Chapter 1
THE INTERNATIONAL ECONOMIC ENVIRONMENT

Canada and the international economic environment

The economies of the member nations of the OECD have experienced five years of recovery since the 1981-82 recession. In 1986, the sharp drop of oil prices and continuing decreases in non-oil commodity prices contributed to significant further improvements in inflation performance, then at its lowest rate of increase in twenty years.

However, economic growth among OECD members declined somewhat for a second year in a row to a level of 2.5 per cent in 1986, the result of a sharp fall in the volume of exports, and despite some strengthening of domestic demand. Japan exhibited the sharpest decline in rate of growth, falling from 4.7 per cent in 1985 to the OECD average of 2.5 per cent in 1986. Canada's economy, while slowing from 4.0 per cent in 1985 to 3.1 per cent in 1986, nonetheless achieved the highest growth rate among the seven largest industrial nations.

Despite improvements in inflation performance and moderate economic growth, progress in reducing unemployment continued to be slow. While the growth rate in employment improved in both Canada and the United States to 2.9 per cent and 2.3 per cent respectively, reducing unemployment rates in these countries, job creation in Europe of less than 1 per cent was insufficient to offset labour market growth. Canada's strong job creation performance, the best among the seven major industrial nations in 1986, led to a reduction in our rate of unemployment for the third successive year, although it still remains high.

In May 1986 negotiations began in earnest on a comprehensive bilateral free trade agreement between the United States and Canada. Canada entered the negotiations seeking to expand and secure access to by far the most important market for Canadian goods and services in the world. The government is committed to the negotiation of an agreement that is fully consistent with its obligations under GATT (see also Chapter 4).

In September 1986 agreement was reached to launch a new round of multilateral trade negotiations, the Uruguay Round. The launch of a new round reflects recognition by the participating countries that the time has come to act in order to counter severe and growing protectionist pressures, to address urgently a deteriorating situation in world agricultural trade, and to strengthen the General Agreement on Tariffs and Trade (GATT) and provide for further trade liberalization.

The industrial economies have been weakened by unprecedented fiscal, trade and current account imbalances, particularly Japan and West Germany on the one hand and the United States on the other. These imbalances have had a dampening effect on world economic growth, disrupted exchange markets, and heightened pressures on legislators to enact protectionist policies, in the United States and elsewhere.

To address these problems, the leaders of the major countries have taken a number of concerted steps in the Economic Summit forum to foster global economic growth and to stimulate world trade. At the Tokyo Summit in May 1986, the finance ministers of the seven largest industrial nations (the G-7) were requested to work together to strengthen economic policy co-ordination. The creation of the G-7 was particularly significant for Canada — and for Italy — which now plays an enhanced role in international economic policy formulation. The G-7 has met on a number of occasions to review policies and economic performance including exchange rate levels. In February 1987, an agreement (known as the Louvre accord) was reached in the G-7 on a package of measures to stimulate domestic demand in the Japanese and West German economies and to reduce the United States fiscal deficit.

International financial and investment issues

As the international debt problem entered its fifth year a number of favourable developments eased the adjustment process for some of the major debtors. Most important of these was the continuing decline in interest rates. For non-oil producing countries, continued weakness in petroleum prices was also beneficial. The rate of economic expansion in industrialized countries, while less than ideal, was also better than had been expected. Although non-fuel commodity prices continued to decline in the first half of 1986, there was some turnaround in the second half of the year. Offsetting generally favourable macroeconomic developments, however, was the recognition that full normalization of debtor-creditor relations and a return to voluntary lending is for most indebted countries a long way off. The "Baker Plan", named for US Treasury Secretary James Baker who proposed it, called for sufficient new financing to permit the debtor countries to continue growing while adjusting. While the Plan remains the most promising approach to dealing with the debt problems of the major debtors, lack of confidence on the part of commercial banks in the capacity of debtor countries to service the increased debt which the Plan implies has tended to limit commercial bank lending to the level necessary to secure loans. Another serious problem is the lack of long term adjustment strategies in some debtor countries, where economic policies may have suffered