Deficit spending in Canada can have little direct influence upon the course of foreign demand for our products. It can do little to increase domestic consumption of things which we normally export. Again, because of the specialized character of the production for which Canada is suited and equipped, it is unusually difficult to meet a decline in foreign demand by creating domestic demand for new things which this country can produce at a reasonable cost. And the necessary shifts of man-power and equipment might be definitely wasteful if the fall in export demand turned out to have been only of short duration.

Agriculture presents a particularly intractable problem in this regard, for farmers have very low industrial mobility. When demand for their exports falls off, the process of putting them to the production of goods or services which will make up for part of the fall in real national income is, at best, a slow and expensive one. Unless the fall in external demand is judged to be of a permanent character, the most that can reasonably be expected is that the farmer be made as nearly as possible self-sufficient during the period of his disability. But this does little to restore his buying power or swell national income.

There are, therefore, greater limitations upon what compensatory deficit spending can do to offset fluctuations in the Canadian economy than there would be in the case of a more diversified and self-sustaining country. There are also greater dangers involved, as I shall now indicate.

An export economy is in the position of having very little influence over the level at which many of its most important prices are set. It should, therefore, do all it reasonably can to keep its costs flexible and to avoid introducing elements of rigidity through borrowings on fixed terms. Otherwise its competitive position in foreign markets may be adversely affected.

I have already indicated why I think compensatory spending is likely to have less influence upon the course of real national income in this country than it would in most others. When large government expenditures are being made and debts are mounting rapidly, there will presumably be relatively less to show for them in the way of an immediate expansion of activity, and the possibility of harmful reactions upon private confidence and spending will be relatively greater.

The apprehension which large government deficits may arouse in the minds of business men and investors, even if it happens to be initially ill-founded, is none the less real. If it is sufficiently strong it tends to bring about its own realization, and is accordingly a factor which warrants most careful consideration when deciding upon fiscal policy.

Another of the main arguments advanced by opponents of a compensatory deficit policy is that it may lead to inflation. In the case of a largely self-contained economy general inflation is unlikely to occur so long as appreciable reserves of productive capacity remain in idleness. In the case of Canada, however, one must also take account of the fact that, under present conditions, there are fairly definite limitations upon the range over which domestic production can compete with imports on a cost basis. At least part of the active spending power created by government deficits is likely to increase imports rather than give work to unemployed Canadian men or machines. If the increase in imports is not offset by increased exports (or by borrowing abroad) the external value of the Canadian dollar will tend to fall and Canadian prices will tend to rise. In other words the mere existence in Canada of large amounts of unused capacity does not in itself preclude an inflationary rise in prices.

Whatever the immediate and intended effects of deficit spending may be, vis-a-vis the price level, if the deficits are financed largely by banks the government does to some extent surrender its power to control future developments