

WHAT'S GONE WRONG WITH CANADA?

NOTES FOR REMARKS BY SIMON REISMAN  
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Mr. Chairman, there is a lot of ground I want to cover today. I will try to do so as briefly as possible. I trust you will understand if, for the sake of brevity, I appear to be somewhat categorical.

I am not by nature given to playing the role of Cassandra. Nevertheless, I have found myself driven to the conclusion that the Canadian economy is in serious trouble. I believe that our problems are deeply rooted in developments of the past decade or so and will not be overcome easily, quickly or painlessly.

In my view, it is essential that we take full advantage of hindsight to analyse what went wrong in the economy. We should do so not for the sake of recrimination but to help determine what must be done to set our affairs right again.

To trace the sources of our present difficulties, let us turn our minds back over the years since the early 1960's. Let us try to recall what perceptions Canadians had formed of this country and its economy and review the attitudes, policies and programs that were developed on the basis of those perceptions.

You will remember that by the mid-1960's we were embarked on one of the longest and strongest economic upsurges in our history. There was growing confidence, particularly in North America, in the ability of governments to manage their economies so as virtually to put an end to the age-old business cycle and achieve sustained growth of output and employment without inflation.

In this country we dared to believe that Sir Wilfred Laurier's famous prediction was partly right: that perhaps at least the latter half of the twentieth century belonged to Canada. Certainly we saw ourselves as a richly endowed storehouse of natural resources in a world that was growing increasingly short of them.

Since the discovery of the Leduc oilfield in Alberta in 1947, our meagre oil and natural gas reserves had been transformed into apparent plenty.

Substantial hydro-electric sources remained to be tapped in the remote areas of Labrador, Quebec, Manitoba and British Columbia - a development made feasible by new techniques for long-distance power transmission.

We had pioneered the development of a sound technology for harnessing nuclear power using natural uranium, which we had in abundance. We had substantial reserves of coal and other minerals.

We were among the world's leading producers of forest products.

Food production for export and home demand, another of the foundations of the Canadian economy, also appeared to have a bright future. We were pioneers in the development of new markets for grain in the U.S.S.R. and China.

The outlook was promising for more than just our basic industries. Secondary manufacturing appeared to have gained new strength as a result of the devaluation of the Canadian dollar in 1962 and the negotiation of the automobile pact with the United States in 1965. Productivity relative to the United States improved significantly and the negative balance of trade in manufactured goods steadily declined over the years to 1970.

Assisted by this turnabout in the manufacturing sector, Canada's overall trade position also improved dramatically. In 1970, we recorded the first current account surplus since 1952, a total of more than \$1.1 billion, which was followed by a second, smaller surplus in 1971.

Over the years, in short, Canada had come to be seen as a country that was already very well off and could surely count on ever-growing wealth and prosperity.

Now, this basic view of Canada's economic prospect, widely held as it was, became the foundation for public policies that have had a profound impact on the

whole shape of our society. We embarked on massive new social programs and greatly expanded the existing ones in the hope of transforming Canada into a more just, more equitable and more egalitarian nation. But few people realized we were building on shifting sands.

Comprehensive health care became a reality with the addition of medical insurance to the government-financed hospital insurance system established in the 1950's. Federal and provincial governments heavily subsidized a greatly enlarged system of post-secondary education to help develop the skilled human resources thought to be needed in an increasingly complex economy.

The qualifying age for old age security pensions was reduced, the universal benefits substantially increased, and a guaranteed income supplement paid to those with little or no other means. The universal old age security system was complemented by the Canada Pension Plan and the Quebec Pension Plan. The Canada Assistance Plan provided a greatly expanded and enriched system of social aid.

The unemployment insurance system was radically overhauled in 1971, considerably reducing the period of work required to qualify for substantially increased benefits payable over a longer period of time. Subsequently, family allowance payments were more than doubled.

Altogether, the social security and welfare system of this country was revolutionized within the period of a

decade, transforming it into one of the most generous in the world - considerably more generous than that in the United States, the wealthiest nation in the world. That transformation, in turn, has had a major impact on the level of government expenditures and on social attitudes.

Our sense of abounding prosperity led us into new and expanded programs for sharing the wealth among the less affluent areas of the country so as to reduce regional disparities of income and opportunity. In some areas, drawing unemployment insurance benefits became a way of life, reducing the incentive for those without work to move to centres where jobs were available or to pursue the occasional occupations through the seasons that in previous times were relied on as an important source of income.

At the same time, governments redoubled their efforts to take jobs to people by force-feeding the establishment of enterprises in regions of slow growth - enterprises that all too frequently foundered because heavy public subsidies proved insufficient to overcome the basic economic disadvantages inherent in the areas where they were established.

During the years to which I refer, a growing sense of nationalism reinforced a heady new feeling of affluence to produce a belief that Canada could afford to rely less heavily on foreign direct investment than in

the past. The Foreign Investment Review Act created a new impediment to the inflow of equity capital from abroad and the benefits that often accompanied it - markets, entrepreneurship, managerial skills, technology.

Our social values and lifestyle also underwent a radical transformation during this period. There developed a view that the material side of life would pretty well take care of itself; that what was more important was the quality of life and of the environment. The old-fashioned virtues that provided the driving force for the building of the nation in the first place - hard work, self-reliance, thrift, saving - became highly unfashionable.

Substantially increased public outlays for social programs, regional development and a wide range of other goods and services, resulted over time in a sharp rise in the proportion of national income passing through the hands of governments. Between 1965 and 1975, the share of government spending in relation to Gross National Product rose from 30 per cent to over 42 per cent, a dramatic shift in a very short period of time. It is still growing.

As a result of the long sweep of prosperity and growth we enjoyed throughout most of the 1960's, we developed firmly rooted expectations that good times would be continued in perpetuity. Governments were expected to maintain high levels of employment through thick and thin, year in, year out. Little allowance was made for changing

participation rates in the labour force or for the impact of the new unemployment insurance and other social programs on incentives. Had not the Economic Council of Canada told us that a 3% rate of unemployment, consistent with virtual stability of prices, was a reasonable goal attainable in the immediate future?

Faced with such pressures and its own rapidly rising spending commitments I suppose it is hardly surprising that the Government of Canada took excessive risks in expansionary monetary and fiscal policy. This led inexorably to the highest rates of inflation we have ever experienced in peace-time.

Individually, Canadians had also developed high expectations about the extent to which they were entitled to share in the growing national bounty through increases in personal incomes. These ambitions were reinforced by the efforts of many Canadians to maintain and increase their take-home pay in a vain effort to offset the larger share of incomes being absorbed by governments.

During the past few years, many of the bright perceptions of Canada as a land of unbounded affluence have been reduced to shattered illusions. We are being forced to face up to hard new realities. The current process of adjustment is a traumatic one and - as I see it - in no small measure accounts for the distemper of our times.

Canada, of course, has not been alone in suffering an economic setback. Most of the other industrial nations had also been following expansionary policies that had led them into inflation, which was aggravated by the dramatic increase in oil prices in 1973. Action by the leading nations to bring their affairs under control was followed by a severe recession throughout the industrial world.

As a result of a combination of circumstances and policies, Canada had the mildest recession of all. Because of this Canadians were slow to realize that the underlying problems in our economy and the reversal in our fortunes were, if anything, more severe than that in many other industrial countries.

In many other nations, inflation was gradually being brought under control by the impact of the recession. In Canada, there was a very real danger that an explosive increase in wage and salary demands would lead to further escalation of costs and prices - worsening the serious deterioration in our international competitive position which, it is now clear, had been underway since 1970.

Moreover, our conception of this country as a vast treasure-house of natural resources had to be considerably scaled down. We discovered that we did not possess certain resources, notably oil and gas, in such abundance as we had thought, and that the development of a large proportion of the resources we did possess had become uneconomic because of cost increases and high taxation.

Export markets for many of our primary products had also become weak, partly because of the recession and partly because our costs had gotten out of line.

The unsatisfactory state of most of our primary industries is more than matched by that of our secondary manufacturing industry. The substantial improvement that took place in its competitive position throughout the 1960's was reversed in the early 1970's. Our negative balance of trade in manufactured goods, which fell below \$3 billion in 1970, rose to more than \$10 billion in 1975. No doubt many influences were at work. But the dominant factor must have been the rise of Canadian wages in manufacturing above those in the United States, despite the fact that our productivity continued to lag well behind.

Much of the story of what has been happening to our economy is reflected in our international balance of payments. By 1974, the surpluses of the first two years of the present decade had been replaced by a record-breaking current account deficit of \$1.6 billion. This was small, however, by comparison with the deficit of more than \$5 billion that followed in 1975, which substantially exceeded that of any other industrial nation. Unfortunately we retained that record in 1976, and the outlook for 1977 is not significantly better.

In part these deficits reflected the reduction in oil exports ordered by the government to preserve our

declining reserves. In part they reflected the deterioration of our terms of trade with other countries because of the world-wide decline in commodity prices.

For some time, however, Canadians lived with the happy illusion that our growing external deficit resulted mainly from the mildness of the recession here in comparison with our trading partners, which caused imports to rise and exports to fall.

It has since become evident that this development was less a reflection of strength than of weakness. What was concealed by the illusion was the serious decline that had taken place in our competitive position at home and abroad. What was concealed, as well, was the fact that we were now living well beyond our means on money borrowed from abroad and by dissipation of our capital at home.

Governments at all levels in Canada were now running record budget deficits and were borrowing heavily. In the case of provincial governments and their agencies, much of the borrowing has been undertaken abroad. This, in turn, has offset our massive current account deficit. Unlike other periods in our history, such as the 1950's, this deficit has not been primarily the result of a heavy inflow of capital goods to build up our productive capacity. Instead, it reflects a heavy inflow of goods and services with which to sustain current consumption at the high level made possible by the supportive actions of governments, and

well beyond our capacity to support out of domestic production.

A number of consequences flow from these developments. Heavy government borrowing at home has created strong upward pressure on interest rates in Canada. Borrowing from abroad has tended to maintain the exchange rate of the Canadian dollar well above the level that would be justified by our competitive position. And it has resulted in the assumption of very heavy new debt servicing charges for the future. It must have come as a shock to many Canadians when the Morgan Guaranty Trust recently reported that Canada was the world's largest borrower in international markets in 1976, and that Canada now has a greater external debt in relation to its Gross National Product than has Britain. Yet some people in high places are telling us Canada should not worry about contracting the so-called "British disease".

One consequence of excessive foreign borrowing was spelled out by the federal government in its discussion paper of last fall entitled "The Way Ahead". "To the extent that such borrowing is used to finance consumption rather than investment," the paper pointed out, "it lowers the rate of future growth and thus shifts some of the burden of supporting current living standards to future generations."

Borrowing from abroad is not the only way we have been mortgaging our future in an effort to put off the day of reckoning. As I indicated a few moments ago, we have also been sustaining the standard of living to which we have become accustomed by eating up our capital.

In nominal terms, capital investment and the earnings with which to finance it appear to have remained until recently at a fairly high level. But these inflated figures are highly misleading. If we had accounts corrected for the distortions of inflation it would be crystal clear that in real terms industry has not been generating sufficient earnings to meet the high cost of replacing existing plant and equipment, to say nothing of creating new capacity. Such figures would also show why it is that in many industries the prospective return would not justify new investment even if funds were available. It is hardly surprising that many Canadian companies are looking to the United States and other countries for the location of new production facilities.

This problem has been aggravated by the kind of restrictions which have been imposed on profits under the anti-inflation program. These compound the difficulty companies face in generating sufficient earnings to compensate for the high capital and operating costs that confront them in Canada today. In its paper, "The Way Ahead", the government indicated it would rely heavily on private industry to provide the increased output, investment and employment this country requires. Through excessive taxation, profit controls and other policies, however, industry is still being denied the means to do that job.

Moreover, even with the present control program, our competitive position in relation to the United States

has continued to deteriorate. Wages and salaries are still rising more quickly in this country than south of the border. This combined with poor productivity performance results in unit labour costs increasing substantially faster than in the United States.

No thinking Canadian would dispute the conclusion that Canada is in deep economic trouble or that major adjustments are required to resolve the problems of growth, unemployment and inflation. And I have not yet mentioned the impact of the Parti Québécois victory in the recent Quebec election.

It is by now a stale, but nonetheless hard, fact that the election to office of a government in Quebec dedicated to taking that province out of Canada has introduced a new and major dimension of uncertainty in our economy. This event cannot fail to make a difficult task that much more onerous. A negative force of formidable weight has been introduced into an already uncertain investment climate. Capital, whether originating at home or abroad, will see this new uncertainty as an added cost of doing business in Canada. Other factors aside, this can only mean less investment than would otherwise have taken place. The main damage will occur in Quebec but there is bound to be a ripple effect across the entire country.

Failure to face this harsh reality can only serve to impede the development of an economic strategy adequate

to the formidable challenges facing us. It will not be an easy task for our present government, or any government for that matter, to provide the economic leadership required, preoccupied as it must be by the daily tests and diversions of this most serious challenge to our national unity.

I want to conclude my remarks with a few suggestions as to how we might find our way out of our economic dilemma. But before doing so I will try your patience for a moment longer on the subject of Quebec.

I have no special credentials to analyse the political implications of this development within Quebec itself, but I would like to make one or two observations about the options open to Canada. In putting these forward however, I recognize that the issue of national unity may in the last analysis be joined - and resolved - not in the calculus of economic gains or losses, but in the less tangible sphere of human emotions and cultural aspirations which, after all, are no further from the heart of the political process.

First, I do not think we can simply cling to the status quo in Canadian federalism. Not only has this become less and less acceptable to Quebec, but to other provinces as well.

At the opposite extreme is the separatist option of Quebec as an independent nation. I do not believe more

than a small minority of Quebecers want this, nor of course do any significant number of other Canadians. It may come to that, but by default and not by choice. It would not be a solution, but rather the failure to find one. It would mean the defeat of Canada - the end of our National Dream. I refuse to even discuss this possibility as a civilized option.

What about political independence for Quebec with some kind of economic union with Canada? On the face of it this notion has a certain attraction. You can have your cake and eat it too; master in your own house with no economic penalties. Small wonder that this idea is emerging as the siren song of the Parti Quebecois!

To my way of thinking this idea breaks down under any kind of rational analysis. Indeed it is a contradiction in terms. Would an independent Quebec with one quarter of Canada's population and a fifth of Canada's economy expect to negotiate with the rest of Canada as an equal in setting commercial policy, monetary policy, fiscal policy, equalization grants, energy subsidies, government procurement policies? Why would the rest of Canada with quite different economic problems and goals accept this? And if the bargaining process and outcome reflected proportional population or economic power what in reality would be left of Quebec political independence?

Mr. Lévesque points to the European Economic Community as his model, but misses the essential point.

States that enter a customs union have to make some pretty basic compromises. Most of Quebec's secondary industry - for example, textiles, garments, boots and shoes. - depends heavily on the highly-protected Canadian market. Other Canadians are prepared to accept this cost only to the extent that they can believe it is part of the cement that binds a nation together. A customs union has to involve major elements of give and take, and the members have to see these as being equitable in their broad interest, or justifiable in terms of some major ideal. Those great idealists, such as Jean Monnet, who conceived the European Economic Community were creators, not destroyers. They saw the Community as a step towards European federalism. This is why the member states in Europe were persuaded to set aside centuries of enmity and radical differences in commercial policy, agricultural policy and industrial policy to try to build a new and more unified Western Europe.

It is of the utmost importance that our Quebec compatriots not be seduced by the facile but highly misleading notion that it would be possible for an independent Quebec to negotiate a meaningful economic union with the rest of Canada.

Another option much discussed in recent years is that Quebec should have a special status within Confederation. Quebec already has acquired a degree of special

status in a number of fields. If this was carried substantially further real questions would arise as to the status and role of the Members of Parliament from that Province. Would they be entitled to legislate along with the other MP's on matters affecting the rest of Canada if in the case of Quebec those matters were reserved for the provincial legislature? It is difficult to see this as a workable regime.

This leaves us with the option of giving more powers and responsibilities to all provinces within our federation. A degree of decentralization is the essence of federalism, and in many respects Canada is already fairly decentralized, as the Prime Minister and others have pointed out. I agree with the Prime Minister that no amount of decentralization will satisfy Mr. Lévesque and the other committed separatists. But surely the objective is not to please them but to meet the legitimate aspirations of those Quebecers who are dissatisfied with the present situation but would prefer to keep their province within Canada.

What do I mean by more decentralization? Do not take fright. I have no intention of attempting a detailed answer here and now. But let me try one proposition by way of a general approach. First we must identify those elements of nationhood which are essential to a modern industrial state - e.g. sovereignty

over international and interprovincial movement of goods, services and people, monetary policy, external affairs, national defence, justice and basic human rights, macro-economic policy, sufficient tax revenue for an effective equalization program, and perhaps one or two other fields of jurisdiction. Everything else - and this takes in a great deal - should be treated as negotiable; resources, education, language, culture, manpower policy, health, welfare, urban affairs, communications - to name only a few.

This would help Quebec attain some of its most cherished goals - and help ease growing tensions in other parts of Canada. A side benefit of such an approach would be to slow down, and in some areas to reverse the process of state intervention in the economy and in the lives of Canadians. The value of this should not be underestimated given the extraordinary federal intervention in recent years often in the face of provincial opposition.

To return to our present economic problems, I see three alternative courses open to us.

We could continue to follow Britain down the long road it has been travelling - consuming more than we are producing by borrowing abroad, printing money at home, and eating into our capital. That would be the road to ruin.

A second option is resort to the old-fashioned medicine of very tight fiscal and monetary policies to halt the rise in prices and incomes and bring our foreign trade into better balance. I believe we should try hard to avoid this course because of the heavy toll it would exact in terms of unemployment and lost output. It may, however, ultimately be forced upon us if we fail to put our house in order in any other way.

Finally, we could follow a middle road. Briefly that involves the pursuit of moderate restraint in fiscal and monetary policies aimed at bringing inflation gradually under control without harshly restricting the growth of output and employment. It involves cutting back the growth of government spending and borrowing in order to reduce pressures on capital markets and increase the resources available for the expansion of the private sector. And it involves a reduction of government intervention to enable the dynamic forces of the market-place to play their role in laying the foundation for the renewal of strong economic growth in the future.

This is the course we should try to follow. To be successful it will require for some time a shift in the distribution of our resources in the direction of more investment and less consumption. Our taxation policies will have to recognize this need and promote this shift. Tax changes will have to be made that will leave enough

earnings in the hands of Canadian businesses to justify and help finance the new capital investment required to provide new jobs and generate healthy growth in output. The A.I.B. direct controls have served whatever limited purpose they could and should be dropped as soon as possible. We will all have to recognize that personal consumption cannot continue to increase faster than or even in line with our domestic product if we are to live within our means and build for the future.

Unfortunately, there are elements in this country who fail to recognize or understand the stark realities that confront us. Many of those same groups and commentators who earlier in the decade were pressing for the excessively expansionary economic policies that contributed so much to our present problems are now beating the same drums again. This is no time to listen to their siren songs.

I do not believe we have travelled so far along the British route that we cannot turn back, but we are dangerously close to the point of no return. Some of the problems that confront us stem from nature and there is little we can do to change them. Most of the problems we face, however, are man-made. We are still endowed with a wealth of human and material resources in this country. But we have allowed many of them to become uncompetitive because our reach has exceeded our grasp. Sooner or later, one way or another, we will be compelled to return to

living within our means. If as a nation we can muster the necessary perception, patience and persistence, we can overcome the problems confronting us and seize the great opportunities that are within our reach.