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Text of an Address by the Honourable E.J. Benson,
Minister of Finance, to a luncheon meeting of
The Canadian Club of Toronto at the Royal York Hotel,
Toronto, January 6, 1969

I appreciate the honour of being invited to speak to you at your first meeting in the New Year, as you have invited my predecessors who came from Toronto. They have taken this opportunity to discuss with you the state of our affairs, to look back upon the progress and the problems of the past and to look forward to the new tasks which lie ahead.

As I take on this pleasant duty for the first time, I am very much aware of the extent of the progress which has been made towards the achievement of our ambitious goals for economic growth and prosperity. This is true not only of the past year but for the past decade, and not only for Canada but also for much of the world economy. Nearly eight years have passed since the record-breaking expansion began in Canada and the United States. A vast increase in the standard of living has been achieved, and the spectre of recession has faded into an insubstantial ghost. During these years, much has been done to transform our cities and adapt them to the new and central functions they must play in our national life; close to where we meet today the largest single urban redevelopment in North America will take place. We can observe a new maturity in the industrial structure of our country and in the patterns of our trade. In our cultural life as well, new dimensions are being added; not only in the vast expansion of our universities, but also in the distinction of Canadians in the performing arts.

But I also find much anxiety in the air, in Canada as well as in the rest of the world. I do not think I exaggerate this, even if anxiety is an occupational disease of Ministers of Finance. Some of it seems ill-founded, and an unwelcome product of the revolutionary advance of communications. We are bombarded by "the news", and what is newsworthy seems all too often to be news of death or destruction. But much of today's anxiety is more soundly rooted in an awareness of problems crying out for solution. As old problems are solved, this very success creates new problems and brings old ones into sharper focus.

The technological revolution on which so much of our economic progress has been based has created a more complicated world. Moreover, our expectations have fed upon our achievements. We are no longer prepared to accept impoverishment in any of its many forms, as our forefathers accepted it. Underlying problems which have been dormant for generations come to life and are felt with a sharp concern, now that we grasp the possibility of solving them.

But let us not lose perspective. We see new problems because we stand on the shoulders of problems which have been solved. These new problems are not insoluble, but they are not all of equal urgency and they cannot all be solved at once.

1968 was a good year for the Canadian economy. The expansion continued without significant interruption. The demand for Canadian goods and services has been firm, our exports increased substantially, especially to the United States, housing activity reached new record levels, and personal consumption continued to rise as personal incomes expanded. The growing volume of Canadian production seems to be calling forth a rising level of capital investment, especially in manufacturing, after some decline in such expenditures. While unemployment has been higher than we would like, it can now be seen more clearly as a reflection of the rapid growth of the labour force rather than as a result of a slow rate of job creation.

At the time of my October 22 Budget, I fully expected that sources of demand strength in the economy in 1969 would be sufficient to allow for another year of substantial economic growth. In looking ahead, it seemed clear that demand for housing would continue strong and that housing activity would likely exceed even this year's exceptionally high level. We expected businessmen to increase substantially the amount of investment in new plant and equipment following

two years of relative stability. While the rate of spending by governments would hopefully decline from the very sharp increases in preceding years, the rate of increase would still prove an expansive force in the economy. Job opportunities would continue to expand, and consumers, bolstered by increasing incomes, were expected to continue to improve their living standards. Even the export picture would seem to be moderately expansive despite the expected slowing down in the United States. In sum, the forces of demand were seen last October to be sufficient to enable us to grow at a rate roughly commensurate with our underlying capacity to grow.

Since that time, all of the evidence has confirmed our view of the Canadian economy for 1969. Moreover, evidence from the United States suggests that the restrictive measures adopted by the U.S. Government in the middle of last year have been slow to act. Economic activity has continued to expand in the United States at a rate faster than anticipated and this, of course, has implication for us in Canada.

Possibly the fact that the tax surcharge in the United States was enacted as a temporary measure limited and delayed its effect on expenditures. Financial conditions in the months immediately following its Congressional approval were relatively favourable to those who wished to borrow and thereby carry out their spending plans. Whatever the explanation, we may infer that under the circumstances prevailing fiscal policy acts with some delay and with force which cannot be measured with precision. It needs to be used as early as possible and in conjunction with monetary policy to achieve the best results.

The most unwelcome feature of the economy's performance during 1968 was the persistent upward movement of prices and costs at a rate much in excess of anything we can regard as tolerable. I singled this out in my Budget of October 22, and I repeat my concern about inflation to you now.

I do not have to repeat to you all of the familiar arguments about the undesirable consequences of inflation. It is socially unjust to the weak and to the old. It is economically disruptive if it persists. It impairs our international competitive position. What is particularly troublesome at the present time is the apparently widespread and growing expectation that inflation will persist.

The most obvious consequences of this expectation are to be found in the securities markets. No other explanation can be found for the contrast between the hunger for common stocks and the marked lack of enthusiasm for bonds, despite their far more attractive yields. This situation is highly unfavourable for those who have to depend on the use of bonds or mortgages for their financing, and for those who have invested in bonds or mortgages in the past. But even those who are less directly affected must surely ask themselves whether this situation is anything but most unhealthy. The demand for stocks has overwhelmed the Canadian supply and overflowed into purchases of equities from other countries at a time when Canada remains a net importer of capital and when Canadian projects of high economic and social priority are increasingly difficult to finance. A healthy bond market in Canada is essential to the achievement of our national objectives. It is also essential if the volume of foreign borrowing by Canadians is to adapt itself to our changing needs.

As Minister of Finance, I feel a particular concern about the state of the long term bond market in Canada and the inflationary expectations in which it is rooted. I share this concern with my Provincial colleagues. While we do not always see eye-to-eye on such questions as the ideal division of the tax fields, we are on common ground in desiring a healthy market for our bonds. We will not overcome our financial difficulties until inflation is checked and the expectations of inflation broken.

You are familiar with the measures which have been taken by the Government of Canada to this end. The measures of restraint contained in the Budget were not welcome, but they were regarded as necessary. Balancing the Budget in the coming fiscal year is an essential part of our anti-inflationary policy. The policies being followed by the Bank of Canada are motivated by the same objective. The Government has recently announced the creation of a Prices and Incomes Commission whose job in part will be to involve the general public, through education and persuasion, in the process of achieving price stability. We do not know as much as we would like to know about the achievement of price stability in a recession-proof world. This is a new problem. The uptrend of prices did not flatten out as much in the relatively less heated economy of 1968 as had been hoped. We

do know, however, that an answer to inflation must be found, and that it will require restraint and a sense of realism from all Canadians.

We should not look at our own problems in isolation but against the background of their international setting. Our problems are not unique, except perhaps that they are less difficult than those confronting other countries. This gives us no excuse for failing to solve them, nor of under-rating our own good fortune and the progress we have achieved. It does leave us with a responsibility to help in the search for solutions to international problems. These were only too evident in 1968.

Sustained growth has been apparent during the last few years, in the world as a whole, especially among the group of highly developed industrial countries. The growth in international trade has been more rapid than the growth in production; the barriers to trade have been progressively reduced. Since 1959, the value of world trade has doubled. This extraordinary expansion started from already high levels which had been reached by the expansion of trade in the 1950's. Real success has been reached in the achievement of the trade objectives which the world set for itself at the end of the war. This is in the sharpest possible contrast with the unhappy experiences of the period between the wars. It has brought about a very much larger degree of economic interdependence among countries, and has gone hand in hand with the growth of international co-operation and consultation.

Present attitudes towards the international payments situation cannot, however, be described as euphoric. What has been gained is largely taken for granted, and new problems occupy the centre of our radar screens. Questions have arisen about the adequacy of the growth of international reserves. While the growth in trade and payments has been rapid, it has not been wholly balanced. Some of the largest trading countries have had persistent difficulties in keeping their balance of payments in line. The United States, the United Kingdom and, most recently, France have been in deficit, while Germany and Italy have had large surpluses.

These deficits and surpluses have given rise to a series of major crises in the past year or so, as massive speculative movements of short term funds have taken place in anticipation of changes in exchange rates. In November 1967, sterling was devalued at the crest of such an assault when it became apparent that the protracted efforts

by the United Kingdom to achieve a viable balance of payments at the old parity had not succeeded. While a considerable measure of success was achieved in limiting the number of other currencies which were devalued in line with sterling, there has been a much greater tendency since that time to question the stability and security of the major currencies.

Early in 1968 there was a run on the Canadian dollar. This in itself was an early manifestation of the increased nervousness in the exchange markets which was to characterize 1968; we can now see in retrospect how basically strong the Canadian balance of payments was during this period, and how slim was any objective reason for a devaluation of the Canadian dollar. In the event, the crisis was quickly overcome by appropriate fiscal and monetary action, international support, and the elimination of uncertainties about the effects on Canada of the U.S. balance of payments programme.

Hard on the heels of the Canadian crisis came the gold crisis. Here the speculators had some success, since it led to the separation of the private and official markets for gold, and the price in the free market has been somewhat above the official price of \$35.00 an ounce. However, the official price of gold and thus the gold parity of the U.S. dollar has been preserved, and price of gold in the private markets has risen less and has been less volatile than had been expected.

In the early summer, the French franc came under pressure as the result of the domestic troubles of May and June. France's reserves were severely depleted in the months that followed, and it became apparent that not even the large accumulations of the past could, by themselves, protect the currency. Meanwhile, attention began to focus upon the remarkable strength of Germany's balance of trade. These trends collided in the crisis of November. This massive outbreak of speculative activity mainly took the form of a flight out of francs and into marks, but sterling was also affected adversely. The crisis was successfully overcome by the clear demonstration by all the countries concerned that they had no intention of changing their exchange rates and by their taking additional measures to remedy their underlying payments imbalances. These measures included the adjustment of border taxes by Germany and France, and the U.K. import deposit scheme. Variations in border taxes have become increasingly frequent

recently and are attracting a good deal of international attention and controversy.

To a most welcome extent, the U.S. dollar was unaffected during this confrontation between European currencies. This undoubtedly reflected the progress which had been achieved in eliminating the payments deficit of the United States. Meanwhile, the exchange position of the Canadian dollar remained strong as a result of our continued good showing on trade and of our continued access to international sources of capital. I would like to refer in this connection to the recent exchange of letters between myself and Mr. Fowler which removed the undue appearance of rigidity in our understanding with the United States regarding our reserves. Mr. Fowler has recently retired as Secretary of the Treasury of the United States. Under his distinguished leadership, the United States Treasury has been very much aware of the special nature of the relationship between Canada and the United States in the balance of payments field, and the co-operation between our two Governments has been most effective.

Our experience in dealing with the several monetary crises of 1968 leaves us with much to think about for the future. Countries seem to be experiencing greater difficulty than expected in maintaining their balance of payments in order without recourse to policy measures which would undermine their own prosperity or the prosperity of others. In part, this may reflect the fact that the absolute size of deficits and surpluses has grown as the volume of trade itself has expanded. Moreover, the United States is no longer in a position to continue running the deficits which have made the task of adjustment easier for other countries in the past. Of particular concern is the fact that major economies have reacted more slowly than was expected to major changes in policy. The United States provided one example, and another was the United Kingdom where successive measures of restraint, culminating in the devaluation and the subsequent highly restrictive budget of March 1968 did not have the predicted effects on consumption and imports. These experiences suggest that action must be taken earlier and with even greater resolution to maintain our economies on an even keel.

Under the pressure of these circumstances, we have seen some drift back towards restrictions on international capital movements

and new barriers to trade. The flow of aid has also been restricted. Those who designed our present international monetary system at Bretton Woods in 1944 accepted capital restrictions as a tolerable device for the maintenance of payments equilibrium. They tried to prevent, however, massive unemployment, exchange rate instability and restrictions on trade and other current payments -- the three scourges of the inter-war period. They recognized the possibility that countries could encounter difficulties too great to overcome by the use of the normal policy instruments. Therefore, they established procedures in the I.M.F. for approving restrictions on current payments and changes in exchange rates when such action was necessary to correct a fundamental disequilibrium. But these procedures are not easy to apply. The sort of trade restrictions that have recently emerged, namely border tax adjustments, import surcharges and import deposits, do not fall clearly within the established framework of international practice. Exchange rate adjustments are proving very difficult to bring about in an orderly way. They are resisted by governments and become the object of speculative anticipation which, as we have seen, can be extremely disruptive. For these reasons, questions are being raised about the basic rules of the international monetary system, despite the enormous progress which they have helped to bring about.

Since the early 1940's Canada has always taken an active interest in international monetary reform. The tradition of active and constructive Canadian participation in these matters was established even before Bretton Woods. It was maintained in all the discussions and negotiations which resulted in the new scheme for Special Drawing Rights in the Fund, which we strongly support and hope will soon be in active operation. This scheme provides for the deliberate creation of international reserves in response to the needs of the international payments system. We have also been active participants in, the growth of the more traditional I.M.F. operations and in the newer kinds of international credit arrangements such as central bank swaps. Without these, our record of success in weathering the speculative storms would not have been as good. We have also given our support to the two-tier gold system; since March, all newly mined gold in Canada has been sold in the private markets, and we have bought no gold from the private market to add to our reserves.

We will want to look very carefully, however, at some of the proposals now being put forward for new kinds of institutional change, particularly those relating to exchange rate arrangements. I see no merit in the proposal that a special international monetary conference should be convened to consider such proposals. The channels for international consultation in the field of trade, payments and international monetary affairs are already effective. They include the International Monetary Fund, the OECD and the Group of Ten. A new kind of conference would only have one result which can be predicted with complete confidence -- a further large increase in speculative activity which would persist as long as the conference lasts.

What is really important, if any system is to be made to work with efficiency, is that countries should keep their own economies on a sound footing. In all of the recent crises, the speculation that occurred had some basis in doubts about the ability of countries to do so. No change in the direction of greater flexibility of exchange rates can possibly serve as a substitute for the determined and concerted efforts of countries to maintain internal and external equilibrium. The only changes in the present international monetary system that can be of lasting benefit are those which can supplement these efforts and make them more effective. In particular, I cannot conceive of any payments system accommodating itself successfully to persistent inflation which will undoubtedly proceed faster in some countries than in others. I have spoken earlier of the dangers of inflation within Canada, and I now speak of them in a wider international context. Some European countries, particularly Germany, have had strong payments positions in recent years because they have been successful in keeping their prices stable. It is sometimes suggested that they should be prepared to inflate their economies in order to reduce their balance of payments surpluses. In my view, a healthier solution would be for the rate of inflation in other countries to be reduced. Such a solution would enhance the benefits for the world as a whole of a high rate of saving channelled through stable financial markets, such as those which the surplus countries have been able to develop.

Because of the expansion and liberalization of international trade and capital flows, we are more interdependent now. The responsibilities of all of us are greater to keep our balance of payments in good order within a framework of stable economic growth and unrestricted

trade. But the game is surely worth the candle. All can suffer when others get out of line. This is recognized in the growth of international consultation in economic matters. This process of consultation in the Fund, in the OECD and in other organizations, confers very important benefits on such countries as Canada which is so greatly affected by economic conditions in other countries. It assists us in the formulation of our own policies and it gives us an opportunity to influence the policies of others. This interchange must be preserved and enhanced, not reduced, by any changes in the exchange rate system.

I do not think it is fully recognized how much improvement has already been made in the process of international adjustment. This is most evident in the movements of long-term capital. There has been a remarkable improvement in the capital account of the United States which wiped out its payments deficit in the third quarter, despite the low level of the trade surplus. This was, in part, the result of the U.S. programme of controls over direct investment and other capital outflows, and in part of the increase in U.S. interest rates relative to those in the surplus countries of Europe. In addition, there were very substantial purchases of U.S. equities by foreigners, amounting to \$1.2 billion in the first three quarters of 1968.

Germany on the other hand has emerged in a short time as an exporter of capital on a very substantial scale. European capital markets absorbed over \$4 billion of international bond issues in 1968, about twice as much as in 1967. Canadian borrowers have benefitted from these new opportunities to the extent of over half a billion dollars in 1968, and have thereby made an important contribution to a more appropriate international flow of long-term funds.

While it has proved more difficult to secure improvements in the balances of trade of the major industrial countries, they now seem to be moving in the right direction. The U.S. trade position now seems to be improving. In the United Kingdom, the trade deficit was decisively reduced in the second half of 1968 and a substantial surplus is in prospect for 1969.

The process of adjustment is difficult, inescapably difficult, but it is not an impossible task for governments which have both the

will and the strength to persist with their efforts to restore equilibrium. It will be more feasible if some perspective is maintained, recognizing how much has been achieved and how much can be lost if patience and persistence do not endure.