver School of Economics, UBC.

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Figure: Sectors and Major Occupation Groups

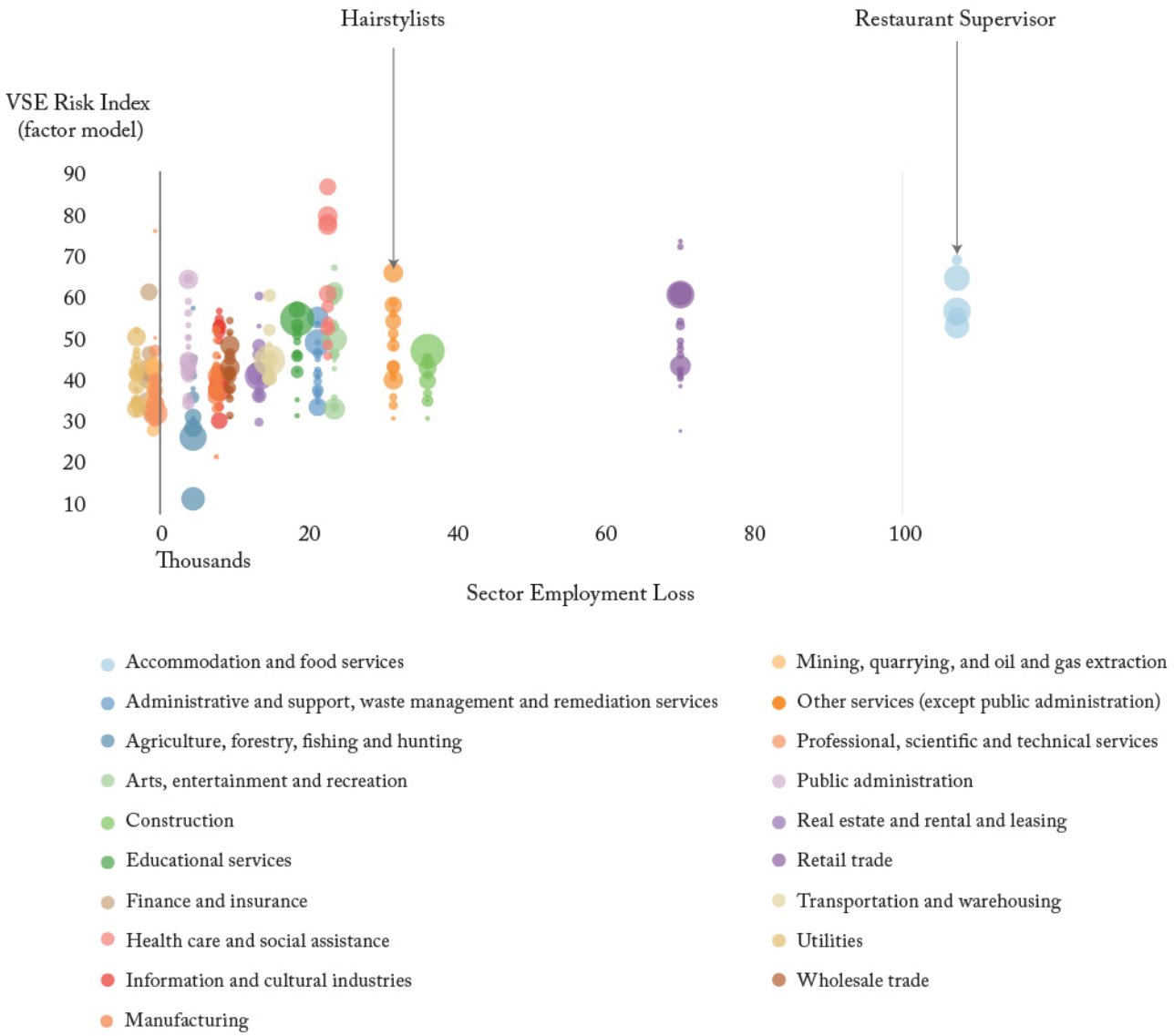

Figure showing occupations' viral transmission risk across sectors of the BC economy. Taken from the VSE COVID Risk/Reward Assessment Tool available at covid19.economics.ubc.ca.

The assessment tool is the result of a collaborative effort of researchers affiliated with UBC's Vancouver School of Economics, École des sciences de la gestion de l'UQAM, HEC Montréal, Dalhousie University, and Analysis Group. Réka Gustafson, the head of the BCCDC, requested this work well before others were pursuing the unintended economic consequences of the virus and policies related to it. She, along with the INSPQ, also provided valuable input into the construction of the VSE Risk Index. The tool is built on data from Statistics Canada, who found timely and innovative ways to provide data access in the midst of COVID-related constraints. The Labour Market Information Council (LMIC) provided financial support to make the VSE COVID Risk/Reward Assessment Tool available for all provinces.

From: Mariam Ragab

To: Canadian Businesses and Governments

Date: June 2, 2020

Re: **Our Tracker Shows Emerging Signs of Recovery, But We Are Not in the Clear**

Statistics Canada's March GDP numbers showed a 7.2 percent overall fall and projected another 11 percent for April. It contained detailed sectoral breakdowns: arts and entertainment and air transportation down more than 40 percent, not remotely balanced by more modest rises in forestry and rail transportation.

The March numbers, released last week, provide a useful picture of where the greatest impact and need will be headed into recovery.

But March is now two months ago. High frequency, near-term data is more important than ever.

The C.D. Howe Institute's COVID-19 Economic Tracker, is an attempt to collect as much current data as available, to provide information, and to highlight the need for more timely quality economic data.

By no means comprehensive, one can see signs of an emerging recovery. For example, based on credit card transactions, RBC reported that consumer spending was only down 14.6 percent from the pre-COVID average on April 28, compared to 37 percent in March. And mobility levels have increased to more than 80 percent of regular levels in all Canadian cities reported by Apple, compared to just 20-40 percent of regular levels in early April. Google also reported increases in movement in most location categories, with grocery and pharmacy, and parks at or above pre-pandemic levels in all provinces. Google also reported that retail and recreation locations have experienced a significant resurgence.

Surprisingly, container imports to Canada at the Port of Vancouver were 2.8 percent above 2019 levels in April, while exports were only a modest 5.9 percent below April 2019 levels. This is a remarkable improvement over the 20 percent decline in March.

Even restaurants are showing a flicker, with OpenTable reporting a slow return to in-person activity at restaurants in Ontario, Alberta, and BC, although Canada overall has only returned to 11.14 percent of pre-crisis levels.

However, consumers are still retrenching, especially for larger purchases. Rail shipments of motor vehicle and parts remained down 78.6 percent year-over-year for the week ending May 23, and motor vehicle sales were down 74.7 percent year-over-year in April. This suggests that notwithstanding data rebound in credit card transactions, overall consumer spending is not in the clear.

Unsurprisingly, the petroleum sector's woes continue. While refinery production is slowly returning to pre-COVID levels, the number of drilling rigs has remained at an all-time low relative, with little sign of growth or recovery, and rail shipments of crude oil are down 45.3 percent.

Similarly, electricity consumption continues to decline in Alberta, likely due to diminished industrial demand. British Columbia's consumption is rising, but slow to return to pre-pandemic levels or historic levels in previous years.

And, uncaptured by the March GDP report, rail shipments have actually tumbled as the commodity supply chain slows, lead by non-metallic minerals (down 53.4 percent), chemicals (20.7), metallic ores and metals (15.8), and forest products (14.8).

Meanwhile the Canada Mortgage and Housing Corporation reports that up to 20 percent of mortgages could be in arrears this fall, creating a "deferral cliff" that could continue to hold Canadian discretionary spending back and impede recovery. This is especially true as federally emergency assistance programs expire, leaving households with diminished income and increasing debt. 8.25 million individual Canadians have applied to the Canada Emergency Response Benefit (equivalent to 44.4 percent of Canada's labour force), and 1.45 million workers are receiving the Canada Emergency Wage Subsidy as of the latest reporting period – April 12 to May 9.

As policymakers continue to make decisions on how to best support economic recovery, monitoring this data with a critical lens for both sector and geography is essential to ensuring effective response to the COVID pandemic.

These numbers show that there are early signs of activity resuming across the economy, but it also highlights much diminished economic activity, as well as threats for a "swoosh" recovery.

Mariam Ragab is a researcher at the C.D. Howe Institute.

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Intelligence MEMOS

From: Paul Jenkins and Jeremy M. Kronick

To: Policymakers at All Levels of Government

Date: July 13, 2020

Re: **Health and the Economy – With Numbers**

When the pandemic nature of the COVID-19 virus was finally recognized, Canada acted boldly to contain and control its spread. We didn't know as much as we know now, and as such we were forced into unmeasurable tradeoffs. In those early days with limited information, the focus was rightly on health and on shutting down the economy to minimize infection and mortality rates.

Now, some four months into the crisis, we are gaining knowledge on a number of fronts, meaning we can measure and minimize those tradeoffs.

With the knowledge and experiences gained, we have reached a point where we can better gauge risks and begin to have informed discussions on the optimal mix of policies—on the health front, on the economic front, and, critically, on the intersection of the two.

By accumulating data during the shutdown, we can ask what mix of polices will give us both the health and economic outcomes we desire—in economic parlance, a Pareto optimal outcome.

We can ask, for example, what combinations of restrictions, work protocols, preventative measures and hospital capacity are necessary to achieve the same (or lower) levels of mortality/hospitalization we achieved with a complete lockdown in the early stages of our COVID-19 battle. And, data availability can now help us respond in an informed, timely and forceful manner if need be to new information.

On the health side, our policymakers have been greatly aided by the use of epidemiological models that generate scenarios of the spread of the virus and ways to contain that spread.

What we have not seen in Canada, however, is the use of these types of models to help us assess the optimal mix of health and economic policies combined.

A recent paper by Acemoglu et al. looked at this issue of the optimal mix of policy using US health and economic data. The story they tell is likely the same in Canada and is exactly the conversation we should be having as we navigate the risks and uncertainties on the road to recovery.

In that paper, the authors' big innovation is they treat their three groups—young (20-49), middle-aged (50-64) and older (65+)—differently, in terms of how they are locked down (or not). This gives policymakers much more flexibility than the uniform policies (i.e., no age differentiation) we were forced to use at the beginning of the pandemic.

Their results show that under a uniform policy, keeping the mortality rate at 0.2 percent in the adult population, the resulting fall in GDP over the next year would be 38 percent.

By contrast, under a targeted policy where the 'old' are locked down more severely than rest of the population, keeping the mortality rate at 0.2 percent, the fall in GDP is reduced to 25 percent.

The authors go further. If we add 'group distancing', where interactions between 'old' and the rest of the population are limited, the results are even better: keeping the mortality rate at 0.2 percent, the fall in GDP is now 16 percent. And, to all these policies, if we add testing and tracing, the results are better yet: keeping the mortality rate at 0.2 percent, the fall in GDP is now 7 percent.

Of course, these scenarios are highly sensitive to the assumptions and parameters chosen for the model, but are nonetheless robust to a variety of different tests.

So, what policy insights can we import from this research? There are four key ones:

1. The need to communicate to the public that opening up the economy isn't a tradeoff with lives lost due to COVID-19, if done responsibly;
2. When you stop treating each group symmetrically, you realize the benefits arising from more targeted policies (whether by age or other criteria), which will be critical to sustaining the recovery;
3. The impact on economic growth of targeted policies, combined with group distancing and testing and tracing, without sacrificing lives, shows that current policies are sub-optimal;
4. The need to discuss the intersection of health and the economy in a transparent way with the public.

The success we will have in our COVID-19 battle rests ultimately on the behaviour of each of us. Our health and economic endpoints and the path to those endpoints are intertwined. We need a narrative from our leaders that engages Canadians to build the understanding and confidence needed to get us to those endpoints.

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1. This is not to underplay the difficulty in keeping the mortality rate at 0.2 percent, even under targeted policies, with the tragedies in Canadian LTC facilities the most notable example.

Paul Jenkins is a former senior deputy governor of the Bank of Canada and a senior fellow at the C.D. Howe Institute, where Jeremy M. Kronick is associate director, research.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Miles Wu

To: Canadian Policymakers

Date: August 5, 2020

Re: **Lessons from Abroad**

China's second quarter economic report – GDP up 3.2 percent year over year, reversing the 6.8 percent first quarter drop – was watched closely around the world, as it offered early glimpses of post-COVID economic recovery.

Unpacking the numbers yields some lessons for Canada of what the road to recovery may look like, and a foretaste of which sectors may need further assistance.

In China, the high-tech sector saw a particularly strong rebound, with its manufacturing revenue up 4.5 percent in the second quarter year-over-year, with June coming in at a brisk 10 percent. Telecommunication industry revenue increased 14.5 percent in the first two quarters. This has fueled optimism in the industry, with investment rising 6.3 percent while investment for other sectors, like property and infrastructure, fell over the same period. This advantage will likely persist, as the relative ease in which employees of this sector can work while social distancing means there are few barriers to returning to work.

Meanwhile, retail sales and restaurants continue to show weak recovery months after reopening, seeing 8.1 percent and 26.8 percent decreases for the first six months of 2020. Consumption continues to be a drag on China's economy, as people are reluctant to spend disposable income amidst economic uncertainties. Although consumption figures are rising again, June still saw a 1.8 percent decrease compared to last year, and the entire first half of the year saw a 11.4 percent drop. Car sales are especially low, with June returning a 6.5 percent decrease in sales year on year.

These statistics illustrate a likely common challenge across economies as they re-open, which is the sheer unevenness as well as potential choppiness of the recovery. A particular challenge in this respect will be rolling back the CERB and CEWS so that we limit the current steep rise in the public debt, without compromising jobs or viable firms in at-risk industries that will recover more slowly due to circumstances outside their control.

The proposed changed to CEWS show the need for the program to evolve as COVID-19 enters different stages and moving forward should account for the different speeds at which industries recover. Wage subsidies for struggling restaurants and retail stores will still be needed, while crisis-related support for high-tech companies may need to be revisited as capital markets stabilize and demand for such products rises back to pre-crisis levels. While it will be difficult to do so without appearing to pick "winners and losers," criteria must be established to wean those who do not need the programs from them and focusing spending on people and firms who need longer to find stability.

Consumer confidence will be difficult to recover until COVID-19 is firmly in the rear-view mirror and people are fully comfortable going outside their homes again and into other enclosed environments. For that, the government must remain vigilant and carefully monitor cases and balance how quickly to re-open the economy. Any setbacks in re-opening could prove catastrophic for industries that need consumer spending to increase in the near future and will mean more government spending will be needed to keep them afloat.

While we are two very different economies, China's road to recovery can hold useful lessons in terms of the difficulties Canadian economic sectors will face in the not-too-distant future.

Miles Wu is a Researcher at the C.D. Howe Institute.
To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Joel Blit, Chuanmo Jin and Mikal Skuterud

To: Canadians Concerned About the Economy

Date: August 21, 2020

Re: **Re-opening and Re-closing the Economy Strategically**

In the relative calm between waves of COVID-19, policymakers are facing pressure to shift their focus from efforts to control the virus, towards ways to revive the economy. But the biggest determinant of our economic recovery will be our ability to contain future waves of the virus.

For the past several months, we have tracked the relationship between new COVID-19 cases and total (aggregate) hours of employment in Canada's regions. The results of our analysis reveal a clear tendency for work hours to decline, through both reduced workweeks and job losses, when case numbers increase.

As shown in Figure 1, which combines six months (February to July 2020) of data for 65 regions spanning all 10 provinces, there is a strong negative relationship between the change in the number of COVID-19 cases between one month and the next, and the subsequent month-to-month change in aggregate hours worked.

While one should always be cautious in inferring causal relationships from correlations, the relationship appears largely driven by the large decline in hours worked between March and April following the initial surge in cases and government-imposed shutdowns. However, a weak negative relationship is also evident when comparing Canadian regions in more recent months, which likely reflects individuals choosing to reduce work activity when health risks are increasing.

These results point to the need to continue prioritizing measures to contain COVID-19 infection rates, even while cases are low. One strategy for sustaining economic activity while managing infection rates is to target sectors and occupations where virus contagion risks are high. The Vancouver School of Economics (VSE) has developed an invaluable tool enabling policymakers to evaluate risks based on the extent to which an occupation requires close physical proximity to other individuals, among other measures.

Using VSE's proximity data as a proxy for the relative risk of infection associated with different occupations, we find that high-risk occupations have experienced a larger average decline in hours following a rise in cases relative to jobs requiring lower physical proximity (see Figure 2.) However, the difference is remarkably small and non-existent when we restrict attention to regions in more recent months. This suggests that there is potential to be more strategic in regulating shutdowns.

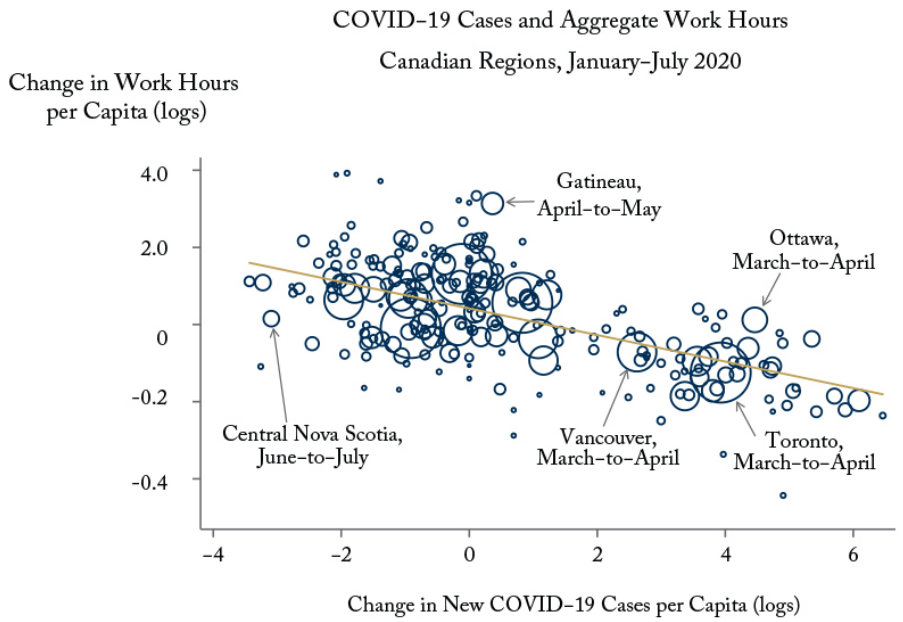
When the pandemic reached Canada in March, we were ill-prepared, with little equipment and no clear plan. We took the unprecedented step to shut down much of our economy. When the next wave arrives, we must adopt a more strategic response that takes into account the health risks associated with different occupations, in addition to their economic, social, and security benefits. A more selective plan would call for activities that present a greater risk to be shut down first in response to local outbreaks.

Moreover, our plan must be proactive and not reactive. We are plotting a difficult path that must balance risks to health on the one hand and economic recovery and individual freedom on the other. To chart the best course forward we need a steady hand at the tiller, that uses the best available evidence and is forward looking. Any adjustments we make today will not be felt for weeks. Even in times of low infection we must make judicious choices, because opening risky activities, like indoor restaurants and bars, today could mean that our children can't attend school tomorrow.

Joel Blit is Associate Professor of Economics at the University of Waterloo, where Chuanmo Jin is a Master's of Economics student and Mikal Skuterud is a Professor of Economics.

To send a comment or leave feedback, email us at blog@cdhowe.org.

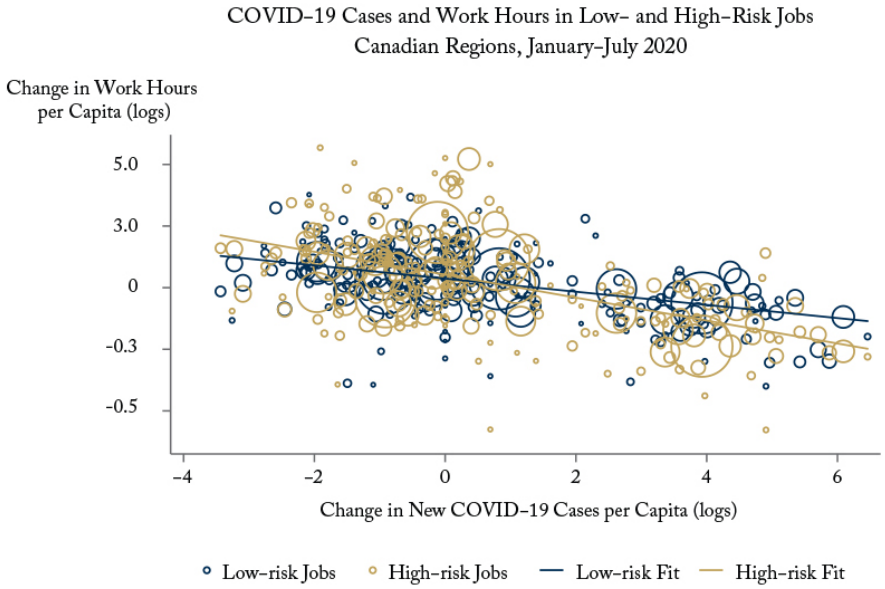
Figure 1:



Note: COVID-19 cases are cumulative new cases in 4 weeks prior to hours of work. Marker size proportional to population. Fitted line from a weighted least squares regression.

Source: Labour Force Survey (RTRA) and https://github.com/ishaberry/Covid19Canada/.

Figure 2:



Note: COVID-19 cases are cumulative new cases in 4 weeks prior to hours of work. Marker size proportional to population. Fitted line from a weighted least squares regression. Occupations are divided into high and low proximity categories based on scores obtained from the VSE?s COVID-19 Research Program. Health-related occupations omitted from the analysis.

Source: Labour Force Survey (RTRA) and https://github.com/ishaberry/Covid19Canada/.

Intelligence MEMOS

From: Jeremy Kronick and Steve Ambler

To: Bank of Canada Watchers

Date: September 10, 2020

Re: **THE GDP STORY IS NOT AS BLEAK AS REPORTED**

Statistics Canada released its initial estimate of second-quarter GDP last month. Output dropped by 11.5 percent compared with the first quarter and by a little more than 13 percent compared with the second quarter of 2019. This is the largest recorded quarterly decline since Statistics Canada began reporting quarterly GDP numbers in 1961.

The estimate was scary enough, but the way it was reported may have caused either unnecessary panic or unnecessary pessimism. Media reports emphasized the "annualized" change in GDP, which was a drop of 38.7 percent, which is worse than scary. Does this mean Canadian GDP will actually wind up falling almost
40 percent, as it did in the Great Depression of the 1930s? Almost certainly not. In fact, in the current context, using the annualized rate of change is misleading.

Calculating the annualized change in GDP involves assuming the second-quarter contraction will continue at exactly the same pace for four full quarters. After two quarters, a quarterly growth rate of -11.5 percent would translate into a decline of 21.7 percent; after three quarters, 30.7 percent; and after a full year, 38.7 percent.

But the contraction almost certainly won't continue at the same pace for four quarters. The Canadian economy already turned a corner in May. The second-quarter growth number resulted from a very large drop in GDP in April followed by growth in May (4.8 percent) and June (6.5 percent). The Statistics Canada quarterly report suggested growth continued in July, albeit with a more modest monthly increase of approximately 3 percent. As long as we can avoid, or at least handle, a second COVID wave, such that restrictions on economic activity won't return, Canada's recession will actually have ended in May, when growth resumed.

The C.D. Howe Institute Business Cycle Council defines a recession as a pronounced, protracted and pervasive decline in real output, as measured by GDP. If growth does continue, this recession will have been the shortest in Canadian economic history, with the peak of the previous expansion occurring in February and the trough of the business cycle in April. (It will still be a two-quarter recession, however: GDP fell by 2.1 percent in the first quarter, with the steep decline in March swamping feeble growth in January and a basically flatline February.)

To put all this in perspective, the recession that began in June 1981 lasted fully 16 months from peak to trough while the recession of the early 1990s lasted 25 months. In both cases, however, the peak-to-trough contraction of GDP was much milder than we have just experienced, at 5.3 percent and 2.2 percent, respectively. The granddaddy of Canadian recessions was, of course, the Great Depression. Contraction started in October 1929 and continued uninterrupted until February 1933, a total of 39 months, with industrial production down by just over 40 percent from peak to trough. In that case, the 40 percent decline was truly 40 percent.

Since the beginning of the pandemic many Canadians with time on their hands have become recession-watchers. But since the short, sharp downturn was heavily influenced by policy lockdowns meant to be temporary, they should keep in mind that annualized changes in quarterly GDP are not a meaningful indicator of the pandemic's ongoing economic effects. The year-over-year decline of 13 percent from the second quarter of 2019 is a much more helpful indicator of our economic state.

Jeremy Kronick is associate director, research at the C.D. Howe Institute, where Steve Ambler is David Dodge Chair in Monetary Policy. Ambler is also a professor of economics (retired) at the École des sciences de la gestion, Université du Québec à Montréal.

To send a comment or leave feedback, email us at blog@cdhowe.org.

A version of this memo first appeared in the Financial Post.

Theme 2:

The Need for Open Trade

COVID-19 Crisis Business Continuity and Trade Working Group

Communique: Prioritize Integrity of Supply Chains by Addressing Weak Links and Coordinating Actions

In order to help Canadian governments confront the public health and economic crisis resulting from the spread of the COVID-19 virus, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The working group on business continuity and trade is co-chaired by Dwight Duncan (Senior Strategic Advisor at McMillan LLP and former Ontario Minister of Finance) and Jeanette Patell (Vice-President of Government Affairs and Policy for GE Canada). Its membership includes industry experts and economists. Meeting weekly, it identifies and prioritizes policy challenges and communicates members' views in published communiques. The group's second meeting was held on Tuesday, March 31, 2020.

At its most recent meeting, the group first commended federal action to establish a broad-based wage subsidy, as recommended by its earlier communique.[1]

Looking ahead, the group underscored the importance of government support to safeguard supply chains for critical goods – and particularly address potential bottlenecks in the transport of goods by truck domestically and internationally. While urging governments to work closely with industry to address obstacles, the group urged caution about governments directly intervening or taking over supply chains.

The group highlighted the following priorities for governments:

- Safeguarding the flow of goods internationally and domestically.
- Collaborating with critical industries to identify and address bottlenecks in supply chains.
- Limiting workplace activities based on specific assessments of the risk of transmission.
- Supporting industry-led efforts to develop health and safety measures to prevent transmission in workplaces.

1 Business Continuity and Trade Crisis Working Group. 2020. "Subsidize Wages, Backstop Credit, Protect Supply Chains." C.D. Howe Institute. March 26. Available online: https://www.cdhowe.org/council-reports/subsidize-wages-backstop-credit-protect-supply-chains-cd-howe-institute-business-continuity-and .

On the federal/provincial division of responsibilities, the group emphasized that provincial governments were best placed to respond to local circumstances. It noted that the federal government has worked collaboratively with provinces and supported provincial efforts and can play an important coordinating role. It also warned that the federal government should invoke emergency powers to manage local production and supply only in extreme circumstances – for example, where provinces request nation-wide coordination – and only in areas where the federal government has the capability to manage efficiently at an industry-specific level.

Members believed that decisions around "restart" must be guided by expert public health judgments about what is necessary to contain the virus. In the likelihood of a protracted duration for battling COVID-19, members noted that governments and industry will need to adapt to a "new normal", learn from other jurisdictions and explore creative workplace measures based on public health risk assessments. Members urged companies to collaborate to develop health and safety practices that will reduce transmission risks within specific industries – particularly for activities that are vital to critical supply chains.

Safeguard Flow of Goods by Supporting De-bottlenecking of Supply Chains

Members identified emerging risks in the transport sector – particularly long-haul trucking – as a potential weak link that could impair supply chains for critical goods. The health of truckers and fewer services along routes were particular concerns. The cost of imports from the U.S. to Canada may also increase as backhaul exports decrease. Trucking is a particular sector where Canadians need context-specific public health measures to contain transmission while ensuring that vital infrastructure continues to function.

Members highlighted the importance of governments working with industry to understand and rapidly address bottlenecks. Government interventions to take control of supply chains in sectors like food distribution may increase confusion and impair companies' efforts to sustain supplies of critical goods. Some members warned that, if other provinces follow B.C.'s example in taking control of supply chains, provincial fragmentation could interrupt national and international supply chains.[2]

2 For elaboration, see: Charlebois, Sylvain. 2020. "B.C.'s government has given itself powers over its food supply chain. That's a big mistake." Globe & Mail. March 30. Available online: https://www.theglobeandmail.com/opinion/article-bcs-government-has-given-itself-powers-over-its-food-supply-chain/ .

Members underscored that domestic production may face constraints as foreign jurisdictions place restrictions on exports of inputs. Workplace closures in response to public health measures may hinder production of certain intermediate inputs. Governments should maintain close lines of communication with equipment manufacturers – particularly those of critical goods – to identify risks to supply chains.

Ensure Workplace Measures and "Essential" Services Calibrated to Public Health Risks

The working group emphasized that workplace closures and precautions must be driven by expert judgment about public health risks. Working group members believed that provincial governments like Ontario had appropriately set a relatively wide scope in its initial list for "essential" services but maintains the ability to flexibly reduce activities based on the risk of transmission.

While supporting provincial governments' continued jurisdiction for decisions over workplace closures and "essential" services, certain members pointed out that the federal government might assist with guidance. For example, certain members pointed to the advisory guidelines by the U.S. Department of Homeland Security as a means of assisting state governments in decision-making around workplace closures.[3]

Regarding the timing for "restart" of the economy, members believed that decisions around "restart" must be guided by expert public health judgments about what is necessary to contain the virus. Members cautioned that premature general timelines for "restart" could risk easing vital physical distancing measures too early, resulting in renewed spread of the virus. Businesses must prepare and make plans for a "new normal" for workplace operations over a protracted period of containment.

Members agreed that governments must be cautious in easing restrictions but adapt measures to restrict workplace restrictions in a "granular" and creative way – for example, based on worker characteristics and approved workplace health and safety measures. Members urged collaboration between companies to develop workplace health and safety protocols that minimize the risk of spread. Governments should support and coordinate with industry groups to understand the efficacy of workplace protocols and, based on expert judgment, calibrate economic and public health measures accordingly.

3 See: U.S. Department of Homeland Security. 2020. Guidance on the essential critical infrastructure workforce. March 28. Available online: https://www.cisa.gov/publication/guidance-essential-critical-infrastructure-workforce.

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Working Group Attendees

Geoff Smith, Chief Executive Officer at EllisDon

The Last Thing We Need in a Pandemic is Me-first Instincts of International Trade

By Lawrence Herman

There's hardly a glimmer of sunshine in the COVID-19 crisis, just a constant stream of horribly depressing news and worrying statistics, with no vaccine or antiviral breakthrough in sight.

The skies darkened even further on Friday, when U.S. President Donald Trump suddenly announced a set of trade restrictions under a Korean-War-era law, prohibiting U.S. exports of medical supplies including surgical face masks made by Minnesota-based 3M Corp. The order specifically bans exports to Canada.

It comes at the same time Canada and the United States just entered into a free trade agreement that says in its preamble that it was concluded in recognition of "the longstanding friendship between them and their peoples, and the strong economic co-operation that has developed through trade and investment."

Coming as a total surprise and at a time when international co-operation is desperately needed, this drew an immediate response from Prime Minister Justin Trudeau, who warned that cross-border trade and services go "both ways," but then wisely backed away from threats of countermeasures, instead preferring dialogue and diplomacy to get the export ban reversed.

This latest America-First move by Mr. Trump has reverberated well beyond Canada. In what can be described as resurgent mercantilism, the order also requires 3M to ship all masks made in its foreign operations to the United States, an astounding assertion of extraterritorial reach.

As reported in the Washington Post and other media, the German government is vigorously protesting this, including a diversion to the United States of 200,000 masks that were en route to Germany from China. The Guardian said that the German allegations "had added to a chorus of complaints about the Trump administration's practice as the U.S. wields its clout in a marketplace for scarce medical supplies that is becoming a free-for-all, with nation competing against nation."

Brazil and France have complained that the United States was outbidding them in the global marketplace for critical medical supplies.

Ironically, on the same day Mr. Trump announced the U.S. export ban, the World Trade Organization and other international bodies issued warnings about the damage trade restrictions have on efforts to curb the pandemic, calling on governments to keep borders open to ensure global supply lines can keep functioning.

The danger is that this episode could start to spin horribly out of control, as governments, under incredible pressure and with tensions running high, take the same beggar-thy-neighbour approach to providing medical supplies.

Even if a solution is found for Canada to get these supplies from its closest neighbour, there's the possibility of me-first actions by other countries taking their cue from Mr. Trump, the last thing needed at a time when the world community needs extraordinary statesmanship and international co-operation.

This flare-up illustrates a harsh geopolitical reality – the instincts of governments to retreat behind national interest even at the expense of friends, allies and trading partners. As every university undergraduate learns the first day of international relations class, self-interest is at the heart of the nation-state system.

It also reveals the frailties of the multilateral trading regime, with rules painstakingly constructed since the end of the Second World War, mostly under past U.S. leadership. These rules are reflected today in the World Trade Organization agreement to maintain open markets, fixed tariffs and non-discriminatory treatment in the exchange of goods and services. For more than 60 years, these rules have been pretty well respected.

The problem is those same rules have major limitations – off-ramps giving countries the right to take exceptional measures in times of international emergency, including the export restrictions to prevent critical shortages of essential products. While countries have tended to exercise restraint in using these exceptions, it would be hard to argue that Mr. Trump's latest move is in breach of these multilateral rules.

Ultimately, it's not a question of international law but of statesmanship, speaking of which are the commendable qualities that 3M CEO Mike Roman demonstrated in interviews he gave in response to the slamming he and his company got last week from Mr. Trump. A news release by 3M said the company would continue to meet its obligations in the current crisis because there are "significant humanitarian implications of ceasing respirator supplies to health care workers in Canada and Latin America, where we are a critical supplier of respirators."

These are just the leadership qualities needed in times of global crisis, the same kind demonstrated by U.S. president Franklin Roosevelt when Britain was facing the Nazi onslaught alone in 1940-41 in a previous crisis that threatened to engulf the world.

It's not too late to hope those same high ideals of goodwill, friendship and co-operation will have some influence in getting a decent response from the White House in face of the current crisis which, as said many times, we are all in together.

Lawrence Herman, a former Canadian diplomat, is counsel at Herman & Associates and senior fellow of the C.D. Howe Institute in Toronto

Published in the *Globe and Mail* .

COVID-19 Crisis Business Continuity and Trade Working Group

Communique #3: Champion Open International Trade and Safeguard Food Security, Public Health and Emergency Measures

In order to help Canadian governments confront the public health and economic crisis resulting from the spread of the COVID-19 virus, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The working group on business continuity and trade is co-chaired by Dwight Duncan (Senior Strategic Advisor at McMillan LLP and former Ontario Minister of Finance) and Jeanette Patell (Vice-President of Government Affairs and Policy for GE Canada). Its membership includes industry experts and economists. Meeting weekly, it identifies and prioritizes policy challenges and communicates members' views in published communiques. The group's third meeting was held on Tuesday, April 7, 2020.

At that meeting, the working group observed a worrisome tide of export restrictions on critical goods internationally. The working group emphasized that open international trade is essential to Canada – both in the immediate crisis and for the long-term. From the ingredients in hamburger buns to motor vehicle production, Canada's economy depends on integrated production across borders.

In this volatile international context, Canada must act on issues within its control. Specifically, Canada must invest in:

- Robust international relationships to draw upon in times of need;
- Strategic reserves of critical goods (e.g., personal protective equipment); and
- Long-run capabilities (e.g., skills and innovation) to support resiliency and rebound from this crisis.

In addition, Canada should take immediate measures to:

- Temporarily reduce import tariffs on critical supplies, including agricultural products;
- Reduce the risk of COVID-19 disruptions in essential sectors (e.g., food processing plants); and
- Aggressively address interprovincial trade barriers.

The working group recommended that Canada champion the mutual benefits of international trade. Alarmed by the U.S. president's (subsequently reversed) prohibition on surgical mask exports to Canada, the working group urged a "Team Canada" approach to countering isolationism abroad – particularly to mobilize political support from allies whose supply chains depend on Canadian exports.

Nonetheless, the group noted a concerning trend toward "zero sum" thinking among Canada's trading partners. The group recommended that Canadian governments rapidly identify gaps in critical goods, coordinate procurement to build adequate stockpiles nationwide, and make smart moves to establish appropriate domestic capacity for production. The group is encouraged by current federal and provincial efforts to this end.

The meeting also addressed emerging concerns regarding Canada's domestic food security. Supply chains remain robust, and Canadians will continue to have enough food to eat. However, Canadians should prepare for less variety and higher costs – particularly for fresh and imported products. Certain working group members estimate that food prices may increase by 10 to 15 percent. Alongside price impacts from the depreciation of the Canadian dollar, members highlighted that food supply chains may face sourcing challenges from slowed international shipments and possible export restrictions or hoarding by certain countries. As well, as a result of reduced mobility for foreign agricultural workers, Canadian farms may face labour shortages over the coming growing season.

Working group members also highlighted risks of near-term bottlenecks in food processing, distribution and retail from COVID-19 related shut-downs and potential labour shortages. Specific processing plants are critical links for access to certain products for major population centres. Health and safety measures are therefore essential to safeguard these workplaces against transmission of the virus. To this end, the working group understands that the Canadian Food Inspection Agency is at full strength and is actively engaged with key food producers to ensure the integrity of these processing plants.

Canada Must Remain Open to Trade and Push against "Zero Sum" Thinking

Countries' conduct during a crisis will shape international relations in its aftermath. The rules-based, multi-lateral system for international trade, from which Canada has long benefited economically, depends on trust.

Working group members observed with dismay the growing list of countries that have imposed some degree of export restrictions during the current crisis. As of April 7, 80 countries had enacted some

form of export restrictions.[1] Most of Canada's major trading partners have invoked such restrictions – notably including market-oriented democracies like the United States, almost all European countries and Australia. Export restrictions are primarily focused on medical devices and personal protective equipment, but restrictions on food exports are also increasing. Canada and Japan remain notable outliers among G7 nations in maintaining open trade for critical goods.

The working group underscored that Canada must continue to be an "honest partner" by honouring international commitments to trade openness and championing market principles. Notwithstanding that Canada immediately must import critical goods to supply our healthcare system, trade integration is essential for Canada's economy – in the recovery from this shutdown and in the long-term.

Canadian companies and governments should also pre-emptively mobilize political support among key trading partners to push back against moves to restrict exports to Canada. The U.S. president's threat to prohibit the export of surgical masks underscores the risks to Canada from fear-driven trade measures abroad. The U.S. president has wide executive authority in the current crisis, but Canada has many commercial and political allies in the United States who recognize the depth of cross-border economic integration. Working group members observed that Canada succeeded in the re-negotiation of the North American Free Trade Agreement through multi-partisan efforts by politicians and businesses to leverage these relationships. A similar "Team Canada" approach is needed in this crisis to reinforce foreign political support for trade openness.

As recommended in an earlier communique,[2] the working group also noted that Canada has rightly waived tariffs on critical medical imports.[3] Certain working group members encouraged the temporary reduction of tariff barriers on a broader range of goods. In particular, certain working group members pointed to an average tariff of roughly 15 percent on agricultural imports across almost half of agricultural goods. Particularly given the risks of increased consumer costs for food, certain working group members encouraged governments to reduce agricultural tariffs.

1 International Trade Centre. Market Access Map – COVID-19 Temporary Trade Measures. Available online: https://www.macmap.org/en/covid19.

2 Business Continuity and Trade Working Group. 2020. "Communique #1: Subsidize Wages, Backstop Credit, Protect Supply Chains." C.D. Howe Institute. Available online: https://www.cdhowe.org/council-reports/subsidize-wages-backstop-credit-protect-supply-chains-cd-howe-institute-business-continuity-and.

3 Canadian Border Services Agency. 2020. Customs Notice 20-12: COVID-19: Tariff Classification and Other Information to Import Medical Supplies. March 31. Available online: https://www.cbsa-asfc.gc.ca/publications/cn-ad/cn20-08-eng.html.

In the immediate crisis, the working group supported the rapid development of certain strategic domestic production capacity for critical supplies and procurement efforts by governments to this end. Given the threats to global trade, the working group recognized the risk of "new normal" for global integration post-crisis, noting calls for greater self-reliance during this crisis and in its aftermath.[4]

To enhance Canada's economic resilience, working group members support reducing internal barriers to trade, boosting domestic innovation and incenting skill-building. In the wake of this crisis, Canada will need to reflect on gaps for critical goods and invest in adequate stockpiles for emergencies. Working group members cautioned that the immediate crisis should not spur a wholesale overhaul of Canada's economic structure or more directive industrial policy. Nonetheless, Canada must reflect on what strategic actions and investments are needed to position our economy for long-run resilience.

Enough to Eat but Expect Crisis-related Disruptions, Higher Prices and Less Variety

Working group members reviewed the status of Canada's food supply. Supply chains remain robust, and it is clear that Canadians will continue to have enough food to eat. However, Canadians should prepare for less variety and higher costs. Depreciation of Canada's dollar will increase the costs for imports. Obstacles to international movement of goods, as well as the likelihood of increasing restrictions on agricultural exports, will likely increase the prices of foreign food products. Domestically, with approximately 60,000 foreign workers annually employed in Canadian agriculture, Canadian farms will likely face labour challenges in the coming growing season given reduced mobility of foreign workers.

More immediately, the working group highlighted that Canadians could face disruption to normal access to food as a result of COVID-19-related closures or work stoppages in grocery retail, distribution or food processing. The working group urged cooperation and transparency around workplace health and safety practices to safeguard critical links and processing facilities.

For example, working group members pointed to certain large meat processing plants that are integral to regional supplies of meat products. This risk of disruption is exhibited by the recent shutdown of large meat processing plants in Yamachiche, Quebec and Brampton, Ontario following confirmation

4 McKay, David. 2020. "How to make Canada a more self-reliant country in the aftermath of the coronavirus pandemic" April 5. Available online: https://www.theglobeandmail.com/business/commentary/article-how-to-make-canada-a-more-self-reliant-country-in-the-aftermath-of-the/.

of several workers infected by COVID-19 at each. Nonetheless, the working group understands that Canadian Food Inspection Agency is actively engaged with major food producers to develop health and safety practices to prevent workplace transmission. The working group pointed out that protocols developed for such essential facilities during the crisis may provide models for measures in other workplaces to facilitate the restart of the economy while minimizing the risk of transmission.

Working group members noted that grocery retailers face challenges for preventing in-store transmission of COVID-19, as well as pressures around worker retention and supply chains. The working group highlighted that grocery workers seek increased wages to compensate for exposure to the public and possible risk of infection. As well, working group members noted that certain grocery workers may chose to refrain from work in order to avoid exposure and instead apply for emergency benefits to offset income loss. Grocery retailers will need to innovate to safeguard workplace safety while sustaining access. The increased adoption of online ordering and curbside pick-up indicate that that retailers and consumers are rapidly adapting.

Working Group Members Include:

Dr. Sylvain Charlebois, Professor, Senior Director, Agri-Food Analytics Lab, Dalhousie University

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Rick Ekstein, President & CEO, Phaze 3 Management

Glen Hodgson, Fellow-in-Residence, C.D. Howe Institute

Caroline Hughes, Vice-President of Government Relations, Ford Motor Company of Canada

Jeanette Patell (Working Group Co-Chair), Vice-President of Government Affairs and Policy, GE Canada

Geoff Smith, President & CEO, EllisDon

John Stackhouse, Senior Vice-President, Office of the CEO, Royal Bank of Canada

Trevor Tombe, Associate Professor of Economics and Public Policy, University of Calgary

Intelligence MEMOS

From: Daniel Schwanen and Glen Hodgson

To: Canadians Concerned about COVID-19's Economic Impact

Date: April 9, 2020

Re: **THE CURRENT PANDEMIC AND LONG-TERM THREATS TO SUPPLY CHAINS**

"Know your customer" is a familiar rule in investing and finance. Even before COVID-19, however, the world was moving to a "know your supplier" requirement for supply chains, movement of people, and data.

The pandemic – with some countries preventing the export of supplies and crucial equipment – will accelerate this trend toward gaining certainty that your supplier will be there for you, whether by government fiat or simply out of good business sense between trading partners and suppliers.

COVID-19 has revealed the critical importance of functioning international supply chains, notably for healthcare supplies and food. It is clear that some jurisdictions approach this cooperatively, recognizing that we will all do better that way. Others are willing to disrupt the international chains to secure, even seize, critical supplies, with little regard – or even understanding – for what this approach might mean for their own supplies or businesses a few months down the road.

The implications of the shift to a "know your supplier" rule that goes far beyond traditional concerns about labour and environmental practices, are vast. It applies to health and food emergencies, and much else. It will affect nations' approaches toward trade, migration, head offices, foreign investment, transportation, communications, and the digital economy. In the long run, considerations of whether it is safe and reliable to do business with specific suppliers will affect entire industries such as travel, as well as the location of production facilities and selection of suppliers of critical health products and equipment.

It is natural for citizens to demand that their governments ensure continuity of critical supplies. Nevertheless, the perceived need for governments to "do something," when they are in fact under-prepared, can lead to myopic actions.

The domino effect of restrictions imposed on the fly by governments around the world can only make global supplies of critical goods less plentiful, less reliable, and more costly.

The European Union and the United States, for example, are exercising their powers to restrict the export of medical equipment, with the US also making federal financial help to states conditional on their maximizing their domestic purchases. Such policies raise the cost of addressing the pandemic. Canada specifically will be hurt by those US policies.

Canada could retaliate – in many ways Canadian products and workers are just as essential to the production of US critical supplies as the reverse. But Canada's long-term interests are not served by encouraging the spread of mercantilism and tit-for-tat approaches.

Internationally, a hopeful model, is the agreement Canada recently signed with a number of (smaller) economies to maintain open supply chains in the face of the COVID-19 emergency.

What lessons can we learn from the current circumstance? First, analysis of supply chains and the risk of low inventories or chokepoints should be an ongoing exercise. Second, it appears that authorities did not follow some important recommendations from past crises, notably the 2003 SARS outbreak, which gave rise to no fewer than three official reports.

Surge capacity for personal protective or other equipment, and coordination of disease tracking and surveillance were all strongly recommended.

Authorities should be continuously be called into account on their choice to heed, or not, relevant recommendations.

Next, we need to ask what tools are available to governments, should supplies become inadequate or vulnerable? How can governments respond to barriers put up by outside jurisdictions, or even the inability or unwillingness of Canadians to provide services essential to ensuring supplies?

The goal is long-term policies in sectors vulnerable to disruption. These might include: policies to ensure domestic supplies are sufficient to ensure domestic needs in times of crisis; plans for a quick retooling of manufacturing capacity to meet urgent needs; the development of arm's-length ways of ensuring critical services to avoid putting many front-line providers at risk; and federal-provincial cooperation mechanisms.

In addition, Canada needs to build alliances with like-minded countries to maintain open international supply chains. This could mean mutual strategies to address threats among the alliance, and pledges of assistance to individual members. Such alliances would supplement and work in concert with existing and future trade agreements.

Efficient supply chains are crucial to delivering high and growing standards of living, but they need to be resilient and secure. We anticipate some supply chains will become shorter, better defined, and complemented by rethinking business strategies to ensure continuity at the local level in individual markets. That would be a fair price to pay to ensure that Canadians continue to benefit, and benefit safely, from international and national commerce.

Daniel Schwanen is Vice-President Research, at the C.D. Howe Institute, where Glen Hodgson is a senior fellow.

To send a comment or leave feedback, email us at blog@cdhowe.org.

From: Jon Johnson

To: Canadians Concerned About Section 232 Tariffs

Date: June 24, 2020

Re: **Relief from Threat of Section 232 Tariffs – End of the Road**

Section 232 of the US *Trade Expansion Act of 1962,* which grants to the president broad powers to "adjust" imports that the Commerce Department finds threaten national security, has become a favoured trade weapon of the Trump administration.

There have been eight investigations under the Trump administration since 2017. Compare this with 26 investigations from 1962 to that point and none since 2001. The Trump administration's first Section 232 target was steel and aluminum. Though Canada successfully negotiated an exemption, imports of steel and aluminum into the US from most countries remain subject to Section 232 tariffs.

The definition of national security in Section 232 is virtually unlimited and an affirmative finding by the Commerce Department or adjustment actions taken by the president cannot be challenged through judicial review.

There have been two initiatives to limit or block the power of the president utilizing Section 232, one congressional and the other judicial.

Many members of Congress have been troubled by Section 232 and Congress has attempted through the introduction of bills to limit the president's Section 232 powers. None of these initiatives progressed in any meaningful way. On May 28, Senate Finance Committee Chairman Chuck Grassley announced that efforts to reform Section 232 have stalled because of lack of consensus and fear among some Republicans of going against Trump.

The American Institute for International Steel, Inc. (AIIS) challenged Section 232 as an unconstitutional delegation of legislative authority. The Court of Appeals dismissed the AIIS challenge and AIIS petitioned the US Supreme Court seeking judicial review of the decision, but the court denied the petition on Monday, June 22 without reasons, which is the end of the road for the AIIS challenge.

Section 232 continues to threaten Canadian exporters. Canada's exemption from the Section 232 steel and aluminum tariffs is tenuous. If imports of steel or aluminum products "surge meaningfully beyond historic volumes of trade," the US may (after consultations) impose duties of 25 percent for steel and 10 percent for aluminum on the individual products where the surge occurred. US Trade Representative Robert Lighthizer said during a Senate Finance Committee hearing last week that there have been surges in steel and aluminum from Canada. The American Primary Aluminum Association has been lobbying hard for the re-imposition of tariffs.

The Canada-United States-Mexico Agreement (CUSMA) will eliminate a potential avenue for challenging Section 232 tariffs. The NAFTA national security exception, like its GATT/WTO counterpart, only applies to actions relating to traffic in arms, taken in time of war of other emergency in international relations, and relating to policies respecting nuclear proliferation.

CUSMA Article 32.2 (Essential Security) provides that nothing in CUSMA precludes a party from applying measures that it considers necessary for the protection of its essential security interests without limitation. The GATT/WTO provision still exists but is ineffective because the US has hamstrung the WTO dispute settlement process.

Section 232 has significant downsides for a US administration. Section 232 tariffs are taxes on US producers and consumers that hurt the US economy. Section 232 tariffs invite retaliation by US trading partners causing further damage.

As has occurred with steel and aluminum, Section 232 necessitates the bureaucratic complication of administering thousands of exclusion requests. These negatives may, in time, outweigh whatever benefits future US administrations may see in pursuing Section 232 investigations.

Jon Johnson is a former advisor to the Canadian government during NAFTA negotiations and is a Senior Fellow at the C.D. Howe Institute.

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From: Daniel Schwanen and Dan Ciuriak

To: Canadian and ASEAN Trade Officials

Date: August 25, 2020

Re: **Canada and ASEAN Trade Agreement can Foster Economic Recovery, Development and Well-being**

ASEAN Member States and Canada are contemplating their next steps toward a possible trade agreement, even as they continue to be burdened with the health, economic and social impact of COVID-19. There are compelling reasons for both sides to launch negotiations and to bring such a trade agreement into force as expeditiously as possible.

ASEAN and Canada are both trade-dependent economies with similar interests in maintaining supply lines as open as possible and subject to minimal disruption of cross-border flows of medical and other critical goods and in travel routes and transport logistics. An agreement – preferably one with an "early harvest" – would strengthen trade flows and the opening of negotiations would send a strong positive signal to markets at a time when uncertainty clouds every horizon.

In terms of trade, each side would gain as reduced tariff and non-tariff barriers would reflect comparative advantages. On that score, ASEAN and Canada have complementary economies, both with strengths in specific natural resources, agri-food, other manufacturing, and services such as tourism, logistics, software, and finance. Trade in areas such as medical devices and pharmaceuticals, as well as digital trade, is also ripe for growth in the post-COVID era.

Importantly, two of the 10 ASEAN member states – Singapore and Vietnam – already have free trade commitments with Canada through the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Moreover, ASEAN already has a trade agreement with an economy with the characteristics and comparative advantages that Canada has. This is the ASEAN-Australia-New Zealand FTA. From an ASEAN perspective, the sensitive issues that such an agreement with Canada would raise have already been largely worked out in negotiations and, indeed, the internal economic adjustments have already been made.

Beyond the direct benefits of a bilateral ASEAN-Canada agreement, there is a much bigger concept in play. A new agreement should allow businesses, other organizations, and talent in Canada and ASEAN member states to more easily partner with their counterparts in each other's countries, thereby enhancing their competitive position in third markets. Growth in joint business ventures including research, and other bilateral links such as the growth of micro-multinationals in each other's markets, should be closely tracked as indicators that an agreement is assisting its signatories to grow and compete globally.

In these regards, Canada's strong research capabilities, intellectual property, and regulatory regime, combined with preferential access to North America and Europe, and reasonable costs even in advanced technology fields, could benefit from the growth of ASEAN businesses in these markets. Meanwhile, greater integration of Canadian businesses into supply chains in the much faster-growing ASEAN region, where GDP could grow seven-fold over the next 30 years, with commensurate growth in infrastructure needs and consumer demand, is an important piece of Canada's trade diversification agenda.

Accordingly, in conjunction with the launch of negotiations towards an FTA, Canada and ASEAN should hold parallel talks on how to help businesses actually take advantage of better access to markets. They should support businesses, investors and institutions from Canada and ASEAN joining forces to address infrastructure, equipment and skills development needs. As well, they should think how collaboration can benefit industries as diverse as tourism, transportation or banking adapt to new post-COVID trends in demand and take advantage of the new business realities, including a rise in virtual collaboration.

The agreement should also support Canada and ASEAN's joint focus on small businesses, whose growth is so important to raising standards of living in economies as diverse as Canada, Indonesia or the Philippines. Reducing trade, information, and technology adoption costs for small businesses should be a key outcome of this agreement. Fairs and virtual marketplaces around specific themes such as health, clean energy, the use of AI, should be sponsored and open to businesses and professionals operating in Canada or ASEAN member states.

In the age of COVID-19, and the resulting reinforcement of what were already emerging emphases on safety, reliability and sustainability, the time-honoured principle of "know your customer" needs to be augmented by another one: "know your supplier."

As every country evolves its own policies to take advantage of new trends and technologies that will accelerate post-pandemic, they will need the reliability and flexibility of a common platform that makes trade easier, fosters innovative business and professional relationships, and promotes fair competition and high product and services standards.

A Canada-ASEAN trade agreement should be the centerpiece of such a move, helping position its members for growth as the world economy struggles to recover.

Daniel Schwanen is Vice-President, Research at the C.D. Howe Institute, and Dan Ciuriak is Fellow-in-Residence with the C.D. Howe Institute, an Asia Pacific Foundation Distinguished Fellow and Director and Principal, Ciuriak Consulting Inc

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The authors are grateful to the Canada ASEAN Business Council, with which they are collaborating on related research, for comments on an earlier version of this memo.

Theme 3:

Policies for the Most Impacted Business: Competition, Restructuring, Rent Deferral, and Foreign Investment

Crisis Working Group Report: Crisis Household Income and Credit Support

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. Several working groups will address challenges in the monetary, fiscal and financial policy domains. One such group is the Household Income and Credit Support Working Group, chaired by Michael Horgan, Senior Advisor at Bennett Jones LLP and Former Deputy Minister of Finance, Government of Canada, and supported by a group of Canadian business leaders and economists. Meeting weekly, this group will debate policy ideas, and communicate the results of its discussions in a public joint Communique. The group's first meeting was held on Tuesday, March 24, 2020. The purpose of the first meeting was to identify and prioritize key risks for households during this crisis, to discus policy options and to consider recommendations.

The working group noted that the COVID-19 crisis is different from other crises as it is a supply-driven crisis and a massive percentage of private-sector employers are at risk. Without a rapid response from governments to prevent layoffs and shutdowns of businesses and not-for-profit organizations, unemployment will continue to rise sharply. Since supply creates demand, focusing only on measures that support the demand side of the economy such as providing supports in generating business and employment income is ultimately not sufficient. That said, Employment Insurance (EI) programs and other income supports can provide a bridge back to lost jobs when the economy recovers; but governments should also help businesses (particularly small businesses) and not-for-profits pay their bills and stay afloat during the crisis.

Businesses in some industries such as travel, tourism, and hospitality have experienced virtually a 100 percent reduction in demand related to the COVID-19 crisis. This highlights the importance of providing income supports for those who lost their jobs due to the crisis. The working group discussed whether the EI program would be able to deal with the flood of applications. Furthermore, the members of the Household Income and Credit Support Working Group agreed that the risks and consequences of not supporting employers and individuals enough is significantly higher than offering them too much.

Due to the complex nature of the policy domain, the group identified various issues and risks as being the most pressing to tackle in the short term. These issues and policy interventions to address them fall under three major themes as follows:

Wage subsidies: The federal government's previously announced 10-percent subsidy was too little to enable businesses and not-for-profit organizations to retain employees. Since the measures to contain the virus are, presumably, temporary, providing generous wage subsidies was identified as an effective and appropriate approach to prevent further massive layoffs and business shutdowns. Preventing job loss not only helps the economy to recover quickly as neither workers nor employers need to go through the process of finding an employment or filling a position respectively again, but also mitigates the impacts on mental and physical health. The wage subsidy program, however, needs to be different from the European style programs, which provide wage subsidies only for furloughed employees. To be nimble, the federal government can adopt the current feature of the EI program and offer a subsidy equal to 55 percent of covered earnings of workers.

Other Income support: While the group endorsed deferrals on payments and financial supports for targeted Canadian businesses and workers to create cash flow, it highlighted the need for further financial emergency support such as forgivable business loans and identified several vulnerable groups who are, potentially, left behind, such as

- tenants, either individuals or businesses and other employers, need an emergency financial support to pay their rents since other types of support such as moratorium on evictions of tenants can have unintended consequences as it puts the ability of landlords to pay their own expenses such as rental property maintenance expenses at risk.
- those whose EI benefit is ending and it is not clear whether there will be some expansion of benefits;
- self-employed individuals and contractors with no income as a result of current circumstances, who are not classified as employees;
- students who are soon graduating and unable to find an employment. The recent survey shows that similar to other crisis young individuals are hit harder than others and see greater increases in their unemployment rate; and
- workers on the front lines of the crisis who need extra support and receive proper equipment.

Time frames: The working group identified the need for a plan on how to resume economic activities and get employees back to work, despite the coronavirus crisis. This requires finding ways to contain the coronavirus without shutting down the economy for more than a reasonable period of time. It requires considering options that make workers feel comfortable with going back work, possibly learning from

the South Korea and Singapore experiences. Otherwise, a large number of businesses and not-for-profits may not survive. There was also a consensus among the members of the group that speed is a key element in this crisis to mitigate the risk and uncertainties in the labour market. For example, the governments need to provide the details of their plans to support employers and workers as quickly as possible to ensure business continuity.

The Household Income and Credit Support Working Group Working Group will meet again next week. Much is likely to change between now and then, and the next meeting will focus on emerging issues and specific policy proposals from the members. Areas for potential consideration include what provinces should do for their residents; how the federal and provincial governments should coordinate in providing supports and taking precautionary measures; what other types of support other jurisdictions have provided; and measures to reassure pensioners and for senior citizens who have lost retirement wealth.

Household Income and Credit Support Working Group members include:

Michael Horgan, Senior Advisor at Bennett Jones LLP and former Deputy Minister of Finance, Government of Canada

Grant Bishop, C.D. Howe Institute

Luc Godbout, Université de Sherbrooke

Brian Kingston, Business Council of Canada

Parisa Mahboubi, C.D. Howe Institute

Kevin Milligan, University of British Columbia

Mike Pedersen, Business Development Canada

Bill Robson, C.D. Howe Institute

Tammy Schirle, Wilfrid Laurier University

Kathleen Taylor, Royal Bank of Canada

Ed Waitzer, Stikeman Elliott LLP

Intelligence MEMOS

From: Michael J. O'Connor

To: Bill Morneau, Minister of Finance

Date: April 16, 2020

Re: **A Tax Policy Response for Commercial Landlords and Tenants**

Commercial landlords and tenants face uncharted issues as a result of the sudden restrictions on mobility due to the COVID-19 pandemic.

None of the government responses to date, which focus on employees and families, fully recognizes that small- and medium-sized businesses along with non-profits and charities have rent obligations.

On April 11, responding to a question in Parliament on rent relief for small businesses, the Government indicated being open to listening to ideas. I suggest the federal government take leadership by implementing a national framework to guide landlord-tenant rent renegotiation, combined with a tax incentive for commercial landlords to enter into such agreements.

The real estate rental and leasing industry, which includes managing, selling and renting real estate, represented about 12.5 percent of GDP and about 2.9 percent of the growth in 2019. Accordingly, any disruption in the supply of property for rent will lead to considerable economic knock-on effects. Government support to landlords and tenants during the COVID-19 dislocation will be essential to the economic recovery.

Provincial governments have taken swift actions that will protect tenants from eviction for non-payment of rent and are allowing deferral of property taxes in some cases.

None of this protects the landlord. Landlords may be able to restructure loans, but capital deployed in the commercial property space does not come solely from debt. There are other landlord costs that do not go away and depending on the terms of a particular lease may well be borne by landlords. Some are payroll related and will be covered by federal wage subsidy programs, but the core of the activity in the landlord-tenant relationship is still rent. High rents in major centres across the country, spawned by the recent low interest rate environment, aggravate the situation further.

With this context in mind, Canada should establish, at least for the benefit of small- and medium-sized businesses, a national framework for lease reduction and renegotiations, combined with a landlord federal tax incentive to encourage wide-scale adoption.

Such a framework would need the support of federal, provincial and municipal levels of government. The principles of the framework could be modelled after the Australian National Cabinet Mandatory Code of Conduct. The landlord tax incentive would be limited to arm's length relationships between landlords and tenants, who would jointly agree to a reduction or deferral of rent in 2020 for say, up to seven months (March through September inclusive) and subject to repayment over the remaining term of the lease, up to a maximum of say, 24 months.

As a tax incentive to landlords, only one-half of the amounts deferred would be included in taxable income, and could include a reduction to the undepreciated capital cost or adjusted cost base for the amount of rent deferred. Governments can then recoup the cost of the tax incentive through deferred taxation on lower depreciation over the remaining life of the property or eventual capital gain.

The proposal would be designed to level the playing field between tenants and landlords and create certainty, while avoiding disputes and providing a clear direction and framework for dealing with the issues facing tenants and landlords. In addition, it provides an incentive for landlords to enter into such arrangements. Special rules may need to be developed to integrate the income of flow-through entities.

The table below illustrates how the effect of a seven-month deferral of rent on cash flow and taxes. During the seven-month period, it is assumed that landlords are eligible for the federal wage subsidies and interest deferrals from lenders. In the example below, the landlord eventually obtains a higher rental rate, subsidized by the proposed tax incentive on the deferred rent.

Governments collect higher taxes in the future as a result of the adjusted cost base reduction, entirely financing the tax incentive. The net present value of lower taxes gives the landlord an incentive to enter into the deferral agreement. Obviously, rent reductions could also be encouraged.

Each of the provinces has taken steps within their own constitutional powers to deal with certain aspects of the landlord-tenant relationship as a result of COVID-19 shutdowns. But these overlook the effects on landlords. A national framework guiding landlord-tenant rent renegotiation, combined with a tax incentive for landlords to enter into such agreements, is badly needed.

Michael J. O'Connor, CPA, CA, is a retired senior tax executive at Sun Life, Alcan, and formerly a partner at a national accounting firm.

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Illustrative Example

Months	Current Rent ($)	Tax on Current Rent ($)	March 2020 > Rent ($)	Repayment of Deferral ($)	Total Rent ($)	Tax on New Rent ($)	
1	12,000	3,120	-		-	-	
2	12,000	3,120	-		-	-	
3	12,000	3,120	-		-	-	
4	12,000	3,120	-		-	-	
5	12,000	3,120	-		-	-	
6	12,000	3,120	-		-	-	
7	12,000	3,120	-		-	-	
8 - 31	12,000	3,120	12,000	3,500	15,500	3,575	
32	12,000	3,120	12,000	-	12,000	3,120	
33	12,000	3,120	12,000	-	12,000	3,120	
	396,000	102,960	312,000	84,000	396,000	92,040	(A)
	NPV of Tax Out-flow	96,009	<<	(11,407)	>>>	84,602	
					Deferred Tax on Cost Base Reduction	**10,920**	**(B)**
					Total Tax Collected by Gov't	**102,960**	**(A) + (B)**

Source: Author's calculations based on a seven-month rent deferral agreement followed by a 24-month repayment schedule, assuming a five percent discount rate and a 26 percent tax rate, and a proposed 50 percent taxable income inclusion rate on the deferred income.

Intelligence MEMOS

From: Michael O'Connor and Benjamin Tal

To: Bill Morneau, Minister of Finance

Date: April 24, 2020

Re: **Integrate Programs to Help Commercial Landlords and Tenants**

The federal COVID-19 response has been swift and sizable, but more targeted support to Canadian businesses is needed.

Specifically, we need a more immediate and direct solution to address commercial rents for SMEs, because there is a great risk of losing a very large number of businesses unable to pay the rent on their locked down premises. The inability to pay rent will force SMEs to lay people off and reduce their participation in the wage subsidy program, further frustrating the economic recovery.

The federal government announced that it intends to provide loans and/or forgivable loans specifically to commercial property owners, who in turn will lower or forego the rent of small businesses for the months of April (retroactive), May and June, through a new program that would be called the Canada Emergency Commercial Rent Assistance (CECRA). No details have yet been announced.

This will be a good first step, but more is needed. Ottawa, working with the provinces, could develop national guidance for landlords and tenants for the proportionate sharing of the financial burden through rent reductions or deferrals. And when a landlord/tenant agreement is reached, the government should extend the level of forgiveness of Canada Emergency Business Account (CEBA) loans used to pay for rent, providing an additional incentive to enter into such agreements. The uptake in the CEBA program is far from overwhelming as many businesses don't meet the requirements to qualify for the loans, and many SMEs are simply reluctant to take on more debt.

Tenants face multiple months of reduced revenues and there is no time to reinvent the wheel. The fundamental issue in developing a solution for commercial rents is who will suffer the loss when premises cannot be occupied; the landlord, the tenant, or governments.

Generally, tenants suffer the loss, unless they walk or fail, and then landlords (and by extension, investors) suffer. Governments at all levels suffer when tax payments by landlords and related businesses dwindle. A government subsidy may be warranted, but must be balanced against the moral hazard of bailing out the landlord's investment risk.

New Zealand may be a model for post-COVID-19 risk sharing between landlord and tenant. The Christchurch earthquake a decade ago spawned a risk-sharing clause in commercial tenancy agreements where a tenant is unable to gain access to premises to fully conduct the tenant's business due to "an emergency" situation.

In this case "a fair proportion of rent" simply ceases to be payable for the period of the closure. That clause is active now, and New Zealand commercial tenants are already negotiating rent relief, subject to "fairness."

Australia's federal government has gone a step further than most and issued specific guidance to landlords of businesses eligible for its wage subsidy program on the need to proportionately share the financial burden between landlord and tenant. Mainly, landlords must offer SME tenants proportionate reductions in rent through waivers and deferrals of up to 100 percent of the amount ordinarily payable, with rent waivers constituting at least 50 percent of the relief. Deferrals are repayable over the term of the lease or 24 months, if shorter. While the guidelines are specific to SMEs, they are an important nudge for all landlords.

In developing guidance for landlords and SMEs on proportional sharing, Ottawa could integrate its guidance with support delivered through CEBA and the upcoming CECRA.

To encourage landlords and tenants to enter into deferrals or rent waivers, we suggest extending the level of forgiveness of CEBA loans used to pay for arm's length rent that has been reduced or deferred by the landlord. This will incent rent deferrals or waivers and SME tenants to seek the support of the CEBA program to honour a fair payment of rent.

CEBA already is interest free until the end of 2022, and 25 percent is forgiven if repaid by then. The level of forgiveness could be increased to 50 percent or higher, if in addition the SME qualifies for the wage subsidy program and the landlord agrees to defer or waive rent during the closure and into the restart. Additional incentives to landlords could be given through the tax system.

Extending CEBA forgiveness through a cost-sharing approach involving landlords, tenants and the government would help ease the financial pressure facing many commercial tenants, increase the attractiveness for the CEBA program, and could be financed by related government savings and preservation of tax revenues. It will also increase the effectiveness of the wage subsidy program, thereby limiting the rising unemployment rate and maintaining the crucial employer-employee link.

Michael J. O'Connor, CPA, CA, is a retired senior tax executive at Sun Life, Alcan, and formerly a partner at a national accounting firm and Benjamin Tal is deputy chief economist at CIBC.

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Intelligence MEMOS

From: Michael J. O'Connor

To: Bill Morneau, Minister of Finance

Date: May 22, 2020

Re: **Commercial Rent Part 3: Levelling the Playing Field**

Final details of the commercial rent relief program for small businesses announced in April emerged this week. That they arrived more than half-way into the eligibility period is just one signal that the Canada Emergency Commercial Rent Assistance (CECRA) risks missing the mark in providing the necessary support to salvage such businesses shuttered by the pandemic lockdown.

Time will tell if landlords realize the important burden placed on them to ensure qualifying tenants have the opportunity to re-open and boost Canada's economic growth in the aftermath of the pandemic. The Canadian Federation of Independent Business estimates that following the COVID-19 lockdown, 42 percent of small businesses will close permanently, and that 58 percent will not be able to pay their May 2020 rent. With an August 31 deadline to apply, there is a limited amount of time to implement a solution that fits small business tenants, landlords and lenders alike if CECRA is to have any positive impact on the economic recovery.

CECRA lacks the precision, debate and transparency of the legislative process that the CERB, CEWS and CESB programs have benefitted from. However, the CECRA funding remains a significant financial incentive for a landlord to reduce a tenant's rent by at least 75 percent and participate in the program administered by the Canada Mortgage and Housing Corporation (CMHC). This model should attract landlords to participate since the alternative for many small businesses may result in no rent at all.

However, CECRA misses the mark in two fundamental ways. First, it does nothing to level the playing field between landlord and tenant. In fact, it puts the decision to participate squarely in the hands of the landlord, exacerbating the existing power imbalance. Second, it originally introduced a secured mortgage lender into the equation, but placed no burden on them. In fact, it in effect collateralizes the lender's interest by making debt service payments (principal and interest) one of the eligible uses of the funds. Absent debt service payments, landlords now seem to have the flexibility to cover other running costs.

Here are some ideas to deal with these issues:

To put the landlord and the tenant on a level playing field, the federal and provincial governments would have to provide an unconditional prohibition or suspension of a landlord's eviction and other customary rights in the event of a failure to pay rent. CECRA restricts evicting affected tenants during April, May and June 2020 (the Target Period), but only with the landlord's consent. Restricting the prohibited evictions period to the three-month period of the COVID-19 lockdown is insufficient time to see how businesses will perform following the re-opening. Australia, New Zealand and the U.K. have all made efforts to level the playing field between landlords and tenants with a moratorium on commercial evictions; none have committed to fund a portion of tenants' rent. If commercial evictions rise above historical levels, the federal government should encourage all provinces to bring in a moratorium until at least September 2020.

Participation in CECRA should be made mandatory so that small business tenants can seek the protection and reliefs offered; with an opt-out by otherwise eligible business tenants and landlords acting in good faith. This would go a long way towards bringing reluctant landlords into a reconsideration of the lease agreements for the period of the COVID-19 lockdown and re-opening.

CECRA appears designed to protect lenders' interests as much as to provide support for tenants. Lenders are however not required to fund any portion of the program. While there are a number of programs available to support lenders such as the Insured Mortgage Purchase Program, much more can be done to encourage secured mortgage lenders in providing additional relief to small business landlords.

For example, lenders could be encouraged by the federal government to waive a borrower's requirement to pay or accrue interest on debt of properties premised by small businesses eligible for the CECRA program during the Target Period. Instead the mortgage payments would be regarded for those three months as payments of principal only. Normally the Canada Revenue Agency will accept a waiver that would otherwise give rise to taxable income between arm's length parties and should be prepared to do so in these circumstances without there being any negative tax consequences to either the borrower or lender. The reduction in the lender's interest income would reduce their current tax bill. The income tax saved on the three months of interest waived could be reinvested by the lender in new investments, with the yield over the remaining term of the mortgage going a significant way towards compensating lenders for the interest waivers but otherwise preserving their cash flow.

Given the reported reluctance of some landlords to participate in CECRA, landlords and tenants should as a minimum seek to involve the lenders in the renegotiations of lease terms by considering the feasibility of a waiver of the landlord's interest during the three months covered by CECRA. Obviously, if there is no lender, then it simplifies the situation and such landlords are better positioned to participate in the CECRA on their own account.

Michael J. O'Connor, CPA, CA, is a retired senior tax executive at Sun Life, Alcan, and formerly a partner at a national accounting firm.

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From: Tim Brennan

To: Competition Policy Watchers

Date: June 8, 2020

Re: **Could COVID-19 Justify Competitor Cooperation?**

As nations around the world try to cope with COVID-19, one hears calls to encourage cooperation among manufacturers and suppliers that normally compete with another.

Cooperation, of course, is good if not necessary in so many aspects of our reaction to this disease, for example, in wearing masks and maintaining social distance to protect healthcare workers and prevent overtaxing hospitals.

However, a broader call to substitute cooperation for competition may appear unwarranted, at least at first glance. The benefits of markets – fostering production and supply in response to buyer demand, and doing so at prices reflecting cost –would seem to be just as important, if not more so, during emergencies.

One possibility, not to be dismissed, is that some firms, following the adage "don't let an emergency go to waste," are taking advantage of pandemic uncertainty to try to get around competition law. I am confident that such efforts will not be successful in Canada, the US, or the EU. Efforts to invoke "failing firm" justifications during the pandemic for anti-competitive mergers meet similar skepticism.

The pandemic-driven decline in demand is causing huge losses in sectors with substantial fixed assets; airlines may be the poster child. However, the preferred policy response has been state aid, rather than permission to collude to raise prices.

To deal with the need for medical equipment, one hears appeals to exploit economies of scale, the idea that bigger firms have lower costs on average. This may be true, but it is not likely for manufacturing in the near term, as production capacity is pretty much set. (This is the same reason why "efficiency" claims for mergers that substantially reduce competition are deservedly hard to validate.)

Although these reasons are not persuasive, there remains an additional consideration. It begins with doubt that the benefits of markets remain compelling in a pandemic.

Prices can't promote good choices if buyers don't have the time to compare offerings from different sellers. Moreover, while economists view prices as couriers of information and incentives, the public views them as devices to move money from one person to another. Having goods end up in the hands of those willing to pay the most, and profiting from doing so, isn't appealing when it comes to masks and ventilators in a pandemic. Price spikes, or gouging, like disease spikes, are to be avoided.

Consequently, some companies are being asked to act in ways different from what prices suggest, especially when policies prevent prices of increasing as a result of the emergency demand for them.

One example is that those that make things critical in dealing with a pandemic, like masks or other PPE, should expand output beyond what prices would compel. Other companies may be asked to switch product lines to address those needs, for example, auto parts companies making ventilators.

Were prices allowed to rise, the firms presumably would do this without being asked. Another action, unrelated to demand spikes but rather to the economic recession induced by policies to cope with the pandemic, would be unprofitable efforts to protect workers; Forbes recently published a ranking of companies by COVID-related benefits for employees.

Consider the choices facing businesses to go along with these social aspirations. A mask or PPE maker that produces at a loss, or any firm that retains workers without the revenue to support them, puts itself at a disadvantage compared to competitors in attracting investors. A car company that switches to ventilators loses market share to competitors that do not follow its lead.

Any company going down this path on its own risks falling behind, even if it would prefer to help. So, how might we get them to respond to the pandemic, when prices aren't there to provide incentives and rewards? Cooperation among them, so none loses out to others, can remove this obstacle for the private sector to do what we need.

Just as we all wish for a vaccine or treatment to get COVID-19 off our backs, this cooperation should be temporary. It may seem small compared to restoring our health and society, but we also can't wait to get back to letting prices and markets do their job.

Tim Brennan is Professor of public policy and economics at the School of Public Policy, University of Maryland, Baltimore County, and a C.D. Howe Institute International Fellow.

Crisis Working Group Report: Business Continuity and Trade

Communiqué #8: Accelerate Infrastructure Projects and Adapt Restructuring Processes

To help Canadian governments confront the public health and economic crisis resulting from COVID-19, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The Working Group on Business Continuity and Trade is co-chaired by Dwight Duncan (Senior Strategic Advisor at McMillan LLP and former Ontario Minister of Finance) and Jeanette Patell (Vice-President of Government Affairs and Policy for GE Canada). Its membership includes industry experts and economists. Daniel Schwanen, Vice-President, Research, and Grant Bishop, Associate Director, Research, at the Institute support the group. Meeting weekly, it identifies and prioritizes policy challenges and communicates members' views in published communiqués. The group met on May 26 and June 2, 2020.

In previous communiqués, this working group emphasized significant headwinds facing recovery.[1] These include: the risk of a "second wave" and tightening of restrictions; "scarring" from widespread business insolvency and frictions on business restructuring; and slow recovery of economy-wide aggregate demand, resulting in idle capacity and protracted levels of high unemployment. As well, many uncertainties surround the post-pandemic "new normal" and much investment activity – particularly large capital spending in key industries – is likely to be sidelined until businesses have greater clarity around future conditions.

To enhance prospects for a resilient recovery, the working group considered:

1. Stimulus through accelerated infrastructure spending – specifically:
    - the possible role of infrastructure spending to boost depressed aggregate demand through a protracted period of weakness, and
    - the need to rigorously target any infrastructure stimulus to boost productivity and address specific social and environmental objectives;

1 Crisis Working Group on Business Continuity and Trade. 2020. *Financing Bridge Needed to Protect At-Risk Sectors as Canada Faces a Long, Hard Road to Recovery*. C.D. Howe Institute. May 19. Available online: https://www.cdhowe.org/council-reports/financing-bridge-needed-protect-risk-sectors-canada-faces-long-hard-road-recovery

2. The adaptability of Canada's bankruptcy and restructuring processes to widespread insolvencies;
3. The importance of expedient merger review and open access to foreign capital, as well as the need to "sunset" government interventions in markets and restore competitive forces as soon as practical; and
4. Governments' use of tools for assessing risk versus economic cost in order to stage re-opening and better calibrate any "second wave" re-tightening of activity restrictions.

First, while various working group members questioned whether spending on public infrastructure could be effectively and rapidly deployed as a near-term stimulus, Canada faces a likely prolonged period of weakness in economy-wide aggregate demand – including in goods-producing sectors for which export demand may remain depressed. In order to employ idle industrial capacity and trades, governments should consider accelerating spending on those public infrastructure projects that boost long-run Canadian productivity and align with social or environmental objectives. Facing a protracted recovery in private-sector non-residential investment, Canada should seize this near-term opportunity to address its maintenance backlog for aging public infrastructure assets – for example, repairing the large shares of bridges, roads and linear water infrastructure that are in poor condition (i.e., at or past projected life).

However, boosting aggregate demand should not be an excuse to relax rigorous cost-benefit evaluation for the value of specific infrastructure projects. Working group members emphasized that many "shovel ready" projects may not be the most effective use of public funds compared with transformative projects that enhance productivity or connect markets. The aim of any public spending should be to build assets and capabilities that enhance Canada's long-term economic prosperity. To guide future national infrastructure priorities, Canada needs a strategic assessment to identify those infrastructure investments that would boost long-run economic growth, enhance social well-being and enhance resilience – particularly in response to risks from climate change.

Nonetheless, while agreeing that public investments today should be consistent with Canada's long-term greenhouse gas targets and climate adaptation, working group members were skeptical of the push for broad "green" stimulus – for example, by subsidizing assets like renewable generation for which market forces and carbon pricing should provide commercial incentives. While reducing Canada's GHG emissions is a critical policy objective, working group members pressed that government should focus spending on "framework" infrastructure or assets with clear positive externalities – for example, inter-regional power transmission or demonstration-scale projects for new technologies like small modular nuclear reactors, hydrogen production or carbon capture, utilization and storage.

The pandemic has also underscored the value of digital infrastructure in enabling economic activity – from work-from-home to agricultural production to education – particularly in rural and remote communities. The working group emphasized the deployment of broadband connectivity as a critical "backbone" for long-term national prosperity. While connecting outlying regions may not be presently profitable for private investment, government should consider support to accelerate capital outlays on digital infrastructure for remote communities where long-term social benefits exceed public costs.

Second, continuing business restrictions and weak demand will exacerbate the financial distress facing many businesses. Many creditors are presently forbearing on defaults, recognizing the extraordinary circumstances and the limited pool of buyers for any assets in liquidation. Credit support for businesses from governments also appear to have provided an effective near-term bridge. However, as the crisis persists, widespread insolvency and liquidations could destroy firm-specific production capacity.

Practitioners expect acceleration of restructuring filings for businesses that entered the crisis with weak balance sheets: more filings under the *Companies Creditors Arrangement Act* (CCAA) occurred in May 2020 than in any month during the past decade. Despite this increased load, courts and insolvency practitioners should not be overwhelmed given the flexibility of Canada's bankruptcy and restructuring processes. Nonetheless, while public financing should not displace private creditors, government should consider putting in place backstop facilities for "debtor in possession" (DIP) financing in the event that traditional DIP lenders face constraints through a wave of restructuring proceedings.

Third, working group members agreed with the recent communique from the C.D. Howe Institute's Competition Policy Council that emphasized the need for expedient and flexible review of acquisitions by the Competition Bureau and under the *Investment Canada Act*.[2] As always, the Bureau must be alert to the competitive consequences of mergers but, if limited acquirers exist for a "failing firm," the Bureau should expedite review to facilitate rapid restructuring. Similarly, reviews under the *Investment Canada Act* should not place additional burdens on foreign acquirers: foreign investment will be critical to the recapitalization of distressed Canadian companies. Unless there are legitimate national security concerns, Canada should not restrict commercially driven foreign acquisitions.

Working group members agreed that the current crisis should not license either a sweeping and sustained displacement of market forces nor central management of the economy for the long term.

2 Competition Policy Council. 2020. *Through Crisis and Recovery, Enforce Competition and Safeguard Open Markets*. C.D. Howe Institute. May 27. Available online: https://www.cdhowe.org/council-reports/through-crisis-and-recovery-enforce-competition-and-safeguard-open-markets-cd-howe-institute

Alongside the fiscal cost, support measures can distort market forces, and the federal government should establish timetables for "sunsetting" business supports as economic activity resumes.

Finally, while many business activities have now resumed, the COVID-19 virus appears to continue its spread in various communities. With significant probability of a second wave of intensifying acute caseloads, public health imperatives may require a tightening of restrictions. Governments must both ensure workplace-level measures to mitigate spread of the virus and prepare plans for a second wave.

With deeper knowledge about community spread, future restrictions on business activity should be more carefully calibrated than during the first wave. To develop "second wave" plans, governments should leverage tools for comparing the economic costs of shutdown with the risk of transmission in specific occupations and industries – such as the risk index developed by researchers at the University of British Columbia Vancouver School of Economics (VSE).

(1) Delivering Infrastructure Can Support Resilient Post-crisis Economy

Working group members supported accelerated delivery of infrastructure projects to support recovery, provided spending is targeted effectively to boost productivity or align with social and environmental policy objectives.

Infrastructure as Stimulus for Weak Aggregate Demand

Various working group members were skeptical that governments could effectively deploy capital spending to boost significantly aggregate demand in the near term. However, working group members see the post-crisis recovery as a key window for governments to accelerate delivery of infrastructure projects that will enhance the productivity and resilience of Canada's economy.

Certain commentators have observed that the contraction in aggregate demand is a function of restrictions on economic activity and pointed out that precautionary consumer behaviour may inhibit recovery. In this setting, they question whether conventional stimulus through government spending will be effective to boost aggregate demand.[3]

3 Boothe, Paul, and Christopher Ragan. 2020. "Canada needs a new prescription for the pandemic recession," *Macleans*. June 2. Available online: https://www.macleans.ca/economy/economicanalysis/canada-needs-a-new-prescription-for-the-pandemic-recession/

As well, the size of public spending to move the needle on aggregate demand would be significant. For example, $20 billion in spending is equivalent to 1 percent of Canada's GDP and any outlays in a small open economy involve "leakage" (i.e., purchases of imports).

Through a protracted recovery, Canada will likely face significant economic slack and elevated unemployment into 2021 and the degree to which demand is impaired will differ sector by sector. For consumption-driven sectors like retail and restaurants, pressures on households' discretionary spending and ongoing physical distancing may dampen the rebound. As the VSE risk index highlights, restrictions can be calibrated to the costs and benefits in different sectors. While workers' skills are occupation-specific in the short run, Canada's goods-producing sectors may be a channel for stimulating economy-wide demand during a period when household spending and demand for consumer services is likely to stagnate.

As well, government capital spending can substitute to some degree for a downturn in private-sector non-residential construction. Construction activity has significantly contracted during the crisis, as shown by the 16 percent decline in construction employment between February and May 2020. While many job losses may be driven by activity restrictions, dampened investment intentions also play a role. Non-residential building permit applications have declined dramatically: the seasonally adjusted value of permits plunged by 44 percent from December 2019 to April 2020 (see Figure 1). This pull-back anticipates continued weakness in non-residential construction activity.

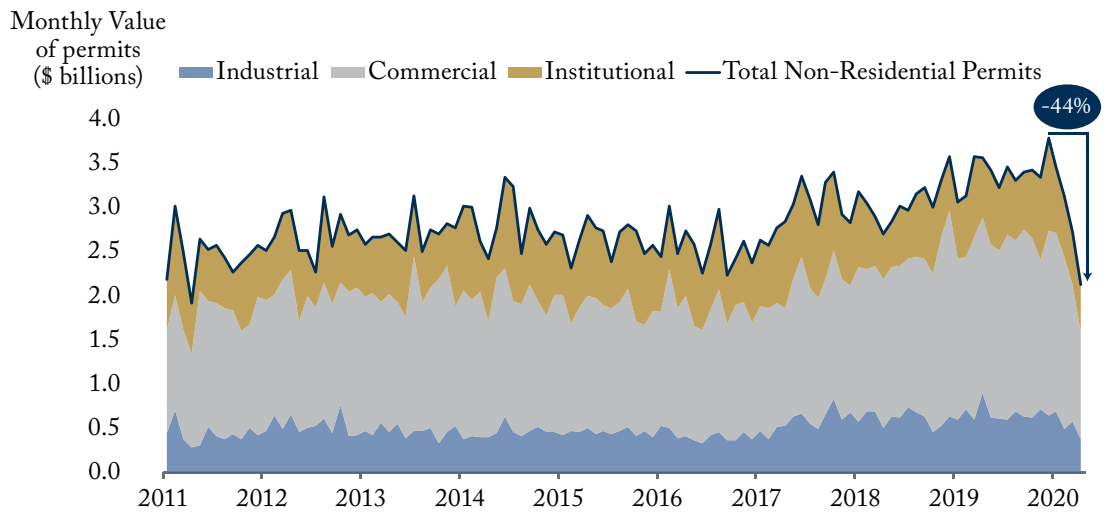
Looking ahead, aggregate private capital investment in key export-focused sectors (e.g., petroleum and manufacturing) could remain depressed given an uncertain outlook for demand. Commentators have also observed that pandemic-driven delays and associated cost overruns may force construction firms into insolvency and risk the failure of in-progress projects.[4]

Simultaneously, the construction sector globally is facing large-scale disruption from digitization, advances in modular construction and consolidation.[5] While construction sector productivity has

4 Murphy, Tim, and Drew Fagan. 2020. *Canada's Infrastructure Bank: An Opportunity to Step Up and Rebuild Canada's Post-Pandemic Economy*. McMillan Vantage Policy Group. May 6. Available online: https://mcmillanvantage.com/canadainfrastructurebank/

5 Ribeirinho, Maria João, Jan Mischke, Gernot Strube, Erik Sjödin, Jose Luis Blanco, Rob Palter, Jonas Biörck, David Rockhill, and Timmy Andersson. 2020. *The next normal in construction: How disruption is reshaping the world's largest ecosystem*. McKinsey & Company. June 4. Available online: https://www.mckinsey.com/industries/capital-projects-and-infrastructure/our-insights/the-next-normal-in-construction-how-disruption-is-reshaping-the-worlds-largest-ecosystem

Figure 1: Monthly Value of Non-Residential Building Permits



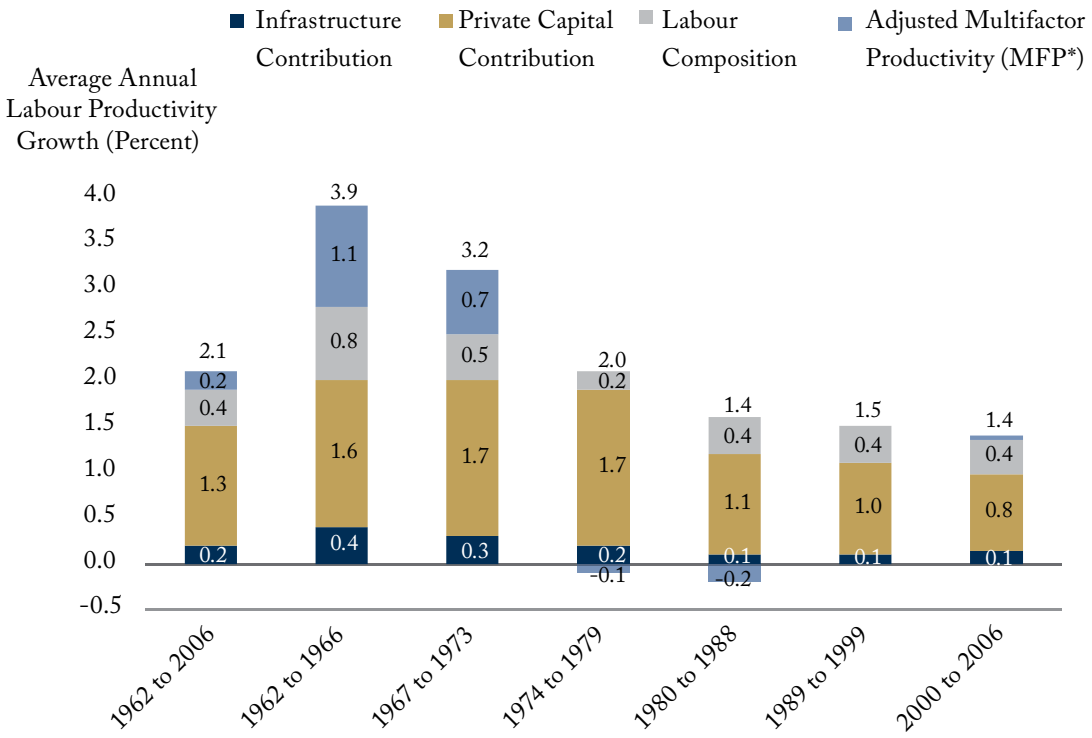
Source: Statistics Canada (Table 3410006601).

long languished, innovation is now driving rapid change in the sector worldwide and post-pandemic restructuring is likely to accelerate this transformation. Canadian construction firms face a significant risk of falling behind and displacement if they cannot seize this moment to learn by doing and adapt to intensified competition. Large-scale and sustained capital investment programs could provide opportunity for Canadian engineering and construction firms to reinvent themselves.

Ensuring Value for Infrastructure Spending

Working group members stressed that long horizons for planning and executing infrastructure projects – often years – create practical problems for synchronizing government spending on high-value capital assets with periods of weakness in aggregate demand. Canada's lengthy timelines for regulatory approvals and jurisdictional frictions (e.g., conflicts between federal and provincial governments) slow development of transformational national infrastructure. As a result, any rush to deploy stimulus risks focusing on "easy" local projects with limited productivity impact.

Figure 2: Estimated Contributions to Canadian Labour Productivity Growth

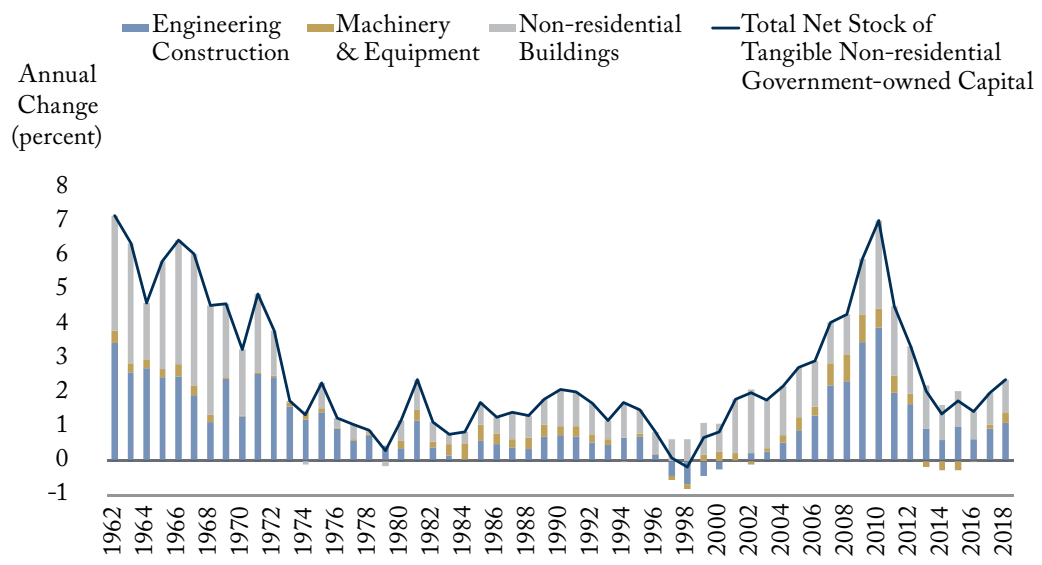


Source: Gu & MacDonald. 2009. *The Impact of Public Infrastructure on Canadian Multifactor Productivity Estimates.*

Historically, spending on public infrastructure has delivered significant benefits for Canadian productivity. A study by Gu and MacDonald (2009), published by Statistics Canada, estimated that investment in public infrastructure had contributed to approximately 10 percent of growth in labour productivity between 1962 and 2006 (see Figure 1).[6] The period from the 1960s to early 1970s saw significant government outlays on tangible, non-residential capital (see Figure 2) – particularly engineering construction (e.g., the completion of the Trans-Canada Highway). The delivery of this public infrastructure complemented intensive private-sector capital investment and contributed significantly to the rapid growth in labour productivity during this period.

6 Gu, Wulong, and Ryan MacDonald. 2009. *The Impact of Public Infrastructure on Canadian Multifactor Productivity Estimates*. Statistics Canada. Available Online: https://www150.statcan.gc.ca/n1/pub/15-206-x/15-206-x2008021-eng.htm

Figure 3: Annual Change in Government-Owned Net Stock* of Tangible Non-Residential Capital



* Based on depreciation of capital stock.

Source: Statistics Canada (Table 3610009701).

Working group members stressed that access to high-quality and reliable infrastructure is a major factor in the location decisions for many activities. For example, in developing new processing or manufacturing facilities, companies are highly attuned to access to transportation, power, digital connectivity and water. Such infrastructure determines a region's competitiveness by influencing the costs and speed of accessing upstream inputs and getting product to downstream markets.

Targeting Government Capital Spending for Value

Working group members stressed that aligning infrastructure spending with economic benefit occurs at the project level and requires rigorous evaluation of the returns on particular projects. Public spending is economically justified where the net benefits to society exceed the costs of the outlays. The private sector is well equipped to deliver projects that will yield profits across the life of the asset. In contrast, governments justifiably deliver or contribute to capital investments when a project provides benefits for society that exceed the net present value that would accrue to a private owner.

A potential opportunity for rapid roll-out of spending may be a backlog of maintenance and repair on aging infrastructure. Retrofits to extend useful service life of existing assets should be more rapid to plan and execute than new projects. The 2019 Canadian Infrastructure Report Card, based on responses for the 2016 year through the Canadian Core Public Infrastructure Survey, found a significant share of public infrastructure assets at significant or advanced states of deterioration and approaching or beyond expected service life.[7] In particular, the survey found that 16 percent of roads, 12 percent of bridges and tunnels, 11 percent of wastewater and stormwater pipes, and 16 percent of roads and tracks for public transit were in poor or very poor condition.

Ramping up infrastructure spending could be viable through repair and maintenance initiatives, for which governments should have prioritized inventories and execution plans. Working group members highlighted that governments may tend to focus on "ribbon cutting" for new projects and neglect the ongoing funding required to maintain assets. If so, the depreciation of these assets will diminish the productivity contribution from the earlier investment.

The pandemic has also underscored the value of digital infrastructure in enabling economic activity – from work-from-home to agricultural production to education – particularly in rural and remote communities. The working group emphasized the deployment of broadband connectivity as a critical "backbone" for long-term national prosperity. While connecting outlying regions may not be presently profitable for private investment, government should consider support to accelerate capital outlays on digital infrastructure for remote communities where long-term social benefits exceed public costs.

Working group members also agreed that the recovery presents an opportunity for "no regrets" acceleration of investments in projects that will be required to meet anticipated social service demands, such as affordable housing and long-term care facilities.

However, choices around projects must be made carefully and avoid displacing the role of market forces. For example, various commentators have criticized the push for a "green" stimulus package through government spending.[8] A clear pathway for an economy-wide carbon price should incent private investments in renewable generation without governments subsidizing specific power generation projects.

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7 Federation of Canadian Municipalities. 2019. *Canadian Infrastructure Report Card*. Available online: http://canadianinfrastructure.ca/en/index.html

8 Ragan, Christopher, and Andrew Potter. 2020. "Engineering a 'green recovery' is a terrible idea," *Globe and Mail*. May 31. Available online: https://www.theglobeandmail.com/opinion/article-engineering-a-green-recovery-is-a-terrible-idea/

However, working group members agree that government does have a potential role to play in the sort of "framework" infrastructure that enables decarbonization. Infrastructure that links markets is distinct from assets used for commercial production. For example, infrastructure for long-distance interconnection can help integrate electricity markets between regions, increase the viability of expanded renewable generation and reduce costs for power consumers.[9] By providing a critical link between producers and consumers, such transmission infrastructure may provide wider economic benefits than would accrue to a rate-regulated private owner. Government could provide the funding needed to meet private hurdle rates for projects with public benefits. Indeed, subsidizing the incremental social benefits of private projects is the exact role that the Canada Infrastructure Bank (CIB) should play.[10]

Additionally, government can play an important role in supporting demonstration-scale facilities to pilot transformative new technologies and provide learning-by-doing for future industry-wide deployment. The development of steam-assisted gravity drainage (SAGD) by the publicly funded Alberta Oil Sands Technology and Research Authority (AOSTRA) provides an example.[11] In the present context of facilitating Canada's energy transition, working group members noted small modular nuclear reactors, hydrogen production, and carbon capture, utilization and storage (CCUS) as examples of pre-commercial technologies where government could valuably support demonstrate-scale projects.

As well, working group members agree that adaptation to climate change is an appropriate focus for public expenditures. Infrastructure that reduces risks from extreme weather events presents a classic "public good" role for government. Climate change is expected to increase the physical risks from variable weather patterns.[12] For example, infrastructure to mitigate floods and droughts will be important as communities potentially face increasing variability in weather patterns.

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9 Hastings-Simon, Sara, and Blake Shaffer. 2020. "Beyond pipelines: The nation-building project that could electrify Canada," Globe & Mail. March 17. Available online: https://www.theglobeandmail.com/opinion/article-beyond-pipelines-the-nation-building-project-that-could-electrify/

10 Dachis, Ben. 2017. "The Role for the Infrastructure Bank," C.D. Howe Institute Intelligence Memo. March 31. Available online: https://www.cdhowe.org/intelligence-memos/benjamin-dachis-role-infrastructure-bank

11 Hastings-Simon, Sara. 2019. *Industrial Policy in Alberta: Lessons from AOSTRA and the Oil Sands*. University of Calgary School of Public Policy. November. Available online: https://www.policyschool.ca/wp-content/uploads/2019/11/Industrial-Policy.Hastings.-Nov-1-FINAL-USE-NOVEMBER-CORRECTED.pdf

12 Jonathan Woetzel, Dickon Pinner, Hamid Samandari, Hauke Engel, Mekala Krishnan, Brodie Boland, and Carter Powis. 2020. *Climate risk and response: Physical hazards and socioeconomic impacts*. McKinsey Global Institute. January 20. Available online: https://www.mckinsey.com/business-functions/sustainability/our-insights/climate-risk-and-response-physical-hazards-and-socioeconomic-impacts

Pressing Need for Long-term National Infrastructure Strategy

Canada's lack of any regular and comprehensive assessment of strategic infrastructure needs is a gap in its ability to effectively target spending. Such an assessment would aim to identify broad classes of public investments to (1) enable incremental economic benefits (e.g., through productivity gains) that exceed the costs of delivery and upkeep; and (2) support those public services that align with societal preferences and government objectives. The United Kingdom has established a National Infrastructure Commission with a mandate to publish a National Infrastructure Assessment once during every Parliament.[13] The Commission's inaugural assessment, published in July 2018, outlines a 30-year vision for the country's infrastructure needs, and is complemented by additional studies on specific classes of infrastructure and regional needs.

Working group members agree that any national strategy must be reconciled with the local and regional needs that drive infrastructure priorities. As well, governments face major questions about how working-life adaptations during the pandemic may accelerate certain trends – such as remote work for certain occupations that could dampen use of regional transportation infrastructure and place an additional premium on high-speed digital connectivity.

Finally, working group members agreed that infrastructure building in Canada faces a disconnect between governments' fiscal capacity and responsibility for infrastructure delivery. Working group members believe that, given immediate budgetary stresses facing provincial and municipal governments, the federal government likely will need to increase transfers for infrastructure if local and regional projects are to be delivered. Nonetheless, certain working group members see an immediate opportunity for using federal funds to "break logjams" between different municipal and provincial governments that have slowed the delivery of certain projects.

(2) Insolvency Poses Risk for Recovery – But Canada Has Robust Restructuring Regime

The longer the crisis persists, the greater the risk that widespread insolvencies – particularly of small and medium enterprises – may threaten the pace at which the overall economy can recover, noted working group members.

13 National Infrastructure Commission. 2018. *National Infrastructure Assessment*. Available online: https://www.nic.org.uk/our-work/national-infrastructure-assessment/

Nonetheless, the working group understands that, given current conditions, creditors are often forbearing on defaults by debtors. Although conscious that courts and insolvency practitioners may face a wave of distressed companies, the working group observes that Canada's bankruptcy legislation provides a flexible and efficient set of processes for resolving insolvencies and restructuring businesses. As well, in the face of the crisis, courts have shown remarkable adaptability and progress in adopting digital processes to expedite judicial proceedings.

Widespread liquidation of insolvent businesses could destroy firm-specific knowledge and relationships, impairing the ability of business to resume economic activity as restrictions are lifted. As well, an increased breadth of financial distress could reduce suppliers' willingness to extend trade credit (i.e., since such unsecured credit will have low priority in any bankruptcy).

Notably, more filings under the *Companies' Creditors Arrangement Act* (CCAA) occurred in May 2020 than in any month during the past decade and the second quarter of 2020 will likely see more filings than any prior quarter in the past decade (see Figure 4). Additionally, because receivers are generally appointed under secured credit agreements, rather than through judicial proceedings, insolvency statistics may not capture the extent of financial distress, default of credit and recourse by creditors. However, the number of actual business bankruptcies and proposals (i.e., filings by businesses under the Bankruptcy and Insolvency Act rather than larger restructurings under the CCAA) in April 2020 were 35 percent lower than in March 2020 and 55 percent lower than in April 2019.[14]

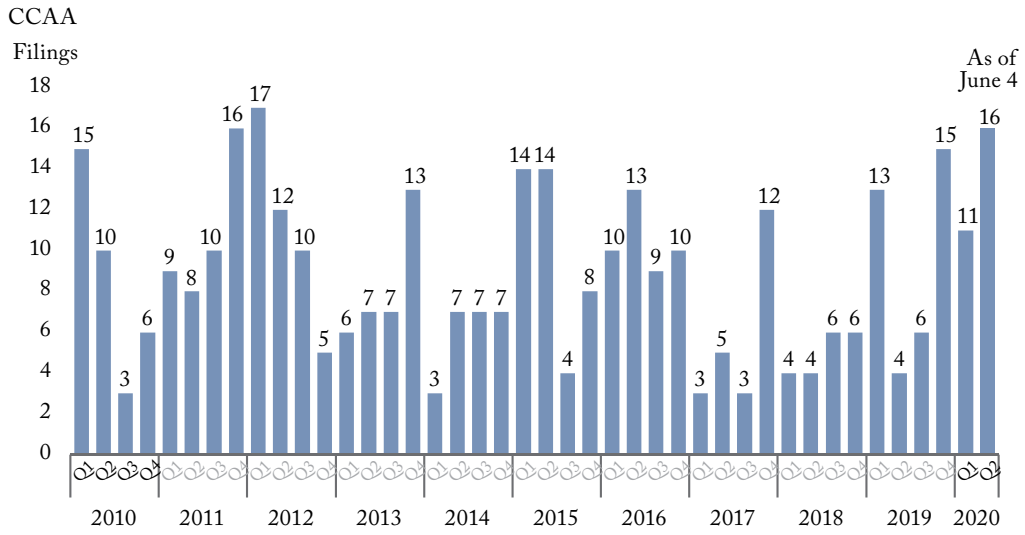
In general, insolvency practitioners are not yet witnessing an unsustainable load of business bankruptcies and restructuring from the crisis. Anecdotally, creditors are generally working with debtors, recognizing the extraordinary circumstances. For many secured creditors, realizing on security would not maximize recovery since there would be limited purchasers for any seized assets. Insolvencies have so far been concentrated in sectors that faced challenges before the crisis (e.g., retail) and businesses with stressed balance sheets.

This working group has previously emphasized the need for "bridge" financing to support viable businesses through the period of weak demand.[15] The continued availability of credit, including

14 Office of the Superintendent of Bankruptcy. 2020. *Insolvency Statistics in Canada – April 2020*. June 3. Available online: https://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/br04308.html

15 Crisis Working Group on Business Continuity and Trade. 2020. *Financing Bridge Needed to Protect At-Risk Sectors as Canada Faces a Long, Hard Road to Recovery*. C.D. Howe Institute. May 19. Available online: https://www.cdhowe.org/council-reports/financing-bridge-needed-protect-risk-sectors-canada-faces-long-hard-road-recovery

Figure 4: Quarterly Filings under *Companies' Creditors Arrangement Act* (CCAA) as of June 8, 2020



Source: Office of the Superintendent of Bankrutpcy (CCAA Records List).

governments' measures to provide market liquidity as well as credit for businesses, will continue to help forestall business insolvency and facilitate the resumption of trade as restrictions are lifted.

If Canada does face a wave of insolvencies of larger enterprises and filings under the CCAA, courts could face the need to triage judicial resources between proceedings. Nonetheless, the CCAA process has a high degree of flexibility and courts have adopted case management processes to effectively manage insolvencies. Moreover, courts actively leverage legal counsel and financial advisors for many aspects of the restructuring process.

In certain large restructurings or in an extreme scenario of widespread insolvencies, governments may have a role to play in providing debtor in possession (DIP) financing for companies during restructuring, but governments should not displace private providers of such credit. Working group members believe that government should only intervene with backstops or facilities where private creditors face demonstrated constraints on their ability to advance sufficient DIP financing.

Finally, working group members did not see a case for legislation that would empower governments to impose a widespread temporary stay on creditors. Such a standstill on creditor collections to provide "breathing room" for debtors has been proposed by, for example, the National Bankruptcy Conference in the United States.[16] Even legislating an option for a standstill would have sweeping ramifications, creating great uncertainty for creditors. Imposing such a standstill would risk a potential cascade of defaults by inhibiting creditors' ability to realize on collateral.

(3) Temporary Government Interventions Must Have a "Sunset" and Ensure Long-run Competition

Working group members are cognizant that temporary government interventions to support businesses may impact competition in the near term. Amid an uninsurable shock to demand in many sectors, the federal government has played critical role in backstopping business credit and providing wage support to preserve employment relationships.

Nonetheless, as recently recommended by the C.D. Howe Institute's Competition Policy Council,[17] the exigencies of the current crisis should not license either a sweeping and sustained displacement of market forces nor central management of the economy for the long term. As governments shift to focus on the recovery, interventions should be based on identifiable market failures, aim to minimally impair competitive intensity and "sunset" on an appropriate horizon.

This working group regards vigorous competition in Canada's marketplace as an imperative for ensuring the long-term dynamism of the Canadian economy. Therefore, in the context of structuring interventions during crisis and recovery, this working group also recommends that policymakers in federal and provincial governments draw upon the expertise of the Competition Bureau to identify market failures, assess market power and evaluate competitive effects from regulatory interventions.

Working group members believe that Canada will need to evaluate the need for domestic manufacturing capacity of products that are essential in public health emergencies. However, capacity to produce

16 National Bankruptcy Conference. *2020 Letter to Congress re Economic Crisis Caused by SARS-CoV-2 Virus*. March 22. Available online: http://nbconf.org/our-work/

17 Competition Policy Council. 2020. *Through Crisis and Recovery, Enforce Competition and Safeguard Open Markets*. C.D. Howe Institute. May 27. Available online: https://www.cdhowe.org/council-reports/through-crisis-and-recovery-enforce-competition-and-safeguard-open-markets-cd-howe-institute

essential goods should not be confused with protection of "national champions." As well, working group members urge governments to reflect carefully on whether emergency needs are better served by maintaining spare domestic production capacity or through advance stockpiling of inventories procured at the most competitive price.

This working group also supported the need to expedite merger review by the Competition Bureau during a period of likely intensified consolidation. With the likelihood of a wave of financial distress facing Canadian businesses and an acceleration in acquisitions, the Bureau must adapt its decision-making on merger reviews to be less formalistic, faster and more flexible. Merger review must enable, rather than inhibit, the efficient restructuring of many industrial sectors that will be financially challenged as the crisis continues and a "new normal" begins to emerge.

(4) Governments Should Calibrate Restrictions to Balance Risk and Economic Cost

Working group members reiterated the importance of a risk-based approach to the easing of restrictions.[18] Public-health buffer capacity and the pace of transmission remain important preconditions for lifting restrictions on activities, but governments must also consider ongoing economic costs.

Quantification of costs and transmission risks for specific sectors and occupations are important inputs into decision-making. Governments should leverage data and analytical tools such as that developed by economists at the Vancouver School of Economics.[19] The VSE COVID Risk/Reward Assessment Tool leverages data on 300 occupations across 100 industries at the provincial level in order to identify costs from restrictions on sectors as well as occupational characteristics that affect viral transmission risk.

18 Crisis Working Group on Business Continuity and Trade. 2020. *Restart Playbook Must Balance Risk with Economic Cost*. C.D. Howe Institute. April 24. Available online: https://www.cdhowe.org/council-reports/restart-playbook-must-balance-risk-economic-cost-crisis-working-group-business-continuity-and-trade

19 Green, David A., Gaëlle Simard-Duplain, and Henry E. Siu2020. "A COVID Assessment Tool to Guide the Opening and Closing of Sectors," C.D. Howe Institute Intelligence Memo. Available online: https://www.cdhowe.org/intelligence-memos/green-simard-duplain-siu-%E2%80%93-covid-assessment-tool-guide-opening-and-closing

Such data-driven tools help governments evaluate risks and benefits for resuming activities, prioritize sectors for re-opening, and target occupation-level initiatives for mitigating spread.

As well, governments face the possibility of a second wave and intensifying transmission, which may require difficult decisions about once again tightening restrictions. To prepare for such a prospect, governments should construct plans that more carefully calibrate occupation-level restrictions to balance the economic cost and transmission risks.

For example, the VSE tool combines occupational characteristics in the workplace – specifically, proximity or close contact with others, frequency of personal contacts, exposure to diseases or infections, interaction with the public, and outdoor work – and behaviour outside the workplace – specifically, commuting on public transit, working from home, living in a crowded dwelling, and living with a healthcare worker. This enables it to generate a risk index for specific occupations. The VSE tool also allows policymakers to quantify impacts of restrictions on sector-level output, overall employment and job loss among low-income earners.

To balance risks and economic costs, working group members recommend that policymakers carefully design any future restrictions and support for impacted workers based on such occupation-level estimates for risks and economic costs.

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Intelligence MEMOS

From: James A. Haley

To: Canada's Policymakers

Date: June 23, 2020

Re: **SECURING THE RECOVERY**

COVID-19 threatens the economic security of all Canadians. It has already led to massive unemployment; it could yet unleash a wave of business failures. Existing bankruptcy frameworks resolve creditor coordination problems and promote orderly restructurings. They are not designed to deal with an economy-wide shock that pushes a wide swath of firms into distress and overwhelms the bankruptcy system. The disruption from such an outcome could impede the robust supply response needed to restore growth and return to full employment.

But risks remain even if the courts are not congested by a wave of business failures. In particular, heightened uncertainty may impair a key element of efficient bankruptcy frameworks—access to debtor-in-possession (DIP) financing.

Bankruptcy disciplines poor management and promotes the efficient utilization of assets. In some cases, this requires liquidation, the sale of assets to pay the firm's creditors. Liquidation entails the destruction of firm-specific "relationship capital," however, and imposes losses on other stakeholders. An alternative approach, the orderly restructuring of failing firms, is preferable because it promotes the efficient utilization of a firm's assets while preserving firm-specific relationship capital.

DIP financing is used to keep the firm viable as a going concern during the restructuring process, enhancing the security of creditors' collective claims. If DIP financing is unavailable or prohibitively expensive—a possibility under current conditions of extreme uncertainty—restructurings may not be an option.

Unfortunately, two factors may limit the availability of DIP financing. The first factor is the *willingness* of lenders to finance troubled firms. DIP financing typically provides a financial bridge to more stable financial conditions for the firm. In the current environment, lenders may be unable to assess the soundness of the financial footings on the other side of the crisis. Recoveries are a function of asset values, which are ultimately driven by liquidity or "cash in the market." If investors are wary of future prospects, they could exercise an abundance of caution and limit such funds.

The second factor limiting the availability of DIP financing is the ability of lenders to increase exposure to firms in financial distress. Lenders mindful of their fiduciary obligations and wary of regulatory and accounting requirements may conclude that they are unable to balance the risk against the expected return from DIP financing.

Recovery of DIP financing must be the first priority. And while DIP financing enjoys senior status should a restructuring prove unsuccessful and the firm is subsequently liquidated, pervasive uncertainty may require lenders to record such high expected losses that scarce regulatory capital is better utilized in support of other business lines. Recent court decisions that elevate some legacy liabilities (e.g., environmental liabilities) and HST claims ahead of DIP financing may increase uncertainty.

At the same time, the role of other creditors in the restructuring process is critical. Even if a lender is prepared to provide DIP financing, other creditors may oppose the restructuring. This opposition can delay and/or increase the costs of restructuring, reducing the likelihood of a successful workout and limiting the availability of DIP financing.

Two measures could help ease these constraints:

First, a DIP financing facility to support restructurings that preserve firm-specific investments. The large banks would need to be involved given their expertise in credit risk analysis and the balance sheet capacity that may be needed to address the potential needs. But bank managers cannot ignore their fiduciary responsibilities to depositors, shareholders, and other stakeholders.

In the current exigent circumstances, some form of public sector backstop in the form of guarantee or stop-loss provision would likely be needed to allow the banks to strike a felicitous balance between risk and return. Since each restructuring entails its own unique circumstances, those negotiating restructurings must have the flexibility to respond quickly and nimbly to secure agreement. Modalities for the facility would need to be clearly specified in advance.

Second, a review of possible distortions that impair DIP financing or create incentives for creditors to seek liquidation rather than orderly restructurings. For example, greater clarity with respect to the priority of pre-existing liabilities could create a more favourable environment for DIP financing. Similarly, past amendments to the Bankruptcy and Insolvency Act regarding the absolute priority of tax arrears may have the unintended consequence of favouring liquidation to restructuring.

The objective of these measures is not to shield firms from the discipline of the market. They are intended to prevent economic scarring—lasting damage to the sinews that bind workers to firms and firms to suppliers—that could weaken supply responses and delay recovery. Such effects are possible if firm-specific investments are destroyed by the liquidation of firms that would be viable if not for the pandemic.

In this respect, the goal is to secure the recovery.

James A. Haley is Special Advisor, Scotiabank Economics. *He gratefully acknowledges helpful comments from and discussions with Ken Thorlakson and Gale Rubenstein.*

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Joel Blit

To: Canadians Concerned about Jobs

Date: July 16, 2020

Re: **COVID-19 Will Transform Our Economy – If We Get Our Policies Right**

Due to the COVID-19 crisis, our economy is undergoing a transformation of unprecedented proportions. This transformation will increase productivity, but more than half a million jobs could be lost due to automation and reallocation.

Since the beginning of the information and communications technology revolution, routine jobs have been disappearing from the Canadian economy. While non-routine employment per capita increased from 31.6 percent to 38.2 percent between January 1987 and January 2020, routine employment per capita fell from 28.1 percent to 23.8 percent.

This decline of routine jobs has not been steady, but rather occurs in predictable bursts; whenever Canada experiences economic downturns, routine jobs are destroyed and never come back. In fact, as shown in Figure 1, the entirety of aggregate routine job losses over the last 30 years occurred during the three major downturns.

The loss of routine jobs during recessions (and downturns) is due both to within-firm automation and between-firm reallocation. Firms are more likely to engage in automation during recessions because of lower opportunity costs, increased manager focus on efficiency, and/or changes to the relative costs and benefits of layoffs. In addition, recessions are turbulent economic times where market share and productive resources are reallocated from less productive (or maladapted) firms to more productive ones. Both mechanisms result in a reduction in routine employment and increased aggregate productivity.

Our economy will experience the same transformation during the current COVID-19 crisis. The self-imposed lockdown means the recession we are now facing is real. Where this crisis is likely to be different is in the scale of transformation.

Superimposed onto the usual recessionary forces of industrial transformation, are COVID-specific health incentives to automate. By replacing workers with algorithms and robots, firms not only help mitigate the risk of infection, they also reduce risk to their operations. Moreover, firms that are already more highly automated will suffer less significant disruption to operations and therefore increase market share. It would thus not be surprising to see a higher fraction of routine jobs being permanently lost than in previous recessions. During the 1991 recession, 8 percent of routine jobs were lost. If the same fraction is lost this time, it would imply more than half a million lost jobs.

This transformation will not manifest equally across all industries. Health-related incentives to automate differ across sectors, as does the feasibility of doing so. One proxy for health-related incentives to automate is, for each industry, the fraction of workers whose job requires close physical proximity to other people. Feasibility can be measured as the fraction of workers that are employed in routine occupations. Figure 2 shows where different industries lie along these dimensions.

Healthcare and social assistance exhibits the highest average physical proximity among workers and hence the strongest health-related incentives to automate. However, it is not clear that significant automation is feasible in healthcare given current technologies. The sectors that are likely to experience the most pronounced transformations are those residing in the top right of the Figure: retail trade, construction, manufacturing, and transportation and warehousing. Among these, retail trade stands out as the biggest candidate.

Not surprisingly, retail is in fact the industry where we have seen the biggest headlines trumpeting change. Walmart recently announced a pilot cashier-less store as it looks to limit human interaction while speeding checkout. Across the industry, market share and productive resources are flowing from brick and mortar stores to more highly automated online stores.

That change is afoot cannot be disputed. What remains to be determined is how best to respond to the challenges and opportunities presented by the crisis. To date, government economic responses have focused on supporting businesses to ensure their survival, subsidizing wages to save jobs, and offering financial support to affected Canadians. In short, policies have aimed to maintain the status quo. But as we put the worst of the crisis behind us, we must embrace change so as to emerge stronger on the other side.

Wage subsidies must be removed so that firm incentives to automate and increase productivity are not stifled. Ultimately, firms that are unproductive or are maladapted to the new ongoing reality must be allowed to fail so that their resources can be reallocated.

The artificial intelligence and robotics revolution that we have been expecting is now at our doorstep. We should embrace it by removing barriers to technological change, by helping to finance investments that make our firms more competitive, and by mobilizing the knowledge that resides in our universities and institutes. The latter is particularly important for Canada's small- and medium-sized businesses.

To be sure, this transformation will entail significant labour market disruption. We should be prepared to assist workers with financial supports like extended employment insurance or a guaranteed basic income (which might naturally evolve from the CERB). Retraining programs could be offered in partnership with colleges and universities. Many affected workers will become under-employed or join the gig economy and we must ensure that assistance also applies to them. The time is now to embark on transformational change, when opportunity costs are lower due to an already upended labour force.

We are in the midst of an historic opportunity. The wave of solidarity and belief in the important role of government presents an opening to reimagine our social safety net, not just to help individuals through this transition, but also to create the institutions and programs that will ensure all Canadians share in the benefits of technology today and for generations to come.

With the right policies, a richer and fairer Canada may emerge.

Joel Blit is Associate Professor of Economics at the University of Waterloo.

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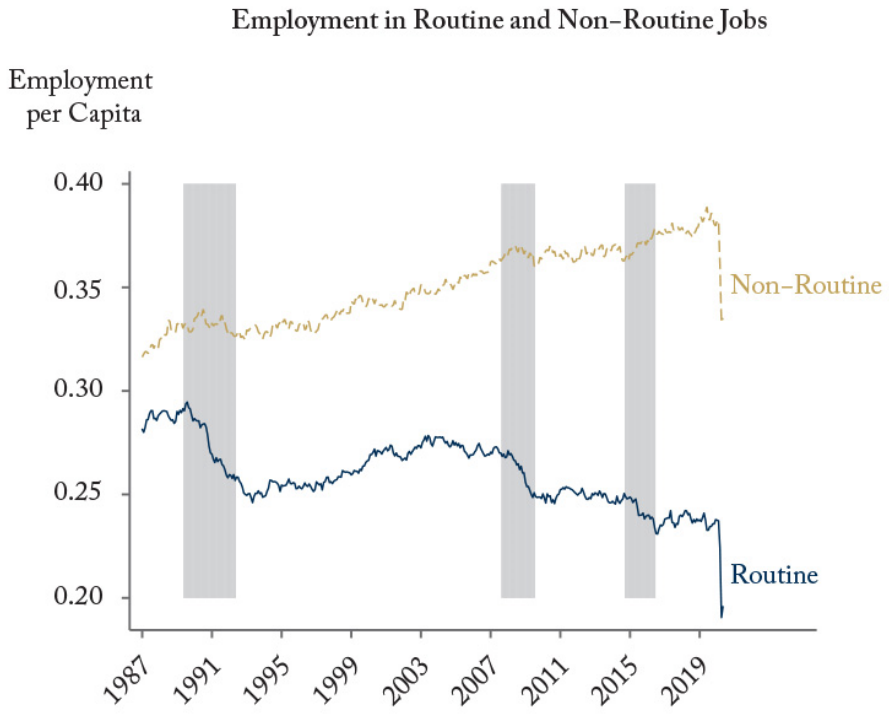
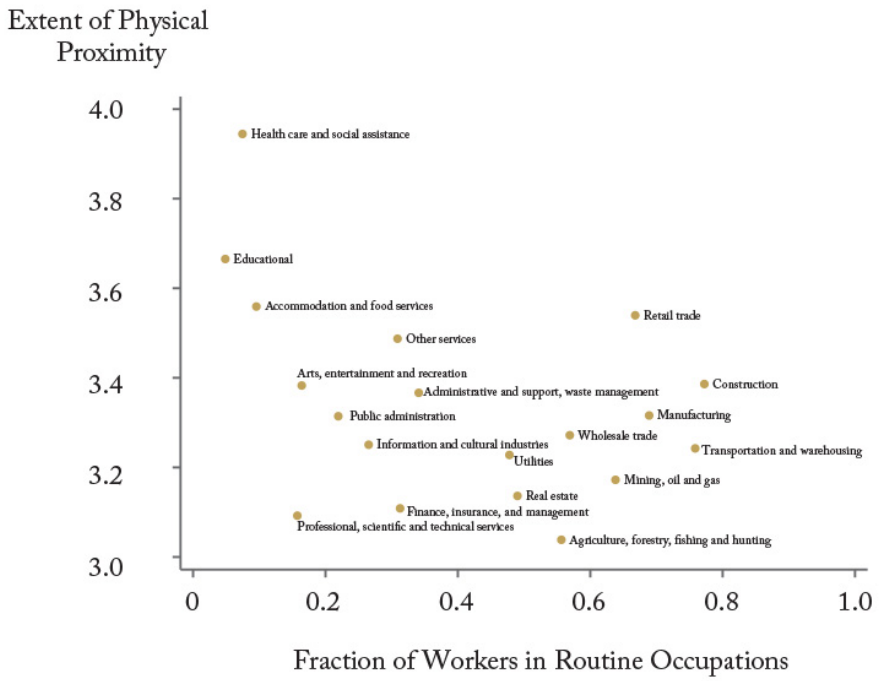
Figure 1



Notes: Economic recessions (and the 2015 downturn) are shaded

Sources: Blit, J. 2020. "Could increased productivity be COVID-19's silver lining?" Forthcoming in Canadian Public Policy Special Issue on COVID-19; Federal Reserve Bank of St. Louis Economic Data; Labour Force Survey (PUMFs).

Figure 2



Source: Blit, J. 2020. "Could increased productivity be COVID-19's silver lining?" Forthcoming in Canadian Public Policy Special Issue on COVID-19.

Intelligence MEMOS

From: John Pecman

To: Canadians Concerned about Competition

Date: July 24, 2020

Re: **Can Antitrust Laws Assist with the Economic Recovery?**

Antitrust enforcers have said they need to remain vigilant to protect consumers and assist with the recovery during the COVID-19 pandemic and economic downturn. Does the strict enforcement of competition laws stimulate a quick economic recovery, or would a more flexible approach in distressed sectors better serve the economy?

Vigorous antitrust enforcement worldwide protects competition and ensures a dynamic of creative destruction, promoting economically efficient allocation of scarce resources, higher quality products, relentless innovation and lower prices. However, during an economic crisis, markets can face disruptions that may impair efficient adjustments of production and prices, resulting in politically unacceptable distributional outcomes and causing longer-term "scarring" for the economy. In the present circumstances, policymakers must reflect on whether competition is truly vital to manage the impacts of the crisis and create the best environment for economic recovery.

First, we note that, for antitrust enforcement, the 2008 financial crisis was "business as usual". The 2008 financial crisis differed from the COVID-19 crisis in cause (i.e., liquidity), effects (primarily a financial shock to demand rather than widespread constraints on real activities) and scale (i.e., the size of the economic contraction). Unlike the 2008 crisis, the economic impacts of the pandemic prompted various countries' competition agencies to loosen their rules.

Notably, agencies emphasize that any temporary flexibility does not mean relaxing enforcement against "cartel" conduct, such as price fixing, limiting quantities or allocating markets. However, agencies have signaled that they will allow competitors to cooperate temporarily to alleviate shortages and ensure the continuity of supply of essential products, such as personal protective equipment and COVID-19 medications. Examples include:

- Permission for exceptional derogations from the European Union's competition rules for the milk, live plants and flowers, and potatoes sectors in order to support the agri-food sector;
- A temporary exemption from Norway's Competition Act to allow two major domestic airlines (SAS and Norwegian) to collaborate on route offerings; and
- Expedited exemptions by the Australian Competition and Consumer Authority for the Australian Banking Association to permit banks to collaborate on implementing a small business relief package.

Should Canada's Competition Bureau allow similar flexibility for non-essential sectors impacted by the pandemic?

The crisis has devastated firms in the travel, tourism, entertainment, and hospitality sectors. The plunge in demand means an unprecedented extent of excess capacity in these sectors. Markets typically respond to excess capacity through consolidation or collaboration. Otherwise, insolvent companies will cease operations, increasing market concentration among the remaining players.

As the global economy teeters on the brink of a prolonged depression, competition agencies will face pressure for more flexible and speedy approaches to aid with the economic recovery. The Commissioner can also exercise the appropriate discretion that serve in the public interest. As well, the OECD anticipates a growing conflict between government subsidization for businesses and competition law enforcement.

Competition law principles developed for "normal" circumstances may be less suited where supply and demand is severely disrupted and industrial supports by governments worldwide have distorted market forces. As noted by US economist Carl Shapiro, "antitrust analysis must always reflect market realities, including financial distress at the industry and/or firm level." In particular, competition enforcement assumes that markets are in stable equilibrium at or near full employment. As an example, data from the pre-pandemic marketplace will not be a reliable benchmark for comparing prices or output levels. Relaxing traditional antitrust enforcement in troubled markets is reasonable where a country is grappling with the more important problems of product shortages, business liquidity and unemployment.

Unlike certain other countries, Canada's *Competition Act* does not permit a more flexible approach to mergers or competitor collaborations which result in a substantial lessening or prevention of competition. The shortcoming was the subject of an April letter from the Canadian Bar Association to the Minister of Innovation, Science and Industry. This letter recommended an amendment to allow the Minister to exempt certain competitor collaborations and mergers from the application of the *Competition Act* on public interest grounds.

Nonetheless, the Commissioner has some latitude to permit certain anticompetitive mergers and collaborations in distressed markets. Specifically, the efficiencies defence allows mergers and competitor collaborations where the resulting efficiencies (e.g., the reduction of excess capacity in a depressed sector) outweighs the reduction in competition. A "failing firm" defence is also available when a company appears on the verge of closure and lacks other potential acquirers. For example, in 1999 the Competition Bureau permitted Air Canada to merge with Canadian Airlines following an expedited merger review and failing firm analysis. In this case, expediently permitting a merger to monopoly in the distressed airline sector was preferable to the liquidation of Canadian Airlines.

To expedite recovery and restructuring of distressed sectors, we recommend the Competition Bureau:

- Clarify and streamline its approach to failing firm claims;
- Use hold-separate arrangements for mergers that do not clearly meet the failing firm or efficiency defences;
- Adopt a broader approach to defining markets (and assessing market share);
- Forgo econometric analysis when pre-pandemic pricing is obviously inconsistent with present conditions (e.g., airlines sector);
- Increase receptiveness to efficiency arguments (e.g., default of no section 11 hearings for distressed sectors);
- Consider broader economic impacts of a merger or collaboration.
- Creatively structure remedies, including behavioral solutions (e.g., no price increases for both passenger travel and cargo delivery beyond those related to operating costs.) where appropriate; and
- Publish comprehensive advisory opinions.

Following the 2008 financial crisis, competition agencies grappled with the consequences of a severe recession for global trade and competition policy. The scale of the COVID-19 crisis increases the urgency and importance of these implications. As the global economy navigates uncertain seas, competition authorities must reflect on how their enforcement can support recovery.

John Pecman is a Senior Business Advisor with Fasken, a Senior Fellow at the C.D. Howe Institute and member of its Competition Policy Council, and the former Commissioner of Competition of the Canadian Competition Bureau.

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Intelligence MEMOS

From: John Knubley and Lawson Hunter

To: Navdeep Bains, Minister of Innovation, Science and Industry

Date: August 4, 2020

Re: **Three Principles for Tougher Foreign Takeover Reviews**

A parliamentary committee is examining recent changes to the administration of the Investment Canada Act, the federal regime for reviewing foreign acquisitions of Canadian businesses.

The pandemic-inspired **changes** include "enhanced scrutiny" of foreign takeovers of Canadian firms that are "distressed," according to an April ministerial statement from Navdeep Bains, Minister of Innovation, Science and Industry.

And, he said, the national security review provisions of the act may be used at the government's discretion. As well, Ottawa would be especially diligent regarding takeovers in the "health sector and other critical sectors," and all transactions by state-owned enterprises – of whatever value – would receive special attention.

Although the changes are well intended, some elements need further consideration.

Our main concern is that economic factors will be given short shrift in the more opaque national security review process at a time when efficiency and timeliness will be crucially important.

The April statement set a $1 billion threshold for net benefit reviews, which are broad-based and largely economic in nature. And, it said, the government may also conduct national security reviews, which typically take longer and apply to any size of transaction.

Most G7 countries and Australia subject foreign direct investment to an economic review. The United States is the only major country that relies primarily on national security reviews, although they are led by the economy-focused Treasury Department.

It goes without saying that our economy – and businesses – will continue to need infusions of foreign capital, as well as a lot of Canadian investment, too. The challenge for the government in conducting more stringent reviews will be in finding the right balance. Stopping foreign investment or imposing a moratorium would make little sense when so many firms may be distressed. Sometimes it will be best to keep firms Canadian. But to save jobs and companies we will, as in the past, need foreign investment.

Subject to reasonable conditions to protect and favour Canada, many foreign takeovers should be approved.

That includes takeovers from China. Some commentators would ban deals with Chinese entities but it is magical thinking to believe we can ignore what by some measures is already the world's largest economy.

Canada is not the only country increasing its scrutiny of foreign investment because of the pandemic. Australia, Germany, France and Italy have all made similar announcements. Most other countries have significantly lowered the review threshold and specified which sectors are of most concern. Germany has also created a fund to help its firms fight opportunistic takeovers.

We believe enhanced reviews will work better for Canada if three goals are met:

First, speedy decisions on acquisitions of distressed assets. Most enhanced scrutiny reviews will use a national security test that is opaque and can take 200 days or longer. And if these really are distressed assets, and if there are lots of them, we will need more timely decisions to save firms and the jobs associated with them.

Second, transparency around the definition of "critical sector" and about issues raised in the review process. Australia openly declared all sectors critical, while France listed such areas as food safety, defence, energy, AI, quantum computing and cyber security, among others. In Canada, we have left "critical sectors" undefined beyond health.

Third, keeping economic security at the forefront. The legal basis for enhanced reviews will fall almost exclusively under the national security provisions of the act, not the economic-based "net benefit" rules. Are takeovers of distressed firms national security or economic issues? We think economic security is mainly at play, even when Chinese firms target technology businesses or specific elements of the energy sector.

National security reviews are led by the deputy minister of public security. But in the case of distressed firms, a better approach would be to have the deputy minister of finance or innovation chair, or at least co-chair, the review. In most other countries, including the US and Germany, economic agencies lead the foreign investment review process with input from other relevant government departments.

It is important we get this right. We want the economy and our firms to thrive. Enhanced reviews of foreign takeovers will need speed and agility. The reviews will also need transparency so foreign investors can have a clearer sense of areas of concern to the government and then better understand where they can invest. The reviews will also need to be driven more by economics and less by national security. This is especially true if we are to get the balance right in the recovery from the pandemic.

John Knubley is a former federal deputy minister. Lawson Hunter, a former Competition Commissioner, is senior counsel at Stikeman Elliott LLP. Both are senior fellows at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

A version of this memo first appeared in the Financial Post.

Theme 4:

Crisis in the Energy Sector

Intelligence MEMOS

From: Glen Hodgson

To: Canadians Concerned about COVID

Date: March 25, 2020

Re: **THE OTHER CANADIAN THREAT: THE OIL SECTOR PRICE SHOCK**

Canada's leaders and policy thinkers are rightly focused today on COVID-19, and its health and economic impacts.

A recession in the first part of 2020, which could be very deep, is a realistic expectation as demand collapses because of public health restrictions.

And regions and firms in the oil sector also face the sharp drop in oil prices today, compounded by rapidly changing prospects for global oil demand.

The deep economic slowdown in China due to COVID-19 contributed to dropping oil prices. And the OPEC effort to regulate supply and stabilize prices has devolved into a price war between Saudi Arabia and Russia, driving down global oil prices.

The key North American reference price, West Texas Intermediate or WTI, has tumbled below US$25 a barrel. The pain is even greater in Canada, where Western Select prices have fallen below US$10 a barrel. A sharp slowdown in cashflow for the sector is anticipated in 2020, perhaps by as much as 75 per cent, with a severe pullback in investment spending and cuts in jobs and salaries.

For Canada as a whole, the net impact of lower oil prices is negative – consumers benefit, but the oil sector and its supply chain suffer, as do investors. For Alberta, as well as Newfoundland and Labrador, this is the latest episode in a painful period stretching back to the previous sharp drop in oil prices in late 2014. Alberta's economy contracted by around 3.5 percent in each of those years and unemployment jumped to 10 percent.

Alberta is now facing yet another recession in 2020, after an expected contraction in 2019. The pressure is acute on the entire provincial economy and on public finances. Large capital investment in the energy sector, drawing upon engineering services and construction, is being deeply affected in the current price environment. The policy initiative to clean up for orphan wells is a welcome stop gap, but very short term. When combined with the impact of COVID-19, we should recognize the prospect of deep recession and the acute impact on many Albertans.

As if that's not enough, the prospects for global oil demand and production are also evolving rapidly, even if oil prices recover to more normal recent levels.

Global oil demand is likely to contract for at least the first half of 2020 because of COVID. And contraction was already in the long-range forecast. After repeatedly under-estimating the growth in energy from renewables, the International Energy Agency (IEA) last November provided two scenarios for oil's long-term outlook. The Stated Policies (or baseline) scenario projected global demand growth that is fairly robust to 2025, but slows sharply thereafter. Global oil demand is projected to increase by only 0.1 mb/d annually on average during the 2030s, eventually reaching 106 mb/d in 2040.

The landscape changes much more quickly in the second IEA scenario, with global policies implemented for achieving faster reductions in GHG emissions, plus more rapid technological change. Global oil demand soon peaks under this scenario and then steadily drops to under 67 mb/d in 2040, which is around two-thirds of current production.

The challenges to the oil sector and producing regions are obvious and will ripple across the entire economy. The negative impact of low prices in the short term could well be joined in coming years by a fight for global market share in a world where oil demand reaches a plateau sooner than many have expected.

For affected firms and for governments, assuming a return to "business as usual" may no longer be realistic or prudent. At this stage, companies and governments need to include multiple scenarios, examining a range of possible outcomes, to inform decision-making. To cope with the extraordinary forces at play, planning and action by both business and government ought to be founded on realism, adaptation, and innovation – and a readiness to continually adjust.

Diversification options like significant expansion in petrochemical production, development of diverse services expertise, and high-value agricultural expansion all become more pertinent. And in the immediate period, significant economic stimulus and adjustment assistance for the affected regions will be required to help mitigate the pain.

Glen Hodgson is a senior fellow at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

From: Brian Livingston

To: Federal and Provincial Governments

Date: April 15, 2020

Re: **Shut and Swap Can be A Lifeboat for Canada's Oil Producers**

The federal government has pledged specific support for Canada's beleaguered oil producers but has yet to deliver.

Ottawa and provincial governments – particularly Alberta – will need to collaborate on the design of support. This note proposes that government provide support to oil producers that shut in production by offering a loan that mimics a "swap" arrangement.

Greg Pardy of RBC Capital Markets has advanced a similar proposal, which he terms "Shut and Swap." Producers would get cash today for production that they would deliver in several months. This would allow them to cease producing and turn back on when prices recover.

The aim of federal assistance should be a "bridge" for producers, allowing them to survive a period of abnormally low prices. Producers and their employees need a life raft. In the present turmoil, government must avoid the uncertainties and lost value from an impending wave of bankruptcies and loss of employment.

Without an orderly shut in of current production, Canada's oil market faces an operational and financial tailspin.

Operationally, there is inadequate demand to take up current production. The Western Canada Select (WCS) price has faced steep declines – now trading below $10 per barrel and possibly facing negative prices. Oilsands resources are especially costly to shut in because of the risks to reservoir integrity and the technical challenges of hibernation.

Excess supply can usually go into storage, providing a buffer. But the tanks are almost full and, when there's no more room, the shut-in process will be immediate and disorderly. Producers will liquidate barrels at firesale prices below variable cost. Without ongoing production, cash flow will disappear.

Nonetheless, forward markets expect oil prices to rise. Current CME futures show an uptick in WCS of about US$8 per barrel by December. Many producers would be viable at those prices. The challenge is to survive that long.

Financially, most oil companies are already shut out of both the debt and equity markets. With credit and capital frozen for oil producers, government is the lender of last resort. And as the ultimate resource owner and tax collector, government has a long term stake in the sector's viability.

Providing a swap-like loan should encourage an orderly shut in of production and provide a life raft of cash flow. The support could be structured as follows:

- Producers shut in production today,
- Government advances an amount reflecting the futures price for each barrel shut in,
- Producers repay this amount in seven months

Mirroring a swap, this would be a commercial arrangement.

Producers would have the option (but not the obligation) to participate. Government could cap its exposure by limiting this swap to, for example, 50 percent of a producer's pre-March output.

Admittedly, such a loan would be unsecured and governments would face credit risk. Some producers may not survive even with this financial assistance. However, the sector needs support now. Urgency does not allow for fine-tuning. The potential cost is warranted given the consequence. If there are no producers, Canadian resources will remain stuck in the ground.

Nonetheless, in advancing this support, government should restrict how funds are used until they are repaid. Covenants might include:

- A company must restrict any payments to shareholders (i.e., no increase in dividends or share repurchases)
- A company must restrict compensation to executives in the form of bonuses and deferred compensation
- A company can meet interest obligations and maturing debt obligations, but not pay down non-maturing debts
- A company should make maximum efforts to maintain current employment and to top up the 75 percent wage subsidy to 100 percent.

Such a Shut and Swap should be easy to implement rapidly. The loan arrangement would be relatively standard. It avoids the logistical challenge and costs of above-ground storage. Oil stays put for seven months, and producers receive immediate cash flow but can hibernate until prices recover.

The government's worst-case exposure for this proposal (i.e., if every participating company goes bankrupt) would be in the order of $4.5 to $6 billion. This assumes 1.5 million barrels per day are shut in for 210 days at current prices over that duration. Government would have a capped downside, an exit strategy and a sunset date.

Is this proposal perfect? No. But it keeps our oil producers alive, and the perfect is the enemy of the good. It can be implemented quickly. It will help the oil and gas sector survive the brutal next six to nine months.

Canada's petroleum sector is in the ambulance. This proposal could get it to the hospital for recovery.

Brian Livingston is Executive Fellow at the School of Public Policy at the University of Calgary.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Grant Bishop and Blake Shaffer

To: Greg Rickford, Ontario Minister of Energy, Northern Development and Mines

Date: April 21, 2020

Re: **AS ELECTRICITY DEMAND SINKS, ONTARIO POWER COSTS RISE 24 PERCENT WITH MORE TO COME**

Many Ontario businesses can expect a surge in their power bills even with the pandemic driven fall in demand and real-time wholesale prices for electricity.

These effects are due to the poor design of Ontario's electricity market. Ontario's government must both (1) take immediate steps to mitigate power costs for Ontario industry and (2) move decisively to reform power pricing.

The current price spike results from the costs of paying guaranteed prices under long-term contracts with many power producers. These costs are bundled into the so-called "Global Adjustment," which is based on settlements at the end of each month (i.e., the difference between guaranteed prices and what generators earn in the wholesale marketplace). The total Global Adjustment is then spread across Ontario's overall electricity load and charged on a per megawatt hour (MWh) basis.

Perversely, a fall in power demand causes higher rates per MWh for Ontario consumers to fund the Global Adjustment. The present crisis will accelerate the vicious cycle of burgeoning power costs for Ontario businesses. As the shutdown continues, Ontario must now urgently confront the burden from the Global Adjustment and its costly long-term power contracts.

The total cost for energy in Ontario is the sum of the wholesale market price – the Hourly Ontario Energy Price (HOEP) – and the Global Adjustment. As illustrated in Figure 1, this total energy cost increased to $133/MWh in March, a 24 percent year-over-year increase. For comparison, the demand-weighted average price in Alberta's power market for the first quarter of 2020 was $70/MWh.

The component propelling the March increase was the Global Adjustment, which increased to $119/MWh, climbing by five percent from February and 50 percent relative to March 2019 (see Figure 1). The preliminary estimate for April projects a further 15 percent month-over-month increase to $137/MWh.

These escalating power costs for Ontario consumers are driven by high-cost policies. Earlier Ontario governments entered into contracts for guaranteed prices for renewable energy resources and natural gas generation capacity. Many of these contracts have terms of 20 years or more.

Such guaranteed prices encourage generation whether power is needed or not. Indeed, for a significant number of hours, the wholesale HOEP dips negative. In 2019, HOEP was negative for 10 percent of all hours. In those hours, consumers and exporters are effectively paid to take Ontario's electricity. Nonetheless, whatever the HOEP during a given month, the bill for paying the guaranteed prices comes due at month's end with a retroactive monthly charge for each MWh of Ontario demand.

With increasing energy efficiency and the ongoing slump in manufacturing, Ontario's electricity consumption has dwindled over past years. This contributed to escalating Global Adjustment costs. Plunging power demand during this crisis will exacerbate these costs.

Ontario's power usage declined in the final weeks of March and this fall has continued into April. Ontario power demand for March 2020 was six percent lower than March 2019. For the week ending April 11, power demand was 12 percent lower than the same week in 2019. The C.D. Howe Institute's dashboard provides daily tracking of Ontario's power demand and exhibits the level relative to the same week and weekday in previous years.

Notably, despite the recent year-over-year decline in Ontario power demand, power generation has actually increased relative to the same week last year (see Figure 2). In the first two weeks of April, the HOEP has declined to roughly $5/MWh from $13/KWh in March. However, incented by contracts with guaranteed prices, generators continue to push power onto Ontario's grid. As a result, Ontario power consumers are subsidizing exports to their neighbours.

The rising Global Adjustment will inflict mounting rates on many power consumers – just as they are struggling to make payments for other costs. But not all Ontario consumers will face the same impact on rates.

With fixed time-of-use rates, many residential and small business consumers are currently insulated from these costs. As well, the Industrial Conservation Initiative (the so-called "High-5" program) allows certain large industrial facilities (so-called "Class A" consumers) to escape the Global Adjustment.

However, while reducing Global Adjustment costs for many Class A consumers, the High-5 program shifts a greater funding burden to other businesses categorized as Class B consumers. In 2019, Class A customers avoided 37 percent of the Global Adjustment allocation. As a result, the average Global Adjustment rate in 2019 was roughly $59/MWh for Class A consumers while Class B consumers paid around $107/MWh.

If generators keep producing power under contract despite plunging demand, skyrocketing Global Adjustment rates will exacerbate the financial challenges facing many Ontario businesses. Ontario's power market is overdue for extensive surgery, but the government must first address today's hemorrhage.

Blake Shaffer is an Energy Policy Fellow at the C.D. Howe Institute and Adjunct Professor of Economics at the University of Calgary. Grant Bishop is Associate Director, Research at the C.D. Howe Institute.

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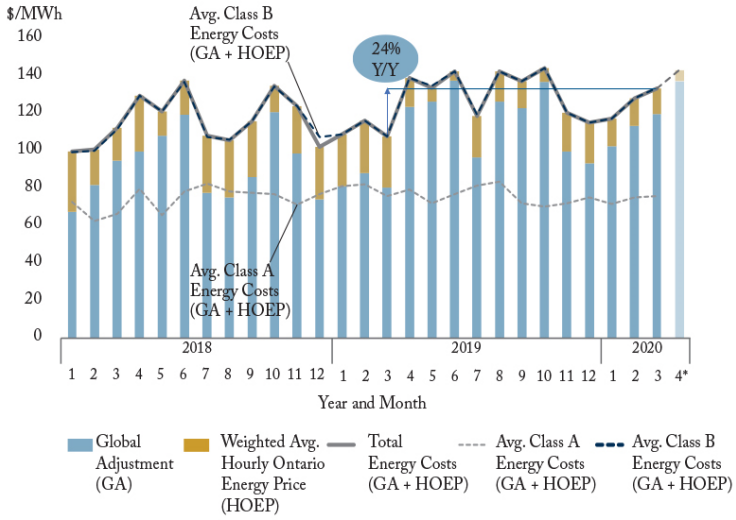
Figure 1

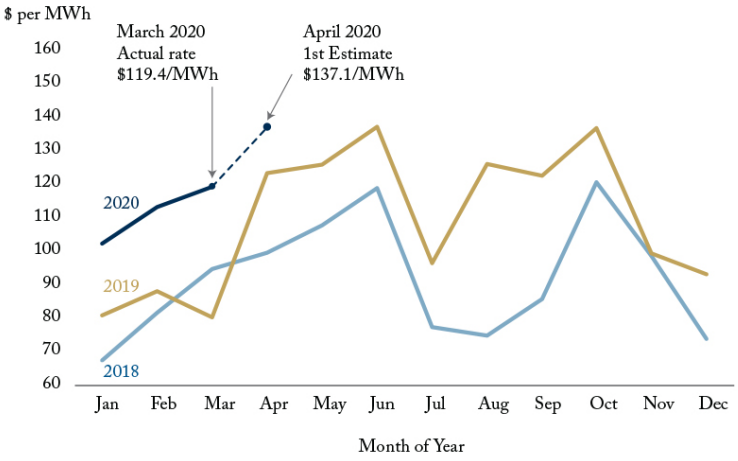
Burgeoning Energy Costs for Ontario Power Consumers



* Projection for April 2020 based on 1st estimate of Global Adjustment and avg. HOEP (weighted by market demand) for April 1 to 15.
Source: Ontario Independent Electricity System Operator (IESO).

Figure 2

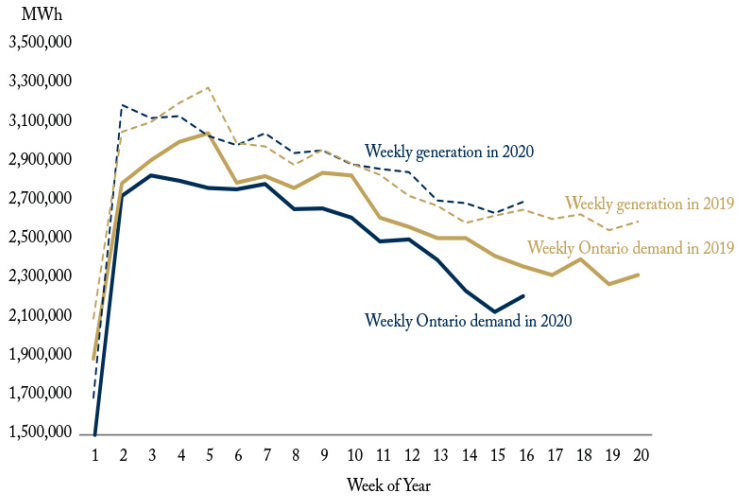
Monthly Global Adjustment Rate for 2018 to 2020



Source: Ontario Independent Electricity System Operator (IESO).

Figure 3

Weekly Ontario Demand and Supply for Electricity in 2019 and 2020 (Year-to-Date)



Source: Ontario Independent Electricity System Operator (IESO).

Intelligence MEMOS

From: Grant Bishop and Benjamin Dachis

To: Greg Rickford, Ontario Minister of Energy, Northern Development and Mines

Date: May 5, 2020

Re: Ontario Industrial Power Prices are Set to Spike: A Four-part Reform

Ontario electricity rates for many businesses will surge just as power demand plunges. This perverse result occurs because reduced load must fund fixed costs for expensive contracts with generators at guaranteed prices. As discussed in an earlier Intelligence Memo, the spike in the Global Adjustment (into which those fixed costs are bundled) risks a death spiral for industrial power usage in Ontario.

Industrial electricity prices in Ontario were a growing problem pre-COVID-19. The government launched consultations in April of 2019. Yet, little progress has yet been announced.

The COVID-19-crisis has now exposed the unhappy effects of Ontario's current market structure. Reforming Ontario electricity rates is the Kobayashi Maru – for non-Star Trek fans, a no-win scenario – of policy problems.

The best path forward is a gradual but decisive transition to more efficient, transparent, and predictable industrial pricing that promotes long-term off-peak growth in electricity use while protecting trade-exposed sectors.

In the immediate term, Ontario's government has helped defray what would have been a 24 percent rise in power costs for industrial users, but only through June. Following this, more comprehensive reform should involve:

1. Transferring this policy-driven cost of paying for renewable power to taxpayers from electricity ratepayers;
2. Introducing an "interruptible rate" and phase-out of the distortionary Industrial Conservation Initiative (ICI or "High-5" program), which contributes to volatility and destroys power demand as industrial facilities chase the same peaks;
3. Transitioning to a time-varying rate for the Global Adjustment – for example, with higher Global Adjustment rates at times when power demand is closer to system capacity; and
4. Introducing express modifiers to reduce power rates for industrial sectors with load that is highly responsive (i.e., highly elastic) to power prices.

First, excessive prices for renewable contracts represent a policy error by an earlier government. The cost of wind, solar and biomass contracts were $3.7 billion in 2019 – representing 28 percent of the total Global Adjustment while only comprising 8 percent of generation. The government should reorient its now $5.6 billion electricity rate subsidy to curb renewable costs for all customers. The current subsidy program is mainly focused on lowering residential power bills. This ignores the impacts of elevated rates on businesses and discourages the siting of electricity-intensive operations in Ontario.

By extracting renewable costs from the Global Adjustment, taxpayers – rather than ratepayers – would transparently fund the costs of previous policy mistakes. The government should also consider means-testing for residential consumers the remaining support it would apply to households.

Second, the ICI should be phased-out. The program distorts power demand by imposing an arbitrarily high marginal cost for consuming power during certain hours. Because the ICI allows an industrial facility to avoid the Global Adjustment based on its share of power during the five hours with the greatest demand during a given year, consuming power during those peak hours represented a cost of approximately $110,000/MWh in 2019. With such excessive costs around peaks, the ICI contributes to increased volatility for directly-connected industrial loads as certain consumers chase the same peaks (see Figure 1). The Independent Electricity System Operator (IESO) should instead create a demand response auction into which ICI customers would make offers for the price to curtail their power consumption when the system is at capacity. This would create a market-based "interruptible rate" for ICI-eligible customers. ICI-eligible customers could get a lower fixed rate based on the amount of their demand they offer into the demand response market.

Third, the Global Adjustment does not vary by hour. Therefore, many industrial and commercial consumers lack incentive to smooth their power consumption. The ICI induces volatility around peak hours but does not encourage overall flattening of daily load. Smoothing load saves costs for a system by reducing the need for additional capacity to meet peak demand. Ontario should move to a time-varying Global Adjustment allocation. For example, the Global Adjustment rate could vary in proportion to the system's reserve margin in a particular hour. This would encourage price-sensitive manufacturers to push production to early mornings to avoid high-use afternoons and evenings. The Ontario Energy Board is examining such a system and should introduce immediately a pilot pricing program for willing customers.

Finally, Ontario should modify rates for highly trade-exposed, electricity-intensive sectors (e.g., pulp and paper and steel manufacturing). Electricity use by these industries is highly responsive to changes in prices. If an industry is highly trade-exposed and/or electricity is a major cost component (see Figure 2), production is prone to "leakage" to other jurisdictions with lower power prices. Offering lower rates to those most able to move production elsewhere, and who would not benefit from a reformed ICI, is both economically efficient and politically palatable.

With Ontario industrial electricity prices set to skyrocket just as demand plummets, now is the time to push overdue reforms.

Grant Bishop is associate director, research, and Benjamin Dachis is director of public affairs at the C.D. Howe Institute.

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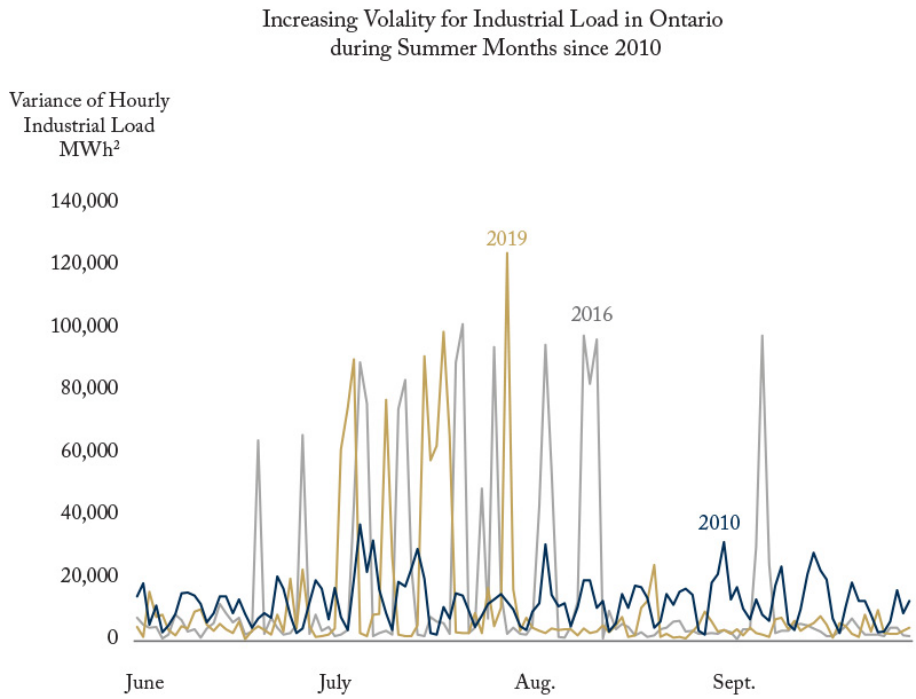
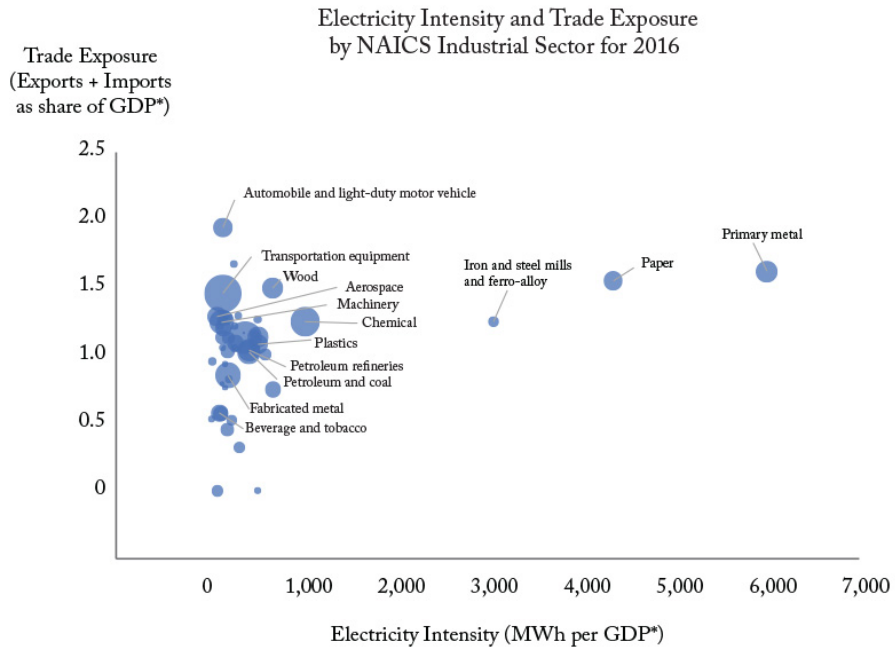
Figure 1



Source: Ontario Independent Electricity Operator (IESO).

Figure 2



* GDP in 2012 constant dollars.
Source: Statistics Canada, authors' calculations.

From: Grant Bishop

To: Jonathan Wilkinson, Minister of Environment and Climate Change Canada

Date: June 26, 2020

Re: **Three Requirements for Canada's Petroleum Industry**

May was a bad month for Canada's beleaguered oil producers. First, the Norges Bank, which manages Norway's sovereign wealth fund, announced its divestment from four oilsands producers, citing their "unacceptable greenhouse gas emissions." Then, presumptive Democratic presidential nominee Joe Biden announced that, if elected, he would cancel the permits for the Keystone XL pipeline. And there was the little matter of an unprecedented plunge in global oil demand thanks to the COVID-19 pandemic.

The Norges Bank's decision is predicated on a misrepresentation of carbon pricing in Canada. Mr. Biden's announcement represents a diplomatic failure, and a potentially fatal setback for a vital project. But those two developments underscore the ways in which Canada has failed to provide a credible pathway for our petroleum producers to flourish in a future of peak oil demand and global decarbonization.

Canada urgently needs three things: clarity around long-term greenhouse gas (GHG) policy, accurate benchmarking for emission intensity (emissions per unit of output), and disclosure standards for energy companies' plans to adapt.

Today, companies face an unstable patchwork of provincial and federal policies around GHGs. The flashpoint around the since-scuttled Teck Frontier mine project – which promised to outperform other facilities on emission intensity – only highlighted the **political uncertainty** facing proponents of oilsands projects. **Significant questions remain**, including around who has constitutional jurisdiction for regulating GHGs. The Supreme Court, for its part, has delayed its hearings on challenges to the federal carbon-pricing backstop until September.

To make investments in new technology and facilities, producers must know the rules of the game and the trajectory for carbon pricing. The price set out by the federal government ramps up to $50 per GHG tonne by 2022, but stops there. Economic **modelling** by the **Parliamentary Budget Officer** and the **federal government itself** shows that this will be insufficient to meet Canada's GHG commitments; the Ecofiscal Commission has **estimated** that Canada will require a $200-per-tonne carbon price by 2030 to achieve its targets.

Without credible and long-term policy on the issue, we risk seeing investors shy away from Canada's energy sector. If investors do not understand Canada's pathway for meeting GHG targets, they will be unable to assess the financial risks facing GHG-emitting operations.

The flaws in the Norges Bank divestment decision illustrates the confusion around Canada's GHG plans. **In its report,** the bank incorrectly characterizes carbon pricing in Alberta, stating that the province lacks a "down-scaling factor" for emission allowances and that "the bulk of the emissions is exempt." The C.D. Howe Institute has **highlighted** distortions in Alberta's Technology Innovation and Emissions Reduction system (TIER) for large-emitter pricing, but TIER does **tighten each facility's benchmark** by one percent each year. Moreover, under an output-based carbon-pricing system like TIER or the European Union's Emissions Trading System, the profit from reducing a facility's emissions intensity is equal to the carbon price. Allowances **do not diminish** that incentive.

Nonetheless, the Norges Bank decision exhibits the intensifying demand from investors that producers rigorously benchmark GHG performance against global competitors, and a belief that oilsands producers emit at a higher intensity relative to the global average, notwithstanding the real numbers.

Canada must do better to help investors understand the decarbonization pathway for our energy sector. Alongside predictable carbon pricing, benchmarking and standard disclosure frameworks will help companies communicate plans to make the transition.

The 2019 report of Canada's **expert panel on sustainable finance** made a similar recommendation, calling for timely, reliable and comparable industry data to enable informed investment and lending decisions. As former Bank of Canada chief Mark Carney has **emphasized**, asset managers need a "50 shades of green" taxonomy for reporting performance and progress, rather than just a binary "green" or "brown" approach.

And that's the irony: the four oilsands producers targeted by Norges Bank do provide audited GHG reporting and sustainability disclosure in accordance with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures. But the conditions are such that companies are forced to formulate their own scenarios for stress-testing and guess at the future carbon price. They lack accurate, up-to-date benchmarking to show where they stack up against the competition on the carbon curve.

Canada's beleaguered oil patch does have cause for anger. But petroleum producers know that no problem was ever solved by yelling into the wind – and so it will need to lean on its long record of innovation around the problems being laid at their feet.

Grant Bishop is Associate Director, Research at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

A version of this Intelligence Memo was first published in The Globe and Mail.

Intelligence MEMOS

From: Glen Hodgson

To: Canadian Energy Watchers

Date: July 21, 2020

Re: **THE GOALPOSTS KEEP SHIFTING FOR THE CANADIAN ENERGY SECTOR**

Canada's energy sector has been hit by an array of factors, global and domestic, that are constraining its capacity to operate and expand. The sector is being squeezed by uncertainty on many fronts – expansion of energy transmission infrastructure, unstable Western Canadian Select price discounts, access to investment capital, protracted regulatory approval processes, and a need to adapt to changing climate policy and limit GHG emissions from energy production.

The pandemic-induced shutdown and wobbly recovery is the latest shock, which has hit the energy sector hard. How are prospects for the Canadian energy sector being affected?

The International Energy Agency (IEA) recently released data for the initial shock of the shutdown, and the energy goalposts have clearly shifted. Global energy demand was down by 3.8 percent in the first quarter of 2020, covering only the beginning of the shutdown period. Oil demand was down nearly 5 percent due to the sharp and rapid drop in aviation and personal transportation, which together represent nearly 60 percent of global oil demand.

For the full current year, the IEA is projecting an incomplete recovery in economic activity and extended restrictions on mobility. Under this scenario, global oil demand would be down by 9 percent for the year, returning annual oil consumption to 2012 levels – a hard shock to revenue, jobs and investment. Oil demand is projected by the IEA to recover somewhat in the coming months, but it would still be about 3 percent below end-2019 levels at the end of 2020.

Global electricity demand has also fallen due to the pandemic-induced shutdown, with knock-on effects on the power supply mix. Demand fell for most conventional sources of electricity generation, including gas, coal and nuclear power. Gas demand declined by about 2 percent in Q1 and could fall for the full year.

Yet electricity output from renewables has been largely unaffected. Renewables were the only energy source that posted global growth in Q1, driven by larger installed capacity and priority being accorded for transmission and distribution. The IEA expects renewable power production to continue to increase, largely because of market forces – low development and operating costs, which are moving renewable electricity production to the front of the queue in power systems.

Not surprisingly, global CO2 emissions are projected to decline by up to 8 percent in 2020, returning to levels last seen a decade ago. Such a reduction in emissions could be up to six times larger than the previous record reduction in 2009 due to the global financial crisis.

Does the sharp drop in energy demand represent a temporary shift in the goalposts, or reflect a more persistent structural change? To address that question, three forces ought to be considered.

The first is the pathway for economic recovery and the impact on energy demand. Oil demand's recovery will encounter numerous hurdles. Air travel is likely facing a prolonged recovery period, as occurred after a previous shock like the 9-11 terrorist attacks. Expanded working from home and a hesitancy to use public transit would also influence the recovery in oil demand.

The second key force is the impact of market forces on the relative cost of producing energy. Natural gas is crowding out coal as a feedstock for thermal electricity generation in North America because of low prices for gas. Renewables have gained a material price advantage over conventional sources of electricity generation in many circumstances, feeding an ongoing structural shift toward renewables like solar and wind.

And, third, policy and business decisions are changing the overall global operating environment for energy. These include carbon pricing, regulations and subsidies designed to limit GHG missions. There are also rising expectations of disclosure and transparency by business generally, and particularly by the financial sector, on GHG emissions and energy investment.

The interaction of these forces points to a structural shift in favour of renewables, and against coal. The net impact on oil (and gas) in Canada and globally is less clear. The IEA had projected in November 2019 that global oil demand would reach a plateau in 2025, at around 106 million barrels a day. But with the shock to oil demand caused by the shutdown, the plateau in global oil demand will likely be lower (and perhaps reached earlier), at a time when Canadian producers were aiming to grow their market share through improved access to global and US markets.

In sum, multiple factors are at play in oil (and gas) markets. Market-determined asset values, and access to new capital, will be critical real-time indicators of what the market thinks about the prospects for Canadian oil and gas. We will only have certainty on developments after the fact, but it's hard to ignore the negative factors adding up.

Glen Hodgson is a senior fellow at the C.D. Howe Institute.

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Theme 5:

Planning for the Recovery

Intelligence MEMOS

From: William B.P. Robson and Grant Bishop

To: Canadian Telecommunications Users and Regulators

Date: March 24, 2020

Re: **Coronavirus Crisis Shows Value of Robust Digital Infrastructure**

Like so many Canadians, we at the C.D. Howe Institute responded to the COVID-19 crisis by suspending almost all in-person activities.

As in most workplaces, everyone at the Institute is collaborating online and by teleconference. Meetings with members and stakeholders are virtual.

All over Canada, people are getting information, communicating with suppliers and customers, buying, selling and transferring funds through wires and wireless networks. Education is going online. Healthcare's transition to virtual has accelerated, with consultations and follow-ups increasingly managed remotely.

This change is a vivid example of the value of robust digital infrastructure that is reliable and cost-effective day-to-day, and able to handle surges in demand under stress. Just as we need a healthcare system that can accommodate sharp increases in acute-care requirements, just as we need border infrastructure that can deal with extra traffic or screening, we need telecommunications infrastructure that can reliably connect us when other ways of carrying on business and staying in touch with each other do not work.

Over the past week, use of Canada's telecommunications networks has surged. Providers tell us that traffic has been unprecedented, and their network overseers are on overtime to ensure system reliability.

Some users, like us, experienced temporary delays in connecting. Cell networks got congested in certain locations. Overall, however, services held up robustly as shut-in Canadians browsed the web, video-conferenced, battled each other's online avatars and binged on streaming services.

Why did this acceleration in digital activity and heightened virtual connectivity work? Because generations of technological progress and physical investment now deliver unprecedented amounts of data across wires and airwaves close to the speed of light.

Lower quality networks would have buckled under the increased demand. A recent report by Boston Consulting Group's Centre for Canada's Future highlighted the history of capital investments in Canadian telecommunications facilities that have yielded world-leading network quality. The enabling role of communications infrastructure – and the extent to which its benefits spill over to society – are much in evidence. Which underlines the importance of a regulatory environment that promotes further investment in this increasingly critical sector.

The federal government and Canada's communications regulators have recently emphasized three priorities. One is geographic. Canada's size and large areas of low population density are challenges for telecommunications infrastructure. Rural and remote connections lag network speeds in higher density centres. But any policy response to this so-called digital divide must wrestle with economic questions: extending equivalent coverage to remote areas involves significant fixed costs ($8 billion is a recent estimate to close the broadband gap).

Demand from prospective users may not deliver sufficient profits to compensate for the outlay. We have fresh evidence of the positive externalities from connectivity. Are governments ready to subsidize the investments to make them attractive to the people who must build them?

Another priority for the government is price. As cellular services have become increasingly central to daily life, the cost of data – whether for online banking, checking COVID information from health ministries, or watching Tiktok – has become a populist issue. The federal government has mandated a 25 percent reduction in cell service charges. Cutting revenue would undermine, not enhance, the incentive and capacity for telecom providers to make the infrastructure investments we want. This is not a good time for supply-crimping price controls.

The third, related to both coverage and cost, is mandated access to the existing networks by new providers. The flashpoint (before COVID-19 sidelined other issues) was whether re-sellers of telecom services should have more access at lower rates to providers' infrastructure. As outlined in a communique from the Institute's Competition Policy Council last week, there is a risk that such mandated access could impair future investments and stagnate roll-out of Canada's next generation of digital infrastructure.

Recent experience demonstrates that, whatever discontents the federal government may be channeling, the quality and coverage of Canada's networks, the cost of services, and the variety of platforms and carriers available, is impressive.

Our telecommunications infrastructure is a vital asset. Good public policy should strengthen it.

William B.P. Robson is President and CEO and Grant Bishop is Associate Director, Research, at the C.D. Howe Institute
To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Jeremy M. Kronick and William B.P. Robson

To: Bill Morneau, Minister of Finance

Date: May 21, 2020

Re: **Making Sure Zombie Firms Aren't Propped up Post-COVID**

COVID-19 has put much of Canada's economy on life support. As we emerge from the crisis and resume more normal activity, a challenge awaits. We do not want viable businesses to disappear. But we also do not want zombie firms to live on indefinitely.

Early in the crisis, governments reasonably prioritized supporting households and businesses through central banks, government lenders and transfer payments. Going big and broad made sense to help us survive the sudden stop.

We now need to navigate a different problem: letting firms go. In an ordinary year an amazing number of businesses in Canada appear and disappear. In 2017, 143,000 businesses came into existence – about one for every eight that already existed. That same year, 127,000 businesses went out of existence – about one in nine. That is normal and healthy, part of the innovation and adaptation that over time give us higher incomes and better goods and services.

As we reopen and explore the changed domestic and international landscape, the goal is an economy full of businesses that can thrive in the post-COVID world. Some are good to go now. Some will require new, patient capital. Others may need restructuring, even complete reorganization, but with the right steps they can emerge on the other side with a bright future. Yet others are still to be born.

The danger is that in our desire to help healthy companies survive we continue to support companies that, unfortunately, have no future in a world in which people will live, work and shop differently. That way lies zombie-land: too many businesses that cannot make the investments in physical and human capital to produce better products, pay higher wages and increase our living standards; and too few enterprises that can.

The federal government's new Large Employer Emergency Financing Facility appears set to accept conditions different from those private lenders would want. As we reopen, however, it should be up to private investors to determine where –and where not – to lend, so that rewards for good decisions and punishments for bad ones once again steer saving to where it can do the most good.

There is plenty else for governments to do. Changing regulations that limit lending by banks and insurance companies in the post-COVID world probably makes sense. That kind of change is neutral: it does not disproportionately prop up one sector at the expense of another. Other changes that can help private capital fill in as government lenders withdraw should also help transition to the new environment without encouraging lending to businesses that can do no better than stagger along.

Governments will also have to wind down their crisis transfer payments – the federal wage subsidy – without replacing them with sectoral supports that impede the adjustments Canadians need to thrive in the long run. We and our customers abroad will still eat, use telecommunication and transportation services, and consume fossil fuels. But we will consume many of these things differently. Some business models that looked viable in 2019 will not be right for 2021.

Better than propping up zombies is an assisted exit and, if firms move quickly, perhaps no exit at all, with restructured businesses emerging livelier and more productive on the other side. In normal times, bankruptcy carries a stigma: nobody goes into business to fail. In a pandemic, stigma may not be such a problem. Our bankruptcy laws are about allowing businesses to reorganize and restructure through negotiations with creditors. Canada has plenty of success stories of companies entering insolvency and coming out stronger. Time is of the essence, however. Ottawa should find ways to streamline the insolvency process, lowering its cost and complexity so surviving firms get up and running as soon as possible.

Governments have blunted the crisis but they cannot remake the world the way it was before COVID-19. Some businesses can survive without the crisis supports. Others would have disappeared anyway or will not survive in the new world. We do not want zombies. We want dynamism and innovation. Businesses that cannot succeed need to wind down so that businesses that can succeed will thrive. Governments should not be choosing which businesses stay upright - private lenders and investors should make those calls. Governments should, on the other hand, use our suggestions to ensure the calls get made.

Jeremy M. Kronick is Associate Director, Research at the C.D. Howe Institute where William B.P. Robson is President and CEO.
To send a comment or leave feedback, email us at blog@cdhowe.org.

(A version of this originally appeared in The Financial Post.)

From: Jennifer Robson

To: Federal and Provincial Policymakers

Date: June 5, 2020

Re: **Not Stimulus, Rehab, That's What the Economy Needs.**

Back in March, I mused that the COVID-19 shutdown was like a medically induced coma.

Used in cases of severe brain trauma to protect a patient's life by temporarily suppressing activity that could cause further harm, the drugs that induce them are slowly withdrawn only when the patient is well enough. Medical teams don't use stimulants to get the patient up and out of hospital.

The nascent debate over whether Canada's next policy priorities should be stimulus for aggregate demand or stimulus for shocks to supply, are misguided on at least two fronts.

First, given the potential for a second wave of COVID infections, "stimulating" the economy could be wrong-headed. If governments start to invest in large-scale and traditional infrastructure, a gold-standard response to economic recessions for decades, only to have to halt work, cost overruns due to delays will mean that Canadian taxpayers get less value for money on each public dollar. Canada already has a mixed record, at the best of times, on sticking to project budgets and demonstrating return on investment when "shovel-ready" is used as the primary selection criterion.

Second, the economic impacts of COVID are on both the supply and the demand side. There's ample evidence from OpenTable and Google mobility data that consumers had already adjusted their behaviours well before government-mandated shutdowns. No re-opening policy plan from government will change the fact that it is consumers who will decide when and how safe they feel to resume a range of activities, whether the supply of goods and services remains constrained or not.

What the Canadian economy needs now is not a big injection of traditional stimulus. What it needs is rehabilitation therapy. The goal of rehabilitation is to support a patient as they regain independent functions, step by step, recognizing the risk of setbacks. It is not a quick fix. Government spending should be on measures that will support Canadians in the recovery, even if a second COVID wave requires shutdowns.

Here are a few examples of what an economic rehab program for Canada should include:

- Spend on infrastructure, but on immediate projects that will bolster the essential goods and services that we lacked most during the shutdown. Spend right now on public education buildings, on parks and safe public spaces, on long-term care and health infrastructure as well community services like libraries and community centres that can provide safe and free internet access to the tens of thousands who still don't have it at home. For example, let's help childcare providers convert to lower-density but multiple-location service models so that more childcare spaces can resume and be sustained, even if we have a second wave.
- Reassure Canadians through clear and consistent health information, especially as scientific understanding changes and advances. Parents won't send kids to school, diners won't come to the restaurant and tourists won't travel if they don't feel safe. While it may be true that the epidemiological curves mean that what is safe in Richmond, BC is unsafe in Richmond Hill, Ontario, people in communities need to be able to trust that their governments are giving health advice informed by scientific evidence. This requires ongoing coordination among health authorities and transparency about the evidence base for government policy in re-opening.
- Deliver clear health guidelines to workplaces and clear recourse to workers. Workplace health and safety has to be prioritized over profit. COVID outbreaks in meatpacking plants, warehouses and in agriculture have exposed vulnerable workers and should be a warning to us all. Employers who are re-opening workplaces need to know their obligations. Workers need to know their rights and to have recourse to effective regulators who can enforce them. So far, regulators seem to be struggling to conduct effective workplace inspections without putting their own employees at risk.
- Accept the ongoing requirement for accessible and responsive income support to Canadians who need it. Starting in early July, perhaps as many as two million Canada Emergency Response Benefit (CERB) claimants will have exhausted their benefits, with another six million to follow in the months ahead. The number of CERB exhausters, and exhausters without recourse to Employment Insurance (EI), will continue to grow over the summer unless there is a sudden and massive change to current employment trends. Without action, we risk encouraging the underground economy and a major increase in provincial welfare caseloads, neither of which offers any real stability. For those unemployed workers who can't get EI, the CRA could still deliver a CERB-like benefit that pays EI-level benefits, requires applicants to disclose monthly employment income and employer information, and adjust benefits accordingly. The EI Working While on Claim program should likewise be streamlined to handle a higher caseload.
- Invest in the services that will help displaced workers regain employment. In normal times, EI also unlocks access to support for job search, skills development and self-employment coaching. Canada's employment program and training providers need to be marshalled and resourced to meet a new level of demand, including serving the millions not covered by EI. And they need to do all of this in a way that permits social distancing. At the height of the shutdowns, the federal government unveiled a very generous package for students and recent graduates who will now face a very difficult labour market. Looking ahead, we need a strategy to help adult learners.

Jennifer Robson is an Associate Professor of Political Management, Carleton University.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Trevor Tombe

To: Provincial Employment Ministers

Date: June 29, 2020

Re: **POTENTIAL GAINS FROM PROVINCES EASING LABOUR MOBILITY BARRIERS**

Migration is central to Canada's economic development, especially in the West.

International immigration receives significant attention, but interprovincial migration is no less important. In normal times, according to the latest 2016 census data, more than 260,000 Canadians move from one province to another each year. Not all stay, and the volume of migration varies over time, but over the latest five-year period, nearly 830,000 Canadians made such a move – and Alberta was the top destination, with more than 226,000 moving into the province.

These interprovincial flows have added significantly to economic activity in Alberta. In a forthcoming C.D. Howe Institute research paper with Daniel Schwanen, I quantify the potential gains from labour mobility. One result is striking: had there been no interprovincial in-migration between 2011 and 2016, Alberta's economy would be nearly $17 billion (or nearly 5 percent) smaller.

The intuition is simple. Each migrant increases economic activity by (approximately) the amount they contribute to output. This is their "marginal product of labour." In Alberta, nominal labour productivity measured as GDP per worker is nearly $150,000 per year. If it were as simple as each person moving to Alberta creating the same economic benefit, each additional 1,000 workers would increase GDP by $150 million.

We go beyond this simple estimate and build on previous quantitative models that feature many complexities. Specifically, we account for differences between workers, sectors, and regions, for how "sensitive" workers are to migration costs, for trade between regions and sectors, and for diminishing returns from migration. That is, gains from migration to a region will diminish as more workers move in.

Going forward, migration may be central to how we recover from the COVID-19 pandemic and resulting economic disruption.

Some sectors are harder hit, as are some regions. Lower fuel demand and lower energy prices create a significant challenge for oil-producing regions like Alberta. Labour mobility across occupations, sectors, and regions is an important way in which economies can respond to shocks.

But such migration is not easy. Those with credentials and certifications from one province may be required to recertify if they move. It may require courses, examinations, or other steps to be completed. The difficulties differ by occupation, profession, and trade, to be sure, but despite recent progress the additional paperwork, time, and explicit costs can represent a meaningful barrier for interprovincial migration in Canada.

Provincial reforms to make moving across provinces easier has a number of benefits. In our analysis, we estimate large gains from lower migration costs.

If costs of moving into Alberta, for example, decline such that workers who move save the equivalent of $500 per year (or, roughly, half a percent of annual earnings), then roughly 30,000 additional workers will migrate to Alberta, and the overall provincial GDP increases $4.3 billion – or just over 1.2 percent. This is a substantial reduction in migration costs, but illustrates potential magnitudes – actual cost reductions will depend on the details of specific policy reforms.

Importantly, this scenario does not necessarily reflect reductions that literally save a mover $500 per year, but could also reflect large one-time up-front costs that, when expressed in annual terms, are the equivalent of $500 per year.

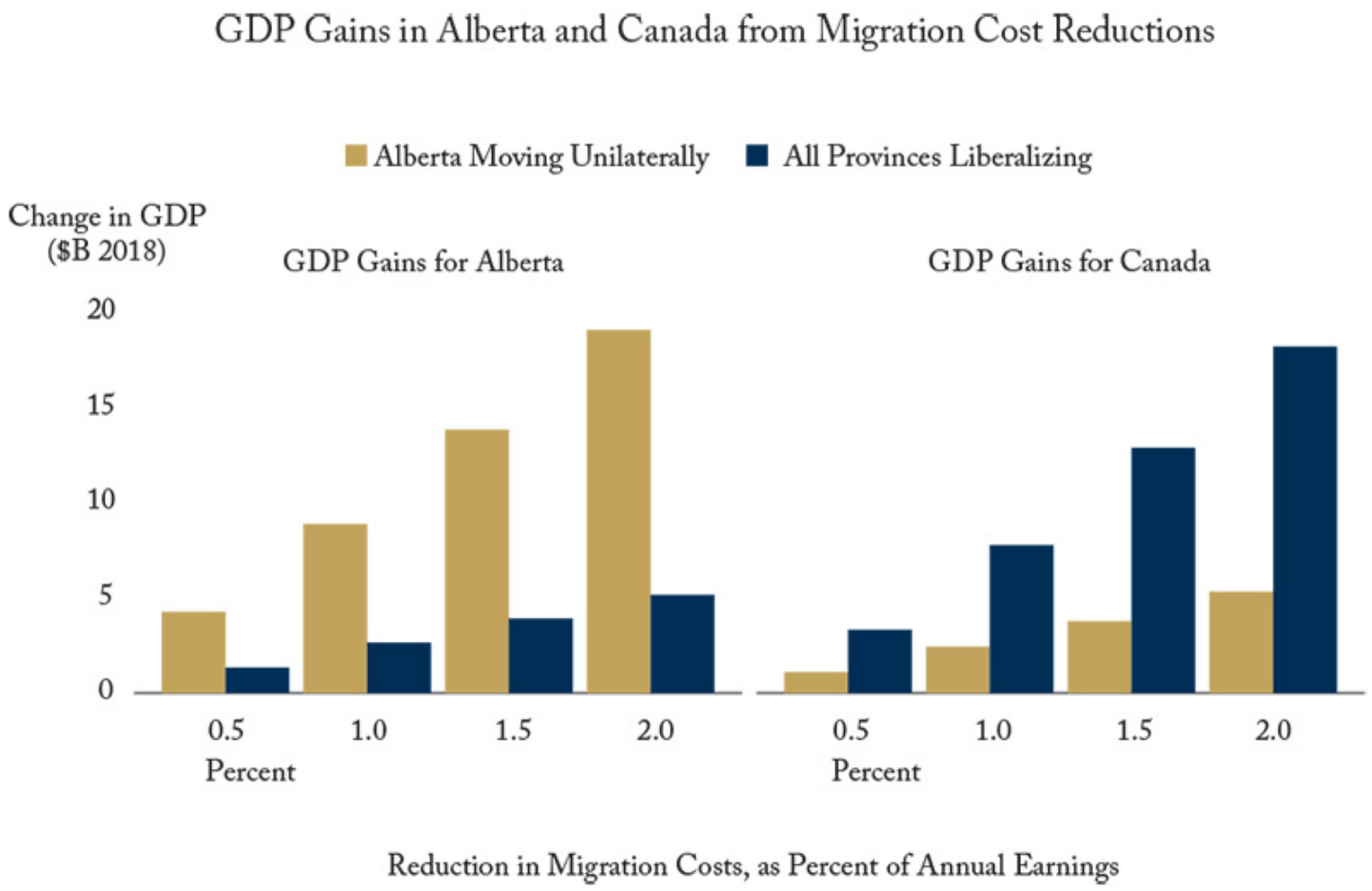
In any case, we illustrate several scenarios in the attached Figure. At the high end, reductions in costs equivalent to 2 percent of annual income would yield GDP gains and migration flows equivalent to what Alberta saw from 2011 to 2016. Overall, as a useful rule-of-thumb that holds across a range of scenarios, Alberta's GDP increases by more than $141 million per 1,000 additional workers that move in. Economic activity is not merely shifted between provinces, but aggregate national productivity also increases. Of course, national gains are larger if all provinces liberalize together, but gains exist even if a single province moves alone.

If Alberta's recovery from COVID-19 is sluggish due to low oil prices, net outflows of workers is a real possibility. But we estimate more than three-quarters of the variation in Alberta's net migration is due to changes in volume of in-migration. Making it easier to move into Alberta during this time may therefore help mitigate what would normally be a net outflow.

Flexible labour markets and easing potential barriers to mobility are an important consideration for governments, especially Alberta, as we recover from the Great Lockdown.

Trevor Tombe is associate professor of economics at the University of Calgary and research fellow at the School of Public Policy.

To send a comment or leave feedback, email us at blog@cdhowe.org.


GDP Gains in Alberta and Canada from Migration Cost Reductions
Alberta Moving Unilaterally
All Provinces Liberalizing
Change in GDP ($B 2018)
GDP Gains for Alberta
GDP Gains for Canada
20
15
10
5
0
0.5
1.0
1.5
2.0
Percent
0.5
1.0
1.5
2.0
Percent
Reduction in Migration Costs, as Percent of Annual Earnings

Crisis Working Group Report: Business Continuity and Trade

Communiqué #9: Support Digitization of Small Businesses and Boost Interprovincial Trade

To help Canadian governments confront the public health and economic crisis resulting from COVID-19, the C.D. Howe Institute established several working groups to rapidly distill expert policy advice. The Working Group on Business Continuity and Trade is co-chaired by Dwight Duncan (Senior Strategic Advisor at McMillan LLP and former Ontario Minister of Finance) and Jeanette Patell (Vice-President of Government Affairs and Policy for GE Canada). Its membership includes industry experts and economists. Grant Bishop, Associate Director, Research, and Daniel Schwanen, Vice-President, Research, at the Institute support the group. Meeting regularly, it has identified and prioritized policy challenges and communicated members' views in published communiques. The group held its final meetings on June 16 and July 14, 2020.

With policymakers now focused on navigating economic recovery from the crisis, the working group's final discussions highlighted the importance of supporting recovery of the private sector and championing economic openness. Through the past months, the working group has noted the headwinds to recovery from diminished private investment and disruption of small businesses in particular. The group has consistently emphasized the degree to which a small economy like Canada's benefits economically from open trade and investment.

The final meetings highlighted these policy priorities:

- addressing vulnerabilities for small and medium-sized businesses;
- accelerating private-sector capital spending;
- reducing barriers to inter-provincial trade and mobility;
- resolving confusion around Canada's foreign investment review regime.

In the near-term, the working group observed the rapid pickup in economic activity as provinces have eased restrictions. However, it highlighted continuing uncertainties around the COVID-19 pandemic – especially the impact of a second wave – and the potential for recovery to stall after the current bounce.

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Based on aggregated credit card transactions, consumer spending levels through July are above year-ago levels.[1] Many economic indicators – particularly for materials sectors (metals, petroleum and non-metallic minerals) – remain depressed: through July, total weekly traffic for goods shipments on Canadian railways remained 10 percent lower than in 2019 and petroleum-sector drilling activity is 65 percent lower than in 2019.[2] Air travel also remains severely diminished, with traffic in Canadian airspace 71 percent lower than in June of last year.[3]

Measures for credit support and forbearance by creditors appear to have forestalled widespread insolvency, evidenced by the 15 percent year-over-year June decline in business bankruptcy filings.[4] Nonetheless, businesses have experienced significant disruption, and small businesses have borne the brunt of net employment losses across all industries (see Figure 1). Many small businesses will continue to face financial pressures from operating at under-capacity and incurring fixed costs for adaptation.

The headwinds facing the recovery increase the importance of measures to boost private-sector investment and facilitate domestic economic activity. In previous communiqués, the working group stressed that Canada faces the prospect of a protracted period of depressed demand for export-focused sectors.[5] Such depressed demand will, in turn, reduce capital spending in these sectors. This poses a significant risk for a prolonged period during which Canada's economy operates at under-capacity.

The working group believes that governments should consider measures to help small businesses transition – particularly to offset fixed costs of physically distanced operations and digitizing their operations and sales channels.

1 RBC Economics. COVID Consumer Spending Tracker (Updated August 10, 2020). Available online: https://thoughtleadership.rbc.com/covid-consumer-spending-tracker/.

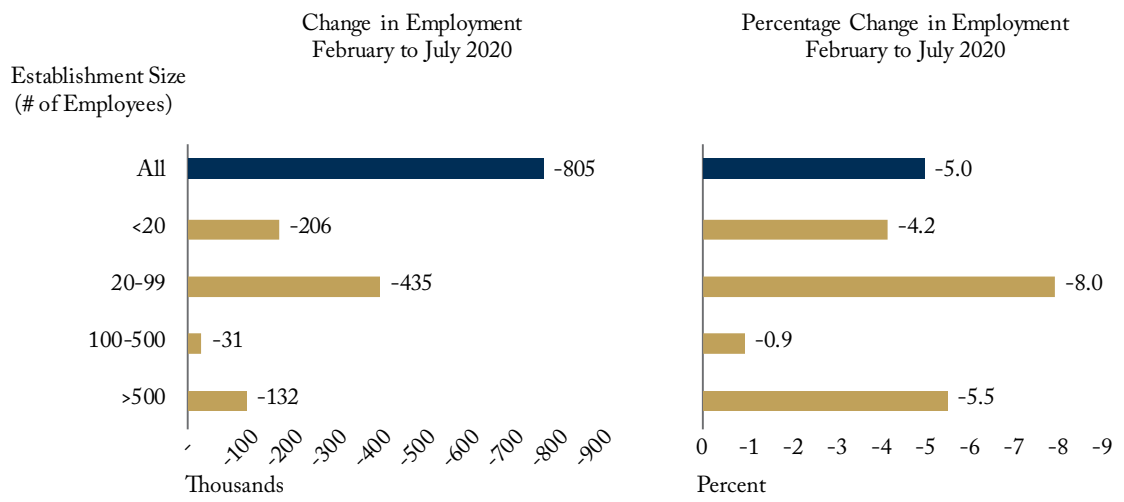
2 See indicators on C.D. Howe Institute COVID-19 Economic Dashboard. Available online: http://dashboard.cdhowe.org/.

3 NAV Canada. June 2020 Traffic Figures. Available online: https://www.navcanada.ca/EN/Pages/NR-31-2020.aspx.

4 Office of the Superintendent of Bankruptcy. Insolvency Statistics in Canada—June 2020. Available online: ic.gc.ca/eic/site/bsf-osb.nsf/eng/br04349.html.

5 C.D. Howe Institute Crisis Working Group on Business Continuity and Trade. 2020. "Financing Bridge Needed to Protect At-Risk Sectors as Canada Faces a Long, Hard Road to Recovery." May 19. Available online: https://www.cdhowe.org/council-reports/financing-bridge-needed-protect-risk-sectors-canada-faces-long-hard-road-recovery.

Figure 1: Employment Losses by Firm Size



Source: Statistics Canada - Labour Force Survey (Table: 14-10-0067-01).

The working group also highlighted the importance of access to capital for Canadian firms and the reduction of inter-provincial barriers to trade and labour mobility.

For internal trade, present circumstances amplify the urgency of overdue reforms to enhance labour mobility between provinces. Facing a volatile and uncertain international setting, Canada must facilitate economic activity at home. Reducing the challenges for skilled workers moving across provinces – for example, by automatically recognizing a trade certification from another province – can boost overall output significantly.

Regarding external trade, members noted that confusion around foreign investment reviews serves as a barrier to capital at a critical time for restructuring of financially distressed Canadian companies and private-sector investment.

Retool Relief Programs and Enable Digital Adaptation to Support Small Business Recovery

Through the recovery, many small businesses face elevated fixed costs related to the pandemic along with reduced volumes, resulting in continuing financial stresses. And many small firms face the

challenge of rapidly retooling their business models – particularly facing the need to digitize operations and sales channels.

Members noted that a recent report by RBC, "Small Business, Big Pivot," underscored the vulnerability of small firms through recovery amid the challenges of curtailed demand, disrupted spending patterns, costs of adapting for physical distancing, and pressures to rapidly digitize operations.[6] To support small business adaptation, this report recommended governments streamline relief programs, invest in safe reopening capacity, and support adoption of digital tools by small businesses – particularly to enable international reach.

Working group members viewed the retooling of relief programs – particularly restructuring the Canadian Emergency Relief Benefit (CERB) and extending the Canada Emergency Wage Subsidy (CEWS) – as important measures to facilitate hiring by small businesses during the recovery. To this end, the C.D. Howe Institute has published a survey of options to address perverse incentives under the current CERB design.[7]

With respect to digital adaptation, many working group members agreed that the pandemic had amplified the "change or die" imperative for firms. These members highlighted that government must be wary about subsidizing firms that have lagged on digital adoption and interfering with "creative destruction" within sectors, as more nimble and creative firms gain market share. To target support to high-potential firms and ensure discipline for these investments, various working group members urged governments to design small business support for digital investments using tax credits or in a manner that leveraged private capital.

Consider Measures to Accelerate Private Capital Investment

With Canada facing a potentially prolonged period of depressed demand, economy-wide, working group members considered several measures to accelerate capital spending in the private sector. Certain working group members observed that arrangements through the Large Employer Emergency Financing Facility or similar channels could be structured to encourage companies to accelerate planned capital spending.

6 RBC Economics. 2020. *Small Business, Big Pivot*. June 11. Available online: https://thoughtleadership.rbc.com/five-ways-to-help-small-business/?utm_source=event&utm_medium=vanity&utm_campaign=ent_smallbusinesspivot.

7 Laurin, Alexandre, and Ben Dachis. 2020. "A Stimulus Plan to Restart the Job Market," C.D. Howe Institute Intelligence Memo. May 20. Available online: https://www.cdhowe.org/intelligence-memos/laurin-dachis-%E2%80%93-stimulus-plan-restart-job-market.

For example, the working group considered a proposal to accelerate manufacturing of components by suppliers to the Bruce Nuclear Power Plant refurbishment. Many of these suppliers face reduced orders for other products in the immediate term but have contracted to deliver components for the Bruce refurbishment in future years. Accelerating manufacture of those components would fill idle capacity and help suppliers bridge a period of depressed demand. However, since the refurbishment will not require the components for several years, the suppliers will require subsidized repayable loans to incur the immediate expense of production and warehousing.

Certain working group members saw some merit to such financial assistance to accelerate production for already-committed projects. Government loans could help boost near-term private-sector output with negligible repayment risk.

However, other working group members observed that actions by central banks had already significantly lowered borrowing costs for private firms. They cautioned that governments should avoid interfering with signals about the credit worthiness of individual firms or with market-based decisions about when and what to produce.

Boost Resilience through Increased Internal Trade

Working group members that the crisis raises the urgency for an overdue reduction in internal trade barriers. Enhancing labour mobility across the federation can facilitate recovery from the pandemic as well as increase Canada's resilience to future shocks.

In particular, modelling by working group member, Trevor Tombe, has illustrated that reduction in costs for inter-provincial labour mobility (such as recertification in the destination province) can dramatically increase migration across provinces and boost output by better matching of skilled workers to jobs.[8]

More broadly, reduction in barriers to inter-provincial trade can significantly boost output in key sectors – particularly financial services, retail, transportation and agrifood.[9]

8 Tombe, Trevor. 2020. "Potential Gains from Provinces Easing Labour Mobility Barriers," C.D. Howe Institute Intelligence Memo. June 29. Available online: https://www.cdhowe.org/intelligence-memos/trevor-tombe-%E2%80%93-potential-gains-provinces-easing-labour-mobility-barriers.

9 Alvarez, Jorge, Ivo Krznar, and Trevor Tombe. 2019. *Internal Trade in Canada: Case for Liberalization*. IMF Working Papers. July 22. Available online: imf.org/en/Publications/WP/Issues/2019/07/22/Internal-Trade-in-Canada-Case-for-Liberalization-47100.

Liberalization of internal trade can be accomplished though unilateral measures by an individual province to recognize certification or standards from other provinces. Modelling shows substantial gains for an individual province from such unilateral liberalization.

Reforms to the Canadian Free Trade Agreement (CFTA) could also improve incentives for private parties to challenge regulatory restrictions on trade between provinces.[10]

Working group members agreed with the urgency of enhancing internal trade and generally favoured measures to reduce barriers between provinces. Certain members pointed to examples of industries – such as agrifood – in which heightened costs for accessing inputs had hindered investments in processing facilities.

However, members doubted that barriers to internal trade could be rapidly reduced. These members highlighted the practical complexities of resolving the many regulatory differences between provinces and the political challenge of accepting standards from another province.

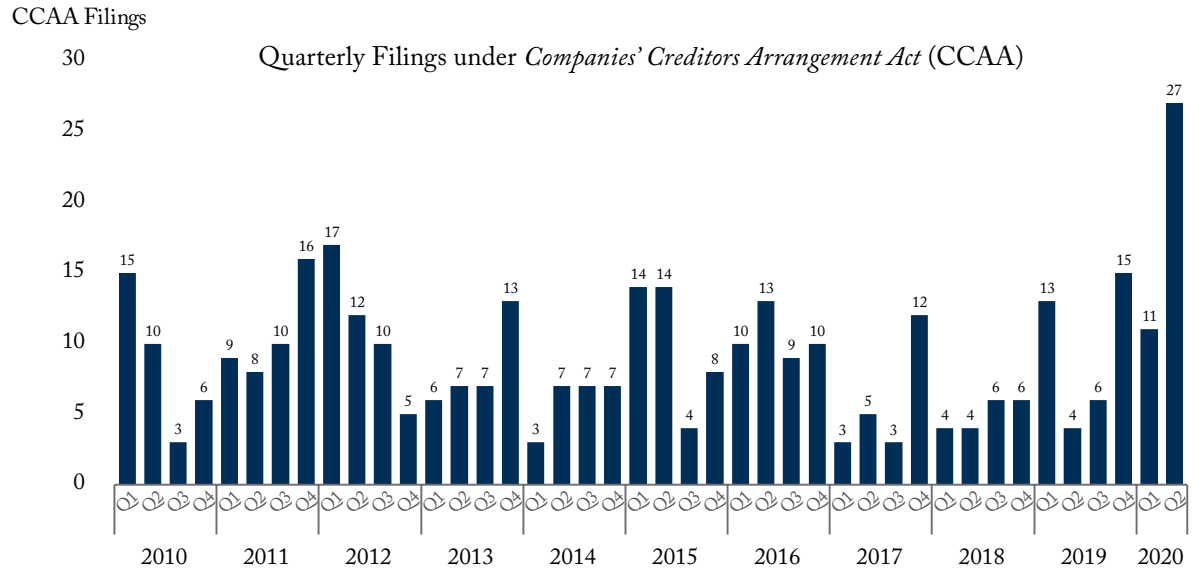
Clarify Canada's Openness to Foreign Investment

Working group members agreed that access to foreign capital will be critical during a period of intensified restructuring for Canadian businesses. While filings under the *Bankruptcy and Insolvency Act* have slowed during the pandemic, filings of large corporate restructurings under the *Companies' Creditors Arrangement Act* (CCAA) in the second quarter of 2020 far exceeded those for any quarter in the previous decade (see Figure 2).

To fund the turnaround of distressed Canadian assets – notwithstanding new investment – companies must have access to capital from foreign sources. Protracted approval processes and stringent conditions on foreign acquisitions of Canadian assets risk hindering Canadian access to foreign capital at a critical time.

10 Manucha, Ryan. 2020. "Ten Recommended Reforms for the Canadian Free Trade Agreement," C.D. Howe Institute Intelligence Memo. Available online: https://www.cdhowe.org/intelligence-memos/ryan-manucha-%E2%80%93-ten-recommended-reforms-canadian-free-trade-agreement.

Figure 2: Large Corporate Restructurings



Source: Office of the Superintendent of Bankrutpcy (CCAA Records List).

Given a recent statement that implies enhanced scrutiny of "opportunistic investment behaviour" by foreign acquirers,[11] working group members recommend that the federal government clarify its openness to foreign investment and approach to reviews under the *Investment Canada Act* (ICA). In particular, the government's recent statement on the ICA leaves unclear its definition or criteria for what "critical sectors" will be subject to enhanced reviews. From the government's statement, it is not clear that the scope of national security is being construed more broadly than traditional security concerns to contemplate concerns of a more economic nature (e.g., strategic technologies). The statement therefore raises the prospect that a broadened set of sectors could be subject to lengthy national security reviews under the ICA. A lack of clarity risks deterring foreign acquirers and Canadian firms' access to capital.

11 See: "Policy Statement on Foreign Investment Review and COVID-19," April 18, 2020. Available online: https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81224.html.

To this end, various working group members agreed with arguments, recently advanced by John Knubley and Lawson Hunter, that the federal government should (1) increase the timeliness of national security reviews, (2) clarify its definition for "critical sector", and (3) involve the deputy minister of finance or innovation in national security reviews under the ICA.[12]

Members of the Business Continuity and Trade Working Group

Dr. Sylvain Charlebois, Professor, Senior Director, Agri-Food Analytics Lab, Dalhousie University.

Dwight Duncan (Working Group Co-Chair), Senior Strategic Advisor McMillan LLP.

Rick Ekstein, President & CEO, Phaze 3 Management.

Glen Hodgson, Fellow-in-Residence, C.D. Howe Institute.

Keith Halliday, Director of Centre for Canada's Future, Boston Consulting Group.

Caroline Hughes, Vice-President of Government Relations, Ford Motor Company of Canada.

Jeanette Patell (Working Group Co-Chair), Vice-President of Government Affairs and Policy, GE Canada.

Elise Maheu, Director, Government Affairs and Markets, 3M Canada.

Geoff Smith, President & CEO, EllisDon.

John Stackhouse, Senior Vice-President, Office of the CEO, Royal Bank of Canada.

Trevor Tombe, Associate Professor of Economics and Public Policy, University of Calgary.

Valuable Perspective Was Contributed by the Following Guests:

Calvin S. Goldman, Q.C., Co-Chair, Competition, Antitrust and Foreign Investment Group, Goodmans LLP.

Lawson Hunter, Senior Counsel, Stikeman Elliot LLP.

John Knubley, Former Deputy Minister, Industry Canada/ISED.

Brian Livingston, Executive Fellow, University of Calgary School of Public Policy.

Ryan Manucha, Frederick Sheldon Fellow, Harvard University.

James Scongack, Executive Vice-President, Corporate Affairs, Bruce Power.

12 Knubley, John and Lawson Hunter. 2020. "Three Principles for Tougher Foreign Takeover Reviews," C.D. Howe Institute Intelligence Memo. August 4. Available online: https://www.cdhowe.org/intelligence-memos/knubley-hunter-%E2%80%93-three-principles-tougher-foreign-takeover-reviews.

Intelligence MEMOS

From: Paul Jenkins

To: Canada's Economic Policymakers

Date: September 11, 2020

Re: **The Long … and the Short of Finding Equilibrium**

Macroeconomics is about optimizing long-run equilibrium conditions (e.g., full employment), and re-establishing those conditions as quickly as possible through short-run stabilization policies in response to unanticipated shocks.

From this perspective, where are we today in our coronavirus battle, and what are some of the issues still facing us?

Given the progress we have made in controlling the spread of COVID-19 and the associated re-engagement in economic activity, the Canadian economy has snapped back. But activity remains well below pre-COVID-19 levels, largely reflecting depressed demand.

At this juncture, there are, broadly speaking, three challenges before us:

i) the need to remain vigilant on the health front and stay focused on the intersection of health and economy through an optimal policy mix;

ii) the need to transition from initial support policies to policies promoting recovery back to full production and employment; and

iii) the need to look long term to take advantage of the opportunity we have to restructure the Canadian economy.

In tackling these challenges, sequencing matters from both an economic and a political perspective.

First off, maintaining confidence that the virus is under control boosts our confidence to re-engage in the economy and begin spending. In turn, confidence in employment and income strengthens the resolve to stay the course with responsible behavior. Using a range of COVID interventions, which can vary by age, economic sector and location, we can both beat the virus and stay on the path of economic recovery.

Today, as we look ahead to coming out the other side, the government has called for us to think big and think differently.

A consensus seems to be developing across Canada that two of the most critical issues we need to address are equality of opportunity, and sustainable economic growth.

Progress on both these fronts will be a multi-year undertaking, requiring a substantial reallocation of resources, with significant relative price adjustments to bring it all about. Past experience tells us that this is not a smooth path. And we also know that how we fund both the transition and the desired endpoint matters – budget constraints remain a fundamental principle of economics. In other words, managing the debt level matters.

Another fundamental principle is the imperative of economic growth to provide equal opportunities for all Canadians and to pay for the type of nation we wish to be. While interest rates are currently historically low, it is interest rates that connect the present to the future. The most durable source of funding is sustained economic growth, not a reliance on low interest rates.

What does this mean in terms of challenges (ii) and (iii) above?

The government has correctly begun the move away from the initial support policies to ones that are cast more in the vein of traditional stabilization policies. For example, the shift from the Canadian Emergency Response Benefit (CERB) to the Canadian Recovery Benefit and an expanded Employment Insurance program will both provide ongoing support where needed and self-unwind as the recovery matures. Combined with other traditional stabilization policies, especially accommodative monetary policy, the goal is to absorb the remaining slack in labour and product markets over the next 12 to 24 months, and in doing so to put the economy on a solid growth footing.

As these short-term stabilization policies bring us back to full resource utilization, policies of long-term structural reform can confidently begin to take hold. These would include policies to bring about the relative price changes needed to encourage the reallocation of resources and changes in behaviour. It would also include pro-growth policies to promote investment (over consumption) in our human and physical capital consistent with our long-run goals as a nation.

We can and should think big. But we cannot jump to a desired endpoint. The sequencing of policies is critical if we are to achieve and fund that outcome through sustained (in every sense of the word) growth.

One Final Thought

Canada has grown and developed as an active member of an integrated global economy – history of punching above our weight. Unfortunately, the world lost much of the spirit of co-operation and multilateralism in recent years.

Now, more than ever, how we all fare in a globalized economy rests on having global governance that works. This, too is critical to Canada's future successes, and thus a goal for Canada to re-commit.

Paul Jenkins is a former senior deputy governor of the Bank of Canada and a senior fellow at the C.D. Howe Institute.

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From: Jennifer Robson

To: Canadians Concerned about the Recovery

Date: September 11, 2020

Re: **Is This As Good As It Gets until We Get Back to "Normal"?**

Like most countries battling COVID-19, Canada went from the economic equivalent of a medically induced coma to a transitional phase. We have tried to regain as many economic and social activities as possible within certain limits. This rehabilitation phase, I've written elsewhere, isn't going to be quick or easy. A safe and effective vaccine will, as pharmaceutical companies themselves have reminded us, take time to develop and then to administer to citizens. Even after a vaccine (or effective treatment for the virus) is widely available, there will still be millions of Canadians bearing the scars of this unprecedented public health and economic crisis.

Many previously healthy Canadians will now have a disability as a result of battling COVID-19. They may face new limitations to their activities and new out-of-pocket costs.

More than a million Canadian workers will have been out of work for more than six months, meaning that their long-term earning potential may be permanently reduced.

Young people who enter the labour force in a recession may likewise see a lasting and negative impact on employment and earnings.

There is no full recovery, no regaining of even our pre-COVID projections for modest GDP growth, unless all Canadians are included in the economic rehabilitation and rebuilding.

In the US, some observers have started to describe their process so far as K-shaped, that is a bifurcated recovery with a stark separation between the groups that have recovered jobs and income, and those, including whole sectors, that have not and do not have good prospects.

Canadians might feel some greater security, relative to our US neighbours, because our emergency measures have been more timely and effective and our collective willingness to follow some basic public health orders (namely wearing masks) has been stronger. Even so, we are seeing evidence of our own K-shaped differences in outcomes.

Who is being left behind?

- Moms of young and elementary school-aged kids have recovered just 50 to 60 percent of their pre-COVID paid hours. Childcare providers that parents would normally rely on are now finding it harder to find a sustainable business model with the pandemic's higher costs and lower revenues, if they've been able to re-open at all. Continued uncertainty about the sustainability of in-person school is only going to compound the problem.
- Low- and modest-wage workers have had the worst recovery so far, with one in five still unemployed or working significantly reduced hours. Gains for some middle-income workers have also started to stall. Meanwhile, Canadians in the top 10 percent by employment income had fully recovered their paid hours by May and are now working more than they did in February.
- Racialized Canadians are not sharing in the same employment gains, with August unemployment figures that are between three and eight percentage points higher than those of Canadians who are not visible minorities.
- Young Canadians (under 25) and older workers (aged 55 and over) aren't sharing in the same gains as prime-age workers, consistent with nearly every recession in living memory. Youth unemployment has been about twice the aggregate national rate for many years, but the gap for youth and older workers has widened, relative to prime-age workers since the March shutdowns.
- Entire sectors that can't readily adapt to physically distanced delivery of goods or services – tourism and entertainment – or where demand remains very low – restaurants, air travel and accommodation – have no viable path to a meaningful recovery in the near future. At the same time, these sectors also employ larger shares of the low-wage workers and groups listed above, compared to sectors like natural resources, public administration or finance.

There are already some early signs that our progress, as a country, is stalling. The pace of aggregate employment gains has slowed. Information on consumer spending and business transactions from bank data suggests that consumer spending growth is slowing. Whatever exuberance there was with the lifting of restrictions, consumers have now bought the clothes, households goods and home renovation materials they were going to buy when things re-opened. If you had been itching to go out for a dinner, you've probably done that by now.

And now, case counts are starting to tick upwards in many parts of the country. Ontario has paused its re-opening for the time being, though there are relatively few health and economic restrictions left to lift. In BC, bars, nightclubs and banquet halls have been ordered to close down again to reduce community spread of the virus.

The question we should be asking ourselves right now is not "when do we get back to normal." Instead, we should be reflecting on where our economic rehabilitation has stalled. We should be asking ourselves if this is as good as it gets.

There is no return to "normal," no solution to a stalled recovery, if it does not include the people in the bottom arm of a K-shaped recovery.

Jennifer Robson is Associate Professor of Political Management, Carleton University.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Part 3

Supporting Households and Families

by Parisa Mahboubi

The COVID-19 pandemic has disrupted economic and labour market activities, imposed tremendous uncertainty, and added many risks for households and businesses. The initial labor market impacts between February 2020 and April 2020 were a significant reduction in aggregate weekly hours (32 percent) and employment (15 percent) among Canadian workers aged 20-64. However, not all Canadian workers have been affected equally and there have been regional and sectoral variations. The crisis has highlighted the need for better and more timely data on key economic and labour market indicators. For example, better data are needed on Employment Insurance (EI) claims to identify gaps in the safety net and to enable individuals, businesses, and decision-makers to make informed decisions to mitigate some economic uncertainties. Furthermore, it is evident that supporting Canadians during the crisis requires strong coordination across all levels of government and that provincial governments can play an important role in identifying the issues and gaps specific to their residents and using available policy tools to address them.

As part of its COVID-19 economic response plan, the federal government introduced two major programs to provide financial support to Canadians and business: Canada Emergency Response Benefit (CERB) and Canada Emergency Wage Subsidy (CEWS).

The Canada Emergency Response Benefit was an early and critical element in the federal government's response to the crisis. In support of "stay at home" strategies to flatten the curve, the CERB was particularly necessary to ensure that households stay afloat while the restrictions are in place. The introduction of the program was also, in part, an attempt to fill coverage gaps in EI. For instance, workers in precarious employment, such as part-timers are less likely to meet minimum required insurable hours to qualify for EI and needed a program with more relaxed eligibility criteria. The labour market statistics show that in addition to young workers and women, the crisis has affected hourly-paid low-wage workers the most, highlighting the importance of the CERB.

While the CERB was intended to support workers who faced job loss or a significant reduction in hours, the CEWS was introduced to prevent further job losses and encourage employers to quickly rehire workers previously laid off. However, unlike the CERB, the CEWS did not get much pickup from employers, despite its generosity.

The heavy use of the CERB could be to some extent related to the slow roll-out of the CEWS program. The lack of a strong message and clarification on CERB eligibility, as well as the sheer number of applicants, could be indicative of problems with the CERB itself.

First, the CERB eligibility criteria at inception were very broad and unlike the EI program, there was no requirement to remain available to work and be actively looking for a job. Second, the amount of benefit was relatively generous for low-income earners and was not linked to pre-pandemic income. Third, the clawback rate was harsh since the benefit went to zero for the first dollar of income earned above the threshold of $1,000. All these factors created potentially significant disincentives to return to work, particularly among low income earners, slowing the recovery.

With attention increasingly turning to reopening the economy, the CERB became a flashpoint since some employers faced difficulties filling vacant positions. Despite the availability of various policy options for reform, using various features of the EI program, the government extended the program by

three months without tackling its issues but with the intention of terminating the program. Interestingly, the decision to end the CERB and the temporary nature of the program seems to have recently helped with increased job search activities, according to an analysis done by Tammy Schirle and Mikal Skuterud of the Statistics Canada's Labour Force Survey.

The government has temporarily expanded the EI program by reforming eligibility criteria and introduced new temporary emergency measures – the Canada Recovery Benefit, the Canada Recovery Sickness Benefit and the Canada Recovery Caregiving Benefit – to ensure continued income support to CERB recipients who, after exhausting their maximum eligibility period, may remain unemployed. However, the new changes to EI, particularly, the high EI benefits floor, can create disincentives to return to work for some low-income workers, despite being a temporary measure. While it is important to address issues related to temporary measures and reforms, it is time for Canada to build longer-term income supports onto existing systems, such as EI, by further strengthening and expanding them to cover a larger number of Canadians through the recovery. Still, Canadians need more support.

Evidence shows that parents and particularly moms face additional barriers to returning to work or remaining employed when there are school and childcare closures and limited childcare options. Any potential school and childcare closures or a supply shock without economic shutdowns requires measures to support parents (e.g., a refundable childcare tax credit and a boost to the Canada Child Benefit) and income support programs that allows for sharing child care responsibilities between parents.

Longer-term policy options to support Canadians during the pandemic and recovery should also include investments in retraining, reskilling, and upskilling to address long-term displacements and structural unemployment.

Theme 1:

What the Labour Market Data Showed (And Didn't Show)

Crisis Working Group Report: Crisis Household Income and Credit Support

In order to help Canadian governments confront the public health and economic crisis resulting from the spread of the COVID-19 virus, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The working group on household income and credit support is chaired by Michael Horgan, Senior Advisor at Bennett Jones LLP and former Deputy Minister of Finance, Government of Canada, and supported by a group of Canadian business leaders and economists. Meeting weekly, this group identifies and prioritizes policy challenges, and communicates members' views in published communiques. The group's second meeting was held on Tuesday, March 31, 2020.

In that meeting, the group focused principally on four issues and policy measures:

- Data frequency and transparency
- Fortification of the Canada Emergency Response Benefit (CERB)
- Rent assistance
- Federal/provincial coordination of income support

Data Frequency and Transparency

The working group called for a higher frequency of release of economic data indicators. An example is employment insurance claims. It asked why the number of claims cannot be provided weekly or even daily.

Individuals and businesses are facing tremendous uncertainty, particularly in regards to the length of the period of maximum social distancing and compulsory closures, creating substantial risks and affecting even near-term planning. Data availability and transparency during the crisis is vital for firms, other organizations, and individuals to make informed decisions given the risks. Canada faces decisions about balancing public health and economic costs, for which better data are vital.

Decision makers need a current and accurate picture of the state of the labour market for choosing the right strategy going forward. The upcoming release by Statistics Canada of its Labour Force Survey (LFS) will not capture the rapid changes in the labour market environment since the data supporting the LFS was collected. In addition to quicker release of economic data, in its presentation of the LFS, Statistics Canada may want to include valuable information beyond common labour market indicators

(part-time and full-time employment and unemployment) to allow a better assessment of labour market conditions and the impact of the crisis on employment and degree of labour market attachment.

Fortification of the Canada Emergency Response Benefit (CERB)

The working group provided its views on how to optimize the CERB to help Canadian families and what the potential impact of the CERB could be on employment.

First, working group members noted that there is an ambiguity about the definition of "ceasing work." While the program will provide financial support for those with zero employment income, there seems to be no consideration for workers who, due to the crisis, experience a severe drop in their earnings due to a reduction in their working hours while continuing to be employed and actually working. To provide support for these workers, the government needs to determine the appropriate income loss threshold for qualification.

Second, the CERB needs some improvements in the details of its eligibility criteria to ensure the inclusion of population groups in need of support, such as students without a work history who had a job lined up; temporary foreign workers; foreign students who cannot go back home; and resort workers.

Third, working group members noted that the CERB complements the Canada Emergency Wage Subsidy to provide financial support to Canadian families. Some sectors such as oil and gas, tourism and accommodation, and air transportation are affected more severely than others: not all businesses can benefit from the wage subsidy program and some will have to furlough or lay off their employees. By providing $500 per week, the CERB will have a negative impact on employment incentives: for some recipients, the benefit exceeds potential earnings from employment. Over time, its efficiency and long-term cost will become an issue. This requires a serious discussion about timelines and a clear plan for transitioning to the recovery period while protecting populations vulnerable to the virus during and after the transition.

Rent Assistance

The working group identified gaps in rental policy and recommended that provincial governments set rules to strengthen accountability and provide rental assistance to tenants who need it.

While some landlords are able to offer help to struggling tenants and postpone rents, other tenants may not be able to or simply refuse to pay rent. This will shift liquidity challenges to landlords, risking further knock on effects. Presumably the Canada Emergency Response Benefits will help tenants and their challenges, but provinces should do more to support tenants.

One province that has taken measures to tackle the rental issue is British Columbia: it has in place a virtual tribunal mechanism to administer residential tenancy laws and has recently introduced a short-term rental subsidy (up to $500 per month) for those who qualify.

Federal/Provincial Coordination of Income Support

The working group highlighted the importance of coordination between the federal and provincial governments to provide support to Canadian families. In particular, a top-down federal approach is not always the best answer. Some issues are region-specific since industrial and demographic structures vary across the provinces. Therefore, it is important that the discussions not be limited to coordination of support: federal and provincial governments should discuss key issues they each face during the crisis and their respective timelines in providing support.

The Household Income and Credit Support Working Group will meet again next week. The next meeting will focus on emerging issues and consider specific policy proposals from the members. One area for potential consideration is what provinces are doing for their residents.

Household Income and Credit Support Working Group Members Include:

Michael Horgan, Senior Advisor at Bennett Jones LLP and former Deputy Minister of Finance, Government of Canada

Grant Bishop, C.D. Howe Institute

Don Drummond, Queen's University

Luc Godbout, Université de Sherbrooke

Brian Kingston, Business Council of Canada

Parisa Mahboubi, C.D. Howe Institute

Janice McKinnon, University of Saskatchewan

Kevin Milligan, University of British Columbia

Mike Pedersen, Business Development Canada

Bill Robson, C.D. Howe Institute

Tammy Schirle, Wilfrid Laurier University

Kathleen Taylor, Royal Bank of Canada

Guests:

Edward Waitzer, Stikeman Elliott LLP

Hugh O'Reily, Vancity Community Investment Bank

Intelligence MEMOS

From: Kevin Milligan and Tammy Schirle

To: Bill Morneau, Minister of Finance

Date: April 8, 2020

Re: **A Labour Force Survey pandemic primer**

Tomorrow's Labour Force Survey (LFS), covering March 2020, will provide the first official statistical look into the impact of COVID-19 on the Canadian labour market.

It will be an incomplete snapshot, because its reference week, Sunday March 15 to Saturday March 21, came in the midst of the pandemic's disruption. But the numbers for employment and hours will still provide valuable insights, unlike the usual headline unemployment measure. Here's why:

- Timing: the LFS was in the field just as COVID-19 started to change the economy.
- Categories: COVID-19 work patterns challenge the normal categorization of work.
- Hours: the distinction between 'actual' and 'usual' hours becomes critical.

First, the survey's reference week was one of transition into shutdowns. For Ontario, that week normally should have been a quiet March Break, with a few extra vacations and kids in day camps while parents worked. Instead, the week was preceded by announcements of public-school shutdowns (March 12), followed by an expansion of job-protected leaves (March 16), required closures of childcare centres, restaurants, libraries, events and more (March 17), and a general push to work from home when possible. Since then, governments across Canada have enforced even more restrictive measures to protect public health, which means the full adjustment to COVID-19 is not captured.

Second, the crisis will lead to large shifts across the standard LFS labour market activity categories of employed, unemployed and non-participants. To understand why requires a deeper dive into the category definitions.

What does it mean to be employed? The survey begins by asking people if, during the reference week, they worked at a job or business. If 'yes,' they are labelled as employed and at work. Seems simple enough, but it's not clear all people who were sent home because of COVID-19 would report working at their job, especially if working from home is new to them. If they said 'no' to being employed they are asked if they have a job but were absent. If absent, the respondent is recorded as employed but absent. Respondents are asked about their reasons for absence, whereby men most often report vacations and women most often report personal or family reasons. Taken together, the clearest picture of the impact of COVID-19 will come from the change in the 'employed and at work' category.

But what if someone reports they didn't have a job? These respondents are placed into the category of 'unemployed' or 'not in the labour force' based on the reasons for not having a job. A person is unemployed if they are available for work and report they have been temporarily laid off due to business conditions, have a job to start within four weeks, or had searched for work in the previous four weeks (including the reference week). With COVID-19 closures, most parents with full time childcare responsibilities would not be considered available for work, and few will be actively searching for work. For many people, it might not be clear whether a layoff is 'temporary.' For others, plans to start a new job in the near future will suddenly appear unlikely. For these reasons, many who might normally be considered 'unemployed' may not be for the March 2020 LFS.

Instead, many of those without a job because of COVID-19 may be categorized as non-participants in the labour force. The non-searchers who enter this category, but wanted work, are asked why they did not search for work. Normally, the most common reasons are one's own illness or disability and (for women) caring for children. These reasons may grow substantially in March 2020. The belief that no work is available – which is normally used to indicate discouraged workers – will also grow in importance in the COVID-19 context. For these reasons, we expect a large shift from employment straight to non-participation, without first passing through the technical state of 'unemployment.'

The third key to understanding the March 2020 LFS is the distinction between usual and actual hours. Everyone who is employed is asked about the usual hours of work; those employed and at work also report their actual hours. For men, there is almost no difference between actual hours of work and usual hours. For women, there is normally a small difference, which in part reflects gendered caregiving responsibilities.

For the March 2020 LFS, the difference between actual and usual hours of work will reveal lost hours associated with COVID-related measures, reflecting a combination of mid-week layoffs, reduced hours associated with working at home, and reduced hours available with many employers. Of course, there are many industries and occupations that may increase hours. Grocery stores and front-line healthcare staff are examples. Overall, a focus on actual hours will be paramount.

Tomorrow's LFS will provide a partial revelation of the tumult the crisis has wrought upon the Canadian labour market. The worst is yet to be revealed. But focusing on movements in 'employed at work' and 'actual hours worked' will provide the surest indications of how the work of Canadians is responding to COVID-19.

Kevin Milligan is professor of economics, UBC Vancouver School of Economics, and a Fellow-in-Residence at the C.D. Howe Institute and Tammy Schirle is Professor of Economics at Wilfrid Laurier University, and is a C.D. Howe Institute Research Fellow.

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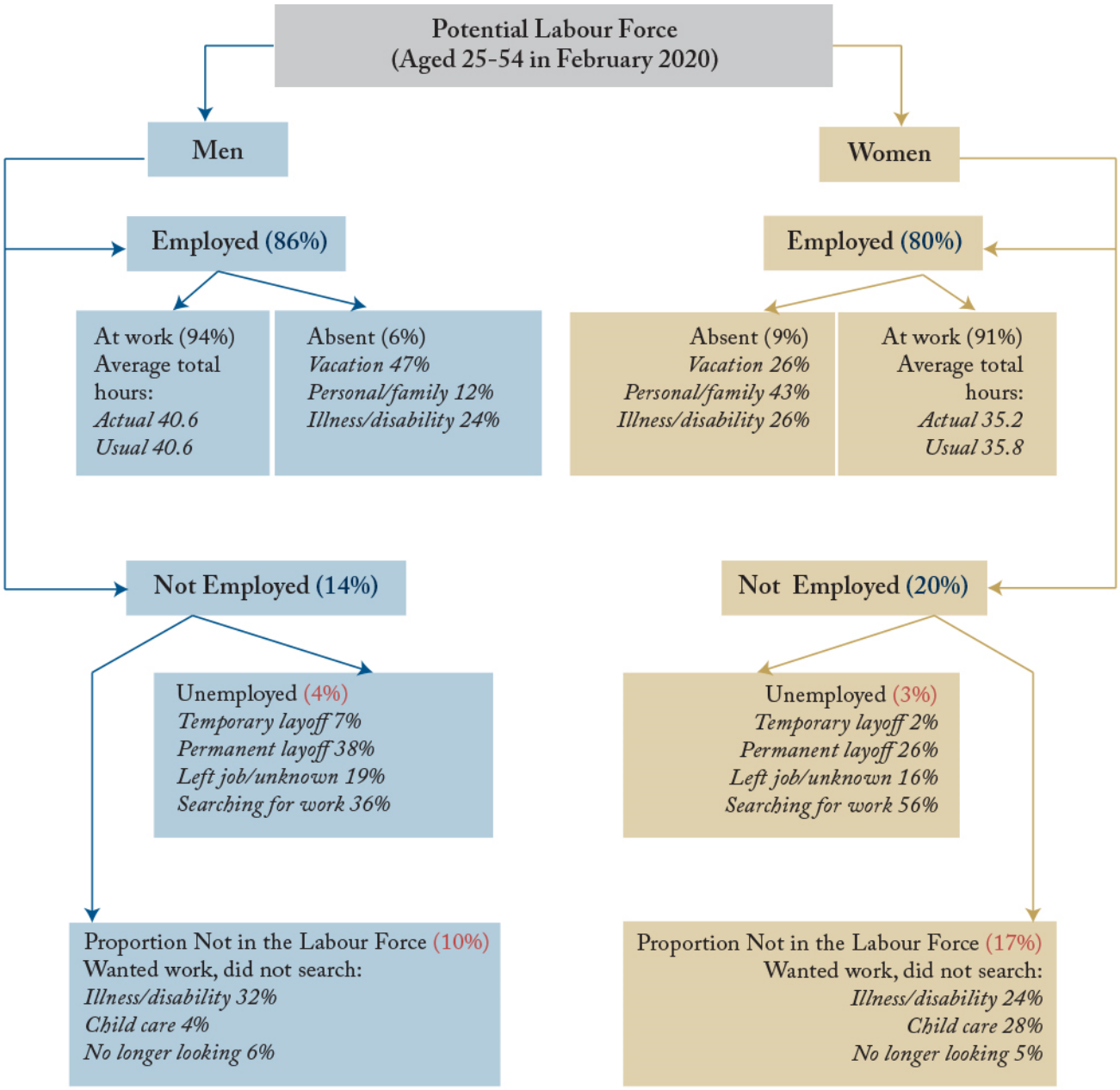


Notes: Authors' tabulations using the February 2020 Labour Force Survey Public Use Microdata Files are not seasonally adjusted. Statistics Canada Table 14-10-0017-01 offers comparable statistics. Above, the reported unemployed percentage represents the unemployed as a proportion of the population, not the unemployment rate as a proportion of the labour force (which was 5.4% for men and 4.5% for women).

Intelligence MEMOS

From: Tammy Schirle, Kevin Milligan and Mikal Skuterud

To: Canadians Concerned about the Labour Market

Date: April 14, 2020

Re: **DIGGING ONE LEVEL DEEPER INTO MARCH'S WORKFORCE NUMBERS**

The Canadian workforce tumbled historically in March. The Labour Force Survey revealed one million fewer people were employed compared to the previous month. Another 1.2 million who kept their jobs saw their hours reduced; often to zero.

Overall, aggregate hours worked dropped by an unprecedented 18.3 percent compared to February. How historic is this drop? In the onset of the financial crisis from October 2008 to April 2009, hours worked dropped by only 2.4 percent.

In this Intelligence Memo we go beyond the aggregate data to uncover who was affected and by how much. This analysis is crucial to building policy to bridge our economy over the crisis and to forming an understanding of how to bring the economy back when the health threat of COVID-19 diminishes.

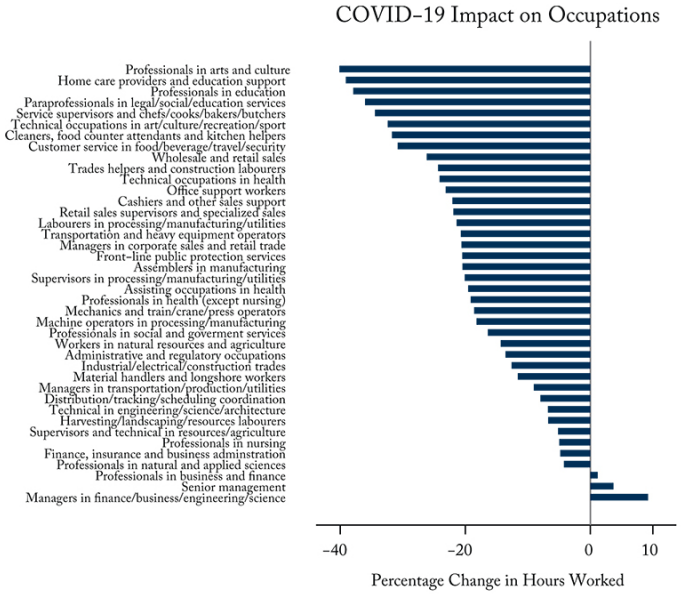
What kind of workers were hurt most so far? Public-facing workers, low-wage earners, and women.

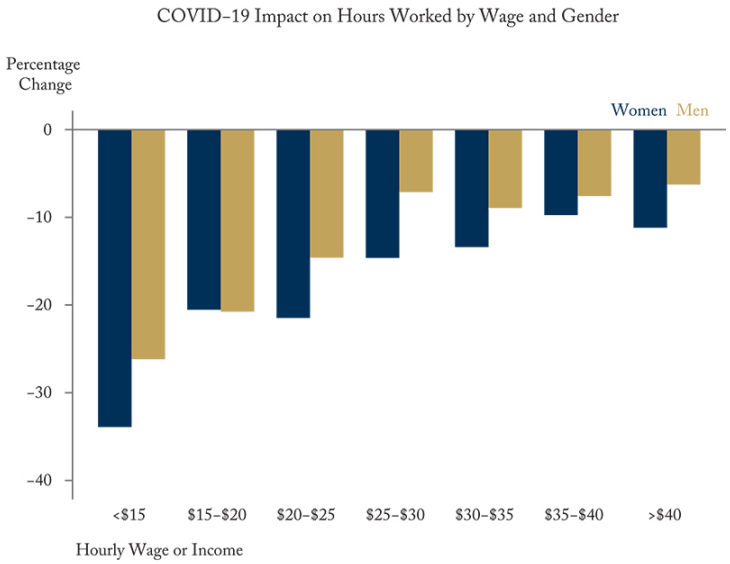
Perhaps predictably, public-facing jobs endured the largest reductions in hours. For example, the hours of professionals in art and culture and in education, as well as home care providers, fell by nearly 40 percent. On the other hand, some occupations by their nature afford opportunities to work from home or alter work arrangements to ensure employee safety. These workplace adjustments offer an important buffer to absorb the COVID-19 shock to our workforce. For this reason, occupations such as sales support and manufacturing jobs experienced a more modest reduction. Those deemed essential, such as nurses or police, continue with relatively stable work hours overall. Some workers, such as those in senior management or specialized middle management, have actually seen their aggregate work hours increase.

Beyond occupations, we can also sort jobs by gender, age, and pay to assess the impact of COVID-19. The decline in hours is larger for lower-wage workers, as the hours for those earning $15 per hour or less fell by more than 25 percent. At almost every wage level, the impact on hours has been larger for women than men. Overall, aggregate weekly hours for women fell 52 percent more than for men. The impact also appeared larger for youth (age 15-24), who are prominently employed in the service industries forced to shut down for COVID-19. These remarkable impacts on lower-wage workers underscore the importance of the Canadian Emergency Response Benefit, available to those workers least likely to be retained by their employers.

An upside to the March data comes from so many workers maintaining attachment to their employers, even with drastically reduced hours. This attachment should ease the transition back into work when less-restrained economic activities resume. However, the results from the March LFS are unfortunately only the beginning of the labour market crunch, as layoffs and furloughs have deepened since the LFS was in the field from March 15 to 21.

The full extent of the pandemic's impact on the work of Canadians will come into clearer focus with the release of the April numbers on May 8.





Notes: Hours are actual weekly hours on main job. Values are the double-difference: (March2020-February2020)/February2020 – (March2019-February2019)/February2019. Source: Labour Force Survey (PUMFs).

Tammy Schirle is Professor of Economics, Wilfrid Laurier University, Kevin Milligan is professor of economics, UBC Vancouver School of Economics and Mikal Skuterud isProfessor of Economics at the University of Waterloo.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Don Drummond

To: Ahmed Hussen, Minister of Families, Children and Social Development

Date: April 17, 2020

Re: **Release EI Data Fast to Track the COVID-19 Damage**

Many economists and policy authorities appear to have initially underestimated the economic blow from the COVID-19 pandemic, just as health authorities missed the depth of the blow to public health.

A consensus is emerging, however, that the economic damage will be sharp and prospects for quick and forceful recovery by no means certain. Yet this shift in economic opinion is to a large extent occurring in the absence of reliable information.

There are considerable lags in the release of key economic indicators, to allow for processing and ensure accuracy. But there is one indicator that could provide an almost real time tracking of the economic carnage: Employment Insurance (EI) claims. It is unacceptable that the Government of Canada is withholding this crucial piece of information.

The C.D. Howe Institute's Crisis Working Group on Household Income and Credit has repeatedly called for release of this data, emphasizing its importance for Canadians to understand the rapidly changing trajectory of our economy.

Under the normal schedule of releases, information on EI for March 2020 would be released May 21, 2020. We have, however, had a few peekaboo glimpses of the numbers.

In a March 20 speech, the Prime Minister revealed that 500,000 claims had been processed for the week of March 16. Eight days later, there were media reports that the week's number was actually 929,000, after the count was revised to include the weekend. That data observation was attributed to an unidentified and perhaps unauthorized source.

On April 7, there were media reports that 2.72 million EI claims had been made from March 16 through April 5. The source of the information is not clear.

Clearly, the Government of Canada collects the data on EI claims on a daily basis and can, if it wishes, release the figures with almost no lag. Yet it is not doing so. Instead we get little nuggets dropped on occasion with no indication whether the figures are official and even correct.

This is no way to operate. On almost any front we should be ashamed to have less data transparency than the United States. Yesterday, the US Department of Labor reported that 5.2 million unemployment benefit claims had been made during the week ending April 11, with a four-week tally of 22 million.

The Canadian Government could easily provide the comparable information on a comparable schedule.

The task could be handled by Statistics Canada. Its release last week of the March 2020 Labour Force Survey proved its worth. That release includes an excellent analysis of how the 2.2 percent increase in the unemployment rate, as shocking as it may seem, dramatically understates the weakening of the labour market.

In particular, the release featured a measure of "recent labour underutilization rate," which combined the official measure of unemployment with those who recently worked and wanted a job but did not meet the definition of unemployed and those who remained employed but lost all or the majority of their usual work hours. The underutilization rate soared to 23 percent, almost double the worst reading during the 2008 financial crisis and ensuing recession.

Release of the EI claims data would help enormously in figuring out how the March 2020 Labour Force Survey, which was based on labour market readings from the reference week of March 15-21, could be updated in a rough fashion for more recent developments.

There is an understandable concern within the government that the EI claims data have a certain amount of unreliability in the form they are originally processed. With time, problems are typically sorted out before public release. But the need for current information is so pressing, it can release the data soon after compilation and make any revisions required after the fact.

There is a desperate need for accurate, timely information on the economy's response to the pandemic.

Critical data are available. We have the professionals who can put it out on a timely basis with objective explanation.

What are we waiting for other than a quest for perfection when perfection seems the enemy of good?

And while we are at it, we should have weekly and official reports on the number of people applying for the new Canada Emergency Response Benefit. The timely data releases won't make the economic suffering any less. But at least we will have a better idea of how the economy is faring and that will better inform how responses should be shaped.

Don Drummond is the Stauffer-Dunning Fellow in Global Public Policy and Adjunct Professor at the School of Policy Studies at Queen's University.
To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Tammy Schirle, Kevin Milligan and Mikal Skuterud

To: Canadians Concerned about the Labour Market

Date: May 13, 2020

Re: **What April's Jobs Data Shows for the Future**

The Canadian workforce tumbled even further in April with a speed never seen before in the Canadian economy.

The Labour Force Survey revealed three million people have lost their jobs since February. Another 2.5 million who kept their jobs saw their hours significantly reduced, often to zero. These losses reflect both the loss of public-facing jobs that dominated the March job loss figures, and spillovers into construction and manufacturing as shutdowns and interruptions affected workers in these sectors.

Which workers has the COVID-19 crisis affected most so far? The brunt of the impact is on hourly-paid workers, with a much softer blow on those who are salaried.

Women paid hourly lost nearly 40 percent of their work hours between February and April, reflecting job losses more than just a reduction of their hours at work. Women who were salaried lost 12 percent of their work hours, with a minority of this loss representing job loss.

Those losing work since February also tended to be lower-wage, non-union, working with temporary contracts, and relatively low seniority. Combined, these characteristics describe workers with the least bargaining power in the labour market. This type of worker is most reliant on government to frame their relationship with their employer, through employment standards legislation and other government policy.

The current economic downturn is clearly different from past recessions in Canada in many ways, but a particularly stark difference is the impact of this recession on the lowest-wage workers. Looking back at the 2008-09 recession, we see a slightly smaller impact on those with higher-wage jobs, but the impact showed no consistent pattern across wage levels.

In contrast, the COVID-19 shutdowns have clearly affected those with the lowest wages. Among those earning $15 per hour or less, hours worked fell by more than 50 percent. On the other end of the wage spectrum, those earning $40 per hour or more experienced only a six percent reduction in hours since February.

What is in store for the Canadian labour market in the months to come? The May Labour Force Survey is in the field this week, and few provinces have relaxed shutdown conditions yet. So, while we do not expect a further large deterioration in the May numbers, it is unlikely to reveal much sign of recovery.

Looking forward to June, the re-opening plans announced by most provinces show substantial relaxation of formal health-related constraints by mid-month. For this reason, barring further resurgence of COVID-19 cases, we expect the labour market to begin its recovery in June.

Our expectations for the form of the labour market recovery are driven by the data we have observed so far – impact has been highest on low -wage earners, women, and public-facing occupations. These facts suggest three necessary factors to spark the labour market recovery.

First, we need to contain the outbreak and prevent further spread of the virus as much as possible. Without confidence in public health, consumers and workers will be held back by fear of infection.

Second, labour standards around safe work and sick leave need to be optimized for the world with COVID-19. Both workers and employers benefit from clear rules that produce safe workplaces and a healthy workforce.

Third, the influence of home life on work must be addressed. For example, life with COVID-19 means that childcare responsibilities curtail the ability of many productive workers to contribute their full efforts to work. Such barriers impede the work of women more than men, and a COVID-19 recovery should not leave productive workers behind.

COVID-19 hurt the Canadian labour market like nothing seen before. But a recovery from the depths of the labour market crisis is possible if policy makers get these data-driven responses in place quickly.

Tammy Schirle is Professor of Economics at Wilfrid Laurier University, and is a C.D. Howe Institute Research Fellow, Kevin Milligan is Professor of Economics, UBC Vancouver School of Economics, and is a C.D. Howe Institute Fellow-in-Residence, and Mikal Skuterud is Professor of Economics at the University of Waterloo.

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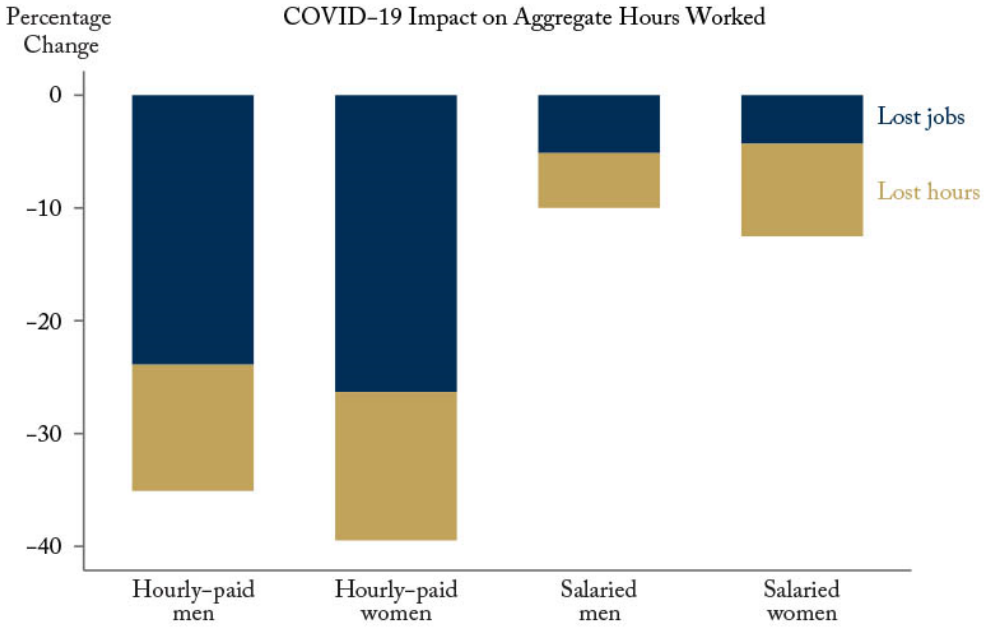
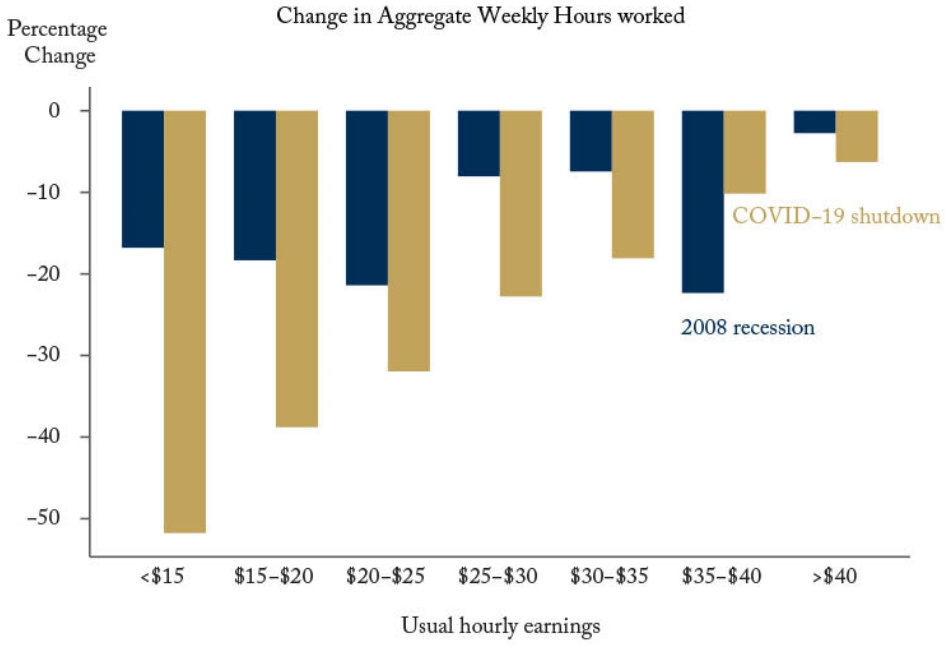


*Hours are actual weekly hours on all jobs. Changes are from February to April 2020.
Source: Labour Force Survey (PUMFs).



*Hours are actual weekly hours on the main job. 2008 recession is September 2008 to April 2009. COVID-19 shutdown is February to April 2020. Earnings are adjusted for inflation.
Source: Labour Force Survey (PUMFs).

Crisis Working Group Report: Household Income and Credit Support

Communique #8: Ottawa Needs a Temporary Income-Support System Built to Last

To help Canadian governments confront the public health and economic crisis resulting from the spread of COVID-19, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The Working Group on Household Income and Credit Support is co-chaired by Michael Horgan (Senior Advisor at Bennett Jones LLP and Former Deputy Minister of Finance, Government of Canada) and Kathleen Taylor (Chair of the Board at Royal Bank of Canada) and supported by a group of Canadian business leaders and economists. The group's most recent meeting was held on Tuesday, June 2, 2020.

In the meeting, working group members identified two options for providing continued income support to CERB recipients who, after exhausting their maximum eligibility period, may remain unemployed without access to Employment Insurance (EI). The options are: (i) extending the CERB but introducing new phase-out modifications learned from the recent experience of EI's Working While on Claim (WWOC) feature; or (ii) expanding the EI program by reforming eligibility criteria to take on the role of the CERB.

The working group noted that this decision largely rests on the length of the crisis and recovery period and the number of CERB recipients in need of post-CERB financial support. This highlights the importance of access to real-time data for governments, particularly on the number of CERB recipients ineligible for EI, as well as the need for agreement on the right assumptions around re-opening of the economy and the potential re-employment of Canadians. The main administrative challenge for the use of income-tested support programs is that these programs currently rely on monthly or more frequent observations. The working group therefore considered a solution for getting real-time pay information on CERB or EI applicants to address the administrative challenge.

Given the likelihood of a slow recovery, the working group leans towards building onto existing systems, such as EI, that are designed for the long term and further strengthening and expanding them to cover a larger number of Canadians through the recovery. The working group also discussed the impacts of working from home on employees and on the gender wage gap and jobs gap and concluded that a business model that involves hybrid work arrangements providing some flexibility in the workplace is likely a better option.

Lessons from Employment Insurance for Future Income Support

The working group starts from the assumption that provinces need to apply a risk-management lens to the reopening of the economy, given the vast differentials in COVID-19 experiences across the country. This is a similar assumption the group made for its previous communique.

The working group discussed what the right transition is for current CERB recipients who will not qualify for EI once their eligibility expires. If adapting existing programs, particularly EI, is the right solution, then it requires special rules to include ineligible CERB recipients. If a continuation of CERB is the right approach, it requires some phase-out modifications to make the transition to work possible and desirable. The answer to which option is preferable depends on the length of recovery. If it is expected to last for years, the right approach is to focus on adjusting the EI program rather than running two parallel systems for a long time.

Short-term policy options can include a combination of extending the CERB program with some modifications such as applying an income-tested claw-back and introducing a temporary Working Bonus program for low-wage workers. But, gleaning from international and national Employment Insurance experiences with Working While on Claim, more can be done to improve the CERB and facilitate the transition to work.

Working while on claim is a common activity among all EI claimants, regardless of gender and age and industry. The past 15 years of experiments with parameters of the program, such as claw-back rates and earnings exemptions, have confirmed that WWOC is effective in creating work incentives and particularly increasing the take-up of part-time work. The results show that higher exemptions for allowable earnings create more incentives to accept short-hours, part-time jobs while staying below the threshold of allowable earnings. A lower benefit claw-back rate beyond that initial earnings exemption helps with the take-up of jobs with more hours.

Before COVID-19, there have been three concerns with the WWOC program. These regard its effectiveness in: (i) facilitating the return to work, (ii) transitioning from working part-time hours while on claim to full-time employment, and (iii) encouraging search for full-time work rather than part-time work.

Regarding the first concern, the existing evidence is mixed with respect to the causal impact of WWOC on EI dependency. The prevalence of WWOC in Canada, however, tends to be higher among those with the highest frequency of past EI receipt. Increasing the income exemption may help reduce that dependency.

The second concern is the WWOC program's effectiveness in transitioning participants from working part-time hours while on claim to full-time employment. International evidence from Belgium, Denmark, Finland, France, Germany and Switzerland shows that an income support program that subsidizes part-time jobs increases the likelihood of subsequent full-time employment.

The third concern is that the WWOC may encourage search for part-time work over full-time work as claimants face a trade-off between time spent searching for, and working in, part-time jobs and searching for a full-time, more stable job.

The working group identified several issues that affect the possible application of WWOC to modifying the CERB. A major issue is to identify the gaps in EI eligibility among CERB recipients who will remain unemployed when CERB ends. This highlights the importance of access to data to assess the needs of individuals. So far, we know that the lockdown has had the biggest impact on precarious employment and low-seniority part-time and full-time jobs, and individuals in these types of jobs are less likely to be eligible for EI. Conversely, gig employment has increased since the beginning of the crisis. On the supply side of the labour market, virus fear and skills depreciation are potential problems, while on the demand side, lack of suitable jobs while on claim is a problem.

For the WWOC system to work under the current circumstances, setting the right parameters is key (e.g., the level of income exemption and the claw-back rate). Members believed Canada can learn from the experiences of other countries' where these parameters are individualized and vary depending on duration of unemployment and working while on claim. Notably, these programs required recipients to report their earnings as well as hours more frequently.

Getting Real-time Pay Information

In its previous meeting, the working group identified a lack of administrative infrastructure for real-time income testing of support programs such as CERB. The main question is how to get timely and accurate information to support the administration of support programs. The traditional paper payroll reporting processes impose a burden on employers as well as employees, and create error and delay. The rules are complex and many organizations, particularly small ones, lack compliance capacity.

The Liberal platform in 2019 included a discussion of "lower costs, less red tape" for business as part of its plan to create an e-payroll system. Recognizing it is still a work in progress, the working group heard that this initiative faces some challenges. It is a major technology initiative that would result in data duplication and a significant shift in privacy relationships.

Members noted there is an alternative to an e-payroll system that can also meet the needs of current income support programs. A large group of organizations, the Human Capital Management (HCM) industry, operates in the space between employers and government. This means the information that government is looking for is already available in digital form. Getting access to the data is therefore a simpler process than trying to duplicate and move the data to a different location. The federal government working with the industry would gather only the specific data it needs for its immediate needs, while employers would continue to maintain the information, leading to accurate information on a timely basis.

Impacts of Working from Home

The pandemic has forced many workers to work from home, impacting both employers and employees. The working group discussed several questions in that regard: What does it mean for employees and employers? What are the implications for the near future? And what are the upsides and downsides of working from home?

COVID-19 and perceived improvements in productivity in some instances may make the business model of working from home more attractive, leading some businesses to permanently shift to a work-from- home business model for some of their employees.

Traditionally, employees would be required to negotiate time spent working from home with their employers. Employers have generally been reluctant to allow employees to work remotely, and employees may previously have accepted lower pay as part of the negotiation. The working group heard

that the remuneration cut has had two sources. First, employers were less able to monitor employees' productivity and may have expected that workers who work remotely are shirking. Second, employees revealing to their employers that care giving is a significant priority may have weakened the bargaining position of employees.

The recent massive shift towards working remotely provides evidence that the productivity concerns of employers, and the organizational challenges, can be overcome. This recent positive experience and the speed of adaptation may help balance employee/employer bargaining power in the future, and ultimately improve the gender wage gap (since women tend to assume more family care responsibilities).

On the other hand, the gender wage gap and jobs gap also stem from women not occupying as many senior positions and higher-paying jobs as men; a situation that a shift to greater work-from-home-arrangements would not improve. The working group noted that working remotely may take away some advantages of working from the office, particularly for younger workers, such as mentoring and training opportunities, leadership development, and social connections. It is possible that more work flexibility would grow the jobs gap between men and women, increasing the gender wage gap.

The working group agreed that a good business model for the future may involve hybrid work arrangements providing some flexibility in the workplace. But more is needed to be done to understand this dynamic.

At its next meeting, the working group will continue to explore options to support Canadians during the pandemic and recovery and ways to improve existing programs.

Members of the Household Income and Credit Support Working Group Include:

Michael Horgan (Working Group Co-Chair), Senior Advisor, Bennett Jones LLP and former Deputy Minister of Finance, Government of Canada.

Kathleen Taylor (Working Group Co-Chair), Chair of the Board, Royal Bank of Canada.

Don Drummond, Stauffer-Dunning Fellow and Adjunct Professor, Queen's University.

Luc Godbout, Professor and Director of the Chair in Taxation and Public Finance, Université de Sherbrooke.

Brian Kingston, Vice President, International & Fiscal Issues, Business Council of Canada.

Alexandre Laurin, Director of Research, C.D. Howe Institute.

Parisa Mahboubi, Senior Policy Analyst, C.D. Howe Institute.

Janice McKinnon, Professor, University of Saskatchewan.

Kevin Milligan, Professor, University of British Columbia.

Mike Pedersen, Chair of the Board, Business Development Canada.

Bill Robson, President and Chief Executive Officer, C.D. Howe Institute.

Tammy Schirle, Professor, Wilfrid Laurier University.

Lara Speirs, Executive Vice President & Public Affairs General Counsel, Randstad Canada.

Guests:

Rodney Dobson, President, Elton Park Consultants Inc.

Stéphanie Lluis, Associate Professor, University of Waterloo

Intelligence MEMOS

From: Thomas Lemieux, Tammy Schirle, Mikal Skuterud

To: Employment and Social Development Canada

Date: June 12, 2020

Re: **INITIAL IMPACTS OF COVID-19 ON THE LABOUR MARKET**

The COVID-19 pandemic forced the Canadian economy into a medically-induced coma in March, and by mid-April about one third of the Canadian workforce had applied for the Canada Emergency Response Benefit (CERB).

While we've seen some solid employment gains in May, it's important to understand the depth of the impact on workers as we develop policy to support re-opening the economy and longer-term recovery.

In a recent working paper, we describe these initial impacts on Canadian workers aged 20-64. Overall, COVID-19 drove a 32-percent decline in aggregate weekly hours worked between February and April. But not all workers were equally effected.

Nearly half the lost jobs (44 percent) belonged to people in the lowest quartile of weekly earnings. The jobs lost by these workers were mostly public-facing, and in occupations hit hardest by the emergency measures – accommodations, food services, and retail. In contrast, only four percent of the jobs lost belonged to people in the top quartile of weekly earnings.

We also found that the nature of workers' employment relationship and their demographic group mattered. For example, workers paid hourly and those not covered by a union were more likely to be laid off than those who were salaried. Aggregate work hours of women who were non-union and hourly paid fell by 44 percent, and 32 percent of them lost their jobs entirely.

We also highlight the challenges for policy makers in designing emergency income support. The self-employed were seriously affected by the COVID-19 restrictions. They reported a 51-percent reduction in aggregate work hours, but only a 3-percent reduction in employment. Clearly, supporting the self-employed in a system designed for paid employees was a necessary part of the CERB design, and policy now needs to determine how to best support them going forward.

While April appears to represent the lowest point for Canada's workforce, it also represents the starting point for a long road to economic recovery. We offer some points to consider as we travel down that road.

- COVID-19 has hit workers with the least bargaining power hardest – non-union, low-wage, hourly paid, young workers, and women. These workers rely heavily on health and safety standards set by government policy to ensure a safe work environment, so these policies are key to get people back to work.
- The impact on parents and other caregivers is substantial, as they balance finding their way back to work while searching for safe childcare options. Without support, many parents, especially women, will be left behind.
- For many workers in the bottom earnings quartile, CERB comes close or even exceeds potential wages from work. Going forward, finding a balance between income support and financial incentives to work will emerge as a difficult policy question.
- With lower incomes, and reduced savings, we can expect a reduction in consumer demand. Regenerating aggregate labour demand must be a priority.
- We need to prepare for workers needing to change jobs within industries and reduce frictions where possible. For example, as there may be reduced demand for many frontline retail workers, we expect increased demand for online retail jobs.
- We also need to help workers find their way into new industries. As health restrictions and concerns reduce demand in some industries (such as international travel or entertainment), we will need to reallocate labour to those growing. This will require support for jobs search and retraining.

Going forward, we know the impact of the pandemic on both labour supply and demand will be large. Labour market policy that responds appropriately can assist the recovery by facilitating fast and efficient matches in the changed labour market.

Thomas Lemieux is Professor at the Vancouver School of Economics, Tammy Schirle is Professor of Economics at Wilfrid Laurier University, and is a C.D. Howe Institute Research Fellow, and Mikal Skuterud is Professor of Economics at the University of Waterloo.

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Intelligence MEMOS

From: Tammy Schirle and Mikal Skuterud

To: Bill Morneau, Minister of Finance

Date: August 12, 2020

Re: **Job Search, New Jobs, and What it Means for Future Policy**

It is now widely recognized that the economic burden of COVID-19 shutdowns in March and April overwhelmingly fell on Canada's lowest-wage workers.

Between February and April, aggregate hours worked by those earning less than $15 per hour dropped by 51 percent, while hours dropped by only 10 percent for those earning $35 per hour or more. Last week's Labour Force Survey reveals that Canada's lowest wage workers have also been the slowest to return to work as businesses re-open: by July their aggregate hours remained 30 percent below pre-shutdown levels, while the hours of high wage workers (earning $35 per hour or more) had actually increased to levels higher than we saw in February.

How concerned should we be that currently jobless workers have weak incentives to return to work?

With access to the CERB's $2,000 per month – a benefit level that is near, and often exceeds, the earnings of Canada's minimum-wage workers – the immediate gain of a return to work may be insufficient to motivate searching for and beginning a new job. Where those jobs pay more than $1,000 per month, they become ineligible for CERB entirely, potentially making them worse off. As labour economists, we are normally acutely concerned about the work incentive effects of worker income support programs.

However, despite our best efforts, we see no clear evidence that the CERB is currently disincentivizing jobless workers to search for and begin new jobs.

We examined the job search activity of workers who are recently jobless – having lost their jobs after mid-February – using the Labour Force Survey. Search activity was exceptionally low in March and April while many businesses were shuttered. But as businesses started to reopen in the spring, search activity picked up and has now reached normal levels (in comparison to search activity among jobless workers following the 2008-9 recession or at the same time last summer).

Moreover, and perhaps more surprisingly to some, we see no evidence that the earnings threshold for CERB eligibility is preventing low-earning workers from taking new jobs. When we looked at newly hired workers in Canada, the proportion earning below $2,000 in those new jobs fell in March, April and May when many businesses that employ low-wage workers were shuttered. But since then, we've seen their numbers rise, so that low-earners' representation among new hires has returned to levels seen in the summers of 2018 and 2019.

As labour economists, we are always concerned about the need for income support programs to balance the need to support workers and their families during unemployment spells with the need to provide workers with incentives to search for and accept new jobs. Job searches were low in March to May, perhaps because of public health efforts to keep people at home, because of the CERB incentive some business groups pointed to, or because of the risks of COVID-19 in the workplace. What the recent LFS numbers suggest is that the work incentive effects of a short-term emergency benefit like CERB are now, if anything, small and perhaps even negligible. Because workers know the benefit is temporary, their concerns for ensuring employment in the longer term appear to be driving their behaviour. When job opportunities arise in the current uncertain climate, it is too risky to turn down those opportunities.

In the near future the federal government will present plans for moving CERB beneficiaries to Employment Insurance (and a parallel EI program for those not normally eligible for EI). In light of what we are seeing in the data, we suggest the following be kept in mind:

- In extending emergency support, meeting the income needs of families should be prioritized over work incentives.
  - ◊ Reducing monthly benefits below $2,000 appears unnecessary to motivate workers.
  - ◊ While reconsidering the strict $1,000 CERB eligibility threshold is sensible, it does not appear critical for the program design in terms of work incentives.
- The distinction between short-term and permanent program changes needs to be clear to everyone in the labour market. While a short-term emergency benefit may do little to reduce work incentives, more permanent changes to EI programs are likely to do more to discourage labour market attachment.
- Both the cause and the solution to the current economic crisis remain first and foremost the COVID-19 virus. Now is not the time to use income support policies to economically push workers back into potentially unsafe work settings that may contribute to a second wave of the virus.

Tammy Schirle is Professor of Economics at Wilfrid Laurier University, and Mikal Skuterud is Professor of Economics at the University of Waterloo.
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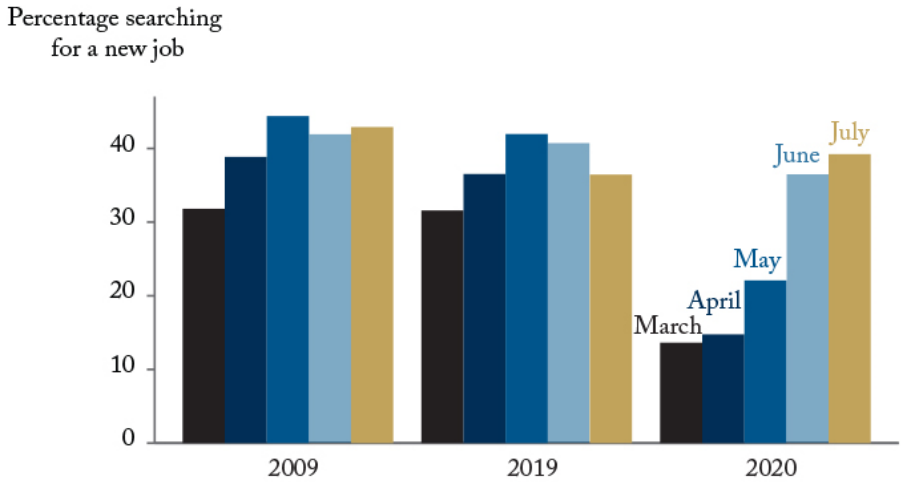
Job Search Activity of Jobless Workers

Workers who were separated from job after mid-February and are still jobless



Note: Sample includes all jobless workers (unemployed and out-of-LF) who were separated from their job after mid-February.

Source: Labour Force Survey (PUMFs).

Percentage of newly hired workers with usual monthly earnings in new job below $2000

Note: Workers with new jobs are respondents with job tenure less than one month. Monthly earnings are usual hourly earnings multiplied by usual weekly hours and four. Sample is unlikely to include laid off workers recalled to jobs. Earnings are adjusted to May 2020 dollars.

Source: Labour Force Survey (PUMFs).

Intelligence MEMOS

From: Morley Gunderson

To: Canadian Policymakers

Date: September 9, 2020

Re: **LABOUR POLICIES FOR NOVEL SHOCKS SUCH AS COVID-19**

Novel and one-off shocks like COVID-19 generally involve uncharted terrain with little or no precedence or evaluation studies to guide policymaking. Policymakers must decide quickly the balance between using existing policies with modifications (such as exemptions for eligibility and changes in the duration) and possible new responses.

Being unanticipated, employers and employees are not generally expected to have taken appropriate precautions to adjust to the shock. Providing adjustment assistance is therefore unlikely to create moral hazard problems whereby the assistance inhibits the private parties from taking their own precautions to avoid and mitigate the risks.

In the case of pandemics, however, moral hazard problems can still prevail if the lack of adjustment assistance creates the perverse incentives whereby individuals conceal infection so as to continue working, leading to the externality of transmission to third parties. However, generous adjustment assistance can also reduce the monetary incentive to return to work and the economy's return to normal.

As I outline in a recent *Canadian Public Policy* article, the playbook to deal with such novel, one-off, unanticipated shocks include:

- Having a *first-responder labour policy team potentially in place*, with the following elements:
  - ◊ A well-defined chain of command;
  - ◊ Updated contact information;
  - ◊ Procedures for both internal communication and external communication with the public;
  - ◊ Practice runs.
- *Acting quickly*, especially in the case of pandemics where delays can foster exponential contagion and delay the transmission of important information and adjustments of the healthcare system. Be flexible and recalibrate swiftly as new information is revealed.
- *Determining early the extent to which the shock is likely to be temporary or permanent*. If permanent, anticipate wage losses in the order of 20-30 percent as well as the health effects and "deaths of despair" resulting from drug overdoses, the opioid crises, drink-induced liver disease, suicide and domestic abuse. Even temporary shocks can leave a legacy of more permanent longer-lasting scarring effects and permanent reallocations.
- *Co-ordinating with other departments* (e.g., health, finance, social services) and jurisdictions (federal, provincial) given that most shocks will likely affect different areas. Division of responsibilities should be established well in advance, and relevant ministers represented on a "first-responder" committee. Co-ordinate with unions or employee representation groups where present.
- *Having background information readily available* on "lessons learned" from previous shocks to deal with such questions as:
  - ◊ Are the existing adjustment assistance programs (e.g., employment insurance, retraining) capable of dealing with the labour adjustment needs from such novel shocks, perhaps by making minor modifications with respect to eligibility and the magnitude and durations of benefits?
  - ◊ Does the assistance provided to employers to have them return to normal filter down to workers?
  - ◊ Is it sensible to have loans to employers that are forgivable if they do not lay off employees?
  - ◊ Is government support for short-time work as an alternative to layoffs a desirable way for employers to retain their workforce, or does it prop up weak firms?
  - ◊ Do government policies that encourage employers to retain their workforces inhibit employers from laying off workers and then re-employing only those that they prefer to keep?
  - ◊ Are wage subsidy programs sensible for companies to retain, or rehire, their workforce that would otherwise be laid off because of a crisis?
  - ◊ Are work-sharing programs sensible where employment insurance is provided to employees who agree to reduce their hours and share a job?
  - ◊ Can wage concession by unions achieve a similar objective of avoiding layoffs?
  - ◊ Have there been unintended consequences from previous policy initiatives?
- *Anticipating and preparing for conflicts and trade-offs* that may occur and having a strategy to deal with them. Such conflicts can include: safety versus protecting the economy and jobs; refusing unsafe work and requiring workplace accommodations; strikes or work-to-rule campaigns; professional versus service worker divides; intergenerational conflict; litigation over alleged negligence; accusations of discrimination; failure to post or enforce back-to-work protocols; and issues around paid and unpaid sick leave
- *Planning for a recovery with an exit strategy*:
  - ◊ For a labour market recovery that is likely to be very slow and lag the economic recovery;
  - ◊ With the possibility of a second shock, especially in the case of pandemics as the economy opens up;
  - ◊ With targeted and phased labour market re-opening;
  - ◊ Relaxing legislative and regulatory constraints that inhibit employment;
  - ◊ With local and timely labour market information.

Policymakers should also pay particular attention to vulnerable disadvantaged workers who lack individual or collective bargaining power, as their voice is often lost to the stronger voices of more powerful interest groups.

Although such shocks may be novel and unanticipated, having a playbook in place enables policymakers to respond quickly to mitigate harm.

Morley Gunderson is professor emeritus at the Centre for Industrial Relations and Human Resources at the University of Toronto where he was the inaugural holder of the CIBC Chair in Youth.

Theme 2:

The Canada Emergency Wage Subsidy

Intelligence MEMOS

From: Thorsten Koeppl

To: Department of Finance

Date: March 16, 2020

Re: **For More and Swift Action, Just Look to Germany**

Over the past two weeks, both the Bank of Canada and the Department of Finance have weighed in with emergency measures to limit the economic damage from COVID-19.

First was the Bank of Canada's 50 basis point emergency rate cut on March 4. Then, in the span of three days, the federal government announced $1 billion in support, followed by a surprise 50-basis-point rate cut by the Bank, and finally another federal announcement to the tune of $10 billion in assistance through the Business Development Bank of Canada and Export Development Canada. And this likely won't be enough, with the federal government admitting as much, saying significant fiscal stimulus will come this week. What should this stimulus look like?

We encourage readers of this piece to look at some other work coming out of this organization. In this memo we look abroad to Germany for some guidance.

On Friday March 6, Germany announced a dramatic new chapter in economic policy. The Minister of the Economy, Peter Altmaier, announced what amounts to unlimited support for German businesses and workers. He went as far as pointing out that "no sound enterprise should be pushed into insolvency, no job should be lost due to the Coronavirus".

The response by the German government is not a surprise, as it can rely on a well-oiled machinery of economic policy tools. The publicly owned development bank KfW has €20 billion available immediately to support struggling businesses with emergency loans to bridge liquidity problems. But more importantly, the German government has announced that this support can be stepped up if necessary to virtually no limit, pointing to a maximum volume of guarantees and loans in the amount of half a trillion Euros. And it would appear from its announcements that a full-fledged stimulus program is ready to be launched, including equity injections by the government to business enterprises.

"We just put all weapons on the table and make clear that we are somehow bigger than the problem that we could face in the economy," said Finance Minister, Olaf Scholz.

Of course, it helps that Germany regularly runs small surpluses. It also can borrow cheaply, at an interest rate of about negative (!) 1 percent for 10 years. This means you lend one euro to the German government and, 10 years later, get about 90 cents back. Moreover, well-designed automatic stabilizers are in place that buffer the economy against severe economic downturns.

The best example is "Kurzarbeit" where the German government pays a percentage of wages when companies reduce production in the wake of a severe recession. The tool is usually deployed swiftly and without much red tape as was the case two Fridays ago.

The Bank of Canada has gone full tilt into emergency measures that, while necessary, unfortunately, do not directly address the first-order problems that businesses and the working population are facing.

Stimulus proposals such as tax cuts and payroll are being thrown around with the goal of relieving the financial burden on households and to stabilize household spending. These measures may help the economy down the road, but are likely insufficient to deal with the immediate, direct fallout of the pandemic.

Canada's most recent $10-billion announcement of BDC and EDC funding rightly focuses on liquidity assistance to businesses. Likely more will be needed, and, one option is Germany's comprehensive short-time work program whereby government supports companies such that they do not lay off workers, allowing them to instead work a reduced schedule, and compensate them for lost wages. This program now has been extended to everyone in the economy, right down to the self-employed taxi driver and the part-time waiter in a restaurant.

This economic crisis lays bare the problem of relying exclusively on the Bank of Canada, and underline the need to ensure governments, both federal and provincial, have the ability to go all in and unconditionally support the economy. The best fiscal responses will go big in the short run, using measures that will reverse as things improve, for maximum positive effect on confidence. Policymakers have recognized the emergency of the situation. More has been promised. And more is needed. Let's hope we have sufficient fiscal room.

Thorsten Koeppl is Associate Professor and RBC Fellow at Queen's University.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Canadian Businesses Need Much Bigger Subsidies for Salaries during This Crisis
By David Samuel and William B.P. Robson

COVID-19 poses a threat to Canada's economy that is unique in modern times. People are self-isolating, businesses and not-for-profits are cutting back or closing, and workers are losing their jobs. The consequences – including the health impact of unemployment, isolation and lost access to goods and services – could rival those of the coronavirus itself.

Governments have responded with measures that proved useful in the 2008-09 financial crisis. Lower interest rates, liquidity and credit-market supports will all help.

Also important are steps to ease the cash-flow crunch that threatens chain reactions of private-sector closings and layoffs. Federal, provincial and local governments are deferring remittance and filing deadlines.

So far, so adequate – but Canadians need more.

Help announced to date is not big or fast enough to arrest the contagion that risks an economic implosion for Canada's businesses and not-for-profits. Last week's wage-subsidy announcement – 10 per cent of payroll up a maximum of $1,375 for each employee and $25,000 an employer for three months – is a step in the right direction. But it is too small to matter for businesses closing their doors and charities with donations drying up. Faster Employment Insurance eligibility will not prevent layoffs.

The federal government should immediately raise the percentage of payroll and the dollar caps for every employee and employer to an amount that will change the outlook. A subsidy of 75 per cent or even 100 per cent for employees earning up to the annual maximums covered by EI or the Canada Pension Plan – the average of the two this year is about $54,500 – would provide the material support and the confidence we need.

That subsidy would cost more for as long as it applied – but the question of time frame brings us to a second problem with responses to date. Many employers are planning or already implementing draconian actions that will exacerbate the contraction, partly because the current situation feels like the new normal – as though isolation and closings will last forever.

They will not. As experience in countries on the front line of COVID-19 already shows, the number of new cases will drop – and so, over time, will the total number of people affected. Most people who get sick will recover. Scientists are racing to create vaccines and anti-viral agents. The world will be different, but it is not going to end.

What Canadians also need from their governments is timelines – some kind of response playbook. There will be a period of maximum containment when the priority is suppressing the virus's spread while we ramp up testing and acute care. There will be a subsequent period of targeted containment when the focus shifts to regions and population groups that are most vulnerable. And there will be a third period, the transition to a new normal, with the novel coronavirus becoming part of the background of colds and seasonal flu.

While we cannot yet commit to firm dates, even provisional guidance would make a huge difference. Parliament is due to resume April 20. If that is an appropriate period for maximum containment – and it may be – make the larger wage subsidy apply for a similar period. Federal, provincial and local governments could co-ordinate their health and other economic measures – other subsidies and tax-deferrals, for example – for a second period that might last until the end of June or September. Even contingent timelines would reduce the uncertainty and attendant paralysis that are now among the biggest threats to Canada's economy.

In short, Canadians need financial support from their governments – but they need more than that. Government actions to fight the virus and mitigate the downturn will be central to our lives in the weeks and months ahead. Too many employers and workers are envisioning an endless downward spiral. They need guidance – a playbook – to help them see the better times ahead. Timelines, even provisional ones, will help us get through this crisis.

David Samuel is a partner at Birch Hill Equity Partners. Birch Hill owns 15 companies that employ more than 40,000 people, the vast majority in Canada. William Robson is president and CEO of the C.D. Howe Institute, a leading economic policy think tank in Canada.

Published in *the Globe and Mail.*

Intelligence MEMOS

From: William B.P. Robson and Grant Bishop

To: Federal Finance Minister Bill Morneau and Deputy Prime Minister Chrystia Freeland

Date: March 25, 2020

Re: **Job Subsidy from Ottawa is Key to Getting through the COVID-19 Crisis**

The spread of COVID-19 and public health measures to combat it have delivered an unprecedented shock to Canada's economy. Businesses and not-for-profits are closing. Recent Employment Insurance (EI) claims suggest the unemployment rate is headed for double digits.

The economic distress is compounding the direct impact of the disease, and may ultimately overshadow it. Unemployment and financial distress hurt physical and mental health, and the implosion of the private-sector economy is propagating that damage. So just as Canadian policymakers must mitigate the health impacts, they must mitigate the economic impacts.

Governments elsewhere have stepped in to support jobs with direct wage subsidies. Canada's federal government has announced a 10 percent subsidy for three months.

That approach falls short on two counts.

The amount is too small, and the per-worker and per-employer caps too low, to stop layoffs. And the time-frame is too long – three months is an eternity for a business that has closed its doors, or a charity with no reserves. Canada needs something bigger, faster, and shorter-term.

How could a high-impact federal job-subsidy program work in Canada?

EI gives us a helpful framework. It provides weekly benefits of 55 percent of an employee's wage up to a ceiling based on average earnings: $54,200 this year. Instead of letting people lose their jobs and apply for a government program, Ottawa should subsidize the jobs directly, helping employers keep their workers.

What would it cost? A subsidy equal to 55 percent of covered earnings for the entire workforce might amount to $6-7 billion a week. Exclude the roughly one-third of employees who work for governments and in the broader public sector – we don't want the federal government subsidizing itself – and the cost would be $4-5 billion a week. Net of federal income tax, it is less than $4 billion – smaller yet if Ottawa can recoup provincial taxes. At 55 percent of covered earnings, the subsidy per worker would amount to some $370 per week.

Even the lower amounts in these ranges would add appreciably to the federal government's deficit and debt. But the looming claims on the federal treasury are larger without it. A chain reaction of closures of businesses and not-for-profits will cause EI claims to mount. Paying EI benefits pre-emptively will keep paycheques flowing.

The federal government possesses the fiscal capacity to deliver this support. Governments will be borrowing to fund any fiscal support, and the debts that we incur today must be paid in the future. While fiscal capacity varies across provinces, Ottawa can borrow to fund this short-term support and repay it from future tax revenues nationwide.

The event it addresses is unique. The economic shutdown is a consequence of the public health measures governments are taking. Nobody can self-insure against this kind of shock. Governments are providers of social insurance. Preventing job loss will mitigate the misery that economic dislocation will otherwise produce.

Ottawa has a start on the administrative machinery to deliver it. EI contributions mean the federal government has a current payroll record on which to base immediate transfers to firms. Reversing the flow of EI payments will require administrative ingenuity. Employers would have to guarantee the jobs, so that the funds could not be diverted elsewhere. While not every dollar that flows will be equally effective, targeting is a bit beside the points when so many Canadian employers are thinking about, if not already implementing, job cuts. Some sorting out of who needed the money and who didn't can wait for 2020 tax filing. These are extraordinary times, and extraordinary times require extraordinary measures.

Finally, and crucially, the measure would be short term. Shutdowns and extreme social isolation are temporary. We can do this for a few weeks; we cannot do it for months. A one-month subsidy along these lines would cost $16 billion. Especially against the backdrop of EI payments – let alone the collapse in tax revenue – that will occur without it, that is a cost the federal government can manage.

A job subsidy should be part of the federal government's next response to the crisis. Canadians need immediate help, and timelines to help them recover. Employers and employees alike will benefit from knowing that the federal government has their backs.

Grant Bishop is Associate Director, Research, and William B.P. Robson is President and CEO at the C.D. Howe Institute

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Benjamin Dachis, Grant Bishop and William B.P. Robson

To: Deputy Prime Minister Chrystia Freeland, Federal Finance Minister Bill Morneau, Minister of Minister of Families, Children and Social Development Ahmed Hussen, and Jean-Yves Duclos, President of the Treasury Board

Date: March 27, 2020

Re: **AN OUNCE OF LAYOFF PREVENTION IS WORTH A POUND OF INCOME-SUPPORT CURE**

Rapid substantial support for jobs is a critical missing piece of the federal government's response to the COVID-19 crisis.

Across the economy, businesses and not-for-profits are losing revenue and laying off workers. The chain reaction is a major reason that a deep recession and double-digit unemployment are anticipated.

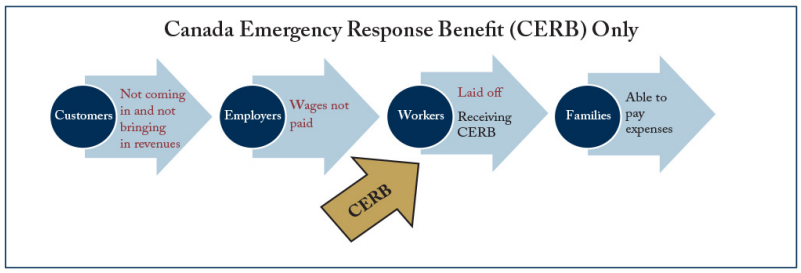
A subsidy for workers still on the job would complement the Canada Emergency Response Benefit (CERB). At a minimum, Ottawa could deliver Employment Insurance (EI)-sized benefits through employers. Or it could go bigger – up to 75 percent, say, as Ireland has done.

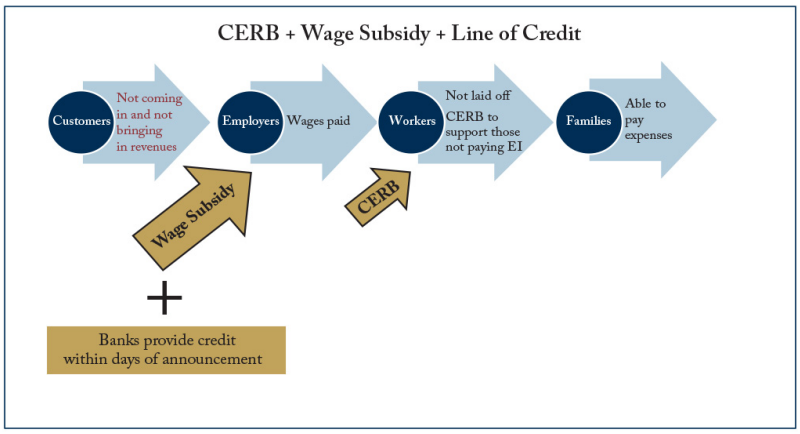
As a practical matter, "reversing the flow" of EI remittances through employers will take time. So the federal government should bridge the gap through government-backed lines of credit (GBLOCs). An employer could access credit equal to the wage subsidy from a bank or credit union. Lenders would be able to establish GBLOCs within days.

Yesterday, the C.D. Howe Institute's Crisis Working Group on Business Continuity and Trade endorsed both wage subsidies and a "bridge" of GBLOCs. Here's why:

1. Under Ottawa's current plan, CERB applications will start April 6 and money would flow 10 days later. GBLOC-supported wage subsidies will be far faster. Employers already have financial relationships with the institutions that would extend credit.
2. EI-sized wage subsidies will reduce demand for both EI and the CERB. EI provides weekly benefits of 55 percent of wages up to a $54,200. Equivalent support to a firm that otherwise would lay a worker off costs the same. Support at the 55-percent level would cost about $4.5 billion a week Support at 75 percent would cost about $6.3 billion a week. If 4 million individuals receive CERB (as anticipated) at $2,000/month, the cost would be $2 billion a week. Maintaining wages will stem the requirement for workers to seek the CERB, reducing the cost of that program.
3. The wage subsidy can use up-to-date information. Employers collect and remit contributions weekly or biweekly. The CERB will rely on income-tax filings, mostly from 2018, to send cheques. Much of that information will be out of date. Fewer layoffs will also reduce administrative strain on CERB applications.

A Better Way: CERB plus Preemptive Wage Subsidy





4. Wage subsidies are targetable. They could be limited to businesses and not-for-profits that experience a sizeable drop in revenue (Ireland's wage subsidy specifies a 25-percent revenue decline) and require a commitment that the employer limit or avoid layoffs.
5. Working through employers will keep employees connected during any downtime – good for morale and mental health. The CERB forces an employer to lay someone off or stop paying wages.

Narrower targeting and more specific plans for recouping overpayments make sense in principle, but time is pressing. The Canadian Federation of Independent Business's mid-March member survey indicated that half are contemplating layoffs.

Ben Dachis is Director of Public Affairs, Grant Bishop is Associate Director, Research, and William B.P. Robson is President and CEO of the C.D. Howe Institute

To send a comment or leave feedback, email us at blog@cdhowe.org.

* Application for CERB will open on April 6, with earliest payment on April 13.

Crisis Working Group Report: Crisis Household Income and Credit Support

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. Several working groups will address challenges in the monetary, fiscal and financial policy domains. One such group is the Household Income and Credit Support Working Group, chaired by Michael Horgan, Senior Advisor at Bennett Jones LLP and Former Deputy Minister of Finance, Government of Canada, and supported by a group of Canadian business leaders and economists. Meeting weekly, this group will debate policy ideas, and communicate the results of its discussions in a public joint Communique. The group's first meeting was held on Tuesday, March 24, 2020. The purpose of the first meeting was to identify and prioritize key risks for households during this crisis, to discus policy options and to consider recommendations.

The working group noted that the COVID-19 crisis is different from other crises as it is a supply-driven crisis and a massive percentage of private-sector employers are at risk. Without a rapid response from governments to prevent layoffs and shutdowns of businesses and not-for-profit organizations, unemployment will continue to rise sharply. Since supply creates demand, focusing only on measures that support the demand side of the economy such as providing supports in generating business and employment income is ultimately not sufficient. That said, Employment Insurance (EI) programs and other income supports can provide a bridge back to lost jobs when the economy recovers; but governments should also help businesses (particularly small businesses) and not-for-profits pay their bills and stay afloat during the crisis.

Businesses in some industries such as travel, tourism, and hospitality have experienced virtually a 100 percent reduction in demand related to the COVID-19 crisis. This highlights the importance of providing income supports for those who lost their jobs due to the crisis. The working group discussed whether the EI program would be able to deal with the flood of applications. Furthermore, the members of the Household Income and Credit Support Working Group agreed that the risks and consequences of not supporting employers and individuals enough is significantly higher than offering them too much.

Due to the complex nature of the policy domain, the group identified various issues and risks as being the most pressing to tackle in the short term. These issues and policy interventions to address them fall under three major themes as follows:

Wage subsidies: The federal government's previously announced 10-percent subsidy was too little to enable businesses and not-for-profit organizations to retain employees. Since the measures to contain the virus are, presumably, temporary, providing generous wage subsidies was identified as an effective and appropriate approach to prevent further massive layoffs and business shutdowns. Preventing job loss not only helps the economy to recover quickly as neither workers nor employers need to go through the process of finding an employment or filling a position respectively again, but also mitigates the impacts on mental and physical health. The wage subsidy program, however, needs to be different from the European style programs, which provide wage subsidies only for furloughed employees. To be nimble, the federal government can adopt the current feature of the EI program and offer a subsidy equal to 55 percent of covered earnings of workers.

Other Income support: While the group endorsed deferrals on payments and financial supports for targeted Canadian businesses and workers to create cash flow, it highlighted the need for further financial emergency support such as forgivable business loans and identified several vulnerable groups who are, potentially, left behind, such as

- tenants, either individuals or businesses and other employers, need an emergency financial support to pay their rents since other types of support such as moratorium on evictions of tenants can have unintended consequences as it puts the ability of landlords to pay their own expenses such as rental property maintenance expenses at risk.
- those whose EI benefit is ending and it is not clear whether there will be some expansion of benefits;
- self-employed individuals and contractors with no income as a result of current circumstances, who are not classified as employees;
- students who are soon graduating and unable to find an employment. The recent survey shows that similar to other crisis young individuals are hit harder than others and see greater increases in their unemployment rate; and
- workers on the front lines of the crisis who need extra support and receive proper equipment.

Time frames: The working group identified the need for a plan on how to resume economic activities and get employees back to work, despite the coronavirus crisis. This requires finding ways to contain the coronavirus without shutting down the economy for more than a reasonable period of time. It requires considering options that make workers feel comfortable with going back work, possibly learning from

the South Korea and Singapore experiences. Otherwise, a large number of businesses and not-for-profits may not survive. There was also a consensus among the members of the group that speed is a key element in this crisis to mitigate the risk and uncertainties in the labour market. For example, the governments need to provide the details of their plans to support employers and workers as quickly as possible to ensure business continuity.

The Household Income and Credit Support Working Group Working Group will meet again next week. Much is likely to change between now and then, and the next meeting will focus on emerging issues and specific policy proposals from the members. Areas for potential consideration include what provinces should do for their residents; how the federal and provincial governments should coordinate in providing supports and taking precautionary measures; what other types of support other jurisdictions have provided; and measures to reassure pensioners and for senior citizens who have lost retirement wealth.

Household Income and Credit Support Working Group members include:

Michael Horgan, Senior Advisor at Bennett Jones LLP and former Deputy Minister of Finance, Government of Canada

Grant Bishop, C.D. Howe Institute

Luc Godbout, Université de Sherbrooke

Brian Kingston, Business Council of Canada

Parisa Mahboubi, C.D. Howe Institute

Kevin Milligan, University of British Columbia

Mike Pedersen, Business Development Canada

Bill Robson, C.D. Howe Institute

Tammy Schirle, Wilfrid Laurier University

Kathleen Taylor, Royal Bank of Canada

Ed Waitzer, Stikeman Elliott LLP

The Canada Emergency Wage Subsidy is the Right tool for This Crisis
By William B.P. Robson and Grant Bishop

On Monday, the federal government announced the framework for a Canada Emergency Wage Subsidy (CEWS) to support employment by topping up payrolls for employers suffering COVID-19-related drops in revenue. More details came out on Wednesday, including the types of employers it will cover, the pay it will supplement, the size and duration of revenue drop that will trigger eligibility, and the estimated cost.

This is an extraordinary measure – something entirely new on the Canadian landscape. Not surprisingly, more details, including the application process and record-keeping requirements, are still to come. Parliament will need to approve it. It is not too early to say, however, that this initiative will turn out to be central in determining how quickly and completely Canada's economy recovers from the COVID-19 crisis.

While we do not yet know the severity of its impact, COVID-19 has already dealt a massive blow to Canadians' livelihoods. Many businesses have cut back or closed as customers disappeared, many more as public health-related restrictions came into effect. Demand for Canada's exports is down and supply chains are stressed.

For people who have lost their jobs, income supports through more generous Employment Insurance or the new Canada Emergency Response Benefit are good. Much better, though, is to forestall layoffs in the first place. Losing a job can be devastating. Breaking the links, and possibly a relationship of trust, between employers and employees is traumatic. Lost incomes will deepen the downturn and permanent closures will slow the recovery. The federal wage subsidy is the right idea.

The widespread coverage of the program is a key virtue. Limiting it to employers below a certain size is politically tempting, but hugely problematic in application. Business structures and employment relationships come in many forms. Specifying a limit – 250 employees, say – creates arbitrary boundaries and perverse results: a large business with franchises might be eligible when a smaller integrated company would not. Making it available to all employers outside the public sector avoids other arbitrary exclusions – not least between businesses and not-for-profits. Moreover, widespread coverage makes the program easier to roll out – and speed is essential in forestalling layoffs.

The generous coverage is also a virtue. Seventy-five per cent up to a per worker threshold of $58,700 annually – a maximum payment of $847 per worker per week – looks like a lot and it is. That earnings threshold is roughly equivalent to average earnings in major Canadian cities. But it needed to be big: many of the businesses and not-for-profits suffering from the crisis are in dire straits. The previously announced 10 per cent wage subsidy, and potentially even a 55 per cent replacement, along EI lines, would make much less difference. The larger amount will help employers retain employees even in low-margin organizations – and many service industries and not-for-profits operate with very low margins.

A third important feature is the requirement to demonstrate a 30 per cent fall in revenue from the same month a year ago. This feature will make the program more effective. Requiring a decline over a longer period would have ruled out many organizations that cannot withstand a revenue decline over a quarter, let alone a year.

With Parliament due to consider the program, what needs attention?

Speed is critical in forestalling layoffs. What we know so far suggests that the process for applying and receiving the CEWS will take weeks or even months. Another part of the crisis-response package announced by the federal government is a Canada Emergency Business Account, which will backstop loans to small businesses and not-for-profits through eligible financial institutions. If employers could borrow from financial institutions they deal with already, and repay when they receive CEWS payments later, job-supporting cash will flow faster.

Working through established financial institutions would also protect against bad actors. Details to come include anti-abuse rules to prevent and punish fraudulent applications and diversion of the subsidy to other uses. Chief executives and other directors or officers should attest that the subsidy will flow to workers, guaranteeing that those workers will keep their jobs. Publishing payments received for larger enterprises would also discourage misuse. Publication would be an appropriate condition for receipt of public funds and to ensure public buy-in.

The cost of the CEWS is huge. Wednesday's announcement put it at $71 billion. That's on top of other major supports, including the Canada Emergency Response Benefit. But the crisis requires going big, fast. Concerns about fiscal sustainability are best channelled into holding the federal government to account for establishing – and staying on – a path back to budget balance once the crisis is over.

For now, Canadians need a bridge to help employers and employees get through the coming weeks. The CEWS is the tool for the job.

William Robson is president and CEO, and Grant Bishop associate director of research at the C.D. Howe Institute.

Published in *the Financial Post.*

Intelligence MEMOS

From: Grant Bishop, Benjamin Dachis, and William B.P. Robson

To: Members of Parliament

Date: April 6, 2020

Re: **Making the Federal Wage Subsidy Work**

Like the battle against the virus itself, the struggle to mitigate the economic impact of the COVID-19 crisis is forcing governments to act swiftly.

The federal government's Canada Emergency Wage Subsidy (CEWS) is a case in point. By supporting up to 75 percent of wages of employers suffering significant revenue loss, it could forestall layoffs that will exacerbate the economic and human costs of the crisis. Three features could help it do that:

1. Eligibility broader than the currently proposed 30 percent revenue decline from the same month last year;
2. Letting financial institutions advance cash to employers immediately; and
3. A graduated, rather than all-or-nothing, scale for the subsidy.

Eligibility is the first hurdle. A 30 percent revenue decline from the same month last year will exclude many organizations – among them, startups, businesses and not-for-profits with lumpy month-to-month revenues, and those still uncertain about the impact of the crisis.

Other countries are taking a broader approach to upfront eligibility: a trust but verify approach akin to what Ottawa's Canada Emergency Response Benefit (CERB) does for individuals. Ireland announced its wage subsidy, saying "eligibility will initially be determined, largely on the basis of self-assessment and declaration by the employer concerned, combined with a risk focused follow up verification." Ireland is allowing the employer to use the previous month's turnover "or on any other basis that is reasonable." New Zealand is allowing employers to use January and February 2020 as a baseline as well as the same month last year. The CEWS also could apply an either/or test of a decline relative to the same month last year, or earlier in 2020.

A reconciliation at the end of the year could reference an employer's revenue decline over the full year, to recoup payments that were not necessary. An economic rebound would leave many businesses and not-for-profits with smaller percentage declines in revenues for the year than for the worst affected months.

Delivering support quickly is the second hurdle. The federal government has said it can deliver the CEWS in three to six weeks. Caution is warranted on that. Ottawa lacks the capacity to process the likely application volume and deliver payments quickly – as its difficulty processing EI claims illustrates and as its closure of Service Canada centres underlines.

Payroll charges are relentless: for most employers, one looms at the middle of April, and another at month-end. Some organizations that postponed layoffs when the government announced the CEWS cannot wait much longer.

This is where the recently announced Canadian Emergency Business Account (CEBA) can help. The CEBA gives small businesses and not-for-profits access to a $40,000 interest-free loan, with up to $10,000 forgiven, through their current financial institutions. The United States has meanwhile established its Paycheck Protection Plan (PPP), which lets businesses and not-for-profits with fewer than 500 workers access loans equal to 2.5 times their monthly payroll, up to a maximum of $10 million.

A similar Canadian plan would let financial institutions advance cash up-front, and reconcile after the employer receives CEWS funds. Canada can emulate elements of the PPP by increasing the CEBA guarantee. The forthcoming wage subsidy legislation could limit businesses and not-for-profits to an end-of-year choice of seeking forgiveness of their CEBA loans or paying back the forthcoming wage subsidy. Involving the financial institutions with which employers have existing relationships will not only accelerate the support, it will be a key bulwark against fraudulent claims.

Fine-tuning the revenue-decline criterion could address the third hurdle – employers who, partly because they do not know if they will be eligible, do not apply. Scaling the subsidy so that it is phased in over a range of revenue declines, rather than the full amount with 30 percent and nothing otherwise, would reassure employers that a bad prediction would not expose them to a major penalty – or, perversely, tempt them to stop sales or defer donations in order to keep themselves safe.

The CEWS can help Canada's economy through the COVID-19 crisis. Adjusting the eligibility criteria, facilitating up-front funds and scaling the subsidy will make it faster and more effective.

Grant Bishop is associate director, research, Benjamin Dachis is director of public affairs, and William B.P. Robson is president and CEO of the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Amin Mawani and Salim Hajee

To: Concerned Businesses and Employees

Date: April 27, 2020

Re: **Assessing How Ottawa's New Wage Subsidy Lines Up with EI and CERB**

The Canada Emergency Wage Subsidy (CEWS) program has opened and businesses need to incorporate the estimated level of after-tax financial assistance offered to their employees by the CEWS, Employment Insurance (EI) and the Canada Emergency Response Benefit (CERB) into their decision-making.

This memo presents a quantitative analysis of these three programs to guide both employers and employees.

The CERB is more beneficial to employees earning less than $37,569, while the CEWS is more beneficial to employees earning more. But the CEWS has additional advantages by offering businesses a competitive edge once economic activity resumes by keeping employees on their payroll.

The wage subsidy is equal to 75 percent of pre-crisis weekly salary to a maximum of $847 per week. The subsidy is offered to employers that can demonstrate a 15 percent or greater decline in revenues (not profits) between March 2020 and March 2019, or between March 2020 and the average of January and February 2020. For April and May 2020, the decline in revenue has to be at least 30 percent compared to the same months in 2019 or compared to the average of the first two months of 2020.

While businesses have to apply on Canada Revenue Agency's web portal each claim period, an employer would automatically qualify in the immediately following period if they were considered eligible in an earlier period. This provision – designed to increase certainty for the employer – makes the second period's requirement to be effectively the same as the first period's requirement – namely, demonstrating a 15 percent decline in revenues instead of 30 percent. For example, if a firm experienced a 20 percent decline in revenues in the first claim period, then it would qualify for the CEWS for both the first and second claim periods. For the third claim period, the employer would have to show a 30 percent decline to qualify. Firms may therefore want to apply for the CEWS sooner to meet the less stringent revenue reduction test for the first period.

Currently, the choice between applying for EI or CERB is up to the employee applicant. Assuming the criteria for both programs are met (not a trivial assumption), CERB offers higher after-tax cash flows than EI for Canadians earning up to $47,273, with EI becoming more lucrative for earnings in excess or $47,273.

The choice between EI and CERB on the one hand and CEWS on the other hand is up to the employer. CEWS offers employees higher after-tax cash flows compared to both CERB and EI at pre-crisis annual wages higher than $37,569.

The after-tax weekly cash flow under CERB is $448.18 (=$500 fixed weekly payout - $51.82 income tax payable at tax-filing time). A pre-crisis annual wage of $37,569 yields a gross weekly payment of $541.86 under CEWS – i.e., 75 percent of ($37,569 / 52) = $541.86. This results in a net weekly cash flow of $448.18 after income tax, CPP and EI deductions – the same as the after-tax cash flow from CERB.

The comparative weekly after-tax cash flows available to the employee from each of these three programs are summarized in the figure below.

The employer's costs are almost equally negligible for all of the above three programs if the employee is on "paid leave" and not doing any work, since the CEWS even reimburses the employer-level CPP and EI premiums. If an employee works remotely during the pandemic, the employer has to continue paying the employer-level premiums for CPP and EI.

Both employers and employees should know which program is the most financially advantageous. Obviously, employers should keep their employees' best interests in mind.

However, there are additional advantages for employers to retain employees through the CEWS. Businesses that do not retain employees may take longer to restart production as customers start to come back. Businesses that are better prepared with a motivated labour force already on payroll may be able to advertise their contingency plans and differentiate themselves from competitors that have not retained and engaged their employees. In a competitive business environment, businesses need to consider that the costs of inaction may be greater than the costs of action.

Ranking of COVID-19 Financial Assistance Programs Based on Employees' Pre-crisis Incomes

Annual Income	CEWS	EI	CERB
30,000	368.35	302.12	448.18
35,000	421.08	344.40	448.18
37,569	448.18	366.12	448.18
40,000	473.81	386.68	448.18
45,000	526.55	428.96	448.18
47,273	550.52	448.19	448.18
50,000	579.28	471.25	448.18
55,000	632.01	506.54	448.18
60,000	671.30	506.54	448.18

Retaining and engaging employees during the disruption can also be a part of an organization's corporate social responsibility. Managing employees by viewing them as internal customers can contribute to their job satisfaction, loyalty, retention and productivity. Keeping employees productive and healthy keeps their interests aligned with those of the owners or shareholders.

Amin Mawani is Associate Professor of Taxation at Schulich School of Business at York University, and Salim Hajee is CEO at EmployeeSoft Inc.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Crisis Working Group Report: Household Income and Credit Support

Communique #6: Extending CEWS Smart Move, More to be Done

To help Canadian governments confront the public health and economic crisis resulting from the spread of COVID-19, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The Working Group on Household Income and Credit Support is co-chaired by Michael Horgan (Senior Advisor at Bennett Jones LLP and Former Deputy Minister of Finance, Government of Canada) and Kathleen Taylor (Chair of the Board at Royal Bank of Canada) and supported by a group of Canadian business leaders and economists. The group's most recent meeting was held on Tuesday, May 05, 2020.

In that meeting, the working group heard from a number of industry experts and identified some of the factors that may be contributing to the substantial difference between the utilization of the Canada Emergency Benefit (CERB) and the Canada Emergency Wage Subsidy (CEWS). These discussions included the need to address potential issues related to submitting an application for the CEWS and switching employees from the CERB to the CEWS. Working group members also identified the need to extend the duration of the CEWS as outlined below (subsequent to the meeting, the federal government announced it will be extending CEWS eligibility past June).

Furthermore, the working group highlighted the importance of timely and reliable data to make informed policy decisions and called for making the CERB statistics available by province, gender and age. Working group members also suggested exploring ways to address the financial needs of Canadians who will not qualify for Employment Insurance (EI) after exhausting the CERB if they remain unemployed due to COVID-19.

Income Support Programs Utilization

As of May 06, 2020, about 7.6 million Canadians had applied for the CERB. In contrast, only 1.7 million workers were benefiting from the CEWS through applications submitted by their employers (96,000 businesses for an average of 17.7 workers per company). Although the CEWS is available to

all eligible businesses regardless of their size, it appears that mostly small businesses applied for wage subsidies. Several working group members worry that some eligible large businesses may prefer not to apply for the CEWS and to let their laid off employees apply for the CERB instead.

Working group members identified several contributing factors for the large utilization gap between the CERB and the CEWS, and recommended ways that may help to better balance the use of these programs.

First, some businesses may have already shut down by the time the CEWS became operational on April 27, 2020, and may require encouragement to shift course and fully subscribe to the CEWS. The remaining affected businesses may simply not be operating at full capacity, depending on their ability to have employees work from home, their industry and other characteristics.

Second, the CEWS provides support for up to three months, while many business shutdowns will likely last longer, since re-openings are expected to be gradual. In addition, during the transition period to full recovery many businesses will likely continue to experience revenue shortfalls, even after restrictions are lifted. They may not be able to return quickly to normal operations or even be allowed to operate at full capacity (e.g., restaurants enforcing social distancing). Given the low take-up for the CEWS program compared to initial government estimates, it makes sense to extend the CEWS beyond its scheduled termination on June 6, 2020.

Lastly, the design and application process between the CERB and the CEWS differ. Some businesses may face technical issues submitting their application or may find it onerous to switch their employees from the CERB to the CEWS. Technical and design issues that may prevent businesses from applying for the CEWS need to be identified and addressed to ensure a greater number of employees remain attached to their employers. Maintaining an active attachment between employers and their employees will facilitate their return to work once restrictions are lifted, which is a major objective for the CEWS.

Need for More and Better Use of Data

Working group members praised Statistics Canada's efforts to take unique labour market impacts of COVID-19 into consideration when it reported the March Labour Force Survey (LFS) results, as well as for providing technical briefing sessions. For the April LFS results (available on Friday May 9th), the working group suggested that Statistics Canada pay more attention to hours worked than to other labour market indicators (e.g., employment) and to focus on cumulative changes since February for evaluating the impact of the crisis on the labour market. Members also suggested that the LFS make

the 'absence of available child care' a more explicit component of the constraints that are now defined as "personal reasons" in the data.

Working group members also recognized the need for more data on CERB applications by province, gender and age. These statistics are important to identify and plan the next steps. The pace and timing of the economic reopening will vary across provinces, while the impact of COVID-19 differs by population characteristics such as gender and age.

CERB Exhausted but No EI Benefits: What's Next?

Workers who were laid off first may be the last to get back to work, while their CERB is currently scheduled to end in July. If the crisis and its related economic slowdown is not over by July, many Canadians will remain unemployed. While some will be able to collect EI, there will be many who do not qualify for EI because they have not accumulated enough hours of insurable employment. Others will be ineligible because of the type of work they had or because they may not be able to search for employment (for example, because they may still be at home caring for their children). These issues need to be addressed. Otherwise, such individuals will be left without benefits and job opportunities.

At its next meeting, the working group will consider options to address looming coverage gaps when the CERB runs out.

Members of the Household Income and Credit Support Working Group include:

Michael Horgan (Working Group Co-Chair), Senior Advisor, Bennett Jones LLP and former Deputy Minister of Finance, Government of Canada.

Kathleen Taylor (Working Group Co-Chair), Chair of the Board, Royal Bank of Canada.

Don Drummond, Stauffer-Dunning Fellow and Adjunct Professor, Queen's University.

Luc Godbout, Professor and Director of the Chair in Taxation and Public Finance, Université de Sherbrooke.

Brian Kingston, Vice President, International & Fiscal Issues, Business Council of Canada.

Alexandre Laurin, Director of Research, C.D. Howe Institute.

Parisa Mahboubi, Senior Policy Analyst, C.D. Howe Institute.

Janice McKinnon, Professor, University of Saskatchewan.

Kevin Milligan, Professor, University of British Columbia.

Mike Pedersen, Chair of the Board, Business Development Canada.

Bill Robson, President and Chief Executive Officer, C.D. Howe Institute.

Tammy Schirle, Professor, Wilfrid Laurier University.

Lara Speirs, Executive Vice President & Public Affairs General Counsel, Randstad Canada.

Guest:

Lynn Barr-Telford, Assistant Chief Statistician, Social, Health and Labour Statistics at Statistics Canada

Intelligence MEMOS

From: Luc Godbout and Tommy Gagné-Dubé

To: Bill Morneau, Minister of Finance

Date: June 19, 2020

Re: **Lessons from Ireland on Pandemic Income Support**

The similarity of Ireland's economic response to COVID-19 to Canada's – in form, scheduling and generosity of emergency measures – makes it worthy of more attention. And it's all the more interesting because Ireland has undertaken the modulation of its emergency benefit to reduce its disincentive effect on work.

Ireland introduced the Pandemic Unemployment Payment (PUP) on March 15 for 18 to 66-year-olds, employees or self-employed, who had lost their income due to COVID-19. Initially, the PUP was designed for six weeks and a fixed amount of €203 ($300) a week. At the same time, Ireland announced the COVID-19 Employer Refund Scheme, a measure inducing employers to retain their employees and pay them at least €203 euros weekly (initial amount of the PUP), an amount fully reimbursed by the government.

Nine days later, the PUP was increased to 12 weeks and the fixed amount of the benefit increased to €350 a week, an estimate of the average salary in the sectors most affected by the crisis in the country, notably hotels and retail. The generosity of the benefit makes it, in many situations, as advantageous as working at minimum wage. As in Canada, the PUP is taxable, although no tax is deducted from the payment. In addition, employees who voluntarily leave their jobs are not eligible. Unlike the Canada Emergency Response Benefit (CERB), PUP does not allow recipients to earn income during the benefit period.

When the PUP enhancement was announced, Ireland also introduced the Temporary Wage Subsidy Scheme (TWSS). As in Canada, the program reimburses a significant portion of wages for employers who experience a decline in income.

The TWSS covers 70 percent of the salary of an eligible employee up to a maximum of €410 a week. This amount is not taxable for the employer, which gives it a value equivalent to a maximum of €500. The salary paid to an employee must not exceed the pre-pandemic level, and the subsidy is clawed back if it does. To qualify for the TWSS, the employer must demonstrate a 25 percent decrease in income.

For low-income workers, the PUP offers greater benefit than the TWSS. Along the way, Ireland amended the TWSS, raising the wage subsidy from 70 percent to 85 percent of pre-pandemic wages for those earning less than €412. And, in a further attempt to encourage work, employers can top up pre-COVID employee salaries up to €350 – equivalent to the PUP – without penalty.

On June 5, Ireland announced the extension of the TWSS until the end of August.

It also extended the PUP from June 9 to August 10, with some changes. There will be two payment levels after June 29, to link the PUP level to prior earnings. No one on the lower rate of payment will receive less than they were previously paid by their employer. This "gentle recalibration" makes PUP more tailored and equitable.

It also aims to make the labour market more attractive for recipients who only worked a small number of hours before the pandemic and, in the words of the announcement, "received significantly more in the PUP than while in employment."

For those whose pre-COVID employment income was €200 or more per week (about 75 percent of recipients), the PUP remains at €350 per week.

For those whose previous income was less than €200 (about 25 percent of recipients), the amount of the PUP will be €203, the maximum rate of Ireland's regular unemployment benefit.

As in Canada, in an effort to stimulate the economy, the Irish government encouraged the transition from emergency benefit to wage subsidy when possible. Early results are encouraging. At the beginning of June, the number of people who benefited from the TWSS exceeded the number of PUP recipients for the first time.

In this week's extension of the CERB, the federal government says it is exploring ways to ensure that support measures, including the Canada Emergency Wage Subsidy (CEWS) and Employment Insurance, help "Canadians get back on their feet." In order to improve the incentive to work and encourage the transfer of CERB recipients to CEWS, the idea of linking the amount received to pre-pandemic income, as Ireland did, through CERB or a return to employment insurance, is worth considering.

Luc Godbout is Professor, School of Administration, and Chair in Taxation and Public Finance, Université de Sherbrooke, where Tommy Gagné-Dubé is Research professional, and Research Chair in Taxation and Public Finance.

To send a comment or leave feedback, email us at blog@cdhowe.org.

	Canada – CERB	Ireland – PUP
Initial announcement	March 25	March 15
Expanded program		March 24
Start of program	March 15	March 15
Maximum weeks	16	12 extended to 24
Weekly payment	$500	Initially €203 Increased to €350 Two rates from June 29: €203 and €350
Voluntary departure	Not admissible	Not admissible
Extension	Announcement: June 15 Detail: 8 weeks added	Announcement: June 5 Detail:12 weeks added and two rates from June 29
Planned end of the program	October 3	August 10
	Canada – CEWS	**Ireland – TWSS**
Announced	March 27	March 24
Start of program	March 15	March 26
Maximum number of weeks	12	12
Weekly payment	75%	70% (up to 85% for low-income earners)
Maximum	847$	410€ (non-taxable for employers)
Declining income	15% (March)/30%	25%
Extension	Announcement: May 8 Detail: May 16	Announcement: May 6 Detail: June 5
Weeks extension	12	12
Expected end	August 29	August 29

NOTE *de renseignement*

De la part de : Luc Godbout et Tommy Gagné-Dubé

A l'attention de : Bill Morneau, Ministre des Finances

Date : 19 juin 2020

Objet : **LEÇONS DE L'IRLANDE SUR LE SOUTIEN AU REVENU PENDANT LA PANDÉMIE**

La similitude de la réponse économique de l'Irlande à la COVID-19 avec celle du Canada, tant sur la forme que sur l'ordonnancement et la générosité des mesures mises en place, mérite qu'on s'y attarde. C'est d'autant plus intéressant que l'Irlande a entrepris la modulation de sa prestation d'urgence pour diminuer son effet désincitatif sur le travail.

L'Irlande introduit le 15 mars le *Pandemic Unemployment Payment* (PUP), une prestation destinée aux 18 à 66 ans, salariés ou travailleurs autonomes, ayant perdu leur revenu en raison de COVID-19. Initialement, le PUP est conçu pour 6 semaines et d'un montant fixe de 203€/semaine. Du même souffle, l'Irlande annonce le *COVID-19 Employer Refund Scheme*, une mesure invitant les employeurs à conserver leurs salariés et à leur verser au moins 203€/semaine (montant initial du PUP) qui leur sera totalement remboursé par le gouvernement.

Rapidement (24 mars), le PUP est bonifié à 12 semaines et le montant fixe de l'allocation passe à 350€ par semaine, soit une estimation du salaire moyen dans les secteurs les plus touchées par la crise (notamment l'hôtellerie et la vente au détail). La générosité de la prestation fait qu'elle est, dans plusieurs situations, aussi avantageuse que de travailler au salaire minimum. Comme au Canada, le PUP est imposable, mais aucune retenue à la source n'est faite et les employés quittant volontairement leur emploi n'y sont pas éligibles. Contrairement à la PCU, le PUP ne permet pas aux bénéficiaires de gagner de revenu pendant la période de prestations.

Lors de l'annonce de la bonification du PUP, l'Irlande met également en place une subvention salariale, le *Temporary Wage Subsidy Scheme* (TWSS). Comme au Canada, ce programme rembourse une part importante des salaires pour les employeurs qui subissent une baisse de revenu.

Le TWSS correspond à 70 % du salaire d'un employé admissible jusqu'à un maximum de 410 €/semaine. Ce montant n'est pas imposable entre les mains de l'employeur, ce qui lui confère une valeur équivalente à un maximum de 500€/semaine. Le salaire versé à un employé ne doit pas dépasser ce qui lui était versé avant la pandémie, à défaut de quoi le TWSS est réduit d'autant. Pour être admissible au TWSS, l'employeur doit démontrer une baisse de 25% de ses revenus. La période initiale du TWSS est de 12 semaines, soit du 15 mars à la mi-juin et un ajustement est effectué pour la période où le *COVID-19 Employer Refund Scheme* était en vigueur.

Pour les employés à faible revenu, il est plus avantageux d'être mis à pied pour bénéficier de la PUP que de bénéficier de la TWSS. En cours de route, des modifications sont donc apportées au TWSS afin que, pour ceux qui gagnent moins de 412€/semaine, la subvention de l'État passe de 70% à 85% de leur salaire hebdomadaire net d'avant la pandémie. Toujours dans un objectif d'inciter au travail, des allégements sont apportés afin qu'un employeur puisse augmenter, sans réduction du TWSS, le salaire d'un employé au-delà de son salaire pré-COVID jusqu'à un maximum de 350€/semaine, équivalent au montant du PUP.

Le 5 juin, l'Irlande a annoncé la prolongation du TWSS jusqu'à la fin du mois d'août.

L'Irlande a aussi prolongé le PUP du 9 juin au 10 août. Toutefois, pour tenir compte de la réouverture de l'économie, la prestation est modifiée à partir du 29 juin selon une structure à deux niveaux pour relier le niveau de paiement aux gains pré-pandémiques. Parmi ceux qui seront au premier niveau, personne ne recevra moins qu'avant la pandémie. Ce «recalibrage en douceur» vise à rendre la prestation plus adaptée et équitable. Il vise également à rendre le marché du travail plus attrayant pour certains bénéficiaires du PUP qui travaillaient un faible nombre d'heures avant la pandémie et qui se sont retrouvés à bénéficier d'un revenu nettement plus important du PUP qu'en étant au travail.

- Pour ceux dont le revenu d'emploi pré-COVID était de 200€ ou plus par semaine (environ 75% des bénéficiaires), le PUP reste à 350€/semaine.
- Pour ceux dont le revenu antérieur était de moins de 200€ par semaine (environ 25% des bénéficiaires), le montant du PUP sera de 203€/semaine, le taux maximum de l'assurance-emploi régulière.

Comme au Canada, dans une optique de relance de l'économie, le gouvernement Irlandais a encouragé la transition de la prestation d'urgence à la subvention salariale lorsque c'était possible. La bonification du TWSS et la modification récente du PUP ont été réalisés en ce sens. D'ailleurs, le gouvernement semble enfin en voie d'atteindre son objectif puisque, au début juin, le nombre de personnes ayant bénéficié du TWSS a pour la première fois dépassé le nombre de personnes ayant bénéficié du PUP.

En annonçant la prolongation de la PCU le 16 juin, le Canada indique explorer des moyens pour s'assurer que les mesures de soutien, incluant la SSUC et l'AE, aident «les Canadiens à se remettre sur pied». Afin d'améliorer l'incitation au travail et d'inciter le transfert de bénéficiaires de la PCU à la subvention salariale, l'idée de faire comme l'Irlande et de lier le montant reçu au revenu gagné avant la pandémie, au moyen de la PCU ou d'un retour à l'assurance-emploi, mérite réflexion.

Luc Godbout est titulaire de la Chaire en fiscalité et en finances publiques de l'Université de Sherbrooke et Tommy Gagné-Dubé y est professionnel de recherche

Pour laisser un commentaire, envoyez-nous un courriel à blog@cdhowe.org.

	Canada – PCU	Irlande – PUP
Annonce initiale	25 mars	15 mars
Programme élargi		24 mars
Début de programme	15 mars	15 mars
Maximum de semaines de prestation	16	12 prolongé à 24
Paiement hebdomadaire	500$	203€ Majoré à 350€ Deux taux à partir du 29 juin 203€ et 350€
Départ volontaire	Non admissible	Non admissible
Annonce du prolongement	Annonce: 15 juin Détail: Ajouts de 8 semaines	Annonce: 5 juin Détail: Ajouts de 12 semaines et deux taux
Fin prévue du programme	3 octobre	10 août
	Canada – SSUC	**Irlande – TWSS**
Annoncé	27 mars	24 mars
Début de programme	15 mars	26 mars
Nombre de semaines de prestation	12	12
Paiement hebdomadaire	75 %	70 % (jusqu'à 85% pour les salariés à faible revenus)
Maximum	847$	410€ (non imposable pour les employeurs)
Baisse de revenus	15% (mars) / 30%	25%
Prolongement	Annonce: 8 mai Détail: 16 mai	Annonce: 6 mai Détail: 5 juin
Nbr semaines prolongement	12	12
Fin prévue	29 août	29 août

Intelligence MEMOS

From: Cyrille Schwellnus and Michael Koelle

To: Bill Morneau, Minister of Finance

Date: June 30, 2020

Re: **SUPPORTING INCOMES WHILE PROMOTING A SPEEDY LABOUR MARKET RECOVERY**

In response to the jobs crisis triggered by COVID-19, a number of countries, including Australia, Japan, New Zealand and most of Western Europe, have established or expanded job retention schemes to preserve as many existing jobs as possible.

These typically aim to subsidize businesses to preserve existing job matches while workers experience only limited wage losses. Other countries, including a number in Central and Eastern Europe and the United States, have taken very limited job preservation measures, and instead expanded unemployment insurance. Firms in these countries have greater incentives to lay off workers in response to the COVID-19 shock.

Canada has resorted to elements of both approaches by establishing the Canada Emergency Wage Subsidy (CEWS) scheme and the Canada Emergency Response Benefit's (CERB) $2,000 a month (taxable) for laid off workers.

In our recent OECD paper, we found that changes in unemployment and applications to job retention schemes suggest that increases in unemployment have typically been smaller in countries with larger coverage of applications (Figure 1). At least in the short term, job retention schemes appear to have been effective in limiting increases in unemployment.

Canada has experienced a fairly large increase in unemployment, which may reflect the fact that CEWS uptake, though not insignificant, has so far been far less substantial than CERB. The relative ease of layoffs compared to most Western European countries may also be playing a role.

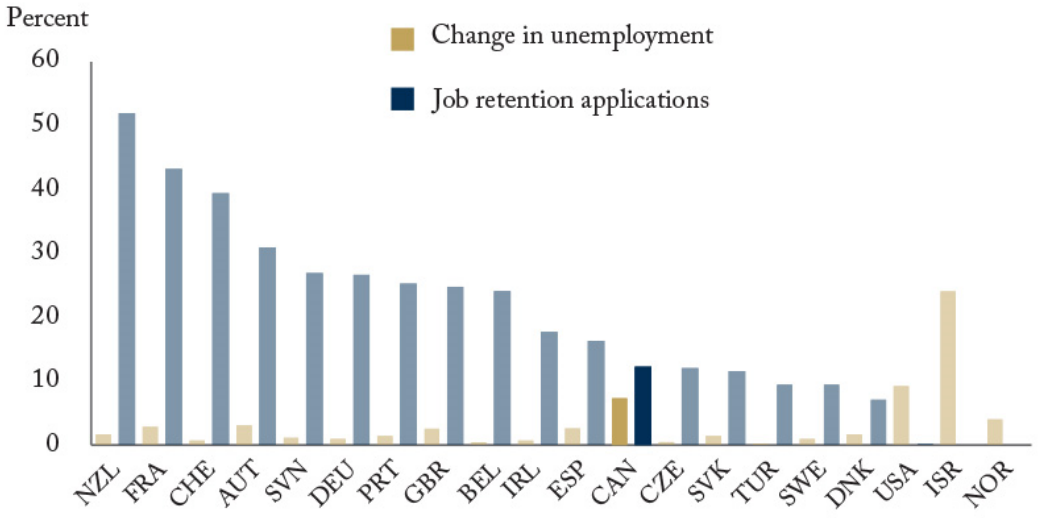
A rapid return to work will require strengthening financial incentives for workers. Policymakers will need to tread a fine line between maintaining exceptional income support for workers who cannot return to work and ensuring that work for returning workers actually pays. This could be achieved by gradually reducing the generosity of exceptional income support while expanding support for earned income.

In Canada, for instance, the generosity of the CERB could gradually be reduced while temporarily expanding the Canada Workers Benefit (CWB), a refundable tax credit that complements earnings for low-income earners. Given that the CWB increases as workers earn more, this may strengthen incentives for workers to move from struggling industries to those with better growth prospects where full-time jobs may be more readily available.

Supporting a rapid return to work will also require strengthening incentives for firms to hire workers. This could, for instance, be achieved by introducing hiring subsidies, including for previously dismissed workers once economic conditions improve.

In Israel, the government introduced a recall subsidy of around $2,100 (US) at the end of May. To limit the risk that job retention schemes or recall subsidies lead to inefficiently low levels of reallocation, employers' contributions to the cost of job retention schemes may need to be raised from the low levels put in place during the acute phase of shutdowns.

In Canada, a first step would be to phase out the full refund of employer social security contributions for complete furloughs in the CEWS. Moreover, access to training and restrictions on combining income from short-time work schemes with income from other jobs could be eased to allow workers to seize new job opportunities as they arise. In Canada, firms that benefit from the CEWS but reduce workers' monthly wages could be required to proportionally reduce working time, which would allow workers to take part-time jobs or participate in training.



Cyrille Schwellnus is a Deputy Head of Division and Michael Koelle is a Junior Economist in the OECD Economics Department.

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Theme 3:

The Canada Emergency Response Benefit and the Next Moves on Income Support

Intelligence MEMOS

From: Kevin Milligan

To: Canadians Concerned about COVID

Date: March 17, 2020

Re: **THE ECONOMY NEEDS A BIG, STRONG COVID BRIDGE**

COVID-19 threatens our health and our economy. Airlines, tourism, hospitality, and retail businesses are being hit with massive shocks now to revenue and soon to payrolls. Without immediate action, businesses will go bankrupt and millions of Canadian families may soon fall short of being able to meet their basic needs.

For an ordinary recession, we might argue over whether and how to stimulate consumer demand to spur a return to growth. This time is different.

Currently, for reasons of public health, we want to actively suppress work for a time, and purposely stifle some forms of economic activity. This challenge here is not "stimulus"; it requires new thinking and new policy ideas.

What we need is to bridge our economy to the other side of the infection when unrestrained economic activity can begin again.

How can we bridge our economy over this crisis? Other C.D. Howe Institute writers have offered productive ideas to confront the emergency. Bill Robson suggests widespread deferrals of tax remittances and payroll deductions. This helps families and businesses with the cash flow crunch they will soon be facing, with negligible net costs for the treasury. Alexandre Laurin and Bill Robson suggest a temporary loosening in rules around retirement savings to allow better access to savings in this time of need. These are excellent ideas that should be implemented. But they are not enough.

Our economic bridge needs to be stronger and broader to get our economy to the other side of the COVID-19 crisis. Our policy focus should be twofold. We need more policy measures to support family incomes and to backstop business balance sheets.

We need to support family incomes because unemployment will spike; and many of those who keep their jobs will see hours and wages curtailed. Policy specialists normally attempt to perfect the details of transfer programs in order to balance the targeting of benefits, negative incentive effects, and overall costs. These policy design considerations are vital in ordinary times.

These are not ordinary times.

Instead, we must prioritize speed over all else, because family incomes will be stretched starting now.

Enhancement of Employment Insurance sick leave is a beginning, along with making it easier to access the work-sharing provisions of EI. But we also need direct cash transfers to families. Some families need extra childcare; others will struggle with rent or mortgage payments. Cash fills these needs flexibly and quickly.

We also need to backstop business balance sheets. With revenue drying up, many large and small Canadian businesses – with sound long-run business models will face sudden danger. The government has authorized an extra $10 billion of loans through the Business Development Bank and the Export Development Bank to help small and medium-sized businesses, along with loosened bank regulations to free up hundreds of billions of private lending.

But more can be done. Employer-side payroll tax cuts or credits can ease the pain of maintaining payroll commitments, keeping businesses open and workers paid. An aversion to using public money to assist business is understandable. But if we want active employers to survive the crisis, temporary assistance will keep payrolls being paid and shelves being stocked through our time of need.

The bill for this package will be large. Moreover, there are further immediate needs for public health and research spending at the federal level, and billions in unexpected direct healthcare expenditures at the provincial level. In addition, the not-for-profit and charitable sectors will need temporary assistance too. This adds up.

How to fit these new expenditures into a sustainable fiscal framework? I propose a compromise: we set aside fiscal targets for a year and spend what is needed now, but we do so with explicit end-dates for each of the new spending items.

We cannot take the risk of building a bridge that is too small or too short, lest our economy suffer permanent harm. After the crisis abates, we take stock, set a renewed path to fiscal sustainability, and repair the fiscal damage.

Canadians will be relying on tireless efforts by our healthcare workers and researchers to get us through the COVID-19 crisis. But Canadians will also rely on public policy to preserve our economic wellbeing for the future. We need to get this right.

Kevin Milligan is professor of economics, UBC Vancouver School of Economics, and a Fellow-in-Residence at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Kevin Milligan

To: Bill Morneau, Minister of Finance

Date: April 1, 2020

Re: **FORTIFYING THE CERB**

The Canada Emergency Response Benefit (CERB) will deliver economic support to Canadians thrown out of work by the COVID-19 crisis.

Its overall structure provides a solid platform for supporting Canadian families, but more policy work is needed to fortify the CERB so that it reaches its potential to help Canadian families and bridge our economy across the crisis.

Among the current features:

- A 'trust but verify' application that allows a 'self attestation' on eligibility subject to future verification.
- Broad coverage not dependent on qualifying for regular Employment Insurance.
- A low and transparent $5,000 earned income test for eligibility.
- A flat and simple benefit structure: $500 per week for every qualifying person.
- Delivery through the CRA, which has the proven surge capacity to handle millions of applications.
- Eligibility for furloughed workers (not formally laid off) to preserve employment relationships.

The resolution of emerging and remaining issues with CERB should make heavy use of the "trust but verify" self-attestation feature of the CERB.

That is, qualification rules should be clear and set in advance but without need for up-front verification. Canadians can simply say they are eligible and unlock the benefit payments, but must also keep in mind that they may later be subject to CRA audits and verification. This delivers the twin benefits of shortening the time between application and payment delivery and also shrinking any incentive to exaggerate eligibility attestations.

For "trust but verify" to work well, however, the rules must be clear in advance. Some important details remain up in the air. Three of these important details are how to define eligibility for those whose earnings have declined, how to assess those (like students) who may have jobs with future starting dates, and 'top-up' payments by firms that may want to supplement CERB for furloughed workers.

The legislation in section 6(1)(b)(i) restricts eligibility to those who have "ceased working" and "do not receive, subject to the regulations, income from employment or self-employment." This leaves some ambiguity about the common circumstance of workers who have experienced a severe drop in earnings, but not a complete cessation of work.

The government must first decide to what extent it wishes to cover those with partial earnings decline. With that decision in hand, the government must then provide a clear rule about earnings decline (for example this could be a drop of 75 percent or more). Whether this can be set by regulation or requires a technical fix to the legislation, some threshold is required swiftly.

A second issue affects students and others whose jobs had not yet started. They may or may not qualify based on the $5,000 earnings threshold, but will see employment opportunities this summer curtailed by COVID-19. Again, a 'trust but verify' approach could help, but clear rules are needed soon about the many reasonable and feasible eligibility options. (Meanwhile, students will need to know how CERB income will be treated by the various student aid systems.)

The final issue to resolve is how to facilitate 'top ups' for some employees. Some employers may wish to supplement the CERB with a top-up payment in order to keep valued employees attached to the firm, and the prime minister was promoting the concept yesterday. Such top-ups are desirable to preserve employer-employee matches that will enhance our ability to ramp up economic activity when public health allows.

Care needs to be taken to ensure that top-up payments do not interfere with CERB eligibility criteria. A model for the technical definition of top-up payments could be drawn from EI parental leave benefits, which some employers now top-up with supplemental payments that do not disturb the core EI benefits.

The fortified CERB will provide a solid bridge for Canadian families over the COVID crisis. The Canadian government will need to consider further regulatory or legislative initiatives for CERB in the days that come. Attention to eligibility for those with severe earnings declines, students and future job-holders, and the treatment of top-up payments will ensure the CERB reaches its potential to provide our economy with an effective bridge and a launching point to resume economic activity when the public health crisis abates.

Kevin Milligan is professor of economics, UBC Vancouver School of Economics, and a Fellow-in-Residence at the C.D. Howe Institute.

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Intelligence MEMOS

From: Jennifer Robson

To: Federal Data System Designers

Date: April 3, 2020

Re: **WHY CAN'T THEY JUST SEND US ALL A CHEQUE?**

Right now, the Government of Canada is racing to roll out income support to allow people to make ends meet while respecting public health orders to sustain physical distancing to contain the threat of COVID-19.

The public health and economic policy goals are one and the same and time is of the essence. Some authors have wondered why government is requiring Canadians to actively apply for financial help instead of placing the onus on government to proactively distribute aid.

Existing systems for income support in Canada have known problems. The Auditor General's 2019 report pointed to long-standing issues in federal call-centres with overwhelmed phone systems and Canadians unable to speak to government representatives. Gaps in Employment Insurance coverage for workers and the share of Canadians that are left out are also well known. Furthermore, in forthcoming work, Saul Schwartz and I find that there are one in ten working-age Canadians who don't file a personal income tax return will be missing out on credits like Canada Child Benefit and the GST credit that they would otherwise receive.

Some would argue that a universal payment, without applications, is the best response. But a proactive effort by government to distribute temporary relief payments will be hampered by a far larger and more serious administrative challenge: The Government of Canada does not know where to send the cheques or to whom to make them payable.

The Canada Revenue Agency (CRA) has the capacity to issue very quick payments to bank accounts and addresses that it has on file when it can verify individual identity and eligibility. But the agency does not maintain a current super-database of all Canadians. In between tax seasons, many Canadians move, change their names, change their banking information or, sadly, pass away.

Add to this the many thousands of Canadians who do not file tax returns at all. Other official pieces of information that might otherwise be used to track the movements and earnings of Canadians, such as Social Insurance Numbers, are not in a database that can be readily linked to information needed to issue a government payment.

Even an urgent effort in this crisis to use tax information on file to proactively issue payments to all adult Canadians could result in a delay of months, not days, before payments can begin. In the US, the Tax Policy Center is warning that distribution of planned application-free payments will be painfully slow.

Governments have historically shied away from investing in building the internal systems that could otherwise have made an automated payment plan possible. This stems from repeated criticism of past efforts to build better data on citizens or spend money on internal systems.

When this crisis is over, and as part of the effort to rebuild, Canada should willingly invest in the information systems and technology needed to support rapid delivery of income supports.

The time is not yet. Government agencies need to focus every resource on getting emergency aid out to Canadians in need. But when there is an opportunity, here are three immediate priorities:

- Ensure that the CRA has the legal authority, with appropriate privacy safeguards, to access, use and share (with other parts of the Crown) taxpayer information needed to enrol Canadians in benefits that will raise their income while letting Canadians opt-out if they don't want those benefits, for any reason.
- Flip the burden for tax-filing from individuals to CRA. Allow as many people as possible to file by simply consenting to a pre-filled annual return using information CRA already has on file, building on the current and niche File My Return program. Even in the current crisis, CRA could introduce deemed or automated filing for tens of thousands of social assistance recipients, one in five of whom may not currently file a return or access key credits.
- Stop tinkering at the edges of government IT systems and make the investment today so that the often invisible but critical infrastructure of government, from call-centres to servers to web-applications, can handle the surge traffic that comes in times of crisis.

Jennifer Robson is Associate Professor of Political Management, Carleton University.

To send a comment or leave feedback, email us at blog@cdhowe.org.

NOTE *de renseignement*

De la part de : Luc Godbout

A l'attention de : Honorable Carla Qualtrough, ministre de l'emploi, du développement de la main-d'œuvre et de l'inclusion des personnes handicapées, et l'honorable Bill Morneau, ministres des finances

Date : 3 avril 2020

Objet : **La prestation canadienne d'urgence: Après l'urgence, prévoir la transition vers le retour au marché du travail**

Comme son nom l'indique clairement, la prestation canadienne d'urgence (PCU) a été spécifiquement conçue comme une aide fédérale d'urgence. Elle a pour but d'offrir un soutien économique aux Canadiens mis au chômage par la crise du COVID-19.

Les seuls critères d'admissibilité pour avoir droit à la PCU sont donc tournés vers le passé. C'est-à-dire, pour y avoir droit un bénéficiaire doit : être un travailleur qui a gagné plus de 5000$ de revenu de travail en 2019 ou dans les 12 derniers mois, avoir cessé d'exercer son emploi ou d'exécuter un travail pour son compte pour des raisons liées à la COVID-19 et être inactif 14 jours consécutifs pendant la période de quatre semaines pour laquelle il demande la prestation.

Contrairement au régime régulier de l'assurance-emploi (AE), aucun critère d'admissibilité ne concerne le fait d'être capable de travailler, disponible pour le faire et à la recherche d'active d'un emploi convenable.

Dans un contexte d'urgence où des provinces ordonnent la fermeture de toutes les entreprises classées « non essentielles » et que des millions de travailleurs doivent rester à la maison, c'est une bonne chose de ne pas avoir conditionné la PCU à une démarche de recherche d'un emploi. Le contraire aurait été un non-sens. À court terme, les paramètres de la PCU sont très bien adaptés à la crise actuelle.

Cela dit, dès lors qu'un travailleur respecte les conditions d'admissibilité à la PCU, ce dernier y aura droit automatiquement pendant un maximum de 16 semaines pourvu qu'il reste inactif pendant 14 jours consécutifs pendant la période de quatre semaines.

Il faut dès maintenant que le gouvernement fédéral réfléchisse au moment où l'économie reprendra progressivement ses activités. Le gouvernement doit favoriser la transition des prestataires vers le retour au marché du travail.

Sinon, avec les paramètres actuels, il y a un fort risque d'observer une désincitation au travail pour certains travailleurs, notamment dans le cas des prestataires qui auraient un travail à temps partiel et faiblement rémunéré. En effet, en l'absence d'une obligation d'être capable de travailler, disponible pour le faire et à la recherche d'active d'un emploi convenable, pourquoi un prestataire accepterait-il, avec empressement à la huitième semaine sur 16 d'admissibilité à la PCU la proposition de son employeur de retourner au travail aux mêmes conditions qu'avant la crise? Prenons l'exemple d'un travail de 20 heures par semaine à raison de 14$ de l'heure, en tout, son revenu de travail atteindrait 280$ par semaine alors qu'il touche 500$ par semaine à la PCU.

Pour certaines PME, déjà qu'elles auront été fragilisées par la crise, cette absence d'incitation au travail de leurs employés aura pour effet de leur ajouter un vent de face important, en nuisant à leur réembauche et au retour à la normale de leur activité.

Alors, quoi faire pour prévoir dès maintenant l'après-urgence et la transition vers le retour au marché du travail?

Même s'il apparait difficile d'établir dès maintenant des conditions additionnelles cherchant à minimiser la désincitation au travail, le gouvernement doit déjà prévoir et envoyer des signaux notamment aux bénéficiaires qui seront capables de travailler et disponibles pour le faire dans les prochains mois. Par exemple, il pourrait déjà prévoir par règlement l'obligation des bénéficiaires d'accepter le retour au travail de leur employeur sous certaines conditions. Ainsi, cette nouvelle obligation pourrait débuter à partir d'une date donnée, celle-ci pourrait être le 15 juin 2020, ou à partir d'un nombre de semaines de prestations de la PCU, ce nombre pourrait être de huit. Cela dit, l'obligation du prestataire de retourner à son ancien emploi devrait être limitée aux situations où les conditions de l'employeur (nombre d'heures par semaine et salaire horaire) ne sont pas moindres que celles prévalant avant le début de l'admissibilité à la PCU.

Luc Godbout est titulaire de la Chaire en fiscalité et en finances publiques de l'Université de Sherbrooke.

Pour laisser un commentaire, envoyez-nous un courriel à blog@cdhowe.org.

Crisis Working Group Report: Crisis Household Income and Credit Support

In order to help Canadian governments confront the public health and economic crisis resulting from the spread of the COVID-19 virus, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The working group on household income and credit support is chaired by Michael Horgan, Senior Advisor at Bennett Jones LLP and former Deputy Minister of Finance, Government of Canada, and supported by a group of Canadian business leaders and economists. Meeting weekly, this group identifies and prioritizes policy challenges, and communicates members' views in published communiques. The group's third meeting was held on Tuesday, April 7, 2020.

At its last meeting, and as recommended in its previous communique, the group urged the federal government to release data on Employment Insurance (EI) claims on a timely and regular basis; the same data release policy should apply to Canada Emergency Response Benefit (CERB) applications. In addition, the group recommended a focus on changes to the "employed and at work" category, and changes to "actual hours worked," instead of the usual headline unemployment figures, in the March Labour Force Survey (available on Thursday, April 9). Because that survey reflected the situation early in the crisis and related shutdowns, it provided only partial insights into the impact of COVID-19 on the Canadian labour market. Next month's Labour Force Survey release will be more indicative of the full impact.

In the meeting, the group principally discussed four issues and policy measures:

- Temporary suspension of tax collection on RRSP withdrawals
- Federal/provincial coordination of income support
- Supporting students and educational institutions
- Back-to-work strategy

Temporary Suspension of Tax Collection on RRSP Withdrawals

The federal government has introduced several financial assistance measures to support households and individuals during the COVID-19 crisis. Many will qualify but gaps inevitably remain, especially among self-employed individuals. For others, existing or planned government financial assistance may arrive too late or may not be sufficient to cover immediate cash flow needs. To complement existing financial assistance measures, the group proposed that the government suspend tax withholdings and collection on RRSP withdrawals, up to a maximum amount, and for a limited time.

Design attributes for this policy measure could draw on existing programs such as the Home Buyers' Plan and the Lifelong Learning Plan. Tax-free RRSP withdrawals would have to be recontributed in the future over a maximum number of years (say, 10) with no loss of tax-deferred retirement savings room for participants. Implementation could be relatively quick through participating financial institutions who currently withhold taxes on withdrawals.

The government would eventually collect the deferred taxes when future recontributions are made out of after-tax dollars and later withdrawn for retirement, or when participants pay taxes on money they fail to recontribute. With interest rates so low, the cost to the government of what amounts to a delay in tax payments would be negligible. While the group noted that some RRSP holders might make unnecessary withdrawals and subject themselves to higher taxes, this measure could help some families and seniors needing liquidity during these difficult times.

Federal/Provincial Coordination of Income Support

Some provincial governments have taken measures to fill gaps or top up areas where federal assistance is insufficient. For example, the government of British Columbia announced a one-time payment of $1,000 for eligible people who have lost their income as a result of COVID-19 through the BC Emergency Benefit for Workers. The working group noted that despite the fact that these provincial initiatives appear to piggyback on federal assistance, they make sense and may be necessary. Furthermore, there is a role for either federal or provincial governments to top up the gaps for workers who make less than the CERB in order to mitigate the work disincentive effects, particularly if the period for receiving the CERB needs to be extended. However, the federal government should coordinate any targeted initiative for the lowest income Canadians and those in poverty with provincial governments since provinces are responsible for social assistance programs. Some group members felt that crisis-related poverty reduction initiatives should rest with provincial governments, who are better placed to assess need and program design.

Supporting Students and Educational Institutions

The group flagged that students are taking a hit: COVID-19 came at a bad time for students and graduates who were expecting summer employment. A weak job market will have long term scarring effects on graduates seeking employment. For students, an income loss during summer time could jeopardize their ability to return to education. In addition, post-secondary institutions will also likely suffer since billions of dollars of yearly tuition revenue from international students are now in jeopardy. In line with recommendations in a C.D. Howe Intelligence Memo, working group members proposed the following policy responses to mitigate the impacts on students, educational institutions and education system stakeholders:[1]

- Extending eligibility for the CERB to students whose job offers are not honoured;
- Making funds available to universities and colleges to make more courses available remotely over the next several months;
- Providing support to university and college instructors to hire student researchers and teaching assistants, thus helping students and graduates find employment;
- Making funds available to school districts to hire post-secondary students as assistants to teachers and parents to adopt online learning during school closures while addressing equity issues, for example related to lack of device and internet availability, among school-age students; and
- Providing additional funding for scholarships for students by next September.

Back-to-Work Strategy

The working group identified the need to start framing a return-to-work strategy, including attention to issues such as health and safety regulations, financial compensation for those unable to return to work, and regional differences. The group identified return-to-work strategies as a topic for its next meeting, for more in depth consideration of what governments and employers need to do to bring workers back to work safely and protect populations vulnerable to the virus.

The Household Income and Credit Support Working Group will meet again this week.

1 Subsequent to the working group meeting, the federal government announced new measures to support students: offering a wage subsidy of up to 100 percent for hiring students and extending the time frame for job placement to the winter.

Household Income and Credit Support Working Group Members Include:

Michael Horgan, Senior Advisor at Bennett Jones LLP and former Deputy Minister of Finance, Government of Canada

Don Drummond, Queen's University

Luc Godbout, Université de Sherbrooke

Brian Kingston, Business Council of Canada

Alex Laurin, C.D. Howe Institute

Parisa Mahboubi, C.D. Howe Institute

Janice McKinnon, University of Saskatchewan

Kevin Milligan, University of British Columbia

Mike Pedersen, Business Development Canada

Bill Robson, C.D. Howe Institute

Tammy Schirle, Wilfrid Laurier University

Lara Speirs, Randstad Canada

Kathleen Taylor, Royal Bank of Canada

Intelligence MEMOS

From: Ken Boessenkool

To: Canada's Finance Ministers

Date: April 17, 2020

Re: **Three Ways to Treat the CERB in Social Assistance**

Canada's social safety net has evolved slowly and carefully in an overlapping federal system of transfers and benefits.

Ottawa has responsibility for the tax system and Employment Insurance (EI). The provinces have primary responsibility for most social assistance and disability programs. As these programs have developed and changed over the years, overlaps and conflicts have been carefully managed – federal tax benefits for children are accounted for and integrated into provincial social assistance (SA) programs, for example.

That entire system, like everything else, has been rocked by the COVID-19 health crisis.

The federal government has designed a new Canada Emergency Response Benefit (CERB) that delivers $2,000 to most people who lost work. This new benefit will interact with provincial SA programs, the amount of which a recipient gets falls at certain thresholds.

In Ontario SA and disability programs, income above these thresholds is clawed back at 50 cents on the dollar. Alberta takes back 75 cents on the dollar. In a review of 2018 caseloads, the Auditor General found 12 percent of Ontario Works caseloads (there were 250,000) earn an average of $815 a month. Many of these individuals would therefore qualify for the minimum CERB requirement of $5,000 in earned income in the last year if they lost work due to COVID-19.

This does raise an issue, however. What about those SA recipients who lose their income due to COVID but do not qualify because they didn't earn $5,000 last year? Should they not qualify for benefits? This is, of course, not just an issue for those on SA, but for anyone who loses work due to COVID but cannot meet the $5,000 earnings threshold for last year.

Ottawa's recent announcement that Canadians could continue to earn up to $1,000 per month while receiving CERB makes questions of SA clawback important.

There are three potential ways provinces could treat CERB in SA.

First, treat CERB like a gift as BC has already announced its intention to do. People on Ontario Works can keep up to $10,000 in gifts per year from friends or relatives without triggering asset or income rules that would reduce their benefits. In Alberta, the minister could designate the CERB as a gift if it exceeded the current $900 per person annual gift limit.

With CERB treated as a gift, people on SA with earned income would be better off than working Canadians who didn't qualify for SA. This would be particularly true for people on SA who were earning small amounts and still qualified for the full $2,000 in CERB.

In addition, if SA programs treated CERB as a gift, anyone receiving CERB could apply for provincial SA programs as their CERB payments would be exempt income. This would create an unanticipated strain on provincial budgets. Oddly, this is how Ottawa is pushing the provinces, which seems to add additional burdens. Provinces shouldn't take this advice and BC has made a poor choice.

Second, treat CERB like EI benefits and claw it back dollar for dollar. This makes sense if you view CERB as an extension of the EI program. As with EI, you need to lose your job to be eligible, and the government is already pushing people who apply for EI onto CERB. EI-eligible workers will still qualify for their usual benefits after the four-month CERB period.

If CERB was treated as EI income, people receiving the largest SA benefits who also worked could be worse off than pre-COVID if their total SA plus earnings exceeded $2,000. Those with net benefits and work below $2,000 would be better off by the difference. For example, an Ontario Works recipient with three dependents would receive basic needs and shelter allowances alone nearing $2,000. If they also lost $1,000 in monthly restaurant shifts (from which they would keep a large portion), they could apply for CERB and receive $2,000 per month. If that CERB reduced their Ontario Works benefit by $2,000 and they no longer had their restaurant shifts to supplement that, they would be worse off (enhancements such as doubling the Canada Child Benefit and the GST Credit would more than offset this). The recipient could also potentially pick up shifts in another line of work and therefore fall under the new $1,000 limit of allowable earnings while on CERB.

Third, treat CERB like employment income. If CERB is a temporary replacement for lost employment income during a crisis, then it makes sense to treat CERB benefits for SA recipients as if it was employment income. If we treat CERB as if it was earned income and then the province claws it back as earned income, those on provincial SA programs won't see their income drop during the crisis. This would also treat SA recipients the same as low earners not on SA. The above family would see its CERB benefit treated just like that restaurant income. It would be no worse off than before the crisis hit – in fact, it would be slightly better off (since it would get $2,000 to replace $1,000 in income), just as workers not on SA that lost $1,000 per month job would be better off on CERB (they would also get $2000).

In summary, treating CERB as a gift would be unfair to low-income Canadians who are working relative to SA recipients. Treating CERB like EI would be unfair to SA recipients relative to working Canadians. Treating CERB as if it was earned income – which is what it is designed to replace – is the fairest option in the current crisis.

Ken Boessenkool is a partner at KTG Public Affairs Ltd.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Crisis Working Group Report: Household Income and Credit Support

To help Canadian governments confront the public health and economic crisis resulting from the spread of COVID-19, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The working group on household income and credit support is co-chaired by Michael Horgan (Senior Advisor at Bennett Jones LLP and Former Deputy Minister of Finance, Government of Canada) and Kathleen Taylor (Chair of the Board at Royal Bank of Canada) and supported by a group of Canadian business leaders and economists. Meeting weekly, this group identifies and prioritizes policy challenges. The group's most recent meeting was held on Tuesday, April 14, 2020.

The working group considered ways to facilitate a gradual reopening of the economy when appropriate. Members agreed that ending the lockdowns and restarting the economy will require a risk management approach on the part of governments, as they balance imperatives related to public health, healthcare utilization, the economy, and public finance.

Cooperation among the various orders of government will be needed, since most of the restrictions on economic and other activities originate from provincial and local governments. The working group noted that timelines for restarting the economy and balancing health and other imperatives when lifting restrictions will vary across regions and sectors.

Industry groups can play an important role in the return-to-work strategy. Different industries have different health and safety needs, structures, and challenges. The working group agreed that industry can play an enormous role in offering a way forward. In particular, creating industry-specific task forces with expertise on key sectors of the economy would provide better insights on how to protect workers, customers and suppliers.

The working group agreed that reopening can proceed in varying ways across the country to account for regional differences. Some provinces have already started. But all provinces and regions should have contingency plans to deal with later waves of COVID-19.

Working group members also highlighted that different population groups will face different challenges when their workplaces begin to reopen and identified several population groups in need of special consideration.

The March Labour Force Survey results show that workers who are the most affected by the COVID-19 crisis in terms of layoffs and hours lost are low-wage earners and women who generally have the least bargaining power. The working group's proposed industry-specific task forces could be responsible for setting up health and safety protocols adapted to their industries, with approval by governments where appropriate, before a lifting of the lockdowns can happen.

A time lag between children going back to school and parents going back to work will create additional challenges for parents with children when no alternative work/care arrangements are available, especially when schools are still closed. Therefore, it is important to think in advance about how child care fits into the bigger picture for working parents, and integrate these considerations into the return to work strategy.

Additionally, the group agreed on the need for special provisions for people most at risk of developing COVID-19 complications, others who may need to provide care to a family member who becomes ill, and vulnerable workers.

The proposed industry-specific task forces should consider the types of workplace accommodations that can protect the safety of the most vulnerable workers should they be required, or want, to return to work. In addition, as governments start to phase out emergency benefits, they need to start thinking about continuing financial protections for the most at-risk workers who are not yet able to return to their workplaces.

Finally, the working group noted that governments and industry can learn from the experience and best practices around the world as other jurisdictions have, or are in the process of, lifting restrictions on economic activity.

The next meeting of the Household Income and Credit Support Working Group will review progress made in the last few weeks since emergency benefits have been put in place, particularly the CERB and recent additions to the program, and potential remaining gaps. Potential areas for consideration are whether support measures in place need any refinements and adjustments, and how quickly they should be wound down.

Members of the Household Income and Credit Support Working Group Include:

Michael Horgan (Working Group Co-Chair), Senior Advisor, Bennett Jones LLP and former Deputy Minister of Finance, Government of Canada.

Kathleen Taylor (Working Group Co-Chair), Chair of the Board, Royal Bank of Canada.

Don Drummond, Stauffer-Dunning Fellow and Adjunct Professor, Queen's University.

Luc Godbout, Professor and Director of the Chair in Taxation and Public Finance, Université de Sherbrooke.

Brian Kingston, Vice President, International & Fiscal Issues, Business Council of Canada.

Alexandre Laurin, Director of Research, C.D. Howe Institute.

Parisa Mahboubi, Senior Policy Analyst, C.D. Howe Institute.

Janice McKinnon, Professor, University of Saskatchewan.

Kevin Milligan, Professor, University of British Columbia.

Mike Pedersen, Chair of the Board, Business Development Canada.

Bill Robson, President and Chief Executive Officer, C.D. Howe Institute.

Tammy Schirle, Professor, Wilfrid Laurier University.

Lara Speirs, Executive Vice President & Public Affairs General Counsel, Randstad Canada.

Guest:

Lynn Barr-Telford, Assistant Chief Statistician, Social, Health and Labour Statistics at Statistics Canada.

Crisis Working Group Report: Household Income and Credit Support

Communique #5: Tackling Disincentives to Work

To help Canadian governments confront the public health and economic crisis resulting from the spread of COVID-19, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The Working Group on Household Income and Credit Support is co-chaired by Michael Horgan (Senior Advisor at Bennett Jones LLP and Former Deputy Minister of Finance, Government of Canada) and Kathleen Taylor (Chair of the Board at Royal Bank of Canada) and supported by a group of Canadian business leaders and economists. Meeting regularly, this group identifies and prioritizes policy challenges. The group's most recent meeting was held on Tuesday, April 21, 2020.

In that meeting, the working group identified some remaining gaps for the Canadian Emergency Response Benefit (CERB) and the need for clarifications on how the program works. The working group also explored various considerations for a gradual winding down of CERB.

Remaining Gaps

There are niche populations who are affected by the COVID-19 but are falling through the cracks as they do not meet the CERB requirements. Working group members, however, advised the government to be careful about further tweaking the CERB. Any remaining support gaps should be addressed through existing or new targeted federal or provincial programs.

Working Social Assistance Recipients and New Entrants to the Labour Market

Some social assistance recipients earn income from employment. Although such earnings partly reduce their welfare entitlements, working on social assistance does help many individuals and families lift their income level to a less precarious level, especially after taking into account the impact of the Canada Workers Benefit. Those who lost their jobs because of the pandemic without having

accumulated more than $5,000 in 2019 or in the last 12 months, either because they have been working only for a few months or because they simply do not earn enough, may experience a drop in income that is essential to them and their family.

Others without a sufficient work history to qualify for the CERB may have recently left social assistance due to an employment opportunity, or simply may have recently entered or re-entered the job market after graduating from school or coming out of other support programs such as EI maternity benefits.

Provincial social service agencies should provide temporary financial assistance targeted to these families in these difficult financial circumstances.

Students

Some students may need financial support because they lost their jobs due to the pandemic without meeting the $5,000 requirement or because they rely on summer work to finance their upcoming school year. Subsequent to the Working Group's meeting, the federal government announced a new Canada Emergency Student Benefit to provide financial support to students and recent graduates who are affected by the COVID-19 crisis. The Working Group will review this new program at its next meeting.

Need for Better Government Information

The working group found the number of CERB applications surprisingly high and noted that the sheer number of applicants, to some extent, may be indicative of issues with the CERB. There were 6.73 million unique applications as of April 21, 2020, which is more than 35 percent of the employed labour force in Canada in February 2020. The heavy use of the CERB could be, in part, related to the late implementation of the Canada Emergency Wage Subsidy (CEWS). We may see reductions in the number of applications as the government starts rolling out the CEWS in coming weeks.

Working group members, however, recognized the need for more information and clarification on CERB eligibility. The group highlighted that communication is key to form the right expectations. Some people might use the program mistakenly due to the lack of clear and detailed explanations on eligibility and future checks. Others may take advantage of the CERB (or other programs) as they meet the requirements as stated, but the program was not really structured or intended for them.

Furthermore, the working group identified the need for better information on how receiving the CERB would affect maternity or parental leave. Will pregnant women receiving the CERB potentially lose eligible weeks on maternity leave? And are those receiving maternity leave benefits eligible for the CERB when benefits run out?

Considerations for a Gradual Winding Down of CERB

The working group also highlighted a number of considerations for the gradual winding down of benefits.

Encouraging a gradual winding down of the CERB will require tackling disincentives to work. Unlike the Employment Insurance program, CERB recipients are not required to be able and available to work, or to seek suitable employment.

There is already anecdotal evidence that some people on the CERB refuse to go back to work when employment opportunities arise. In some cases, this may be due to legitimate pandemic fears, but in many other cases employees may prefer receiving the CERB rather than working difficult shifts even if they would make more than $500 per week.

To address this issue, the government could mandate that recipients accept their employer's offer of return to work under certain conditions. For example, the claimant's obligation to return to his or her old job could be limited to situations where the employer's conditions (number of hours per week and hourly wage) are not less than those prevailing before the start of the eligibility for CERB.

Alternatively, an appeal mechanism could be put in place for employers. CERB eligibility requires involuntary work stoppage, but there do not appear to be provisions covering employees voluntarily declining work opportunities as economic activity resumes. A system of income-tested CERB clawbacks could also be envisaged, where employees returning to work would be able to keep a declining amount of CERB up to maximum earnings threshold.

Finally, a gradual winding down of the CERB should be built with childcare roles in mind. In two-parent families, parents would not be able to share child care responsibilities by both returning to work but could need to take on a reduced workload. Similar to the EI Parental Sharing Benefit, the CERB could allow both parents to take time off work for child care purposes, with both collecting a proportionately reduced CERB amount.

The Household Income and Credit Support Working Group will meet again in two weeks and assess the progress made. Much is likely to change between now and then on both the health and economic fronts. With the upcoming roll out of the Canada Emergency Wage Subsidy program, and the potential release of more data on program enrolments and the labour market, it will be interesting to make sense of the data and assess the dynamics of the various support programs in place.

Members of the Household Income and Credit Support Working Group Include:

Michael Horgan (Working Group Co-Chair), Senior Advisor, Bennett Jones LLP and former Deputy Minister of Finance, Government of Canada.

Kathleen Taylor (Working Group Co-Chair), Chair of the Board, Royal Bank of Canada.

Don Drummond, Stauffer-Dunning Fellow and Adjunct Professor, Queen's University.

Luc Godbout, Professor and Director of the Chair in Taxation and Public Finance, Université de Sherbrooke.

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Lara Speirs, Executive Vice President & Public Affairs General Counsel, Randstad Canada.

Intelligence MEMOS

From: Parisa Mahboubi, Alexandre Laurin and William B.P. Robson

To: Federal Economic Ministers

Date: April 30, 2020

Re: **How best to Curb the CERB Once It's Safe to Return to Work**

The Canadian Emergency Response Benefit (CERB) was an early and critical element in the federal government's response to the COVID-19 crisis. The government first announced the CERB in late March, promising $2,000 a month for up to four months for workers who lost their incomes. In mid-April, eligibility was expanded to people earning up to $1,000 per month and to workers whose EI benefits had run out.

Widely praised for providing immediate income support and helping contain the coronavirus by reducing pressure on lower-income people to work, the CERB made sense in an emergency. With attention increasingly turning to reopening the economy, however, the CERB is becoming a problem.

Measured by its popularity and the amounts paid out, the program has been a striking success. Between April 6 and 28, the government received about 7.3 million unique CERB applications and paid more than $25.6 billion in benefits. Applications were twice the number of Canadians who experienced COVID-related job losses or reduced hours (3.1 million, according to the Labour Force Survey) during the week of March 15-21. They were fully 40 percent of the number of Canadians employed in February. These huge numbers reflect the unprecedented implosion of the labour market. Moreover, alternative supports such as the Canada Emergency Wage Subsidy (CEWS) were slow to roll out.

On the other hand, such heavy use suggests there may be problems with the CERB itself. Its eligibility criteria are very broad. Unlike the Employment Insurance program, which requires recipients to keep a written record of prospective employers contacted, CERB recipients are not required to actively seek work or even be "ready and willing" to.

There are stories about some CERB recipients refusing to return to work or accept new employment opportunities when they have arisen. Legitimate health-related fears certainly explain part of any hesitation, but potential employers are learning in other cases that employees may prefer receiving the CERB to working, even when offered pay higher than the CERB provides. Or they are hearing from employees that they don't want to earn more than the $1,000 per month that would disqualify them from the CERB.

The rollout of the CEWS program on Monday now provides the opportunity for businesses to keep employees on their payroll. However, the CERB remains more advantageous financially than the CEWS for employees at the low end of the income scale, further complicating incentives to return to work.

When the government first established the CERB, worry about perverse incentives took a back seat – moral hazard was a minor concern in a crisis the virus had clearly caused. The longer the CERB lasts, however – and the more familiar its rules become both to potential users and to employers making decisions about hours and pay – the more the program's distortions of Canada's labour market begin to matter.

As health-related indicators improve, provinces are beginning to lift their restrictions. British Columbia, which never shut down as completely as other regions, is reopening. Saskatchewan, New Brunswick and Ontario have announced restart plans. Quebec will be gradually reopening daycares and elementary schools starting May 11, and its economy for potentially 500,000 workers over the next four weeks, with nearly 200,000 starting Monday. Businesses that were operating at reduced capacity are ramping up; businesses that were closed are reopening. With CERB recipients totalling nearly 40 per cent of people who held jobs before the crisis, Ottawa also needs to start changing course.

We can think of at least three possible ways for Ottawa to tackle this issue. It could mandate that CERB recipients accept their employer's offer of return to work, provided conditions are no less favourable than before the start of their eligibility for the CERB. It could establish an appeal mechanism for employers with regard to employees voluntarily declining work opportunities as economic activity resumes. It could also set income-tested CERB clawbacks, so that for a limited time CERB claimants returning to work or accepting a new job could keep a declining amount of the CERB up to a maximum earnings threshold.

Another compelling reason to wind down the CERB is the federal government's own finances. The program costs more than $4 billion a week, which by any standard is a lot of money. The federal deficit for this year is already expected to exceed $200 billion – and that figure will grow the longer it takes to reopen the economy. It is nearing time for Ottawa to shift towards policies that accelerate the recovery and generate the revenues it needs to repair public finances.

CERB helped cushion COVID-19's impact. But it now threatens to impede the recovery. Part of the federal government's plan to reopen the economy should be to wind the CERB down.

Parisa Mahboubi is a senior policy analyst at the C.D. Howe Institute, where Alexandre Laurin is director of research and William B.P. Robson is president and CEO.
To send a comment or leave feedback, email us at blog@cdhowe.org.

(A version of this memo first appeared in the Financial Post.)

Intelligence MEMOS

From: Luc Godbout

To: The Hon. Carla Qualtrough, Minister of Employment, Workforce Development and Disability Inclusion, and the Hon. Bill Morneau, Minister of Finance

Date: May 5, 2020

Re: **THE CERB AND THE CESB: BALANCING WORK INCENTIVES AGAINST FAIRNESS CONSIDERATIONS**

Temporary income support measures responding to the COVID-19 crisis, such as the Canada Emergency Response Benefit (CERB) and, to a lesser extent, the Canada Emergency Student Benefit (CESB), are achieving their initial objective to support household income during time of crisis. Despite this good news, questions remain on the potential impact of these income support initiatives on work incentives.

Unlike Employment Insurance, a CERB recipient has no obligation to remain available for work or to be actively looking for a job. This provision suited the emergency of the crisis, but now we need to ensure economic activity can restart. To avoid the risk of disincentivizing work for certain workers, the federal government will need to adjust certain CERB eligibility requirements.

In a recent analysis with Suzie St-Cerny, we showed that the CERB provides good income support to households that have lost their jobs, but also that its relative generosity for minimum-wage workers can have undesirable effects.

Whether for a single person, a couple with or without children or a one-parent family, it appears more financially advantageous to cease minimum-wage employment and receive the CERB for 16 weeks than to keep working full time.

For Québec households staying at work earning minimum wage and therefore not receiving the CERB, disposable incomes for 2020 will be lower by $832 to $1,824, depending on their family situation.

To counter CERB's negative impacts on work incentives, Québec introduced an additional benefit topping up incomes for essential sector workers, thus preserving the financial gain of working. The gain, however, is modest. In the case of a single person earning minimum wage, being at work for 16 weeks compared to receiving the CERB provides a gain of $88, the equivalent of 16 cents an hour during those16 weeks.

On the CESB side, the program's interference with students' work incentives is even clearer, and proving to be counterproductive to the workings of provincial work incentive programs designed to attract young people (for example, Québec's incentive for seasonal agricultural workers working at minimum wage).

Based on the current CESB parameters, a post-secondary student who is not working will be better off than a student working at minimum wage for 21 hours per week. The same is true for a student benefiting from the CESB and working part-time for less than $1,000 per month. The latter gives up only $28 for eight weeks of work compared to agricultural work of 35 hours per week.

During the debate on the adoption of the CESB in the House of Commons, we heard that government efforts would be made to ensure that the CERB and the CESB can encourage employment in all circumstances while continuing to play their role. Therefore, we can expect future adjustments to these income support programs.

This is commendable, but is also a complex exercise. Regardless of the fiscal cost, modulating a gradual reduction of these benefits for those who go back to work or take on a job would increase their incentive to work. At the same time, however, one must also take into account fairness considerations regarding the "unlucky" who have not lost their jobs. The desire to increase work incentives must be balanced against treating people equitably whether they are or not entitled to CERB/CESB.

As currently designed, the CERB and the CESB, unlike the Canada Emergency Wage Subsidy, will act to slow down the economic recovery. Fortunately, these benefits are adapted to a temporary and very specific context.

While the CERB has played its emergency support role very well, there is still time to act to minimize its negative effects on work incentives and the resumption of economic activities.

Gain (loss) in Disposable Income from Working Full Time Earning Minimum Wage Compared to Ceasing to Work and Collecting the CERB in Québec

	No Work Stoppage 16 Weeks	
	Non-Essential Worker	Essential Worker
Single person	($855)	$88
Single-earner couple without children	(832)	379
Dual-earner couple without children	(1,824)	140
Lone-parent family, one child	(1,004)	316
Single-earner couple, two children	(859)	381
Dual-earner couple, two children	(1,064)	110

Luc Godbout is Professor, School of Administration, Université de Sherbrooke; and Chair in Taxation and Public Finance.

To send a comment or leave feedback, email us at blog@cdhowe.org.

NOTE *de renseignement*

De la part de : Luc Godbout

A l'attention de : Honorable Carla Qualtrough, ministre de l'emploi, du développement de la main-d'œuvre et de l'inclusion des personnes handicapées, et l'honorable Bill Morneau, ministres des finances

Date : 5 mai 2020

Subjet : **La PCU et la PCUÉ: Trouver l'équilibre entre incitation au travail et équité**

Les mesures de soutien temporaires du revenu liées à la crise de la COVID-19, comme la Prestation canadienne d'urgence (PCU) et même dans une moindre mesure la Prestation canadienne d'urgence pour les étudiants (PCUÉ), atteignent l'objectif initial de soutenir le revenu des ménages pendant la crise de la COVID-19. Malgré cette bonne nouvelle, il reste à s'interroger sur l'effet que ces initiatives gouvernementales peuvent avoir sur l'incitation au travail.

Contrairement à l'assurance-emploi, une fois qualifié à la PCU, le bénéficiaire n'a aucune obligation de rester disponible pour le travail ou d'être à la recherche active d'un emploi. Cette disposition était appropriée à l'urgence de la crise, mais il faut maintenant pouvoir assurer le redémarrage des entreprises. Pour éviter un risque d'observer une désincitation au travail pour certains travailleurs, le gouvernement fédéral devra ajuster certaines conditions d'admissibilité à la PCU.

Une analyse de la CFFP montre que la PCU assure un bon soutien de revenu aux ménages ayant perdu leur emploi, mais aussi que sa générosité relative en regard du salaire minimum peut avoir des effets indésirables. Tant pour une personne seule, un couple avec ou sans enfants ou une famille monoparentale, il apparait plus avantageux de perdre son emploi à temps plein au salaire minimum et de recevoir la PCU pendant 16 semaines que demeurer au travail. Pour un ménage québécois restant au travail au salaire minimum et n'ayant donc pas reçu la PCU, le revenu disponible pour 2020 est inférieur d'entre 832$ à 1824$ selon la situation.

Pour contrer l'effet négatif de la PCU sur l'incitation au travail, Québec a ajouté une prestation (PIRTE) afin préserver le gain financier du travail dans les secteurs essentiels.

Le gain financier du travail, bien que présent grâce à cette prestation demeure modeste. Dans le cas d'une personne seule au salaire minimum, être au travail pendant 16 semaines comparé à bénéficier de la PCU procure un gain de 88$, l'équivalent de 0,16 $/heure pendant les 16 semaines.

Du côté de la PCUÉ, il apparait encore plus manifeste qu'elle nuit à l'incitation au travail et qu'elle s'avère même contreproductive à l'égard d'autres programmes provinciaux d'incitation pour attirer des jeunes (par exemple, l'incitatif québécois aux travailleurs agricoles saisonniers travaillant au salaire minimum).

Sur la base des paramètres actuels de la PCUÉ, un étudiant postsecondaire qui ne travaille pas aura plus en poche qu'un étudiant travaillant au salaire minimum 21 heures/semaine. Même constat pour un étudiant bénéficiant de la PCUÉ et travaillant à temps partiel en gagnant moins de 1 000 $ par mois. Ce dernier renonce à seulement 28 $ pour huit semaines de travail comparé à un emploi agricole de 35 heures/semaine.

Toutefois, lors du débat d'adoption de la PCUÉ à la Chambre des communes, il fut annoncé que des efforts seraient faits afin que le gouvernement s'assure que *la PCU et la PCUÉ soient offertes* […] *tout en incitant à l'emploi en toute circonstance*. Il est donc possible de s'attendre à une adaptation de ces prestations.

L'idée est bonne et louable. Cependant, il s'agit d'un exercice complexe. Sans égard au coût, il est vrai que moduler la réduction de ces prestations pourra augmenter l'incitation au travail, mais, il faut aussi tenir compte de l'effet de cette modulation sous l'angle de l'équité envers les «malchanceux» n'ayant pas perdu leur emploi. La volonté d'augmenter l'incitation au travail doit s'exercer dans le respect de l'équité entre les personnes ayant droit ou non à la PCU/PCUÉ.

Telles qu'elles sont conçues actuellement, la PCU et la PCUÉ, contrairement à la Subvention salariale d'urgence, agiront de manière contreproductive à la reprise économique. Heureusement que ces prestations sont temporaires et agissent dans un contexte particulier et passager. Bien que la PCU a très bien joué son rôle de soutien d'urgence, il est encore temps d'agir pour minimiser ses effets sur l'incitation au travail et sur la reprise des activités.

Écart de revenu disponible sans arrêt de travail au salaire minimum comparé au cas avec arrêt de travail avec PCU, Québec, 2020

	Sans arrêt de travail 16 semaines	
	Secteur non essentiel	Secteur essentiel
Personne seule	(855)	88
Couple sans enfant avec un revenu	(832)	379
Couple sans enfant avec deux revenus	(1 824)	140
Famille monoparentale avec un enfant	(1 004)	316
Couple avec deux enfants avec un revenu	(859)	381
Couple avec deux enfants avec deux revenus	(1 064)	110

Luc Godbout est titulaire de la Chaire en fiscalité et en finances publiques de l'Université de Sherbrooke.

Pour laisser un commentaire, envoyez-nous un courriel à blog@cdhowe.org.

Intelligence MEMOS

From: Tammy Schirle

To: Bill Morneau, Minister of Finance

Date: May 12, 2020

Re: **Designing a CERB that Supports Efforts to Re-open the Economy**

In mid-March, large parts of the Canadian economy needed to shut down. The Canada Emergency Response Benefit (CERB) was quickly introduced, designed as an emergency measure to support Canadians who we needed to stay at home so that we could "flatten the curve."

In the coming months, however, I envision two problems with CERB.

First, many of the workers first eligible for CERB will run out of benefits in July. Without an extension of the program, or a replacement or complementary program, many will be left without support.

Second, as provinces move to re-open some sectors of the economy where health risks are more manageable, CERB's design could slow things down, given its poor work incentives.

When thinking about the factors affecting the decision to work, the most important is simply whether a reasonably safe job is available. For many of the businesses shuttered in March, a full re-opening (and hiring back workers) is a long way off. For other workers, health and safety concerns or the unavailability of safe childcare may pose barriers to re-entering the workforce. As CERB was designed to offer benefits for only 16 weeks, workers laid off from some of the most affected sectors will need further support. While some would be able to move into the EI system, many others will be left without support unless an extension of benefits is available.

As some provinces move toward re-opening sectors of the economy where health risks are more manageable, many people are eager to work and the financial benefits of working will become a more prominent factor in work decisions.

For many workers, CERB will affect the financial incentives to work. In CERB's original design, enabling people to stay at home was a feature of the program. Consider, however, that CERB currently offers a $2,000 benefit and allows workers to earn up to $1,000 in a month before losing their benefits, so that their total potential income from earnings and CERB (before any taxes) is $3,000. If they accepted even one more dollar's worth of work, they lose the $2,000 CERB benefit and are left with $1,001 to support themselves and their family.

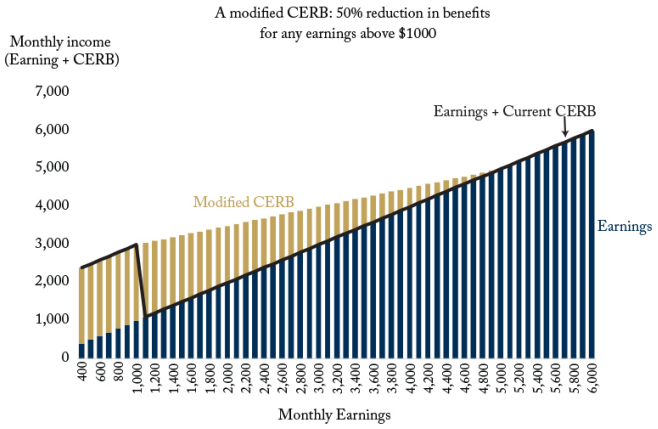
Moving forward, the CERB benefit structure could be slightly modified so that workers able to find work that pays more than $1,000 are better off by doing so, without harming the people unable to find jobs. For example, a base benefit of $2,000 could be offered, with an earnings exemption and a reduction in CERB benefits for earned income above the exemption. If for example we continued with a $1,000 exemption for earned income, and reduced the CERB benefit by 50 cents for every dollar earned over that, workers would continue getting at least some CERB support while earning up to $5,000 per month (see figure).

I see many benefits to this modified CERB design. First, a gradual reduction of benefits for earned income will better support parents who want to share caregiving responsibilities by coordinating partial-return-to-work schedules until safe childcare options are available. Second, for workers without safe job options, support would continue.

If CERB is left to expire, some of the individuals unable to find employment will be able to move into the EI system, receiving up to $573 per week. There are opportunities to earn while receiving EI benefits, with benefits reduced by 50 cents for every dollar earned, until one earns 90 percent of insurable earnings. (As an aside, the marginal effective tax rate on earnings for the EI program, especially when viewed in the full context of the tax and transfer system, is quite high but perhaps unavoidable).

An extension of CERB would be more broadly available to all workers affected by COVID-19. While an extension that accounts for earnings will be more difficult to administer, it is worth determining whether continued benefits are best administered as a CERB extension or the transfer of so many individuals to the EI system.

The CERB extension suggested here offers a relatively generous benefit not available to essential workers. As Luc Godbout has pointed out in a recent memo, we should also take into account fairness considerations. On May 7, the federal government announced an agreement to boost the wages of low-income essential workers which may offer some balance to any extension of CERB benefits.



Finally, it is important to recognize that CERB is not the only policy available to support workers in the transition to re-opening sectors of the economy. The Canada Emergency Wage Subsidy can also support the workers who remain attached to their employer. However, the subsidy only covers wages from March 15 to June 6, although some extension is promised. While the speed at which provinces are able to re-open sectors is uncertain, and will clearly differ across regions, continued management of these supports across the country poses an extraordinary challenge to the federal government.

Tammy Schirle is Professor of Economics at Wilfrid Laurier University, and is a C.D. Howe Institute Research Fellow.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Ken Boessenkool

To: Bill Morneau, Minister of Finance

Date: May 15, 2020

Re: **OTTAWA HAS THE TOOLS TO REPLACE THE CERB**

Canadian governments moved swiftly and massively to provide personal supports to Canadians during the COVID crisis. This Intelligence Memo looks at income from three families in February before the crisis hit, in April when generous federal and provincial supports hit their zenith, and in July when the employers of all of our families have taken advantage of the Canadian Emergency Wage Subsidy (CEWS) and are paying wages accordingly.

The purpose of the exercise is not to criticize what the government has done to date – clearly the government had to react quickly and decisively, and they did, with unanimous support – or to criticize families who received those hastily designed benefits. Rather the purpose is to foster debate around what type of supports the government might consider during the recovery phase – which will be the subject of subsequent Intelligence Memos.

Our first family is Chris and Intisar. Chris works on average 35 hours a week at McDonalds as a shift manager and made $500 per week in February. Intisar teaches piano two evenings a week at a local music store and typically makes $100 per week. Chris and Intisar have two children, ages two and four. Their total family income in February, including federal and Ontario child benefits, Goods and Services Tax Credit (GSTC) and Trillium benefits totalled just under $3,400.

Our second family is Avery and Quinn. Avery is a bartender and made $500 per week in February and Quinn works at the Koodo kiosk at the mall and made $250 per week in February. They have no kids. Their total family income in February was just under $3,100.

Our third family is Sandy and Charlie. Sandy is a restaurant manager at the Keg and makes almost $55,000 and Charlie manages a high-end hair salon and earns just shy of $44,000. They claimed the full $16,000 in childcare expenses for their two children, aged three and five which reduces their federal tax by $3,358 and they get $4,640 in Ontario CARE benefits. Including these amounts, their family income was just shy of $9,500 in February.

All six of these individuals lost their jobs in mid-March and applied for the Canada Emergency Response Benefit (CERB) of $500 per week. Chris managed to keep a few shifts at McDonalds running the drive-thru and averaged $250 per week through April – but remained below the $1,000 threshold at which he would lose his CERB.

In normal times, Employment Insurance (EI) would have paid 55 percent of eligible earnings so Sandy would have received an EI benefit of $2,500 a month, not the $2,000 received on CERB.

The first two families would also receive supplemental GSTC cheques that doubled their current annual benefit. And the two families with kids would see an additional $300 per child. Plus the Ontario Ministry of Education provided $200 per child in April.

If we spread these supplemental amounts over March 15 to May 31 then Chris and Intisar saw their family income rise in April to just shy of $7,500 while Avery and Quinn saw a more modest increase to just over $4,300. Sandy and Charlie saw their family income drop to just under $6,000.

The CERB is taxable, so our first two families would see their tax bill rise next April. Our third family would pay less tax – but also save on childcare expenses. But that's down the road, for now the table reflects the "cash in hand" that these families would see. As such, it assumes no mid-year adjustments to existing supports.

Jump ahead to July. All of the employers of our couples have applied for and received the CEWS that pays 75 percent of the salary bill of Candian firms. All of our family members are now working at their former jobs at 75 percent of their former salary. All other family and sales tax benefits return to what they were in February as these benefits do not change mid-year.

In a companion Intelligence Memo , we examine what kind of programs are needed for this recovery to be sustainable for Canadian families.

The Hon. Konrad W. von Finckenstein, Q.C., was Chair of the Canadian Radio and Telecommunications Commission, a Federal Justice and Commissioner of Competition.

	Chris and Intisar	Avery and Quin	Sandy and Charlie
	February ($)		
Earned Income Primary	2,000.00	2,000.00	4,545.45
Earned Income Secondary	500.00	1,000.00	3,636.36
CERB Primary	na	na	na
CERB Secondary	na	na	na
GSTC	73.83	48.33	0.00
CCB	1,105.60	0.00	551.99
CCED			352.58
Trillium Benefit	97.27	49.93	0.00
Ontario Child Benefit	176.91	0.00	0.00
Ontario CARE Childcare			386.67
Ontario COVID Education	na	na	na
Total Income	**3,953.61**	**3,098.26**	**9,473.05**
	Chris and Intisar	Avery and Quin	Sandy and Charlie
	April ($)		
Earned Income Primary	1,000.00	0.00	
Earned Income Secondary		0.00	
CERB Primary	2,000.00	2,000.00	2,000.00
CERB Secondary	2,000.00	2,000.00	2,000.00
GSTC	428.23	280.33	
CCB	1,345.60	0.00	791.99
CCED			352.58
Trillium Benefit	97.27	49.93	
Ontario Child Benefit	176.91	0.00	
Ontario CARE Childcare			386.67
Ontario COVID Education	160.00	0.00	160.00
Total Income	**7,208.01**	**4,330.26**	**5,691.24**
	182%	140%	60%
	Chris and Intisar	Avery and Quin	Sandy and Charlie
	July ($)		
Earned Income Primary	1,500.00	1,500.00	3,409.09
Earned Income Secondary	375.00	750.00	2,727.27
CERB Primary			
CERB Secondary			
GSTC	73.83	48.33	0.00
CCB	1,105.60	0.00	551.99
CCED			352.58
Trillium Benefit	97.27	49.93	0.00
Ontario Child Benefit	176.91	0.00	0.00
Ontario CARE Childcare			386.67
Ontario COVID Education			
Total Income	**3,328.61**	**2,348.26**	**7,427.59**

From: Ken Boessenkool

To: Bill Morneau, Minister of Finance

Date: May 15, 2020

Re: **Ottawa Has the Tools to Replace the CERB**

A separate Intelligence Memo summarized the impact on fictional families of the combination of the Canada Emergency Response Benefit (CERB) and the boosts to the Goods and Services Tax Credit and Canada Child Benefit from February to July.

It showed that the CERB is a very blunt instrument that was appropriate for the first phase of the crisis where income replacement, speed of delivery, and a uniform payment were both operationally required and suitable to the situation. While not perfect, the federal government is to be commended for meeting all three goals.

But even with modifications, CERB could be unnecessary and unhelpful for the next phase because Ottawa has better tools at hand. To address a slow recovery will almost certainly require continued supports. Those tools are much more targeted in terms of who receives support and how much they receive.

Two groups of Canadians face particular difficulties – low-income Canadians and families with children.

Low-income Canadians have been hit hardest, as they make up the largest proportion of a service-sector led shutdown. And that sector is unlikely to see a rapid return to pre-COVID levels as phased physical distancing relaxation and anxiety about a second wave hold back a full recovery.

The government's initial response to the crisis reflected this concern – it pledged $5.5 billion for a one-time addition of the Goods and Services Tax Credit (GSTC) equal to whatever your current total annual benefit was. This provided a one-time income supplement in May of $443 for singles and $580 for couples and $153 per child for those with the lowest incomes based on their 2018 income tax filing.

Instead of extending the CERB, GSTC boosts should be repeated during the next phase of the crisis. And we should allow Canadians to update what they receive based on filing their 2019 tax returns. All Canadians currently receiving CERB payments should be encouraged to file updated returns.

Families with children will be facing the challenges of primary caregivers having school-aged children at home and facing the prospect of cancelled summer camps. This will make it much more difficult for primary caregivers – primarily women – to return to work in the coming months. Further, even if their jobs came back immediately, many of these parents simply wouldn't be able to return to work. This challenge will be particularly acute due to a reduction in available childcare spaces due to physical distancing rules and the likely bankruptcy of existing childcare providers.

This points to two kinds of required supports – one to assist with childcare expenses and another for families who are not both working full time and are coping with additional children at home.

I consider in another Intelligence Memo the significant challenges facing families who require childcare. In particular, I have proposed a very generous refundable tax credit for up to 75 percent of childcare expenses as a way forward on this issue.

The government's initial response to the COVID crisis reflected the concern for families by providing a $2 billion one-time boost to the Canada Child Benefit (CCB) of $300 per child in May. And again, these payments could be repeated and Canadians – particularly those on CERB – should be encouraged to update and/or file their returns to receive appropriate benefits.

A low-income family with two adults working would receive all three benefits – a boost to GSTC ($580 plus $153x2), a boosted CCB ($300x2) plus a large annual refundable tax credit (up to $12,000). A single income family – whether by choice, because they cannot find work or childcare or because they are caring for school-aged children – would receive the GSTC boost and the CCB Boost. For many families, these benefits plus their earned income would far exceed what they would get with an extension of the CERB, but in a series of appropriately targeted programs rather than a broad-based one.

The level of economic activity and the pace of the recovery can determine the appropriate level of additional payments to coincide with GSTC payments this November, February 2021, May 2021 etc. Each additional payment of the GSTC and CCB would cost $7.5 billion. So a commitment to continue the full CCB and GSTC amounts to the end of 2021 would cost $15 billion more this year and $30 billion next year.

Extending the CCB and GSTC boosts will allow low-income Canadians and families with children face the post-CERB knowing that they would have the income security they need to face the likelihood of a slow and uncertain recovery.

Ken Boessenkool is an independent public policy economist.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Alexandre Laurin and Benjamin Dachis

To: Finance Minister Bill Morneau

Date: May 20, 2020

Re: A Stimulus Plan to Restart the Job Market

As governments partially lift their restrictions and economic activity resumes, many more employees will soon be asked to return to work, and new work opportunities will arise for the unemployed.

Many people may hesitate to return to or to accept work. Health-related concerns are top of the list, of course. But in other cases, employers are learning that some may prefer receiving the Canada Emergency Response Benefit (CERB) to working. As governments look to economic stimulus for the recovery while also creating fairer supports across the labour force, they should look to the Canada Workers Benefit (CWB) as the main tool.

One way to encourage unemployed workers to return to a job before their four-month CERB ends, is to let them keep a declining amount of the CERB up to a maximum earnings threshold. That, along with reducing the CERB amount (for example, to about $1,000 a month), should also be a feature if the government extends CERB eligibility to cover those who do not qualify for Employment Insurance (EI) and have not returned to work when the 16-week eligibility period ends. That is early July for many.

One major problem with an income-tested CERB is the unfairness it creates between those who ceased to work and those who kept working during the crisis while not collecting the CERB (earning more than $1,000 per month). Those returning to work would have their income supplemented by a reduced CERB, while those earning the same income who kept working would not. This would violate the fiscal policy principle that individuals with similar income and characteristics should be treated the same by the tax and transfer system.

An announcement on May 7 that the federal government will co-fund provincial essential worker bonuses is a potential start to a fairness solution. But a better design is needed for the economic restart.

The CWB already performs the function of supplementing the income of low-wage individuals and families. The CWB, an "earned-income" refundable tax credit, provides a financial incentive for unemployed low-income individuals to enter and remain in the workforce. The value of the benefit increases with income, up to a maximum. Most single individuals can receive up to $1,355 ($2,335 for families) which is gradually reduced when net income exceeds $12,820 ($17,025). Provinces have the ability to modify the parameters of the CWB for their residents.

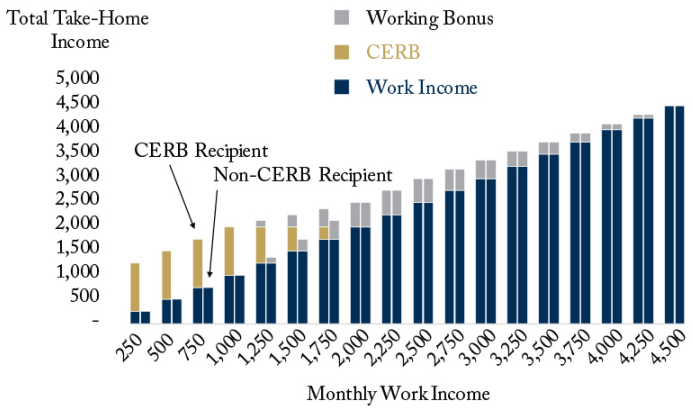
A temporary "Working Bonus" for low-wage workers could cover, say, the months of June, July, and August. It could pay, say, a maximum of $500 per month per worker. The design would be inspired by earned-income credits like the CWB, but the Working Bonus would be administered separately. To be eligible, workers would need to earn from employment or self-employment at least $1,000 per month. It could be phased in at a rate of 50 cents per dollars of earnings, such that the maximum monthly benefit amount would be reached at monthly earnings of $2,000. The monthly supplement could then be clawed back at a rate of 25 cents per dollar of earnings past the $2,500 monthly earnings mark.

Because the amount of the bonus increases with earnings at the lower end of the income spectrum, it would encourage them to work more, supporting the economic re-opening. The national cost for this support program would be in the ballpark of $3 billion. A more generous program would provide stronger work incentives, but would add to the fiscal cost.

Normally, a person or family's CWB benefit is based on the previous year's net income. Our proposal is to base the working bonus on expected monthly earnings (same basis as the CERB) this summer starting early July. The new Working Bonus would use the trust but verify approach of CERB, which is already income tested on a monthly basis.

This Working Bonus, because it can be targeted to non-CERB recipients, would complement the CERB. If Ottawa expands the CERB to allow recipients to earn more than $1,000 per month and keep an income-tested reduced amount, as suggested in the chart above, the CWB would preserve work incentives while allowing for the CERB to wind down.

Take Home Income for CERB and Non-CERB Recipients
Including Proposed Working
Bonus and Scaled Back CERB (with Clawback)



Another option to focus on fairness within a company would be for Ottawa, subject to addressing technical hurdles, to target the Working Bonus to those not able to return to a previous job at the same hours and pay and letting them continue claiming an income-tested CERB. This would provide a top-up to workers in sectors that have no path to re-opening to seek work in other – lower-paid – areas with job openings. Ottawa would need to create supporting documentation and administration and handle similar implementation hurdles around those with multiple jobs.

Our proposal would encourage people to work more or take on a new job when restrictions are lifted and is targeted to the lowest-income workers hurt most in this recession. It should be the centrepiece of a plan to restart the job market.

Alexandre Laurin is Director of Research at the C.D. Howe Institute and Benjamin Dachis is its Director of Public Affairs.

To send a comment or leave feedback, email us at blog@cdhowe.org.

**Note: Revised CERB assumes a $1,000 monthly amount and a $1:$1 clawback on the benefit amount with work earnings.*

Intelligence MEMOS

From: Alexandre Laurin and Benjamin Dachis

To: Finance Minister Bill Morneau

Date: May 25, 2020

Re: **An Income Support Plan to Support the Recovery**

The first cohort of Canada Emergency Response Benefit (CERB) recipients are about to lose eligibility on July 5. Ottawa must announce soon what's next.

As the province-by-province restart begins, income support needs to shift from broad-based programs to targeted initiatives addressing the lingering economic pain. Governments should balance the need for a continuing safety net with encouraging those who can find safe and rewarding work to do so.

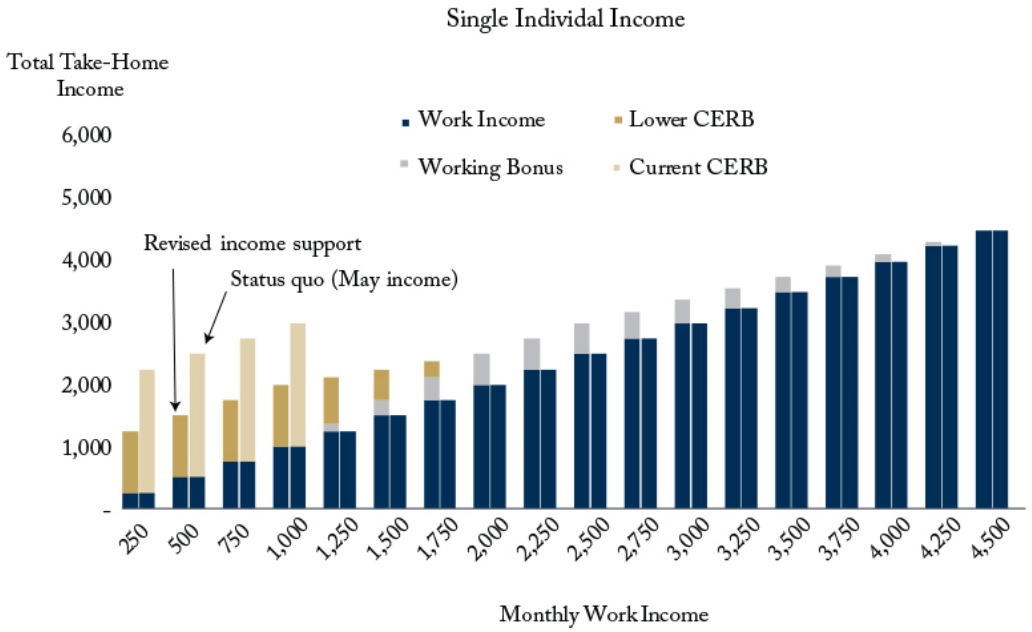
The recovery and restart income support plan should have three complementary pillars:

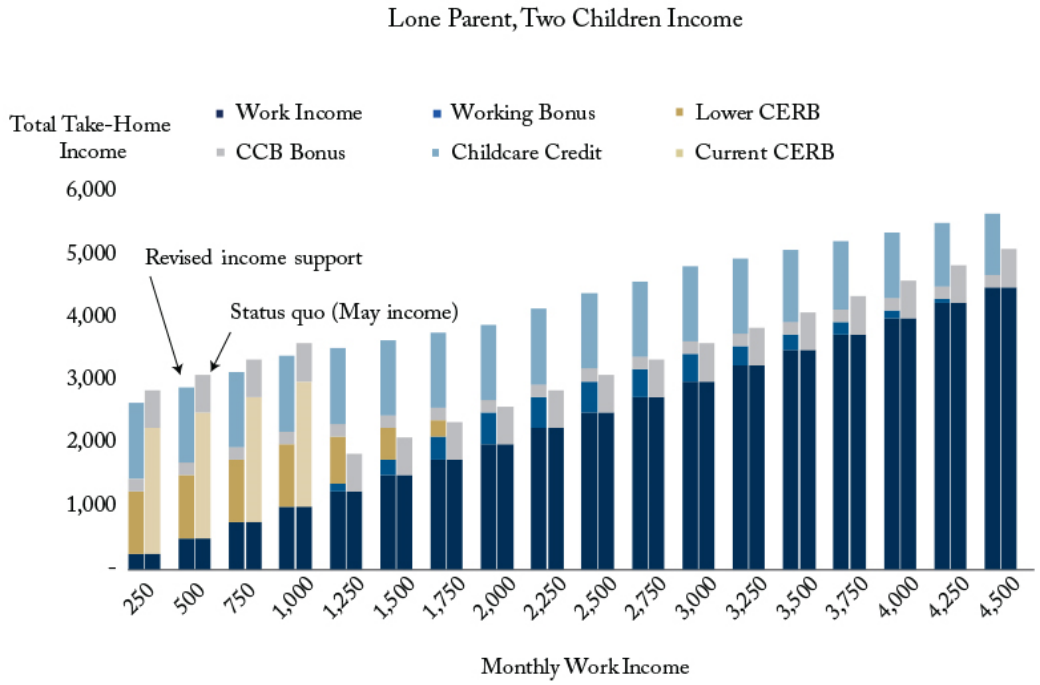
1. **Extend CERB eligibility for a limited time to those who, after 16 weeks on the CERB, do not become eligible for Employment Insurance (EI).** The maximum CERB amount should be scaled back, from $2,000 to $1,000 for example. And rather than have workers lose all of the CERB when they earn more than $1,000, let them keep a declining portion as they earn more. Ottawa and businesses will also need to enforce eligibility and return-to-work requirements. Ottawa will need to invest in income verification administration for EI and CERB.
2. **Enhance the Child Care Expense Deduction and the Canada Child Benefit (CCB).** Women are bearing the brunt of labour income losses. Limited childcare options will impede the recovery for women the most. A big, temporary boost to the CCB cash transfer and a revised childcare tax credit providing enhanced support to low-income earners is the best way to target families with dependent children. A richer CCB supports families whether or not they find childcare. A childcare expense credit will expand childcare options – subsidizing a wide range of in-home childcare options, incenting a larger supply – for those who can get back to the workforce. A targeted program lets parents choose for their family.
3. **A new temporary "Working Bonus" modeled on the Canada Workers Benefit (CWB).** The CWB is a refundable tax credit that tops up employment income for low-income earners and increases as workers earn more. A new monthly Working Bonus should be the core of the job-recovery and stimulus plan. The bonus would go to everyone earning a monthly income above a certain threshold, growing with income until it is phased out. It would be especially useful to those who worked in sectors that are not recovering and who need to find jobs elsewhere. It could dovetail with the proposed scaled back CERB, clawed back one-for-one with employment income. It could be administered alongside the current monthly income test for the CERB, or alternatively alongside the CWB, in which case workers could get a 50 percent immediate subsidy for their income, with the rest to come at tax filing next year. Provinces could also modify the phase-in or -out, as they do with the current CWB, or potentially top-up this bonus.

These three pillars would work together. Reducing the CERB only works for families if they have certainty that they will be able to afford childcare or otherwise support their families' basic needs. Such a wind-down of CERB leaves the most vulnerable (a low-income single parent currently receiving the CERB with two children, for example) in a similar situation, and better off if they earn more than $1,000 of income and use childcare. Those without family obligations facing lower CERB payments would benefit from the Working Bonus and the reduced and income-tested CERB, encouraging the restart.

The fiscal outlook for this year and beyond would likely dictate the exact dollar figures for the above proposal. The enhancement to the CCB and the Working Bonus could be partly paid for out of announced programs by scaling back the CERB and a wind-down of the Canada Emergency Wage Subsidy, lowering the net cost of the economic stimulus. Such a recovery and stimulus plan centered around the needs of low-income workers and women should be Ottawa's focus.

Alexandre Laurin is Director of Research at the C.D. Howe Institute and Benjamin Dachis is its Director of Public Affairs.
To send a comment or leave feedback, email us at blog@cdhowe.org.





Notes:

1. CERB scaled back to a monthly maximum of $1,000 phased out with income over $1,000;
2. Working Bonus phased in at a rate of 50 cents per dollar of earnings over $1,000 and phased out at a rate of 25 cents per dollar of earnings over $2,500;
3. CCB bonus of $100 per month per child; status quo CCB bonus of $300 per child for May
4. Refundable childcare credit of $600 per child phased out on a sliding scale of family income.

Crisis Working Group Report: Household Income and Credit Support

Communique #7: Staggered Re-opening Should Inform Tailored Income Supports

To help Canadian governments confront the public health and economic crisis resulting from the spread of COVID-19, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The Working Group on Household Income and Credit Support is co-chaired by Michael Horgan (Senior Advisor at Bennett Jones LLP and Former Deputy Minister of Finance, Government of Canada) and Kathleen Taylor (Chair of the Board at Royal Bank of Canada) and supported by a group of Canadian business leaders and economists. The group's most recent meeting was held on Tuesday, May 19, 2020.

In the meeting, working group members identified the need to apply a risk-management lens to the reopening of the economy and reflected on how the vast differentials in COVID-19 experiences across the country necessitate a move away from a national one-size-fits-all re-opening plan and related income support plans. The working group also discussed policy options for modifying the CERB in the short term and phasing out the CERB over the long term, with a particular focus on financially supporting families as well as low-wage earners with potentially diminished incomes. The working group argued that Ottawa should increase transparency around details of the implementation of future income support plans and ensure that near-term policies reflect the limited supply of childcare options. Furthermore, the working group proposed longer-term policy options to support Canadians during the pandemic and recovery, including investments in retraining, reskilling, and upskilling.

Risk-Management Assumptions to Determine Income Support

In the beginning, Canada's stay-at-home strategies were specifically designed to flatten the curve of infection in order to protect the healthcare system. Stay-at-home rules were never designed to eliminate the virus from circulation. In support of "stay at home," The Canada Emergency Response Benefit program (CERB) was necessary to ensure that households stay afloat while these restrictions are in place.

As the data have shown, the curve has been flattened considerably across the country. Parts of the economy are now re-opening in stages and at various speeds across the country. The working group highlighted the need to be transparent about our assumptions in regards to the re-opening, as these assumptions are critical when evaluating the effectiveness of current income support systems, plans for the next phases of reopening, and resulting policy alternatives.

First, we assume the virus will remain in circulation for some time. Therefore, living safely with COVID-19 should become the underlying premise, especially for the most affected provinces. Several provinces, such as the Atlantic provinces, have practically eliminated the virus for the time being and they may choose to follow a New Zealand-type strategy of limiting inbound access, with the upside that social and physical distancing conditions can largely be lifted locally. In other provinces, the virus continues to spread, albeit at much lower rates than previously, which is allowing gradual and staged re-opening. In either case, the use of personal protective equipment is likely to be required for many industries and premises for an extended period of time.

Second, we assume that any re-opening of the economy will be gradual, regional and sector by sector. Different industries will return to operation at different rates and at different times. Regardless of timing, all businesses need to follow stringent health and safety protocols. Re-opening presents safety issues, both in the workplace and in commuting to work, that will need to be addressed to ensure that workers can return safely.

Third, we note that some schools and daycares have been re-opening while others will remain closed. It is important to eventually get all children back to school or into care when it is safe to do so, not only because parents will need to go back to work, but also because of the negative impacts prolonged isolation is having on the development and long-term well-being of children.

Finally, the group identified the risk of a return to periodic economic shutdowns if the spread of the virus re-accelerates. More widely available testing and tracing is key to mitigating this risk.

What these assumptions point towards is that federal income support policies, such as the CERB, must shift from a one-size-fits-all approach – appropriate for a broad national shutdown – to a more targeted support approach. A more targeted income support approach would account for regional and sectoral differences, while addressing specific needs, such as childcare, and specific sectors, such as tourism, travel, or oil and gas, which are experiencing the largest and most sustained displacements.

Modifying the CERB and Other Short-term Support

In previous meetings, the working group raised two concerns with the CERB. The first concern was about CERB recipients who, after exhausting their benefits, will remain unemployed without access to Employment Insurance. The second concern was that the CERB may discourage people from returning to work as some businesses start to re-open, slowing down the recovery.

A number of policy options are available to address these concerns. CERB eligibility can be extended beyond the July cutoff with an income-tested claw back to tackle disincentives to work. At the same time, when planning out the next phase, Ottawa should aim to preserve fairness between those who would continue to receive the CERB and others who would continue to work without receiving the CERB. One proposal for balancing concerns of work incentives and fairness would be an extended but lower CERB with a steep income-tested claw back, combined with a temporary Working Bonus program (WB) for low-wage workers. A Working Bonus would be similar in design to a conventional earned-income tax credit, such as the Canada Workers Benefit. To address the coverage gap for those who are not able to return to work, the Working Bonus and the clawed back CERB can be complemented by targeted supplemental measures such a refundable childcare tax credit for parents returning to work and an immediate boost to the Canada Child Benefit.

Working group members, however, noted two challenges with these proposed options: first, a lack of administrative infrastructure for real-time income testing of support programs such as CERB; and second, the absence of childcare options due to childcare closures, which limits the potential effectiveness of a refundable childcare credit in supporting working parents.

The federal government must, therefore, be transparent with administrative challenges for the next phase of income support in regard to verification of monthly income level, either through the CERB (which is already income-tested on a monthly basis) or the Employment Insurance system. Furthermore, subsidizing a wider range of childcare options may help address the supply issue for parents who can return to work. Lastly, designing any income support should include the opportunity for both parents to share childcare responsibilities when no childcare option is available. In designing future income support programs, governments need to ensure that their structure does not reinforce traditional gender roles.

Long-term Income Support Plans

As highlighted earlier, we assume that absent a vaccine, infection risks will stay with us for some time. Keeping the economy in an induced coma for a sustained period time is neither desirable nor feasible. With planned gradual re-openings, some sectors may not come back to their normal state of operations

for an exceptionally long time. At the same time, keeping emergency programs in place for the long run is challenging and impractical.

The working group noted that major shifts in the economy had already been underway prior to the crisis, and that COVID-19 will likely create permanent displacements or lead to businesses choosing to operate differently when they re-open. The working group expects that these shifts will lead to structural unemployment. With some sectors struggling while others are growing, the working group believes policymakers should focus on how they can support workforce reallocation through retraining, reskilling and upskilling of workers. Skills' adjustments are painful but necessary to address long-term displacements and structural unemployment, by creating new opportunities for workers to move to higher paying jobs. The existing framework to address skills mismatch is currently within the EI system – but the working group is uncertain if that is the right system for the future. Existing training programs may need to be repurposed for this effort. For example, the working group highlighted that the Canada Training Benefit announced in the 2019 budget may be a good fit to adapt quickly to the current situation. Some of the most successful models for retraining have involved partnerships between business and government.

At its next meeting, the working group will dive into some alternative transitional solutions.

Members of the Household Income and Credit Support Working Group include:

Michael Horgan (Working Group Co-Chair), Senior Advisor, Bennett Jones LLP and former Deputy Minister of Finance, Government of Canada.

Kathleen Taylor (Working Group Co-Chair), Chair of the Board, Royal Bank of Canada.

Don Drummond, Stauffer-Dunning Fellow and Adjunct Professor, Queen's University.

Luc Godbout, Professor and Director of the Chair in Taxation and Public Finance, Université de Sherbrooke.

Brian Kingston, Vice President, International & Fiscal Issues, Business Council of Canada.

Alexandre Laurin, Director of Research, C.D. Howe Institute.

Parisa Mahboubi, Senior Policy Analyst, C.D. Howe Institute.

Janice McKinnon, Professor, University of Saskatchewan.

Kevin Milligan, Professor, University of British Columbia.

Mike Pedersen, Chair of the Board, Business Development Canada.

Bill Robson, President and Chief Executive Officer, C.D. Howe Institute.

Tammy Schirle, Professor, Wilfrid Laurier University.

Lara Speirs, Executive Vice President & Public Affairs General Counsel, Randstad Canada.

Intelligence MEMOS

From: Rodney Dobson

To: Diane Lebouthillier, Minister of National Revenue

Date: May 27, 2020

Re: **How to get governments real-time pay information**

Payroll information has never been more important, or fluid, than during the current pandemic.

Managing the Canada Emergency Response Benefit (CERB) and the new wage subsidy program have underlined for Ottawa that it needs new ways to move information from business to government, especially real-time payroll data.

The flow of this information from business to government is vital for the operation of a wide range of programs including tax withholding at source and Employment Insurance, and now for income replacement. It matters a lot to all Canadians and it must work smoothly. Great care needs to be taken to avoid further complicating a process that is already difficult for both employers and employees.

In Canada, a successful Human Capital Management (HCM) industry operates in the space between business and government. Engaging with the wide variety of software providers and business services that manage payroll processes in our complex federal system would be a good way to begin a constructive dialogue.

Much of the opportunity lies in the fact that there is digital payroll data for the bulk of Canadian workers, including the half of all private-sector employees who are paid through such business services today. Ottawa could get pay information now if protocols were put in place to retrieve it securely when required to service a request for benefits.

Investment would be required to support new processes, but far less than any attempt to build a new data repository from scratch, which seems to be an option under consideration for federal access to real-time pay information (the "e-payroll" initiative).

Building on the current HCM industry, a truly effective distributed solution would enable access to the relevant information for all workers, which government could access when needed. Standards could easily be set for a simple central repository that identifies where information is located and manages security. Pay information would be retrieved only when a benefit is requested.

Historically, governments have outsourced much of the administrative tasks for key programs to business. In the case of Employment Insurance, for example, employers are required to pre-process an employee's pay history and present it within prescribed times and in certain formats and coding. This has frequently been the source of a great deal of work and error for both business and government, and delay for the worker seeking benefits. Allowing business to simply provide raw pay history in a digitized format, to which a government could apply its rules to administer various programs, would result in a much-improved administrative environment for all parties.

Information could be managed online or gathered electronically when requested. HCM service providers could provide this function, and software vendors could develop their own compliant systems. The impact on small employers would need special consideration to avoid adding further complexity to a group with limited administrative resources. Self-employed persons could provide information directly when they present a claim.

Importantly, business would continue to have competitive options and service level commitments from a choice of vendors.

The suggested approach would avoid significant issues with an alternative approach using a central data repository of all pay data.

First, it would be significantly simpler and faster to implement. Data would be maintained in only a single location which already exists (the employer's pay history database), and the massive continuing effort to report and synchronize pay history with an external centralized database (yet to be created) would be avoided completely.

Second, it would avoid the significant new data privacy issues that arise from any consolidated government database with detailed employee pay history. Employers are already required to maintain this information securely, and government already has authority to use it when required for program administration.

Third, it would respect the fact that business works to deadlines, and records are not necessarily updated until required. Employers could be given the opportunity to review information before processing, eliminating a potential source of error and delay.

The Liberal platform last year promised "lower costs, less red tape" for business as part of its plan to introduce an e-payroll system. There is an opportunity here to significantly move in this direction by re-thinking the business/government interface in our digital world.

Rodney Dobson was president of the Canadian human capital management industry leader and held executive roles with global organizations in Europe and Asia.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Stéphanie Lluis

To: Canadians Concerned about the Labour Market

Date: May 28, 2020

Re: **Lessons from Employment Insurance for the CERB**

The Canada Emergency Response Benefit (CERB) was designed as an emergency measure to offset the income losses of millions of individuals following the COVID-19 outbreak.

It has been effective in providing financial support to many individuals and families quickly through the Canada Revenue Agency system. But in the longer run, CERB is not affordable and raises issues of fairness and work disincentives that may impede economic recovery.

With the gradual re-opening of the economy and the rollout of the Canada Emergency Wage Subsidy, an increasing number of CERB recipients will have opportunities to return to their previous work or to new jobs, but what type of jobs and work arrangement will be available (full/part-time, hourly, temporary casual or contract) is still uncertain.

Existing tools of our income maintenance programs can be used to facilitate the transition for workers out of CERB into the labour force. The unemployment insurance system of most developed countries allows individuals to collect benefits while engaged in part-time work.

In Canada, it is administered by the Working While on Claim (WWOC) program of the Employment Insurance (EI) system. In normal times, working while on claim is a common activity among EI benefits claimants; 42.5 percent of male claimants worked at least one week during the length of their claims and 46 percent of female claimants did. The shares of claimants with an episode of working while on claim are relatively similar across all age groups and industries in the 30-50 percent range. For seasonal industries, the rate is 57.9 percent.

What did we learn from the WWOC program's ability to promote work incentives? Typically, an individual can work and earn up to a certain amount of allowable earnings (the disregard) with no reduction in benefits, but earnings beyond this threshold will reduce the benefits the individual is entitled to receive (applying a clawback rate). The magnitude of the benefits reduction, the partial benefits and number of part-time hours depend on the clawback rate. Under the current parameters of CERB, the disregard is set at $1,000 and the clawback rate is rigid – the first dollar earned from work past $1,000 reduces CERB benefit to $0.

Fifteen years of experimentation with the WWOC parameters of the EI program has consistently demonstrated that WWOC is effective in encouraging the take-up of part-time/short-hours work. In 2005, the allowable earnings provision for working while on claim increased from $50 to $75 per week or 40 percent of a claimant's weekly EI benefits. Earnings above would be reduced by a dollar with each additional dollar earned (100 percent clawback).

In 2012, new provisions were introduced to clawback EI benefits by 50 cents for each dollar earned up to a threshold of 90 percent of a worker's insurable earnings for EI. After this threshold, EI benefits would get clawed back at a rate of 100 percent.

The main conclusion from these pilots was that increasing the disregard leads to higher incentives to accept work and report earnings up to the threshold of allowable earnings, thereby increasing the take up of short-hours part-time jobs but not beyond the disregard due to the clawback rate.

A reduction in the clawback rate from 100 percent to 50 percent induces claimants who work while on claim to take up jobs with more hours.

There is no consistent evidence on the ability of the WWOC program to enable a permanent return to work in Canada, and results are mixed from a few empirical studies in other countries.

Potential barriers to the take up of part-time work for CERB recipients may be a low level of earnings exemption and/or the lack of availability of jobs/hours with earnings around the set disregard level.

This will be especially the case since the labour market impact of COVID-19 have been strongest for hourly wage jobs and services industry work that typically offer part-time/short hour earnings.

How beneficial would it be for the WWOC feature of EI to be ported over to the CRA for administering an income-tested modified CERB?

With an individual-based EI account system, it would be possible to condition the benefits on the history of employment, unemployment and working while on claim (receiving partial benefits).

Individuals with multiple spells of working while on claim (frequent or repeat users) could receive different benefits relative to those working while on claim for the first time.

In sum, this would have two main benefits: In the short-run, it would help support the proposed extended CERB system, encouraging part-time work (with careful parameter settings). In the longer run, it may improve the EI system to allow a more targeted approach to providing insurance while maintaining work incentives.

Alvarez-Parra and Sanchez (2009) offer many insights to optimizing the unemployment insurance system when individuals receive partial benefits and engage in part-time work (whether doing so legitimately or not).

Their key recommendation – that EI benefits be adjusted to unemployment duration as well as the history of working while on claim – offers a way to optimally adjust the trade-off between working part-time and receiving partial benefits and searching for full-time employment.

Stéphanie Lluis is associate professor of economics at the University of Waterloo.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Lori Sterling

To: Canadian Businesses and Governments

Date: June 4, 2020

Re: **The Next Phase of Economic Recovery, Part Two: Reforming Pandemic-Related Programs for Business**

This memo examines certain pandemic-related business programs, and is a companion to a review of individual support programs. The overarching goal of the recommendations is to tailor these programs to the needs of business and eventually, to end these emergency measures. In particular, it is recommended that wage and commercial rent subsidy programs be modified and the interest-free small business loan program be brought to a close.

The Canada Emergency Wage Subsidy (CEWS) program is a generous wage subsidy program for business. The Canadian government pays 75 percent of lost wages up to a maximum of $847 per employee per week. This is approximately $167 less than the January 2019 average Canadian weekly wage.

CEWS has a requirement of 30 percent lost revenue except for the month of March which has only a 15 percent threshold. The first recommended modification to this program is to adopt the approach used in the Netherlands, which is a sliding scale for eligibility based on the extent of lost revenue. The sliding scale wage subsidy ranges from 20 to 90 percent, depending on business loss. Canada need not go as high as 90 percent replacement, but it should institute a more nuanced approach.

At present, an employer contribution is voluntary. As the economy recovers, the government should consider making at least some portion of the employer contribution mandatory. The U.K., for example, recently announced an extension of their furlough support system, and will require employers to contribute to the cost.

The current end date of CEWS is August 29. The uptake up of this program has been limited. If the program is modified and participation remains low, then the deadline could be extended to match the end date of the individual unemployment benefit, the Canada Emergency Response Benefit (CERB). The rationale for this extension is to encourage employers to keep employees at work rather than lay them off.

The **Canada Emergency Commercial Rent Assistance (CECRA**) program assists commercial landlords and tenants, but only opened for applications last week. Under this program, tenants pay 25 percent of the rent, landlords forego 25 percent and the government subsidizes the remainder. Although it is difficult to assess this program without data on usage, three modifications should be considered.

First, rather than requiring the tenant lose 70 percent of more of their business revenue before becoming eligible, the government should allow a broader sliding scale approach. The tenant contribution should increase, and replace the government subsidy, as business resumes. For example, with a 60 percent loss of business, the tenant could pay 40 percent whereas with a 90 percent loss of business, the tenant could pay 20 percent of rent.

Second, the end date of June 30 for this program should be extended, especially for businesses that still cannot open. In Ontario, for example, this date penalizes businesses such as those that provide personal care or restaurants that have yet to fully open.

Last, CECRA is dependent on voluntary participation by the landlord. Some provinces have prohibited evictions even without landlord participation. In the event there are few applications from landlords coupled with high eviction rates, the government could incent greater participation by lowering the landlord contribution.

The **Canada Emergency Business Account (CEBA**) is both popular and expensive for the government. Since April 9, small business can apply online for funds. The maximum loan is only $40,000 but it is interest-free and $10,000 will be forgiven if the remainder is paid by the end of 2022. CEBA should conclude by the end of the summer given that it is a one-time loan that has existed for some time and businesses can continue to apply for loans under programs discussed below.

Another program that should be re-assessed is the $962 million in the **Regional Relief and Recovery Fund (RRRF)**, administered by regional development agencies. The program is for rural business, culture, heritage, tourism and anyone who cannot access other funds. Given the size of this fund, the absence of detail about eligibility and the catchall nature of its purposes, the government ought to provide more transparency about this program.

In order to enhance access to short-term credit, the government co-funds and provides guarantees through the **Business Credit Availability Program (BCAP)**. The $40 billion set aside for small and medium enterprises has the benefit of partnering with private financial institutions who will perform due diligence and assess risk. For large businesses hardest hit by the pandemic, the **Emergency Employer Financing Facility (LEEFF) program** will provide bespoke loans with no cap but significant restrictions and oversight.

There is no publicly announced end date for BCAP and LEEFF programs, and negotiation of these loans is ongoing. These programs should be extended into fall for several reasons: financial due diligence is being carried out before a loan is made; there are no outright government grants; interest is charged; and business needs will change as the economy recovers. However, if default rates spike, the government should re-assess eligibility for these co-funded programs.

Lori Sterling, a former federal deputy minister of labour, is senior counsel at Bennett Jones.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Mike Veall

To: Bill Morneau, Minister of Finance

Date: June 5, 2020

Re: **Freezing EI Premiums**

The federal government has, in your words, "no plan to raise taxes." This should extend to Employment Insurance (EI) premium increases as well.

When the Canada Emergency Response Benefit (CERB) and the Canada Emergency Wage Subsidy (CEWS) are gone, EI will again be the main federal government income support program for workers. And as CERB delayed but did not reduce pre-CERB EI eligibility, pending EI obligations are very large.

The EI plan is fully funded by premiums and is required to break even over seven years. The EI account was in good shape entering the COVID-19 era, but that won't last long with current employment rates. Its shortfall will be worse if any CERB payments will be charged to it, as seems possible under the recent amendments to the *Employment Insurance Act* in Bill C-13 that created CERB. And under current rules, an EI account deficit automatically triggers premium increases.

The law now limits the increase in January 2021 to five cents for employees, from $1.58 to $1.63 per $100 in earnings, and a seven-cent increase on employers, from about $2.21 to about $2.28. With no freeze, that increase can be projected to click in every year for the foreseeable future. It is the wrong signal to send when the focus should be on the creation of permanent, full-time jobs.

The most recent evidence from Canada suggests that employer payroll tax increases are passed on by employers to employees as reduced wages with little effect on employment. (The authors actually exclude "social contributions" such as EI premiums from the employer payroll tax effects they study, but it seems very likely that EI employer premium effects would be similar.)

Their estimates imply that during 2001 to 2011 an increase in EI premiums was almost entirely borne by the employee, with the employee share paid directly and the employer share passed through. An EI premium increase would essentially be the same as the tax increases that you have indicated that your government is not planning, and would disproportionately affect the incomes of low and middle earners. Their marginal tax rates, including direct and passed-through payroll taxes, already can be as high as those for more affluent workers who pay no EI premiums on much of their earnings because of the program's cap, $54,200 this year.

However, in the current unprecedented situation, with negative or very low inflation, employers may not be able to pass through an EI premium increase by just delaying wage increases, which could require wage cuts, which might in turn have negative morale and productivity effects. Firms may therefore choose not to pass through. However, that makes labour more expensive.

While from different institutional contexts, the results from one recent paper for Sweden and another for the US suggest higher premiums could lead to less employment. EI premium increases, actual or anticipated, may be job killing.

One solution would be to increase premiums (without increasing benefits) for high-income workers, but not for low to middle-income workers or firms. A better alternative would be to transfer general revenue to the EI account, the opposite of what happened during the 1996 to 2010 period when $57 billion was transferred the other way.

The government will already be in effect borrowing money to keep EI afloat. Borrow a small percentage more to freeze EI rates. Send the signal that the priority is job creation, not just income support.

Mike Veall is Professor of Economics at McMaster University and Director of the Productivity Partnership.

Intelligence MEMOS

From: Janice MacKinnon

To: Policymakers in Ottawa

Date: June 12, 2020

Re: **The CERB Decision: Reform or Replace?**

The Canada Emergency Response Benefit (CERB) begins to wind down next month, and the government must decide what happens to its most popular, and expensive, income support measure.

There are two possible paths: either the CERB – reformed to meet its shortcomings – continues, or existing programs – expanded and made more flexible – address the needs for the hundreds of thousands of dislocated workers who will still need its $2,000 a month.

CERB was an emergency program designed to get money quickly to recipients, which created many structural problems.

And the lack of screening for the program opened the door to fraud; the government has established a mechanism for complaints about fraud and is proposing steep fines and even jail time for offenders.

Also, the inequities created by the fact that the wages of some essential workers are lower than the CERB benefit caused governments to top up the wages of lower-income essential workers and remains an issue for employers.

And still unaddressed is the unpleasant surprise awaiting some CERB recipients who applied without understanding that it will be considered income, which will reduce other income tested benefits.

The federal government proposes to address the disincentive to work resulting from the size of the benefit by requiring recipients to return to work when requested, to re-open businesses when reasonable and to accept a reasonable job offer.

But there is no incentive for workers to return to work. In fact, it can be argued that the proposal to reduce the monthly amount of other income that can be earned by CERB recipients from $1,000 to $500 lessens the incentive to work.

As well as its many shortcomings, the CERB is expensive, costing more than $42 billion in 12 weeks.

A phase-out for CERB therefore seems the sensible course. Other programs can provide more targeted assistance, encourage a return to work, reward those in low-wage jobs and provide funding to retrain unemployed or underemployed people.

Canada has a robust social safety net that includes many targeted programs that can easily be increased when additional support is needed. Seniors are covered by the Canada Pension Plan, Old Age Security, and the Guaranteed Income Supplement, which can be expanded to provide additional support for low-income seniors, as has been done in the past.

Low-income families are supported through the Canada Child Benefit, which can also be easily increased, as has occurred previously. Also, the Childcare Expenses Deduction can be increased and expanded to cover additional forms of childcare to provide support for families and facilitate returns to work.

Also, the criteria for accessing Employment Insurance (EI) and the level and duration of benefits could be expanded so that more unemployed could use the program. Changes of this kind could be made temporary with a commitment to end them as the economy improves to avoid a permanent increase in premiums.

To help workers transition from struggling sectors of the economy to growing ones, the federal government should expand training programs like the Canada Training Program, which provides financial assistance to workers to upgrade their skills. Since training offered by governments or educational institutions can be slow to respond to changing labour markets, the government should develop business-government partnerships whereby both help fund job training for growing sectors.

An important program to encourage a return to work is the Canada Workers Benefit (CWB), a refundable tax credit that tops up employment income for low -income earners and increases as workers earn more.

The program provides a financial incentive for unemployed low-income individuals to enter and remain in the workforce and it can incentivize moving from part-time to full-time employment since the value of the benefit increases with income. It would be especially useful to those who worked in sectors that are not recovering, and who need to find jobs elsewhere. The CWB could also be ramped up to dovetail with the scaling back and phasing out of the CERB.

Using these programs in an emergency highlights Ottawa's lack of adequate up-to-date data. For instance, the CWB benefit is based on the previous year's net income, and there are also data problems with EI. Accessing real-time data is essential for the government to strengthen programs like EI and CWB.

Emergency programs like CERB were put together quickly in response to the economic shutdown. Now is the time to tune up our existing programs for COVID-19 use and for future emergencies.

Janice MacKinnon is former Minister of Finance and Social Services in Saskatchewan.

Crisis Working Group Report: Household Income and Credit Support

Communiqué #9: Ottawa should Rethink Bill C-17, and Use CERB Extension Time Wisely

To help Canadian governments confront the public health and economic crisis resulting from the spread of COVID-19, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The Working Group on Household Income and Credit Support is co-chaired by Michael Horgan (Senior Advisor at Bennett Jones LLP and Former Deputy Minister of Finance, Government of Canada) and Kathleen Taylor (Chair of the Board at Royal Bank of Canada) and supported by a group of Canadian business leaders and economists. The group's most recent meeting was held on Tuesday, June 16, 2020.

In the meeting, working group members assessed the amendments to the *Canada Emergency Response Benefit (CERB) Act* in Bill C-17 entitled "an Act respecting additional COVID-19 measures," and reached two conclusions: First, the group generally agreed that proposing imprisonment as a penalty for those who have committed CERB fraud is neither justifiable nor constructive in the current circumstances. Second, the group observed that making it a requirement that workers "go back to work when it is reasonable to do so" in order to maintain eligibly for CERB is far too vague. In order to be workable, the requirement needs significant clarification on what reasonable means and how it will be verified and implemented.

The working group also identified the need for: (i) introducing training support benefits to assist CERB recipients transitioning to work during a staggered re-opening across the country, (ii) measuring and managing uncertainties to improve decision-making by households, and (iii) increasing coordination with provincial governments to ease the transition back to work and in safe premises.

Bill C-17: Amendments to the *Canada Emergency Response Benefit Act*

Amendments to the *Canada Emergency Response Benefit Act* include, among others:

- enhancing the administration and enforcement of the *Act* by considering penalties including imprisonment as punishment for a CERB recipient who was ineligible and deliberately takes advantage of the system; and

- requiring a worker to return to work when it is reasonable to do so and to accept a reasonable job offer.

In regards to the enforcement of the *Act*, the working group noted that the government had decided not to provide strong and clear messages from the beginning of the CERB to prevent fraud, instead opting for broad and speedy adoption by as many Canadians as possible. Given that stance, the group, which welcomed more disciplined management of the program, argued that including imprisonment as a penalty retroactively is neither justifiable nor constructive for a number of reasons.

First, when the government announced the CERB, there was no clarification on the consequences of misusing the system, other than requiring ineligible recipients to repay CERB benefits after verification. Although it is necessary to consider penalties to address issues with fraud, the working group agreed that imprisonment is excessive and that if considered necessary, should be considered only for new applications and serious abuse. Second, the group agreed that the consequences of committing CERB fraud in terms of severity should be in line with those the Canada Revenue Agency applies for tax fraud. Third, the group noted that applying severe penalties to programs such as CERB can have unintended consequences, such as a chilling effect on the decision of an eligible worker to apply for the program for fear of making mistakes.

Although the working group approved the need for requiring the CERB recipients to return to work or accept a job offer, it identified that the use of the term "reasonable" in both cases is too vague and requires a clearer definition. The government needs to define what reasonable means and make clarifications on which parameters a worker needs to consider in reapplying for CERB versus returning to work. The group also discussed what type of infrastructure is going to be required to support the effective management of the CERB. The group concluded that the answer to these questions largely depends on the duration of CERB program.

The Need for Training Benefits

The government has announced the CERB program will be extended for another eight weeks. Although more details are yet to come, it is very unlikely that the program will include any training benefits to support CERB recipients transitioning back to work through retraining, reskilling and upskilling. The working group highlighted the need for rolling out such a training benefit program to provide opportunities for CERB recipients and tackle the issues of long-term displacements and structural unemployment.

The working group highlighted that the Canada Training Benefit (CTB) announced in the 2019 budget may be a good fit to adapt quickly to the current situation with some modifications. The CTB is designed to serve eligible workers (ages 25-64) at a rate of $250 per year, up to a lifetime limit of $5,000. The working group suggested considering the roll out of such a program at a realistic rate to address long-term displacements and structural unemployment during the current crisis. Working group members also noted that some of the most successful models for retraining have involved partnerships between business and government.

Managing Uncertainties to Improve Decision-Making

Although the working group recognized that the federal and provincial governments face many uncertainties that can affect their decisions and approaches to reopening of the economy, members highlighted the need for managing those uncertainties to improve decision-making among Canadian households. This means that governments need to identify potential scenarios and specify with more lead-time their plans on how to resume economic activities and schools and support Canadians under various circumstances.

For example, provincial governments, such as Ontario, need to clearly state their criteria for, and approaches to, re-opening schools in September, and openly communicate the details of their plans under potential situations with families and educators well in advance of a relaunch. Planning, however, requires gathering more data and identifying best practices based on other jurisdictions' experiences with the re-opening of schools in the past couple of months.

Roles of Provincial Governments and Ottawa in Supporting Re-opening

Working group members noted that the extension of CERB is useful for parents who are unable to go back to work for reasons related to child-care responsibilities, particularly due to lack of child-care options such as summer camps. However, the working group called for support from provincial governments to ease re-opening of the economy and supporting parents as they go back to work. Similarly, the extension of the CERB for initial applicants through to September gives Ottawa time to update its administrative architecture for Employment Insurance to ensure it can handle a surge in applicants at that time.

Unlike restricting economic activities, re-opening businesses takes more time due to extensive planning and investments. It also requires a high degree of coordination between provincial governments and

business owners to ensure that appropriate infrastructures, particularly in regards to child care, is in place to support reopening.

For example, the government of Ontario recently announced allowing the re-opening of child-care centers. While this was a welcome move, industry participants have commented that the announcement came before broad engagement with operators and without giving them access to appropriate financial and infrastructure support to allow them to open in accordance with new guidelines. Moreover, given strict rules designed to ensure the safety of children and staff, existing child-care infrastructure will be insufficient to support the full range of families in need of child care, requiring additional government support and involvement to address the gaps.

Members of the Household Income and Credit Support Working Group Include:

Michael Horgan (Working Group Co-Chair), Senior Advisor, Bennett Jones LLP and former Deputy Minister of Finance, Government of Canada.

Kathleen Taylor (Working Group Co-Chair), Chair of the Board, Royal Bank of Canada.

Luc Godbout, Professor and Director of the Chair in Taxation and Public Finance, Université de Sherbrooke.

Brian Kingston, Vice President, International & Fiscal Issues, Business Council of Canada.

Alexandre Laurin, Director of Research, C.D. Howe Institute.

Parisa Mahboubi, Senior Policy Analyst, C.D. Howe Institute.

Janice McKinnon, Professor, University of Saskatchewan.

Mike Pedersen, Chair of the Board, Business Development Canada.

Bill Robson, Chief Executive Officer, C.D. Howe Institute.

Tammy Schirle, Professor, Wilfrid Laurier University.

Lara Speirs, Executive Vice President & Public Affairs General Counsel, Randstad Canada.

Intelligence MEMOS

From: Stéphanie Lluis

To: Canadians Concerned about the State of the Labour Market

Date: July 2, 2020

Re: **Regional Differences in Job Growth Shows Ottawa Must Think Regionally**

The massive and sudden drop in employment caused by the pandemic has been followed by uncertainty about when, where, and how quickly the economy is re-opening.

Collectively, these factors create a coordination problem in the labour market. This skews job losses in many parts of the country towards part-time workers, and the design of the Canada Emergency Response Benefit (CERB) further amplifies this part-time work disincentive. Governments need to address this.

The Canada Emergency Wage Subsidy (CEWS) program can help address the issue. Previous research shows that a policy that offers firms wage subsidies for new hires can bring the economy out of a low-employment rut. Financial support to overall payroll expenses allows firms to rehire workers who would otherwise remain laid off. This can be self-sustaining because when all firms rehire, the resulting rise in household incomes generates demand for goods and services, which supports employment.

EI's work-sharing program, which has been adapted to address the current situation, is also useful as it enables employers to adjust their production and work arrangements to the reduced capacity required to operate under the strict COVID-19 safety restrictions. Yet, the CEWS has seen little take-up compared to the CERB.

The re-opening restrictions impose reduced capacity, which means businesses are limiting hours and/or employees. As the economy re-opens, therefore, available jobs are not going to be equally attractive in terms of work conditions, work schedule, and pay. This means unemployed job seekers on CERB may prefer to wait for better and safer job opportunities.

Currently, CERB discourages individuals to take up any part-time work that pays more than $1,000 a month because recipients lose their entire $2,000 monthly benefit at the first employment dollar earned beyond $1,000. This puts additional constraints on employers trying to hire at part-time hours and take advantage of the CEWS and/or the EI work-sharing programs.

Some economists have suggested CERB be modified to allow recipients to work more hours and earn more without losing all their benefits. This feature exists in the Working While on Claim program of EI and in many income support programs in other developed countries. There is evidence in some of these nations that subsidize short-hour/low-earning jobs, that encouraging part-time employment can help an unemployed worker find more stable employment, especially among the long-term unemployed.

Working While on Claim is designed to provide work relief as an alternative to public assistance or loans to individuals and firms as they navigate the economic hardship of recessions. Indeed, part-time employment typically increases during economic crises since it offers businesses the flexibility needed to adjust to business cycle fluctuations.

For example, part-time jobs in Canada grew by 25 percent during the financial crisis (November 2008-May 2009) while full-time employment dropped by more than 27 percent, resulting in a 17 percent decline in total employment. On the demand side, this may come from the fact that a higher share of full-time employees is more strongly affected by the cycle. On the supply side, in an environment of falling economic activity and/or rising unemployment, workers may be more willing to consider part-time work as an alternative to their preferred labour supply choice of full-time employment.

The May jobs report from Statistics Canada indicates some employment rebounds with variations by sector and province showing that the province of Quebec accounts for 80 percent of the employment gains. Did the employment gains affect full-time and part-time jobs similarly?

Figures 1 and 2 show a mapping of the April to May changes in part-time and full-time employment by economic regions. In Figure 1, employment gains (in blue) with respect to full-time work are spread across the country with the largest gains in Quebec and the Eastern provinces. Only a few regions are still experiencing employment losses (in pink) in full-time work. In contrast, from Figure 2 for part-time work, large employment losses (in red) are still taking place across the country. Except for parts of Western Canada, the region of Northern Quebec and some regions in the Eastern provinces which are seeing large gains in part-time employment, the losses of part-time jobs are large and taking place in all provinces.

Why isn't part-time work picking up as much or even more broadly than full-time work, especially in the regions that re-opened sooner? Is it because the safety restrictions force businesses operating at lower capacity to reduce employee numbers rather than employees' hours? Or are the part-time jobs available but vacant because job seekers are waiting for full-time and safer jobs while remaining under CERB?

Having more regionally disaggregated and timely data would help better understand the behavioural responses coming from CERB on the labour supply side and those coming from CEWS and work-sharing on the labour demand side. From a policy perspective the strong regional differences in part-time employment also suggests that any future modification of CERB in terms of clawback of benefits needs to consider tying the design of income support to the unemployment rate of the CERB recipients' region.

Stéphanie Lluis is associate professor of economics at the University of Waterloo. *Thanks to Ben Dachis and Parisa Mahboubi for useful comments, and the creation of maps to present the results.*

To send a comment or leave feedback, email us at blog@cdhowe.org.

Figure 1

Employment Growth April-May 2020

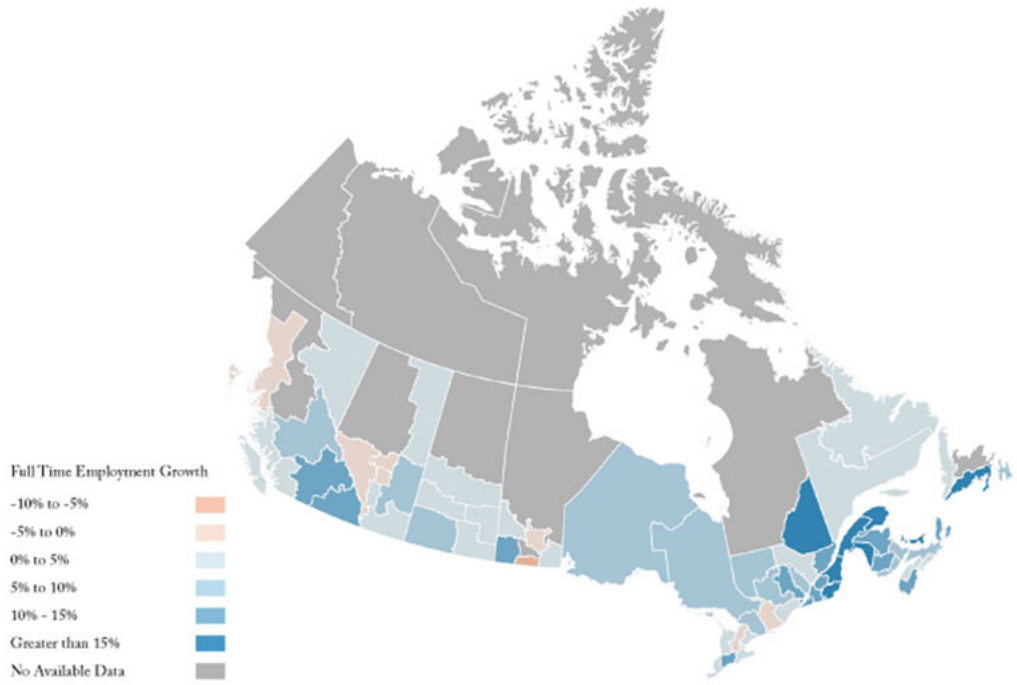
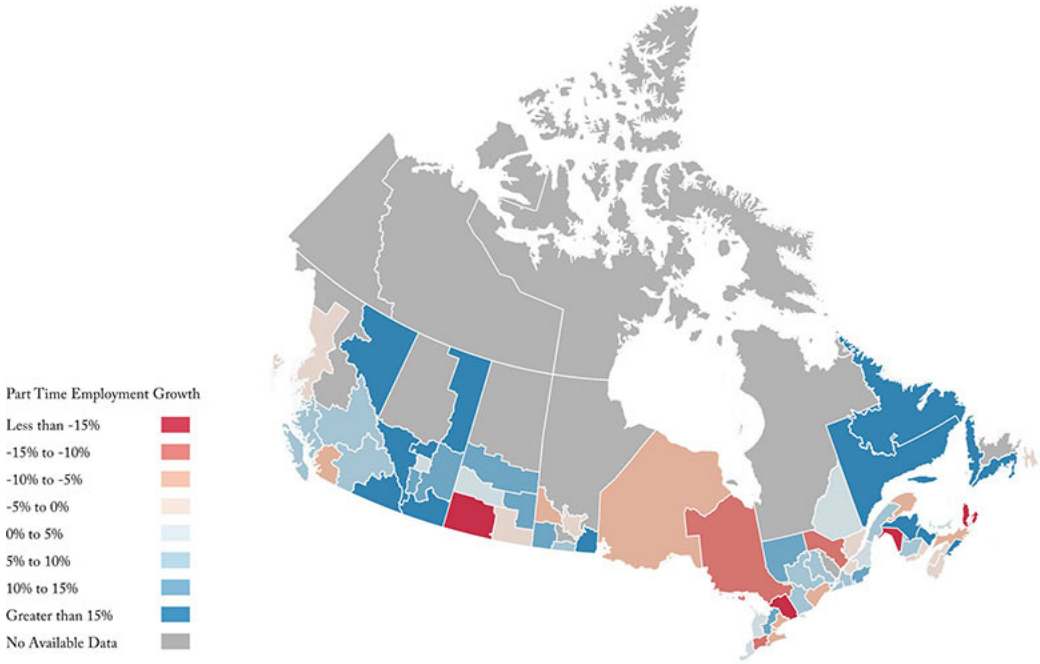


Figure 2

Employment Growth April-May 2020



Source: Master Files of the Labour Force Survey through RTRA – Thanks to Eduardo Zhu for excellent research assistance.

Intelligence MEMOS

From: Stéphanie Lluis

To: Canadians Concerned about the State of the Labour Market

Date: September 17, 2020

Re: **Consequences of the High EI Benefits Floor**

Last month, the government announced new temporary emergency measures – the Canada Recovery Benefit, the Canada Recovery Sickness Benefit and the Canada Recovery Caregiving Benefit – following the end of CERB to extend income support to individuals whose employment and/or income has been affected by the health crisis.

These temporary measures are targeted to specific groups otherwise ineligible for EI benefits. These emergency programs will start on Sept. 27 and remain in force for one year to support Canadians through the next phase of the economy re-opening and clearer paths to the job market.

Another temporary change is the introduction of a benefit floor equal to $400 of weekly EI benefits. Unlike the three measures above, this change applies to all current and potential EI recipients during the upcoming year, which raises interesting issues in the short-run and potentially in the long-run.

Income from the new EI benefits floor implies replacement rates of 190-200 percent of the average earnings of the part-timers laid off in March and April as a result of the lockdown.

Pre-pandemic, the EI system did not define a benefits floor. For the sake of comparison, one could estimate minimum benefits by applying the 55 percent replacement rate to a minimum wage job; assuming a full-time-full-year minimum wage job, the weekly benefits could vary between $257 in Saskatchewan and $338 in Alberta depending on the minimum wage rate of the province. The benefits floor of $400 now implies replacement rates between 65% and 86% for full-time workers as illustrated in Graph 1. When separating full time from part-time work with average usual hours around 17 hours per week for most provinces, the replacement rates more than double. Therefore, while the benefits floor is lower than CERB's $500 in weekly benefits and less likely to compete with full-time minimum wage jobs, it has been set at a level that replaces 190-200 percent of the income of a part-time minimum wage job (between $187 and $255 based on the minimum wage rate and average part-time hours of the province).

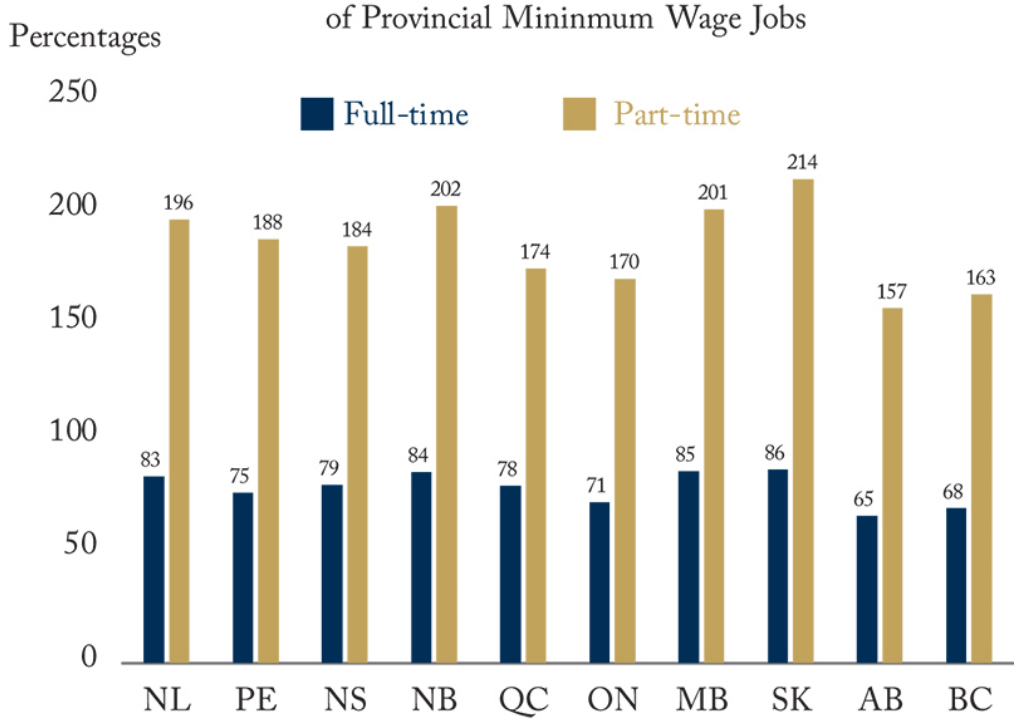
A large proportion of the COVID-19 induced layoffs in March and April were drawn from the bottom of the earnings distribution. Labour Force Survey numbers show that between 20 and 35 percent of the 2.1 million workers laid off in March and April 2020 were working in part-time jobs (Graph 2). There is some variation between provinces, but the Graph shows that the current health crisis has hit part-timers much harder than during the 2008-09 recession from the financial crisis.

The key takeaway is that the changes to EI have created the strongest disincentive to return to work this autumn for the types of workers most likely to have lost their job during the pandemic.

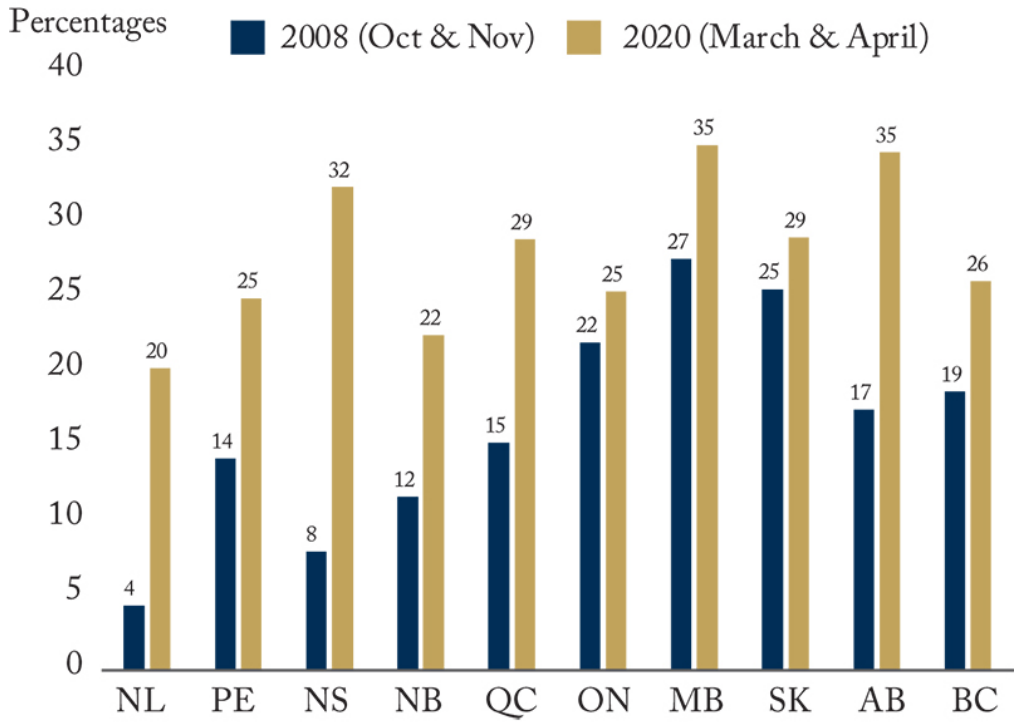
In tomorrow's Memo, we'll address the potential consequences of this disincentive to take on part-time work.

Stéphanie Lluis is associate professor of economics at the University of Waterloo.

Graph 1: EI Benefits Floor Replacement Rates of Provincial Mininmum Wage Jobs



Graph 2: Percentage of Layoffs from a Part-time Job



Intelligence MEMOS

From: Stéphanie Lluis

To: Canadians Concerned about the State of the Labour Market

Date: September 18, 2020

Re: **Consequences of the High EI Benefits Floor (II)**

My memo yesterday showed that Ottawa's recently expanded Employment Insurance (EI) program with a benefit floor of $400 per week will mean replacement income of more than 200 percent for some part-time workers making minimum wage.

What are the potential short-term effects of this high benefit floor? An equation using Labour Force Survey data over the period of January 2018 to February 2020 lets us link hourly wages to employed workers individual and job characteristics, making it possible to predict the earnings of a sample of displaced workers who lost their jobs in March and April 2020.

Graph 1 shows that the average predicted weekly earnings of those who lost a full-time job are well above the EI benefit floor. Average earnings of the laid-off workers who lost a part-time job during the early stages of the COVID crisis (who worked an average of 17 weekly hours) are substantially below the benefits floor.

With the introduction of a benefits floor, one third of the workers who were displaced from a part-time job as a result of the pandemic and are still unemployed by September will have little monetary incentive to return to their old part-time work.

On average, the benefits floor generates a 19-33 percent increase in income from EI benefits over income from employment earnings for an average part-time worker who lost his/her job as a result of the pandemic. While many may be students or older workers approaching retirement, a significant proportion of the part-timers are women (from the LFS data and the sample of displaced workers in March and April who lost a part-time job, 64.8 per cent are women).

The short-term effects of fewer people seeking part-time jobs will have long-term consequences as well. For example, as women are disproportionately likely to be in part-time jobs, they are most likely to not have an incentive to return to such jobs. The wage penalty associated with career interruptions in terms of loss of human capital and accumulated experience can be substantial and for married women, the cost has been increasing in the last 50 years.

A guaranteed minimum benefit may influence the pandemic-induced job reallocation process away from low-paid jobs towards higher paid jobs and reduce poverty coming from job precarity. There is no question that contingent nonstandard employment with low pay and little protection (such as temporary contract work and gig employment) creates poor working conditions. Hospitality and personal services, two sectors mostly affected by the pandemic, are particularly prone to such contingent work. That may be the upside of the move away from part-time work.

Additionally, however, such a change will affect the productive mix of permanent full-time and part-time work desirable to firms and workers.

Part-time work has increased in the last 20 years. The trend persisted after the financial recession in the US and the UK and a similar evolution can be seen in Canada especially among women who are voluntary part-timers, at least until the start of the pandemic.

Of the 2.4 million people who usually worked part-time in February 2020, 77.5 percent did so for noneconomic reasons; more precisely, 73 percent of men and 80 percent of women are in voluntary part-time work. However, part-time work in Canada since the pandemic is showing a slower recovery relative to full-time employment. While this could be the result of seasonal trends, interest in part-time jobs is reflected in the increase in job search for part-time work in the past few months (Graph 2). Consistent with previous observations regarding increasing job search activity since February, the proportion of unemployed on temporary layoffs who lost a part-time job is higher in the last six months of the current crisis than over the equivalent months of the 2008-2009 financial crisis.

Among the unemployed who quit or were permanently laid off as well as among those transitioning back into the labour force for job searching, the percentages looking for a part-time job are also higher relative to the previous recession. The new benefit floor is going to reduce the number of part-time job seekers and potentially increase vacancy rates for this type of employment in the short-run.

In the medium and longer terms, an income support program that sets a generous guaranteed minimum benefit to EI recipients such as the newly introduced EI benefits floor may have an impact on the job reallocation our economies are currently experiencing. EI benefits that are more generous than an average part-time job at the minimum wage may help encourage job search for higher earnings full-time jobs by discouraging workers' uptake of low earnings, short hours and more precarious jobs. It may also induce firms' to rely more heavily on layoffs in a recessionary period.

However, a reduction in the take up and availability of short-hours part-time jobs will also compromise the productive mix of jobs and hours in the economy which can be detrimental to the recovery. It can reduce the effectiveness of other parts of the income maintenance program such as working while on claim aimed at maintaining individuals' labour force attachment while unemployed. It can also impede the recovery of small businesses that more heavily rely on permanent part-time work. The reliance on permanent part-time work is twice as large for small and medium size establishments relative to larger ones. Finally, it will directly affect the joint labour supply decision of households optimizing their work and nonwork hours as well as women who increasingly seek jobs with flexible hours.

Stéphanie Lluis is associate professor of economics at the University of Waterloo.

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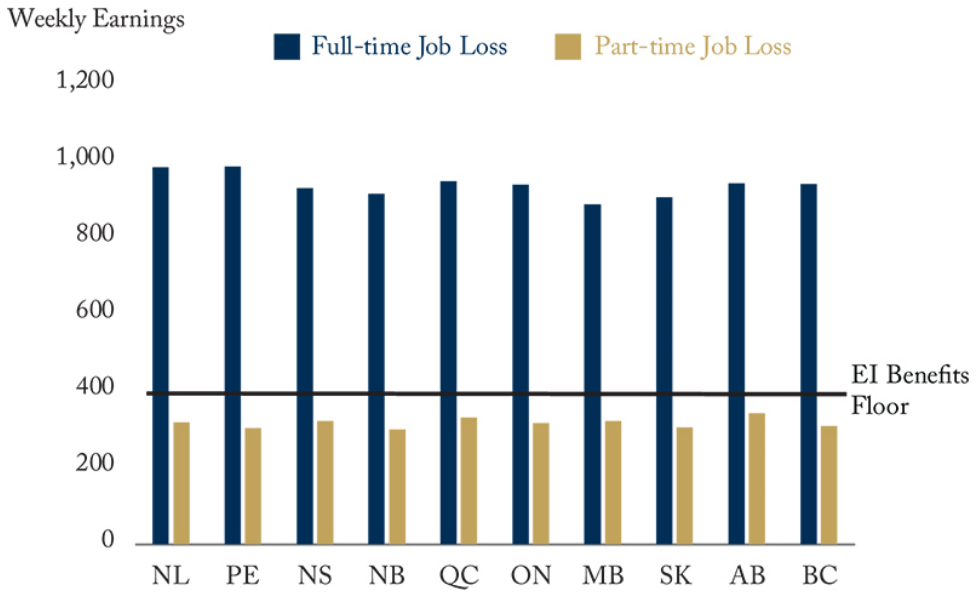
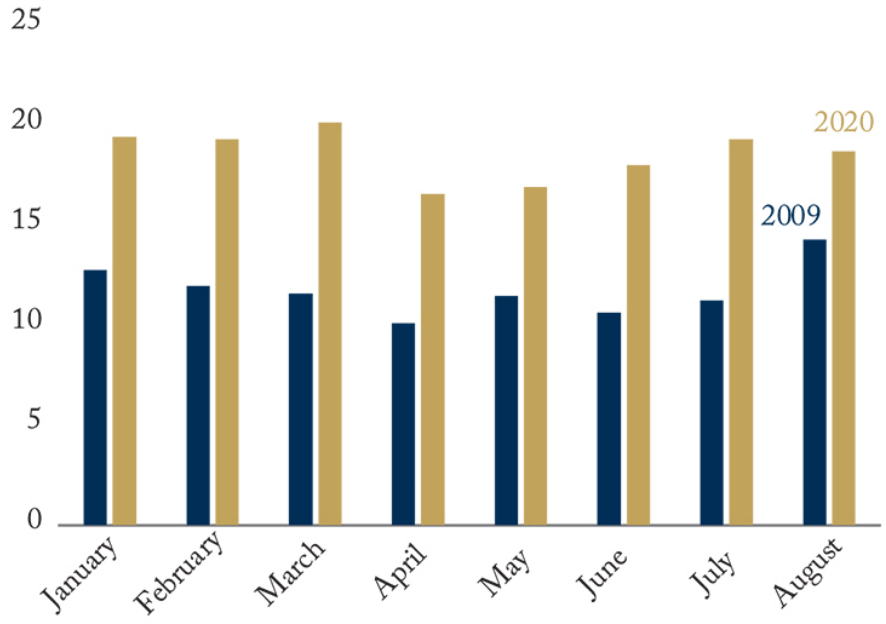
Graph 1: Predicted Earnings of Those Laid-off due to COVID-19



Graph 2: Percentage of Unemployed Laid-off from or Searching for a Part-Time Job, 2009 and 2020



Notes: Sample of unemployed on temporary layoff and job seekers transitioning from work and individuals entering unemployment and job search after a period spent out of the labour force.

Theme 4:

Other Tax and Household Supports

Intelligence MEMOS

From: William B. P. Robson

To: Canada's Governments

Date: March 16, 2020

Re: **COVID-19: How Canada's Governments Can Really Help**

Actions and promises of more from policymakers last week and over the weekend gave Canadians badly needed signs that elected leaders and officials are working to limit the impact of COVID-19 on their health and their economy.

An emergency interest-rate cut from the Bank of Canada, and its announced new facility to support short-term credit, will help. Relaxed capital standards to facilitate bank lending from the Superintendent of Financial Institutions are also welcome. The federal government has announced some targeted spending, and plans to make credit available through Crown lenders. Finance Minister Bill Morneau has promised more fiscal measures shortly.

Helpful though these moves and announcements are, the economic repercussions from COVID-19 threaten to exacerbate the coronavirus's direct impact on people's health, and magnify the inevitable interruptions of travel and trade. Prudence and fear of contagion are keeping people away from hotels, restaurants and entertainment venues. If slower sales and payments ricochet through the economy, businesses struggling to come up with cash will buy less and pay more slowly – a vicious circle.

At the same time, the pandemic is confronting people, at home and in the workplace, with top-of-mind challenges. How to take care of kids when schools and other facilities are closed? How to protect employees and customers? How to balance these new demands with a schedule already packed with demands for time and attention: things to read; decisions to make; deadlines to meet?

Governments seeking to reassure Canadians and help them work through the crisis can help in many ways.

On the financial front, one kind of measure – adopted by other countries – is grace periods for tax collections. Delaying deadlines for collections of HST and GST, for personal income tax instalments – perhaps extending the deadlines for filing personal income tax returns – would ease cashflow crunches and send a vital signal that the federal government understands that these are not normal times. The current front-loading of EI and CPP payroll remittances at the beginning of the year dates from the fight against the federal deficit in the 1990s when interest rates were high. Let's suspend collections until later in the year. The CRA should also lower its interest rate on late payments.

Provinces could likewise delay deadlines and reduce penalties for taxes they levy. They can provide holidays or reduce rates on taxes that apply to sectors that are hurting, such as occupancy taxes on hotels, or are insensitive to people's and business's ability to pay, such as property taxes.

On the regulatory front, governments should do more in a very few areas, and less in many more.

Faster approvals for medical tests and treatments – yes!

Decisive action to limit transmission of the virus – yes!

Cabinet approvals for projects that could help the economy when it needs it – yes!

New restrictions on products, services, business practices – no!

Managers dealing with crises in their businesses – including accommodating employees who are sick, caring for loved ones, or simply fearful – can at least know that things they have been doing for years will not suddenly become illegal.

And the many consultations and invitations to comment that make Canadian governments' approach to regulation-making relatively transparent? Pause those too. OSFI just suspended discussions of new mortgage rules. Federal and provincial health, environmental and labour ministries should follow that example.

For the foreseeable future, the attention of Canada's entrepreneurs and managers will be focused, as it should, elsewhere.

We need flexibility and imagination. A seizing up of the Canada-US border is a threat. What if we temporarily suspended collections of duty and taxes to free resources for protection against disease while easing entry for shipments of goods and returning travelers?

Alongside big central bank moves and talk of billions in fiscal stimulus, addressing the myriad concerns afflicting Canadian families and businesses will mitigate the economic damage from the coronavirus.

Leaders say they feel our pain. Relieving financial stresses, and giving people time and breathing room to deal with other impacts, will alleviate it.

William B.P. Robson is President and CEO of the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Alexandre Laurin and William B. P. Robson

To: Finance Minister Bill Morneau

Date: March 16, 2020

Re: **Crisis Relief for Canadian Savers**

Plummeting stock markets are aggravating anxiety and the potential economic impact of COVID-19. The market crash is worst for older Canadians who rely on savings in registered retirement saving plans (RRSPs) and defined-contribution pension plans, and who are drawing down savings in registered retirement income funds (RRIFs).

Many will now want to save more. So, at the very least, they should not face tax rules that force them to sell when the market is down, permanently lowering their prospects for retirement.

You can help.

Step one is to give retirees a break on mandatory RRIF withdrawals. The current schedule, starting at 5.28 percent of the RRIF's market value as of December 31 of the previous year at age 71, and steadily rising thereafter, was already out of date. Life expectancy is up, yields on safe investments were low and just went lower, and too many seniors risk depleting their tax-deferred saving. Withdrawals for 2020 will be calculated from pre-crash values, which will force drawdowns at a terrible time.

The federal government responded to the 2008/09 crisis with a temporary cut in mandatory RRIF withdrawals. Now would be a good time to suspend them entirely. If permanent elimination is too radical a step, you should simultaneously announce a subsequent one-percentage-point reduction of minimum withdrawals mandated for each age. Retirees will breathe a sigh of relief in the present, and be better off from now on.

Step two is to raise the age at which Canadians must stop contributing to, and start drawing down, tax-deferred saving. The current age of 71 is, like mandatory RRIF withdrawals, already out of date: it discourages Canadians who would like to work and/or save longer, and increases the likelihood that retirees will exhaust their savings in these accounts.

For people close to that age, the market crash is a particular disaster. They may want to work and save longer. You should let them. Raising the age to 73 immediately would alleviate anxiety – and get us to a better place long-term.

A complementary third step would be to raise limits on tax-deferred saving in defined-contribution pension plans and RRSPs for all participants. Those limits are also badly out of date. They presume that the cost of providing a dollar of income in these plans is nine times the rate at which benefits accrue in a typical defined-benefit pension plan. But increases in life expectancy and lower yields on safe investments have dramatically increased the cost of providing a dollar of income in retirement. A more realistic equivalency measure would now be around 15, which would raise the limit for contributions to these plans from the current 18 percent to 30 percent of income.

That recommendation will grate on people who see tax-deferred saving as a perk for the rich. So it is worth mentioning that the defined-benefit pension plans enjoyed by members of Parliament and other federal employees involve much more tax-deferred saving than that. And being tax-backed, those plans automatically protect their participants from market crashes or anything else that might threaten their lifetime incomes. Mandatory drawdowns and age-related dollar limits on saving do not affect them. These are measures to help everyone else.

One final point in favour of these moves is that they fit perfectly in a framework of responding to the crisis with decisive moves that do not threaten the government's long-term fiscal framework. The taxes deferred in RRIFs, RRSPs and pension plans are just that: deferred. Money the government does not collect in 2020 will be due in 2021 and beyond. The fiscal stimulus is temporary. The relief to seniors would be immediate.

The market crash threatens to exacerbate the distress and economic damage from COVID-19. Older Canadians are hurting. You can help.

William B.P. Robson is CEO and Alexandre Laurin is Director of Research at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Tammy Schirle

To: COVID Response Policymakers

Date: March 19, 2020

Re: **The Next Piece of the Puzzle**

For policymakers, the COVID-19 crisis is like a puzzle. But it's a puzzle whose pieces are changing shape every day, with new pieces added and dire consequences if they don't solve the puzzle quickly.

The announcements yesterday by the federal government offering support to families and businesses have helped piece together a large part of that puzzle, but more work is clearly needed.

The income supports are targeted. For those with children, families can receive up to $300 per child per month in support from the Canada Child Benefit expansion (adding to the current CCB, which is set at $553.25 for children under 6). Families and individuals who received the GST Credit will also see a boost, and new benefits will be available through the Emergency Care Benefits (for those quarantined, in self-isolation, or caring for kids out of school but ineligible for EI sickness benefits) and the Emergency Support Benefit (which will target the unemployed who may not have the hours required to be eligible for regular EI benefits).

As a package, this is one of the quickest ways to offer targeted support to individuals and families whose incomes are affected by the crisis. And beyond the well-being of individuals and their families, it is also important for supporting consumer demand and maintaining the confidence of Canadians. It is vital that people know our social safety net is working, and will break their fall.

But gaps will remain, and some gaps will be harder to fill.

We need to listen to the non-governmental organizations and others who are already working with those not supported by the existing social safety net. The federal announcements on Wednesday included additional support for women's shelters and sexual assault centres, which might expect increased demand for services as uncertainty and loss result in greater stress for families.

But more general support is needed for the organizations serving those most in need – food banks seeing increased short-term demand among families losing work, nutrition programs for kids, filling the gaps left by school closures, and other centres scrambling to provide mental health supports to those in need of help.

Now is also the time for the provinces to step in. They are better able to identify gaps specific to their residents and often better able to address them. The provinces have generally offered income assistance to those who lack strong work histories, and provincial programs' work requirements and expectations must be reviewed and communicated.

Provinces are responsible for employment standards legislation, defining leave provisions and job protection for workers who are not unionized, and some have already stepped up to clarify and even expand protections for workers during this crisis.

A lot has happened in a very short time period. There is no blueprint for responding to this crisis

It has been clearly stated that policymakers are working through the challenges as they come, and we can expect further policy responses going forward. I take this opportunity to applaud the policymakers, public servants, and everyone on the front lines, who have been working so hard to help us all. I thank you in advance for your efforts in the coming weeks.

Tammy Schirle is Professor of Economics at Wilfrid Laurier University, and is a C.D. Howe Institute Research Fellow.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Benjamin Dachis

To: Provincial Governments

Date: March 20, 2020

Re: **Provincial Economic Policy Responses to COVID-19**

The federal government has announced immediate moves and will likely announce more to support the Canadian economy in light of COVID-19. What should provincial and local governments now turn their minds to on the economic front?

Some of the large provinces (such as Alberta, Quebec, and B.C.) have already presented their budgets. Others, including Ontario, have yet to present their fiscal and economic outlook.

Regardless, published or planned numbers are out the window. Every jurisdiction will need to address a dramatic fall in revenues, an increase in health expenses, disrupted education and social services, and pressure to support local economies.

Here are some principles they should follow in the coming weeks.

First, in dealing with the short-, medium-, and long-term economic hurt, provinces should use the tools they are best suited to using to address current and longer-term concerns. The federal government holds most of the tools for immediate fiscal response: Employment Insurance, personal and corporate income tax filing, and most macro-prudential policies (such as banking regulation).

Provinces face unique challenges on which they must chart their own course. Schools, hospitals, and the many other provincial services are on the front lines of social distancing and treating patients. Much has been written on these urgent issues elsewhere. What else should provinces look to do in the coming months?

Here's one example: provinces set policies regarding municipal finances and property taxes. They should ensure that cities have the ability to defer property tax collection. Business property taxes are particularly insensitive to short-term ability to pay from income and economically harmful at the best of times, and should therefore be top of the list for tax deferrals.

On top of the business property taxes cities collect for their own purposes, most provinces set 'education' property taxes at the provincial level. Those provinces then require cities to collect them and remit them to school boards or the provinces. Provinces should allow cities to defer collecting this revenue from the hardest hit businesses, with provincial coffers filling the temporary gap.

Provinces and cities should also be concerned about the health of housing markets. Being able to change homes is a key aspect of a healthy economy. House sales will likely plummet, with potential buyers not able or willing to inspect homes during the busy spring buying season. Transaction volumes will crater, along with the land transfer tax revenues that come with them. To kick-start housing markets once the COVID isolations lift, provinces (and cities such as Toronto and Montreal with extra land transfer taxes) should look to defer to the end of the year collection of economically costly land transfer taxes on transactions over the next few months.

Provinces and cities should resist the temptation to follow playbooks from previous stimulus episodes such as the 2008-09 recession tactic of boosting infrastructure or non-health spending. Additional infrastructure spending risks bidding up prices for already scarce trades labour that is already committed to provincial infrastructure plans.

What provinces and cities can do is ease the burden on permitting and regulation on many activities they regulate to help business come roaring back once our COVID isolations lift.

Provinces will need to look at their employment and licencing laws, for health workers in particular. As a previous C.D. Howe Institute memo argued "physicians are licensed provincially, which acts as a barrier to labour mobility and impedes progress on the development of virtual care services." Provinces could unilaterally recognize licences from other provinces to address local shortages with health workers from less affected provinces.

Finally, provinces have less fiscal room than Ottawa. The federal debt-to-GDP ratio is comparable to that right before the 2008 recession and forecast to improve. In contrast, the combined provincial debt-to-GDP ratio went from around 20 percent in 2007 just ahead of the 2008 recession to more than 30 percent as of 2018. It is 40 percent or more now in some provinces and forecast to worsen for most provinces. These long-term fiscal challenges make tax deferral, not outright tax cancellations, the ideal way to bridge through the current crisis.

The clock is ticking on people not going to work, businesses not seeing customers, and many fearful about their short-term financial outlook.

Provinces and cities should follow the key principles of helping businesses and employees get through immediate dislocations in markets and building the conditions for robust growth when they return.

Benjamin Dachis is Director of Public Affairs at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

From: William B. P. Robson

To: Bill Morneau, Minister of Finance

Date: March 20, 2020

Re: **Give Businesses a Lifeline: Relief on GST/HST Remittances**

The COVID-19 outbreak presents a unique threat to Canada's economy. The last major crisis, in 2008-09, had the financial system at its core and it responded well to injections of liquidity and support for credit markets.

The coronavirus is not like that. It has stopped the economy cold. People are staying home. Many service industries have shut their doors. Output and employment have plummeted.

Canadian governments have responded. The Bank of Canada has slashed the overnight rate and is supporting credit markets. The federal government is subsidizing wages, providing income support and supporting specific sectors through its various lending agencies. These are important measures and the experience of 2008-09 made them faster and more effective.

In 2008-09, however, people were not self-isolating. Hotels, restaurants and cultural facilities did not close. Airplanes still flew and factories still ran. This time is different, and because it is, different governments need to do more.

A critical problem for many businesses, large and small, is liquidity. Sales are down and customer payments will slow. The indirect benefits from lower interest rates and Bank of Canada support for credit markets will not help their cashflows for weeks or even months. Meanwhile, businesses will be forced to lay off staff and stop making payments themselves, which will only exacerbate the crisis. They need immediate help.

A tool well suited to this situation is tax deferrals. The federal and Quebec governments have already announced later deadlines for personal income tax filings. Cities across the country have announced a grace period for property taxes. As former federal finance officials David Dodge, Serge Dupont and Michael Horgan, now at Bennett Jones, have suggested, the next target – one that would help businesses of all sizes across the country – should be GST/HST remittances.

The federal government should let businesses defer net monthly and quarterly GST/HST remittances, starting with payments owed on or after March 31. No interest would accrue until the new due dates for the payments, whenever they might be. As things stand, businesses have to remit GST/HST when they invoice their customers. Even in good times, it's not unusual that they wait weeks for payment. Under current circumstances they may not receive payment for months. Relief on remittances would be a lifeline for many of them.

The immediate positive impact would be huge. Suppose the deferral lasted until the end of 2020, and that the economic impact of COVID-19 – mitigated by the deferrals – reduced the GST and federal portion of the HST by 10 percent year-over-year in the second quarter of 2020 and by 5 percent year-over-year in each of the third and fourth quarters. Total remittances might be some $30 billion lower. That is cash that businesses would still have in hand to pay their employees and their bills. The government could even turbo-charge the measure by refunding remittances businesses made in the first quarter – a further $10 billion.

Provinces would also forgo revenue in the short run – but for them, as for the feds, this measure has the critical feature of deferring taxes, not forgiving them. To be sure, some deferred taxes will turn out not to be collectible, as some businesses do fail – but any such shortfall will be negligible compared with the taxes that won't be collected in the event of a protracted depression. Governments are immortal – they can wait. Businesses without cashflow will die.

The economic boost from deferring GST/HST remittances would be big, widespread, and immediate. It would show as strongly as any measures taken to date that the federal government understands the gravity of the crisis and is stepping in to help businesses across the country. It should be a centrepiece of the federal government's next response to this unprecedented crisis.

William B.P. Robson is President and CEO of the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

A version of this Memo first appeared in the National Post.

Intelligence MEMOS

From: Rob Gillezeau, Gillian Petit and Lindsay Tedds

To: COVID Response Policymakers

Date: March 24, 2020

Re: **Recommendations for Immediate Provincial Policy Responses to COVID-19**

With COVID-19 sweeping across the globe, conditions in Canada are, unfortunately, likely to get worse before they get better.

Given the scale of the wealth shock in stock markets alone – ignoring the unique economic impacts of the virus itself – we are entering a recession that will likely be one of the most severe in the last century both domestically and globally.

Because of the unique nature of the economic shock, it is creating massive disruptions for the labour force, particularly for those in the service sector and particularly for younger Canadians and for women. Further, it is exacerbating income hardships faced by many vulnerable populations, whose numbers are likely to grow in the coming months.

The federal government has now moved forward with a substantial suite of measures to sustain households and firms over the short run. With the federal measures now known, provincial governments should be looking to close gaps in the federal response package.

We recommend that provincial governments move forward rapidly with economic policy in two broad, but often overlapping areas, both related to creating financial bridging measures for individuals, nonprofits, and firms. In particular, we recommend that provincial governments should move forward on providing support that:

1. incentivizes labour force behaviour consistent with disease management (i.e., help flatten the curve); and,
2. assists vulnerable populations and sustain their households as quickly as possible through pre-existing tools and programs. This is consistent with disease management and will help to smooth consumption and, to some degree, moderate declines in economic activity.

This crisis will last many months and businesses and non-governmental organizations will also need support in helping sustain their businesses during this period of social distancing and self-isolation. Programs should be based on existing ones to ensure rapid implementation.

While traditional economic stimulus programs will also be needed to recover from the recession, such programs should be planned today, but not be rolled out, with the exception of direct income transfers, until after the virus is under control and social distancing and self-isolation measures are permanently lifted.

Provincial cooperation with federal partners is essential given the jurisdictional split. Here are the top ten proposals that provinces should consider for their initial economic response to the virus while being clear that more is to come.

1. Stimulus infrastructure spending is not currently the optimal response, but targeted funding for the construction of temporary health facilities (e.g., testing facilities) and space conversion (e.g., hotels and convention centres should hospitals be at capacity) are worthwhile measures to conduct immediately.
2. Increased transfers to municipalities in exchange for policies related to property tax deferrals, utility deferrals and other relief programs along with increased revenue sharing arrangements with Indigenous communities where such arrangements or similar alternatives are in place for local relief programs.
3. Update Employment Standards Acts to include unpaid job leave for the duration of a national emergency such as the current pandemic, but also for future crises like an earthquake, forest fire, flooding, and related emergencies.
4. Update Employment Standards Acts to guarantee two weeks of paid sick leave with an offsetting credit to any existing provincial payroll tax or provincial business taxes.
5. For businesses: Introduce a temporary credit to businesses taxes if firms maintain employment levels. For nonprofits: Introduce a temporary proportionate grant that maintains current employee levels.
6. Mirror work by BDC/EDC for private-sector firms to provide short-term liquidity to nonprofits.
7. Defer utility payments without fees in the event of job loss. Create a crisis fund to aid utility clients who cannot pay. Cease all utility disconnections. Cease all rental evictions and provide assistance to renters to help them pay rent either through rent bank programs or through rent assist programs like Rental Assist Program in B.C. or Rent Assist in Manitoba. Ensure program accessibility parameters are as broad as possible.
8. Emergency crisis supports are often only available to social assistance recipients or under very narrow eligibility criteria. Relax these restrictions and increase maximum amounts.
9. Top-up income assistance to 75 percent of Statscan's market basket measure and reduce the benefit reduction rate. Remove all financial and assets tests to qualify for income assistance. Remove the requirement to actively search for work or attend work training programs while the social distancing and self-isolation constraints are in place.
10. Top up provincially funded, tax delivered programs for low-income seniors such as the Seniors Supplement in B.C. and the Seniors Benefit in Alberta.

Rob Gillezeau is Assistant Professor of Economics at the University of Victoria, Gillian Petit is a doctoral student at the University of Calgary where Lindsay Tedds is Associate Professor and Scientific Director, Fiscal and Economic Policy.

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Intelligence MEMOS

From: Edward Waitzer

To: Jean-Yves Duclos, Minister of Families, Children and Social Development and Minister Responsible for Canada Mortgage and Housing Corporation

Date: March 30, 2020

Re: **Fairness to Tenants – The Urgent Need for A Nationally Coordinated Policy Response**

Residential tenancies represent more than a third of the national housing stock.

Given their relative income profiles, one would have thought tenants in need of financial support as a result of the current pandemic would be receiving such assistance at least equivalent to and ahead of home owners.

Equity, as well as sound public health management and housing policy, suggests that mechanisms be put in place to provide targeted assistance to those legitimately in need to help them pay their rent.

In the absence of such policies, we are seeing calls for arbitrary rent strikes and the imposition of eviction moratoriums. Neither are sustainable solutions. They will, in short order, lead to considerable systemic damage.

Aside from the general encouragement of rule-breaking (at a time when the opposite must be a critical public message), reduced cash flow to landlords will quickly result in mortgage defaults (triggering CMHC guarantees) and the inability to properly maintain properties (putting the security of tenants at risk). Signaling a lack of accountability for those who refuse to pay rent is analogous to making payment for groceries (or other essentials) optional.

What, then, is required?

Immediate solutions, such as rental assistance for those in need and the maintenance of tribunals to administer residential tenancy laws virtually and informally, having regard for the special needs of those who are experiencing financial hardship as a result of the pandemic.

B.C. already has in place such a tribunal mechanism (which could be activated to adjudicate eviction proceedings) and has just introduced a short-term rental subsidy (up to $500 per month) for those who qualify. Such provincial tribunals might play a role in determining access to benefits and crafting relief (e.g., releasing last month rent deposits).

The Canadian Emergency Response Benefit (CERB) is a good start, but isn't tied to housing costs and hasn't yet addressed housing gaps (e.g., students and recent graduates, and those returning to the labour force).

A lesson to be learned from the National Housing Strategy (announced in November 2017) is that national leadership and coordination between all levels of government are essential, and in very short order.

Subsidies should be generous (for those in need) and directed (to the payment of rent obligations). Existing provincial subsidy platforms are likeliest the easiest to operationalize, although financial institutions could also play a role. Ideally assistance will be on a deferral basis and government backstopped (if not directly administered).

If the crisis persists, landlords may also require assistance to help manage material increases in bad debts. Such assistance could be implemented in conjunction with the deferral programs being introduced by CMHC. In turn, landlords should be prepared to assist by, for example, immediately accepting freezes on rental and "above guideline" increases.

Harmful tenant initiatives for rent strikes and the maintenance of general eviction moratoriums will only be avoided by clear and integrated government commitments to ensuring adequate assistance for those in need.

The longer it takes to get this message out, the greater the risk of inappropriate conduct and knock on effects posing significant systemic risks. The time to act is now, and to do so boldly.

Edward Waitzer is a Senior Fellow at the C.D. Howe Institute, a professor at Osgoode Hall Law School and the Schulich School of Business and a partner at Stikeman Elliott LLP. Stikeman Elliott represents a number of multi residential landlords.

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Intelligence MEMOS

From: Hugh O'Reilly and Edward Waitzer

To: Bill Morneau, Minister of Finance

Date: April 1, 2020

Re: **Rental Chaos – The Need for A Rules-Based Eviction Framework**

During the COVID-19 crisis, all levels of government in Canada are responding decisively with policies to create a climate of certainty and respond to those in immediate need during a decidedly uncertain time.

One of the most difficult aspects is that crisis management can resemble the game of whack-a-mole. Solving one problem can create other, unanticipated, problems that require their own urgent solutions. This is partially why, in normal times, government responses can take what appears to be a maddeningly long period of time.

We fear that one recent policy initiative that will create unforeseen problems is the eviction moratorium that applies to tenants who cannot pay their rent as a result of COVID-19 income loss.

From a social and public health policy perspective, an eviction moratorium is good policy. Individuals should not suffer the consequence of losing their home while they await government support. From a public health perspective, it is also sensible to avoid this outcome while social distancing is required.

However, a general eviction moratorium may create the conditions of market breakdown (at a time when the opposite is required) and could have a number of unfortunate knock-on effects. For these reasons, the eviction moratorium needs to be targeted, time limited and include a return to more normal conditions in its design.

The need for a rules-based eviction moratorium can be seen when the example of a social, not-for-profit or affordable housing provider (NFP Providers) is considered (the issues created for landlords are considered here).

NFP Providers typically do not have other sources of income or liquidity beyond rental income. After the eviction moratorium ends, is it unclear how lost rental income will ever be recouped. NFP Providers may not be able to sustain such a permanent loss of rental income.

Another factor to consider is that NFP Providers often have tenants who are recipients of provincial social assistance.

There is no income interruption for these tenants, but it appears that the eviction moratorium will apply to them even if they choose not to pay their rent. We do not dispute that provincial social assistance may be insufficient, but a general eviction moratorium that results in the NFP Provider subsidizing these tenants surely isn't an appropriate or effective mechanism to solve a broader income assistance problem. For this reason, we believe that the eviction moratorium should make clear that it does not apply to tenants who are in receipt of provincial social assistance.

For those tenants whose incomes are interrupted or insufficient, any eviction moratorium should be targeted, and rules based.

It could, for example, be made conditional on landlords and tenants being required to enter into a deferred rent payment arrangement based upon a prescribed payment schedule and receipt of income benefits by the tenant.

Rent subsidies, such as the $500 subsidy, payable directly to the landlord, such as B.C. is offering, could be part of such a rules-based framework. Rules will clarify to whom the moratorium applies, but also make it clear that it does not relieve the tenant of the obligation to pay rent.

The length of the eviction moratorium needs some definition as well. A definite end point, say 90 days after the end of social distancing, would allow those who have lost their jobs to return to work and regain a stable income.

In the absence of clear rules, the transition when the moratorium ends will be very difficult. Those most in need will have accumulated additional debt, rental tribunals will be swamped, and it is highly unlikely that the unpaid rents will ever be collected.

The potential for permanent dislocation is substantial. NFP Providers will be forced to bear the consequences of the crisis, and could even lead to the failure of these organizations. If this were to occur, then the consequences for those in need would be severe.

The types of difficulties faced by NFP Providers will apply to most landlords and tenants.

In times of crisis, certainty becomes increasingly valuable. The income support measures announced by all levels of government in Canada are an important element of creating certainty in these unprecedented times. Housing also needs certainty.

Hugh O'Reilly and Edward Waitzer are Senior Fellows at the C.D. Howe Institute. Edward is also a partner at Stikeman Elliott LLP. Stikeman Elliott represents a number of multi residential landlords. Hugh is also a Member of the Board of Directors of Namerind, a not-for-profit aboriginal housing provider in Regina. Their views are their own.

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Intelligence MEMOS

From: Brian Dijkema and Sean Speer

To: Department of Finance

Date: April 10, 2020

Re: **Saving the Charitable Sector from its COVID Crisis**

The charitable sector has not been spared by the sharp decline in economic activity brought on by COVID-19.

Charities normally function as society's shock absorbers when crisis hits, but the pandemic poses serious threats to the sector's ability to absorb these shocks as donations, grants and fees dry up. Canadian charities may see financial losses this year of between $9.5 billion and $15.7 billion, according to one estimate, and may have to lay off between 118,000 and 194,000 workers.

Canadian governments have taken steps to address these challenges. Charities and their employees are eligible for wage supplements and enhanced unemployment benefits. But some with irregular revenue flows or primarily volunteer work forces may not qualify or fully benefit from these programs. More needs to be done. Ottawa is now reportedly considering the creation of a significant stabilization fund (ranging from $8-10 billion) for the sector.

In a recent policy briefing, we recommend that the federal and provincial governments adopt a matching funds model as the primary means of allocating and distributing immediate-term support to Canadian charities. We identify some of the key design and implementation considerations, including eligibility criteria and possible funding caps.

Program design and administration details need to be refined, but there are seven virtues to the matching funds model as opposed to other policy options.

1. **Speed:** Various factors (ranging from legal limits, to the nature of competition in the market for donations) prevent charities from holding cash reserves that can tide them over in tough times. The upshot is they need cash quickly. Delivering incremental support via the tax system or an application-based process will necessarily involve a lag. In a matching scenario, by contrast, charities could submit charitable donation receipts to the government on a monthly or semi-monthly basis and receive matching public funds equivalent to those receipts immediately.
2. **Administrative Simplicity:** There are already systems in place within the federal bureaucracy (*e.g.*, Global Affairs and Health Canada) that administer matching funds. These systems can be expanded and mobilized rather than built from scratch or shoehorned into agencies or processes built for other reasons (*e.g.*, local economic development agencies). The administrative burden on charities is similarly light when compared with application-based models.
3. **Accountability:** Charities are already required by law to provide proper accounting of charitable receipts to maintain their charitable status. Matching funds leverage these pre-existing processes and structures, and do not require new or additional reporting that other policy options such as application-based grants might.
4. **Equitable:** A matching model would have public monies follow private decisions and in so doing would preclude the government from having to pick and choose which charities get access to public support. The matching fund model, in this sense, aligns with, and reinforces, the voluntary character of the sector. This decentralized approach would have the government play a bridging and supporting role rather than a top-down one. The result is that funds would be broadly distributed based on the preferences of Canadians rather than public officials.
5. **Enables, enhances, and expands existing donor base:** Matching funds serve as a spur to greater giving by private donors. Studies show that matching increases the likelihood of charitable giving and revenue per solicitation by around 20 percent, and these positive outcomes can persist after the matching period ends. Both the more direct grants and enhanced tax credits, by contrast, seem to risk crowding out individual contributions over time.
6. **Inspires and Builds Solidarity:** The COVID-19 crisis is analogous to wartime. In such times, social solidarity is key to maintaining trust, a sense of common sacrifice, and ultimately stronger institutions and relationships. A national effort around charitable giving can be a key ingredient to a sense of national unity and a common mission. Giving has significant psychological effects on both individuals and communities. One study, for instance, notes that "giving is in many cases an almost automatic emotional response, producing a positive mood." A matching fund initiative can therefore help to spur positive feelings of solidarity and togetherness in a time of crisis. Incremental tax relief or an application-based program would not ostensibly have the same effect on Canadian society.
7. **Fiscally responsible:** The decline in giving will likely result in the federal government saving over a billion dollars that it budgeted as expenditures related to the charitable tax credit. Those funds could, and should remain dedicated to charities. Moreover, studies have shown that higher income earners - those most likely to give - have been saving large amounts of money: up to $5.3 billion in two months alone. A matching initiative would provide significant motivation to release those savings into the charitable sector.

A matching funds model would thus meet the government's primary objective of stabilizing the charitable sector but also have secondary benefits such as contributing to social solidarity that, in our view, make it superior to the other options available.

Brian Dijkema is Vice President of External Affairs at Cardus, a non-partisan, faith-based think tank and registered charity, and Sean Speer is assistant professor at the University of Toronto's Munk School of Global Affairs and Public Policy.

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Intelligence MEMOS

From: Louise R. Summerhill

To: Finance Minister Bill Morneau

Date: May 4, 2020

Re: **Avoiding a COVID-19 Income Tax Distortion**

The federal government is to be congratulated for moving quickly to deal with the myriad income support, wage subsidy, business loan tax holiday and related liquidity measures to support Canadians and our economic well-being during the COVID-19 economic shut down.

But sometimes, unexpected force majeure conditions can create unintended consequences in terms of tax liability. This is precisely the case with the impact of COVID-19 lockdowns, travel bans and border closings on lawful visitors to Canada, who are tax residents of other countries.

Section 250 of the *Income Tax Act* specifies how long a resident of another country can be in Canada without incurring tax liabilities here. That is normally 182 days in any 12-month period. Many business people, professionals and investors visit Canada to discharge board duties, visit friends or family, oversee investments etc., and do so lawfully, departing for their home tax jurisdiction well within the statutory limit.

As a result of the lockdown and border closings, many have been unable to do so this spring. Border closings, flight cancellations, and a general ban on international travel has made their departure impossible.

This problem has been spotted by other advanced economies.

The U.K., Ireland, Australia, Belgium, the United States and the OECD itself have all recognized the problem, and engaged to ensure that lawful visitors unable to return home are not exposed to unexpected and unintended tax liability.

Between March 19 and April 3, all of the above tax jurisdictions and intergovernmental organizations have issued clear statements to protect the lawful visitor caught through no fault of their own by the present lockdown.

The normal rhythm of free movement of persons for legitimate economic, social, cultural and trade reasons, especially in the post pandemic future, should not be limited or discouraged by failing now to clarify present tax policy, and its specific statutory intent.

Non-compliance with the *Income Tax Act* does have consequences and penalties, and always has. But forced non-compliance, caused by public health advice on lockdowns, travel and border closings, when taken by government for solid public interest reasons, should not cause problems for lawful visitors to Canada, trapped temporarily by circumstances beyond their control.

This would be a good time for the Canada Revenue Agency to clearly indicate, as revenue agencies in various advanced economies have already done, that no tax liability for staying longer than planned will be visited upon visitors to Canada unable to return to their tax domicile until present restrictions are lifted.

It's a small thread that will shape the fabric of economic recovery, but an important one, nonetheless. Failing to do so would weaken the 'open for business' attraction that Canada and Canadians seek to portray.

Louise R. Summerhill is a senior tax litigator at Aird & Berlis LLP where she co-chairs the tax litigation and not for profit law group.
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Theme 5:

Education and Childcare Policy

Intelligence MEMOS

From: Phil Oreopoulos

To: Canada's Ministries of Education

Date: March 30, 2020

Re: **An Evidence-based Approach to Education During A Pandemic**

The physical closing of schools is among the unprecedented COVID-19 disruptions across the world. Schools across Canada are planning to keep doors shut to millions of students until at least summer, and some indefinitely.

Multiple studies have shown that academic progress stalls consistently over summer breaks, suggesting that the current isolation will be no different without alternative action. Disadvantaged students from lower socioeconomic backgrounds may be particularly harmed from a prolonged recess.

This makes the need to substitute to some other form of learning urgent. School boards are scrambling, but face many hurdles in developing strategies to deliver education. Among them: inexperience using online resources, hardware and software availability, anxiety, stress, and lack of Internet availability.

Adopting new education technology will play a role, though many educators and parents are being left on their own to sift through its many forms, not all of which are created equal.

Fortunately, convincing research exists to help make sense of how to proceed.

Last year, my co-authors and I conducted a systematic review of 126 randomized controlled trials examining the effectiveness of many different kinds of EdTech interventions.

Here are some conclusions for making evidence-backed decisions about how to switch to E-learning effectively.

First, one particular type of intervention stood out for improving academic achievement across a wide range of programs and settings: Computer-assisted learning (CAL) programs, defined as educational software designed to develop and practice skills, such as reading and math.

Effective CAL programs that have been rigorously evaluated typically share a few common features. They allow students to review classroom instruction while receiving interactive support at home. Students can watch online or tablet-based instructional videos and proceed through exercises at their own pace, much as with a tutor.

Students can proceed incrementally, retaking quizzes until mastering the material. Or, teachers can 'flip' their class, and ask students to watch the videos and work through exercises, while using data about how well they are progressing to offer student-specific support.

An example of a promising evidence-based CAL program is ASSISTments, a free online math homework platform that provides students with immediate feedback and support as they solve problems. Multiple randomized evaluations of ASSISTments over different grades and regions reported impressive academic gains. One study found significant improvement even while students used the program for less than an average of 10 minutes per night, three to four nights per week.

Khan Academy is another free CAL program that provides children with personalized feedback. Featuring a library of courses across subjects and levels, it enables teachers to assign tests that differ for each student and grade. Students can practice at their own pace before moving through new content. In response to the pandemic, Khan Academy has released daily schedules for students and resources to understand how to use its platform effectively.

A second conclusion from our research review is that online education is more productive when made interactive or combined with incentives to learn.

Students watching passive educational videos, such as those offered on Ontario's 'Learn at Home' website, are easily distracted and unlikely to retain content in the long-run. Studies of Massive Open Online Courses (MOOCs) show that, no matter how awesome the video content, few students actually get past the first few lectures.

Assignments that get students to react to videos, through grade incentives or online discussion, can ensure that students process the material.

Lastly, families from less advantaged backgrounds are more adversely hit from online only education due to lack of Internet and computer access. Only about 70 percent of households earning less than $25,000 have access to a computer, and frequently also lack broadband access.

The solution is not to deny online education to all students. Rather, the solution is to mobilize resources. Many school boards, such as Hamilton-Wentworth, are making arrangements to loan or give tablets and Internet access to those in need, sometimes working with corporate and government partners.

It will take time to sort through what works best, but a silver lining of this massive enforced experiment is that we may discover more effective learning strategies.

By adopting an evidence-based approach to education technology, teachers and parents have reason to be hopeful that students at home can continue to learn, and even thrive, during these uncertain times.

Phil Oreopoulos is a Professor of Economics at the University of Toronto and the Education Co-Chair for the Abdul Latif Jameel Poverty Action Lab.

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Intelligence MEMOS

From: Don Drummond

To: Post-secondary Policymakers

Date: April 6, 2020

Re: **COVID-19 and University and College Students**

There are more than 2 million university and college students in Canada. Their face-to-face classes were among the first casualties of the COVID-19 pandemic.

As students and instructors quickly adapt to remote learning platforms, their attention will increasingly turn to what is next.

The timing of the pandemic could not be worse for student incomes. Normally about half a million graduating students would be joining the work force in what might have been the beginning of careers. For others, it would have been co-op placements or summer employment. All are now in jeopardy.

A policy response is necessary to protect the post-secondary students.

Studies show that students graduating into weak labour markets suffer long-term consequences. Their skills atrophy. They lose a few rungs on career ladders. Employers look with suspicion at lack of experience. They often take jobs not well aligned with their interests and training and find it difficult to get back on the track they intended.

This all suggests the policy response must focus on income preservation and maintenance, if not enhancement, of skills so that students' actual income and earnings potential are protected.

The most effective policy response to support students is to do everything feasible to contain COVID-19 so there can be an early return to what would have been normal activities over the spring and summer. However, those activities are likely to be disrupted for some time and other actions are called for.

Five recommendations to support post-secondary education students:

1. Students whose job offer has vanished should be made eligible for the Canada Emergency Response Benefit (CERB). In effect this would mean treating foregone income as lost. The agreement might be a formal, legal job offer or it could confirmation from a would-be employer.
2. Funds should be made available to universities and colleges to make more courses available remotely over the next several months. Universities already offered some courses online, but are scrambling to convert many others. The course coverage and quality of the remote learning modules would be enhanced with additional support over the coming weeks and months. Efforts could be made to attract revenues from international students, who pay $6 billion of tuition per year, which is now jeopardized. More and better online courses would not only help through the pandemic but would be an investment for the future as it seems likely more education will shift to this format.
3. Funds should be made available to university and college instructors to hire student researchers and teaching assistants. The easiest transition into employment is in the post-secondary education environment where the students have already established a connection rather than trying to enter a new workplace remotely. The additional research capacity would benefit society in many ways. Graduate students could be used to help universities and colleges with the task of converting learning platforms to remote modes.
4. Funds could be made available to school districts to hire post-secondary students as assistants to teachers. Over the past two weeks, teachers across Canada have been told that in very short order they must prepare online learning modules for their students. In many cases little guidance or co-ordination is being provided. Many parents are also struggling with how to best bring online learning into their homes. Who better to help than college and university students?
5. Additional funding for scholarships will be required for students by next September. Even with the programs recommended above, many students will suffer an income loss that could jeopardize their return to studies. Loan programs could be adjusted, but we should be leery of piling more debt on students. If history repeats, they may already suffer longer-term income losses as a result of the pandemic. Further, they may disproportionately bear the cost of the return to fiscal normalcy through higher taxes and contributions. So additional support should be more in the form of scholarships or grants.

Together the five programs would mitigate the harm that is going to fall on Canada's university and college students and generate benefits for society. As it will be for other Canadians, it is still going to be a tough time for students.

Don Drummond is the Stauffer-Dunning Fellow in Global Public Policy and Adjunct Professor at the School of Policy Studies at Queen's University.

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Intelligence MEMOS

From: Phil Oreopoulos

To: Canada's Graduating Students

Date: April 30, 2020

Re: **Graduating During the COVID-19 Recession**

The pandemic response means bleak job prospects for this year's graduating students.

There's no sugar-coating that many will be unable to find full-time work after finishing high school or completing a postsecondary program. The weaker labour market will also have long-lasting effects. But with the significant relief offered recently from the federal government, some patience and ingenuity, there are ways to make the most out of the situation and even come out better for the experience.

Some of my past research with Till von Wachter from UCLA and Andrew Heisz from Statistics Canada examined the consequences of graduating in a recession sometime during the 1980s and 1990s.

In the first year after graduation, earnings were about 10-15 percent less, on average, than peers who graduated when unemployment rates were 3-4 percentage points lower.

Earnings were lower even after finding work, even after five years. The gap eventually closed after a decade, but by then, unlucky labour market entrants had lost, on average, 5 percent of their lifetime earnings.

What's more, other research found that graduates in a recession also experienced long-term negative health effects, including lower life-expectancy by an average of half a year.

The consequences of the COVID-19 recession could be even more severe. This year's graduates face labour market conditions significantly worse than those used to estimate past effects.

Months of closed, non-essential, businesses will make finding any work challenging. The longer the 'stay-at-home' restrictions, the more likely a longer economic downturn, compelling hundreds of thousands of graduates to settle for lower paying occupations unrelated to their field.

Fortunately, there are ways to minimize these kinds of adverse impacts. In the short term, job vacancies are likely to be extremely thin, especially while business closures remain enforced. Youth could instead consider acquiring new skills, potentially through online courses, or even staying on in school. Now would be an excellent time to pursue a one- or two-year graduate program of interest that leads to higher earnings, a new career, or a chance to enter the labour market in better times.

Another opportunity is to volunteer. Many organizations and households are currently in dire need of help. Volunteering not only benefits others, but also increases well-being to the volunteer. It also improves skills that employers value.

In one study, for example, resumes that randomly listed volunteer experience were significantly more likely to receive an invitation for a job interview than those without. Volunteer Canada provides links to organizations currently looking for help during the pandemic, including virtual volunteering. Some placements require only a few hours per month. Others include travel across the country, are full-time, and pay a living allowance.

The government has proposed a smorgasbord of spending to provide summer financial relief and financial incentives towards some of these activities. Additional spending has been proposed for increasing summer job wage subsidies, training programs, and new job placements in STEM. Its Canada Student Service Grant, offering at least $1,250 per month until September, should ease pressure over the summer for those who cannot find work, though the program has the potential to also disincentivize graduates from seriously entering the labour market until the fall. Offering the support only to those receiving financial aid could help reduce this behaviour.

Increased financial grant, loan, and scholarship aid should make it easier to continue with graduate studies. Particularly intriguing is the new Canada Student Service Grant that offers students who volunteer up to $5,000 in subsequent education support. Also offering this to graduates as cash could allow them to similarly pursue rewarding experience while benefiting communities. The government can also encourage entrepreneurship with start-up seed money. In the longer term, it can promote improved career services for assisting better matches between youth and firms and further subsidize job creation.

As the economy recovers and businesses begin to hire again, there are steps youth can take to minimize adverse effects from the recession.

My co-authors and I found that those who were more mobile – switching jobs more often – recovered faster. Getting back onto a steeper wage trajectory, therefore, likely requires keeping an eye out for and seizing better job opportunities when they come along, no matter the city or industry.

My advice to graduates this year is to take a long-term perspective. What matters is your long-run well-being, not how much you earn. The pandemic presents opportunities to gain experience, help others, and mature in ways you never otherwise would have imagined.

Phil Oreopoulos is a Professor of Economics at the University of Toronto and the Education Co-Chair for the Abdul Latif Jameel Poverty Action Lab.

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From: Ken Boessenkool

To: Bill Morneau, Minister of Finance

Date: May 7, 2020

Re: **Change the Child Tax Deduction to Address the Coming Childcare Shortage**

Three related facts about the COVID-19 economic recession are becoming clearer. The most affected sectors are public facing sectors – largely the service sector; the most affected income group is the poor; and the most affected demographic is women.

This makes the current recession quite unlike the last three recessions, which mostly affected men in construction and manufacturing and jobs.

The public policy response will therefore need to be very different than the response to recent recessions. The financial crisis recession, for example, prompted a large corporate bailout for the auto sector, large infrastructure investments and tax cuts.

The forces underlying the harm to the service sector, women and people with lower incomes seem unlikely to fade soon or quickly. Although it is early days, Canadians strongly support their government's physical distancing requirements and fears about getting the disease is increasing despite small moves from governments to open up the economy.

Canadians, whether or not governments require it, are likely to continue to physically distance for a while yet. And that suggests the service sector recovery is likely to be uneven and slow.

The federal government's childcare expense deduction (CCED) allows families to reduce annual taxable income by up to $8,000 for children under six and $5,000 for children 7-16. The CCED must be deducted from the income of the lower income spouse and the amount deducted cannot exceed two-thirds of the income of the lower earning spouse.

There are three reasons the current CCED is not up to the task of supporting families during this recovery.

First, the CCED is calculated at tax time and refunded against tax owing. As the economy recovers, this separation between need and support will hamper the recovery effort.

Second, the CCED is too restrictive on the type of care allowable to claim the credit. With physical distancing restrictions likely to persist for existing childcare spaces, flexibility in childcare delivery will also be critical to meeting expanding demand with shrinking supply.

And one of the key challenges in the recovery is that the number of spaces available, whenever re-opening occurs, will be far smaller than in February 2020, due to physical distancing rules. As well, there is the unfortunate likelihood that some childcare providers will simply have failed to survive the downturn.

Third, the CCED is payable to the lower income spouse whose benefits cannot exceed two-thirds of the income of that lower income spouse – the so-called "two-thirds limit." Fully 40 percent of CCED recipients are affected by this rule.

In an uneven recovery where primary caregivers face an uneven return of service sector jobs – most often held by women – these rules will unhelpfully reduce childcare assistance at the worst possible time.

There is a better way.

The federal government should heed the advice of Alexandre Laurin and Kevin Milligan and replace the current CCED with a generous refundable tax credit. They propose a rebate of 75 percent of childcare expenses for families with incomes that fall below about $35,000. The rebate falls to 26 percent for families with incomes above about $155,000. Eligible expenses match that of the CCED: up to $8,000 for children aged 0-6 and up to $5,000 for children aged 7-17.

The government should pay this benefit monthly or quarterly (a similar benefit can be paid quarterly in Quebec). This is important as a family with two young children would qualify for a monthly cash benefit of up to $1,000 and it would better match benefits with needs during an uneven recovery.

Those claiming the credit should be granted the maximum flexibility in the type of care that would qualify for the credit. The credit is a flexible way to encourage more childcare spaces in homes outside of groups or other more heavily regulated settings.

Families should be given the maximum flexibility to find childcare for more children than usual as schools and summer camps take time to get back up and running. Caregivers who cannot find work might consider providing care for another family's children as a source of temporary income. In short, greater flexibility in the types of care that qualify is one way to overcome the reduced supply due to continued physical distancing.

A refundable tax credit for childcare expenses that pays benefits monthly and is more flexible and fairer to lower income spouses would be a critical part of getting women back to work during our economic recovery from the COVID-19 crisis.

Ken Boessenkool is an independent public policy economist.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Ken Boessenkool and Jennifer Robson

To: Federal and Provincial Childcare Funders

Date: June 24, 2020

Re: **Thoughts on Forestalling the Coming Childcare Crisis**

As the economy continues to re-open, albeit differently across jurisdictions and over time, many sectors are going to struggle with necessary and ongoing rules on physical distancing and disinfecting. These new constraints, while essential, will have a particularly difficult impact on childcare providers.

Why does this matter? The growth in female earnings has been one of the principal sources of increases to household income and a key economic driver in recent decades. Increased female earnings were driven by a number of factors, among them childcare availability and cost. This is true even though public support and the availability of childcare prior to the pandemic was far from adequate, as we have written.

The necessary adaptations of childcare spaces and services for COVID rules will magnify the shortage of safe childcare many times over. New but variable rules reducing the number of children allowed in each classroom, keeping facilities and toys disinfected, and equipping staff with appropriate personal protective equipment will help children and workers stay safe.

But these measures will also bring significant new financial challenges for childcare providers. What's more is the disturbing reality that one third of childcare providers are not sure they will be able to re-open at all.

All of this adds up to a serious reduction in the supply of available childcare spaces in Canada. That supply shock will constrain our economic recovery because it will make it more difficult for parents, and particularly mothers, to accept full- or part-time work. If that supply is lost permanently, it could lower our longer-term opportunities for economic growth.

So, what's to be done?

In the spirit of contributing to this debate, we offer this list of proposals – a public brainstorming if you will.

At the core of our proposals is the idea that the childcare sector requires an immediate injection of capital and a rapid expansion of space(s) in this critical phase of re-opening the economy.

First, on capital, the federal government has already put in place a federal transfer to provinces for childcare guided by the Multilateral Early Learning and Childcare Framework. This transfer should immediately be boosted to pay some or all of the costs of a temporary injection of much-needed capital into the childcare sector.

Why the federal government? It has more immediate fiscal capacity than provinces to be able to do this. The federal government has already committed $14 billion to assist with recovery measures, including spending on childcare.

Second, that boost should be conditional on the provinces developing a new and complementary portable benefit for parents to help pay for the operating or capital costs of childcare. Provinces could determine the precise size and form of these portable benefits, which would be redeemed by providers. This could be integrated with temporary measures already introduced by PEI and BC and with portable subsidies in Ontario. We will need both supply and demand-side solutions.

Third, provinces should actively support childcare providers to make use of community spaces that can accommodate satellite locations for childcare (including day programs for school-aged children). This could include public schools, university and college campuses, community centres and other municipal or provincial spaces that could safely accommodate a small group of children who would otherwise exceed the new limits in the primary facilities run by childcare providers.

Schools would be available during the summer to meet the immediate crunch, but even in the fall, it is not at all certain that all schools will open. Universities and colleges appear to be preparing to offer a blend of online and in-person for the fall which should leave some additional space available. To the extent these are publicly-owned, no facility charges should be required to use these spaces for satellite childcare services.

Provinces should fast track approvals and certification for licenced providers to open up satellite operations in these facilities, and cover the temporary start-up costs involved. And they should actively support childcare providers to access programs like the Canada Emergency Wage Subsidy that could defray an important share of the labour costs so that each program is supervised by qualified staff.

Finally, provinces and the federal government should work together to make it easy for primary and satellite childcare facilities and summer camp programs to get rapid access to the enhanced youth employment funding and the as-yet to be launched Canada Student Service Grant.

For many childcare and day camp programs, early childhood education students and other youth are an important workforce component. As governments take steps to support youth employment and community engagement, we think that community need for childcare should be a priority.

These ideas may not be perfect, but failure to quickly address the childcare supply shock will not only inhibit our recovery from the COVID recession, but permanently lower Canada's growth trajectory.

Ken Boessenkool is a Research Fellow at the C.D. Howe Institute and Chair of Sonshine Community Services, a Calgary women's shelter that operates a trauma-informed childcare centre. Dr. Jennifer Robson is Associate Professor of Political Management, Carleton University.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Tammy Schirle and Mikal Skuterud

To: Canadians Concerned about the Labour Market

Date: July 15, 2020

Re: **THE MOMS ARE NOT ALL RIGHT**

Last week's release of the June Labour Force Survey gave Canadians reason for optimism – the numbers made it clear that many workers are finding their way back to work.

It is now evident that April 2020 represented the low point of this crisis for the labour market, as more than 5.5 million workers were affected by the COVID-19 shutdowns. By mid-June, about 2.4 million workers made it back to work at regular hours. When we look at total hours worked, Canadians had recovered 40 percent of the April loss in work hours.

But not everyone is finding their way back.

The June numbers also made clear that the recovery in women's hours of work is lagging those of men. Women's aggregate hours had dropped only slightly more than men's between February and April. But by mid-June, women's hours had recovered by 37.5 percent, while men's hours had recovered by 44.3 percent.

Why the gendered difference in recovery? Part of the reason is that occupations dominated by men, especially in construction and manufacturing, are among those seeing the biggest recovery in work hours. Many occupations dominated by women, in particular face-to-face service occupations, have seen fewer jobs come back.

But we are particularly concerned with the lack of recovery among moms with younger children, whether living with a spouse or alone. Moms whose youngest child was aged 6-12 had recovered only 36 percent of their lost work hours by mid-June, while moms with children aged 18-24 at home had recovered 78 percent of their hours. The challenge is especially acute for lone-parent mothers whose hours had recovered only 23 percent by June.

Parents are facing important constraints on their labour market activity right now. Kids always need to be educated and cared for, both physically and mentally, and COVID-19 shutdowns have made that particularly challenging. Childcare centres, summer camp opportunities, and other activities for kids under age 12 have been extremely limited by measures taken to mitigate virus outbreaks.

As parents look ahead to September, with concerns that kids won't return to school full time, the longer-term prospects for returning to work are bleak, reducing the payoff to any job hunting this summer.

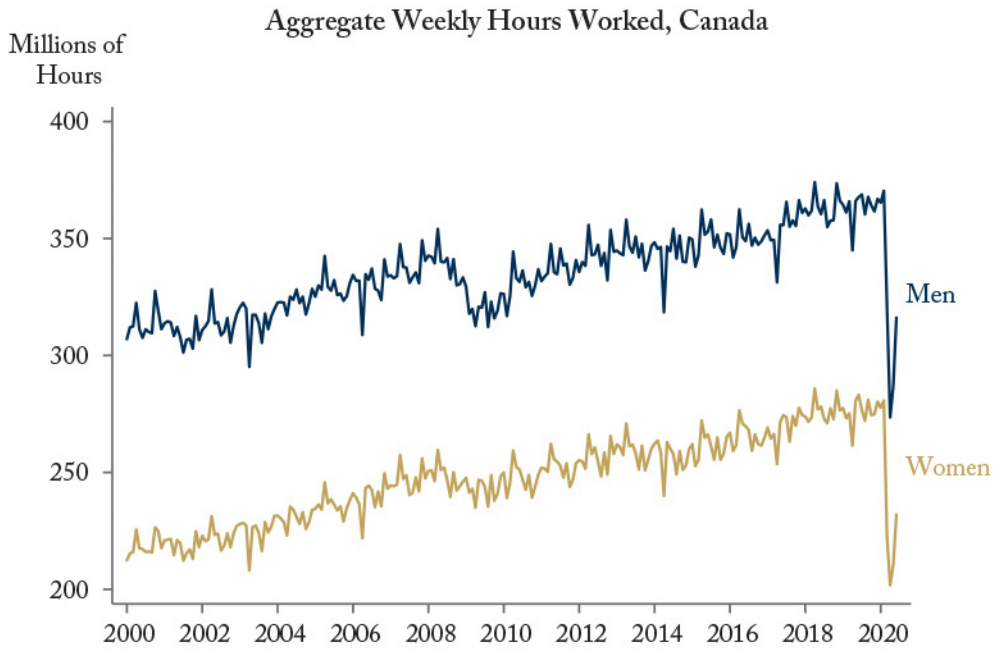
We wish to emphasize that this caregiving constraint is affecting moms much more than dads. Among dads, the weakest recovery is also for those with children aged 6-12 at home, but their recovery has been much greater than for moms – having recovered 62 percent of their lost hours in April.

Why are moms bearing the brunt? In deciding which parent will stay home with children, even the most egalitarian parents will weigh the options: in families where both parents work, it's likely that dad's job re-started first and that it pays a higher wage. Social norms and the traditional caregiving roles of women have contributed to the pre-existing gender gaps in pay. But those social norms also nudge moms, rather than dads, to take on those caregiving roles now.

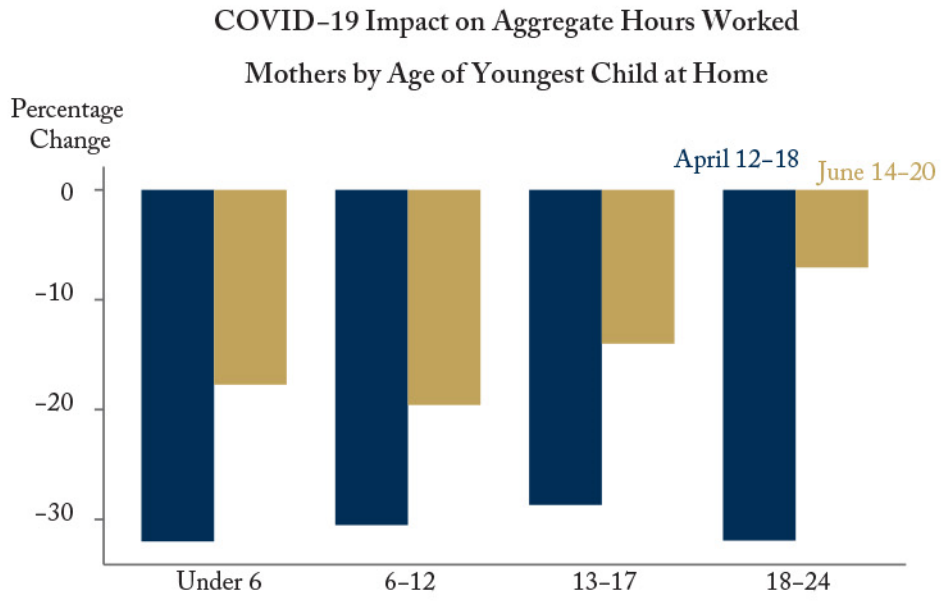
We are only six weeks away from the end of summer. To get childcare and schools ready, huge investments are needed now: in classroom space, staff, teachers, and PPE. While concerns for education are often delegated to those focused on offering high quality education and care, it's been made clear that there is more at stake here. We risk losing a large part of Canadian economic activity – and our tax base – if the barriers to all parents' full participation are not removed.

Tammy Schirle is Professor of Economics at Wilfrid Laurier University, and Mikal Skuterud is Professor of Economics at the University of Waterloo.

To send a comment or leave feedback, email us at blog@cdhowe.org.



Note: Actual weekly hours worked on all jobs. Seasonally adjusted by removing month fixed effects.
Source: Labour Force Survey, Statistics Canada, Table 14-10-0032-01.



*Hours are actual weekly hours on all jobs. Values are difference relative to February 2020 minus equivalent month-to-month change in 2018.

Source: Labour Force Survey (PUMFs). Produced by @mikalskuterud.

Intelligence MEMOS

From: David Johnson

To: Canadians Concerned School Reopening

Date: August 7, 2020

Re: **Teaching with COVID Restrictions in Elementary Schools: What Can Be Done?**

Last week, the Ontario government announced a plan to reopen elementary schools. Its plan requires very little additional spending, operates within the existing school day and space, operates exactly within existing collective agreements and, partly because of the choices above, defines a student cohort as the existing class sizes. Boards must offer an online option to any parent who opts out.

Is there a more attractive alternative model with some of the same features as proposed by Ontario – and other provinces – that could be considered, given some of the early negative reactions?

I believe there is, if schools move to a split schedule.

My proposal is a morning class from 8 a.m. to 12:30 p.m. (270 minutes) and an afternoon class from 1:30 p.m. to 6:00 p.m. (270 minutes), with one 40-minute nutrition break for students and an hour of cleaning between. Elementary class sizes would average 17 students.[1]

Students and teachers would take turns as required by space availability in the less desirable afternoon teaching shift. The proportion of each school's schedule that is in the afternoon could be as high as 50 percent or as low as zero. It would be an option to focus afternoon shifts on older children, particularly in a K-8 school. It would depend on the proportion of parents who choose fully online education and the amount of available space within a school. Each school or board could decide what works for them.

School-based pre- and post-class childcare is a problem with both the two-shift day and in the government's proposal. In the two-shift proposal, it is likely there would be no childcare before or after school. It is worth noting that in the government proposal, before and after school care exposes students to a different cohort and the current school start and end times are not convenient for many parents. It is perhaps surprising that the vast majority of parents already find options outside the licenced child care spaces located in schools and manage the inconvenient times in the traditional school day.[2]

How would a school day look? In a pre-COVID school day in Ontario, each student attended school for 380 minutes with two 40 minute breaks. In the usual 380-minute school day, a teacher instructs 252 minutes, has 40 minutes of preparation time, an average of 16 minutes of supervision time, with the remainder of the day for lunch.

In my proposed post-COVID day, there would be two instructional periods of 125 minutes with one 40-minute break for students.[3] The students' nutrition break might be supervised by the same EA, ECE or lunchroom supervisor every day who then eats their lunch at a different time. Teachers receive only a 40-minute break within the shorter instructional day. Their preparation time and part of their lunch comes after or before the instructional day (see Table 1).

The post-COVID instructional day has 70 fewer minutes of instruction than the 300 minutes in the pre-COVID day, a significant loss. Some of these 70 minutes are made up in not losing class time beginning and ending a second activity break; by fewer changes of teachers; and having no assemblies. If professional development time was scheduled outside the shorter instructional day, then teaching on the seven PD days would generate 1,610 additional minutes of instruction in the year.

How would it look for elementary teachers, EAs and ECEs? Some teachers take a group of 17 non-French immersion students and teach those students every day limiting the exposure of this teacher to 17 students (Table 2).[4] A French immersion teacher is paired with a non-French immersion teacher with a class

1 In 2018-19 there were 16.50 students per elementary teacher in Ontario. Thus a cohort of 17 for all students fits the proposal within existing teaching resources if almost all teachers take a class as a unit of instruction. There were also 10,076.7 ECEs in Ontario schools in 2018-19 (and an unknown number of EAs in the elementary system). Some classes may be smaller to handle special needs students with EA resources allocated to that task and using teachers with some extra training. Then other classes would have to be slightly larger than 17. The central parts of the proposal would still work.

2 In 2018-19 there was a total of 282,048 licenced child care spaces in publicly funded schools (an unknown number are pre-school spaces) and 977,371 students from junior kindergarten to Grade 5 in Ontario publicly funded schools. While these are important programs, it is clear the vast majority of parents do not use before and after school programs. Source:

3 Breaks could be staggered or offset to reduce entry and exit congestion and playground congestion causing slight variation in the length of instructional blocks.

4 Core French instruction in either model is a challenge. In the government proposal it is implicit that a core French teacher sees six classes for 40 minutes, between 100 and 200 students. One possibility is to place teachers with limited French in the primary divisions and teacher with better French in the junior division. Another possibility would see a cohort teacher guide their students through a French class online. Having a supply teacher moving from cohort to cohort and even across schools is another issue. Could such a teacher become a carrier? Is such a teacher more likely to be exposed to the virus? limited French in the primary divisions and teacher with better French in the junior division. Another possibility would see a cohort teacher guide their students through a French class online. Having a supply teacher moving from cohort to cohort and even across schools is another issue. Could such a teacher become a carrier? Is such a teacher more likely to be exposed to the virus?

of 17 French immersion students. Students in immersion receive half their instruction in French and half in English on alternate weeks. This pair of teachers sees 34 different students over the two-week cycle. Finally, a third type of teacher handles all the children from families who wish to opt out of physical school attendance, seeing no students in person.

A huge advantage of this proposal is that all teachers, EAs, ECEs and possibly lunchroom supervisors could readily be limited to exposure to a maximum of 34 students. A teacher could also choose to be exposed to zero students. The two-shift day reduces teacher exposure to large groups of students. The small cohorts of students are delivered within the existing school teaching spaces and staffing.

There may be other disadvantages. Is one hour a sufficient time to safely clean what ever classrooms are needed for the afternoon shift? There would be transportation complications. Perhaps students in urban high schools would have to use public transit, walk or use bicycles to free up needed bus space for elementary students. School administrators and secretarial staff as well as custodians would have to split shifts across the longer school day.

The reality is that, given the presence of COVID-19 in our society, many activities are being modified in ways that are not perfect. We all just have to try. This proposal seems feasible without the addition of vast resources to the elementary school system and has some advantages relative to the government's proposal.

Table 1: Examples of Pre-COVID and Post-COVID School Days in Ontario

Minutes	Total	Teaching Block	Nutrition/ Activity Break	Teaching Block	Nutrition/ Activity Break	Teaching Block
Pre-COVID school day	380	100	40	100	40	100
Post-COVID school day	270	125	40	125	Not applicable	Not applicable

Table 2: Examples of Proposed Types of Teachers/Educational Assistants in the elementary System

Type	Duty	Number of Students in Physical Contact Group
Teacher: Standard assignment – outside French immersion	Teach same group of 17 students every day at same physical school they already attend. Sixty minutes available per week for online consultation with their students as needed.	17
Teacher: English teacher paired with French immersion teacher in a French immersion class and French immersion teacher paired with English teacher in a French immersion class	Teaches two groups of students in English every other week at same school they already attend. 60 minutes available per week for online consultation with their students as needed.	34
Teacher: Fully online teacher	Responsible for online learning of a group of 17 from different schools	0
Educational assistant/Early childhood educator	Assigned to students within one cohort for a day plus nutrition break supervision in another cohort as needed	34

David Johnson is professor of economics at Wilfrid Laurier University and a C.D. Howe Institute Research Fellow.

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Intelligence MEMOS

From: John Richards and Parisa Mahboubi

To: Provincial Ministers of Education

Date: August 10, 2020

Re: **Canada Has Three Other Education Problems in Addition to Teaching During the Pandemic**

Once provincial governments, parents, and teachers decide how best to teach kids during the pandemic, here are three other problems to tackle. Although Canada continues to rank among the best OECD countries for quality of schools, learning outcomes have declined over the last two decades, the gap between top and lowest preforming provinces has widened, and gaps between advantaged and disadvantaged students are large.

The OECD's Program for International Student Assessment (PISA) has become a widely respected means to assess student outcomes (in reading, mathematics, and science) in national school systems at the upper secondary level. PISA also provides disaggregated results – at the provincial level for Canada.

In each "round", starting in 2000 and including the latest in 2018, Canadian schools have performed well above the relevant OECD PISA averages in all three subjects. Our schools are good – but there are weaknesses.

Since "benchmarking" of grading in the 2000s, average scores among the original OECD countries have been relatively stable over successive rounds. On the other hand, Canadian PISA scores in all three subjects have experienced statistically significant declines since benchmarking. (Benchmarking means that the average international student performance was set at 500 for each subject for the benchmarking year – 2000 for reading, 2003 for math, and 2006 for science – to allow comparisons over time and across countries.

The largest decline has been in mathematics. Relative to the other provinces, Quebec is a positive outlier. One explanation is that Quebec's mathematics curriculum is more rigorous and secondary level math teachers receive more intensive training than in other provinces. Another explanation may be that private schools are more prevalent in Quebec than in other provinces and private school students perform significantly better than their counterparts, mostly due to family supports. Nonetheless, Quebec public school scores are above the national average, outperforming all other provinces.

A second problem is that average PISA subject scores have consistently been lower in the six small provinces than in the four large provinces, and the gap between the two groups is slowly increasing. The most troubling trend in PISA scores is in Manitoba. In all three subjects, it has experienced the largest provincial declines since benchmarking.

Two probable explanations for lower small-province scores are inability to realize scale economies accessible by the large provinces and somewhat lower socio-economic conditions among participating students in the six small provinces.

The third problem is the equity gaps in the education system – gaps that are likely to widen due to the COVID-19 school closures. A country in which virtually all upper-secondary students can read, use mathematics, and understand science at a reasonably high level is likely to be more prosperous and enjoy more social trust than a country with the same average PISA scores but more polarized results in terms of socio-economic conditions. An implicit goal of Canadian education policy is not only achieving high average scores, but also minimizing the decline in outcomes among students as socio-economic conditions decline from advantaged to disadvantaged. Although Canada has more equitable outcomes than most other OECD countries, the Canadian difference in PISA scores between advantaged and disadvantaged students is still considerable and needs special attention.

An important dimension of equity policy is closing the gap between Indigenous and Non-Indigenous student scores. Based on fragmentary evidence, this gap is probably of similar size to that between advantaged students from the top quarter of students, ranked by family socio-economic characteristics, and disadvantaged students from the bottom quarter. Six of 10 provinces – the four western provinces plus two Atlantic provinces – agreed to add a voluntary question in the 2018 PISA round, inviting Indigenous students to self-identify. Despite availability of the identifier in six provinces, the agency responsible for administering the Canadian PISA sample decided not to release the Indigenous results, claiming they were "not representative." Without explanation, it is hard to know what "not representative" means. The decision to withhold results flouts the fundamental rationale of PISA surveys, namely providing a better empirical foundation for discussion of education policy.

Provincial government goals should include both reversing declines in core subjects and targeting low-income and disadvantaged communities – including Indigenous students. Early child education and intense tutoring and mentoring among secondary-school students are programs worth funding – because they succeed. Provinces other than Quebec should also put greater emphasis on mathematics in teacher training, and consider adopting mathematics curricula akin to Quebec's. Finally, smaller provinces, particularly Manitoba and Saskatchewan, can benefit from partnering with other more successful provinces, sharing curricula and encouraging their university education faculties to develop complementary specialties.

John Richards is a senior Fellow at the C.D. Howe Institute, and Professor, Simon Fraser University. Parisa Mahboubi is a Senior Policy Analyst at the C.D. Howe Institute.

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Part 4

Ensuring Financial Market and Monetary Stability

by Jeremy Kronick

This section looks at the role of monetary policy and financial markets policy in navigating two periods: (i) the crisis period brought on by the COVID-19 pandemic, and; (ii) the economic recovery period.

Crisis Response: Early on, the federal government recognized that businesses would have a tough time accessing capital during a period where they were earning little to no revenue, upending traditional risk metrics used by financial institutions to assess creditworthiness. The Canada Emergency Business Account and Business Credit Availability Program were meant to provide support to these businesses through, for example, interest-free loans and co-lending agreements, to make it easier for financial institutions to set aside these traditional risk metrics.

As we move from the crisis to the recovery phase, these programs will be wound down or will be modified to reflect the changing economic circumstances.[1] However, traditional risk metrics will continue to be problematic as they are likely going to make even healthy businesses appear unhealthy until the recovery is well underway and economic uncertainty has eased. Of course, we do not want to support zombie firms that keep workers and investments in firms that, unfortunately, have no future, but we also want to make sure healthy firms with viable business models do not disappear. Therefore, some continued government involvement is likely warranted. Important questions answered in this section include: whether the uptake of these programs has been sufficient? what modifications are necessary? and what principles should guide any future government involvement?

As for monetary policy, the Bank of Canada's mandate is to target 2 percent inflation. Financial stability, however, is also a part of the Bank's assessment of the economic conditions underlying its setting of the overnight rate, as well as the possibility of it engaging in other forms of policy, including quantitative easing (QE). In this regard, the Bank undertook a large-scale asset purchase program that included federal, private-sector and provincial debt. Efforts to ease provincial funding pressures by backstopping provincial debt were effective. Before the crisis, all 10 provinces had interest rate spreads over federal debt of less than 100 basis points. Fast forward to March 26, the day before the Bank of Canada announced it would start buying short-term provincial debt, spreads across all provinces were well above 100 basis points, with Newfoundland closing in on 200 basis points. By April 17, two days after the Bank announced it would also buy longer-term provincial bonds, spreads had returned to much more normal levels. The latter announcement also had the effect of reducing actual borrowing costs across all provinces back to the levels seen in February before the crisis. All this occurred despite little in the way of actual purchases by the Bank of Canada. Indeed, the Bank's mere presence acted as a signal to markets. There is danger in suppressing market signals, and there remains concern over what buying up non-federal government debt means for the Bank of Canada's operational independence, but there can be little doubt that the backstop was successful in easing provincial funding pressures.

1 For example, the federal government announced in its Speech from the Throne on September 23, 2020, that it would expand the Canadian Emergency Business Account to help businesses with fixed costs.

These first two sections have focused on what has been done to mitigate the impact of the COVID-19 crisis. What does the future hold?

The Economic Recovery Period: The Bank's first foray into quantitative easing led to an unprecedented increase in the size of its balance sheet. During the crisis period, where there was very little economic activity, the Bank did not need to worry that this increase would lead to inflation; indeed, deflation was the bigger concern. However, as the economy begins its recovery, questions remain, including the credit and political risk of taking on assets outside of federal government debt, and whether the balance sheet expansion will lead to inflation above the 2 percent target.

Much of the Bank's balance sheet increase has been in the form of short-term assets that will roll off the balance sheet, hopefully leading to a natural decrease in its size. However, some of these assets are longer-term, and the Bank may be forced to sell these assets in secondary markets. This brings on credit risk, as well as political risk, if doing so risks increasing the interest rate faced by respective issuers. With respect to inflation, the Bank must ensure the right timing of the reduction in its balance sheet, as an elevated balance sheet of this magnitude, once the recovery has taken off, will lead to more money chasing fewer goods and services. The reverse is also true in that shrinking the balance sheet too early could cause an increase in the spreads on the assets (public- and private-sector debt) the Bank worked hard to bring down during the crisis.

Financing Canada's fiscal response has no easy answer. On the one hand, we have reached debt levels not seen in our country's history. On the other hand, interest rates are so low that debt-servicing costs are near their historical low point. Whether interest rates remain at these low levels, given the likely need to increase debt further, is a critical question. What many will see from what the Institute has published is that a fiscal and monetary anchor is imperative. Canada has benefited tremendously from having both a fiscal and monetary anchor over the past 25 years, including the very low-risk premiums on government borrowing costs. These anchors put discipline on program spending, and force government officials to take into consideration the strong relationship between increased debt, inflation, and interest rates. Both monetary and fiscal anchors are up for debate now, and the outcome of these discussions will be critical in charting Canada's path forward.

Theme 1:

Canada Emergency Business Account, Business Credit Availability Program, and Financial Supports for Businesses

Intelligence MEMOS

From: Glen Hodgson

To: Canadians Concerned about COVID-19

Date: March 17, 2020

Re: **The Role of Crown Financial Institutions During a Pandemic**

COVID-19 has quickly become a global threat, causing a massive public health response and economic dislocation. Crown financial institutions, notably Business Development Bank of Canada (BDC) and Export Development Canada (EDC), can play an important role in these exceptional times.

Economic impacts

The spread of COVID-19 is affecting specific sectors, including hospitality, hotels and tourism; airlines and cruise ships; the meetings industry; and large public sporting and entertainment events. More broadly, significant uncertainty has been created for all economic actors. This uncertainty has quickly turned into a reluctance to take economic decisions and action today, let alone plan for the future. Uncertainty amplifies the economic slowdown and makes it harder to see a positive turning point.

Based on the pattern of past epidemics, we anticipate an economic pathway over the next quarter or two that would likely resemble a downward "V". This would mean a pronounced drop in GDP for a quarter or two, leading to a recession in many jurisdictions. If the epidemic is brought under control as hoped, a quick bounce-back to trend growth is possible. There would be a loss of GDP during the "V" period but a quick return to a normal growth trend by mid-year.

However, a more difficult economic pathway, with a more prolonged recession and slower recovery, is also a realistic scenario.

An added factor for Canada is the concurrent steep drop in oil prices, which benefits consumers but puts regions and firms in the oil sector under added pressure, with a related negative impact on investors and investment.

Financial markets are feeling the combined effects of pandemic risk, heightened uncertainty and lower oil prices via a sharp drop in equity prices and lower interest rates across the yield curve. Policy intervention is now taking place with interest rate cuts and fiscal action. Ideally the policy intervention would aim to address both uncertainty and affected sectors and firms; but there may be a limit to what traditional stimulus policies can do.

The role for BDC and EDC

BDC and EDC each have a public policy mandate to meet the credit needs of Canadian businesses in their respective markets, and specifically to help fill market gaps. During the 2008-09 global financial crisis, BDC and EDC's direct lending capacity was used actively to provide credit to clients when the financial system became constrained and where commercial lenders and insurers pulled back from the market. The federal government announced last Friday that they are being given a similar role during this period of heightened turmoil and uncertainty.

A rapid economic slowdown caused by COVID-19 will quickly translate into disruption in business cash flow, imperiling business balance sheets for highly leveraged and small businesses, particularly in exposed sectors. BDC and EDC are being asked to take a number of steps to ease such cash flow pressure. They can help existing clients to maintain access to liquidity in order to keep operations active. They could also develop new facilities as required and serve new clients. In some cases, there may be a need to address a client's debt service payment capacity, including restructuring payment terms if necessary.

Moreover, BDC and EDC may be asked to play a larger role in the Canadian national financial system, as they were in 2008 and 2009. They could examine structural gaps that have been exposed in financial markets, stepping in to help fill those gaps as required. To ensure BDC has the requisite financial strength to take on larger volumes and added risks, it may require additional financial backing from its shareholder, the government of Canada. EDC may be similarly called upon as it relates to trade finance.

Maintaining access to liquidity for their clients is an important first step, and these Crowns can do much more to help the economy stabilize and return to growth while efforts are undertaken to tame COVID-19.

Glen Hodgson is a senior fellow at the C.D. Howe Institute.

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Crisis Working Group Report: Monetary and Financial Measures

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. Several working groups will address challenges in the monetary, fiscal and financial policy domains. One such group is the Monetary and Financial Measures Working Group, co-chaired by David Dodge, former Governor of the Bank of Canada, and Mark Zelmer, former Deputy Superintendent, OSFI, and supported by a group of financial market experts and economists. Meeting weekly, this group will debate policy ideas, and communicate the results of its discussions in a public joint Communique. The group's first meeting was held on Monday, March 23, 2020.

The working group noted how the COVID-19 crisis is a black-swan event for which businesses and consumers could not have been expected to prepare. It is fundamentally different from the global financial crisis of 2008. This time around the need to protect health has necessitated social distancing provisions around the world that are effectively shutting down large parts of the Canadian and global economies. As a result, the group agreed that, while expanding credit on relaxed commercial terms is absolutely essential, this alone will not be sufficient. Some form of government guaranteed credit facility will be needed in tandem with various forms of targeted fiscal measures to help Canadians and the business community survive and begin resuming more normal operations when the worst of the crisis has passed.

For purposes of stimulating conversation within the group, an example of such a facility was presented, with the following features:

- 100% guarantee by the Government of Canada, and available to Canadian firms either through federal and provincially-regulated deposit-taking institutions, or crown agencies like Business Development Bank of Canada, Export Development Canada or Farm Credit Canada.
- The facility would be open until such time as the public health crisis has passed and economic activity restarted. At that point any borrowings would be repayable over the subsequent five years at a rate charged at a premium to commercial terms.

- Any firm that was solvent as of February 29, 2020 would be eligible to borrow, and the maximum amount they could draw would be negotiated by the borrower and lender based on an assessment of the borrower's capacity to repay the funds over a five-year period, in a normal business environment.
- Any credit extended through the facility, and administered through financial institutions would be excluded from the calculation of lender regulatory capital and leverage requirements on the grounds that the credit is fully guaranteed by the Government of Canada.

The working group generally agreed that such a facility should be targeted to those most in need, simple so that it can be introduced quickly, scaled to the necessary size, and priced to compensate the public for the risk of allowing firms to borrow using the government's guarantee. The group also thought that it makes sense to leverage existing lending relationships to operate the facility given lending officers know their clients' financial situation better than if the government tried to operate it on its own. It debated how best to incent lenders to extend credit prudently under this facility given the extreme uncertainty present in the crisis as well as with respect to what business conditions will look like after the virus has been contained. In addition, there is the need to ensure that borrowers use the funds received to help resolve the crisis, continue to pay their own suppliers promptly, and be prepared to resume more normal activity as the crisis passes.

Other issues flagged by working group members included where such a facility would sit in relation to other borrowings incurred by firms from a credit hierarchy perspective, how the facility would be managed as part of the government's own financial obligations, and how such a facility would fit within the broader range of measures that are being introduced by all levels of government to moderate the economic fallout from the crisis.

In general, there was interest and support for a proposal of this nature. If the issues highlighted in this Communique can be resolved, the working group believed this credit facility could be beneficial to the economy in this unique crisis.

The Monetary and Financial Measures Working Group will meet again Monday, March 30th, 2020 at 3pm. Much is likely to change between now and then, so we want to give ourselves flexibility to offer timely advice as circumstances change. That said, some areas for consideration raised by members included what is happening in other jurisdictions and how this could affect the credit situation in Canada, how will the government debt incurred through this crisis be financed, and how can we can place the real economy on a solid footing for when things start back up.

Monetary and Financial Measures Working Group members include:

David Dodge, Co-Chair, former Governor of the Bank of Canada
Mark Zelmer, Co-Chair, former Deputy Superintendent, OSFI
Riaz Ahmed, TD Bank
Steve Ambler, Universite du Quebec a Montreal
Dwight Duncan, McMillan LLP
Paul Jenkins, Former Senior Deputy Government, Bank of Canada
Phil Howell, Former Superintendent, FSCO
Thor Koeppl, Queen's University
Andrew Moor, Equitable Bank
Tamara Vrooman, VanCity
Jeremy Kronick, C.D. Howe Institute
Duncan Munn, C.D. Howe Institute

Intelligence MEMOS

From: David Powell

To: Department of Finance

Date: March 27, 2020

Re: **Filling the Gap: Emergency Funding Programs and Asset-Based Finance in Times of Economic Crisis**

In times of economic crisis, the federal government should have in place a large-scale program for funding asset-based finance intermediaries. No one wants to see a repeat of the 2008-09 crisis where many non-bank lenders were lost, and Canadians were left with a less competitive market of available capital.

The asset-based finance industry (ABF) is very important to the Canadian economy, and is the biggest available financing alternative to classic bank lending.

In 2018, the value of ABF financing on the books was an estimated $416 billion of vehicles and equipment for consumer and business customers in Canada. That is equivalent to 22 per cent of non-mortgage loans made by the total private banking sector.

The ABF industry supports a broad network of dealers, manufacturers, distributors, vendors and brokers, and their customers throughout the country.

ABF is offered by banks, credit unions, insurance companies, government financial institutions, manufacturer finance companies, and independent finance companies. Several of these entities are regulated and therefore have access to existing Bank of Canada programs for emergency lending. Others, however, are not, and I focus on these in a forthcoming C.D. Howe Institute Commentary, as they are also critical to the functioning of the economy.

Ninety per cent of new vehicles – from automobiles to big rigs – are financed, and non-bank asset-based finance companies handle almost half. If the big rigs are to be kept on the road transporting essential supplies, this industry needs to be supported in times of stress.

Similarly, almost 40 per cent of all machinery and equipment (M&E) is financed by this industry and almost two-thirds of that is financed by non-bank ABFs.

ABF entities ran into deep trouble during the 2008-2009 global financial crisis and required an emergency liquidity program that took months to devise and implement. The primary source of funding of the ABF sector was, and is, the asset-backed commercial paper and securitization markets, often with bank backup or standby lines, purchased by private pools of investment capital – insurance companies, pension plans, hedge funds, banks and others.

The 2008-2009 experience revealed that a complete loss of liquidity could occur within a few weeks, even days. Government was needed to step into the shoes of absent private-sector investors.

To avoid something similar today, and given the ABF industry's low delinquencies, I argue that, during periods of extraordinary financial market turmoil, the federal government should activate a large-scale securitization program to fund ABF intermediaries who finance customers based on real assets. It would purchase term asset-based securities backed by a pool of assets and their receivables, receiving the same protection and profit that a private-sector investor would receive.

Once liquidity is restored and private investor confidence returned, the commercial markets would again resume their normal functioning and government could withdraw its temporary emergency funding program.

The 2009 federal budget established the Canadian Secured Credit Facility, a $12-billion fund administered by the Business Development Bank of Canada (BDC) to purchase these securities. Since then, under successor programs, the BDC has continued to purchase asset-based securities, albeit on a smaller scale. With more than 10 years of experience, the BDC understands the policies and rules for such funding. Existing BDC programs could, therefore, be easily scaled up in a severe downturn, with experienced people in place for effective, prudent and efficient funding.

For more than 50 years, federal governments have sought to diversify the number of financial service providers. If liquidity is not supported, many non-bank financing entities and service providers will disappear from the Canadian marketplace leaving fewer financial alternatives available to Canadians.

In a profoundly disrupted market, the policy objective should be to restore liquidity to allow the financial services sector to continue offering financing to credit-worthy consumers and businesses in support of the Canadian economy, and that includes the ABF industry.

David Powell is the former president and CEO of the Canadian Finance & Leasing Association, and was previously a partner in the Montreal office of a national law firm.

Crisis Working Group Report: Monetary and Financial Measures

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. Several working groups will address challenges in the monetary, fiscal and financial policy domains. One such group is the Monetary and Financial Measures Working Group, co-chaired by David Dodge, former Governor of the Bank of Canada, and Mark Zelmer, former Deputy Superintendent, OSFI, and supported by a group of financial market experts and economists. Meeting weekly, this group debates policy ideas, and communicates the results of its discussions in a public Communique. The group's second meeting was held on Monday, March 30, 2020.

The meeting began with a discussion centered on three questions:

1. How to operationalize the Canada Emergency Business Account (CEBA) facility to ensure the money gets quickly to those that need it the most?
2. As long as business loans are backed by a government guarantee, do financial institutions have the funding capacity to support this program?
3. If funding capacity is an issue, will financial institutions need more access to Bank of Canada facilities? Are the facilities that exist sufficient, and, if not, what would another facility look like?

As oft-repeated throughout the policy response to the COVID-19 crisis, the most important issue is putting these new facilities in place as quickly as possible. One concern members raised was whether financial institutions will be able to get these loans out quickly with many of them operating at reduced capacity. On this point, the group discussed a series of ideas, including:

- Digitizing as many of the processes as possible. This would help both small and large financial institutions;
- A public-private partnership, with financial institutions using their pre-existing relationships with clients to administer and adjudicate the credit, while the Canada Revenue Agency (CRA) database, with its unique ID system, supports a safe, secure, and speedy process;
- As the facility is being ramped up, using the GST register at CRA to quickly get loans out the door;
- Making the first $10,000 of CEBA a grant, since this amount is forgivable under the terms and conditions of the facility in any event. A grant would make for a simpler application checklist for businesses through their financial institutions.

- For smaller loans, implementing a simplified approval process, either through auto-adjudication, or through basic credit criteria.

Members raised the possibility of an increase in fraud cases, if, for example, businesses have accounts at multiple financial institutions, or if businesses shut down and re-open under different names. The group felt that while these are realistic possibilities, they should not prevent the implementation of this facility. An ex-post review could be announced up front, discouraging attempts at fraud. Use of the CRA's digital ID will help catch some attempting to defraud the system.

On whether financial institutions were able to fund the likely scale of this credit facility, it was largely felt that they were, with those in the provincial domain more likely to be subject to some additional pressures. To the extent that provincially-regulated financial institutions do face funding pressures, they would want to turn to the Bank of Canada for liquidity support. Critical here, then, is to ensure these financial institutions are able to access Bank of Canada liquidity facilities.

On whether the scale of the facility itself was sufficient, members looked at it in the context of other policies introduced to date, notably the 75% wage subsidy, which now applies to all businesses who have experienced at least a 30% drop in revenues. The 30% number was raised as a potential concern, given that the focal point should be the individual. More positively, the wage subsidy provides the critical assurance that many businesses will be ready to hit the ground running once allowed to re-open.

The remaining discussion focused on how this massive increase in fiscal stimulus was going to be funded. Would it all be funded through the sale of bonds to the market, through financial repression where financial institutions might be compelled to hold government debt, or would the Bank of Canada finance much of it?

Members determined that this is not a central short-run issue. Governments are acting appropriately to contain this large negative shock through extensive liquidity provision. Moreover, the introduction by the Bank of Canada of quantitative easing, i.e. buying government securities in the secondary market to lower interest rates across the yield curve, would ease pressure on servicing the debt, and with the economy shut down, inflation was not an immediate concern.

In the longer-run, if inflation does increase because the Bank of Canada expands its balance sheet, putting additional money into the economy, nominal interest rates might increase, putting upward pressure on government debt financing costs. Asking whether nominal GDP growth would outpace any increase in interest costs, members pointed out that the macroeconomic recovery will not be determined only by the effects of Canadian fiscal and monetary policy, with concern centered around the situation in the US. Members reinforced again, however, that these long-term concerns should not prevent governments from taking action now.

In summary, the Monetary and Financial Measures Working Group recommends the following:

- Of first-order concern is quickly operationalizing CEBA and ensuring credit flows to businesses most in need;
- Support financial institutions in this regard by a) finding ways to digitize processes through, for example, using the CRA's digital ID system and GST register, b) by making the first $10,000 of CEBA a grant, and c) by simplifying the credit approval process;
- Announce up-front that an ex-post audit will happen to discourage fraud;
- While funding is not a concern for most financial institutions, these pressures might be more acute at the margin for provincially-regulated financial institutions, and the Bank of Canada should ensure these financial institutions have access to its liquidity facilities; and
- Despite the need for governments and central banks to monitor the impact the increase in debt will have on inflation, and, therefore, interest costs, this should not come at the expense of the immediate term need for large-scale fiscal stimulus.

The Monetary and Financial Measures Working Group will meet again Monday, April 6th, 2020 at 3pm. The group will continue to monitor policy actions taken over the course of the next week, and from here determine the most relevant topics for our April 6th meeting. The group will consider both the immediate needs of the country, as well as important monetary and financial considerations for both the medium and longer-term.

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David Dodge, Co-Chair, former Governor of the Bank of Canada

Mark Zelmer, Co-Chair, former¬ Deputy Superintendent, OSFI

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Steve Ambler, Université du Quebec à Montreal

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Andrew Moor, Equitable Bank

Tamara Vrooman, VanCity

Jeremy Kronick, C.D. Howe Institute

Duncan Munn, C.D. Howe Institute

Intelligence MEMOS

From: David Losier

To: The Department of Finance

Date: April 6, 2020

Re: **Government Guaranteed "Ready for Business" Cash Flow Loans**

Many economists are predicting a V-shaped recession, deep and temporary.

Fact is, the V will probably be a lopsided U, a sharp downturn followed by a flat line and a sloping recovery. The longer it takes to give a green light to business as usual, the longer the flat line. Governments must help Canadian businesses through that flat line by providing financial assistance. The economic recovery depends on businesses staying open and getting Canadians back to work.

Ottawa has designated $65 billion for a Business Credit Availability Program (BCAP). Its Canada Emergency Business Account (CEBA) only provides new guaranteed interest-free loans of up to $40,000 to small businesses, so larger ones will likely have to turn toward two other components of the BCAP program being managed by BDC and EDC. The question then becomes whether EDC and BDC have the resources to handle the additional business.

How big might this additional business be? This is a difficult question, but here is one way of thinking about it. According to the Canadian Federation of Independent Business (CFIB), 60 percent of Canada's 1.25 million SMEs have seen a significant drop in sales with 33 percent reporting a reduction of greater than 75 percent. Of those 1.25 million SMEs, a little over 700,000 are micro-businesses that are the likely target of the expedited $40,000 program. This would leave somewhere around 550,000 businesses, 60 percent of which may need significant support for their operational needs, to be managed through EDC and BDC.

Will EDC and BDC be able to support this? First, SMEs cannot predict when the crisis will be over and therefore most SMEs simply won't qualify under standard underwriting criteria. Secondly, the needs are immediate, and the time required to execute current underwriting processes on those larger SMEs facing a significant drop in sales will overload the system and grind it to a halt. Not to mention that many of these processes still require face-to-face meetings and exchanges of paper – interactions currently being avoided.

To the extent that BDC and EDC will not be able to handle the requests from most SMEs, many of which will need far more than $40,000, financial institutions are going to be turned to in droves. CEBA would then have to adapt. Details of an updated CEBA could include:

- An increase to $250,000 to cover the needs for the majority of small businesses;
- A 100 percent government guarantee;
- Eliminating the time required to underwrite (assess the risk) of these loans and ensure that they are made available rapidly. If funds beyond $250,000 are required, a proportionate increase in underwriting standards could be undertaken, as determined by the financial institution;
- Interest being paid by the federal government until the zero-percent interest period has ended;
- Auditing the use of the facility afterwards instead of extended credit adjudication beforehand.

This is not meant to be a traditional lending program; this is a black swan lending program. Borrowers themselves don't know if they will be able to repay.

The uncertain duration of the slowdown means traditional underwriting will be impossible for most of these SMEs.

All financial institutions must be called upon to get these small business loans into the economy, with an absolute minimum of underwriting criteria. The underwriting should be focused on the assessment of the business's needs as opposed to the ability to repay, in order to ensure support is available, widely and rapidly, to all Canadian SMEs. These are the businesses that will get the economy humming again.

David Losier is a corporate director and consultant, and the former CFO for Uni Financial Cooperation, Canada's first federally regulated credit union.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Hugh O'Reilly

To: Bill Morneau, Minister of Finance

Date: April 16, 2020

Re: **Regional, Economically Important Credit Unions Must be Included in STLF**

The Bank of Canada has made a series of interventions designed to support Canada's financial system and ensure the availability of credit during the COVID-19 crisis.

These actions are important to ensure that small and medium-sized businesses survive in the short term, and that they are able to lead the economic revival that will be needed.

But there is a potential policy gap in the design of the Standing Term Liquidity Facility (STLF), which overlooks the importance of large, regional credit unions in the Canadian financial system.

In Ontario and British Columbia, large, regional credit unions are critically important lenders to small and medium-sized enterprises. The two largest credit unions in those provinces collectively serve one million Canadians and 70,000 small businesses, from local farms and coffee shops to clean energy providers and small manufacturers. They are part of the small business backbone of the Canadian economy, which employs two-thirds of the private-sector workforce.

In order to participate in the STLF, a financial institution must be a direct participant in the Large Value Transfer System (LTVS) of Payments Canada. Direct participants must satisfy the following administrative criteria: (i) be members of Payments Canada; (ii) use SWIFT; (iii) have adequate capability for its LVTS operations: (iv) have a settlement account with the Bank of Canada; and (v) be capable of entering into loan agreements with the Bank and pledging collateral in support of those loans (the "LVTS Criteria"). The only criterion large, regional economically important credit unions don't meet is having a settlement account with the Bank.

Regional economically important credit unions serve many of the people and businesses upon which any meaningful, inclusive recovery will rely. To ensure those businesses are empowered to help drive the recovery, those credit unions must be able to access the same liquidity measures as other large Canadian financial institutions. And that means they should be qualifying financial institutions for the STLF.

Canada's financial system is complex, and its key institutions are regulated by different levels of government. The Bank has intervened to provide liquidity support to its most important elements and institutions. The key mechanisms are the STLF for the chartered banks and other participants in the Large Value Transfer System (LVTS) and a Contingent Term Repo Facility (CTRF) for federally and provincially regulated institutions (pension funds, banks, securities dealers and insurance companies) with significant activity in the Canadian fixed income or money markets.

The CTRF shows that the Bank's role in maintaining financial system liquidity is not limited to areas of federal jurisdiction. Inclusion in the CTRF is based on the participation of the financial institution in certain Canadian fixed income and money markets. This suggests that those institutions must not only be systemically important, they must also be sophisticated.

But under the current design of the STLF, big credit unions do not participate directly. Instead, they participate through Central 1, a cooperative set up by member credit unions for the purpose of participating in the Canadian Payments System. While Central 1 has a relationship to its institutional members, it does not have any connection to their retail and business members. Its ability to act as an effective intermediary between the banks and big credit unions is therefore limited. Moreover, using an intermediary that serves all credit unions may create bottlenecks and information gaps that could create barriers for regional economically important credit unions to gain access to the STLF by adding an extra layer.

Obviously, in a federal system, a one-size-fits-all policy has the potential to create more problems than it solves. The Bank appears to have recognized this when it designed the CTRF. The same factors that support the design of the CTRF also apply to the STLF.

Given their outsized regional importance, excluding big credit unions from the STLF could lead to some regions suffering a greater credit contraction and slower recovery than others. Therefore, those regional economically important credit unions that are LVTS Non-Participant Partners should be allowed to participate directly in the STLF.

Leaving these major credit unions out of the STLF could, in fact, undermine the Bank's short- and long-term goals of avoiding a credit crunch and putting small and medium businesses in the best position possible to revive the post-pandemic economy.

Hugh O'Reilly is a Senior Fellow at C.D. Howe, former President and CEO of OPTrust, and a member of the Board at Vancity Community Investment Bank.
To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Don Drummond

To: Bill Morneau, Minister of Finance

Date: April 20, 2020

Re: **Debt Could Choke a Post-COVID-19 Economic Recovery**

Canadian public policy is understandably focusing on mitigating the near-term losses the shutdown associated with COVID-19 is causing to employment, income and business. And high marks must be assigned to the swiftness and breadth of action and the sensitivity to adjust policy when deficiencies surface.

At the same time, however, the policy challenge is to create the conditions to foster a strong, sustained economic recovery once the pandemic subsides. The private sector debt resulting from the policies to deal with the present may compromise the prospects of recovery. Unless carefully designed, the pending program to assist with commercial rent issues may amount to piling on.

Addressing the sharp loss in economic activity will inevitably result in debt accumulation.

There should be a debate between the balance in the public and private sectors. The pubic sector is taking on a massive amount of debt. It is generally considered that this is appropriate. The federal government at least has the borrowing capacity and interest rates are low. With a moderate debt load, it has some flexibility to work off the extra debt over time.

Many corners of the private sector have neither that borrowing capacity nor the luxury of time. The household sector is already heavily indebted, with a debt-to-income ratio over 175 percent, requiring households to devote about 15 percent of income to service that debt. The mortgage interest deferral option offered in the wake of COVID-19 is proving popular with about 500,000 Canadians applying in the first two weeks alone. The deferrals will help families cope with income losses, but there will be a reckoning. A six-month deferral on a $300,000 mortgage at three percent increases overall interest payments to $12,346, which might be worked off at a rate of $41.99 per payment.

The Canada Emergency Business Account offers an interest-free loan of $40,000 but in order to be eligible for up to $10,000 of that amount being forgiven, $30,000 must be fully repaid on or before December 31, 2022.

Despite this program and the Canada Emergency Wage Subsidy that covers up to 75 percent of certain labour costs, Canadian businesses have made it clear that commercial rent payments are a clear and present danger to their survival. This is coming from the perspectives of both landlords not getting paid and tenants unable to pay.

Disappearance of either party over the coming months would greatly hamper the prospects of economic recovery. It appears the Government of Canada is again sensitive to gaps identified in their support programs and has indicated some sort of relief will be announced soon. From the vaguest of descriptions available, it appears it may have a similar structure to the Canada Emergency Business Account. That is, the rent support for landlords and tenants will be largely in the form of loans. Again, the support will be welcome and helpful. But again, it will add to the debt burden and the payments required as the economy struggles to regain its footing.

Increased debt is inevitable as the public and private sectors of Canada grapple with the economic effects of COVID-19. As policies are rolled out, governments should be mindful not to load too much of that debt onto the private sector or prospects of eventual economic recovery will be compromised. The next opportunity to pay heed to such concern is with the design of the forthcoming assistance on commercial rents. The support should go easy on the loan component.

Don Drummond is the Stauffer-Dunning Fellow in Global Public Policy and Adjunct Professor at the School of Policy Studies at Queen's University.
To send a comment or leave feedback, email us at blog@cdhowe.org.

COVID-19 Crisis Working Group: Monetary and Financial Measures

Communique #5: Viable Businesses Need Access to Capital

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. Its Working Group on Monetary and Financial Measures is co-chaired by David Dodge, former Governor of the Bank of Canada, and Mark Zelmer, former Deputy Superintendent, OSFI, and supported by a group of financial market experts and economists. The group's fifth meeting was held on Monday, May 4th, 2020.

The group's focus at the meeting was on the recovery phase and how to ensure companies with viable business models can make the types of investments needed to adapt to the changing structure of the economy, avoid unsustainable debt, and replenish their working capital. Traditional risk metrics are likely to show that potential borrowers are riskier than they were pre-pandemic. Private lenders might be unable or unwilling to take on the associated risk in this highly uncertain environment. The primary question then is whether there are steps governments can take to facilitate business access to both short-term working capital and new sources of patient capital without propping up businesses that would have failed anyway, or whose models will not work post-pandemic.

Members agreed that one of the major impediments to private-lender capital provision is high uncertainty about how the economy and public policy will evolve in the recovery. Anything that governments at all levels, as well as the central bank and regulators, can do to provide forward guidance and reduce uncertainty about how public policy and regulation will unfold as the economy recovers will help ensure private lenders and borrowers can match up as the recovery takes hold.

Members felt that the underlying issue of replenishing business working capital is one of liquidity. On this front, the Bank of Canada has supported financial institutions with plenty of liquidity through the pandemic. Therefore, as long as companies have viable business models, financial institutions should be there to help companies restore their working capital.

The focus then turned to the other two concerns, namely the ability for businesses to invest in the new economy, and restructuring their balance sheet in order to do so.

Members began by pointing to the three different types of companies that will emerge from this crisis. First, there are companies that no longer have a viable business model despite the liquidity support they have received. Second, companies that do have viable business models, but need to restructure their finances and obtain new sources of capital to invest. And, third, companies that are going to have to do a deeper restructuring, and will likely have to shrink in a post-pandemic world.

The group felt that focusing on how to support these last two buckets – those needing to restructure their finances, and those needing to restructure in more depth – would be critical for the success of the recovery.

On those companies needing to restructure their finances, the group discussed regulatory impediments that might restrict the type of necessary patient capital flows in an environment where traditional risk metrics may not tell a company's true story. One such impediment highlighted by the group was life insurance company capital requirements. In particular, life insurer regulations assign the same capital charge to all unrated debt investments regardless of the inherent credit risk of the investment. This effectively dis-incents investments in lower risk investments like many infrastructure projects. Members advocated allowing major life insurance companies to use their own risk models to measure and capitalize the risk for those projects in the same way regulations allow major banks to use their own risk models to measure and capitalize the risk in their lending activities. That would help facilitate greater institutional investor supply of capital for infrastructure projects and to unrated companies more generally.

For companies that need to restructure their operations, the two main federal insolvency statutes are the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*. This bankruptcy system allows companies to reorganize and develop a restructuring plan in negotiations with creditors with protection from liquidation, effectively giving businesses a second chance. Members felt that governments should encourage companies to take advantage of the system, removing any stigma attached and assessing whether there are ways to streamline the process.

Members did feel, however, that some companies are likely too systemically important, as judged by their knock-on effects in the rest of the economy, to be able to go through the bankruptcy and insolvency process. The challenge is determining which companies are truly systemically important. Governments need to be clear on the criteria they will use to make this determination. And once these criteria have been laid out, the question is what role should government play. Alternatively, members pointed to an approach used in other jurisdictions whereby companies are encouraged to look to

employees and other stakeholders first for capital. Members acknowledged, however, that this was a longer-term approach and actual government intervention might be necessary in the more immediate term.

One option for government intervention involves incentivized loans, where government provides favourable terms to companies in exchange for them making specific investments. Members were wary of this option, with governments directing investments. Members pointed to other options such as government or Crown lenders taking a mezzanine debt or preferred equity position, which would allow companies themselves to determine the appropriate investment. One potential concern here is that this type of investment puts the government, and by extension the taxpayer, lower in the creditor stack, i.e., behind secured debt holders. While no perfect option exists, members did favour the preferred equity approach. The group did not discuss tax issues but noted that the government might want to consider tax measures that facilitate the flow of patient equity capital.

In summary, the group felt that policymakers and regulators should take the following steps to ensure capital is flowing efficiently to businesses best placed to drive economic growth during the recovery:

- Reduce uncertainty about the future course of public policy and regulation by continuing to be transparent in communication with the public;
- Reduce regulatory impediments to capital flow, through, for example, allowing life insurance companies to use their own internal risk models, thereby incenting more investment in companies and infrastructure projects that do not have public credit ratings;
- Encourage companies to take advantage of Canada's bankruptcy and insolvency programs, which in effect, give companies with viable business models a second chance through negotiations with creditors; and
- Be upfront about the criteria that will determine systemically important Canadian businesses, and if forced to invest, lean towards preferred equity.

The next meeting of the Monetary and Financial Measures Working Group will be on Wednesday, May 20th, 2020 at 3pm. The group will continue to monitor events and policy actions in determining the most relevant topics for that meeting.

Monetary and Financial Measures Working Group Members include:

David Dodge, Co-Chair, former Governor of the Bank of Canada

Mark Zelmer, Co-Chair, former¬ Deputy Superintendent, OSFI

Riaz Ahmed, TD Bank

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Thor Koeppl, Queen's University

Andrew Moor, Equitable Bank

Tamara Vrooman, VanCity

Jeremy Kronick, C.D. Howe Institute

Duncan Munn, C.D. Howe Institute

From: Jeremy M. Kronick and Duncan T. Munn

To: Financial Sector Regulators

Date: May 11, 2020

Re: **Ensuring Capital for the Recovery**

The COVID-19 crisis has ravaged economies and damaged private sector balance sheets all around the world, Canada included.

The Bank of Canada has seen its balance sheet more than triple in the last two months. With all that liquidity floating around, access to capital remains a potential problem. The C.D. Howe Institute's Working Group on Monetary and Financial Measures recent communique addressed the issue and what can be done to ensure capital ends up in the hands of businesses critical for Canada's economic recovery.

Despite massive fiscal and monetary stimulus, many companies won't survive. As the economy reopens, some businesses and some business models will no longer be viable. Those that will, are going to need working capital and more patient capital to restructure their balance sheets to make the types of investment critical for survival and eventual growth.

Financial institutions might provide the short-term liquidity needed to replenish working capital but not necessarily at the breadth, depth, and time periods required. Lenders' traditional risk measurements are going to show companies much riskier than they were pre-pandemic. And even before the pandemic, despite the important contributions of EDC, BDC, the Canadian Business Growth Fund, alongside our financial institutions, there were reasons to be concerned that Canada was underperforming when it came to business lending, in particular to SMEs.

The most recent OECD data suggests Canada ranks at or near the bottom in SME lending as a share of total business lending and as a percentage of GDP, and has one of the largest (and by some measures the largest) spread in interest rates charged to SMEs relative to those charged to large firms.

There are a variety of explanations, but many come down to incentives. And, the good thing is incentives can be changed. We focus on three.

First, in Canada, incentives are skewed towards household lending. Insured mortgage loans are risk-free, with a 100 percent CMHC guarantee, and the insurance premiums CMHC charges are a flat percentage based on loan-to-value. This should be changed so that the premiums also take into account the characteristics of individual borrowers. In other words, the premium should reflect the quality of the borrower and not just the quality of the collateral. As in every other form of lending, risk-based pricing ensures a more efficient allocation of capital, perhaps freeing up more lending for productivity-enhancing businesses.

The second issue is risk-weights more generally. With traditional risk metrics, and company balance sheets turned upside down by this pandemic, it is imperative that regulators and policymakers work to remove impediments to capital flowing to businesses critical to supporting the recovery.

One example and opportunity, focuses on life insurers. Life insurer regulations assign the same capital charge to all unrated debt investments regardless of their credit risk, allowing no incentive for lower risk investments. We could instead allow major life insurers to use their internal risk models to measure and capitalize risk the same way major banks are allowed to use their own models to measure and capitalize the risk in their lending activities. That would help facilitate greater institutional investor supply of capital.

Lastly, the issue of competition. This has been hotly debated for years in Canada's financial services sector, and the Competition Bureau points specifically to the lending space as an area where barriers to entry are unnecessarily restricting competition.

One solution involves ensuring regulations blend the function being performed and the entity performing it. For example, though there are exemptions, peer-to-peer lenders, like traditional lenders, must file a prospectus for each loan where securities are sold to investors. The functions are the same, but the cost could be prohibitive to smaller less risky players, creating an unnecessary burden to increased competition.

The recovery from this crisis is going to be hard. Ensuring businesses have the capital they need to invest in the recovery is imperative. Canada has a tremendous track record of working together during crisis times, including this one. Now it's time to work together to help build the future.

Jeremy M. Kronick is Associate Director, Research at the C.D. Howe Institute, where Duncan T. Munn is Senior Vice President and Chief Operating Officer.
To send a comment or leave feedback, email us at blog@cdhowe.org.

COVID-19 Crisis Business Continuity and Trade Working Group

Communique #7: Financing bridge needed to protect at-risk sectors as Canada faces a long, hard road to recovery

To help Canadian governments confront the public health and economic crisis resulting from COVID-19, the C.D. Howe Institute has established several working groups to rapidly distill expert policy advice. The Working Group on Business Continuity and Trade is co-chaired by Dwight Duncan (Senior Strategic Advisor at McMillan LLP and former Ontario Minister of Finance) and Jeanette Patell (Vice-President of Government Affairs and Policy for GE Canada). Its membership includes industry experts and economists. Daniel Schwanen, Vice-President, Research, and Grant Bishop, Associate Director, Research, at the Institute support the group. Meeting weekly, it identifies and prioritizes policy challenges and communicates members' views in published communiques. The group met on May 5 and May 12, 2020.

At these meetings, the working group discussed the risks and headwinds for economic recovery and the action that is needed to prevent "scarring" in key economic sectors. If businesses face distress and a disorderly wave of insolvencies, the ability of the economy to rebound will be impaired and the recovery slowed. Without an effective "bridge", the disruption of productive capacity will further slow the recovery – even as restrictions on workplace activities are lifted.

Working group members recommended the following:

- Governments must carefully consider how to structure sustained support required to bridge companies through a protracted period of depressed demand in various major sectors.
- With headwinds facing recovery in many sectors, likely for years to come, governments will need new and creative channels to provide economic stimulus.
- The private sector must remain the primary source of credit; however, governments should identify where impaired access to liquidity could disrupt key productive capacity, as well as complement private lending where credit access is bottlenecked and disorderly insolvencies would hinder economic recovery.
- The air travel, agrifood, petroleum, tourism and accommodation sectors represent significant shares of the Canadian economy and each face a likely protracted plunge in demand. Without

credit support to "bridge" companies in these sectors, a large portion of production capacity might be lost, resulting in knock-on effects in the wider economy.

- Nonetheless, governments must clearly identify the particular market failures that policy is targeted to address, and interventions should not displace market forces. Government backstops should not displace private creditors, impair efficient, pro-competitive consolidation or forestall restructuring of distressed companies.
- Although awaiting details for eligibility and structuring, the federal government's Large Employer Emergency Financing Facility (LEEFF) appears a good measure with broad availability across sectors and appropriate conditions to help large companies access bridge financing.
- With increasing risk of a shift towards protectionist policies internationally, Canada must remain a champion of open borders and integrated trade. However, Canada may need an "elbows up" defence to ensure key Canadian industries survive amid restructuring of global value chains.

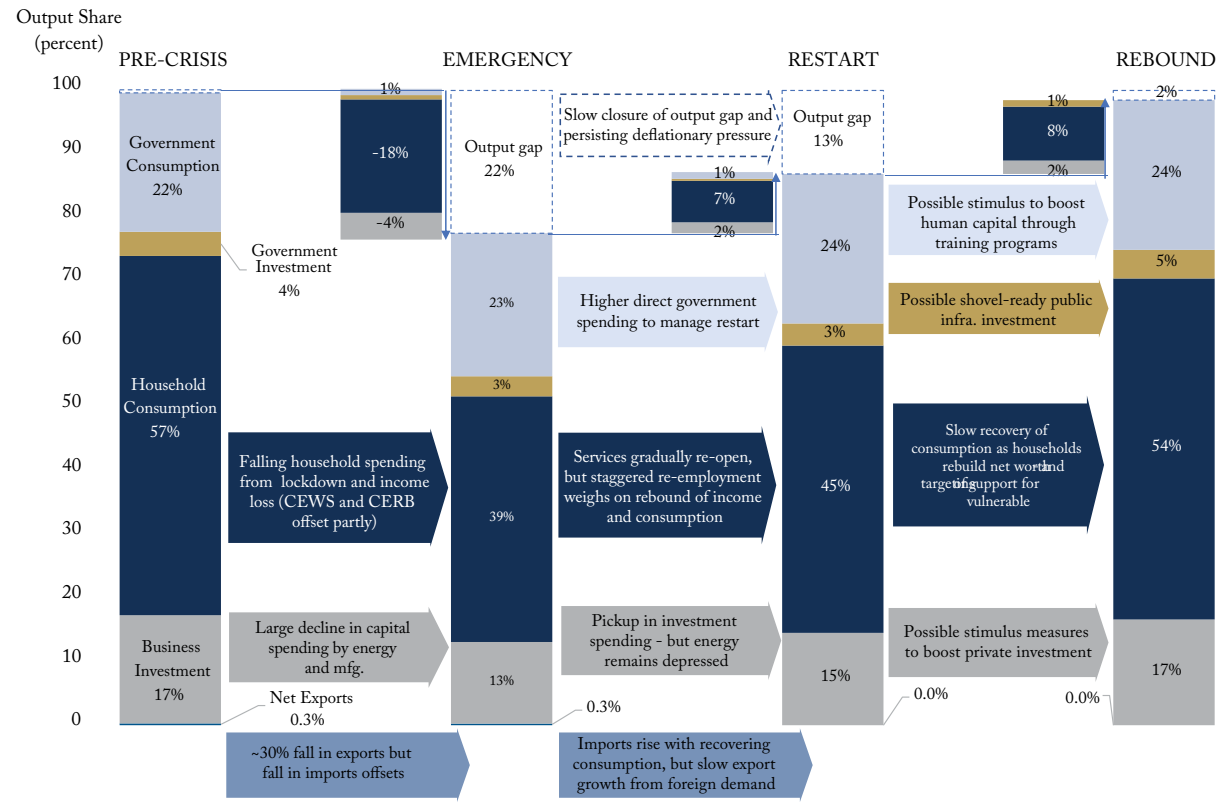
Recovery Will be a Long, Hard Road

Working group members expect the period for recovery will be long and difficult. Governments are now restarting the economy and easing shutdown restrictions gradually. Provincial governments' announced roadmaps for return to work help anchor expectations, but timelines remain tentative and much uncertainty remains around the containment of the COVID-19 virus. Uncertainty will continue to drag on economic activity. Even where allowed to return to work, many businesses and households face greatly diminished demand.

Without extraordinary and effective stimulus, Canada's economy will face idle capacity and high unemployment for an extended period. While not a forecast and not projecting timelines, Figure 1 illustrates an example pathway through restart and recovery to help conceptualize the headwinds to the recovery of Canada's economy. With the estimated plunge in household spending and private investment, the illustration shows that Canada's output gap would remain wide, absent other measures to boost aggregate demand.

The fall in household consumption has been the greatest downdraft to Canadian aggregate demand. Household spending will be slow to recover as physical distancing measures continue and households' incomes remain depressed. Even well into recovery, households will need to save rather than consume as they rebuild their net worth.

Figure 1: Estimated Crisis-driven Contraction and Example Restart/Recovery Pathway

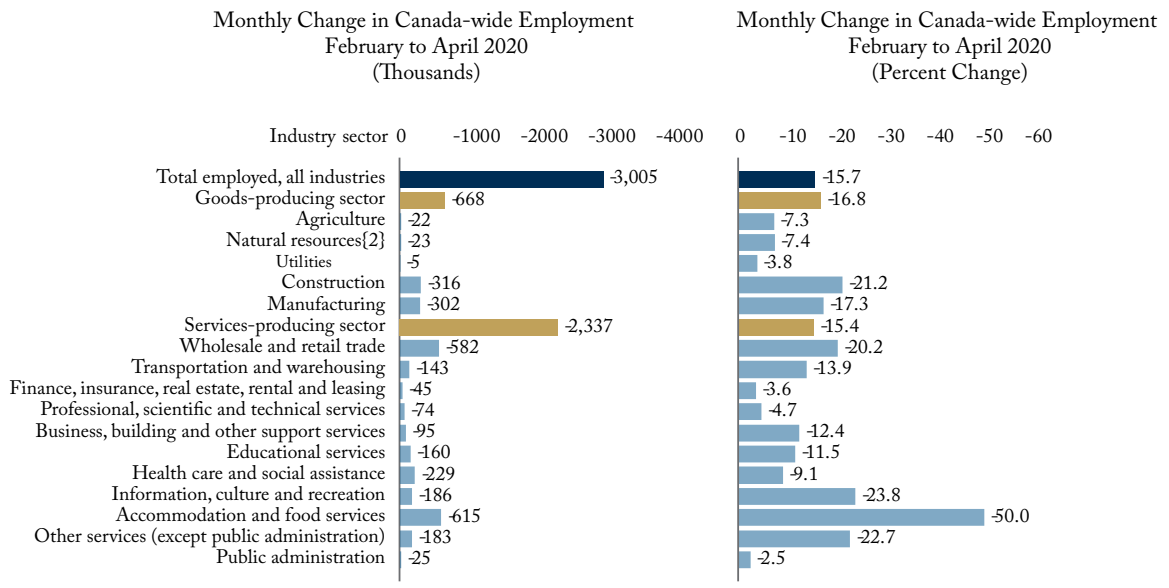


The steep contraction in Canada-wide employment since February (Figure 2) indicates severe impacts on household incomes and underscores the pullback in output across the economy. Aggregate credit card transaction data, published by RBC, indicate an over 30 percent contraction in household spending.[1] Reduced consumption on durable goods is reflected in the 75 percent year-over-year decline in Canada-wide motor vehicle sales in April.[2]

1 Guldimann, Colin. 2020. COVID Consumer Spending Tracker. May 4. RBC Economics. Available online: https://thoughtleadership.rbc.com/covid-consumer-spending-tracker/?utm_medium=email&utm_source=salesforce&utm_campaign=special

2 See: "Monthly Motor Vehicle Sales in Canada" on the C.D. Howe Institute COVID-19 Economic Dashboard. Available online: http://dashboard.cdhowe.org/#mv

Figure 2: Canada-Wide Employment Contraction since February 2020



Source: Statistics Canada Labour Force Survey.

Now expecting multi-year horizons for depressed demand in export markets, sectors like oil & gas and manufacturing are dramatically reducing capital expenditures. Exporters face diminished volumes and prices, which will drag on the net export component of aggregate demand. In turn, expecting reduced returns for an extended horizon, such exporters will reduce their capital expenditures. This pullback in private investment will further drag on aggregate demand.

Credit Support Critical to Avoid "Scarring" – But Must not Displace Market Forces

Governments must also address the risks of long-lasting disruption to productive capacity – so-called "scarring" – from a disorderly wave of insolvencies. Business distress and diminished output in key sub-sectors can have knock-on effects on related industries – such as suppliers, service contractors and downstream manufacturing/processing.

Canada could lose agrifood manufacturing capacity without stable farm production

Working group members emphasized the importance of Canada's agrifood industry as a channel of export-driven growth and highlighted the threat if its operations and value chain is decimated. The federal government could simplify its agricultural supports, targeting temporary subsidies based on lost revenue and volumes.

In Canada's agrifood industry, much manufacturing capacity serves export markets and depends on a stable annual supply of produce. If financial distress for farmers results in depressed crop and livestock production for several years, agrifood manufacturers will look abroad for new investments and reorient supply chains away from Canada. Facing large losses on this year's crops, farms lack cash flow to fund cultivation in the upcoming growing season.

Canada's agricultural risk management programs have been arguably designed for the economics of the grain sector, and recently announced farm credit support appears cumbersome for growers of produce and livestock. With produce growers already selling at low margins, the virtual elimination of revenues as domestic and export demand collapses will impose steep losses. Up to 15 percent of Canada's farms may be at risk of insolvency and closure. The loss of this agricultural capacity could cause the departure of agrifood processing/manufacturing capacity to jurisdictions with stable production. Investments are made for the long-term and, if agrifood producers shift production elsewhere, it will be difficult to win back to Canada.

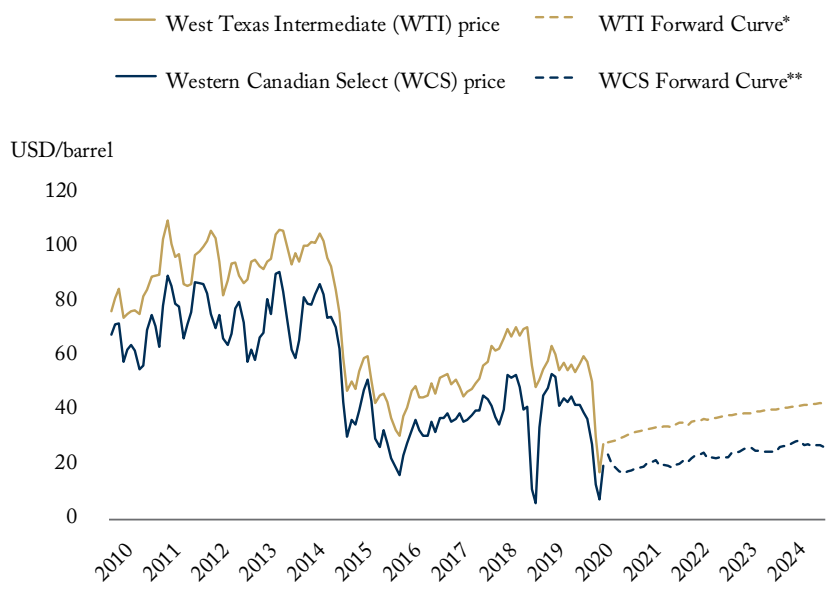
As well, Canada's federal government has been slow compared to other countries in establishing programs to buy up and distribute perishable products. The disposal of produce – for example, unused potato stocks – could also have a significant ecological impact and compromise future planting. In contrast to Canada, the United States has rapidly extended and established programs for purchase and redistribution of food stocks to avoid the financial and ecological costs of disposing of current inventories.

Even with near-term credit bridge, petroleum sector needs "view to the other side"

Canada's petroleum sector faces forecasts for depressed crude oil prices for years to come. Even as the shock to global petroleum demand eases, competition from low-costs exporters will likely weigh on oil prices.

Figure 3 exhibits the outlook for benchmark oil prices in the forward market. Based on futures contracts to December 2024, markets do not expect prices of Western Canadian Select (the common

Figure 3: Benchmark Oil Prices and Forward Curve



* Forward prices as of May 15, 2020.

** WCS forward prices computed based on index for discount to WTI.

Sources: BNN Bloomberg, NYMEX.

benchmark grade of heavy oil produced by the oil sands for delivery at Hardisty, Alberta) to exceed USD 30 per barrel.

At these prices, many producers will not be economically viable, having extraction costs per barrel greater than that price. Other, more efficient producers could profitably produce at these prices but face borrowing constraints to meet near-term cash flow obligations.

"Bridge" support for the sector will help preserve production capacity and employment. This will ensure that the sector is able to "turn on the taps" as demand recovers and expand takeaway for access to other markets. As the resource owner, provincial governments have particular interest in capacity for efficient petroleum production that maximizes revenues over the reserve life.

Working group members highlighted differences between petroleum producers' cost structures, balance sheets and access to credit. Many large, integrated oil companies entered the crisis with robust balance sheets, resilience from diversification across upstream and downstream activities, financial hedging to near-term price swings, and available credit facilities. In contrast, facing a plunge in netbacks on oil sales and immediate cash flow constraints, many smaller operators and service companies have struggled to access credit and meet financial obligations.

Specific support for petroleum producers could take the form of a loan based on forward sales of future production. Greg Pardy of RBC Capital Markets and Brian Livingston have each advanced a proposal for a "shut and swap" program structured along these lines.[3]

Such a program – effectively an unsecured loan based on forward prices for presently shut-in oil production – would place taxpayer funds at risk. The horizon of support is also a major question: the longer the duration of support, the greater the taxpayer risk and the potential interference with market forces. For example, certain working group members raised the possibility that access to subsidized credit could forestall consolidation within the sector.

For any credit, governments will need to verify that producers receiving funds would likely be viable at the maturity of the loan. Governments would need to screen potential borrowers based on the strength of their balance sheet and operating costs per barrel in order to verify that production would be economic at future prices and producers would have sufficient cash flow to cover the additional debt. Working group members were cautiously complimentary of the federal government's announcement for establishment of the Large Employer Emergency Financing Facility (LEEFF).[4] Many details remain undecided: First, it is unclear how the support would be structured – whether as loans to complement private-sector credit or as partial guarantees. Second, the federal government lacks in-house capacity to itself conduct the necessary due diligence and execute such transactions.

Nonetheless, LEEFF has been long-awaited, and working group members expect that this will help backstop the petroleum sector. If properly rolled out, LEEFF can address immediate credit constraints

3 Livingston, Brian. "Shut & Swap can be a lifeboat for Canada's oil producers," C.D. Howe Institute. April 15. Available online: https://www.cdhowe.org/intelligence-memos/brian-livingston-%E2%80%93-shut-and-swap-can-be-lifeboat-canada%E2%80%99s-oil-producers

4 Government of Canada. 2020. "Prime Minister announces additional support for businesses to help save Canadian jobs," May 11. Available online: https://pm.gc.ca/en/news/news-releases/2020/05/11/prime-minister-announces-additional-support-businesses-help-save

for businesses that might otherwise face disruption and loss of productive capacity. Certain working group members underscored that taxpayer funds should not displace risk capital. For example, the stated constraints on executive compensation, dividends and share repurchases may provide effective screening to ensure that any companies who access this financing are in pressing need of these funds.

As well, certain working group members affirmed that the required commitment for disclosure of material climate-related risks is an appropriate requirement. Such climate reporting has already been adopted by Canada's major petroleum producers. As emphasized by the Financial Stability Board's Task Force on Climate-related Financial Disclosures, physical risks to assets from climate change and commercial exposure to decarbonization policies represent material factors for investors to assess a company's long-term financial viability.[5]

Looking forward, Canada's petroleum sector faces a difficult horizon. Governments must design any support with robust financial criteria, appropriately calibrated duration and an exit plan that limits taxpayer exposure. Governments should not impede efficient consolidation within the petroleum sector or displace private creditors. Where complementing private credit, governments must conduct expedient but rigorous due diligence and should not support firms with dubious economic viability – even at future prices. Consolidation and vertical integration will enhance scale economies and increase resilience for Canadian petroleum producers.

However, any near-term credit support will add to the sector's debt levels. New equity will be required to rebalance companies' capital structures. Alongside any near-term credit support, governments must ensure that companies and their shareholders understand the path forward for Canada's petroleum sector.

Access to equity capital will be critical for Canada's petroleum sector to invest in new, more efficient facilities and lower-emission technology for extraction, processing and downstream petrochemical manufacturing. Government must be transparent around its planned long-term path for carbon pricing and regulatory requirements for the petroleum sector. Clarity is essential for the petroleum sector to plan its investments accordingly and anticipate the returns for investments in emission-reducing technologies like carbon capture, utilization and storage (CCUS). Regulatory uncertainty will

5 Task force on climate-related disclosures. 2017. *Final TCFD Recommendations Report*. Available online: https://www.fsb-tcfd.org/publications/final-recommendations-report/

discourage the equity investment that petroleum producers require to sustainably emerge from this crisis.

Tourism sector faces prolonged slump and loss of capacity

For tourism, many in this sector now expect that any return to normal will take years. Figure 2 exhibits the 50 percent decline in employment – over 600,000 jobs lost – for the food services and accommodation sector. These businesses have been rapid to close but re-opening will require significant lead-time – particularly to restock, re-hire and re-train new employees. The tourism sector involves a high share of small and medium enterprises which lack the scale to spread increased fixed costs for implementing health and safety measures and to survive an extended horizon of depressed demand. While large hotel chains and operators may be more resilient, the attractiveness of tourism to Canadian destinations will depend on an ecosystem of smaller players to offer unique experiences to visitors.

Near-term prospects for any quick rebound are poor and there is a likelihood that this sector's ecosystem of small businesses will be shuttered, dampening the long-term capacity. Facing the likely loss of the upcoming summer season, these businesses will hibernate at best and more likely close in order to avoid ongoing fixed costs and lack of revenue.

First, in most provinces, the sector faces a continued lack of certainty about the timelines and pre-conditions for re-opening. The differing pace for easing restrictions between jurisdictions is also a challenge for tourism: even if operators in a given province can open, potential visitors may still face restrictions in their home provinces and be unable to travel. Major operators are implementing safety protocols and will communicate these measures to potential travellers, potential travellers will likely remain precautious.

Second, operators face a near-term labour supply challenge. As has been highlighted by the C.D. Howe Institute's Crisis Working Group on Household Income and Credit Support, the availability of the Canada Emergency Response Benefit (CERB) creates a potential disincentive to accepting work – particularly in service sectors like accommodation and food services.[6] The wage premium required to secure labour will be a challenge for operators. The federal government must also consider how to

6 Crisis Working Group on Household Income and Credit Support. *When the Smoke Clears: Tackling Disincentives to Work*. C.D. Howe Institute. April 27. Available online: https://www.cdhowe.org/council-reports/when-smoke-clears-tackling-disincentives-work

ramp-down CERB in order to encourage re-employment as the economy re-opens and workplaces put safety measures in place.

Third, even as governments ease restrictions, demand for accommodation and food services will not likely rebound at a quick pace. Most tourism spending is domestic and stateside visitors propel foreign visits. In the near-term, physical distancing will continue. However, even if and when the virus is contained or a vaccination available, households will likely deprioritize discretionary spending on travel as they rebuild net worth. Many operators will lack the necessary occupancy or volumes to cover fixed costs.

How Does Canada Win in an Increasingly Protectionist World?

This working group previously underscored the importance of championing open trade through this crisis.[7] Access to foreign markets for inputs and sales of exports is essential for a relatively small economy like Canada. Learning from this crisis, companies will also want to ensure that they are buffered against shortages of intermediate inputs. However, the need for resilient supply chains favours diversification rather than domestication of suppliers.

As well, the current crisis underscores the importance of ensuring stockpiles and manufacturing capacity for certain critical supplies. But establishing domestic production capacity for many imported goods would be impractical and economically inefficient.

Nonetheless, Canadian policymakers must be conscious of a worrisome tide of zero-sum thinking among certain of our trading partners. While governments have a poor record of "picking winners" through industrial policy, policymakers must be attuned to loss of systemically important companies and production capacity.

Governments could intervene to support such large companies through distress and restructuring – for example, where a company plays a lynchpin role as a purchaser or supplier and its closure threatens many other businesses. Similarly, as exhibited in the agrifood and petroleum sectors, governments may

7 Crisis Working Group on Business Continuity and Trade. *Canada Must Be Champion of Open Trade*. C.D. Howe Institute. April 9. Available online: https://www.cdhowe.org/council-reports/canada-must-be-champion-open-trade-cd-howe-institute-crisis-working-group-business-continuity-and

need to provide targeted near-term support to preserve production capacity, even while ensuring market forces drive consolidation and scale for long-term resilience.

With outlook for depressed demand for many goods over an extended period, companies will scale and strategically rationalize their footprint. Industries will face pressure to consolidate many activities geographically to reduce costs and locate production nearby to sources of inputs and major downstream markets. If Canada loses key production capacity to clusters abroad, these industries will be difficult to win back and the Canadian economy may face an even longer road to recovery. Policymakers will face difficult, imperfect and inevitably politicized choices about what Canada's economy will look like after this crisis – and which bridges should be built to get to the other side.

The Members of the Business Continuity and Trade Working Group Include:

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Geoff Smith, President & CEO, EllisDon.

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Don't Force Canadian Banks to Cut Dividends

By William B.P. Robson and Jeremy Kronick

Banks are often in the political and regulatory crosshairs during times of economic stress, and COVID-19 is no different. Support for the payments system and credit markets can look like support for banks themselves. And supports for businesses are controversial. Few people want to prop up firms with no future and nobody wants government credit or transfer payments to fund executive bonuses or flow to shareholders through share buybacks or unsustainable dividends. Canada's banks have just reported weak second-quarter earnings. Laurentian Bank just cut its dividend. Should the Office of the Superintendent of Financial Institutions (OSFI) ask other Canadian banks to do the same?

If they did, they would be following a trend. The European Central Bank has called on European banks to suspend dividends until fall. Dividends of banks in the United Kingdom are under pressure from the Bank of England. Australia's prudential regulator has suggested a "prudent reduction in dividends." U.S. banks cut their dividends during the 2008-9 crisis and some argue they should do it again now – perhaps as a quid pro quo for support from the U.S. Federal Reserve.

Canadian banks might, as Laurentian just did, cut dividends to conserve capital. But that should be their decision as the case for regulatory pressure is weak. To start with the government supports, the Bank of Canada's injections of liquidity into the financial system and unusual asset purchases to support credit markets generally were motivated by fear that the slump triggered by COVID-19 might trigger a financial crisis. But the slump did not originate with deposit-taking institutions. Banks were more the channels of assistance than the recipients of it.

We are depending on the banks to help Canada's economy through the crisis. OSFI announced early on that financial institutions could treat mortgage deferrals as performing loans, reducing the amounts of capital they would otherwise have to hold. It also reduced its domestic stability buffer, meaning Canadian banks can hold less high-quality capital for at least 18 months, which created $300 billion in lending room. In good times, the buffer obliges Canadian banks to hold more high-quality capital than systemically important banks elsewhere. The payoff is that in bad times they have more capacity to reduce the buffer, cushion the downturn and accelerate the recovery.

The federal government's credit support involves partnerships with private-sector lenders. That is partly to give a push to private lending stalled by uncertainty. It also leverages the expertise of financial intermediaries to get the money out and adds a layer of protection against fraud.

Both OSFI's moves and the federal government's credit supports in partnership with private lenders will work better if the private lenders are making decisions on the basis of their own assessments of risks and rewards, including the risks and rewards of those decisions for their shareholders.

With the economy as fragile as it is at the moment, it is also worth noting how important dividend flows from banks have become for Canadian investors – both individuals and institutional investors such as pension funds. Earlier this year, the Big Six banks alone paid about 30 per cent of all dividends from companies in the TSX index, a figure that has almost certainly risen in the wake of dividend cuts by energy companies, the next highest category. Nothing can or should protect shareholders in a bank from dividend cuts reflecting a deterioration in its business. But that is not the case here.

While Canadian bank earnings for the quarter ending April 31 were down, that followed an extraordinary run of good performance. Canada's Big Six banks reported an average return on equity of almost 16 per cent in the previous quarter – well above the figures in other advanced economies, including the United States. We have not yet seen anything to suggest the need for OSFI to oblige the banks to do anything they would not do on their own.

A stable, well-performing banking system has been an asset to Canada in previous periods of economic stress, and we will want private deposit-takers and lenders to be in the forefront as we emerge from the COVID-19 crisis. Happily, our banks are in a position where they can be allowed to make their own decisions about paying out dividends. Canada's policy-makers have enough to do without worrying about that.

Jeremy Kronick is Associate Director, Research, and William B.P. Robson president and CEO of the C.D. Howe Institute.

Published in the *Financial Post.*

Intelligence MEMOS

From: Lori Sterling

To: Canadian Businesses and Governments

Date: June 4, 2020

Re: **The Next Phase of Economic Recovery, Part One: Transitioning Pandemic-Related Relief Programs for Individuals**

As we move from lockdown to a more open economy, the existing government pandemic-related programs will have to evolve. The Canada Emergency Response Benefit (CERB) achieved its goal of an immediate benefit. Those laid off, at home with children or sick relatives or were without work even before the pandemic, received government funds within days of applying. CERB is now set to expire October 3, 2020.

CERB pays $2,000 a month, and is generous by both international standards and existing Canadian standards. It is above minimum wage in virtually all provinces, and is equivalent to marginally less than $15 an hour assuming a 35-hour work week. As long as it remains in place, there will be little incentive to return to a minimum wage job. Approximately 30 percent of the workforce earns income at the minimum wage level.

One reform would be to better align CERB to local minimum wage rates so that there is an incentive to return to work. For those on the East Coast, where minimum wages are the lowest in Canada, that would mean an income drop of roughly $3 an hour for those who received CERB and are now returning to minimum wage jobs. The government could amend CERB to take into account this regional variation in wage rates.

A second reform would be to tie CERB to the extent to which the local economy is open, which is not uniform across the country. There are few cases of COVID-19 in Atlantic Canada and the Prairies, and their economies will soon be fully operational. It is, therefore, appropriate to ask whether a more regional approach to the availability of CERB would be preferable.

A further reform would be to tie CERB more closely to work income. At present, CERB is cut off when employment income reaches $1,000. A sliding scale which pro-rated CERB to work income would have several benefits. First, it would encourage previously laid off workers to look for full-time work, as they would not be penalized for earning more than $1,000. Second, it would tailor the government grant to the needs of the employee. Those with lower levels of work have a greater need for CERB than those with higher levels of work, but the need does not drop to zero at the $1,000 mark. It must be acknowledged, however, that while this proposal makes sense from a policy perspective, it may be difficult to implement given that CERB is delivered by the Canada Revenue Agency, which does not typically keep real-time data on individual monthly earnings.

Once CERB ends, the question remains what will replace it for the unemployed. Historically, the EI system has provided the social protection needed for the unemployed, but could not provide the relief needed during the pandemic. As part of the economic recovery, consideration should be given to reforming EI to make it simpler, nimbler and better able to respond to shocks in employment levels.

The federal government has also created numerous support programs for specific groups, including students, seniors, essential service workers, the homeless, parents, women in shelters or who are victims of domestic violence, and people with disabilities. Most of these group membership programs will and should end as planned. For example, the student summer work program ends naturally at the end of the summer when students return to school. The seniors benefit program is a single lump sum of up to $500 for anyone who receives OAS and/or GIS, and it, too, should not be revisited.

There are, however, two group membership income support programs that Ottawa ought to consider for an extension. One is the Canada Child Benefit (CCB), which targets low-income families with children. There has been much discussion about the disproportionate impact of the pandemic on women in the labour force, and enhancing the CCB would assist with their return to work.

Essential workers are a second group that may be in need of continued government support, in particular, those in the health and personal care sectors. Ottawa has joined with the provinces to create a wage supplement program for essential workers. As a result, most provinces now offer a wage top-up to a defined list of essential workers who earn less than $25,000 a year.

The federal supplement for essential workers should extend into the fall. There are two reasons for this recommendation. One relates to the fact that even as the economy recovers, these workers continue to work in high-risk settings. A second rationale is tied to the historic under-valuation of these traditionally female-dominated jobs. This subsidy indirectly goes some way toward remedying pre-existing pay equity concerns.

The existing individual income support programs were emergency measures created for unprecedented times. They were not intended to be permanent income support, nor is their original design carved in stone. These programs should, therefore, be continually re-assessed in light of COVID-19 incidence data, the nature of our economic recovery and individual circumstances. In a companion Intelligence Memo we assess supports for business.

Lori Sterling, a former federal deputy minister of labour, is senior counsel at Bennett Jones.

To send a comment or leave feedback, email us at blog@cdhowe.org.

COVID-19 Crisis Working Group: Monetary and Financial Measures

Communiqué #7: Guidelines and Creativity Key to Restoring Financial Confidence

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. Its Working Group on Monetary and Financial Measures is co-chaired by David Dodge, former Governor of the Bank of Canada, and Mark Zelmer, former Deputy Superintendent, OSFI, and supported by a group of financial market experts and economists. The group's seventh meeting was held on Monday, June 1st, 2020, and its eighth meeting on Monday Jun 15th, 2020. This communiqué reflects the conversations at both.

Governments have stepped in with unprecedented stimulus to shepherd businesses and households through the crisis. In many cases, this has been through specific lending programs in partnership with financial institutions. On the business side, these lending programs include the Business Credit Availability Program, the Canadian Emergency Business Account, and the Large Employer Emergency Financing Facility.

As we move from the crisis to the recovery phase, these programs need winding down or modification to reflect the changing economic circumstances. Members noted, however, that traditional risk metrics are likely going to make even healthy businesses appear unhealthy until the recovery is well underway and economic uncertainty has eased. Members agreed we do not want to support zombie firms, but we also want to make sure healthy firms with viable business models do not disappear. Therefore, in the view of members, some continued government involvement is likely warranted. With uptake of certain support programs underwhelming so far, certain big questions arise: why this lack of uptake is the case? what modifications are necessary? and what principles should guide any future government involvement?

Members pointed out at the outset that the last question of principles assumes a degree of certainty about the path of the recovery and the kind of government support required. The current high degree of uncertainty regarding both the future course of the pandemic and how policymakers will respond

and ultimately fund the support provided, makes it much more difficult for lenders, investors and even business owners to assess the prospects of even healthy businesses. This high uncertainty matters both for lenders and investors considering taking an equity stake and for businesses deciding what form of support would be most useful for them. Members thought that the programs to date have focused on (i) helping borrower creditworthiness and (ii) supporting financial institutions in bridging the initial mandated restrictions on business activity. But the bigger challenge going forward will be to assess business prospects during a recovery that is uncertain, reflecting in part the uncertainty surrounding future government regulatory policies and fiscal support measures.

As much as possible, then, governments should look to reduce the uncertainty within their control, noted members. They felt that governments rightly prioritized health outcomes at the outset of the COVID-19 crisis. However, as physical distancing measures are relaxed and economic activity recovers, reducing uncertainty for businesses involves taking a more holistic approach; one that focuses on the intersection of health and economic outcomes. Members agreed that governments could provide more clarity on how they will approach a second wave, and expressed support for a more targeted, regional approach. In addition, more clarity is needed on how the existing support measures will evolve during the recovery and on how the government plans to restore fiscal sustainability over the medium term. Such clarity would help to tangibly reduce the uncertainty that is currently hindering business planning and associated investment and lending decisions. A coherent, credible story will increase confidence for households and businesses, members noted.

Assuming forward guidance helps reduce some of the uncertainty, members agreed that a broad creative approach to capital allocation was necessary, one that looks at both credit, as well as equity and equity-like investments.

Some members raised the possibility of a sandbox of sorts, allowing for some experimentation and creativity on the design and execution of traditional credit facilities and investment arrangements. We need to create an environment where there is enough confidence for lenders and investors to engage with businesses. Different businesses might need different types of support, making one-size-fits-all programs less appropriate. The approach needs to find ways to create custom-designed solutions.

Members agreed that some of the low uptake of certain government support loan programs stems from the demand side: a result of both economic uncertainty and the concerns of businesses over saddling themselves with even more debt than they had coming into the crisis. As an example, while it is early days in the recovery, only a small fraction of earmarked funds for the Business Development Bank of

Canada (BDC) co-lending program have been used. While the Canada Emergency Business Account has seen greater uptake, at $26.6 billion it is still far below the $55 billion earmarked for the program.

Members felt that should governments succeed in reducing some of the uncertainty through forward guidance, some demand for current programs might pick up as the recovery gathers strength. However, members agreed that the issue of debt fatigue is significant and governments need to look at ways to unlock more capital to take equity and equity-like investments, through the sandbox or otherwise. Governments and regulators need to ask themselves how they can motivate more interest from investors in supplying equity and/or equity-like capital to businesses looking to build capacity during the re-opening. Members raised the idea of making sure regulatory requirements do not unnecessarily impair investment by domestic and foreign institutional investors like pension funds and life insurance companies. They also favoured looking for ways to facilitate the tapping of large saving pools among retail investors, possibly through various types of collective investment schemes – or investment funds – such as mutual funds, which bring a number of investors together with the intention of sharing in any profit from the investment, and benefiting from, among other things, the economies of scale of investing together.

To the extent that lending programs continue, members pointed to a set of principles that should guide government support. Members felt that the first principle is to ensure that the decisions on who to lend to rests with the financial institutions with the necessary expertise.

Moreover, the market should be competitive and encompass as many financial institutions as possible, and governments should be clear about who qualifies for access to the support programs and who does not; and the reasons behind any exclusions.

Furthermore, clarity is needed on how these programs of support will evolve over time. Financial markets have continued to be supportive – in the form of low borrowing costs – of the monetary and fiscal support offered as a crisis response to the global pandemic. However, they will only continue to do so as long as they remain confident that governments have a plan to restore fiscal sustainability over the medium term. Governments are reacting in real time to an evolving pandemic, but clarity – through, among other things, fiscal updates and formal budgets – on how support programs will be wound down and eventually exited will go a long way to maintaining market confidence. Some members felt that should the existing programs not lead to sufficient aggregate demand amongst borrowers, governments may have to turn to more traditional countercyclical fiscal stimulus such as lower taxes or job-creating government spending, e.g. infrastructure spending, but again, with an eye towards maintaining investor confidence.

In summary, members of the Monetary and Financial Measures Working Group recommended the following:

- On the issue of uncertainty, governments should provide a clear state-contingent roadmap for how they will react to the evolution of the pandemic from an integrated health and economic standpoint;
- In addition, governments should provide clarity on the medium-run plan for a return to fiscal sustainability;
- Governments and regulators should set guidelines for a sandbox that allows for experimentation between businesses looking for capital and lenders and investors looking to provide it. Equity and equity-like investment should be prioritized;
- As part of these guidelines, policymakers should ensure rules and regulations do not impair domestic and foreign institutional investment;
- They should also look for ways to tap into retail investor savings pools through, for example, collective investment schemes;
- To the extent that credit programs continue, they should be guided by the following principles:
  - Any credit decisions on who to lend to should rest with the lender not the government;
  - Any facility should be a facility of last resort for borrowers, i.e., the incentive should exist for borrowers and lenders to negotiate on commercial terms first;
  - Any government support, be it through a guarantee or as a co-lender, should provide a return for taxpayer commensurate with the risk being taken by the government, plus provide incentives to encourage lenders to conduct proper and complete credit assessments and structure lending on proper commercial terms;
  - Programs should recognize that longer repayment terms may be appropriate for some borrowers but that longer terms for repayment should compensate the taxpayer for the associated additional risk;
  - The taxpayer, through the government, should rank on equal footing with other senior unsecured creditors in the creditor stack or should be compensated accordingly for supporting more subordinated exposures;
  - Government should consider the broad range of financial institutions that might appropriately have access to these facilities and make clear the rationale for including or excluding any type of institution for a particular type of facility; and
  - Government should make clear its plan for modifying programs over time related to objective indicators of economic conditions.

Monetary and Financial Measures Working Group Members Include:

David Dodge, Co-Chair, former Governor of the Bank of Canada.

Mark Zelmer, Co-Chair, former Deputy Superintendent, OSFI.

Steve Ambler, Université du Québec à Montréal.

Clayton Buckingham, VanCity.

Derek Burleton, TD Bank.

Dwight Duncan, McMillan LLP.

Paul Jenkins, Former Senior Deputy Governor, Bank of Canada.

Phil Howell, Former Superintendent, FSCO.

Thor Koeppl, Queen's University.

Andrew Moor, Equitable Bank.

Jeremy Kronick, C.D. Howe Institute.

Duncan Munn, C.D. Howe Institute.

Theme 2:

Backstopping Provincial Finances and Access to Credit Markets

Crisis Working Group Report: Monetary and Financial Measures

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. Its working groups on monetary and financial measures is co-chaired by David Dodge, former Governor of the Bank of Canada, and Mark Zelmer, former Deputy Superintendent, OSFI, and supported by a group of financial market experts and economists. The group's third meeting was held on Monday, April 6th, 2020.

The focus of the meeting was on options for dealing with the funding pressures faced by provincial governments. Members indicated that so far, both the federal and provincial governments have been successful in financing the revenue gaps and spending demands related to the crisis and their responses. But yields on provincial debt have widened relative to yields on federal debt, and investors do not have unlimited appetite for Canadian debt. While tax deferrals will not necessarily lead to an increase in debt loads for both federal and provincial governments to the extent they are paid back, they do represent a loss of revenue for governments in the immediate term. This loss of revenue will require an increase in borrowing, putting additional funding pressures on governments whose financial positions are already precarious. Separately, but not less importantly, provinces need to continue to provide services such as health care and education. The group focused on the following potential policy responses:

1) Increased revenue sharing between federal government and provinces;
2) The federal government accessing credit markets on behalf of provincial governments to take advantage of its lower interest costs and higher credit rating;
3) The federal government guaranteeing provincial government borrowing; and
4) The Bank of Canada intervening through increased purchases of provincial debt securities across the maturity spectrum.

Members recognized that each of these options runs up against the same problem: provincial governments are not starting from the same fiscal position (see figure below and here), nor do they have the same revenue collection tools. Questions of equity would be critical to any solution.

It was also pointed out that provinces are in worse shape going into this crisis than they were in advance of the 2008 financial crisis (again, see figure below). Their debts are generally higher relative to their revenues and economies, and unlike the last financial crisis when energy producing provinces

fared relatively well, each province will experience a substantial economic hit as a result of COVID-19. Energy provinces are in fact worse off this time with the oil price collapse.

Demand for provincial debt was also raised as a potential issue. Some felt that Canada's debt relative to the size of global capital markets was small so demand might not turn out to be much of a concern. Others, however, felt that the fact that countries the world over are issuing massive amounts of debt will make it more difficult for sub-national borrowers.

Responses to these immediate-term issues need to avoid undue medium-term concerns. The fact that yield spreads reflect governments' fiscal positions is usually appropriate. Federal government guarantees might distort the market view of provincial borrowing moving forward. The group also expressed concern about conditionality related to federal support for provincial borrowing, which could undermine provincial autonomy in the longer term.

As a result, members focused on the need to first and foremost support the functioning of markets for provincial debt more generally. The Bank of Canada is already purchasing provincial money-market securities, but will likely also need to purchase longer-term debt. However, the Bank must not be seen to support one province over another, and this will require a clear, simple, rules-based approach to Bank of Canada interventions. Some members noted that the Bank cannot expand its balance sheet to the extent some advocates of supporting provincial debt might wish without compromising its inflation objective.

If specific provinces require additional support beyond these central bank interventions, the group felt that the most appropriate response would be to make use of the fiscal stabilization fund, which is designed to help provinces whose economies are experiencing large negative shocks. Doing so will avoid the federal government guaranteeing provincial debt, and distorting the market's view of future provincial borrowing.

The Monetary and Financial Measures Working Group will break for Easter Monday and reconvene on Monday, April 20th, 2020 at 3pm. In addition to a focus on how best to finance government interventions in the medium-term, the group will continue to monitor policy actions taken over the course of the next two weeks, and from here determine the most relevant topics for its April 20th meeting.

Provincial Net Debt Between 2007-08 and 2018-19 Fiscal Years, $ Millions										
	BC	AB	SK	MB	ON	QC	NB	NS	PE	NL
2007-08	23,811	-39,410	5,873	10,561	156,616	124,681	7,069	12,115	1,347	10,188
as % of GDP	11.9	-15.1	11.2	21.2	26	40.6	24.9	35.6	29	36
2018-19	42,681	27,477	11,834	24,999	338,496	172,558	13,959	15,010	2,124	15,374
as % of GDP	14.4	8	14.7	34.4	39.5	39.3	37.8	33.8	30.4	46.3
Difference	18,870	66,887	5,961	14,438	181,880	47,877	6,890	2,895	777	5,186
Percentage Points	2.5	23.1	3.5	13.2	13.5	-1.3	12.9	-1.8	1.4	10.3

Source: RBC Economics, Canadian Federal and Provincial Fiscal Tables, March 20 2020.

Monetary and Financial Measures Working Group Members Include:

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Riaz Ahmed, TD Bank

Steve Ambler, Universite du Quebec a Montreal

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Andrew Moor, Equitable Bank

Tamara Vrooman, VanCity

Jeremy Kronick, C.D. Howe Institute

Duncan Munn, C.D. Howe Institute

Intelligence MEMOS

From: William B.P. Robson and Jeremy M. Kronick

To: Federal and Provincial Finance Ministers

Date: April 13, 2020

Re: **Backstopping Provincial Borrowing**

Governments around the world are responding to the COVID-19 crisis with myriad measures – additional resources for healthcare, supports for individuals and businesses, tax deferrals and public health edicts that have slowed or stopped activity in many sectors of the economy.

One common consequence of these measures is that governments need massive amounts of money, both to finance the deficits that the new spending and recession will cause, and to backstop credit markets and cover temporary requirements from the delayed collection of taxes.

In addition to longer-term concerns about sustainability and intergenerational fairness, this surge of sovereign borrowing raises more immediate concerns about the willingness and ability of lenders to hold the debt. National governments with their own central banks, such as Canada's, face less of a problem on this front – they can create new money at will. For other governments, such as Canada's provinces, the situation is different. Lenders may demand much higher interest rates to take their debt – and may hit regulatory or other limits that prevent their taking it at all.

Although the crisis is only weeks old and the fiscal responses are just getting under way, concerns about provincial access to funds are already intense. Several provinces – including the largest, Ontario and Quebec – already had sizable net debts. Others, notably Newfoundland and Labrador, are economically as well as fiscally precarious. The spread between the yields on their bonds and those of the federal government has jumped since the beginning of the year. Premiers and others have asked Ottawa for help.

We see four approaches to helping provinces through this difficult period.

One would be enhanced revenue-sharing between the federal government and the provinces. Canada already has revenue-sharing in the form of equalization payments, designed to mitigate differences in provinces' ability to raise revenue. It also provides per-capita transfers to support healthcare and social programs. Ottawa could increase these transfers to reduce the provinces' borrowing needs and help them cover their higher interest payments.

A second option would be for the federal government to borrow on behalf of the provinces. This would allow the provinces to benefit from Ottawa's lower borrowing costs and potentially access markets that might be closed to them.

A third would be for the federal government to guarantee provincial borrowing. This would also benefit from the federal government's lower borrowing costs, but without using Ottawa as an intermediary.

A fourth is to have the Bank of Canada buy provincial debt. The central bank's response to the COVID-19 crisis has already involved purchases of federal bonds beyond what it normally holds for monetary-policy purposes, as well as purchases of provincial short-term securities. The Bank could buy longer-term provincial debt too.

Like much else during this crisis, we need to think about both the short-run effectiveness of these options and their longer-run consequences. Anything that undermines the fundamental principle of federalism – that the federal government and the provinces are sovereign in their respective spheres – is hugely problematic in principle and would encounter fierce opposition in practice.

Each government must be accountable to its own citizens for the funds it raises and the programs it delivers, as well as for ensuring that its capacity to deliver services over time remains intact. For this reason, any revenue-sharing, federal borrowing on provinces' behalf, debt guarantees or Bank of Canada purchases would have to be limited in size, duration and conditionality.

Issues of fairness also need considering up front. Some provinces need immediate help more than others. But not all have made similarly farsighted decisions when it comes to their programs, their taxes and their bottom lines. Measures to get us through the crisis should not reward, or be seen to reward, bad fiscal choices. Simple formulas – based, for example, on equal dollars per person – may be the best approach to ensure speed and widespread acceptability.

Floating debt also involves practical considerations. Some investors have limits on how much Canadian debt they can hold, no matter which level of government issues it. Speed to market may matter as well – debt markets are volatile at the moment, and the need for cash around the world has caused selloffs even in US Treasuries.

The federal government and the Bank of Canada need to be ready. Provinces may need help maintaining their access to credit during the crisis. If they do, our responses need to be effective in the near term – and leave us with the fewest regrets in the long term.

William B.P. Robson is President and CEO of the C.D. Howe Institute and Jeremy M. Kronick is Associate Director, Research, at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Kyle Hanniman

To: Monetary Policy Watchers

Date: April 28, 2020

Re: **Backstopping Provincial Debt: How The Bank of Canada Made Its Move**

On April 15, the Bank of Canada announced plans to extend its new quantitative easing program to provincial debt. The new Provincial Bond Purchase Program (PBPP) will buy up to $50 billion of provincial bonds with maturities of 10 years or less over a 12-month period.

What precipitated this move? What are its immediate effects?

It was not obvious the Bank would announce the PBPP when it did. The provinces had issued more that $8 billion in bonds the day before the Bank's announcement, and nearly $20 billion in April to that point, shattering the sector's daily and monthly records. Even Newfoundland and Labrador, widely reported to be running out of cash, managed to issue $500 million in five-year and 30-year bonds in early April. Why, if provinces were getting money in the door, did the Bank step in?

One widely cited possibility was provinces' skyrocketing bond spreads. The additional interest rate provinces pay over the federal government always increases during periods of financial distress, as investors seek safety and liquidity in federal bonds. But the scale of day-over-day increases was unprecedented. On March 6, provinces saw their 10-year bond spreads rise 18 to 27 basis points, two to three times higher than the largest increases during the 2008-09 financial crisis.

As Figure 1 shows, resource-based provinces (also reeling from plunging oil prices) were hardest hit, while British Columbia (with its triple-A rating), and Ontario and Quebec (with their relatively liquid debts) fared best. But all provinces saw their spreads increase 66 to 102 basis points in just a month.

But spreads also rose precisely as yields on Government of Canada bonds plummeted, keeping overall borrowing costs low and mitigating the need for central bank intervention (see Figure 2). One can ask, of course, how appropriate spreads of 100 basis points or more are during a pandemic, when the case for sharing risk is so strong. But that is a question best left to the federal government, not the central bank.

A more likely motivation – and one consistent with the Bank's mandate – was ensuring liquidity. Issuance was spectacular, but almost all of it was going to a small number of large investors, and secondary trading of provincial bonds was thin. These are not markets provinces like to test. They don't get to choose the maturity or other terms of the bond and often have to pay a premium over unreliable spread indications from secondary markets. Provinces, especially small ones with relatively illiquid pools of debt, often step back from these markets and issue short-term debt until volatility subsides and missing investors return.

This appeared to be the path provinces were taking. There were no provincial bonds issued from February 20 until March 18, when Quebec came to market with a $350 million deal. Shortly after, however, the floodgates opened, despite a continued lack of broad-based demand. What prompted the frenzy?

An initial motivation may have been trouble in short-term markets. The usual well of crisis liquidity – the money markets – had run dry, compelling the Bank to establish the Provincial Money Market Purchase program (PMMP), which began buying up to 40 percent of each of provinces' short-term debt offerings March 25. (Though less discussed, the provinces' short-term borrowing also benefited from the Bank's Bankers' Acceptance Purchase Facility. This preceded the PMMP and supported money markets by removing pressure from primary dealers' balance sheets).

The bigger and more enduring problem, however, is the nature of the crisis. We are experiencing the fastest economic contraction on record, with untold potential for market dislocation. Provinces face great uncertainty with respect to borrowing requirements, and whether markets (already looking shaky) will continue to supply them. Logically, therefore, they have been stockpiling liquidity just as fast as investors will allow it. And it does not hurt, of course, that overall borrowing costs are so low.

This was the context in which the Bank decided to act. The provinces were borrowing at a torrential pace, but under extraordinary levels of market and fiscal uncertainty.

The initial effects were dramatic. The provinces' 10-year spreads fell an average of 21 basis points the day of the April 15 PBPP announcement. As Figure 3 shows, the rise and fall of spreads the past two months has been far quicker than anything seen during the financial crisis, the commodity bust of 2015-16 and other periods of global distress.

But provinces are not out the woods yet. Oil prices plummeted last week and spreads reversed their downward trend. Meanwhile, demand for provincial bonds remains chunky. The PBPP will help stabilize provincial borrowing and finances over the coming year, but we may need additional supports and tools to see provincial borrowers through.

Kyle Hanniman is assistant professor of political studies and a research fellow at the Institute of Intergovernmental Relations, both at Queen's University.

Figure 1: 10-year Provincial-Federal Bond Spreads

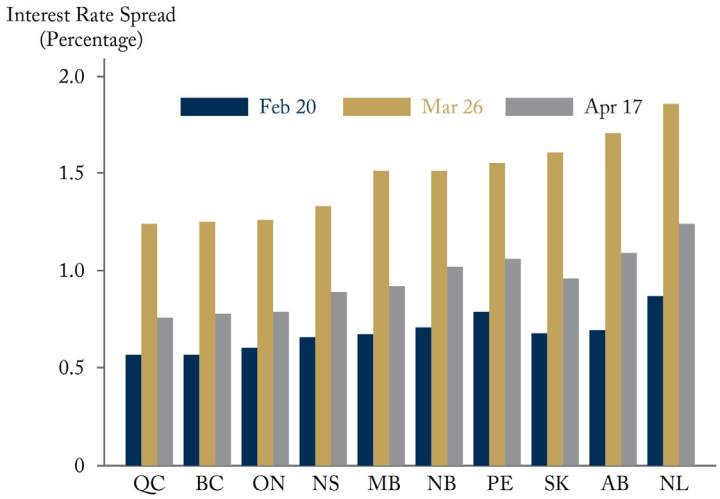


Figure 2: 10-year Yields on Federal and Provincial Bonds

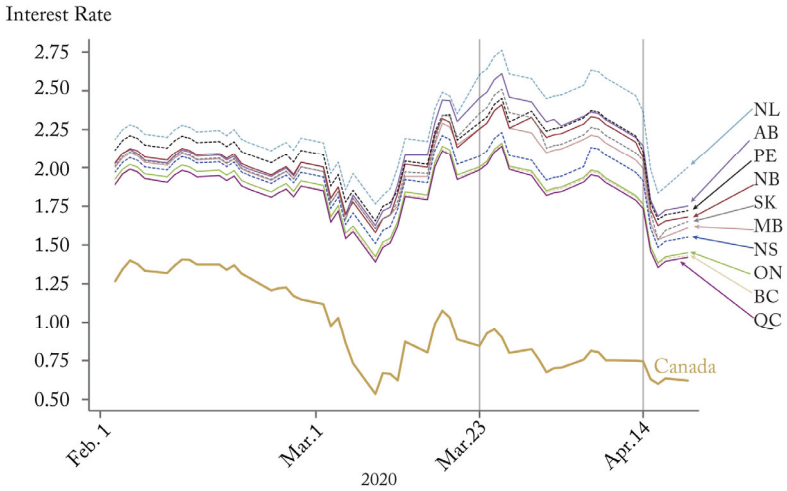
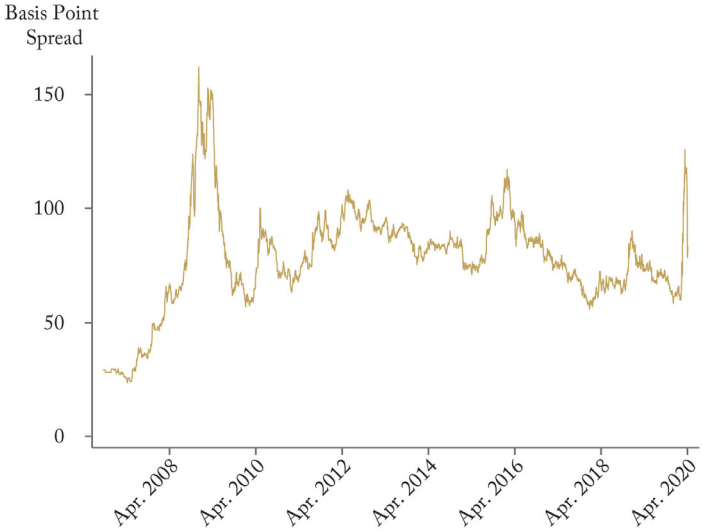


Figure 3: 10-year Ontario-Federal Bond Spread



Source: BMO Capital Markets.

Intelligence MEMOS

From: Michael Smart

To: Bank of Canada Governing Council

Date: April 30, 2020

Re: **Ensuring the Independence of the Bank of Canada remains Intact**

With its recent decision to extend quantitative easing policies to provincial debt, the Bank of Canada is setting off into uncharted waters.

In recent weeks, the Bank has announced new large-scale asset purchase programs permitting it to purchase up to 40 percent of new short-term paper issued by provincial governments, and up to $50 billion in long-term provincial bonds through secondary markets.

While these interventions make good sense in the short term, they are unprecedented. The Bank's policies deserve a careful look in the coming months by Parliament and all Canadians.

Without a doubt, governments are facing extraordinary pressures in the current crisis, and a massive increase in borrowing is inevitable. These pressures are especially strong at the provincial level – where increasing health sector expenditures combine with declining tax receipts in a fiscal double-whammy – and for municipalities, which face statutory restrictions on borrowing.

Fortunately, the conditions are right for government borrowing. Short- and long-term interest rates are at historic lows. With the decline in business activity, the risk of crowding out private sector investment is small in the near term. Governments can – and must – borrow heavily to see us through this crisis.

And the Bank has a key role to play. Its asset purchases help ensure market liquidity and support the economy at a time when conventional monetary policies cannot. It is an essential move right now. As well, the Bank's decision to include provincial bonds in the plan evidently reflects real concerns about the financial health of governments and liquidity in their bond markets.

But there are caveats.

First, the Bank should make clearer the case for including provinces in its purchases. It is true that provincial bond spreads have recently widened, but this reflects the sharp reduction in Canada yields, not necessarily an increase in provincial borrowing costs. It is also true that spreads have fallen since the program was announced. But in the volatile markets of the last few weeks, it is impossible to know how spreads would have evolved if the new bond purchase program had not been announced.

Second, the move could undermine the Bank's independence from government, and bring it dangerously close to engaging in fiscal policy.

By taking this step, the Bank may end up holding a large proportion of the new debt issued by provinces in the coming months in response to the crisis. In effect, the Bank will be financing much of the provinces' fiscal response to the pandemic through an expansion of its balance sheet. This will mark its first direct intervention into provincial finances since the late 1930s, when the federal government extended loans to western provinces on the advice of the Bank.

Bailouts of subnational debt can be problematic if they lead to moral hazard among debtor governments, or to unintended transfers among regions of the country. Canada has long avoided the subnational bailout problems that have bedevilled other fiscal and monetary unions such as Argentina, Germany, and the Eurozone countries.

That reflects our sound fiscal arrangements that give provinces sufficient own-source revenues to finance operations most of the time, and rules-based federal transfer programs that step in automatically in response to fiscal shocks. All this has kept provincial balance sheets sound, and allowed the central bank to remain aloof on the sidelines with respect to sub-national governments in past crises.

Clearly, this time is different, and Canada does not have its own Greece to contend with. Not yet anyway. So naturally the concerns about bond purchases and moral hazard are not as strong in Canada today as they are in the Eurozone. But the Bank should be conscious of the precedent, and cautious in how the provincial bond program is operated.

Third, there is a need for transparency. Details of the bond purchase program announced today need to be closely scrutinized. How will it operate? Will some provinces' bonds be disproportionately targeted, or will purchases be allocated in equal per capita terms across all provinces? Under what conditions in the future would the Bank consider expanding the program, or winding up its positions? Meanwhile, the Bank has announced that it will draw on advice from BlackRock Financial, which is one of the largest players in government debt markets globally. The potential for self-dealing here is real.

The government is accountable for its fiscal policy choices through its institutions for transparency, and through the normal course of parliamentary scrutiny of budgets. This program, though operated through the central bank, deserves the same level of transparency. It is up to Parliament and Governor Steven Poloz to provide it.

Michael Smart is a professor at the University of Toronto and co-editor of the Finances of the Nation project.

To send a comment or leave feedback, email us at blog@cdhowe.org.

From: Trevor Tombe

To: Provincial Debt Watchers

Date: May 8, 2020

Re: **Federal Support to Provinces**

Government budgets are under strain from the unprecedented spending being deployed to control the spread of COVID-19 and help bridge individuals and businesses through the crisis. And collapsing revenues from a shrinking economy add to the burden.

In Canada, rising federal debt is, so far, manageable and sustainable. But provincial governments may be in a more difficult situation.

The most detailed recent analysis by RBC Economics projects more than $78 billion in provincial borrowing in 2020/21 – or roughly $53 billion more than the prior year. This will increase total provincial debt by well over 10 percent in a single year.

For most provinces this is manageable in the short-term, but it adds to their already significant fiscal challenges. The Parliamentary Budget Officer's regular analysis finds the finances of many provincial governments largely unsustainable. COVID-19 has made this worse. And as federal borrowing costs are significantly lower, there is a case for their support. The question is what form it should take.

This crisis may represent a critical juncture in fiscal federalism, leading to fundamental reform. But in the short-term, action is constrained by existing arrangements. This memo details two existing federal programs that can provide immediate and significant support, with little to no need for legislative changes.

First, the federal government can help provinces with direct COVID-related costs.

The Disaster Financial Assistance Arrangements aim to "assist provinces with the costs of dealing with a disaster where those costs would otherwise place a significant burden on the provincial economy and would exceed what they might reasonably be expected to fully bear on their own." The current COVID-19 pandemic is surely that. The healthcare spending for treatment, testing, tracing, and so on, could therefore be shifted to the federal government.

The trouble is, DFAA guidelines explicitly exclude "pandemic health emergencies." But this is a regulatory restriction, not a legislative one, so the government could quickly change its own guidelines. Support under this program could be substantial.

The current formula leaves provinces to cover the first $3.25 per capita in costs on their own, with the federal government taking on increasingly large shares of incremental costs: 50 percent of the next $6.51 per capita; 75 percent of the next $6.51; and 90 percent of all costs beyond that. To illustrate, if direct COVID-19 related expenses are on the order of $250 per capita (to pick a random number) then the current DFAA formula implies the federal government would cover $219. Total direct federal support would total $8 billion – or roughly 0.4 percent of GDP.

Though historically unprecedented in Canada, federal relief for pandemic costs is observed elsewhere. South of the border, for example, the US relief package featured $150 billion (USD) to help offset state and local government expenses related to the crisis – equivalent to 0.8 percent of GDP.

Second, on the revenue side, the federal Fiscal Stabilization Program is available. It supports provinces experiencing sudden and significant declines in income, but is currently limited in scale (for details, see this).

Provinces are likely to see massive revenue shortfalls this year. The PBO projects 2020 nominal GDP may contract almost 14 percent. This would directly lower provincial income and sales tax revenue. Ignoring changes in revenue elsewhere in provincial books, the current stabilization program covers revenue losses in excess of 5 percent: that is, provinces would absorb the first 5 percent drop and the federal government the next 9 percent, in this case. This would, very roughly, work out to approximately $17 billion to provinces.

But the current program caps cash transfers to no more than $60 per capita. This limits direct federal support to $2.2 billion – or only a fraction of the projected loss.

The cap is problematic, to say the least. The $60 limit was arbitrary and implemented with little analysis or scrutiny. Given the arbitrary nature of the cap, the federal government has already signaled its willingness to review the program – and that was before COVID-19.

Changing the cap would require legislative changes, but there is a provision within the existing program for the Minister of Finance to provide an interest free five-year loan to provinces for any stabilization claims beyond the $60 per limit cap. Such loans have never been made before. Now may be the moment to consider doing so.

For a federal government facing a $250+ billion deficit, this coming year, the prospect of adding yet more burden may be difficult to swallow. But COVID-related public debt will happen either way. And the federal government is – for a shock of this kind – able to carry the added debt at lower cost than the provinces.

Whatever form support takes, whether through existing arrangements or not, support to provincial governments will soon rise in importance. It's worth exploring options now.

Trevor Tombe is associate professor of economics at the University of Calgary and research fellow at the School of Public Policy.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Jeremy M. Kronick and Thorsten Koeppl

To: Bill Morneau, Minister of Finance

Date: May 8, 2020

Re: **For a Revamped Federal Backstop**

The debate on whether and how the federal government should support the provinces given the exceptional circumstances surrounding COVID-19 has raged on over the last few weeks.

Terms such as fiscal federalism, provincial spreads, liquidity, and moral hazard have been bandied about. The truth is, no matter how you slice it, massive increases in debt will lead to increased servicing costs. The real question is can provinces support these increased costs, and should they have to.

On February 20, yield spreads for provincial 10-year bonds over equivalent federal debt were all under 100 basis points (1 percentage point). Fast forward to March 26, and all were well above 100 basis points, with Newfoundland even approaching 200 basis points.

After the Bank of Canada took the unprecedented step of announcing its large-scale asset purchase program – better known as quantitative easing (QE) – which included buying up longer-term provincial debt, spreads fell back, though still higher than they were February 20.

Perhaps more importantly, because federal government borrowing costs have been lowered across the yield curve – in part as a result of Bank of Canada purchases of federal debt – the actual borrowing costs for some provinces have fallen below where they were in February. So why would more support be necessary?

The issue comes down to sheer size. The annual increase in provincial debt is expected to be three times higher in 2020-21 than it was the year prior (from $25 billion to a little over $75 billion). As this occurs, the debt to GDP ratio will rise accordingly.

Now, the debt to GDP is a poor measure on its own as it conflates stock (debt) and flow (GDP) variables. What is needed, of course, is the interest rate, to complete the picture. Interest rates (and hence provincial borrowing costs) are lower than they were in February, but likely not by enough to compensate for the increased provincial debt loads. Some provinces with healthier balance sheets heading into the crisis will be able to take on this increase in servicing costs. Others will need further support.

Ottawa has a backstop in place in the Fiscal Stabilization Program, which is designed for exactly the current scenario, in which a large decline in a province's revenues calls for additional federal transfers. Unfortunately, the program is far too small at $60 a person, and any amount beyond that becomes an interest-free loan, which, if provinces are still in the same dire fiscal situation once the interest-free period ends, may not be much help.

A potential design option for a federal-provincial joint borrowing plan involves "consols." Consols are bonds, which in this case are issued by a province, that can be repaid at any time and that – until repaid – bear an interest payment in perpetuity. The money they raised could effectively bail out a province but would cost it something so long as interest rates were set appropriately. For example, one could use the average interest rate on a five or 10-year bond over a fixed period, say five years prior to the COVID-19 episode.

Putting real numbers to this hypothetical, the average interest rate on a five-year Government of Canada bond for the five years between January 2015 and December 2019 was 1.32 percent. Using Ontario as an example, if the federal government wanted to support half the projected $20.5 billion deficit – around $10 billion – assuming the interest rate is fixed, the cost to Ontario to service this debt (interest only) would amount to $132 million a year, or approximately $9 per person.

A province could regain full fiscal independence by redeeming the debt in the future. In effect, it would pay for its bailout but spread the cost out over a period of its own choosing.

Provinces started the current crisis from a worse fiscal position than in 2008 when, arguably, they bore the heaviest fiscal impact. Unfortunately, they did not use the subsequent recovery to put their books in order. We should not reward the poor decisions of the past but we do need to recognize that the COVID-19 economic shock is unique. Having the Bank of Canada act first was best. If some provinces need further support, a redesigned Fiscal Stabilization Program will serve. In fact, crisis or no crisis, it's time to revamp the federal backstop.

Jeremy M. Kronick is Associate Director, Research, at the C.D. Howe Institute, and Thorsten Koeppl is Professor and RBC Fellow in the Department of Economics at Queen's University.

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Theme 3:

What will the Bank of Canada's Fight against Deflation Today mean for Inflation Tomorrow?

Intelligence MEMOS

From: Jeremy M. Kronick and William B.P. Robson

To: Monetary Policy Watchers

Date: March 11, 2020

Re: **The Bank of Canada and COVID-19**

With 50-basis-point cuts in their policy interest rates last week, the Bank of Canada and the US Federal Reserve sharpened debate about how central banks should respond to the threat to our health and our economy posed by the COVID-19 virus. While we do not yet know how serious that threat will turn out to be, we can set out the considerations the Bank of Canada and other central banks need to weigh as we learn more.

In normal times, a central bank tries to foster steady economic growth and stable inflation – 2 percent in the Bank of Canada's case. The economy's productive capacity is expanding at a fairly steady rate, as the workforce grows and productivity rises. Spending moves more cyclically, as events outside Canada and changes in consumer and business sentiment boost or depress it.

The current and expected difference between spending and productive capacity is a key driver of monetary policy. If spending looks likely to exceed productivity capacity for a while – an inflationary output gap – the Bank of Canada may raise the overnight rate to dampen it. If spending looks likely to fall short of productivity capacity for a while – a disinflationary output gap – the bank may lower the overnight rate to support it.

The impact of COVID-19 on spending is clearly negative: demand for Canadian exports is weakening, and consumers and businesses are fearful about the future. In business-as-usual mode, the Bank of Canada should lower the overnight rate.

At the same time, however, COVID-19 is also a threat to the economy's productive capacity. People who are sick, or trying to avoid becoming sick, cannot work, and disruptions to domestic and international supply chains may cut off access to key inputs.

Suppose that the resulting reduced workforce and lower potential output per worker cause the economy's productive capacity to fall, before resuming growth from a lower base.

Spending is falling, but the resulting disinflationary output gap, the excess of supply over demand, is less than it would have been without disruptions in productive capacity. That means that the interest-rate cut consistent with 2-percent inflation will be smaller and/or shorter in duration than in the business-as-usual case when productive capacity kept growing steadily.

For the sake of covering an important, and happier, possibility: what if the hit from COVID-19 on productive capacity is temporary?

Productive capacity falls as people get sick and supply chains get disrupted, then returns to the path it was previously on as people and supply chains recover. In this optimistic scenario, the disinflationary gap created by lower spending is not as big as in the business-as-usual case, and not as small as when productive capacity faces a longer-term disruption. This in-between scenario would warrant an in-between interest-rate cut.

Scenarios like these, and variations on them, are at the heart of discussions of demand and supply shocks from the coronavirus.

At this point, there is no reason to question the Bank of Canada's and the Fed's decisions to cut interest rates. Debate on the depth and duration of central bank interest rate cuts remains another matter. Answers here will depend on the longer-term impact of the virus on people's health and the economy's productive capacity.

Jeremy M. Kronick is Associate Director, Research of the C.D. Howe Institute where William B.P. Robson is President and CEO.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Steve Ambler and Jeremy M. Kronick

To: Bank of Canada Watchers

Date: March 13, 2020

Re: **The COVID-19 Monetary Policy Problem**

The Bank of Canada was right to cut interest rates last week, but 25 basis points rather than 50 would have kept valuable firepower in reserve in case, as seems likely, it's needed in coming weeks.

Given the complexity of COVID-19, a cut of at least 25 basis points was likely the right call. The key was to move swiftly and decisively, which the Bank did by following the US Federal Reserve's 50-point reduction last Tuesday.

These moves by the Fed and the Bank of Canada appear to be part of a co-ordinated series of central bank actions around the world to fend off the possible negative economic effects of COVID-19. This initiative has been criticized in some circles, so the macroeconomic effects of the COVID-19 shock and the best response of domestic monetary policy require unpacking.

We think of the negative shock as having three main components.

First, it is a negative demand shock originating abroad. Chinese demand for US and Canadian exports has already fallen and things may get worse. Some sectors of the Canadian economy will feel the impact more than others. Travel and tourism are likely to be severely hit. The correct response for a central bank to a negative demand shock is a cut in the overnight rate to encourage spending both domestically and from abroad. Growth in foreign demand will be determined by both the impact of a rate cut on the exchange rate and the degree to which COVID-19 continues to disrupt economic activity abroad.

Second, it is a negative supply shock. Canadian firms' supply chains have suffered disruptions that may well get worse before they get better. Supply chains for some goods are quite complex and can cross many international borders, and Chinese manufacturers are important links in many of these chains. Falling supply as a result of these disruptions will tend to raise prices. In this instance, the best response of monetary policy might actually be to leave the overnight rate untouched.

However, to the extent that these supply-chain disruptions lower productivity, they cause the so-called neutral rate of interest to fall. The neutral rate, which is linked to capital's productivity, is the rate at which overall saving in the economy equals investment. If capital becomes less productive, investment falls relative to savings, and the real interest rate must fall to encourage firms to invest more and households to consume more and save less. In this context, keeping the overnight rate constant would be tantamount to tightening monetary policy. So, this consideration also calls for a rate cut.

Third, the heightened uncertainty induced by the virus has caused a flight to safety. The demand for safe and liquid assets, including cash, has increased sharply. Central banks typically respond to this kind of situation by pumping liquidity into financial markets, or at least announcing that they stand ready to do so. Indeed, the Bank of Canada's website features the COVID-19-related "Statement of G7 Finance Ministers and Central Bank Governors," in which they promised to continue "supporting price stability and economic growth while maintaining the resilience of the financial system." This statement was short on detail, however, so a complementary rate cut was very much in order.

The last time the Fed cut rates by more than 25 basis points was in December 2008, when it cut by 75 basis points – the Great Recession was already well underway. The Bank of Canada's record includes one 75-basis-point cut in 2008 and five 50-basis-point cuts between March 2008 and March 2009. Unfortunately, the Fed had held the fed funds rate constant between May and October 2008 because of a spike in inflation due to rising oil prices. This prevented it from acting in a more proactive way and helped turn what could have been a milder recession into a major crisis. This time round, the Fed's 50-basis-point cut suggests it is trying to get out in front of a potentially deteriorating situation. The Bank of Canada is doing the same. We would suggest, however, that for Canada, a 25- basis-point cut would have achieved the same outcome, thus holding on to more ammunition should things get worse – a critical consideration when the overnight rate is already starting from a low base.

The size, severity and persistence of these three components is highly uncertain and can be debated. What is clear, however, is that all three components of the negative shock pointed to the need for a cut.

Steve Ambler is David Dodge Chair in Monetary Policy, C.D. Howe Institute, and Professor of Economics, École des sciences de la gestion, Université du Québec à Montréal. Jeremy Kronick is Associate Director, Research, C.D. Howe Institute.

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Intelligence MEMOS

From: Jeremy M. Kronick and Steve Ambler

To: Governing Council at the Bank of Canada

Date: March 18, 2020

Re: **THE PATH FORWARD FOR THE BANK OF CANADA**

As economists, rather than epidemiologists, infectious-disease doctors or tea-leaf readers, we cannot tell readers whether this pandemic will end in three weeks, three months, or later. But it will end, and if central bankers and fiscal policymakers continue on the path of responding to this crisis with the urgency they have, it should have the V-shaped recovery economists talk about.

Judging by the downward gyrating of world stock markets, however, more is likely needed from policymakers, both fiscal and monetary.

What is missing from a monetary policy perspective is a clear outline of the path forward, the steps that can be taken in the short, medium and long term.

First, the short term. The Bank of Canada has already lowered the overnight rate target by 100 basis points in less than two weeks, and it now sits at 0.75 percent. It appears very likely that the rate will fall further in the near future.

We have written on the need for a cut to stimulate demand during this crisis, even if the coronavirus shock is a supply shock arising from disruption to firms' supply chains.

However, if restaurants, bars, cinemas, stadiums and arenas, concert halls, etc., are shut, and travel is severely restricted by decree, it is hard to see how making it cheap to borrow to spend will have much of an impact. In the current situation, both firms and households are likely to be facing severe liquidity crunches, and banks' loan portfolios have suddenly come to look much more risky. This will likely hamper banks' willingness to lend to each other in overnight markets. This is why the bank's well thought-out plans to provide liquidity to financial markets is likely to be more beneficial than its rate cuts in the short term.

Second, the medium term. If the Bank of Canada lowers the overnight rate to zero (or near zero), the question becomes what tools does it have if more support is required. While zero is no longer the lower bound, negative rates in Canada are yet to be tried, and their success abroad is mixed at best. Canada was successful with forward guidance – the art of convincing markets you will leave the overnight rate at zero for as long as necessary – during the 2008 financial crisis. This should be the first step the Bank of Canada takes in terms of unconventional monetary policy.

If forward guidance proves insufficient, the Bank of Canada has other tools in its toolbox. Most notably, they could turn to quantitative easing (QE). Unlike most other countries, Canada did not have to use quantitative easing (QE) during the crisis. QE involves central bank purchases of government bonds (or other kinds of debt) so as to push down yields on these securities and stimulate borrowing and lending activity as a result. The evidence on the effectiveness of QE is mixed, but as we have written elsewhere, the key is for a central bank to credibly establish a firm end point over the medium run for the level of a nominal aggregate, which could be the level of nominal GDP. By committing to a higher path for monetary aggregates, QE can also affect inflation expectations, which has the effect of lowering real interest rates and stimulating spending.

Lastly, the long run. If the economic recovery is in full swing, and the neutral rate (the rate at which the economy is neither overheating or underperforming) returns to its pre-COVID 19 range of 2.25-3.25 percent, the bank will look to bring the overnight rate back up. The bank's job is to hit the 2 percent inflation target, and that will continue to be its focus. But there is no doubt that raising the overnight rate will be more difficult than lowering it. The highest overnight rate since the financial crisis was 1.75 percent, far from the peak of 4.5 percent in July 2007. In our view, the Bank should outline as part of its communication strategy its views on returning the overnight rate to neutral, guided by its 2 percent inflation target.

These are unprecedented times. The future is uncertain. Outlining the path forward might bring some comfort.

Jeremy Kronick is associate director, research, at the C.D. Howe Institute. Steve Ambler is the David Dodge Chair in Monetary Policy at the C.D. Howe Institute and professor of economics at the École des sciences de la gestion, Université du Québec à Montréal.

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Bank of Canada's Unprecedented Actions Mean There May be Inflation Ahead

By Jeremy Kronick and Steve Ambler

The Bank of Canada's rate announcement last week – no change – was no surprise. But the effects of its asset purchases could be. The Bank had already lowered the target rate to its effective lower bound of 0.25 per cent, so a further cut was not expected. The Bank didn't say so but the rate may stay where it is for a while.

The Bank did discuss expansions to quantitative easing (QE), however. How QE will play out for monetary policy, and especially the inflation target, is cause for concern. In its Monetary Policy Report and subsequent press conference, the Bank emphasized that its actions to date have been oriented towards supporting the smooth functioning of financial and credit markets. A focus on financial stability at a time like this makes sense. But it is also worth thinking about the medium-term consequences for inflation and how that might impact the economy.

The exact design of the wide array of emergency facilities the Bank has set up in recent weeks is open to debate. The sheer size of these facilities is not. It is a fact – and unprecedented. In less than a month (March 11 to April 8), the Bank's balance sheet more than doubled – from $120 billion to $275 billion. By contrast, its largest one-month increase in 2008 was a mere 20 per cent. Even the Fed didn't move that fast or that much, either in 2008 or during this pandemic, for that matter.

Most of the increase was in so-called high-powered money: currency in circulation plus deposits held at the Bank of Canada by financial institutions (their "reserves"). This expanded from slightly more than $89 billion on March 11 to almost $227 billion on April 8. The financial institutions' deposits ballooned from just $250 million (with an "m") to over $134 billion (with a "b"), a direct consequence of the Bank's asset purchases. In 2008, they increased from $25 million to $3 billion, which looks extremely modest compared to what is happening now.

In the short run, Canadian financial institutions are not generally using this massive increase in their reserves to expand lending, which would lead to a commensurate increase in inflation. Should this change, however, such a huge increase in the money supply will eventually be highly inflationary, with more money chasing after a limited supply of goods.

The Bank will be faced with hard choices about how to avoid the inflationary consequences of its actions. What are its options?

One possibility would be to make clear the expansion of its balance sheet is temporary, as it was in 2008. But announcing a path for the balance sheet will rob monetary policy of its power to boost demand. If households and businesses know all the money will soon be taken away, they will adjust their spending and saving accordingly. On the other hand, central banks often have trouble shrinking their balance sheets after engaging in QE. The Fed's balance sheet was just $1 trillion before the financial crisis but sat at $4 trillion before COVID-19 began.

A second possibility would be to maintain what is now effectively a "floor" system for the overnight interest rate. In normal times, the Bank operates a "corridor" system that encourages financial institutions to lend to each other at the target overnight rate. The "encouragement" is that if they wish to borrow from the Bank, they pay 25 basis points above the target, while if they leave reserves on deposit with the Bank, the interest on those reserves is 25 basis points below the target.

In exceptional times, such as today, the Bank of Canada operates a floor system in which the interest banks get on their deposits with the Bank is the overnight rate target itself. So there's no interest gain from lending funds to other banks rather than leaving them with the Bank of Canada. Higher deposits at the Bank usually means less lending to the economy. That does mute economic activity somewhat but the silver lining is slightly less inflation.

Finally, the Bank could do what it normally does when inflation bubbles up: increase the overnight target rate, which will push up interest rates generally. Unfortunately, that will raise the carrying cost of all the new debt our governments are taking on as they try to fight the COVID slowdown. If interest rates rise above the rate of economic growth, servicing the debt becomes unsustainable without either a reduction in government spending or an increase in taxes. The alternative, keeping rates low, could lead to a situation similar to a famous episode in the U.S. in 1951 when the Fed continued buying Treasury bills at ultra-low rates even as inflation was skyrocketing. This untenable situation led to an accord between the Fed and the Treasury, allowing the Fed to focus on fighting inflation instead of financing U.S. war debt, which had been a preoccupation in the immediate postwar years.

Each option will have different consequences for both the prices Canadians face and the prices they expect to face. Transparency on the part of the Bank of Canada will be crucial in order to align expectations with reality.

Jeremy M. Kronick is associate director, research, at the C.D. Howe Institute, where Steve Ambler is David Dodge Chair in Monetary Policy. He is also a professor of economics at Université du Québec à Montréal.

Published in the *Financial Post.*

COVID-19 Crisis Working Group: Monetary and Financial Measures

Communique #4: Expanded Bank of Canada Balance Sheet Requires Balancing Act

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. Its Working Group on Monetary and Financial Measures is co-chaired by David Dodge, former Governor of the Bank of Canada, and Mark Zelmer, former Deputy Superintendent, OSFI, and supported by a group of financial market experts and economists. The group's fourth meeting was held on Monday, April 20th, 2020.

The focus of the meeting was on the massive expansion of the Bank of Canada's balance sheet over the last month. Between early March and mid-April, the Bank of Canada's balance sheet more than doubled. It now sits at approximately 10 percent of GDP, which dwarfs anything seen in 2008.

Moreover, unlike 2008, the Bank of Canada has expanded its normal purchases of federal government debt to include provincial debt of both short- and longer-term maturities, as well as private-sector debt. As a result, the increase in the liabilities side of the balance sheet is not due to higher government deposits – which would offset, or sterilize, the impact of assets purchased on the monetary base – it is due mostly to higher deposits held by financial institutions (settlement balances).

In 2008, settlement balances increased to $3 billion; today, they are over $130 billion. During the pandemic, members pointed out that these new settlement balances are unlikely to cause inflation since lending in such an environment is difficult for lenders when borrower finances are disrupted for an unknown period of time. Unlike last time, however, the increased monetary base has implications for inflation in the future.

With this context in mind, two sets of critical questions arise:

1. How can the Bank of Canada manage the credit and political risks of its new assets? In other words, how should the large-scale asset purchase program (LSAP) be operationalized?
2. What will be the more medium-run inflation risks for the Bank of Canada? What are the options for mitigating these risks, and what are the consequences of these actions?

The conversation began with members reiterating some of the key principles the Bank of Canada laid out in 2009, then again in 2015, around conducting monetary policy in a low interest rate environment. Members pointed out that these principles apply just as much today and can be used to help guide the operationalizing of the Bank's expanded balance sheet. While continuing to focus on the underlying inflation control objective, the Bank will look to:

1. Maximize the economic impact of a given policy action;
2. Ensure market neutrality; and
3. Minimize risk to the balance sheet.

To minimize credit risk on the balance sheet, the Bank could ask for some sort of guarantee from the federal government. The Treasury has done something similar for the Federal Reserve in the US, by backing the first round of losses. The group discussed whether this guarantee should be an open-ended indemnity agreement or a first-loss agreement – a key question for the Bank and federal government if that option arises.

The Bank should also be clear on the parameters for deciding which assets to purchase; i.e., what criteria guide its portfolio allocation. This becomes especially important when buying non-sovereign and private-sector debt, as it reduces the politicization of its operations. Members felt an explicit agreement with the federal government could be helpful for maintaining its independence.

Communication will also be critical for laying out an exit strategy. The Bank should not lay out a timeline, as to not jeopardize the potency of their large-scale asset purchases, but indicating how it intends to exit down the line will be important in order not to destabilize inflation expectations. This exit strategy would be facilitated by adjusting the portfolio towards securities that mature and simply run off, as opposed to having to be sold in secondary markets.

The group then transitioned more fully into the question of unwinding the Bank of Canada's balance sheet expansion.

Members discussed first and foremost the extent to which it was necessary to unwind these positions. To the extent the Bank of Canada buys up shorter-term assets, e.g., commercial paper, it can let it simply run off, adjusting the balance sheet accordingly. For longer-run debt, one option is to do what the Fed did after the financial crisis, which was maintain the floor system they implemented during the crisis. In a floor system, which the Bank is essentially using now, the overnight rate and the deposit rate financial institutions earn on excess reserves at the Bank are equal. This dis-incentivizes interbank lending, keeping the size of the Bank's balance sheet intact, and may also help keep inflation in check

if financial institutions do not lend as much as they otherwise would. If the Bank is considering a more permanent switch to a floor system when the economy returns to normal, the group felt they should be upfront, given the consequences to the interbank system.

Members felt there was no easy solution to the inflation problem in the medium term. Decisions on selling longer-term assets are fraught with political risk. Alternatively, maintaining a floor system has very clear tradeoffs. To have the greatest impact, while mitigating as much risk in both the short- and medium-run, the group recommended that the Bank should:

- Buy debt at the shortest term possible to allow as much roll-off as possible;
- Ensure some form of federal government guarantee or backstop on non-sovereign and private-sector debt to minimize credit risk;
- Set a target for the intervention for a particular asset-class based on the estimated size of the market disruption, starting small to see the impact from the Bank's mere presence in that market;
- Be transparent about the criteria on what assets to buy, and on any third-party or parties used to buy these assets;
- Operate under an explicit agreement with the federal government to minimize politicization;
- Be transparent on exit strategy, and if considering the longer-term use of a floor system, be upfront.

The Monetary and Financial Measures Working Group will reconvene on Monday, May 4th, 2020 at 3pm. The group will continue to monitor policy actions taken over the course of the next two weeks, and from there determine the most relevant topics for its May 4th meeting.

Members of the Monetary and Financial Measures Working Group include:

David Dodge, Co-Chair, former Governor of the Bank of Canada
Mark Zelmer, Co-Chair, former¬ Deputy Superintendent, OSFI
Riaz Ahmed, TD Bank
Steve Ambler, Universite du Quebec a Montreal
Dwight Duncan, McMillan LLP
Paul Jenkins, Former Senior Deputy Government, Bank of Canada
Phil Howell, Former Superintendent, FSCO
Thor Koeppl, Queen's University
Andrew Moor, Equitable Bank
Tamara Vrooman, VanCity
Jeremy Kronick, C.D. Howe Institute
Duncan Munn, C.D. Howe Institute

Intelligence MEMOS

From: Mark Zelmer

To: Governing Council and Minister Morneau

Date: April 27, 2020

Re: **FACILITATING AN EXIT STRATEGY FOR BANK OF CANADA MARKET INTERVENTIONS**

The Bank of Canada balance sheet has ballooned by more than $200 billion over the past six weeks.

This has been accompanied by an unprecedented expansion in the range of assets held by the Bank as it began purchasing short- and longer-term provincial government securities and private sector debt to provide liquidity. The Bank financed these transactions by crediting the settlement balances held by financial institutions with the Bank with additional Canadian dollars; thereby expanding base money in Canada accordingly.

When the pandemic subsides and economic activity recovers, the Bank will need to shrink its balance sheet, and hence the amount of base money outstanding, to keep inflation on target.

Expanding the Bank's investment portfolio beyond its traditional holdings of Government of Canada securities exposes the Bank to new credit and political risks. It may also make it more difficult to shrink its balance sheet on a timely basis as most provincial government and private -sector securities tend to be less actively traded than Ottawa's issues.

One way to manage those risks would be for the federal government to create a new account in the Public Accounts of Canada to hold the provincial government and private-sector securities acquired by the Bank, thereby removing the securities from the Bank's balance sheet. In exchange, the government would issue new Government of Canada securities to the Bank, which would now be held on its balance sheet. The net debt of the federal government would not change because the additional debt issued by the government would be offset by the new assets acquired.

This would help separate the conduct of monetary policy from operations in support of financial markets.

Or, to put it another way, separate transactions conducted for quantitative easing purposes – normally within the realm of monetary policy – from credit easing transactions, which are more in the realm of financial stability. Government of Canada securities are the lowest risk and most liquid instruments in Canadian dollar markets. As such, they are the easiest for the Bank to sell when it eventually needs to shrink its balance sheet. Moreover, holding those instruments insulates the Bank from any credit risk or political issues that may arise if it were perceived to be involved in credit allocation decisions for other levels of government or the private sector. And from an operational perspective, Government of Canada securities are the easiest instruments for the Bank to manage on its own given its past experience in operating in that debt market.

Of course, the issues and risks associated with holding provincial government and private sector securities still remain. But they are ultimately issues and risks that are borne by the federal government in any event and for which it is better placed to manage. That said, the Bank is well placed to continue to provide advice to the government as to which markets might need support and to oversee the execution of that support on the government's behalf.

Indeed, this is very much in the spirit of how the Bank currently operates with respect to the management of Canada's foreign reserves and exchange rate where the Bank serves as the federal government's fiscal agent when it buys and sells foreign currency and borrows and invests on Ottawa's behalf using the federal government's Exchange Fund Account, which is also part of the Public Accounts of Canada rather than an account on the Bank's balance sheet.

The pandemic-driven need to quickly provide liquidity support to the broader marketplace was perfectly understandable. The Bank was able to promptly provide that support using its own balance sheet. It was a quick way of launching operations for the affected markets.

But now that those operations are underway, it would be a good idea to consider how best to organize them and help facilitate a future exit strategy from this unprecedented balance sheet expansion, and preserve the independent conduct of monetary policy that has served Canada well for many years.

Creating a new government account to hold the provincial government and private-sector securities acquired by the Bank should do the trick. The federal government can hold those securities until they mature if necessary and manage the risks in the interim through its own operations, while the management of the Bank's balance sheet can return its focus to achieving the inflation target.

Mark Zelmer is a Senior Fellow at the C.D. Howe Institute. He was the Deputy Superintendent of OSFI from 2013–2016.

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Intelligence MEMOS

From: Jeremy M. Kronick and Mark Zelmer

To: Incoming Bank of Canada Governor Tiff Macklem

Date: May 6, 2020

Re: **Can the Bank of Canada Keep Inflation on Target When the Economy Recovers?**

Congratulations on being appointed the next Governor of the Bank of Canada. The job is as important as ever.

The Bank of Canada's balance sheet more than tripled in size between March 11 and April 29, and is likely to continue growing.

While necessary, given the jump in financial system liquidity requirements, this massive expansion raises two questions. First, does it affect the ability of the Bank to conduct monetary policy to achieve its inflation target? The answer is probably not. And, second, when the time comes time to shrink the Bank's balance sheet again, what constraint will Canada's public and private debt overhang pose? The answer to that is less clear.

First, the expansion. On March 11, the Bank's balance sheet was a little over $120 billion. By April 29, it was a little over $384 billion. In normal times, the bulk of the Bank's assets are Government of Canada securities. Lately, however, the Bank has not only increased the size of its typical purchases, it has extended the term of its loans to financial institutions, broadened the type of assets it accepts as collateral, and expanded the types of assets it purchases outright. It has done this to meet the needs of the financial system's demand for liquidity to ensure markets and the banking system function as normal, and to provide easier monetary conditions when interest rates are at or near their lower bound.

Of the almost $265 billion of assets acquired so far, around $165 billion have been resale agreements (repos) where financial institutions agree to buy back the assets sold to the Bank after an agreed upon period of time. Of the counterpart increase in liabilities, around $210 billion of the $265 billion increase is excess reserves (settlement balances) held by financial institutions at the Bank of Canada. This high-power money, currency in circulation plus reserves of financial institutions at the central bank, has the potential to support credit and spending – but with so much of the economy locked down, it so far has not. For now, then, we need have no worries about inflation.

As the economy opens up, the Bank can simply let the repos run down and exchange the purchased debt for settlement balances as it matures. If timed right, its balance sheet will shrink before the additional liquidity creates inflationary pressure.

Where it might be more complicated is with respect to the other assets the Bank has begun purchasing, specifically longer-term provincial bonds and private sector debt. While the purchase amounts so far remain low, their maturities could be more difficult to time with the economic recovery. Those investments are also fraught with credit and political risk.

One way forward would be for the Bank to exchange these assets, once purchased, with Government of Canada debt more consistent with its normal operations. The government could create a new account in the Public Accounts of Canada to hold these provincial government and private-sector securities. The federal government can hold those securities until they mature if necessary and manage the risks in the interim through its own operations, making it easier for the Bank to manage its own balance sheet, and achieve its inflation target.

The good news about shrinking the balance sheet is that when it happens, the economy will be in a recovery phase. As this occurs, however, if inflation requires tightening the stance of monetary policy beyond a shrinking of the balance sheet, how easy will it be for the Bank to increase the overnight rate? Both the private (households and businesses) and public sectors (governments) will be highly levered in the wake of the pandemic. A more heavily indebted country makes any monetary policy action more potent. Calibrating monetary policy actions will be more challenging in the future.

This puts even more pressure on the Bank of Canada to ensure it gets the timing of the shrinking of its balance sheet right, and to communicate the reasoning transparently with the public, so expectations are in place before the need arises to raise the overnight rate. A not so easy challenge for you as the incoming Governor.

Jeremy M. Kronick is Associate Director, Research at the C.D. Howe Institute and Mark Zelmer is former Deputy Superintendent at the Office of the Superintendent of Financial Institutions and a Senior Fellow at the C.D. Howe Institute.
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COVID-19 Crisis Working Group: Monetary and Financial Measures

Communique #6: Canada Must Recommit to Fiscal and Monetary Anchors

The C.D. Howe Institute has initiated a special project to provide rapid expert insights to help Canadians and Canadian policymakers navigate the COVID-19 crisis. Its Working Group on Monetary and Financial Measures is co-chaired by David Dodge, former Governor of the Bank of Canada, and Mark Zelmer, former Deputy Superintendent, OSFI, and supported by a group of financial market experts and economists. The group's sixth meeting was held on Wednesday, May 20th, 2020.

Discussion focused on the importance of fiscal and monetary anchors in Canada and the dangers both now face as a result of the needed stimulus and support provided by all levels of government and the Bank of Canada during the crisis. Canada has benefited tremendously from having both a fiscal and monetary anchor over the past 25 years, including the very low risk premiums on government borrowing costs. However, fiscal anchors, e.g., debt to GDP ratios, were necessarily set aside with the spending programs required to overcome the government-imposed economic shutdown.

Canada is emerging from the first wave of the pandemic with very high public and private debt loads and has become even more dependent on foreign investors to finance those debt loads. While other countries are in similar situations, Canada is nevertheless highly dependent on both domestic and foreign investor confidence so that public and private debt can be carried at a reasonable cost. This reinforces the importance of Canada's monetary anchor: a low and stable inflation target. Members agreed that the Bank of Canada and federal government should reinforce their commitment to the 2 percent target. By doing so, the Bank would retain ample latitude to increase its balance sheet over the next couple of years to support the economy and the financial system in a deflationary environment but provide assurance that it will promptly move to deal with any inflation that may emerge later as global supply chains are reorganized.

In the short-run, members felt that deflationary pressures will be an elevated risk. Deflation causes an increase in the real cost of holding debt, especially important given the size of Canada's debt overhang. Deflation also limits the effectiveness of any stimulus as real rates cannot be lowered by as much as needed.

Despite these monetary concerns, members felt that greater dangers lay on the fiscal side. Placing the economy in a partial coma made sense during the first wave of the pandemic, but if there is a second wave, a second economy wide shutdown should be avoided in favor of more targeted approaches that are effective and avoid further erosion of public finances and the risk of hitting debt walls and loss of borrowing capacity. Members also recommended governments explain how they plan to stabilize public finances over the medium-term, something even more critical given the commitment to the 2 percent inflation target and the need to restore fiscal maneuvering room to cope with future shocks.

Members raised the risk that, even after some reopening, economic growth may be sluggish, and what were supposed to be temporary programs may take on more permanence, turning one-off deficits into structural deficits. Should that be the case, investors will become concerned with fiscal sustainability, Canadian dollar denominated debt will become riskier, and borrowing costs could increase rapidly.

Members then turned to the question of what can be done to ensure fiscal sustainability. Placing government finances on a more sustainable path will require fiscal policy to shift from emergency spending and tax deferrals to more sustainable and much lower levels of spending on transfers to persons and business subsidies. At the same time, the tax base needs to broaden out to capture a portion of the rents that are accruing to some firms in highly concentrated digital and other sectors, and to individuals with skills in high demand or who have benefited from large capital gains. Actions on this front are best pursued in tandem with other jurisdictions to contain the risk of tax avoidance, and to maintain Canadian competitiveness. Over the longer term, Canada's revenue sharing arrangements among federal, provincial and municipal governments should also be reviewed to promote a closer alignment of revenue generating powers with the delivery of public services.

On a practical basis, some members felt a combination of restraint, growth and revenue tools will be necessary, and governments should double down on economic growth efforts in the medium term, look carefully at all non-core expenditures, and focus any tax raising efforts in ways that have the least impact on economic efficiency and the overall competitiveness of the Canadian economy.

Members pointed out that the neutral rate of interest is lower today than it was during the financial crisis, and may fall further should excess savings arising from the economic shutdown become more permanent. This is true in both Canada and abroad. Individuals who remain employed are saving far more than they were pre-crisis, and businesses are not going to invest with all the uncertainty surrounding the pandemic. Sluggish business investment in Canada was a problem before the pandemic, indicating that this issue might be more long-term structural than related to COVID-19. Members agreed that as the recovery takes hold, governments should look for ways to work with their international counterparts to unlock savings and boost investment incentives to bring up the neutral rate of interest and ensure we do not end up permanently close to negative interest rate territory, as in Europe and Japan.

In summary, members of the Monetary and Financial Measures Working Group recommended the following:

- The federal government and the Bank of Canada should continue to reinforce that they remain committed to the 2 percent inflation target, explaining to the public why such a target is so important in light of the crisis at hand;
- Governments should make clear to Canadians how they will re-calibrate and eventually remove the temporary fiscal programs currently in place, as part of a transparent plan to stabilize public finances over the medium term;
- To ensure fiscal sustainability, governments will likely need revenue sources beyond tax rate hikes. One avenue is through the digital taxation of economic rents realized by the few dominant players in these sectors and through taxation of individuals who have benefited from large capital gains;
- Any such new revenue sources must be done in conjunction with other jurisdictions so as not to be seen as an outlier, thus harming Canadian competitiveness; and
- Over the longer run, governments should work with their foreign counterparts to look for ways to unlock excess savings for investment, in order to increase the neutral rate of interest, providing more breathing room from the zero lower bound.

The next meeting of the Monetary and Financial Measures Working Group will be on Monday, June 1st, 2020 at 3pm. The group will continue to monitor events and policy actions in determining the most relevant topics for that meeting.

Monetary and Financial Measures Working Group members Include:

David Dodge, Co-Chair, former Governor of the Bank of Canada

Mark Zelmer, Co-Chair, former Deputy Superintendent, OSFI

Riaz Ahmed, TD Bank

Steve Ambler, Université du Québec à Montréal

Dwight Duncan, McMillan LLP

Paul Jenkins, Former Senior Deputy Government, Bank of Canada

Phil Howell, Former Superintendent, FSCO

Thor Koeppl, Queen's University

Andrew Moor, Equitable Bank

Tamara Vrooman, VanCity

Jeremy Kronick, C.D. Howe Institute

Duncan Munn, C.D. Howe Institute

Intelligence MEMOS

From: Jeremy M. Kronick, Mark Zelmer, and David A. Dodge

To: Policymakers in Ottawa

Date: May 26, 2020

Re: **Inflation Target – The Only Anchor Left**

As governments across the country continue to announce massive fiscal stimulus, fiscal anchors have been appropriately set aside. However, to keep investor confidence in Canadian dollar denominated debt high, the monetary anchor – low and stable inflation – must be protected.

Canada has benefited in many ways from having both a fiscal and monetary anchor over the past 25 years, not least of which through very low risk premiums. The fiscal anchor in Canada has largely shifted from whether the federal government runs a surplus or a deficit in a given fiscal year, to the debt to GDP ratio. Under current circumstances, the debt-to-GDP ratio, along with other fiscal anchors, have been set aside. With interest rates low, in the short-run at least, this is not a serious concern.

Things get more interesting in the medium term, especially given our dependence on foreign investors.

And that's where the monetary anchor comes into play.

The only anchor that maintains value in all circumstances is the Bank of Canada's inflation target. With the inflation target renewal coming up in 2021, it is important to remind ourselves why this target is so important, what it means for financing this stimulus, and why it might come under threat.

The Bank of Canada has been an inflation targeter since 1991, with the target constant at 2 percent – the midpoint between 1-3 percent – since 1996. The Bank must renew its inflation-control agreement with the federal government every five years, with the next renewal coming up next year. Because the target is agreed to by the government, in setting its fiscal policy, the Minister of Finance must take into account potential actions the Bank will have to take to hit the target.

Much has been written on the success of a low inflation target, both in Canada and abroad: the inflation rate itself and its variability has fallen, real GDP growth has increased with lower volatility, and there has been lower overall unemployment.

However, this success, and the Bank of Canada's mandate faces its toughest test as a result of all the COVID-related government spending.

In addition to taxation (a political non-starter at present), financing government deficits can be done in two ways: through the issuance of interest-bearing debt to the public, or through monetary financing, i.e., an increase in the central bank's balance sheet.

A crisis of this size makes the traditional approach of selling federal and provincial bonds to the public, both domestic and foreign, more difficult, as liquidity dries up with the public facing their own constraints. That leaves monetary financing.

During the crisis, the central bank blowing up its balance sheet has been required to meet the financial system's demand for liquidity and to resist deflationary pressures in the economy. With large parts of the economy shut down to deal with the health consequences of COVID-19 there are unlikely to be any of the usual inflation pressures. Additionally, by purchasing government debt, the Bank of Canada keeps borrowing costs low. And, in doing so, servicing that debt becomes much less expensive, giving the government more room to increase the debt-to-GDP ratio.

However, rising public debt, especially when financed by expansion of the Bank of Canada's balance sheet, increases the perceived risk of both inflation and fiscal unsustainability. This perception could require the Bank of Canada to have to work doubly hard in terms of more stringent monetary policy to demonstrate its commitment to the inflation target, as was required in the early 1990s.

This argues for continuation of a firm and transparent monetary anchor keeping the inflation target at 2 percent so that confidence is maintained in Canadian dollar debt.

Should the government feel it necessary to facilitate debt restructuring as the economy starts to recover, it is best done through fiscal policy rather than inflation, as the former can be applied in a more measured and targeted fashion than the latter. Moreover, inflation disproportionately hurts lower income folks who have less disposable income to cope with price increases.

The focus in a crisis of this magnitude is rightly on putting a floor on the fall in economic activity. Governments and the central bank have done just that. Their ability to do so is a result of the credibility of their anchors. It may take some time for the return of fiscal anchors. In the meantime, the monetary anchor can help take up the slack.

Jeremy M. Kronick is associate director, research, C.D. Howe Institute, Mark Zelmer was the Deputy Superintendent of OSFI from 2013–2016, and David Dodge is senior advisor at Bennett Jones and former Governor of the Bank of Canada.

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Intelligence MEMOS

From: Andrew Spence

To: Inflation Watchers

Date: May 28, 2020

Re: **WHITHER INFLATION WHEN SUPPLY CHAINS COME HOME?**

Canada was forced to ride into the medical supply wild west as pandemic driven supply shortages laid bare our inability to handle surge capacity in healthcare.

And the suddenly exposed lack of domestic production capacity for key medical supplies and pharmaceuticals is one factor in the chorus of calls for more Canadian supply chains and reshoring generally.

Healthcare is but one example of the need for more robust, generally shorter, supply chains. Given that pandemics have become recurrent, corporate efficiency and lean production will likely give way to surge production capacity, despite its cost.

What are the implications for inflation control if we pivot to domestic supply – in healthcare and beyond?

Stepping back, it is clear that the proliferation of global supply chains in the past half century delivered a large positive productivity shock to advanced economies and, as a result, lower inflation.

By severing the link between domestic wages and prices, globalization de-fanged organized labour, vanquished cost-push inflation through increased aggregate supply with more players competing on important goods and services, and stabilized inflation expectations by reducing inflation persistence. This helped central banks bring inflation into their target ranges with relative ease, and it has helped keep inflation in check ever since.

As globalization took hold through the 1970s and beyond, the price persistence coefficient (a measure of how likely a price continues to move in its current direction) fell, meaning inflation expectations fell with it. The International Monetary Fund estimated that this coefficient only dropped from 0.6 to 0.4, but over time it had a powerful cumulative effect on inflation and inflation expectations.

Current low inflation expectations are hard to break, and are especially important given the current big negative shock. They keep our assumptions about inflation and its control grounded. However, once expectations break higher, with all actors presuming prices will rise, they can have a devastating impact on inflation control, and the expectation genie is difficult to put back in the lamp without enormous cost.

In Canada, and other advanced countries, inflation has remained very low since the early 1990s, and this can be attributed almost entirely to goods prices. For example, in Canada goods prices have been on average one percent lower than service prices since 1993. The reason why is simple: service prices are mostly determined by domestic wages; offshoring a haircut to low-wage developing countries is not possible.

The persistent trend in lower goods prices inflation left more income to spend on services, making social consumption an ever-larger share of the economy.

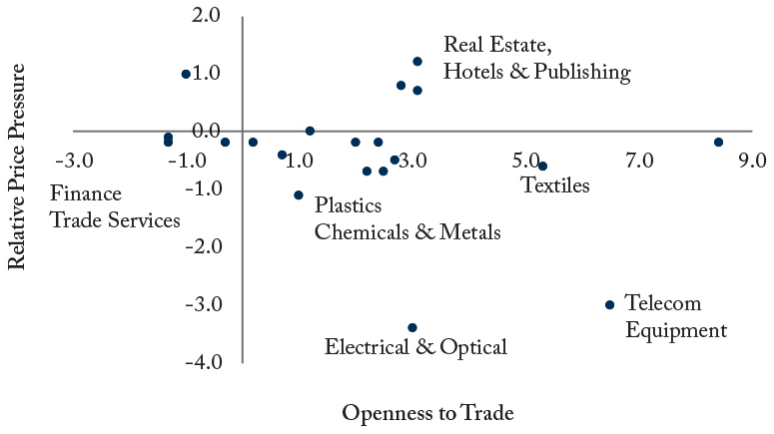
As the scatter plot below shows, industries across 11 advanced countries that were most open to trade, contributed most to relative price declines. This is what one would expect given the large productivity shock from globalization.

However, this may now be reversed. Many of the industries that restrained prices the most are among those most likely to be ordered home: medical supplies, pharmaceuticals, medical equipment and pharmaceutical chemicals. It doesn't take a leap of imagination to see that offshore production's helping hand to inflation risks being withdrawn.

Economic policy matters, and the coming transformation of our economies and the state's role in them is coming clearer.

The challenge will be to marry the rebuilding of domestic strategic surge capacity to manage future emergencies without losing the benefits of globalization.

Open Industries Experienced Lower Prices



Andrew Spence is former Global Head of Rates and FX Research at TD Securities, and VP and Chief Economist for Ontario Teachers' Pension Plan.

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The views expressed here are those of the author. The C.D. Howe Institute does not take corporate positions on policy matters.

Source: IMF. Change in relative producer prices relative to a change in trade openness based on OECD data from 11 advanced countries.

Intelligence MEMOS

From: Jeremy M. Kronick and Steve Ambler

To: Monetary Policy Watchers

Date: June 11, 2020

Re: **The Bank of Canada's Next Trick? Balancing the Balance Sheet**

Even before the Bank of Canada's interest rate announcement last week, the eyes of monetary policy watchers had shifted elsewhere – to the Bank's expanding balance sheet.

There was little surprise when the targets for the overnight rate and the deposit rate paid to banks both remained at 25 basis points.

It is clear that the overnight rate will not be the centrepiece of the Bank's monetary policy. It's stuck at a level at which the Bank considers further cuts to be counterproductive until at least well into 2021.

Instead, the Bank's balance sheet will play the starring role in achieving its monetary policy objectives. And, while the immediate needs of the COVID-19 crisis have meant a focus on financial stability and ensuring functioning credit markets, as the recovery gets under way, the balance sheet will also be instrumental in the Bank's ultimate objective: hitting the 2 percent inflation target.

Let us first consider the balance sheet as a tool for financial stability. As of May 27, the Bank's balance sheet had ballooned to $465 billion, through, among other things, its "large-scale asset purchases," which is more popularly termed quantitative easing, or QE.

The Bank's asset purchases, both traditional federal government debt and non-traditional provincial and private sector debt, have ensured the smooth functioning of financial markets. It would appear the Bank's strategy has largely succeeded, with borrowing costs on federal and provincial debt coming down after huge spikes and measures of liquidity in these and private markets returning to much more stable levels.

During the shutdown, the concern has been likely more on deflation than inflation with demand suppressed by pandemic closures. Therefore, the expansion of the balance sheet was able to deal with financial stability concerns, without threatening the usual inflationary pressures.

However, as the economy starts to recover, this balance will prove more difficult. With so much uncertainty, the Bank's use of the balance sheet must achieve three things at the same time: boost demand to aid in the recovery; prevent inflation and inflation expectations from falling significantly below the 2 percent target in the short run; and ensure that inflation rises to the Bank's 2 percent target over the medium run once the recovery is under way.

A few things for the Bank to consider:

First, the precariousness of the recovery means Bank of Canada watchers should expect the balance sheet to stay big for quite some time. There is ample evidence that QE will boost private sector spending only to the extent that it is expected to remain in place over a longer period of time. Households, businesses and markets get jittery if they think the expansion will be quickly reversed. We have seen the failure of other central banks to generate robust recoveries because they shrank their balance sheets too soon.

Second, there are implications for continuing to leave the deposit rate paid to banks equal to the overnight target rate. Doing so means banks earn the same interest leaving excess reserves at the Bank of Canada as they do lending to each other. As a result, the opportunity cost to banks of holding reserves on deposit with the Bank of Canada is lower, and this may reduce incentives for banks to expand lending. This contributed to lower-than-expected inflation after the financial crisis – despite continuously big central bank balance sheets for those countries who used QE – and will be an important part of ensuring inflation – and inflation expectations – return during the recovery.

Third, allowing a period further down the road during which inflation exceeds the 2 percent target (but remains within the acceptable 1 to 3 percent band) might offset the period of lower-than-target inflation that began with the onset of the pandemic and which will likely continue for some time after lockdowns end. This will also help anchor inflation expectations, and allow the Bank to hit its 2 percent target over the more medium run.

Achieving these objectives will require a major balancing act by the Bank. It has shown immense flexibility so far. More will be needed.

A move from the overnight rate to the balance sheet as the primary monetary policy tool is a big change. Clarity and transparency, as always, will be key.

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A version of this memo first appeared in The Globe and Mail.

Intelligence MEMOS

From: Stephen Williamson

To: Central Bank Watchers

Date: August 11, 2020

Re: **Three Questions about Bank of Canada Balance Sheet Expansion**

Given the unprecedented challenges of a global pandemic, the Bank of Canada has implemented some unconventional policies, with the goal of mitigating the economic effects of COVID-19 and the associated economic constraints.

First, the Bank's overnight interest rate target has been reduced to 0.25 percent – the effective lower bound, according to the Bank – for an extended period of time. Second, the Bank has greatly expanded the size of its balance sheet. This balance sheet expansion, and some important related questions, are the subject of this memo.

Large central bank balance sheets have become commonplace since the 2008-2009 financial crisis. The Federal Reserve System in the United States, the Bank of Japan, the Bank of England, the European Central Bank, and the Swedish Riksbank, for example, all expanded their balance sheets during the crisis and thereafter, typically through large-scale asset purchases, or quantitative easing (QE), financed by the expansion of interest-bearing reserve balances held by banks. Until March 2020, however, the Bank of Canada had refrained from engaging in QE.

As shown in the chart, as of March, 18, 2020, the Bank of Canada's assets were 5.4 percent of GDP, and these asset holdings were financed mainly by currency outstanding and deposits of the Government of Canada with the Bank. However, by July 29, Bank of Canada assets had grown sharply to 23.8 percent of GDP. Though this is a very large increase over a short period of time, it brings the Bank of Canada's assets to a level that is still modest relative to what we see at some other central banks in the world. Central bank assets relative to GDP are currently 36.1 percent in the United States, 54.5 percent in the Euro area, and a whopping 121.8 percent in Japan, for example.

On the asset side of the Bank's balance sheet, in the table, the Bank has greatly expanded its holdings of Government of Canada securities, as well as its lending – overnight and term – in the market for repurchase agreements (repos). There have been some purchases of provincial government debt, corporate debt, commercial paper, Canada mortgage bonds, and banker's acceptances, but that was a relatively small part of the expansion.

The increase in assets of course shows up as matching entries on the liabilities side of the Bank's balance sheet, with an expansion in the interest bearing deposits (reserves) of Payments Canada members with the Bank, a large increase in Government of Canada balances, and a modest increase in currency in circulation.

With this unprecedented expansion of the Bank of Canada's balance sheet, some key questions come to mind regarding the policy rationale and market phenomena:

1. Early in the crisis, the Bank's asset purchases were intended to improve the functioning of financial markets, and those markets indeed improved. In the July Monetary Policy Report, however, the Bank makes clear that its rationale for QE is now more like the conventional one given by other central banks for conducting QE in a crisis. But, the conventional rationale could be deeply flawed. For example, it is not clear why taking widely traded safe collateral (government debt) out of financial markets, and replacing it with reserves in the banking system, is a good idea. QE may not work, or be detrimental, so why continue with it now in the Canadian context?
2. The increase in currency in circulation may appear puzzling, as we might expect that the demand for currency has fallen, due to the decline in economic activity, and because some retailers are not accepting currency. But the increase in currency outstanding is also observed in the United States and the U.K. One potential explanation is that COVID-19 has hampered illegal money laundering, causing cash to pile up outside the financial system.
3. Why the large increase in Government of Canada deposits held at the Bank? If QE works, it does so by replacing Government of Canada debt with bank reserves. But, a larger Government of Canada deposit account means that the stock of government debt held by the public must be larger, and reserves smaller. This happens because government debt issuance effectively moves reserves from the banking system to the government's account with the Bank. This then negates the effects of the Bank's QE program.

The Bank has a good record of transparency, before and during the current crisis. Providing a deeper explanation for the policy issues in #1 and #3 would be helpful, and would continue that tradition of transparency.

	March 18, 2020 % of GDP	July 29, 2020 % of GDP
Assets		
Treasury Bills	1.2	6.1
Government of Canada Bonds	3.3	8.5
Repos	0.8	8.1
Other	0.1	1.1
Total	5.4	23.8
Liabilities		
Currency	3.9	4.4
Deposits, Government of Canada	1.0	7.1
Deposits, Payments Canada Members	0.1	11.9
Other	0.5	0.5

Stephen Williamson is Professor of Economics at Western University, where he holds the Stephen A. Jarislowsky Chair in Central Banking.

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Intelligence MEMOS

From: Jeremy M. Kronick and Steve Ambler

To: Central Bank Watchers

Date: September 15, 2020

Re: **Parting Ways: The Bank of Canada Holds Steady, the Fed Experiments**

The two most recent announcements by the Bank of Canada and the US Fed are a study in contrasts. The Fed's major shift in its monetary policy framework should be met with caution at home.

Last week's rate announcement by the Bank of Canada contained little new information. The Bank reaffirmed its intention to hold the Overnight Rate Target at 25 basis points "until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved." It did add to the language around the large-scale asset purchase program, indicating these purchases will be calibrated to achieve the inflation target, seemingly providing notice to markets that Bank purchases might taper off in the near future. But, as before, the Bank said it would continue its large-scale asset purchase program of at least $5 billion a week.

Contrast that with the Fed, which, on August 27, announced a major modification of its monetary policy framework, moving towards a policy of average inflation targeting (AIT). The announcement stated that "following periods when inflation has been running persistently below 2 percent, appropriate monetary policy will likely aim to achieve inflation moderately above 2 percent for some time."

Let's look at the implications of the announcements in more detail, starting with the Fed.

In the current context, the Fed's AIT policy, if credible, will increase expected inflation because the Fed has committed to letting inflation sit above 2 percent after periods where the US runs below target. This will have the effect of reducing real interest rates (nominal interest rates adjusted for inflation), the main channel through which expansionary monetary policy operates in order to increase spending. When nominal interest rates, both short term and long term, are already low, for monetary policy to encourage more spending, and therefore inflation, it must work through real interest rates.

But there are major problems with the Fed's announcement. A credible AIT regime would specify the exact length of time over which average inflation would be calculated, and critically, it would also be explicitly symmetric, such that both persistent undershoots and overshoots are acknowledged so that in the medium term, inflation sits at the 2 percent target. Otherwise, inflation expectations become unanchored, and in the Fed's case, biased upwards. With unprecedented government debt flooding markets, unanchored inflation above the 2 percent target is a problem.

While there were no major shifts in policy by the Bank of Canada, questions remain. For example, if markets have been calmed, and yields across the curve are quite low, does QE continue to provide additional stimulus to the economy? On September 9, the yield on 10-year government bonds was 0.592 percent, just 34 basis points above the target overnight rate. Shorter-term yields on government bonds (one year or less) were all below the target overnight rate. If the main goal of the QE program is to push down the nominal yield curve, as the Bank says, it seems unlikely that asset purchases can drive down these yields more than a few basis points. And perhaps we want a healthy spread between short and long-term yields, as that would indicate a pick up in inflation expectations.

Some ground that the Bank of Canada could safely explore is its thinking on the overnight rate, given that its own research concluded that the effective lower bound on the Target Overnight rate was much lower than the current 25 basis points, in fact as low as -50 basis points. There are good reasons to keep the lower bound at 25 basis points, including lending spreads for financial institutions, but why not look to lower the interest to financial institutions on what amounts to a significantly higher level of settlement balances held at the central bank if you can?

The Fed's announcement of a move to AIT came after a consultation period much like the Bank of Canada recently announced. For the first time since the Bank became an inflation-targeting central bank, it is giving serious consideration to an alternative framework, of which AIT is one option. A high bar is needed to make any change to Canada's monetary policy framework given that the inflation-targeting framework has been one of the most successful economic policies over this period.

Extraordinary times call for extraordinary measures. A move to AIT might not seem it, but in the context of central banking, it would be.

Jeremy Kronick is Associate Director, research, at the C.D. Howe Institute. Steve Ambler is David Dodge Chair in Monetary Policy at the C.D. Howe Institute and a professor of economics (retired) at the École des sciences de la gestion, Université du Québec à Montréal.

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Should the Bank of Canada follow the Fed's inflation policy shift?

By Jeremy Kronick and Steve Ambler

On Aug. 27, the U.S. Federal Reserve Board announced an important modification of its monetary policy framework, moving towards "average-inflation targeting" (AIT). As the Fed's announcement said: "following periods when inflation has been running persistently below two per cent, appropriate monetary policy will likely aim to achieve inflation moderately above two per cent for some time." The obvious question for Canadian policy-makers is whether the Bank of Canada should follow suit. Our answer is: Perhaps, but the bar for changing the policy regime should be set high.

As the name suggests, under "average-inflation targeting," the central bank's target would be the average inflation rate over a specified time, say three years. If inflation is below the two per cent target for any length of time, as it has been in recent years, the bank would aim to raise it above the target for the same time so that average inflation would equal the two per cent target over whatever period it has committed to.

Under the current inflation targeting (IT) regime, by contrast, deviations from the target are treated as bygones. If inflation falls below two per cent, as it is now, the central bank aims to return it to target, but not subsequently overshoot so as to offset the past undershoot. If the bank succeeds, average inflation remains below the two per cent target.

If AIT is credibly implemented, it leads to very different inflation expectations. In the middle of a pandemic-induced recession, most people expect inflation to remain muted for some time. Under AIT, Canadians could expect that over the medium term the Bank of Canada would compensate for the current period of below two per cent inflation with a period above two per cent. By contrast, under the current regime, the Bank would simply return inflation to two per cent, with no offset for time spent below the target. In today's context, AIT would therefore be expected to produce more inflation overall.

In a recession, this can be beneficial. With more inflation, a given quoted or "nominal" interest rate represents a lower "real" (i.e., inflation-adjusted) interest rate. Assuming nominal interest rates don't rise under AIT, Canadians could reasonably expect real interest rates to be lower under this new regime than they would be under IT. Monetary policy is effective when it can modify spending decisions by both households and businesses by affecting real interest rates. When short-term nominal interest rates are as low as they can go and longer-term nominal rates are also very low, as they are now, the only available lever for changing real interest rates is through expected inflation.

Does this make AIT a panacea? Certainly not, and especially not in the form proposed by the Fed. A close reading of its announcement shows that it is not really switching to a rigorous AIT regime. Not being rigorous has critical consequences for credibility, something the Bank of Canada has certainly earned under its current IT regime.

First, the Fed did not specify the time over which the inflation rate will be averaged. This inexactness is reinforced by its latest interest rate announcement, which said it "had decided to keep the target range for the federal funds rate at 0 to 1/4 per cent and expects it will be appropriate to maintain this target range until … inflation has risen to two per cent and is on track to moderately exceed two per cent for some time." This is vague, perhaps deliberately so, and suggests there may be a lack of consensus among Fed members.

Nor did the announcement say anything explicit with respect to the crucial question of symmetry. Symmetry means a period of higher-than-target inflation would be followed by a period in which the Fed aimed to push inflation lower than two per cent. Without an ironclad guarantee of symmetry, average inflation could easily wind up being higher than target. As a result, inflation expectations could become un-anchored, making it more difficult to achieve the target in the long run. One of the main benefits of Canada's current IT regime – inflation expectations firmly centred on the two per cent target – would be lost. If the bank seriously considers switching to AIT, it should require a symmetric target with a precisely defined length of time for the calculation of average inflation.

Should the Bank of Canada make this change to its framework?

In fact, Canada's IT regime already has some of the features of AIT. The bank's official target is headline inflation, defined as the rate of change of the consumer price index over 12 months. Technically, this is the same as a 12-month moving average of monthly inflation rates. AIT would simply require a change from this 12-month moving average to a window of 24 months, 36 months, or some other length. For most of us, however, a fixed 12-month period is easier to grasp than some other period of changing and uncertain length.

Inflation targeting has been one of the most successful economic policies of the past quarter century. The policy question is whether the bank's struggles to hit the inflation target in the years following the financial crisis are sufficient reason to change its policy regime. A true AIT regime, avoiding the pitfalls of the Fed's announcement, could be beneficial, and is the least radical among different policy regimes being considered. However, the bar for change is and should be high.

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Published in *the Financial Post.*

Theme 4:

Financing Canada's Fiscal Response

Intelligence MEMOS

From: Steve Ambler and Jeremy M. Kronick

To: Government Debt Watchers

Date: March 31, 2020

Re: **Financing the COVID Deficit: Short and Long Runs**

The federal government is ramping up spending to counteract the economic impact of the coronavirus.

The Parliamentary Budget Office has predicted a deficit of more than $110 billion this year. And that rises to around $200 billion – 10 percent of GDP – if Canada matches the average stimulus of other nations, according to the economic analysis group at RBC.

How will this increase in spending be financed in the short run? And what are the longer-term economic consequences?

Some historical context: Since the federal government paid down its war debt in the 1940s, the peak of the ratio of federal government debt to GDP occurred in the mid-1990s, at over 65 percent, then gradually fell to a little above 31 percent in 2008. After a spike due to the Great Recession, it fell again to 31 percent in 2015 before creeping up to almost 34 percent in 2018.

A deficit of 10 percent of GDP would lead to the largest post-war spike in this ratio, but would only take us to approximately 45 percent. If it is truly temporary, we would not reach the levels seen in the mid-1990s. Of course, if it takes time to ramp down the extraordinary spending, it could become worse.

As we have pointed out in other work, while the debt to GDP matters, the bigger issue is the burden of servicing the debt.

In 1990, just before the peak in the federal debt-to-GDP ratio, 10-year bond yields were above 11.5 percent. Today they are below 1 percent. And the Bank of Canada's first-ever foray into quantitative easing, i.e., buying up government securities across the maturity spectrum to lower yields, should further suppress interest costs.

This all means that the situation, while dramatic, should be manageable in the short run. The debt-to-GDP and deficit-to-GDP ratios are not unprecedented, and interest rates are historically low.

Nevertheless, the federal government will be putting an unprecedented amount of new debt onto the market.

There are several imponderables here.

The economic shutdowns to combat the spread of the virus may persist for longer than currently contemplated, especially if a second wave of the virus occurs. This could mean an even larger deficit in 2020 and an unexpectedly large deficit in 2021.

Canada's provincial governments will also be running larger-than-normal deficits. When provincial debts are added to the federal government debt, Canada's government debt-to-GDP ratio is close to 90 percent, in the same ballpark as the US and the U.K.

Moreover, the fiscal measures undertaken by the federal government are part of a coordinated international effort to counteract the economic impact of fighting COVID-19. The federal government will be increasing its borrowing along with the central governments of many other countries. Unless demand for this debt is sufficient to meet this increase in supply, its price (at all maturities) may decrease substantially, meaning an increase in yields and a higher cost of carrying the debt burden.

Of course, as we argued above, the Bank of Canada can mop up any government debt in order to keep yields low. Doing so has consequences, however.

One is inflation, as new money enters the system as the Bank expands its balance sheet. And, with fewer goods and services being produced, as a result of COVID-19, that is more money chasing fewer products.

The other is what happens when the Bank of Canada looks to reduce its balance sheet, i.e., when the bill comes due. When this happens, debt will be sold back to the market pushing yields up. The hope, of course, is that the negative shock from the virus is temporary and future GDP growth exceeds the higher interest cost on this government debt – if not, hello lower government spending and/or higher taxes.

The changing relationship between interest rates and economic growth rates, and the degree to which the negative impact of the current shock on the level of GDP is permanent are key macroeconomic variables that federal and provincial governments, and the Bank of Canada, will have to monitor closely. As will we all.

Steve Ambler is the David Dodge Chair in Monetary Policy at the C.D. Howe Institute and a professor of economics at the École des sciences de la gestion, Université du Québec à Montréal. Jeremy M. Kronick is associate director, research, at the C.D. Howe Institute.

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Intelligence MEMOS

From: Mark Zelmer

To: Bill Morneau, Minister of Finance

Date: April 2, 2020

Re: **Managing the Economic Consequences of the Coronavirus Pandemic**

The social distancing intended to slow the spread of the coronavirus has shut large segments of the Canadian and global economies, disrupting the ability to produce, consume and pay for goods and services.

High uncertainty about how long it will take to contain the virus, how severe will it be, and what the world will look like post-virus means that it may become impossible for households and businesses to access credit on normal commercial terms.

The primary focus for governments at this stage has been on taking steps to contain the financial damage to households and businesses so that the economy has a better chance of staying intact and recovering when the pandemic eventually passes.

This is appropriate. But gaps remain, and policymakers and central bankers should continue to be vigilant to the need for further intervention in every area.

Overview of Government Measures Announced So Far

With the benefit of hindsight, it is tempting to argue that Canadian governments have been slow to respond to the pandemic. However, we must bear in mind we live in a liberal democracy not an authoritarian regime.

Governments are very mindful that introducing measures to combat a pandemic and protect public health constitute major intrusions on the rights and liberties of Canadians. The introduction of such measures needs to be based on objective evidence and the public needs to be brought along. Such measures can only succeed if they enjoy widespread public consent.

Hence, the over-riding objective of the economic measures announced to-date (see here as of March 30th) has been to alleviate as much as possible the economic and financial damage to Canadians and Canadian businesses during the pandemic so that they have a chance to survive financially and participate in the eventual economic recovery when the pandemic abates.

So, the key question at this stage is whether enough has been done.

Remaining Gaps & Where do We Go from Here

Speed is of the essence in a crisis like this, as is the need to be bold.

While government responses are becoming bolder, even more radical steps may be needed before we are done.

For example, in the case of the business sector, governments have started to move from supporting credit flows on commercial terms to entertaining outright government guarantees for credit to small and medium-sized businesses. Those programs may need to be expanded both in scope and size if the ability to extend credit on commercial terms evaporates.

Similarly, the Bank of Canada's willingness to expand its balance sheet in support of the Government of Canada securities market is welcome and will give it more flexibility to support the financial system. But, again, if conditions deteriorate further it may need to contemplate doing the same in support of other parts of the financial system.

At some point governments will also need to confront the question of what is to be done for critically important firms in deep financial distress where loan guarantees may not be enough – think airlines and oil and gas firms. Who to subsidize, on what scale, and on what terms will be important challenges.

Finally, there is the question of how do we pay for all of this. This is not a pressing issue at this stage because governments can borrow in financial markets at close to zero interest rates. They are not exactly crowding out private borrowers in this environment. And, if worse comes to worst, the Bank can finance the federal government in Canadian dollars.

But when the pandemic subsides this issue will come to the forefront.

At first glance, the choices for paying the bill will boil down to some mix of higher taxes, reduced government spending and possibly inflation. Unhelpfully, our starting point is not great given our society's high level of indebtedness. However, if interest rates on the additional government debt are lower than economic growth after the pandemic subsides, as was the case pre-COVID, we should be able to cope with the additional burden over time.

Governments and central banks have reacted forcefully to this unprecedented shock. Filling in these gaps as new needs arise is the next critical phase.

Mark Zelmer is a Senior Fellow at the C.D. Howe Institute. He was the Deputy Superintendent of OSFI from 2013–2016.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Almos Tassonyi

To: Municipal Debt Watchers

Date: May 19, 2020

Re: **From the Black Death to the Depression to COVID-19: Using Debt to Overcome the Municipal Fiscal Squeeze**

Despite the drumbeat of warnings of an imminent crisis in municipal fiscal ability to cope with the impact of the COVID-19 pandemic, the silence from the provinces has been deafening.

British Columbia and Nova Scotia have provided some interim borrowing possibilities and others have eased the deadlines for municipal tax remittance or collection of provincial property taxes, but these minimal responses suggest that municipalities must now seriously consider their options to manage the pressure on their cash flow.

And the lesson from history, and current limited municipal debt levels, suggests cities today have debt room to get through the crisis.

Coping with fiscal crises is an age-old feature of municipal fiscal response. In the aftermath of the Black Death, the spokesmen for England's medieval towns sought "to persuade the king that their burden of civic obligations was hopelessly onerous and the fiscal demands they had to meet were beyond their means," given population shortage and an irretrievable deficiency of revenue.

Subsequently, tax-less finance became a feature of local finance in Victorian Britain, antebellum United States and in Canadian municipalities after the Great War. In the 1930s, municipalities that defaulted were placed under newly developed rules of supervision, the essence of which persist today as hard constraints on municipal fiscal flexibility.

Until the current crisis erupted, the general consensus on municipal fiscal health was that it varied from reasonably healthy, with some exceptions, to overwhelmingly asset rich with significant levels of fiscal surplus.

Municipalities have taken the initiative to reduce the cash flow pressures on local businesses and residents. However, there are immediate fiscal consequences to deferring tax payments, penalties and interest and utility fees as well as transit fare holidays and the decline in transit ridership.

Generally, the municipal ability to borrow is constrained within the provincial-municipal hierarchical relationship. While municipalities throughout Canada face constraints on long-term borrowing, little attention has been paid to the context of short-term borrowing, that is, borrowing repayable during the municipal fiscal year (usually the calendar year). Municipalities are able to borrow on a short-term basis, generally with repayment or budgetary provision within a calendar year (see Table 1). Borrowing on an interim basis for capital purposes is also done to begin the financing of projects prior to the issuance of a long-term debenture.

Table 1: Short-term Borrowing Rules (as of March 2020)

Newfoundland and Labrador	Borrowing up to 20 percent of revenue; St. John's limit $1.5 million to be repaid in-year; ministerial approval can raise the limit and extend the repayment period.
Prince Edward Island	Borrowing up to 50 percent of the estimated operating revenue.
Nova Scotia	Borrowing up to 50 percent of taxes levied plus any transfers received from the province or the federal government or their agencies.
New Brunswick	Interim borrowing limited to four percent of the budget or $15,000, whichever is greater.
Quebec	Interim borrowing provided that repayment is budgeted for in anticipation of revenues for a maximum of 12 months.
Ontario	Fifty percent of total estimated revenues in a budget from January 1 to September 30; 25 percent from October 1 to December 31 or on estimated revenues in budget of previous year excluding arrears and reserve fund withdrawals.
Manitoba	Winnipeg: not to exceed previous year total of taxes and transfers.
Saskatchewan	In cities, borrowing may be up to twice the total of taxes and transfers; in other municipalities up to the total of taxes and transfers.
Alberta	Interim borrowing must not exceed estimate of taxes to be raised in the year of the borrowing.
British Columbia	Municipalities can borrow through the Municipal Finance Authority which must be repaid once revenue is received. Any securities issued must be repaid within five years.

Sources: Various statutes governing municipal powers.

Hypothetically, if all municipalities could borrow up to 50 percent of their last year's taxes, the result would be a cash infusion of more than $27 billion.

The borrowing rules imposed by provincial governments on municipalities are a reflection of the hierarchical relationship between the two levels of government that characterizes policy with respect to municipal finance. The existing set of rules has its roots in the crisis created by the Great Depression.

Most Canadian provinces use an ex-ante regulation or guidance from a provincial borrowing agency to control municipal borrowing (see Table 2).

Table 2: Long -term Borrowing Rules (as of March 2020)

Province	Restrictions Based on a Formula
Nova Scotia	Debt service ratio limit of 30 percent of own-source revenues.
New Brunswick	Annual borrowing in excess of two percent of the assessed value of the real property of the municipality.
Ontario (Excluding the City of Toronto)	Debt service limit of 25 percent of own-source revenue adjusted by debt service payments to other governments; City of Toronto sets own policy.
Manitoba	Total debt, maximum seven percent of municipal assessment, annual debt service not to exceed 20 percent of annual revenue guideline set by Manitoba Municipal Board.
Alberta	Cities of Edmonton, Calgary, Medicine Hat and Regional Municipality of Wood Buffalo: Debt limit of two times total revenue excluding capital transfers; debt service limit of 35 percent of revenue; debt limit of 1.5 times of total revenue excluding capital transfers; debt service limit of 25 percent of revenue.
British Columbia	City of Vancouver: aggregate debt not to exceed 20 percent of assessed value based on average assessment of previous two years; own policy limit of 10 percent of operating expenditures. Debt service limit of 25 percent of consolidated re-occurring own-source revenues and municipalities 'whose economies are not well-diversified may face a lower limit,' administered by the Municipal Finance Authority of BC.
Newfoundland and Labrador	Ministerial approval
Nova Scotia	Ministerial approval for lease agreements or commitments in excess of $100,000; $500,000 for Halifax Regional Municipality.
Quebec	Ministerial approval
Saskatchewan	Established by Saskatchewan Municipal Board upon application.

Source: Slack and Tassonyi (2017) in Slack and Bird (2017).

Based on current data and rules in Ontario, municipalities in Ontario alone could borrow an additional $20 billion in long-term debt before exhausting their regulatory borrowing room. Admittedly, borrowing to the hilt is not desirable practice but there is room for capital borrowing.

In contrast to the municipal situation prior to the Great Depression, municipalities in general are not overborrowed and have access to cash reserves. The debt to tax ratios in the major metropolitan areas of the country in the 1930s exceeded five to one compared to generally less than two to one today (see Figure).

There is little evidence of any reluctance on the part of investors in Canadian municipal bonds and the Bank of Canada has indicated its willingness to provide short-term liquidity.

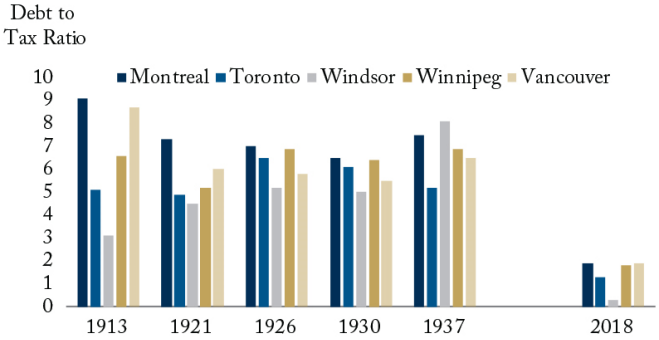
Constraints on interim borrowing should be loosened by the provinces as an immediate step and municipalities should use enhanced borrowing power in the interest of smoothing cash flows and to buy time to establish policy as well as provide time for the economy to begin its recovery.

The rules on long-term borrowing for capital purposes do not appear to be an impediment to municipal access to funds, and act as a well-recognized seal of "Good Housekeeping."

The major unknown will be the ability of municipalities to repay both this short- and long-term debt if property tax collections collapse as a consequence of the inability of the non-residential property owners to meet tax obligations for many years. Governments will have to adjust rules depending on the long-run recovery in fiscal capacity as more evidence becomes available on the extent to which the local tax base has been ravaged.

That's a problem for another day – in the meantime, many cities can safely rely on debt to address their current needs if provinces allow sufficient flexibility in borrowing rules.

Debt to Tax Revenue Ratio of Canadian Cities, 1913-2018



Source: Rowell-Sirois Commission and Ontario Financial Information Returns.

Almos Tassonyi is Executive Fellow at the School of Public Policy, University of Calgary and adjunct lecturer in the Department of Geography and Planning, University of Toronto.

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Intelligence MEMOS

From: Jeremy M. Kronick

To: Government Debt Watchers

Date: June 15, 2020

Re: A Baseline Understanding of Fiscal Sustainability

When the COVID-19 crisis erupted, and it was clear economies would be shut down, there was widespread agreement that both fiscal authorities and central banks would have to inject unprecedented stimulus to create a bridge to the other side.

Governments across this country, as well as the Bank of Canada, have done just that. Now that the economy is re-opening, old debates about whether government debt is good or bad have renewed.

To answer this complex question, we need to begin by acknowledging that there is a difference between whether debt is sustainable versus whether it is optimal.

I will leave the question of whether it is optimal for another time - or someone else. The focus here is explicitly on ensuring the math that underlies the question of fiscal sustainability is well understood.

We do not want governments to default on their debt. To ensure that doesn't happen we need some kind of credible fiscal anchor. At present in Canada, in non-COVID times, that anchor is the debt-to-GDP ratio. To keep this ratio from growing, the primary budget balance must be greater than or equal to the stock of outstanding debt multiplied by the difference between the interest rate the government has to pay on its debt and the rate of nominal GDP growth (for more mathematical detail see here).

Using simple numbers, imagine the debt-to-GDP ratio is 100 percent and governments do not want to see it go higher. Now, imagine governments forecast economic growth at 2 percent and forecast the interest rate on debt to be 1 percent. The so-called risk premium (interest rate minus GDP growth) is then -1 percent. Then, as long as the primary budget balance relative to GDP is greater than or equal to -1 percent – in other words the primary deficit is no greater than 1 percent - the debt-to-GDP ratio will be no higher than 100 percent

You may have noticed that what this is really saying is that as long as the interest rate on government debt is less than the growth rate of the economy, we can run primary deficits of varying sizes. This requires both an ability to forecast the growth rate of the economy – and, by extension, tax revenue – and an ability to forecast the interest rate on government debt. And, do so, over many years.

Those unconcerned about budget deficits would argue that with interest rates low, the economy doesn't have to grow by much for it to outpace government borrowing costs. But the present doesn't guarantee the future. So, let's get a more historical appreciation for the risk premium.

A relatively new dataset from Oscar Jorda, Moritz Schularick, and Alan M. Taylor aggregates datasets from across 17 advanced countries and 45 real and nominal variables dating back to 1870. This database allows one to calculate the risk premium using Government of Canada long-term bond interest rates and nominal GDP growth. This tells us how often economic growth outpaced government borrowing costs since, essentially, the birth of our country.

Their database stops in 2016, but over the 146 years of data, 85 show the economic growth rate exceeding the interest rate, i.e., a negative risk premium. Of the 61 years where it was positive, 19 of those came in a row from 1980 to 1998, which is why we were forced to move aggressively on the federal deficit in the mid-1990s.

Since 2000, the interest rate exceeded the economic growth rate only five times: 2001-2003, during the dot-com bust and 9/11, 2009 during the financial crisis, and 2015 during the oil price collapse. Since WWII, other than the 1980 to 1998 period, there have been consecutive years with the interest rate exceeding the economic growth rate just twice: 1960-61, and 2001-2003.

That's the good news as we look ahead. The bad news is that the volatility of the risk premium is quite high, and far exceeds the average of the premium itself. Over the post-WWII period, the average risk premium was -1.23, but the standard deviation was 4.89, meaning the risk premium can be pushed positive quite abruptly. And, as Mauro and Zhou show, the volatility in the premium comes mostly from changes in the interest rate. Therefore, keeping investor confidence high is critical for our ability to keep government borrowing costs low.

Canada has benefited immensely from strong fiscal and monetary anchors over the past 25 years, including through low risk premiums. We should not take this for granted, however. We have a strong monetary anchor with our commitment to a 2 percent inflation target. We had to give up the fiscal anchor during the COVID-19 crisis. We are going to need governments to help us get back to full employment. But we should not lose sight of what allows us to do that, so that the next time a crisis hits, we have the flexibility to do it again.

Jeremy M. Kronick is Associate Director, Research, at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Glen Hodgson and Peter van Dijk

To: Canadians Concerned About the Recovery

Date: June 17, 2020

Re: **CORNERSTONES FOR A REALISTIC FISCAL PLAN**

The pandemic-induced economic shutdown has created a deep crater in Canada's fiscal position, federally and provincially. Exceptional spending programs, combined with shrinking government revenues, will mean massive fiscal deficits and much higher public debt that will likely spill into one or more subsequent years.

As the economy begins to restart, fiscal policy will need to be re-anchored if the emerging recovery is to be sustained while successfully managing those deficits and that debt.

We propose four cornerstones for realistic and credible fiscal management in the coming period.

1 Exceptional times demand nimble and prudent fiscal planning.

The recovery has begun. Economic growth in the coming months will build slowly and unevenly across regions and sectors. Mitigating a significant relapse through ubiquitous testing and tracing, having a widely available vaccine, and providing effective and efficient treatment for the coronavirus are essential for a complete re-opening of the economy domestically and internationally.

In view of the exceptional degree of uncertainty, governments should share the full range of scenarios they are developing for fiscal planning purposes. A Fiscal Update would be an ideal occasion to show Canadians the potential way forward.

Prudent economic projections should be used. The federal government and many provinces rely on a consensus of private forecasts for projections of nominal GDP (the expected change in real GDP plus the outlook for inflation), which drives the revenue forecast for governments. Private sector forecasters are currently projecting a deep Canadian GDP contraction in this quarter and then a return to growth in the third and fourth quarters of 2020. For the year, a 6 to 7 percent contraction in real GDP in 2020 is being projected, with muted inflation of 0.5 percent or lower. This will shrink government revenues, in addition to the fiscal cost of the exceptional spending programs. Real GDP growth of 6 to 7 percent is being projected for 2021, with inflation at around 1 percent.

2 Exceptional spending will be needed for a while longer.

The forced shutdown has thrown three million Canadians out of work and the unemployment rate soared to 14 percent, with women and young people particularly affected. The combination of Employment Insurance, the Canada Emergency Response Benefit and the wage subsidy have helped to cushion the blow.

Jobs are returning as the economy is gradually re-opened. The exceptional labour market support programs should be scaled back, but agile labour market policy will continue to be needed if long-term scarring is to be minimized. A forward-looking policy mix would encourage people to further their education, invest in improving labour market skills, support worker mobility, and provide some direct employment opportunities where required. These measures will all require funding from governments.

Some ongoing support for business will also likely be required, particularly for SMEs, notably through credit from Crown financial institutions as well as targeted government programs.

3 Governments need to look for money.

To help contain fiscal deficits and debt, and then re-establish a downward pathway for the public debt burden, governments should be examining options for generating more revenues in the immediate period. Without added revenue, debt ratios could become stuck at an elevated level. Further increases to personal and corporate income tax rates are to be avoided since they could stifle the recovery by adding to work and investment disincentives. Instead, innovative areas such as taxation of digital transactions and cash-flow taxes could be considered. Consumption taxes are generally very efficient in raising revenue without having a significantly negative macroeconomic impact. While often perceived to be regressive, they can be designed to be progressive. We fully recognize, however, that increasing consumption tax rates has been a populist flashpoint.

4 Announce fiscal and debt anchor points.

The pandemic-induced shutdown and support programs will result in a massive fiscal deficit this year and a significant increase in public debt; federal debt alone could increase by nearly 50 percent and reach 45 percent of GDP by the end of the fiscal year next March 31. Realistically, large federal deficits will be generated for at least another fiscal year as the economy recovers, increasing the debt-to-GDP ratio further. Provinces will also have higher debt burdens as consequence of the shutdown.

To build credibility and confidence that public finances will be brought back under control, Canadian governments should define a desired downward pathway for debt-to-GDP for the coming period. They may also want to highlight and target the share of debt service relative to fiscal spending and/or revenues, a more immediate guide to the debt being carried by governments.

Glen Hodgson and Peter van Dijk are senior fellows at the C.D. Howe Institute.

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Intelligence MEMOS

From: Alexandre Laurin, Miles Wu and William B.P. Robson

To: Canadians Concerned about Government Debt

Date: July 6, 2020

Re: **Fiscal Snapshot Will Show A Grim Picture of Federal Debt**

Over the last three months, the regular spending announcements from Canadian governments in response to COVID-19 have progressed from reassuring to alarming.

In late June, one of the three largest credit rating agencies lowered Canada's rating. With more spending likely to come to stimulate the gradual economic re-opening across the country, debt concerns are looming.

The upcoming federal fiscal snapshot on July 8 will provide a long overdue official outlook for federal finances and will be closely watched by investors and taxpayers worried about governments' capacity to take on new debt.

Earlier in May, we projected several fiscal scenarios for the federal government, from a more optimistic view of the future to a more pessimistic one. Now, more than three months into COVID-19, we have a somewhat clearer picture. The Parliamentary Budget Officer (PBO) recently updated its "most likely" fiscal scenario for 2020/21, yielding a possible $256-billion deficit and a one-year jump of more than 10 percentage points in the federal debt-to-GDP ratio. Canada's largest banks' June economic forecasts, on average, anticipate declines in nominal GDP of 6.5 percent in 2020, and rebounds of 6.6 percent in 2021. With this new information, we update our earlier projections and compute a fiscal scenario for the next four years – conservatively (and rather unrealistically) assuming no new stimulus spending.

The good news is that our updated view is close to our May's most optimistic scenario, with the debt-to-GDP ratio stabilizing around 45 percent over the medium term.

The bad news is how much red ink the federal government will be spilling long after temporary income supports such as the Canada Emergency Response Benefit and the Canada Emergency Wage Subsidy have ended.

Ottawa's net debt will hit $1 trillion by 2021/22. We project deficits of $275.6 billion this year and an average of over $47 billion per year from 2022/23 to 2024/25. Should the government continue to extend income supports and introduce new stimulus packages, the accumulated debt could be $100 or even $200 billion higher by the end of the period.

This scenario would be problematic if Ottawa was the only order of government that mattered. But provincial and local governments raise more than half of all government revenues and provide most of the direct public services to Canadians, including healthcare and education. Even before the pandemic, Canada's aging population was squeezing provincial health budgets, and COVID-19 is exacerbating their sustainability challenges.

Provinces are also borrowing, and by mid-decade, they will be looking for tax room to meet these demands. This is why federal finances matter. Federal and provincial governments share the same tax base, and up to recently, a largely favourable long-term outlook for the federal government had shored up taxpayer and investor confidence.

But this is changing. Expecting the coronavirus response to raise Canada's federal-provincial consolidated gross general debt to 115 percent of GDP in 2020, up from 88 percent in 2019, Fitch Ratings, one of the three leading credit rating agencies, downgraded Canada's credit rating from AAA to AA+. Fitch highlighted that Canada's gross debt ratio, and interest-to-revenue ratio, are among the highest in the AA category. Fitch highlighted several underlying weaknesses, including a deteriorating corporate income tax advantage compared to the US, slow oil and gas investments, and high interprovincial trade barriers.

Canada is not the only country downgraded during the pandemic, and it still has the third highest rating among the G7. But even in our rather optimistic scenario, rising interest rates would make it very difficult for Ottawa to keep its debt ratio from rising over the long run without increasing its revenue take, leaving provinces already pressured from rising healthcare costs in a very difficult position.

This week's federal fiscal snapshot deserves close scrutiny. A more dynamic view reveals that Ottawa needs to change course. As Canada adjusts to a post-crisis world, federal spending and borrowing have to come down. Ottawa needs to get out of the way.

Alexandre Laurin is Director of Research at the C.D. Howe Institute, where Miles Wu is a research assistant and William B.P. Robson is CEO.

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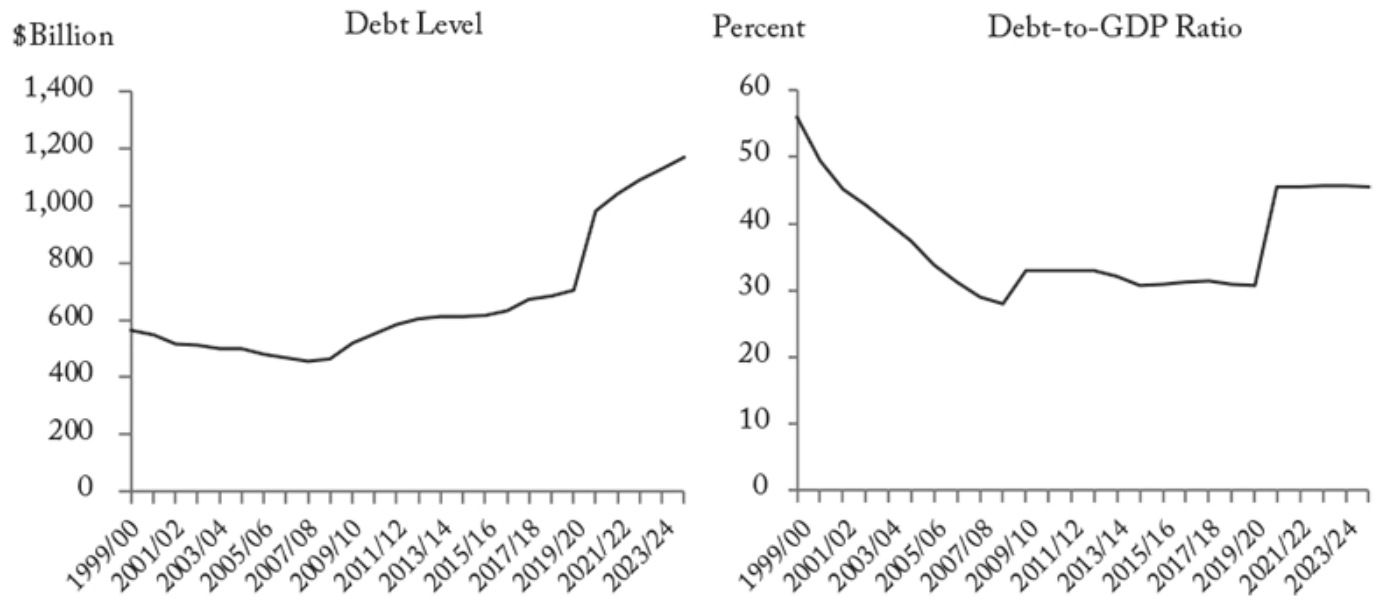
Historical and Projected Federal Debt, 2020/21 to 2024/25



Source: Authors' May 13 Intelligence Memo updated for the latest PBO analysis and the average June economic forecasts of the largest six Canadian deposit-taking institutions.

Fitch Credit Ratings for G7 Countries		
G7 Countries	2019 Rating	Current Rating
Canada	AAA	AA+
France	AA	AA-
Germany	AAA	AAA
Italy	BBB	BBB-
Japan	A	A
United Kingdom	AA	AA-
United States	AAA	AAA

Source: Fitch Ratings.

Intelligence MEMOS

From: Peter van Dijk and Glen Hodgson

To: Canadians Concerned about the Recovery

Date: July 7, 2020

Re: **How to Pay For The COVID-19-induced Federal Debt?**

COVID-19 forced Canada to take the drastic measure of shutting down its economy, resulting in massive government spending to support individuals and businesses, and unprecedented fiscal deficits and a much higher and rising public debt burden.

While we strongly prefer to manage fiscal deficits and public debt through a combination of economic growth and carefully controlling government spending, we anticipate governments will be forced to increase their revenues by raising taxes.

Macroeconomics should drive these tax increases and not ideology, politics and populism. We should remember Jean-Baptiste Colbert's adage that "the art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the smallest amount of hissing."

To protect Canada's recovering economy, we strongly suggest that any tax increases follow Colbert's recipe: raising the largest amount of revenue with the smallest amount of economic damage.

So, what does this mean concretely? In a nutshell, Canada's federal and provincial governments should be prepared to increase consumption taxes and add digital taxes, while marginally reducing personal and corporate income tax rates. Increasing consumption taxes and adding digital taxes will increase tax revenues – and marginally reducing personal and corporate income taxes will also likely increase personal and corporate income tax revenues.

Consumption taxes, such as the GST, HST and provincial sales taxes, are generally better for raising additional revenue while limiting the negative impact of taxes on economic activity. We recognize this has been a populist flashpoint, but appropriately designed, consumption taxes can be quite progressive. Therefore, increasing consumption taxes should be the main area for consideration when raising additional tax revenues.

Canada's consumption tax rates are modest compared to other parts of the world, such as Europe, so we certainly have the room to increase our rates. Many Canadians benefitted from the extraordinary spending programs, and they should contribute to debt management through an increase in broad-based consumption taxes.

The OECD's efforts to establish an international framework for digital taxation is on life support, so Canada should also start thinking about how to tax the digital economy. As a minimum, the federal and provincial governments should follow Quebec's lead to subject e-commerce businesses located outside Quebec and selling digital services to Quebecers to QST. Not only does this generate revenue, but it would also level the playing field with conventional businesses.

From an economic perspective, personal and corporate income taxes are generally very inefficient ways of raising tax revenues. Although often considered attractive politically, further increases to personal and corporate income tax rates are to be avoided since they would stifle the recovery by adding to work and investment disincentives. Moreover, recent research focusing on provincial governments suggests that reducing the high marginal personal and corporate income tax rates in Canada could, in some instances, result in higher personal and corporate income tax revenues.

Some politicians market high progressive income tax rates as a tool to reduce income inequality in Canada. At best, high progressive income tax rates only deal with the symptoms of income inequality, not with the underlying root causes, such as access to education and healthcare.

As an alternative, reducing income inequality through the tax system without harming Canada's economy could be achieved by gradually increasing the tax rate on income from capital and capital gains. Currently, capital-related income is taxed at significantly lower rates than labour-related income.

Recently, we have heard more calls for introducing a wealth tax in Canada to raise revenue and reign in income inequality. Before adding a wealth tax, we need to fully understand the impact of such a tax on our economy. Many countries – notably in Europe – have tried to introduce a wealth tax and have largely abandoned it. Their experience has been that wealth taxes never raised significant revenue, are difficult to administer and harm economic growth.

We should also consider redesigning the way we tax businesses. Instead of taxing businesses on an income basis, Canada should consider taxing businesses on a cash-flow basis or an economic rent basis. Cash-flow basis taxation allows for the immediate deduction of current expenses and investments in machinery and equipment. Economic rent – or excess profit – taxation would tax profits that exceed a specified average rate of return. This would significantly improve the competitiveness of Canada's business tax regime and can lead to increased tax revenues.

Finally, governments worldwide are making significant efforts to ensure that the economic recovery is a "green economic recovery," developing a low-carbon economy aligned with the Paris Agreement. Canada's federal and provincial governments should collaborate and show leadership by significantly increasing our carbon emissions price on consumers and major emitters. Additional carbon tax revenues can be used to reduce fiscal deficits and public debt, to provide rebates, or to fund fiscal measures to encourage projects and investments that reduce greenhouse gas emissions.

We have listened to our public health experts in dealing with the medical aspects of COVID-19. We should now listen to economic and fiscal experts in ensuring that our economic recovery from COVID-19 will be successful and robust.

Peter van Dijk and Glen Hodgson are senior fellows at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Alexandre Laurin and William B.P. Robson

To: Canadians Concerned about Government Debt

Date: July 14, 2020

Re: **THE FEDERAL FISCAL SNAPSHOT HAS SHOWN US THE PROBLEM. SO WHAT'S THE PLAN?**

Last week's fiscal "snapshot" from Finance Minister Bill Morneau was, as its name implied, a static picture – leaving us hanging about what comes next. Like the basketball caught on camera in mid-air as it bounces from rim to rim: will it go in or stay out? Or a person teetering on a cliff's edge: will she pull back safely or fall? Likewise our fiscally overextended federal government: will it return to sustainable levels of spending and borrowing, or are Canada's public finances out of control?

Previous forecasts from the Parliamentary Budget Officer and other projections had muted the shock value of the snapshot's numbers, but they are alarming. Federal spending in the current fiscal year (2020/21) is now projected to be $612 billion, which would be $235 billion above the level prefigured in the fall 2019 fiscal update. With revenue projected at $269 billion – $84 billion below what the update prefigured – the deficit would come in at $343 billion, which would be $319 billion worse than in the fall update.

Before the year is done, the federal government's net debt will surpass the previously unimaginable mark of $1 trillion. Relative to Canada's economy, it will grow from 31 percent of GDP to 49 percent. This is an unprecedented peacetime deterioration in an indicator the Finance Minister has repeatedly assured us was the government's fundamental guide to responsible fiscal policy.

The size of the federal government's debt, in absolute terms and relative to the economy, matters for many reasons.

Federal borrowing absorbs saving otherwise available for investments that will make us better off in the future, such as housing, technology and infrastructure – and the healthcare we need for COVID-19. It erodes Ottawa's future capacity to deliver services. Federal spending and borrowing also crowd the provinces, which are on the front line when it comes to current and future demands for healthcare. Canada's ability to service all its debts is already a concern: one of the major credit rating agencies downgraded the federal government just last month.

We need to get beyond the static snapshot. Now, what comes next?

It is possible to project, assuming a robust economic recovery and the ending of emergency support payments, that deficits could shrink to an average close to $50 billion annually from 2022/23 to 2024/25. This is a remarkable amount of red ink for a government to be spilling while the economy is expanding. It could, however, stabilize the debt ratio around 50 percent of GDP. As long as interest rates remain low, we could avoid tax hikes, and leave room for Canada's provinces, businesses and households to finance their own needs in the medium term.

But the document released by the Finance Minister does not show the way to that happy outcome. Should the government continue to extend income supports and introduce new stimulus packages, the debt could be $100 billion or even $200 billion higher, and the ratio of debt to GDP would keep climbing.

Ottawa would keep competing with other borrowers to fuel its own operations and transfer payments, depriving provinces and the private sector of the funds they need to rebuild the economy. Pressure will mount for tax hikes, the mere threat of which would further depress business and consumer confidence.

What Canada needs is a timely wind-down of federal emergency measures and restraint in Ottawa's own operating costs. Even before the pandemic, deficits that Canadians understood would be modest and temporary had become large and chronic. From 2015/16 to 2018/19, actual expenses exceeded the already rapid growth prefigured in annual budget projections by a cumulative $13.2 billion.

The July 8 snapshot shows Ottawa's operating expenses – not the transfer payments, just the payroll, employee benefit, capital and other internal costs of the federal government – running $14 billion ahead of the projections in last fall's update. More discipline would help the deficit shrink, making more room for other borrowers, while reducing the likelihood of additional credit downgrades and tax hikes, which could further damage an economy that will struggle to grow and create jobs in the difficult years ahead.

The Finance Minister's snapshot showed us the static problem. We see the ball in the air – the person teetering at the edge of the cliff. What we need now is a dynamic plan that takes us forward to a sustainable fiscal future.

Alexandre Laurin is director of research and William B.P.Robson is CEO at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

A version of this memo first appeared in The Globe and Mail.

Intelligence MEMOS

From: Alexandre Laurin, William B.P. Robson and Miles Wu

To: Canadians Concerned about Government Debt

Date: July 20, 2020

Re: **Was Ottawa's Frightening Fiscal Snapshot a Prelude to Something Worse?**

The July 8 federal fiscal snapshot unveiled numbers so awful that a reasonable person might suspect an expectations-management exercise.

The projected deficit of $343 billion for this year was nearly $100 billion worse than the Parliamentary Budget Officer's June 18 projection, and $40 billion worse than the most pessimistic numbers circulating. If realized, that deficit would be the same as last year's total federal revenues. It would mean that the federal government borrows more than half the money it spends this year. It would increase Ottawa's net debt by almost half in one year.

Adding to the impression of an unfolding fiscal catastrophe was the absence of commentary in the snapshot about the perils of this path and how the federal government plans to get off it. Avoiding some future combination of drastic spending cuts and tax hikes will take more than good luck.

Private sector forecasters anticipate a relatively strong rebound in 2021: their projections for nominal GDP growth average almost 8 percent. That, plus continued low interest rates, a timely wind-down of emergency spending, and restraint in the federal government's operating costs,

But a strong rebound is not a given – aside from the potential for resurgences of COVID-19 abroad and here in Canada, concerns about the consequences of out-of-control federal finances will sap the confidence of investors and business managers.

While interest rates are likely to stay low for now, there's an element of risk there, too. Combined federal and provincial net debt is set to increase by more than 25 percent of GDP this year. While the long-term outlook for provincial governments' finances was grim even before the pandemic, the fiscal prudence of past federal governments had underpinned solid credit ratings for senior governments generally. As the downgrade of Ottawa's debt by Fitch in June highlighted, bottom-line considerations have been less salient for the current federal government.

Which gets us to the most critical assumptions of all – that emergency spending will wind down in a timely way, and the government will address the recent rapid growth of other program spending.

Perhaps those things will happen. Perhaps the snapshot's awful numbers are setting us up to celebrate a final deficit less than $340 billion. Its projections for the Canada Emergency Wage Subsidy anticipated the July 13 announcement of the program's extension, but absent long-awaited changes to its eligibility criteria, may still be high. There might be other padding in the numbers – not least a $9 billion boost to baseline spending since the fall update, of which almost half is "non-announced measures."

But an alternative explanation for the awful numbers is that they are softening us up for yet more spending and borrowing still to come. Extensions to the CERB, and continued growth in the federal government's operating costs and other program spending could easily produce deficits of $50-$100 billion in fiscal 2021/22 and beyond – and a continued rise in the debt ratio.

If that happens, pressure for tax increases and cuts to other federal programs, such as transfers to the provinces, will grow. That is an unwelcome prospect. Tax increases, whether on Ottawa's part or by provinces struggling with healthcare and social assistance costs, will undermine economic growth, further exacerbating the adverse debt dynamics. We have plenty of evidence from our own past and from other countries that restraining the federal government's own programs, especially its rapidly growing operating costs, would be less damaging to growth, and more effective in achieving fiscal stability.

Canadians would be far better off if the next federal budget, which should be no later than this coming September, confirmed a shift to a lower-spending, lower-borrowing government. Until then, it is reasonable to worry that the awful numbers in the fiscal snapshot are a prelude to worse in the years ahead.

Alexandre Laurin is Director of Research at the C.D. Howe Institute, where William Robson is CEO and Miles Wu is a Researcher.

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	Past		Base Case				Weaker Rebound				Weaker Rebound + Extra Spending			
	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2020/21	2021/22	2022/23	2023/24	2020/21	2021/22	2022/23	2023/24
	$ Billions, except as noted													
Revenue	332	341	269	333	363	377	269	329	356	368	269	329	356	368
Expense	346	375	612	400	409	421	612	400	409	421	662	430	419	431
Balance	-14	-34	-344	-66	-46	-44	-344	-70	-53	-53	-394	-100	-63	-63
Net Debt	686	717	1,060	1,127	1,173	1,217	1,060	1,131	1,184	1,237	1,110	1,211	1,274	1,337
Debt-to-GDP Ratio, %	30.8	31.1	49.1	48.4	48.5	48.4	49.1	49.3	50.1	50.7	51.5	52.8	53.9	54.8

Source: Authors' calculations from July 8 Economic and Fiscal Snapshot. Weaker rebound: 20 percent weaker recovery than in the baseline. Extra Spending: $50 billion more this fiscal year, $30 billion next year, $10 billion per year over the next three.

Intelligence MEMOS

From: Glen Hodgson and Peter van Dijk

To: Canadians Concerned about Government Debt

Date: July 23, 2020

Re: **Developing a Credible Public Debt Management Plan**

The federal government's fiscal snapshot revealed the impact of the pandemic-induced shutdown on Canada's public finances, and it isn't pretty. The projected $343 billion deficit for this fiscal year will mean a significant jump in the federal debt-to-GDP ratio: from 30 percent in the 2019-20 fiscal year to 49 percent at the end of the 2020-21 fiscal year. Until the economy fully recovers, it is reasonable to expect continuing exceptional financial support in some form, with large deficits beyond 2020-21. We therefore expect further increases in the federal debt-to-GDP ratio, rising to as much as 60 percent of GDP.

Provincial debt will also be much higher. We expect each province's debt ratio to increase by 20 percent or more. Taxpayers support both the federal debt and the debt of their respective province, so the real public debt burden for taxpayers is the sum of the two. For Ontarians, the combined federal and provincial debt ratio will push toward 100 percent of GDP and beyond.

While the media focus has been on the net increase in debt, the federal government plans to borrow a staggering $713 billion in the 2020-21 fiscal year to refinance maturing debt and fund the new debt. The Bank of Canada is now purchasing much of the federal debt at exceptionally low interest rates – a ten-year federal bond is currently yielding around 0.5 percent. Indeed, thanks to these low interest rates, the federal government is now projecting its annual debt service costs to be $4 billion *lower* than initially projected, remarkable given the huge increase in the stock of debt.

Interest rates are likely to remain exceptionally low for years, which will help mitigate the budgetary impact of a higher debt burden. Nevertheless, interest rates will eventually rise as the economy returns to operating at full capacity, increasing the cost of carrying the added debt. Rating agency Fitch has already signaled its concern through a credit downgrade for the federal government from AAA to AA+, which will add to future debt service costs.

A strategy is needed to ensure sustainable fiscal and debt management over the longer term. What is a realistic plan for managing this added debt? Three broad approaches are possible.

One approach would be to rely on growth alone to reduce the debt burden. Don Drummond reminds us that once the debt-to-GDP ratio stops rising, long-term sustainability of the debt burden depends upon whether the nominal growth rate of the economy is higher than the effective interest rate on the debt. The sustainable long-term nominal growth rate for the Canadian economy is generally estimated at around 3.8 percent (consisting of annual real growth of 1.8 percent and inflation of 2 percent).

It is reasonable to expect nominal growth to exceed the long-term bond rate for some years; the nominal growth rate will likely be in the range of 6-7 percent for the next two years, provided there is no significant relapse or second wave. But we should expect the debt-to-GDP ratio to also continue rising over that period. Interest rates will eventually rise, and a credit downgrade will add to the cost of debt. It will therefore be hard to rely on growth alone to achieve a significant reduction in the debt ratio once it stabilizes.

A second approach to debt management would be to carefully control future spending once the economy returns to more normal conditions. Recall that when the federal debt was brought under control in the mid-1990s, it was through a combination of tight control of spending, notably cuts to transfers to the provinces for healthcare and social programs, and solid sustained economic growth. Now, however, an aging population has meant that provinces were facing acute fiscal pressures before the shutdown, largely related to healthcare spending growth. The pandemic has also exposed major flaws in our elder care system that will require more public spending. Containing spending growth could therefore be hard to implement, and a hard sell politically.

The third approach is for the federal government to find more revenue. As discussed in a previous Intelligence Memo, we anticipate new revenue sources will have to be identified to bring public debt under control. Increasing consumption taxes should be the main area for consideration when raising additional tax revenues. Canada should also start thinking about how to tax the digital economy, beginning with the federal and provincial governments following Quebec's lead by subjecting e-commerce to sales taxation.

Realistically, a mix of the three approaches will need to be used. There is strong evidence that reducing government spending is significantly less costly from an economic perspective than raising taxes. To the extent that raising taxes is required to reduce our federal and provincial debt, the tax mix is critically important to economic growth; for example, personal and corporate income taxes have a significantly more negative impact on our economy than consumption taxes.

Ottawa needs a long-term view with attainable targets for reducing the debt ratio over time. Ideally, the federal debt ratio would be reduced progressively back to 30 percent of GDP, where it was prior to the pandemic, with interim targets. The key is to develop a realistic debt management plan that can be shared with voters and capital markets to re-build confidence that Canada will manage its debt wisely.

Glen Hodgson and Peter van Dijk are senior fellows at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Jeremy Kronick, Steve Ambler and William B.P. Robson

To: Bank of Canada Watchers

Date: July 30, 2020

Re: **Welcome Clarity about Monetary Policy in Pandemic Times**

Amid the health and economic stresses of the coronavirus pandemic, clarity from public officials is especially valuable. The July Monetary Policy Report (MPR) from the Bank of Canada was a model.

Back in March, the Bank cut its traditional instrument, the target overnight rate, to 25 basis points, alongside heavy interventions in financial markets to provide liquidity. The high degree of uncertainty associated with the virus and the ensuing economic lockdown led the Bank to be vague in its accompanying commentary, including the key question of its strategy to hit its 2 percent target. The April MPR did not include the Bank's traditional economic forecast, presenting instead two starkly different scenarios, with no indication of which scenario the Bank thought more likely.

This time, the Bank gave us much more.

First, it provided more explicit guidance concerning its interest rate target than ever before, committing to "hold the policy interest rate at the effective lower bound until economic slack is absorbed so that the 2 percent inflation target is sustainably achieved."

Second, the MPR provided a central economic scenario through to the end of 2022. Recognizing that its assumptions concerning the pandemic itself are highly conditional, the Bank laid out a scenario assuming that there will not be a second wave severe enough to throw the economy back into lockdown, and that 2022 will see the development of a vaccine or effective treatment. With that central scenario showing inflation at only 1.7 percent at the end of 2022, the overnight rate will be at its effective lower bound for quite some time.

Third, the MPR provided guidance about quantitative easing (QE). It stated that the Bank will purchase at least $5 billion of Government of Canada bonds until "the recovery is well underway." While at first QE was intended as a liquidity tool to ensure financial markets function properly, its focus now is to keep interest rates low across the yield curve, and help stimulate the economy.

An additional helpful element in the MPR was an analysis of how changes in consumers' spending patterns have affected the consumer price index (CPI). The MPR announced the construction (in cooperation with Statistics Canada) of an adjusted price index with weights that reflect more up to date purchases. The CPI is used to define the Bank's inflation-control target, and this should lead Statistics Canada to update its weights more frequently. The adjusted index revealed slightly less disinflationary pressure from the pandemic, with many goods and services whose prices had fallen, such as travel, being effectively unavailable. This new measure should make for a more accurate reading of the cost of living Canadians face, allowing monetary policy to react more appropriately.

Lastly, the MPR gave a clear picture of how the Bank sees the difference between actual and potential output, and its implications for inflation. With output falling by 15 percent in the first quarter of 2020, and 60 percent of that representing lost or idled capacity, the output gap that matters for inflation is likely 6-7 percent. That will take a long time to close, underpinning the need to keep rates at their effective lower bound for some time.

We would like to see one more piece of information to complete the portrait of the Bank's pandemic strategy. Since the emergency cuts to the overnight rate, the deposit rate – the interest rate banks receive for holding positive settlement balances with the Bank of Canada – has been equal to the rate banks get when lending to each other overnight. This reduces banks' incentives both to lend to each other and to expand their loan portfolios to households and firms. The Bank could be more explicit about whether this situation will continue and, if it does, how the Bank will encourage the financial sector to meet an increased demand for borrowing in an environment of exceptionally low interest rates.

In uncertain times, the more information our public officials can provide the better. The Bank of Canada provided a blueprint for how to do so.

Jeremy M. Kronick is Associate Director, Research, at the C.D. Howe Institute. Steve Ambler is David Dodge Chair in Monetary Policy at the C.D. Howe Institute and a professor of economics (retired) at the École des sciences de la gestion, Université du Québec à Montréal, and William B.P. Robson is CEO of the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

A version of this memo first appeared in the Financial Post.

Intelligence MEMOS

From: Peter van Dijk and Glen Hodgson

To: Canadians Concerned about Government Debt

Date: August 17, 2020

Re: **ADDRESSING CANADA'S COVID-19-INDUCED PUBLIC DEBT AILMENT**

Last month's federal fiscal snapshot projects a pandemic-induced deficit of $343 billion and a debt-to-GDP ratio jumping from 30 to 49 percent this fiscal year. Don't forget provincial debt, too.

An Ontarian's combined government debt-to-GDP ratio will push toward 100 percent of GDP and beyond. Such a high debt burden is an ailment that will become threatening when the economy returns to normal operating and interest rates rise. Just as we have done with the pandemic, we should be proactive and address this ailment head-on. Fortunately, there is an evidence-based treatment plan.

The least painful treatment is to rely on economic growth to reduce our debt burden. However, it is risky to rely on economic growth alone when interest rates will eventually rise. Our second option is to control future spending once our economy returns to more normal conditions. However, with an aging population, the unrelenting growth in healthcare spending and major climate change challenges, containing spending growth will be challenging. Our third and most painful treatment is for governments to find more revenue.

If Canada has to raise additional taxes, we should be mindful as we go about it. Not all taxes are created equal and some taxes have a significantly more negative impact on our economy than other taxes. Relying on taxes that are a drag on growth creates a vicious cycle and further impairs our ability to manage our debt burden. More painful remedies would be required, such as squeezing spending and further increasing taxes.

So, what are the most – and least – harmful taxes from an economic perspective?

Personal and corporate income taxes are generally very inefficient ways of raising tax revenues. Although often attractive politically, further increases to personal and corporate income tax rates should be avoided since that would exacerbate investment disincentives. Moreover, recent research suggests that reducing high marginal personal and corporate income tax rates in Canada could actually result in higher personal and corporate income tax revenues.

Some politicians market high progressive income tax rates as a tool to reduce income inequality in Canada. At best, this only addresses a symptom of income inequality, not the root causes, such as access to education and healthcare, and an open and flexible labour market. As an alternative, gradually increasing the tax rate on income from capital and capital gains could be used to address inequality in income and wealth.

Recently, we have heard calls for a wealth tax in Canada to raise revenue and rein in income inequality. Many countries – notably in Europe – have tried to introduce a wealth tax and largely abandoned it. Their experience has been that wealth taxes do not raise significant revenue, are difficult and expensive to administer, and ultimately harm economic growth.

Consumption taxes, such as the GST or HST, are better choices for raising additional revenue while limiting the negative effect on economic activity. We recognize this is a populist flashpoint, but appropriately designed, consumption taxes can be progressive. Therefore, increasing consumption taxes should be the main source for raising additional tax revenues.

Taxing the digital economy is another option. The OECD's efforts to create an international digital taxation framework are on life support, so Canada should examine how to tax the digital economy. Following Quebec's lead to subject e-commerce businesses located outside Quebec to its consumption tax is a start. It can generate significant revenue and level the playing field with conventional businesses.

Finally, governments worldwide are making significant efforts to ensure the economic recovery is a "green economic recovery." Further increases to carbon taxes would make a positive contribution and can provide more revenues for managing our debt.

We have listened to our public health experts in dealing with the medical aspects of COVID-19. We should now draw on economic and fiscal expertise in ensuring our economic recovery from COVID-19 is successful and robust.

Peter van Dijk and Glen Hodgson are senior fellows at the C.D. Howe Institute.
To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Don Drummond

To: The Office of the Prime Minister

Date: August 24, 2020

Re: **Don't Forget a Fiscal Anchor for the Speech from the Throne**

Prime Minister Trudeau has indicated the government will disclose expensive initiatives to Canadians in a Speech from the Throne on September 23.

Without also proposing very large tax increases, this new agenda would clearly abandon any return to the fiscal anchors of the last two Liberal election platforms, respectively to balance the budget by 2019 and gradually reduce the debt-to-GDP ratio toward 30 percent.

While Canadians support the extraordinary measures taken to address COVID-19, they have not been given the opportunity to discuss, much less give the government a mandate to permanently veer off that fiscal course. The government has an obligation to give people the information necessary for a national discussion about the country's economic and fiscal future and set out the choices for the future.

One choice is to re-establish a fiscal anchor. Without one, Canada could wind up in a fiscal crisis as occurred in the mid-1990s when the debt-to-GDP ratio crested at 66.8 percent, after which great sacrifice was required to make the fiscal situation sustainable. There is no great magic in the pre-pandemic 30-percent debt ratio, but it had the desirable features of establishing a rough sense of intergenerational equity, keeping interest payments down so the bulk of tax revenues could finance the services Canadians want, and providing flexibility to respond to future shocks, like the appearance of COVID-19.

It would not be easy to return to that ratio any time soon. Assuming 3.5-percent average annual growth in nominal GDP from the 2019 base and a deficit of $100 billion for 2021-22, down sharply from the estimate of $343.2 billion for this year, it would require nine years of average surpluses of $16.7 billion to hit a 30 percent debt ratio by 2030-31. Merely balanced budgets would lower that ratio to 34.5 percent.

Considerable pressures work against such scenarios. As the Public Health Agency of Canada has warned, the virus could linger for several years, preventing the economy from recovering fully and making it difficult to phase out pandemic rescue measures. Moderate productivity growth and pandemic-related hits to investment, immigration and the matching of labour demand and supply could depress Canada's growth rate for many years. Interest rates will go up eventually; a one-percentage point increase in the effective interest rate paid on federal government debt would add $10 billion per year to the deficit. The federal government is unlikely to be able to withstand the policy and political pressure of its lessening share of healthcare costs under the Canada Health Act, especially given population aging.

The largest pressure may well be the initiatives the government is considering for the Speech from the Throne. A Guaranteed Basic Income has been estimated by the Parliamentary Budget Office (PBO) to cost $47.5 to $98.1 billion for just six months. The PBO put the price tag on a National Pharmacare Plan at $22.6 billion per year. A National Childcare Program could easily double the $7 billion over 10 years the Liberals gave to the provinces in the 2017 Budget.

If a fiscal stimulus plan becomes necessary to strengthen economic recovery, 1 percent of GDP ($20 billion) would be the minimum table stakes. Estimates of Canada's current infrastructure vary wildly from $50 and $570 billion. Green initiatives could add billions to spending or reduce revenues. The Assembly of First Nations estimates that more than $10 billion more needs to be spent annually to address the poor living conditions. To the extent such initiatives raise economic growth, there would be an offset through higher revenues, but it would be partial.

Canadians may have been shocked that the debt burden will rise to 49.1 percent of GDP this year. They now need to realize that it could remain at that elevated level under the sort of agenda being hinted for September's Speech from the Throne.

That result would flow if deficits after 2021-22 flattened to around $50 billion because a portion of the initiatives listed above were implemented without significant tax increases.

Going further and allowing the deficit to persist around $100 billion would drive the debt burden back close to the 1995-96 crisis mark within 10 years; the sacrifice would be paid by today's children and grandchildren.

Alternatively, taxes could be raised to pay for new initiatives but the choices there are tough given Canadians already pay high taxes and the essential need for Canada to be competitive in the global economy.

The economic and fiscal future of Canada has perhaps never been more uncertain. That is not a good context from which to spring a Speech from the Throne launching the country in a new and risky direction. Canadians need to understand the risks and the choices they face and be given the required information to have an informed national discussion of our country's economic and fiscal future.

Don Drummond is the Stauffer-Dunning Fellow in Global Public Policy and Adjunct Professor at the School of Policy Studies at Queen's University.

To send a comment or leave feedback, email us at blog@cdhowe.org.

C.D. Howe Institute Fiscal and Tax Working Group

Communiqué #1: Ottawa Needs a Clear Fiscal Anchor

The C.D. Howe Institute has initiated a special project to rapidly provide expert policy advice to Canadian policymakers as they navigate fiscal policy during the COVID-19 recovery. The Institute's Fiscal and Tax Working Group is co-chaired by John Manley, former federal minister of finance, and Janice MacKinnon, former minister of finance of Saskatchewan, and comprised of a group of experts in both the private sector and in academia. The group's first meeting was held on Friday, September 4th, 2020. This communique reflects the conversations held at the meeting.

The federal government, like all governments, must adopt a clear fiscal anchor that provides a framework to guide and control expenditure choices across competing government priorities. Without such discipline, government spending is likely to grow unsustainably.

Fiscal sustainability means more than avoiding government insolvency. Debt growing faster than the economy and the tax base may act as a drag on economic growth and the government's capacity to provide services. For example, public debt may displace private investment competing for the same pool of capital, negatively impacting economic growth prospects. Lower economic growth will result in less productive capacity in the workforce to finance government services. In other words, fiscal sustainability is key to ensuring future government services.

The group consensus[1] was that a clear fiscal anchor is absolutely essential now to ensure we are anticipating fiscal realities down the line, while recognizing the need to ensure the recovery is on solid footing. Imposing limits on program spending growth makes sense as one potential anchor since it focuses on the fiscal variable governments control best. Aiming for a declining debt-to-GDP ratio is another option as this metric can be used to compare Canada's fiscal sustainability to other countries. Regardless of what the targets are, Ottawa needs to announce a long-term fiscal anchor to impose fiscal discipline and maintain government credibility with credit rating agencies and the public.

1 Consensus denotes agreement amongst an important share or majority of members, not unanimity.

The Importance of Fiscal Sustainability

One member of the working group indicated that the cost of public borrowing extends beyond the interest payments on the debt. The higher taxes that are required to finance the interest payments on a higher public debt create disincentives to work, save, and invest, thereby reducing the growth rate of the economy. Key to determining the cost of raising additional revenues is the baseline, or initial tax level of a given jurisdiction. Higher taxing countries generally incur a higher economic cost when raising incremental revenues through tax increases.[2]

However, incremental debt-financed spending can be socially beneficial if its benefits exceed its economic costs. In this sense, there are no hard and fast optimal public debt levels. Rising debt will not necessarily result in a reduction in future living standards if the social benefits of new borrowings exceed its cost.

Nevertheless, if left unanchored, public debt can eventually be monetized, leading to higher inflation and devaluing the wealth of debtholders in Canada and abroad.[3]

Should credit rating agencies and foreigners react negatively to the fiscal outlook of Canada, we may see a rise in interest rates and payments, crowding out the ability of governments to provide public services.

We also need to consider the total consolidated debt of Canadians in the analysis; i.e., the federal debt, subnational debts, and personal and corporate sector debts. All are rising. One member of the working group pointed out that this year alone, the consolidated deficit of federal and provincial governments will likely be in the order of 25 percent of GDP.

For these reasons, fiscal sustainability is important for governments and Canadians.

What is the Ideal Fiscal Anchor for Canada?

With that in mind, members began exploring the question of the appropriate fiscal anchor. The starting point for members was that fiscal anchors are essential to impose some kind of fiscal discipline on

2 For a good discussion of the social welfare cost of incremental tax increases by tax type, see Bev Dahlby and Ergete Ferede *What Does it Cost Society to Raise a Dollar of Tax Revenue?* C.D. Howe Institute Commentary 324, March 2011. As the authors write: "A tax drives a wedge between the value of an asset or service to society and the return the owner or provider receives. These tax wedges distort economic decisions, leading to an allocation of resources that, generally speaking, is less productive or beneficial to society as a whole."

3 Monetization of debt can take place when a central bank buys government bonds on the market with freshly printed money, thus pumping money into the economy.

governments. They are easy to understand, and they provide credibility for governments, not only with the rating agencies, but also with the public.

In this respect, Canada as a country is becoming significantly more reliant on foreign sources of funding to finance government deficits. One member of the working group remarked that the proportion of federal bonds held by foreigners is as high now as it was in the mid-1990s. This could be dangerous if investors become less enamored with Canadian debt in the future. The ability of governments to run deficits year-over-year while maintaining a stable or declining debt-to-GDP ratio depends on keeping interest rates low. Minimizing the likelihood of downgrades by bond rating agencies is key.

With that as backdrop, members largely agreed that policymakers need to determine the appropriate fiscal anchor now, in order to guide the fiscal spending that will be needed both today and in the medium to long term. The significant output gap (i.e., the difference between actual and potential output) at present will likely require more deficits in the near term; however, we must decide on the appropriate fiscal anchor now to create the framework for future sustainability. As a member pointed out, to guard against a debt rating downgrade, these targets should be unveiled or announced at the same time as the next economic recovery plan.

Members focused primarily on two types of fiscal anchors: the debt-to-GDP ratio; and program spending targets. Members also pointed to the likely unevenness in the economic recovery across different societal groups, and the need to consider multiple targets, such as achieving social policy goals, in setting fiscal policy.

With respect to the debt-to-GDP ratio, members were of the view it is fairly easy to explain to people and to compare with other jurisdictions. This is especially relevant when a significant percentage of Canadian debt is owned by foreigners. But it is difficult to determine and justify an appropriate target for the level of debt to GDP. One member of the working group reminded us that as long as the interest rate on the debt remains lower than potential economic growth, governments can run deficits year-over-year while sustaining a stable debt-to-GDP ratio. This strategy, however, relies on interest rates remaining low, which in turn depends on maintaining investors' confidence.

A member of the working group pointed out that long-term historical surveys of Canadian financial data show that the annual interest rate on the debt was lower than the growth of the economy in roughly half of the years. But even if we assume that the current trend to lower interest rates will persist, it would not necessarily ensue that the cost of running deficits is low. First, the cost of borrowing an additional dollar can exceed the interest rate on the incremental debt. Higher taxes to finance interest payments lead to a loss of future income-generating opportunities.

Second, while the additional interest payments incurred when borrowing an additional dollar is lower when interest rates are low, these payments will typically go on forever. The cost to future generations (expressed in today's dollars in present value terms) of additional interest payments is higher when interest rates are low.

Another member of the working group pointed to the limits of a stable debt ratio as a share of GDP. Indeed, if the ratio remains stable instead of decreasing when the economy is at full potential, it can only increase when the economy slows down or declines. In the long run, this strategy inevitably leads to a ratcheting up in the debt burden. At the very minimum, when the economy recovers, the federal government should restore its fiscal capacity to manage future shocks by bringing down the debt-to-GDP ratio as the economy expands.

The other anchor considered was the growth of program spending. The fiscal variable that government has most control over is its program expenditures. Several members supported the idea that the most appropriate medium- to long-term fiscal anchor is a public expenditure target. This target may be expressed as a percent of GDP or the growth rate of program spending, or perhaps some combination of the two.

Focusing on program spending also invites discussions about the nature of spending: spending on current consumption (redistributing the economic pie) is not the same as spending on investment (growing the economic pie). More needs to be done to raise economic growth.

Consensus of the Working Group

In conclusion, the Fiscal and Tax Working Group recommends the following:

- The federal government must recommit to the idea of fiscal sustainability.
- While governments will continue to incur deficits in the near term to address the significant output gap (the difference been actual and potential output), establishing what the anchor will be now is an absolute necessity in order to guide fiscal policy for the medium to long term.
- A fiscal anchor is also essential to impose fiscal discipline and improve government credibility with credit rating agencies and the public.
- Program spending targets make good fiscal anchors because they focus on the aspect of public finance that governments control the most. They are supported by many members of the group.
- While there is no optimal level of public debt, targets should be set such that the debt-to-GDP ratio is not bound to increase in an "escalator" pattern, undermining creditor confidence. Many supported the notion that the debt ratio should be set such that it would decline when the economy expands, building fiscal capacity to face the next crisis.

The next meeting of the Fiscal and Tax Working Group will be on September 17th, ahead of the Speech from the Throne. At this meeting, we will discuss the implications of these fiscal anchors for assessing Canadian fiscal sustainability.

Fiscal and Tax Working Group members include:

Janice MacKinnon, Co-Chair, former Minister of Finance, Province of Saskatchewan.

John Manley, Co-Chair, former Government of Canada Minister of Finance.

Robert Asselin, Senior Vice-President, Policy at the Business Council of Canada.

Robin Boadway, Emeritus Professor of Economics, Queen's University.

Paul Boothe, Faculty Director at the Ivey Academy.

Bev Dahlby, Research Fellow, C.D. Howe Institute.

Heather Evans, Executive Director and CEO of the Canadian Tax Foundation.

Luc Godbout, Titulaire Chaire en fiscalité et en finances publiques, École de gestion, Université de Sherbrooke.

Glen Hodgson, Senior Fellow, C.D. Howe Institute.

Michael Horgan, Senior Advisor, Bennett Jones and Senior Fellow, C.D. Howe Institute.

Stéfane Marion, Vice President and Chief Economist, National Bank of Canada.

Jack Mintz, Senior Fellow, C.D. Howe Institute.

Jennifer Robson, Associate Professor, Arthur Kroeger College, Carleton University.

Bill Scarth, Research Fellow, C.D. Howe Institute.

Lindsay Tedds, Associate Professor and Scientific Director, Fiscal and Economic Policy School of Public Policy, University of Calgary.

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Benjamin Dachis, C.D. Howe Institute.

Intelligence MEMOS

From: Bev Dahlby

To: Canadian Debt Watchers

Date: September 16, 2020

Re: **On Fiscal Anchors**

Current low interest rates have led to complacency concerning government deficits and higher levels of public debt. However, the debt sustainability equation is only an accounting relationship and does not incorporate the economic impacts of increased borrowing.

Even if the debt-to-GDP ratio is falling because the interest rate on public debt is less than the growth rate of the economy, the increased borrowing by governments may crowd out private sector investment because investors may only be willing to hold a certain fraction of their wealth in Canadian assets. The result is higher public sector borrowing crowding out private sector investment, lowering productivity growth and future incomes. In addition, governments may increase distortionary taxes to finance debt payments further reducing future income-generating opportunities.

The cost of the public debt is the loss of future income-generating opportunities because of higher taxes and/or interest rates, i.e. crowding out of private investment. The argument that low interest rates mean a low cost for running deficits is flawed. While the annual additional interest payments incurred when borrowing an additional dollar to finance a deficit is lower when interest rates are low, these payments will typically go on forever. We can measure the cost of these future interest payments using the present value of the income losses from having to finance these higher interest payments. The cost in today's dollars of future taxes is correspondingly higher when interest rates are lower.

If the government's debt to GDP ratio is not an appropriate fiscal anchor, what anchor or target should a government adopt?

An optimal fiscal policy means equating the marginal social benefit from additional public sector spending with the marginal social cost of the raising revenue. Although extremely difficult to apply in practice, this condition should be the basis for fiscal policy decisions and therefore should be the fundamental anchor or target.

In trying to apply this condition to derive the "flagship" anchor for fiscal policy, we should distinguish between the federal government's short-term policies and its longer-term target. Currently, and probably for the next two years, the Canadian economy will be operating below its potential. That means private sector investment rates will be depressed, aggregate private sector savings rates may be high, and there will be a continuing need to provide a social safety net for unemployed and under-employed workers. At the same time, raising tax rates to reduce deficits will have a high economic cost in terms of reduced investment and employment. Thus, a series of relatively large primary deficits for the next two to three years is probably warranted.

What governments will need to plan for is the scaling back of some of the income transfer and infrastructure spending to bring them into line with tax revenues if, as expected, the economy returns to something near its long term growth potential. However, growth rates may be somewhat lower than was experienced prior to 2000.

What fiscal anchor should be adopted in the medium to long-term? One desirable characteristic of any fiscal target or anchor is that it the government should be able, to a reasonable degree, to meet the target by varying its fiscal policy.

Governments have limited control over aggregate tax revenues in any given year as they rise and fall with economic fluctuations. As a result, they have little control over deficits, given the year to year shocks to the economy, and therefore they also have little control over the public debt ratio, as our recent experience shows.

The fiscal variable over which a government has most control is its program expenditures. Consequently, the most appropriate medium to long-term fiscal anchor is a public expenditure target – expressed as a percentage of GDP or the growth rate of program spending, or perhaps some combination of the two. The medium-term public expenditure target(s) should take into account the enhancements and reforms to public programs that are envisaged over the next two or three years. The value of these new and existing programs, at the margin, need to be compared to the tax revenues that will be needed to finance them and the marginal cost of taxation (in terms of foregone economic growth) that would be implied.

Given that the provincial and municipal governments are the big spenders on goods and services in Canada, Ottawa should also take into account current and future provincial and municipal spending.

Choosing a program spending target for the federal government will be challenging, but public discussion of a spending target will be a step in the right direction and away from the flawed emphasis on public sector debt ratios.

Bev Dahlby is a Research Fellow of the C.D. Howe Institute and was a member of the Blue Ribbon Panel, which published its report on Alberta's fiscal situation in September 2019.

To send a comment or leave feedback, email us at blog@cdhowe.org.

Intelligence MEMOS

From: Luc Godbout

To: The Hon. Chrystia Freeland, Minister of Finance

Date: September 21, 2020

Re: **A Quebec Model for a Fiscal Anchor**

It's important for governments to have fiscal targets. It's a credibility issue for federal government, not only with the rating agencies, but also with the public. To guard against a downgrade of rating agencies, the federal government should unveil these targets at the same time as it announces its economic recovery plan.

The current federal situation shows the policy limits of a stable debt ratio as a share of GDP. Indeed, if the ratio remains stable instead of decreasing when the economy is at its full potential, it can only increase when the economy goes bad. In the long run, this can only lead to an increase in the burden of debt. A stable debt-to-GDP ratio targets puts debt on an escalator that only stops or goes forward, never backwards.

At a minimum, the government should target a gradually declining debt-to-GDP ratio with the recovery.

It can look to how Quebec has set up fiscal targets with its two budgetary rules, the *Balanced Budget Act* (BBA), implemented in 1996, and the *Act to Reduce the Debt and Establish the Generations Fund* (Debt Act), since 2006.

Together, they have contributed greatly to cleaning up Quebec's public finances and creating its enviable pre-pandemic budgetary situation.

Under the BBA, the government is prohibited from incurring a budget deficit, except in special circumstances. In the event of a deficit, the BBA provides for a relatively restrictive mechanism to return to fiscal balance.

For surplus fiscal years, the BBA also provides for the creation of a "stabilization reserve," to which an amount equal to the budget surplus is allocated. This reserve is basically theoretical, but it serves to maintain a balanced budget: the balance in the reserve is reduced by the amount necessary to achieve a budgetary balance when a budget deficit appears for a given year. The government incurs a budgetary deficit, within the meaning of the BBA, if and only if it has a budgetary balance that remains negative even after being offset by the entire balance of the stabilization reserve fund.

If a deficit less than $1 billion is recorded for a fiscal year, the government must achieve an equivalent surplus in the next fiscal year. And, the BBA allows the government to incur deficits for more than one fiscal year if it plans, in a budget speech and before the implementation of a financial compensation plan, to exceed at least $1 billion, due to the following circumstances:

- A disaster that has a major impact on revenues or expenditures
- A significant deterioration in economic conditions
- Any substantial reduction in federal transfer programs.

In these cases, the Minister of Finance must, in the next budget speech:

- Report to the National Assembly on the circumstances that justify deficits
- Introduce a financial plan to address these deficits within five years
- Implement deficit reduction measures of at least $1 billion in the fiscal year covered by this budget
- Reduce at least 75 percent of the overruns in the first four years.

Obviously, some adjustments should be made to the BBA to improve it. For example, a fixed number in the legislation was a mistake, because $1 billion in 1996 and $1 billion in 2020 is not of the same importance. A percent of revenue or of provincial GDP would have been better. Also, the horizon for the return to balance should also be allowed to vary depending on the magnitude of the circumstance that caused the deficit.

The key objective of the Debt Act is to reduce debt in relative terms, in order to curb the intergenerational transfer of the debt burden. Accordingly, it sets debt targets for 2025-26: debt representing accumulated deficits cannot exceed 17 percent of GDP and gross debt cannot exceed 45 percent of GDP. In order to achieve these goals, the government has established the Generations Fund, which is to be used to eventually repay the debt. Prior to the pandemic, debt ratio data showed that targets would be met.

Given the current environment, such federal rule-making would need to be more flexible. But even a flexible framework would have a positive effect. The federal government should at least present its vision as to whether or not its deficits should be reduced over time and how fast it intends to repay the debt. We must avoid giving the impression to investors and credit rating agencies of an uncontrolled spending machine. That would only lead to even more painful outcomes all governments in Canada, and their citizens.

Luc Godbout is Professor, School of Administration, Université de Sherbrooke; and Chair in Taxation and Public Finance.

To send a comment or leave feedback, email us at blog@cdhowe.org.

C.D. Howe Institute Fiscal and Tax Working Group

Communiqué #2: Federal Finances Vulnerable to Adverse Shocks, Have Negligible Room for More Unfunded, Ongoing Spending

The C.D. Howe Institute has initiated a special project to rapidly provide expert policy advice to Canadian policymakers as they navigate fiscal policy during the COVID-19 recovery. The Institute's Fiscal and Tax Working Group is co-chaired by John Manley, former federal minister of finance, and Janice MacKinnon, former minister of finance of Saskatchewan, and comprised of a group of experts in both the private sector and in academia. The group's second meeting was held on Thursday, September 17th, 2020. This communique reflects the conversations held at the meeting.

The group discussed and debated the question of whether the federal government's fiscal trajectory is sustainable, given already announced plans. Overall, the consensus[1] of the group was that the crisis will leave federal finances vulnerable to significant downside risks, and there is negligible fiscal room for major post-crisis federal initiatives without further raising taxes. Any significant levels of new spending would need to be accompanied by broad-based tax increases that will affect the average taxpayer.

Downside Risks to the Outlook

The group looked at different federal finance scenarios. To start, the group looked at a, perhaps unrealistically favourable, status-quo scenario in which all spending measures announced this year do not extend into future years, and in which pre-pandemic spending plans resume starting next year. This scenario, helped by persistent low interest rates, would lead to recurring annual deficits in the order of around $40 billion over the long run (next 10 years) and a stable (if not slightly decreasing over the long term) debt-to-GDP ratio.

For a variety of reasons – including the election cycle and the fact that historical spending grew faster than status-quo projected spending – many group members suggested that a more realistic baseline scenario would see greater spending and therefore greater deficits, sending the debt-to-GDP ratio on

1 Consensus denotes agreement amongst a large share of members, not unanimity..

an upward trend. For example, if unfunded, ongoing federal program spending permanently increased by $30 billion over the pre-crisis planned level, the recurring annual deficit over the next 10 years would nearly double, to around $75 billion.

Most members, but not all, felt that such a trajectory is unsustainable, unless taxes are raised. Some members argued that there is little appetite in the population for the spending restraint that would be needed to shrink the debt-to-GDP ratio immediately. For example, simply to send the debt ratio downward on a one percentage point per year trajectory would require a permanent 5 percent reduction of pre-crisis planned program spending, starting in 2022/23.

That being said, some felt that while federal transfer payments to individuals and provinces should be left untouched, there is room to reduce operating costs in the federal government, such as compensation levels. Tighter spending controls are not the equivalent of austerity.

This outlook leaves the federal government vulnerable to future shocks, and to rising interest rates. The Bank of Canada's buying of government bonds at the moment is helping to keep interest rates low, but one member pointed to the limitations of this strategy over the longer term, given the free flow of international capital. Members pointed out that interest rate movements present a one-sided risk, in that they are as low as they can go. Furthermore, as governments look to finance new debt, they are likely looking at having to borrow at longer terms, which will increase the underlying borrowing rate.

Other members mentioned that there are strong headwinds working against future GDP growth, notably the hard hit to the resource sector and the reduction to hours of work and labour force participation of parents, particularly mothers. Lower revenues due to lower GDP than projected would have an upward effect on the debt ratio.

That said, others felt that the risks to the outlook are overblown, particularly interest rate risks, and therefore there is room for increasing the size of the federal government without increasing taxes, especially if new program spending addresses the economic problems that were induced or more clearly revealed by the crisis. If interest rates rise in the future, that will be a gradual process, and the federal government will have runway to react, both in terms of how it sets spending and/or raises revenue.

Immediate Crisis Response: Growth-Enhancing Investments

The group mentioned that the immediate focus should be on spending that promotes growth and incentivizes a return to work more broadly; for example, parents leaving the workforce is a glaring example of both a social and economic problem and investments in daycare could be seen as meeting

the criteria. Others mentioned that more needs to be done to dismantle labour force barriers to participation in the economy for disadvantaged and racialized groups, and women in particular.

Investments in the country's infrastructure can also provide an immediate boost to the economy. To that effect, the federal government should concentrate on investing in its own capital infrastructure. Investments in tangible capital are amortized over long periods, and raise the government's service capacity without producing large deficits.

The federal government has other policy levers as well to boost the country's economy and the tax base. A return to pre-COVID immigration levels, and a clear focus on economic immigrants, for example, would increase the population base needed to increase tax revenues.

Limited Room for Major Permanent Spending Initiatives

Looking at future scenarios for the federal government's finances, members noted that absent spending reductions, there will be a prolonged period of program expenses (expenses excluding debt charges) exceeding revenues. Providing more services for the revenue collected over a long period of time risks obscuring the perceived relative value of publicly provided versus privately provided goods and services.

The key is that any new major spending initiatives must be important enough for the broad population to be willing to pay for them through tax increases felt by all. Public discussions around the introduction of a generous guaranteed annual income is a case in point. Such initiatives are inevitably costly, and there is no room in the current fiscal outlook to finance them unless we are prepared to raise taxes more broadly.

Conclusion

Most members of the group agreed that federal government's finances face significant downside fiscal risks, and that there is negligible fiscal room for major ongoing post-crisis federal initiatives without broad-based tax increases. Further, many members felt that the current long-term trajectory for federal finances leaves the country vulnerable to adverse shocks and is likely not sustainable. Others felt that the current trajectory could be sustained for the time being with investments in growth-enhancing programs.

The next meeting of the Fiscal and Tax Working Group will discuss the most efficient ways for governments (federal and provincial) to raise additional revenues post-crisis should the need arise.

Fiscal and Tax Working Group Members Present at the Meeting Included:

Janice MacKinnon, Co-Chair, former Minister of Finance, Province of Saskatchewan.

John Manley, Co-Chair, former Government of Canada Minister of Finance.

Robert Asselin, Senior Vice-President, Policy at the Business Council of Canada.

Paul Boothe, Faculty Director at the Ivey Academy.

Bev Dahlby, Research Fellow, C.D. Howe Institute.*

Heather Evans, Executive Director and CEO of the Canadian Tax Foundation.*

Luc Godbout, Titulaire Chaire en fiscalité et en finances publiques, École de gestion, Université de Sherbrooke.

Glen Hodgson, Senior Fellow, C.D. Howe Institute.*

Michael Horgan, Senior Advisor, Bennett Jones.*

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Jennifer Robson, Associate Professor, Arthur Kroeger College, Carleton University.

Bill Scarth, Research Fellow, C.D. Howe Institute.

Lindsay Tedds, Associate Professor and Scientific Director, Fiscal and Economic Policy, School of Public Policy, University of Calgary.

Peter van Dijk, Senior Fellow, C.D. Howe Institute.

Mark Zelmer, Senior Fellow, C.D. Howe Institute.

*Did not attend meeting on September 17th.

Supported by:

Jeremy Kronick, C.D. Howe Institute.

Alexandre Laurin, C.D. Howe Institute.

Benjamin Dachis, C.D. Howe Institute.

William B.P. Robson, C.D. Howe Institute.

Intelligence MEMOS

From: William B.P. Robson

To: Members of Parliament

Date: September 24, 2020

Re: **Will It Take Outrage at Waste to Stop the Federal Government's Borrowing Binge?**

The $343 billion deficit for the 2020/21 fiscal year, announced in the federal government's July fiscal snapshot, was shocking at the time. Partly it was the number itself, which implied that debt would top $1 trillion before year-end. And because the tally was clearly incomplete. Since then, further announcements have led some to predict a deficit close to $400 billion this year, and yesterday's Speech from the Throne prefigured tens of billions of new spending – with borrowing to match – in fiscal 2021/22.

The 2015 election commitment to run "modest deficits" was a politically clever wedge issue – a pledge the Conservatives did not want to make, and the NDP dared not make. And borrowing in the depths of the COVID-19 crisis is better than hiking taxes or cutting programs in the middle of the downturn. But neither political tactics nor the exigencies of a pandemic overturn the principles of sound public finance. The binge must stop sometime. When will Canadians decide they've had enough?

Interest payments are a clear, potential bad consequence of borrowing. We all know how out-of-control consumer debt or a big mortgage can squeeze household budgets. In the mid-1990s, when the federal government finally addressed the chronic borrowing that originated during the era of Pierre Trudeau, interest was absorbing 35 cents of every revenue dollar.

At present, though, a big interest bill seems a remote threat. Savers are buying bonds and central banks are printing money. Worries about defaults and inflation may push interest rates up in a year or two. But in political terms, that is eons away. However painful the squeeze may be when it comes, it won't make us stanch the red ink in 2020.

Another reason to dislike borrowing is that it erodes our fiscal capacity and limits our future choices. Like a household spending more than it takes in, or a business running at a loss, a government in deficit is depleting its capacity to provide future services. Former finance minister Bill Morneau's talk about deficits as "investments" in the future, was flim-flam: investments make us richer; deficits make us poorer.

But this erosion of fiscal capacity is gradual. We enjoy the government's largesse now. Crumbling infrastructure and higher taxes to support less generous services – that is for the future. Like an onerous interest bill, it is something we may only regret when it is too late.

There's a third reason to dislike big deficits, however. They promote waste. Good stewardship, at home, at work, or in government, means thinking about the value of each dollar we spend. Is it worth it? Where will we find a dollar to pay for it? Can we earn it? If not, what should we give up in return? That is the essence of smart choices.

When there's no bottom line constraint, anything goes. Even before COVID-19, the federal government was spending more on everything – transfers and subsidies to households, business and other levels of government, and its own operating costs, including the salaries and benefits of federal employees. Since COVID-19, it has announced program after program after program. While it was understandable that supports designed on the fly would have gaps, the response to complaints that any measure – the Canada Emergency Response Benefit (CERB), credit-market supports, the Canada Emergency Wage Subsidy – was leaving someone uncovered was always to expand, add, extend. As the Speech from the Throne promises to do, yet again.

We now have confirmation from the fiscal snapshot and Statistics Canada's second-quarter GDP numbers that government income supports vastly exceeded the pandemic-related decline in Canadians' incomes. Seniors, students living at home, CERB recipients who had not worked – the list of payments made to people who did not need them or should not have received them is growing. And as the flood of spending continues, the examples that outrage people grows. Think of former cabinet minister Bev Oda expensing a $16 glass of orange juice and former Royal Canadian Mint head David Dingwall claiming $1.29 for a package of gum. Those examples are years old – but we remember the numbers. The WE scandal resonated not just because volunteers don't get paid, but because the amounts paid to people involved were relatable.

The federal government's embrace of debt is bad news. It will bring higher interest payments. It is eroding our fiscal capacity. We should not need outrage at silly examples of personal extravagance and waste to stop it. But those, too, are coming our way.

William B.P. Robson is CEO of the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

A version of this Memo first appeared in The Globe and Mail.

CLIMBING OUT OF COVID

Edited by

Grant Bishop, Benjamin Dachis, Jeremy Kronick, Parisa Mahboubi, and Rosalie Wyonch

About Us

The C.D. Howe Institute is a registered charity, and an independent not-for-profit research institute whose mission is to raise living standards by fostering economically sound public policies. Widely considered to be Canada's most influential think tank, the Institute is a source of trusted policy intelligence, distinguished by research that is nonpartisan, evidence-based and subject to definitive expert review.

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