

also stimulate savings. Monetary policy is much more blunt and limited in scope than fiscal policy which can have a selective impact on all types of spending.

Moreover, the influence of monetary policy on the supply and demand of credit is not necessarily definitive. A reduction in the money supply can be fully or partially compensated by an increase in the velocity of circulation, which always occurs under tight money conditions. There is no doubt that the turnover of money has been rising rapidly with the recent emphasis on shorter term loans. High interest rates are intended to cut spending by increasing the cost of borrowing and reducing the demand for credit; but, especially in an economy characterized by monopolistic power, suppliers can simply shift the higher cost of money to consumers in the form of increased prices.

When this happens, as it does on a large scale today, unduly high interest rates feed inflation instead of combating it, in spite of Mr. Bouey's claim before the Standing Senate Committee on National Finance that "this proposition will not stand critical examination any better than the common-sense proposition that the world is flat because it looks flat." What the governor of the bank does not see is that, under tight money conditions, the higher prices generated by the rising cost of borrowing by suppliers can be maintained by the use of market power, and force consumers, if necessary, to reduce their over-all spending in real terms, thus producing a further depressed economy but with a higher price structure.

The governor of the bank went on to say to the members of the committee:

No proposition in economics is more certain than that a move of the bank to allow significantly higher rates of monetary expansion in an effort to lower short-term interest rates would increase the rate of inflation.

This proposition would be valid, of course, under conditions of demand-pull inflation; but I could refer to other circumstances in which it is definitely not valid. How is it, for instance, that the bank rate was reduced by about 33 per cent in mid-year 1980 without any visible effect on the consumer price index?

Nevertheless, there is a general consensus among economists that a tight money policy has a depressing effect on the economy and that it properly belongs in our arsenal of weapons with which to fight over-all excessive demand and demand-pull inflation. We should also expect, however, that monetary policy should be much less restrictive during recessions, and when the performance of the economy is below its potentialities, as it is today.

I would like to add, however, that even under conditions of demand-pull inflation, fiscal policy should be our main weapon because it can be more effective and more balanced than monetary policy, which has a particularly unfair impact on certain specific economic sectors such as housing, small business and durable consumer goods.

Extreme tight money can, of course, choke the economy. Applied within more or less tolerable limits, it has little effect on supply-push inflation, as we can see today. It is the wrong

tool to use under such conditions. It has no direct impact on the price of imports. It has no significant effect on the conservation of energy or on the administered price of oil. Its downward influence on the price of food is minimal. It certainly curtails residential construction, but by contributing to an increase in the price of new homes and the housing shortage, it makes shelter more expensive. If one looks at the consumer price index, broken down by goods and services, it becomes obvious that the sector of non-durable goods has been the most responsible for the rise in the total index, but there is not much that monetary policy can do in this area.

More generally, under conditions of supply-push inflation, demand management policies are ineffective. Tight money, like restrictive fiscal policy, cannot effectively curb this type of inflation. It can even worsen the situation. Indeed, when the economy operates below its potentialities, tight money can intensify supply-push inflation, or further depress the economy or, more likely, it can have both effects, thus contributing to more stagflation. I fully share the bank's concern about rapidly rising prices. I maintain, however, that the weapon it is using under present circumstances does more harm than good, as the experiment conducted during the last six years clearly shows.

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Monetary policy should, *in the long run*, provide an adequate money supply to satisfy the needs of the economy at moderate rates of interest compatible with a proper level of savings, and, *in the short term*, monetary policy should stimulate the economy when it is depressed and curb demand-pull inflation when the economy is overheated. In other words, monetary policy should be neutral in the long term and anti-cyclical in the short run.

Ultimately, of course—and Senator Everett referred to this yesterday—if we want our economy to reach its full potentialities without causing inflation, we will have to improve productivity and launch, at last, a general industrial strategy with specific goals by sectors. Canada, with its great dependence on external trade, cannot afford to stay behind in the so-called international technological race.

#### THE CANADIAN DOLLAR AND THE WORLD MONETARY JUNGLE

On reflection, I believe that the bank's conversion to monetarism has been more apparent than real, and that it has been less than candid with the Canadian people. The bank, in my view, cannot be convinced that tight money will lick supply-push inflation and the so-called inflation psychology. It is pursuing its current policy for another more compelling reason. In his presentation to the Standing Senate Committee on National Finance, Mr. Bouey made the following intriguing remarks:

With respect to Bank of Canada responsibility, looking over the current situation one could say, if one wanted, that it would be nice if events in the United States had evolved differently and the Americans were not now experiencing such high and volatile interest rates... However, saying what would be nice doesn't get you very