

**ONTARIO  
SUPERIOR COURT OF JUSTICE**

**BETWEEN:**

**ASSOCIATION OF JUSTICE COUNSEL**

Applicant

and

**ATTORNEY GENERAL OF CANADA**

Respondent

**AFFIDAVIT OF PAUL ROCHON**

I, PAUL ROCHON, public servant, of the City of Ottawa, in the Province of Ontario,  
MAKE OATH AND SAY:

1. I am currently the Associate Deputy Minister and G-7 Deputy in the federal Department of Finance, a position I assumed in July 2010. I was previously the Senior Assistant Deputy Minister of the Economic and Fiscal Policy Branch (the Branch) of the Department of Finance from 2009 to June 2010, and Assistant Deputy Minister of the Branch from 2007 to 2009. I was the General Director of the Branch from 2005 to 2007.

2. I joined the Department of Finance as an economist in 1990 after close to three years as a research associate at the Conference Board of Canada, having completed a Masters degree in Economics at the University of Toronto. I have since held a number of increasingly senior positions in the Department. A copy of my *curriculum vitae*, which outlines my work history and education, is attached as **Exhibit “A”**.

3. As Senior Assistant Deputy Minister and Assistant Deputy Minister, I was responsible for overseeing and managing the activities of the Branch, which center principally on monitoring, analyzing and forecasting Canada’s economic and fiscal situation and advising the Minister of Finance on these matters. The Branch plays a lead role in the preparation of the federal budget and the fall Economic and Fiscal Update. It develops the revenue and expenditure projections that form the basis of the budget and debt management decisions, develops policy options that support the Government’s fiscal objectives, and provides analysis and advice to the Minister on overall fiscal and economic policy.

4. The Branch monitors the economic and fiscal situations of other industrialized countries and of provincial governments in Canada in order to understand their financial implications and impact on the Canadian economy. The Branch also represents Canada at expert-level economic policy discussions at the Organisation for Economic Co-operation and Development (OECD) and takes a lead role in facilitating the economic surveillance of Canada carried out by the OECD and the International Monetary Fund (IMF). In my former position as Senior Assistant Deputy Minister and in my previous positions in the Branch, I have been involved in virtually all aspects of the Branch’s work, including the monitoring and analysis of domestic and international economic developments and advising the Minister of Finance on a

wide range of economic and fiscal issues, including compensation policy issues. As such, I have personal knowledge of the matters to which I depose in this affidavit. Where my knowledge is based on information compiled by Branch officials at my request, the source of the information, and my belief in its accuracy, are stated.

**A. BACKGROUND TO THE *EXPENDITURE RESTRAINT ACT*: OVERVIEW OF THE GLOBAL FINANCIAL CRISIS**

5. Beginning in August 2007 and peaking in late 2008 to early 2009, the world experienced a massive financial crisis, unprecedented in scope and severity, which resulted in the most serious global recession since the 1930s.

6. The crisis, which originated in the collapse of the U.S. housing market, rapidly intensified and spread around the world, causing stock markets to plummet, economic activity to contract, producer and consumer confidence to fall, employment to decline, and major financial institutions to fail.

7. The speed and steepness of the global economic downturn led to unprecedented responsive action by governments and central banks around the world. There was strong consensus at the international level that governments needed to act quickly to mitigate the recession and its socio-economic impacts, as well as support the economic recovery.

8. The global recession has had a significant impact on the Canadian economy and on the fiscal position of the Government of Canada.

9. The private sector in Canada was hard-hit by sharply declining exports and commodity prices, weaker consumer spending and waning investor confidence. To contain costs and adjust to falling demand and shrinking profits, businesses cut jobs and restrained wage increases.

10. The federal and provincial governments acted to offset the effects of the recession by implementing a wide range of measures. Coupled with a sharp decline in revenues, these efforts resulted in large budgetary deficits. At the federal level, the government went into deficit for the first time in 11 years in 2008-2009, with the budgetary balance declining to -\$56 billion in 2009-2010.

11. The Government of Canada's response to the crisis included a suite of policy and legislative actions intended to address the negative impacts of the recession and stimulate the economy. In doing so, the Government pursued an announced economic strategy founded on responsible fiscal management. Responsive actions aimed at supporting the economy in the short term were combined with measures designed to ensure appropriate management of financial resources and help restore budgetary balance and fiscal sustainability in the medium to long term.

12. Some responsive actions, including the *Expenditure Restraint Act*, were initially proposed in the November 2008 *Economic and Fiscal Statement* but were implemented, along with additional measures, through the January 2009 federal budget.

## **B. THE EVOLUTION OF THE FINANCIAL CRISIS – AUGUST 2007 TO NOVEMBER 2008**

13. Following the collapse of the U.S. housing market in the summer of 2007, the downward slide into the global financial crisis occurred with surprising rapidity. The early months of the crisis saw the freezing up of certain segments of the financial market, large write-downs and losses by several commercial banks, and unprecedented action by the U.S. Federal Reserve and other major central banks around the world to alleviate market stresses.

14. By spring 2008, the impact of the crisis on advanced economies<sup>1</sup> had intensified. In the following months, the slowdown in the U.S. and other advanced economies deepened, reflecting an expansion and intensification of the ongoing financial crisis, major contractions in housing markets in a number of advanced economies, and faltering business and consumer confidence<sup>2</sup>.

15. As economic conditions deteriorated over the course of 2008, the IMF, a specialized United Nations organization with 187 member countries that monitors economic developments on a national, regional and global basis and provides macroeconomic and financial policy advice to member countries, successively and significantly downgraded its growth forecasts for both the global and Canadian economies, reflecting the virulence and unpredictability of the crisis. By April 2008, the IMF's projection for real GDP growth in 2008 had dropped a full percentage

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<sup>1</sup> The IMF classifies 32 developed countries, including Canada, as “advanced economies”. Of these, a sub-group of seven developed countries, including Canada, are classified as “major advanced economies” (also known as the G-7). The remaining member countries of the IMF are classified as “emerging and developing economies”. Source : <http://www.imf.org/external/pubs/ft/weo/2008/02/weodata/groups.htm#aem>.

<sup>2</sup> Consumer confidence is the degree of optimism on the state of the economy expressed by consumers through their saving and spending activities. The Conference Board of Canada's Index of Consumer Confidence declined by 38% from February 2008 to October 2008. Source: Conference Board of Canada, data on its Index of Consumer Confidence downloaded from <http://www2.conferenceboard.ca/weblinx/>.

point lower than it had been in October 2007, both globally and in Canada. Attached as **Exhibits “B”** and **“C”** respectively are the relevant excerpts from the IMF’s October 2007 and April 2008 World Economic Outlook (WEO) reports.

16. In September and October 2008, the global financial crisis escalated significantly, triggered by the failure and near-failure of major financial institutions in the U.S. and Europe<sup>3</sup>. As a result, liquidity in financial markets dropped sharply, raising banks’ financing costs, making access to credit more difficult and more costly for firms and households, and causing stock markets around the world to plunge steeply. The interest rates at which banks lend to each other soared to unprecedented levels, a key indicator of the anxiety and instability in the financial markets. Attached as **Exhibit “D”** is a chronology, from August 2008 to March 2009, of the global economic events relating to the financial crisis, which was prepared at my request by officials in the Economic Analysis and Forecasting Division of the Branch from reliable source data and which I believe to be accurate.

17. By October 2008, the rapid deterioration in the economic situation in the U.S. and globally was beginning to have serious implications for the Canadian economy. As a result of the global financial crisis, consumer confidence was falling sharply, economic and fiscal projections were revised down, uncertainty was high and growing, and there were significant risks that the economic and fiscal outlook would be weaker than expected.

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<sup>3</sup>The financial crisis resulted in the failure and subsequent nationalization or acquisition of a number of major banks around the world: nationalization of Northern Rock, a mortgage lender in the United Kingdom (February 17, 2008); acquisition of Bear Stearns, the fifth-largest bank in the U.S., by JP Morgan Chase (March 16, 2008); bankruptcy of Lehman Brothers (September 15, 2008); acquisition of Merrill Lynch by Bank of America (September 15, 2008); partial acquisition of Washington Mutual by JP Morgan Chase (September 25, 2008); acquisition of Wachovia Corp by Wells Fargo (October 3, 2008); and partial acquisition of Fortis by BNP Paribas (October 5, 2008). A number of other major banks received significant funds from governments to reduce the risk of their failure.

18. With continued deterioration in economic conditions across the world, the IMF released successively updated economic outlooks for the global economy in October and November 2008. Within a month, the IMF projection for global real GDP growth in 2009, which had already been revised down from 3.9% in July to 3.0% in October, was further reduced to 2.2% in November. Attached as **Exhibits “E”** and **“F”** respectively are the relevant excerpts from the October 2008 IMF report<sup>4</sup> and a copy of the complete November 2008 report.

19. Economic activity in advanced economies as a whole was now expected to contract for the first time since the 1930s. According to the IMF, “prospects for global growth have deteriorated over the past month, as financial sector deleveraging has continued and producer and consumer confidence have fallen” (see **Exhibit “F”**). The Fund further added that the “financial crisis remains virulent” and the “economic outlook is exceptionally uncertain.” The outlook for real GDP growth in Canada in 2009, which had already been revised down from 1.9% to 1.2% in October, was further downgraded to 0.3% in November.

20. On December 5, 2008, Statistics Canada reported that employment in Canada also started to decline abruptly in November 2008, registering a loss of approximately 71,000 jobs in that month<sup>5</sup>.

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<sup>4</sup> A complete copy of the October 2008 IMF WEO can be found at <http://www.imf.org/external/pubs/ft/weo/2008/02/>.

<sup>5</sup> Statistics Canada’s December 5, 2008 employment report can be found at <http://www.statcan.gc.ca/daily-quotidien/081205/dq081205a-eng.htm>.

### C. THE GOVERNMENT'S INITIAL RESPONSE TO THE CRISIS: THE ECONOMIC AND FISCAL STATEMENT – NOVEMBER 2008

21. Finance Minister James M. Flaherty acknowledged the new economic and fiscal reality and summarized the nature of the challenge facing the Government in his October 29, 2008 speech to a joint meeting of the Empire Club of Canada and the Canadian Club of Toronto, attached as **Exhibit “G”**:

In a remarkably short period of time, the collapse of financial institutions in the U.S. and the seizing of international credit markets have taken financial markets down sharply and have resulted in a worldwide economic slowdown.

...

Without question, these are uncertain economic times. And after the extraordinary developments that have taken place in a matter of weeks, no one can reliably predict what will happen next.

This is the new reality Canada faces today – wild swings in financial markets, increasing attempts to keep credit flowing, and economic forecasts that have grown more pessimistic by the day.

We are entering an extremely difficult period for Canadian families, who are counting on their governments to get down to work and follow a sensible, realistic plan to protect their earnings, their savings and their jobs.

22. This unprecedented period of acute strains in global financial markets and instability in economic prospects coincided with the preparation of the *Economic and Fiscal Statement* (the *Statement*) during October and November 2008. As a result of downward revisions to projected economic growth in Canada, the *Statement*, delivered by the Minister of Finance on November 27, 2008, projected budgetary deficits (before the impact of any responsive measures) in fiscal

years 2009-10, 2010-11 and 2011-12. Attached as **Exhibit “H”** are relevant excerpts of the *Statement*.<sup>6</sup>

23. Against the backdrop of rising uncertainty and rapidly declining economic and fiscal prospects, the *Statement* proposed measures to reinforce the stability of the financial system and support the economy in the face of the deteriorating economic situation and heightened risks.

24. In response to the worldwide credit contraction, the *Statement* proposed measures to buttress the financial system; provide temporary relief to seniors with Registered Retirement Income Funds and to federally regulated private pension plans; and to enhance credit availability for Canadian businesses affected by the global credit crisis. In particular, the *Statement* announced the purchase by the Government of up to \$75 billion in insured mortgage pools through Canada Mortgage and Housing Corporation under the Insured Mortgage Purchase Program (IMPP). This action provided Canada’s financial institutions with significant and stable access to longer-term funds that they could make available to customers, homebuyers and businesses in Canada. The IMPP would earn a modest rate of return for the Government with no additional risk to the taxpayer.

25. The Government also proposed actions to constrain the sharp projected rise in the costs of the Equalization program, the federal transfer program that addresses fiscal disparities among provinces. Driven largely by the impacts of higher commodity prices, the Equalization program was projected to grow by more than 47% between 2008-09 and 2010-11, from \$13.6 billion to nearly \$20 billion. This was nine times the projected rate of growth of nominal GDP

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<sup>6</sup> A complete copy of the November 27, 2008 *Statement* can be found at: [http://www.fin.gc.ca/ec2008/pdg/EconomicStatement2008\\_Eng.pdf](http://www.fin.gc.ca/ec2008/pdg/EconomicStatement2008_Eng.pdf).

over that period, and the Government did not consider that fiscally sustainable. The Government proposed changes to put Equalization on a sustainable growth path in line with that of growth in the overall economy. The annual growth was set at a three-year moving average of nominal GDP growth, which helped to ensure stability and predictability for both orders of government while still being responsive to economic growth.

26. Measures were also proposed to ensure the effectiveness and reduce the cost of government operations. These included:

- (a) ongoing Strategic Reviews (*i.e.*, assessments) of departmental spending;
- (b) expanding Strategic Reviews to include a systematic review of corporate assets to make sure that the initial rationale for government ownership was still relevant;
- (c) limiting spending in the areas of hospitality, travel, conferences and professional services; and
- (d) introducing stronger departmental spending management by the Treasury Board Secretariat, through a closer alignment of planned and actual spending, resulting in a smaller gap between departmental appropriations and actual departmental spending.

27. As part of its overall effort to ensure spending sustainability, the Government also acted to better manage its wage and salary bill, as highlighted in the October 2008 speech by Minister Flaherty (see **Exhibit “G”**):

This commitment to responsible fiscal management will also extend to public sector compensation.

We all recognize that public sector employees work hard for Canadians, and that they must be adequately compensated. It is in the public interest that public sector compensation be determined responsibly in a manner that does not add pressure on businesses that are already feeling the pinch of an economic slowdown.

28. It was in October 2008, in the rapidly evolving environment of the unfolding financial crisis, that the Department of Finance informed Treasury Board Secretariat officials of emerging fiscal concerns and of the urgent need to design responsive measures. The Department of Finance initially asked the Treasury Board Secretariat to develop measures to restrict spending. Since the wage bill comprises a significant component of government spending, it later asked the Treasury Board Secretariat more specifically for advice on measures to limit spending on compensation.

29. Because many collective agreements were being contemporaneously negotiated, the time was also seen as opportune to re-evaluate the appropriate rate of growth in compensation costs.

30. The Treasury Board Secretariat recommended a limit on wage increases and proposed a supporting negotiation strategy. Limiting wage increases would moderate wage growth and ensure predictability by crystallizing the Government’s compensation cost estimates, thus

avoiding the uncertainty of the collective bargaining and arbitration processes. This predictability was considered crucial to the credibility of the overall economic and fiscal response plan being developed for the *Statement*.

31. The Government accepted this recommendation and instructed the Treasury Board Secretariat to return to collective bargaining with a mandate to negotiate within the defined limits. It also instructed the preparation of legislation that would apply where wage increases within the defined limits had not been achieved by collective agreement.

32. This legislation, the proposed *Expenditure Restraint Act (ERA)*, would prescribe maximum wage increases for the federal public administration as well as Members of Parliament, Cabinet Ministers and Senators.

33. Under the umbrella of the Government's overriding objective of managing its way out of the crisis in a fiscally responsible manner, the policy objectives of the *ERA* were threefold: (i) to help reduce undue upward pressure on private-sector wages and salaries; (ii) to provide leadership by showing restraint and respect for public money; and (iii) to manage public sector wage costs in an appropriate and predictable manner that would help ensure the ongoing soundness of the Government's fiscal position.

34. The suite of responsive measures outlined above, including the *ERA*, were designed to help ensure the sustainability of federal spending programs and the financial position of the Government of Canada not only during the recession but on an ongoing basis beyond the recession, as their effect was to permanently reduce the level of government spending.

35. Based on the private sector economic forecast available as of September 2008<sup>7</sup>, the measures proposed in the November 2008 *Statement* were projected to raise the federal budgetary balance from a deficit position to a surplus of \$0.1 billion in 2009-10. The *Statement* acknowledged, however, that surpluses could not be guaranteed (**Exhibit “H”**, at p.86):

The Government is taking steps to maintain a balanced budget over the coming period of lower growth, although balanced budgets cannot be guaranteed.

36. While recognizing the extreme volatility, uncertainty and unpredictability of the economic environment at the time, the Government publicly committed in the *Statement* (**Exhibit “H”**, at p. 9) to chart a course through the economic crisis that would ensure that it would not be driven into long-term deficit but would, rather, restore budgetary balance and fiscal sustainability as soon as possible:

In the coming months, the Government will closely monitor the economic situation. It will continue to take necessary actions to support the economy, balancing the economic benefit of such actions with the impact on the fiscal situation. To the extent that actions to protect the economy or a further deterioration in global economic conditions lead to a deficit, the Government will ensure that the deficit is temporary.

37. Shortly after delivery of the November 2008 *Statement*, Parliament was prorogued. As a result, legislation to implement the measures proposed in the *Statement* was not tabled in the House of Commons at that time.

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<sup>7</sup> The Government bases its fiscal projections on the average Canadian private sector forecast for key economic indicators, such as GDP and interest rates.

#### **D. THE COLLAPSING ECONOMY: SHARP DOWNWARD REVISION OF THE CANADIAN ECONOMIC OUTLOOK – NOVEMBER 2008 TO JANUARY 2009**

38. Following the November *Statement*, global economic conditions deteriorated further, reflecting the effect of acute financial strains on the global economy, a sharp loss of confidence and the disruption of global trade. In its January 2009 report, attached as **Exhibit “I”**, the IMF projected only 0.5% growth in the world economy and stated that “despite wide-ranging policy actions, financial strains remain acute, pulling down the real economy” as a “pernicious feedback loop between the real and financial sectors is taking its toll.”

39. The IMF also downgraded its outlook for the Canadian economy in January 2009, projecting a decline of 1.2% in real GDP, while private-sector forecasters in Canada downgraded their 2009 outlook to a decline of 0.8%. This represented the first year of negative growth since 1991. (See **Exhibit “I”** and the relevant excerpts from the Government’s 2009 Budget, attached as **Exhibit “J”**<sup>8</sup>)

40. The downward revision to the outlook reflected the negative impact of the global recession on Canadian exports, on the world prices of many of the commodities produced and exported by Canadian businesses, and the weakened confidence of Canadian households and businesses.

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<sup>8</sup> A complete copy of the 2009 budget can be found at <http://www.budget.gc.ca/2009/pdf/budget-planbudgetaire-eng.pdf>.

41. The Canadian economy was also shedding jobs. By January 2009, employment had declined by 264,000 since its peak in October 2008.<sup>9</sup>

#### **E. BUDGET 2009 IMPLEMENTS ECONOMIC STIMULUS MEASURES AND MEASURES AIMED AT BETTER MANAGING THE GOVERNMENT'S SPENDING**

42. Against the backdrop of a collapse in global and Canadian economic prospects, the federal budget of January 27, 2009 introduced 40 billion dollars in federal stimulus measures over two years aimed at supporting the economy and maintaining and creating jobs (the Economic Action Plan) (see **Exhibit "J"**). The Economic Action Plan was based on three principles, namely, that stimulus spending should be: *timely*, to support private demand when it was at its weakest; *targeted*, to businesses and families most in need; and *temporary*, to avoid long-term deficits, with the vast majority of measures expiring on March 31, 2011.

43. The January 2009 Budget also reintroduced most of the spending restraint measures proposed in the November 2008 *Statement*, including the *ERA*.

44. These latter measures were enacted simultaneously with many Budget 2009 stimulus measures through the *Budget Implementation Act, 2009*, which received Royal Assent on March 12, 2009.

45. Stimulus and restraint measures were purposely enacted together. In the Government's view, the credibility and maximum effectiveness of the Economic Action Plan

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<sup>9</sup> Source: Statistics Canada, data from its Labour Force Survey downloaded from its online data service CANSIM <http://cansim2.statcan.gc.ca>.

rested on the Government's ability to demonstrate its commitment to sound ongoing fiscal management and long-term sustainable public finances. In order to restore confidence among Canadians, the Government considered it necessary to act boldly with a stimulus package and also to ensure that the Government's fiscal position was sustainable coming out of the crisis. The *ERA* and other spending restraint measures were introduced to help achieve this latter goal.

46. In limiting public sector wage growth rather than increasing wages as a stimulus measure, the Government acted consistently with a December 2008 IMF recommendation that public sector wage increases should not form part of any stimulus package:

Public sector wage increases should be avoided as they are not well targeted, difficult to reverse, and similar to transfers in their effectiveness.

Attached as **Exhibit "K"** are the relevant excerpts (p. 5) of the December 29, 2008 IMF Staff Position Note *Fiscal Policy for the Crisis*<sup>10</sup>.

47. The Government's overall approach was also consistent with the consensus reached by G-20 Leaders at the November 14-15, 2008 Summit on Financial Markets and the World Economy:

Against this background of deteriorating economic conditions worldwide, ... we will... [u]se fiscal measures to stimulate domestic demand to rapid effect, as appropriate, while maintaining a policy framework conducive to fiscal sustainability.

Attached as **Exhibit "L"** is the relevant excerpt from the G-20 Declaration of November 15, 2008.<sup>11</sup>

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<sup>10</sup> The complete version of the Note can be found at: <http://www.imf.org/external/pubs/cat/longres.cfm?sk=22546.0>.

## **F. THE ERA**

48. The *ERA* was an integral element of the Government's overall response to the economic crisis. Its three policy objectives were complementary elements of the Government's larger economic and fiscal policy.

### **1) Help reduce undue upward wage pressure on private sector wages and salaries**

49. Public sector employment accounts for approximately 20% of total employment in Canada.<sup>12</sup> Economic studies support the existence of a relationship between public sector wage settlements and private sector wage settlements, given that private sector firms compete directly and indirectly with the public sector for labour in many markets. Most of these studies also suggest that an increase in public-sector wages tends to put upward pressure on private sector costs as it increases the attractiveness of public-sector jobs relative to private-sector jobs, inducing some private-sector employees to look for jobs in the public sector. As a result, firms in the private sector need to increase their wages to retain or attract employees. Higher wages, not justified by economic conditions, have been shown to dampen private sector job creation. Attached as **Exhibits "M-1" to "M-8"** are copies of economic studies and articles on the interaction between public and private sector wages compiled at my request by Claude Lavoie, Director of the Economic Studies and Policy Analysis Division of the Branch. I am informed by Mr. Lavoie, and I believe, that these studies and articles support the existence of an interactive relationship between public sector and private sector wage settlements.

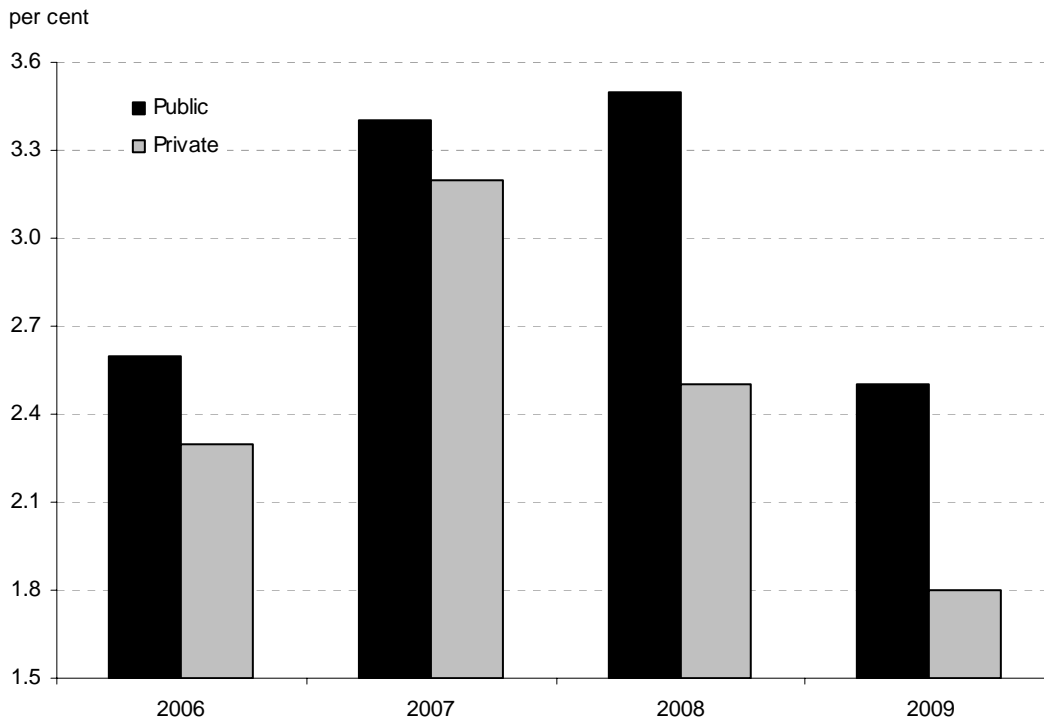
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<sup>11</sup> A copy of the complete G-20 Leaders November 2008 declaration can be found at [http://www.g20.org/Documents/g20\\_summit\\_declaration.pdf](http://www.g20.org/Documents/g20_summit_declaration.pdf).

<sup>12</sup> Data for 2009. Source: Statistics Canada, data from its Labour Force Survey and National Economic Accounts downloaded from its online data service CANSIM <http://cansim2.statcan.gc.ca>.

50. The growth in public sector wages had been accelerating and had surpassed that of private sector wages in both 2006 and 2007. While the increase in private sector wages had begun to moderate in 2008, the upward trend in public sector settlements continued, as shown in **Chart 1** below, which was compiled under my direction by Irka Poplawetz, economist in the Economic Analysis and Forecasting Division of the Branch, from statistics published by Human Resources and Development Canada. By 2008, the differential between growth in public sector and private sector wages was sizeable and had the potential to create pressure on the private sector.

**Chart 1 - Wage Increases in Major Settlements**



Source: Human Resources and Skills Development Canada.

51. According to economic theory, upward wage pressure on private sector wages and salaries, not justified by the economic conditions, would cause private firms to have fewer

employees than they would have had otherwise. Based on that theory, the Government was concerned that a large and growing public-private wage differential in light of falling growth in private sector wages would have put upward pressure on the private sector wage costs at a time of significant difficulty. This would have exacerbated the impacts of the recession and led to a greater number of job losses.

52. Minister Flaherty alluded to this concern in his October 2008 Speech (see **Exhibit “G”**):

. . . It is in the public interest that public sector compensation be determined responsibly in a manner that does not add pressure on businesses that are already feeling the pinch of an economic slowdown.

53. Consequently, one of the aims of the *ERA* was to appropriately manage public sector compensation so as to reduce pressure on private sector wages in order to allow private sector employers to adjust wages to the extent needed to deal with the economic downturn. This objective of reducing pressure on the private sector is stated in the 2008 *Statement* (**Exhibit “H”**, at p. 54):

Since the beginning of the year, wage growth in the public sector has been leading that of the private sector. The Government believes that more moderate growth in public sector compensation is appropriate in the current circumstance.

54. This factor was, and remains, of particular concern in the Province of Ontario. The federal government is the largest single employer in Canada, with more than 400,000 employees<sup>13</sup>. More than 40% of these work in Ontario. The federal government therefore competes most directly in, and has the greatest influence on, Ontario’s labour market. The

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<sup>13</sup> Data for 2009. Source: Statistics Canada, data from its National Economic Accounts downloaded from its online data service CANSIM <http://cansim2.statcan.gc.ca>.

Ontario labour market has been among the most severely hit nationally during the recession, reflecting an export sector that has been under extreme pressure from a rising Canadian dollar, strong productivity gains in the U.S. manufacturing sector, ongoing restructuring in the manufacturing sector and, most importantly, the sharp decline in U.S. demand for Canadian exports (more than 80% of Ontario's exports of goods go to the U.S.<sup>14</sup>). The Government therefore considered it important to avoid putting any undue upward pressure on private sector wages in Ontario and also elsewhere in the country.

55. Similarly, the federal government aimed to indirectly reduce pressure on private sector wages by setting an example for other orders of government in Canada through the introduction of the *ERA*. All other governments in Canada have been affected by the recession and also compete, to varying degrees, in labour markets with the federal government and the private sector.

56. Since the introduction of the *ERA*, most provincial governments (Nova Scotia, New Brunswick, Ontario, Manitoba, Alberta, British Columbia and Quebec) have also acted to moderate the growth of their public service compensation. For example:

New Brunswick

Public sector wages make up a significant portion of government spending and today I am announcing a new wage restraint policy that will freeze wages for two years and apply to all unionized and non-unionized employees in Parts I, II, III, and IV of the public service.

Attached as **Exhibit "N"** are the relevant excerpts (at p. 25) from the March 17, 2009 New Brunswick Budget 2009 Speech.<sup>15</sup>

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<sup>14</sup> Data for 2009. Source: Industry Canada, Trade Data Online, <http://www.ic.gc.ca/eic/site/tdo-dcd.nsf/eng/home>.

<sup>15</sup> A complete copy of the New Brunswick 2009 budget Speech can be found at [http://www.gnb.ca/0160/budget/buddoc2009/Speech\\_2009-2010-e.pdf](http://www.gnb.ca/0160/budget/buddoc2009/Speech_2009-2010-e.pdf).

## Ontario

Still, we must take significant steps to control expenses in one of our largest spending lines so that we can protect public services. . .

. . . the fiscal plan provides no funding for incremental compensation increases for any future collective agreements.

Attached as **Exhibit “O”** are the relevant excerpts (at p. 13) from the March 25, 2010 Ontario 2010 Speech.<sup>16</sup>

## Alberta

And we will have Alberta back into a surplus position — saving for the future — in three years. To help accomplish this, salaries for Civil Service Managers will be frozen for two years. And we will be asking the entire public sector to share in this effort. For a short while, we must all share in the goal of putting jobs before raises.

Attached as **Exhibit “P”** are the relevant excerpts (at p. 2) from the October 14, 2009 Alberta Premier’s Address 2009.<sup>17</sup>

## British Columbia

. . . [W]e will return to a balanced budget by 2012. To make sure we meet that goal, we intend to hold the line on public sector wages. We will respect existing agreements, and we will take steps to mitigate the impacts of spending cuts on public sector workers. But... in the current economic climate... we do not have additional room in the budget to increase wages.

Attached as **Exhibit “Q”** are the relevant excerpts (p. 10) from the February 17, 2009 British Columbia Budget 2009 Speech.<sup>18</sup>

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<sup>16</sup> A complete copy of the Ontario 2010 budget Speech can be found at <http://www.fin.gov.on.ca/en/budget/ontariobudgets/2010/statement.pdf>.

<sup>17</sup> A complete copy of the Alberta Premier's October 2009 Address can be found at [http://www.premier.alberta.ca/speeches/The\\_Way\\_Forward\\_October\\_14\\_2009.pdf](http://www.premier.alberta.ca/speeches/The_Way_Forward_October_14_2009.pdf).

<sup>18</sup> A complete copy of the British Columbia Budget 2009 Speech can be found at [http://www.bcbudget.gov.bc.ca/2009/speech/2009\\_Budget\\_Speech.pdf](http://www.bcbudget.gov.bc.ca/2009/speech/2009_Budget_Speech.pdf).

2) **Provide leadership to Canadians by showing restraint and respect for public money**

57. A second objective of the *ERA* was to demonstrate Government leadership and respect for public resources in a time of economic stress and to set an example by exercising spending restraint where appropriate. In the context of a recession that resulted in widespread job losses in the private sector and significant concern over the health and viability of some private sector pension plans, constraining the public sector wage bill was seen by the Government as particularly important, considering that employment levels in the federal public service were generally stable and pensions were secure.

58. In this context, the Government judged it appropriate to moderate the growth of public sector wages and to extend the salary growth provisions under the *ERA* to Members of Parliament, Senators, Cabinet Ministers and senior public servants, as stated by Minister Flaherty in his speech delivering the November 2008 *Statement*, the relevant excerpts of which (pp. 8-10) are attached as **Exhibit “R”**:

We cannot ask Canadians to tighten their belts during tougher times without looking in the mirror.

Canadians have a right to look to government as an example. We have a responsibility to show restraint and respect for their money.

...

We will introduce legislation to ensure that pay for the public sector grows only in line with what taxpayers can afford as the economy slows.<sup>19</sup>

59. These broad aims of the *ERA* were acknowledged by the Public Service Alliance of Canada (PSAC) when it signed a collective agreement with the federal government that provided

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<sup>19</sup> A complete copy of the 2008 *Statement* Speech can be found at: <http://www.fin.gc.ca/ec2008/Speech/speech-eng.html>.

for wage increases identical to those of the *ERA*, resulting in increases totalling 6.8% over 4 years<sup>20</sup>. As stated in a November 24, 2008 Press Release, attached as **Exhibit “S”**:

While these increases are less than what our members expected when bargaining began, circumstances have changed and many Canadians are now facing the prospect of layoffs and the loss of pension benefits.

In response to these difficult economic times, PSAC and its Bargaining Teams adjusted wage expectations . . .

These agreements serve to protect and enhance the employment and economic security of PSAC members and provide the government with a predictable wage bill until 2011.

While our expectations were higher for this round of collective bargaining, we should be proud of what we were able to accomplish in these difficult economic times.

### **3) Manage the public sector wage bill to help ensure the ongoing soundness of the Government’s medium-term fiscal position**

60. The public sector wage bill is a major federal expenditure, representing about one-third of the Government’s direct program expenses (*i.e.*, government spending excluding transfers to persons, transfers to other orders of government, and spending on public debt charges).<sup>21</sup> As a result, growth in the wage bill has a strong and direct influence on federal spending and the Government’s overall fiscal position.

61. In canvassing options to respond to the economic crisis and weighing their economic and fiscal impacts, the Government considered it appropriate, given the size of the wage bill, to take action to reduce the growth in public sector wages to ensure the soundness of the Government’s medium-term fiscal position. In a time of declining government revenues and

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<sup>20</sup> For the years 2007/2008=2.3%; 2008/2009=1.5%; 2009/2010=1.5%; 2010/2011=1.5%.

<sup>21</sup> Source: Public Accounts of Canada, 2008-2009, [http://epe.lac-bac.gc.ca/100/201/301/public\\_accounts\\_can/2008/index.html](http://epe.lac-bac.gc.ca/100/201/301/public_accounts_can/2008/index.html).

looming deficits, public sector wage increases needed to be affordable.<sup>22</sup> Moreover, this was considered to be an area in which significant fiscal benefit could be achieved (in combination with other spending restraint measures) through moderate means without exacting a heavy sacrifice from public servants. Other options like increasing taxes or cutting transfers to individuals through income support programs would have been more burdensome and very disruptive to the economy.

62. Effectively managing the wage bill also helps the Government to maintain sound finances with minimal disruption to public goods and services while freeing up resources for other purposes.

#### **G. BUDGET 2010 CONTINUES THE GOVERNMENT'S STRATEGY TO ENSURE SOUND AND SUSTAINABLE FISCAL MANAGEMENT**

63. The world economy began to stabilize in mid-2009, supported by unprecedented macroeconomic and financial policy actions. By the fall of 2009, modest global growth had resumed.

64. Like the global economy, Canada's economic recovery is expected to be relatively modest. Based on IMF forecasts, the economic activity lost during the recession is not expected to be recouped in the coming years through higher growth, making this output loss permanent. On average, private sector forecasters expected in December 2009 that the level of real GDP in

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<sup>22</sup> November 2008 *Economic and Fiscal Statement (Exhibit "H")*, at p. 54.

Canada would be \$96 billion (or roughly 6%) lower by 2014 than what had been anticipated at the time of the October 2007 *Economic and Fiscal Statement*.<sup>23</sup>

65. The 2010 Budget, tabled in Parliament on March 4, 2010, continued the Government's strategy to ensure sound and sustainable fiscal management as Canada emerges from the recession, while recognizing the still fragile nature of the economic recovery. It had three broad aims: to contribute to the recovery by confirming \$19 billion in new stimulus measures in fiscal year 2010-11 under Year 2 of the Economic Action Plan; to invest in a limited number of new initiatives to support jobs and growth; and to set a course to restore government finances to balance over the medium term. Attached as **Exhibit "T"** are the relevant excerpts from the 2010 Budget.<sup>24</sup>

66. The actions proposed by the Government to restrain spending in the 2009 Budget, enacted through the *Budget Implementation Act, 2009*, as well as the actions taken in Budget 2010 to restrain spending are reflected in the government's latest fiscal projections. Table 1 below, which was prepared under my supervision by Josée Leblanc, economist in the Expenditure Analysis and Forecasting group of the Fiscal Policy Division of the Branch, from the Government's published budgets and economic and fiscal statements and updates shows the budgetary balance returning to equilibrium in 2015-16, making the Government's fiscal situation sustainable in the long term.

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<sup>23</sup> That expectation has since been revised. It is currently expected that the level of real GDP in Canada will be about \$104 billion (or 6.5%) lower by 2014 than anticipated in October 2007.

<sup>24</sup> A complete copy of the 2010 budget can be found at <http://www.budget.gc.ca/2010/pdf/budget-planbudgetaire-eng.pdf>.

**Table 1 Evolution of the Canadian Budgetary Balance Outlook**

	2007- 08	2008- 09	2009- 10	2010- 11	2011- 12	2012- 13	2013- 14	2014- 15	2015- 16
	(\$ billion)								
Economic Statement 2007	11.6	4.4	4.3	7.5	10.2	12.8			
Budget 2008	10.2	2.3	1.3	3.1	4.7	5.3			
Economic and Fiscal Statement 2008		0.8	0.1	0.1	1.1	4.2	8.1		
Budget 2009		-1.1	-33.7	-29.8	-13.0	-7.3	0.7		
Update of Economic and Fiscal Projections 2009		-5.8	-55.9	-45.3	-27.4	-19.4	-11.2	-5.2	
Budget 2010			-53.8	-49.2	-27.6	-17.5	-8.5	-1.8	
Update of Economic and Fiscal Projections 2010			-55.6	-45.4	-29.8	-21.2	-11.5	-1.7	2.6

67. Returning to budgetary balance within that timeframe is consistent with the consensus reached by G-20 Leaders at the June 26-27, 2010 Toronto Summit:

[f]ollowing through on fiscal stimulus and communicating “growth friendly” fiscal consolidation plans in advanced countries that will be implemented going forward . . .

fiscal plans that will at least halve deficits by 2013 and stabilize or reduce government debt-to-GDP ratios by 2016.

Attached as **Exhibit “U”** is the relevant excerpt from the June 2010 G-20 Declaration.<sup>25</sup>

68. Governments of other countries, in particular the U.S., Ireland and the United Kingdom, have also used public sector wage restraint measures in order to manage their finances in the recent economic downturn. Attached as **Exhibit “V”** is a summary of these measures prepared at my request by officials in the Fiscal Policy Division of the Branch based on reliable source information and which I believe to be accurate.

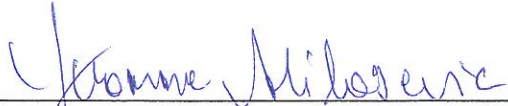
<sup>25</sup> A copy of the complete G-20 Toronto Summit June 26-27, 2010 Declaration can be found at [http://www.g20.org/Documents/g20\\_declaration\\_en.pdf](http://www.g20.org/Documents/g20_declaration_en.pdf).

## H. CONCLUSION

69. From a fiscal management perspective, the *ERA* is neither an isolated nor an interim measure. Though temporary in application, its effect on government spending is permanent. It is therefore a “structural” spending measure and a significant element of the Government’s integrated and phased response to a set of extremely challenging economic and fiscal conditions. That response was carefully crafted and driven by the overarching imperative of avoiding long-term deficits and returning to balanced budgets as soon as possible.

70. It was designed in all of its elements to address not only the short-term negative impacts of the recession in Canada but also, and more importantly, to strengthen the Government’s fiscal position as it emerges from the recession and help return it to budgetary balance and long-run fiscal sustainability. Achieving balance and fiscal sustainability is not an end in itself nor is it government-centric. It is the means of ensuring Canada’s long-term growth and prosperity, stabilizing its economy, preserving its standard of living, and maintaining programs, services and social benefits.

Sworn before me at the City of  
Ottawa in the Province of Ontario  
on November 5, 2010

  
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A Commissioner, etc.

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PAUL ROCHON