On the other hand, at the present time the deficit is largely caused by an economy that is operating grievously below capacity. It is also suffering from the fact that we index our tax receipts so that personal taxpayers do not suffer from inflation. At the same time, we index almost all other payments so that they reflect the effect of inflation. That exacerbates the deficit situation.

● (2130)

Under the six-and-five legislation, it is my understanding that we propose to index the personal tax to a maximum of 6 per cent in 1983 and 5 per cent in 1984. The basis of the deficit, however, is fairly clearly a combination of an economy operating below capacity and the fact that we have indexed our personal tax and suffer from inflation on the expenditure side. In that position, the question you ask yourself is: How important is the deficit to the workings of monetary policy and its effect upon inflation rates?

It is certainly true that a large deficit makes it harder for a monetary policy to be effective. This is because the demand for money from the federal government creates higher interest rates, and, therefore, the policy takes longer to operate. The important aspect of the deficit, however, is whether or not it is monetized. Presently, and over the last reasonable mid-term, our deficit has not been monetized by the central bank. In other words, the fact that we have been running large deficits has not created an increase in the money supply. That situation could change. Obviously it would change if this deficit continues to be large and if spending continues to increase at rates that equal those of, for example, the past 10 years. At that stage it will be impossible for the central bank not to monetize the deficit. At the present time, however, that is not taking place.

The question we must ask ourselves is: Are we seeing a change in central bank policy in that regard? We must ask ourselves that question because the direction of the central bank at this point is crucial. What we have as evidence of the central bank policy is the speech given by the Governor of the Bank of Canada before the Canadian Club in Toronto on November 29. He again spoke out against inflation. He is clearly concerned about the problems of international liquidity and what various countries in the world will do to accommodate those countries which have taken on a great amount of debt. He articulates concern about the level of interest rates in relation to the domestic debt that was undertaken in inflationary times on the grounds that inflation would take us out of the problem of debt. He has abandoned the target for M-1.

That worries me a great deal. It is true that, because of changes in our banking system and the way in which we deal with bank balances, it is difficult to maintain a target for M-1, but it is not difficult to maintain a target for the monetary base. There is a fair amount of empirical evidence to indicate that M-1 is influenced by the monetary base.

Honourable senators, you have to ask yourselves: Why has the Bank of Canada made this change? If it has decided that M-1 is not a reliable aggregate to follow, why did it not go to the monetary base, which is reliable and which can be reasonably controlled? The monetary base is made up of currency in circulation and bank reserves; it is highly controllable by the central bank. We have to ask ourselves why the bank is doing this.

Honourable senators, I do not believe that the central bank has given up on the fight against inflation. What I suggest might be happening, however, is that instead of being concerned with the level of the money supply—using whatever aggregate you want to determine where that supply is—the central bank has reverted to its previous policy of some 10 years ago of being concerned about the level of interest rates. In other words, the bank is going to set the interest rate and the money supply will be allowed to increase or decrease in order to sustain that rate.

A number of people might very well say that that is good, that it would be a step forward if we could have interest rates at a certain level. Well, we went through that period, and it is a retrograde step. Honourable senators, it is a very retrograde step, and it would be a grave mistake if that is what the Governor has in mind.

Having said that, I have no conclusions to draw. I have merely expressed my concern that we may have been watching, over the last two or three months—and we may have come to that fulcrum point in the speech given on November 29—a major change in central bank policy in this country. If it is the change that I suspect it is, then it is indeed a change for the worse.

Hon. Duff Roblin (Deputy Leader of the Opposition): Honourable senators, perhaps I might ask my honourable friend a question before another honourable senator speaks.

My question arises from the fact that, when I read the reports of the Governor's speech, as my honourable friend did, exactly the same question crossed my mind; namely, what is going to be the rule with respect to monetary restraint if we are abandoning M-1? I also concluded, as I believe my honourable friend did, that the Governor did not give any clear exposition of the policy. If a policy change has taken place, he did not explain what that change is.

My question is: Does my honourable friend think it would be useful if we could ask the Governor of the bank to do us the courtesy of appearing before the National Finance Committee to give us an opportunity to discuss this matter with him, and to give him an opportunity to produce any clarifications which he might think desirable with respect to his policy?

Senator Everett: Indeed, honourable senators, I do.

Senator Roblin: I take it from that, then, that the committee would extend an invitation to the Governor?

Senator Everett: Yes, we would do that.

On motion of Senator Doody, debate adjourned.