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CANADA AND CAPITAL

An Address by the Honourable Mitchell Sharp,
Minister of Finance, to the Economic Club,
New York, November 14, 1967.

...The Canadian economy has enjoyed a long period of expansion since the low point it reached in 1960. We have seen a vast increase in our production, in our employment, in our trade, in our incomes, our savings and our capital investments. We weathered quite successfully a short but very sharp exchange crisis in 1962 that was the culmination of a readjustment -- a necessary readjustment -- in the valuation of our currency relative to others.

This period of expansion reached the stage of a boom in late 1965 and 1966 which was curbed with some success by monetary and fiscal policy. In retrospect one can say we should perhaps have moderated our expansion somewhat earlier, but the measures of restraint we took were sensible and salutary and were recognized as such, I believe, here in New York.

In the past 12 months, the rate of expansion in our economy has been much more moderate; the boom has given way to a more sustainable rate of growth. This moderation in the expansion was welcomed and indeed, it was the objective of official policy. Our budget of last June 1 was intended to permit a rate of expansion that we could expect to sustain without excess either in the direction of inflation or of unemployment.

However, the momentum in the increase of costs and prices has persisted, notwithstanding the lesser momentum in production and demand. Wages and prices have been rising at too rapid a rate. Earlier this year I had hoped that the moderation in our rate of expansion of aggregate demand, and of production, would lead to a significant moderation in the rate of increases in prices and costs. This has not yet taken place to any substantial extent.

The price inflation and the cost inflation are harming Canadians in several ways. Their effects are inequitable, giving gains to the economically strong and injuring the economically weak. They are eroding the competitive position of Canadian industry in competition with producers and traders in the United States and elsewhere. They are producing "feedback" effects through their influence on the demands which labour is making for wage settlements substantially larger than the increases in productivity that are going on. And finally, they have led to a belief on the part of investors that prices will continue to rise and that the purchase of long-term bonds and mortgages exposes one to a risk of continued erosion of the real value of his investment which must be offset by current rates of interest far higher than what we have known before.

I am sure that this sounds familiar to many of you, and that your own experience in the past 18 months has illustrated the dangers of an inflationary psychology taking hold both of the labour and capital markets.

Confronted with this situation, the Canadian Government has reached the conclusion that more restraint through fiscal policy is now required. I therefore announced on Friday last that the Government had decided to introduce new fiscal measures later this month, including temporary tax increases. These tax measures will be part of an integrated programme to check the inflation of prices and costs now occurring in Canada.

Another aspect of our fiscal and economic problem in Canada has been the rate of increase of government spending. This has reflected the growth and development of our economy, the increasing role of the state in modern life, particularly in education, and also a zeal for social reform that has been widespread in Canadian society and which I share. This expenditure has been for purposes that are sensible and worthy. The rate of increase, however, has been substantial and has resulted in public expenditures taking a larger proportion of our gross national product. Consequently, taxes have had to be increased both at the federal level and at the provincial and local levels. Governments have also been making increased demands upon the capital market at a time when business demands on the market have also been high. In the case of the Government of Canada, these borrowing demands have also reflected the requirements for funds to finance housing, farm credit and other commercial-type investments through government agencies. Our Government has recently become a financial intermediary on a large scale. The amount we are lending for housing and farm credit alone in this fiscal year is expected to be more than half the total of the Government's net cash requirements.

Early this fall, the Government reached the conclusion that this rapid rise in government spending and lending, and in government borrowing, must be firmly restrained if we are to secure adequate restraint across the economy as a whole and check the inflationary rises in prices and costs. We cannot expect others to exercise the restraint in their demands that is necessary unless the Government gives a firm and clear lead. We do not control our provincial governments -- any more than Washington controls your states -- but we wish to give them a lead in this general direction.

After considerable soul-searching, our Government decided that it can and will reduce very substantially the rate of increase in its expenditures -- despite the higher wages and prices we face, despite the higher interest rates we are paying, despite the growth in the population we serve. We are going to reduce our lending through government agencies to levels lower than this year. We shall limit the increase in our expenditures next fiscal year to 4 1/2 per cent over this year compared to increases of more than 10 per cent in the past two years. This is going to be painful -- particularly at a time of moderately increased unemployment. It is essential, however, if we are to accomplish our objectives and check the inflationary rise in prices before it does lasting damage to our economy. This limitation on our spending is also essential, too, if we are to limit our demands on the capital market to amounts we can expect to get without the use of inflationary methods that would help to increase prices further.

The moderation of the demands of Canadian governments upon the capital markets will be highly desirable for some time to come because of the other urgent needs for capital investment in Canada to be expected during the late Sixties and early Seventies. Because of our dispersed geography, our affluent society and our capital-intensive industry, we are a country that normally uses a large volume of capital. In the period now confronting us, our needs for capital -- and our opportunities for using it productively -- will continue to be abnormally high because of the delayed consequences of the great baby boom that Canada experienced just after the Second World War.

Between 1965 and 1970, we expect the numbers of our young people in the important 20- to 24-year-old age group to increase by 33 per cent. In the following five years we expect this age group to grow by a further 15 per cent. Our university enrolment is increasing by leaps and bounds. Our labour force is growing by more than 3 per cent a year -- a rate that far exceeds that of other industrialized countries and is half as large again as that of the U.S.A. A continued high rate of growth in the labour force can be expected for many years.

This rapidly growing number of young adults -- better educated and trained than their predecessors -- will want homes and schools and the other capital requirements of modern living, and they should be earning enough to pay the costs of such facilities. But larger capital investments will be required to make this possible. Similarly, the growing labour force will be able to build and operate a rapidly growing Canadian economy -- primary industries -- manufacturing industries -- and services. We shall have the manpower, the resources and the markets for this great expansion, but we shall need vast quantities of business capital to finance it. We shall need the institutions and the policies to enable savings to be generated and channelled effectively into the many investments required. There seems likely to be no shortage of opportunities for good investment and the good jobs and incomes which they will make possible, if we manage our affairs efficiently. We in Canada won't lack things to do.

Our overall rate of savings in Canada is high -- among the highest of all countries in the Western world. Last year it was estimated that total Canadian savings amounted to nearly $12 billion, of which almost $3.5 billion were personal savings in one form or another and $8 billion were gross business savings, including capital cost allowances, which we permit under our tax laws at a high rate compared to other countries. These domestic savings amounted to 90 per cent of capital investment, including inventories in Canada during that year. However, so large was our investment programme that we had to have a net import of capital of almost $1.25 billion in 1966. The total inflow of capital was even larger, because there was a substantial offsetting outflow of Canadian capital, much of it back to the United States. The import of capital took many forms, but chiefly it was in the form of the purchase by U.S. investors of Canadian bonds and the direct investment by U.S. firms in businesses in Canada which they control.

As we look ahead to the large Canadian requirements for capital in the next few years, we anticipate that we shall continue to supply the bulk of these ourselves from our own savings, but we shall rely upon imported capital in substantial volume in the future as we have in the past. Indeed, the import of such capital is essential not only to supplement our own savings but in order that Canada may meet its foreign-exchange requirements vis-à-vis the United States. Each year, you in the United States have a large surplus in your trade and other current account transactions with Canada. This is a mainstay of your own balance of payments. We pay you in part for this surplus by the surplus we earn in overseas trade and by the gold we produce, but this is normally far from enough to cover your current surplus with Canada. It is only because of the large flow of U.S. investment in Canada and the dollars we receive from it that our mutually profitable trade can continue to grow the way it has.

In making our plans and policies for the Canadian economy, we therefore look forward in future years to a continued substantial flow of capital from the United States, and in particular, of course, from New York and the institutions that are centred here.

To a large degree, we anticipate that this capital will come in the form of direct investments by American businesses. Much of this investment is made by what are now called international, or multinational, corporations. Such investment is taking place on a large scale in Europe as well as in Canada, and understandably gives rise to concern over the degree of domestic control of the economy in which it is placed. We in Canada have probably more reason for concern than others because such very large sections of Canadian business are owned and controlled outside Canada. We welcome the signs we see that American businesses and multinational corporations are becoming more conscious of their dominant role and aware that they must take into account the desire of Canada and other countries that they be good corporate citizens in the various nations where their businesses are located.

We in Canada have been conducting an intensive and objective study of this problem this year. We expect as a result to publish soon an official paper on this subject and the views of Canadians on it.

Meanwhile, however, our Prime Minister has made quite clear earlier this year our basic attitudes and policies. Mr. Pearson has stated that we are going to continue to need foreign capital and the know-how that so often comes with it. We shall welcome such capital and shall avoid unfair discriminatory treatment which would create the kind of atmosphere that discourages foreign investment. It is our objective that Canadians should own and control as much of our industry as is possible; that their own investment in Canadian business should enable them to have as much as possible of the control of the resources and economic development of Canada. Mr. Pearson emphasized, however, that we shall achieve this objective not by action that is unfair to foreign interests but by action that will marshal and encourage Canadian capital to invest increasingly in Canadian enterprises.

In addition to direct investment of capital in Canada, we shall continue to rely upon a substantial flow of portfolio investment in the obligations of Canadian borrowers in the United States. These include primarily, as most of you know, the provincial governments, our major municipalities and our major Canadian corporations. All of these borrowers are very proud of their credit standing in New York and are anxious to maintain it. We in the Government of Canada are conscious of the importance of following policies that enable our provinces, our major municipalities and our major corporations to continue to borrow in the U.S. market. We recognize that this involves operating and developing the Canadian economy in the most sensible and efficient way so that we may continue to enjoy the respect of your investors. We recognize, too, that it means that Canada must continue to offer the prospect of political stability that has for very many years been one of its attractions to foreign capital.

In this year of Expo and our centennial celebrations, you, as our next-door neighbours, will have heard something of our debate about the political future of Canada. News being what it is, I expect that some of what you have heard and read has involved the question of Quebec separatism -- an issue raised by certain small but highly vocal groups in that province. I welcome this opportunity to say something of it from the point of view of Canada as a whole.

The "Canadian debate" has been going on, intermittently, for almost two centuries -- ever since the French and English communities began to live and develop together in one country and, at the same time, sought to preserve their own identiti of language and culture. In the last decade, the debate has taken on a new dimensio and vitality. Quebec has undergone a remarkable transformation, not only by great industrial development but with a changed social outlook that is progressive and self-confident. French-speaking Canadians, while still concerned to maintain their cultural identity, are also determined to achieve economic progress and to participate fully in the direction and control of Canadian development.

This Canadian debate is not centred now on negative solutions like separatism. It is concerned rather with the positive reforms that are necessary in economic and social affairs and in political and constitutional matters. Separatism is not the objective of any of the main political parties of Canada or indeed of Quebec. The people in general, both in Quebec and elsewhere in Canada, have no desire for it. The goal of our major political parties, and of the vast majority of Canadians, is to make our country a prosperous one where all of us, whether our language be English or French, and whatever our origins, can share fully in its economic and cultural development. There will be continuing discussion and argument about the means, and in particular about the role and status of the provinces, but Canadians generally have the same goal and that is what counts.

The Federal Government, in its policies, is continuing to give its fullest support to the economy of Quebec, as it does to that of other areas of Canada. It is also determined that the national institutions of Canada -- particularly the Government in Ottawa -- shall be institutions in which French-speaking Canadians as well as English-speaking Canadians can work and speak and write in their own language. It is also our desire that French-speaking Canadians should be able to live and educate their children using their own language wherever there are significant French-language communities across our country.

The people of Quebec -- like the people elsewhere in Canada -- favour political stability and economic development. I believe that investors can properly share our optimism, because it is based on the underlying realities rather than on the words and the moods of the moment.

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