

SPEECH

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Bank Financial Group



Groupe Financier Banque TD

Thank you Marilyn, for your generous introduction.

It is always a great honour and a pleasure to be invited to speak at the Canadian Club.

The challenge of being invited back is finding a topic that will interest you as much as it interests me. I am, after all a banker, and bankers as a breed are better known for our ability to read balance sheets than deliver riveting prose.

That being said, I hope I have found a solution that will serve both our interests well.

I would like to talk to you about fundamentally rethinking the future of Canada.

In a few moments I will suggest an ambitious goal we could aspire to achieve in, say, 15 years, what we need to do to get there and where I think we need to concentrate our efforts and energy.

But first let us look at where we stand today.

There are three tests that I believe are core indicators of Canada's national health.

One is the unity of the country. But I made my views clear on this last time I spoke at the Canadian Club.

The second is how we fare relative to our most important partner and competitor, the United States. When you are a mouse in the shadow of an elephant you learn to watch the elephant.

I would suggest that our relationship with the elephant should be a means to an end and not the primary focus of our plans for the future.

To paraphrase historian Jack Granatstein: we need something more positive and enduring than simply not being Americans.

The plan I shall suggest could help us achieve what pollsters are telling us we want for our country.

According to the most recent Maclean's magazine poll, published last December, there is growing public concern about social issues -- particularly our education and health care systems and the fact that we are seeing more homeless people on our streets. Remember this poll was taken in November when most Canadians were still feeling quite optimistic about expansion.

The third test of our national health is how the economy is performing.

This is the area where I would like to see us focusing our energy and our efforts.

We have had some unsettling market events since the Maclean's poll. Despite many positive developments in our economy, it will be no surprise to any of you that it is not as robust as we would like.

The question on everyone's mind today is: how will the U.S. slowdown affect Canada? Will there be a recession? How deep might any downturn be? And how long will it be before the economy recovers?

If there is to be an economic slowdown in Canada we need it to be like reality television -- shallow and short-lived.

I don't think Canadians have forgotten the damage done by the recessions of the early 1980s and 1990s. They set Canada's economic and social progress back, not just for the periods that were officially defined as recession, but for many subsequent years.

The ugly result is that for the last decade and a half our living standard has declined relative to the U.S. And, even more discouraging, it has also declined relative to an increasing number of other countries, countries that have traditionally trailed us -- like Denmark and Norway.

Let's take a look at the facts.

Real disposable income per person -- that is, what remains after we pay income tax, and contribute to the Canada Pension Plan and Employment Insurance -- began and ended the decade at precisely the same level.

By this comprehensive measure, over the last decade of the century, Canadians saw absolutely **no** improvement in their standard of living. **None.**

You might logically conclude that we maintained the status quo. But the trap of statistics, and particularly averages, is that they can hide unpleasant truths. The fact is that the income distribution gap widened during the 1990s. What is particularly discouraging is that the standard of living for many of our lower-income groups actually dropped.

The most favourable measure of what our dollar buys here versus what their dollar purchases in the U.S. tells us we had 86 per cent of an American's standard of living in 1984. In 1999 we had 78 per cent.

While we've had our eye on the U.S. economy ahead of us in the left lane, we've paid little attention to the fact that a number of other economies have zoomed by us in the right lane.

In 1990, Canada had the fourth highest standard of living within the OECD economies. By 1999 we had sunk to seventh as Japan, Norway and Denmark overtook us.

In the last 15 years, while our real income per capita plummeted from 86 to 78 per cent of the US standard of living, Ireland soared from 47 to 76 per cent.

A country that was among the poorest in Europe 15 years ago now almost matches our living standard.

In fact, looking at the 28 countries the International Monetary Fund classifies as “advanced”, Canada had the fourth worst cumulative growth rate over the past 15 years.

These statistics are troubling, and I relay them to you not to depress you or to castigate governments or anyone else. I relay them to set a context for the plan I would like to see us adopt as a country.

That plan would set us at least one ambitious goal that would return Canada to what I believe is its reasonable place, as a growth leader in the world economy. This isn't about “What's good for TD is good for Canada.” Rather it's about “What's good for Canada is good for all of us, hopefully including TD”

It will help us achieve our social objectives by strengthening the fundamentals of our economy. It will make us more competitive commercially as well as financially. It will increase the economic pie so that there is more to share with those at the lower end of the income scale. It will give us the resources to tackle and resolve our social issues without putting future generations into hock.

I am suggesting that our goal should be to increase our standard of living so that in 15 years it is **not just equal** to the United States, it is **better**.

Now before you start thinking that the air must be getting thin in the TD Centre, let me acknowledge that this is a very ambitious goal.

Can the mouse outrun the elephant? If Luxembourg, with a very much smaller population than ours, can do it, I have no doubt that we have the capacity to do so.

We are known as a modest nation and we have tended to have modest ambitions, but we are not, to paraphrase Churchill, a modest country with much to be modest about. We have many advantages over our smaller rivals, not least that we are much richer in resources, and we are ideally located to serve the US market.

I believe that if we set our minds to it, if we put some passion behind it, we absolutely **can** challenge the elephant's growth.

But what do we have to do to achieve that goal?

On average, we have to have 1.6 percentage points faster growth than the United States, every year, for 15 years. If the U.S. economy were to grow on average 3.4 per cent per year, we would have to grow 5 per cent.

Impossible? No. We have some very solid strengths that bode well for the future.

Our first strength is that we have now enjoyed almost a decade of low inflation. This has kept a lid on borrowing costs for households and corporations. And it is giving the Bank of Canada the flexibility to address potential economic weakness by lowering interest rates.

In addition, to their credit, governments at both the federal and provincial levels have turned chronic deficits into surpluses. Debt burdens, although still high, are coming down sharply.

Our second strength is that most jurisdictions have started tax relief plans that are lowering personal and corporate income taxes.

This relief will sharpen the incentives to Canadians, to work, save and invest and put Canada in a much more favourable competitive position vis-à-vis the U.S. and other economies.

Our third strength is that our economy has been diversifying successfully into the so-called "new economy" industries.

This new economy sector accounts for eight per cent of Canada's output. Over the past four years, it has contributed between one-quarter and one-third of Canada's overall economic growth each year.

The technology that inspired the "new economy" has spread throughout the entire economy. We have seen our more traditional sectors, such as mining and logging, become leading edge in their use of technology. And some of the most remarkable technological innovation is taking place in the oil field. It cost \$25 US a barrel to produce synthetic oil 10 years ago. Today it costs about half that.

Banks, too, have become part of the new economy through innovative financing to wireless and web-based companies. We have also embraced the Internet as a delivery channel for retail banking and discount brokerage.

Our fourth strength is that Canada has begun to enjoy the benefits of globalization. Canadian industry used to be a target for foreign takeovers. Now there is more Canadian acquisition of foreign companies than foreign acquisition of Canadian companies. Look at Nortel, JDS Uniphase, and some of our banks, TD included.

In 1999 Canadian direct investment abroad was more than \$257 billion compared with foreign direct investment in Canada of \$240 billion.

Significantly, these companies are investing in the fast growing new economy sector. And their investments are split evenly between the United States and the rest of the world.

We are also exporting around the world. Exports account for 42 per cent of Canada's GDP today versus 24 per cent in 1990. You may be surprised to learn that Canadian banks are major exporters, generating 49 per cent of their earnings outside Canada.

By expanding markets globally, our domestic companies can benefit from economies of scale that lead to more profits for reinvestment, more cost-effective investment in technology, more jobs, and more taxes and income generated in Canada.

That's the positive side of the ledger. We have already taken many of the steps required to exceed the United States' standard of living, but there is much left to do.

The plan I suggest involves four economic levers: debt, taxes, education, and globalization.

Let us start with government sector debt.

At its peak, the federal debt-to-GDP ratio was 71 per cent in fiscal 1996 . As of last March it had dropped to just below 59 per cent. A significant achievement -- but hold your applause. All we have done is rewind the clock to where we were in the late-1980s. We still have one of the highest debt burdens of the developed countries.

For every tax dollar you submit this year, 24 cents will go to pay interest on our debt. That money is paying for past consumption. It is not available to invest in strategies to achieve accelerated growth. There is no acceptable middle ground here. The debt burden simply must continue to come down, and at a faster pace.

I don't believe that has to happen at the expense of providing some form of personal tax relief. While it would be naïve to think that lowering the Canadian tax burden would cure all that ails our economy, the tax system is an important lever for the economy. It can provide the proper incentives for business growth and make us competitive with other countries.

Again, to their credit, our federal and provincial governments have been cutting personal income taxes recently. But in a few years, when the promised cuts have been fully implemented, Canada's personal income tax burden will still be the highest in the G7 group of countries.

For some taxpayers, the marginal rate can reach over 70 per cent when you factor in the benefits they lose as income rises. This clearly dulls the incentive to work, to save, to invest. In some cases it is enough of an incentive to leave the country.

The top marginal tax rate in Canada, which starts at about the lowest income level of any developed country, is still almost 50 per cent on average. Meanwhile, south of the border, the Bush administration plans to cut income taxes and widen the gap even further.

The promised federal cuts to the corporate income tax rate and the recent commitments from Ontario and Alberta, will give many Canadian corporations income tax rates that are quite competitive with the United States.

Much could be gained by going further and creating a distinctive advantage in this tax area. As Ireland discovered, this led to the creation of large sectors in their domestic economy – sectors that barely existed before, such as electronics manufacturing, software development and financial institutions. Why not make it more attractive to locate in Canada than in the US?

Complaining about personal and corporate taxes has almost become a cottage industry, but we often overlook the treatment of capital in Canada. Capital is a primary engine of growth in today's technology-charged economies. It certainly has been the key behind the tremendous U.S. expansion in productivity and output in recent years. But capital today is more mobile than ever.

In all but one province, corporations pay capital taxes that are almost four times the burden U.S. companies face. If we are serious about supporting growth in output, jobs and income, we have to eliminate capital taxes.

While I am advocating lower personal and capital taxes I am not in the camp of those who would decimate government spending. The debate that says government spending is either all good or all bad is too simplistic.

I believe that there are areas where governments should be allocating funds. Education and public infrastructure are examples.

At precisely the time when the "knowledge-based" economy is crying out for better educated workers -- people who can think and solve problems -- we have seen a shocking decline in education spending.

In the US, government spending on public universities in the last two decades increased 20 per cent per student. In Canada spending decreased 30 per cent.

This ill-advised thrift on our part has led to a shortfall in the billions of dollars for campus infrastructure. We have 11 per cent fewer faculty members today than in 1992. And one-half of those are scheduled to retire within the next 10 years.

Not only are we letting our brains drain to the south, we are not even producing as many highly educated brains in relation to our population as we did 10 years ago. In Ontario we have no more Ph.D. students in universities now than we did in 1991 when Ontario had a million fewer people and the economy was far less dependent on skills and knowledge.

The best and the brightest people in our country are our intellectual pioneers. They are the ones who make discoveries, develop theories, create new companies and strengthen existing companies. These initiatives generate jobs and taxable income for a broad array of people. This, in turn, strengthens the safety net for all Canadians.

The health of our universities is critical to the health of our economy. Universities don't just incubate new academic theories. They fuel research that leads to the development of industrial clusters around the campus. These clusters in turn feed new knowledge, new questions, and new experience back into the universities. It is no coincidence that the United States is the world leader in patents.

We are beginning to tackle the huge imbalance between investment in the Canadian and American education systems. Three years ago, the federal government created the Canada Foundation for Innovation to invest public money in infrastructure in universities, colleges and research hospitals. In many cases, it is leveraging private and corporate matching funds.

Last year, the federal government also created 2,000 new research chairs at Canadian universities. It launched 13 new institutes of health and is building five centres for genomic research.

And the Province of Ontario took a good first step when it announced last year that it would invest more than \$1.4 billion to fund 35 new post secondary capital projects.

We are on the right track, but we need to do more. Education is not just good economic policy. It is also the best social policy. The best way of creating the opportunity for a rewarding life is to give our young people a good education and to create opportunities for existing workers to constantly upgrade their skills.

But if Canada is to achieve the increased standard of living I have proposed, we have to take even more aggressive action, and very soon.

It takes 18 years to prepare a new generation for a new kind of economy. That takes a child from birth to high school graduation. It takes another 10 years to transform that same child into a doctor, a physicist, or a scientist.

How many more years will expire before that doctor — or physicist, or micro biologist, or mathematician — will find the path to a Nobel Prize, a cure for Alzheimer's, a new mathematical concept that will do for the 2040s what the Internet did for the 1990s?

Last Thursday, TD announced a new initiative that we hope will encourage nurses and doctors to stay and do their research here in Canada. The TD Grants in Medical Excellence will fund post-doctoral research and allow practicing nurses and physicians to apply for grants to further their education.

To reach our standard of living goal we will have to spend heavily on people, not just new academic offices, classrooms and lecture halls.

As, Derek Bok, former President of Harvard said: "If you think education is expensive, try ignorance."

Investment in post-secondary education pays back a significant return in the vital research and development capabilities that universities attract around them.

For a developed nation Canada has dismal performance on the research and development front. We are only 15th among OECD countries in expenditure on research and development. Finance Minister Paul Martin has set a target of being among the top five. He has committed to doubling federal expenditures on R& D.

But the private sector, including my own industry and company, needs to be part of the solution as well. We too need to foster more innovation to fuel the growth we need to meet our standard of living objective.

The banking sector has already adapted quite rapidly to the "new economy". It was a logical and relatively easy step for us to use the Internet as a distribution channel for retail banking and brokerage. But lending on the basis of intellectual capital is more challenging. We are comfortable assessing credit risk when there is tangible collateral, but it is more difficult to determine the value of intellectual collateral in a dot.com start-up.

That's why, this past year, TD created TD iCapital. It is a US\$100 million venture capital fund to nurture and support fledgling high tech firms.

As we look at achieving our standard of living goal we have to acknowledge that we limit ourselves if we only have our sights set on domestic markets. Despite the progress we have made in exports, we are still a very long way from maximizing our potential.

There are huge economic benefits to Canadians in getting this situation right. These include more jobs and increased profits for reinvestment, and the national pride we would have in keeping our head offices Canadian and having national champions rather than letting them be swallowed up and transferred to other countries.

To be successful and significant international players, companies have to achieve a certain scale. In many private sector groups, including banking, we as a country have not yet come to terms with how best to grow to take advantage of business opportunities in markets outside the country. This is one area where the private and public sectors could work together.

I began by telling you that we need a new plan for Canada. And I suggested an ambitious goal of overtaking the U.S. standard of living within 15 years.

To meet this goal, we will have to boldly change what we do and how we do it. If you are always late to work, you won't be on time by catching the same bus. Government, academia, labour and business will have to work closely together to agree upon goals, and the means to achieving those goals.

Fundamental change goes a little against our Canadian nature. Dr. Clotaire Rapaille, a French-born medical anthropologist, has studied Canadians intensively. He has concluded that Canadians are driven by an innate sense of preservation.

A Montreal commentator concurred when he described a Canadian revolution as "a populist revolt in favour of the status quo."

By spending our energy trying to protect and preserve the status quo, we can only fall behind, and indeed, as I have pointed out, we already **have** fallen behind.

I have suggested that continuing to drive our debt down, lowering taxes, investing intelligently in education and turning our sights to the opportunities that globalization affords us will increase our chance of resuming our place as a leader on the world stage. We can only accomplish that if our various constituencies agree upon the goal and work together to achieve it.

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Robertson Davies wrote that "Canada is not a country you love, it's a country you worry about." Personally, I believe there is a lot to love about Canada and I think it's time we stopped worrying and started acting.

Thank you.