# Finance Finances

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Notes for Remarks by
Finance Minister Donald S. Macdonald
to the Canadian Club of Toronto,
Toronto, Monday, January 26, 1976

Mr. Chairman, I understand you have established something of a tradition in inviting the Minister of Finance to speak at a luncheon gathering of your members early in each new year. As a relative newcomer to the office and as the Member of Parliament for a Toronto riding, I particularly welcome the opportunity you have extended to me to maintain that tradition.

Having now put in four rather hectic months in this portfolio, I would like to take this occasion today to reflect a bit on some of the central economic issues of concern to all of us in Canada today.

Earlier this month I represented Canada for the first time at the meetings in Jamaica of the Interim Committee of Ministers of the International Monetary Fund and the Development Committee of the Fund and the World Bank. As you would expect, there were many different views expressed on the various problems that were before us. Those differences were successfully reconciled in the final decisions of the meeting. What impressed itself forcefully on me was that the give-and-take of debate was carried on within the confines of a clear recognition of the very considerable degree of interdependence that now exists between nations.

I was particularly struck by this evident awareness of the substantial interdependence between nations because it contrasts rather sharply with the limited recognition here in Canada of the substantial interdependence that exists between the various groups that make up our own economy.

It seems to me that this failure to recognize the extent of the interdependence between various groups stems in no small part from a lack of understanding of the extent to which various facets of our economy - such as personal incomes, consumer expenditures, output, employment, capital investment, prices, profits, savings and interest and exchange rates - are all interrelated. In a modern economy everything connects and, like the parts of an automobile engine, they must be properly synchronized to get the best performance.

The central challenge to governments is the formulation of policies and programs that will maintain the best possible balance between these many interrelated factors in the face of often sharply changing circumstances at home and abroad in an effort to achieve sustained and stable economic growth.

Just where the balance should be struck is, of course, a matter of judgment and, therefore, open to argument. And maintenance of any given balance over an extended period is far more easily said than done even in the best of circumstances. But it strikes me that the task is made more difficult by the tendency of many groups to overlook the important interrelationship of all these various facets in the operation of the economy as a whole.

Over the past few years, that task of maintaining a reasonable balance has been made immensely more difficult by the extraordinary upheavals that have afflicted the world economy. As a major trading nation, Canada inevitably was highly exposed to the inflationary tidal wave that swept around the globe in 1973 and 1974 and subsequently to the deep and prolonged recession among many industrial countries that led to a sharp slump in demand for our exports.

Looking backwards for a moment, it seems to me that the world was brought to its present state largely as a result of an extraordinary series of developments stretching over the past 15 years. During the 1960s, we experienced the longest and strongest period of uninterrupted growth in history, which helped to create some pretty unrealistic expectations for continuing improvements in our standard of living in the future.

A global economic slump in the early 1970s temporarily dashed these expectations. The slowdown was relatively short-lived, however, as country after country shifted to expansionary policies in an effort to restore the momentum of the "sixties". As a cumulative result of action by individual countries a rip-roaring economic boom was set in motion. The demand for many industrial raw materials quickly began to outrun supply and their prices began to soar.

This would have created problems enough by itself, but the problem was enormously compounded by its conjuncture with two other major events - widespread crop failures around the world that led to a drastic increase in food prices and quadrupling of oil prices by the major petroleum exporting nations. All three factors combined served to create an inflationary tidal wave that has continued to sweep around the globe long after it left a severe economic recession in its wake.

As an open economy, Canada could not help but be affected by these international events, firstly by the dramatic price increases, and then by the drastic slowing down of economic activity. Partly as a result of natural advantages - domestic supplies of oil and wheat, for example and partly because of conscious policy choice, we have been able to cushion Canadians against the most severe of these blows. We have experienced neither the full ferocity of international inflation nor the deeper recession that have shocked some of our international trading partners.

The prospects for revival of economic growth in this country are also relatively bright. In the December Economic Outlook, the OECD forecast that the "path of recovery in Canada is likely to follow that of the United States, but by end-1976 the level of activity, in relation to the previous peak, may be higher for Canada than for the other major OECD countries."

If, throughout 1973 and much of 1974, we have been able to respond to the adverse impact on our economy of global inflation and recession, over the past several months circumstances have been changing significantly. This change, in turn, has called for a changed response in government policies. International inflationary pressures have been gradually subsiding and the world economy is slowly pulling itself out of recession. In Canada, however, inflationary pressures have remained strong as a result of an accelerating spiral of costs and prices that has become increasingly domestically generated.

The response of the government to these changing circumstances was outlined in the four-part program announced in the policy statement of mid-October. This involved the maintenance of fiscal and monetary

policies that would facilitate the recovery of economic growth without impeding the gradual restoration of price stability, structural policies to increase the efficiency and competitiveness of the economy, moderation of the growth of government expenditures, and the establishment of price and income guidelines aimed directly at gearing down the cost-price spiral.

Cutting back the rate of growth of government spending has become essential for a number of reasons. It is, for example, an important element in achieving the gradual reduction in the federal deficit and federal cash needs that will be required as the recovery of the economy becomes increasingly self-sustaining. It is important also as a concrete demonstration of the government's determination to do its part in exercising restraint as part of the national effort in which we are now engaged to bring inflation under control.

Having said that, I would like to add a few comments in an effort to put the issue into better perspective because it is one on which many people comment without taking full account of the circumstances.

The impression seems to be widespread that government expenditures can be easily and painlessly reduced substantially merely by rooting out "waste and extravagance". I haven't any doubt that there is a good deal of waste and extravagance in the federal government, as there is in any large organization. On different occasions, businessmen have cited to me what they see as inefficiency in government operations. I appreciate that and I urge not only other businessmen, but anyone who discerns wasteful government procedures to draw those to my attention or the attention of my colleagues. Plentiful examples are provided annually by the Auditor-General, who subjects federal spending programs to a more searching public scrutiny than that to be found virtually anywhere else in the country. When, incidentally, did you last see the auditor of a private company document his findings of "waste and extravagance" in the firm's annual report? Even if all the water and fat was squeezed out, however, I simply do not believe from my own hard experience that it is possible to make meaningful reductions in the growth of government spending without cutting into the marrow - and that can hurt many people.

The fact of the matter is that there are very real and practical social and economic limits on the extent to which the government can or should pare its expenditures, the point was inadvertently well illustrated recently by a labour spokesman, who cited as an example of government extravagance expenditures of almost $2 billion on the hiring of consultants. In fact, expenditures in the category he was referring to are closer to $1 billion and a substantial portion of that total goes to provide manpower training and schooling for Indians off reserves - the reduction of which he would be the first to oppose.

Now I would like to comment on two other aspects of the anti-inflation program - fiscal and monetary policy and price and income guidelines.

On the question of monetary policy, I agree with the Governor of the Bank of Canada that in terms of growth of the money supply our objective should be to accommodate the real growth in the economy plus some, but not all, of anticipated price increases. In conformity with our target under the prices and incomes program of a gradual reduction in inflation, there should be a corresponding moderation in the growth of the money supply.

With respect to fiscal policy, we have continued to proceed on the basis of the analysis and proposals put forward by my predecessor in June 1975. I do not anticipate making a budget statement before Easter at the earliest, and I expect to deliver the budget some time in May. In choosing that timing I am motivated by two considerations. Firstly, I want to get a clear reading of the impact upon the economy of the anti-inflation program and that information will not be available for a number of months. Secondly, I also want some clearer signs as to the direction of the international economy and, in particular, the extent of recovery in some of the major markets for Canadian exports.

Earlier in my remarks I suggested that the policy course followed in Canada for dealing with inflation was different than the course of other countries, which adopted restrictive economic policies. It is argued that if we had pursued restrictive policies, we would not be confronted as we are today by the problem of a sharp upward spiral of costs and prices. A massive increase in unemployment and plunging sales and production of

goods and services undoubtedly would have acted as a major force in restraining workers and companies from pressing for higher incomes and higher prices to meet - and if possible beat - anticipated inflation in the future, which only serves to increase inflationary pressures. We rejected that solution, however, because of the enormous cost that would have to be paid in terms of lost output, employment and incomes. We chose instead to adopt a prices and incomes policy aimed at gradually braking the inflationary spiral without seriously impeding continued growth of production and jobs.

While there remains a lot of room for argument over details, I believe the great majority of Canadians strongly support this approach. This consensus was clearly reflected in the Twelfth Annual Review of the Economic Council, which was recently made public. The report disclosed that at a meeting only eight days before the government's program was announced members of the Council "emphasized the gravity of present and anticipated inflationary trends and the urgency of modifying the expectations of both business and labour with respect to claims on the economy's resources." Without commenting on the specifics of the particular approach which we adopted, the Council emphasized the need for "clear government guidelines on income and price increases" to reinforce fiscal and monetary policies in controlling inflation.

In one important respect this "consensus document" of the Council raises something of a conundrum, since the position on the inflation problem adopted in the report - and endorsed by the half-dozen senior labour representatives among Council members - is sharply at variance with the official position adopted by a good part of the trade union movement. If nothing else, I hope that the Council's report will persuade labour leaders - most of whom are pretty hard-headed realists - to ponder whether their outright opposition to this national effort to wind down inflation should not be reconsidered in the interest of their own members, as well as in the interest of the country as a whole.

It seems to me that labour leaders should in particular take a hard new look at the view they have held up to the present that there is no reason to believe the cost-price spiral raises a threat to Canada's

international competitive position. The report of the Economic Council itself repeatedly referred to this danger and especially expressed "deep concern" over the deterioration it considered had already taken place in the competitiveness of Canadian manufactured products. The Conference Board of Canada also recently warned that the "competitiveness of many Canadian exports, particularly manufactured goods, has been significantly eroded by rising unit costs." And in its December Economic Outlook, the OECD forecast that in 1976 the "most substantial worsening" in competitiveness among the major industrial nations would take place in Canada and Britain, "causing market losses for both after rather impressive gains in 1975".

The prices and incomes control program itself is now well launched. The Anti-Inflation legislation has been passed by Parliament, the regulations have been issued, the Anti-Inflation Board is in full operation and the Administrator has been appointed. A number of the provinces have established rent controls or are in the process of doing so. An agreement has been signed with Ontario bringing its public sector under the jurisdiction of the federal regime and I expect that agreements with a number of other provinces will follow shortly.

Prompted by remarks make by the Prime Minister in a series of year-end interviews, the focus of public attention has shifted, at least for the time-being, from debate over particular aspects of the present program to the question of where we go after that.

There has been a great deal of sound and fury over the question of what structural changes we should contemplate for the post-control period. It is not a secret that I have no very great confidence in the ability of an economy to operate efficiently under a mandatory control system for any extensive period of time. Therefore, I proceed from the assumption that some time between the second and third anniversaries of the prices and incomes restraint program we will have to take a decision with regard to bringing the present controls to an end. I hope we can talk about this post-control period in a somewhat calmer atmosphere. Let's forget about the rhetoric and get back to the actual issues - the ways in which existing economic institutions in Canada may need to be adjusted to meet the challenges of the '70s and '80s.

I would like to be specific about some of those issues that we will have to deal with in the next two to three years. First let me refer to the question of industrial relations. While the final figures have not yet been compiled, I believe they will show that in 1975 work-days lost in Canada as a result of industrial disputes climbed to a record of more than 10 million. This follows the previous record in 1974, when Canada was second among the OECD nations in terms of work-days lost as a proportion of the labour force. What a toll is represented by those dim statistics! They mean serious economic losses sustained by workers themselves and by their employers. They mean economic hardship for the rest of those in the communities where there have been work stoppages and, in a broader national sense, they mean the loss for all time of the productive benefits of those employees and the capital investment that is standing idle.

The government has taken what I believe is an important first step in attacking this problem with the establishment of the Canada Labour Relations Council. This has been set up by my colleague, the Minister of Labour, with the participation of representatives of labour and management. But I believe that the Council does offer an important opportunity for the two participants in industrial relations discussions, as well as representatives of the broader public interest, to come together to seek some better means of dealing with these questions to achieve mutually a better recognition of the interdependence of the actions of each on themselves and on the community as a whole.

I would offer only one caveat in this regard, and that is that the solutions they seek for Canadian industrial relations problems must reflect the circumstances of the Canadian scene. Sometimes, when we are faced with a policy problem we are tempted to imitate an approach or an institution which has been successful abroad. In Japan, they have achieved a record of labour-management accord which we might envy. But we should recognize that the Japanese success is deeply rooted in the distinct character of the Japanese community; that it will not necessarily translate readily to the Canadian scene.

A second important area for decision in the next two or three years is with regard to our banking system. We are now engaged in the decennial review of the Bank Act, which involves a number of important issues: Firstly, the role of foreign banks in Canada; secondly, the role of "near banking institutions" and; thirdly, the powers of the present chartered banks. Those issues all have at their base the more fundamental question - is there adequate competition between financial institutions in Canada? We are facing here the age-old problem of making certain that adequate financing at reasonable cost is available when needed against our concern for the security of funds which are entrusted to financial institutions.

What must be clear to us all is that in the next decade we will need a highly efficient financial system. Figures on future energy investment alone show that we are faced with a major financing task. That task, plus the reality of changes in Canadian financial markets, mean that we are going to have to scrutinize with care the present operation of our banking system and weigh carefully the kind of amendments which will be brought forward for the consideration of Parliament during the course of this year.

A third area for examination is competition policy. Parliament has now enacted amendments with respect to what might be described as the fair-trading part of competition policy. We have before us, however, some important decisions to make on the question of mergers and monopolies. I have often been bemused at the way the ideological boundary line on this question becomes confused. As I see it, the basic purpose of a competition policy is to assure a freer and more competitive market and that rests in turn on the assumption that the customer will be best served if he has the freedom of choice between competing products and services. With the increase in concentration of economic power and technology, maintaining that freedom of choice becomes more and more difficult. But, that is a basic task for competition policy. I anticipate that my colleague will be bringing forward proposals for this next stage during this calendar year.

All these are problems of a specific nature which should engage the concern of us all. I believe that the most meaningful way of coming to terms with the kind of system we will have in the post-control period is to deal with these problems one-by-one in a concrete and constructive manner.

At the opening of my remarks, I made reference to international developments which have created serious economic and social strains, adding to the turbulence from other causes that is prevalent in so many parts around the globe today. Out of this harsh experience, however, we can hopefully learn some lessons that will help us prevent history from repeating itself.

It is obvious, for example, that individually and collectively nations must exercise great care not to push their economies forward at a pace that risks the danger of overheating them once again. Both citizens and their governments must also develop a clearer recognition of the practical limits to our ability to provide new and expanded public services and facilities.

Earlier, I also spoke of the interrelationship that exists between various facets of our economy and the interdependence that exists between various economic groups, I hope that over the next two or three years we can gear down the rate of inflation, establish a better and sounder balance among the major elements of our economy, and increase public understanding of the extent to which the common interest requires the maintenance of responsible price and income demands. In the final analysis, however, the outcome does not depend on the decision of any government, but on the collective wisdom of the Canadian people.