CANADIAN IMPERIAL
BANK OF COMMERCE

THE DIRECTION OF POLICY

Notes for an address by

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to

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Anyone who is free enough, determined enough, fortunate enough to attend these Canadian Club luncheons every week manages by the end of the season to have a very comprehensive and balanced picture of this country and our world. An invitation to speak here is not accepted lightly; people like Darcy McKeough, Bob Scrivener, John Turner, Alf Powis, - my old bank confrere Doug Gibson, and other outstanding people you have heard recently add up to a very tough act to follow.

What I hope to do today is to add some thoughts from my perspective as the Chief Executive of an institution which plays an intimate role in the business life of Canada. I want to talk about the general economic atmosphere in which we will be living and doing business in the immediate future. I will have some comments to make on our options for the longer term; I want to talk about the lessons we can learn from the mistakes and successes of other countries like Germany, Brazil, Britain, Japan and the United States. The foreign experience, good or bad, holds valuable lessons for Canada and, because Canada is so heavily involved in foreign trade, the s tability and prosperity of foreign economies is a matter of intense interest and concern to us.

It can be argued that Canada depends more than any other major country on foreign trade. For example, Canadian exports amount to roughly 21% of the country's GNP, whereas the corresponding numbers for the United States and Japan are 5½% and 9% respectively. Largely because of our success as exporters we have been able to buy the good things we need but do not produce. We are, in other words, a very good example of how a middle sized economy can benefit from taking a world view of production and trade.

We hear criticism about Canadian sales of resources abroad, but we should remember that this segment of our trade is closely interconnected with other aspects of trade and cannot be considered in isolation. We have reached a standard of living and a level of economic well-being that would not be available if we had taken a narrower view.

Having got to the point where we are now, we find the country plunged into a period of self-examination and self-doubt. Have the policies and the attitudes that have made us what we are outlived their usefulness? Are there new policies which could serve our people better? Where will they come from? Can we expect government to transform us into a better and happier society? Will the traditional type of business enterprise be able to meet the expectations of Canadians in providing for a fuller life, a fair sharing, a desirable environment?

Let me talk for a few moments about some other parts of the world which influence us and whose fortunes affect ours. As an economist would put it, the international economy is in a highly fluid state. The fluid could be the tears shed by investors, bankers, entrepreneurs, the unemployed, and even by some politicians. Economic activity is sagging, and has been sagging for some time in most of the western industrialized countries. We are living with a combination of recession and inflation. Prices are continuing to rise in most countries, though perhaps not as fast as they were rising in the recent past. However, in some countries price increases are accelerating.

An examination of fiscal and monetary policies in the major countries suggests that we can look forward to very little growth in the near future -- the next few quarters at least. Inflation should moderate and some relief in the commodity and industrial price sectors could lead to a modest easing at the retail level. Wage demands and other costs will, however, continue to create pressures in production costs and final prices. By 1976, I believe that economic activity will have recovered and the word recession may no longer fit and we will, at least temporarily, have inflation rates lower than they are at the present time. We can look forward to improvements in both employment and corporate profits.

But this relatively favourable turn of events assumes that we get the right kind of policies from government here and elsewhere and the right type of leadership at all levels.

I would like to start my quick survey of other economies with the most successful example, which also happens to be a key member of the European Economic Community. We can learn something from the policies Germany has followed. They had a recession in 1970, but expansion was rapid in the next two years and the country was operating at close to full capacity by early 1973. At this point Germany began to feel the effects of inflation. What did the German policy makers do? Well, they went against the trend and, unlike so many other countries in recent years, they opted for the traditional stabilization tools of monetary and fiscal policy.

Germany moved to restrain domestic demand early in 1973. This policy was implemented gradually, consistently, and with some flexibility. The results? Inflation has been contained in the 5 to 7% range. Real growth slowed down in 1974, but did not suffer a major decline. Now West Germany has set in motion expansionary policies to encourage domestic growth while avoiding rapid price inflation.

Perhaps most important of all, German workers have co-operated by accepting wage increases generally in line with the government wage guidelines. I do not think this proves that the German worker is any less militant than his Canadian counterpart, but it suggests to me that the German worker has built up some trust in his government and has confidence that it will practice what it preaches. Recent events in Canada suggest that Canadian workers do not have the same degree of confidence in our government. I do not mean to suggest that all is well in Germany; there is unemployment and export markets are not as strong as they could be. Nevertheless, I believe that Germany, through well-timed application of economic policies, has established a sound base for future progress and we can learn from their experience.

What about Japan? The economic miracle has been temporarily suspended. Japan has one of the most restrictive monetary policies of the major countries. It has been forced into this policy because it was late in restraining excessive demands in 1973. As bad luck would have it, the effects of this failure were compounded by the Middle East oil crisis which led to the quadrupling of the price of Japanese crude oil imports. The net result was a 25% price inflation during the first half of 1974, accompanied by a 30% average - wage increase - in the so-called labour offensives of last spring.

Japan's experience has a message for us. What you do in the economic field is important, but when you do it is equally vital. Over-reaction or failure to react at an early stage of economic change can lead to unfortunate economic and social consequences later. The ultimate result can be excessive and highly disruptive policy shifts in opposite directions.

Let's now take a brief overview of the United Kingdom. Consider the array of policies, pulling in opposite directions, which that country has adopted over the last few years. There was a price freeze; a price and incomes policy; a pro-Common Market policy; an anti-Common Market policy; further nationalization of the private sector; strict monetary restrictions and the social contract. The social contract was the voluntary government-union policy aimed at reducing wage demands. It turned out to be pretty much in the same category as Sam Goldwyn's famous description of a verbal agreement -- 'not worth the paper it is written on'.

In trade and finance, the United Kingdom is a sophisticated nation and it reacts quickly to changes and expected changes. In today's world that means enormous uncertainties and deep division over the likely course of economic events. The result is that no one feels able to plan for the future. One trade association spokesman said he felt industry was being kicked around like a ball between two opposing teams. Labour, too, is frustrated, as the failure of the social contract proves.

Government, for a time, placed the responsibility for inflation on business instead of shouldering it itself. The new budget was intended to ease this burden, but business will need plenty of convincing before it will take the risks necessary to significantly expand productive capacity. The British economy more than most has been a victim of politics. The effort to win votes has led to a government sector continually growing from within, rather than responding to continuing pressures from without. If this sounds something like what we are experiencing in Canada, and I think it does, I hope we will be intelligent enough to learn from the British experience.

Brazil holds a great deal of interest for Canada because of our long-standing economic and investment ties. The impressive growth performance of Brazil over the past few years is well known and is, in no small measure, due to the competent economic planners in that country. Unfortunately, Brazil has lately been used by some observers as an example of how to stop worrying and live with inflation. It may be a good example for some countries in coping with inflation, but I do not think it is a good example for Canada.

The Brazilian approach is to index a number of elements in the economy. Corporate and financial sectors get a massive recount each year, capital assets are revalued, interest rates are reset retroactively, profits are recalculated.

If rapid inflation is inevitable - and that point is highly questionable - then I suppose we would have to learn to live with it. But learning to live with inflation is a second best solution; let's aim for the best solution. We don't have to live with a rubber dollar, and I am convinced we can control inflation if we are all determined to do it.

Brazil adopted indexing because of the economic chaos which prevailed there when the present administration took over in 1964. At that time, there was no growth and inflation ran at 140% per annum. Through indexation, confidence was restored and a prolonged economic expansion began. Since Brazil did not have the market mechanisms of an industrialized country, it had few options but to adopt its own system of price adjustment. In Canada, we do, of course, have a market system and the application of the Brazilian experiment, which has worked marvels in Brazil, therefore seems irrelevant in our own economic context.

What can we learn from our nearest neighbour? We think of the United States economy as being like ours in many ways, but there are important differences. The Constitution, with its checks and balances, protects the United States to some extent from blundering into undesirable long-term economic and political policies. However, in the short term the United States is less flexible and less capable of fast effective action than we are. If Canadian governments know the right thing to do they have the power and the freedom to do it quickly. The short-term direction of fiscal policy can be monitored and re-examined frequently, and appropriate policies adopted without long action lags. Thus, in the short term, we should be able to outperform the United States on both the output side and on the inflation front, provided the Canadian government is willing to lead and take decisive action as required. In the long run, only correct long-term policies, directed to the basic strengths of the economy, can guarantee success.

The United States is currently attempting to redefine its basic thinking as it relates to the role of prices in the economic system. President Ford and his advisors are relying primarily on the price mechanism to reduce energy demand and to encourage further energy supplies. This is a welcome turn of events because the role of price, as an allocative mechanism, is the basis of our economic system.

The U. S. effort at wage and price controls highlighted the fact that our system is extremely complex and that attempts to use devices such as controls and rationing tend to lead to severe bottlenecks and inequities. This is a lesson we should keep in mind in Canada when formulating our own policy. There is all too often a tendency to want to substitute direct measures and controls - which tend to destroy our market system - for traditional policy tools which operate within the market system and which utilize the price system. There is also a basic difference in assessing what action the U. S. is taking and relating this to Canada, keeping in mind our great dependence on international trade and the size of our own domestic market.

To sum up my quick survey: Germany has kept cool, acted promptly and avoided execessive economic swings; Britain has done the wrong thing at the wrong time and faces serious economic difficulties; bad timing of economic policy, combined with bad luck, has created more serious problems for Japan than she might have had; the United States is having difficulty deciding on the right policies and reaching the kind of consensus that is necessary to implement them.

How about Canada? Early in 1973, Canada was rapidly approaching its capacity level of economic activity. We should have then instituted policies of fiscal and monetary restraint; instead, we were more concerned about increasing our output than in controlling inflation. Policies were geared to strengthening demand and only lip service was paid to the idea of restraint. We heard constantly about inflation being the product of external forces and by 1974, we had little room to manoeuvre. We were already into a high rate of inflation and the economies of our trading partners were seriously disrupted.

The Minister of Finance chose in his fall budget to encourage domestic demand as a means of offsetting some expected weakness in the external sector. In the short term that made a desirable result, but in the long term we are simply continuing the steady growth of government spending, a seemingly endless expansion of the public sector at the expense of the private sector.

I believe that in this way Canada has built in an inflationary bias which we will have to live with for years to come. We can be thankful, however, for one thing -- we have not had to live with wage and price controls which have been so harmful in other countries. But even here we have seen a growing trend to selective fine-tuning of profits, particularly of the resource companies. There is a type of price control and is likely to have serious effects on future supply.

Part of the growth of government expenditure has been due to the fact that in inflationary times the government cannot avoid taking in large extra amounts of money through the tax system. The government's recent policy of indexing personal income tax has given some relief to taxpayers and has helped to reduce the automatic expansion of tax revenues. But, if indexing makes sense for the individual taxpayer, why does it not make sense for the corporate taxpayer as well? Indexing now serves to bolster consumer spending; we should be equally concerned about making it easier to finance an adequate amount of investment. Some form of inflation accounting or of indexing corporate taxes would be needed to make this possible.

The present system of accounting is based on historical costs and it is misleading during inflationary times. Shell Canada has experimented with inflation accounting, following the principles laid down by the Canadian Institute of Chartered Accountants. Normal accounting procedures showed consolidated earnings of $124 million for 1974; recalculated to take inflation into account, profits were shown as $73 million. That was the real profit in terms of the stable dollar -- far, far less than the phantom profit which traditional procedures showed.

I have talked about the lessons we can draw from other countries; perhaps the most sobering example for us is that of the United Kingdom, with which we have such close and historic ties.

Can we in Canada protect ourselves from being bought out and brought down by government favours we ourselves are paying for? Can we reverse a trend which is already too well established? Can we avoid the errors we have seen other countries make?

I do believe, and I believe strongly, that there are steps which can be taken to assist our economy and reduce the rate of inflation. We can not only study the results of what is happening here, but, because of some fortuitous time lags, we still have the opportunity to study the steps that others have taken and to ascertain those that could be applicable to the Canadian scene. No course of action is without its dangers, nor without its sacrifices. In the short run it might be easiest for most people to live with continued expansionary fiscal and monetary policies. However, I am sure that the long-range price we would have to pay and the sacrifices we would all have to make at a later date would be far greater than those that would be required if the necessary action were taken now.

As Canadians, we do have the chance and the responsibility to guide our policy makers to make the right decisions; Canada is a great country in any international context. Our future is bright if we choose the correct short-term and long-term policy options. Let's tell our elected representatives what we think the correct options are. Above all, let's tell them we do not want governments that live beyond their means on a permanent basis, thereby creating an inflationary bias in our economic system. Instead, we want to see government policies which, rather than siphoning resources away from the system, encourage us to expand and to invest for the future. Only in this way can we expect to see Canada achieve its potential of long-range growth and prosperity.

More than ever it is time for strong, imaginative and courageous leadership at all levels of government, industry, labour and business organizations. However, strong leadership and strongly directed policies will only be really effective if there is confidence. Confidence in our governments, confidence in a strong opposition -- confidence in our fellow man.

We are all concerned about present attitudes, and rightly so - work stoppages - disruptions in essential services - stop and go government action. It is easy to sit back and have the privilege of blaming someone else, but what is our attitude - yours and mine - as to what is taking place?

Are we willing to stand up and be counted? Are we prepared to let our elected representatives know we will support strong, well-directed policies even if they involve some hardship for us? We must not forget that they are just like us, looking for advice, encouragement and support and a clear indication that they have our confidence.

All of us in business, in unions, in the professions -- all of us have more reason to have confidence in the future of our own country than any other people on this earth. But without personal involvement, a willingness to serve and a willingness to accept the discipline of good citizenship, it is meaningless. We must have confidence in ourselves.

What is even more important, there must be a real willingness to accept our responsibility to contribute by our votes, our suggestions, our criticisms, to decision-making; and then to accept strong leadership and co-operate to the greatest possible extent.

We have the power to direct the direction of policy. Ladies and gentlemen, this applies to every one of us -- the industrialist, the member of the financial community, the white-collar worker, the blue-collar worker, the housewife, the school teacher, the farmer, the pensioner -- we are all in this together.