

The second point that emerges is that over the twelve month period ended May 1966 nine of the countries, including the United States, had a smaller increase in the cost of living than did Canada. Canada on that table is shown as having a cost of living increase of 4 per cent. I want to say straight away that this is as of May. If you take the most recent figure, that 4 per cent becomes closer to 3 per cent. So, things have not been getting worse; they have been getting a little better, and there will not be as many countries having a smaller increase than Canada in the last 12 months if we take the 12 months ending in August rather than in May.

Obviously, by international standards, Canada has not had serious inflation over recent years. However, when it is remembered that Canada had substantial unemployment over some of those years—whereas many of the other countries did not—that the United States has had slightly lower price increases than Canada, and that in the last year or so prices have risen less in some other countries as well, it would seem that there are sufficient reasons for pursuing the matter somewhat further. I suppose one could summarize this by saying: Well, let us not get panicky, but let us look some more. First, however, I would like to outline why foreign price movements are important for Canada.

When the prices of our imports rise because of inflation in other countries, or because of a devaluation of the Canadian dollar—a point to be made straight away—it will affect our cost of living directly because some of the goods imported are consumer goods. It will almost certainly affect them after a certain period of time through their effect on Canadian costs, since some of the imported goods enter into Canadian production cost. The latter may be viewed as a form of “cost-push” inflation—“import-price-push” alongside the more familiar forms of “wage-push” and “profit-push” inflation. While one cannot say with certainty by how much Canada’s consumer price index will rise as a result, say, of a one per cent rise in import prices—this, frankly, is quite a controversial area—with everything else remaining the same, it does seem that the relationship between the two is significant; at least, it seems to be to me. This seems particularly to be the case in the relationship between United States prices and Canadian prices.

What this means then is that if Canada wishes to maintain a stable consumer price level when consumer prices in other countries are rising, it will actually have to pursue a policy of forcing domestic prices down so as to offset the effect on the price level of higher import prices.

Now, you might think that such a policy would be a sensible one. The trouble is that it would seem to lead to two important consequences, and consequences which the nation might not at all be prepared to tolerate. These consequences relate to its effect on employment, and on the balance of international payments and exchange rate.

There seems to be considerable evidence that because of numerous factors—such things as bottle necks, the nature of collective bargaining in wage determination, inadequate price competition in some sectors, and other rigidities—it is at present possible to obtain complete price stability only with considerable slack or unemployment in the economy. Therefore, a policy of actually trying to drive domestic prices down to completely offset the effect of rising import prices might well lead to intolerably high unemployment.

As I have already implied it would also lead to certain exchange rate and balance of payments consequences. In the short-run the “tight money” policy that it implies would cause a capital inflow, and, with a fixed exchange rate, would require an accumulation of exchange reserves; while after a period, when Canadian prices had fallen well below those of other countries, it would lead to a need to accumulate reserves or export capital because of exports exceeding imports.