policy, rather than flowing from the balance of payments itself, is unlikely to permanently affect trade flows or achieve commercial policy objectives.

High real *interest rates* represent a major obstacle to new investment necessary to sustain long-term competitiveness. The weak pace of world economic activity over the past three years was attributable, in some measure, to the height of interest rates and the resulting economic slowdown placed strains on the international trading system and encouraged protectionist pressures. High interest rates are in part an offshoot of the existing non-accommodating monetary policies being pursued in most industrialized countries. Inflationary expectations and large budgetary deficits are other major causes. Canada generally continues to support the non-accommodating macro-economic policies being followed by most countries, while recognizing that the weak pace of economic activity engendered by such policies in the short-run is leading to increased pressures on the trading system. Adherence to this policy thrust, however, is not slavish, and takes account of changing circumstances and needs. In view of such risks we have supported attempts at further dialogue in both the GATT and the OECD Group on Positive Adjustment (with the latter being specifically charged to examine the interactions between the macro-economic environment and the trading system). It needs to be recognized, however, that over the medium to longer term, pressure on the trading system will be even greater if demand management policies are not sufficiently firm and consistent to bring about the permanent lowering of inflationary expectations necessary to sustained growth.

It will thus be crucial throughout the decade to restore stability to long-term financial markets to ensure that savings can be effectively channelled into productive investment. The recent downward trend in interest rates and active stock-market trading reflects a gradual return of investor confidence. It will be necessary to build on and maintain that confidence. In addition, a reduction in the federal deficit would ensure that government borrowing is not diverting funds from the capital market and placing renewed upward pressure on interest rates.

Canada's *fiscal regime* is a further fundamental factor determining international competitiveness. As with monetary policy, the basic thrust of the government's current fiscal policies is to control inflation by reducing government expenditures, either directly or through tax expenditures. Complementary to controlling government expenditures is the goal of maintaining a level of taxation (corporate and personal, direct and indirect) which does not place Canadian exporters at a competitive disadvantage.

Industrial democracies rely in large measure on taxes to finance the provision of public goods and services, to mould and shape the level and pattern of economic activity and to redistribute economic resources among various groups in society. In order to minimize any adverse consequence of the imposition of taxes, governments have come to rely on a number of criteria in designing their tax systems. These criteria, which have evolved over time and reflect social, political and economic influences, include the principles of equity, neutrality, simplicity and certainty. However, their application is far from precise. For example, there is no objective measure of equity and a balance must be struck among the criteria in circumstances where they conflict.