



Finance Finances

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Notes for Remarks by
Finance Minister John N. Turner
to the Canadian Club of Toronto,
Monday, January 28, 1974

Were he alive today, Sir John A. Macdonald might well wonder about the state of the nation.

He was convinced that the grand design for Canadian Confederation hammered out by the founding fathers would "avoid all conflict of jurisdiction and authority" between Ottawa and the provinces by giving the federal Parliament control over "all the great subjects of legislation."

But as the meetings in Ottawa last week of federal and provincial First Ministers and later of Finance Ministers demonstrated once again, our existing Confederation - shaped as it has been by time, circumstances and the British Privy Council - provides ample room for sharp conflict between the two levels of government on a wide variety of issues.

No one could blame the founding fathers when they allocated to the provinces the prime responsibility for natural resources for not having foreseen the emergence of an international energy crisis decades later that would produce one of the potentially most critical challenges to Confederation.

In Sir John A's view, it was "a matter of great importance, and one of the chief advantages of the federal union and of local legislatures, that each province will have the power and means of developing its own resources and aiding its own progress after its own fashion and in its own way."

Over the years, the exercise of major responsibility for resource development by the provinces has worked reasonably well. But the sudden eruption of a massive international oil crisis late last year, which endangered eastern Canadian petroleum supplies and placed sharp upward pressure on prices, has

threatened to distort Canada's whole economic and fiscal structure.

These events confronted us with an urgent challenge of reconciling the legitimate rights of the producing provinces to control petroleum resources "after their own fashion and in their own way" with the broader national interests of all the Canadian people.

It has been a fundamental responsibility of the federal government over the decades to provide leadership in the shaping of policies aimed at providing reasonable equality of economic opportunity and of public services and facilities throughout our country. The practical application of this responsibility has, of course, frequently created stresses and strains between different parts of the country and the different levels of government. Rarely, however, has the potential for conflict been so great as that involved in framing a new oil policy that will best serve the national interest in the radically changed circumstances that now confront us.

The complex questions discussed at last week's federal-provincial meetings are in a sense a very real manifestation of the kind of problem about which we were forewarned by Alvin Toffler in "Future Shock" - the premature arrival of the future. The sudden emergence of a potentially serious supply shortage in most of the industrial countries, including Eastern Canada, and skyrocketing oil prices presented a critical challenge to which all of us were ill-prepared to respond.

The voluntary price freeze on domestically-produced petroleum products agreed to by the oil companies and the tax

on Canada's oil exports to the United States helped to buy some time in which to work out a longer-term solution.

During the intervening months an intensive and at times heated debate has raged over the form of a solution. This has divided provinces and political parties. I believe, however, that a substantial measure of consensus has gradually emerged that there is a very real need to reconcile the legitimate interests of the oil-producing provinces in receiving a fair return for a depleting resource with the broader national interest. This arises because of the tremendous distortions to our economic and fiscal system which could be caused by the staggeringly large increase in oil revenues and costs. As I said in the House of Commons, national unity requires a sharing of the burdens as well as the benefits of Confederation. This means that there must be some reasonable apportionment of the new revenues and new costs, together with a recognition that Western Canada deserves support in its goal of broadening its economic base.

There has been some progress toward a national consensus. This was reflected during last week's conference of First Ministers.

We seem to be agreed that we should do whatever is necessary to maintain our self-sufficiency in energy and that we must have one national market and one uniform price. What still remains to be resolved is the critical question of what that price should be.

It was accepted that Canadian oil for export should be sold at the going international price and that the voluntary freeze on the price of domestically produced oil should be

extended to the end of March. It was also agreed that the existing price disparity on petroleum imported from abroad should not be widened. This requires the adoption of means to shelter Eastern Canada from the further increase in import prices due to take effect early next month.

But some important issues still remain to be settled. What is the price eventually to be? How quickly is that price to be phased in? How are the revenues obtained from that higher price to be shared? How are the costs of providing a price shelter for Eastern Canada - which could run to \$1½ billion a year or more - to be paid?

In arriving at a negotiated solution to all of these questions, I think it is paramount that we recognize the legitimacy of Western Canada's search for a broader economic base. But it is also important to ensure that the Canadian taxpayer does not pick up too heavy a tab.

Western Canadians pose a legitimate question - why the special treatment for oil and not other commodities? The fact is that oil is not a commodity like the others. It is a unique resource because it is part of the very lifeblood of our economic system. It is essential to heat and light our homes, power our industries, and propel our cars, trucks, planes, trains and ships.

It is exceptional also because the sudden and drastic increase that has taken place in world oil prices in recent months was not the result of rising costs or the normal competitive forces of supply and demand. It was instead dictated by the monopoly pricing decisions of the major oil exporting nations and reinforced by the cutback in supplies

decreed by the oil-producing nations of the Middle East as part of their geo-political strategy.

While I would not argue that some increase in international petroleum prices was not justified, the very magnitude of the increase in costs involved in the tripling of prices makes it impossible to continue to regard oil as a resource like any other. With total domestic consumption running at around 2,000,000 barrels per day, an increase in price to the prevailing level of about \$10.50 a barrel would involve increased costs to Canadian consumers approaching \$5 billion a year and a similar increase in revenue to governments and/or oil companies. While some Canadians might enjoy new-found wealth beyond their wildest dreams, others would suffer extreme hardship. Our whole economic and fiscal structure could, as I suggested at the outset, become weakened and distorted.

An acute awareness of the havoc that could be wrought by a sudden and massive jump in Canadian oil prices is reflected in the agreement by all governments that any increase that does take place should be in gradual stages.

Another critical dimension to the problem grows out of our system of federal equalization payments to 7 of the 10 provinces to bring their per capita revenues up to the national average so as to enable them to provide an average level of services and facilities for their citizens. If Canadian oil prices rose to the world level and all the additional funds went into the Alberta treasury as general revenue, there would under the existing equalization system be a massive increase in the average of provincial revenue and a massive increase in the amount of equalization payments for which the federal government would be liable. That increase could be in excess

of \$2 billion, with Ontario and perhaps British Columbia becoming eligible for equalization payments as "have-not" provinces. Covering that heavy added cost to provide "wind-fall" revenues to provincial treasuries could involve a personal income tax increase of some 22 per cent. This would impose a further substantial burden on every Canadian taxpayer. He would not only be hit as a consumer by drastic increases in the prices that he would be forced to pay for gasoline and fuel oil - to say nothing of the increase in the prices of other products caused by higher energy costs, but he would also be hit by higher taxes.

Clearly such an outcome would not be manageable economically or politically. It would call into question our whole equalization system. I am sure you will appreciate my concern that this particular problem be worked out in a way that would not have such drastic consequences. While the international events that have given rise to this problem are beyond our control, it is not beyond our control - and, indeed, it is our responsibility - to ensure that the equalization system is not imperilled. I feel I have a particular duty on behalf of the Canadian taxpayer to see that he is not inflicted at the same time with higher taxes and higher petroleum prices. I don't like a solution requiring the cost of a price shelter and the cost of equalization to be taken out of the pockets of Canadians, rather than from the pool of revenue that has suddenly become available because of those higher prices.

The events on the international oil front have also been of concern to me as Minister of Finance because of the far-reaching effects they can have on the Canadian economy both directly and indirectly through their adverse impact of the

economies of the other industrial nations and the international monetary and trade system.

To put the issue in some perspective, let me point out that 1973 was a bumper year for the Canadian economy. Our real national output increased by about 7 per cent, with the result that economic growth was straining at the limits of capacity. Employment increased by a record rate of 5.2 per cent with new jobs created for 430,000 Canadians. Unemployment dropped from an average of 6.3 per cent in 1972 to 5.6 per cent last year and would have fallen much more if the labour force had not also increased at a record rate - 4.4 per cent - in response to the new job opportunities that were created.

Like every other country, we were badly afflicted by a worldwide surge of inflation touched off by the unprecedented simultaneous expansion of the economies of all the industrial nations and their demand for industrial and agricultural commodities at a time when many of them were already in short supply. With the benefit of hindsight, I am reinforced in my conviction that the decision of the government not to be stampeded into adopting price and wage controls in the circumstances confronting us - despite their superficial attractiveness - was in the best interests of the Canadian people. Certainly the experience in the United States and Britain indicates that in a situation of worldwide inflation caused by an imbalance of supply and demand, controls are largely ineffective in curbing rising prices for any significant period. U.S. consumer prices in December were up by 8.8 per cent over a year ago, only fractionally less than the year-over-year increase in Canada of 9.1 per cent. British consumer prices in November were up by 10.3 per cent over the year before.

Despite the substantial increase in consumer prices, the fact remains that in 1973 Canadians enjoyed one of the sharpest rises in real disposable income - that is their income after payment of direct taxes and after discounting the impact of inflation - in their history. While the figures for the whole of 1973 are not yet available, in the first nine months the average real personal disposable incomes of Canadians per capita rose by 7.3 per cent over the same period in 1972. That substantial improvement is the result of the very large increase in the number of Canadians at work, the tax reduction in my February budget equivalent to 12 or 13 per cent, and increases in old age pensions and other social payments. I would point out, too, that the large increase in real personal disposable income per capita in 1973 follows exceptionally large increases of 6 per cent in 1971 and 6.7 per cent in 1972. Those figures do not suggest, as sometimes claimed, that Canadians as a whole have been falling behind in the battle against inflation. Undoubtedly many Canadians have been badly hurt, however, and the government has done its best to protect them - those on low incomes, pensioners, those with large families.

Before the outbreak of the international oil crisis, we had anticipated that during 1974 the Canadian economy would grow at the upper limits set by its industrial and manpower capacity - approximately 5.7 per cent. We were also hopeful that there would be some easing of worldwide inflationary pressures as a result of increased output of commodities previously in short supply and moderation in the growth of demand for goods and services.

While the Canadian economy will probably be less affected by the adverse impact of the international energy

crisis than that of other industrial countries, it will by no means be immune. It will, in particular, be influenced by three major factors:

First, the growth in our exports will be more moderate than was otherwise to be expected because of slower growth in the economies of our major trading partners.

Second, the prospect for an easing of worldwide inflationary pressures has become dimmer as a result of the sharp upward thrust of petroleum prices. While the impact may be somewhat less severe in this country than many others, Canadians still face the certain prospect of higher prices for heating oil and gasoline and for all goods and services for which petroleum is an important cost component. The effect could be to slow the growth of real income of Canadians and to slow the volume growth of goods and services which they consume.

Third, rapidly expanding capital investment of all kinds will provide the major driving force behind the economy for a considerable period ahead, reinforced by a rising tempo of investment in new energy resources. A boost to the economy will be provided later this year as work gets underway on construction of the oil pipeline to Montreal.

The growth of total national output in 1974 will probably be less than would otherwise have been expected, but I anticipate that it will still be substantial. In the uncertain situation that confronts us at home and abroad, however, it is still too early to be able to forecast the economic impact of the energy crisis with any degree of precision or to determine the response of economic policy. As the Organization for

Economic Co-Operation and Development observed in December, "it is not yet evident that the situation calls for a major shift in the overall thrust of demand management policies in either a restrictive or an expansionary direction." What is essential, as the OECD report also concluded, is that governments maintain a very careful watch over the course of developments and that they stand ready to act quickly to offset difficulties that may begin to arise in various sectors of the economy.

As a major trading nation, Canada must be deeply concerned about the possible impact on its own economy of the massive upheaval in the trade and payments position of other developed and developing nations that could be caused by the energy crisis.

The magnitude of that potential upheaval became fully apparent during the discussions of the International Monetary Fund's Committee of Twenty which I attended in Rome the week before last. In the absence of any decline in prices, the cost of oil imported by the consuming countries will rise by some \$65 billion, which can only have the effect of retarding their economic growth and creating potentially mammoth balance of payments deficits. The latter could very well be reflected in a series of exchange market disturbances - perhaps foreshadowed by the recent floating of French and Spanish currency.

While the potential problems on the international front are enormous, I am encouraged by the fact that members of the Committee of Twenty recognize the problems and are endeavouring to come to grips with them. An important first step was the agreement to establish a 20-member council of the IMF Board of Governors to enable the Fund to deal quickly and effectively

with difficulties that may arise. The decision to give urgent consideration to the proposal by the Fund's managing director for establishment of a new facility for financing deficits caused by the increase in oil import prices was also a welcome development.

I was particularly glad that the Committee of Twenty accepted our long-held view that reform of the international monetary system should proceed on a step-by-step basis rather than attempt to devise a comprehensive new system at one stroke. In the circumstances that confront us, it is all the more important that we should remain flexible rather than seeking to establish rigid new structures.

Perhaps most important of all was the recognition by all of those attending the Committee of Twenty meetings in Rome that every nation must seek to avoid the temptation to protect its own flank through what I would describe as predatory measures - such as competitive currency devaluations or adoption of trade and exchange controls, - aimed at easing its own problems at the expense of its trading partners. By the same token, there was also an important recognition that efforts by individual nations to retard the growth of domestic demand within their own economies in an effort to reduce imports and payments deficits could have the contagious effect of retarding world growth.

What it all comes down to, as I have tried to emphasize before, is that if we want to prevent history from repeating itself we must never lose sight of the crucial lesson of the depression days of the early 'Thirties, when self-serving actions by individual nations to isolate themselves from the

rest of the world proved self-defeating for every nation.

From what I have said to you today it is quite clear that we are not without problems on the domestic scene or on the international front. But it should be equally clear that compared with almost every other nation in the world we are indeed in a fortunate position.

Much of what is taking place in Canada is a microcosm of what is happening in the world. But we at least can meet these problems as a single nation capable of developing workable solutions. On the world front, the problems seems much more difficult to manage. The institutions and practices of international co-operation will be tested to the full in the weeks and months that lie ahead. But I am persuaded that with goodwill and a lot of hard work we will find solutions to those problems as well.