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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT
1970

THE SENATE OF CANADA

PROCEEDINGS OF THE

STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

Honourable DOUGLAS D. EVERETT, *Chairman*

No. 1

WEDNESDAY, DECEMBER 2, 1970

Complete Proceedings on the Estimates (A)
laid before Parliament for the fiscal year ending March 31, 1971

REPORT OF THE COMMITTEE

Witnesses: See Minutes of Proceedings.

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THE STANDING SENATE COMMITTEE
ON NATIONAL DEFENCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Laird
Beaubien	MacDonald (*Queens*)
Benidickson	*Martin
Bourget	Methot
Bourque	Molson
Desruisseaux	McDonald (*Moosomin*)
Everett	McLean
*Flynn	Nichol
Fournier (*Madawaska-Restigouche*)	Paterson
	Pearson
Gelinas	Phillips (*Rigaud*)
Grosart	Phillips (*Prince*)
Hays	O'Leary
Isnor	Sparrow
Kinley	Walker—(27)

(Quorum 7)

**Ex officio members*

Orders of Reference

Extract from the Minutes of the Proceedings of the Senate, November 24th, 1970.

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Smith:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures set out in the Supplementary Estimates (A) laid before Parliament for the fiscal year ending the 31st March 1971.

The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Minutes of Proceedings

Wednesday, December 2, 1970.
(1)

Pursuant to notice the Standing Senate Committee on National Finance met this day at 9.30 a.m. to consider the Supplementary Estimates "A" laid before Parliament for the fiscal year ending March 31st, 1971.

Present: The Honourable Senators Everett (*Chairman*), Aird, Beaubien, Desruisseaux, Gélinas, Grosart, Isnor, Kinley, Laird, McLean, Méthot, Molson, Paterson, Pearson and Phillips. (15)

Also present but not a member: The Honourable Senator Lafond.

On Motion of the Honourable Senator Gélinas, it was *resolved* that 800 copies in English and 300 copies in French of the Proceedings be printed.

Witnesses from the Treasury Board:

The Honourable C. M. Drury, President;

C. Osbaldeston, Deputy Secretary, (Program Branch);

F. Fry, Assistant Secretary, (Program Branch);

B. A. MacDonald, Director General, Budget Coordination.

The Treasury Board undertook to provide the Committee with a breakdown of amounts to be distributed by Provinces and by Departments out of the $60,000,000. They also undertook to provide a list of votes legislative in nature that are not one dollar items.

It was agreed to report on the said Supplementary Estimates (A) after approval by the Steering Committee, composed of the Honourable Senators Everett, Molson, Grosart, Sparrow, Hays and Beaubien.

At 12.10 p.m. the Committeed adjourned to the call of the Chairman.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

Report of the Committee

Wednesday, December 2, 1970.

The Standing Senate Committee on National Finance, to which was referred the Supplementary Estimates (A) for the fiscal year ending March 31, 1971, has in obedience to the order of reference of November 24, 1970, examined the said Supplementary Estimates and reports as follows:

1. Your Committee has examined the said Supplementary Estimates (A) and has heard evidence there on from the Honourable C.M. Drury, President of the Treasury Board, Mr. G. Osbaldeston, Deputy Secretary, Programs Branch, Mr. F. Fry, Assistant Secretary, Programs Branch, and Mr. B. A. MacDonald, Director General, Budget Co-ordination, all of the Treasury Board.

2. The said Supplementary Estimates provide for total expenditures for which Parliament will be asked to provide funds in the amount of $239,112,754, statutory expenditures in the amount of $195,808,000 and loans, investments and advances in the amount of $22,200,002. This brings the total of the Main and Supplementary Estimates for the current fiscal year to $14,209,415,192.

3. Included in the said Supplementary Estimates (A) are fourteen $1 items about which your Committee made enquiries and the explanations of these items are contained in a statement furnished by the Treasury Board and attached as an appendix to this report.

4. Your Committee expressed concern about a number of Votes in these Supplementary Estimates which are legislative in nature. Six of these Votes are $1 items and are contained in Part III of the aforementioned appendix to this report. However, other Votes which are not $1 items are also legislative in nature and your Committee has requested explanations of these items from the Treasury Board.

5. Your Committee is of the opinion that the aforementioned Votes which are legislative in nature should also be contained in summaries to the Main Estimates and Supplementary Estimates so that they will be more readily available to persons consulting the statutes so amended, as well as being available for inclusion in statute consolidations.

6. In the appendix attached to this report a description of the source of funds is given for each $1 Vote. Your Committee recommends that Supplementary Estimates contain such a description of the source of funds in every case where funds are transferred from one program to another program. The supplementary estimates presently indicate the vote from which the funds are taken, but your Committee recommends that in addition to this a description of the actual program being abridged or abandoned be given.

7. Your Committee received evidence from the witnesses to the effect that these Supplementary Estimates (a) contain $60 million of expenditures for the alleviation of unemployment where unemployment conditions are especially severe. Your Committee reviewed the method used by the Treasury Board in selecting the programs, to be included in this expenditure, and your Committee is to receive a breakdown of these expenditures by government department and by provinces from the Treasury Board.

Respectfully submitted.

D. D. Everett,
Chairman.

EXPLANATION OF ONE DOLLAR ITEMS

SUPPLEMENTARY ESTIMATES (A), 1970-71

SUMMARY

The one dollar items in these Estimates have been grouped in the attached according to purpose.

(I) One dollar items authorizing transfers from one vote to another within a ministry to meet certain increased costs or additional expenditures to be incurred (6 items).

(II) One dollar items which require listing in Estimates in order to secure approval of certain grants and contributions (2 items).

(III) One dollar items which are legislative in nature (6 items).

November, 1970

PART I

One Dollar Items Authorizing Transfers from One Vote to Another Within a Ministry to Meet Certain Increased Costs or Additional Expenditures to be Incurred (6 Items)

COMMUNICATIONS AND POST OFFICE—Communications

Vote 1a—Amount of transfer to this vote $225,999.

Purpose—It is planned to establish a task force to study and recommend specific policies and institutions to ensure the orderly and efficient growth of combined computer/communications systems in the public interest. It was originally proposed that this task force would commence its work on April 1, 1971 but in order to co-ordinate its proposals with other legislative recommendations resulting from the telecommission studies it is essential that this work begin immediately.

Source of funds—Vote 5 ($225,999)—these funds are available as a result of the deferment of the purchase of minor capital items in the Management of Radio Frequency Spectrum activity and a less rapid rate of expenditures than anticipated in the ISIS "B" SATELLITE PROGRAM.

ENERGY, MINES AND RESOURCES

Vote 5a—Amount of transfer to this vote $649,999.

Purpose—To provide a further $450,000 required to cover the cost of additional aerial photographic work carried out during the year. The mapping and survey work has progressed more quickly than anticipated due to better weather conditions and use of jet aircraft. An additional $200,000 is also required to cover the loss of anticipated revenue due to the cancellation of proposed price increases from maps and air photographic products, as a result of the government anti-inflation measures.

Source of funds—Vote 25 ($649,999)—Due to engineering problems and renegotiation of timing and cost sharing formulas, certain delays have been incurred in the payments for federal-provincial water control works.

Vote 20a—Amount of transfer to this Vote $374,999.

Purpose—A further $375,000 is required within the Inland Waters activity to provide not only for the purchase of additional equipment needed by the Canada Centre for Inland Water Laboratories to monitor the water samples being tested for waste content but also for the purchase of furnishings ($300,000) for certain laboratories now under construction. The purchase of the furnishings for the new laboratories was originally scheduled for delivery next year, however, due to the completion of the laboratories ahead of schedule the equipment will be required in the current fiscal. year.

Source of Funds—Vote 25 ($374,999)—Due to engineering problems and re-negotiations of timing and cost sharing formula, certain payments have had to be delayed for federal-provincial water control works.

INDUSTRY, TRADE AND COMMERCE—Dominion Bureau of Statistics.

Vote 30a—Amount of transfer to this vote $1,599,999.

Purpose—To provide for the additional costs of the Decennial Census of 1971. The increased costs consists of publicity costs including advertising ($335,860), freight and supplies purchased ($318,825), increased printing costs and quality control ($749,500) and certain other costs such as salaries, travel, office expenses, etc. These increased costs were not known when the Main Estimates were prepared.

Source of Funds—Vote 5 of the Department of Industry, Trade and Commerce ($1,599,999)—disbursements under the Program for Advancement of Industrial Technology have been less than were anticipated.

TRANSPORT—St. Lawrence Seaway Authority

Vote 95a—Amount of transfer to this Vote $199,999.

Purpose—To provide for the increased expenditures resulting from keeping the Lachine Canal open to navigation ($50,000) and the continuation of the operation of the Cornwall Maintenance shops

($150,000). It was originally proposed to close the Lachine Canal however this has been delayed pending the results of an appeal now before the Courts. The shops are to be kept open because of current economic conditions in the area.

Source of Funds—Vote 85 ($199,999)— Due to the delay of certain maintenance projects for the Welland Canal funds are available for transfer.

VETERANS AFFAIRS

Vote 45a—Amount of transfer to this Vote $1,296,499.

Purpose—Additional funds are required to carry out renovations and maintenance projects to the Queen Mary Veterans Hospital in Montreal and the Ste. Anne's Hospital, Ste. Anne de Bellevue. These projects are part of the stimulation of economic expansion program.

Source of Funds—Vote 35 ($1,296,499)—Forecast Pension expenditures resulting from the implementation of the "White Paper" proposal will be less than anticipated due to certain delays in implementation.

PART II

One dollar items which require listing in estimates in order to secure approval of certain grants and contributions (2 items).

INDIAN AFFAIRS & NORTHERN DEVELOPMENT

Vote 35a—To authorize grants as detailed in the Supplementary Estimates, for a total of $553,500.

Explanation—These grants are required to:

(a) Provide for the payment of $133,000 to the Government of the Yukon Territory to assist with the cost of a second language training program in the territorial school system.

(b) Provide for a capital grant of $420,500 to the Government of the Yukon Territory for the purchase of the renovated Dawson Water System from the Northern Canada Power Commission. The Commission on receipt of the purchase price will use this money to repay advances made by the Minister of Finance to the Commission.

Source of Funds—The provision within the Main Estimates for the Northern Mineral Development Assistance Grants will not be totally used, due to certain of the claims under the regulations being less than was initially estimated due to a recent limitation of $50,000 having been placed on the amount payable to each eligible claimant. It is proposed to reuse part of the funds already voted.

MANPOWER & IMMIGRATION

Vote 20a—to authorize an additional grant of $20,000.

Explanation—An additional grant of $20,000 is requested for the Frontier College of Canada. A grant of $5,000 has already been made to the college this year by the Department of Labour.

Source of Funds—It is proposed to use part of the funds already allocated to the Planning, Evaluation and Research activity for grants for Manpower Research and Development for the payment of this additional grant.

PART III

One dollar items which are legislative in nature (6 items).

FISHERIES & FORESTRY—Freshwater Fish Marketing Corporation

Vote L20a—To authorize an increase of $5,000,000 in the borrowings limit under Section 17 of the Freshwater Fish Marketing Act.

Explanation—The Freshwater Fish Marketing Corporation is requesting authorization to permit interim financing of fixed assets through additional borrowings from the Minister of Finance as well as the private sector. These additional funds will be used to finance the plant construction program of the Corporation. The approval of the increased borrowing limit does not mean any substantial changes in the Corporation program.

INDUSTRY, TRADE & COMMERCE

Vote 1a—To authorize a change in the Vote Wording so as to extend eligibility criteria with respect to insured loans under the General Adjustment Assistance Program to certain industries and manufacturers.

Explanation—The revision to the Vote Wording proposed is intended to provide for the extension of the loan insurance feature of the General Adjustment Assistance Program to:

(a) Canadian manufacturers of textile and clothing goods who require loans to restructure their operations in order to improve their competitive position in domestic or export markets and who are unable to obtain loans at reasonable rates without such insurance; and

(b) To any person or body providing marketing, financing or other essential services to a manufacturer covered by the existing provisions of the General Adjustment Assistance Program and to manufacturers covered by para. (a) preceding.

The change under (a) is required because of the problems of the textile and clothing industries in Canada.

The Change in (b) is intended to permit assistance, consistent with the general intentions of the General Assistance Adjustment Program with respect to firms providing marketing, financing, and other essential services to manufacturers.

Vote 5a—To authorize an increase of $20,000,000 in the commitment limitation during the current and subsequent fiscal years for payments to advance the technological capability of Canadian manufacturing industry by supporting selected civil development projects.

Explanation—The present ceiling on the program for the advancement of industrial technology is not sufficient to meet the applications for commitments for future years. The nature of the program is such that the Department generally has to make commitments of assistance for three to five years in advance. While the current year disbursements are estimated to be within the approved estimates for 1970-71, the commitment requirement for future years is growing more rapidly than anticipated and cannot be met within the current ceiling.

Vote L11a—To authorize the extension of the eligibility criteria with respect to direct loans under the General Adjustment Assistance Program.

Explanation—The revised Vote Wording is needed to permit the Government to make direct loans to a manufacturer of textiles and clothing who has suffered or is threatened with serious injury from low cost imports and who cannot receive loans on reasonable terms to enable him to adapt efficiently. This assistance is an essential element in the implementation of the new textile policy announced by the Government earlier this year.

TRANSPORT

Vote 1a—To authorize the spending of revenue received during the year to cover expenditures made under the Vote.

Explanation—Authority is required to reuse revenues received for computer services rendered by this Program to other Programs of the Department. The Main Estimates for 1970-71 included estimated revenue to be credited to the Vote, however, authority was not included in the Vote Wording for the reuse of these revenues.

TRANSPORT—Canadian Transport Commission

Vote 60a—To authorize the payment of grants and to extend the statutory level of subsidization.

Explanation—Authority is requested to:

(a) Amend the present grant in aid of transportation and research authorization included in the Main Estimates to include the words "university students" thus enabling the Commission to provide fellowships to post-graduate students carrying out research in connection with transportation. It is anticipated that approximately $150,000 of the $500,000 presently included in the Estimates will be awarded as fellowships.

(b) Revise the present Vote wording in order to extend the Statutory level of subsidization of truck freight rates on shipments "within" the Atlantic region beyond that provided under the Atlantic Region Freight Assistance Act of 1969.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Wednesday, December 2, 1970

[*Text*]

The Standing Senate Committee on National Finance, to which was referred the Supplementary Estimates (A) laid before Parliament for the fiscal year ending 31st March, 1971, met this day at 9.30 a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, I would like to have the usual motion for the printing of proceedings.

Upon motion, it was *resolved* that a verbatim report be made of the proceedings and to recommend that 800 copies in English and 300 copies in French be printed.

The Chairman: We are honoured today to have with us the President of the Treasury Board, Honourable C. M. Drury, in our consideration of Supplementary Estimates (A) for the fiscal year ending March 31, 1971. Accompanying Mr. Drury are officials of the Treasury Board, Mr. G. F. Osbaldeston, Mr. J. L. Fry and Mr. B. A. MacDonald. Since Mr. Drury's time is restricted I wonder if we could proceed immediately to his statement on the Estimates.

Hon. Senators: Agreed.

The Honourable C. M. Drury, President, The Treasury Board: Mr. Chairman and honourable senators, I have a relatively short statement which gives an overall view and after reading that I would be glad to answer any questions I can and the ones I cannot the officials will be glad to help out.

I see that you all have before you the printed copy of the Supplementary Estimates (A). As will be seen these Estimates contain budgetary items in the amount of $435 million, which brings the total of the budgetary items for the fiscal year 1970-71 to $13,345 million, a summary of which appears at the beginning of the book. These Estimates also contain loans, investments and advances which amount to $22 million. I would like to draw attention, if I may, to certain aspects of the contents of these Estimates and, in addition, to certain changes that have been made in the form.

Dealing first with matters of content, you will recall that the Minister of Finance, when speaking during the debate on the Address in Reply to the Speech from the Throne, announced that the Government would be seeking the approval of Parliament for an additional $60 million of expenditures for the alleviation of unemployment where unemployment conditions were especially severe. Spread through these supplementary Estimates are items reflecting the requirements of departments to carry out various operations and maintenance and capital projects which have been specifically undertaken with a view to alleviating unemployment.

A second matter of content involves the special efforts which the Government made last summer to provide summer employment for students. The total expenditure by the Government to this end was about $17 million. Almost all of this expenditure is being charged to the Treasury Board contingencies vote. This is the main reason that a supplement to the contingency vote is being sought in these Estimates.

The $25 million supplement to the contingencies vote also covers other salary items arising from a number of circumstances, including unprovided-for salary costs arising out of additional personnel hired in the Ministry of Transport to allow air traffic controllers a shorter work week, in accordance with a collective bargaining agreement. There are also costs arising out of the reclassification of certain employees in another department and the usual adjustments we have made at this time of year in the contingency vote in the light of our experience in arriving at salary settlements generally.

In introducing supplementary Estimates in other years I have had occasion to tell the committee that as a matter of policy the Government puts its provision for meeting salary increases arising out of collective bargaining into a number of pockets. It places some of the provision in the contingency vote in the main Estimates, some in the departments' main Estimates and some in supplementary Estimates in the contingencies vote. This way we hope to keep those on the other side of the bargaining table somewhat in the dark as to the final settlements we expect will emerge so that meaningful collective bargaining can take place.

If I may, I would like to say a few words about the design of these documents in which the supplementary Estimates proposals are incorporated when laid before Parliament. This spring we introduced a new form for the main Estimates; one which presented the expenditure proposals of the Government along program lines and one in which the quantity of information supplied was greatly increased in comparison with previous years. In changing the form of the supplementary Estimates we have, of course, had to bring them into compatibility with the main Estimates. We have also tried to increase

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the store of information. For the first time we are showing certain statutory items in supplementary Estimates, those for which the latest information we have reflect substantial changes. In general what we have done here is to show any change in the expected outlay for a statutory item where the change has been at least $1 million in magnitude and where it represents at least a 10 percent increase or decrease from the level shown in the main Estimates when they were tabled.

We are also showing, in all cases, approved construction projects which were too late for reflection or detailing in the main Estimates. We are showing these even in cases where no new funds are involved. A department may well have a capital vote in the main Estimates which is not all taken up in approved projects in excess of $250,000 when the main Estimates material is drawn up.

In the course of the months after November the Treasury Board will approve other capital projects expected to cost in excess of $250,000. We take the opportunity afforded in the supplementary Estimates to update the capital project table shown in the main Estimates whether or not there is, at the same time, a request for additional money to finance the projects.

Another change involves the treatment of grants. From time to time in the course of the year the necessity for new grants arises, usually relatively small ones. These are met from the Treasury Board's contingencies vote which provides for miscellaneous, minor and unforeseen expenditures. We show in these supplementary Estimates all cases where such grants have been temporarily financed from the Treasury Board's vote. As you know, it is customary to have each grant or group of grants submitted for parliamentary approval through the appropriation act that arises out of the Estimates.

I will be glad to endeavour to answer any questions that you have during the time I will be here, and you may be assured that throughout this morning and the rest of the period of your deliberations the Deputy Secretary of the Treasury Board, Mr. Osbaldeston, and his staff, will be here to provide further details.

The Chairman: Thank you, Mr. Minister. Before we proceed to questioning, honourable senators, may I say the minister has filed with your chairman an explanation of the $1 items in the supplementary Estimates. If there are copies, could these be distributed to honourable senators?

Hon. Mr. Drury: Yes.

Senator Grosart: Would you read the headings of the breakdown of the $1 items?

The Chairman: I will read the summary in the front. It is:

> The one dollar items in these Estimates have been grouped in the attached according to purpose.
>
> (I) One dollar items authorizing transfers from one vote to another within a ministry to meet certain increased costs or additional expenditures to be incurred (6 items).
>
> (II) One dollar items which require listing in Estimates in order to secure approval of certain grants and contributions (2 items).
>
> (III) One dollar items which are legislative in nature (6 items).

Senator Laird: You mentioned an increase in employees for the Department of Transport. Would you explain that? What does the increase take in and why is the increase there?

Hon. Mr. Drury: The particular increase to which I had reference arose really out of the inquiry into the life and working conditions of the air traffic controllers. It was decided or agreed with the air traffic controllers as a group that a shorter working week would be more conducive to the proper discharge of the responsibility these men have. A shorter working week still with seven days, 24 hours a day, of operations, called for a substantial increase in staff.

Senator Laird: I have one more question along the same line. You mentioned something about new construction projects. Could you give any idea as to what unforeseen new construction projects arose?

Hon. Mr. Drury: What I had reference to there was not so much unforeseen projects. When the main Estimates are made up, it has been the habit in the past to list specifically those items, those new projects, costing in excess of $250,000. At the time the main Estimates go to print, it is known in general terms what the quantum of capital projects will be but the details of all the individual projects have not necessarily been worked out. Provision is made for the gross amount of money in the main Estimates. The details which are worked out subsequently during the course of the fiscal year are now being put into the supplementary Estimate presentation without new money being involved.

Senator Laird: Thank you very much.

Senator Isnor: How do you arrive at that list?

Hon. Mr. Drury: I suppose the easiest answer to that, Mr. Chairman, is that the process by which any capital project is gestated is that the need for it is seen and articulated by the department having the need, as the means of executing its program. In some instances the construction work, the design and construction, is carried out by the department concerned; in other cases, by the Department of Public Works. By way of example, take the changes currently being made at the international airport, Toronto, at Malton. The development of a stated need or requirement is produced by the Department of Transport, and the satisfaction of this need is approved and the money voted and the work of design and construction is carried out by the Department of Transport. To take as another instance, a new laboratory for the Department of Fisheries, the need and justification would be the responsibility of the Department of Fisheries. When this had been approved and the money voted, the provision would be the responsibility of the Department of Public Works.

Senator Isnor: Is the unemployment situation taken into consideration?

Hon. Mr. Drury: Most certainly, and as I mentioned here, in these Estimates there are a number of such projects specifically designed for areas of high unemployment.

Senator Isnor: Thank you.

Senator Grosart: I wonder if the minister would give us an overview of the effect that these Supplementaries will have on the total budget situation in respect particularly to the switch from the anticipated surplus to a deficit and the percentage increase in anticipated expenditures this year compared to last year. I think you have said it meant a switch from $200 million surplus to a $400 million deficit, did you not—elsewhere?

Hon. Mr. Drury: Elsewhere, yes. In the ordinary course of events, the task of representing or presenting the policy of balance as between revenue and expenditure is done by the Minister of Finance and I was merely quoting figures that he used in his review of the economic situation. These Estimates here merely give legislative effect to that expression of intention. It is a little hard to say what effect those Estimates are going to have on the change of economic posture. This is more clearly seen, I think, and arises more directly out of the statement of policy of the Minister of Finance.

Senator Grosart: I was speaking about the numbers. You have given a figure of $13,345,000,000, which seems to me to be about a 10 per cent increase over last year as against a hoped for increase of merely 7.4 per cent when we had the main Estimates. In other words there is a very substantial increase in expenditure this year, $60 million of which is accounted for by the special situation, which leaves a very substantial amount of money involved in the supplementary Estimates that has not been anticipated or is the result of emergency and I would just like to know the magnitude of this.

Hon. Mr. Drury: If I could refer you to the table on page 5, which lists the departments making up this, it will be seen that the main Estimates in the first column were $13,752,000,000. In the current supplementary Estimates there are two types of additional expenditure involved. One is the so-called budgetary expenditures to be voted, in the amount of $239 million.

In addition, we have a revised forecast of statutory expenditures. The statutory expenditures which arise out of enabling statutes do not have to be voted We have updated the forecasts as best one can where, as I indicated in my statement, the difference between the forecast contained in the main Estimates of last February and the current forecast is more than $1 million and more than 10 per cent of the sum in question. This updating calls for an additional $22 million. This gives a total increase in expenditures, statutory, non-statutory and loans, investments and advances, of $457 million on a figure of $13,752 million.

I might get somebody to work that percentage out for you.

Senator Grosart: What I was really asking for was a comparison with last year's expenditures. What is the percentage increase? I have estimated it to be over 10 per cent myself. Is that correct?

Hon. Mr. Drury: Over the previous year?

Senator Grosart: Over the previous year, yes. We were on a scale where we were actually dropping the percentage increase from year to year. We had it down to 7.4 last year. It looks like we are going up the other way.

The Chairman: Excuse me, Senator Grosart, but are you referring there, in respect of percentages, to the percentage of the Supplementary Estimates to the total?

Senator Grosart: No. I am referring to the new total—the new anticipated total expenditures for this year compared with last year. After I get that I am going to ask if we are going to have any more supplementaries this year.

Hon. Mr. Drury: The answer is yes to that. So one can only compare what it is today against some period last year. The forecast expenditures for the current year as of today are $14,209 million. What would you like to compare that with? The main Estimates of last year or the final supplementaries or the Estimates as of October?

Senator Grosart: It does not matter. Say the total. When the main Estimates were tabled we were given the comparison then and we were given the figure of 7.4 as the anticipated increase in expenditures this year.

Hon. Mr. Drury: One has to be careful. The expenditure figure is derived from the Public Accounts. So you are not comparing like things. I have not got that figure here. We can compare it with what the Estimates were last year, but the Estimates and expenditures are not necessarily the same.

Senator Molson: How about the main Estimates and the supplementaries? In other words, the total Estimates of last year.

Hon. Mr. Drury: We will try to work that out.

Senator Grosart: May I just read this to you? I am reading from the report of the committee on national finance:

> The Main Estimates for 1970-71 amount to $12,910 million, an increase of 7.4 per cent over the Main Estimates for 1969-70. This increase compares with a percentage increase of the 1969-70 estimates over 1968-69 estimates of 9.5 per cent.

Now, it is in that area that I was looking for some comparisons.

Hon. Mr. Drury: You have in that statement, which is quite easy, a comparison of main Estimates in one year with main Estimates in another year. If one takes the main Estimates in one year and compares that with the main plus the supplementaries in another year, you get a different set of figures. But I think what you are getting at is that the rate of increase in Government expenditures one year to the next is rising rather than

falling. Whereas the rate of increase had been declining this year, it is likely to rise. I think we can say that.

Senator Grosart: The reason I raise that in this committee, Mr. Minister, is that we have a recommendation made by this committee to the effect that in any one year the percentage rate of increase of Government expenditures should not exceed the rate of growth of the economy. That was a recommendation of this committee.

Hon. Mr. Drury: Well, if this is a convenient index as a guide to policy it does considerably inhibit the Government in endeavouring to pursue a position, or to achieve a position, in which it can effectively influence the economic cycles through which we travel.

The Chairman: I wonder if I could ask Senator Grosart if the statement that was made by this committee was not a statement that when the economy is travelling at its full potential or close to that, the Government would limit its increase in expenditures to the increase in the gross national product?

Senator Grosart: I don't think it was qualified, but that does not matter. The point is, of course, and we are all aware of the fact, I am sure, that we cannot go on indefinitely in a situation where the rate of Government expenditure is definitely and continuously in excess of the rate of the national productivity. Somewhere we have to stop, obviously. I am not suggesting it is this year.

Hon. Mr. Drury: I would be inclined to agree that, unless the Government did all the spending and the private sector did none, you could not go on indefinitely. That is true.

Senator Grosart: There are some who advocate that, too, but I do not think you are one of them, Mr. Minister.

Senator Beaubien: What did we spend in 1969-70? How much was spent?

The Chairman: That would be the Estimates plus the supplementaries, Senator.

Hon. Mr. Drury: That figure has to come out of the Public Accounts. It does not come out of the Estimates books.

The Chairman: That is right.

Hon. Mr. Drury: We are trying to get that figure out now, if we can.

The Chairman: Perhaps what would satisfy Senator Beaubien would be the amount of the 1969-70 Estimates plus the supplementaries, which would be a figure you would have at this stage.

Senator Beaubien: That would be close enough.

The Chairman: It would not be a final figure. Perhaps while we are on that subject I could ask Mr. Minister how much of the supplementaries of $457 million is attributable to the present policy of the Government to accelerate the economy. Is it the $60 million or does it go beyond the $60 million?

Hon. Mr. Drury: Well, there are specific projects covering the $60 million figure. I think probably in relation to some of the statutory increases these would be a reflection of the policy of some stimulation for the winter. What we have tried to do in relation to the $60 million is to seek out projects which would have their principal impact in areas of high unemployment and which could be undertaken rapidly and the full trust of which would be during the current winter, not the initiation of large capital projects which could only get started now and perhaps take four or five years to complete.

The Chairman: Have you compiled a list of those projects?

Hon. Mr. Drury: We have, yes.

Mr. G. F. Osbaldeston, Deputy Secretary, Program Branch, Treasury Board: It is not ready in the form of a table yet.

The Chairman: Is it agreeable, honourable senators, that this list detailing the $60 million worth of special projects be tabled with the clerk?

Hon. Mr. Drury: This I think will be of some but perhaps not too much assistance. I think members will understand that $60 million of relatively minor projects which can be carried out during the current winter represents a great many both in number and in detail. What I have here shows by departments the amounts of money involved for each department. For instance, the Department of National Defence is shown on this list as undertaking $1,250,000 worth of work. This is principally an acceleration of operations and maintenance, to a large degree in the camp at Valcartier, Quebec. This will require the services for the relatively short period of the winter of a considerable number of casual labourers. The Department of Indian Affairs and Northern Development is proceeding with the kind of clean-up work involving manual labour in the newly established parks and in some of the older parks. This again in a sense is directed towards relief of winter unemployment. This list here does show the departments with the amounts of money opposite them, but it does not specify, and it would be a very long list to do this, how many men are going to be employed in cleaning up Pine Forest north of Three Rivers.

The Chairman: Is this list satisfactory?

Senator Isnor: Just one question; what amount do you have there to relieve unemployment in Nova Scotia?

Hon. Mr. Drury: This list is not broken down by provinces, but rather by the agencies that are going to do the work. Most of the departments operate on a national basis, and the way we have tabulated this is on the basis of what can be done by a department in the total number of man-years, and the sum total we have that these expenditures relating to the departmental projects should total about 11,000 man-years. If one compresses all this

into a four-month period it would represent about 33,000 man-winters, if I can use that term. It will involve employment continuously for four months for some people, longer for others and shorter than that for some others.

Senator Phillips: Mr. Chairman, I think what Senator Isnor wanted and I would be interested in the same thing is the breakdown in the areas. It is fine to say there is so much to be done nationally, but we would like to know what is going into Quebec, what is going into the Maritime Provinces and Newfoundland which are areas of high unemployment.

Hon. Mr. Drury: We can get this. It will involve, I think, some effort in that each department with these projects will have to break them down or recompile them on a national basis.

Senator Phillips: The Public Works Estimates are fairly well broken down on a regional basis, and I believe it will be possible for the other departments to do the same.

The Chairman: Are you referring to the supplementary Estimates, Senator Phillips? Where do you say it is broken down?

Hon. Mr. Drury: On page 66. These are capital projects which are a lot easier to do because they are specific, discrete and relatively large.

The Chairman: I wonder, honourable senators, if we could perhaps have the Treasury Board officials table the information in the way they suggest, and if at that time it is not satisfactory to honourable senators, we could ask for more information, because we may be asking for something that will create an enormous amount of expense or work, and what they propose to table with us may well satisfy us. Would that be agreeable?

Senator Pearson: I notice under the heading of Manpower there is the large amount of $93 million for supplementaries. I wonder how successful you are in developing work or jobs for these people who are retrained.

Hon. Mr. Drury: This, I think, is a very good and interesting question. I suppose the extent to which one is successful in general depends on the level of employment and the growth in the labour force which really means the growth in the number of jobs at any given moment. In relation to specific individuals, the answer, I suppose, is partly the same, but it may be quite different. A man who takes training as a welder may be able to secure employment as a common labourer, but not as a welder. I think we would have to ask the Department of Manpower really to answer this particular question—the success that they have had in marrying the output of these specific training courses to demand.

Senator Pearson: Could you have a tabulation made for us of the number of people who have actually taken welding, bricklaying, carpentry and such courses by province? Are they kept so that when employment does develop you can call on these particular areas for these men already trained, or are they just lost in the crowd?

Hon. Mr. Drury: I think there is currently being made a conscious and quite intensive effort to categorize and to analyse and have records of the availability of particular skills, both by skill and geographical location, and to match these to employer demands. This is being done in a general way over the years. I think it is now a lot more effective and a lot more efficiently done than it has been in the past. But a new thrust of the Department of Manpower has been an active one of seeking from employers additional employment rather than merely waiting until the employer presents a demand. But the Department itself has not been, I think, engaged in the job of creating or trying to create jobs for welders, carpenters or whatever it might be. I think the list that you suggest would be quite a vast one, in that there are probably a large number of different vocational courses being financed through this program, I do not know how many categories there might be, and to break this down into relatively small areas by numbers would run to quite a large book.

Senator Pearson: Each division of Manpower in every part of the provinces would have a list, would it not?

Hon. Mr. Drury: Each Manpower office would have a list of available manpower under the various skill headings, and this should be translatable from one office to the other. Whether this is done in advance of demands arising or after, I do not know. It might be of interest to the committee to call the Manpower department to answer these questions. I am perhaps rather more remote from this than I should be.

Senator Grosart: Mr. Chairman, in this committee we have always been interested in the one-dollar items, which the minister has made a specialty of explaining. He said on one occasion that the Treasury Board avoids making substantive legislative changes by way of an Appropriation Act.

Mr. Minister, do you see any substantive changes in these one-dollar vote items you label as legislative? Would you regard any of those as substantive in terms of your comment elsewhere?

Hon. Mr. Drury: It has been our policy, as indicated, not to legislate by way of the Appropriations Acts the kind of items which perhaps could more properly be dealt with by way of a special bill. I think we have been successful in avoiding this. Obviously, there is a question of judgment as to whether extending the date of operation of a particular statute is a substantive act or rather more procedural, as to whether increasing the total amount available in a fund is substantive or otherwise; but such things as extending the period of duration of an act, changing the amounts of money covered and, to some degree, the method of disbursing or controlling, have not been regarded as sufficiently, shall I put it, significant to call for a special bill. In this case I do not think we have strayed outside those limits.

Senator Grosart: This is not a one-dollar item, but I wonder if the minister would mind looking at page 8, Vote L6a under Agriculture, which seems to be an authorization sought on the authority of an Appropriation Act of 1952. I wonder if there has been an amendment put through to cover that? It just seems unreasonable to go on on the basis of an Appropriation Act of 1952 and to continue regarding this as a statutory authority. I do not know what this particular item is, but it might be an example that would explain this queer process to us.

Hon. Mr. Drury: Like Senator Grosart, I do not know what this particular item is in detail. However, let me say that the Appropriations Acts are themselves substantive legislation. There is a resolution presented, a bill for the Appropriation Act. It receives three readings, a rather more intensive committee study than most other bills, and requires passage through both the House of Commons and the Senate. So this is a statute, a regular statute of Parliament.

I think perhaps the problem is that it is in the nature of an omnibus bill rather than a specific subject bill. The way most new programs of governments are initiated, in legislative terms, is through the Appropriation Acts. These are the statutory authorities for initiating and carrying through most programs. A rather more limited number of them receive statutory authorization through special bills, and if one were to require a separate, distinct act to cover each program, most of which have to be amended each year, I am afraid the legislative calendar of these two houses would just grind to a halt, overburdened.

Senator Grosart: I do not want to get into a discussion on this, but I do not agree with that viewpoint, Mr. Minister, because there are various ways it could be handled. I would suggest, for example, that there be an omnibus amendment attached to a supplementary Appropriation Act where you would say, "Here are the acts that we are amending, in effect, that are being amended in the normal form so they will show up in office consolidations." The problem is that if a lawyer some place today goes to look at a statute, to give advice to a client, he looks at the statute, gets the office consolidation and believes that he has an up-to-date version of this act, but he has not. He would have to go all the way through the supplementary Estimates, maybe back to 1952, to find out really what the intention of Parliament was. This is my objection to this procedure.

Where, for example, would someone, regarding this particular case on page 8—the Agricultural Revolving Fund, which was established by a vote in 1952—find this appearing in our statutes? The Appropriations Acts, as such, do not appear in the statutes, as I understand it. Perhaps one of the officials might have an answer.

Mr. MacDonald: They do appear in the statutes.

Hon. Mr. Drury: They do appear in the annual statutes but not in the revised statutes.

Senator Grosart: They do not appear in the office consolidation in many cases, and that is the act as it stands which people are going to. You have amended an act and the office of a department puts out a consolidation of the statute, and it is a false document.

Hon. Mr. Drury: Perhaps we should have a look again at this office consolidation. That would seem to be an easier approach perhaps than that of entirely revising Parliament's *modus operandi*.

Senator Grosart: I do not think it would be. My suggestion, for what it is worth, is that you should merely add to the appropriation act a document saying, "The following amendments are made...". They would then be here, and people would become aware of the fact that there was a tabulation of the amendments to appropriation acts as well as to ordinary statutes. It would go through just as easily as the supplementary estimates. You would add to it by putting in a table consolidating these legislative changes, and thus ask Parliament to pass not only that part of the appropriation act which provides money but also that part of it which is a tabulation amending previous votes or statutes. It is just a suggestion.

The Chairman: This would be an addendum to the Estimates something along the lines of Part 3, or the one-dollar items?

Senator Grosart: That is right, something along that line.

The Chairman: But it would also include items which are not one-dollar items, but which are legislative in their character.

Senator Grosart: That is right.

The Chairman: Would the committee like to request the minister to supply a list of items that are legislative in their nature but which are not one-dollar items?

Senator Grosart: I think it would be useful to have it, because there are quite a few of them that extend the purpose of a vote. I do not think there are any that extend the purpose of an act, but there are some that extend the purpose of a previous vote. There is a distinction we have to make between extending the purpose of an act and extending the purpose of a vote. I think that that is where the minister makes his distinction between substantive and non-substantive legislative amendments.

Mr. Minister, I believe you gave two examples of the kind of legislative effect achieved by the appropriation act that you do not regard as substantive. One was where it is merely the dollar numbers, and the other—for the moment I forget what it was.

Hon. Mr. Drury: It was extending the period.

Senator Grosart: Yes, exending the period.

The Chairman: But we are only referring here to items that change the substance of the act itself.

Senator Grosart: Or a previous vote.

Hon. Mr. Drury: In that case every one of these falls under that category.

Senator Grosart: Do you mean the six here?

Hon. Mr. Drury: No, everything in the book is, in effect, an amendment of the previous appropriation act. The Appropriation Act, 1969-70 might provide for and authorize the construction of a large terminal somewhere which will take five years to build, and towards that is provided $600,000. The Appropriation Act in the next year comes along and amends that by putting in the second year of the program, but providing for a different sum of money.

Senator Grosart: Yes, but what I am referring to, Mr. Minister, is an item such as that found on page 8. An appropriation act has established an agricultural revolving fund, which is substantive legislation. It is a change to that kind of thing that should be clearly set out. There is a difference between saying in the Main Estimates, "We provided $600,000, and now we want $700,000." That is an example of where an appropriation act actually establishes a Crown corporation. We had a case such as this last year where the supplementary Estimates actually established a Crown corporation. The chairman will remember that case because he drew attention to it.

Hon. Mr. Drury: Are you referring to the Telsat corporation?

The Chairman: No, it was something to do with a co-operative that handled Indian or Eskimo crafts. A Crown corporation, which turned out to be a very small one, was, in fact, established by the Estimates themselves. But, this could be the subject of our report. We can make a recommendation to the Senate along these lines.

Senator Grosart: I am just making some suggestions, Mr. Chairman, as a worried layman who has tried to understand this Blue Book.

The Chairman: But what you are more concerned about, Senator Grosart, is that a list be appended to the Estimates and to the supplementaries which would give notice to anybody reading the consolidated statutes that an amendment has been made? Is that correct?

Senator Grosart: Yes. I think the situation is that the distinguished members of the Public Service understand this, but sometimes they are not too keen to have members of Parliament understand it as well as they do.

Hon. Mr. Drury: Mr. Chairman, I protest.

The Chairman: That is a view of a member of the committee. It is not necessarily the view of the committee.

Hon. Mr. Drury: We have made a conscious and I think not entirely unsuccessful effort to make these Estimates meaningful, or, at least, more meaningful than they were. I think that this has been to a large degree successful.

If I may make what is perhaps an unkind observation here, I should like to say that Senator Grosart is really directing his views not at the form of the Estimates but at the form of the appropriation act as a statute enacted by Parliament. The appropriation act itself contains very few clauses, but attaches as a schedule the revised Estimates. The problem is that no one, including the office consolidators, have been willing to take the trouble to sit down and index and analyze the schedules to the appropriation act. This is where the problem lies, and not really in the form of the Estimates, which I hope are considerably more informative than they have been in the past.

Senator Grosart: I would agree generally, Mr. Chairman, but perhaps I might give an example of a qualification I have. I refer to page 6, Vote la under "Agriculture" there is the subheading "Activity to be Supplemented". This is our new system of giving full information. There is "Economics", and an extra $1,300,000 provided. I would suggest that that is hardly full disclosure.

The Chairman: But it goes on to break that down under "Objects of Expenditure".

Senator Grosart: They are not objects of expenditure. I would suggest that "objects" is a wrong word to use, because they are classifications of salaries and wages. The word "economics" does not help me a bit, Mr. Chairman. I want to know what "economics" is.

Hon. Mr. Drury: I think if we go to the main Estimates we will find quite a few words describing these activities, which it has not been felt desirable to reprint in the supplementary Estimates—that is, unless you want this book to be as thick as the main Estimates.

On page 1-8 of the main Estimates under "Agriculture" we have

> PROGRAM DESCRIPTION
>
> **Economics**—Conduct and evaluation of research of economic importance to the agriculture industry; assistance in the formulation of agricultural policies and programs, projection of trends and developments in agriculture and related sectors of the economy; development and dissemination of economic guidelines for production, marketing, management and adjustment.

That is what is meant by the single word "economics" here.

Senator Grosart: I suggest it is just too much of a short cut. If it is economic research, which it is, then I think in another capacity you would agree with me.

I have a final question, Mr. Chairman. Throughout the supplementaries I notice a substantial number of research projects. I think the minister will understand why I ask this question. Would these research projects have been the subject of an overview by the cabinet committee on Science and Research?

Hon. Mr. Drury: Not in these supplementary Estimates in the way which I think would require an affirmative answer to your question.

Senator Grosart: But probably the main Estimates upon which they are based would be subject to that kind of review?

Hon. Mr. Drury: Scrutiny, that is correct, sir.

Senator Grosart: I am sorry for taking up so much of the committee's time, Mr. Chairman.

The Chairman: Not at all, Senator Grosart. I was wondering if, in connection with your request, it would be outrageous to ask the minister for a list of the legislative items that are not one-dollar items—that is, the substantive legislative items.

Hon. Mr. Drury: Well, I am afraid, Mr. Chairman, I shall have to ask for a rather more precise definition, in that every item here is a legislative item. It is part of the schedule of an appropriation act.

The Chairman: We agree with that. We would use the definition which you use in Part III of the explanation of one dollar items. We would be content with that. I think you consider those items fairly substantive.

Hon. Mr. Drury: This is one dollar items which are legislative in nature?

The Chairman: Yes, you have six of them. For example, Vote 1a extends the eligibility criteria with respect to loans. Presumably you mean by eligibility the persons or firms or corporations who can be included. I suppose that would be substantive. It changes the application of legislation.

Hon. Mr. Drury: I suppose really there are some hair-line judgments as to what would be substantive.

The Chairman: We would be content with your judgment.

Hon. Mr. Drury: All right. We can do that; gladly.

The Chairman: If it is not an enormous undertaking, and I notice that Mr. MacDonald is shaking his head indicating that it is not an enormous undertaking.

Hon. Mr. Drury: Oh, the cost to the Public Service is going up.

Senator Grosart: Judging by what Mr. Minister has said, Mr. Chairman, I think he is making a distinction between items that are legislative in nature and items which are substantively legislative in nature. I think he is saying that there are none that he would regard as substantively legislative but that there are some he would classify as legislative changes. There is that distinction. I think we should ask the Minister for all effects here that are legislative, and not necessarily just for the substantive ones, because the Minister is going to come back and say that they are not substantive. I think I would agree with him.

Hon. Mr. Drury: Mr. Chairman, that is quite true. This is a proposed schedule to a legislative enactment. It has no statutory life, if you like, outside the schedule. How much of the schedule is legislative and how much is not? How much is substantive and how much is not? Clearly all of it is legislative; but how much of it is substantive depends really on whether you come from the Maritimes and regard a post office as important or come from Ontario and figure that perhaps post offices in the Maritimes are not substantive or significant.

The Chairman: I think that I had indicated to the Minister, Senator Grosart, that if they used the test which they provide in Part III that would be sufficient definition.

Senator Grosart: The Treasury Board itself has established these categories, Mr. Chairman, because we can go back quite a time in this committee and see that the Treasury Board has been giving us these breakdowns for some time. All we are asking is that they exend the current categories to the legislative categories to include items over $1 as well as one dollar items. That is all we are asking.

Hon. Mr. Drury: I am not sure we all understand the same thing, Mr. Chairman. You referred to category III in this paper. You refer to one dollar items which are legislative in nature. There are six of those. For example, the first one given is under the Department of Fisheries and Forestry, Vote L20a, under section 17 of the Fresh Water Fish Marketing Act. This is amending the Fresh Water Fish Marketing Act. It is not amending the Appropriation Act.

The Chairman: That is what we are referring to, Mr. Minister. It is an amendment of the actual act itself and not an amendment of the Appropriation Act.

Senator Grosart: But, Mr. Chairman, if you turn to page 44 of the Supplementary Estimates (A), you will find three items there that are in one department's classification which are to extend the purposes of Appropriation Acts. As a matter of fact, all six of the items segregated here as legislative are of the same type.

The Chairman: They are listed as part of these one dollar items, however, Senator Grosart.

Senator Grosart: It so happens that in this particular set of supplementaries they are all to extend the purposes. The six of them happen to be that kind. But when we had the breakdown from the department previously, and I am referring now to December 4, 1969, the heading there was:

> (III) One dollar items to amend legislation usually approved through Estimates.

I think we can leave it at that.

Hon. Mr. Drury: I hope that the list we have this time, dividing it up into three headings, is a little more clearly defined.

The Chairman: I agree that it is.

Senator Grosart: I would agree with that.

Hon. Mr. Drury: Here we have one category with six items—amendments through the vehicle of the Appropriation Act—amending acts. There are six items of that kind. The programs of the Department of Industry, Trade and Commerce which received their statutory authorization in an earlier Appropriation Act are in there. Now, clearly the Appropriation Act is the vehicle to amend

that previous act. Then we have other one dollar items which merely particularizes grants made without any increase in money required.

Senator Grosart: The total of the one dollar items is as follows: there are six transfers, six extending the purposes, one to increase and one the purpose of which I do not know.

Senator Phillips: Mr. Chairman, I should like to come back to the question that Senator Isnor and I had raised before, dealing again with the Department of Public Works' estimates. They are clearly laid out province by province, specifying each project. Nevertheless, there is not one project in there for the Atlantic provinces. That is why I should like a breakdown of the Estimates and a little more detail so that I can determine if the Atlantic region has been completely left out of any other departmens. I would point out to the Minister that the Atlantic provinces have the highest rate of unemployment in Canada and, if these Estimates are to be a means of combatting unemployment, I find it rather strange that the Atlantic provinces should be completely left out of one department. Moreover, I should like to know how many other departments have omitted the Atlantic provinces.

Hon. Mr. Drury: I will undertake to see if we can prepare some material to satisfy Senator Phillips, Mr. Chairman.

The Chairman: The Minister has made the point, Senator Phillips, that the $60 million of projects breaks down into a multitude of projects. I think in the interest of economy he is trying to avoid listing every single project and breaking it down as to provincial application.

Senator Phillips: I am not convinced that it is going to break the Government to do this.

The Chairman: I wonder if it would be agreeable if there were a breakdown of the expenditures by province.

Senator Phillips: Yes, by province would be fine. You can just give it for the Atlantic provinces. I can add up the four Atlantic provinces myself.

Senator Grosart: And perhaps by man-years.

Hon. Mr. Drury: I think the money is easier to get. I think one of the problems that this could give rise to is this; if one were to look at our summer student employment programs, there are records obviously in the pay offices of the names and the jobs the various students are engaged in. But if one tries to divide this up by province, are you interested in the normal residence of the student or are you interested in where he worked? We have, of course, a record of where he worked, but I am not sure if we have a record of where he came from. This is the kind of thing I worry about, but we will have to try to give it to you. We can do this by province and the location of the proposed expenditure. I think your observation in relation to the apparent omission from this program so far as public works is concerned is a valid one. I think a large number of the items put in here under the heading "Public Works" do not represent the thrust of the $60 million program, but relate rather to a particularization of an earlier program as the projects have become defined. I think you will discover in the main Estimates that provision is made for quite substantial Public Works expenditures in the Maritime provinces. The work on and progress towards public work activities in the other areas of Canada where unemployment has not been so serious has been left until later. That is why this particularization appears later. My attention has been drawn to the fact, and I am glad to get confirmation of my view, that in this Public Works Estimate it is called "new Major Capital Projects (Information only—no appropriation required.)" That is on page 66.

Senator Phillips: Then it goes on to list the projects item by item after that.

Hon. Mr. Drury: That is correct. As I say this is a specification or a particularization of projects of the Department of Public Works which they had in fact when the main Estimates were tabled and the necessary money provided for that. But the specification of them has been left until later in the year, and the specification of ones in more urgent areas was contained in the main Estimates. This was done first.

Senator Desruisseaux: This could be misleading in relation to work being done in certain areas, because you find for instance on page 72 what has been done for the Cape Breton Development Corporation which calls for a supplementary Estimate of $5 million making a total of $26 million right there. There may be other items.

Senator Phillips: I don't think it would be misleading. I think it would be interesting to make the comparison by region.

The Chairman: You are referring specifically here to the $60 million additional expenditure?

Senator Phillips: Yes.

Hon. Mr. Drury: I am sure we can provide at least a statement of the breakdown of the $60 million as between the various regions of Canada, and also we have a breakdown by department.

Senator Gélinas: Referring to page 16 under Energy, Mines and Resources, I see Vote L10a—Loans to Hydro Quebec Research Institute to assist in the financing of the construction of laboratories. Are those term loans and interest-bearing loans?

Hon. Mr. Drury: They would certainly have a term attached to them, and I would be very surprised if they were not the normal type of loan with the normal rate of interest attached to them. I understand they are 25-year loans and the precise rate of interest we do not have. It probably would be the long-term Crown corporation rate, the kind of rate of interest that the CBC is charged.

Senator Gélinas: It could not come in under the Industrial Research and Development Incentive Act? This is research.

Hon. Mr. Drury: This was quite a specific agreement negotiated between the federal Government and the provincial Government acting through Hydro on the one side and the Minister of Energy, Mines and Resources on the other. This is for the construction, not far from Montreal where the main energy lines pass by, of a new laboratory which would concentrate principally on ultra-high voltage transmission problems. We have had some experience of this in the attempt to design and construct long lines from Manicougan at first and Churchill subsequently. This has given rise to the necessity or desirability for new techniques and new insights into long distance transmission of electrical power. One of the main objects of this new laboratory will be to innovate in this particular field. The federal Government has had for some time a body of expertise in this and the method by which we intended to operate on a joint basis rather than an outright grant and let the Hydro to it all themselves is this loan arrangement, and the laboratory will be jointly operated by Hydro and by the agency of the federal Government.

Senator Paterson: I should like to ask the Minister if the Government has information or if it has made up its mind as to what type of government expenditure affords the best distribution of quick employment?

Hon. Mr. Drury: The question, Mr. Chairman, was whether the government has made up its mind. The government has some views on this and has endeavoured to implement them with the $60 million. In order to get the most employment for the fewest dollars in a most rapid way, I would suggest that the launching of projects directly under the control of the federal Government, requiring the direct hiring of those who are without work now would be the quickest and indeed cheapest way of relieving unemployment.

There are a number of other ways which take rather longer to work through the system. There are some people who advocate a reduction in taxes as being a way of stimulating employment.

Senator Beaubien: Right!

Hon. Mr. Drury: But it does take some time before a reduction in taxes moves through the system and produces a direct increase in employment. This is not as rapid a means and, more particularly, is probably not as specific in relation to locales or regions or areas as the direct undertaking of projects.

Senator Pearson: Would you do that through the regional expansion program?

Hon. Mr. Drury: Mr. Chairman, the question is, "Would you do 'that'?". One would not reduce taxes.

Senator Pearson: No, not reduce taxes, but increase the employment.

Hon. Mr. Drury: This is being done in two ways. One is through the operations of the Department of Regional Economic Expansion. Their approach, however, is longer term than what we are looking at here, and improvements of the infrastructure of a municipality have a longer term benefit, perhaps, than the immediate relief of unemployment. In the case of the $60 million, some portion of this will be moving through the Department of Regional Economic Expansion, but a great deal of it goes directly through other government departments that are not engaged in this specific kind of work.

Senator Desruisseaux: I hope, Mr. Chairman, you will overlook the fact that I may be out of order on this question.

There is considerable concern over what is being said in the papers at the present time about Mr. Henderson. There is also the impression being created in the press, as far as I am able to view it myself, that the Government is trying to starve off his staff, so to speak, so that the checking will not be done as it used to be—just to put it in a few words.

In view of that, if it is to be done, as seems to have been decided, is there going to be any really serious replacement for close checking in the different departments, such as Mr. Henderson used to do? I am sorry if I put this now, but I am taking advantage of the fact you are here.

The Chairman: In view of the fact that this is a consideration of supplementary Estimates, my ruling would be that it is in order.

Hon. Mr. Drury: In order?

The Chairman: Yes, in order.

Hon. Mr. Drury: Mr. Chairman, to use the phraseology of the House of Commons, the question is based on a false premise. If I understood the senator correctly, he said, "If this is going to be done, and it appears to be in process." There is not, there has not been and, as far as I am concerned, there will not be any attempt to starve off, stifle, muzzle, inhibit, limit, or terrorize the Auditor General; and the work that he has been doing in the past, through his staff, will, I hope, continue to be done by him.

The Public Accounts Committee in the House of Commons has been seized with this complaint, I guess I might call it this, of the Auditor General that he has suffered as a consequence of the system of pay classification in the Government, and the Public Accounts Committee is addressing itself to getting to the bottom of this, to discover whether there has in fact been any such discrimination.

I guess I need hardly say here that I am satisfied there has not been any such discrimination, and there certainly should not be.

Senator Desruisseaux: In the press the impression is certainly otherwise, if I may say so.

Hon. Mr. Drury: That I would not deny at all, but you have another committee which examines the media.

Senator Molson: Mr. Chairman could I revert to this matter of the $60 million for unemployment relief?

The Chairman: Yes, Senator Molson.

Senator Molson: I find it difficult to believe that the Government would plan to spend the $60 million without specifically feeling that that is going to reach the regions and pockets of the worst unemployment.

The minister has been asked several questions in this regard, as to regional, provincial, and so on, plans. It sounds as though $60 million have been produced for the pot but have not actually been designed to move rapidly into the pockets of high unemployment. I find this difficult to believe—not the minister's words, but that in the course of this plan for the $60 million they are not actually looking at the worst hit areas for the deployment of these funds.

Hon. Mr. Drury: Mr. Chairman, the reason I am unable to give the kind of precise detailed documentation of this point is not because this was not the intention, but I can assure the committee that the instructions which went out to the departments to review their particular activities over the period of the forthcoming winter, were to review them in order to secure a maximum of accelerated employment in the areas of high unemployment; and it was in the light of these instructions that action has been taken. I have just cited one example which, in a sense, I learned of by accident. The Department of National Defence, in looking at its operations and maintenance procedures, would accelerate them and plan to accelerate them in these areas, and then send in a list—not perhaps in the kind of detail that is needed to satisfy the committee here in this respect—showing that they needed supplementary sums of money for operations and maintenance under various of these budgetary headings or classifications.

The Chairman: But, Mr. Minister, do you not in the Treasury Board employ a method of program analysis which decides the priorities submitted by the various departments, and would you not employ a program analysis on this $60 million? Would you not determine in some way those projects? It seemed that you left it up to the department. That raises two questions, one of which is: How did you achieve the total figure of $60 million? Does that mean there was no analysis of the priorities?

Hon. Mr. Drury: No, it does not. You are quite correct. The analysis was made not by one man but by a number of individuals working to a system with a great deal of documentation. These papers could be collected and put together again in a different way if that is what the committee wants. The information does exist. It is a question of gathering it together and collating it in a particular way.

The Chairman: I think what Senator Molson is interested in is the method by which you determined the priorities of the $60 million. What determined the amount to start with, and what determined the priority as between the various departments?

Hon. Mr. Drury: Well, the process followed was that all departments should review their operations to meet this problem. The criteria in respect of the projects and the increased sums of money were that the projects should be of short duration, and not ones that would last four or five years, and have their main impact during the winter of 1970-71; that they should be in areas of high unemployment in Canada—and the principal ones that are known are in the Maritimes and in the Province of Quebec; that they should involve a maximum of local men as distinct from imported materials and heavy machinery from elsewhere; and that they also should be related to the particular program that was being accelerated or reinforced. By that I mean is that one would hope that the Secretary of State would not put in a project to build a stretch of road somewhere just because it involved a lot of people and was in an area of high unemployment, and would be done during this winter.

Senator Molson: You would not even consider roads to fishing camps and other such useful works?

Hon. Mr. Drury: Unfortunately, we do not have a program to which that could be related.

Senator Molson: May I ask the minister one other question in an endeavour to complete this, Mr. Chairman? Would it be correct to say, Mr. Minister, that as far as you are concerned you are quite satisfied that the $60 million has been put out under specifications which ensure that it is going to be used for the immediate relief of unemployment in the worst areas of unemployment in the country, but you have not got a detailed breakdown here to give us today? Is not this the answer?

Hon. Mr. Drury: That is correct, not in the kind of detail in which you want it. We can give you what each department is spending.

Senator Molson: But from the plans and the way it is being dealt with you are satisfied that it will achieve this purpose?

Hon. Mr. Drury: That is correct, sir.

Senator Grosart: May I ask a supplementary question, Mr. Chairman. I am a little concerned about the fact that the total is $60 million. I believe the minister said that this will create 11,000 man-years of employment. This works out, if my arithmetic is correct—and I asked Senator Beaubien to check it—to about $5,400 per man-year. It would seem that all the money you have would go to salaries, so there must be some other money provided in the $60 million to create these jobs.

Senator Beaubien: They will not be paid more than $300 a month.

Senator Grosart: It works out to about $5,400 a year, which is about the average pay.

Hon. Mr. Drury: Speaking generally, Mr. Chairman, this will not provide for the purchase of equipment which would have a longer life. When I mentioned its being program-related I meant that it is hoped that this will mean an intensive use of the types of construction equipment that departments now have.

Senator Grosart: But will not the whole of the $60,000 have to go into salaries in order to create 11,000 man-years of work?

Hon. Mr. Drury: I have said that this program is concentrated as much as possible on job producing opportunities in the current winter. The sum provided for expenditure in the current year is $60 million. Some of the projects, however, are of a longer duration than this, and they will involve capital expenditures. This means that there will need to be further sums of money provided in relation to those capital projects in next year's Estimates, so that the total cost of this effort is not $60 million. This is the expenditure in the current year. It will mean, as I say, some additional moneys next year, and it is out of these, in a sense by anticipation, that you get this money required for non-salary expenditures. I have not really got the breakdown of that.

The Chairman: Clearly, Mr. Minister, the committee is most interested in how you established the $60 million, and how effective it is, and how you relate the 11,000 man-years to cost. As you can see, the committee keeps coming back to it.

Hon. Mr. Drury: Yes, they do, and the only way to do this is by way of an intense analysis of the whole program. There are always dangers in taking gross numbers and dividing them up, and reaching conclusions. One can secure a man-year's removal from the unemployment relief roles through the manpower training scheme for considerably less than $5,000. For $4,000 or $5,000 under that arrangement you can get two or perhaps more man-years. This is a danger in using gross figures.

The Chairman: This committee is particularly interested in the effect of Government expenditures on the economy, and the fact as to whether or not the economy is reaching its potential or is below its potential. For that reason the method you use in the Treasury Board and the Department of Finance to determine these matters, such as a fast acceleration of expenditures in low growth areas, is of a great deal of interest to this committee.

Senator Grosart: Mr. Chairman, could I say this, that it might help if the minister could explain the statement he made that the departments were asked to come up with projects that might assist in this, and then the Treasury Board made choices from among those suggestions from the departments. Can you give us a rough idea of the relation of the $60 million to the suggestions? In other words, what was your choice element there?

Hon. Mr. Drury: Mr. Chairman, a number of the suggestions of the departments did not fit 100 per cent with the criteria, and there were included a number of large capital projects which would have had some effect on this kind of program, but because of the amount of money involved in terms of both expenditure in the current year and commitment in the future, we put aside. I suppose there would be a tendency on the part of some departments anyhow to bring out the old chestnuts that they had been unable to get approved in principle in previous times, and try to run them under this umbrella. These were not accepted. What we tried to do was get those which most nearly fitted the criteria I have indicated.

Senator Grosart: Which is high labour intensity, really.

Senator Beaubien: Mr. Chairman, I should like to ask the Minister to look at page 4, Information Canada. It shows previous estimates of $7,300,000 and it shows the amount added by this vote to be $555,000, making a total of $7,900,000.

On the other hand, if we look at page 84, item D, Information Canada, we see that the previous estimates are put down in the same way as $7,300,000 and there is the supplementary of $555,000, making a total of $7,900,-000. But then, in explaining it, it says "Activity to be Supplemented", and it has "Information OUT", which is a program of $8,500,000, to which you add the same figure of $555,000 to get a new total of $9,088,000. That does not seem to make any sense to me. Is that another program altogether? In the Supplementary Estimtes (A) on page 4 Information OUT is not shown.

Hon. Mr. Drury: We will have to go back to the main Estimates to see what this Information OUT is all about, Mr. Chairman. I believe one will discover there that in relation to Information OUT there is submitted to Parliament what is called a net vote. Part of the expenditures comes from a parliamentary appropriation and part of it comes from revenues.

Senator Beaubien: Should it not all be included in this total figure of $14,200 million?

Hon. Mr. Drury: Well, the $555,000 should certainly be included.

Senator Beaubien: Well, it is. The $555,000 is, but it seems to be added to two different amounts.

Hon. Mr. Drury: One must distinguish between the amount to be voted, which is Vote 25a for a net vote of $7,900,000, and...

Senator Beaubien: What is the Information OUT for $8 million?

Hon. Mr. Drury: Well, Information OUT, in relation to that activity, has put forward a total expenditure program in the main Estimates of $10 million.

Senator Molson: That is a new figure.

Senator Beaubien: Where would you find it in here?

Hon. Mr. Drury: It is summarized here. In the main Estimates it is a total expenditure of $10 million less receipts and revenues accredited to the vote, of $2,850,-000, or a net on that account of $7,249,000. That is further adjusted by other receipts and the cost of services provided by other departments to get to the figure of a net vote of $7,355,000.

Senator Beaubien: Mr. Minister, you vote the $10 million which is set aside, then some other money comes in which reduces that. Where would that money come from?

Hon. Mr. Drury: From either the public, in relation to sale of materials or services, pamphlets and that kind of

thing, or the cost of services provided to other departments of Government for which a charge is made.

Senator Beaubien: Then that would be reflected. So it is a net amount the Government pays for Information Canada.

Hon. Mr. Drury: That is correct.

Senator Beaubien: All right. I understand.

Senator McLean: Mr. Chairman, I would draw the attention of the Minister to page 56, National Defence. I note that new major capital projects are cited for Canadian forces stations right across Canada, including such bases as Valcartier, Quebec; Borden, Ontario; Kingston, Ontario and so on, but the base at Gagetown is not mentioned. May we take it from the fact that the Gagetown base is not mentioned that either it is going to be eliminated or it does not need any money?

Hon. Mr. Drury: Do you mean that because we have not got a supplementary to the main program for Gagetown that that is an indication that it will be eliminated?

Senator McLean: It is not mentioned here. What can we take from that?

Hon. Mr. Drury: That the needs of Gagetown in respect of capital projects either have been met earlier in time than the current year, and that these other bases are coming along late, or that the Gagetown base was able to formulate the capital projects required at Gagetown in time for the main Estimates so that they do not need to put it in the supplementaries. These others are the johnny-come-latelies.

Senator McLean: Do the main Estimates include Gagetown, then?

Hon. Mr. Drury: I will have to check on that.

Senator Phillips: Mr. Minister, on page 70 I find Vote L25a for an amount of $12,025,000. Directly underneath that is the expression "Economic Expansion and Social Adjustment—Central Canada", and again the figure of $12,025,000 is given. Is that the same vote?

Hon. Mr. Drury: That is the detail of Vote L25a. It is the same vote. It is the same subject, but it is the detail of it.

Senator Phillips: I suppose it would be unfair of me to suggest that this smacks somewhat of the same sort of thing as the department ahead of it; therefore I will not do so, Mr. Minister. But I must point out that again this emphasizes central Canada.

Hon. Mr. Drury: I am sure the honourable senator is aware that the Department of Regional Economic Expansion in one of its programs negotiates and concludes agreements with the provinces in relation to the department's program for limiting and reducing regional disparities. The agreements embodied in the program, relating to the province, have to be approved by the Governor in Council. The department has proceeded to formulate and discuss programs with the provinces apparently most in need, and Ontario is one of the last provinces for which such an agreement has been concluded.

Senator Phillips: I am aware of that, but the point I should like to make, sir, is that, if this program is designed to provide employment, I would expect to see the Department of Regional Economic Expansion direct more efforts towards those areas of low employment than they have. I am not criticizing this vote, but rather I am criticizing the department for not having taken up and provided for the proposal as made by the Government.

The Chairman: Senator, you are going to be given the breakdown of the $60 million expenditures which you are concerned about, and perhaps you can review that then. The Minister has explained that in the case of the Department of Regional Economic Expansion—the specific matter you raise—the agreements were concluded prior to the supplementary Estimates for your region and this supplementary refers to an agreement to be concluded subsequent to that time.

Senator Phillips: I still would like to see more activity on the part of the department.

The Chairman: I thought the Minister explained that you had to take the program in toto, and it was only the question of the signing of the agreement that was involved here.

Senator Phillips: I am aware of that, but I would like to explain that my criticism is directed at the lack of action on the part of the department.

The Chairman: Lack of adequate action?

Senator Phillips: Lack of adequate action, yes.

Hon. Mr. Drury: This could lead to a prolonged debate on how much is enough.

Senator Gélinas: May I refer the Minister to page 76, Secretary of State's Department, Citizenship Development Program. In activities to be supplemented here, it says, "Travel and Exchange" and it is the word "exchange" I am trying to clarify. It is the exchange of what?

Hon. Mr. Drury: People who are not foreigners. This department has a program which subsidizes—I suppose that is the best term—travel between the various regions of Canada by young people. It has nothing to do with foreigners.

Senator Molson: Does that include the Canadian Council of Christians and Jews in this case who have a program for young people to exchange visits across Canada?

Hon. Mr. Drury: This would be part of it.

The Chairman: One of the things that has concerned this committee in the past is exemplified, perhaps, on page 36 where you take an appropriation from Vote 35, if I understand it correctly, and you add it to Vote 25 and call it Vote 25a. I realize we could refer back to the main Estimates to find out what was cancelled, but we wonder

whether it would be possible to designate exactly what was cancelled in that Vote 35a. In other words, to put in the supplementary themselves that "The following project was cancelled or reduced."

Hon. Mr. Drury: There has been under Vote 35a a gross amount provided for grants for Northern Development, and in the main Estimates there will be a number of specific grants proposed which in total add up to less than the gross amount voted at the time. But we come along now and specify additional grants still within the original sum and these additional grants make up the total. The names of these will be found on page 40 in this case. Within the total amount of money provided under this heading "Grants" and under the subheading "Territorial Relations" there is a specific grant made to the Government of the Yukon Territory towards the cost of a Second Language Training Program of $133,000.

Senator Molson: What is the second language in this case?

Hon. Mr. Drury: In the Yukon it would be the second official language, and I suspect that in the Yukon the majority would be English speaking so this would refer probably to French. There is another grant to the Territorial Government to enable them to purchase the renovated Dawson Water System which is a specification of an expenditure within the total sum appropriated in the main Estimates. It does not in fact represent an increase in money to be granted, but it does represent a spelling out precisely of how this money is to be spent.

The Chairman: Then on page 36 you authorize the transfer of $21,373 from Indian Affairs and Northern Development, Vote 35, and I am wondering what program in the main Estimates that refers to, and what program was modified. We wonder whether you should state in the supplementary Estimates as a footnote that "this reduces the following program by this amount," and then describe the reduction. It would make the supplementary Estimates clearer. In other words, you detail increases in expenditure, and we wonder if you should also detail decreases.

Hon. Mr. Drury: I think it would be clearer and more informative, but then one runs into the problem as to how much information one should try to get into this kind of document. As you will recall in some previous years the Supplementary Estimates (A) have been four pages long for a comparable amount of money. Now we have a booklet which is 94 pages long. However, I will take note of the suggestion and we shall see whether we can add further information. As a matter of fact I suppose there is no limit to the amount of information you can provide but then one runs into the danger of trying to provide too much and the document becomes, as Senator Grosart's informants on the outside have discovered, so big that you cannot find your way through it and you have to have somebody else do it for you. This appears to be the state we have reached in the public accounts. You have the situation where there is so much information and so much detail that you cannot really make too much out of it. You cannot find your way through it and so we have to make a judgment or this kind of trade-off as to how much detail you put in here.

Senator Grosart: I think the problem that faced us before in this is that when a department can find, as in this case, almost $1 million in its Estimates, we begin to wonder if there isn't a temptation to overestimate in the first place. We find these transfers throughout the Estimates which means that the department has found some money some place. In this case it is a very large sum, $900,000. Admittedly out of a total of $82 million it is not too big, but the point is that something has been found to be less expensive than anticipated, which is not likely, or even more likely that some project approved by Parliament has been cancelled.

I think this is the point the chairman is raising, that if programs that have already been approved by Parliament are cancelled at departmental discretion, and if this is how they find the money, Parliament should be told that a department has changed its mind.

Hon. Mr. Drury: This is quite correct. There are two possible sources: one is loose estimating—and I hope we are making progress in limiting this; the other is change of priorities during the course of the year. I can understand the problem. We are told in these Estimates what are the new higher priorities, but perhaps there is not a clear indication of what ones have gone down in the scale.

Senator Grosart: Particularly in view of the fact the priorities are Parliament's, in the first place.

The Chairman: I wonder, Mr. Minister, if your officials had an answer to Senator McLean's question about Camp Gagetown.

Hon. Mr. Drury: I have a note here that says there is no item in the main Estimates for capital expenditure at Camp Gagetown in the current year in excess of $1,000,000; and there is no item in the supplementary Estimates for a capital project in excess of $1,000,000.

Senator McLean: What may we take from that?

The Chairman: That probably you will make a speech on it!

Hon. Mr. Drury: You could take a number of things from that, which would be assumptions. I think probably the best way to find out is to inquire of the Department of National Defence how it is that capital expenditures appear to be necessary on a number of other bases, but not on Camp Gagetown.

Senator McLean: Do you say we should inquire directly from the Department of National Defence for this information?

Hon. Mr. Drury: That is from where the information would have to come.

Senator McLean: Would it be proper for me to inquire myself?

Hon. Mr. Drury: I think this would be entirely proper.

Senator McLean: Thank you.

Senator Grosart: Mr. Chairman, I would like to raise one matter with the minister. This is in connection with the policy of keeping the other side somewhat in the dark in respect to collective bargaining with Public Service employees. The minister has pointed out to us today that the amounts the Government regards as possibly necessary to meet increases in salaries negotiated are, I think it is fair to paraphrase his statement and say, "hidden" or "disguised" by placing them in three different places—in the contingency vote, in the departmental Estimates and, sometimes, in supplementaries. I wonder if this is really a good policy, for the Government to play hide-and-seek with its employees in this way.

What I am really saying is: Is there not some other way, rather than saying, "We have to hide the money and we must not let you know how much we think negotiations may cost us"? For example, could it not be done by making no prior provision to reaching these agreements, subject to appropriations in supplementary Estimates? I am sure this has been considered.

Hon. Mr. Drury: It has, of course. Given the fact, then, that there would have to be some provision made for salaries, presumably, in the new year at the rates which prevailed during the previous year, and making no forecast at all of what the increases might be, when these are of the order of 5 per cent or, in some cases, more than this, 6 per cent, in a year, you are leaving out of the main Estimates, the kind of summary budgetary presentation, 5 per cent of $2 billion, which is quite a substantial sum of money.

Senator Grosart: That is if everybody got a new contract in the same year.

Hon. Mr. Drury: I see. One would regard in the Estimates the state of Affairs which collective agreements reflect and then just leave out of accounting new agreements. I am afraid this would produce quite a misleading picture. In some years the omission would be relatively insignificant, and in other years it would be very significant indeed.

In attempting to achieve the balance between revenues and expenditures, and to get an overall picture of the budget, there would have to be this footnote, "While we are budgeting for a surplus of $200 million, for all we know or are prepared to think now, this may turn into a deficit of $200 million, or it may be a surplus of $400 million."

This is not really a very satisfactory way of presenting your plan to the public, so we have tried to come as reasonably close as we can to what we estimate the final result will be; and, indeed, in these Estimates, in the main Estimates of departments, provision has been made for the 5 per cent increase. It is going to be marginally different from that, and the object is to keep the margin as small as possible without, hower, getting into a situation where a union analyst can look at these things and figure out pretty closely what the result will be.

Senator Grosart: If you are assuming 5 per cent normal, across-the-board increases, why do you have to hide the dollars?

Hon. Mr. Drury: We do not assume 5 per cent across the board. What we have done is to make provision in the main Estimates for 5 per cent across the board, and then make provision in the Contingencies Vote for a sum of money over and above the 5 per cent, and have in our minds another sum in the supplementary Estimates to make the full provision for the excess over 5 per cent.

The Chairman: That is contained in other items in the supplementaries, the Contingencies Fund, is that correct?

Hon. Mr. Drury: No, in relation to salary increases this is financed out of the Contingencies Vote. Normally, in the case of payments made out of the Contingencies Vote, these are charged back to departments where there are specific projects. In the case of salaries, to try and spread them back through all the departments affected would mean that there would be a supplementary Estimate for every single department of Government. The book then would be almost as big as the main Estimates.

The Chairman: So the sum you are talking about is entirely contained in the Contingencies Fund?

Mr. Osbaldeston: That is, in the main Estimates plus the supplementaries.

Senator Grosart: I notice immediately a difference between the policy of a large corporation and that of the Government. Perhaps the difference is only in the fact that the large corporations do the same thing but do not admit it.

Hon. Mr. Drury: Well, there are relatively few corporations which publish to their shareholders a detailed list, such as is contained in the main Estimates, of their operations projected over the forthcoming year. This is a discipline from which I am sure the private entrepreneur is glad he is free.

Senator Molson: I think that that is a pretty safe assumption.

Mr. Chairman, I should like to ask what is referred to on some television programs as a quickie. On page 64 I see a supplementary Estimate of $1 million for Royal Commissions and Task Forces. May I ask what this envisages in this present year?

Hon. Mr. Drury: The $1 million is made up of three items. There is provision for $350,000—roughly a third—for the expenses of the Indian Claims Commission for 1970-71, the current fiscal year.

Senator Molson: Is that an additional amount?

Hon. Mr. Drury: I think the Indian Claims Commission was established and began its operations in the current year. It had no existence at the time of the printing of the main Estimates.

Senator Molson: That is a new one?

Hon. Mr. Drury: Yes. $150,000 is an additional expense for the completion of the report of the Royal Commission on the Status of Women. This is a supplementary item to the provision in the main Estimates for this particular commission. The sum of money provided, it is hoped, will be sufficient to enable it to complete its report and wind up its operations.

There is a contribution of $500,000 to the National Committee on Indian Rights and Treaties. I have a note here that the expenses of the National Committee on Indian Rights and Treaties are included and will be provided in the form of a contribution to the committee. The Government's statement on Indian policy which was presented to the first Session of the Twenty-eighth Parliament by the Minister of Indian Affairs and Northern Development has concluded that appropriate support will be provided to the committee so that it can conduct a search on the Indians' behalf and assist the Indian Claims Commissioner in his inquiry. The amount of money has been provided through this particular channel of the Privy Council office rather than through the Department of Indian Affairs and Northern Development to indicate a rather more neutralist approach, because obviously the Minister of Indian Affairs is directly involved in this operation.

Senator Molson: That seems to be a very laudable purpose.

Senator Isnor: Mr. Chairman, I wonder if I am in order in asking the question I wish to ask. It is nice to have a minister here to give us the information we seek. I was impressed by the questions asked by Senators Phillips and McLean concerning expenditures in the Maritime provinces. Yesterday we were supplied with a news release in connection with the Department of Supply and Services. Would I be in order in asking the minister a few questions concerning these contracts?

The Chairman: Do they relate to the supplementary Estimates?

Senator Isnor: They relate to expenditures.

The Chairman: Perhaps you could give us an example, Senator Isnor.

Senator Isnor: In this release there is mention of something like 132 contracts awarded, of which 62 went to Ontario and 30 to Quebec. In comparing those two provinces with the rest of Canada I notice that Nova Scotia had eight contracts out of the 132 and New Brunswick seven. The provinces of Quebec and Ontario received 75 per cent of the contracts awarded, and this is apart from the larger contracts of which, of course, they received most. As these contracts affect employment I was wondering just how they were awarded. Was price taken into consideration, or conditions in the various provinces, or what were the other factors that entered into it?

The Chairman: This may be part of a departmental examination, Senator Isnor. It might be difficult for the minister to give you an answer on that ground, but I am prepared to let him try.

Hon. Mr. Drury: Mr. Chairman, you are entirely right. I have not seen this press release so I do not know what the contracts are all about, but generally speaking the Department of Supply and Services has been given the task of purchasing the needs of the various departments of Government. It is a service agency, and it generally follows the approach of acquiring what it is required to acquire at the lowest possible price, and it does this basically through a system of calling for tenders and accepting the lowest tender that meets the specification. This, of course, has resulted in contracts being placed for the most part where the manufacturing or supplying facilities are.

By way of example, if the Department of National Defence has a demand for motor vehicles the contract will be placed with the company that can produce these in a factory which exists at the lowest possible price, and the location of the execution of the contract is where the manufacturing plant happens to be. This tends to produce a large volume of contracts in areas of Canada where there is the greatest concentration of manufacturing and producing facilities, namely, Ontario and, to some degree, Quebec.

There is an attempt made to supply or acquire by making use of regional productive facilities through regional offices to meet regional needs of the departments concerned. I suppose the simplest example would be the nutrients required by the Department of National Defence. This requirement is met to the greatest extent possible by calling on the local economy in relation to the base to which food is to be supplied, rather than consolidating the entire food requirements and having them supplied from a central depot.

If a particular base requires tomatoes it will seek them out from a local supplier rather than inviting tenders from the United States or from producers in British Columbia.

That is a general exposition. Perhaps in relation to a specific contract I could be more specific, but apart from this general exposition I have nothing more to add.

Senator Isnor: I might point out that I only received that document last evening. Moreover, while the discussion has been going on today I have been listening carefully to the questions and answers and I have been doing a little figuring. It has struck me that there is too much going to those who now have and too little to those who do not. For example, 75 per cent of the 136 contracts awarded went to Ontario and Quebec. In my opinion greater care should be taken in respect of, and more study devoted to, the Maritime provinces who require assistance along this line. That is why I brought the question up at this time. I hope the Minister will bear that thought in mind.

The Chairman: Your point is well taken, Senator Isnor. Perhaps when we examine the main Estimates next year we can ask the Minister of Supply and Services to come to the committee and give some explanation of that.

Senator Isnor: Why not this year?

The Chairman: Yes, it could be done this year. Perhaps we could discuss that with the steering committee.

Senator Isnor: All right.

The Chairman: Thank you, Senator Isnor.

Hon. Mr. Drury: Mr. Chairman, the answer lies largely in the efforts of departments such as the Department of Regional Economic Expansion, whose task it is to try to organize in these disadvantaged areas manufacturing and producing facilities which can meet these requirements. To come back to my case in point, the Minister of Supply and Services really has not much option when he is seeking to acquire automobiles. For instance, in that respect he would hardly look to the province of Manitoba. He could look but that is about all he could do. Until such time as the province of Manitoba has facilities for the production of automobiles it is unlikely that the federal Government will be able to buy automobiles from Manitoba.

It is one of the regrettable characteristics of the Canadian economy now that manufacturing and producing facilities tend, for historical and economic reasons, to be concentrated in what is known as central Canada. It is the specific and explicit objective of the Department of Regional Economic Expansion to reduce this concentration and to increase the size, scale, quality and quantity of manufacturing and producing establishments in areas which in this sense in the past have been at a disadvantage.

Senator Isnor: I do not think they are buying very many automobiles from the manufacturers; they are buying them from the agencies, are they not?

Hon. Mr. Drury: I am sorry, sir, but we buy them from the manufacturers direct.

Senator Laird: Always.

Senator McLean: They might be shipped to the agencies.

The Chairman: That might be the subject of another inquiry.

Hon. Mr. Drury: The economics to the taxpayer in buying them direct from the manufacturer are very substantial indeed.

The Chairman: Senator Isnor nevertheless raises a point that while the burden of this sort of thing may fall upon the Department of Regional Economic Expansion, the purchasing branch of the Department of Supply and Services could perhaps do a lot for regional expansion by giving consideration to the freight disadvantage that is on the shoulders of manufacturers in the Maritimes. It would be worthwhile at some point discussing this with the Department of Supply and Services to see whether they have any regional consideration in their purchasing policy.

Senator Phillips: I might point out, Mr. Chairman, that quite often the delivery point is destined to be central Canada, and then the products are shipped back to various other parts of Canada; this places both the east and the west at a disadvantage.

Hon. Mr. Drury: I must say that the economics of paying freight to a central point from a producer and then shipping it back again at public expense leaves a little to be desired. I do not know why this would be done.

Senator Phillips: Perhaps we can take the Chairman's suggestion and go into that aspect in this committee with the Department of Supply and Services.

The Chairman: I would suggest to honourable senators that the reason I am suggesting we delay it to next year is that, if we are going to make such an investigation, we should have more information than we would have or would be able to put together in the time that is available to us in the examination of the Supplementary Estimates. But that would be a matter for discussion whith the steering committee.

That is my reason for suggesting that we do not go ahead immediately.

Senator Isnor: That is all right, Mr. Chairman.

The Chairman: Thank you, Senator. Are there any further questions?

Senator Grosart: If Senator Isnor wishes to have the Minister of Supply and Services called this year, he could move in the Senate to have the matter referred to this committee. Perhaps he would do that.

Senator Isnor: Thank you for the suggestion, Senator.

The Chairman: That is possible. I have one question for the Minister; can he tell me whether the fact that a budget is a cash budget, in certain times in the economic life of Canada, causes the Government to lease accommodation as opposed to constructing accommodation? In other words, a business which carries an asset on its balance sheet would undertake a capital project with the idea that it would be written off in 20 to 25 years, and, therefore, if the cash were available and there was sufficient cash flow, the business would not look upon it as a serious matter as to whether or not that was constructed as a capital asset or whether they went outside and leased the space. There might be other considerations such as cash flow or cost. But in the case of a government I can see in terms of restraint, for example, where you might need space, that you might very well say, "We are tight on the budget; we are holding down; we will pay $100,000 a year rent, because that is all we have to include in this particular budget, but we won't pay $2 million or $3 million for a building because that is going to put us into a worse deficit". Is that good reasoning?

Hon. Mr. Drury: I think, generally speaking, Mr. Chairman, that, when the provision of space is contemplated, an assessment is made of the economics of buying the land and doing the work ourselves as a capital project financed through annual appropriations and at the rate of expenditure on the building—not on an amortized basis. Given the present value of the future expenditures, there is an assessment between a leaseback arrangement and this, and the economics of this depend on the notion-

al value that the entrepreneur puts on the land he has and the rate at which he can borrow money with ultimate ownership residing in the Government, and finally just a straight short-term lease rental. These three possibilities are examined in cases where it is foreseen that the particular space is going to be needed on a long-term basis. Now there are other occasions where the requirement, if I can call it that, cannot be defined in terms of long term precise needs, and we are liable then to go into just a short term lease.

The Chairman: Yes, but I was referring more to the long term.

Hon. Mr. Drury: Basically the examination is made of these three alternatives.

The Chairman: That is something we might inquire further into in future.

Any further questions, honourable senators?

Our procedure is not really to adopt a report, but rather to examine and report upon the supplementary Estimates. We have had a full and frank discussion with the Minister this morning. When the Appropriation Bill comes, it is of course debatable, and I wonder if honourable senators would be satisfied if the chairman wrote the report in accordance with the discussions we have had here and submitted it to the Senate? Is that agreeable?

Senator Grosart: With the Steering Committee?

The Chairman: I would be prepared to discuss it with the Steering Committee or the full committee if desirable.

Hon. Senators: Agreed.

The Chairman: Thank you.

I would like to thank Mr. Drury and his officials for coming before us this morning and taking so much of their time, which I am sure went far over the amount of time he was able to allot to it. On behalf of all honourable senators, I would like to thank you very much.

Hon. Mr. Drury: On behalf of my officials, I want to thank you for the very courteous and friendly reception.

The committee adjourned.

Queen's Printer for Canada, Ottawa, 1970

THIRD SESSION—TWENTY-EIGHTH PARLIAMENT
1970

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

Honourable DOUGLAS D. EVERETT, *Chairman*

No. 2

WEDNESDAY, DECEMBER 16, 1970

**Complete Proceedings on the Estimates (B)
laid before Parliament for the fiscal year ending March 31, 1971**

REPORT OF THE COMMITTEE

Witnesses: See Minutes of Proceedings.

23250—1

THE STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

The Honourable Senators:

Aird	Langlois
Beaubien	Laird
Benidickson	Macdonald (*Queens*)
Bourget	*Martin
Bourque	Methot
Desruisseaux	Molson
Everett	McDonald (*Moosomin*)
*Flynn	McLean
Forsey	Nichol
Fournier (*Madawaska-Restigouche*)	Paterson
	Pearson
Gelinas	Phillips (*Prince*)
Grosart	O'Leary
Hays	Sparrow
Isnor	Walker—(28)
Kinley	

(Quorum 7)

**Ex officio members*

Orders of Reference

Extract from the Minutes of the Proceedings of the Senate of Tuesday, December 8, 1970:

With leave of the Senate,
The Honourable Senator McDonald moved, seconded by the Honourable Senator Cook:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures set out in the Supplementary Estimates (B) laid before Parliament for the fiscal year ending the 31st March, 1971.

The question being put on the motion, it was—
Resolved in the affirmative.

Extract from the Minutes of the Proceedings of the Senate of Wednesday, December 9, 1970:

With leave of the Senate,
The Honourable Senator McDonald moved, seconded by the Honourable Senator Smith:

That the names of the Honourable Senators Forsey and Langlois be added to the list of Senators serving on the Standing Senate Committee on National Finance.

The question being put on the motion, it was—
Resolved in the affirmative.

Robert Fortier,
Clerk of the Senate

23250—1½

Minutes of Proceedings

Wednesday, December 16, 1970
(2)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 9:30 A.M. to consider the Supplementary Estimates (B) laid before Parliament for the fiscal year ending March 31st, 1971.

Present: The Honourable Senators Everett (*Chairman*), Aird, Beaubien, Benidickson, Grossart, Laird, Langlois, Pearson and Sparrow. (9)

On Motion of the Honourable Senator Laird it was *Resolved* that 800 copies in English and 300 copies in French of the Proceedings be printed.

Witnesses from the Treasury Board:

Mr. G. F. Osbaldeston, Deputy Secretary (Program Branch);

Mr. B. A. MacDonald, Director General, Budget Coordination.

It was agreed to report on the said Supplementary Estimates (B) after approval by the Steering Committee.

At 10:45 A.M. the Committee adjourned to the call of the Chairman.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

Report of the Committee

Wednesday, December 16, 1970.

The Standing Senate Committee on National Finance, to which was referred the Supplementary Estimates (B) for the fiscal year ending March 31, 1971, has in obedience to the order of reference of December 8, 1970, examined the said Supplementary Estimates and reports as follows:

1. Your Committee has examined the said Supplementary Estimates (B) and has heard evidence thereon from Mr. G. Osbaldeston, Deputy Secretary, Programs Branch, Treasury Board, and Mr. B.A. MacDonald, Director General, Budget Coordination, Treasury Board.

2. The said Supplementary Estimates (B) provide for total expenditures for which Parliament will be asked to provide funds in the amount of $54,000,001 and loans, investments and advances in the amount of $150,000,001. This brings the total of Main and Supplementary Estimates for the current fiscal year to $14,413,415,194. The Main Estimates called for an expenditure of $13,752,-294,436. Supplementary Estimates (A) and (B) increase this by $661,120,758.

3. Included in the said Supplementary Estimates (B) are two $1 items about which your Committee made enquiries. The first one dollar item extends loan insurance under Industry, Trade and Commerce Vote 30c, Appropriation Act No. 1, 1968 to manufacturers and marketers of footwear and to those who provide services to such manufacturers. The second one dollar item extends the authority to make loans under Industry, Trade and Commerce Vote L80, Appropriation Act No. 4, 1968 to certain manufacturers of footwear to permit them to adapt efficiently to competition from footwear imports.

4. An amount of $54,000,000 is provided in these Supplementary Estimates (B) to provide an immediate increase of 10 per cent in unemployment insurance benefits pending the implementation of the new system of unemployment insurance in July 1971 as outlined in the White Paper on Unemployment Isurance.

5. An amount of $150,000,000 is provided for loans to provinces for capital development projects which involve construction that the provincial government would not otherwise undertake in 1971-72 and which will contribute directly and quickly to additional employment. The loans will be repayable within 15 years at the Canada Pension Plan interest rate. Distribution of the loans follows the number of unemployed persons in excess of 4 per cent of the labour force, determined by averaging rates reported and forecast for the last six months of 1970 together with estimated unemployment among treaty Indians on reserves. On this formula the tentative distribution of the funds is as follows:

Province	Amount	Percentage of total
Newfoundland	5,000,000	3.6
Prince Edward Island	1,000,000	0
Nova Scotia	4,000,000	2.6
New Brunswick	4,000,000	2.6
Quebec	68,000,000	45.1
Ontario	17,000,000	11.3
Manitoba	8,000,000	5.6
Saskatchewan	5,000,000	3.1
Alberta	4,000,000	2.6
British Columbia	35,000,000	23.6

Respectfully submitted.

D. D. Everett,
Chairman.

Report of the Committee

The Standing Senate Committee on National Finance

Evidence

Ottawa, Wednesday, December 16, 1970.

[*Text*]

The Standing Senate Committee on National Finance, to which was referred the Supplementary Estimates (B) laid before Parliament for the fiscal year ending March 31, 1971, met this day at 9.30 a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, our witnesses are Mr. G. F. Osbaldeston, Deputy Secretary of the Programs Branch of the Treasury Board, and Mr. B. A. McDonald, Director General, Budget Co-ordination of the Treasury Board. Both these gentlemen are well known to you.

Before we begin, I will ask Mr. Osbaldeston if he has any statement to make.

Mr. G. F. Osbaldeston, Deputy Secretary, Programs Branch, The Treasury Board: I do not have any particular statement to make, Mr. Chairman, unless it would be helpful for the senators to have me comment on each item. They might prefer that I do that.

Senator Benidickson: I think a little comment at the beginning to put in plain language the long wordage that we have here with respect to this vote would be helpful.

The Chairman: I might point out that there are only three items in these Supplementary Estimates (B) and if it is agreeable to you we could have Mr. Osbaldeston comment on each one.

Mr. Osbaldeston: The first item, Mr. Chairman, is the special loan program, Department of Finance, Vote L12b. Now this program is intended to stimulate employment by providing loan funds to the provinces which would permit them to proceed with capital expenditures, such as roads, bridges, buildings, et cetera, which the provinces had not included in their own capital programs for the fiscal years 1970-71 or 1971-72. The provisions as to eligibility for the loan in a province is where the unemployment exceeds 4 per cent of the labour force and then that province becomes eligible to apply for a loan. The amount for which they are eligible is then related to the total unemployed in the province over 4 per cent, as it relates to the total of unemployed in Canada over 4 per cent. Therefore, if a province had 100,000 unemployed over 4 per cent of the labour force and in Canada there was 400,000 unemployed over 4 per cent that province would be eligible for one-quarter of the loan fund—one-quarter of the $150 million. Given the situation that existed at the time Mr. Benson spoke in the House of Commons on the budget, I can provide, if you like, Mr. Chairman, detail on how the $150 million would be allocated by province on that formula as at the time Mr. Benson spoke.

Senator Benidickson: I was going to ask that question eventually, anyway.

Senator Beaubien: Are there any provinces under 4 per cent?

Mr. Osbaldeston: No. Every province would be eligible for part of the loan fund.

Senator Benidickson: One province gets less than one per cent of the grant.

Mr. Osbaldeston: That is correct. If I can refer to the figures...

The Chairman: If I can interject, I did notice, looking at those figures, that Prince Edward Island is not eligible under either of the tests, that is, apparently according to these figures it has no Indians unemployed and unemployed above 4 per cent. But it is shown that it receives $1 million.

Mr. Osbaldeston: I believe what we have there is a rounding of figures. If you notice, the figure in the front comes to $151 million, but I believe that is a rounding. The document I am quoting from, Mr. Chairman, is a document put out by the Department of Finance and was a document of the highlights of the budgetary speech by Mr. Benson. I could give you the date. It is on the front.

The Chairman: There is only one copy of this document. Would senators like the details?

Senator Benidickson: I think we were given it. I got one the other day. While it was dated December 3, I only received it a day or two ago.

The Chairman: Perhaps the witness could read the percentage distribution.

Senator Benidickson: Of the dollar items.

Senator Laird: For each province.

Senator Pearson: Is this a cost sharing loan?

Senator Benidickson: No, it is a straight loan.

Mr. Osbaldeston: It is a loan available to the provinces.

Senator Pearson: The provinces do not have to put up an equivalent amount?

Mr. Osbaldeston: No, they do not.

Senator Beaubien: They pay interest on the loan?

Mr. Osbaldeston: Yes, at the rate that the Crown charges in the Canada Pension Plan, which as of December was 7.71 per cent.

Senator Laird: Mr. Chairman, could I get this straight? Is the fixing date the date when Mr. Benson gave his speech? In other words, you do not vary from the unemployment percentages after that?

The Chairman: I believe it is the average of the six months.

Mr. Osbaldeston: It is spelled out in the vote—the number in that province of unemployed workers in excess of 4 per cent of the labour force in the six months period commencing on July 1, 1970 and ending on December 30, 1970 as estimated by the Minister of Finance.

Senator Laird: That is right. That is what I wanted to get at.

Mr. Osbaldeston: The figures are, in dollars and percentages:

Province	Dollars	Percentage
Newfoundland	$ 5 million	3.6
Prince Edward Island	$ 1 million	0
Nova Scotia	$ 4 million	2.6
New Brunswick	$ 4 million	2.6
Quebec	$68 million	45.1
Ontario	$17 million	11.3
Manitoba	$ 8 million	5.6
Saskatchewan	$ 5 million	3.1
Alberta	$ 4 million	2.6
British Columbia	$35 million	23.6

If I may just conclude these remarks, I would say that the loan repayment period is fifteen years and, as I mentioned, the rate of interest is that in effect for the Canada Pension Plan at the time of borrowing and in December 1970 it was 7.71 per cent.

Senator Beaubien: Has the money been lent?

Mr. Osbaldeston: I am not aware that it has been lent, but I do know that the Minister of Finance has been in touch with the provinces, but I am not aware whether it has been lent.

Senator Benidickson: None could be lent until we pass this legislation.

Mr. Osbaldeston: I am sorry, that is quite right, not until the legislation is passed. I was thinking of the agreements—getting agreement in principle.

The Chairman: Perhaps you would like to proceed with the second item.

Senator Benidickson: Could we not deal with them one by one?

The Chairman: If that is your wish. We will deal, then, with the $115 million special loans program.

Senator Grosart: Where do we find the original vote?

Mr. Osbaldeston: On the special programs?

Senator Grosart: On this item, Vote 12B.

Mr. Osbaldeston: It is a completely new vote. There is no previous vote.

Senator Grosart: So this is not a supplementary to a vote. It is, in effect, a new request for authorization for expenditure.

Mr. Osbaldeston: That is right.

Senator Benidickson: I have a few questions. Presumably this is an attempt to help alleviate the most deplorable situation that we have and which will doubtless worsen with respect to unemployment over the next period of time. We cannot foresee how long, but for some time. Everybody I think says that. This was one of the most important items in the recent budget, dollarwise. I have some questions in my mind as to how rapidly any employment can be created by this vote. We have not any longer got a winter works program, have we?

Mr. Osbaldeston: No, not by the federal Government.

Senator Benidickson: A special project to cope with unduly, heavy winter unemployment? That has been abandoned, has it not?

Mr. Osbaldeston: The project that I believe you refer to as the federal one, relative to the municipalities, is no longer in existence. However, relative to winted works, I think the government's program of $60 million in October, relative to capital works, and the Government's program here...

Senator Benidickson: That includes the Montreal Airport?

Mr. Osbaldeston: No. The first program was in the order of $60 million, which was devoted to operation and maintenance work by the federal Government on their federal properties, and also included smaller capital item—the $60 million in October. Then, within this budget which Mr. Benson has just brought down, you have $250 million worth of new funding, among which is $23 million for capital works. So when I say there is no winter works program in that, I want to make it quite clear that there are other programs operating at the moment.

Senator Benidickson: But in the context of the federal Governement budget—I think these Supplementary Estimates (B) now says that for the 1970-71 year our total estimates to date are $14,413,000,000—it is not very significant. Back to the point as to how quickly any action could take place with respect to the spending of this $150 million, you have referred to some discussions already

with the provinces. As a result of those discussions, how much good do you think this vote is going to be this winter? I see that it can be spent beyond this winter and could go later—what is the terminal date for all the loans for the fiscal year 1971-72?

Mr. Osbaldeston: Quite.

Senator Benidickson: So we are really doing something unusual here, we are providing funds for the year ahead —which we normally do not do.

Senator Beaubien: We are letting them borrow.

Senator Benidickson: No. The loan would be made in a future fiscal year—which is not normal for appropriation.

Mr. Osbaldeston: Could I comment on that?

Senator Benidickson: I can understand the reason for it. The provinces naturally want assurance as to when they can do this. But my first question is back to the one of what action is likely to help with unemployment under this vote in the current winter.

Mr. Osbaldeston: Senator, I have not been involved in these earlier discussions with the provinces, nor would I likely be. But could I comment from the point of view of something in which I have been heavily involved that is, the $60 million federal program of capital works and the present $23 million program of capital works. I think the provinces would have similar problems to face as we, in the federal Government, have had to face in trying to mount these capital works programs quickly.

Senator Benidickson: Yes.

Mr. Osbaldeston: Our experience has been that you can do a considerable amount rather quickly, because you have a number of items that are really shelf items, a number of items that have been prepared, the plans have been drawn, the property has been expropriated, but the funds were not available, so it had to stop at a certain point in the planning process.

Senator Benidickson: There was retrenchment.

Mr. Osbaldeston: That is quite so. So these items can come off the shelf and I think we can get a certain amount of action this year. I think I would anticipate that from our federal experience. However, it is true to say that when you are engaged in a larger program it does take time, there is planning time required. Therefore as is evident in this, if this program is seen as extending into the fiscal year 1971 to 1972, for the very reasons I have suggested, that you mentioned, the fact that capital programs take some time to get going.

Senator Benidickson: That is what I am afraid of. I think it has not really too much immediate value.

Mr. Osbaldeston: I think we will really only know that, senator, when the bill has been passed and we have concluded discussions with the provinces. At that point we will know the percentage. We will not know until then the shelf items that the provinces have. I certainly do not.

Senator Benidickson: This stipulates that the loans will be made only with respect to projects that the provinces had not decided to undertake in 1970-71 or 1971-72. Now probably all the provinces have prepared their Estimates for 1970-71, but they probably have not prepared any Estimates to indicate what they propose to do in 1971-72. So how are you going to determine whether or not they would have gone ahead with a certain project in 1971-72 irrespective of this loan?

Mr. Osbaldeston: Provincial planning would now have concluded relative to 1971-72. All their plans would have been decided upon at this point, but they would not have tabled these plans. Simply in conversation with the provinces we would determine what their plans were and what items they were unable to finance, and these are the items that would be eligible.

Senator Benidickson: You would then more or less have to conduct informal discussions with them to decide whether or not to take their word that except for this loan they would not have gone ahead with a specific project in 1971-72.

Mr. Osbaldeston: That is correct. It would be a matter of negotiation with the provinces.

Senator Benidickson: This is only a loan and even at that they have to pay an interest rate under the formula of 7.71 per cent. Now what is the advantage or what is the difference between that 7.71 per cent and what, say, Quebec would have to pay on its own borrowings if it was concerned with unemployment and wanted to put on some projects that otherwise they could not have gone ahead with except for the current unemployment situation?

Mr. Osbaldeston: I am not aware of the present rate that applies to Quebec borrowings, but I would expect it would be higher than 7.71 per cent.

Senator Benidickson: But what is the incentive to take advantage of this loan?

Mr. Osbaldeston: The first incentive would be quite clearly the difference in rate, and the second incentive is relative to the two-year total borrowing power. That, of course, is reflected in the interest rate which raises as your borrowing capacity or capability tends to reach its limit. But these two incentives are working directly, the difference in rate between that which we apply with the Canada Pension Plan and the difference in rate which must be paid by the province, and secondly the question of your total borrowing capability. Those are the two incentives.

Senator Benidickson: But over this length of time, surely one of those criteria does not amount to very much because if it is known that the total debt of the province has increased by virtue of a repayable loan to the federal Government by so many millions, the lenders are aware of that and if they feel that the province has been borrowing too much money already they may be

rather cool to them in the money market. The are going to be very well aware of this so it will not help very much.

Senator Grosart: They are not forced to take the loans.

Mr. Osbaldeston: I think we will really know how attractive it is when we see the amounts that are taken up. The indications I have seen, only in the press, are that the provinces welcome the loan fund.

Senator McLean: Any province that goes out to borrow will borrow through a bond issue, I presume.

Mr. Osbaldeston: Yes.

Senator McLean: Most provinces are offering 9 1/2 or 9 1/3 per cent. So naturally they can afford 7 per cent on $60 million. They would not let that drop.

Senator Benidickson: That is the incentive I wanted to know about, and how valuable it would be in encouraging them to do something which they otherwise did not plan to do.

Senator McLean: I imagine 2 per cent would be quite a difference.

Senator Grosart: The limitation is as to capital expenditure. The amounts authorized under these loans must be expended on capital works.

Mr. Osbaldeston: That is correct.

The Chairman: Does it not have to go further than that? Does it not have to be job-creating?

Mr. Osbaldeston: Yes, it cannot be used for 0 and M operations.

Senator Grosart: And they are different from the winter works programs, or the former winter works programs, I should say.

Mr. Osbaldeston: Yes.

The Chairman: Any further questions on this point?

Mr. Osbaldeston: Then Vote Ib and Vote 11b are interrelated, both extending assistance to the footwear industry, and senators will recall that in Supplementary Estimates (A) similar votes appeared relative to the clothing and textile industries. The extension of the GAP which is the program to assist Canadian manufacturers to adjust to the new trading environment that began with the Kennedy Round to both these industries is, of course, to help them restructure in the face of this new world trading environment. In particular, in the case of the votes you have before you here, they are to help them to restructure in face of low import competition. The elements which would concern you in this vote are precisely the same elements that appeared in the Supplementary Estimates (A) which dealt with the clothing and textile area. The first aspect of the assistance is the insurance of loans made by private lenders to the manufacturer or to a company or group that provides marketing, financial or other services to a manufacturer. The first item is insurance of loans made by private lenders, and the second item is direct loans made by the government to the manufacturer. In the case of the direct loans, the Board operates as a lender of last resort.

Senator Pearson: What do you mean by "restructure"? And where or in what province does this mostly take place?

Mr. Osbaldeston: This particular program is available to a company that makes footwear in any province in Canada. It is open to any manufacturer of footwear.

Senator Pearson: It might be a brand new industry, then, in some province?

Mr. Osbaldeston: Yes, but of course there are certain criteria here where they must prove to the Board that in fact they have been hurt by low import competition, and secondly, they must show to the Board, the lending authority, that they have a plan for restructuring which over time would make them competitive, so it is not simply a question of extending a loan or providing a guarantee to a private lender just on the basis that somebody wants a loan. And, as I mentioned earlier, not only must they show these things, but they must also show that they could not, in the case of a direct loan, secure the loan from any other source.

Senator Sparrow: It is not for new industries, then, but only for existing ones?

Mr. Osbaldeston: This is a question of restructuring an existing industry. I am sorry, senator, I missed your point.

Senator Pearson: To whom do you anticipate most of this loan will go?

Mr. Osbaldeston: I am relying now on my own knowledge of the footwear industry in Canada, which I believe is concentrated in Quebec and Manitoba, and I believe that there is also a fairly healthy industry in Ontario.

The Chairman: Have you any idea of the rough percentage breakdown as between those?

Mr. Osbaldeston: I am sorry, senator, I do not.

Senator Grosart: Does this come under the assistance program for adjustments as a result of the Kennedy Round?

Mr. Osbaldeston: It is an extension of the GAAP, the General Assistance and Adjustments Program.

Senator Benidickson: The original Vote 30c in 1968 was limited to a hurt that resulted from the Kennedy Round of agreements.

Mr. Osbaldeston: That is correct.

Senator Benidickson: What you are doing here is making provision for assistance, even if it does not directly relate to something that happened as a result of the Kennedy Round agreement.

Mr. Osbaldeston: That is correct.

Senator Benidickson: We had sub-items (a) and (b) in item 30C in 1968. In effect, for the textiles the other day and now for the footwear industry, you are doing what is tantamount to adding (c) and (d)?

Mr. Osbaldeston: That is correct, senator. When the GAAP was brought in it was to assist Canadian companies to be more competitive in the face of the new international trading environment. At that time, when it was brought in, one related the need for this specifically to the Kennedy Round. That was the fact at that point in time that was dominant. At this point in time, still dealing with this world trade environment, you have new facts presented. One is that the Kennedy Round effects have been felt and the more favourable entry that was provided under the Kennedy Round is still with us. However, we are faced with the low-cost import competition, as I am sure all honourable senators are aware.

Senator Benidickson: From Asiatic countries and other countries that had nothing whatever to do with the Kennedy Round.

Mr. Osbaldeston: That is right. I think they can only be related to this new world trading environment where they are shipping into the North American market in heavy quantities, as senators are well aware. Therefore, this program is really an extension of the GAAP in terms of ensuring that Canadian companies can compete in the world trade market. In that sense, senator, it is a continuation of the GAAP.

Senator Benidickson: I was not at the last meeting with respect to Supplementary Estimates (A), Mr. Chairman, and I have noticed that Senator Grosart raised a point that has always been a sore point with me, that is that we have these dollar items and not only do we legislate something important by a dollar item originally—as we did in 1968—but then we build on top of that legislation, instead of bringing in a separate bill which somebody can find in the statutes properly indexed, and we bring in subsequently, in another couple of years, another dollar item based on that original piece of legislation that is simply entitled Appropriation Act No. 1. I am not going to repeat that argument. I was not here last week because I was not able to attend the last meeting, but I have read the remarks of Senator Grosart and what went on with the President of the Treasury Board at that time. I have for years shared the view that we have too many of these dollar items that are really of a rather permanent nature and should be presented in the form of an act of Parliament.

The Chairman: I think, senator, that forms part of the report of the committee on Supplementary Estimates (A) and is now before the Senate.

Perhaps we could return though, before we get on to that item, to Senator Grosart's question on the footwear industry.

Senator Grosart: My question was very much along the line that Senator Benidickson is commenting on at the moment. Why is there not an act of Parliament, other than an appropriation act of 1968, to authorize these expenditures? I am not asking you a political question, but why within the responsibilities of Treasury Board is there not a suggestion that this kind of thing should be in a regular act of Parliament and not an appropriation act of 1968.

Mr. Osbaldeston: Senator, I believe that Mr. Drury undertook to give a response to a similar question at the last meeting he had with you. I can only really repeat the essence of that which, as I recall his comment, was to the effect that an appropriation act is an act of Parliament and does go before the House and before the Senate for consideration at the time it is past, obviously. Therefore, as senators all know better than I, this vehicle, this particular bill has been used for this purpose. I do not think I can go past that, senator.

Senator Benidickson: It has in the past, but I think its use is increasing, and I think the way of use is being enlarged.

I learned, I think for the first time yesterday, that under the rules in the other place, in the House of Commons, this is a very good gimmick to put through legislation, because I think I read that with respect to a certain supplementary estimate the other place was discussing last week it was stated that under the rules, if they did not complete their discussion within two or three days—I have forgotten what it was exactly—the thing was carried and had to go back to the House for a vote. That is practically closure. If that is their new rule, this is going to be a temptation for the Ministry to use this increasingly, rather than to present bills which might be subject to some debate at length.

Senator Grosart: I wonder if Senator Benidickson would allow me to carry through with my questioning on this, Mr. Chairman.

I am aware of the explanation given by Mr. Drury and your summary of that explanation, but this does not answer the question as to why we use this formula sometimes but not always. In other words, if this is a valid formula, why do we have acts of parliament, other than appropriation acts? This is the point I am getting at. I say that because when we have this item in an appropriation act it is a couple of paragraphs. An act of Parliament spells out the respective powers of the minister, the respective powers of an Order in Council. It has an interpretation section. In other words, it is designed to give us information so we know exactly what is contemplated, what authority is given. I suggest that this is not so when we have legislation by an appropriation act.

Senator Benidickson: You point out that lawyers, accountants and other interested individuals should be able to find some reference to it in the statutes.

Senator Grosart: That is one point, but the more fundamental point is that this is not, by any means, the normal way of enacting legislation, particulary legislation that authorizes the spending of large sums of money. I am not concentrating merely on the one dollar aspect of it now, but the fact that any money can be repeatedly spent and the authority of an appropriation act used year

after year, when we have no act in the normal sense, to define the parameters of the authority given to the Executive.

This is perhaps a policy question, in which case, we would not expect you, Mr. Osbaldeston, to give an answer, but what I am asking is: In the Treasury Board has there not been some suggestion that this Appropriation Act of 1968 should have been brought before Parliament as a normal Act of Parliament? There may be reasons. Is there a reason? Is the reason that this may be ephemeral? I am anxious to get some understanding of the thinking that presents us over and over again with this type of legislation to which we have been objected so often.

Mr. Osbaldeston: I think, senator, as you have pointed out, the issue as to whether or not you bring an item forward in legislation or whether you bring it forward in an appropriation bill, is, of course, a policy decision of the Government. I do not think I can really comment on it. I have only held my present position for a short while, but in the two supplementary Estimates I have been involved in myself, the $1 items are, generally speaking, to extend the puposes of an appropriation bill itself. In that sense, I have not personnaly had experience with legislation in the appropriation bill that is not of the order of the sort of thing we are looking at here.

Senator Grosart: We sometimes have an appropriation act going back to 1957 and earlier.

Senator Benidickson: And no legislation.

Mr. Osbaldeston: At the last meeting the question of search was raised. We will be in discussion with the Department of Justice to determine whether that aspect cannot be resolved, because in developing an office conlidation or such there is no reason why the appropriation bill should not be searched to make sure the proper references are there and give the lawyers and others who are interested proper office consolidation.

Senator Grosart: I will ask this final question. Is there, to your knowledge, any categorization of legislative formula that would separate this kind of legislation from the normal kind of legislation?

Mr. Osbaldeston: I am not aware of any formula that one can test this question against, because I would think, given that the appropriation bill is an Act of Parliament, the question of how you legislate seems to be a matter of judgment in each case.

Senator Grosart: The normal understanding in an appropriation act is that this is an act to appropriate money under an authority already given by Parliament. That is the normal definition of the purpose of an appropriation act in the literature written on the sujbect. Parliament itself does not always actually appropriate the money in the original statutes. There is normally a statute on which the appropriation act relies for the authority to engage on a certain program and then comes back and asks for the money. These seem to be abnormal amounts in that respect. That is the point I am getting at. After examining them I have come up with one suggestion of a category which might be used where it is felt this is temporary legislation. You might say this is unemployment directed to a certain period, the remainder of this fiscal year and the next and presumably it will lapse.

The Chairman: As I understand it, you are not so concerned about this particular $1 vote but that it refers back to a 1968 act. You would not be concerned if it referred back to a statute.

Senator Grosart: I would not be concerned at all. I would say that it was a statute which has gone through six readings of both houses and been fully examined.

Senator Benidickson: And all the principles and manner of administration.

Senator Grosart: This does not apply here and this is my objection to this. This is why I keep asking if this is in a special category in the minds of those presenting legislation of both kinds to us.

Mr. Osbaldeston: As to your general question, I am not aware of the category. In the case we have in front of us, of course, it is an extension of an appropriation act and in this case it is perhaps appropriate that it be handled here. As to the original vote being used in the appropriation act, I think that is a question for the Government as to how they will legislate.

Senator Grosart: It could be called a continuation of a bad habit.

Senator Benidickson: As to the main Estimates in 1968 with respect to both of these times, one of which is an operating expense and the other a loan, by means of an appropriation act we gave the Department of Industry, Trade and Commerce certain authority in these matters. In intervening years does the department get down to some estimate of what it is going to cost them in the next current year and put in dollars and cents an item in the main Estimates for the purposes we are discussing here today?

Mr. Osbaldeston: Yes. In the case of the guarantees we do not publish a figure. In the case of the loans there is a figure published in the main Estimates.

Senator Benidickson: So that next year with respect to loans to the footwear industry, if this thing is authorized to continue we can contemplate that the department will put in its main Estimates an item under the loan section indicating what it proposes to spend and what it will put in outlay in 1971-72 for these purposes.

Senator Grosart: I think what Senator Benidickson is asking is will they put (c) and (d) in the main Estimates which they obviously would not, because they are (a) and (b) and the others are (a) and (b).

Senator Benidickson: I do not think they know what this is going to cost and it is something they had not decided to do at the time the main Estimates were printed.

Mr. McDonald: The original appropriation act, under item L11b, provided for a sum of money for a loan amount which has not been entirely used so that the estnesion here is to permit...

Senator Benidickson: As to purpose.

Mr. McDonald: Yes, they are extending the purpose, but the amount of money originally provided under the item has not been added to.

Mr. Osbaldeston: I have some information on the background. In the two years of operation of this GAAP program a total of $32.6 million worth of loans have been insured—no direct loans.

Senator Benidickson: You are authorized for $100 million.

Mr. Osbaldeston: That is correct and no direct loans have been provided during that two-year period. As Mr. McDonald has pointed out, there is no need for new limits.

The Chairman: I note that under Vote 1b there is a previous estimate of 40 million odd dollars. How do you achieve an estimate on a guarantee

Mr. McDonald: That was in the previous Estimates for the fiscal year 1970-1971. For the trade-industrial-operating expenditures vote some $40,165,000 was provided, and we are showing the previous estimate. It has no reference though to this particular item.

Senator Benidickson: In other words, the answer to my question is that if you had used up the $11 million that was provided in Appropriation Act No. 1 in 1968, or had used up with respect to loans the $8 million authority that was provided in Appropriation Act. No. 4 of 1968, then you would require in the future to put new figures in the main Estimates?

Mr. Osbaldeston: That is correct or in the supplementaries if indeed this program at this point required new funding or extension of the limits of the funding.

The Chairman: If there are no further questions.

Senator Grosart: I am sorry to be persistent, but this point has just occurred to me. This is called the "trade-industrial program". Could you give us the genesis of that, how this name was acquired, was it authorized by Parliament?

Mr. Osbaldeston: I think I can answer that in general and perhaps Mr. McDonald can answer specifically on the main Estimate. That describes the program. As senators are aware, the new form of the Estimates provides for the programs. This program appeared in the main Estimates of 1970-71 as the trade-industrial program and it was then attached first as an appendix to the appropriation bill relative to the main Estimates. It was at that point that the program was given birth to, at the time of the 1970-71 main Estimates. I might go on further. Senators perhaps are aware that the form of the Estimates was discussed at length with the Public Accounts Committee.

Senator Grosart: I am aware of that. Not the form, but I am aware of the fact. I am just wondering where this name came from, on what page of the main Estimates.

Mr. McDonald: On page 10-4.

Mr. Osbaldeston: The name is, I believe, an attempt to be descriptive of what is contained within the program vote.

Mr. McDonald: There is then a further description on page 10-8 of some of the objectives and activities under the program.

Senator Grosart: My point is that normally we would expect there to be an act called the Trade-Industrial Programs Act.

Mr. Osbaldeston: That is to take care of the elements, or the gap, within the vote. As the senator realizes, there are some other elements within the vote which would not have been contained probably within such an act.

The Chairman: If there are no further questions on this section, we will move to Vote 7B.

Mr. Osbaldeston: Mr. Chairman and honourable senators, this item relates to the unemployment insurance benefits. It provides a supplementary benefit of 10 per cent of the existing UIC benefit rate, for all those drawing unemployment insurance benefit in the period January 3, 1971 to June 30, 1971. As senators are aware, the Government's White Paper proposes a change in the UIC legislation to increase the rates. Given the present situation relative to unemployment, the Government decided to bring forward this item to supplement the UIC rate to a level which would presumably approximate the final decision on the UIC benefits.

Senator Pearson: This would be the Government's share of it?

Mr. Osbaldeston: No, this is a 10 per cent supplementary benefit paid by the Government.

Senator Benidickson: It says that the increase is not to exceed 10 per cent. It does not say that it will be 10 per cent. You have an estimate here that the authority to go up to 10 per cent would be $54 million extra. I assume that that $54 million is based on the maximum, the 10 per cent.

Mr. Osbaldeston: That is correct.

Senator Benidickson: To your knowledge has there been any commitment either in the committee of the Estimates when this was examined in the House of Commons, or in the House of Commons itself? Has there been any statement made by a minister to say that the increase will be 10 per cent, or will it be less than 10 per cent?

Mr. Osbaldeston: If I just might make reference to Mr. Benson's statement—certainly the commitment was not given there. I think that obviously the reason was that Parliament had not dealt with the legislation, so there was no commitment in Mr. Benson's statement. I was not

present when the Unemployment Insurance Commission appeared, and Mr. Benson appeared, before the house committee and I cannot really answer your question. I do not know that a commitment was given to that level.

Senator Benidickson: This of course does not help that mass of young people who probably have not got unemployment insurance entitlement this winter. This has been of great concern, I suppose, to all parliamentarians and officials. Probably the mass of that group are not qualified—in the group under 24 years of age.

Mr. Osbaldeston: That is correct. There are several programs that were begun by the Government in this past summer relative employment of students.

Senator Benidickson: But there is nothing presented yet with respect to winter projects for that age group.

Mr. Osbladeston: No, there is not. It is only those who are eligible for UIC benefits.

The Chairman: Are there any further questions? Moving on from there, I would like to ask you a question, Mr. Osbaldeston. In the budget speech, the Minister of Finance spoke of certain projects which were designated to increase employment or to get the economy moving again. I am speaking specifically of the additional $23 million to the $60 million that was spent on federal capital projects; $20 million of roads to the Montreal International Airport; amendments to the industrial incentives program; ship building incentives. I wonder if you could tell me where those funds are provided in the Estimates or where they will be provided?

Mr. Osbaldeston: In most of the cases that you referred to, Mr. Chairman, they are 1971-72 programs. I am thinking particularly of the shipbuilding program. It is not anticipated that this can be put into play as a particular program until April 1, 1971. Obviously, it will have an effect on their planning in the intervening months. In the case of the capital programs, as you are aware, the federal Government initiated capital programs under the $60 million program earlier and therefore many of the federal Government programs on capital could only begin in 1971-72. I think the general answer to your question is that these new funds would appear in 1971-72 main Estimates. Some of these activities—without going through them in detail—can begin in 1970-71 and would be found within the existing appropriation.

The Chairman: Let us speak specifically of the $23 million in the budget highlights communiqué, where they show the $23 million as being reflected in the Government's accounts for 1970-71. I do not know of any Estimate or supplementary Estimate that covers it.

Mr. Osbaldeston: I would like to check that, if I could, honourable senators, because my undestanding is that some of these may begin in 1970-71. I do believe that there will be a large portion of that which would appear in 1971-72. I would like to check to see if I am correct on that. I did not bring it with me.

The Chairman: I note further that, in the increase in the unemployment insurance benefits, again the budget highlights show that of the $54 million that we are appropriating here by this supplementary Estimate, $31 million will be spent in 1970-71 and $23 million will be spent in 1971-72. I wonder why we appropriate a sum in 1970-71 that could be dealt with in the main Estimates of 1971-72, that is, the $23 million.

Mr. Osbaldeston: As I understand it, Mr. Chairman, the reason the Government proposes this is that they wish to assure the unemployed, the presently unemployed, as to the income that they would have over this period of time. It is true that it could be in two sections, but I think it would then leave the unemployed uncertain as to what their income would be for the period April, May and June.

The Chairman: With respect, in the cases of the provinces you are appropriating $40 million of $150 million in this fiscal year, and $110 million in the next fiscal year. Are you prepared to reassure the unemployed that you are going to leave the provinces?

Mr. Osbaldeston: Perhaps the provinces are more sophisticated in looking at these matters. I would like to point out that these are our Estimates, and in the case of the provinces they are Estimates of what is going to be drawn down in 1970-71 and 1971-72. I do think it is a question of trying to provide some assurance to the unemployed.

The Chairman: There is one other point; in our last meeting with the Minister, and I quote from our *Minutes of Proceedings:*

> The Treasury Board undertook to provide the Committee with a breakdown of amounts to be distributed by provinces and by departments out of the $60 million. They also undertook to provide a list of votes legislative in nature that are not $1 items.

Do you know if those lists are forthcoming

Mr. Osbaldeston: If they have not gone forward, I shall certainly see that they come forward to you today, senator, and if they have not come forward to you, I can only apologize.

The Chairman: In the programs that have been suggested here in the budget highlights and some of the programs we have been dealing with today, do you have any figures? Now we have figures on the $150 million fund, but I am thinking of the $60 million fund in which we are going to get figures, and the $23 million fund, the ship building assistance, the footwear assistance, the industrial incentives program. Do you have figures as to what percentage of the benefits, the total benefits that are being put into operation by the government to alleviate the unemployment situation that are going to the Province of Quebec

Mr. Osbaldeston: Senator, in the majority of the programs you have mentioned, the government is responsive to requests from industry. I have not seen estimates of what the requests are likely to be. I would not be at all certain that such estimates have been made. I could check that with the department under which most of

those programs come, the Department of Industry, Trade and Commerce—and here I am thinking of shipbuilding and footwear—to determine whether they did make such forward forecasts of what the likely requests are to be from each province. I have not myself seen them.

The Chairman: Do you know what portion of the $60 million and the $23 million, which is $83 million altogether, is going to the Province of Quebec?

Mr. Osbaldeston: In the case of the $60 million, we have undertaken to provide that breakdown and I will see that you do receive it. In the case of the $23 million, we are still working with the department in the development of final projects. That will be available and I could provide it when it is available. I would like to make my point clear; we collect from the departments in advance of this operation a rather large list of projects, and then as the Minister pointed out at the last meeting, we check each project against certain crteria such as the employment it gives, where it falls and that sort of thing and then we arrive at a final list and authority to go ahead is then given to the department. That is the explanation, sir. We will have that when we get the final lists, and we will provide it. I do not think I would be too far wrong in saying that it is probably somewhere in the neighbourhood of 45 per cent, similar to the percentage used in the case of the $150 million fund.

In the case of the $60 million figure, that is correct, and it will appear from the figures that it is in that order. In the case of the $23 million, I would prefer to wait to see what the final breakdown is by department. I would anticipate it will be considerably higher than that.

The Chairman: Higher than 45 per cent?

Mr. Osbaldeston: Yes.

Senator Grosart: I have a general question, Mr. Chairman. I wonder if I might ask the witness if he anticipates any further supplementary Estimates this year.

Mr. Osbaldeston: Well, I am a new boy, senator, but I understand that there is nearly every year a demand for supplementary Estimates towards the end to tidy up the books, if for no other reason, in terms of transfer between allotments and things of that sort.

Senator Grosart: I ask the question because the Supplementary Estimates (B) bring our total of supplementaries for this year to $661.1 million, the highest supplementary Estimates in any year back to 1960 according to Table 1, "Total Budgetary Estimates" on page xii of the main Estimates. The highest during that time was the 1962 when they amounted to $282 million. In this committee we are hopeful that there would be a trend to keep supplementary Estimates low, but now they are at their highest point for this period. This also means that our total Estimates for the year now of $14.4134 billion, which is an increase of $1.5 billion over last year which again is the highest increase year to year since 1960-61, and there has been an increase of $1.196 billion in 1969-70 over the previous year. So that in effect total Government expenditures have now doubled in the six years from 1964-65. In that year the total, that is main and final supplementaries, was $7170.3 million. We might want to comment in our report in view of the statements by the Economic Council and others that high Government spending is one of the contributory problems to our other problem of inflaton. We are back into very, very greatly increased Government spending this year. I am not being critical in saying that.

The Chairman: If I might just comment on your remark on the supplementary Estimates, one of the reasons for the increase in the amount of the two supplementary Estimates that we have had has been a shift in Government policy to overcome a massive unemployment situation.

Senator Grosart: There are always reasons, Mr. Chairman. We have never had an increase, whether great or small, unless there was a reason. I am not discussing this politically at the moment, I am merely saying that that is the fact before this committee, which is the National Finance Committee, and I think we should take note of these things. I am not saying it in any way critically at all.

Mr. Osbaldeston: Mr. Chairman, may I comment on the figures that the honourable senator has quoted? They are, of course, correct, but there has been one change this year which adjusts your figures slightly and that is that we showed in the Supplementary Estimates (A) the statutory amount of $200 million which has not been shown in previous years. In effect we have updated the forecast for the statutory amount which in effect has not been done in previous years.

Senator Grosart: I am very glad you called that to my attention because otherwise I would have forgotten it. That would subtract $200 million making it somewhere in the neighbourhood of $400 million which is still higher than any year back to 1964.

Mr. Osbaldeston: In 1966-67, senator, the supplementary Estimates gross tabled amounted to $607 million and the final was $2,367 million, but the gross tabled during the year was $607 million, and in 1965-66 the gross was $426 million.

Senator Grosart: I am sorry, I was quoting the final supplementary figures and not the total during the year. I will withdraw that statement. It may also apply to my Table 1 comparisons.

The Chairman: Any further questions?

The procedure we follow, honourable senators, is to make a report on Supplementary Estimates (B) to the Senate. The report on Supplementary Estimates (A) is now tabled in the Senate and should be dealt with this afternoon. Is it your wish that you leave the report on Supplementary Estimates (B) in the hands of your chairman and the Steering Committee?

Hon. Senators: Agreed.

The Chairman: Honourable Senators, if there are no further questions, on your behalf I would like to thank Mr. Osbaldeston and Mr. McDonald for giving of their time to us and for being so willing to answer our questions.

The Committee adjourned.

Queen's Printer for Canada, Ottawa, 1970

THIRD SESSION—TWENTY-EIGHTH PARLIAMENT
1970-71

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 3

THURSDAY, MARCH 18, 1971

**Complete Proceedings on the Estimates (C)
laid before Parliament for the fiscal year ending March 31, 1971**

REPORT OF THE COMMITTEE

(Witnesses and Appendix—See Minutes of Proceedings)

23252—1

THE STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Langlois
Beaubien	Laird
Benidickson	MacDonald (*Queens*)
Bourget	*Martin
Bourque	Methot
Desruisseaux	Molson
Everett	McDonald (*Moosomin*)
*Flynn	McLean
Forsey	Nichol
Fournier (*Madawaska-Restigouche*)	O'Leary
Gelinas	Paterson
Grosart	Pearson
Hays	Phillips
Isnor	Sparrow
Kinley	Walker—(28)

(Quorum 7)

**Ex officio members.*

Order of Reference

Extract from the Minutes of the Proceedings of the Senate of Wednesday, March 10th, 1971.

"With leave of the Senate,

The Honourable Senator Smith moved, seconded by the Honourable Senator Urquhart:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures set out in the Supplementary Estimates (C) laid before Parliament for the fiscal year ending the 31st March, 1971.

The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate

23252—1½

Minutes of Proceedings

Thursday, March 18, 1971
(3)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10:00 a.m. to consider the Supplementary Estimates (C) laid before Parliament for the fiscal year ending March 31st, 1971.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Desruisseaux, Flynn, Grosart, McDonald, Pearson, Phillips and Sparrow. (9)

Also present but not of the Committee: The Honourable Senators Connolly (*Ottawa West*) and Smith.

In attendance: Mr. E. Russell Hopkins, Law Clerk and Parliamentary Counsel.

It was *resolved* that 800 copies in English and 300 copies in French of these proceedings be printed.

Witnesses from the Treasury Board:

The Honourable C. M. Drury, President;

Mr. G. F. Osbaldeston, Deputy Secretary (Program Branch);

Mr. B. A. MacDonald, Director General, Budget Coordination.

It was *resolved* to print Appendix "A"—Breakdown by Departments of $60 million in 1970-71 Supplementary Estimates (A) as well as the breakdown by Region of Canada re: unemployment, to these proceedings.

It was also resolved to print as an addendum to these minutes: Explanation of the $1.00 items of the Supplementary Estimates (C) 1970-71.

At 11:55 a.m. the Chairman vacated the Chair.

On motion of the Honourable Senator Pearson, the Honourable Senator Desruisseaux was elected Acting Chairman.

At 12:05 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

Report of the Committee

Thursday, 18th March, 1971.

The Standing Senate Committee on National Finance, to which were referred the Suplementary Estimates (C) for the fiscal year ending March 31, 1971, has in obedience to the order of reference of Wednesday, 10th March, 1971, examined the said Supplementary Estimates and reports as follows:

1. Your Committee has examined the said Supplementary Estimates (C) and has heard evidence thereon from the Honourable C. M. Drury, President of the Treasury Board, Mr. G. Osbaldeston, Deputy Secretary, Programs Branch, Treasury Board, and Mr. B. A. MacDonald, Director General, Budget Co-ordination, Treasury Board.

2. The said Supplementary Estimates (C) provide for total expenditures for which Parliament will be asked to provide funds of $29,914,877, statutory expenditures of $43,036,000 and loans, investments and advances in the amount of $268,571,692. This brings the total of the Main and Supplementary Estimates for the fiscal year ending March 31, 1971 to $14,531,986,886 of which $13,470,600,000 is for budgetary item and $1,061,300,000 is for loans, investments and advances.

3. The Minister enunciated the following rules used by the Treasury Board to limit the use of dollar items in the Appropriation Acts to amend other legislative enactments:

(a) to alter financial limitations imposed by legislation or by previous Estimates (as an example, an increase in the maximum amount which may be loaned by C.M.H.C. for housing purposes);

(b) to alter time limitations imposed by legislation or by previous Estimates (an example of this was the change in the termination date of the Trans-Canada Highway Program);

(c) to extend the application of legislation to persons not covered by the legislation so as to authorize the making of payments to such persons in accordance with the substance and purposes of the legislation (for example, authority to make payments under the Government Employees' Compensation Act to similar employees of Dosco suffering from silicosis);

(d) to amend legislation originally approved through broadening the scope of a Revolving Fund, items in the Estimates or the Appropriation Fund, itself established by an Appropriation Act; and

(e) to effect transfer of available funds to votes where additional funds are required.

4. Your Committee was provided with the explanation of certain items in the said Supplementary Estimates (C). These items have been grouped in the following categories:

(a) Items authorizing transfers from one vote to another within a Ministry to meet certain increased costs or additional expenditures to be incurred. These items consist of 19 items for $1 and 5 others. This listing includes 9 items, including 7 $1 items which appear in other sections.

(b) $1 items which require listing in Estimates in order to secure approval of certain grants and contributions. This listing includes 4 items which are also listed in other sections.

(c) Items which are legislative in nature, consisting of 17 items for $1 and 9 other items which also request additional sums for various purposes. This listing includes 5 items, including 3 $1 items which appear in other sections.

5. Two of the items contained in summary (c) of the previous paragraph, being Votes 10C and 35C, have been withdrawn by the Treasury Board. Vote 10C was to authorize the payment of increased War Veterans Allowances and Civilian War Allowances effective April 1, 1971. Vote 35C was to authorize legislative changes required as a result of the increased pension benefits to ex-members of the Armed Forces or their dependents.

6. Your Committee has noted that in several explanations in these Supplementary Estimates (C) expenditures are lumped under one heading and suggests that wherever possible such expenditures be broken down into their constituent elements.

Respectfully submitted.

D. D. EVERETT,
Chairman.

ADDENDUM

EXPLANATION OF CERTAIN ITEMS SUPPLEMENTARY ESTIMATES (C), 1970-71

SUMMARY

The items in these Estimates have been grouped in the attached according to purpose.

A Items authorizing transfers from one vote to another within a ministry to meet certain increased

costs or additional expenditures to be incurred (24 items).

B One dollar items which require listing in Estimates in order to secure approval of grants and contribution (6 items)

C Items which are legislative in nature (26 items)

Estimates Division,
March, 1971
71-16

SECTION A

Items authorizing transfers from one vote to another within a ministry to meet certain increased costs or additional expenditures to be incurred (24 items). These items consist of 19 items for one dollar and 5 others. This listing includes 9 items including seven one dollar items which appear in other sections.

ENERGY, MINES AND RESOURCES

Vote 20c—Amount of transfer to this Vote $485,999.

Purpose—A further $486,000 is required to:

(a) Provide for the purchase of equipment and machinery by the Water Quality Division to equip the Sewage Treatment Pilot Plant at the Canada Centre for Inland Water. Due to unforeseen demands for water quality studies and analysis, the completion date for this Plant was advanced one year. Funds were consequently not included in the Estimates for the equipment required—$334,000.

(b) Purchase equipment ($152,000) required for the completion of the following three main projects now underway within the Hydrological Sciences Division:

(i) Ice thickness measurements;
(ii) Oil contamination studies; and
(iii) Ice Science Laboratory

Source of Funds—Vote 25 ($485,999)—Due to engineering problems and the renegotiations of timing and cost-sharing formulae, certain payments have had to be delayed for Federal-Provincial Water Control Works.

EXTERNAL AFFAIRS

Vote 5c—Amount of transfer to this Vote $1,599,999.

Purpose—To provide for the construction and acquisition of various buildings in Hong Kong, Madrid, and New Delhi; for the commencement of design work for a new Chancery in Brazilia and miscellaneous property acquisitions.

Source of Funds—Vote 10—($1,599,999)—It is expected that the following grants totaling $1,750,000 will not be required in the current year because of:

(1) A grant was provided in the Estimates to assist in defraying costs of accommodation for the International Civil Aviation Organization. The payment of this grant of $1,000,000 hinges upon this Organization moving to a new and larger headquarters building in Montreal. This move has not yet taken place.

(2) No expenditures are now anticipated in the current year under the grant provided for defence support assistance to Greece and Turkey because agreement has not been reached on the form of assistance—$750,000.

INDIAN AFFAIRS AND NORTHERN DEVELOPMENT

Vote 1c—Amount of transfer to this Vote $99,999.

Purpose—A further $100,000 is required by the Technical Services Branch. This Branch was established effective April 1, 1969 to provide departmental engineering and architectural services and functional direction of materiel management. In preparing the 1970-71 Budget certain expenditures for salaries, and associated costs previously borne by other branches, were not provided for.

Source of Funds—Vote 5 ($99,999)—Funds are available from operating expenditures as a result of certain under-expenditures for salaries due to staff vacancies and an under-utilization of manpower.

Vote 25c (Also listed in Section C)—Amount of transfer to this Vote $300,000.

Purpose—An additional amount of $475,000 is requested to cover the cost of forest fire fighting in the Northwest Territories. Approval is requested in these Estimates for $175,000 to supplement this transfer.

Source of Funds—Vote 5 ($300,000)—Forecasts of grants and contributions to fairs, other organizations and individuals to promote agriculture, handicrafts and economic enterprises indicate an under expenditure.

Vote 65c—Amount of transfer to this Vote $50,000.

Purpose—To finance a study to be undertaken by the Canadian Wildlife Service on the prevention, reduction or control of environmental degradation as it relates to Wildlife and ecosystem preservation in the North.

Source of Funds—Vote 35 ($50,000)—Forecasts of grants for northern research and for northern scientific expeditions indicate an under expenditure.

INDUSTRY, TRADE AND COMMERCE

Vote 23c (Also listed in Section C)—Amount of transfer to this Vote $249,999.

Purpose—To provide for the reimbursement of the Canadian Wheat Board for payments to producers of soft white spring wheat.

Source of Funds—Vote 5 ($249,999) Credit subsidies on wheat sales to developing countries will be less than expected.

MANPOWER AND IMMIGRATION

Vote 5c (Also listed in Section C)—Amount of transfer to this Vote $7,500,000.

Purpose—To finance the purchase of additional training courses (both academic and skilled) through provincial authorities.

Source of Funds—Vote 10 ($7,500,000)—The costs of the Canadian Manpower Training Program are represented by two elements: course costs and Training Allowances. Each element is based on a forecast of the activity anticipated for the following fiscal year. Throughout that year, as the particular economic situation unfolds, it may become necessary to read-

just the allocated funds between the two elements. As a result of the current years experience a transfer of the elements is required.

NATIONAL DEFENCE

Vote 5c (Also listed in Section C)—Amount of transfer to this Vote $1,099,999.

Purpose

(a) To finance the clean up operations in connection with the oil leakage attributable to the oil tanker "Arrow". The out-of-pocket expenses of the Department cannot be recovered until the involved claims procedure against the tanker operators is settled—$500,000.

(b) To finance the activities of the Canadian Forces outside the Province of Quebec following the proclamation of the War Measures Act. These costs do not include pay and allowances for the Forces.

Source of Funds—Vote 10 ($1,099,999)—Funds are available due to unforeseen delays in the acquisition of capital equipment for the Canadian Forces.

Vote 30c—Amount of transfer to this Vote $107,999.

Purpose—A sum of $108,000 is required for the procurement of low range meters for the National Radiological Defence Monitoring System which is operated in cooperation with the Provinces and Municipalities. These meters are capable of measuring the rate of radiation dosage.

Source of Funds—Vote 1 ($107,999)—Funds are available as a result of staff vacancies.

NATIONAL HEALTH AND WELFARE

Vote 1c—Amount of transfer to this Vote $454,999.

Purpose—An additional sum of $455,000 is required for the following purposes:

(1) To provide for cost of research contracts, payroll costs and travelling expenses for the remainder of the current fiscal year in connection with the LeDain Commission of Inquiry into the Non-Medical Use of Drugs—$250,000.

(2) To cover the costs involved in the reorganization of the office of the Deputy Minister of National Health—$20,000.

(3) Additional costs have been incurred as the result of increased administrative workload created by the Interim Report on the LeDain Commission; the White Paper on Income Security; Studies on Alienation; Bilingualism and Personnel Management Systems—$185,000.

Source of Funds—Vote 20 ($454,999)—Due to increased recoveries of hospital costs from Provincial Hospital Insurance Plans, revenues are higher than was anticipated.

Vote 30c—Amount of transfer to this Vote $536,999.

Purpose—To provide for the additional costs incurred because of the increased workload resulting from the changes in the Old Age Security and Guaranteed Income Supplement legislation recently approved by Parliament.

Source of Funds—Vote 20 ($103,999)—Due to increased recoveries of hospital costs from Provincial Hospital Insurance Plans, revenues are higher than was anticipated.

—Vote 35 ($433,000)—As a result of a lower rate of immigration in 1970 the forecast payments for Family Assistance with respect to children of immigrants and settlers will be less than was expected.

SECRETARY OF STATE

Vote 1c—Amount of transfers to this Vote $177,999.

Purpose—To provide for the increased costs incurred in connection with the Committee on Youth ($74,000), departmental travel expenses, supplies, etc.

Source of Funds—Vote 5 ($109,500)—Due to delays in developing the Bilingual Districts Advisory Board.

—Vote 10 ($68,499)—Grants for language research will be less than expected.

Vote 15c—Amount of transfer to this Vote $41,500 and approval of an additional sum of $670,000.

Purpose—To provide an additional sum of $711,500 to cover the cost of two royal tours (1970—$620,000 and 1971—$50,000), costs of two cultural conferences ($20,000), monitoring expenses of the Edmonton educational television ($14,000) and other minor increased costs. Approval is requested for an additional $670,000 to supplement the transfer of $41,500.

Source of Funds—Vote 5 ($41,500)—Due to delays in developing the Bilingual District Advisory Board.

Vote 20c (Also listed in Section B)—Amount of transfer to this Vote $49,999.

Purpose—A further grant of $50,000 is requested to assist with the annual operating expenses of the Fathers of Confederation Memorial Trust Building in Charlottetown. A sum of $175,000 was provided in previous Estimates for this purpose.

Source of Funds—Vote 5 ($49,999)—Due to delays in developing the Bilingual Advisory Board.

Vote 25c—Amount of transfer to this Vote $29,999.

Purpose—To provide for the cost of studies carried out on Post-Secondary Education by the Association of Universities and Colleges in Canada ($10,000), the cost of a survey on financial assistance extended to post-secondary students ($11,000) and the cost of consultants retained by the Branch ($9,000).

Source of Funds—Vote 5 ($29,999)—Funds are available due to staff vacancies.

Vote 30c—Amount of transfer to this Vote $119,999.

Purpose—To cover increased administrative expenses in the Translation Bureau due to the general increase in the activities of the Branch as well as costs associated with the recruitment campaign for translators.

Source of Funds—Vote 5 ($119,999)—Funds are available as a result of forecast under expenditures for Bilingualism Development due to staff vacancies, delays in developing Bilingual Districts Advisory Board and reduced costs for contractual summer language training for students.

Vote 35c (Also listed in Section B)—Amount of transfer to this Vote $324,999.

Purpose—Additional funds are required for the following purposes:

(1) To cover the costs incurred by the Department of National Defence in providing hostels for transient use during 1970—$58,000.

(2) To assist ethnic cultural groups and disadvantaged segments of the population—$53,000.

(3) To assist Indian Friendship centres in urban areas and citizen groups concerned with native people—$70,000.

(4) To provide grants of up to $138,000 to alienated and disadvantaged groups and a further $6,000 to cover the cost of a small Secretariat to the Ad Hoc Interdepartmental Committee on Financial Assistance to Voluntary Organizations—$144,000.

Source of Funds—Vote 10 ($324,999)—Grants for language research will be less than expected.

SOLICITOR GENERAL—CORRECTIONAL SERVICES

Vote 15c (Also listed in Section B)—Amount of transfer to this Vote $574,999.

Purpose—To provide for further payments to provincial and private After-Care agencies for the provision of case preparation and parole supervision under contract ($500,000) and for additional grants ($75,000) to these agencies for residential services.

Source of Funds—Vote 10 (574,999)—Due to delays in completing the design of the Maximum Security Institution at Mission, British Columbia.

ROYAL CANADIAN MOUNTED POLICE

Vote 25c—Amount of transfer to this Vote $899,998.

Purpose—To provide for increased costs incurred in the provision of police services under contract ($590,000), increased motor vehicle costs as the result of the withdrawal of the fleet discount by major manufacturers and increased costs of vehicles in 1970 ($130,000) and the purchase of 3 spare aircraft engines ($180,000).

Source of Funds—Vote 10 ($899,998)—Due to the delay in the design of the Maximum Security Institution, the construction of certain anciliary facilities must be delayed.

SUPPLY AND SERVICES—CANADIAN ARSENALS LIMITED

Vote 15c—Amount of transfer to this Vote $680,000.

Purpose—To assist in covering the operating deficit of the Corporation for 1970-71 of $1,202,000.

Source of Funds—Vote 5 ($680,000)—Anticipated under expenditures in the Supply Program ($506,000) and the release of the reserve set up to the finance purchase consolidation within the Department ($174,000).

TRANSPORT

Vote 5c (Also listed in Section B)—Amount of transfer to this Vote $1,517,436.

Purpose—Additions funds are requested to provide for the following:

(1) To meet the cost of oil clean up following the sinking of the oil barge "Irving Whale"—$308,000.

(2) To provide a grant to the Fraser River Harbour Commission for demolition of a grain elevator and wharf—$558,987.

(3) Additional funds required for the maintenance and upkeep of the Coast Guard College—$298,450.

(4) Additional sums are required to cover the operation and maintenance of a former RCMP vessel assigned to search and rescue activities—$167,000.

(5) To provide for the cost of a formal inquiry into the grounding of the "Arrow"—$185,000.

Source of Funds—Vote 10 ($1,218,986)—Funds are available because of deferral of several projects.

—Vote 35 ($298,450)—Funds originally provided under Air Services Operating Expenditures for the Coast Guard College will not be required as the result of the College now being the responsibility of the Marine Services.

Vote 20c—Amount of transfer to this Vote $424,999.

Purpose—Due to the loss of the rail car ferry "Patrick Morris" in April, 1970 charter arrangements have had to be made to provide the freight capacity needed ($425,000).

Source of Funds—Vote 30 (424,999)—Expenditures for grants in aid of urban transportation research are less than was expected.

VETERANS AFFAIRS

Vote 15c (Also listed in Section C)—Amount of transfer to this Vote $49,999.

Purpose—To reimburse the Vetcraft Revolding Fund for accumulated operating loss of the Vetcraft Manufacturing Operation to March 31, 1971.

Source of Funds—Vote 35 (49,999)—Anticipated expenditures for the implementation of the White Paper proposals will be less than expected due to the late implementation of the proposals.

Vote 45c—Amount of transfer to this Vote $379,999.

Purpose—Additional funds are required to carry out renovations to the Ste. Anne's Hospital Mental infirmary at Ste. Anne de Bellevue, Province of Quebec.

Source of Funds—Vote 35 (379,999)—Anticipated expenditures for the implementation of White Paper proposals will be less than expected due to the late implementation of the proposals.

SECTION B

$1 items which require listing in estimates in order to secure approval of certain grants and contribution (6 items). This listing includes four items which are listed in other sections.

ENERGY, MINES & RESOURCES

Vote 5c—To authorize a grant of $2,000.

Explanation—It is proposed to assist the Canadian

National Committee of the World Mining Congress in defraying the expenses of its Committee Secretariat.

Source of Funds—Vote 5—It is planned to use funds originally provided for operating expenditures.

EXTERNAL AFFAIRS

Vote 10c—To authorize grants and contribution as detailed in the Estimates for a total of $28,380.

Explanation—The grants and contribution consist of (1) A payment of $5,050 to assist with the support of the Association of Canadian Studies in the United States Academic institutions. This Association fosters the development of a wider knowledge and understanding of Canada thoughout the United States.

(2) A payment of $20,000 is proposed to assist with the support of the International Commission of Jurists. This one-time grant is required to assist in maintaining the Commission until permanent financing is found. The Commission was previously almost completely supported by the Ford Foundation. This Foundation has terminated support of such permanent in nature organizations.

(3) A contribution of $3,330 to cover Canada's share of the first assessment to the United Nations International Conventions on the Elimination of Racial Discrimination. Canada is one of 43 states sharing in the cost of this Commission.

Source of Funds—Vote 10—A grant previously approved for the International Civil Association Organization to cover the cost of new accommodation, will not be required since the move to the new and larger headquarters has been delayed.

SECRETARY OF STATE

Vote 20c (also listed in Section A)—To authorize an additional grant of $50,000.

Explanation—An increase of $50,000 is proposed in the sustaining grant to the Father of Confederation Memorial Trust to cover operating deficits. A grant of $175,000 has already been paid to assist in the operation of the Centre.

Source of Funds—Vote 5 ($49,999)—Due to delays in developing the Bilingual Districts Advisory Board.

Vote 35c (also listed in Section A)—To authorize grants as detailed in the Estimates of $261,000.

Explanation—Payments are requested for the following purposes:

(1) It is proposed to assist certain organizations of ethnic cultural groups and disadvantaged segments of the population whose aim is to assist ethnic minorities to adjust to Canadian life—$53,000.

(2) A further amount is requested to assist in the financing of Indian Friendship Centres in urban areas and citizens groups concerned with native people. With the increased numbers of individuals of Indian ancestry moving to urban areas, greater use is being made of these facilities than was expected—$70,000.

(3) Additional funds are to be made available to meet the numerous requests from voluntary organizations for financial assistance. A sum of $213,000 has already been provided in previous Estimates for this purpose—$138,000.

Source of Funds—Vote 10—Due to delays encountered in the establishment of the "Language Research Council" funds are available for transfer.

SOLICITOR GENERAL—CORRECTIONAL SERVICES

Vote 15c (also listed in Section A)—To authorize a further grant of $75,000.

Explanation—A sum of $165,000 was originally provided in Estimates to assist After-Care Agencies, however, due to increased costs of residential services a further sum is required.

Source of Funds—Vote 10—Delays have been encountered in finalizing the design of the maximum security institution at Mission, B.C.

TRANSPORT

Vote 5c (also listed in Section A)—To authorize a grant of $55,987.

Explanation—It is proposed to assist the Fraser River Harbour Commission financially with the demolition of a grain elevator, ($179,987), and the rehabilitation of a grain wharf.

Source of Funds—Vote 10—Funds are available to the deferral of several Marine Services capital projects.

SECTION C

Items which are legislative in nature (26 items). Consisting of 17 items for one dollar, and 9 other items which also request additional sums for various purposes. This listing, includes 5 items, including 3 one dollar items, which appear in other sections.

AGRICULTURE

Vote 15c—To authorize an extension to the vote wording so as to permit the implementation of a new Grassland Incentive Program and to extend the purposes of the LIFT Program Reserve Account.

Explanation—This extension is proposed to permit the implementation of a new Grassland Incentive Program and to authorize the use of unspent funds from the non-lapsing Reserve created under the LIFT Program for the making of payments to farmers under this program.

ENERGY, MINES AND RESOURCES—ATOMIC ENERGY OF CANADA LTD.

Vote L55c—To authorize the extension of the original vote wording to permit the use of loan monies for the manufacture of heavy water.

Explanation—The present vote wording provides for the purchase only of heavy water for lease or resale to Canadian and foreign users. It is proposed to extend the loan authorization to permit the funds to be used for the manufacture as well as for the purchase of heavy water for resale or lease to Canadian or foreign users of heavy water.

EXTERNAL AFFAIRS

Vote L11c—To authorize the increase of $4,000,000 in the limit of accounts outstanding at any time under the special account esetablished for the financing of employees and posts abroad and to revise the purpose of this account so as to limit it to the making of advances to posts only.

Explanation—Due to the integration of Suppor Services for foreign operations under the Department of External Affairs and the proposed creation of a new working capital advance account (Vote L12c) certain changes are required in the existing special account:

(1) It is proposed to increase the statutory limit from $3,000,000 to $7,000,000 in order to permit the amalgamation of all previous advances of all departments for the financing of posts under the Department of External Affairs.

(2) The present Account includes authority for the making of advances to employees on posting and during service abroad. This authority is to be transferred to a proposed new working capital advance. The existing advance account is to be restricted to the making of advances to posts only.

Vote L12c—To authorize the creation of a Working Capital Advance during the current and subsequent fiscal years of $1,300,000.

Explanation—It is proposed to create a separate Working Capital Advance account to provide for the making of loans and advances to employees posted abroad and to authorize the provision of recoverable advances to other government departments to enable them to make loans and advances to their employees posted abroad. The creation of this account will permit the regularization and centralization under the Department of External Affairs of the legislative authority required for the making of these loans, while still permitting the control of administration and repayment of the loans and advances to remain with individual departments.

FINANCE

Vote 7c—To authorize the extension of the Established Programs (Interim Arrangements) Act covering special welfare and health grants, and hospital insurance to the Province of Quebec for a further period of 24 months.

Explanation—The Act covering Special Welfare and Health grants expired March 31, 1970, and the Hospital Insurance December 31, 1970. Authority is requested to extend this Act for a further 2 year period from the date of expiration.

Vote L13c—To authorize not only the establishment of a revised special program to provide loans to provinces, provincial agencies and municipalities during the current and subsequent fiscal year, but also for the repeal of the present Special Program.

Explanation—This vote provides for the repeal of the special program created under Vote L12b of Supplementary Estimates (b), 1970-71 and its replacement with a proposed program which provides for an increase of $10,000,000 in the amount of loans to be made available. The new special program also extends the availability of loans to municipalities within the various provinces as well as setting the maximum amounts for each province.

FISHERIES & FORESTRY

Vote 5c—To authorize the extension of Vote 5 to include for the current and subsequent fiscal year authority for the purchase and disposal of commercial fishing vessels.

Explanation—In addition to the voting of money for the continuation of the program, authority only is requested for the purchase and disposal of fish vessels.

INDIAN AFFAIRS & NORTHERN DEVELOPMENT

Vote 5c—Authority is requested to delete certain accounts due amounting to $8,183.24.

Explanat on—It is proposed to waive collection from the Kahkewistakaw Indian band of land rental.

Vote 25c (also listed in Section A)—Authority is requested to extend the purposes of Vote 25 and to authorize the entering into of an agreement with the Government of the Northwest Territories for the transfer of certain responsibilities to the Northwest Territories.

Explanation—Authority is requested for the following purposes:

(1) To permit the entering into of an agreement to provide for the continuation of the transfer to the Government of the Northwest Territories of the responsibilities for Provincial-type activities and functions (education, etc.) which were previously carried out through the Department of Indian Affairs and Northern Development. Authority is also included within this agreement for the transfer of maintenance, operation and management of buildings, works and installations in the Northwest Territory as well as the management of continuing leases, contracts and agreements entered into by the Minister of Indian Affairs in respect of activities or portions thereof transferred to the administration of the Government of the Northwest Territories. The transfer of the operation of the facilities was affected on April 1, 1969 in the Mackenzie district and April, 1970 in the Eastern Arctic, however, the transfer of title to these properties was delayed due to lack of definitive property surveys.

(2) To provide for the transfer of responsibility for collection and retention of rents and revenues in the Mackenzie district and the Frobisher Bay Development Complex in the current and subsequent fiscal years, as well as the collection and retention of rents and revenues in the Arctic district for subsequent fiscal years.

INDUSTRY, TRADE & COMMERCE

Vote 23c (also listed in Section A)—To authorize the making of payments to soft spring wheat producers by the Canadian Wheat Board.

Explanation—The extension of the vote is required to enable the Canadian Wheat Board to distribute to

producers of soft white spring wheat a sum equal to the surplus in the accounts of the Canadian Wheat Board arising from the operations in soft white spring wheat for the crop year 1968-1969 for a total of $250,000.

LABOUR

Vote 1c—To authorize an increase in the permanent disability compensation rates for 8 former federal employees who were disabled in Newfoundland and Prince Edward Island prior to 1956.

Explanation—A legislative item is required to authorize a revision in the permanent disability rates in the provinces of Newfoundland and Prince Edward Island so as to provide for the payment of these increased rates as if the injuries had occurred since 1956. In 1956 all provincial Workmen's Compensation Boards increased their permanent disability rates to 75%; and, except for these two provinces, provided for all pre-existing awards.

MANPOWER & IMMIGRATION

Vote 5C (also listed in Section A)—It is proposed to revise the present vote wording to authorize an amendment to the Occupational Training of Adults Act and to secure approval of an additional $641,100.

Explanation—Authority is requested to amend the Occupational Training of Adults Act so as to enable the Department to reimburse the provinces for certain administrative costs arising out of provincial supervision of arrangements for the Training-in-Industry Program.

NATIONAL DEFENCE

Vote 5C (also listed in Section A)—To authorize an extension of the purposes of this vote to provide for the deletion from the accounts of certain claims.

Explanation—It is proposed to write off debts due the Crown in respect of a former employee as well as funds confiscated by the Japanese during World War II.

NATIONAL REVENUE—CUSTOMS & EXCISE

Vote 1C—To authorize an extension to Vote 1 to provide for the reimbursement of the Customs and Excise Working Capital Advance Account and the deletion of certain debts.

Explanation—Authority is requested to write off a deficit in the Working Capital Advance Account and to reimburse the Account for the value of tobacco excise stamps and surplus spirit age labels. These stamps were rendered obsolete as a result of the reduction in the number of sizes and the need to make stamps bilingual.

PRIVY COUNCIL—CENTRAL MORTGAGE & HOUSING CORPORATION

Vote L16C—To authorize an increase from 6.1 to 8.0 billion dollars in the aggregate amount to be advanced for the making of loans.

Explanation—An increase of 1.9 billion dollars is requested in the aggregate amount to be advanced under the National Housing Act for low rental housing projects, public housing projects, home ownership and rental housing projects, and to reimburse the Corporation for losses sustained in respect of loans made for low rental housing or public housing projects. It is estimated that the new ceiling will be sufficient to carry through to the end of the calendar year 1973.

Vote L17C—To authorize an increase in the statutory ceiling by one billion dollars.

Explanation—Authority is requested to provide an additional one billion dollars of insurable loans under the National Housing Act. It is estimated that this increase will be sufficient for the period ending December 31, 1973.

SECRETARY OF STATE—NATIONAL LIBRARY

Vote 85C—To authorize an increase of $35,000 in the amount of payment to the National Library Purchase Account.

Explanation—An increase of $35,000 is requested for the purchase of additional books for the Library.

NATIONAL MUSEUMS OF CANADA

Vote 90C—Authority is requested do not only increase the statutory limit of the National Museums Purchase Account by $116,000, but also to provide the additional funds required.

Explanation—The increase of $116,000 is requested to enable the National Museum of Canada to purchase items selected by the National Gallery of Canada from the Manoir Richelieu collection of Canadiana.

PUBLIC ARCHIVES

Vote L97C—To authorize an increase of $30,000 in the working capital within the Central Microfilm Unit Revolving Fund.

Explanation—An increase is required because of an anticipated increase in the volume of work to be processed and the increased value of work in process due to the recovery of full costs through user charges.

SOLICITOR GENERAL—ROYAL CANADIAN MOUNTED POLICE

Vote 20C—To authorize the deletion of certain debts.

Explanation—To delete a claim against a former member of the Force resulting from an automobile accident.

SUPPLY & SERVICES

Vote 5C—Approval is requested to reimburse the Supply Service Revolving Fund and to reimburse the Defence Production Revolving Fund.

Explanation—Approval is requested to:

(1) Reimburse the Supply Service Revolving Fund for inventory losses and the value of stores excess to requirements or obsolete declared surplus in the fiscal year 1969-70 in the amount of $50,013.

(2) To reimburse the Defence Production Revolving Fund for net losses on sale and disposal of stocked strategic materials in the amount of $104,064.

Vote L6C—To authorize the consolidation of the Publishing Working Capital Advance and the Canadian Government Printing Bureau Revolving Fund as well as increasing the statutory limit by $1,000,000.

Explanation—The proposed consolidation of the working capital advance and the Revolving Fund will simplify the financial system of the Printing Bureau by replacing two funds by one. Previously the Revolving Fund had provided for printing specialists advice on printing, inspection, and distribution and mailing while the working capital advance provided for the payment of contractors invoices. These will all now be within the Revolving Fund.

TRANSPORT

Vote 35c—To authorize the deletion of certain debts.

Explanation—It is proposed to write off certain accounts receivable of the Canadian Air Transport Administration which are uncollectible.

VETERANS AFFAIRS (WITHDRAWN)

Vote 10c—To authorize the payment of increased war veterans allowances and civilian war allowances effective April 1, 1971.

Explanation—A 10% increase in the benefits payable under the War Veterans Allowance Act and the Civilian War Pension and Allowance Act was announced. This item is included in these Estimates to obtain parliamentary approval of the changes to the Act and the new rate schedules attached.

Vote 15c (also listed in Section A)—To authorize the reimbursing of the Vetcraft Working Capital Advance Account for an operating loss sustained to March 31, 1971.

Explanation—The Department, in complying with the government's price restraint policy, withheld price increases on items manufactured through the Vetcraft Revolving Fund. The price increase was to have covered operating charges resulting from the decision of the government to operate the Fund on a commercial basis.

Vote 35c—To authorize legislative changes required as a result of the increased Pension Benefits to ex-members of the Armed Forces, or their dependents.

Explanation—The revision to the existing vote is required to make the necessary changes in the Pension Act and the Civilian War Pensions and Allowance Act and the rate schedules in order to implement the increase of 10% in pensions effective April 1, 1971.

Vote 40c—To authorize the deletion of certain debts due and claims.

Explanation—It is proposed to delete certain debts which cover some 15 cases where veterans were hospitalized for lengthy periods and have died with no known estate.

Vote 50c—To authorize the deletion of a debt.

Explanation—It is proposed to write off a loss which was incurred as a result of the sale of a property which had reverted to the Director.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Thursday, March 18, 1971

[*Text*]

The Standing Senate Committee on National Finance, to which was referred the Supplementary Estimates (C) laid before Parliament for the fiscal year ending 31st March, 1971, met this day at 10 a.m.

Senator Douglas D. Everett (Chairman) in the Chair.

The Chairman: Honourable senators, I would like to have the usual motion for the printing of proceedings.

Upon motion, it was *resolved* that a verbatim report be made of the proceedings and to recommend that 800 copies in English and 300 copies in French be printed.

The Chairman: Honourable senators, before we proceed, at a previous meeting of this committee Senator Phillips asked for some information from the Treasury Board regarding the $160 million provision in the supplementary Estimates. He asked for a breakdown of that provision by the department and also by regions. This was supplied by Mr. MacDonald of the Treasury Board in a letter dated December 16, 1970, which has since been given by your chairman to Senator Phillips.

With your permission, honourable senators, I would like to suggest that this be printed as an appendix to today's proceedings. Is that agreed?

Honourable Senators: Agreed.

Senator Phillips: Before you do that, Mr. Chairman, I appreciate your courtesy in supplying it, but I am still rather amazed that the letter is dated December 16 and I received it some time around the middle of February. There is a time lag there that seems rather extensive in view of the attitude that it would take the department so long to obtain the information. They obtained it very quickly; there was a time lag of about two months before I received it. I am not blaming any particular person, but I would like the record to read that the department was far more efficient than our staff. It is very seldom I give you a compliment.

The Chairman: Just to round out the point, it was your chairman who failed to bring it to your attention and, in fact, I think you had to approach your chairman to remind him that he had given you that undertaking.

(*For text of letter, see Appendix A*)

Honourable senators, we are here to consider supplementary Estimates (C) for the fiscal year ending March 31, 1971. We have been given by the Treasury Board an explanation of the one dollar items in those supplementary Estimates. Each of you, I understand, has a copy of that explanation. Is it agreed that we print the explanation as an appendix to the proceedings of this day?

Honourable Senators: Agreed.

(*For text of explanation, see Addendum to Minutes of these Proceedings.*)

Senator Grosart: I have one point, Mr. Chairman. The summary total in categories 1, 2 and 3 is 14. My count was 17 one dollar items. Are any one dollar items that are in the Estimates not included in the summary?

The Chairman: Perhaps that is something the Witnesses could deal with in their opening statement.

Senator Grosart: Mine was a quick count.

Senator Phillips: Before we have the opening statement, Mr. Chairman, I would like to raise a point of order based on the ruling of Mr. Speaker Lamoureux in the other place.

It is my understanding that these Estimates are based on the appropriations introduced at that time, of which certain items were declared improperly introduced, and these Estimates have in no way been amended. It is my understanding that there has been no additional appropriation bill introduced in the other place. In view of the rather pious incantations that I heard in another committee yesterday concerning the ability of the Senate to initiate appropriations, I maintain we are thoroughly out of order here in initiating and even discussing these Estimates.

The Chairman: Senator Phillips, the Senate refers the supplementary Estimates to this committee for consideration and the committee is charged with the responsibility of considerng them and reporting back to the Senate. I think I would have to rule that in doing that we are not legislating in any way; we are merely reporting on a document that has been referred to us.

When the appropriation bill comes forward, then we would be legislating and I think your point might be well taken at that time. I think we will have a thorough discussion probably this morning on that very point that took place in the other place. However, I do not think that the meeting is wrongfully constituted by virtue of the fact that your point rests on the concept that we would be legislating in money matters. We are doing nothing more than considering this document and reporting back to the Senate.

Senator Phillips: I realize we are considering it, but the point is why are we considering it? Are we considering it from a legislation viewpoint or are we considering it just because this is an interesting document? If we are going to consider it at all, we have to be considering from a legislative viewpoint and not because of the fact that there are a lot of one dollar items, as well as other interesting items contained in the Estimates. We, by the very virtue of the fact that we are considering it, must be moving in some legislative process. Therefore I maintain that we are out of order in considering it this morning.

The Chairman: Senator Phillips, I am afraid I cannot accept your point of order and must rule against it. I rule subject to an appeal to the committee.

Senator Phillips: With all due deference, Mr. Chairman, may I suggest that we obtain the opinion of the Law Clerk before there is any ruling made?

Mr. E. R. Hopkins, Law Clerk and Parliamentary Counsel: I have had very short notice of this. My own view would be, for what it is worth, that the document has been referred to us by the Senate and it would be the function of this committee to consider it in any way the committee deems appropriate and report back to the Senate accordingly.

If I am correct in thinking that these Estimates, as they stand or as they purport to be, were referred to the committee, it is the duty of the committee to consider them.

Senator Phillips: Despite the fact that they were ruled improper in the other place?

Mr. Hopkins: I have not studied the matter from that point of view.

Senator Phillips: I fail to see how you can give an opinion if you have not studied it.

Mr. Hopkins: I have studied it from the point of view of the Senate.

Senator Phillips: They were ruled out of order in the other place and only the other place has the authority to initiate an appropriation, therefore they must also be out of order here.

Senator Connolly (Ottawa West): I apologize for being late. Could I ask what is Senator Phillips' point or order?

The Chairman: Perhaps you could explain it again, Senator Phillips?

Senator Phillips: Senator Connolly, Supplementary Estimates (C) as they are presently constituted have been declared out of order by the Speaker of the other place.

Senator Connolly (Ottawa West): All of them?

Senator Phillips: Not all of them, except that he has directed there will have to be another appropriation bill.

Senator Connolly (Ottawa West): Several items were ruled out of order.

Senator Phillips: Yes, there will have to be a separate appropriation bill brought in for these items and they have not been deleted.

Senator Connolly (Ottawa West): And you say it is out of order for the Senate committee to discuss them?

Senator Phillips: Yes.

Senator Connolly (Ottawa West): I wonder if it would satisfy the committee to consider it in this way? We know the ones that have been ruled out of order by the Speaker in the other place. Now, when it comes to this committee—I did not come in here for this purpose; I did not know anything about it until I arrived.

Senator Phillips: I am not accusing you of that.

Senator Connolly (Ottawa West): We know those which are out of order in the other place and they will be in due course deleted, but we have all these here. I would like to direct your attention to this, that for so long in the Senate we have been confronted with appropriation bills based upon Estimates and supplementary Estimates which we had no opportunity whatever to consider. Year after year, you have heard me say this so often in the Senate, senators have risen, even long before I came in, and said "We are asked to rubber-stamp something done by the Commons". This particular committee—unfortunately, I am not a member—has done a magnificent job in the last five or six years in making it possible for senators to become acquainted with items in the Estimates so that when appropriation bills arrive we really have no excuse for saying, "We do not know anything about these and we will not consider them; we will not be able to do anything but simply rubber-stamp them". It may be that there are two or three items here that will have to go back and that are not appropriately in here.

The committee is here; it wants to do some work; it wants to look at the Estimates. I would suggest that we perhaps get a ruling from the chairman, which I think the chairman could give, that the items in question that have been ruled out of order should not be considered, but that we do the other work that must be done, and can be done, by the committee, and deal with the others at another time under appropriate circumstances. In that way the work of the committee can proceed.

Senator Phillips: Senator Connolly, you are almost as eloquent as you were yesterday on St. Patrick's Day.

Senator Connolly (Ottawa West): Oh, no, that would be impossible.

Senator Phillips: I agree with your viewpoint that the committee wishes to work, and I am prepared to do that. In another committee yesterday I received rather lengthy arguments concerning the authority of the Senate to deal with appropriations, and particularly initiate them, and it is my viewpoint that this applies in all committees and on both sides of the house. In other words, the rules are the same for me as they are for anyone else.

The Chairman: Is there any other argument on this point?

Senator Connolly (Ottawa West): We have the minister here; we do not always have the privilege of having the minister here to talk about these things with him and I think we should avail ourselves of this privilege.

The Chairman: Is there any other argument?

Honourable senators, it is true that the Speaker of the other place has taken certain actions in respect of these Supplementary Estimates, but we are not bound by the ruling of the Speaker in the other place. We are a sovereign body. We are here as a committee to examine a document that has been referred to us by the Senate itself. If we find, as they did in the other place, that certain items are legislative in character and in our judgment should not be included in these Estimates, we should so report to the Senate. The Senate can then take the appropriate action. I do not believe that the Senate, in referring these Estimates to us, is asking us to legislate in any way. It is purely a matter of consideration.

For that reason, and for no other—and I base my ruling on the reason I have given—I regretfully, Senator Phillips, cannot accept your point of order, though I would like the committee to examine the very point you have raised. If I accept your point of order we would be unable to examine it. I think we should not exclude our right to examination of the Estimates based on the ruling of the Speaker of the other place. If I accept your ruling we would, in effect, be allowing the Speaker of the other place to determine what should be within the ambit of the Speaker of the Senate.

Senator Grosart: I make just one further point. If your ruling is that we may not be able to deal with items because they are legislative in nature, six of the items are described as legislative in nature in the summary. I ask for no comment on that.

The Chairman: Then perhaps we can proceed.

The witnesses who have come from the Treasury Board are, of course, well known to you: the Honourable Mr. Drury, Mr. Osbaldeston and Mr. MacDonald.

Do you have an opening statement, Mr. Drury?

The Honourable C. M. Drury, President of the Treasury Board: Yes, Mr. Chairman, it is very short.

Mr. Chairman, honourable senators, this is the third set of Supplementary Estimates to be tabled in the current fiscal year and the last expected to be tabled in this supply period. They contain $29 million for budgetary expenditures and $197 million for non-budgetary expenditures—that is, loans, investments and advances. The latter amount includes a $160 million provision that carries with it a proposal to repeal a $150 million provision made in the second Supplementary Estimates. Therefore, the net increase for non-budgetary items is only $47 million. Members of the committee may recall that the practice of presenting in Supplementary Estimates revisions to the forecasts for statutory items was instituted with the first Supplementary Estimates of this year. The revisions in this document amount in the net to $43 million.

As you see, these are relatively small Supplementary Estimates, even when the amounts involved in the revisions to forecasts are taken into account.

Total Estimates for 1970-71 are then $13,470.6 million for budgetary items and $1,061.3 million for loans, investments and advances.

There are 35 one dollar items included here to seek the authority of Parliament through an appropriation act for a variety of measures. About half propose transfer of funds from one vote to another, the funds having been previously approved in an earlier appropriation act. Others concern grants where funds are available in the vote concerned, and only authority is needed or the deletion from the accounts of a number of departments of debts and claims which are deemed uncollectable. Finally there are a few concerned with amendments to previous appropriation acts or to other pieces of legislation.

The booklet you have before you still includes the two one dollar items concerned with veterans pensions and allowances that were withdrawn from the reference to committees of the other place on the ruling of the Speaker.

This committee of the Senate has always shown a particular interest in items in Estimates involving transfers between votes or amendments to previous legislation. For some time it has been the custom for my staff to supply you with a listing of all such items where the amount to be appropriated was one dollar. On this occasion the list has been expanded so that it contains as well items of this nature where there is an additional appropriation proposed in excess of one dollar. That list is the one to which you made reference in your opening remarks and it has been circulated to honourable senators.

That completes my introductory remarks and I will be happy now to deal as best I can with any questions you may have on these Supplementary Estimates.

Senator Grosart: My first remark is perhaps more of a comment than a question to the minister. If you look at page 5, we have the phrase "budgetary expenditures", which was used by the minister in his introduction. I suggest that this is a very confusing phrase, because it is very often used to refer only to column 1. When we try to isolate items to be voted in the budget from statutory votes we do not seem to have any word. Very often these are described as the budgetary items, and have been no described in documents from the Department of Finance. Does the staff have any other word that we can use to separate the items to be voted from the statutory items in these two columns described now as "budgetary expenditures"?

Hon. Mr. Drury: The words, of course, are those that appear in print to be voted on statutory items. Sometimes reference is made in an informal way to the division as between statutory and discretionary to indicate that the executive in respect of the discretionary expenditures have some choice other than the choice of amending the

legislation, which is the only way of dealing with the statutory expenditures. I think the phrase "to be voted" makes it quite clear that there is an option here. "Discretionary" may not be as descriptive.

Senator Grosart: I think it is a very good word, Mr. Minister; it is much better than the one usually used, which is "controllable", which suggests others are uncontrollable. I am glad to have "discretionary", which I will use in future. I thank you for your contribution to the semantics of the Blue Book.

I merely comment again on the one dollar items, because I think other members of the committee will speak to them. You gave us a figure, and I had added it up to 29. Would you repeat the number of one dollar items that you said were in the supplementaries?

Hon. Mr. Drury: In my statement I said there were 35 of these.

Senator Grosart: I seem to have two documents before me, one headed "Explanation of One Dollar Items, Supplementary Estimates (A) 1970-71", and another called "Explanation of Certain Items, Supplementary Estimates."

I take it that the first document which has been supsupplied to us accounts for only 14 items in three classifications: six in No. 1; two in No. 2; and six in No. 3. Are we not to have an explanation of the others?

Hon. Mr. Drury: The document I have called "Explanation of certain items, Supplementary Estimates (C)," which are the ones we are dealing with, "1970-71" contains rather different numbers in the summary.

Senator Grosart: I am sorry. Someone has just handed me the wrong one, so we come to "C" which is not the usual heading and not the heading that we have been promised in this committee, and that is, "Explanation of one-dollar items." This is now "Explanation of certain items." It is very difficult now to follow because the total here is fifty-six. I merely suggest—and I leave it at that—that in future we return to our original type of presentation, which is an explanation of every single one-dollar item grouped together and not—I was going to say "camouflaged," but I do not know what the reason was—not diffused among other items. Perhaps the minister will take that into consideration.

Hon. Mr. Drury: Perhaps we have erred on the side of providing too much information, Mr. Chairman.

Senator Grosart: Yes, and this is one of the great problems in the Blue Book, but often the information is too much in some ways so that it hides the things that are not there. I will make a reference to that immediately, if I may, as an example. Under the Estimates of the Secretary of State—and I am now referirng to page 54 of the supplementary Estimates that are before us—I was immediately interested in the fact that there is here a supplementary Estimate in the amount of $670,000, doubling the previous estimate, so in relation to the original Vote 15c, this is a very large increase, a 100 per cent increase.

In attempting to find out from the supplementaries what that might cover, I naturally moved down to the next classification which is, "Activity to be Supplemented," and I saw, "Special Events and State Protocol," and almost the same amount is accounted for by the fact that there are sums available from another vote.

Then, not being able to find what this covers, I naturally moved down to, "Objects of Expenditure," where one would expect to find the objects, and all I found was, "Operating Expenditures. All Other Expenditures." I suggest to you this is the kind of thing that should not be presented to us. This new breakdown is here to explain exactly what these items are. It may be said that we can go back to Vote 15c, but that is an appropriation act other than the main Appropriation Act. I wonder if you would care to comment on that, why it is somewhere, either under "Activity to be Supplemented" or under "Objects of Expenditure," and there is not an explanation of what the doubling of the original vote is about. Perhaps you could tell us what it is.

Hon. Mr. Drury: Firstly, with respect to the format, Mr. Chairman, this is a continuing problem, to try and get generic headings which will be, to the greatest possible extent, fully expository, but at some point you must recognize that with the amount of detail into which one goes in the subheadings or breakdowns of classifications, if one were to detail every expenditure down to the last dollar, the book would come in several volumes. A line has to be drawn somewhere and, as is customary in every form of classification of payments, there is a so-called basket clause which is made up of a number of relatively small items called "All Other"; and it is indicated in the Blue Book here, I think, that this is an increase in what one might refer to as the basket clause, the "All Other". It does not detail in this book any more than a number of other cases. We could give all the detail in relation to a particular program, and the technique which has been evolved is to have these Estimates referred to standing committees of the legislature which will ascertain in respect of items of interest oral explanations, which go into the record. I might ask Mr. Osbaldeston to give an oral indication of what the $670,000 additional is for.

Mr. G. F. Osbaldeston, Deputy Secretary, Program Branch, Treasury Board: The $677,500 is to provide funds for two royal tours: one, some of the expenses remaining from the royal tour of Manitoba and the Northwest Territories; and the other, the royal tour in British Columbia as part of that province's centennial.

Senator Grosart: I thank you for the answer, and I think it perhaps supports my point. Instead of, "Special Events and State Protocol" it would not have taken up any more space to have said, "Royal tour, B.C.; royal tour, Manitoba." I come back to the fact that we grant $50,000 of this $677,000 as a grant for the Charlottetown Fathers of Confederation Memorial Fund. So we say, "All right, we will tell you what the $50,000 is,

but we will "not bother to tell you here and we will just put in, 'Special Events and State Protocol' ".

If the bill had been there to say, "Let us use this to disclose as much as possible so that people do not have to ask these questions," the whole of the supplementaries and Main Estimates could be made much clearer, without expanding them unnecessarily.

The Chairman: Senator Grosart, I am just constrained to wonder what you would think if that broke down, say, into 25 items.

Senator Grosart: If it were 25 items, that would be another matter. Perhaps in this there are more than these two royal tours, but if the major part of it was accounted for, that is fine. If the real problem—as it often is, and as the minister has suggested—is space, then I have no quarrel. But I suggest that there are many places in here where the problem is not space; it is the tendency to use officialese which is generally less descriptive than the kind of language we get, say, in an oral explanation.

The Chairman: Have you any further comment on that point?

Hon. Mr. Drury: No; I appreciate Senator Grosart's point. There is no question about it. If these were edited by a single individual who was exercising considerable discretion in his choice of language, they probably could be made more expository. However, the fact is that these documents are up against the problem of a multitude of authors, if I can put it this way, and also an injunction to be precise, accurate and have no lack of clarity as to where the expenditures fit and how they are to be coded.

An attempt is made here to make it quite clear that this particular expenditure goes in a particular classification in the main Estimates and nowhere else. While for purposes of exposition perhaps they are not as helpful as one would prefer, in order to ensure lack of error in the accountability we perhaps have to resort to what Senator Grosart refers to as officialese.

Senator Grosart: I am sure, Mr. Minister, knowing your interest in making the Estimates as clear as possible, that you will perhaps take that into consideration.

As the lead questioner in this committee, I think I should perhaps make it clear that we are interested in a supplementary Estimate on page 46, part of which is under the name of the office of the Leader of the Government in the Senate. I would not wish it thought that that was the type of matter we would pass over when we are critical of others.

Hon. Mr. Drury: I am not quite sure of the import of the question.

Senator Grosart: Just what is it? We have an item of $200,000 "Activities to be supplemented—Offices of the President of the Privy Council," which we do not need to inquire into because we know that is in such good hands. We might feel the same way with regard to the next item, which is the Leader of the Government in the Senate, but we would like to know what supplementary Estimate is necessary to the office of the Leader of the Government in the Senate?

The Chairman: In other words, you are asking for the amount and the purpose of that particular appropriation.

Senator Grosart: That is right; what does it cover?

Senator Connolly (Ottawa West): To answer your questions regarding the CNR.

Hon. Mr. Drury: I would say that the Leader of the Government in the Senate is not, in the sense in which the question was directed, implicated in this supplementary Estimate, but it does provide for ministers without portfolio.

Senator Phillips: I have a supplementary question to that of Senator Grosart: In studying the Estimates last evening I looked at the same item and tried to work it out per capita, or on a per office basis. As the minister knows, the number of ministers without portfolio changes continually; everyone has difficulty keeping up with them. I telephoned the Prime Minister's office to inquire how many ministers without portfolio exist at the present time. Much to my surprise the person I spoke to in the Prime Minister's office could not tell me. Now, if the Prime Minister's office does not know it exists, why are we voting $200,000 for it?

The Chairman: You should have phoned the Privy Council office.

Hon. Mr. Drury: I am not sure, Mr. Chairman, who the informant was.

Senator Phillips: Well, they switched me to three different people.

Hon. Mr. Drury: I would be very much surprised indeed if the Prime Minister's office, as an institution, was unaware of how many ministers without portfolio there were at any moment and, indeed, of their names.

The Chairman: Maybe not the first names.

Senator Phillips: It is a bit of a shocking situation, I agree with you, but I am still curious as to if the Prime Minister's office does not know they exist, why are we providing $200,000?

The Chairman: The minister has given you his answer, Senator Phillips, but you apparently got to the wrong man or woman in the Prime Minister's office.

Senator Phillips: I got three of them, but I still did not get the information.

Senator Grosart: There may be more than three wrong ones in that office.

Senator Flynn: There may be too many there.

The Chairman: Perhaps we could pass on?

Senator Grosart: My last question, Mr. Chairman, relates to the numbers on page 42, under Welfare Services

Program. I do not question the figures in detail, but are these expenditures the result of open end agreements?

Hon. Mr. Drury: On page 42, Administration?

Senator Grosart: Under "A—Department—Welfare Services Program" there is Vote 30c. Then there is a statutory one, amounting in all to $19 million.

Are these supplementaries required because we have open end programs?

Hon. Mr. Drury: I suppose one might call them open end. Specifically, the statutory revision—and that is what this is, a revision of the forecast of statutory expenditures to try to bring more up to date what the likely final bill will be—is our forecast of the cost to the federal Treasury of the participation in the Canada Assistance Plan which is, as honourable senators I think are well aware, half the cost of programs administered by the provinces under that statute. To the extent that the expenditures are controllable by the provinces rather than by us, they are open ended in so far as we are concerned.

Senator Grosart: Is it Government policy to as gradually as possible terminate open end agreements and again as far as possible to avoid entering into them in the future?

Hon. Mr. Drury: Our general line has been to attempt to make arrangements with the provinces under which we will know with perhaps greater certainty than we have in the past the kind of bill that is likely to be encountered for a program.

Senator Grosart: Have you been successful in that? I say that because about 18 months ago the public accounts were seriously distorted towards the end by unexpected, unanticipated payments respecting open end agreements. Have you brought that situation under control more or less to your satisfaction, Mr. Minister?

Hon. Mr. Drury: We now have some very large programs for which there are terminable dates, which is leading to a review of them, or others without specific terminal dates, which are also under consideration. For instance, I think the Medicare program would fall under your classification of open ended. It has a prospective terminal date and there are now considerations being given to achieving a more satisfactory and certainly more certain scale of disbursements than the present indefinite one.

Our expenditures are not yet all on a definitive basis.

Senator Grosart: Thank you, Mr. Minister. Excuse me, Mr. Chairman; I am going away happy, not mad, but I have another engagement.

The Chairman: Thank you, senator; are there other questions?

Senator Phillips: Mr. Chairman, I am referring to this document which was passed to us at the beginning of the meeting. I am rather intrigued at page A-1 by the explanation. It states:

> Due to unforeseen demands for water quality studies and analysis—

It seems to me that over the last three years I have heard a great deal with respect to pollution of all areas of our environment and I am intrigued by the wording "unforeseen demands for water quality". What were they?

Hon. Mr. Drury: I think this relates, Mr. Chairman, rather more to scale than to the nature of the payment. What is suggested here is that it was expected there would be requests for water quality analysis from a number of government agencies of the federal Government and other public bodies as well as private bodies.

The interest in this has arisen rather more rapidly and to a greater extent than was contemplated at the time the provision was made for this in the main Estimates. We have as a consequence augmented, or are proposing to augment, in the Supplementary Estimates the size and availability of resources to this end. In an unforeseen way, it relates rather more to the quantity than to the nature of the demands.

If I might make a parenthetical remark, it is really quite encouraging, because it means the public interest in this anti-pollution campaign is greater and at an earlier date than the planners had assumed.

Senator Phillips: Now, Mr. Minister, that you have got in a little bit of what I will kindly describe as boasting, it would be unfair for me, I am sure, to comment that the public interest seems to me to be much greater than the Government's so I will not make that comment.

I will move instead to vote 5C, which refers to the amount of money needed for the new chancery in Brasilia, Brazil. This estimated cost is listed as $2,225,000, which seems to me a rather exorbitant figure for a chancery or official residence, whatever you wish to call it. You could almost build an art centre for that.

Hon. Mr. Drury: I wish we could. Where do you get that figure?

Senator Phillips: On page 16 of the blue book, page A-1 of the explanation provided by the department.

The Chairman: You are referring to the total cost of the embassy in Brazil of $2,225,000?

Senator Phillips: Yes. There are a number of others, such as Madrid, Hong Kong and so on. I am intrigued by the difference. In Madrid the cost is $457,000, and in Brasilia it is $2,225,000.

Hon. Mr. Drury: I wish we were sufficiently astute to have provided the total chancery needs in Madrid for the sum of $457,000. Unfortunately, this is not the total bill for space, but only for part of the space. The same is true in Hong Kong; this is not the total cost of the space required for official purposes, but is accommodation for the staff.

Senator Connolly (Ottawa West): In Hong Kong that is?

Hon. Mr. Drury: In Hong Kong. If you refer to the item relating to New Delhi, as is customary in a number of countries outside of Canada, the foreign representation is in a complex frequently referred to as a compound, a grouping together. This is what is planned in Brasilia, that there will be not only an office building, a chancery in one place, but perhaps the residence or embassy in another building, and staff accommodation obtained on a rental or some other basis elsewhere in the community. This is the cost of the total accommodation—embassy, chancery and staff accommodation.

Senator Connolly (Ottawa West): At Hong Kong?

Hon. Mr. Drury: At Brasilia.

Senator Phillips: Possibly I am in error here, because I am trusting on my memory, which is a dangerous thing to do. It seems to me that it was with reference to Brasilia that the Department of External Affairs received criticism several years ago for their expenditure, including one item of, I think, $50,000 for a mirror. Am I right in that regard?

Hon. Mr. Drury: I am told there was some comment on the purchase of a mirror. That was not for Brasilia but for Rio de Janeiro. The country is right but it was a different city.

Senator Phillips: Are we going to have the same type of expenditure in this new building?

Hon. Mr. Drury: I would hope that in the new building there would not be expenditures that would attract criticism.

Senator Phillips: I will join you in that hope.

Senator Flynn: When you speak of a new chancery in Brasilia, you do not mean a second one in Brasilia, you probably mean a second one in Brazil. This is to replace the one we have in Rio now, I suppose?

Hon. Mr. Drury: As I understand it, the Government of Brazil is endeavouring to move the *de facto* capital of the country from Rio de Janeiro to Brasilia. This necessitates a relocation of the principal seat of activities of all the foreign embassies as well, and this is part of the program.

Senator Flynn: We have nothing there presently. We are acquiring or building a chancery there; this is the first in Brasilia that we are building?

Hon. Mr. Drury: I think at the moment we own land there, we have acquired land, and this is, if I can so put it, the exploitation of the land, the use of the land.

Senator Flynn: There is some confusion when you speak of a new chancery in Brasilia rather than in Brazil; it would suggest that you already have one there and are acquiring a new one, whereas I think presently the chancery is located in Rio, and because the capital has been moved to Brasilia you are acquiring or building a new one there.

Hon. Mr. Drury: That is correct.

Senator Connolly (Ottawa West): I should like to ask about the Madrid situation. Quite frankly, I am always confused between the chancery and the embassy. The embassy is the home of the ambassador, is it?

Hon. Mr. Drury: The home of the ambassador.

Senator Connolly (Ottawa West): The chancery is his office?

Hon. Mr. Drury: That is correct.

Senator Connolly (Ottawa West): I will forget that after I leave the room. In Madrid, have we been renting the embassy, by which I mean the home of the ambassador? Have we been renting there or do we own the building?

Hon. Mr. Drury: I am unaware of that. I am sorry, senator, my officials cannot answer what we are currently doing.

Senator Connolly (Ottawa West): I was there at one time and I thought it was a very good place; it was not over-pretentious, but it seemed to be a very excellent home. It may be that it was rented. It would have to be a replacement. You have these problems all the time. Can any of the officials tell us, Mr. Minister, whether any solution has been found to the problem of providing an embassy in Rome? We had been renting there for many years. I know this is rather a hot potato, because it has been rather expensive.

Hon. Mr. Drury: To my own knowledge, I do not think we have yet found the answer in Rome. I suppose the answer really is that by Canadian standards very high prices indeed have to be paid for urban real estate in the centre of the community. We have, as you suggest, been looking for a number of years.

Senator Connolly (Ottawa West): We own land there, very valuable land, upon which we have not built, but I think building on that land to the standard of the area would be even more expensive.

Hon. Mr. Drury: We have to conform, given this particular site, to the architectural demands of a public body, the name of which I forget, but which corresponds in a sense to the aesthetic department of the National Capital Commission. As you suggest, this calls for a rather more fundamental type of architecture than perhaps the Department of External Affairs normally envisages.

Senator Connolly (Ottawa West): I think this is sensible and I commend the Treasury Board for being slow and careful about this. May I ask another question? We have another ambassador now in Rome, accredited to the Holy See, and I wonder whether he is using rented quarters or whether we own the building?

Hon. Mr. Drury: I do not know the answer to that but I would suspect, given the difficulties of acquiring appropriate space, that he is likely in rented space now.

Senator Connolly (Ottawa West): He is not living in a hotel, for instance.

Senator Flynn: He is not living in Vatican City.

Senator Connolly (Ottawa West): No, he must be outside Vatican City. He could not get in there.

The Chairman: Honourable senators, the minister has a cabinet meeting which is going on now, and I have told him I hoped he could leave by 11 a.m. However, his officials can stay. Senator Pearson and Senator Phillips have questions.

Senator Pearson: The minister made a statement that we already owned considerable property in Brasilia, the chancery, etcetera, but the explanation here says "miscellaneous property acquisitions". Are we extending our holdings?

Hon. Mr. Drury: This probably comes back to the confusion which arises through using general classifications and this falls under the heading of property acquisitions and development but it does not mean that in each specific instance there is involved a property acquisition. It falls into that category but it does not mean that in this instance we are acquiring additional land, we already have it.

Senator Phillips: I do not know whether this should be a question or a compliment. Since I have already given the minister one during this meeting, I had better—

Senator Flynn: That should be enough.

Senator Phillips: I will make it a question. On page A-2 of the summary you refer to the source of funds, Vote 5, $99,999, a nice figure.

You stated that funds are available due to underutilization of manpower. If this is an admission that manpower is not being properly used, I will make it the second compliment. If it is not, I would like to know what it means.

Hon. Mr. Drury: Mr. Chairman, the honourable senator suggested that "if this is an admission that manpower is not being properly used"—it is not what I would really interpret as a compliment.

Senator Phillips: A compliment as to your honesty.

Hon. Mr. Drury: There is an estimate made at the beginning of the year as to the number of man years which will be needed to give effect to a particular program. The man years are by grades, classes, classifications and so on. Due to a number of circumstances, including in some cases the difficulty of recruiting, the vacancies persist, if I could use that term, longer than anticipated and consequently the funds for which provision is made for the payment of salaries would be unused.

What is being done here is to transfer that unused money to another vote, which has been underestimated. There is a over-estimate made in one line of activity and an under-estimate in another and this is an integration or consolidation or netting of the under-estimates with the over-estimates.

Senator Phillips: Throughout the book there is a number of similar transferrings of funds and I am wondering if the departments are deliberately in the beginning of the year making their Estimates high so that they will have this cushion to fall back on if need be.

Hon. Mr. Drury: I would hesitate to impute this kind of motive to departments. They do face some real difficulties. If one looks at the timetable of this operation, I think it is understandable. As the pamphlet which the Treasury Board got out some time ago indicated, the departments are now being asked to evolve detailed Estimates—in May and June of this year—for their expenditures in the fiscal year 1972-73. So they are being asked to forecast, with some degree of precision, for some six to eighteen months in advance. As honourable senators are aware, quite a lot can change in that period. A number of these $1 items represent a reconciliation, if I can call it this, of a slight and in many cases not very significant imprecision in this kind of forecasting or prediction. Provided this does not assume gargantuan proportions, it seems to be inherent really in the process and I would be rather unhappy to label this as a deliberate attempt to over-estimate.

The Chairman: Are there any further questions to the minister? Mr. Minister, in the other place, you enunciated five rules on which your department based the $1 items. In your absence, could Mr. Osbaldeston read these rules for us, so that they might form part of our record, because the Senate has been interested for a number of years in $1 items.

Hon. Mr. Drury: I think that probably would be very helpful if he could do that. I would be glad to read them myself, if that would be convenient. I have them here.

The Chairman: We do not want to hold you up.

Hon. Mr. Drury: With your permission, I will read them, Mr. Chairman. This is the statement or part of a statement which I made in the house in respect to this procedural discussion. In the course of it I said:

> The Government uses appropriation bills to amend or set aside legislation when it is sought
>
> (a) to alter financial limitations imposed by legislation or by previous estimates. For example, an increase in the maximum amount that may be loaned by Central Mortgage and Housing Corporation for housing purposes.
>
> (b) to alter time limitations imposed by legislation or by previous estimates. For example, the termination date of the trans-Canada highway program.
>
> (c) to extend the application of legislation to a person not covered by the legislation so as to authorize the making of payments to such persons in accordance with the substance and purpose of the legislation. For example, authority to make payments under the Government Employees Compensation Act to DOSCO ex-employees suffering from silicosis.
>
> (d) to amend legislation originally approved through Estimates items. For example, broadening of the scope of a revolving fund.

(e) to effect transfers of available funds to votes where additional funds are required.

I may add, parenthetically, from votes in which there is a surplus of funds.

Senator Pearson: Could not all those items be put into one fund and call it a revolving fund?

Hon. Mr. Drury: No, Mr. Chairman, because the date of expiry of a particular statute is set forth by an act of Parliament. And I would suggest that one should not be able to change these dates, or the executive change them, merely through providing for additional money out of some revolving fund. In the process in which we are engaged currently in relation to supplementary Estimates, this Blue Book here represents the basis, the justification for legislation, the legislation taking the form of an appropriation act. This is an explanation. As a statutory document it has no validity, other than merely being an explanation. The statute, the executive act of Parliament, is the Appropriation Act, and we are using a statute of Parliament to amend other statutes of Parliament, and these are the kinds of amendments to the will of Parliament effected through the Appropriation Act.

There is another way of giving effect to the will of Parliament in respect of change, and that is through the normal process of a separate, distinct bill, and where, as this list indicates, the intention is to change in some substantive way a bill or a statute, then the normal procedure is to introduce a separate bill and discuss the change in substance; but where the changing of a statute is related to such a thing as merely alterating the termination date, but without altering the substance of the bill, or where it is to amend the amount of money available, without changing the substance, then the Appropriation Act appears to be appropriate. Where Parliament has voted a certain amount of money for one activity, and that amount of money is not needed but a related activity does need more money, then Parliament is asked to legislate this change, and it does so through the Appropriation Act, the explanation of which and justification for which is in the one-dollar item in the supplementary Estimates.

I think perhaps there is some confusion, in the sense that Estimates are not properly regarded as legislation—and they are not. The Estimates are merely explanations or the foundation for an Appropriation Act, and the Appropriation Act which gets three readings in both houses and royal assent, just like any other bill, is in fact the legislation.

Senator Connolly (Ottawa West): And committee consideration.

Hon. Mr. Drury: Yes, and committee consideration.

Senator Flynn: Mr. Minister, I do not believe that the Government always proceeds by way of Estimates in all the cases you have indicated. I was wondering if there was any ground rule to proceed by a separate bill in some of these cases and through the Appropriation Act in others. In many of the cases you have indicated they sometimes come to us in the form of a separate bill. For instance, if you increase the amount available to a crown corporation...

Senator Connolly: Central Mortgage.

Senator Flynn: ...say, Central Mortgage—we have had separate bills in such cases. We have had it for crop insurance.

Hon. Mr. Drury: I would think that coupled with a provision to increase an amount would also be some other substantive changes in the bill; and where substantive changes are being made—and, of course, there is the question of judgment as to what is substantive and what is not—the preference would be to proceed by way of a separate bill and a separate statute rather than an Appropriation Act.

Senator Flynn: The extensive use of this device in all these cases you have mentioned makes all the appropriation bills omnibus bills which Parliament, as a rule, just does not like too much to have to deal with, because we are called upon to make a decision on so many matters that are in fact unrelated. I think that in some cases it is more than incidental amendments to the act, and it really comes very close to substantive legislation. However, in any event, you have told us what the practice is.

Hon. Mr. Drury: Just let me say that there is, in a sense, a philosophical conflict regarding a single bill which focuses attention and consideration on a particular item, and this argues against the omnibus bill. On the other hand, the omnibus bill has the virtue of enabling the legislators to look at the whole framework, the one in relation to the other, more easily than dealing with it on a piece-by-piece basis.

Senator Flynn: If they are related, yes, I agree with that.

Hon. Mr. Drury: There is some hanging together, and increasingly in our complex society it is getting very much more difficult than perhaps it use to be to enact almost any provision which does not have a signficant impact on a whole lot of other areas. Perhaps if one could look at these altogether, the end product might be more useful than if it is just looked at in isolation. There is a balance here, clearly.

Senator Flynn: I appreciate that. You are not suggesting, however, that Parliament has not the time to look at all these problems individually, and that the Government is saving time by introducing legislation in this manner

Hon. Mr. Drury: Undoubtedly, that is one useful by-product that, given the pressure there is on parliamentary time—and I think the honourable senator is well aware of the number of legislative enactments which die on the books at the end of every session because of lack of time—there is something to be said for trying to make a better use of our time, and if in the same process one can get a rather more rounded picture of the topic under discussion, it has a double advantage.

Senator Connolly (Ottawa West): I venture the prediction that these one-dollar items are going to be with us for all time and that they are going to become more difficult as time goes on, because it really boils down to the question of judgment as to whether you open an act or put it into the Estimates. If you exercise your judgment and put it in the Estimates, there is certainly going to be criticism, but I think the fact that the criticism does arise at least provides an opportunity for parliamentarians first of all to pinpoint the problem, to look at the result that is sought to be achieved, and to warn a given government, "Perhaps you have gone too far in that. Don't go that far on the next go around." As I say, I think this process is going to remain with us for all time.

Senator Flynn: You have also enabling legislation or legislation—we call in French, loi cadre—that gives general powers of regulation to the Government, and the holes are filled by items in the Estimates and in the appropriation bill.

Hon. Mr. Drury: I would suggest, Mr. Chairman, the suggestion here is that there is some confusion between Estimates and bills. The bill is merely the justification for a statute; the Estimates are the justification for another statute, called the Appropriation Act. They are both subject to the same, as I indicated, type of scrutiny and process of scrutiny, cross-examination, consideration and expression of parliamentary will, one as another.

The Chairman: If I may interject I will say there is some doubt in the Senate as to whether we would have the same ability to deal with a One Dollar item which is legislative in nature as we would an actual bill taking into account our right to create money legislation. I think that is why we have been so jealous of it.

Hon. Mr. Drury: I think that is quite true, except I do not think that the Senate can legislate Estimates leading to an Appropriation Act.

Senator Phillips: I thought that was the argument I made earlier.

The Chairman: It was, but in a different context.

Hon. Mr. Drury: Whereas I assume, I am not sure of this, that the Senate could initiate legislation, if not extending, as this might involve a charge on the exchequer, certainly curtailing the termination date of an agreement.

Senator Connolly (Ottawa West): I doubt it; decreasing it, I am not too sure, because time after time and year after year when that was suggested successive leaders in the Senate have said, "you are interfering with ways and means".

Senator Flynn: No, I think we can always reduce the amount.

Senator Connolly (Ottawa West): I can even remember Senator Aseltine when he was Government leader, taking the same position that Senator Ross Macdonald had taken when he was leader.

Senator Flynn: That is another viewpoint.

The Chairman: Perhaps we could have that debate at another time.

Senator Phillips: I know the minister wishes to leave for his Cabinet meeting. I would like to make a personal request of him before he goes, that at the meeting he ask the Prime Minister how many members of the Cabinet are without portfolio.

The Chairman: Mr. Minister, in the past few months the Minister of Finance has taken certain initiatives to stimulate the economy. Presumably the result of some of those initiatives is in these Supplementary Estimates (C). Do you have a list of the amounts which are included in these supplementary Estimates that refer to that initiative?

Hon. Mr. Drury: There is the $160 million, I think, of which the details have been given.

The Chairman: Yes, they are here.

Hon. Mr. Drury: My staff do not have anything in addition to the $160 million, but we would be glad to gather this together and provide it to the committee.

I apologize for running out.

The Chairman: Thank you very much for your time, Mr. Minister.

Are there any further questions of Mr. Osbaldeston or Mr. MacDonald?

Senator Phillips: Yes, at page A-3, under the heading National Defence, there is a transfer of an amount over $1 million. In rather an unusual combination we have the *Arrow* clean-up combined with the War Measures Act. The expense is listed as outside the Province of Quebec and I am interested in obtaining a breakdown in the various areas in which this money was spent.

Mr. Osbaldeston: It is true that both items to which you refer appear under the explanation of requirement, general military support services. Both expenditures were incurred within that activity of the Department of National Defence and within Vote 5c.

The only explanation I could give you, sir, as to why they both appear there would be to the effect that in both cases the military performed a supporting or, in one case, a military support service but in the second case, of the *Arrow*, they equally performed what I now understand to be the normal support service of the military in the civil sector. So both the civil sector and the military police action aspect appear within that activity.

Senator Phillips: Let me be more specific in my question: How much of the vote under (b) was spent in Ottawa?

Mr. Osbaldeston: There are two items making up the $1.1 million. The first item, the *Arrow* clean-up, cost $500,000. The second item, relative to the activities during the period the War Measures Act was in force, cost $600,000 outside of the Province of Quebec. There-

fore, it includes within it $600,000 of expenditures incurred in Ottawa and other parts of the country, excluding Quebec.

Senator Phillips: Yes, but can you give be a breakdown?

Mr. Osbaldeston: I do not have it in that detail; I am sorry, senator.

Senator Phillips: I am rather curious as to the cost of the various guards in Ottawa at that time. Perhaps you could give us an undertaking to provide it at a later date?

Mr. Osbaldeston: Fine.

The Chairman: What specifically are you requesting?

Senator Phillips: The total cost of providing guards during the so-called insurrection in Quebec last year.

The Chairman: The total cost of providing guards in Ottawa?

Senator Phillips: Yes.

The Chairman: Is that exclusive of pay and allowances, because generally such items are expressed in those terms.

Senator Phillips: Exclusive of pay and allowances.

Mr. Osbaldeston: We can certainly make the inquiry.

The Chairman: Perhaps you could send a copy to the chairman and a copy to Senator Phillips, so that if the chairman fails in his duty Senator Phillips will have the information.

Senator Phillips: And I cannot complain.

Senator Flynn: In Item (a) of the same explanation I see that it is expected to recover the full amount expended to clean the damage caused the tanker *Arrow*. I think the witness said that the expenditure is half a million dollars. It is indicated here that procedure against the tanker operators would be settled and there is an intimation that we would recover the full amount.

Mr. Osbaldeston: Senator, should I make it clear that the total cost of the operations incurred by both the Department of Transport and the Department of National Defence will be in the order, we understand, of $3.8 million. The portion of that cost that you have in front of you is simply that of the DND, $500,000.

Further as to the possibility of recovery, they are endeavouring to recover as much as possible, given the legal limitations, of $3.8 million, in other words, the total cost.

Senator Flynn: They hope to recover the total cost?

Mr. Osbaldeston: That is correct.

Senator Connolly (Ottawa West): Was that insured?

Mr. Osbaldeston: I think there is some difficulty in this case. In the case of the other tanker, it was insured under the International Tanker Consortium; there was insurance whereby the Government could claim against that. In this case, the information I have from the lawyers is that it is not certain that situation exists. They may have to claim directly aganst the owners.

Senator Pearson: Were the pay and allowances of the armed forces increased while working on this clean-up?

Mr. Osbaldeston: Not the pay, to my knowledge; I would not think so. The payment of allowances would reflect where they were housed during the period, and I just do not have any knowledge on that.

Senator Connolly (Ottawa West): I notice on page A-3, to which Senator Phillips referred, there is a $500,000 item under National Defence. At the bottom of page A-6, under Transport there is a $308,000 item for clean-up following the sinking of the oil barge *Irving Whale*. I wonder why in one case the army or the Department of National Defence was used and in the other case the responsibility fell on the Department of Transport.

Mr. Osbaldeston: I believe the Department of National Defence acted in support of the Department of Transport, which has the prime responsibility. It was at the behest of the Department of Transport that the Department of National Defence supported them. In the case of the *Irving Whale* operation, I can only assume the Department of Transport did not require that sort of assistance. I believe that is further supported by the fact that in the *Irving Whale* case there was very little beach damage, as I understand it. With the *Arrow* is was considerable.

Senator Flynn: Is the *Irving Whale* the property of a company controlled by Mr. K. C. Irving? I am asking on behalf of Senator McElman.

Mr. Osbaldeston: According to the newspaper comments, I understand so.

The Chairman: We will continue to speculate on that.

Senator Phillips: Is the $308,000 referred to by Senator Connolly the total cost as opposed to the figure you gave of $3.8 million for the *Arrow*?

Mr. Osbaldeston: As you are probably aware, the barge is still submerged, and the costs you have in front of you are the costs that have been incurred to date. Therefore, given that additional work will be required to some extent I assume there would be additional cost.

Senator Phillips: For the Commissioner of Official Languages I see the figure of $328,000 as opposed to a previous estimate of $113,000, which is an approximately 300 per cent increase. Normally this committee looks rather askance at any increase over 10 per cent, but when we see 300 per cent we tend to take a harder look at it. Why is this necessary?

Mr. Osbaldeston: The office of the Commissioner of Official Languages came into being on April 1, 1970. At that time moneys and staff were provided to begin the

work with which he was charged. During the course of the past 10 or 11 months he has initiated activities, and he now has a better understanding of the type of resource he requires in order to carry out his operations. The $113,000 was the amount required to begin. The costs you have before you in the Supplementary Estimates indicate the full year costs of carrying out his operations, from certain knowledge he has gained over the last 9 to 10 months.

Senator Phillips: For a 300 per cent increase he must have gained a considerable amount of knowledge.

Senator Flynn: If I might interject, it is more than that, because before we had the Commissioner of Official Languages we were not spending a cent on this.

Senator Phillips: It makes it even worse.

Senator Flynn: It has a double meaning, Senator Phillips.

Senator Phillips: I refer now to page 50 of the blue book. I am rather intrigued by Vote L29c:

> Loans in accordance with terms and conditions approved by the Governor in Council, for the construction of an oil refinery terminal wharf at Come-by-Chance, Newfoundland.

Mr. Osbaldeston: The loan, the details of which have not yet been finalized to my knowledge, is for the construction of an oil refinery terminal wharf at Come-by-Chance, Newfoundland. What is proposed here is a loan, which would be repaid with interest over time, in order to provide an oil refinery terminal wharf.

Senator Phillips: What means are provided for the recovery of this loan? Is it on wharfage charges?

Mr. Osbaldeston: It would be a loan repayment. The debtor, if you like, would secure the funds to meet the terms of the agreement; I think it would be his responsibility. There would be a loan repayment schedule attached to the agreement.

Senator Phillips: Are we approving the loan without even any terms to the loan? This is unusual, is it not?

Senator Connolly (Ottawe West): Perhaps this is a regular type of thing, where the Department of Public Works constructs waterside facilities, and then for a period of time, through wharfage charges, as you call them, the facilities used to provide the harbour facilities for oil tankers, the charges are designed to write off the loan after a given period.

Mr. Osbaldeston: That is correct. This is a usual process.

Senator Connolly (Ottawa West): I mention this, Senator Phillips, not to try to make an answer for the witness, but because in my days on the Treasury Board I used to ask the question you have just asked all the time. As I understand it, this is the function of the minister on the Treasury Board, sitting as he does under the chairmanship of the President of the Treasury Board.

Senator Phillips: I appreciate your explanation, Senator Connolly, but I still feel it is a rather unusual procedure to be voting the money in advance, when the terms of the loan are still not completed.

Senator Connolly (Ottawa West): In other words, we do not know what the terms of those loans are. Frankly, this is the problem the minister and the Treasury Board have. The minister wants to know, as well as you do, just what the schedule of repayment is, what the rate of repayment is, and how long it will take. I would assume in this case they would estimate the extent to which that facility would be used, whether there is the possibility of an extension of the refinery facilities that are to be involved in the use of the wharf, and that kind of thing. I think it is quite proper to inquire what, in a given case, the prospects are, and how quickly the loan is expected to be repaid, and even what the rate is going to be.

Senator Phillips: I agree.

Senator Flynn: There may be a problem of policy, but I suppose there is also a problem of negotiation in each case. That has been my experience.

Senator Connolly (Ottawa West): Sometimes this facility is rented out to a private owner.

Mr. Osbaldeston: If that was the case changes would be appropriate, or, if a private entrepreneur he could in effect set up charges against himself. I might mention to Senator Phillips that the terms and conditions of this loan would go to the president of the Treasury Board.

Senator Connolly (Ottawa West): In this case, do you know whether or not the wharf or the facilities are to be leased out to an entrepreneur, or whether the department is going to operate the wharf itself.

Mr. Osbaldeston: In this case, because it is a loan, I would presume that the department would not operate it, that the responsibility for operation, maintenance and repair would rest with the person to whom the loan is granted.

Senator Connolly (Ottawa West): In other words, the concession is granted, perhaps even to the employer, the refinery company.

Mr. Osbaldeston: I think that would depend on the need of the Department of Public Works for public access.

Senator Phillips: Can you tell me who the entrepreneur is in this case?

Mr. Osbaldeston: I do not know, senator, to whom the loan specifically would be made. It could be made to any one of a number of authorities—to an entrepreneur, to a provincial Crown corporation or to a province. There are a number of possibilities there.

Senator Phillips: Mr. Chairman, my remarks are not intended to reflect—

Senator Connolly (Ottawa West): Do you mind, Senator Phillips, if I interrupt you? Who is going to own that refinery which this facility is to serve?

Mr. Osbaldeston: I cannot recall the name of the consortium or the group that is putting the refinery in. It has slipped my mind.

Senator Connolly (Ottawa West): It is not one of the major oil refineries?

Mr. Osbaldeston: No, it is not one of the normal group of companies. I believe it is a group being put together to operate the refinery. I am sorry I cannot recall the name of it.

Senator Connolly (Ottawa West): That is all right.

Senator Desruisseaux: Would it be a Canadian firm?

Senator Connolly (Ottawa West): Not necessarily, I guess.

Mr. Osbaldeston: I am sorry.

Senator Phillips: I would like to put my views on record. I think it is rather unusual for us to be asked to approve a loan when we do not know the terms and conditions of the loan and in fact we do not even know who is getting the loan.

The Chairman: I must say I am inclined to agree with you on this, senator. Perhaps this committee is entitled to a much better explanation than we have had up to now, as to who is the recipient of the loan and what the terms and conditions of the loan are, and what the terms of repayment are.

Senator Connolly (Ottawa West): We could ask for that.

Mr. Osbaldeston: Could I speak to the Department of Finance or the Department of Public Works to see if they could provide us with this information.

The Chairman: That is agreeable.

Senator Phillips: I have one further question and then I will leave you in peace. On page 20 of Supplementary Estimates (C)—have all the provinces participated in these special programs?

Mr. Osbaldeston: Yes, sir.

Senator Phillips: I am rather uncertain as to the basis on which the amounts for the various provinces were arrived at. Could you explain the basis for arriving at these figures?

Mr. Osbaldeston: Yes. In the statement that appears under Vote L13c, in the vote wording, it says:

> —for purpose of assisting in the creation of employment in areas where the number of unemployed workers was in excess of 4 per cent of the labour force in the six-month period ending December 31, 1970—

That is the basis on which the division of the money was made between the provinces. It was worked in this way, if I may use a hypothetical example. If the number of unemployed in Canada over 4 per cent, had totalled let us say, 1,000, and if 100 of those unemployed were located in a given province, then that province, having 100 of the 1,000 over 4 per cent would then be eligible for 10 per cent of the loan fund.

Senator Phillips: I thank you for your answer, but I notice here that Quebec gets $70 million and Ontario $17 million, and I am still not clear as to the basis of arriving at that distinction.

Mr. Osbaldeston: Given that Quebec has received $70 million of the $160 million, it means that Quebec, during the six-month period ending December 31, 1970, had 70/160ths of the total unemployed during that period.

Senator Desruisseaux: Would you repeat those figures please?

Mr. Osbaldeston: Given that Quebec is to share in the $160 million loan fund to the order of $70 million, therefore they had within the province 70/160ths of the total unemployed in Canada, over the 4 per cent base.

Senator Sparrow: Did I understand the witness to say that all of the provinces had accepted funds?

Mr. Osbaldeston: All of the provinces are eligible to share in the funds, in the amounts indicated here.

Senator Sparrow: Was not Senator Phillips' question whether they had accepted?

Senator Phillips: Yes, accepted.

Mr. Osbaldeston: Negotiations, I believe, are still under way. As to whether or not they would accept, is still to be determined. The loan funds are available through the fiscal years 1970-71 and 1971-72. Some are still under negotiation.

Senator Sparrow: They may accept any time up to March 31, 1972?

Mr. Osbaldeston: That is correct.

Senator Phillips: And how many provinces have accepted to date?

Mr. Osbaldeston: I do not know that, senator.

Senator Phillips: What is the relationship—

Senator Connolly (Ottawa West): Would you wait a moment, as this is important. Under this item, provinces are allowed to borrow, to the limit set out on page 20 for each province. They have known of this provision for quite some time, I take it?

Mr. Osbaldeston: That is correct.

Senator Connolly (Ottawa West): Could you give us how much has actually been advanced—by provinces?

Mr. Osbaldeston: I could ask that, if I may, of the Department of Finance. I do not have that figure with me.

Senator Connolly (Ottawa West): I think a successful program depends on the extent to which a province participates in the program.

The Chairman: Can you tell me what this sum of $160 million is to be used for?

Mr. Osbaldeston: The amount is to be used for the construction of capital works, such capital works not to have been included in the normal capital work program of the province. In other words it is to be a supplement to capital work in each of the provinces.

The Chairman: Seventy per cent of the $160 million, that is, $114 million, goes to Quebec, Ontario and British Columbia, which are the most highly capital-developed provinces in Canada. Does it not strike you as strange that 70 per cent of a Government initiative goes to capital development in the provinces that are the most highly capital-developed provinces? And only 30 per cent goes to the Maritimes and the Prairie Provinces, which are in dire need of capital development? Is that not an odd way to fight unemployment?

Senator Phillips: Mr. Chairman, you have expressed my question better than I could, and I want to thank you for it.

Mr. Osbaldeston: In looking at this vote, I think one has to take into account the total package that was developed by the Government in August and in October. The one package amounts to $60 million which senators have discussed at another meeting, and the second package of the economic stimulation program was in the order of $250 million. Mr. Chairman, as you recall, at the December meeting, when we discussed the $250 million loan fund, which this one replaced, it was set out there that in addition to the loan fund there was to be $23 million in federal Government public works. There was to be additional money for training, et cetera. I think it is only in that context that it is possible to comment on your remark.

The second comment, though, was to the effect that this program is directed at unemployment. It is quite true, and it is evident from the vote wording, that the program was directed at areas of high unemployment. The question of the amount of capital that was present in a geographic area, clearly from the vote wording, is the secondary consideration. The primary one was the unemployment. However, I do repeat it has been seen within the total context of what DREI is doing, in terms of infrastructure—

Senator Pearson: Would it not be possible to generate capital expenditure in one of the Prairie provinces and spend more money there and bring the unemployed from British Columbia or Quebec into that area? It would be easy to develop industry where there is a scarcity of industry, rather than in an area where there is a greater percentage of industry.

Mr. Osbaldeston: I think it is true to say that in the Department of Regional Economic Expansion they do have grants which facilitate precisely what you suggest. That is outside of this program entirely.

Senator Connolly (Ottawa West): Is it fair to say that this program was developed by looking at the number of unemployed in a given area, at a specific time, with a view to employing those people? Is it not a matter of—as the Chairman suggested—what capital may be available for investment in those areas. I heard you say that perhaps infrastructure was one of the items to which the moneys borrowed could be devoted. I take it—and I am not apologizing here for the Government—perhaps one of the motivations of this kind of loan, particularly in respect of infrastructure, as to provide a basis upon which the private sector could go forward with other capital investments and perhaps also alleviate the unemployment to an additional extent, than the employment generated by the use of those funds.

Senator Pearson: On the other hand, the unemployment in British Columbia was supplemented to a great extent by the unemployed in the Prairies moving out there. This brings a weightly problem to British Columbia to start to build up the infrastructure, as you say, to take in all the unemployed who really belong to the Prairies.

Senator Connolly (Ottawa West): In other words, you say it might have been cheaper to have done it on the Prairies rather than in British Columbia.

Senator Pearson: Exactly.

Senator Connolly (Ottawa West): Except I suppose that at a given time—and here I stand to be corrected, because I do not know, but given the answer the witness has supplied us, I suppose that at a given moment those unemployed who had come from the Prairies were in fact in British Columbia.

The Chairman: But it seems to me there is a more basic point than that, Senator Connolly, and that is that if, as the witness suggests, we take the total program, it still was a program designed to alleviate unemployment in those regions of Canada where in the last six months of 1970 it was the greatest, so that the bulk of the program in dollar and percentage terms went to Ontario, Quebec and British Columbia.

You cannot argue the obligation of the federal Government to use its financial ability to alleviate unemployment, but it seems to me to be ludicrous to exacerbate the regional differences that already exist in Canada by using a capital infrastructure—roads to airports, loans for capital projects—in the very provinces that are already intensively capital developed. If you are going to use means of alleviating unemployment in terms of employing people or in terms of payments to people, that is understandable; but to go ahead and exacerbate the difference that is already terribly dangerous in this country, between the wealthy, capital-developed provinces and the under-developed provinces strikes me as being foolish in the extreme.

Senator Phillips: I would like to add to the remarks of the Chairman that it appears to be working in direct contradiction to the Department of Regional Economic Expansion. We are developing areas that are already highly developed and, to me, there is a conflict between the two programs.

Senator Connolly (Ottawa West): I do not know there is that, but I think perhaps in the absence of specific information we are talking in a vacuum. I would like to suggest that the witness get from the Department of Finance, if that is the appropriate department, not only the amounts that have been actually drawn down by each province, but the nature of the work which was undertaken by the use of these funds; and, secondly, the number of people who were in fact employed as a result of the expenditure of the funds.

Senator Pearson: And where the expenditure was made, in what location.

Senator Connolly (Ottawa West): Yes. If that detail could be supplied, I suppose it might be helpful too. In other words, we would like to know how this substantial program is in fact working out and how much they know about it at this time. I think the figures would not be too conclusive just now, but they may be at the time of another go around on these Estimates.

Mr. Osbaldeston: Mr. Chairman, if I may respond to the senators' requests, I would say that we would endeavour to secure that information.

Senator Connolly (Ottawa West): It may be a little difficult to get it, but it may be helpful to us.

Could I refer the witness to page C-4 of the document?

Senator Desruisseaux: Before we deal with that, on this very item I would like to have a little more explanation. On page 20, in item (ii) we see:

> —the term to maturity is twenty years or such lesser period as may be fixed by the Minister of Finance.

I fail to understand this because if you have a project you usually plan it for a definite time, and it is usually not less than 20 years.

The Chairman: Which item is this?

Senator Desruisseaux: It is Vote L13c, item (b) (ii).

The Chairman: The term to maturity is 20 years, et cetera.

Mr. Osbaldeston: The only purpose in having that provision to reduce the term is to facilitate, if you like, a policy of the provincial government. They may wish to pay it off over a shorter period. Rather than forcing them into a 20-year loan this would permit them to enter into an agreement.

Mr. Connolly (Ottawa West): They could pay it off without notice or bonus.

Mr. Osbaldeston: That is right. The term of interest is set out in paragraph (b) (iii), and there is a provision put in there to establish the interest rate to be charged. The formula under the Canada Assistance Plan for determining that interest rate is rather lengthy. That is, it is wordy. Therefore, in terms of drafting this appendix to the Appropriation Act, the lawyers, rather than repeat the formula, have simply given a reference back to the Canada Pension Plan.

Senator Desruisseaux: The only thing we are really interested in is the rate.

The Chairman: It seems to me that the Minister of Finance did announce the rate.

Senator Connolly (Ottawa West): It is below the market rate, I take it.

Mr. Osbaldeston: It is a favourable long term rate.

The Chairman: We can be informed on that.

Honourable senators, I have to appear before the Internal Economy Committee. If there are still questions you wish to ask, perhaps you could choose an acting chairman. Perhaps Senator Desruisseaux would take the Chair, if that is agreeable.

Hon. Senators: Agreed.

The Chairman: I apologize for leaving, but I really must go.

Senator Desruisseaux (*Acting Chairman*) in the Chair.

Senator Connolly (Ottawa West): I should like to direct the witness's attention to page C-4 of the summary. Under National Defence Vote 5c, it states that it is to authorize an extension of the purposes of this vote to provide for the deletion from the accounts of certain claims. The explanation of that is that it is proposed to write off debts due the Crown in respect of a former employee as well as funds confiscated by the Japanese during World War II. I do not want to know the name of the employee, but can you tell me the amount and the origin of the claim?

Mr. Osbaldeston: The amount is $7,409.30 and the origin of the claim relates to the fact that when he joined the services in 1947 the birth certificate indicated his date of birth as August 31, 1909. However, when he subsequently retired in 1968 he produced a province of Ontario birth certificate showing his birth date correctly as 1901. In effect, senator, he was employed beyond his 65th birthday and the salary paid to him after his 65th birthday would not fall within the appropriate legislative authority and, in effect, he would have a debt to the Crown.

Senator Connolly (Ottawa West): Which you cannot collect.

Mr. Osbaldeston: For having received moneys for working an extra five years and this, in effect, is to permit him to retain his salary.

Senator Connolly (Ottawa West): And because he is an older man presumably he has less income.

Mr. Osbaldeston: And because, in fact, he worked for the Crown from 1965 to 1970.

Senator Connolly (Ottawa West): With respect to the funds confiscated by the Japanese during World War II, I assume that is a debt due by the Japanese government.

Mr. Osbaldeston: Yes, senator. These are funds which were confiscated during World War II in 1941, and the amount at that time was $224,558.13 Canadian. It was deposited in banks in Hong Kong by the Canadian military authorities. Then it was confiscated by the Japanese subsequently.

After the end of the hostilities the War Claims Commission was established in 1952 and it was empowered to distribute funds received by the Japanese government to honour the claims of governments which suffered losses in the war. Reimbursement from the funds available to the Commission was made on the basis of the prevailing rate of exchange on the Hong Kong dollar. By the time the final settlement of the claims was made in 1956, it had declined in terms of Canadian dollars for Hong Kong dollars. It had declined to .19 cents from the original .30 cents. So there was about a 50 per cent drop in the value. The depreciation of the Hong Kong dollar between 1941 and 1956 has resulted in an unsatisfied balance of $70,000 in the deferred claims account.

Senator Connolly (Ottawa West): And that cannot be collected. I take it that it is perhaps deemed to be inappropriate to try to collect it.

Mr. Osbaldeston: Yes, given that the War Claims Commission set the rate as the 1956 rate.

Senator Connolly (Ottawa West): On page C-5 there is an item concerning the National Museums of Canada. Apparently there is an increase of $116,000 sought to enable the National Museum of Canada to purchase items selected by the National Gallery of Canada from the Manoir Richelieu collection of Canadiana. Are these exclusively pictures? If so, are they by Canadian artists of some repute? In other words, are they good pictures and is the amount involved a reasonable amount? I ask this because I realize the Canada Steamship Lines have wound up the business at Manoir Richelieu.

Mr. Osbaldeston: That item should be read in connection with the item under Public Archives. In the Public Archives supplementary Estimates before you you will see the amount of $759,000, which also reflects part of the purchase price of the Manoir Richelieu collection. Therefore, the Manoir Richelieu collection really will have cost $759,000 plus $116,000, or an approximate total of $1 million.

Senator Connolly (Ottawa West): How many items are involved in that collection?

Mr. Osbaldeston: Besides paintings, senator, there were also included maps and prints. It is all early Canadiana.

Senator Connolly (Ottawa West): They are originals, I take it.

Mr. Osbaldeston: I am not certain whether the prints or maps are originals. I know that prior to purchase there were a number of appraisers called in by the Public Archives and the National Gallery. As I understand it, the cost to the Government is rather favourable relative to an appraised cost.

Senator Connolly (Ottawa West): I think that is only proper, because we want to try to preserve our own original works, and the Manoir Richelieu collection is reputedly a very good one, although I have never actually seen it.

The Acting Chairman: It is indeed a good collection. I had occasion to see part of that collection before it was sold, and I was astonished at their ability to bring together such a fine collection of Canadiana.

Senator Connolly (Ottawa West): It is important to keep Canadiana in Canada.

The Acting Chairman: If there are no further questions, I would suggest that the committee now adjourn.

The Committee adjourned.

APPENDIX "A"

Breakdown by Departments
of $60 Million in 1970-71 Supplementary Estimates (A)
Directed towards alleviation of Unemployment

Department	$
Agriculture	3,804,350
Consumer & Corporate Affairs	52,000
Energy, Mines & Resources	406,500
Fisheries & Forestry	3,216,800
Indian Affairs & Northern Development	5,444,700
Unemployment Insurance	451,000
Manpower & Immigration	18,993,000
National Defence	1,252,000
National Health & Welfare	22,000
National Revenue—Customs & Excise	327,000
Public Works	7,560,000
Regional Economic Expansion	12,025,000
National Capital Commission	400,000
Secretary of State	129,000
National Film Board	90,200
Public Archives	5,000
Solicitor General	—
R.C.M.P.	744,000
Supply & Services	920,000
Canadian Arsenals	60,000
Information Canada	555,000
Transport	3,379,200
National Research Council	6,500
Veterans Affairs	853,200
Anticipated Shortfall	—
Total	60,696,450

Breakdown by Region of Canada of
$60 Million in 1970-71 Supplementary Estimates (A)
Directed towards Alleviation of Unemployment

	(Millions of dollars)
Atlantic Provinces	9.2
Quebec	29.7
Ontario	4.7
Prairie Provinces	9.1
British Columbia	6.9
Total	59.6

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 4

TUESDAY, MAY 4, 1971

First Proceedings on the Question of
Growth, Employment and Price Stability

(Witness—See Minutes of Proceedings)

23254—1

STANDING SENATE COMMITTEE ON
NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald (*Moosomin*)
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
Gélinas	O'Leary
Grosart	Paterson
Hays	Phillips
Isnor	Sparrow
	Walker—(27).

*Ex officio Member

(Quorum 7)

Orders of Reference

Extract from the Minutes of Proceedings of Tuesday, March 9th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said Estimates reaching the Senate.

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of Proceedings of Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The Question being put on the motion, it was—

Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Extracts from the Minutes of Proceedings of Wednesday. April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Benidickson, P.C.:

That the name of the Honourable Senator Croll be added to the list of Senators serving on the Standing Senate Committee on National Finance.

The question being put on the motion, it was—

Resolved in the affirmative"

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achive full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of Proceedings of Tuesday, May 4, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relation thereto.

The question being put on the motion, it was—

Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Minutes of Proceedings

Tuesday, May 4, 1971
(4)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 2:30 p.m. to consider the question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Benidickson, Bourque, Isnor, Kinley, Laird, McLean, Methot, Nichol, O'Leary, Paterson and Sparrow. (13)

Also present but not of the Committee: The Honourable Senators Haig, Kinnear, Lamontagne, McGrand, Smith and Urquhart.

In attendance: Dr. James. Gillies, Director; Mr. A. B. German, Administrator; Mr. W. Neville, Editorial Writer; Mr. L. Birchall, Assistant to the Director; and Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Heard as a witness: Sir Roy Harrod, Professor of Economics of Oxford University (retired), now of the Department of Economics, University of Maryland.

At 4:35 p.m. the Committee adjourned to 10:00 a.m. on Wednesday, May 5, 1971.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa Tuesday, May 4, 1971

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 2.30 p.m.

Senator Douglas D. Everett (Chairman) in the Chair.

The Chairman: Honourable senators, this is the inaugural meeting of the Standing Senate Committee on National Finance on the problem of growth, employment and price stability in Canada.

In the course of these hearings we will hear evidence on this subject from economists in Canada, the United Kingdom, the United States, Germany and Japan, whose knowledge and experience cover the widest possible range of economic activity.

The objective of these hearings and of the subsequent report to the Senate will be to discover the articulate methods which could be used in Canada to achieve our full potential growth and full employment without inflation.

This committee does not seek to lay blame for past performance. Rather, we direct our criticism against current methodology and hope to discover better methods of achieving our objective.

We therefore have four purposes:

(1) To examine in the public forum new concepts for achieving our objective;

(2) To have those charged with the direction of our economy comment publicly on those new concepts;

(3) To improve public understanding of the difficult problems and choices involved in directing the economy; and

(4) To record the essence of these hearings, written briefs, and studies on growth, employment and price stability, in a report that we hope will have a pronounced effect on the direction of the Canadian economy.

Honourable senators, as our first witness, we are fortunate in having Sir Roy Harrod, the distinguished British economist, who has spent most of his life as a tutor at Christ Church, Oxford. During the war, Sir Roy worked closely with Sir Winston Churchill and Lord Cherwell, as a member of Sir Winston's personal staff. He is the author of many books and studies on economics, the best known of which is his biography of Lord Keynes.

Sir Roy is an international expert in his field. To give you an idea of what he stands for, I read from his preface to a book related to another relevant policy question of immediate concern. In that preface he states:

> The general long run principle relating to wages and salaries is clear increases should be limited by reference to increases in the gross domestic product; but the techniques to be used in securing this objective, if the correct regulation of demand fails to do so, have still to be developed.
>
> It is contrary to sound principle to push total demand down to a level below the supply potential of the economy with a view of getting an abatement of wage demands. That would be to sacrifice the certainty of a greater good for the problematic attainment of a lesser one. Furthermore, the moral flavour of such a policy is not, in the last analysis, altogether pleasant.
>
> Despite all man's achievements in the physical sciences, and despite such achievements as there may have been in economics and psychology, his moral sense remains the greatest attribute of civilized man—and the one most important for economic welfare.

Honourable senators, it is with great pleasure that I introduce the distinguished economist, Sir Roy Harrod.

Sir Roy Harrod: Thank you, Mr. Chairman.

Senator Isnor: Mr. Chairman, when was that preface written?

The Chairman: Sir Roy, do you remember when that was written?

Sir Roy Harrod: It is fairly recent.

The Chairman: You are not turning your back on it?

Sir Roy Harrod: No.

The Chairman: It is as recent as that, Senator Isnor. Now, Sir Roy.

Sir Roy Harrod: Mr. Chairman, honourable senators, I should like to say at the beginning that I regard it as a great honour and a great privilege to have this opportunity to testify here.

I apologize for my script not being in your hands earlier, but I have had various frustrations—not here but elsewhere—both with regard to the question of typewriting and also with regard to the question of postal delays.

23254—2½

It seems that what I should do now is not to read this script but to make a few remarks covering similar ground in order to outline my position.

I am basing what I say primarily on my own country, Britain, and on the United States of America, whose economy I have made it a practice to follow very closely over a number of years. I think, therefore, that what I should say, if it is to be well informed, should be based primarily on the two economies that I know best.

There is a very striking similarity between these two economies at present, namely, the great paradox that exists of the combination of rather high unemployment—production is certainly below what the two economies are capable of—with unprecedented galloping inflation. I say "unprecedented". It is unprecedented in peacetime. We have to go to times of war to find periods of inflation of the order of magnitude that we have been having in Britain and that they have been having in the United States. This similarity is rather striking.

The first thing we want to ask is why this has been happening. Hitherto it has seemed quite plausible to say that when you have a price inflation of this sort it is due to over-full demand. The economy has been heated up too much. That means rising prices. "But," you say, "there has not been over-full demand very recently." Then the defenders of the orthodox say, "But there may be a time lag." In other words, the present inflation explosion may be due to excessive demand of two or three years back. Well that is a possibility, of course, but I am rather doubtful of the time lag explanation. But I would twist it round a little and ask you this: If we look through the history since the war, there have been other occasions in both those two economies when there as been a certain amount of over-heating, a certain amount of excess demand, and those other occasions were not followed by inflationary explosions of the kind we have been having in the last two years. What is the difference? Why is there a difference? If over-full demand regularly leads to this kind of inflation, why did it not do so on other occasions?

I can only give you one example, and that is the Korean war. I think people do not now realize that the American defence effort associated with the Korean war was actually bigger than the defence effort associated with the Vietnam war. The Korean war was over quickly, of course, but a big defence build-up followed it because the Americans began to be alive to dangers in the world and to think that they must build up a much stronger defence position. Thus, the defence effort associated with the post-Korean period was much bigger than the defence effort associated with Vietnam. For one thing, they ran a heavier deficit in the federal budget; for another, much bigger proportions of the national resources were devoted to defence in the years shortly after the Korean war than have been devoted to defence in any of the years since the Vietnam war broke out. But if you look at the situation after the Korean war you do not see this period of wage-price spiraling, as I call it.

Where is the difference? There must be some difference. It is the novelty of this explosion which makes one doubt the orthodox explanations of its being due to some past errors, whether of the central bank or of the Treasury in either country.

I now come to the question of remedial measures. Again, the orthodox wisdom would say, "Well, if you are confronted with this sort of inflation, you ought to damp down demand." There is a recognized method of damping down demand by what are called monetary and fiscal policies. Monetary policy is executed through the central bank and fiscal policy is executed through the budget.

But, we have to ask ourselves: Suppose it to be the case that these phenomena are not due to excessive ease in monetary and fiscal policies in the past, then is the remedy necessarily right?

Nearly two years ago I ventured to write an article for *The Economist*, which they kindly christened "Harrod's Dichotomy". I should like to explain that. It is that if the aggregate demand of the economy is excessive in relation to what the economy can supply, this, in my opinion, will certainly tend to pull prices up. Really, I think everyone is agreed that, if you have excessive demand which cannot be met, there is an inevitable force in pulling prices up. Sometimes we call that "demand-pull inflation."

If that is going on, then obviously the right remedy is to reduce aggregate demand and have tight money through the banking system, build up perhaps a budget surplus, and so on, so as to reduce aggregate demand. If excess aggregate demand is causing price inflation, then reduce the aggregate demand if you want to cure the price inflation.

So far so good, but now we go to the other side. Suppose that the aggregate demand is manifestly not running above the supply potential of the economy. Suppose that it is substantially below the supply potential as I do not think anybody could deny it has been for some time in both countries to which I have referred. Does this remedy work? With respect to these two countries that are experiencing strong inflation, supposing you cannot show that that is due to overheating in the near past; supposing that it is very doubtful whether it is due to any overheating at all; are you necessarily going to cure that by reducing demand and increasing unemployment still further? I submit that there is no presumption that you will do that.

I hope that I have made this plain. I call it the dichotomy that, if total demand is excessive and is pulling prices up, reduce total demand and that will be a cure of inflation; if it is not excessive, if, indeed, it is under what the economy could meet at full employment, then it becomes an open question whether a further damping down of demand is going to do any good to the inflationary situation, and there is even a possibility that it may do harm. This is not accepted by all economists, but I think the point is worth pressing home. There are certain features of damping down demand still further that could even be price inflationary. Of course, I am talking about an economy that is not fully employed. Now, if you reduce demand below that point, you will assuredly add to the unit costs of producers. I do not say that they will put those higher unit costs straight into prices. They

would not do that, but it might have a more subtle effect. Suppose you have wage increases going on and you have a damped economy and high unit cost, then you are almost forced to push those wage increases into prices. But if you have an expanding economy, with productivity rising—that means production per head rising—you may be able to absorb part of the wage increase without pushing it all into prices. In that case damping demand still further, so far from being curative of the inflationary situation, might make it worse.

Then there are certain elements in monetary and fiscal policy designed to dampen the economy which are really inflationary. Take the case of high interest, and here I am not talking of the difference between 3 and 4 per cent, but a substantial increase in interest rates is apt to be pushed by the price fixers into prices as part of the cost. Take indirect taxes, for example; they certainly go into the cost of living. Even direct taxes may in certain cases go into the cost of living, although there is some argument about that. So these measures designed to cure inflation could, in certain circumstances, make it worse.

That is what I feel about the present situation. I do not think that any damping of demand within any reasonable amount in either the United States or the United Kingdom would have an anti-inflationary effect.

Then you may say, "Well, what are we going to do about it. We do not like this inflation; it is destructive of many values; it imposes hardship on many people; it is an evil to be avoided if it possibly can be avoided." But before you ask what we can do about it, you have to ascertain what has caused it. It seems there is a new element in the situation. When wages go up more than productivity and producers are forced to put some of that into prices, then the unions say they want still more wages, that they want enough to cover the inflation coming in the following year, and then there is a higher increase in wages than is justified by prices at the particular moment. Then the price fixers say that they have to put these extra wages into prices with the result that prices will go up more, and so you have what I call wage-price spiralling.

I believe that the basic cause of this is not something economic at all, but what I would call sociological. It is a new attitude of mind; it is a more activist attitude on the part of the trade unions and a more permissive attitude on the part of employers. Then you can carry it one stage further and you can say that the employers are a little more activist in fixing the prices they charge and the consumers have also become more permissive so that instead of protesting violently in the store, they just shrug their shoulders and say, "Well, we know there is inflation on now," and they do not resist. I would say that I consider this, which I consider to be a new phenomenon, is first cousin to student unrest. It is a reflection of a more activist state of mind on the part of the trade unions.

If that is the kind of thing that has caused this explosion which, as I say, is unprecedented, you have to have a new remedy. It is no good to turn on the old taps of fiscal and monetary deflation and hope that that will cure it. You have to face a new problem in these circumstances, and in my opinion the least that can be done now is to have what we call an incomes policy which means that in one way or another you just do not permit these excessive wage and price increases.

There may be arguments as to whether such a policy can be effected voluntarily or must have legal sanctions; whether it should be across the board or selective; whether it should be something for a short period or contemplated for a longer period. Perhaps there will be some questions about that, and particularly about the British experience. Sometimes people say that this sort of policy has been tried in Britain and has failed, but I would say it has not been tried very seriously. There have been just half-hearted attempts. But now that the phenomenon has become so much worse in Britain, and it has also become rather bad in the United States, I think there is a challenge to take this policy more seriously, and it is the only way that I can suggest of solving the problem. If monetary and fiscal measures do not cure it, then what other measure is there except direct interference in the course of wages and prices?

On the side of the orthodox methods I would not deny that if a country were prepared to bring on a really heavy slump such as we had before the war, when you had an unemployment rate of 15 or 20 per cent, that might stop it, not by any economic law but simply because it would produce an atmosphere of crisis where everybody would say, "Well, we have to stand still." But any monetary and fiscal policies with intolerable limits, in my view, are very unlikely to cure this new phenomenon.

With regard to the British experience, I should like to answer any questions that people may have to ask. I should also like to answer any questions about how in general detail this could be done. But, as I have said, that is my general feeling, that you have to have a new policy called an incomes policy.

The Chairman: Thank you. Now, honourable senators, we are open for questions.

Senator Paterson: Could I ask the speaker if there is any truth in the old saying that inflation is cured by unemployment?

Sir Roy Harrod: Well, I have been rather arguing against that. As I say, if you have very heavy unemployment—20 per cent or more—then I think you could probably take the wind out of the sails of inflation, but, after all, in the United States, which I have been talking about, the unemployment rate has risen to over 6 per cent. Not long ago they said there, "We know we have to have some unemployment. We cannot be like the Swedes, who did not intend to let their unemployment rise above 1 per cent." And I say good luck to them, but the target figure for the United States was put at 4 per cent. It has gone way beyond that, and yet they have this very bad bout of inflation.

Senator Nichol: Sir Roy, if I may, I would like to move directly to the question you invited in the second-to-last paragraph of your paper. You suggested that you had in mind a mix, with some detail about mechanisms—"the mix between voluntary and mandatory and the mix

between interference with wages and dividends." I think it would be very helpful if you could enlarge on that point, and tell us what you had in mind, because I suspect that this is the debate which is going to be raging in this country.

Sir Roy Harrod: Yes. I would not like to venture an opinion about Canada because there are special features in the economy here, and it is not quite parallel to the two countries I have talked about, though it is somewhat similar. Also with regards to Canada there is this great regional difficulty which may require a policy of its own, so to speak—the difference between the Maritime provinces and Ontario, and so on. So that may give rise to special problems for Canada.

Americans are hoping that the explosion is easing off now. Prices have not been too bad, but wages have continued to rise much too fast.

I have not been in Britain much in the last couple of months, and I would like to see how things are going there, but my impression is that it is rather acute there still, and I think that when it gets as acute as that you have to give people a sense of urgency. Therefore, to start with and not as a permanent measure, I would favour a freeze. We had a freeze for six months in 1966, but it was not followed up and no advantage was taken of that freeze to get around and see what sort of longer term policy was possible. I would think that a temporary freeze would be desirable; and, under cover of that, you should have round-table discussions with the principal trade union leaders, pointing out to them, "You cannot have this freeze going on forever, but we want to hammer out a "mutually agreed policy for the more rational behaviour of wages and prices." That might or might not be successful. I believe that it would be successful, that you would get co-operation; but I think it should be under cover of the temporary freeze.

Then you could have, so to speak guidelines for policy. Whether they would have to be statutory or optional you would find out at your round-table discussions. You would determine whether there was enough co-operation on the part of the union leaders to make it feasible to rely on a voluntary policy. If there did not seem to be—and I would face up to it—you would have to have some legal basis for abating the rise of wages and prices.

I think that in the long run you cannot interfere with prices in a free-enterprise economy. In the long run interference would have to be on the side of dividends. You would have to do something to balance the interference with wages, otherwise the workers would say, "Well, are we limiting our wage demands simply to put more money into the pockets of the profit-takers?" You have to do something. I think the point at which you could do something would be by somehow ensuring that the rate of increase in dividends per annum was not greater than the rate of increase in wages, by some sort of surtax on dividends. If dividends began shooting up, then you would have a surtax to reduce the rate of increase of dividends.

Senator Nichol: If what you say is correct, that there is a new element, which is a sociological or, if you wish, a psychological one in the mix which makes the problem very difficult to solve by the traditional fiscal and monetary methods, then this is something which, if it is going to be cured, I would think would take many, many years to change. Do you think it would be possible to change the psychological environment during, say, a six months' freeze, or do you think the freeze period would add a crisis sense to the thing which might make people think harder about it?

Sir Roy Harrod: I do not think you could change the psychology for many years. Therefore, I think it depends on the front put up by the Government. If it puts up a manful front and says, "We are determined to stop it," Then, after all, a government which takes a strong line about inflation knows that it has the people behind it because people do not like inflation. The union members themselves do not like inflation, but they grab more wages because, if they do not, some other fellow will and they will be made to look foolish. You have wide popular support, and if the Government puts a very firm face on it, it might work. After all, it is almost something like a war. You do not say, "Well, it will take us a good many years to prepare for this war." You have to do it now. The evil is upon us.

I do not want to speak too strongly about Canada because I am not quite sure what the base of inflation is, but certainly in the case of the United Kingdom, and I should think almost certainly in the case of the United States, the evil is upon these countries, and it is up to the Government to take a firm stand.

Senator Nichol: On the question of price and wage controls, in wartime there is a psychological background for acceptance. Although I suspect that a majority of Canadians would accept price and wage controls, or that before they came in they would say they would, is it logical and possible to maintain wide, firm price and wage controls in peacetime?

Secondly, can you do it without moving towards some form of economic isolation from the rest of the world? In other words, do you not need foreign exchange controls, and all the rest of it, to go with it? Is it something which is relatively easily done and relatively easy to maintain in peacetime; or is it something which is extraordinarily difficult; or is it somewhere in between?

Sir Roy Harrod: I think it is very difficult. I think it is something that needs doing. From time to time in this world very difficult problems do arise, and I think a very difficult problem has arisen and it is not going to be easy.

It ought to have a favourable effect to the extent it was at all successful on the balance of payments, which happily is pretty good now here in Canada. It should have a favourable effect, but I also think that part and parcel of this kind of policy is that it should be tackled internationally, because this inflation has been to some extent an international phenomenon occurring in most of the advanced countries.

I was at a meeting on international monetary problems in Bologna a few weeks ago, and I put the sort of point I have been putting just now. It seems quite natural to have international conferences on the rate of interest, Central Bank policy and all that sort of thing, but would

it not be a rather good idea—and I made this suggestion in Bologna—to have an international conference on the wage-price spiral and to have trade union leaders at that conference from various countries? I believe that would make them feel a greater sense of responsibility. You would have a Canadian, an American, a Briton around a table, such as was the case at Bologna, discussing it. They would ask, "What ought we to do?" I think they would come back and realize that it was not simply that the profit-takers or monopolists in their own country were trying to control them, but that it was a world-wide movement for greater control or restraint in regard to wage inflation.

Senator Nichol: In the suggestions that you have referred to, do you think of a tax policy as part of the mix of controls in the system; and, if so, what type of tax policy?

Sir Roy Harrod: I would not know enough about that. I would have thought that a tax policy was part of the orthodoxy of fiscal and monetary policy. When you want to damp the economy you have a budget surplus. The British have had an enormous budget surplus in the last two or three years. If you want to stimulate the economy you run a budget deficit. They are doing a little bit of that in the United States now. When you come to specific taxes it is a question of the detailed structure of the economy, whether there are certain specific taxes in this country which might help gain acceptance for a wage policy. But I would not know enough about that.

If we are trying to overcome inflation, as far as possible we want to avoid extra indirect taxes. The British Government apparently are thinking of instituting a "value added" tax which is bound to be inflationary. Joining the Common Market will also be inflationary.

Senator Beaubien: Sir Roy, in 1967 there were two or three labour contracts signed here which worked out at a $33\frac{1}{3}$ increase over three years. We are now starting on a new batch. How has England fared since 1967? Has it gone up a little over 33 per cent in three years?

Sir Roy Harrod: I think it has been running at about that rate in the last year, but only in the last year. Devaluation is no good in the fight against inflation. The United Kingdom imports such vast quantities of food and materials, and so on, which enter into the cost of living. It is very difficult to combine the fight against inflation with devaluation. That is one reason why the British Labour Government's half-hearted attempts in this direction were bound to be frustrated until enough time had elapsed to work through the effects of the devaluation of sterling.

Senator Beaubien: It worked the other way with us. Our dollar's value increased in the last year and a half by 8 per cent in terms of the American dollar. An increase of 10 per cent to your employees over and above that had a much stronger effect on our exports.

Sir Roy Harrod: The upward valuation of the Canadian dollar, surely, for what it is worth, is deflationary. It gives grounds for resisting such big wage demands.

Senator Beaubien: If you are producing iron ore and you are selling it in the world market, you are getting American dollars for it. If you are giving your men an increase of 10 per cent over and above your costs will increase by 8 per cent, so your iron ore is costing much more.

Sir Roy Harrod: It is intolerable to have to combine an upward valuation of currency with wage increases which ignore valuation. It is a further argument for not allowing such wage increases to take place.

Senator Lamontagne: There is one problem that you have not touched upon in your introductory remarks. It is a problem that we have had to face in Canada, and it is one that was faced unsuccessfully by the United States. It is the problem of short-term forecasting, agreeing as to what stage of the short-term cycle we are in.

I remember making a speech in Toronto in March last year more or less along the lines of your remarks today, saying that we were on the eve of a recession. Nobody at that time believed in what I said. In the post-war period we in Canada have had a very bad record of short-term forecasting. As a result of that we have applied on the demand side relatively good policies, but at a bad time, so that we started to avoid the 1953-1954 recession in 1955. In doing so we contributed to the inflationary spiral of 1955-1956. We never really started to fight the recession in 1957, and we ignored the recession of 1960. We have had a very bad record, and it seems that even if we were to develop a relatively good set of policies to deal with this kind of problem, and even if we do not have as a kind of prerequisite a better system of short-term forecasting, we may always be a recession too late.

The Government really started to move in to fight the current recession in December, while for all practical purposes the recession started in March, 1970. I would like to have your comments on this aspect.

Sir Roy Harrod: For a fiscal monetary policy you want as good short-term forecasting as you can get. It will only be effective if your forecasting is fairly good. I would not have thought that for an incomes policy you would need short-term forecasting. You need a long-range program which can be adapted. You could say, "We think that this economy should be able to increase productivity 4 per cent a year." If you find that you have been unduly pessimistic or optimistic you may have to adjust. By and large, I think the target should be set for a long-term program.

Senator Lamontagne: But you also need a short-term policy.

Sir Roy Harrod: You will always need an anti-cycle policy. This country is very much influenced by the United States of America. If their diagnosis is bad, if there is a recession there, or undue expansion, there will be a rather strong effect felt here. I was thinking that this country ought to make one of its short-term targets to offset American mistakes—if America was intending to export an unhealthy boom here, to put on a rather deflationary monetary and fiscal policy as an offset to the influence coming from America, and conversely.

Senator Lamontagne: I was very much interested in your remarks today. At the time of the depression, when the classical economists still prevailed, we started to fight that condition by taking action on the supply side. We thought that by developing a better climate for producers we would start things moving again. Then one day the Keynesian revolution took place, and we were told that was wrong and that we should start from the demand side.

It seems to me that Keynesism has become in some circles a kind of dogma and it is time to have a new economics, which would again give more attention to the supply side in dealing with this long-term problem of inflation. Unless this new economics is developed and preached in high circles in the United States, Canada and elsewhere, we will not go very far in terms of establishing a new approach such as you have explained this afternoon. Unless conventional wisdom is replaced by new wisdom, we will not make much progress in that direction.

Sir Roy Harrod: I am not quite sure what would be general measures on the supply side.

Senator Lamontagne: They would include, for instance, income policies and so forth.

Sir Roy Harrod: Do you call that the supply side?

Senator Lamontagne: Yes, because it applies to the agencies of production, the suppliers as opposed to the men.

Sir Roy Harrod: The British policy of subsidizing agriculture is on the supply side, is it not?

Senator Lamontagne: Yes.

Sir Roy Harrod: Keynes' ideas are really embodied in monetary and fiscal policy, which I consider good, but we must not rely on them exclusively. Looking beyond Keynes who, after all, was carrying on his work in the thirties, we find more of a growth policy, which projects growth rates of the different elements in the economy, such as exports.

There is practically nothing in Keynes with respect to the inflation in wages and prices. During the whole of the inter-war period, and especially after 1929, there was no inflation problem. People were not worrying their heads; they wanted prices to rise. The question was how to make them rise. Prices were so low that it was unprofitable to the producers. We thought that we were giving too large a share of the national cake to those with fixed incomes.

Senator Lamontagne: Of course, this is really not the problem Keynes was interested in.

Sir Roy Harrod: He was as soon as the war started.

Senator Lamontagne: It seems to me to be wrong today to apply the Keynesian framework to a problem for which his analysis was not intended.

Sir Roy Harrod: I do not know how Keynes' theories would be applied to wages and prices; there is nothing to apply. We should go on applying Keynes, I submit, in the monetary and fiscal policies. In Britain, almost up to the war, the fiscal policy was not accepted by the Treasury or other British authorities; they termed it nonsense and insisted that the budget must be balanced. It was declared that a deficit budget would not do anything for employment.

It was only after the war that Keynes' fiscal policy came to be accepted. However, he has nothing to say with respect to the spiralling of wages and prices. If he stated that their spiralling could be ended by certain tactics, I would ask what those tactics are. There is no doubt he would want expansion, because he regards employment as his top priority.

Senator Lamontagne: That is exactly what I mean. We still apply the techniques proposed by Keynes on the demand side in terms of monetary and fiscal policy to fight a long-term and chronic problem which really lies on the supply side. As you said, it is a very roundabout way of solving the problem.

Sir Roy Harrod: I agree with you entirely.

Senator O'Leary: Sir Roy, you said at the conclusion of your excellent remarks: "My opinion is that Canada should now revert to a policy of reasonably full employment." Canada is not a single economic region; we have five regional economies in Canada—the Atlantic Provinces, Quebec, Ontario, the Prairie Provinces and British Columbia. Could you tell us how a full employment or incomes policy could be applied intimately to the problems and potentials of those five separate economies?

Sir Roy Harrod: I think I did mention in the course of my oral remarks the special regional problems in Canada. It is a very difficult problem, and to apply different fiscal and monetary policies to the regions would be practically impossible. It would be necessary to have five national banks and five capital markets separated from one another. That would be rather difficult, but we could attempt to lessen the differential between the regions on the side of what is referred to as supply.

Before this meeting I was asked about the differentials in the United Kingdom between the south, northeast and northwest of England, Scotland, and so on, which have existed for a long time. Those differentials remain, but for quite a number of years there have been policies on the supply side to encourage investment in the lower income regions. Although the differentials still exist, they have been lessened. By "differentials" I mean such developments as unemployment rising by one per cent overall, but quite likely by 3 per cent in Scotland. There are still differentials in the level of employment in the different regions, but the spread is smaller. That is due to a deliberate policy of subsidizing capital development in the less advanced regions.

Senator O'Leary: Would you agree with me that one of the questions to which this committee should apply itself would be a method of dealing with five economic regions? In my opinion it makes no sense to have one economic policy for the whole of Canada. In my opinion, a solution to that problem is the objective of this com-

mittee. A policy that would benefit Ontario but not touch the intimate problems of the Maritime Provinces would not be the answer. Just how should we do this?

Sir Roy Harrod: I agree. It seems to me a thing the committee should certainly consider, but whether they will find the answer is the difficulty. I would add, while acknowledging these regional differences, it is still surely the case that there is a national movement up and down; there is a national increase of unemployment which may go at different rates in different regions, but it is in the same direction; there is an upward movement in unemployment, and you can see a national cycle as well as some regional differences.

Senator Lamontagne: Would you not agree that the problem Senator O'Leary raises calls for different approaches, because in most of our depressed areas—you have them as well as the United States and Canada—the problems are really structural, and not cyclical. Most of these regions are more stable in the short term than the Ontario economy, so we cannot approach these régional problems with the same set of policies, because the problems are quite different. However, it seems to me that if you have a general strategy there is no incompatibility between organizing a national economic policy, and then having regional and different types of policies for these depressed areas.

Sir Roy Harrod: That seems perfectly correct. You want a national policy to even out the business cycle and maintain reasonably full employment overall, and then it is highly desirable to have regional policies. But how are you to have those policies without the machinery? There is not the machinery of government, banking, etcetera by regions.

Senator O'Leary: You would agree this is something for this committee to explore?

Sir Roy Harrod: Certainly.

Senator O'Leary: That is, as to how we do this?

Sir Roy Harrod: Certainly.

Senator O'Leary: We know about it, but knowledge comes and wisdom lingers. Have we the wisdom to do it?

Sir Roy Harrod: That is right. It is a problem, but one would think it would take rather a long time to work out possible mechanisms when there is, after all, no regional government. You have provincial governments and a federal government and so on, but how are you going to employ a policy? It has to be done somehow. I think the British way is perhaps the natural way. The British central government designates certain regions—which used to be called "depressed", and after that they were called "special"—and there are definite policies specific to those regions.

The Chairman: Supplementary to that, Sir Roy, could you tell me whether it is theoretically possible in a country like Canada to have a regional monetary policy or a set of monetary policies conducted by the central bank?

Sir Roy Harrod: I would think it was impossible. I mean, money is fluid. It goes around the country. I think these fiscal and monetary policies would be national policies for ironing out the national cycle, such as it is, maintaining employment and so forth. I do not see how they could be regional policies. Of course, in the United States they do have those 12 federal reserve banks, but funds flow very easily. I do not think it is at all easy to have, say, a stiffer monetary policy in California than in New England.

Senator Lamontagne: In these cases I suppose it is certainly possible to complement the national monetary policy, as managed by the central bank, by selective credit policies for the depressed areas, which amounts more or less to the same thing. We have, for instance, a bank owned by the government which has not really met its original objective, it seems to me, but it could lend money at lower rates of interest in depressed areas. Then, of course, we have all kinds of credit policies as well to help other economic groups, so that our credit policy can be an essential complement to our general monetary policy.

Sir Roy Harrod: I find it a little difficult to separate credit and money, because money is fluid; it goes about the country. I should have thought you could have more projects for the less developed parts of Canada—specific projects of a capital kind. You can subsidize investment, or some particular forms of investment, in these areas and so on. I would not have thought you could have five different monetary policies.

The Chairman: What would happen, Sir Roy, if the central bank were to finance the deficits of certain provinces that show less than the aggregate national demand, thereby creating an additional money supply in those provinces, as opposed to the provinces financing their own demand by selling their own bonds on the market and not increasing the money supply?

Sir Roy Harrod: Would it not be the federal government rather than the central bank that finances? The idea that the central bank should finance deficits in the less developed provinces reminds one of the proposal that has been discussed a good deal—and everyone says it will not work—what is known as the link between this new form of international money, the special drawing rights, SDRs, and aid for less developed countries. People say, "Why don't you issue those special drawing rights, not by handing them evenly around all members of the fund but by channelling them to the less developed countries which need them most?" You could have a link, in fact, between money creation in the form of SDRs and aid in the form of trying to boost up. The general view is that that would not work. It will go on being discussed, but at the moment the view is that there are objections to the link between a money policy which would be general and universal and specific aids to less developed regions.

The Chairman: I am speaking about a situation in which by prior agreement a province that is not operating at aggregate demand would run a deficit and issue bonds to cover that deficit, which would be purchased by

the central bank, the effect of which would be to increase the money supply in that particular province. I am just wondering if that is correct, and what would happen.

Senator Lamontagne: It would increase the money supply in the whole country.

Sir Roy Harrod: Yes, because that money circulates. The province that gets the money in the first instance buys goods from other provinces and the money circulates, so you cannot confine the money to the particular less developed province. It is bound to circulate. I do not think you can do it through money supply. Money supply must be looked at for the nation, because it circulates all over the nation.

Senator Isnor: I was much impressed with what Senator O'Leary had to say, coming as I do from the Maritimes. I was wondering what factor would be the most important for Canada. I think Sir Roy's remarks were based largely on Great Britain and the United States; I believe he said that himself.

Our situation in Canada, Sir Roy, is that 63 per cent of our population is in two central provinces, Ontario and Quebec. Ontario has 35.4 per cent and Quebec has 28.4 per cent, a leaving all the western provinces to make up 26.4 per cent and the Maritime or Atlantic Provinces only 9.5 per cent.

We must have a market in the Atlantic Provinces. What can we do about that? This is something for the committee to consider, if it is interested, as I am, in the Atlantic Provinces. What can we do to assist the Atlantic Provinces to develop a market in Central Canada?

Sir Roy Harrod: May I ask for a list of the products. Do you want the Atlantic Provinces to go on producing what they now produce, or do you want them to get into a fresh product?

Senator Isnor: I want a policy—the factors that are going to enter into the planning of this committee with relation to the Atlantic Provinces. I think the situation is quite different, Sir Roy, in both Great Britain and the United States in so far as trade conditions are concerned. From the point of view of the Maritimes, we look on those two central provinces as a place where we should be able to do a greater amount of business.

Sir Roy Harrod: Yes, but I was asking the question: What do you want to sell there? What do you want to sell in Ontario?

Senator Isnor: We want to manufacture and sell what they need.

Sir Roy Harrod: That means really some differential assistance to manufacturing industry in the Atlantic Provinces, is not that it—differential assistance to manufacturing industry.

Senator Isnor: The close market is the best possible market, as far as selling is concerned. The cost of manufacturing, the cost of delivery, and so on, all enter into the selling price. We want something like greater freight rate benefits, if we have to put such goods as we have, into central Canada, or some other place.

Mr. Chairman, I think that is one of the problems we have to study in so far as the Maritimes are concerned.

Sir Roy Harrod: But have you the goods that central Canada wants?

Senator Isnor: We have the finest apples produced.

Senator Beaubien: We sell them to England.

Sir Roy Harrod: There is a limit to the amount of apples that people want. In America I have been eating two a day, but most people do not. The people can consume only so many apples.

Senator Isnor: It may be that we need industrial growth.

The Chairman: Senator, I think that is a problem to which we will be addressing ourselves. Sir Roy did indicate, in his submission, that his expertise was in the area of United Kingdom experience and world experience, and that his especial knowledge was not in the regional problem of Canada, although he recognizes that is a very real problem for Canada and one that this committee, as Senator O'Leary says, will have to consider.

Senator Isnor: Senator O'Leary brought it up. That is why I mentioned it.

Senator Beaubien: Sir Roy, earlier on you pointed out very carefully that our inflation was not cost-pull—in other words, it was not caused by too many buyers running after too few goods.

Sir Roy Harrod: I said it was not demand pull.

Senator Beaubien: You intimated very clearly that all our inflation is cost-push, simply because wages have gone up and up. Would you not say, then, that the only thing that can be done is to put a limit on wages, to prove that there is absolutely no cost-pull or that it is not a question of price increases. Every one of our paper companies in the last three months has either passed its dividends completely or cut them very severely. The mining profits of all our big companies were down 30 per cent in the first three months of this year, and the chemical companies are closing up plants right and left and going out of business, because they simply cannot raise prices, and their costs have gone up so high. If it could be explained how one could run a business when he has to face a 10 per cent increase in wages every year, I think that would be one of the great pieces of news the world could use. I do not see how else you can meet that situation.

Sir Roy Harrod: I agree in substance if the situation is, as I am sure it is, as you have defined it. All the same, their profits may have been very poor over a wide range.

This must be a general policy; it is no use having a policy just for this year or for these six months. We need a general policy. In a general policy you must have some offset to interference with wages, otherwise the wage earners will think it is grossly unfair and will resist it. You may say that there is no need for a profit, because all the big companies have not been making profits; they

have been reducing dividends. But you still need an undertaking that if and when they begin increasing their dividends in a big way they will be checked, in line with the check on wages. You must have a two-sided approach, to give the wage earners a sense of fair play; otherwise, they will think they are being cheated.

Senator Beaubien: The paper people would be awfully pleased if they thought they had a means of increasing dividends. They would not mind any limitation on an increase in dividends. They have all passed them.

Sir Roy Harrod: In the short time, that may be contradicted. In five years, there may be a great movement in the paper industry.

Senator Beaubien: We hope so.

The Chairman: You have suggested, Sir Roy, that the restriction should be on the increase in the amount of dividends. There are companies, of course, that determine a policy to plough back their earnings and do not declare dividends on the ground that their stock price will increase and that the holder of the share will be the beneficiary by virtue of the gain in stock price as opposed to the return. How would you handle that situation?

Sir Roy Harrod: To start with, I ought to have said that I would include in dividends anything like bonus issues—anything that a stockholder gets by virtue of his stockholding, like bonus shares or rights issues, or that sort of thing. That should be reckoned and added to the dividends, to show how much dividend he has got in a particular year.

With regard to the other aspect, if a company does not distribute and the value of the stock goes up, then the stockholder can sell and make a gain. But what about the capital gains tax? Are not those gains looked after by a capital gains tax? We have a capital gains tax in England.

The Chairman: Do you think that would control it? How do you propose to control the dividends—by a surtax?

Sir Roy Harrod: I do not want to penalize companies which declare good dividends, because that is private enterprise. You have got the efficient companies that declare good dividends—and that double them every year, if you like—and then you have the inefficient ones, which are not able to do that. My idea is to take the overall average of dividends paid out, including those paid in bonus shares and so on. If wages are allowed to go up by 5 per cent, then the overall average of dividends must not go up by more than that. If the overall average of dividends is found to have gone up by 7 per cent, then I would impose a surtax of 2 per cent on the distribution. That leaves the differential. One company may increase its dividends by 50 per cent and, under the system of private enterprise, one says good luck to that company, it has been very efficient. Another company may not increase its dividends at all. The surtax should be across the board, 2 per cent on everybody, in a year when dividends have gone up 2 per cent more than wages. If the dividends have not gone up more than wages, there should be no surtax.

It seems to me that that is the kind of thing that would make the wage earners feel they were getting something like that back.

Senator Lamontagne: Do you not feel that at some stage, on both the side of labour and that of business, we shall have to introduce the concept of productivity in some way as a kind of general criterion for all these things?

Sir Roy Harrod: Certainly. My idea was that you might do this. One does not want too many things to be left to discretion. Moreover, like your montary and fiscal managers, people make mistakes. Why not say in the year 1972 that we will allow a rise of wages equal to the actual, known—because we have statistics on this—increased productivity in 1971? If you get a better increase of productivity in 1972, you will raise the wage limit in 1973. You will say, "Well, the productivity has been better than we thought, so we will have a greater increase of wages in 1973 than we did in 1972." You could make it automatic, I think, and link wages to productivity.

The Chairman: What always bothers me about that sort of statement, however, Sir Roy, is the problem of what happens to the one business or the one industry that enjoys enormous increases in productivity as opposed to the other that does not. In other words, if you apply a broad definition of increase in productivity, are you not going to distort the economy beyond any reasonable means?

Sir Roy Harrod: Yes, but I think that you must allow a margin. I would say, if productivity goes up by 4 per cent, that perhaps there should not be any automatic wage increases of more than 3 per cent, which would leave a margin for dealing with these special cases of productivity.

Productivity is a difficult question which I think should perhaps be discussed with the trade union leaders. The trouble is that, for example, here is a company which entirely reorganizes its methods of production and gets a huge increase in productivity and, quite naturally, the workers feel that they should share in that. But fighting against that all the time is the theory of comparability. The fellows who are in the company which does not have an increase in productivity also quite naturally ask, "Why don't you increase, too?"

There may be no technical method of increasing productivity in a different kind of production, but the employees say, "Those fellows have had a 20 per cent rise in wages. Why shouldn't we?" The company answers, "They have had a 20 per cent rise in productivity." "Well," the employees say, "that has nothing to do with us. Why don't you give us a rise in productivity?" But it may be technically impossible. So there is the countervailing principle of comparability. If you go too far with giving wage increases because of increases in productivity, you are going to get bad distortions on the side of

comparability, and you are going to get trouble. That was one of the points our Prices and Incomes Board did go into rather carefully. I do not think they got very far, but they were aware of that problem.

Senator Sparrow: Sir Roy, in your earlier remarks about unemployment affecting inflation, I think you used the expression that heavy unemployment might stop inflation, but you also said that that amount might be 20 per cent. Was that the figure you used? And in regard to that, what do you consider, if I may word it in two ways, either a necessary amount of unemployment or a satisfactory amount of unemployment? Again in your remarks, you mentioned that you wished Sweden good luck on 1 per cent. Could you answer those questions?

Sir Roy Harrod: Clearly it is probable that in a country like Canada you cannot get right down to the sort of Swedish level. The target should be like the Swedish target, which is to have no unemployment. Of course,we do have some fractional unemployment with people moving out of jobs. I believe the Swedish workers are rather good at going from one thing to another, if they know they are redundant. They do not oppose labour-saving devices that make them redundant, because they feel confident that they will get jobs. But, as regards near-unemployables in Sweden, they have special institutions to give special kinds of work to people who really are not good enough for ordinary standard employment. In those two ways they hope to reduce unemployment to a very low level. They have had a little trouble just lately, but for years the figure has been running below 1 per cent. Very good!

Senator Sparrow: Would you have any idea what percentage of the labour force would be involved in that sheltered workshop environment to which you have referred?

Sir Roy Harrod: Do you mean: What percentage of the labour force would be comprised of less sufficient workers in homes and in institutions?

Senator Sparrow: Yes.

Sir Roy Harrod: I am afraid I do not know that figure. But, after all, some countries, like this country, the United States and Britain, have had their unemployment figures quite low for periods of time. Why should they not get those figures back to those low levels? The United Kingdom had its unemployment running between 1 and 2 per cent. I do not think it was ever suggested that there were many people being employed then who were really not fit to be employed. I have not seen our latest figure, but it is over 3 per cent. In the United States of America the unemployment was at one time below 4 per cent. It is now up to 6.2 per cent.

Senator Nichol: Sir Roy, we are talking here about a search for new methods. From talking to yourself and other professional economists, like Senator Lamontagne, I get the feeling that up to now we have been dealing with methods developed in the aftermath of the depression after the war. In trying to solve all the sociological problems which came so much into focus at the time of the depression, government built up all kinds of enormous structures in society and in government, such as agricultural subsidy structures, marketing co-operatives, unions and very large corporations, with behind them all big government and big banks.

Do these structures which we built in the past now from part of the problem of combatting inflation? Would you agree that these large institutions have a constipating effect, let us call it, on the working of the economic system?

For example, in the recent liquidity crisis of 1968-69, according to figures I have seen, the current ratio of all the companies which reported to the American Manufacturers Association—it may have been the Securities Exchange Commission—fell between 1958 and 1968. In 1958 the current ratios were 2.5 to 1, on average. They fell to 2.4 in 1959, to 2.3 in 1958 and went all the way down to 1.5. All of the companies were becoming increasingly strapped for money.

Yet, while that was happening, and while you would have expected to find some falling in prices as these people moved to get rid of inventories and cut back, and you would have expected to find some slow-down in the amount of wages they would be willing to pay, and so on, that did not happen at all. Instead of that, the liquidity crisis kept growing until there was such an extreme case as the Pennsylvania Railway company going into bankruptcy without having made any adjustment of wages, freight rates, or anything else.

I wanted to ask you about the effect of these large institutions. We have created them. Now perhaps we cannot handle them.

Sir Roy Harrod: You mentioned some period as seeing a large number of these new institutions being created. Did you say post-war?

Senator Nichol: From 1958 to 1968, when the liquidity of corporations, broadly speaking, and of banks was just decreasing steadily and the current ratios were dropping steadily so that the companies were getting into increasingly dangerous positions, and yet, despite that, inflation kept going up. When the forces do not work within or between the institutions, what does work?

Sir Roy Harrod: Is it that the institutions are too big?

Senator Nichol: That is what I am asking. Is it the size of these institutions and their invulnerability to change?

Sir Roy Harrod: Well, I can never satisfy my mind that these conglomerates serve a useful purpose. I do not know whether it would be easy to interfere with them.

Senator Lamontagne: But is the problem perhaps not a little deeper than that? I think perhaps we could go back to what you said a moment ago, sir, about the new sociological phenomena. I think perhaps the change of our economy from one of scarcity to one of affluence has, contrary to what economists used to think about a century ago and reducing our wants, multiplied the wants of the individual, and now the individual is becoming more and more frustrated, more and more in revolt, because his new affluence is not sufficient to meet his new needs.

Of course, institutions are a problem, and are becoming even more so fundamentally, and we see this now when the workers more and more do not follow the directives of their own leaders. The result is that we have a society in revolt as a result of affluence, because that affluence generates a new need or even more affluence. This is the sociological process of the new society, or so it seems to me.

Sir Roy Harrod: I think there may be something in that. Perhaps the greatest book ever written on sociology remains *l'Ancien Régime* by Comte de Tocqueville, his analysis of the French Revolution. For many years after the French Revolution in 1789 people thought that the French peasants had been so downtrodden, and had had to pay such heavy taxes and had been so maltreated in so many ways, that finally they could bear it no longer and rose in revolution. But what Comte de Tocqueville shows is that all along the line they had been treated better and better, and had been getting more and more with one person leading another in various aspects of their life with the result the revolution was the result of their greatly improved condition in France—that having improved so far, they wanted something more such as votes in Parliament and so on.

Senator McLean: Sir Roy, which would you say is the more important factor in a country's economy—unemployment or inflation?

Sir Roy Harrod: I think unemployment is worse than inflation. Mind you, I think inflation is a very bad thing, but I do not see why we should have to choose. I think economists and economic policymakers ought to be able to overcome both. I suppose unemployment is a rather serious evil when you have families and the whole structure of life broken up, but then inflation is also a very serious evil for people who have worked hard, saved their money so as to achieve a certain pattern of life for their later years and then find they cannot have that. The result is bitter disappointment. Also, it messes up our planning.

Senator McLean: Do you put one ahead of the other, or are they both bad?

Sir Roy Harrod: I think unemployment is worse than inflation.

Senator Laird: I have a supplementary question. As I understand your thesis, you believe that the ultimate sanction is the imposition of wage and price controls. Can you point to any examples in the world where any country has imposed wage and price controls, and has successfully stabilized its economy?

Sir Roy Harrod: No, because I do not think they have tried hard enough lately. Of course, if you go away back, you find that in England, for instance, for several centuries maximum wages were fixed by the Justices of the Peace. That system was only dropped in the 18th century, but until then it had gone on for a long time. So these things have been done. I think the best success we had in England was when Sir Stafford Cripps had a wages policy—it was in fact a wages and prices policy, but many prices were still under control at that time—and he got the wage increase down to 2 per cent per year for two years. But that could not go on because of the devaluation of sterling. They had to kill the policy, and Sir Stafford Cripps was no longer Chancellor. And then there was also the Korean War which came very soon after the devaluation. Those two things made it impossible, but Cripps did succed in having wages rise at 2 per cent per year for two years.

Senator Benidickson: Referring back to Senator Nichol's question in which he indicated that for several years there were signs of decline and the likelihood of trouble. Now my question is: To what extent have we in big business got ourselves in the hands of the managerial element—not the owners and not the stockholders, but the managerial people, the people that made the mistakes in the first place? These people do not admit their mistakes, and they stay on longer than they would if the business were younger and still controlled by the owners. I do not want to embroil you in our problems, but we have had two cabinet ministers resign within the last couple of years, and they both made identical statements to the effect that we would be much better off if we got rid of about half of what we call our mandarins, the people who formulated our policies in the first place and who still stay in that position of authority. In the case of labour you can reduce your payroll fairly rapidly, but if a wrong decision is made concerning the model of car to be manufactured or some other form of marketing, the man who makes that decision stays on because the stockholders have very little to say at the annual meeting.

The Chairman: That did not happen to the man who was charged with the responsibility of merchandising the Edsel.

Senator Benidickson: I am thinking of managerial authority as opposed to shareholders' authority.

The Chairman: In reference to the size of the business, or the size of the institution?

Senator Benidickson: In big business.

The Chairman: Can you comment on that, Sir Roy?

Sir Roy Harrod: Only that the idea surprises me that shareholders, stockholders, would know better. The managerial folk may make big mistakes, but how could stockholders know anything about these mistakes? That is what rather surprises me.

If you have a small owner-controlled business, that is all right, but then is there not a problem about hereditary ownership there? The father may be all right, but his son may be no good. However, this idea of the stockholder does surprise me. They have simply been advised by a firm of brokers of the list of stocks they ought to hold. They know nothing about the mistakes inside the business made by the managers, do they?

Senator Lamontagne: Do you not think that in the long run also the problem of unemployment might become for certain countries—at least for smaller countries, and I might even include, in certain fields, Great

Britain—more and more acute as a result of what I call the new technological revolution; that with this new technological revolution, including computers, the hardware will be more and more costly and will be reserved more or less for the big powers, so that as small nations we shall be users of this new technology, but we shall not have the industries to support the hardware, so that these industries will not develop in our respective countries, but will develop in other, bigger countries that can afford it? As a result of this we would buy the hardware from these countries without creating new industries and new employment opportunities at home.

Sir Roy Harrod: I am surprised at the idea that this hardware was of such magnitude. Take a nation like Switzerland or Sweden. Do you mean it is too small to equip itself with the hardware? I would not have thought so.

Senator Lamontagne: But they are not producing the hardware in the field of computers, for instance.

Sir Roy Harrod: No, they are buying it.

Senator Lamontagne: Yes, they are buying it, and they are buying it from the United States, and it creates employment in the United States but not in Sweden. The same thing might apply with regard to the supersonic plane, if it comes off, or any of these new fabulous technologies which, because of their tremendous cost, will be reserved for the big powers.

Sir Roy Harrod: The production of these things, but not the use of them.

Senator Lamontagne: Yes, but their production will not produce employment at home, among smaller nations.

Sir Roy Harrod: It will raise the productivity of the people who buy this hardware. I mean, we are not going back to the Luddites who broke machinery. If these small nations buy their hardware from abroad it will make their labour more productive and enrich them.

Senator Lamontagne: They may become more productive in the process, but most of the devices are labour-saving devices so the net effect might be to destroy jobs, without the corresponding creation of jobs in the producing industries.

Sir Roy Harrod: I am afraid that there is just a little bit of the economist in me, and that proposition is totally unacceptable. It is particularly associated with the Luddite riots against machinery in 1811, when the spinners or weavers broke up the machinery because they said that it was depriving them of jobs. But ever since the Luddite riots that argument has been regarded as economically fallacious. You then get another job. The more productive you can make workers, the more jobs there ought to be, because people will be able to afford more goods.

Senator Lamontagne: I suppose this was true in those years when the innovation process was a rather slow one.

Sir Roy Harrod: Rather quick, I would have thought.

Senator Lamontagne: I think that at the moment when the United States is spending $25 billion a year on research and development and innovation, we are entering into a completely different period of history which may have quite a negative impact on the volume of employment in smaller countries.

Sir Roy Harrod: In relation to the size of the national income at the time, I would have thought that the period from 1800 to 1820 was one of terrifically rapid substitution of manual work by machines. I think it was much quicker than the rate of substitution now.

Senator Lamontagne: It was not the same type of machines, and smaller countries could then afford to build and develop these new machines.

Sir Roy Harrod: No.

Senator Lamontagne: As we did, for instance, in the field of the newsprint industry in Canada. But when we come to the new fabulous technology, I do not think we can do it that way.

Sir Roy Harrod: I do not know about the electronic and what you call the hardware. It may be that in some of the smaller countries they will not produce it, but they will have the benefit of it; they will buy it, and that will raise the productivity of their people and multiply employment; and not the other way around. I am not a Luddite myself!

Senator Paterson: Early in Sir Roy's statement he stated that people do not like inflation. I think that statement ought to be qualified because apparently labour likes inflation, storekeepers like it when inventory is going up in price, members of Parliament like it, Government employees like it. If the public was generally against inflation there would be more done about trying to stop it. Does not Sir Roy think that that statement should be qualified?

Sir Roy Harrod: No, I would not think it should be qualified. Of course, people like their own pay to go up; that is clear. You especially like your own pay to go up when all your neighbours' pay is going up: every man for himself. But I think that the vast majority of people dislike the result of rising prices. It is no good saying to the individual, "Will you knock 20 per cent off your income?" The swift reply is, "Certainly not!" But if everyone were treated in the same way, then I think people would be heartily relieved if they felt the dollar was going to preserve its purchasing power for the rest of their lives.

Senator Isnor: I have in mind the exporters to the United States. I was wondering if this was a fair question to ask Sir Roy. What do you think of the action taken by Canada to float the Canadian dollar in the world market?

Sir Roy Harrod: I had assumed that it was almost forced upon this country. As I understand it, it was the consequence of the reflux of American Eurodollar borrowing. Many Canadians were in that market and were lending to American banks who were paying fantastic rates of interest for Eurodollar loans. Then the time

comes when the Federal Reserve System in America eases credit and people are no longer prepared to pay very high rates for Eurodollar loans, and the Eurodollar rate drops. Much of the Canadian lending into the United States has a return flow, so that the Bank of Canada was inundated with dollars. I thought that more or less forced its hand in letting the Canadian dollar float. Then after the Canadians got their excessive dollars coming back from the Eurodollar market it became deflected to the countries of Europe, and the Bundesbank and all the central banks in Europe have been getting dollars as a result of the reflux out of the Eurodollar market. The Americans ceased absorbing the Eurodollar loan as soon as the banks eased policy. You only went in for the 10 or 13 per cent maximum and you only paid that per Eurodollar loan because your own bank said, "We are very sorry, but we are short of cash, there is a credit squeeze, and although I would normally lend you money I cannot do so now." You say to your bank in America, "But I must have money." and the bank says, "If you would like to pay the Eurodollar rate of interest then it is easy enough to raise Eurodollars." Meanwhile there are Canadians borrowing money from their own banks and putting them in the Eurodollar bank and providing these Eurodollars.

The return flow began some time early in 1970 with the Eurobank easing money policy. The Americans were no longer prepared to pay these Eurodollar rates and the Eurodollar rate returned fairly quickly to its proper position, which was below the prime lending rate of the American banks and above the prime deposit rate which would be somewhere between those two.

Senator Isnor: Do you not think that it is higher today than they thought it would go?

Sir Roy Harrod: The Canadian dollar? I do not know what it is this morning. Is it above par?

Senator Isnor: It is not above par, but it is close to par.

The Chairman: Sir Roy, if your prescription to invoke even temporary or permanent wage and price controls were to take place, would you not still be faced with the need to control inflationary pressure, and would you not still have to apply Keynesian monetary and fiscal tactics in order to overcome those pressures, lest you blow the lid off the ceiling? And are you not in that case right back where you started?

Sir Roy Harrod: I think that both things are needed. You have to maintain your Keynesian weapons to check excessive demand, demand for inflation. You do that by having a monetary policy, a budget surplus. The standard weapons will still be needed. The mere effect of controlling price and wages does not mean that there will not be excessive demand. You will need to control excessive demand or stimulate the economy if it is below par, as the Canadian economy is at the present time. Keynesian weapons are needed for that purpose. My contention is that Keynesian weapons, although excellent for that purpose, do not in themselves stop wage-price spiralling. Supposing you had a real fight in this country and had a tremendously excessive demand, and let it run a few months or longer, that might set off wage-price spiralling. It could be quite independent of excess demand.

The Chairman: Let us assume that a country tried the concept of a wage freeze, sat down at the bargaining table with various elements to control prices and wages, and was, as in Canada, unsuccessful in concluding an agreement. Let us assume that the country moved forward to a general, all-embracing control of wages and prices. Would this not, over a period of time, institute a terrible proscription on the freedom of the individual? Would it not set up a multiplicity of boards and people who could say whether or not you must change your job or move from one area to another, and so forth?

Sir Roy Harrod: I do not see why it should interfere with the freedom of movement of labour. I would not have it applied to prices because you must have freedom of movement on prices. I think I would have it on dividends rather than on prices. But you must do something as well as wages, otherwise wage-earners will say, "You are not playing fair with us."

It is an interference with liberty, but it seems to me that it has been recognized as a duty of the Government, going way back into remote history, that it should maintain a decent currency. The modern equivalent of maintaining a decent currency is seeing that its purchasing power for goods is not eroded progressively. We no longer have gold coins. We have these bits of paper. Anybody can print bits of paper. I think it is the duty of the Government to ensure that the purchasing power of the bit of paper is not eroded.

Going back to old times, I was recently reading Dante's *Inferno*. Near the bottom there is a man who was suffering agonies of torment because he had introduced an alloy into the golden florins of Florence. Why should he not issue some nice coins with an alloy? But it was regarded as the duty of the government to maintain the coinage.

Queen Elizabeth I of England, when Gresham, who was a sort of weak-kneed person, told her about bad money driving out good, wanted her new coins to be circulated against the old coins. She said that nothing would induce her to debase them. She knew her father had debased the coinage, and she issued an edict that all coins in the country must be brought into the mint, which was rather difficult in the year 1560. If anyone failed to do so he would be hanged, drawn and quartered. That is an interference with individual liberty, but it was considered to be the duty of the sovereign or of the government to maintain the coinage, and in terms of present currency to maintain the purchasing power.

I do not regard measures necessary to sustain the purchasing power of the Canadian dollar or the British pound as undue interference of individual liberty. If one can find another way of doing it, well and good. I would say that an incomes policy is the only way for which you can do it. If there is another way, then I am in favour of it. An incomes policy does mean interference with liberty, but it is in the greater cause of having a decent currency.

Senator Lamontagne: You said at the beginning that the approach you were proposing would be a very difficult one to implement. I agree that both the approach and the recognition of it is difficult. The difficulty is of course political as well as economic. I was wondering whether in Great Britain or the United States there is any real research effort by economist with the hope of finding better means and different alternatives, because there is not much going on in this field of research in our own country at the moment?

Sir Roy Harrod: The *Financial Times* had a poll of readers. I do not know what the size was. It was taken among economists. It announced that 90 per cent of British economists were in favour of an incomes policy, and that is quite a high figure.

Senator Lamontagne: That merely states an objective rather than a method. As you have fully recognized, it leaves many problems even for the economist. Is any research carried on in an attempt to overcome some of the difficulties which properly relate to the profession of the economist?

Sir Roy Harrod: There ought to be such research taking place, but I am not aware of any in the field of these various difficulties. We have to go way back to find standard books. Of course there have been reports. For instance, the Prices and Incomes Committee under Mr. Aubrey Jones issued a number of reports which dealt with some of these problems. That committee was purely voluntary and really had no power except at one stage when they had to be given notice and had the power to delay.

Senator Nichol: I presume that when you referred to wages and dividend control as opposed to wage and price control you meant dividend control as opposed to earning control?

Sir Roy Harrod: Yes.

Senator Nichol: In other words, a form of tax which would draw off the dividends above a certain level. If this is done and the corporation does not pay the dividends, presumably they will accumulate as earnings?

Senator Isnor: That is if they do earn.

Senator Nichol: Yes; what happens then? Do they simply accumulate the earnings in surplus and do you suggest they should not be taxed until they are declared as dividend?

Sir Roy Harrod: Yes; I would not be in favour of taxing profit, which is required for the expansion of the firm. Some hold back a large proportion of profit, others not so much.

Senator Nichol: Why would a corporation wish to plough its money back into expansion if the amount of dividend paid to its shareholders was limited by law?

Sir Roy Harrod: No, I was not suggesting that it be limited in the amount of dividend, but the total distribution of dividend across the board. We have indices of how much wages rise; we say the average rise in wages last year was, for instance, 5 per cent. If we refer to statistics with regard to the across-the-board issue of dividends and find the basis was 107, a 2 per cent surcharge would be applied. That does not mean that a particular company could raise its dividend to 100 per cent; it would still pay just the 2 per cent rate. Therefore the differential would be just the same as before the tax, but it would be an across-the-board tax in order to keep the aggregate increase in dividends down to the aggregate increase in wages.

Senator Sparrow: Would labour agree with that type of argument?

Sir Roy Harrod: I do not know, but one might try. There are very strong arguments against price control except for the short period, because there are all the difficulties of quality and so on. It would seriously eat into the working of the economy to have price control for more than a short period. Six months would not matter. We do not wish to control profit, because a large part of it is ploughed back. It is the best way to expand the industry of the country. After all, it only becomes personal when it is distributed as dividend or bonus shares, et cetera.

Senator Sparrow: In the same context salary increases, labour's share, in turn would increase in relation to the total increase in gross national product. You would not relate it to individual industries for increases. Individual industries might expand their payroll.

The Chairman: I believe you said, Sir Roy, that you would leave maybe a one per cent differential for individual productivity.

Senator Sparrow: So that in fact one industry could pay higher than another.

Sir Roy Harrod: It would have to be made subject to supervision.

The Chairman: Presumably the variation would have a one per cent limit.

Sir Roy Harrod: There would be some sort of order making it legal to pay everyone 3 per cent more, for instance. We recognize that some firms will wish to pay more, because they have had productivity increases and their workers have discontinued restrictive practices. In many cases they would be paying 10 per cent more and the overall average would work out.

Dr. James Gillies, Study Director: Sir Roy, one of the traditional approaches to controlling rapidly rising prices is competition. I notice you said nothing whatsoever regarding that this afternoon. Do you have any views on that issue?

Sir Roy Harrod: The trouble is that it does not seem to have been very successful. We now have what is known as imperfect competition. I hope it is accepted. Of course, different problems are encountered in economies producing commodities at prices controlled in world markets rather than in the country itself. That applies to manu-

facturing industries. Services, of course, have been serious offenders in the matter of inflation and the wages of those employed in the services are increasing more rapidly. In my opinion the right approach is that of imperfect competition. The producers of primary products may be in perfect competition; there, I admit, is the problem.

Dr. Gillies: In reply to a question relating to freeing the exchange rate you stated that in your opinion Canada had to do it but if that were not so you would favour floating exchange rates as a means of protecting the economy against inflation.

Sir Roy Harrod: Yes, I would.

Senator Nichol: I suspect that a lot of demands for wages are demands whose justification is based not on productivity but on the fact that certain segments of society—it is the sort of argument often made by school teachers, who have a very heavy responsibility in social terms—do not approach a raise in terms of productivity but rather the position of their group or profession within society. If you have wage and dividend controls—and I agree with you completely that they have to go together—what happens in the system to these people? Are their wages perpetually frozen in what they consider to be an inequitable position vis-à-vis other wage earners? How do you allow for that within the system? How do they fight for a relative improvement in the structure?

Sir Roy Harrod: I meant to include that. I gave two cases where you cannot have complete uniformity. One was increase in productivity. The other was comparability. The school teachers come under the comparability criteria. A certain level of education is needed and so on. How do the school teachers compare with, say, technicians or technologists doing work requiring educational levels? A very bad case in England was that of the hospital nurses, who until recently were getting appallingly low wages. That would be a case of comparability. Something must be allowed for that. The trouble is that inflation is making matters worse. When electricians in the United Kingdom suddenly get, say, a 20 per cent increase when they do not perhaps deserve anything comparabilitywise, they are quite well paid. When they go shooting up like that all sorts of other workers who do not get those increases begin to complain and say, "Look how the electricians are paid. Why shouldn't we get more?" The absence of a wage policy may make the comparability question worse.

Senator Nichol: If the board that decides these questions is in any sense a government board it will be up pretty late at night listening to discussions on the subject, I would think, from an awful lot of people. It will not be an easy job.

Sir Roy Harrod: Yes, it is hard work. Cannot we release some labour from government employment? Cannot we simplify the income tax? Think of the hundreds of thousands of bureaucrats in a country the size of the United Kingdom plying their pens on matters that I feel sure can be greatly simplified. This would be a big administrative problem, but one well worth while, instead of monkeying about with the income tax and altering it all the time, complicating the forms that have to be filled out.

Senator Beaubien: We have that too, sir.

Senator Sparrow: In advocating wage and dividend controls, would you advocate it on all facets of society or could you pick out certain industries within the country on which you could put these controls?

Sir Roy Harrod: It seems to me very difficult to do that with equity. I notice that in his last book Professor Kenneth Galbraith has suggested it is quite enough to keep the big monopolistic corporations and big important unions under control, and the rest will follow suit. I rather doubt that.

The Chairman: What do you think would happen if that were tried?

Sir Roy Harrod: I think the others might go on asking for more.

The Chairman: In other words, there will be a distortion of the investment pattern?

Sir Roy Harrod: I think so, yes.

The Chairman: Honourable senators, Sir Roy is catching a plane around 6.15 and has to get to the airport, so if you have no further questions perhaps we should now conclude the hearing.

I would like to thank Sir Roy on your behalf for taking time from his extremely crowded schedule to prepare a paper, and to come and discuss it with us so openly. We wish him well, and hope to see him again. Thank you very much, sir.

Sir Roy Harrod: Thank you.

The committee adjourned.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 5

WEDNESDAY, MAY 5, 1971

Second Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses and Appendix—See Minutes of Proceedings)

23339—1

STANDING SENATE COMMITTEE ON
NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
Gélinas	O'Leary
Grosart	Paterson
Hays	Phillips
Isnor	Sparrow
	Walker—(27).

(Quorum 7)

**Ex officio Member*

Orders of Reference

Extract from the Minutes of Proceedings of Tuesday, March 9th 1971:

"With leave of the Senate,
The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, PC.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said Estimates reaching the Senate.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Wednesday, April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Tuesday, May 4, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relation thereto.

The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Minutes of Proceedings

Wednesday, May 5, 1971.
(5)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10:15 a.m. to consider the question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Bourque, Benidickson, Grosart, Isnor, Kinley, Laird, Langlois, Manning, Méthot, McLean, Molson, Nichol, Paterson and Sparrow. (16)

Also present but not of the Committee: The Honourable Senators Cameron, Haig, McGrand and Urquhart.

In attendance: Dr. James Gillies, Director, Mr. A. B. German, Administrator, Mr. W. Neville, Editorial writer; and Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Heard as witnesses:

The Economic Council of Canada

Dr. Arthur J. R. Smith, Chairman;
Dr. O. Thür, Vice-Chairman;
Dr. Sylvia Ostry, Director;
Mr. F. W. Belair, Secretary.

It was agreed to print to these proceedings as Appendix "A" a brief submitted by Dr. Arthur J. R. Smith, Chairman, Economic Council of Canada.

At 12:30 p.m. the Committee adjourned to 4:00 p.m., today.

At 4:00 p.m., the Committee resumed.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Bourque, Flynn, Grosart, Isnor, Kinley, Laird, Langlois, Manning, McLean, Méthot, Molson, Nichol and Sparrow—(15).

Also present but not of the Committee: The Honourable Senators Burchill, Cameron, Choquette, Haig, Inman, Lamontagne, McGrand, Smith and Urquhart.

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator, Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Witness: Dr. R. C. Bellan, Dean of Studies, St. John's College, University of Manitoba.

At 6:05 p.m. the Committee adjourned to Thursday, May 6, 1971 at 10:00 a.m.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Wednesday, May 5, 1971

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 10 a.m.

Senator Douglas D. Everett (Chairman) in the Chair.

The Chairman: Honourable senators, we have with us this morning the Chairman of the Economic Council, who sits on my right and is well known to you, Dr. Arthur Smith. To his right is Dr. Sylvia Ostry; and to her right is the Vice-Chairman of the Economic Council, Mr. Otto Thur.

It is not going to be our practice to print as part of the day's proceedings the briefs submitted to us. However, I have asked Dr. Smith to attend two sessions, one this morning and one tomorrow morning. The concept I had was that at this morning's session and in this morning's brief Dr. Smith would lay the groundwork for our investigations. Therefore, I think it is wise, if the committee so agrees, that since this is a background paper to our entire investigation we might in this particular case print it as an appendix to today's proceedings. Is that so agreed?

Hon. Senators: Agreed.

(For Text of brief, see Appendix A)

Senator Isnor: What is the object of not printing the others?

The Chairman: The additional cost of printing the briefs. We can supply briefs to anybody who wants them, at a nominal cost to ourselves, by mimeographing them. If we have them printed as an appendix to the proceedings the cost is considerably greater.

Senator Benidickson: And, I suppose, time in printing and translation?

The Chairman: I am informed that is so.

Honourable senators, without further ado, I introduce Dr. Arthur Smith, who will make his presentation.

Dr. Arthur J. R. Smith, Chairman, Economic Council of Canada: Mr. Chairman, honourable senators, we are very pleased to have been invited to appear as witnesses before this committee in this important set of hearings that you are conducting, and we will be very pleased to try to assist you in any way we can.

As the chairman mentioned, we have prepared a brief which is intended to set out in a rather broad way, in some ways in a rather over-simplified way in order to be brief, some of the main functions and approaches to our work in the Economic Council of Canada, and some of the highlights of the policy conclusions that we have incorporated in our various annual reviews since 1963 when the Economic Council was established. I do not intend to summarize that brief. I will just take it that you may have had an opportunity to see it, because we tried to make it available to you before the hearings today so that members could have an opportunity to see it in advance.

I had wondered, Mr. Chairman, whether we might perhaps include one other set of information as a background to the hearings, namely, a set of charts which would rather briefly summarize the highlights of some of the main aspects of the performance of the Canadian economy. If you wish us to do that, we are prepared to do so.

The Chairman: Is it your wish, honourable senators?

Hon. Senators: Agreed.

Dr. Smith: I will use the chart book that I understand has been circulated, and we will show some corresponding charts on the screen.

Mr. Chairman, when established the council was asked to try to assess potentialities for growth in the Canadian economy, and in line with that we have attempted to make some estimates of what the potential output of the Canadian economy would be, looking a number of years into the future, on the basis of the concept that potential output or potential growth should reflect the track an economy would take if it were making reasonably full use of its available productive resources and over time making reasonable progress in terms of increasingly efficient use of the productive resources at its disposal. We have calculated potential growth rates, and in each of our reviews, and last year in a special report which I appended to the brief sent to you, we have looked at the performance of the economy in relation to potential, and in relation to some of the goals with which we have been and have to be concerned with as a council.

The first chart shows, for both Canada and the United States, the potential growth rate paths of the two economies, and then the actual output paths of the two economies. The Canadian potential growth rate is rising more steeply than that in the United States, about one percentage point a year faster. The reason for that is essentially because our labour force is growing about one percentage point year more rapidly than in the United States.

On the chart you can see that both economies had a considerable amount of economic slack in the early 1960s, when actual output was well below potential. During the period from the early 'sixties through the middle of the decade, both economies moved up at an extraordinarily

rapid pace. In the United States the economy broke through potential and remained, if anything, slightly above it during some of the lears of the latter part of the 'sixties. More recently the United States economy has flattened out and a significant gap has emerged between actual and potential output. In the Canadian case, we also moved up very quickly in the middle of the 1960s. We were very close to potential in 1966, and subsequently have come somewhat below.

The next chart shows a closer view of the last four years, on a quarterly basis, than the preceding chart. You can see more dramatically the way in which the United States economy has flattened off over the past year or so. In the Canadian case we have had more growth. As I will indicate later on, a very important factor in the Canadian growth in the past year has been that our exports have remained exceptionally strong. In this period external demand forces have remained strong; internally our demand forces have not been so strong.

In our Sixth Annual Review, which is the last review in which we took a look ahead to the medium term future, we estimated not only the potential output, the supply capabilities of the economy, but also what we called a possible pattern of demand that would be consistent with that output, and which would reflect some of the council's judgments about the forces and factors that were operating and affecting the pattern of demand, as between consumption expenditures, government spending, business investment and so forth.

The next table summarizes the mainn highlights of that demand analysis. On the right hand side in the column 1967-75, are shown, in red, the growth rates. At the bottom, for gross national expenditure, the equivalent of total output, we estimated that on the average there would be a 5½ per cent rate, a 5½ per cent rate of increase in real output from the actual level in 1967 to our estimated potential in 1970.

Looking at the components, at the top, we suggested personal consumption expenditures might advance a little less rapidly than that, 5.3 per cent; that government expenditures would increase somewhat more rapidly, 6.1 per cent; that housing would grow more rapidly, 6.1 per cent; that business plant and equipment expenditures would also increase slightly more rapidly, 5.8 per cent; and that on the export side, on the trade side, we would have high rates of growth of both exports and imports.

What we have done here, in a series of charts, is to take those growth trends for major sectors of the economy, and have simply plotted out these average growth rates to 1975, and what has been happening in the economy in relation to those trends towards potential, to that kind of pattern of demand at potential output.

In the case of business plant and equipment outlays we have had something of a "U"-shape pattern—quite a sharp decline in 1967, relatively low in 1968, with some small increase subsequently, but still with a significant gap below potential. This suggests that in order to move the economy to potential output in 1975 we will need a relatively very large rise in business plant and equipment expenditures.

Senator Isnor: Before you leave that, what was the main factor for the decline in growth?

Dr. Smith: I think there were several factors. One of the things that has happened, as I pointed out in the "potential" chart, is that the economy has been somewhat below potential in the interim, so that there has been less general demand pressure on the economy. We have also had a variety of circumstances—increased costs, perhaps greater difficulties in financing investment, may also have been factors. I am not sure I could be precise about the various elements that are involved, but I think a combination of elements have been involved in this, but probably the most important factor would be that the economy has not been moving smoothly forward close towards potential output.

Senator Benidickson: In this context, what does "potential" mean?

Dr. Smith: In the estimates that we have tried to develop—and I would emphasize they are rough estimates and there is no precise figure that is "potential"—we have tried to use two or three different kinds of ways to estimate it, but the basic concept rests upon the view that we are trying to get an estimate of what the level of output would be if we were making reasonably full use of our resources—our labour resources, our productive capacity—and over time, as the potential path tracks out, what we consider to be reasonable progress is rising productivity, in increasing efficiency in the use of resources. We can provide you with more technical information, if you wish.

Senator Benidickson: No.

Dr. Smith: Then let us look briefly at one of the components of total investment, construction. Here the pattern has been rather more flat, but recently there was quite a sharp upturn in the latter part of 1970. Basically this reflects, I think more than anything else, the upturn in housing which has occurred in the latter part of 1970. After an earlier decline in residential construction, housing has turned up more strongly.

Senator Beaubien: Would the housing be mostly Government inspired?

Dr. Smith: No, I would say most of the housing expenditures we have are in the private sector, but the Government has come to play a larger role in housing, particularly in the past year.

Looking at housing now more closely—this chart, I might emphasize, takes a longer sweep and goes back to the mid-fifties. Fifteen years or so ago, around that period, we had very little growth in family formation, and our housing was not rising very rapidly. Coming along to the mid-sixties, we moved into a period in which the leading edge of the post-war baby boom became the leading edge of a series of surges—surges in the educational system, in household formation and in demands for housing—and we are going to be in a period of very rapidly rising demand for housing and needs for housing in the seventies.

This chart indicates quite a steep growth that we had allowed for in housing to the mid-1970's. Housing has tended in the past to be fairly volatile. The last plot there for 1970 shows housing down, and it is already in the process, as I indicated earlier, of going up, and will undoubtedly be a good deal stronger in 1971.

Then we turn to personal consumption expenditures. Here one can see quite clearly the growth that was moving quite closely along the trend until the early part of 1970, when there was hesitation, a pause, and for the year as a whole in 1970, over 1969, we have had one of the smallest increases in the volume of consumption for a long time in Canada. Our increase was only about 2 per cent for the year. So personal consumption expenditures are now somewhat below the trend line we had indicated.

Similarly, in the case of Government expenditures. I might point out that that trend line to 1975, which reflects the 6.1 per cent growth line from our Sixth Annual Review, depended on two very important underlying assumptions. One was that we made no allowance in the Government sector for any significant changes in taxes, for no increases in taxes, beyond those in effect in the early part of 1969, when we were doing our analysis. On the other side, we made no allowance for any major new Government expenditure programs. The rising Government expenditures basically reflected the expansion of existing programs, in some cases as population expanded, some trend in these programs towards some improvements, and allowance for some very small adjustments and changes in a few fields.

What has been happening is that here Government expenditures—and I emphasize that these are Government expenditures on goods and services, and they do not include transfer payments—have been moving up, but slightly below the trend line we indicated.

Then we turn to the trade side, and here we come to a dramatically different view from the earlier expenditure patterns. In the case of exports, they have risen very strongly. As you will see, for 1970 they have been fairly flat, but they came into 1970 at a very high level, after a strong expansion in 1969. In other words, they have been tending to run ahead of the trend line to 1975, in spite of the fact that in volume terms we allowed for an increase of around 8½ per cent per year in export growth.

On the import side, in contrast, we have a pattern which shows that while imports were rising relatively strongly in 1967-68, they have subsequently been relatively flat. I think that the downturn in the fourth quarter of 1970 shown there is, to a significant extent, influenced by the automobile strike but, in effect, on the import side we have had a rather sluggish situation. Here again, this I think largely reflects the generally slow growth of domestic demand in the Canadian economy, and hence for imported goods.

The effect of these changes on exports and imports, which are plotted in the top panel of this chart—the red line is exports and the blue line imports—you can see there the very rapidly widening export surplus in the past year over the earlier period. This has been a major factor—if you look at the bottom panel in the chart, the one in green—in a very dramatic swing from quite a significant deficit, of over, $1 billion on our international balance on goods and services, to a substantial surplus. This, as you can see, was quite an unusual phenomenon. We have had nothing like that at all in Canadian experience since the mid-1950s.

Senator Isnor: May I ask a question? What is the effect on the economy of the country? Which is the better, to have that as it is, or the reverse?

Dr. Smith: Senator, I think this has given us several effects. One of the effects has been that that swing has inevitably tended to give us a very strong international economic position and has tended to put upward pressure on the exchange rate. I think this is the major factor involved in that shift.

Senator Benidickson: The only problem is with the export industries.

Dr. Smith: As you can see, exports have remained very strong in this picture, through this period, up to now. The question of the implications for the export industries really remains in the future. Some of our analyses have suggested that a significant change in the exchange rate may take some time to work its way through the economy and that it may be two or three years before we feel the full impact of major changes in the exchange rate. I think the lags are quite long.

The other factor about that, senator, as I mentioned earlier, is that there is a very strong export performance, which obviously has helped to sustain the growth in the Canadian economy during the past year. If we had not had that kind of growth in exports, our economy would have been flatter, we would have had more unemployment, and we would have had a larger degree of economic slack.

Senator Molson: Mr. Chairman, may I ask a question, with regard to services? The spread between payments and receipts seems to be increasing broadly and steadily over the whole chart.

Dr. Smith: It has been, since the 1890s. It seems to be a chronic situation.

The Chairman: The tourist trade, for the most part?

Dr. Smith: There are a great many items in there. Interest and dividends are a major factor. Tourist transactions are a major factor. Transportation and insurance are in there.

The Chairman: Those are the hidden receipts.

Dr. Smith: Yes.

We turn now to another aspect of performance. On the unemployment side—again, we have Canadian and United States figures. On the whole, there has been a broad similarity in the trends in this extended period, except in the latter part of the 1960s, corresponding with the rather different picture, as I indicated at the begin-

ning, in the performance of the economy's actual in relation to potential output.

In the past two or three years, unemployment in Canada has tended to be somewhat higher than in the United States, and increasing.

If we now take a closer look at what has been happening more recently on a quarterly basis, again taking the end of that chart and blowing it up, we can look at what has been happening since 1967, when the Canadian rate remained relatively high and fairly stable, largely in the 4½ to 5 per cent range, and then surged, in the earlier part of 1970. The United States remained relatively much lower—if anything, with even slightly lower rates of unemployment in 1969, in 1968 and 1967. Then unemployment in the United States has moved up very rapidly indeed during 1970. This gap in unemployment between the two countries has narrowed. In fact, on the latest measures, for March, 1971, unemployment rates in the two countries were identical, as I recall, at 6 per cent.

We might turn now to take a very quick look at the regional pattern of unemployment. That pink line in the centre is the Canada total unemployment rate. We show here rates for the Atlantic Region in white, Quebec in blue, Ontario in white below, and the Prairies in yellow.

The typical pattern in the past has been that when the national unemployment rate rises, as it did in the latter part of the 1950s, very rapidly, we tended to get unemployment rates running up much more rapidly than the national average in the Atlantic Provinces, much less in Ontario and the Prairies—and then again, as the national unemployment rate declines, the tendency for these disparities in unemployment rates to narrow.

This time we have had somewhat similar tendencies, but we have had two or three somwhat unusual movements. One of these is that the Quebec rate in 1970, for the first time, moved up over the Atlantic rate; The Atlantic rate did not rise as rapidly as it did earlier. There was a very sharp increase in the British Columbia rate, probably mainly associated with indirect effects of strikes and perhaps also with a very high inflow of labour force to British Columbia, which may have been difficult to absorb quickly.

The rate in the Prairies, with some weakness in agriculture and so on, moved up for the first time slightly above the Ontario rate, with slightly different patterns.

To some extent, these factors are more temporary, I think, than the ones in the more usual developments.

We might now look very quickly at a table showing changes in the labour force and employment, by the main regions.

Perhaps you would look first at the column on the far right. This is the latest five-year average of the rates of increase in the labour force in Canada. That pink number, 246, indicates that on the average in these years our labour force has grown at close to 250,000, about a quarter of a million people a year. But under the softer labour market conditions of 1969-70, as unemployment moved higher, the labour force grew less rapidly; it grew by just a little over 200,000.

If one looks at changes in employment, on the bottom part of the chart, similarly, over the past five years, employment has grown at just slightly over 200,000 a year—that is the bottom pink figures on the right—whereas the employment increase for the country as a whole in 1970 was 100,000.

One of the other striking features of that is that, if you take the Ontario line for 1969-70 at 60, and British Columbia at 16, you have 76,000 for the increase in employment, out of 100,000 in two provinces. In other words, three-quarters of the employment growth last year was very heavily concentrated in two provinces and the increases were really relatively small in comparison with past trends in the Atlantic regions and in Quebec and in the Prairies.

We turn now to prices. This is a rather longer look at price trends since the mid-1950s, for a number of countries. There are several countries which have had relatively lower rates of price increase than others. Prominent here are Canada, the United States and the Federal German Republic. Most other industrially advanced countries have had rather persistently faster price increases. We show here France, Japan and the United Kingdom, where the rates have been a good deal higher. If we look closely at the more recent Canada-US trends, we see that in the past year or so the Canadian increase in consumer prices has moderated somewhat. This has been partly due to the benefit of some special factors, partly in the context of less demand pressure. In the United States, on the other hand, prices have continued to increase very rapidly and very persistently through to the latter part of 1970.

Senator Isnor: What was the biggest factor entering into that condition in the United States and Canada?

Dr. Smith: I am not sure that I have a good answer to that question, senator. I think to some extent the United States developed a good deal more momentum in its price increases in the period in which its economy was pressed more strongly against its potential output. These very strong demand forces set in motion a variety of strains that are continuing to work their way through the economy with some lags. Price changes tend generally to lag behind a number of other kinds of change in the economy.

Let us now consider some of the key elements in the changes in the consumer price index in Canada during the three years 1967 to 1970. At the top left of the table you will see that over that period the increase in the consumer price index was 12.4 per cent. We ask ourselves in what major area of prices have the price increases been occurring? The righthand column indicates about 30 per cent of that 12.4 per cent increase was accounted for by food and clothing. A higher proportion, close to 40 per cent, was accounted for by housing, and 31.9 per cent by all other items put together.

The most interesting feature of that is the comparison between the first and last columns. Under housing, particularly under shelter costs, we have a component that accounts for about 18 per cent of the consumer expenditure basket on which this price index is based, accounting for 30.4 per cent, on the far right column of the 12.4

per cent increase in prices. This is a sector which has shown up particularly as one that has made a significant contribution to the price increases out of proportion to its weight in the consumer expenditures.

The price indexes of Gross National Product are rather similar to those of the consumer prices. I will therefore turn next to manufacturing and consider one or two aspects of performance. There are four groups of bars on this chart. On the left is a group related to output per man hour, which is a measure of productivity. The next group shows the changes in industry selling price. The next shows wage and salary costs per unit of output. On the far right profit are shown. Within each of these groups we have four year-over-year comparisons, for 1967 over 1966, 1968 over 1967, and so forth. The first group illustrates that particularly in the last year or two, our productivity growth in manufacturing has been relatively low, 2 to 2½ per cent.

The year of quite high increases in industry selling prices was 1969. 1970 was a year of more moderate increases, but still increases of over 2 per cent. For wages and salary costs per unit of output, very high increases are shown here in the last year or two. The wage increases have been very high, wage costs per unit of output. There has been an even higher rate of growth in salary costs per unit of output.

In the far right column profits are illustrated very dramatically. Unfortunately, this chart contains only a comparison through the third quarter of 1970 over the third quarter of 1969. It indicates a major profit squeeze, a profits decline, that would have been even more pronounced had the fourth quarter data been included. In the next two charts two measures of wages and profits—the average annual percentage changes in base rate wages and corporate profits in relation to total output—are illustrated. During the period of slack in the late 1950s and early 1960s the increase in base rate wages was relatively low. It reached quite high levels by the middle of the 1960s, the increases remaining quite high during 1970.

On the other hand, the next chart portrays profits as a percentage of Gross National Product. This illustrates that the profits squeeze in effect has been going on for a number of year. Profits in 1970, as a percentage of Gross National Product, are at the lowest level of the entire postwar period.

With respect to fiscal policy setting, it has become part of our conventional wisdom to think in terms of budgetary surpluses acting as restraints on demand, and budgetary deficits acting as stimuli to an economy. However, one of the key questions is what budget surpluses or deficits should be used? Since the early days of our work in the Council we have suggested that although it is far from a perfect measure, having a number of difficulties and not being as comprehensive as we would like, the best measure, to start with at least, for assessing the setting of fiscal policy is what we call a "high employment budget surplus". This is a calculation to suggest what the surplus or deficit position would be if the economy were at potential output.

Perhaps I can explain it this way: the green line in the chart indicates that during the early 1960s the United States had budgetary surpluses of 1 to 2 per cent of its Gross National Product. However, in fact, in the United States during that period, the budgetary deficits shown, were really reflecting the fact that Government revenues were depressed because the economy was performing well below its potential. In other words, what was really showing was not "a budget in disequilibrium" tending to stimulate the economy but "an economy in disequilibrium" that was depressing revenues and appearing as a deficit in the budget. That was one concept used to urge that a major tax reduction should be undertaken in the United States. Eventually it was undertaken, after a significant lag, in 1964. That revision in taxes began to have major effects on the US economy about 1965. It was just at that time that the United States moved to increasing involvement in Vietnam. Government expenditures rose very rapidly; the budget swung very sharply into a high employment deficit, of large proportions by 1967. Concern then arose about a shift towards tax increases. The tax increases were introduced in 1968, along with more constraints on government expenditures, and as a result the high employment budget position came back to a small surplus.

In Canada, as you can see, we had a rather different pattern: a position that was rather closer to neutrality in the early 1960s; a high employment surplus of modest proportions by the mid-sixties; then a very rapid swing to a position of very powerful fiscal restraint in the latter part of the 1960s.

I should like to emphasize that this measure covers not just the federal Government but all levels of government, which is a very important matter for Canada, especially when the provincial and municipal governments are a very important factor in terms of expenditures on goods and services, to which this chart is related. Provincial and municipal governments now spend more than twice as much as the federal Government on goods and services.

Senator Benidickson: And they took the cue at that time.

Dr. Smith: Yes. The swing into higher surplus reflected three things. First of all, it reflected the introduction of the Canada and Quebec Pension Plans, which became a new factor, also included here, tending to syphon off purchasing power from the private sector into various kinds of channels for savings and expenditures and investment through government operations. It reflected a shift from deficits to surpluses on the part of provincial and municipal governments taken together, and it reflected a shift towards more fiscal restraint by the federal Government. There were all these elements involved in that build-up.

Homing in a little more closely on the last few years, by quarters, on this same basis, the high employment budget surplus basis, what has been happening in Canada is that we have been moving down from the peak of restraint by this measure. Again I stress that it is not a perfect measure; merely, I think, the best one we have to start with. In the United States there is rather more

stability, but a somewhat lower level of restraint. In the case of monetary...

The Chairman: Before you leave that, I wonder if you could explain to me, Dr. Smith, the specific meaning of the budget surplus or deficit as a percentage of potential Gross National Product. I understand what you mean by a high employment budget surplus, but I am trying to relate the significance of a percentage of potential figure.

Dr. Smith: These estimates are very rough. I think any estimates of a high employment budget position are necessarily quite rough. They are calculated in the following way. They take expenditures on goods and services as they show up. Then an estimate is made of the added revenues that would accrue if the economy were operating at potential output and at a relatively high employment level, which would imply that total output and total taxable incomes, would be higher. We have applied average rates of taxes to this added margin of income available, have added that on to the revenue side, and have then asked what kind of balance would be struck.

I think our estimates are conservative, because we have not made specific allowance for the progressive nature of the tax structure, and the fact that if incomes had been higher the revenue increases might have been even larger than our estimates. Nor have we made allowance on the other side for the fact that some expenditures might very well have been less—expenditures on income support and other things during a period of slack. You can take a great variety of factors into account and try to develop much more sophisticated measures, but I am not sure they would come out very differently.

The Chairman: I understand that then, but why do you show it as a percentage of the potential? Why not show it as a dollar figure?

Dr. Smith: It can be shown that way too.

The Chairman: Would it have made a significant difference on the chart?

Dr. Smith: If you are looking at it over a number of years, the potential output is changing, it is growing quite rapidly, and therefore using this as a percentage is a way of standardizing this, to say relatively how it is changing.

The Chairman: But to see whether or not a particular budget is in relation to its high employment figure, would you not see it better by dollars than by percentage?

Dr. Smith: At any one point of time, yes; we sometimes use the dollar figures as well. We can make those available to you.

The Chairman: I think it would be useful.

Senator Benidickson: Are you close to something Keynesian there?

Dr. Smith: Well, I suppose in a very basic sense there is a Keynesian flavour to this. It was Keynes who drew special attention to the fact that government budgets, levels and patterns of taxes and expenditures, can have broad effects on the economic system, and he pointed out particularly the importance of surpluses and deficits and the kinds of effects they would have on the economy.

Dr. James Gillies, Study Director: Have you made any calculation as to what a tax cut now would do in terms of coming to full employment or potential for GNP?

Dr. Smith: No, we have not.

On the monetary side there is again a variety of measures to suggest what the setting of monetary policy is. I think a growing amount of analysis has suggested that one can discern very important relationships between the broad performance of an economy and changes in the money supply. This chart shows year-over-year increases, in percentage terms, of the money supply—the United States in green, Canada in red. You can see the pattern, in which there is a good deal of volatility in the changes: in the latter part of the 1960's, until more recently, quite high rates of monetary expansion; and then at the end of the decade there is major monetary restraint.

If we turn again to look more closely at the more recent performance—and I emphasize the next chart is on the same scale as the preceding one—it shows the fairly significant volatility from quarter to quarter. It shows very clearly the period of very vigorous restraint, running to the latter part of 1969, and it shows more recently that the policy has shifted again in the past year. We had relatively high rates of increase in the money supply, now running for Canada around 10 or 12 per cent.

The Chairman: What do you define as the money supply in that chart? Is that currency and demand deposits, or currency and total deposits?

Dr. Smith: It is currency and total deposits. This is a broad definition of money supply.

The Chairman: I will come to that later, but I have one other question, doctor. Have you related the changes in the money supply chart to the changes in the high employment budget as a percentage of total potential growth, and have you found any correlation?

Dr. Smith: We have tried to look at these together. There is a section in our Performance of Potential Report where we take this up. There are periods, like the period in the latter part of 1968-69, coming into 1970, when the two policies were both set at very vigorous restraint levels, probably in combination producing the most vigorous restraining posture of these demand policies at least since the early 1950's.

More recently, as you will recall, we still seem to have a significant high employment budget surplus, implying some restraining posture of fiscal policy. On the monetary side, however, we now have a fairly expansionary setting, with quite high rates of increase in money supply.

Senator Benidickson: When you talk about government, are you speaking in terms of the United States and Canadian governments acting in similar ways?

Dr. Smith: I think we have tried to emphasize that what happens in the United States has very considerable influence and effect on Canada; that we cannot think that we can pursue radically different policies for any lengthy period in Canada without having some sort of adjustments take place.

I would like to emphasize again "on the fiscal side," because it is very important indeed that we look at all governments together, for the United States as well as Canada.

Finally, we have this small chart which we used before. This is a hypothetical chart. The first question is usually: Let us put some numbers and years on it. We do not know enough yet to put numbers and years on a chart like this, but this shows the potential growth rate in the economy, the red line. It shows actual output diverging from that. You can see that even without a recession, even without a clear downturn in actual output, you can produce a significant amount of slack in the economy if the potential growth rate is very high.

We asked ourselves the question: If you are in this kind of situation, what kind of growth path would you think to be most appropriate in trying to move forward?

If you were merely to try to move an economy forward from that position of slack at the potential growth rate itself, you would follow the "B" line on the bottom right. Our potential output, the red line, is increasing at a rate of about 5¼ per cent per year, on our estimates. So if we resume growth at about 5¼ per cent per year, in real terms, what happens is that the amount of slack that you have in the economy remains large. If, on the other hand, you were to attempt to move very quickly towards potential, to stimulate demand very powerfully and very strongly, and use a variety of devices to do this, the kind of path you might aim for there would be path "A". There is a danger with that path that the economy may gather very great momentum, and come up sharply and hard to the potential line and perhaps break through it, with consequent risks and dangers of touching off strains and distortions and perhaps a major new round of inflation. We suggested that the appropriate path was the intermediate one there; that from a situation of significant slack you could move up fairly rapidly for a while, but that well before you got close to the potential you would want to exert some efforts to moderate the approach to come towards the potential output line more gradually.

That is a very easy thing to say and a very difficult thing to do, but this was what we suggested ought to be the approach that would be appropriate.

Mr. Chairman, that concludes the charts.

Senator Laird: Mr. Chairman, before we go further: Dr. Smith, have you shown us on the screen what appears in this blue book that was circulated?

Dr. Smith: Yes, I think, senator, all except two or three charts. I omitted one labour force chart and some charts on the price indexes for Gross National Product. Otherwise I think we have shown all the charts.

The Chairman: Dr. Smith, does that complete your statement, or have you a further statement to make?

Dr. Smith: No, I have already taken up a lot of your time.

The Chairman: Not at all; we have enjoyed it and it has been very useful.

Senator Nichol: Dr. Smith, the charts and so on that you have presented really present us with the background to the brief, and you have not gone into the brief itself. Do you intend to do that tomorrow, or are we free to move on now to discuss your brief with you?

Dr. Smith: I was going to suggest that we take the brief as read, if members have had a chance to read it.

The Chairman: I think maybe, honourable senators, that is the best method, that we feel free to discuss the brief or the presentation. It will give Dr. Smith a chance to examine the testimony that is given today and to come back tomorrow maybe with a brief opening statement, and we can continue tomorrow.

Senator Nichol: Taking the brief as read, I would like to ask a mechanical question. Assuming that what you say is true, in the whole question of the performance of the Canadian economy, in terms of the broad sense of economics, including the sociological side, jobs, housing, welfare and everything else that is involved in it, it seems to me that what you are really saying is that there needs to be some sort of a massive—and that may be the wrong word—certainly some sort of overall planning structure within the Canadian society far beyond what exists today.

I mean, even in the field of narrow economics, we have yourselves, the Bank of Canada, the Department of Finance and other people, all working on it. It seems to me that what you really said is that somehow the system is inadequate to cope with the problem. I wonder if you could comment on that, as to whether I have read you correctly or not?

Dr. Smith: I would think that, especially in this kind of country, with its constitutional system, which provides for quite a large division of powers, with a highly decentralized system of private decision-making, with quite wide regional defferences between different parts of the country, the concept of having some fairly centralized planning system would not likely work very well.

I think we do need a strengthening of the bases for planning in many areas. In fact, in a small way, in the Economic Council this is what we were really asked to do, to provide information and analyses that would be relevant to planning decisions in various parts of the economy.

Again, with this kind of economy, the achievement of good performance is not just a matter that can be handled by the federal Governent or by the provincial governments or by the private sector. There needs to be good planning and good decision-making in many places.

In our work at the Council we have addressed ourselves to quite a wide variety of areas in which we thought we could provide some information, some analysis, some advice and recommendations from time to

However, I would think this must go on in many time that would assist with this kind of planning for decision-making.

different ways. We probably need to find a variety of ways in which the planning mechanisms can be improved, can be better co-ordinated in some ways, can be strengthened a good deal further, by the development of more and better information and analysis, and evaluation of the effectiveness of policies, programs and decisions within the private sector, too, and in many different places.

Senator Nichol: This seems to be a basic problem, though. Assuming what you suggest in here is correct, assuming for the moment that all of these disparate groups in the fields of economics and planning could even agree, the structure towards doing it really does not mechanically exist at the moment. In any formal sense, it certainly does not.

Dr. Smith: I am not sure what kind of structure you may have in mind.

Senator Nichol: I have none in mind.

Dr. Smith: Again I would say, if one were to think of a structure in which in some way there were to be a short of large institution to do this, I think that would probably not work well. There is a need for the development of more research, more analysis, more information, in many different places, and a better co-ordination of many of these things for decision-making purposes, within governments, between governments, and between the governments and the private sector.

Senator Nichol: Yesterday, Sir Roy Harrod was here, as you know, and he rather suggested that, as he said, the old-fashioned Keynesian methods of control were really inoperative, except in a case where inflation was really caused by strong demand-pull forces. He suggested that the reason they were not working as well as they had in the past was that there was a deep psychological shift within the psyche of the people, if you want to put it that way, which was not operating in the days of Keynes, and that there was a deep—I think the words he used was "psychological"....

The Chairman: "Sociological," I think.

Senator Nichol: ...sociological drive, which was making these things ineffective in control. Could you comment on that?

Dr. Smith: I do not really have any great light to shed on this. This point of view has been emerging in a number of places. Perhaps there is particular concern along these lines in a country like the United Kingdom, where the situation is somewhat different from Canada, where they now have a combination of developments which suggests, I think, a poorer performance in relation to the sorts of goals we have been talking about here. On a year-over-year basis, their consumer price index is now running about a 9 per cent increase, which is somewhere in the vicinity of three times our rate of increase. Their wage increases are running around 12 per cent or so, compared to somewhat around, on the base rate wage in Canada, a 7½ to 8 per cent rate.

Their unemployment has moved to the highest level in the post-war period, and has been tending to rise. Their industrial production for a year or more has been fairly flat. This is an unusual combination of developments and, I think, a very troubling one. There is deep concern to try to find out more about what is producing this kind of performance. I do not know whether Dr. Ostry might want to add something to this.

Dr. Sylvia Ostry, Director, Economic Council of Canada: Unfortunately, I did not hear Sir Roy. It is probably worth exploring and I hope that we will be able to do some work on it. The notion is that, after a very long period of continuing price change, in either direction, people begin to adapt to this, their behaviour begins to change. Keynes talked about something called "money illusion". That is people, did not think in terms of real changes; they were suffering from an illusion that money changes were real changes. That kind of illusion obviously disappears after many years, when people expect that there will be some increase or decrease. It could happen in either direction. In this case it has happened all in one direction. So in a variety of ways people's behaviour begins to adapt—in collective bargaining and in a variety of other ways—in the way in which they allocate their budget.

This is a question which is now beginning to be explored. It suggests that if inflation is anticipated, its effects may be very different from inflation which is unanticipated.

As I said, this is an area which will require not only a good deal of empirical investigation, but also some very high deliberative work which is now going on.

The Chairman: On page 4 of the Council's submission you quote from the Third Annual Review and state:

> We live in an age of 'rising expectations', and the people of Canada have come to expect much from their economy. They expect the kind of economic and social progress which will maintain high employment and generate rapidly rising standards of living in a material way. They also expect the economy to provide growing resources for dealing with social problems and for improving the quality of life.

Sir Roy Harrod said that basically this was a sociological problem and that there was really no way of controlling inflation at all, using either Keynesian or any other means of trying to stabilize the economy, and that the only logical method of stabilizing was to employ wage and price freezes, hopefully on a temporary basis, but, if it were not successful on a temporary basis, then on a permanent basis. We are trying to elicit your comment. You both start from the same departure point. Sir Roy says the result in wage and price freeze. At page 15 of your brief you reject that medicine when you say:

> But these policies generally cut across market forces and mechanisms, and in economies in which markets (markets for goods and services, markets for labour,

and financial and other markets) are important mechanisms for allocating productive resources and productive outputs, incomes policies have not been very successful policy instruments.

Dr. Smith: Mr. Chairman, perhaps the members might like to spend a little time discussing controls. I preface my remarks by saying that the Council has not really dealt with controls; I speak here in a personal capacity. It is quite possible at some stage that we might reach a situation containing some kind of emergency elements, a seriously distorted situation widely recognized in this country, and which might provide the basis for a very broad concensus that really major emergency action should be taken. However, with regard to the matter of controls we would have to ask ourselves a series of pretty hard and pretty tough questions before arriving at them. I have the impression that some of the emerging discussion of controls does not reflect the very tough questions involved in approaching their use.

First of all, one of the questions is, of course: How have controls worked? In this context I might start from the Canadian side by saying that we used price controls during the war.

There is a rather good summary, if I may read it, of that experience contained in the first volume of the Report of the Royal Commission on Prices in 1949, the Curtis Commission, in which they have put it this way:

> But we do not believe that the price ceiling by itself could have prevented prices from rising. A price ceiling is like a lid on a boiling pot. It can be held down only if the pressure within the pot does not become excessive.
>
> Therefore, although for reasons which we give elsewhere, it would have been impractical to use fiscal and monetary measures with sufficient force to prevent prices from rising under the conditions that existed in Canada in wartime, they were an indispensable part of the stabilization program. The high rates of individual taxation necessary for war purposes helped to keep consumer spending down. Taxes on corporations, particularly the excess profits tax, took much of the profit out of war and thus helped to reduce the pressures that would otherwise have arisen from labour for a larger share in the gains and from Canadians generally for relief in individual income tax.
>
> Although wages were never held under a rigid ceiling, a substantial degree of wage and salary control was maintained and seems to have been indispensable. It is significant in this connection that except on rare occasions, wage increases were not recognized during the period of the over-all ceiling as justification for the payment of subsidies or for price increases. Export controls, import subsidies and foreign exchange control too were indispensable. Without them a sufficient supply of essential goods could not have been kept in Canada and rising prices for imports would soon have made the domestic ceiling untenable. Even so, the evidence presented to us and our own investigations have led us to the conclusion that it would have been exceedingly difficult, if not impossible, to hold the line in Canada, had it not been for the timely control of prices in the United States early in 1942. It should not be overlooked, too, that although the over-all ceiling was maintained more or less intact at the retail level for some four years, there was, in fact, a considerable increase during that time in returns to Canadian producers, made possible by the payment of domestic subsidies on a large and rising scale.
>
> Over and above all else we are convinced that the lid was kept on largely because the people of Canada were determined to keep it on. Persuaded by a skilful and extensive publicity campaign as to the dangers of inflation and the purpose of the price regulations, they held themselves in check and they held each other in check. The retention of the price ceiling became an integral part of the war effort, or as one witness put it "the public support of price controls was a patriotic duty".
>
> There may be some argument as to whether an over-all price ceiling was the right policy or whether it would not have been better to have permitted somewhat greater flexibility. For example, a less rigid policy might have made post-war adjustments less difficut. But this is arguing after the event. In 1941, we were engaged in an all-out war effort and it was prudent public policy to anticipate the worst and to prepare for it. Nonetheless, the very success of the over-all price ceiling did add to the post-war difficulties of restoring freedom of trade.

This is a rather concise summary of the kinds of issues in question. It helps to convey the type of atmosphere in which the total system of controls was used. This reflected not merely the operations of the Wartime Prices and Trade Board, but also the fact that we had a War Labour Board, with enormous powers, and that the twin sister of the Wartime Prices and Trade Board was the Commodity Prices Stabilization Corporation, which played a very large role in bulk purchasing of commodities and distribution in Canada. We had a Foreign Exchange Control Board, which controlled all foreign transactions. In effect we had the basis for both export controls and import controls. W employed a number of export embargoes and prevented the export of any product to certain areas.

On the import side, quite arbitrarily at times, tariff and import barriers were removed in an effort to keep prices down. It was really a total control system. It was operated with great skill during that period, but it was a very difficult system to operate. It intervened in every aspect of the economic life of this nation.

I think therefore we face a question that I might put this way: In considering controls we must ask, first of all, why we need them. Is it merely a matter of containing inflation? Is it to achieve other objectives? During wartime, of course, part of the rationale for this was not just to prevent inflation; it was to re-allocate resources in the economy.

One of the most crucial factors, about controls on incomes and prices is that we regulate prices,—whether

of labour, of goods, or other prices and exchange rates. We are breaking the price system. The price system has been developed and used basically as an allocating mechanism. If you break the allocating mechanism, what do you put in its place? That is a very critically important question. During the war, in part later on, we came to use rationing. In effect, this replaced the price mechanism in some very important areas.

It would be my judgment that if we were to think of permanent controls, either on a selective basis or on a total basis, they would be unlikely to be workable. There are too many problems they would give rise to. They would give rise, especially in today's complex economy, to these kinds of questions: How do you cope with adverse shifts in quantity and quality? You can control the price of a tin of mushroom soup, which is one of my favouraite illustrations, but do you then have to control the number of mushrooms that go into it? You can control the price of a chocolate bar, but do you also have to control what goes into it? You can control the wages of truck drivers, but do you also have to control how many miles per day they will travel? You get into a whole series of underlying very difficult questions and problems. For instance, how do you protect the consumer? How do you assure, as was assured during the war under the total control system, that low-priced products do not just disappear from the market? How do you assure that certain essential kinds of goods for consumers do not just disappear under a tight system of controls?

Also, you will have to have some kind of system to take care of exceptions. How do you determine the criteria? How do you administer the criteria for exceptions? How do you handle fringes and all sorts of other things? How do you handle the question of re-classification of jobs? Even in a relatively short period, I might say, of controls, of freezes, some of these questions will appear. They began to appear in less than six months in the United Kingdom during its freeze in 1966. I remember at that time visiting an important publisher in the United Kingdom. A government department had just offered three of his good men better jobs at £1,000 increase in salary a year. He said, "What am I to do? I cannot increase their incomes now or I am breaking the freeze. If I let them go, what am I going to do? I will set up three new jobs, re-classify them, with higher salaries, recruit three new people. In the meantime it will take some time for these new people to get to know the ropes here and contribute effectively. The three people I lose to the government department will take some months to be able to settle in and make a good contribution there." These are some of the nitty-gritty kinds of problems that arise under a control system. Again, I emphasize that we may get to a point of emergency where we may think we want to use them, but it will raise a whole host of very difficult kinds of problems.

I suppose there is another way of coming at them too. If you were to think of controls—in what kind of a country might you have the best chance of making them work? I think probably in a country that is fairly highly centralized, with quite a high centralization of decision-making; fairly tight, small, compact, fairly homogeneous, a country with a minimum amount of international connections, which are very difficult to cope with, a country without too many regional differences. Canada is not this kind of country. I think for us the use of controls—to try to fit them and insert them in the kind of country we have—would be a particularly difficult kind of phenomenon, and especially difficult if the United States did not have controls at the same time.

Finally, I think there is a fundamental question here. How do you maintain controls for any length of time, as a policy tool, in the light of the criticism and attacks that will inevitably occur and develop, especially in the light of the inequities and imperfections that will be involved in a system of this kind, and with increasingly bureaucratic involvement on one way or another in decisions in the economy? This raises very fundamental political issues and problems as to how this kind of system could be effectively used.

May I just mention one other thing about the wartime situation, which I think is very important. At that time, under controls, it was feasible, with the patriotic background and fervour, for the Wartime Prices and Trade Board, and many other control agencies, to have access to some of the most knowledgeable and best minds across the country from many industries, many of whom came to Ottawa with immense experience and practical knowledge about the actual workings of industry, of markets. Many of them came as dollar-a-year men. It did not cost the government too much to get access to that expertise in the conditions of the time.

One of the basic questions is this: If you were to run this kind of an apparatus, where the administration may be very difficult, would you really have access—unless you do have an emergency on which there is a broad consensus in this country to support controls—to the talent, expertise and knowledge of how the real world works to make this kind of thing work effectively and reasonably well?

I am sorry, I have taken a long time.

The Chairman: Not at all. It is a very important subject, and the committee is very interested in what you have said.

Senator Beaubien: Dr. Smith, I do not know if this is a fair question. I should like to ask you what you think of the prospects for the pulp and paper industry, which I suppose now includes building materials. Is that too much on a practical level?

Dr. Smith: Senator, we have so far in our work confined ourselves largely to looking at the economy as a whole. At least, that is where we started. What we are working towards gradually is what we call increasing "disaggregation" in our approach, to get down below the big aggregates and averages. This is a very important way to proceed. I think it was Clifford Clark who once said he was always concerned when he saw averages, because he remembered the man who drowned crossing a river whose average depth was nine inches.

We want to probe down more and more beneath these averages to find out various things. There are the different patterns of expenditures in the economy, and we

have started to go some way in that direction, especially in our Sixth Review, when we looked to 1975 with more detail on consumption. We have done a little bit on the regional side in looking at some of the aspects of regional performance; not very much, but some. In the last annual review we started in the direction to which your question is addressed, towards industrial disaggregation. So far, however, this has been fairly limited, and mostly backward looking to what has been happening in the last 20 years in some of the major sectors of the economy. We would like to carry our work forward in this direction a good deal further. I hope we will be able to carry it a good deal further in a more forward and future-looking way in our Ninth Annual Review next year, and we have some work under way on that.

However, I am not in a good position to take individual industries yet and assess those, especially within the framework, which I think is very important, of a total view of the economy. In the past, we have had a great many industry studies in Canada, but some of them have been rather isolated. They look at a particular industry and are not set within the broad framework of inter-industry relationships, so you get interactions taken into account.

Senator Cameron: Dr. Smith, in connection with the very vital and important work in planning that you are doing, I have wondered for some time if we have in our data gathering, our statistical gathering organization, the DBS, and in the provinces, sufficiently sophisticated machinery to give you the tools you need, not only in terms of the quantity and the quality, but the timing of the information you need. Could you give us some idea of what are the weaknesses of the existing structure in providing these tools to you?

Dr. Smith: Senator, I think I will ask Dr. Ostry to answer this. She was a senior person at the Dominion Bureau of Statistics before she came to us and is an outstanding statistician in her own right.

Senator Cameron: I am not saying this in any critical sense, but I have felt for some time that we have not the degree of sophistication we need in the gathering of statistics.

Dr. Ostry: I think this is a case of a prophet being without honour in his own country.

Internationally, I think it is recognized that Canada has one of the best statistical systems in the world, next to the United States and perhaps some of the Scandinavian countries. But in many areas we are more advanced than the Scandinavian countries and we have more difficult problems than some of the Scandinavian countries.

I think too that there has been over the past three or four years a concerted effort on this question of timeliness. Indeed, there is a report which has just been prepared for an international statistical meeting in the fall which presents some very interesting evidence on the improvements in timeliness of some of the major series. I think too that in the last decade, and since the last census, there have been some major developments in computerization, and there are one or two surveys which are fully computerized from beginning to end, "untouched by human hand," which also are almost unique internationally.

It is quite true, however, that the demand for data has far outstripped both the supply in sheer quantitative terms, but more particularly the level of sophistication, and the demand has outstripped it because the policy-makers have become more sophisticated in their use of analysis and data. But I think the Bureau is well aware of this.

It seems to me that one problem is that in the past there has been insufficient consultation between the policy departments and the data agency. Certainly in my experience in other countries the closeness, the degree of linkage, the continuing dialogue, and so on, between the major policy departments and the statistical agency is closer than it is in this country. But I think that now there is an awareness of this problem, and there are steps being taken to improve the situation.

Senator Cameron: The reason I asked was that several times during the hearings of the Senate Committee on Science Policy this question came up, the need to improve the quantity, the quality and the timeliness. I think you have put your finger on one of the difficulties, and that is the need for co-ordination between the policy-makers and the people who supply the information.

The Chairman: In that context, Dr. Ostry, would you have a view as to whether or not the econometric model is a useful part of statistical information? And what do you think of the econometric model?

Dr. Ostry: I will answer the first part, if I may!

I think that any form of comprehensive, integrated, rigorous, analytical approach becomes an enormously useful device for ordering priorities, for improving classification, for making more uniform, for integrating a statistical system, and also for developing new methods for storing and retrieving data, all of which are very important, and all of which require considerable sophistication in use of the most advanced technology.

I am certain that the Bank of Canada's econometric model—and the Economic Council played a role in this—has had an important effect on data storage and retrieval, so that we now have much better access to current series in a timely way.

Our own econometric work, in which we are working very closely with the Bureau, was also intended and is—although it will not have this effect overnight—the way of beginning to look at the statistics and of beginning to open up areas arising from differences in classification, lags in series and data gaps, so that questions which we thought we could answer we cannot really answer because a particular series is late or is not consistent in some way. So, yes, I see the econometric model, as long as there is this close and continuing liaison with the statistical agency, as an important device for integrating and improving statistical output.

The Chairman: What, in your judgment, are the defects of the econometric model?

Dr. Ostry: Oh dear!

The Chairman: Well, perhaps we could come back to that later.

Dr. Ostry: Somebody said that we certainly know how to build models; it does not mean we know very much about the real world.

Senator Molson: I think Dr. Smith's statement on controls was very impressive and important. Before we leave that subject, I would just like to ask him if we could over-simplify what he said there.

May I ask: Would it be right to say that, in your opinion, any prospect for success of control really, in the light of experience, would depend on practically complete and overall control? In other words, partial controls have a very small prospect of success.

Dr. Smith: I think it would depend on circumstances, perhaps. I would have reservations as to whether a selective system of controls would operate very well in an environment in which you had strong demand forces working and relatively tight markets. If you use selective controls in these circumstances, then there is a question about whether the demand forces will not simply go into the areas that are not controlled, and whether you may still have the same problems.

I might say that in a speech in October, 1944, Donald Gordon, who was then head of the Wartime Prices and Trade Board, made a very flat statement in which he said:

> During a time of serious inflationary pressures a system of selective price control cannot succeed.

He cited the illustration in that context of the fact that during the period from 1939 to 1944 in Canada, with the use of total controls in a total control system, we had managed to keep price increases over the five years—what was then called the cost of living index—to about 18 per cent. Ireland,—which was not in the war, and probably did not have as serious strains and pressures on its economy, in terms of re-allocation of resources to war effort and so on, and had opted for selective controls—had a 70 per cent increase in prices in those five years, and was then on the verge of moving to a total control system. Whether that sort of experience is really relevant or not, I am not prepared to say, but it is one instance in which this question was focussed on.

Here again I think there is a very real question about this. If you are going to use selective controls, what do you control? If one looks at the pattern of development over the past decade, where have been the areas where we have had persistent, difficult problems, persistent price increases? They are not so much in the goods areas. On the latest indexes, in the consumer price index, many of the goods areas show that prices are perhaps even somewhat lower than in 1961—The index for new passenger cars, the index for television and radio, the index for pharmaceutical products, the index for hosiery. There is a series of goods that show this pattern. Where you find that the large and persistent price increases have been occurring have been mostly in the service industries—in health care—doctors, dentists, nurses, rather than pharmaceuticals—in repairs, insurance, transportation, home ownership.

Senator Molson: And in construction, now.

Dr. Smith: Construction is a major sector, which has had very persistent, very difficult, very substantial, price and cost increases. In a system of controls, one of the things you might want to do focus on is this. In a market system, one of the things you want, if you are to get a reasonable price stability, is a mixture of price declines and some price increases. As the system works, prices decline in some of the areas where high productivity growth is occurring, and where there may be declining demand for things, so that resources will shift to some of those areas where price increases are occurring, where demand may be strong, where productivity gains may be easier to achieve, that is, measured productivity increasses.

Now, how do you order controls here? Do you really try to say, "We are not going to have any price increases"? That may be very favourable for industries where there is a shifs in demand, in tastes, in consumer not difficult from a strengt point of view. Or do you try to direct these to some of the service areas, where very large increases in prices persistently have been taking place and where the effect may be, if you were to put a lid on these, you would simply stop the growth in areas where there is a shift in demand, in tastes in consumer desires as reflected in consumer spending? If we put on really tight controls and say, "No more increases in prices of haircuts," we might all look pretty long-haired after a short while.

An hon. Senator: We are somewhat that way now.

Senator Molson: And not due to the increase in price, either.

The Chairman: Have you a supplementary question, Senator Molson?

Senator Molson: I want to ask Dr. Smith this supplementary question. I asked what sort of a country would controls work in, and he gave a physical description, perhaps. I think that politically, too, it might take, for effective controls, a rather different political system from ours. Do you not agree with that, Dr. Smith?

Dr. Smith: Yes. I pointed to the fact that we have a constitutional system in which the operation of controls would be particularly difficult. There is another broad area of questions, too, about them, in a sense. If you have to try to use a system of controls, is there a danger that so much energy, effort and attention would get concentrated on trying to make this instrument work, that inadequate attention might be paid to many other important areas of policy where we need improvement? Is there a danger that, if we were to try to operate a system in this way, you would get shifts in the private sector, too, from concentration on efforts on improving efficiency and improving technology, and so on, and conceivably a shift in efforts to spending a lot of time in finding out

how to evade the controls in one way or another, which may not be a very productive effort.

So there is a question here of what would be the effective controls on the performance and operation of the economy in other respects.

Senator Molson: Thank you.

Senator Manning: Mr. Chairman, my question has been largely answered by the one that Senator Molson has just raised. I might pursue this point in a little different manner.

As you know, Dr. Smith, this committee is primarily concerned with trying to come up with some techniques that will permit the control of dislocations of inflation, without creating the high unemployment situation that we have been faced with.

One of the things I am sure we have to decide in the committee is, should we write off the concept of arbitrary controls entirely, in assessing what techniques should be considered and which might be practical.

One of my two questions—and, as I say, you probably have answered this one almost entirely now—was whether you felt that there can be such a thing as a partially controlled economy, or whether the imposition of controls in certain areas simply increases the pressures, which then necessitates similar controls being put on the perameter of those first ones, until ultimately you end with either 100 per cent control of the economy or the whole thing collapses.

If I could follow that comment and deal with these two things at once, let us assume that the evolution of controls is to control the economy completely. Then my question is, what would be your assessment of Canada's position, because of the proximity of the United States, assuming that their economy remained free? We are already losing both professional personnel and skilled technical personnel and others, to the United States, because of higher wage and income opportunities. If all of these things are frozen in Canada, it would be reasonable to assume that we would impair our own productivity by the loss of personnel to a free economy, if we have a 100 per cent controlled economy here.

Dr. Smith: Yes, senator. I think that is one of the dangers that was implied in my comment. To try and run a controlled system in Canada as opposed to a free system in the United States, would pose particular problems and this would be one of them. I am not sure what the present balance is. I suspect that the balance may have shifted enormously. It may even have shifted into a net inflow of brain power from the United States in the latter part of the 60's. That has been part of a dramatic change, perhaps for many reasons.

Going back to the earlier part of your question, here again I think there is a tendency for things to evolve in the way in which you have implied. There was a number of situations in which approaches to incomes policy, for example, have started very slowly, perhaps rather vaguely.

When the United States set up its guideposts in 1962, in the Council of Economic Advisors report, there were not even any specific guideposts. Then the thing moved to specific guideposts. They were conceived of as voluntary guideposts. Then beyond that came increasing thought about how different kinds of elements of government intervention could be used, beyond jaw-boning into perhaps a little arm-twisting. There is a tendency for these things to escalate.

In the United Kingdom. in the incomes policy, the thing also tended to escalate. You reach a point where you have to make a decision, as to whether you go to a freeze, or to controls, or whether you finally back down and let the thing go again.

In the United States the decision was made in the mid-sixties to let the guideposts go. It was a situation in which they had to go to a good deal more intervention or let them go. In the United Kingdom case they took the step into the freeze, but the question became very quickly: How do we get out of it again? They tried to ease themselves out after six months of freeze through six months of what was known as the "squeeze", in which there were still some limitations. However, in many cases, after a period there was some tendency to escalate; in one way or another the system collapsed. Even the Dutch system collapsed. Here we have a country that is very highly centralized, very small, with large powers of government to intervene—in fact, legal powers to enforce prices and wages. However, on two occasions the Dutch system has simply exploded. Then there is a catching up in a sense, an adjustment to some of the strains and distortions which were created during the interim.

I do not wish to sound as if these are instruments that should never be used at all. Very difficult emergency situations arise, in which one may wish to experiment with never devices, even though they may not have worked very well elsewhere, work very well for very long, and only give some respite for a period of time. However, the record so far has shown that these kinds of policies that really intervene in various areas in market processes are difficult to operate and get much out of over any sustained period of time. This led us in the Council in our Third Annual Review, after looking very carefully at incomes policies, to suggest the need for exploring, examining and determining how we can develop a whole set of other instruments that would tend to work more with market forces than intervene in them.

Senator Grosart: Dr. Smith, the Council has recommended the establishment of an independent research institute. Does this indicate that the Council feels it is not an independent research institute?

Dr. Smith: Well, we suggested that there should be an independent research institute to look regularly at some of the shorter term trends and developments in the economy in a way for which the Council does not have a mandate.

The Council is not organized and structured in such a way as to enable it to do this very effectively. We have a large and very heterogeneous membership. We meet five or six times a year and produce an annual review. Incidentally, in our act we are asked to look medium and long term, not short term. A short term institute needs a greater capacity for flexibility and nimbleness to look at

matters as they move along in the short term area. We do not have that type of body in Canada. A number of other countries do and they play a useful role—in Sweden, for example, Britain or Japan.

Senator Grosart: Do you mean something like the Brookings Institution in Washington?

Dr. Smith: Perhaps not so much the Brookings Institution, which is a rather more broadly based research institution looking at more fundamental matters, as the National Institute for Economic and Social Research in Britain which does short term forecasting, or the Japan Economic Research Centre which every three months issues an 18-months forecast of Japan's economy. We lack this type of institution in Canada.

Senator Grosart: Does the Council now give private advice to the Government? That is advice that is either in general or in detail not known by the public?

Dr. Smith: No sir; the Council has decided that it would arrive at its consensus views on the basis of underlying research and analysis. Its conclusions and recommendations are incorporated in its annual reviews and in other consensus documents, such as the reports we have released in response, for instance, to the special reference on consumer and corporate affairs. So they are made public.

Senator Grosart: Is private advice ever asked for by the Government, or business and industry?

Dr. Smith: No; we do not act as a consultant to industry either in such a capacity as offering advice to a business firm or an industry association or other private group. We operate entirely in the public arena.

The Chairman: In the United States the President has a Council of Economic Advisers who, I believe, make an annual report to him and advise him from time to time on economic activities and trends.

Should there be a similar institution in Canada, perhaps attached directly to the Prime Minister's office?

Dr. Smith: I do not have a view on this. In the United States the Council of Economic Advisers, as you imply, is quite different from our council. It is part of the government. In the last analysis it is under the instructions of the government. The Chairman has acted in nearly all cases since it was established in 1946 as a personal adviser to the President. He sees the President frequently on policy matters. That council is very much engaged internally in short term affairs, often in day-to-day consultations. There are regular meetings with officials of the Treasury, the Bureau of Management in the President's office and the Chairman of the Board of Governors of the Federal Reserve System. It has been brought in in a variety of ways to comment on and assess programs and policies in a great variety of other departments and fields. So it operates internally in a very close-in way on policy advice and formulation in the US Government.

Our Council, by contrast, was quite clearly devised to be an independent advisory body, not part of a Government department, taking the form of a Crown Corporation, to advise from this independent viewpoint. We have a very heterogeneous membership, drawn from across the country and from different sectors of the economy. In Canada at some stage perhaps we might wish to consider whether there might be some value in such an organization as you have suggested. We have very different forms of government, however, between the two countries.

Whether this is really relevant and how it might be designed is another question. I am not very much in favour, frankly, of looking at the institutional structures, and in many cases the policy approaches, in other countries to see whether we can somehow adopt holus bolus something which has been developed elsewhere, which might be very useful abroad, and bring it directly and simply into our context. We need to evolve, in a sense, our own institutions and approaches to fit Canadian conditions and circumstances.

Therefore I am not really sure whether this kind of institution would be suitable for us. It has been proposed by two or three people in Canada as one option in recent years. However, I do not have a personal view with respect to it.

Senator Grosart: Is our system of ministerial responsibilities, which was recently indicated by a former member of the Cabinet not part of that problem? Conflicting evidence is given the Cabinet by different official advisers in the Public Service; is this a problem?

Dr. Smith: Yes; I would emphasize that it is not simply a problem of the Canadian federal Government, to which you may refer. It is a problem in the world today for all governments. Government policies and programs in Canada, federal, provincial and municipal, and those in other countries have become much more complex. There are larger questions arising with reference to achieving adequate coherence, synthesis and interrelationships among these when the policies and their effects may be interrelated in a great variety of very complicated ways. How we get an adequate coherence is, I think, a very important issue. Large corporations face the same issue too, with multiple activities in various fields. They face the same kind of issue about how to get coherence, how to bring the various elements of planning together into a meaningful whole.

Senator Grosart: We used to hear a great deal about essential polarity between what was called the trade and commerce approach and the Department of Finance approach, particularly before its annual budget—should it be expansionist or should it be restrictive. Other countries seem to have solved this by developing a central mechanism for economic advice. Are you suggesting that in addition to this independent institute there should be a central government mechanism for analyzing and synthesizing this advice?

Dr. Smith: We have a number of mechanisms in operation now.

Senator Grosart: Perhaps that is the trouble.

Dr. Smith: If I may take the federal Government for a moment, we have Cabinet committees; we have a variety

of interdepartmental committees; we have the Treasury Board; we have certain kinds of reviews of various things in a broader context undertaken in the Department of Finance; we have the Privy Council Office; we have a number of institutional structures that exist and that to some extent in fact look at these matters. I think the question of how we can improve on these structures is a very important one. I do not have any easy solution to it.

Senator Grosart: Dr. Smith, has anybody attempted to formulate any kind of a set of criteria to determine the responsibility for performance goals, both economic and societal, as between the public and private sectors? I ask that because there are some who say that the public sector is assuming responsibilities, for example in health, that would be better left to the private sector. Has anybody attempted to formulate a set of criteria by which some judgment might be made in this area?

Dr. Smith: No, sir, not that I know of. Perhaps I could add one other thing that I think is perhaps significant in this context, and also in the context of the broader question you asked earlier. Here again we have a number of institutional elements that we have developed in the public-private relationship area. I suppose in a sense the Economic Council brings together a great variety of people from private sectors, but it operates very much in a public way and has been asked to be concerned about operating in the broad public interest for Canadians. We also have in Canada a variety of committees and councils that have been established, in some cases attached to a minister to advise him or assist him, sometimes in a broader way. This is another area where we probably need to have a look.

Recently the Economic Council published a study by one of our staff members, Mr. Malles, looking at the economic consultative bodies and the arrangements that exist in a variety of other countries, just to bring these together, to bring together some up-to-date information on these and how they work. Strangely enough, this study has received virtually no public attention in Canada. It has received quite a lot of attention abroad, where there has been quite a lot of interest in it, because no study like this has been done before. It is a very useful and interesting study, I think, in some ways, and may provide the background at least for asking some questions about whether consultative economic institutions may need some further evolution in Canada, but I do not have any particular views about them.

Dr. Gillies: Going back for a second to the discussion of rising expectations and the possibility that they can be translated into wage increase elements that are substantially higher than productivity, fo you foresee the result of this will be that we may be living in a society of gently rising prices for a long period of time?

Dr. Smith: I am not sure. If in fact there may have been changes in expectations. If we have come to a stage where there is a broad pressure throughout our system, not only on the part of individuals but on the part of business firms, institutions, universities, health care institutions, also governments, that they all want access to more and more resources and are prepared to press very hard for these, then we have a kind of environment, a kind of climate, that will be difficult in which to operate. This is one of the major points Professor Myrdal made when he was in Ottawa last year; he was concerned about this fact, that people seemed to be demanding more and more out of an economic system without recognizing adequately that the resources we have available are limited, and that we can only make progress in total in relation to the resources we have and the productivity, the increased efficiency, with which we use the resources.

In the shorter term, I think I would have some hopes that we may have been through a rather bad patch in Canada, when with the slowdown in the economy the productive performance was not so good, as I illustrated on the manufacturing chart this morning, and when we were still getting to some extent pressures for wage and salary increases that both reflected the inflation that was stronger earlier and lagged developments to earlier things. We may conceivably now have a little easier time if our productivity picks up with expansion, as it often has done in the past, and if at the same time, again with lags, we begin to get a little moderation in our income increases.

I think one of the most interesting things one can see in the base wage rate settlements in the past year is that, while the overall rates are still pretty high, the first quarter figures were released yesterday and are down a little, being slightly below the rates of increase in any of the five preceding quarters. In addition to that, they are becoming what we call more "front-end loaded". The increases are still very high in the first year of three-year contracts. They are now relatively low for the second, and even lower for the third. We may already be seeing a pattern emerge in which the wage increases working through the system over the next two or three years may moderate.

Senator Nichol: I understand we are meeting again tomorrow morning, Mr. Chairman.

The Chairman: That is correct, at 10 o'clock.

Senator Nichol: Presumably tomorrow we will go into some of the rest of your brief?

Dr. Smith: I am at your disposal.

Senator Nichol: Perhaps you could give us something to think about overnight. I think the most significant part of what you have said is on page 12, where you say the policy formulation must be future-oriented instead of using what you call reactive policies, which, coupled with the lags we are talking about, produces the effect at times of shooting at ducks that are almost out of range before you pull the trigger. Could you talk for a moment about the question of "future-oriented policy" as opposed to what critics might say we have had in recent years, or always have had I guess is the better way to put it.

Dr. Smith: This has been one of our views in the council, and we have applied it to various areas. I think here we touch in part on the monetary and fiscal areas. There is a tendency, much more marked earlier, for policies to operate essentially in a reactive way. You wait

until you see the whites of the eyes in one way or the other of a serious instability problem, or significant slack developing, before policy gets changed. Then policy operates with a lag, and by the time it produces its effects it may not be the right kind, and perhaps not even in the right direction.

There are many other areas in which this is true too. I think we should have been able to do a better job earlier in anticipating the kind of expansion that was really going to be required in Canada in our educational system. It is not very well known generally, I find, but in Canada, as late as 1951, at the time of the 1951 census, we had less than half of our 14- to 17-years olds in school. We had more than half of our young people dropping out in this age group. This is something we obviously were going to have to build up, and we should have been working at it earlier. The Americans, in fact, were working at it more in the twenties and thirties. We rather let our secondary school system go in that period and concentrated on getting most of our young people just through elementary school

The Chairman: Was that, in your judgment, simply due to the fact that the American federal Government has much more say in education than is the case in Canada?

Dr. Smith: I think the governmental factors may have had some important role to play, particularly in the circumstances in Canada in which the provincial governments came under very great financial pressures in relation to their responsibilities, not just in the depression of the thirties, but even in the twenties, and we did not have a system that really adapted very readily to shifting resources to areas of important responsibilities. But that may also be related to the fact that we did not have the sort of plan, the kind of longer term horizon, the kind of vision for seeing what needed to be done. I think really what I am saying is that we need more of that, and then perhaps we can adapt some of the other developments towards that end.

We should have anticipated sooner the need for a further build-up at the higher levels of education. We have done it in a great swoosh in the 1960's, very rapidly.

Similarly, we drew attention in one of our reviews to the area of pollution. There is no question, if one looks forward over the next 10 to 20 years, that we are going to have to allocate very large resources to dealing with environmental and pollution problems. I think it is very important now to begin to plan to do that in an orderly sort of way. We need to start, probably, quite far back, with the manpower side of it. One of the first things we are going to need in devoting more resources to this is to start on the manpower side. I do not know what our situation is in Canada, but someone told me the other day that in the United States last year they graduated only 80 people specially qualified to be sewage engineers. We are going to have to cope with a very rapidly expanding program here, and we are going to need large increases in resources.

With regard to our urban areas, here again I think we need a much longer horizon of view as to where we are going, what are going to be the kinds of problems; and again, all the way back into the manpower area. Up until very recently we had virtually no capacity in Canada for training young people to move into municipal administration. This is one of the critical areas of requirement for good, highly trained and qualified manpower. This is the sort of thing we had in mind.

Different areas will require different kinds of planning horizons: if you are going to be dealing with urban problems and areas, you need very long horizons; if you are going to be dealing with an educational system, you need horizons that are going to stretch maybe to a 5 to 10-year sort of range. These are some of the sorts of things we had in mind about future orientation.

Senator Nichol: As I read it, you were also talking about—quite aside from these, which are mostly sociological examples—the specific field of economic policy formation. This is what you were really thinking about, I suspect, when you wrote that sentence.

Dr. Smith: Yes.

Senator Nichol: I see your point exactly, and I think you are right. The thing I have been grappling with in my mind here is how this works. How do we do it? Within what sort of structure can this function? I guess this is what we are sitting here for, Mr. Chairman.

The Chairman: Perhaps, Senator Nichol, that could be the opening question for tomorrow, because I imagine you would want to expand for some time on that.

Dr. Smith: All right.

The Chairman: Would that be satisfactory?

Senator Nichol: That is a deal!

Senator Isnor: I was wondering if Dr. Smith could tell us as to whether the studies of the Council centered around Canada and the various provinces and their problems, as this affects them, in their relationship one with the other.

I have in mind particularly, as I mentioned yesterday, the Maritimes and the markets we should have in central Canada for some of our products. Have you made any study of the problems affecting us in the Maritimes?

Dr. Smith: Senator, we have been asked in our act to undertake consultation with officials of provincial agencies, and we do this from time to time. In any year there is a number of consultations with provincial people, sometimes with provincial premiers in the Maritimes and some of their colleagues and senior officials. I will be going down shortly for consultations of this kind with three Maritime provincial premiers. In the course of such discussions, we have found that there are two things that are very valuable. First of all, I think we have been able to set out certain information, certain kinds of views that they have found relevant and useful.

Senator Isnor: Such as?

Dr. Smith: Well, views about how the national economy was operating, and some of the implications of this

for their areas, for example. Then there are some of our views about federal Government policy approaches in a regional area. For example, we had quite a number of consultations following our Fifth Annual Review, when we devoted a whole chapter to the regional impact of federal policies.

At the same time we ourselves derive considerable advantage from these discussions, because they give us the opportunity to have some first-hand views about problems in the area, the developments in these regions, which are very important for us to take into account in our work, looking at the overall economy.

In the course of our work we have also undertaken some analysis of regional developments and problems in various ways. We started this in our Second Annual Review when we looked at the regional disparities and some of the factors involved in regional income disparities. We have done some monitoring of the developments and the trends in the regional areas, and occasionally we put a chapter in our reviews on that, for example, in the Third Review.

We have also looked at some aspects of structure which have regional implications. For example, we have looked at manpower in primary industries, in the Fourth Annual Review, which had considerable relevance for some regions.

So, in a number of aspects of our work we have been very conscious of regional developments and matters, and continue to be so.

Senator Isnor: Am I right in saying that you suggested that in these areas known as depressed areas people should move to other regions of Canada? If so, I would like you to enlarge on that.

Dr. Smith: No country, I think, in terms of its regional problems and regional policies, has arrived at some very simple conclusion—which I expect would be greatly oversimplified, if they ever were to do so—some simple conclusion, that you either move people to jobs or move jobs to people. You always have some combination of both.

In Canada, accordingly, we have supported the use of an assisted mobility program, for example, that would help to adjust people to job opportunities. We have also supported various kinds of measures that would be taken to stimulate productivity in particular in some of the lagging regions and therefore, in effect, provide greater opportunity for industry to develop in these areas.

The Chairman: Honourable senators, Dr. Smith, Dr. Ostry and Dr. Thür will return tomorrow. I know you have many more questions, but with your permission, I should like to adjourn at this time. We will meet again at 4 o'clock to hear from Professor Bellan who has a scheme for taxing the inflationary element of wage and price increases.

The Committee adjourned until 4:00 p.m.

Upon resuming at 4 p.m.:

The Chairman: Honourable senators, in continuing our hearings we have with us today Dr. R. C. Bellan. Dr. Bellan is Dean of the Department of Economics at St. John's College, University of Manitoba. He received his early education in Winnipeg. He took his undergraduate studies at the University of Manitoba. He has his doctorate in philosophy from the Faculty of Political Science, Columbia University.

Following graduation, he made his very specialized knowledge of the city of Winnipeg available in special studies, as this had been the subject of his doctoral dissertation. Following an academic career with emphasis on the ability to correlate economic theory with actual Canadian conditions, the result has been that his *Principles of Economics and the Canadian Economy* went into its third edition in 1967.

He has also written an economics text for high school students, and his outstanding ability to bring together all phases of a subject in a comprehensive theoretical framework is of immense value in pursuing the implications of monetary and fiscal policy.

Dr. Bellan's work has always involved the broadest possible areas, and his conclusions have always been presented with the utmost clarity.

Honourable senators, you have received the brief and the summary of the brief from Dr. Bellan. In his brief he deals with two broad subjects: a means by which it is possible to maintain full employment; and a most interesting concept,—and one in which I know hounourable senators will be most interested—for taxing inflationary wage and price increases.

Dr. Bellan, I will now ask you to make a few opening remarks, and after you have described your concept we can move on to questions.

Dr. R. C. Bellan, Dean of Studies, St. John's College, University of Manitoba: Thank you very much, Mr. Chairman.

First of all, Mr. Chairman and honourable senators, may I say how pleased, gratified and honoured I am to be here. It is an honour for any Canadian economist to appear before you to present his views. I must say that I feel very pleased to have this opportunity because I am strongly convinced that the measures which I propose here, and which I shall set before you, are potentially very useful indeed for our country.

As my brief indicates, I recommend, in effect, a two-sided program—one side to achieve full employment and the other to ensure that we do not experience inflation. The two go together because the fact is that it is really no great trick, when all is said and done, to achieve full employment. We had full employment during the war years as a result of the fact that the government spent enormous amounts of money on the procurement of munitions and the maintenance of the large armed forces we had in those days. So that we have demonstrated that, if the government is prepared to spend enough money in enough ways, we can have full employment.

However, the reason why a good many people say today that we cannot have full employment is that in the context of our times, that is in peacetime, if the government spent money the way it did in wartime, then we would inevitably have a serious degree of inflation. In wartime, when the government spent money the way it

did and procurred or achieved full employment, we did not have inflation because then, of course, we had price and wage controls which ensured that, despite the enormous amount of money being spent and despite the inflationary pressures existing at a time of full employment, everything was kept under restraint. But in peacetime we cannot expect to have wage and price controls, and, even if we instituted them, we could not expect that they would work nearly as well or that they would be as well accepted as they were in wartime. The consequence is that we cannot readily make the assumption that just because the government demonstrated its capacity to arrange for full employment in wartime, this should be duplicated as a matter of course in peacetime.

I suggest to you that we have the kind of problem that would best be illustrated by the following analogy. It is as though I had an automobile which could be made to go at 60 miles per hour because the engine was perfectly capable of driving at that speed. But at the same time, I had no brakes or very poor brakes, with the result that I did not dare to drive that automobile at the speed of which it was capable or, for that matter, at any speed in excess of 10 miles an hour because, if I were to drive it faster than that, the lack of braking power would lead to grave difficulty when it came to stopping. If I could get those brakes fixed, or if I could install a decent set of brakes, then I could operate the vehicle at 60 miles per hour, but until I get those brakes I dare not go beyond 10 miles per hour. I suggest to you that that is the kind of problem with which we are now faced. We have the same problem as the motorist whose car could go at 60 miles an hour but because of poor brakes, dare not go beyond 10 miles per hour.

This is why, to translate my illustration into the economic context, we could have full employment and it would be perfectly possible for the government to spend enormous sums of money and have full employment, but we do not have the brakes. The consequence of such an action by the government today would be an impossible degree of inflation. This is why I feel that the program I present must necessarily be taken as one piece; the two halves must be taken together.

The first part of my program is really an obvious kind of demonstration of how we could achieve full employment if a decision were taken to do so. I suggest that the most rational way of proceeding to achieve full employment in Canada would be if we were to decide that within a matter of three months we wanted to have everybody working in Canada—and this would not be an impossible order; we could achieve it. But the way we would have to proceed, I suggest, would be this: we would have to survey the unemployed, see who is unemployed, see what skills and what capacities those people possess, and see in what part of the country they exist. At the same time, we would have to carry out a survey of our economy to see what industries we have and what work is being done in all parts of the country and, looking at our economy, see what additional work could usefully be done. Here I am referring to additional work, over and above anything being done now. Then we would have to see how this additional work that could usefully be done in the country could be brought into existence and could be translated into jobs through government action.

To cite the illustration I used in my brief, it is obvious that if we wanted to create additional jobs in the construction industry, then the government would be perfectly capable of engineering such jobs by spending more money on construction, by making more money available to the contractors of Canada to enable them to build more houses, by having CMHC disburse its funds more liberally. On the other hand, the government could arrange for an increase in the scale of road construction in Canada by making larger grants to the provinces for that purpose. If the government wished to arrange for an increase in the jobs existing in Canada in factories making clothes or processing foods, if it were to reduce the personal income tax, then the probable result would be an increase in such jobs because then the ordinary member of the public would have more money to spend and he would buy more clothes, more canned goods. Therefore there would be more jobs in the factories which make clothes and the factories which make canned goods. So here we have jobs which are within the capacity of the government to arrange.

However, this is not true of al kinds of jobs. I suggest, for instance, that if we were to decide that it would be a very good thing to have more jobs available in, let us say, the copper mining industry, then it would not be possible for the government to bring about an increase in such jobs, because you could only increase the amount of work done in the mining industry if there were an increase in the world demand for Canada's copper, and the Canadian Government is in no position to determine what the world demand is going to be for our copper. So here is an area in which the Government of Canada is in effect powerless. It is not really in a position to arrange for additional jobs in the Canadian copper-mining industry in the same way that it could arrange for jobs in road construction, building, the clothing industry or the food processing industry.

What I suggest, therefore, is that having regard to the kind of jobs that could be created by the government and through government spending in the right way, what we ought to do is to arrange that the government take whatever action is necessary and spend whatever money is necessary to bring into being the jobs which could be done by people who are unemployed, jobs which would enable them to work in the most productive way of which they are capable.

Therefore, if the government adopted this attitude, we could arrange that the people who are now unemployed could be put to work at the best jobs that could be arranged for them. It could well be that we would still be unhappy with the jobs that they were doing, but this would be the best that could be arranged in the circumstances. And that, after all, is the most realistic target we can set for ourselves, and it is what we must be content with.

Taking it a step further, I would suggest that if we were to adopt this attitude, and were determined to achieve full employment virtually immediately, then,

having achieved it—and I am confident that it could be quickly achieved if we adopted this procedure—the next step would be to express dissatisfaction because we would inevitably find that the Canadian work force was not deployed in the best possible way. Then, looking at where our people were working and what they were doing, we would very quickly decide that some of our people who were working could be better employed because they were capable of more demanding and more productive work, and we would therefore want to rearrange our work force so that everybody would be working. But what we would like to achieve now would be a better and a more productive distribution of work, and not to be content with the fact that everybody had a job. We would now have to try to achieve a situation where everybody had the best possible job in which he could make the best possible contribution to the Canadian economy.

Finally, I would suggest that we adopt this kind of attitude on a permanent basis. I suggest that we ought to develop what are, in effect, contingency plans to assure jobs at all times. That is to say, we should envisage the possibility that at some future date a major firm in a larger city might experience difficulty, for whatever reason, through finding that a large market has suddenly disappeared or that new technology has suddenly come upon the scene, which would mean that its product is no longer required; or it may be that the firm has decided that it is economic to consolidate its operations in some other part of the country. For whatever reason, we may suddenly find that several hundred people are thrown out of work in one of our Canadian cities.

I would urge that we should envisage this kind of possibility and develop a set of contingency plans which could be implemented at any time, so that if indeed a major industry in, say, Toronto, Montreal, Winnipeg or Vancouver suddenly announces that it has to lay off 500 employees for any reason, we would be prepared for that and we would have a plan almost immediately for the productive employment of those workers who have been laid off, so that either they would not need to be unemployed or their period of unemployment would be brief. Very quickly we would absorb them into other employment we had arranged on a contingency basis and which we would implement the moment it had to be drawn on.

Those are the suggestions that I have to make regarding how we can achieve the objective of full employment.

I have said nothing about inflation. If I were to stop at this stage I could be criticized, and rightly so, for ignoring the fact that each one of the proposals that I have made have strong inflationary implications.

We must now see what we can do, in effect, about developing a good set of brakes, so that we can safely apply the kind of measures that I have just described.

Senator Choquette: Do the provinces come in on that program? You seem to put the whole burden on the federal Government and seem to think that everybody would be quite happy. Would not the nine or ten provinces have some say in it and some plans that would be acceptable to people?

Dr. Bellan: Quite. I merely say that the money would ultimately have to come from the federal Government, but certainly the decision on what should be done, what plans should be developed, should be developed in conjunction with the provinces, by all means. I should have made that clearer.

Senator Beaubien: The chemical industry is closing four plants right now, largely because we did away with tariffs and the value of our money has risen compared to that of Americans. Among them they are laying off 600 or 700 men. What do you suggest we should do there?

Dr. Bellan: Sitting here at this moment, I have not thought about the possibility. I would say that we should have had our economists, in Ottawa and the provinces where these chemical plants are located, sitting down beforehand and envisaging the possibility of employment for the several hundred oil workers who were laid off, envisaging the kind of productive job that could be done by men with experience in the chemical industry, so that the moment those men were laid off we could have arranged for those jobs to be made available, and the men over a very short transition period could have shifted to those other jobs. What those jobs would be, I cannot tell at the moment, but I am confident that if you had instructed me or other economists to do this sort of thing, it could have been done.

Senator Beaubien: Would we not be drawn into a complete control of the economy?

Dr. Bellan: No. There would be no obligation on the part of any worker to take any job offered him; there would simply be the opportunity. If you offered a worker a job and he said, "I do not want to work there," then that is his right, but the job is there.

Senator Laird: Do we not run up against a very practical problem, in that it is easy to say, "Shift the workers around from one spot to another," but they have established themselves in their homes and they simply will not go. I seem to recall, and my friend Senator Urquhart will verify this, that in the case of Cape Breton a serious attempt was made to move people about, but they would not go. Is that not right?

Senator Urquhart: Yes.

Senator Langlois: They moved, but they went back.

Dr. Bellan: I will not quarrel with that. If people insist on staying in Cape Breton, then we should find productive work for them in Cape Breton. I would be quite prepared to accept that.

Senator Laird: At Government expense, because obviously this system of yours would kill private initiative.

Dr. Bellan: If they are to be unemployed, they will be living at Government expense anyhow.

Senator McLean: Senator Beaubien spoke about the fact that chemical companies are laying off people and shutting down plants. Does that relate also to the pulp and paper industry, and is that not connected to the

devaluation of the dollar? Does not all this come back to the paper industry, the chemical industry and to other industries that have to buy Canadian dollars?

Dr. Bellan: That is a complicated issue. I am not attempting at this stage to describe what the causes are. What I suggested in response to Senator Beaubien's question was, in effect, that whatever the cause of the difficulties of the chemical industry, here is what we might do to help workers become employed.

Senator McLean: It will take Government money.

Dr. Bellan: If they are going to be unemployed, then it will involve Government money in the form of welfare cheques or unemployment insurance cheques. I am suggesting that if the Government subsidized a private industry it might see its way clear to employ these people. Government money must be spent, but we would be achieving something. Instead of having these men idle, the spending of Government money would provide them with jobs.

Senator Kinley: The Government's wartime policy of full employment left us with a huge debt. What do you say about that?

Dr. Bellan: The fact is that one must distinguish between the national debt and the ordinary debt of a private person. The national debt of Canada is not the same thing, because if I am in debt to somebody then it is a real burden on me and I must pay out some of my money to another person who is my creditor. But when we talk about the national debt of Canada we are talking about the debt which the people of Canada owe to themselves. That is a very different proposition from a debt which one owes to another party.

Senator Kinley: They owe it to the country. You have talked about unemployment insurance. Who pays unemployment insurance?

Dr. Bellan: It is contributed partly by the individual and partly by the Government.

Senator Kinley: In other words, somebody pays the shot for everything?

Dr. Bellan: I would not deny that.

Senator Grosart: Before Dr. Bellan goes on to the estimated cost of inflation, has he any estimate of the cost of creating full employment in three months by federal Government funding? I have seen a figure of $60,000 per job.

Dr. Bellan: I carried out this little paper exercise in the year 1965. I did the sort of thing that I have described in my book. I obtained from the National Employment Service the figures of unemployed in greater Winnipeg during the calendar year 1964. Their records indicated that at the end of January there were in Winnipeg so many carpenters, bricklayers, unskilled labourers and other categories unemployed. The same figures were available for the months of February, March, April and the remainder of the year. I used those figures to determine just what the unemployment experience was in greater Winnipeg in the calendar year 1964. It totalled approximately 20,000 man-years of unemployment experienced by men and women. Of course, it was in the form of one person being unemployed for three weeks, another five weeks, another six, and so on.

I and assistants visited business firms and departments of the city, municipal and federal governments inquiring what additional work they might conceivably have undertaken during the year 1964 had the demand existed, and what additional manpower they would have needed. The response to these inquiries indicated the circumstances under which more people would have been hired during 1964. We then determined how the Government could have in fact induced them to do these things and triggered this increase in demand. We compiled a list of projects which the Government might have initiated, sponsored or financed, which, by our reckoning, would have brought into being in the calendar year 1964 20,000 man years of employment. What is more, it would have been the amount and timing of employment required to exactly offset the unemployment experienced.

It was our calculation that this objective would have required an expenditure in the order of $40 million in greater Winnipeg by the federal Government. If the federal Government had spent $40 million in 1964 in the ways we prescribed, there would have been jobs in 1964 for every one of the people who had been unemployed.

Senator Grosart: Surely, that is completely unrealistic. That is at the rate of $2,000 capital expenditure to create one man year of employment.

Dr. Bellan: There is very little capital expenditure.

Senator Beaubien: They do not build plants; they just hire the workers.

Senator Grosart: You are speaking of capital expenditure to provide one man year of employment.

Dr. Bellan: No, there is no capital investment. Remember, we are just considering Winnipeg and forgetting the rest of Canada.

Senator Grosart: But are you not proposing that the Government should give 20,000 people $2,000 a year apiece?

Dr. Bellan: No, not "give" them. If the Government were to reach a decision to build a subway in Winnipeg and spent $5 million during the year on its construction, it would result in the generation of a certain number of jobs. An increase in the Old Age Pension of $15 per month would increase the spending power of old people; they would buy more in the stores, generating more jobs. I am a little hazy on these figures because I have not seen them for some time, but if the Government were to spend $5 million to $10 million on urban renewal in a list of approximately ten different measures mostly in the construction area, the total cost would have been $40 million, which would have generated 20,000 jobs in Winnipeg during the year.

Senator Beaubien: In other words, the jobless would do it?

Dr. Bellan: Yes.

Senator Beaubien: Then, instead of being on the dole, the jobless would work?

Dr. Bellan: That is right.

The Chairman: The point that comes to mind immediately is that that looks after the first year, but the question is: What happens in the second year?

Dr. Bellan: We should do it again.

Senator Molson: My question is parallel to that of Senator Grosart, I am not quarrelling with this thesis at all and I would like to see it work, but I find it very difficult to think that you can provide a substantial number of jobs without an outlay, not necessarily the average amount per job, but on equipment and machinery for the people you can employ. It is rather rare that any plan can be substantially altered to provide increased employment without increased equipment either in plant, machinery, trucks or handling equipment. It may be well below average, but there must be some increased outlay of a capital nature to take care of any substantial number of men. Do you not think, Professor Bellan, that this is so?

Dr. Bellan: It varies from industry to industry, of course. To employ more people in oil refining in Canada would require an outlay of about $100,000 per worker.

This illustration is referred to in the brief. At the University of Manitoba for the last two years we have instituted a program to provide summer jobs for students because we are very concerned about the problem of summer unemployment. In 1969 we introduced a scheme on a limited basis because of shortage of funds. We received $50,000—$25,000 from the university and $25,000 from the provincial government. This money was used to hire students to act as professors' aides during the summer months. A very large number of our professors are engaged in research projects and naturally carry out the bulk of them during the summer when they are not teaching. We circulated a questionnaire to all members of the teaching staff of the university, asking them if they could productively employ the services of a student during the summer for low-level assistance. It would have to be simple clerical work or physical assistance in the laboratory. We received a very large number of replies, several hundred of which were positive. We hired 100 students, had them work 10 weeks each, paid them $50 a week and allocated one student to each professor who had indicated a need. There was no capital outlay whatsoever, not one cent. Last year we repeated the program, but changed the format a little. The work period was reduced to six weeks and we hired 150 students on that basis.

Senator Molson: At the same rate?

Dr. Bellan: No, we paid $55 a week.

Senator Grosart: Inflation!

Dr. Bellan: Inflation, right. We circulated the questionnaire this year in February. Based on the replies, we decided that we could employ 800 students as professors' assistants at the University of Manitoba this summer helping them with research projects. It would not be necessary to spend five cents on capital equipment, which is all there; all we need is the money to pay the students' salaries.

Senator Grosart: Was this for six weeks again?

Dr. Bellan: In some cases it was for six weeks; in other cases the professors said they could employ them for 15 weeks. It therefore depends on the industry.

Senator Grosart: Can you think of anybody in Canada who would not be willing to have low-level assistance for the summer if somebody else would pay for it?

Senator Molson: Or perhaps at $50 a week.

Senator Grosart: Or at $50 a week.

Dr. Bellan: The point I am making is this. If there is a person who would like to have somebody working for him because there is productive work that person could do, and if there is some person who is unemployed and would like to work, it would be very desirable if we were to bring the two together.

Senator Grosart: And then have Parkinson's law operate.

Senator Nichol: Looking at your proposal, I find that I cannot disagree at all with your first concern, which is that it would be desirable to have everybody in Canada who needed a job to have one. Neither can I disagree with the argument that we are quite capable of doing this; it is certainly within our power to do so. I agree with you, too, that contingency plans are an extremely good idea, because I know of mines, for instance, which are not owned in Canada but which are owned in the United States, and if the price of the given metal drops they shut the mines down. Everybody knows the price some day will drop; they shut down the mine, and then there is a big panic as to what these individuals are going to do.

Dr. Bellan: Right.

Senator Nichol: Over the years, through manpower mobility programs, make-work projects, and all kinds of things that go back to the days of Franklin Roosevelt, governments have tried to do a lot of the things you described. If we were working in a vacuum, I would say this would all be splendid and no one could argue with it. But the problem this committee is dealing with is how to do, perhaps not exactly what you mean, but close to what you are talking about without runaway inflation in the country.

The aim you describe, that of full employment and a good job for everybody, is quite right. I think if you spend enough money and bring in enough foreign capital, if you are not concerned about foreign ownership, this is

probably possible. I question the three months. For any government I have ever had anything to do with it would take three months to type up the initial memo. Perhaps within three years it could be done. That is why I would like to get to the question of how you can do all these things, because I am sure we could do them. How do you do them without having the whole thing fly right out of control?

Dr. Bellan: A right, let us see what the brakes ..

The Chairman: I think we have a couple more questions on this from Senator Lamontagne.

Senator Nichol: It will cost one hell of a lot of money. Maybe we should spend it, but you have got to tell us where it comes from, where we should spend it, and how we should buy that idea.

Senator Lamontagne: My question is just supplementary to the proposal that we could go on from one year to the other repeating the operation. What would you do if in the next year we had a different type of unemployment? Then we would have to change the programs and find new kinds of jobs.

Dr. Bellan: Sure.

Senator Lamontagne: From what I have heard, it seems to me the proposal you are putting forward at the moment is to improve the labour market, even by artificial means, to bring the supply and demand close together so as to reduce unemployment in that way. We have, of course, in this country seasonal unemployment; we have frictional unemployment, and frictional unemployment might be cured partly by the kind and number of projects you are talking about, which would, as Senator Nichol has said, create a number of problems for the Ottawa administration. When we get to other types of unemployment, such as cyclical unemployment, I do not think this kind of thing alone could do the job.

Dr. Bellan: May I make this point in reply to your criticism? I would suggest the situation is as though we have 100 people who want jobs; 95 can do work "A", three can do work "B", and two can do work "C." The way our economy is operating, what is happening, I would say, is that we are creating right now 95 "A"-type jobs, and that is all. The consequence is that the three people capable of doing only "B"-type work and the two capable of doing only "C"-type work have no jobs, because they cannot learn to do "A"-type work, or they do not want to move to where "A"-type work is available. It may well be that in any case there are only 95 "A"-type jobs, so even if they did move to where "A"-type work, they still would not get jobs because there are only 95 available.

What I am in effect proposing is that the government use its capacities to arrange that there come into being three "B"-type jobs and two "C"-type jobs, so that the "C"-type job people will be able to get the kind of work they are capable of doing, and the "B"-type work people will be able to get the work they are capable of doing. I myself feel that this is not beyond the realm of possibility.

We could achieve a situation so that at all times every Canadian who wanted to work would have the opportunity to get a job that was reasonably related to his capacities. This I do not regard as an impossibility. It is the sort of thing that exists as a matter of course in Sweden, Germany and Switzerland. In those countries there is no unemployment of the sort that we take for granted here. Every Germany, every Swiss and every Swede who wants to work is always able to get a job. He may perhaps for a matter of two or three weeks look around because he is not quite satisfied with what is available, and he might like to look around a little more, but if he wants to work, the job is there.

Senator Beaubien: Is he paid if he does not work?

Dr. Bellan: Yes, they have unemployment insurance, but the job is there. Unemployment in those countries is virtually zero.

Senator Grosart: But are not those jobs created by industry rather than government?

Dr. Bellan: Yes, but there is no reason...

Senator Grosart: If you are talking about Sweden and Siwtzerland, the answer is that industry is creating them.

Dr. Bellan: The answer I would make so that, senator, is that I agree it would be desirable if our industry created those jobs, but if our industry fails to create those jobs there is no reason why we must as a nation sit back and way that is the end of it. It is within the power of government to supplement and to create those jobs. I therefore say, if industry does not do it, rather than have the people unemployed let the government step in and create the jobs.

Senator Grosart: Is not the large part of the problem that the "B" and "C" type jobs are the ones that are being phased out because they are uneconomic, and is this not why we have manpower retraining and so on?

I am just suggesting that the problem is not quite as simple as you suggest, because in times when there was no inflation problem and this very type of thing was tried to some extent, it was not an unqualified success.

Dr. Bellan: Very few successes are completely unqualified. I would not claim, senator, that my arrangements would work perfectly. The only claim I make for them is that they result in a better situation than what we have now.

Senator Grosart: The reason I say "a not unqualified success" is that many of them wound up as work camps—which I am sure you are not suggesting.

Dr. Bellan: No. I think we can do better than that. I am confident that we can draw on our past experience to improve on our past record.

Senator Molson: I want to ask about two other possible roadblocks in the professor's scheme. One is, what is he going to do about minimum wage laws?

Dr. Bellan: There are pgoblems, I admit.

Senator Molson: Something has to give, on one side or the other. Either special provision must be made, or else the laws have to apply. And, of course, if they apply, the whole thing becomes economically out of kilter. The other thing is this: Have you talked to any of the senior union people about this?

From my own experience, I know that temporary work is very carefully measured and watched in industry, and with some justification. Also, if somebody is injected into the work stream, then they, as you know, have to join the union and union rates have to apply. Again, as in the case of the minimum wage, you would have very considerable difficulty with your scheme. How would you get around it?

Dr. Bellan: There are two possibilities, one better than the other. One is where the Government could see that private enterprise might be induced to hire people who are unemployed, but private enterprise is not prepared to pay them the minimum wage. Say that some private firm would be prepared to hire men who were jobless but it could afford to pay them only $1 an hour and the minimum wage was $1.50. Then the Government could say to this private firm, "We will make up the difference. We will give you a subsidiy of 50 cents an hour, so that you will be able to pay these men $1.50, even though you can afford to pay only $1 yourself." That would be one way of handling it. An alternative—and probably, from the administrative point of view and from all points of view, a preferable method—would be for the Government to employ them on some sort of Government project where the issue of how much they are worth, and so on, the problem that they are really not producing a dollar's worth yet the Government is paying them $1.50, does not become too critical. The Government simply pays them $1.50, and that is all there is to it.

Senator Molson: What about the union? There is the minimum wage aspect and it is probably the less complicated, but to put them in beside union workers, there must be a way around that?

Dr. Bellan: They probably would not be employed there. In most instances, you would be taking these people on for kinds of work not now being done by union people.

Senator Molson: Then they could not be in any large company anywhere. Even in transportation, cleaning up or in the fringes, there are practically no large companies, and not many companies, that are not unionized.

Senator Grosart: Or construction workers.
Did nobody call your $50-a-week student "scabs"?

Dr. Bellan: The point I want to make clear here is that they were not displacing anybody. The point is not that they were taking a job away from somebody else. The jobs that we created for them were net additions; those jobs existed over and above all other jobs; so nobody could complain that he was being hurt because those students had that work.

Senator Kinley: Today the Government does quite a job on technical training. If a man works for so many months, he can go there. I know someone who went there and got $90 a week for attending school. He has a wife and family and is paid to attend the technical school, to become a good machinist or to become a good fitter. They are at the program now and it costs a lot of money.

Dr. Bellan: That is very true.

Mr. Chairman, I wonder if I could get on to this second point.

The Chairman: You certainly could. I would just like to ask you one question before you continue. You are talking about the problem of structural supply and demand in the economy, as opposed to aggregate supply and demand.

Dr. Bellan: Both.

The Chairman: Perhaps both, but you are approaching the solution of the problem in a structural manner rather than in creating aggregate demand, as I understand it. You are using the government expenditure to create that structural demand. Let us assume that you succeed in the first year to create that structure. Let us assume that in the second year, as Senator Lamontagne says, the problem shifts. Over a period of years, will you not create a worse structure, that is, an incredibly inefficient structure that is not built on productivity but rather is built on an ad hoc means of creating employment? And will you not suffer down the road? Although you may have solved the problem on the short-run basis, do you not, as you go down the road, create an enormous problem that almost defies solution, except by a terrible shake-up?

Senator Lamontagne: May I ask a supplementary question, which I think follows from what the chairman has just said? I am sure the doctor is aware of this. In the post-war period, or even before that because we were not even trying to do it, we have never succeeded once in the Government as a whole in forecasting a recession, so how can we forecast the kind of unemployment that we will have next year—not only forecast the aggregate unemployment that we will get but also make the kind of detailed forecast of pockets of unemployment throughout the country?

Dr. Bellan: If I may deal with your question, Mr. Chairman, I would say this. We are in a situation something like this, where right now in Canada we have these 100 people looking for work. We have only 95 "A"-type jobs. Roughly speaking, I would say that is our situation in terms of my figures. This means that if, say, the Government merely attempted to increase by 5 per cent what we are doing now, it would not be good enough. If it did that, we would wind up with 100 "A"-type jobs, if we merely increase what we are doing now by 5 per cent. But even if we had 100 "A"-type jobs, that would not serve the purpose of my three people who can do only "B"-type work and my two people who can do only "C"-type work. So we suffer at one and the same time from both an inadequacy in the total number of jobs and a structural problem.

The Chairman: Then what you say is that you have to combine aggregate demand policies with the structural demand policy?

Dr. Bellan: Yes.

The Chairman: Is that not precisely what Manpower and DREE are doing?

Dr. Bellan: No.

The Chairman: Is not that their attempt?

Dr. Bellan: DREE, yes, but Manpower, no. Manpower does not attempt to create jobs. Manpower merely attempts to find out where jobs are; they only seek existing jobs. My argument here is that, given this situation, what is needed is the creation of additional jobs. Here I am saying that we have a situation where we have 100 people looking for work, and we have only 95 jobs. Therefore, 5 additional jobs must be created.

The Chairman: You see your concept as an incremental method?

Dr. Bellan: Yes.

The Chairman: To be applied on top of aggregate demand policies.

Dr. Bellan: Right. We must have five more jobs that exist today and, what is more, these five jobs must be distributed this way: three of them must be "B"-type jobs and two of them must be "C"-type jobs.

Senator Lamontagne: How can you solve your problem for 1972 in 1971?

Dr. Bellan: This procedure could be applied on a contemporaneous basis, senator. The Chairman and you argued, and it certainly is a significant consideration, that if indeed we created, as I am recommending, these three "B"-type jobs and two "C"-type jobs, then you might develop a structure, a pattern, of employment in the country which was not desirable, which hindered the optimum deployment of our labour force, and so on.

I agree that there probably would be difficulties. However, I would insist that even with those difficulties we would be better off than having these five people altogether unemployed. Because, surely, it is not good when these five people are unemployed: we have very bad results; they produce nothing; their capacities and skills deteriorate during the period of unemployment; their mental attitudes deteriorates as well; they become hostile, become prone to criminality and delinquency, and so on.

Even though we may not achieve perfection by providing them with two "C"-type and three "B"-type jobs, we still create a better situation altogether than the situation we would have had if they were just without work.

The Chairman: I think, honourable senators, that we can proceed to Professor Bellan's concept of how he would control the inflationary results of his experiments.

Dr. Bellan: The proposal that I make, honourable senators, to control inflation is basically a very simple one. It is simply that we impose a new tax which would be over and above all existing taxes, and this new tax would be applied only to increases in income from one year to the next. Let us say that last year my income was $10,000, but that this year my university recognizes my "qualities" and gives me an increase of $1,000. I would then be liable to a special tax on this $1,000. I would pay the regular tax on my new income of $11,000, but I would also pay a special tax on this $1,000 increase in my income.

Senator Beaubien: Are you looking at us, Dr. Bellan, and thinking that we might get an increase this year?

Dr. Bellan: No, I am thinking of the people on the other side.

Senator Grosart: The tax system does that now.

Dr. Bellan: Let me show you the logic of this again. Supposing that last year the people of Canada, collectively, had a national income of $70 billion. Supposing that this year we could increase our national income by 5 per cent. In real terms we could actually produce more goods and services this year by a factor of 5 per cent.

The Chairman: What do you define as "national income", The GNP?

Dr. Bellan: No, there is no deflator. The actual figure although I am using the term coincidentally with national income. They are the output of goods and services.

The Chairman: Is there a deflator?

Dr. Bellan: No, there is no deflator. The actual figure for last year's national income was $70 billion. That was the actual value last year as expressed by DBS. Let us say, as I suggest, that this year—because we are a little more skilled, because we have a few more people in Canada and are using a little more capital equipment, and because we manage to put all our unemployed people to work—we achieve a 5 per cent increase in real terms. Well, that would mean that in 1971, with the price level unchanged, we would have a national income of $73.5 billion. Five per cent on $70 billion would be $3.5 billion, with the price level exactly the same. We have increased our real output by 5 per cent and therefore this year we could have a national income of $73.5 billion.

Supposing, however, that we have inflation of the order of 4 per cent. That would mean, therefore, than in 1971 our national income is actually $76.3 billion.

Senator Lamontagne: Before you go on, do you not think that in order to calculate your real gain in output you have to put your national income figure on a per capita basis?

Dr. Bellan: Let me go on without that for the moment, to keep the argument simple, so as to concentrate on what, to me, is the essence. Let us say we have inflation of 4 per cent. If we have this inflation because trade unions got inflationary wage increases, farmers got larger prices for their products in 1971 than in 1970 and businessmen were able to impose higher mark-ups, this means that for these various reasons we wind up with inflation of the order of 4 per cent. The consequence of

that is that while our real output has increased by only 5 per cent, the money value of our output has increased by 9 per cent. So in money terms, the increase in value of output of $6.3 billion. That is an inflationary figure. And incidentally, this means that the people of Canada, collectively, are going to possess $76.3 billion in income in the year 1971 and, therefore, we are going to experience inflation because here they have $76.3 billion of income which they will be spending on goods of a quantity which is really only worth $73.5 billion.

Senator Lamontagne: You are assuming full employment of resources?

Dr. Bellan: Yes. If we want to eliminate this inflationary purchasing power, what we must do is reduce the total spending power of the people of Canada by $2.8 billion. If we could tax away from the people of Canada $2.8 billion, this would reduce their income in 1971 to $73.5 billion.

That, in turn, would mean that they would have a purchasing power corresponding exactly to our real output, and there would be no inflationary pressure coming from the fact that while we had only produced $73 billion worth of goods, people in fact had $76 billion to spend on those goods.

Senator Beaubien: Before you go any further, doctor, would you apply that to each individual taxpayer?

Dr. Bellan: To everybody who had achieved an increase.

Senator Beaubien: So if I achieved an increase of 10 per cent in the year, my real income would in fact never change?

Dr. Bellan: No, no, that is not what I mean. Canadians collectively would have achieved an increase of $6.3 billion. Therefore, we would apply this tax of mine only to those Canadians who shared in this increase, and we would take away $2.8 billion from the people who had got the $6.3 billion so they would be left with $3.5 billion.

Senator Urquhart: When would you tax them?

Dr. Bellan: When they pay their taxes.

Senator Urquhart: But if the 1971 figure were $76.3 billion, then that would be your inflation and they would not be taxed until the following year.

Dr. Bellan: Well, it could be done on a monthly or a quarterly basis to keep current.

Senator Urquhart: But you would not know what the inflation was until the end of the year.

Dr. Bellan: You would have to make estimates of that.

Senator Beaubien: But, doctor, supposing I was getting $40,000 a year in 1970 and then in 1971 I got $50,000, how would you apply it then?

Dr. Bellan: You would have to pay the tax on that $10,000.

Senator Beaubien: That would be 6.3 per cent on the $10,0000?

Dr. Bellan: No. Let me put it this way: all Canadians together would have got $6.3 billion more in 1971 than they had in 1970, but the tax would be applied only to those Canadians who got the increase, and we would take away from those a total amount which would come out to $2.8 billion.

Senator Beaubien: Then you would have to work it out.

Dr. Bellan: Right, and the schedule I would recommend as being objective and fair would be one whereby, if a poor man got an increase, you would tax it very lightly. Let us take the case of a man who is earning $5,000 a year. If he got a 10 per cent increase, that would bring him to $5,500 a year, and then you would impose a tax to the extent of 5 per cent, or something like that. But then in the case of a man getting $40,000 a year who gets a 10 per cent increase, then you would tax him at the rate of 70, 80 or 90 per cent. So then the bulk of this $2.8 billion that you want to take away from the people who had got the $6.3 billion increase would come mostly from the well-to-do people.

Senator Beaubien: Then if you were getting $40,000 a year no matter how much you worked, it would not be worthwhile.

Dr. Bellan: I will deal with that later on.

Senator Lamontagne: I think you are forgetting two things here. First of all, you are forgetting the change in the velocity of money because here you are just taking money out of the system, but you can get inflation also if the velocity of money increases. If you do not consider this, you are refusing to accept the universally accepted equation about the supply of money in circulation and its velocity, because it is money in circulation multiplied by its velocity. Otherwise you come back to the Social Credit system and it seems to be the main weakness of the Social Credit theory, in my view, that they do not take into account the velocity of money. You can get an inflationary situation from an increase in the velocity of money as well as from an increase in the quantity of money in circulation. That is my first point.

Then the second point I want to make is that I think you have not taken sufficient account of the fact that if you are going to tax the rich much more than the poor, there is also the universally accepted principle that the propensity to consume of the rich is much lower than the propensity to consume of the poor, in relative terms, so that you might get from this kind of tax the amount you mention without rectifying the situation at all.

Dr. Bellan: It is possible. With regard to your first point, I would say that if, indeed, there is a change in the velocity of circulation, then one must simply allow for it. That is all.

Senator Lamontagne: And in terms of full employment, as you assume, you will also have to assume that the velocity of money will increase.

Dr. Bellan: Even allowing for the velocity of circulation, you still impose whatever tax will produce this result and will reduce spending power to a figure that is non-inflationary.

Senator Nichol: Doctor Bellan, with respect, I cannot see in this proposal of yours what is really basically new. First of all, and correct me if I am wrong, you have a major full employment policy consisting basically of government expenditures, presumably subsidies, make-work projects, manpower policies, encouragement to industries, construction of roads, and so on. Then having done that, you apply to an expanding economy what is essentially a graduated income tax.

Dr. Bellan: It is not that.

Senator Nichol: Well, it is not quite that, and here we may be playing with words, but actually that is what you are doing because you are saying that the more money a person makes, the more you are going to take from him, which is perhaps what we have been doing unsuccessfully for a long, long time.

Dr. Bellan: I cannot agree with you, senator, because, you see, the critical point here is...

Senator Lamontagne: It is a graduated income tax on that additional income.

Senator Nichol: It is a sophisticated burden on the graduated income.

The Chairman: Is it not at least a transfer tax? You say you transfer it to those who enjoy large incomes so that you will not hit the people who have lower incomes. Has that not become a classic case of what Senator Nichol calls a high-rate transfer tax?

Senator Nichol: This is what everybody has been trying at all times to do, without success.

Dr. Bellan: May I illustrate my point by using a couple of university professors for the purpose? Let us assume we have two economics professors both of whom are receiving $10,000 a year. Professor "A" does not get a salary increase this year; he stays at $10,000; he pays the regular tax. Professor "B", however, has approached his university president and has demanded that he get an increase of, let us say, $2,000, so this year he gets $12,000 a year.

The point is, however, that he has contributed to inflation, because those two professors previously had a combined purchasing power of $20,000. Now they have a combined purchasing power of $22,000. Supposing we were to decide that we wanted to eliminate the inflationary purchasing power of those two professors and we felt that their combined income should be held to $20,000 as it was last year. We should introduce a new tax of the order of 9 per cent imposed on each of their incomes, so that Professor "A", who is getting $10,000, would have to pay an additional $900 in tax, while Professor "B", who received an increase of $2,000, would pay about $1,100 in tax. That is how you would get the $2,000 out of the system, that I have suggested, to eliminate the inflationary element.

Professor "A" will naturally be very unahppy. That is why I feel that the approach that I adopt, where we apply the tax only to those who have received increases, eliminates the inequity of imposing taxation on those who did not received increases but who would be made to suffer because other people did receive increases.

If we apply the tax only to those who have received increases, then we are taxing only those who are responsible for inflation and we are not burdening those who are not responsible for inflation.

Senator Nichol: You are presupposing that those two men are equally competent and productive. It may be that "Mr. $10,000" is an idiot and is not worth $3,000, and that "Mr. $12,000," in terms of producing goods for Canada, may be worth much more.

Dr. Bellan: I cannot accept that a Professor of Economics would be an idiot.

Senator Nichol: I thought that we were talking about one of those other groups.

Senator Beaubien: If you got $40,000, you could not get any more, according to you.

Dr. Bellan: I did not say that you would be taxed 100 per cent. It would depend on the way it was worked.

Senator Nichol: I agree that it is not the same as a graduated income tax but, in effect, it is very close to the effect of a graduated income tax. I do not really see the difference between what you are proposing in terms of this massive job program, plus a graduated income tax to pull off the demand-pull side of inflation.

Dr. Bellan: I have not yet finished my argument.

Senator Sparrow: You want to recapture the $2.8 billion and you suggest that you would tax 89 per cent of the higher income brackets, but you would tax the lower income brackets, say, 5 per cent. I do not know how you can relate that, when the smaller income earner is in the 70 per cent bracket. Those in the higher income tax brackets represent a small percentage of total income earners. To recapture the 100 per cent you would have to tax well over 100 per cent the higher income brackets to recapture that $2.8 billion.

Dr. Bellan: Nobody would be taxed at over 100 per cent.

Senator Sparrow: Then there is no way that you could get back the $2.8 billion?

Dr. Bellan: Oh, yes. You are taking $2.8 billion from people who got a total of $6.3 billion. Collectively, they would be left with $3.5 billion after you had taken the tax. Perhaps you would have to adjust it. I said that you would only tax poor people at the rate of 5 per cent. Perhaps you would have to tax even the small fellow on his increase at the rate of 10 or 15 per cent. Your accountants would have to figure out what would be the appropriate schedule. You could certainly rig it so that you imposed a lower rate of tax on the poor fellow and a higher rate on the rich fellow. What would be the exact rates, I could not tell you right now.

Senator Bourque: When we read the table of income tax there is a rate there that says that the rate from $4,000 to $6,000 is 20 per cent. From $10,000 to $12,000, which is the figure we are speaking about, it may be the same rate or perhaps 30 per cent. How can you differentiate? Where does that $2,000 come in? The rate says 30 per cent.

Dr. Bellan: If last year you had an income of $10,000 and in 1971 you had an income of $12,000, then in 1971 you would pay the regular tax on the basis of an income of $12,000 and, in addition, you would pay a special tax on the $2,000 difference. The scale of that tax would have to be worked out.

As I sugggested, if a poor man received an increase in his income you would tax it at a low rate, but if a rich man rreceived an increase you would tax it at a higher rate. If a man received an increase from $10,000 to $12,000 he would pay two taxes, his regular income tax and my tax on the $2,000 increase which he received.

Senator Molson: One thing about the mathematics that disturbs me a little. We find an increase in the national income of 9 per cent, which includes the inflationary element of 4 per cent. That is the only additional tax that we should be talking about. We should not sock Senator Beaubien on the full increase in his salary. It is only that portion of his salary that is a contributor to inflation, which is 4 per cent, so it should only be that 4 per cent that has the additional tax on it.

Dr. Bellan: That would be the idea.

Senator Molson: He could still have an increase at his normal existing rates, but he would have a special tax on the increment which was inflationary.

Dr. Bellan: To follow up the point that you made, Senator Molson, I recognize that some means would be necessary to distinguish an increase attributable to increased effort on the part of the worker, better quality effort or perhaps the acceptance of higher responsibility. Those increases must be distinguished from those which represent merely more money for the same work.

Senator Molson: Yes, an across-the-board increase; it would be very difficult to sort that one out. Across-the-board and merit increases are constantly awarded today.

Dr. Bellan: Yes, I agree that this would be a real problem but, again, as I have acknowledged, my proposal will not bring the millennium. There will be many problems associated with it and its implementation. My only plea is that it is better than the alternatives. As Winston Churchill said of democracy, it is a stupid, inefficient system and all you can say in its favour is that the alternatives are worse.

Senator Langlois: Are we discussing a proposal for a tax, or some kind of compulsory saving?

Dr. Bellan: No, an absolute tax.

Senator Nichol: Assuming that we have done these things, what happens to the money? Do you give a tax rebate?

Dr. Bellan: Right, but a special kind. We have the problem that the cost of production for everything produced in Canada in 1971 is now $76.3 billion. It has the 4 per cent inflation and the 5 per cent real increase built into it. I have so far argued that when the people of Canada receive this $76.3 billion, $2.8 billion should be taxed away so that they are left with only $73.5 billion in purchasing power. At the same time, we must arrange that the total cost of production is kept down to $73.5 billion. If that is not done, how will the people who only have $73.5 billion to spend be able to buy goods whose total cost is $76 billion? That is why I recommend the Government take this $2.8 billion which it has realized through this special tax and distribute it in subsidies to all producers, so that all employers of labour would receive a share.

Senator Beaubien: Tax Free?

Dr. Bellan: Yes. The consequences would be that the producers who had produced goods and services which cost them $76.3 billion would receive a subsidy of $2.8 billion and, therefore, would be able to sell their production for $73.5 billion. This subsidy could be paid to all producers in relation to their payrolls. There are about 7 million workers in Canada, and a subsidy of $2.8 billion would amount to about $400 per worker.

Senator Sparrow: But they have already spent the $76.3 billion.

Dr. Bellan: No.

Senator Sparrow: How will you know the amount of the rebate until the tax is collected so that the refund can be made to the employer of labour? You have to know that they produced or sold $76.3 billion, so it is already spent. The $2.8 billion would be refunded a year late.

Dr. Bellan: No, I suggested that this be done on a quarterly basis. Assuming for a moment that there are approximately 7 million workers in Canada, $2.8 billion...

Senator Isnor: The figure of 7,248,000 is accepted.

Dr. Bellan: That would be $400 per worker. I am suggesting that the Government on January 1 announce that it expects to take in through this anti-inflationary tax one-quarter of $2.8 billion during the next three months and therefore will distribute during that period that sum of money to all employers of labour.

Senator Lamontagne: But that is based on some kind of projection or forecast.

Dr. Bellan: Yes. So, on the basis of my figures of an annual rate, each employer in the country would receive a subsidy of $400 per worker employed.

The Chairman: It seems to me that to reduce that to its simplest equation the employee would be taxed to reward the employer.

Dr. Bellan: No.

Senator Beaubien: Only the people who received the increase would get this.

Dr. Bellan: Only the people who received the increase would have contributed to the $2.8 billion.

The Chairman: Nevertheless, looking at it from the viewpoint of the employee, yes, he got an increase, but that is his income, which is now $11,000. So you impose a tax of 8 per cent and $800 goes, which is split into two parcels of $400 and paid to some employer. That would not be politically feasible, would it?

Dr. Bellan: The point is that the employer would not keep those payments. The fact is that with the subsidy from the Government he would presumably revise his selling prices, which he would be forced to do by competition.

Senator Beaubien: Would you pay the same amount to a man losing money on a factory operation as you would to a man making money in the same type of operation?

Dr. Bellan: That would be a matter for political judgment.

Senator Beaubien: Friends of the Government would do well.

Dr. Bellan: On the average you would pay $400 per worker to each employer. If you decided that some firms were particularly meritorious and should receive $800 and others were not so meritorious and should receive only $200, you could do that.

The Chairman: Meritorious on what basis?

Dr. Bellan: You might decide that firms in a particular region of the country should be given special assistance; particular industries having difficulty; those employing low-paid labour might be given special assistance. There are various criteria whereby such a decision can be made.

Senator Nichol: I wish to make it clear that I am not proposing this, but why would the same end not be achieved by a law which provided—and I am definitely not proposing this—that if you have a wage settlement of, let us say, 50 cents an hour in a new contract only 90 per cent of it should be paid? You can only pay 50 cents an hour. You settle with the union for 50 cents an hour, but the government says that if you settle at 50 cents you can only pay him 40 cents. What you have done is transfer 10 cents from the pocket of the wage-earner to the pocket of the corporation in a very direct way. You are doing the same thing, are you not?

Dr. Bellan: No.

Senator Nichol: You are taking a dime that he would have got and are putting it back in the employer's pocket, so why not take it off him at the time the contract is signed?

Dr. Bellan: Let me pursue my argument. If you followed this procedure, if you paid out in subsidy the $2.8 billion on an average of $400 per worker employed, this would produce the result that all employers collecitvely would now be able to sell their product for only $73.5 billion, which would be non-inflationary, because our real output had gone up to that level. So long as they charged, as they now could do, a total of $73.5 billion we would have no inflation.

The Chairman: But if they did not, you would increase profits by $2.8 billion, if I am correct, taken directly from the employees' pocket.

Dr. Bellan: Sure, but they would not.

Senator Beaubien: Corporation tax would come in.

Dr. Bellan: I discussed this with the operational manager of a large department store. I put the proposition to him, "Suppose your store and those of all your competitors were to get this sum of money, would you be able to keep it?" He said, "Of course not. How could we? Competition would force us to lower our prices corresponding to the amount of the subsidy we are all getting."

The Chairman: But, doctor, is not Senator Nichol basically right? Instead of going through the circle, could you not accomplish the same thing by just saying that wage increases will not exceed a certain productivity amount?

Dr. Bellan: Oh no. Now you are exercising controls; now you are imposing a wage control, which is what I am getting away from.

Senator Nichol: I was not talking about wage control, Mr. Chairman. I was suggesting that the increase is 50 cents an hour and that the government says in terms of control it is not going to be 50 cents, but is only going to be 40 cents.

Dr. Bellan: It is still not good enough, senator, with all due respect.

Senator Nichol: I agree it is not. I am just trying to follow the argument.

Dr. Bellan: The point achieved by my procedure is a dual one, in that while the aggregate cost of all goods and services produced remains the same, at $73.5 billion—which is the proper aggregate, the aggregate you want—individual prices do not remain the same. The fact is that where there had been a sharp increase in cost attributable perhaps to higher mark-ups, or attributable to higher wages, the selling price would go up, but at the same time the selling price of other things would go down, and it would be the decline in the selling price of other things that would serve to offset the increase in the price achieved here.

Dr. James Gillies (Study Director): Is this not really just a pure commodity theory of price determination—that is, that the amount of money at the time in circulation determines prices? If you put that money back in in the form of a subsidy, the general price level is certain to rise again, because the money that goes back and forms

the subsidy will be spent in savings, investments and something else; the total amount in circulation is the same, and the prices will go up the $76.3 billion.

Dr. Bellan: No. The fact is that producers collectively will have incurred, as I have said, a total cost of production of $76.3 billion.

Dr. Gillies: That is the amount of money supplied by the Bank of Canada to finance it.

Dr. Bellan: However you want to call it, the fact is that if you were to consult all producing firms in the country and ask each one what his cost of production was, what his selling price was, and so on, and added up all the results, you would come up with an aggregate figure of $76.3 billion.

Dr. Gillies: Correct, and the Bank of Canada would have to supply funds in relation to the velocity of circulation to finance $76.3 billion.

Dr. Bellan: No, you are introducing an extraneous complication which is not really relevant.

Senator Lamontagne: I think it is extremely relevant, because the supply of money consists of the quantity of money in circulation multiplied by its velocity.

Dr. Bellan: No.

Senator Lamontagne: Well, this is self-evident.

Dr. Bellan: No. The point I am making here is that the producers would have incurred a cost of $76.3 billion. It is true they would have paid that out in the form of wages, rents, interest and profit. The fact that they incurred this cost of $76.3 billion would not oblige them to charge $76.3 billion when they were selling to the public, because they would have the benefit of this subsidy. That is the key point I am making here.

The further point I want to get across, which is crucial, is that while you would be controlling the aggregate in this way, and controlling the aggregate to make sure it was only $76.3 billion, you would not be controlling individual prices; the prices of some goods would go up but the prices of other goods would go down, and it would be the downward movement of some that counteracted the upward movement of others and enabled you to maintain this constant price level.

Dr. Gillies: What would these people who receive the subsidy—which I presume is paid in money, cheques or something—do with it when they got it?

Senator Nichol: Spend it.

Dr. Gillies: Would they put it in the bank?

Dr. Bellan: It would mean they would be enabled to sell for $73.5 billion goods which had cost them $76.3 billion to produce, just as with any producer who gets a subsidy.

Dr. Gillies: But what would they do with the difference? Would they put it in the bank? It does not disappear from the system; it is still in the system.

Dr. Bellan: No, they would pay it out.

Dr. Gillies: Then we would have the same amount of inflation again.

Dr. Bellan: No. Let us follow through your argument. The producers would have taken in a total of $76.3 billion—$73.5 billion in sales to the public, $2.8 billion via subsidy from the government. This is the total amount they pay out to factors of production. That, however, is the inflationary income that is being received by people. Assuming we went on without any further change, that would mean the people who receive that $76.3 billion would be liable to my tax on the extra $2.8 billion, so you would have a continuous round of proceeding on this basis.

The Chairman: What you are doing though, surely, in one way is nullifying the wage increases in a roundabout fashion; you are nullifying the inflationary element of the wage increases in a roundabout fashion?

Dr. Bellan: Yes.

The Chairman: We can agree on that?

Dr. Bellan: But, you see, you are nullifying it in this particular way: you are allowing some prices to rise, those prices which had been particularly subject to the cost-push pressure; you are nullifying the effect of that by bringing down the prices of others. In other words, you are not keeping prices frozen, you are permitting prices to rise, but what you have is a mechanism that ensures that if some prices rise other prices go down.

Senator Langlois: What would you do with the producer whose cost of production has not increased to the same degree as the national average?

Dr. Bellan: He can sell at a lower price because he will be getting the subsidy.

Senator Langlois: What would force him to do that?

Dr. Bellan: Competition would force him.

The Chairman: Suppose you have a highly productive industry that is highly capital intensive, they will not get this subsidy.

Dr. Bellan: That is right. You see, I suggested that the subsidy be related to your wage bill. If you did not like that you could relate it to something else: you could relate it to output; you could say you give the subsidy as a percentage of sales.

The Chairman: I think the point Dr. Gillies is making is that if the initial cause of the inflation is to be found in excess of money supply, by this means you may have nullified the raise for one year, but the engine of inflation, the velocity of the amount of money in circulation, is still there, and will still create the same conditions in the following year.

Dr. Gillies: I can see your argument, if you decide to reduce the supply of money or reduce the velocity in circulation and simply take it right out of the system. But as long as it stays in the system, and if you wish to

argue your case on the basis that inflation is caused by money supply times transaction, as long as MB equals PT in your equation, as long as you keep the money supply as high as necessary to generate your $76.3 billion, you can never bring prices down in the aggregate sense.

Senator Lamontagne: If you add to that the fact that the velocity of money increases as you reach full employment, then you are in an even worse position.

The Chairman: Then we come to the very integral question. The committee can understand how it works one year, but what happens in the second year? Do you validate the inflation of the previous year?

Dr. Bellan: No, with all due respect to Dr. Gillies and Senator Lamontagne, there is no reason why this procedure could not be applied each year, and each year you are able effectively to deal with the situation of that year; that is, each year, you tax whatever is the mount of excess purchasing power that is present that year.

The Chairman: But then you have validated the previous year, have you not?

Dr. Bellan: If you have been carrying on in this way for a period of years, there would be no inflation in the previous year.

Senator Lamontagne: I am afraid we are not understanding each other. My point is that you cannot deal with this problem only by increasing or decreasing the quantity of money. You have also to take care of the velocity of money.

Dr. Bellan: I am not talking, Senator Lamontagne, about the quantity of money, I am talking about gross spending, which is the functional quantity times velocity. So I am taking velocity and quantity implicitly into account, because I am talking only of total spending.

Senator Lamontagne: Not in the kind of example you have given us this afternoon.

Dr. Bellan: Oh, yes. There is no reason why, say, this $73.5 billion, for instance, of total spending—my reduced figure of total spending—could not be achieved with, say, a $10 billion money stock and have a velocity of circulation of 7. I have not said anything about money supply.

Senator Lamontagne: I am referring more to your previous point about your tax. You were supposedly taking a definite quantity of money out of the system.

Dr. Bellan: A quantity of spending power, senator, not necessarily a quantity of money. There is a difference.

Senator Lamontagne: A quantity of money. You deducted how much, $4 billion? I do not remember the figure.

Dr. Bellan: $2.8 billion.

Senator Lamontagne: No, but in the previous example, in order to deal with your special tax.

Dr. Bellan: That was the amount.

Senator Lamontagne: $4 billion?

Dr. Bellan: No. I said in my example the amount of excess purchasing power in the country was $2.8 billion. Therefore, I impose this tax which was calculated to take away $2.8 billion from the public and then transfer it in subsidy to the producers.

Senator Lamontagne: Depending on the velocity of money, it might be $4 billion or $1 billion.

Dr. Bellan: In that case, we simply adjust our procedure to whatever the velocity is, so that allowing for the velocity, we wind up with the result that I want—that is, we take away in tax a sufficient sum so as to leave a non-inflationary aggregate of purchasing power in the hands of the public. This can be achieved. It may be that you would have to make some pretty shrewd calculations about velocity of circulation and so on; nevertheless in principle it can be done.

Senator Bourque: Of course, I am not an economist and I do not understand all the intricacies, but you have up there on the board 7 million workers, and we have not talked about the workers. Say that I am a worker in a company that employs 8,000 people altogether, and that the categories are from floor sweeper to finisher. The floor sweeper may have 8 children and he gets $1.98. Everything goes up for him, the same as for everybody else. If canned goods go up a cent, he has 8 children to feed and it takes a lot of money. When you have brought all this down, how is he going to get a rebate or a return because his cost of living has gone up?

Dr. Bellan: Frankly, senator, he does not get that rebate. The way I have arranged it, that subsidy of $400 per worker that it would work out to, in my example, goes not to the worker but to the employer; and it is used to reduce the selling price of the employer's product. It does not go to increase the incomes of the workers; it is used strictly to bring down selling prices.

Senator Bourque: On the other hand, if I have been a floor sweeper and I have had a lot of trouble to keep my family eating properly and everything, and if there is going to be a division out of a pot of some kind, why should I not get something out, because it has cost me a lot of money to raise my family?

Dr. Bellan: That is another issue, senator. That does not relate to my problem of inflation. I have merely attempted here to deal with the specific issue of inflation. I accept that there are poor people in the country and we should help them, but that is a different issue. I am just trying to solve one problem, and obviously I am having trouble enough solving that one, without taking on more.

Senator Lamontagne: We do, too.

Senator Beaubien: As our work force grows every year, we have to have growth in the economy.

Dr. Bellan: Yes.

Senator Beaubien: Would not that take all the growth out of the economy?

Dr. Bellan: That is a problem. First of all, the growth factor would be allowed for, because if we had real growth as a result of having more workers, that would show up in the fact that we have an increase in our real output. I would not worry about that.

Senator Beaubien: But, doctor, if I am running a business and I make $40,000 this year, work terribly hard to make $50,000 next year. I am putting the growth into it, but according to you I do not get any more. The growth in my business would not be very big.

Dr. Bellan: I have tried to do that. I acknowledge that as a problem, dealing with individuals. I agree that if you instituted an arrangement like this, you would have to have some kind of other arrangement whereby you distinguish between increases in income that are received merely because a man was paid more money for doing the same thing and another man was paid more money because he worked harder, worked longer hours, took on a higher job. We would have to do that. Otherwise, I agree, the fellow who could take a promotion, who could work harder, could say, "To hell with it! I am not going to get anything out of it." We would have to have some means of discriminating between these two reasons for increase in income.

Senator Isnor: Dr. Bellan, have you taken into consideration that you are sending this new money that you are saving to the most prosperous part of the country? There are 7,245,000 workers, roughly speaking. Of that number, 2,800,000 are employed in Ontario, as compared to 520,579 in all the Atlantic provinces. All you have to do is to multiply one factor by the other and you see where the money is going—to Ontario. It is a subsidy you are paying to the most prosperous part of the country.

Dr. Bellan: Well, in answer to that, senator, I said that this would be the average figure. This would be the national average and there would be, if we so decided, nothing to stop the Government from giving only $200 to employers in Ontario and $600 to employers in the Maritimes. If you wanted to achieve that, there is nothing to stop you from doing so.

Senator Nichol: Dr. Bellan, I have been trying to reduce this to what actually happens. Suppose a corporation earns $400,000 a year. Because of this subsidy it would receive a cheque from the Government for $100,000, for example.

Dr. Bellan: Related to its wage bill?

Senator Nichol: Yes. According to your system it would receive, for example, $100,000. The accountant sitting down to work out what happens would write that down in the profit and loss statement of that company as, "Other income, $100,000."

Senator Beaubien: Which is taxable.

Senator Nichol: I presume it is not taxable. In any event, it would be income which would be as good as any other kind of income the company makes. What happens to that $100,000 of income? The company could pay it out as dividends; it could be used to pay off a bank loan or other obligations of the company; it could be left in the bank to accumulate a surplus; or it could be reinvested. My opinion would be that the most likely thing that would happen is that the money would be paid out in dividends. But the union is going to understand exactly what is happening and it is going to ask for its extra 10 per cent on top of that. They would say, "Don't tell us you are only making 'X' dollars. You are making "X" dollars plus what the Government is giving you. In negotiating for wages, we have to compensate for the system. Therefore, we are not going to go for 50 cents; we are going to go for 65 cents."

Dr. Bellan: You left something out.

Senator Nichol: I am sure I left something out. That is why I am asking the question.

Dr. Bellan: You left out the point I am making. This company has earned a profit of $400,000, as you suggested, because they had sales of so much and they had costs of so much and they have earned their profit of $400,000. The Government then gives the company a rebate of $100,000 to be used to bring down the company's selling price by $100,000.

Senator Nichol: You mean that the Government would tell a company to bring down its prices?

Dr. Bellan: Yes.

Senator Nichol: I thought it would be on the basis of the competitive forces.

Dr. Bellan: Well, it would be on the basis of competitive forces, yes. I think we can reasonably assume that competitive forces would have that effect.

The Chairman: Just a moment, now. The cost of those goods is $76 billion.

Dr. Bellan: Yes. That is the cost of production to the employers.

The Chairman: The $2.8 billion goes to the employers. I do not know of an employer, no matter what his competitive position is, who would go out to sell his goods at a loss.

Dr. Bellan: Why would this be a loss? Why would they lose?

Senator Molson: Mr. Chairman, the $76 billion has a profit element in it. Surely that includes a profit element?

Senator Lamontagne: He could not lose under that scheme, Mr. Chairman.

The Chairman: Then let us have a look at what the average profit on sales is. If the after-tax profit on sales is approximately 2 to 2½ per cent, and the percentage of reduction that you were talking of is 4 per cent, then, indeed, you would use up your profit and you would be into a net loss.

Dr. Bellan: With respect, Mr. Chairman, no. I am saying that if the Government did not do anything, if the Government did not give the subsidy, then the producers, collectively, would be charging $73.6 billion. This is their cost of production. As Senator Molson suggested, presumably that includes a reasonable profit for themselves.

The Chairman: Which we say is roughly 2 to 2½ per cent of sales, which would be roughly $1.6 to $1.7 billion.

Dr. Bellan: Roughly. But the point is that if they can sell their output for $76.3 billion they will be happy. This covers their cost and gives them a normal return, and so on. What I am saying is that, if you gave them a subsidy of $2.8 billion, this would enable them to sell to the public for only $73.5 billion, while allowing them to achieve exactly the same profit results as they would have achieved had they been selling to the public for $76.3 billion.

Senator Lamontagne: But suppose part of that rebate goes to Molson's, do you think that the competitive forces there would be active enough to force the Molson company to keep part of that for itself?

Senator Molson: Never! Mr. Chairman, they would not think of keeping any of it. It would all be passed on.

Dr. Bellan: But the rebate would also be going to Labatt.

Senator Beaubien: You said the Government had a certain amount of discretion, so they might give Labatt only half of the rebate.

Senator Lamontagne: This is what we would call in our own jargon an oligopoly. They could phone each other and suggest not reducing their prices.

Senator Molson: Mr. Chairman, I have to object to that. That is quite contrary to Mr. Basford's principles.

The Chairman: I am sure that the two points you made are mutually exclusive.

We will hear from Dr. Gillies.

Dr. Gillies: Mr. Chairman, the point at issue is that, if you have an economy that is producing $76.3 billion, you have to have a money supply to fund that, and it does not really matter where it goes or whether it is subsidized and comes back. Unless that money is taken out of circulation and hoarded, it is going to come back into the system and be an inflationary force, just as it was before. With respect, professor, the only way this could work, which is the ordinary compensatory fiscal system, would be if you wanted to take purchasing power out of society through taxation. Fine. That is what one does under the ordinary system.

Senator Beaubien: It is being taken out, because it reduces the price.

Dr. Gillies: But then it is put back in, and once it goes back in it brings the prices up.

The Chairman: Honourable senators, I will ask Dr. Bellan if he has a concluding statement. I think we should give him the last word.

Dr. Bellan: Thank you very much. Again I might say that it is an honour and a pleasure to be here. I trust that I have had some impact. I might say in defence of my proposition, which I agree has its probable difficulties, that the great virtue that I see is that through applying a scheme along this line we would be able to preserve the basic freedoms, we would not require wage controls, and we would not have to impose price controls. Unions would be free to demand whatever wages they wanted to. Employers or businessmen would be free to impose whatever prices they wanted to. All that we are controlling is, in effect, the aggregate. The sort of situation that I am trying to achieve is one where, if you have an air-filled cushion, for example, you maintain the total quantity of air constant, and, in consequence, if you punch it in one place it will bulge in another, and if you force a bulge in one place then there will be a compensating reduction somewhere else. This is the sort of thing that I am trying to achieve here, to maintain the aggregate purchasing power at a constant rate and the aggregate cost of production at a constant rate, while at the same time leaving room for play in individual prices, individual wages, and so on. And I think that can be achieved.

The Chairman: Dr. Bellan, I might say that you are not alone in suggesting that there is some means of controlling inflation by the use of such tax impositions on the inflationary element in wage and price increases. We have been made aware of this by other people who have been in touch with us, and we are most pleased to have had your presentation. I cannot report, and I think it would be unfair of me if I were to, that the committee is entirely converted to your point of view. Nevertheless, since it is an issue which has been raised by a number of people, and since it is thought by a number of people to be a means of controlling the problem that we are faced with, we thank you very much for your most articulate presentation, and we also thank you for your good nature in enduring some of the grilling to which you have been subjected.

The committee adjourned.

APPENDIX "A"

Brief to the

Standing Senate Committee

on

National Finance May 1971.

Submitted by Arthur J. R. Smith, Chairman, Economic Council of Canada.

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STRONG, STABLE AND WIDELY SHARED ECONOMIC GROWTH

Introduction

We are pleased to be invited to appear before the National Finance Committee of the Senate. Your Committee, in this set of Hearings, is taking an initiative to make a valuable contribution to public discussion of important economic issues in Canada.

It is my understanding, Mr. Chairman, that these Hearings will concern the very important policy questions involved in achieving and maintaining high standards of performance in the Canadian economy. At the outset of your public Hearings on this theme, we welcome the opportunity to provide this Committee with a brief summary of the approach to these matters by the Economic Council of Canada under the terms of reference given to the Council by Parliament.

Policy Innovation—Mid-1930's to Mid-1940's

The human miseries and economic dislocations of the Great Depression in the 1930's produced a growing conviction and consensus that effective means must be found to maintain high employment in the context of strong, stable and widely shared economic growth. Moreover, such conviction and consensus was reinforced as the further dislocations and strains of the Second World War bred uncertainties and fears about postwar reconstruction and readjustment—efars about ensuing inflation, as well as fears about postwar recession, and perhaps even a return to the depressed, stagnant economic conditions of the 1930's.

In these circumstances, the period from the mid-1930's to the mid-1940's was a period of major policy innovation. In this period, for example:

The Bank of Canada was established, and the basis was laid for the evolution of monetary policy as a major instrument for economic stabilization;

New conceptions and techniques of fiscal policy were adopted, involving increased attention to the broad economic effects of changes in levels and patterns of government expenditures, revenues and public debt;

The ground was prepared for the development of new rules for international trade and new mechanisms for an international monetary and payments system; and

Major steps were introduced to improve Canada's social welfare system, as a basis for coping more adequately with the problems of the unemployed, the aged, the disabled and, more generally, the poor.

One can also find in this period, the essential roots of many of the subsequent major developments that have taken place in other fields—greatly accentuated emphasis on education and human resource development: more adequate health care: assistance to the less-developed countries of the world: promotion of research, development and innovation: and increased attention to the deep-seated problems of poverty and regional disparities.

Canada's Postwar Economic Progress

Partly on the basis of the wide-ranging policy innovations that were introduced—many of which were accompanied by important institutional changes—Canada's economic and social progress over the past quarter of a century has exceeded even the most optimistic assessments of the early postwar years. Depression has been avoided. New job creation has been achieved on a huge scale for Canada. Large gains have been achieved in average real incomes of Canadians. Great industrial advances have been attained in conjunction with far-reaching changes in products, services, markets and processes of production. New dimensions of national economic maturity have been reflected in the declining relative importance of net inflows of capital from abroad, as well as in the rising relative importance of the *service* industries and of *urban* activities. And our national life has been enriched in many ways.

Of course, not all of the economic developments of the past quarter century are regarded as being wholly favourable or advantageous. Indeed, public discussion and debate at any point in time tends to focus particularly on problems and instabilities, on current shortfalls from "good performance", and on fears or uncertainties about the future. Yet, to a considerable extent, such discussion and debate often indirectly reflects how much we take "good economic performance" for granted, and how demanding and ambitious our national goals and aspirations have become.

In the late 1950's and early 1960's it did not take a Depression to revitalize concern about how to achieve and sustain high standards of performance in our economy—but merely an extended period of slower growth and the building up, for a time, of significant economic slack. In the late 1960's, it did not take an inflation on the

scale of that of 1948 or 1950-51 to produce extremely vigorous anti-inflationary actions. Moreover, poor economic performance now tends to elicit a search for new policy options and the development of new channels for policy advice—for example, the creation of the National Productivity Council, and subsequently the Economic Council of Canada, against the background of the slow-growth problems a decade ago; and, more recently, against the background of inflationary problems, the Special Reference to the Economic Council in 1965 on the subject of prices, costs, productivity and incomes, the setting up of the Special Joint Committee of the Senate and the House of Commons on Consumer Credit (Prices) in 1966, and the subsequent establishment of the Prices and Incomes Commission in 1969.

The demanding and ambitious aspirations of Canadians in the 1960's were set out in the following terms in the Economic Council's *Third Annual Review:*

> We live in an age of "rising expectations", and the people of Canada have come to expect much from their economy. They expect the kind of economic and social progress which will maintain high employment and generate rapidly rising standards of living in a material way. They also expect the economy to provide growing resources for dealing with social problems and for improving the quality of life. They expect not only to have rapid gains in real incomes, but to have these along with wider choices of job opportunities, improved working conditions, more leisure, greater security from economic hardships, and more adequate means for helping people to adjust to rapidly changing conditions. They expect *steady* advances in real income and wealth, and an avoidance of the setbacks and inequities which in the past have arisen from inflations and prolonged recessions. And they expect that all Canadians should share in the country's social and economic progress. In other words, such progress is not judged to be satisfactory if various segments of the population or regions of the country are left out of the mainstream of the nation's over-all growth and development.

It is obvious that effective progress towards meeting this constellation of demanding and ambitious aspirations of Canadians calls for a major new round of policy innovation.

The Economic Council of Canada

As already indicated above, the Economic Council of Canada was established, at least in part, as a direct consequence of the shortfalls in the economic performance of the Canadian economy in the late 1950's and early 1960's, when we had (in varying combinations) inflation, slow growth, high unemployment, underutilized productive capacity, depressed investment, aggravated problems of poverty and regional economic disparities, and balance-of-payments strains culminating in devaluation and a return to a fixed exchange rate system. Against the background of these conditions and the aspirations for higher standards of economic achievement, Parliament explicitly directed the Economic Council in the terms of reference in its Act,

> "to advise and recommend...how Canada can achieve the highest possible levels of employment and efficient production in order that the country may enjoy a high and consistent rate of economic growth and that all Canadians may share in rising living standards...to recommend what government policies, in the opinion of the Council, will best help to realize the potentialities of growth of the economy; to consider means of strengthening and improving Canada's international financial and trade position;...[and] to study how national economic policies can best foster the balanced economic development of all areas of Canada..."

In other words, the economic Council was established by Parliament as an institutional response to the need for new policy innovation, in part through strengthening the base of information, analysis and advice relevant to the achievement of challenging national economic and social goals. This is not an easy task, especially in a country such as Canada, with its wide regional differences, its substantial and varied links to the economies of other countries, its highly decentralized system of private decision-making, and its constitutional framework in which very important economic policy powers are divided between federal and provincial governments. Nor is it an easy task in the light of the growing complexities in a modern economic and social system, and the difficulties of delineating a consistent set of economic and social goals among which there are very important and complicated interrelationships.

There are no simple or easy answers to such fundamental questions as:

> What are the goals—a *consistent* set of goals—towards which we should seek to strive?
>
> What are Canada's future economic potentialities for growth?
>
> How is the economy performing in relation to its medium-term potentials and goals?
>
> What are the appropriate policy strategies for achieving and maintaining high standards of economic performance in relation to its medium-term potentials and goals?

Basic Performance Goals

These are, however, the central questions to which the Council has directed its attention since its inception in 1963. In doing so, it has kept constantly in mind the five basic economic and social goals embodied in its terms of reference:

full employment,
a high rate of economic growth,
reasonable stability of prices,
a viable balance of payments, and
an equitable distribution of rising incomes.

The Council's Key Functions

Over the past seven years, the Council has sought to mesh the wide-ranging experience and practical judg-

ments of its unique membership with the professional knowledge and competence of its expert staff (and also with outside expertise in many fields) to perform certain key functions:

Clarifying, and to some extent quantifying, the basic economic and social goals embodies in its Act. This has been done periodically in those of its Annual Reviews devoted mainly to setting out Canada's medium-term economic potentialities for growth—the *First, Fourth* and *Sixth Annual Reviews.* Chapter 1 of the *Sixth Annual Review,* which incorporates the recent statement of Council views about these goals, is appended.

Studying, in increasing depth, the way in which our economy works—the sources of growth, the sources of economic instabilities, the country's changing industrial structure, the importance of Canada's international economic relationships, and so forth—as a basis for understanding the possibilities for (and constraints on) making it work better.

Analysing the potentialities for growth—in short, depicting over the medium-term future, what we believe an economically healthy Canadian economy could look like, if reasonably full and increasingly efficient use could be made of its growing human and material resources. These *potentials* are developed within the framework of the basic performance goals mentioned above. A central feature of this endeavour has been to develop *quantitative* measures of such growth potentials, in increasing detail—including estimates of output, employment, capital, productivity and other key elements of growth. Also portrayed has been a possible future pattern of demand (although not the only such pattern), that would be consistent with these productive potentials. The pattern outlined has reflected judgments by the Council about the influence of various forces and factors on future trends in consumer, government, housing, business investment and other spending and in international transactions. (The latest such assessment of medium-term potentials and demand possibilities—to the mid-1970's—was set out in Chapter 2 of the Council's *Sixth Annual Review,* which is appended.)

Monitoring certain key aspects of the economy's performance—for example, growth, employment, price and cost changes and balance-of-payments developments, and assessing regularly each year the progress of the economy in relation to potentials and the basic performance goals to which the Council was asked to direct its attention. (The latest of these assessments was published in October 1970, in a Report entitled *Performance and Potential: Mid-1950's to Mid-1970's,* which is appended; an up-to-date chart review of the Canadian economy will be presented when the Economic Council testifies before the Committee.)

Advising about policies, both government and private—and, occasionally, about programs, institutional changes, information needs and other matters—relevant to achieving and sustaining good prformance in relation to national potentials and goals. The essential focus of the conclusions and recommendations see below) is that they are directed towards attainment of *future* potentials and goals.

Developing wider public understanding, especially as a background for decision-making, about economic issues, problems and policies. To this end, the Council operates in a very open way, publishing a wide range of reports and studies, maintaining close working relations with many other bodies and groups, and arranging and participating in various conferences and meetings across the country.

Key Elements in the Council's Policy Advice

Since the beginning of its work, the Council has recognized that in focusing its attention on the *performance goals* listed above, it is dealing wit *means* and not *ends.* Successful attainment of strong, stable and widely shared growth is not an end in itself. It would merely provide a basis for steadily increasing the resources available to Canadians, both individually and collectively, for meeting rising wants and aspirations. Such growth is essential in circumstances in which we are facing hard choices about how to allocate limited current resources among many escalating and competing claims upon them. At the same time, the Council has drawn special attention to the need for greatly intensified "goals research" into the ends to which our resources are being, or should appropriately be, allocated.

In advising on performance goals, the Council has, in effect, been calling in the 1960's for a major new round of economic policy innovation—innovation that would, at least in some ways, seek to be as far-reaching as that referred to earlier in the 1930's and 1940's. As a basis for such innovation, a number of critically important and interrelated elements have been stressed.

1. Policy formulation should shift from periodic overwhelming concentration on poor performance in relation to one goal at a time—for example, from alternating preoccupation with inflation in one period, to unemployment and slack in another—to the view that full employment, a high rate of growth, reasonable good stability, viability in the balance of payments and equitable income distributions at rising incomes, must be sought *simultaneously, consistently and continuously.* In the absence of such a view at the centre of policy formulation, there are substantial risks that economic policies, far from contributing to good performance in the economy, may themselves contribute to slower long-term growth, more "stop-go" instabilities, a variety of international payments strains and adjustments, and domestic regional and industrial stresses.

2. Policy formulation must become more *future-oriented.* A large component of economic policy formation has essentially been "reactive": policy shifts are made *after* problems have developed or when impending problems are no longer avoidable. Given the typically long lags that exist before policy measures can take effect on the economy—arising from the whole process of recognizing that problems have emerged or are emerging, of taking actions to deal

with them, and of having such actions exert broad effects on the economy—such reactive policies run serious risks of aggravating instability and other problems. What is needed is more attention to policies aimed at *steering* the economy in desirable directions over a number of years into the future.

3. Policy formulation in this context should essentially be *potential-oriented*. The aim should be—within the constraints imposed on Canada by international conditions and forces (and the very important implications these may have for Canada's balance of payments and for price, cost and other aspects of the performance of the Canadian economy)—to keep the economy growing as steadily as possible at its potential *rate* and as close as possible to its potential *level* of output. In other words, the key question to ask in the process of policy formulation is not whether productivity, or prices, or employment, or the balance of payments, or other indicators of performance, should be encouraged to move up or down or sideways, but rather how they should be encouraged to change in relation to what is possible and desirable in terms of the consistent longer-term *potentials* of the economy. To illustrate, an increase of less than 2 per cent a year in employment in the 1950's represented "good" performance, when Canada's labour force was expanding at an average annual rate of about that order of magnitude, but an expansion of employment of 2 per cent a year in 1965-75 would be "poor" performance, inevitably accompanied by rising unemployment and increased economic slack, because Canada's labour force is now expanding at close to 3 per cent a year.

4. Policy formulation must be viewed as encompassing a very wide range of carefully co-ordinated policies to cope adequately with the complex realities of Canada's present economic and social system. Such co-ordination has many dimensions. To be appropriate and effective, it must involve co-ordination of policies within particular governments, as well as between governments and between government and private decision-making (see below).

There are no simple prescriptions for assuring good performance in relation to ambitious and complex goals. In particular, too much attention tends to get focused in public discussion and debate on the role of demand management policies—monetary and fiscal policy—and not enough on their implications for a need to be complemented by a wide range of other policies that must be better developed to play important roles. In its work, the Council has placed very heavy emphasis on the importance of many of these other policies.

Monetary and fiscal policies do not tend to play a direct role in stimulating productivity growth, although correct settings for them are an indispensable precondition for the success of productivity-stimulating policies. Nor do sharp shifts in monetary and fiscal policies encourage progress toward the *simultaneous* reconciliation of high employment and price stability. Although they tend to operate with substantial time lags, shifts to vigorously restraining monetary and fiscal policies constitute a powerful means for curbing inflation—but at the cost, initially, of significant unemployment and slack, and perhaps ultimately of some permanent loss of growth potential. Similarly, allowing again for long time lags, shifts to expansionary demand policies constitute a powerful means for reducing economic slack, although a serious risk is entailed that large-scale monetary expansion and stimulation of demand would set the stage for economic costs associated with a subsequent surge and prices and costs.

Various forms of incomes policies aimed at better reconciliation of high employment and price stability, in the context of sustained growth, have been tried in a number of countries. But these policies generally cut across market forces and mechanisms, and in economies in which markets (Markets for goods and services, markets for labour, and financial and other markets) are important mechanisms for allocating productive resources and productive outputs, incomes policies have not been very successful policy instruments. Beyond incomes policies lie price and incomes controls; but these will tend to create even more problems, intervening even further with market mechanisms. It is partly for these reasons that the Council has sought to lay emphasis on eliminating the causes of instability and on developing more effective "reconciliation policies" that would tend to work *with*, rather than *against* market forces and mechanisms, which are relatively important in the Canadian context (see below).

Similarly, the Council has urged that many of these reconciliation policies be brought more effectively into the central processes of policy formulation, and be given attention and status equivalent to that of demand management policies. For this reconciliation to develop appropriately, there will perhaps be a need to experiment, both within governments and between governments, with new initiatives and improved arrangements for developing the informational and analytical bases that would promote more effective policy planning and co-co-ordination (somewhat akin to the policy planning mechanisms being pioneered in large multi-faceted business corporations). Likewise, attention is also needed to the question of how more co-ordinated government and private decision-making can be achieved to better serve their respective sets of interests.

5. As regards the goal of an equitable distribution of rising incomes, a key element in the Council's approach to relevant policy formulation has been a view that effective steps to promote better performance require, as a prerequisite, strong and stable growth of the whole economy. In particular, it is likely that only within the framework of overall policies to achieve such growth will it be possible to develop appropriate means for steady progress towards reducing regional economic disparities and eliminating poverty.

6. A high priority is required for generating better information, applying improved analytical techniques, and developing more effective decision-making procedures, both in the formulation and evaluation of economic policies and programs. This is a matter to which the Economic Council will be giving more attention in its next Annual Review, scheduled to be completed in the fall of this year.

7. In its approach to policy advice, the Council has taken an essentially pragmatic view. Frequently, it has promoted the use of policy instruments and strategies that depend on making market forces work more effectively "under the spur of competition and the lure of higher returns"—not so much because of any deep attachment to a laissez-faire philosophy, as because this appeared to be the most promising avenue to make our economic system best serve the broad interests and needs of all Canadians. Conversely, in other policy areas, the Council has supported and promoted increased government involvement and intervention in fields in which market mechanisms are unlikely to yield good results, particularly in fields in which social costs and benefits are unlikely to be taken adequately into account by private decision-makers.

In varying degrees, all of the above key elements have had some bearing on the Council's evolving policy advice, the main features of which are briefly summarized in the following section.

Summary of Council Policy Conclusions

The Council's policy conclusions may conveniently be grouped under four broad headings: *demand management policies; supply and adjustment policies; structural policies; and complementary policies* aimed at raising the levels of public understanding in all parts of our economic and social system.

1. In the area of *demand management policies*—monetary and fiscal policies—the Council has urged the adoption of a different approach from that which has characterized much of the postwar period. It has recommended that within the limits set by various constraints that are beyond Canada's control, the strategy should be modified and redirected towards "steering" the economy along a smoother underlying growth path, in line with the economy's continually expanding potential. It has noted that, in the past, governments have tended to think of their role in stabilization policy as being that of a "balance wheel" in the economy, with their actions aimed at offsetting fluctuations in demand—adding to total demand when private demand weakened, and constraining total demand when private demand became excessive. But such compensatory measures have not always been appropriate in relation to the timing and amplitude of variations in total demand. Indeed, attempts in the past to counteract cyclical fluctuations have sometimes had destabilizing effects, involving large oscillations in monetary and fiscal settings whose impacts continued to work their way through the system long after the basic underlying conditions they were initially designed to cope with had changed.

The Council's approach would build demand management policies *around* the concept of "potential". This approach would aim to hold the economy reasonably close to the path of its steadily expanding potential. It would aim for more evenhanded management of fiscal and monetary policy, and seek to avoid shifts which themselves can generate instabilities. It would, in other words, seek to avert substantial and frequent changes in the rates of monetary expansion and, on the fiscal side, alternating large deficits and large surpluses. Any basic adjustment of strategy towards greater restraint or towards greater stimulation should depend on views about whether strong and persistent forces can be firmly anticipated that would either press the economy too hard against potential or induce substantial economic slack. Consistent with the Council's proposed basic strategies for such policies, would be various tactical departures to deal with the shorter-term instabilities that will inevitably arise from time to time in volatile financial and exchange markets. But the Council's approach would essentially aim for a "growth-oriented" rather than a "cycle-oriented" approach to the management of demand.

To this end, the Council has recommended that:

Monetary policy, over the longer term, should be directed towards keeping the growth of the money supply roughly in line with the underlying growth rate of potential output. There is evidence that the United States is moving away from an earlier preoccupation with shorter-term cyclically oriented policies, towards a longer-term policy strategy of the kind outlined above. This implies larger scope for, and may indeed facilitate, the use of a similar approach for Canada.

Fiscal policy should be directed towards the maintenance of a small but sustained budget surplus at high employment. This surplus, the Council has suggested, should be measured on a national accounts basis, taking into account *all levels of government,* and including the transactions of the Canada and Quebec Pension Plans.

2. These major instruments of demand management need to be supplemented by a wide-ranging set of *supply* (growth-oriented) and *adjustment* policies:

Policies designed to *enlarge* supplies of goods and services, particularly by encouraging greater efficiencies in all parts of our economic system;

Policies designed to bring about *a better matching* of supply with effective demand through improved resource allocation, the elimination of bottlenecks and rigidities, and the removal of barriers to the easy flow of resources to some points in the system (and also away from other points in the system) where changes in demand are occurring. Additional emphasis is needed on policies to make markets work better, so that resources can be allocated or reallocated more smoothly and efficiently—that is, with minimum disruptions in employment and production—in response to changing economic conditions resulting from external influences, government policies and other forces.

Such policies are essentially "productivity enhancing" policies. They aim to provide more output for a given amount of input; or the same output for a reduced amount of input. Productivity thus stands at the very centre of these policies. And it is a crucial reconciling factor in the link between supply and demand in the economy.

A wide-ranging variety of such policies are required to reach deeply into almost every aspect of economic life. Over the past several years, the Council has devoted much of its effort to the study of strategies for improving such policies in many fields. Among the fields to which the Council has drawn special attention are the following:

Education: Policies to achieve appropriate advances in the education and skill levels of the labour force, including management.

Manpower: policies to achieve a better matching of supply and demand for labour.

Tariffs: policies to promote an increased degree of scale and specialization in Canadian industry.

Competition: policies to promote increased efficiencies in the production and marketing of goods and services.

Innovation: policies to raise and strengthen risk-taking and the innovative capabilities of Canadian industry. Technological change, covering the whole range of activities from research and development through to production and marketing, can be a powerful engine for economic progress.

Adjustment to change: policies to facilitate adjustment and ease the hardships on individuals and industries which arise when broadly beneficial changes in commercial policies and technology disrupt existing labour and product market patterns.

Consumer protection: policies to ensure that the growing production capabilities of the economy are serving the interests of consumers in matters of cost, safety and effectiveness.

Copyrights, patents, trademarks and industrial design: policies to encourage creativity and invention, and to facilitate the dissemination and wider and more effective application of knowledge.

Construction: policies to stabilize the massive and distorting "stop-go" cycles that have been occurring in the construction industry, and to promote cost reduction and improvements in productivity.

3. A third important class of policy conclusions of the Economic Council relate to matters of "structure" in the Canadian economy. For example, as regards the goal of high employment, the Council has stressed that special measures are required to reduce the very high rates of unemployment that are typical in the lower-income regions, as well as the relatively high incidence of unemployment in various age groups (particularly among the younger age groups). It is also important to seek to achieve further moderation in seasonal fluctuations in employment. In addition, there is a need for effective measures to reduce significant chronic unemployment which may threaten to make some members of the labour force unemployable.

Similarly, the Council has drawn attention to structural differences in rates of increases in prices and costs, and to the need for special measures in some fields in which particularly high rates of price and cost increases may be persistent. To illustrate, the Council has stressed the need for an effective combination of policies to moderate the disturbingly high rates of increase in prices and costs that have become typical in the construction sector. Similarly, in the *Seventh Annual Review,* it emphasized the need for new initiatives in such important service sectors as education and health care that would help to increase productivity and moderate the essentially "cost-plus" basis on which these sectors now appear to be operating.

Of particular and continuing importance in the context of a high-employment economy is careful attention to the removal of structural impediments to the achievement of price stability. As a result of the psychological defensiveness engendered by the shattering experiences of the Great Depression of the 1930's, many somewhat rigid practices (the purpose of which was to frustrate the operation of economic forces, although, at the time, designed to provide protection to those likely to be seriously hurt by forces beyond their control) have been built into social attitudes, business practices and legal arrangements governing the operation of our markets for goods, services and labour. A number of additional practices, such as restrictions placed on freedom of entry into certain skilled occupations and professions, the fragmentation of bargaining and detailed differentiation of skills, have anachronistically persisted into the present economic environment. Such practices can have little place in a society dedicated to high employment and to an ambitious additional range of social objectives, since they may merely serve to frustrate the achievement of these high aims. Systematic examination and overhaul of many of these arrangements and practices is long overdue.

Again, the Council has noted the varying patterns of productivity increase in different sectors of the economy—this was the main theme of the *Council's Seventh Annual Review*—and the need to search for the most important sources of economic growth in the various sectors, as a basis for developing more effective industrial policy strategies to promote productivity growth.

In various Annual Reviews, the Council has attemped to describe and analyse factors contributing to regional disparities, and to develop a framework of policies that might assist in narrowing such disparities. These disparities have been large and persistent in Canada. A stubborn influence has been exerted by provincial variations in manpower utilization, due in part to differences in age composition of the population, in rates of participation in the labour force, in the incidence of unemployment, and in the average number of hours worked per week. Also, the Council has drawn special attention to the disparities that appear to exist in productivity levels between different regions in Canada. In the *Fifth Annual Review,* special attention was drawn to a framework of policies that would contribute to making fuller and more productive

use of both human and material resources in Canada's lower-income regions. In this context it has also warned against programs which serve mainly to lock people into low-productivity industries and declining occupations, and has recommended increased investment in human as well as industrial capital and in natural resources, and the active promotion of efficient urban growth centres. In this field, it is exceptionally important to have both clear-cut objectives for regional development policies and programs, and essential co-ordination, not only with other federal, but also with wide-ranging provincial, policies and programs.

In this context, the Council has concluded that monetary and fiscal policies can probably do little to help to improve these structural disparities, and has suggested that a wide variety of "structural policies" of the kind suggested above will be needed. In general, expansionary fiscal and monetary policies will be looked upon with favour by all regions when the national unemployment rate is high. But when policies are used to restrain demand pressures that appear to originate mainly in the higher-income regions, the possibilities for conflicts of regional interest increase. Regardless of varying regional economic circumstances, the impact of a general policy of restraint is likely to be diffused throughout the national economy, with braking effects not only on the higher-income regions in which such effects may be most appropriate, but also on the lower-income regions just as they appear to be making promising progress towards fuller use of resources. In these circumstances, the Council has briefly explored the question as to whether some regional differentiation might be attempted in the use of demand management policies. The Council's conclusion is that there would appear to be significant limitations on the extent to which regionally differentiated actions may be taken to fit differing regional circumstances and problems, especially in the case of monetary policy. For fiscal policies, there may be larger scope for differential regional actions—not only in the light of the relatively large fiscal role of provincial and municipal governments (which, taken together, now have total expenditures on goods and services that are twice as large as those of the federal government)—but also in the light of some flexibility that could be developed for regional variations in federal fiscal actions. In both the monetary and fiscal policy fields, exploration of possibilities for greater regional differentiation of policy should be explored.

The Council has also undertaken a very brief look at the structure of incomes—more particularly, at the problem of poverty. Poverty was the subject of chapters in both the *Fifth* and *Sixth Annual Reviews,* in which the Council attempted to estimate, in very rough terms, the magnitude of poverty in Canada, to describe the principal characteristics of the poor, and to suggest a variety of near-term and longer-term measures that might be developed as part of a program for the elimination of poverty in Canada. In its approach, the Council was concerned both with ameliorating the direct human and social consequences of poverty, as well as with reducing the substantial economic costs involved in large-scale poverty. Such poverty, the Council emphasized, acts as a brake on Canada's economic growth and detracts from the well-being of all Canadians.

4. The Council has also emphasized the importance of a fourth important set of policies. These concern raising the level of public understanding, involvement and decision-making in all parts of our economic and social system. In this area, the Council has advocated, among other things:

> Improved policy co-ordination between the public and private sectors, *to be carried out within a comprehensive framework of objectives and priorities* to which both government and private decisions could be more coherently related.
>
> Longer-term planning in both the private and public sectors, such as manpower planning and the planning of investment outlays in a more stable way over longer periods of time.
>
> Linking more public and private decisions to a framework of potential output estimates.
>
> Improved co-ordination of expenditure programs and other fiscal matters by the three levels of government, and the publication of more information (including five-year government investment plans) to facilitate improved private decision-making.
>
> More basic economic research, new and better statistics, improved economic analysis, and the development of wider public understanding and discussion of current economic developments.

In this latter context, the Economic Council has emphasized that the framework of economic and social statistics needs continual adjustment in response to shifting requirements for information under rapidly changing social and economic conditions. The tolerances with respect to relevance, timeliness, and accuracy at the decision-making level have become finer. In particular, to support major new thrusts of enalysis and policy formulation, more and better data relevant to longer-term studies and regional analysis are needed. The Dominion Bureau of Statistics has a fundamental role to play in providing the higher quality information base needed throughout Canada for better decision-making. It should be a matter of high priority in federal government policy to ensure that this agency has adequate resources, especially of highly skilled manpower.

The Council also believes that an informed public opinion, based on a more widely diffused understanding of the problems of managing a modern economy, is an essential prerequisite to meet the challenge of attaining higher standards of economic performance in Canada. This is because good economic performance is everydoy's business. As stated in our 1970 report on *Performance and Potential,* every citizen shares responsibility for good performance of the Canadian economy; every producer of goods and services contributes to whatever success is achieved, and every person can benefit, directly or indirectly, from good performance. In the final analysis, Canada's economic policies are closely linked to public opinion, since public policies cannot far outrun public understanding and acceptance.

Accordingly, the Council has recommended that high-quality teaching of economics in secondary schools be widened and strengthened. Attention has been drawn to the important role which the mass media play in contributing to public understanding about economic developments, problems and policies. Business organizations, professional associations, labour unions, and other private interest groups have the opportunity and, indeed, the responsibility to extend the awareness and public grasp of economic issues.

The Economic Council also recommended that certain basic economic documents—such as the Economic Council's Annual Review, the White Paper on economic trends previously attached to the federal Budget Speech, and a survey of investment intentions—be published prior to the annual meeting of federal and provincial finance ministers and treasurers. Such reports and documents would serve not only as useful background information for these meetings but also as a basis for stimulating broader public debate about economic developments, problems and potentialities in advance of the formulation of annual budget policies.

More generally, the Council has drawn attention the fact that although there are a number of insitutions serving useful purposes in developing public information and analysis in various special fields, Canada is not now adequately provided with institutional means for enhancing public understanding of today's complex problems and policy issues. Thus, for example, the Council has recommended the establishment of an independent research institute to analyse and report regularly on shorter-term economic trends and problems. Similarly, the Council has pointed to the important contributions to improving public understanding of economic issues that could be made by committees of the federal parliament and provincial legislatures, providing that such committees could have access to competent secretariats and expert witnesses, with a continuing mandate in some cases for an evolving program of Hearings. In this context, the Council proposed that a Standing Joint Committee of the Senate and House of Commons be established, one of whose functions would be to hold annual hearings on economic issues, and on the Economic Council's Annual Reviews and perhaps other public reports and documents. This set of Hearings by your Senate Committee, Mr. Chairman, is an important step in the direction of providing public awareness of the issues involved in achieving strong, stable and widely shared economic growth.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 6

THURSDAY, MAY 6, 1971

Third Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses:—See Minutes of Proceedings)

23341—1

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird
Beaubien
Benidickson
Bourget
Bourque
Croll
Desruisseaux
Everett
*Flynn
Fournier
(*Madawaska-Restigouche*)
Gélinas
Grosart
Hays
Isnor
Kinley
Laird
Langlois
Manning
*Martin
McDonald
McLean
Méthot
Molson
Nichol
O'Leary
Paterson
Phillips
Sparrow
Walker—27.

**Ex officio Member*

(Quorum 7)

Orders of Reference

Extract from the Minutes of the Proceedings of the Senate, of Tuesday, March 9th, 1971:

"With leave of the Senate,
The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said *Estimates* reaching the Senate.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,
The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, April 28th, 1971:

"With leave of the Senate,
The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Tuesday, May 4, 1971:

"With leave of the Senate
The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relations thereto.

The question being put on the motion it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

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Minutes of Proceedings

Thursday, May 6, 1971.
(6)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10:15 a.m. to consider the question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Benidickson, Bourque, Grosart, Isnor, Kinley, Laird, Langlois, McLean, Methot, Molson, Nichol and Sparrow.—(14)

Also present but not of the Committee: The Honourable Senators Haig, Inman, Lang, McNamara, McGrand, Quart, Smith and Urquhart.

In attendance: Dr. James Gillies, Directors; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Heard as witnesses:

The Economic Council of Canada

Dr. Arthur J. R. Smith, Chairman;
Dr. Sylvia Ostry, Director;
Dr. Otto Thür, Vice-Chairman.

At 12:35 p.m. the Committee adjourned to Wednesday, May 12, 1971, at 10:00 a.m.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Thursday, May 6, 1971

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 10.00 a.m.

Senator Douglas B. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, we now resume our hearings with Dr. Arthur Smith, Chairman of the Economic Council of Canada, as our witness. Dr. Smith is accompanied this morning by Dr. S. Ostry, and the Vice-Chairman of the Council, Mr. Otto Thür.

In his testimony yesterday Dr. Smith referred to the study of the Council conducted by Paul Malles entitled: "Economic Consultative Bodies". If it is the wish of honourable senators, the Council is prepared to distribute copies of this book following the hearing this morning. Is it your wish that the Council do so?

Hon. Senators: Agreed.

The Chairman: When we concluded our hearing with Dr. Smith yesterday we were dealing with a question from Senator Nichol that was so broad that it precluded a proper discussion in the time that was available when the question was asked. With your agreement we will commence this hearing with Senator Nichol's question. Is that agreed?

Hon. Senators: Agreed.

Senator Nichol: Dr. Smith, yesterday we went through a very interesting beginning with many charts and figures, but we did not really have time to reach a discussion of Dr. Smith's suggestions. I was referring particularly to paragraph 2 at the top of page 12 of Dr. Smith's brief, where he says: "Policy formulation must become more future-oriented."

I think we could agree with Dr. Smith that as far back as anybody can remember approaches to economic policy have been reactive. As I put it yesterday, we have been taking the position of shooting at ducks after they have passed us. It seemed to me that this was a very significant paragraph in Dr. Smith's brief and I simply asked if he would be willing to talk about that part of it to us to start off this morning's session.

Dr. Arthur J. R. Smith, Chairman, Economic Council of Canada: Yes. Mr. Chairman, we tried to indicate in our brief that starting in the early post-war years there was generally an approach to economic policy formulation on the part of government that viewed the operations of an economy as essentially cyclical in nature; that saw alternating periods of expansion and recession largely arising from instabilities of various kinds in the private sector of the economy; and, therefore, saw the role of government essentially as that of a balance wheel. When the private economy was contracting in recession, the government would undertake expansionary actions; when the economy was expanding, perhaps moving into an inflationary period, the government would use retraining actions.

The objective was to try to cut off both the peaks and the valleys and give us an economy that would operate in a more stable way. But essentially this sort of approach depended upon the view that there could be a very good system of information to indicate when peaks and valleys were emerging so that the policy actions taken could have relatively quick effects in moderating undue expansion or recession, and I think what we found—perhaps in part because the economy has been becoming more complex and perhaps more cumbersome in some ways—was that it has sometimes proved to be very difficult to recognize when instabilities are really emerging. For example, there is often a considerable recognition lag before a fiscal action is taken to expand of curtail expenditures or change the tax system. I suppose in this respect the United States situation is fairly clear; the major tax cut which came in 1964 was not really needed then, but it was needed three or four years earlier. It missed the mark not by months, but by years. In fact looking back with the accuracy of hindsight we realize that the tax increase of 1968 was needed not then but further back, that is to say in 1965 or 1966.

Senator Benidickson: Has that anything to do with the professionals in your field, in their access to what is in the broad term, the White House?

Dr. Smith: Well, talking about the situation in the United States, the advisors had recognized that action was needed long before the action was taken, and had undoubtedly so advised the administration, but it took a long time for action to be taken.

Senator Benidickson: And the eminent of those changed their minds fairly promptly in a six-month or twelve-month period.

The Chairman: I wonder, senator, if we could allow the chairman to complete the statement and then we will come to your question.

Dr. Smith: I was going to say that in Canada we have the capacity, with a different form of government, to

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move more effectively from the recognition of a need for significant change to action. But then we have a third area of lag and this is one to which we have been giving increasing attention in recent years. This is the lag between the time when action is taken and when such action produces an impact on the economic system in broad terms. We need to know much more about these impact lags than we now know; they probably differ in different circumstances. They differ depending on the kind of action that is taken. We do not know nearly as much as we should know, but the indications are that the lags are quite long. For example, if a major shift is undertaken in monetary policy, some of the effects are quite quick on financial indicators. The financial markets may respond very quickly, within a few days, and sometimes almost instantaneously in some respects.

Senator Benidickson: They will react on a speech.

Dr. Smith: Then the impact proceeds through another stage where many of the activities which are financially related are affected, perhaps within six months. One can take the case of housing for example which is closely related to the mortgage market because a major change in monetary policy begins to have an impact on housing activity somewhere in that range. Because of the connections with consumer credit, this is another area which feels the impact but with probably a somewhat longer lag still. This might be in the order of nine to twelve months. I am just giving some rough orders of magnitude about things we need to know more about. In other areas there are perhaps still longer lags. So that the total impact on an economy of a major shift may take something in excess of a year to begin to show.

Now in these circumstances there is a danger that trying to use these policies may mean that you cannot really fine tune an economy in the way in which we thought earlier, and that view is explicitly recognized, for example, by the Governor of the Bank of Canada in his latest Annual Report. In these circumstances since we began our work in the Council we have been suggesting that rather than trying to shift policies in a rather frequent, nimble kind of way to deal with instabilities of this kind that it would be better to orient policies to the potential growth rate of the economy, that is to where we wanted it to go in the future so far as this was possible.

Our approach has been not to suggest the very fine details of how this could be done, but the very broad strategy of approach. We have basically been concerned with the general principles and the general criteria; we have articulated a strategy on how to do it, and we have said that this strategy must operate within the context of external constraints. We also have in mind that we may run into a situation over an extended period of time of either slack or persistent demand pressures on the economy where there is some shift from the strategy of linking money supply to potential growth and we have allowed also, as anyone must allow who recognizes the difficulties in operating monetary policies in volatile markets for tactical departures from strategy in a very short-term framework.

But at the Council we have not attempted to suggest precisely how this could be done because we are not in a position to do so. Again, using the illustration of monetary policy, there is a number of actual measures or actions that may be taken. There are open-market operations; there are changes in the bank rate; there are changes in reserve requirements. There are a number of instruments, and the timing and the degree and the use of these may vary, and the kind of information and the analysis needed to operate a strategy and tactical departures from it does not reside with the Economic Council. That resides in the areas in which the authorities operate.

This has been our basic approach to putting these into focus.

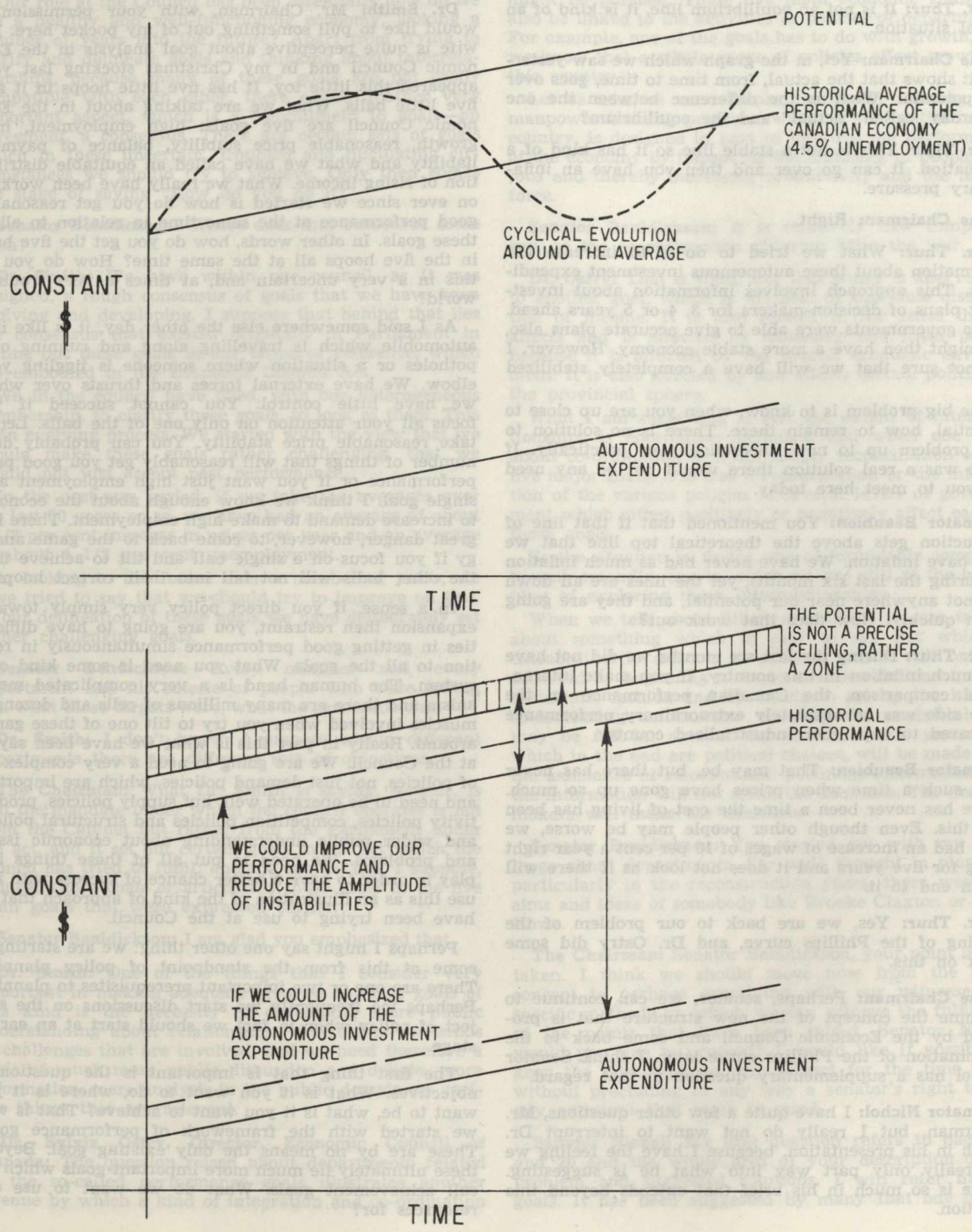
Mr. Otto Thür, Vice-Chairman, Economic Council of Canada: May I add some thoughts to the stabilization issue and the future-oriented policy? I think that for a certain number of years—perhaps about 15—general economic policy has been future-oriented in a sense. It does not react immediately as it did in the 1920s and the 1930s. However, our problem today is that we do not have the information and we do not have the precise knowledge of the future to have an exact picture of what the situation has to be or might be in about four, five or six years. May I make a very short schematic presentation of what we are trying to do in the Economic Council—and we are not the only people in the world doing this.

Yesterday we saw that the Economic Council is using a potential development line which is a rather exacting aim, because it involves an unemployment rate of about 3 per cent, and we know that we did not realize this kind of unemployment rate in a systematic way in the past, therefore our potential line is a kind of an objective. We also know something of a certain number of investments—let us call them "autonomous investments" —which are done regularly year after year. Out of these autonomous investments we may derive a kind of equilibrium line for production and it indicates what we have been doing as an historical experience for the last 20 years.

That could represent exactly the traditional trade-off of the Canadian economy of 3-1/2 per cent price increase and about 4-1/2 per cent unemployment. If we had 3 per cent unemployment instead of 4-1/2 our production would have been higher up to the potential line.

Our big problem today, and it is not only a Canadian but a world-wide problem of any industrial country, is to try to increase the content of these autonomous investments. If we had some possibility of increasing the content of what is stable in the economy then our equilibrium line would be pushed closer to the potential line. It is because of the need of such information that the Economic Council undertook years ago a program of surveying public and private investment projects for five years.

The Chairman: Excuse me, Mr. Thur. By the equilibrium line do you mean...


POTENTIAL
HISTORICAL AVERAGE PERFORMANCE OF THE CANADIAN ECONOMY (4.5% UNEMPLOYMENT)
CYCLICAL EVOLUTION AROUND THE AVERAGE
CONSTANT
$
AUTONOMOUS INVESTMENT EXPENDITURE
TIME
THE POTENTIAL IS NOT A PRECISE CEILING, RATHER A ZONE
HISTORICAL PERFORMANCE
WE COULD IMPROVE OUR PERFORMANCE AND REDUCE THE AMPLITUDE OF INSTABILITIES
CONSTANT
$
IF WE COULD INCREASE THE AMOUNT OF THE AUTONOMOUS INVESTMENT EXPENDITURE
AUTONOMOUS INVESTMENT EXPENDITURE
TIME

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Mr. Thur: It is not an equilibrium line, it is kind of an actual situation.

The Chairman: Yet, in the graph which we saw yesterday it shows that the actual, from time to time, goes over the potential. What is the difference between the one yesterday, called "actual" and the equilibrium?

Mr. Thur: This is not a stable line so it has kind of a fluctuation. It can go over and then you have an inflationary pressure.

The Chairman: Right.

Mr. Thur: What we tried to do is to increase our information about these autonomous investment expenditures. This approach involves information about investment plans of decision-makers for 3, 4 or 5 years ahead. If the governments were able to give accurate plans also, we might then have a more stable economy. However, I am not sure that we will have a completely stabilized one.

The big problem is to know, when you are up close to potential, how to remain there. There is no solution to this problem up to now, theoretically or practically. If there was a real solution there would not be any need for you to meet here today.

Senator Beaubien: You mentioned that if that line of production gets above the theoretical top line that we then have inflation. We have never had as much inflation as during the last six months, yet the lines are all down and not anywhere near our potential, and they are going down quickly. How does that work out?

Mr. Thur: During the last six months we did not have too much inflation in this country. If you make international comparison, the Canadian performance on the price side was an absolutely extraordinary performance compared to any other industrialized country.

Senator Beaubien: That may be, but there has never been such a time when prices have gone up so much. There has never been a time the cost of living has been like this. Even though other people may be worse, we have had an increase of wages of 10 per cent a year right along for five years and it does not look as if there will be an end to it.

Mr. Thur: Yes, we are back to our problem of the shifting of the Phillips curve, and Dr. Ostry did some work on this.

The Chairman: Perhaps, senator, we can continue to examine the concept of the new structure that is proposed by the Economic Council and come back to the examination of the Phillips curve later. I think Senator Nichol has a supplementary question in that regard.

Senator Nichol: I have quite a few other questions, Mr. Chairman, but I really do not want to interrupt Dr. Smith in his presentation, because I have the feeling we are really only part way into what he is suggesting. There is so much in his brief that extends beyond this question.

Dr. Smith: Mr. Chairman, with your permission, I would like to pull something out of my pocket here. My wife is quite perceptive about goal analysis in the Economic Council and in my Christmas stocking last year appeared this little toy. It has five little hoops in it and five little balls. What we are talking about in the Economic Council are five goals: high employment, high growth, reasonable price stability, balance of payment liability and what we have called an equitable distribution of rising income. What we really have been working on ever since we started is how do you get reasonably good performance at the same time in relation to all of these goals. In other words, how do you get the five balls in the five hoops all at the same time? How do you do this in a very uncertain and, at times a very troubled world?

As I said somewhere else the other day, it is like in a automobile which is travelling along and running over potholes or a situation where someone is jiggling your elbow. We have external forces and thrusts over which we have little control. You cannot succeed if you focus all your attention on only one of the balls. Let us take reasonable price stability. You can probably do a number of things that will reasonably get you good price performance or if you want just high employment as a single goal. I think we know enough about the economy to increase demand to make high employment. There is a great danger, however, to come back to the game analogy if you focus on a single ball and tilt to achieve that, the other balls will not fall into their correct hoops.

In a sense, if you direct policy very simply towards expansion then restraint, you are going to have difficulties in getting good performance simultaneously in relation to all the goals. What you need is some kind of a system. The human hand is a very complicated mechanism and there are many millions of cells and dozens of muscles involved when you try to tilt one of these games around. Really in part this is what we have been saying at the Council. We are going to need a very complex set of policies, not just demand policies, which are important and need to be operated well, but supply policies, productivity policies, competition policies and structural policies and wider public understanding about economic issues and problems. We need to put all of these things into play in order to have a better chance of success with it. I use this as an illustration of the kind of approach that we have been trying to use at the Council.

Perhaps I might say one other thing: we are starting to come at this from the standpoint of policy planning. There are one or two important prerequisites to planning. Perhaps too frequently we start discussions on the subject of policy when in fact we should start at an earlier stage.

The first thing that is important is the question of objectives. What is it you want to do, where is it you want to be, what is it you want to achieve? That is why we started with the framework of performance goals. These are by no means the only existing goal. Beyond these ultimately lie much more important goals which we call achievement goals. What do we want to use our resources for?

Our role at the Council has been essentially how do we get a healthy and well-functioning economy, looking a number of years into the future? Apart from trying to clarify and delineate goals and thinking about interrelationships, because many of these goals are not easily compatible with each other, there comes another very important aspect, which is a commitment to goals—an agreement, a consensus. There are certain sets of goals which in these uncertain, troubled and fluctuating circumstances we should try to achieve. Only then comes the stage of saying "How do you do it?"

Senator Benidickson: Where does that consensus come from?

Dr. Smith: We have within our council, as it was designed, a rough consensus of goals that we have been evolving and developing. I suppose that behind that lies the consensus that existed originally in Parliament in setting out these goals in our terms of reference, which are embodied in the Economic Council Act.

We in the council have tried, with our heterogeneous membership, to clarify these goals, to look at them. This is an evolving process. We started with the view that we should make these goals rather challenging, that we should not just accept past performance.

In the post-war period, if we take the averages over the last 20 years or so, we have had an average of about 3 1/2 per cent increase in prices per year and an average of about 4 1/2 per cent unemployment.

In looking to the future over a number of years, we have tried to say that we should try to improve on this. In our delineation of these goals we have deliberately set rather challenging goals.

Senator Bendickson: Every minister and every department had his coterie of people who were telling him what those targets were, what the consensus was.

Dr. Smith: I don't know. I suppose within different departments there are different sets of objectives.

The Chairman: What Dr. Smith is saying, senator, is that the mandate under which the council operates is not from the Cabinet but rather from the Parliament under the act, and it set out certain goals in the act which the council has tried to fulfil; and the council has, I suppose, reduced those goals or articulated those goals in the five main goals that were expressed earlier.

Senator Benidickson: I am glad you emphasized that.

Dr. Smith: One of the things that I consider very important in making adequate progress towards goals of this kind is the necessity of developing more public understanding about relationships, difficulties, the kinds of challenges that are involved, and we need therefore a basis of much more public discussion and debate, more information, more analysis in the public domain on various things that are relevant.

Dr. Sylvia Ostry, Director, Economic Council of Canada: The question raised about departments related to the so-called performance goals illustrates another avenue by which a kind of integration and co-ordination might be pursued. These five main economic goals can also be linked to the activities or policies of departments. For example, one of the goals has to do with growth, and we know that a whole range of policies affect growth in this country.

Let us take, as an example, manpower training. The manpower training program, which is substantial in this country, is designed in part to improve the performance of the economy by improving the matching of people and jobs and thereby increasing productivity and the labour force.

Senator Benidickson: It is relatively new compared, say, to the reconstruction program after the war.

Dr. Ostry: That is right. But that policy is also related to another goal, which is the goal of equitable distribution of income. It is also related in the sense that it affects and is affected by monetary and fiscal policy, because it is affected by the overall economic environment. It is also affected by and affects certain policies in the provincial sphere.

What I am suggesting is that the extent of interrelationships is enormously complex, and when one talks about co-ordination it is not simply reconciliation of the five major goals; it is also a reconciliation or the integration of the various policies at several levels of governnment which either positively or negatively affect each of those goals.

So the situation is, firstly, one of formidable complexity and, secondly, one in which we are still at the beginning of exploring these interrelationships.

When we talk about future orientation we are talking about something which is easy to say but which is extraordinarily difficult to achieve, and it will only be achieved by beginning to explore these relationships in a systematic fashion and by trying to set up the kind of co-ordinating mechanisms whereby the analytical aids may be fed in; so that the choices which you make, which in the end are political choices, will be made with the assistance of relevant and pertinent information. But the information will not make the decisions. The decision makers will make the decisions.

Senator Benidickson: You started out with my challenge about departments. For wide thought in planning, particularly in the reconstruction years, there were the aims and ideas of somebody like Brooke Claxton or C. D. Howe.

The Chairman: Senator Benidickson, your point is well taken. I think we should move now from the broad concept to perhaps examining with our witnesses the specific methods by which we can achieve the fulfilment of the points that have been raised. Senator Nichol, would you like to proceed? I would like if possible to keep the discussion on this subject for the time being without precluding in any way a senator's right to ask any questions that come to mind.

Senator Nichol: My first question refers to pages 19 and 20 and the whole area of your description of the problem and suggested solutions. I will refer first to goals. It has been suggested by many that one of the

problems with goals is that we have tended, almost since the beginning of our society, to define them entirely in monetary terms. For instance, when debating whether or not a valley should be flooded to provide hydro-electric power, those in favour can express the value of their goal in monetary terms, whereas the conservationist is quite unable to express monetary terms. He refers to tourist attractions or the whole ecological problem. The debate breaks down because one side is talking dollars and the other nothing, or nothing definable or measurable.

How big a problem is this in terms of defining the types of goals to which you refer?

Dr. Smith: We refer to broad performance goals. We have endeavoured to define them by different methods, not so much in monetary terms, although this enters here and there. We refer to employment, a percentage of the labour force; we are talking about people, in other words. We refer to our growth rate. Productivity is really referred to as the essential element, which is measured in terms of real output in relation to the labour and volume of capital used to produce it. The ultimate focus has been on the potential side, on the real resources of the economy.

In fact, over the longer haul one aspect that must evolve from this base is the discovery of more linkages into the financial areas. This is one of the major developments that are very much needed. New devices, techniques and methods must be found of linking the real economy to the financial elements that are important in its work.

You are right to point out that in other areas various approaches have been made to the use of cost-benefit analyses and other kinds of techniques in making decisions, with an attempt to quantify them in an appropriate manner. The common denominator being sought in many cases is some type of costing. This enters the financial area. There are still a great many problems in connection with doing this well.

The Chairman: Senator Nichol, I am going to ask Senator Grosart to ask a question at this stage. This was not pre-arranged, but I know this is a subject in which Senator Grosart has great interest. He has discussed with me from time to time means by which we might quantify such matters as ecological considerations and conservation measures.

Senator Grosart: Thank you, Mr. Chairman; you took me somewhat by surprise. I would have to say, Dr. Smith, that I am sometimes concerned with what appears to be your obsession with these five goals in both your written and verbal presentations. I have heard a few of them here and elsewhere. You sometimes remind me of the experience often encountered when enquiring of department representatives as to their function and receiving the answer that they administer certain acts.

These five goals to which you refer are not really goals at all. They are operating parts of a mechanism. They could all be achieved 100 per cent and we would still be in an absolute mess as a nation. We could have full employment, economic growth or potential, price stability, viable balance of payments and an equitable distribution of rising income, yet as Senator Nichol suggests we could write ourselves out of existence because of pollution and in other ways.

Therefore it seems to me that you are contributing in this emphasis to those who say that you are part of the GNP cult, you become GNP cultists. I am not say you have, because I recognize that over and over again in your reports you hedge. You say that although these are five important things, we do realize that they are only means to an end. I notice in Performance and Potential:

> —high standards of economic performance are not ends in themselves. The ultimate purpose of achieving sustained, balanced and widely shared growth at high levels of employment is to generate the means for more fully satisfying the diverse needs and rising aspirations of Canadians—not only in material terms, but also in terms of a better quality of life for individuals, families, communities, and our society as a whole.

Senator Benidickson: It sounds like the Bank of Canada.

Senator Grosart: Perhaps I can put my question this way: Would you not relate this GNP emphasis to some new schools of thought? Japan, for example, has just declared that it will set up a net welfare product series. The Prime Minister the other day suggested maybe the GNP. There is a GNP cult and it is dangerous.

The Chairman: Is this Japanese experiment known as the net welfare?

Senator Grosart: NWP, Net welfare; they use the word "welfare". I think the Prime Minister used the words "net social". That is the translation.

The Chairman: Dr. Ostry, would you like to comment on that?

Senator Grosart: I would like your comments on those two points. May I ask this question: If GNP is not as useful an arbiter as we have always thought, what is the alternative? How would this other scheme work?

Dr. Smith: May I answer briefly and Dr. Ostry will develop it further. This is something that we have in fact recognized from the start. In our last Review we set it out more explicitly than before. We state:

> That economic growth, as it is conventionally estimated, is a questionable indicator of human welfare is, of course, not a new notion. Few societies or individuals have failed to make some distinction between maximum and desirable growth. The goals of all societies include a wide range of human values that are not adequately reflected in measurements of their gross national products.

Senator Grosart: I agree with that.

Dr. Smith: May I add just one other point: In the existing situation we have demands, wants, needs and aspirations in excess of our capacity. We are concerned with the problem of at least operating reasonably on the

supply side to develop our potentialities so that we have in a sense the largest possible number of choices among these many competing claims. The gross national product measure is not an indicator, as we said, of human welfare. In fact, in many ways it is not all that good an indicator of economic growth.

I wish to quote from Mr. Juster of the National Bureau for Economic Research, in which he said last year:

> Although most economic concepts remain a mystery to the majority of even well-informed laymen, the "Gross National Product" has become part of our everyday vocabulary. The widespread use of this concept, both at professional and popular levels, attests to the fact that GNP is generally thought to be a simple, unambiguous and comprehensive measure of economic performance. But what has always been recognized by professionals is now beginning to be recognized by others: that the GNP is neither simple, nor unambiguous, nor comprehensive; and that it is not necessarily a good measure of economic performance.

Senator Grosart: Where is that quotation from?

Dr. Smith: This is from some notes which Dr. Juster of the National Bureau of Economic Research put down. I think they may have been background to his annual report.

Dr. Ostry: They are also part of an article that appeared in the *American Economic Review*. If you like, I will send you a Xerox copy.

Senator Grosart: Yes, I would like to have it. I may say, it is obvious that I have been taken by surprise, but you were not. You brought your music!

Dr. Ostry: I think what Dr. Juster has said indicates, not only that the National Bureau of Economic Research is doing some work in this area, but that the recognition, which has long existed among economists, that GNP was largely confined to market transactions, was not a measure and never intended as a measure of welfare, and that it is becoming increasingly difficult to co-relate changes in GNP with changes in welfare. In economies which are close to subsistence, it is fair to say that a rise in GNP is probably co-related with a rise in welfare.

Senator Grosart: You are using "welfare" now in a very broad sense.

Dr. Ostry: I am using it in a broad sense, in terms of human satisfaction. But in advanced economies it is clear that that co-relation is becoming increasingly misleading. It is becoming misleading for the reasons you have said: that environmental deterioration does not enter into the accounts; that the whole area which we have come to recognize as very important, which is investment in people in terms of their health, their education, and of knowledge, does not enter into the accounts; that if a man is an alcoholic and buys lots of liquor, that enters into the accounts, and so does the expenditure on institutions for alcoholism enter into the accounts. The thing is becoming increasingly less a measure of welfare.

There are two major developments taking place now. One is an effort to revise the GNP to take account of some of these major deficiencies, to net out some estimated environmental deterioration, to approach the question of education and health, and other areas of investment in human resources, to put them into the accounts, to deal with an area that is becoming increasingly absurd, and that is that we do not count non-market activity, so that when housewives enter the market that increases GNP, but we have no estimate of non-market activity. This is not only housewives, but students and so on. I would not hold my breath on that. I think that will take decades. It is an enormously difficult problem. We will not scrap GNP, which is still a very useful indicator; it will take many decades to do the theoretical and statistical work and to reach international agreement for a new measure.

The second development, I think, is closer perhaps to what you were thinking of, and that is a totally different approach, which says, "We are concerned in particular areas, political and social and economic, with some kind of direct measure of human welfare. We are not concerned with statistics on crime, or statistics on numbers of policemen. We are concerned with a welfare measure which captures some notion of public order and security. We are not concerned in health with measures of the numbers of doctors and hospitals. We are concerned with some measure of wellbeing or its obverse, and so on in education. This is the social indicator movement, in an effort to get real output measures of direct welfare or its obverse, and then hopefully to be able to link these to real objectives of government policy. Instead of saying that our target is to spend X dollars on health, our target is to improve life expectancy by X years, to reduce infant mortality by X numbers and so on—real measures that capture real phenomena, which mean something to individuals.

That would not throw economics out of the window, because there is an expenditure of resources involved, and to choose to lower infant mortality is also to choose not to do something else; to choose to extend the life expectancy of people in older age groups is to choose not to do something with teenagers and so on. The choices involved are imposed because of the scarcity of resources. But then we could relate directly at some point in time, when this development takes place, the economic imperative, which will always be with us, to these real goals, which would be visible to the public and which we know: are we getting better off or are we getting worse off in a real sense, not in terms of the output measured in terms of market transactions?

Senator Grosart: I am mostly thinking of some other criteria, other than this polarity that you are suggesting between welfare—social justice if you like—and economic measures. A good example is the Japanese experience with population control. For some years now the world has lauded Japan as one of the three countries in the world that held their birth rate down to the WHO level. Very recently the Japanese say they have to abandon this because they are suddenly discovering they will have an old population. This you can put economic numbers to, obviously. How do you factor that into GNP or this parallel? How do you factor these things in? You men-

tioned infant mortality. It so happens, I believe, that Canada's infant mortality rate is extremely high among the western nations. Surely you can quantify this sort of thing in a kind of expanded GNP that would be more meaningful.

The Chairman: But is not Dr. Ostry saying that it will take us years to quantify that, but that what can be done in the meantime is to establish goals that will accomplish just that?

Senator Grosart: With all due respect to you, Mr. Chairman, and to Dr. Ostry, I do not think that is a very good answer. We know it will take years. That is what I tell my wife at times about her demands. She does not accept that answer; she wants it tomorrow.

The Chairman: Well, Dr. Ostry?

Dr. Ostry: I am expressing a personal view. I do not believe you will get a measure of human happiness, and I think the search to try to add together things like infant mortality, a decline in cancer, an increase in the skills of the population, an improvement in the environment of security in urban cities, in the cores of urban centres, is like searching for the Holy Grail. These are incommensurable, even if they are measurable. They cannot be weighted and added; there is no common unit that will allow us to weight them and add them. I think you could if you were prepared to lay out your value judgments and say, "I value the human life of a man between the ages of 45 to 54 twice as much as I value the human life of an Indian child whose probability of death because of X, Y and Z can be reduced by a certain amount." That kind of value judgment can be made explicit and give you weights to add it up.

Senator Grosart: You are doing it.

Dr. Ostry: We are doing it all the time, it is quite true, we are doing it with implicit weights. I am saying it is better if we could get these measures, write them out, establish some public discussion which would say we want these goals and we are prepared to exercise these value judgments in the political system, rather than have a group of statisticians adding these things together to give you an index which they call an index of human happiness. I think that would be more misleading, far more misleading than GNP cultism.

Senator Grosart: I do not want to pursue this too far, except to say that I am trying to make a distinction between those components of GNP or other series which are merely components of human happiness and those which are clearly quantifiable such as the population control in Japan which I mentioned. This is surely quantifiable, but what is going to happen if you have in Japan a labour force that is four years older than Yugoslavia?

Could I ask one more question, which I think is somewhat related. That is, what are the components of your potential line? I looked through and read your part about performance and potential in your report and I find a great deal about performance, but I did not find a definition of potential. It might be that I missed it, but I looked through it twice. I would like to know what the components are. What do you put in here to say, this is what we should be shooting at, this is what you call somewhere the moving target?

Dr. Smith: What we sought to do, over time, in building up our estimates of potential, is to try and move forward into somewhat more sophisticated ways of estimating potential output. We could supply you with technical details of exactly how we did it. Let me describe it very briefly. When we started our work, in something of a crash program in the first year, and had to produce an annual review in a relatively few months of work, we used very much a Model-T approach to calculating the potential.

We did some estimates on what would be the increasing manpower resources available, the increasing employment potential. We looked at the postwar trend of productivity, output per man hour, and we essentially built that in. We did some adjustment here for hours of work, to refine it to output per man hour in the productivity calculation. We made one or two adjustments. One adjustment, as I recall, was on the agricultural side. It was a very simple model. We simply basically said that potential output is calculated on the basis of increasing employment and increasing output per man hour, and this is the sort of resulting target for potential into the future.

By the time we did our next exercise, in the Fourth Review, we tried to do this in a little more sophisticated way. In that review, we took account not merely of the increasing numbers of people who would be employed and the hours of work, but we tried to ask ourselves what kind of effect would future changes have on the output potential, as a result of changes in the age and sex mix of the population, what kind of effect might result from changes in the educational stock as a sort of proxy for skill in the labour force, changes in the age distribution a sort of proxy for experience in the labour force.

By that stage, we also started to ask ourselves what kind of effect increasing capital per employed person has on growth. We looked at that.

Then we had a residual. One always has a residual in this, which is a measure of ignorance. Again operating with a long-term post war productivity trend, there are a great many things you do not know about.

Essentially, in our Sixth Review, when we came to do the potential exercise again, to 1975, we had a similar sort of approach.

Over time, I think that what we would like to do in the Council is to develop and apply still more sophisticated techniques for estimating potential output. We are now engaged in some work which I hope may allow us to become somewhat more sophisticated.

By and large, I would not like to leave the impression that potential output is some very precise number that is exactly appropriate. The calculations are rough, they are based on various kinds of assumptions. You build in assumptions about participation rates, you build in assumptions about immigration; you build in assumptions

about certain kinds of changes in the hours of work, and so on. So you calculate these. Basically, we have been trying to give a rough order of magnitude of the kind of growth potential we have.

I think that, so far, in our analysis, as we look back over the work we have done and the potential estimates we have made, they have been reasonably in the right sort of ball park, for the potential output growth in Canada. Do you want to add anything to that, Mr. Thur?

Mr. Thur: I would suggest that what we have is not a straight line, what we have is rather a kind of a zone—uncertainty—so it is somewhere near the potential and it can be refined and there can be accidental evolutions. What we know is something which is a kind of a zone, more than just a straight line.

Dr. Smith: So what we have done is to take a figure of 5½ per cent, let us say, for the potential growth rate from the actual level of 1967 to the potential in 1975. That is intended to be a sort of a round number and, by different estimates and different calculations, you can get something that may range from a little over 5 to something above 5½. We have picked this as a reasonable order of magnitude for potential growth rate.

Senator Grosart: Yet your short fall assumptions seemed to be rather precise.

Dr. Smith: I would not like those to be interpreted as precise. Again, they are orders of magnitude.

Dr. James Gillies, Study Director: In connection with a nation with such diverse economic regions as Canada, I think it is useful for policy-making to talk about national economic goals rather than regional economic goals. I am thinking that perhaps the people in the Maritimes would rather have full employment and less price stability, and the people in Ontario would rather have more price stability and perhaps less employment. When you are looking for a policy, you should perhaps look on the regional economic needs rather than on the national economic needs.

Dr. Smith: Yes. This is an important matter. When we took up this matter in the Fifth Annual Review, where we looked at the regional impact of federal policies, we said that when you come to regional policies, there are policies that we were looking at in that context, narrowing regional disparities—this was our focus of attention—we said that there are two sets of reconciliation problems that are involved. One set of reconciliation problems confronting regional development policies is the possible conflicts between a strong national economic growth and an improved regional balance. We said that, in a sense here, perhaps in a somewhat similar kind of way as in the concept of trade-offs between unemployment and inflation, there may be trade-offs, but we know very little about these sorts of trade-offs yet. There are many kinds of linkages and leakages in the operation of policies in approaching these problems. We pointed to the need here for finding better systems of developing reconciliation policies.

I do not think we are going to have a basis for good improvement in regional balance unless we have a strong national economy. On the other hand, merely to achieve a well-performing national economy does not automatically imply that we are going to deal adequately with regional disparity problems.

Then we said that there is a second problem. The second problem related to our federal system of shared responsibilities. Particular regions or provinces may set objectives for themselves which are basically incompatible with our definition of the goal of regional balance. In other words, federal views about what are the basic objectives you are implying now may not coincide with regional views about what you feel their objectives are. Here again there needs to be some kind of reconciliation. There needs to be some kind of co-ordination of views.

If the two levels of government are going to proceed in some basic and important ways to try to do things that really are not easily compatible, then we are likely to have a good deal of wasted effort, and wasted resources and, undoubtedly, frictions in the process, too.

The Chairman: Have you thought about the vehicles that might be used for this co-ordination?

Dr. Smith: We have suggested two or three things. In this Fifth Annual Review, for example, we have pointed out among other things that we now have a system in which, so far as the federal Government is concerned, there are many departments that have regional activities of various kinds. Various departments have regional offices. They are engaged in various activities. At least at the time when we wrote this review—and I cannot comment on what may have evolved since then because I have not looked at it carefully—there were no occasions in which the principal officers of the various departments ever met together, even to interchange views and ideas about what they were doing and whether some of these things were compatible or not. We propose the establishment of, in effect, regional committees of some of the federal public servants in these areas for an exchange of views of this kind with a small secretariat for these purposes. That was not with the idea that that is where all the co-ordination would take place but at least it would bring together in one place the different lines of activities that were being undertaken, and a report would be sent back, we suggested at that time to the Treasury Board in Ottawa, at least once a year reporting on the actual activities that were taking place.

In the Performance and Potential mid-1950's to mid-1970's of last fall, we again took up the question of policy co-ordination. We say, among other things, that in this area too frequently the recommendation for greater co-ordination is translated merely into a call for proliferation of institutional arrangements and particularly for more meetings between decision-makers. We refer specifically to the vital field in Canada of federal-provincial relations, and we suggest that there may already be almost too many meetings.

Senator Grosart: What page is that?

Dr. Smith: That is on page 79. In fact, we added after that that indeed we sympathized with the officials and ministers—especially from the smaller provinces where staff resources are quite limited to service these meetings. We now have a great number of these meetings. We suggested that we should look really in some other directions for the most part for improved co-ordination. We said that we do not have some nice, neat definitive answer to this problem and we think that this is an area that deserves more attention and more study.

Implied in what I said earlier is the fact that we need some kind of better basis of agreement and consensus about what are the objectives and the goals. One must start again with that. Then within that framework we suggested, in the case of the federal-provincial relations explicitly, a further expansion of staff resources to the development of information and analysis, perhaps with some provision for more permanent secretariats to serve these federal-provincial meetings—with personnel rotated at regular intervals to avoid any build-up of what might be termed a new level of government—and for drawing more than in the past on supplementary staff resources through contract arrangement.

Both on a national level and within provinces, we said, there is also a need for greatly strengthening the bases for information analysis and program co-ordination in all matters relating to municipalities in Canada. For this country is now essentially an urban society. Under our constitution municipalities are creatures of the provincial governments, but here again is another intergovernmental level where I think improved co-ordination and more adequate resources for information and analysis underpinning decision-making is required.

Senator Isnor: Was it in that section that you recommended transferring population from depressed areas to the more developed sections of Canada?

Dr. Smith: No, sir. We have not recommended a transfer of population from any area of Canada to any other area of Canada.

Senator Isnor: You have not?

Dr. Smith: We did support the development of manpower policies in a broad sense, including assisted mobility policies and programs which would facilitate the matching of workers to jobs. In some cases that would involve movement of workers. In some cases it would involve movement of workers interprovincially, but in many more cases it would involve moving workers within provinces.

Dr. Gillies: Dr. Smith, speaking about this problem on a federal level, if we assume that the Council is looking at the longer-range problems, do you have any feeling that there is a need for some type of agency or institution to be the co-ordinator of policies, which would be attached to the cabinet or to the prime minister's office and which would not make policy but would refer to the economic implications of the various policy decisions that are coming out so that there would be more co-ordination? How could this be achieved between the policy-making in the cabinet and the long-range economic work of the Council?

Dr. Smith: I am not sure how improved co-ordination in various ways can be achieved. It may be that some new institutional developments would be useful. I think these might very well be looked at. Personally, I am not very much in favour of proliferating and creating institutions. We can get a lot of institutions, and sometimes there is a tendency to feel that institutional change will help to solve problems. This is not necessarily so. We should have institutional evolutional development, but in many cases I think the evolution can occur within a framework of existing institutions, if they can adapt to change.

One of the great problems with institutions is that any kind of institution, be it a large corporation or a government department, a hospital or a university, is that institutions tend to get increasingly bureaucratized in various ways. Conventional wisdoms develop. Existing channels tend to firm in. What one needs is a capacity to innovate; a capacity to evolve and develop. An economic system is not basically the sort of thing you should approach architecturally but rather organically. This may require institutional change, but often you can change many things within the framework of existing institutions with new ideas and new approaches.

Senator Molson: Mr. Chairman, I should like to ask Dr. Smith how much of a complicating factor are the many independent, perhaps, and not related decisions—I suppose I could call them political decisions—to our overall economy? I am thinking of, for example, wage parity where we relate wages in Canada to those in the United States, and it seems to me that it is not particularly related to the overall Canadian economy. The same thing applies to a certain extent between, say, Vancouver and Quebec City. We have had in the Province of Quebec recently a great deal of difficulty over the question of wage parity for construction workers throughout the province, and some difficulty has also been caused over the question of wage or salary parity for teachers in the Province of Quebec with the question of reclassification by qualification. How much of a complicating factor is that type of thing to the Canadian economic scene?

Dr. Smith: Let us take one or two of these. It is not feasible for us in Canada to have in a general way across the board wage parity with the United States unless we had essentially productivity parity. As we put it in our Third Annual Review, having looked at the fact that there seems to be a persistent and rather significant disparity between the two countries in productivity, if we were by fiat of some kind to declare wage parity some morning, then we would have a devaluation of the dollar that afternoon. There would be some kind of adjusting mechanism that would move to reflect the underlying realities. That does not preclude the possibility that, in particular situations where Canadian performance may be relatively strong or where the demand for certain things in Canada for certain kinds of people may be particularly strong, wage or salary levels may not roughly equate with those in the United States. We have some

industries where parity exists and where relatively in Canada in those areas quite strong productivity performance exists and where there are quite good marketing and production capabilities. We have some areas, and I suppose the educational field is one, where we have a demand for professional people to build up our universities where we have, I believe, at some levels, virtual salary parity with the United States.

Within Canada itself I think very much the same situation applies in some instances. If one were to declare wage parity between the different regions where the underlying productivity differences were significant and had been persistent, then there would be some kind of adjusting mechanism. This might lead to adjustments in people or different patterns of investment of capital and so forth. But here again this may not preclude something approaching parity for a certain particular situation. For example, if you want to build a strong educational system in one of the lower-income regions of Canada, you may have to be competitive on salaries with other areas of the country especially where you are concerned with people who tend to be quite mobile.

Senator Grosart: Would you add price parity, Dr. Smith, to your productivity parity as an element in that?

Dr. Smith: Well, we tend to have a pattern as between Canada and the United States. This seemed to be the picture when we looked at it last. We had the Dominion Bureau of Statistics undertake a survey for us to price the Canadian consumer index basket in a few United States cities and the United States basket in some Canadian cities, and very roughly what emerged from that was that the levels of consumer prices for the two national economies were rather similar. We in Canada tend to be rather higher on goods prices where our productivity disparity may very well be larger, and we tend to have relatively lower levels of service prices, for example, in the field of medical care or dental care. Here our prices are lower, and in fact a good deal lower in Canada on the average. But if you average them all out, they come out about the same. Here again, even within the two countries, one finds quite large price disparities as between different regions and different areas. So once again you see a situation in which there is rather a mixed pattern of differentials of levels.

Senator Nichol: Dr. Smith, we talked about goals this morning and we have talked about the identification of this potential line or this potential area that Senator Grosart asked about. Let us assume that we can identify goals, both national and regional, and let us assume that we can identify the potential, and let us also assume that it is desirable to drive for this potential. Now, having made those three assumptions, I should like to ask you about something that looks to me like a serious problem. It is admitted and I do not think that anybody pretends otherwise that it has been extremely difficult for people to spot major economic swings in time to do anything about them. You referred to the problems in the United States in 1964 with tax cuts being out of place, and so on, and some people would think that some of the things that have happened in this country in the last 25 years have been badly out of phase. If we have such a problem in identifying these major economic swings in time to do anything about them, and if we are unable to identify the lags correctly so that we can fire at the right time, is it not going to be extremely difficult to get into this very fine tuning that is involved in the steering mechanism you describe? You talk about steering the economy and I assume you mean steering with a delicate hand rather than driving from one side of the road to the other. Am I right in thinking that what you are really saying is that we are going to have to be much more technically competent in the field of applying the various controls than we have been, whether we are driving for a potential line or for a position 10 per cent below the potential line? Is not this the problem? And how do we get to it?

Dr. Smith: Well, the question we have raised here is as to whether major shifts in policy, in part, perhaps, aimed sometime earlier in the post-war period at the swings as they were seen—whether these large shifts might not in fact not stabilize the economy but contribute to destabilizing it. I say this because by the time one worked through this sequence of lags and got to the point where the impact of a major policy change has been felt in the economy, it might not be coming through in the right degree or perhaps not even in the right direction at the time it was needed.

Senator Nichol: May I interrupt you for just a moment and add one further point. Sir Roy Harrod said the other day that swings in the U.S. activity inevitably have a rather strong effect on the Canadian economy. It would seem that Canadian policy should be directed to offsetting swings in the U.S. economy. Perhaps this is done already. Pump-priming of the Canadian economy should be especially vigorous when the U.S. is in recession.

Dr. Smith: Yes, these external forces are very important and very powerful. I am not greatly persuaded that we can pursue radically different policies from the U.S. for any length of time. I think to some extent our economy will be influenced by this and we will get adjustments in one way or the other if we try to pursue substantially different policies.

Senator Nichol: I did not mean to interrupt you. It just struck me as being a problem. How does this fine tuning work?

Dr. Smith: In the past the term "fine tuning" has really been applied to the concept that you could somehow move in a quick nimble, and effective way with fairly short lags to deal with the problem we saw. What we have been saying is that kind of fine tuning does not seem to work too well. What we need is a longer view about how policies ought to evolve. We should try to avoid, if we can, large shifts in policy from restraint to stimulation and steer a more even course in these policies. That of course, will not be easy. There will still be in this sense scope, I think, for some elements of tuning, but it will not really be very fine tuning. I do not think it can be.

Senator Nichol: This is the question I am really getting to. Assuming that we are going to leave behind the fantastic monetary and fiscal swing from one extreme to the other, running six, eight and nine months behind events, you are suggesting we are going to have a much smaller deviation from some sort of normal fiscal monetary policy? Is not this a difficult and sophisticated problem, or at least as difficult and sophisticated as the one we have now, and if we cannot make it work this way, how much more difficult is it going to be to make it work here?

Dr. Smith: I think we are going to have a number of other policies and measures we will try to develop from others which will also fit with this. One illustration is construction. Here is a section of the economy that has gone through large swings. If we cannot find a steadier growth pattern for construction, it is going to be very difficult to operate steadier policies in the sense we are talking about them here.

If you look back at the construction industry, we have had in the past 15 years or so, or since the early sixties, this kind of pattern and I am talking about the volume of construction. We had a huge boom from 1955 to 1957, an increase of something like 45 per cent in real terms, within three years. In 1963 we had a volume of constructiom a little different from that in 1957. In fact, by 1963 or somewhere around that period, we had about 35,000 less people working in the construction industry than in 1957. We had a greatly weakened industry in which quite a number of construction firms went bankrupt and a reduction in capacity.

Somewhere in the early sixties the whole construction industry was in a loss situation. We then had a situation from 1963 to 1966 in which we pulled in 100,000 additional paid male employees. We had an increase of about a third in the total volume of construction and subsequently we have had very little increase, as you saw from the charts the other day. In fact, from 1966 to 1970, 30,000 paid male employees came out of the construction industry again and again a number of contractors have gone bankrupt.

We have a weakened industry. I think we should have a concern that we may, some time during the seventies, go through this process with another huge construction boom again. We must find some way to get a steadier course on construction activity. It is vitally important for our economy and we have suggested a number of ways in our work, particularly the Third Annual Review.

We have undertaken medium term investment surveys, covering larger business spending units and we have been trying to encourage the development of more longer range planning and more future orientation. We have asked in at least two of our Reviews for all major governments in this country to prepare and publish, annually, five-year estimates of their investment intentions. We have been encouraging business firms to prepare for medium-term plans in a steadier way and there has been in the course of the past few years some considerable development, both in Government and in the private sectors in this kind of planning. At the same time, one of the things which I think is troubling and which emerged from the last medium term investment survey is an indication that beyond 1971, in 1972 and 1973, the present investment intentions from the businesses surveyed showed a decline.

The Chairman: Dr. Smith, I wonder if I could interrupt you there. I think what is bothering the committee is really contained in your statement of your brief on page 19 and part of page 18. Starting on page 18 you say:

> The Council's approach would build demand management policies around the concept of "potential".

You then go on to say on page 19:

> Monetary policy, over the longer term, should be directed towards keeping the growth of the money supply roughly in line with the underlying growth rate of potential output.

Further on you say:

> Fiscal policy should be directed towards the maintenance of a small but sustained budget surplus at high employment.

Dr. Smith: For all levels of government.

The Chairman: You then say at the bottom of page 18:

> Any basic adjustment of strategy towards greater restraint or towards greater stimulation should depend on views about whether strong and persistent forces can be firmly anticipated that would either press the economy too hard against potential or induce substantial economic slack.

You have taken all your controlling mechanisms—long-term potential, monetary and fiscal policies planning—and directed them to a long term adjustment of the economy. As that adjustment takes place, as Senator Nichol said, it does narrow the area of difficulty and narrows the swing, but you still are going to have short-term problems. If you take away all these methods, where does the Bank of Canada or the Department of Finance or various provinces—the people who are operate economy—find the tools for controlling the short-term swings.

Senator Grosart: I will make your question a little more difficult by suggesting that one of the real problems is futurology and forecasting. The more imprecise your long-term forecasting, the greater are the short-term problems that you create. If you are out in this long-term forecasting the problems that are thrown up are much worse than going the way that we have been going for all these years.

There is an ancillary question: how do you get out, even if you want to, of annual budgeting. You recommended that the federal Government should put five-year estimates on its spending intentions. How can it do that under our parliamentary system?

Dr. Smith: The Government of Sweden issues every year five-year estimates of its investment intention plans.

Senator Grosart: How close are they to reality? My recollection is that the Swedish one is away out.

Dr. Smith: They are adjusted from year to year. It provides a broad view in the public arena—and in many cases it is very relevant to private decision-making as well—as to what all governments are intending to do, and therefore allows private decision makers to proceed with, I think, more certainty and perhaps more appropriately.

Senator Grosart: Do you think there would be any realism, for example, in such a projection made by the Government of Canada in 1968 when we were going to have this very short six months recession? How realistic would that line of forecasting have been of Government intentions? We had the statement of what was going to happen regarding the total of federal Government spending, the total of spending for all governments in Canada over this five-year period, and they were miles out.

Dr. Smith: One of the things that is very important is that we do plan very effectively for steadier growth in an area like construction. If we do not do this in a steadier way we will inevitably find that having deferred certain things in a period that may be slack—and construction tends to be one of the areas where restraints can be applied on Government expenditure—we will find that we tend to build a good proportion of our airports, harbours, roads, sewers, and so on at times when we are in the middle of an investment boom. Then we get to the point when things cannot be deferred any longer and they have to go ahead even under circumstances of strain and difficulty.

Business firms who came out of the period in the early 1960s having done very little investment for a number of years because market forces were weak had excess capacity in 1961-1962, and many of them said "We have got capacity available, we will await expanding demand, and we will use some of this capacity and divert some of our expansion until the situation gets stronger; and all of a sudden a great many decisions were made all over the place at the same time. Everybody wants something done quickly and we did not have the resources to be able to do it.

Senator Molson: The tendency has been to add increased capacity when the capacity was already excessive. This has happened in the pulp and paper industry in one or two instances.

Dr. Smith: I should emphasize that in the construction field, in governmental terms, the levels which are relatively large and important in terms of construction are municipal and provincial governments rather than the federal Government. The federal Government is a smaller factor in construction. Quite clearly in the past governments have exacerbated problems by simply increasing their construction expenditures at a time when private expenditures were increasing very rapidly.

Senator Grosart: How do you know where you are going to be when you seldom know where you are? When did the current recession end, or has it?

Dr. Smith: I would say that we are obviously expanding.

Senator Grosart: Is the recession over?

Dr. Smith: I do not know whether or not we have something that is called a recession. This gets determined by economists after the event.

Senator Grosart: We have had three fairly firm consensus predictions as to when this recession is going to end. It is always in the first or last quarter of some year.

The Chairman: If we come back to the question of having taken many of the tools and committed them to long-term planning, what are you going to do even in your narrowed swing problem about short-term control, because as you move to the potential aspect it seems that the short-term problem is going to get greater and not smaller?

Dr. Smith: Let me add something to what I have said: I think there exists much too much belief, conviction, that somehow there are easy answers, things that can be done to produce quick short-term effects.

The forces that are really operating in the economy at any point in time very largely have their roots in things that happened very much earlier, not a few months earlier but in many cases years earlier. We live in the kind of age in which we feel there ought to be instant answers. We live in a credit card age, an instant food age. We like to turn the electric light switch and have the light come on right away.

In fact an economy is a cumbersome, slow-moving sort of thing. It is rather like a very large ocean liner. If an ocean liner is moving in a certain direction and one wishes to change direction while it is moving at any speed, one turns the wheel and it takes about three miles before one sees the boat turn. That is the way we should think more about policy.

Once you are into a serious imbalance situation, whether it is serious inflation or serious slack, there is no quick way out once you get serious short-falls from good performance.

The Chairman: I do not know whether it is the council or others who have used the automatic pilot analogy, that you set the settings here for monetary and fiscal policy and you have your long-term planning. I think the committee would accept the fact that long-term control of the economy is probably extremely important, probably the most important thing. Like an automatic pilot there are bound to be small adjustments even though the adjustments are small. What I cannot see in your paper, which I think is almost impossible not to accept, is where these small adjustments are to be made. I do not think that you can avoid them on a purely long-term basis.

Dr. Smith: Let me use an analogy which reinforces your view that we must be more sophisticated. In the old days we would go up in a small biplane. When we saw the mountains ahead we would fly over them, and when we saw the valleys we would drop down. We now live in an age where flight plans are important. This requires a great deal of sophistication and a great deal of sophisticated machinery. It does not mean that we can operate

these things untouched by human hands. There are enormously sophisticated aspects of management that are implied in this. We must look further ahead to where we are going on our flight plan. This is really what we are saying.

Senator Grosart: What we are forgetting here is that the automatic pilot is the best example in the world of the necessity for instant feedback. The whole principle is instant feedback, which is what we are talking about.

Senator Molson: Even that overreacts in rough weather.

Mr. Thur: We have a certain number of problems because we cannot avoid a certain number of reactive policies. We will always have some accidental developments in our economy, therefore we need some devices for reacting to those developments.

The big problem in it—and this perhaps is the reason why we do not expand on this problem—is that if you try to make the reactive policies stabilizing policies, they cannot be used all the time, because any policy that is foreseeable is inefficient. You try it once. Perhaps, if you would like to pull down private investment, as Sweden did in the 1950s, you have a special tax on investment expenditure. If that is a normal policy of the Government, then you can be sure that all the investment will be tied up in the first part of expansion because everyone expects that the taxes will come. If they do not organize the investment for this period then they would pay the tax, but incorporate it immediately in their prices. So that is absolutely inefficient. If you have a policy setting which is foreseeable for some time, then it is absolutely insufficient for any stabilization purposes.

We use another method for private investments now; it is a kind of a tax holiday for one part of the investment funds. We do not know, but up to now there is no specific evidence that it has extraordinary stabilizing effects. The same thing happens in Germany; they have another approach, that the Lender, the provinces, have to make deposits in certain periods of inflationary pressure at the Bundesbank. They cannot use all the revenues they have. However, that did not avoid a big recession in 1967 and extraordinary inflationary pressure in 1970 and 1971.

We need a rapid adjustment of extraordinary inventive policy measures, which must be inventive for every situation, all the time. We have to avoid relying upon one or two policies solidly and using and over-using them all the time with the idea that at the end it has to produce some result. This kind of policy setting is not easy, so there will be uncertainties and I do not expect that with our problems and inflationary pressure we will see a very stable evolution within 10 to 15 years.

We are aiming for an exacting goal; it is not a situation of equilibrium, but of tension. I am sorry that we cannot expand on this short-term promise more than that, but the state of the art today is unable to produce a better result.

Senator Grosart: As someone said, Mr. Chairman, we have to invent the future because we cannot predict it.

Mr. Thur: This is not the opinion of the Council, but my personal guess is that the turning point in the present situation will turn out to be the fourth quarter of 1970.

Dr. Gillies: Further to Senator Nichol's exchange with the witnesses, there is quite a body of opinion among professional economists that fine tuning really cannot be done effectively and therefore ought to be avoided. They maintain that trying to apply it in monetary policy has caused more harm than good. Therefore Professor Friedman and his school argue that there should be a constant increase in the money supply and departure from the swings and changes it brings about.

What is your opinion with regard to the Friedman approach to constant increase in the money supply with increase in production?

Dr. Smith: There is a great range of opinions in this area, even in advocates of Professor Friedman's position. Some express views that are Friedman-ish, Friedman-ite or Friedman-iac. Our view is that we cannot practically visualize operating the monetary policy with some specific rule of thumb in which month after month, or quarter after quarter, the money supply is increased by such and such percentage. We do not live in the kind of world in which that is feasible.

Particularly in Canada, exposed as we are to a variety of disturbances, forces and influences of various kinds externally, that is not feasible. Internally we have also very highly developed and sensitive capital markets. A few years ago we witnessed the failure of a significant financial institution. Such an occurrence has effects in markets and the monetary authorities simply cannot ignore the ramifications and influences of this sort of thing.

That is why in laying out our strategy from the early stages of the First and Second Annual Reviews we have had a view which I suppose one might call Friedman-ish. However, it does not stipulate that there is some specific percentage increase in money supply to which we ought to adhere. There should be scope and we have even allowed, as I indicated, for adjustments in strategy under certain conditions, certainly for tactical departures in a variety of situations. However, our opinion is that we should really endeavour to move more in the future than in the past from very large to substantial expansion over a period of time, to substantial constraint and very tight liquidity situations for a period of time, then back to expansion in a major way.

My personal view would be that if the present situation, with increases in the money supply of approximately 10 to 12 per cent per year, were to continue for an extended period we would be laying the basis for developing increasing liquidity, which would make the problem of stabilization more difficult. That is the type of development we try to avoid.

Within the constraints, uncertainties and instabilities in which we have to operate I do not have a precise view as to what is exactly appropriate. We are discussing a rough order of magnitude approach.

Mr. Thur: One consideration is that in a rigid money supply evolution we must accept very high flexibility in interest rates. If that very high flexibility is accepted it may close a certain number of international channels, or everyone has to take the same step and accept the idea that they will become Friedman-ized.

It is not sufficient to be Friedman-ized; we must all be Friedman-ized to the same extent. If the United States money supply expanded by 6 per cent and that of Western Germany by 4 per cent we would see $10 billion invested in Western Germany within two hours. It is not a very easy problem. The rigidity in supply may represent extraordinary flexibility in interest.

Senator Molson: Is our Canadian operation with regard to money supply not more complicated by the fact that our control over the monetary system is less than ideal, in that we have apart from the banks all the near-banks, non-banks, and so on, which are a very large factor in this country?

Dr. Smith: Yes; this is a complication in all countries that have developed increasingly sophisticated and elastic systems of financial institutions and financial relationships. In a country like Japan, for example, where to a very much larger extent the financing of business expansion is done through the banks, the capacity of the central bank to get relatively quick effects from its policies, say within six months or so, is much larger.

Senator Molson: In other words, if you want fine tuning you have to take another look at our system and say, "Can you have fine tuning if we accept the Canadian system as it is without modification?"

Dr. Smith: Yes.

The Chairman: Would you enlarge on that, doctor?

Dr. Smith: No, I think this is a well taken point.

Senator Beaubien: Dr. Smith, our pulp and paper industry is very important in Canada. Its wellbeing can have a big effect on the GNP and employment. In the last three or four years their costs went up tremendously through wage increases, and when the dollar was unpegged last year it had the effect of breaking the camel's back, because their selling price is based on a world price and they have no control over that. At the moment they are in a very very poor condition; even the strongest have passed their dividends, and a lot are in danger of going insolvent. Is there any way that could have been foreseen two or three years ago; if it had been, could anything have been done about it; and if it could not be foreseen, what can be done about it now? This can have a big effect on our employment and our GNP.

Dr. Smith: I do not have enough knowledge of the economics of the pulp and paper industry as such to be able to provide a good answer to those questions.

Senator Beaubien: In any industry can you foresee that ahead of time?

Dr. Smith: I think that various industries have varying factors involved in their growth and development. Some of these factors are market considerations, which differ a great deal from industry to industry.

Senator Beaubien: Oh yes.

Dr. Smith: Some are technological considerations, which again may differ very largely from industry to industry; some of them relate to the capacities that may exist through a variety of channels to effect their productivity performance, and therefore their capacity to meet rising costs, absorb rising costs in some ways, without increasing prices. There is not some simple view that applies, in a sense, across the board to industry, which is what we are really trying to begin to get at in our last Annual Review, when we started to look at some of the major sectors of the economy. At that stage we were still looking at manufacturing, for example, as a whole, and not at its components. I would hope in due course the council's work could develop to a point where it would have a better developed view about some of the elements involved in particular industries within manufacturing, such as the pulp and paper industry.

Senator Nichol: Dr. Smith, taking the whole of your paper on balance, are you saying that what is needed is a much cooler approach than we have used in the past? In other words, in public terms and political terms the people of Canada should accept some variations from the ideal, both in terms of inflation rate and in terms of employment rate within Phillips curve, if you want, without demanding—if that is the word— a violent reaction on the part of the authorities to correct it. In other words, if you are working on a long-term plan towards this potential line, this means there will be variations on either side. Are you suggesting we should be more tolerant of variations on both these sides and not react as quickly or as heavily to correct them; let them move with the knowledge, hopefully, that the line is going the right way and that with time this will come back on its own, or with some moderate adjustment rather than having to be hammered back into the mould?

Dr. Smith: Yes, I think to some extent that is relevant. We have been trying to suggest that there should be more attention to and more concern with where it is we want to be five to seven years in the future, and how we get there. This should not preclude attention to as has been pointed out, shorter term problems. We will have to deal with many of these on the way along. Perhaps especially in circumstances when an economy is performing relatively poorly there is a great tendency to focus very great attention on the short run problems, on the departures from good performance in the circumstances; there is a tendency perhaps generally to feel there must be some way to get this corrected quickly and easily; we just have to find a way, and we have not found it yet.

I think that what we are really saying is that in the modern complex economy there is not some easy and simple way; we should not expect that there is some simple and easy way. We should set our sights on trying to do some of the things that will give us a better chance in the future to avoid recurrences of major difficulties of

this kind, recognizing that the difficulties we now face are not ones that in effect have their roots in what happened a few months ago and therefore something can be done now to change it back within a few months to something, that the roots go back into very complex, interrelated elements that take time to work themselves out. Policy needs to recognize that it is looking ahead over time in doing certain things that will make the economy work out, and make the policies and programs work out over a number of years.

Senator Nichol: I do not want to take anyone else's time. May I ask another question, Mr. Chairman?

The Chairman: Yes.

Senator Nichol: It is my impression, which may be an incorrect one, that over the last period since 1945—I am not sure I am using the right date when I say this—the provincial governments by and large have been completely expansionary in their policies towards industry, towards jobs, towards everything. Almost every one, in fact every one has been. This has been their preoccupation with attempting to reach their growth potential line, without identifying it perhaps, I suggest, but just the same trying to do it. The federal governments—I do not mean this Government specifically, but federal institutions—seem to me to have been preoccupied with restrictive policies over the last generation in many ways, in comparison to the attitude the provinces have taken. Is this because (a) that is correct—and I admit it is pretty broad brush stuff—and (b) if it is correct, is it because of the federal Government's responsibility for the currency system, or are there some other factors, psychological factors, that enter into this?

Dr. Smith: I think I would say the federal Government has taken a lead in these major policy settings, but I would say that at other levels of government there have been changes, let us say on the fiscal policy side of significant proportions. A number of provincial governments have constrained expenditures, and perhaps even more in some cases, various municipal governments are caught up in the difficulties.

Senator Nichol: By choice or by force?

Dr. Smith: Perhaps not so much by choice, but because of the realities of the difficulties of financing or of increasing taxes.

Senator Nichol: In psychological terms, it has not been a decision to do it because they wanted to do it but because they have been forced to do it by some other institutions.

Dr. Smith: There does appear to me to be a very broad basis. This applies in governments generally and in the private sector and in individuals' business concerns and institutions. There appears to be a very broad basis in which most units and organizations in our system would like to have more access to resources, and do more things. Some of these aspirations have been obviously very high, on the part of municipal governments and perhaps in some cases in provincial governments and to some extent from time to time in the federal Government, in its expansion. There are needs that are perceived in the cities, for coping with a great range of very difficult problems. The cities have been growing with striking speed and vigour, much faster than those in the United States or in Europe, on the average.

We have been facing an array of difficult problems, some administrations have wanted more resources, in the provinces in responding to a variety of needs as they perceive them, in their areas of their jurisdictional responsibility.

I do not know how one strikes some kind of balance here as to what is appropriate, but I would say that there is certainly growing scope and growing need for a broader co-ordination of fiscal policy on an inter-governmental basis.

We have talked here, we talk in our work always, about the fiscal position with respect to all levels of government combined. I think that is the proper focus that we should be looking at, in our approach to the use of fiscal policy instruments.

Senator Nichol: I think part of the reason is because the provincial and, below them, the municipal governments, deal in their expenditures and in their operations, by and large, with demands from the people, which are much more intimate, much more direct and much more personal. If you are dealing with demands for sewers, schools and roads and garbage collection, this is a much more intimate and much more driving force on the political system than is NATO or foreign affairs or something of that nature.

Dr. Smith: I do not really have any comment on that, senator. I think that may be the case.

The Chairman: Dr. Smith, as you reach this potential line through the exercise of your proposed policies, you would likely be involved in some sort of what is termed creeping inflation. Do you feel that a little bit of inflation in the economy is not a bad thing?

Dr. Smith: I feel that we ought to strive to place reasonable price stability into the same context of other goals. I think we know enough to know that at least serious price instability poses a number of very difficult problems.

At the same time, I would not be prepared to say that reasonable price stability must be the kind of goal that supersedes all the others, that it stands on a pedestal by itself. We must see this in the context of other goals with inter-relations and inter-actions about this.

Senator Grosart: What is the long-term number on inflation in our economy since we started our statistics?

Dr. Smith: Over the post war period, the average annual increase in prices has been about 3½ per cent.

Senator Grosart: Is that not a measure, to some extent, of what we loosely call prosperity?

Dr. Smith: No, I do not think I would accept that as a measure of prosperity. I would accept it as a measure of

simply what price increases have occurred, as best we can measure them. There are some deficiencies in the measures, too. There are probably some biases that tend to make the price calculations look a little higher than they may actually be. I would not want to press that too far, but somewhat higher.

Senator Grosart: Is not price deflation a function of depression, much like the 1930s?

Dr. Smith: If you have a situation in which there is a great deal of slack in the system and not much demand, if demand is depressed, you have an environment in which it is more difficult, if this slack is large and persistent, to make price increases stick.

Senator Beaubien: Doctor, you are talking about price now, but would not you say that wages have gone up by about 60 or 70 per cent in ten years, a little more? Would you not say that?

Dr. Smith: Yes. I do not have the figures of wage increases.

Senator Beaubien: So, roughly, though our prices in a lot of cases have stayed, by mass production, and the price may not have gone up terribly, wages have gone up. Somebody, who should know, told me the other day that a teller in a bank has had a 100 per cent increase since 1961.

Senator Molson: Underpaid, perhaps.

The Chairman: Have you any idea of bank profits in the same period?

Senator Beaubien: The banks have done well. I am not complaining about the banks. The banks have been pretty smart. I am saying that that is what has happened. I know that a carpenter ten years ago was getting $2 in half an hour and now he is getting $6 in half an hour. This is due to a few different things here and there, I know. Though you may say prices have gone up 3 per cent, it is a very mixed bag, it all depends on whether you have to hire a lot of people or not.

Dr. Ostry: I wonder if what is bothering Senator Nichol and some of the others is the question of whether we can sort out strategy and tactics. You put it in terms of turning points. I think we have said that, ideally, one would not want to depart from this broad setting of the dial, except for short term tactical reasons. But then the question comes, how can you tell what is going to be short term tactical and how can you tell what is the beginning of an underlying change, either in structure or in trend, which would necessitate the rethinking of strategy?

One of the things that is emerging in the literature is that you need a larger range of policy instruments, you need a larger range of selective instruments, which have to be ready; but that you should not make a decision until you have to.

I know this sounds contrary to what we are saying, but it is built into the system, that you should not make a decision until you have to, because you maximize information in that way.

What we have seen in the past is that we have made decisions in great uncertainty—and there is always going to be great uncertainty—and we have made decisions which are very large, so that their consequences are very long-run, (a) because of the uncertainty and (b) because we have not had a large enough range of selective instruments whose impact is less pervasive, to deal with these tactical approaches.

If you can do that and if it turns out that you were wrong and it really is a strategic thing you are dealing with, at least you have not jumped that decision. I think, doctor, you were saying there is going to have to be enormous ingenuity in this and we have now no specific suggestions. I think there has been a perceptible shift to more selective instruments in many countries and away from massive instruments.

What we are saying is that massive instruments used for tactical reasons become very difficult because their consequences are so pervasive and so long run.

Senator Bourque: My question is simple, Dr. Smith, but I think it has a great bearing on the finances of Canada. Do you believe there is any possibility that the financial situation existing in the United States right now will have any effect on our financial position here in Canada?

Dr. Smith: Yes, senator. I think the financial developments in the United States, in a great variety of ways, have very considerable influence in Canada. Our two economies in financial terms are quite closely linked. We are linked through a number of institutional channels. We are linked in various kinds of market ways. Funds flow very easily between markets and institutions in the two countries. There are information bases of various kinds that can have at times almost instant reflections.

I think in some ways there are extraordinarily close financial relations between the two countries, but in a rather general way in today's world, as one can see from this morning's newspaper, there are very close financial links that have merged and strengthened in the post-war period.

Senator Grosart: Dr. Smith, there must be some limitations on long-term forecasting or planning based on GNP figures. In the past there have been many factors that have had nothing to do with the GNP but have been major determinants in our productivity.

I think of Rachael Carson's book and the time lag of 10 or 15 years before the ecological problem became a major factor in the general life of every western country. Nobody predicted the problem. It was there for the economists to see and for the politicians to see. It came. But it was laughed at. It was the subject of scorn in its own discipline. Suddenly it is governing our lives to a very large extent at the present time.

Look at Japan. I have seen three different predictions in learned papers in the last six months on the direction of the Japanese economy in the next five years. Will they

devalue or not? Some say yes; some say no; some say they will have to do it three times.

How can we factor-in these things into any kind of planning?

Look at the common market situation. I am sure you are well aware of the different interpretations of the effect on our economy of the British, Scandinavian and other entries into the common market. I actually saw one statement to the effect that it would only affect 6 per cent of our total exports to Britain. But another statement by another economist was that it would affect 60 per cent. I checked that to see if it was a typographical error. It was not.

Consider the problems of regional disparity which have been with us since confederation. They have certainly been greater in earlier times than they are now, at least in human terms, and yet, suddenly, regional disparity becomes a topic of popular discussion. Suddenly, if you like, politicians are forced to take account of it.

What will happen tomorrow? What will be the external pressure that will make all predictions and all planning that might be made today absolutely invalid?

I heard something a while ago about a distinction between tactics and strategics. The soldiers in Viet Nam have found out very quickly that the tail usually wags the dog. Nobody worries about strategics there any more. It is tactics now, if you like to make a distinction, although that distinction has pretty well disappeared by now.

How do you factor-in these things into these predictions based on the GNP numbers?

Dr. Smith: Well, senator, I do not think we know how to do that very well with respect to many of these large basic things. One hopes that over time we will find better ways to take account of these things.

In that context I would suggest that we should be thinking about how we can develop and devote more significant resources to social science research in Canada. We need better information and better analysis in this broad sense.

Senator Grosart: Has the Economic Council a social scientist on its staff?

Dr. Smith: We have a mixture of people from different areas, but no one who is a psychologist or sociologist as such. We have a mixture. Perhaps you are pointing to the need for more synthesis and interdisciplinary work, but that is very difficult to accomplish in the social sciences.

Senator Grosart: They all say they do it.

Dr. Smith: We are not alone in Canada, but we are spending in relation to the resources we have available for research in the physical and natural sciences a very small amount on research in social sciences.

I think in both Canada and the United States the amount being spent on social sciences is about 3 or 4 per cent of the funds being spent on the natural physical sciences. It is very small. We need to devote more to it.

One of my favourite analogies that I often use concerns the DC-8 aircraft. It took eight million professional man-hours to put the DC-8 aircraft into the air. We have made very few major economic or social policy-decisions in Canada with, I suspect, anything like 100,000 hours of professional man-time.

We come up with quite large projects and proposals for programs of various kinds, and with very little work we put them into the air.

We also need with that two or three other things. We need more experimentation to find out what will work and to find out what the wing shapes should be to make something fly really well. We need much better developed evaluation mechanisms to ask ourselves after we have launched something, "Does it really fly? Does it really work in relation to the objectives and goals we had in mind?"

Senator Grosart: Without mentioning names, I must say that sometimes evaluation means that we do not launch programs.

Dr. Smith: Sometimes when there is good evaluation beforehand we realize that we should not put the thing into the air, because it will not fly.

The Chairman: We will have one last question from Senator Nichol and then we will adjourn.

Senator Nichol: The crisis news this morning concerns the U.S. dollar in Europe. What fascinates me about it is that at the moment it is not really being called the devaluation of the American dollar; it is being called the revaluation of the other currencies. Perhaps it is really the same thing. It used to be in the past that we would read in the paper every week that Fort Knox gold was going down—and at that time it was going to France. We have been reading in the papers for years about the strain of inflation. There was the Johnson administration and then the Nixon administration and after that the strain of the Viet Nam war and what that was going to do to the dollar.

President Nixon predicted a $3 billion deficit which turned out to be almost a $17 billion deficit, and in recent months there has been a fantastic output of money in the United States which has put the stockmarket way up.

And yet no one, except a few reasonably sophisticated people, have been looking at what was going to happen to the U.S. dollar. It now appears that "it" is happening. Perhaps nothing will happen, but it looks pretty messy as of this morning.

Senator Grosart: Could you name the few who predicted it?

Senator Nichol: I could name some, yes.

Senator Grosart: I have not seen their predictions.

Senator Nichol: There are several market services and banking houses and so on, and I think I am correct in saying that Pierre Rinfret discussed it quite a bit, although I may be wrong there. But I am really asking how can this happen. Does it happen deliberately? Does

it happen by accident? Or is the whole thing an uncontrollable situation? That is a good question.

Dr. Smith: And I do not have a good answer.

Senator Nichol: But it did look almost inevitable, did it not?

Dr. Smith: Well, I think there have been a number of people who have been concerned that the United States balance of payments position was one that was not so healthy and there were certain vulnerabilities involved in the large accumulation of dollars abroad. Consideration of how to cope with this type of problem has been on the analyses have been made but nobody has really come up with good simple solutions to basic problems of this kind. There have been some fairly fundamental studies going forward under the International Monetary Fund to look at the whole international monetary mechanism which was set up after the war and which, on the whole, has served very well over the last 25 years. But there are problems involved, and they have been looking at these problems to see whether they can change or adapt the system in some useful way. There have been some changes made such as the introduction of the Special Deposit Receipts but obviously there still remain needs for further adaptation and development, and these are still under study.

Mr. Thur: In general we had this situation for about two or three years and everybody was aware of the problem. The problem is one of the real timing of this crisis which nobody expected now. Everybody expected that it would happen in about two or three years from now and for one very basic reason. You can see in the newspapers today that some central banks refused to buy dollars while others did not. The Bank of France is continuing to buy them as well as the Bank of England and the Bank of Italy. So everybody expected that the general arrangement of exchange rates would take place when some progress was made on a European common currency, because the problem of devaluation or revaluation of moneys or the devaluation of the dollar involves a question as to the exact level. Today the situation of the dollar having regard to all the different countries is very different. The surprise was that the market was so nervous about the future of the American dollar and just one common communique of five research institutes in Germany which meet twice every year and which issues communiques twice every year, had just one sentence that perhaps the German problem would be solved—that is inflationary pressure—by accepting the Canadian example and floating the exchange rate. And then you had the next day the explosion of this speculation.

Senator Nichol: What I really wanted to say there was that with all the economic planning and all the plotting and figuring and analysing and everything, in the final analysis what has happened has been, perhaps, not the result of economic forces in a narrow sense but of political forces which have said "Enlarge the money supply and we will stay in Vietnam", which makes your job infinitely more difficult.

Senator McLean: With reference to Senator Nichol's question concerning the American dollar and the pounding it has taken in the last two days, what effect will that have on the Canadian dollar in relation to the American dollar?

Dr. Smith: I don't have a view on that, and I think it would be a very brave and bold man who would express a view as to what might happen. It may have very little effect.

Senator Grosart: I just want to say, Mr. Chairman, that a philosopher a long time ago was asked for a definition of inevitability and he said the only definition he could give was that "It is what happened."

The Chairman: Honourable senators, next week we will hear from Dr. Lipsey who is an expert on the British prices and incomes policy; from Dr. Crispo who has filed with the committee a most provocative paper on the problems of labour unions and negotiations and the Government position apropos those negotiations; and from Mr. Gibson who I think will probably represent the views to a large extent of some of the members of the practical business community. It should be an interesting week.

I should like to thank Dr. Smith, Dr. Ostry and Mr. Thur for so skillfully laying what I consider to be an excellent foundation on which the committee hearings can go forward.

The committee adjourned.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT
1970-71

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 7

WEDNESDAY, MAY 12, 1971

Fourth Proceedings on the Question of
Growth, Employment and Price Stability

(Witnesses:—See Minutes of Proceedings)

23343—1

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
	O'Leary
	Paterson
Gélinas	Phillips
Grosart	Sparrow
Hays	Walker—27.
Isnor	

**Ex officio Member*

(Quorum 7)

Orders of Reference

Extract from the Minutes of the Proceedings of the Senate, Tuesday, March 9th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said *Estimates* reaching the Senate.

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Tuesday, May 4, 1971:

"With leave of the Senate

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relations thereto.

The question being put on the motion it was—

Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

23343—1½

Minutes of Proceedings

Wednesday, May 12, 1971.
(7)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10:00 a.m. to consider the question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Benidickson, Bourque, Croll, Grosart, Laird, Langlois, McLean, Nichol, Phillips and Sparrow. (11).

Also present but not of the Committee: The Honourable Senators Cameron, McGrand and McNamara.

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. W. Neville, Editorial writer; and Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Heard as witness: Dr. Richard G. Lipsey, Professor, Department of Economics, Queen's University.

At 12:45 p.m. the Committee adjourned to 2:30 p.m. today.

At 2:30 p.m. the Committee resumed.

Present: The Honourable Senators Everett, (*Chairman*), Beaubien, Benidickson, Bourque, Croll, Hays, Isnor, Laird, Langlois, Manning, McLean, Methot, Molson, Nichol and Sparrow. (15)

Also present but not of the Committee: The Honourable Senators Lamontagne, Lawson, McGrand and McNamara.

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; and Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Heard as witness: Dr. John Grispo, Director, Centre for Industrial Relations, University of Toronto.

At 5:10 p.m. the Committee adjourned to May 13, 1971, at 10:00 a.m.

ATTEST:

Gérard Lemire
Clerk of the Committee

The Standing Senate Committee on National Finance

Evidence

Ottawa, Wednesday, May 12, 1971.

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 10 a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, in resuming our hearings on growth, employment and price stability in Canada, we are fortunate in having as a witness this morning Dr. Richard Lipsey who is presently the Sir Edward Peacock Professor of Economics at Queen's University.

Dr. Lipsey holds his doctorate in economics from the London School of Economics. He was Professor of Economic Theory at the London School. He has been Professor of Economics at the School of Social Studies at the University of Essex, in Colchester. He spent the academic year 1969-1970 as Professor of Economics at U.B.C. before moving to Queen's.

Dr. Lipsey's publications include an English publication entitled *An Introduction to Positive Economics*. An American publication is entitled *Economics*. He has also written a work entitled *Introduction to the Mathematical Treatment of Economics and a Study of the Theory of Custom Unions*.

From 1961 to 1963 Dr. Lipsey was Director of Research into Obstacles to Growth in Britain for the National Economic Development Council. He has also worked with the Social Science Research Council, the National Institute of Economic and Social Research, and was a member of the Council of the Royal Economic Society.

Dr. Lipsey has specialized in the relationship of the theoretical and practical aspects of economics. He is an expert on the method through which the British Price and Incomes Policy operates and he has made a particular study of the results of direct intervention of price levels.

Honourable senators, you have the brief that has been filed by Dr. Lipsey. It is not our practice for witnesses to read the brief, but rather to speak briefly on the highlights and on any other material that they wish to bring forward, and then to have questions. I would now ask Dr. Lipsey to take the stand.

Professor Richard G. Lipsey, Department of Economics, Queen's University: Mr. Chairman, honourable senators, I should first like to tender an apology. The brief, due to my absence until yesterday afternoon, was dictated over the telephone and there are a few typographical errors which I am sure you will all manage to catch. I do know that plural verbs should go with plural subjects, which did not always come across the telephone. I do not think that any of the typographical errors will upset the understanding of the brief. However, I should like to point out that on page 2, line 8, The word "known" should be "non".

I do not really propose to rehearse what I have written here, but I should like to highlight and elaborate on two points that I did not have the space to elaborate on in the Written brief, and then I would like to make four short comments on the brief presented to you by Sir Roy Harrod. After that I shall be pleased to try to answer any questions.

There is a long history of incomes policies in the European countries since the war. These attempts have been made at varying times with varying degrees of intensity ranging from pretty well merely exhortation through to policies with some fairly strong teeth in them.

The experience of these policies has been chronicled in great detail by Professor David Smith in his study of the Economic Council of Canada, and that is an absolutely excellent source for the facts of what was done in various European countries and an assessment from the horse's mouth of how successful they thought their policies were.

Coming now to the first point in the brief, one of the really unsettled questions in economics is the extent to which post-war inflations have been what the economists call demand poor inflations associated with too much demand pressure in the economy, and the extent to which they were what are normally called cost push inflations, inflations that were generated by pressure particularly from the unionist sector of the economy on wages, pressure that was independent of the level of demand—and if it is independent of the level of demand by traditional measures of fiscal and monetary policy.

I think it is the majority opinion—one can always find exceptions, but I think it is the majority opinion, and that opinion is chronicled in Dr. Smith's work—that it is extremely difficult over any long period of time to control inflation by means of an incomes policy, whatever its particular form, when the economy is suffering from severe excess demand pressures. This seems to be an extraordinarily difficult thing to do. Incomes policy really comes into its own if the economy is suffering from cost-push pressures that cannot be controlled by aggregate demand policies. When I say "come into its own", I mean that here is the place where we cannot say on the basis of past evidence, categorically, that it cannot work, but even here it has extreme difficulties.

I would say that one of the questions that will be settled in the next few years by professional economists but which is still a subject of debate—and is not an easy question to settle—is the balance in the amount of inflation in the various countries including Canada that can be accounted for by an independent cost-push inflation. But since we are not by any means certain, and since it is a very difficult issue to settle—and I know because I

have tried it for the U.K.—the scope for an incomes policy to stop cost-push pressures is as yet somewhat uncertain and somewhat a matter of debate.

Nonetheless, if one does try, there are really two things that have to be distinguished, and both of these have been tried in Europe. One is that you may wish to use an incomes policy to slow down temporarily the rate of inflation to get over some temporary crisis. Typically in the U.K. and in the Netherlands and elsewhere this temporary crisis has been a balance of payments crisis, but it does not have to be.

There is good evidence, some of which is chronicled in work that I have done, that for a short period of time the rate of inflation can be substantially slowed. By "substantially" I mean 2 to 3 per cent less than it would have otherwise been for a short period of time by direct intervention. And even quite informal direct intervention, if it has the co-operation of unions and employers can work for a short period. And by "short" I mean anything from a quarter of a year, which was the U.K. experience to which Sir Roy Harrod referred, up to two years, which was the experience under Sir Stafford Cripps in Britain in the late 1940s.

I take it, however, that when we become concerned over the problem of full employment without too much inflation we are not thinking of some temporary slowdown in the rate of inflation. We are really concerned with the long-run behaviour of the economy. If we contemplate an incomes policy to reduce the apparent dilemma between trying to have full employment and trying to have something close to a stable price level, we are thinking of a policy that must operate over a very long period of time.

The evidence is, I think it is fair to say, that this is very much more difficult than some short term of slowing down the rate to meet some temporary crisis.

I shall just allude to two of the problems that occur in any incomes policy but which become more important the longer that policy is meant to operate. The first and obvious problem is how to operate it. How do you get a rate of increase of prices and costs lower than they otherwise would be. Exhortation guidelines do seem to have had some effect for short periods in the times that they have been tried. I think it is fair to summarize the evidence by saying that they tend to have progressively less effect as time goes by. This is an opinion, and it is always extraordinarily difficult to read the diverse facts of many countries, but I think my opinion on reading the facts is that if we are going to imagine an incomes policy that really has a substantial bite over a long period of time, something much more substantial than exhortation is required. This means some kind of control and, generally, some kind of teeth that can punish those who avoid it or try to seek to avoid it.

I do not want to go into these controls now, but it is obvious from wartime experience and experience elsewhere that these controls are not easy things to administer. They are costly. They are things that would be accepted in a relatively free market society only if it were thought that the gains were substantial and were worth the cost.

Even if you could overcome the problem of control, really serious problems arise when you ask yourself how to exercise the control.

In the brief I quote Professor David Smith in his study for the Economic Council of Canada. I would just draw your attention to Smith's general conclusions as the result of his study in the countries that he looked at in Europe. His conclusion was that the cruder the target that is given for the increase in wages and prices the easier it is to control. If everybody gets 3 per cent a year that is, administratively, fairly easy to control, but it tends to cause problems with the workings of the market in in adjusting relative prices and relative wages.

The more subtle the control or the more you attempt to take account of differences in market conditions in the sectors of the economy, the harder it becomes to administer. So there is always some dilemma between ease of administration and a control that does allow the various sectors of the economy to adjust to each other.

I should like to spend two minutes elaborating the problems with one of the slightly more subtle controls than just the statement: Everything goes up at X per cent per year. To show them I will just concentrate on controls over wages, which must always be a key part of any incomes policy.

Beyond saying that every wage rate goes up by some amount per year—usually the trend increase in productivity, the next more subtle control is to say that each sector will have an increase in wages equal to its own productivity increase. Experiments along some of these lines have been tried in the U.K. Now, the problem with that is that as the economic growth proceeds and people become richer in real income, the way in which they want to spend their money does not necessarily, and by observation does not, conform to the way in which productivity is increasing. And of course the most dramatic example from past history has been the rapid rates of growth of productivity in the agricultural sector combined with very low increases in demand. The opposite one would be very rapid increases in demand in the service sector combined with rather low productivity increases.

If the pattern of demand changes, as we observe it to as income rises, then it is necessary that the resources of the economy, labour, et cetera, are reallocated to meet the changing pattern of demand. If we say arbitrarily that wages will go up according to the rise in productivity in a particular sector, we may quite easily find ourselves in a position where we are raising wages fastest in those sectors where not only is more labour not needed but the supply of labour needs to be reduced. Conversely, we are denying increases in wages in those sectors where more labour is required.

The Chairman: Would you go back over that again, Dr. Lipsey?

Dr. Lipsey: I will take a run at that again. If we say that each sector will have an increase in wages equal to the rate of productivity growth of the labour in that sector, then we will say, for example, that one of the fastest rates of increase in wages will be in agriculture,

because productivity is growing rapidly there, and one of the slowest rates of increase will be in those service sectors where productivity is growing slower. So we will change the structure of relative wages according to what is happening in productivity. That does not necessarily conform to what is happening to the change in demand, as people's real income rises. Indeed, it is observed that it does not, and I have tried to give two examples.

Senator Grosart: How long is the lag between the establishment of a productivity rate and its visibility publicly?

Dr. Lipsey: Well, there is also, of course, a lag problem. Short-term changes do not show up and you have a very difficult problem in calculating them. Economists have great difficulty in calculating rates of productivity growth. Indeed, one of the Dutch problems referred to by Professor Smith is that the unions became convinced that the Dutch measures of productivity growth were not correct and were indeed biased downwards. One of the reasons for the breakdown, I think, was the loss of confidence because the productivity measures to which wage increases were geared were not fair. But it is extremely difficult just in principle, even with the best will in the world, to calculate these things.

Secondly, as you mentioned, senator, there is lag in your information. And then you come back, to finish it, to my problem that if the pattern of demand is changing you wish to move labour into sectors even though productivity is not rising. If that is what people want to spend their income on, then it is necessary to get labour allocated in that direction.

Senator Grosart: Would your knowledge lag be less than a year at any time?

Dr. Lipsey: No. I think it would be almost impossible to have reasonably agreed productivity figures with less than a year lag. If you look at the productivity figures reported by any government—and I have not looked carefully at DBS; I am more familiar with the British ones—they are being revised continually for about three years after their publication. The revision is often quite substantial. There was a period in Britain where we thought the underlying growth rate was quite substantially different and then three years later we finally came to agree that it was, so that the lags can be very long.

Senator Grosart: Would it not also be influenced by capital investment, technological developments and so on?

Dr. Lipsey: Indeed. If I may elaborate a little on this, one of the reasons the British wanted to get some productivity gearing is that quite naturally they wanted union co-operation in introducing new techniques that might displace some people from jobs but would raise productivity and wages for those remaining. So one of the reasons for saying "if you have an extra high productivity rise in your sector or industry, we will give you an extra high wage increase," was an incentive to the unions to co-operate. But it does pose this problem that you are then going to gear, if I can put it in an economist's nutshell, the structure of relative wages to the supply side of the economy while ignoring the demand side.

Senator Laird: Having in mind your theory, where does this group on fixed incomes fit in.

Dr. Lipsey: This is another thing that becomes extraordinarily difficult with an incomes policy—how you operate on those people with fixed incomes, or, if I can elaborate on this, those people for whom it is almost impossible to get any productivity measure, and the public sector is a classic example of this. Here I am referring to schools, civil servants and all sorts of people. It is much easier in industry than it is in the other sectors.

Senator Laird: It is in fact impossible in these sectors?

Dr. Lipsey: Oh, yes, it is. By that I mean there is no way in which I could imagine getting an agreed productivity figure for the other sectors. The tendency, therefore, is to take the national average.

Senator Laird: Therefore there is no solution to the problem so far as they are concerned.

Dr. Lipsey: No, indeed, there is not. There is no question that there are sectors for which it is for all practical purposes impossible to get anything approaching an agreed measure of productivity, and those are the places where the two sides to the bargain are obviously going to fall out because the room for disagreement is so large.

Senator Laird: Then what happens to these unfortunate people?

The Chairman: Senator, I wonder if we could allow Dr. Lipsey to complete his statement and then we will come back to those questions.

Senator Laird: Fine. He knows what I have in mind.

Dr. Lipsey: That is one point I had not elaborated on in the brief, and the other point which I have referred to in the brief, the last point, is something on which I did a lot of work in Britain in trying to assess the effectiveness of the British incomes policy experiment that tended to get progressively more serious—that is, more teeth—as time went by. Professor Parkin and I put two man-years into getting really firm evidence on this as opposed to opinion which was extraordinarily difficult, and I am not surprised at how little we know because it is so difficult to answer even one question properly. But what did we find? I shall state the conclusion and then try in two minutes to deal with the reasons why. I think this is an extremely serious problem with an incomes policy. What we estimated for Britain was that in the latter part of the 1960s the incomes policy, operated at its strongest and with the most teeth in it, actually was inflationary. It is awfully hard to put a figure on it, but our estimates, which were the closest we could get, were that it raised the rate of inflation in Britain something between 1 and 2 per cent above what it otherwise would have been for equivalent market conditions. That is the state of demand, employment, output, etcetera. Now the reasons for this take a lot of expounding and there is a ten-page

article in front of me but I shall try to give the reasons very briefly. First, you have to start with an overall guideline and then you are going to allow departures for the reasons we have discussed. It is awfully hard to sell anybody an overall guideline that is less than the trend rate of growth of productivity. Why should we accept anything less than that? Whether you could do it is a political question, but it certainly is politically difficult. Let us assume that we start with the guideline being the trend rate of growth of productivity. Now if money wages rise at that rate, that, as a rough rule of thumb, is a non-inflationary increase. But what actually happened was that the guideline became the floor, particularly in the public sector which was already alluded to, and where it is awfully hard to know what it should be anyway. The guideline, as I say, became the floor and then the bargaining started as to how much you could go up from the guideline and the evidence is that some sectors did manage to get substantial increases above the guideline. Now that was all very well when they had a real demand inflation on their hands. They might have had an explosive situation. They appeared to slow down the rate of increase of wages slightly. Then they said, "Let us do the rest of the job by traditional measures of depressing demand." So they depressed demand, and because they had built the floor in they lost the demand effect that they otherwise would have got, and if we take the economy when it was slightly cooled with a slightly higher level of unemployment, the evidence is that the rate of increase of money wages was substantially more than it had been for that level of demand when there were no guidelines. The net effect was that they got the unemployment, they got more inflation than they would otherwise have had and they had all the apparatus of controls as well.

Now, that does not have to happen, but I think at the very least it can be said that it did happen in Britain and I think it should be pointed to as a real danger in having your guideline become a floor and having an effective average increase substantially exceeding the guideline, because you are never 100 per cent effective, and then, particularly when the economy is in slightly depressed conditions, you are worse off than you would have been, because you lose the depressing effect of a slightly slack labour market that you would otherwise have had. Now, if that is not clear, I would be quite happy to come back to it later.

Now, if I could pass on, I should like to make four comments on the brief presented to you not long ago by Sir Roy Harrod. At the outset I want to stress, as I have already tried to stress, that this is not a simple area. It is an area in which what we do not know is at least equal to what we do know. There is some knowledge, but there is plenty of uncertainty and plenty of room for honest differences of opinion. However, I just want to deal with four points arising out of what Sir Roy said which I think were very important.

First, he said that the inflation in the last two or three years was a totally different phenomenon from what we have had in the past and that we must therefore look to new explanations and to new cures. Now, I took the trouble last night of just plotting the level of wage and price inflation in Canada against the level of unemployment as an index of demand in Canada, and without bothering you with the details, I think that is a slightly extreme judgment. I think that quite clearly something is happening to cause concern, but I think there are other explanations that need to be studied by economists. It is too soon—and here a careful study has to be made and I hope to set out on one myself in the autumn—to take the view that the whole world has changed and we must look for new choices and new solutions. If you take the figures for wage inflation in 1968 and 1969 in Canada, you will see that they were high for the levels of unemployment which we had. But if the level of unemployment was three-quarters of 1 per cent lower than it now is, no one would have looked twice at those points; the points would have looked to be very close to what we had—let us take it a little stronger and say if the level of unemployment had been 1 per cent less than it was.

I am still disturbed at the inflation that we have had, going along with the unemployment, but given that it was about what we would have expected with 1 per cent less, it seems to me that before we accept this extreme view other possibilities as to why the economy behaved, as I would say, slightly differently from the way it had in the past would need to be investigated. I have not investigated that yet but intend to try. However, I think that is just a little strong.

There are two other points. Sir Roy Harrod addressed himself to the British experiment and referred—and this was widely quoted—to the six months' wage freeze which, in his words, was 100 per cent successful. I am afraid I cannot agree with that, and I think one must accept that as a slightly off-the-cuff view.

I have in front of me a chart from the study to which I have already referred, that we made of British incomes policy and what, in fact, we found was that in the first quarter of the wage freeze wages did rise much less than would have been expected for the equivalent state of the economy; they rose by almost 3 per cent less for a quarter. But in the second quarter of the wage freeze they were only half of 1 per cent less than you would have expected. Indeed, David Smith in his study states that the six months' wage freeze was already breaking down before it was abandoned; and the objective evidence here is that it was, in the sense that in the second quarter you were almost back to what you had. But even more interesting—and this chronicles what has happened in so many places—when the six months' moratorium was over, the most rapid wage increase ever achieved in Britain, for that level of the state of the economy, was posted for the next two quarters. The wage increase was 4 per cent above what it had ever been for the equivalent state of the economy, so that the six months' moratorium was reversed in the following six months. I think that supports what has been found so often: you can do it as a shock measure, for a while; but if it does not then work the effect is reversed, and a year and a half from then it is very hard to tell, looking at the level of wages and prices, that anything had ever happened.

Senator Nichol: I just want to get the figures clear in my mind. You said 3 per cent less and a half per cent less. You are talking about 3 per cent and a half per cent of the total cost; you are not talking about 3 per cent of the increment?

Dr. Lipsey: I am sorry.

Senator Nichol: You said it was a half per cent lower than it had been. You mean it is a half per cent of the absolute figure?

Dr. Lipsey: I am sorry. I can state it again.

Senator Nichol: No, I understand it.

Dr. Lipsey: The technique is to estimate from times when there was no incomes policy what you got by way of wage increases for given states of demand. In that quarter the index of wages rose by 3 points less than it ever had before for an equivalent state of demand. In the following quarter it rose by one-half of one point less than it did normally. In the following quarter it rose by four points more than it normally did for that state of demand.

The Chairman: The freeze was off then.

Dr. Lipsey: The moratorium was off, and there was then an attempt to operate a review policy, but a voluntary one. The actual freeze officially lasted two quarters, but appeared to be breaking down anyway and was very difficult to operate, and once the absolute freeze was taken off this is what happened.

Senator McLean: And the average of the four quarters was higher?

Dr. Lipsey: I have not got it here. I am reading it visually from a graph, but I think there is no doubt that the average for the four quarters was higher than it would have been, which supports what I said earlier. I do not think there is any question that if I average those four quarters it would be above what they were getting without an incomes policy for the equivalent state of the economy.

The Chairman: Is not the empirical data the same for the Korean war freeze imposed by the United States?

Dr. Lipsey: From memory I believe that is true for the United States; from knowledge it is true for Britain. Sir Stafford Cripps had the wage restraint that did work in the late fifties but, as soon as they took the lid off, the rate of increase was faster, and if you average it over the wage freeze in the subsequent two years it is just what you would have expected without an incomes policy for that kind of pressure demand.

That is really all I wanted to say with respect to Sir Roy, but I just mention one thing. Sir Roy quotes the Dutch experience. The Dutch experience is very mixed, and I do not want to go into it in detail. It is chronicled by David Smith, but Sir Roy says he thinks it broke down because of entry into the Common Market. I think that is too brief a statement to get one's teeth into but, certainly. David Smith, in his summary of the Dutch experience, suggests that it broke down for more fundamental reasons.

If I could just summarize them, they are three in number. The first is a much heavier pressure of demand in the economy than they had before, and it proved almost impossible to operate the incomes policy fighting very heavy demand. The second is the lack of belief in the unions that they were being fairly treated, the distribution of income had been moving against wages and towards profits, and the unions ceased to believe that they were being fairly treated and their corporation evaporated. And the third, and final point, a more fundamental feeling anyway that the unions felt they were there to serve the special interests of labour and to push for them, and it became very difficult for them to do this while committed to such a severe incomes policy.

I would like to put on record that there is an imposing view that has been studied in more detail and chronicled in detail, that the Dutch experiment broke down for more fundamental reasons than was suggested.

The Chairman: On behalf of the Committee, Dr. Lipsey, I would like to thank you for your statement that is notable for its clarity. We will now move to questions.

Senator Laird: Perhaps you would continue dealing with the particular segment of society I have in mind, the old age pensioners, who face the very real problem of inflation on fixed incomes. You have not touched on that in your brief, and I consider it a very vital factor.

Dr. Lipsey: If you take old age pensioners and people like that, of course, the incomes policy, which is meant to try to control inflation, is meant to be in their interests. You really have two questions then. If you have an incomes policy that works, how do you give protection to these people? If incomes policy really worked, that is, if it stopped inflation, then you will have given them the protection they needed. All the evidence is that even in the most fierce incomes policies they do not work to that extent; at best, they might slow down the rate of inflation. Then it becomes a problem of building into your policy inflationary hedges for people such as this, and I suppose the typical one that is looked at is something along the trend rate of growth of productivity.

I do not think there is much doubt from British evidence that they were left behind, and indeed, one of the things that always worried me about the incomes policy in Britain was that when everyone complained about the very real suffering of these groups the reply was "Our incomes policy is just about to get off the ground, it is just about to start working, so we do not have to build any hedges for you." Twenty-five years later we are still trying. We are still agreed that if it is going to work it has not worked yet, and this allows the Government to partially avoid or evade, whatever word you want to use, this very real responsibility of worrying about these people.

I would prefer us to say "We are going to try, but we must accept on evidence that it will be very difficult to completely remove inflation and we must therefore address ourselves as a matter of policy to built-in hedges

which will remove the worst causes of inflation from those who suffer most."

Senator Laird: What hedges, for example?

Dr. Lipsey: The cost of living hedge and old age bonuses.

Senator Laird: This is what worries some members of the committee—namely, that the simple solution is to increase the fixed rate of income from Government sources, and in the National Finance Committee we know it is not easy to raise any more money by taxation.

Dr. Lipsey: It is not easy to raise money by taxation. The demands on the Government for the taxes that it raises is always heavy and in excess of what it can get its hands on. But if you are having an inflation of, let us say, 3 per cent or 4 per cent per year, your money tax revenue is automatically rising at least that and usually more, because the built-in progressivity of the income tax does not allow for inflation, so that your real yields are rising. If other people demand part of those funds, that is something of a political problem. But there is not an economic problem in the sense that the Government's money revenues automatically raise, and if its money expenditures on such things as old age pensions automatically rise by the same rate, the rate of inflation, then no real extra burden has to be found.

The danger is that since demands are expending elsewhere, the money is used for other purposes. But there is not, as it were, an economic problem of real demand on the economy. If your taxes go up with the rate of inflation, your expenditure on these groups go up at the same rate.

Senator Laird: May I introduce another topic?

The Chairman: I have Senator Grosart, Senator McGrand and Senator Nichol. May I come back to you later?

Senator Laird: Yes.

Senator Grosart: Have economists been able to find any historical relationship between the rate of inflation and the rate of rising income? In other words, have they been able to assess income rises as a component of inflation?

Dr. Lipsey: By income rises, you mean real income?

Senator Grosart: That is right.

Dr. Lipsey: No. It is on eof the things that bothers me a bit. It has been the subject of continual debate. But turn it the other way around: does inflation contribue to or harm the rate of growth of real output, real productivity in the economy, and hence a rise in real living standards.

In Britain this was debated a great deal. The Government, by official statement, took varying views on this. The traditional wisdom of economists varying from Keynes was that mild inflations were more conducive to growth of real output and real living standards than stable or falling price levels. This was challenged and debated but never conclusively settled.

There was an unpublished paper of mine where I tried to discuss this aspect, but it was so extraordinarily difficult that I really needed the resources of a full research team, which was not forthcoming at the time. The only honest answer is that there is no firm evidence that the rate of growth of real income and real living standards would be much different if we had, say, one per cent inflation or 5 per cent, taking that modest range. I believe we should be able to do better than that. At least, I hope we will at some time.

Senator Grosart: In the Canadian experience, or any other national experience with which you are familiar, have you been able to isolate wages as a percentage component in any inflationary period?

Dr. Lipsey: I think you probably have something on your mind about which I am being obtuse. You can certainly take the increase in total money income in a year—let us say it is 10 per cent—and you can say "What fraction of that was represented by an increase in money wages, what fraction was money profits and what fraction represented the other components?" That is statistically not a difficult thing to do. I do not have the figures at my finger tips, but such a table could be constructed. I am not sure where you want to go from there.

Senator Grosart: If it is possible I should like to get an opinion as to the order of magnitude of wages and salaries as a component of inflation.

The Chairman: In relation to what?

Senator Grosart: Wages and salaries in relation to inflation.

The Chairman: Is there any other relative term?

Senator Grosart: We know there are a number of components in the rate of inflation. It has causes, and one of the causes is said to be wages and salaries. I am asking you what is the important cause?

The Chairman: Against interest rates?

Senator Grosart: We have an inflation rate. Of that how much is wages and salaries responsible? Is it large or small? Is it significant or insignifiant—or is there no causal relationships at all.

Dr. Lipsey: It is certainly accepted that there can be a causal relationship and there probably is, that inflation can initiate in the wage sector. You can demand and get wages well in excess of productivity and this can be a cause of inflation. It is also possibe that if we have a general boom in the economy brought about by Government policy, or a private investment boom, the excess demand can lead to a rise in prices and also to a rise in wages as employers compete for scarce labour or try to stop their labour drifting off elsewhere.

The reason that it is difficult to disentangle is because both of these are going on at the same time. If we discover that wages went up last year 6 per cent and

productivity 3 per cent, it does not follow that the wage increase was the cause, because it could be that the demand in the economy led to a rise in prices, that the competition for labour put up the wage rate. But that is different from saying it was initially the fault of the wage earning sector. Usually you have both of these things happening at the same time. That is the reason why economists still debate whether the cause of inflation is related to the cost portion and how much each of them contributes to inflation. I think that like so many of these issues, it is better to be honest that foolish.

With respect to so many of these issues, the answer is that what looks so simple when you start turns out to be very difficult to disentangle, and this case is difficult to disentangle because you have two processes happening at the same time. You have some arbitrary effect through unions that would be absent if there was not a heavy pressure of demand, but some ordinary market pressure due to shortages, et cetera, in some places in the economy leading to a rise in prices and the bidding-up of wages, earnings, on the part of employers seeking to gain or hold scarce labour.

Senator Grosart: What I am really trying to get at is a hypothetical situation where there is a threat of inflation and we all say that we will live with it. We saw we will take this as a penalty and will not raise our own incomes in any way. What would this do? If you could have incomes controlled voluntarily, what would the effect be on inflation, since we are discussing really one aspect of inflation? Perhaps you could relate that to the other measures that have been taken at times such as foreign exchange controls and rationing, both of which perhaps have been more successful in the past.

Dr. Lipsey: Certainly, if you are prepared to put up with the full set of wartime-style controls, then you have an alternative of direct price control. If you do have excess demand in shortages with rationing, you may have black marketing and all the rest of it. But certainly there is the alternative that you did experience in the wartime. I have never studied the wartime experience seriously myself, but I do not think it is clear that it was an unmitigated success or that it would have continued as such into the indefinite future.

Coming back to the main question, if it were possible to have voluntary agreement that, starting with labour, no one's wages would rise at all, and if that was enforcible by voluntary agreement, then what you would be left with would be the question of whether prices would go up anyway leading to a rise in profits and a change in the distribution of income towards labour. This, of course, is at the root of your question as to what extent the inflation is caused by demand pressures and to what extent it is caused basically by the rise in wages.

I think there is very little doubt that, if you could get and enforce a voluntary agreement that no money wages or salaries would increase beyond some modest amount, that would slow down the rate of inflation. I think that is fairly clear. I think the problem is that it has proved extremely difficult to get such agreement and to enforce it.

Senator Grosart: There have been official statements laying much of the blame for this inflation on organized labour. Organized labour has rejected these hypotheses and has said that they are quite wrong. They have gone so far as to say the Government's statements are hypocritical and false. Who is right?

The Chairman: Do you have an opinion on that, Dr. Lipsey?

Dr. Lipsey: No.

The Chairman: I am sure Dr. Crispo will have an opinion on that.

Dr. Lipsey: Everybody has an opinion on it.

Senator Grosart: I am sorry to be pushing this, but I know of your long involvement in this problem and I do not know anybody in Canada more competent to answer the question than you.

Dr. Lipsey: I can only say in all honesty that I do not know. Moreover, I do not believe any other person knows. We all have opinions on it. People have attempted to study this on a fairly dispassionate level, but it has not been settled. I really do not have an official opinion on it.

The Chairman: Perhaps we can accept that as your answer, then, Dr. Lipsey.

Senator Grosart: Unless we could have his unofficial opinion.

Dr. Lipsey: I do not mind sticking my neck out, so long as it is clear what I am doing. I am, myself, skeptical of the view that it is all the fault of the unions, that it is their behaviour which is the main cause of inflation. I am skeptical of that view on some evidence which I can chronicle if you want a five-minute answer. But it is not firm evidence. The sort of evidence on which I would be lead to be skeptical, is that in periods when serious controls have been operated on union-agreed wage rates they have led to the phenomenon that I refer to in my paper as wage drift, where employers in tight labour markets find other ways round the agreement in order to, as I say, attract labour—and much more serious, of course, to stop the present labour force from drifting away, because drift rates tend to go up in times of heavy demand.

I think Senator Grosart was present when I referred to an unpublished study—which I wish had been published—by Professor Phillips on the Australian economy. Probably the most effective severe controls over agreed wage rates were established there and were there effectively. What happened was that labour earnings were discovered to respond to market conditions in just the way they did in economies where these agreements over rates did not occur, and the rise in earnings could not be laid solely at the foot of the labour unions. The rise in earnings was certainly condoned by and partly initiated by the employers.

As I say, what was found in Australia was that when they slacked off the level of demand, lo and behold! the rate of increase of earnings slacked off as well. Of course,

it is earnings that influence the cost; not the agreed rates. So certainly I would say that on the basis of that study, and from other similar evidence of which I am aware, I would not myself accept the view that it is all the fault of the unions.

Where I was hedging, where I think we do not know is where we say, if it is not 100 per cent, then what is it? Is it 40 per cent, 30 per cent, 50 per cent? It is just very difficult to know.

The Chairman: I think we have examined that to the fullest possible extent, senator.

Senator Grosart: Thank you.

Senator McGrand: Dr. Lipsey, my question concerns wage inflation with respect to people on fixed incomes and those who are in the civil service and in schools and so on. If you can control the cost in industry, in the private sector, where you can measure productivity, will that not control the rising cost in wages in schools and in the civil service where productivity is difficult to measure? If you control No. 1, will No. 2 not sort of look after itself?

Dr. Lipsey: I wonder if I could take a few minutes and talk round that. My first answer is that if you are effective in controlling the industrial sector's wages and prices, you obviously control the material components of the other sector. With schools' capital expenditures, this can be important. What you do not automatically control, however, is the wage deal. You have to go to the teachers and ask them how much you are going to allow them this year. You also have to go to the civil servants, and that is a direct bargain for which there is no automatic control just following from the fact that you control the rest of the economy. It may be, of course, easier if you can say, "Look, we have controlled the other sectors down to 4 per cent. You can be satisfied with a certain number." But you still must agree on a number with them. So that there is this direct bargaining problem.

I would like to elaborate a bit on one point that I did not labour before that suggests that because the public sector is subject to direct bargaining—within Canada either federal or provincail governments but generally with some governmental authority—it tends to be easier to control it than it is to control the private sector. I think the British experience is that if the government wants to operate an incomes policy on nurses, doctors, school teachers, postal workers, etcetera, they can, and indeed they can just say "Well, we will not give you so much this year." In fact one of the real dangers that Smith alludes to and which I certainly found in Britain is that a half successful incomes policy tends to bite harder on the public sector than on the private sector. You just say "We are going to give school teachers 3 per cent, and they can take it or leave it." But you find that in the industrial sector the worker gets his 2 per cent plus 2 or 3 per cent more and even if you slow them down a bit, you change the relative earnings of people in the two sectors. Now, this does not hurt for a year, but in 5 years or in 10 years, it is really going to hurt. I think the difficulty of manning the state schools in Britain is a direct result of holding down teachers' salaries partly as a result of running an incomes policy which did not then work anywhere else.

The Chairman: I suppose that is the trouble with selective controls too, is it?

Dr. Lipsey: Yes. Again, to take selective controls, you must believe that that will automatically affect everything else. There is no real evidence that it will. But if it does not, then you have the same problem in that you control one sector and leave the rest uncontrolled. It may be all right for six months but five years later you find you have a really serious distortion and it really becomes very difficult for a man to take up a career as a teacher in a state school in Britain. And that is without any question partly the result of this holding down in the interests of an incomes policy. If I may put one tendentious sentence on it, it is often said "Well, all right, try exhortation; it cannot do any harm. It might not work, but let us have a try at it." But the trouble with exhortation is that the government must show that it is serious and the way it has to do this is to say, "Well, we are going to make this bite where we have the power; we are going to make it bite in the public sector and we are going to exhort the private sector." Well, if it does not work in the private sector, then you end up with the same effect. You seriously distort the relative incentives as between the two sectors. Of course the bigger the private sector, the more serious the problem, and I assume therefore it is much more serious in Britain than it is here, but nevertheless with any substantial public sector, exhortation, where the government follows its own advice and the private sector does not, can cause trouble.

The Chairman: Are you able to make a positive statement—and I am not suggesting that up to now your statements have not been positive—but can you make a positive statement to the effect that the approach of Professor Galbraith to the question of selective controls is unworkable?

Dr. Lipsey: Well, I will make two, a characteristically academic one and then I will stick my neck out, since I was invited to. I said in the paper that this is a really untested theory, and I think that this is true. I was drawn out as a result of previous questions to quote some evidence, although I did not really want to do that, but I think the Galbraith idea that selective controls over a few sectors can in the long run have a significant effect on the rate of inflation really has not been investigated. The reason it has not been investigated in this case too seriously is that there really has not been all that much evidence about it. I myself very much doubt if it would work in a large economy where price setting and wage setting is fairly decentralized. I would think that an attempt to control a few key sectors would not in the long run do very much to your rate of inflation just because I see it having very little effect on the problems of one B.C. employer versus another when he is bidding for scarce labour. He is going to carry on the same as he

always did and this is going to contribute to the rise in wages and prices.

The Chairman: It would have the additional effect of distorting the economy at the same time.

Dr. Lipsey: Yes, because if it does work in one sector, it will distort, so I find it very hard to believe that it will work and I see risks if it does not work.

Senator McGrand: I have one more question following on Senator Grosart's. You said that wages and salary increases perhaps contributed very little to inflation because there was the influence of the demand-pull which would do the same thing.

The Chairman: I think I should interject here in fairness to the witness and in reference to the term "very little".

Senator McGrand: I am not quoting his exact words, but I got that impression.

The Chairman: I think he is saying that it is less than it is generally thought.

Senator McGrand: Now if there is an element of inflation and more goods are sold, then profits are going to rise. Is not that increase in profits a good way of estimating how much the demand-pull influences our inflation?

Dr. Lipsey: I wish it was. The reason it cannot be quite that simple is that such a demand inflation with an initial rise in prices and hence a tendency for profits to rise is almost always fairly quickly accompanied by a rise in earnings of the labour force, because in a tight labour market employers are increasing the rates of income they offer to attract labour and to stop their present labour force from drifting away. So that even in cases where we have no doubt—for example in the late 1940s when the excess demand built up during the war was let go and there was no argument that that was a demand inflation as a result of the removal of rationing—if you actually look at the course of wages and profits through that time you see them going up very closely together, and since quarterly figures tend to be rather inaccurate and you are stuck usually, but not always, for annual figures if you want good figures, but the lag is so short between the rise in profits being transmitted to a rise in wages, it is just awfully difficult to sort it out in that way. That is one of the reasons it is so difficult to answer this question with any degree of finality. If I may just restate my position, it is simply this; I do not believe or accept the view that it is all the fault of the unions. What I find very hard to do is to say what proportion is due to them. I believe some of it is. I do not dispute that.

Senator Nichol: Dr. Lipsey, Sir Roy Harrod suggested that one of the reasons that fiscal and monetary policies had been unsuccessful—and here I am using absolute terms; he didn't quite say it that way—but relatively unsuccessful in controlling inflation through reduction of demand has been that we live in an age where there are sociological and psychological pressures which perhaps did not exist when the Keynesian theories were originally drawn up. For instance, there was no massive television advertising in those days. There was no, what is called, crisis of rising expectations, at least not of the same kind. And today he seems to suggest there are psychological pressures in the system which did not exist and which allowed the older systems to function. Can you comment on that?

Dr. Lipsey: Yes, I should like to make a couple of comments on that. That is also my understanding of what he said, as long as one realizes that he speaks of a relative failure of traditional policies. We as people, and, I guess, as a profession, have often been too quick in reading enormous trend changes into two or three years which often under the aspect of ten years back look to be just outriders for one point or another. One of the reasons I am referring to this chart when I comment on Sir Roy is that although the differences are disturbing, and I hope I am as disturbed about them as anybody else, it seems to me that it is too small and too soon for us to be able to get any really firm view on it. But I certainly could not rule out what he says. On the other hand, I am slightly sceptical because I have seen this view go wrong so often before, and maybe I can just take one minute with what I think is the most dramatic illustration of this view going wrong.

I was raised to believe that the reason why Britain ran into so much trouble in the inter-war period, when it returned to the Gold Standard of the old pre-war parity rate, was that the price level could not be driven down because of the modern emergence of unions, and that it was the unions that put downward inflexibility into the price level and prevented the old Gold Standard mechanism from working—and, of course, the Gold Standard mechanism was that if you have a balance of payments deficit your price level is driven down. That was in all the textbooks, and that is what I was raised on.

Then Professor Phillips, followed by some work that I did, invented this basic technique that lies behind all that I have been talking about empirically, which is the way of estimating what the economy would have done by way of wage and price inflation for certain levels of demand. When he did it, the first thing he did was to compare the nineteenth century with the inter-war period in Britain and, to his enormous surprise, discovered that the fall in wages and prices, when they tried to depress the British price level in the twenties, was exactly predicted by the experience of the nineteenth century in Britain before there were strong unions. And yet we all believed this until someone took these two academic years, did the work and looked at it and, lo and behold, this great structural change, which seemed so obvious to the casual observer, just was not chronicled in the facts at all. So having had my fingers burned once or twice like that, I am just sceptical of being told that the world has changed. I may be wrong, but I feel it really is too early. Obviously, to make a decision you have to take a view on it, but I would take the view that this slight change in the behaviour of the economy, getting a wage increase that is typical of 1 per cent higher unemployment than you had before, may yield to explanations a little less dramatic, such as further sectoral imbalance. I think we

must look much more carefully at the inflationary impacts of the periods when we have been holding an under-valued exchange rate, and various other matters of this sort. Until those have been carefully investigated, I would just maintain my academic scepticism.

The Chairman: I wonder if I could interject to ask Dr. Lipsey to come back to that chart and explain again what its significance is.

Dr. Lipsey: It is merely what we are pleased to call a scatter diagram. It is very simple and you have to do a lot to it to get very much out of it, but all I have is the level of unemployment in Canada, the percentage rate...

The Chairman: Would it help you to put the diagram on the board?

Dr. Lipsey: Very well. Along here you have the percentage of unemployment overall—This is why it is so crude and we have to look a lot closer at the sectoral details—starting from zero. Since we are talking about wage increase, let us put here the annual percentage increase in money wages which, for historical reasons, has been indicated by "W"—"W-dot"—by economists. That is the scatter diagram of it, and you see at very low levels of unemployment—that is, peak demand in the economy —these very big rates of inflation, and then you see the various points down here which show what has happened to wage inflation. You have the wage inflation in the Canadian economy in each year.

The Chairman: That is a Phillips curve at that stage?

Dr. Lipsey: That is right, but we have to do a little more with it because, as you see, it is rather messy and there is very little relation in most of that. However, that does not affect the point I am making. If we say we have some sort of broad-band relation like that, here are our two outlyers. I only have the material on 1968 and 1969. If you had moved those one percentage point in here and in there, it would look just exactly like it was on, if you had the Phillips curve. So we had two years where the increase in money wages is associated with the level of unemployment about 1 per cent higher than what would not have surprised us. If I had those two points there no one would be surprised at all.

The Chairman: And what is the significance of that?

Dr. Lipsey: The significance of that is to say that small bit of evidence, two observations, where if I told you the wage rate and asked you to guess the level of unemployment from the previous experience, you would have guessed it to be about 1 per cent less than it was; that is all. So you would have been about 1 per cent wrong. If I told you the increase in wages in these years, and asked you to guess what the unemployment was and gave you the previous data, you would fit a Phillips curve to it, with a lot of statistical sophistication, and you would make a mistake of about 1 per cent.

That is interesting and disturbing, but that does not lead me to say yet that it is obvious to me that the whole state and structure of the economy has changed. That just seems to me a little too drastic. So if you want me to stylize it, there is the sort of stylized curve which would represent what was happening in Canada. This is the increase of wages, annual, to various levels of unemployment, and here we are with a couple of outlyers like that. Had they been there, with 1 per cent less unemployment, they would not have been there, which is what we would have expected.

Dr. Gillies: Are we talking about a 1 per cent error or a 25 per cent error, if you take as your basis 1 per cent?

Dr. Lipsey: You can calculate it any way you want. Of course, you will notice, if you want to be technical on that, that I am taking the error that way and not that way. In fact, there is a lot to be said on that. It is much more dramatic, if you take it that way, and that is why the dramatic calculations have been suggested, because this thing is curved enough that the error that way is much smaller than the error this way. Of course, the statisticians will tell us that you will want to measure error that way, but that is a whole series of maintained assumptions about dependent and independent variables, and this is a reduced form.

I come back to the simple point I want to make, that surprisingly and, indeed, disturbingly—and I am worried about it and I would like to know what has caused it—it seems to me to be rather slim to say that we have to re-write the whole theory of the way people and the economy behave. I think we need more years and alternative explanations as to why we got a little extra wage inflation, investigated beforehand, and it is too soon to expect that to be done.

Senator Laird: In the past few days many people have been deeply concerned about the current monetary crisis. Would you care at this stage of the game—and perhaps it is a little premature—to comment on what effect it may have on the problem we are discussing here this morning?

The Chairman: I wonder if perhaps the question would be as effective if it were rephrased, to ask Dr. Lipsey how necessary it is for some sort of floating mechanism to be part of the Canadian exchange rate, vis-à-vis other exchange rates, in having an independent economic policy in Canada, whether it is by floating or anything else.

Dr. Lipsey: The reason I was hesitating for so long on the more general question is that it depends upon predicting the outcome, which is as much political as economic. It is very hard to predict what changes in the monetary system it will lead to. Until we know that it is hard to predict its consequences for Canada. If I had to give a capsule guess, I would say not much. I have always maintained what used to be a totally unorthodox view but which is now becoming much more accepted although not orthodox, that the whole trouble was the disastrous mistakes that we made in misreading the lessons of the twenties and thirties and believing that the IMF represented a sensible way of running our monetary affairs. I have always believed that the system we have instituted has been the cause of our troubles, that they

were man-made and that we should get rid of them by changing the IMF system. That is another story.

I have not very much that is original to say about the question that the chairman asked me. I can only reiterate what most of my colleaues who have studied the Canadian economy more than I have would say, which is that with a really fixed exchange rate that we were determined to hold over long periods of time there is very little freedom to have an in-price level policy for Canada that is independent of that in the United States. If the United States is going to inflate and we are committed to keep our exchange rate fixed, then we are going to inflate as well. Conversely if we inflate and they do not, then the inflation will rapidly come to a halt at probably pretty heavy cost if we are keeping the fixed exchange rate. If we are going to do so much trading with the United States, the relationship between our price and their price is critical and we have not much room to vary. We can vary over a small margin but not a large one.

I would say that if Canada was determined to operate a price level policy that was independent of the United States, to let us have, let us say, a substantially different experience of the rate of exchange on prices, either faster or slower, over any reasonable minimum term period, four or five years, one would have to contemplate either a floating rate or a paid rate that was adjusted fairly frequently.

Aside from my own basic prejudice against the whole international monetary system, if you are inflating very differently from the United States, everybody can see it. Nothing is more obvious to anybody in trade that that is happening. The effect on the balance of payments will be obvious, and you will get a series of speculative prices of the kind that are besetting America and which beset sterling for many years.

Since it is so predictable that you must change the rate if your price level experience is very different from America's, and speculators can predict it, the only question is the timing, and then you will find that they will try to outguess you and you will be unfortunate and one speculative crisis after another will follow. It would seem to me therefore that if that is ruled out, then an independent price level policy requires a floating rate.

The Chairman: And you think that a crawling peg would be unworkable for that reason?

Dr. Lipsey: A crawling peg is okay if your experience is broadly similar and you are forced to change the rate every 10 years. If you had a really different price level behaviour it would be obvious that you would be beset with one price level after another.

Senator McLean: So pegging of the currency is out, in your opinion?

Dr. Lipsey: Yes, plus a substantially different behaviour of the Canadian price level and the American price leve. That, as a package, is what I say is out. If we are going to inflate at broadly the same rate as they are we can do away with pegging the currency. If we really want to behave differently with respect to price level, then pegging the currency seems to be out.

Senator Grosart: I do not understand what is meant by "crawling peg", and why people use those words. Pegs don't crawl. Somebody picks them up and puts them in another hole.

The Chairman: Only, as I understand it, the spread instead of being one per cent might be 3 per cent. It is a floating exchange rate within a definite level.

Senator Grosart: I was wondering why economists use the phrase "crawling peg". Is there some hidden significance in this? Are they pretending that nobody does it?

Dr. Lipsey: All sorts of schemes have been put forward. Everybody has tried his hand at a scheme for modestly changing the present system under which we live. The scheme the chairman was referring to is normally referred to as widening the bands so that the rate can fluctuate around the band of 3 per cent instead of one per cent. There were schemes to let the mean around which the rate varied change gradually as some moving average of the past rate, so that the rate can change slightly and fluctuate over a wider band than it can at the present time. There was some sort of automatic mechanism to allow the rate to change if the experience over the last two or three years showed that it was wrong. None of these have proved to be foolproof, even for an academic analysis let alone trying them.

They all suffer from one problem, that once a speculator knows which way the rates go you are in trouble because they immediately start speculating. If you feel that you are going to get an automatic rate in your exchange next year, we know which way it is going, and clearly there is a straightforward gain for anybody who can read. The slow crawls are difficult in this way. There have been many attempts to try to get more flexibility into the system.

I was talking about what is more usually referred to as an adjustable peg, where there is a peg change over two or three years. That is the position when somebody takes the peg out and puts it in a new hole. That suffers from the problem that if it is predictable in advance about when and how far, you run into speculative prices. If we inflate it at one per cent or the Americans at 6 per cent, if we had a large difference over a long period, which is possible if there were enough offsetting changes, particularly if we do not worry about odd combinations of facts, you would run into real trouble if you had substantially different long-term behaviour on this price level or the Americans were determined on a fixed or adjustable peg in the rates.

Senator Grosart: The reason I asked is that some of us on this committee who are not young any more and who took our political science many years ago have a continuing problem of keeping up and penetrating the jargon that economists keep inventing. I thought the reason for the use of the word "crawling" was that it suggested that you stayed on your hands and knees on this problem because you were afraid to get up and walk.

The Chairman: When we examine wages, the tendency in a highly competitive industry is probably for wage earners in that industry to achieve wage increases in relation to the increase in productivity.

Coming back to your point, if it is true that you have different degrees of productivity and the increase in productivity does not always relate to the increase in demand; and if there tends to be a relativity between wages—that is, the man who does not work in the productive industry but is the subject of demand will nevertheless relate his wage to the man who is in a highly-productive industry and who may or may not be related to demand; and if, although you state that wages are not the sole component of inflation, wages are a component; then do we have to face the fact that wage increases will not ever be related to productivity? And since they are not related to productivity is it the case that we will always have to have a degree of inflation unless we are prepared to move the Phillip's curve over so far as to raise the level of unemployment so high that we just dampen demand right out?

In other words, in normal situations are we, by virtue of the operation of this theory, put into a position where we have to accept inflation and should we just stop getting terribly worried about it, except as a matter of extremes?

Dr. Lipsey: Let me answer yes and then say that that is a very intricate piece of analysis. I think I would agree with almost all of it; there was one point in your question when I wanted to put in a caveat, but I have now forgotten it.

The Chairman: I do not think I can go through the question again.

Dr. Lipsey: Before I worry about the minuteness of your economic analysis, I would be inclined to say that for some of the reasons you alluded to, and for some other reasons, the objective of a really stable price level is not on. I am sticking my neck out. It is a guess, but at least there are reasons for believing this. I think there is a big difference between even 3 or 4 and 10 per cent. I would prefer 2, 3, 4 to 10 to 15 per cent. But I am inclined to think that the cost of trying to go to zero would turn out to be inordinate if it were obtainable at all.

I said in my summary, although it is not there as a conclusion, that a lot more thought, both academic and governmental, needs to be given to the question of how we can better adjust the economy so that we can live with 2, 3 or 4 per cent and remove the worst harm that it does—the widows, orphans and other people we traditionally refer to.

If I can add one other academic point, the textbooks have a lot of traditional wisdom about the harm that inflations do. I am guilty of it in my own textbook. All of the textbook discussions that are rather casual talk about unanticipated inflation. This is what would happen if suddenly, as in Germany after the first war, a price level changed dramatically and no one expected it. The consequences and harm done by the expected inflation are clearly different. I also expect that quantitatively the harm is less for the obvious reason that if people expect a 3 or 4 per cent inflation they invest their money in inflation-hedged investments and they do things on the assumption that that will happen. They lend their money at a rate of interest that takes account of the inflation.

So there is no question that the harm done by an unexpected inflation is different from the harm caused by an expected inflation.

That is the first point. The second point is, although this is just now beginning to be studied, I suspect that it is also less. But it is certainly there. What I would like to see is further identification of where the harm is done and to see if we cannot design the system so that the costs are really small and we can say, "All right, we will still try, but, if we find we are stuck with the sort of inflation we have had since the war, we will have removed the most serious harms anyway."

Just one last point. Do not forget that although what you said about labour, et cetera, is broadly right, relative prices and relative wages do change in the economy. If you go back and take a 50 year look at the economy it is quite clear that the relation between wages in different occupations and different kinds of prices do change. So we have to have relative prices. If the object is a stable price level, then we are saying, weighted, half the prices will have to fall. If we are going to have relative prices change, then we are saying, weighted, half the prices have to fall.

If we take the line that, broadly, few prices are actually going to fall—that they could but that few are going to fall—then, necessarily, change in relative prices requires a mild inflation. That is the same point you made but on the price side.

The Chairman: Could we reduce it then to a principle that in a normally-employed economy both wages and prices will rise faster than productivity?

Dr. Lipsey: Yes. I will agree with that. It is a subjective reading of the evidence. It is nothing like as firmly based as some of the things I have said before, but I believe that to be true. I believe that there is at least evidence, although it is not conclusive.

The Chairman: There is one thing on your contemplated inflation, and that is, what about inflation psychology? You say you can take into account the 3 per cent inflation per year and hedge against that inflation, but can that 3 per cent inflation per year cascade upon itself and lead you to an unexpected inflation?

Dr. Lipsey: As one is not surprised to learn, that is one of the most hotly debated issues in economics at the present time. The reason is that many economists have come to believe that a stable price level is either unobtainable or is too costly to attain. Some modest rise in the price level is much more likely to be our experience. And the next question that immediately arises is, can we sustain indefinitely an anticipated 3 per cent inflation or will it accelerate continuously and turn into a hyperinflation? That is the subject of enormous debate right now and of a great deal of investigation, not just debate.

The only thing I can say, and I will make two points, is that it is not in theory inconsistent. That is, you can make a perfectly acceptable economic model based on the normal assumptions that work when we come to look at the behaviour of markets in which a fully-anticipated inflation continues forever. So there is nothing logically contradictory in it in the sense that the model can easily be built. It then becomes an empirical question: do people really behave as we think they do in our theories or is there something we are not aware of because we have not yet studied behaviour when people expect indefinitely a 3 per cent inflation? In other words, we could be wrong and we need more evidence to know about this.

But I would only add on the empirical side that, if it does accelerate, it certainly does so slowly. It certainly takes an awfully long time. Look at the experience of European countries and Canada and the United States. It is over 20 years. Now it may be that the thing that is worrying Sir Roy is just the beginning of this effect of acceleration due to people building in inflationary hedges. It is too soon to say. But it is quite clear to me that if it accelerates, which I rather doubt, it is going to be a fairly slow acceleration. In other words, we will have plenty of warning and plenty of time to try to do something about it. We will not be suddenly faced with a German-type inflation overnight.

As I say, the reason for that belief is that we have lived with inflation for over 25 years now. All the evidence is that at least a lot of people expect it and take account of it.

Senator Nichol: When Arthur Smith was here he talked at length about national goals in a broad sense—not just pure economic goals but social and economic goals. Making three assumptions with which you may or may not agree, let us assume first that national goals are identified; second,—and many people have said this—that massive changes in monetary and fiscal policy causing the structure to veer, so to speak, from one side of the road to the other have serious human disadvantages; and, third, that price and wage controls in any affinitive sense are hardships and would be difficult to put in and maintain, my question is this: What directions do you think Canada should follow, first with the situation as it exists today? This is really what we are here for.

Dr. Lipsey: Well, let me say a couple of sentences and then possibly I could be a little bit more specific and that might help. I am not too sure exactly what you have in mind, but I think a lot of this I have already said. I would not go for wage and price controls. I think there is a lot of evidence and although it is not absolutely convincing I think I must be academically honest about it, my reading of the situation is that we are likely to get very little out of wage and price controls at a very great cost. So, I would rule them out. I would then say that we want to do our best to control inflation, and there are certain things we can identify such as not having swings into wild booms of excess demand, not trying to maintain an undervalued exchange rate, about which I have not said much but which I think even in our context today would be important, and certain other ordinary policies to try to at least reduce the inflationary pressure. Then I would want to see every possible investigation made into ways in which the harm that inflation does to isolated groups could be mitigated. I think we could reduce by two-thirds the harm that inflation does by putting in two years hard work at designing measures to get inflation hedges in for those who cannot look after themselves. That is really what I have been addressing myself to.

Of course, if you want my list of social reforms at home, I think if you do free yourself from enormous efforts to fight inflation and maintain wrong exchange rates, you release more energy and achieve greater direction towards social goals, and I think one of the sad failures of the Labour Party in Britain was that so much of its effort went into a losing battle to maintain a wrong exchange rate. There was no point to it. So, I think if you solve those great classic historical problems, then much more time, energy and money is available to get down to the little things which really matter for a good society.

The Chairman: Are you interested, Senator Nichol, in whether our present exchange rate is too low or too high?

Senator Nichol: No, I was interested in the broader question. I was really trying to find out as between price and wage controls on the one hand, which some people were saying is the answer, while other people were sticking with fiscal and monetary policies, and obviously the answer does not lie entirely there, and I was trying to find out from Dr. Lipsey what he felt about it, and he answered my question very well.

Dr. Lipsey: I would like to say once more as bluntly as I can, because I think is is so often assumed that someone who is opposed to an incomes policy must therefore believe that traditional measures work, and work happily and easily, I do not believe that they do. I think at best they work in a rather messy way and there is some evidence to make us worry that they may not be working as well now as they did in the past. So that leads me to think about an incomes policy. I have thought about it for a long time and I have tried to study it for myself and I have read what I can and I find it very hard to believe in the face of all the evidence that an incomes policy over a long period of time is going to do much good to control inflation. Therefore I think we are left with the third point, that we may have to learn to live with some modest inflation.

Senator Nichol: I have a further question which you may not want to deal with since it deals with the mechanics of economic management. Obviously different countries approach this in different ways and have different structures to do it, but we seem to have, from time to time at least, and I give two very small examples, policies which fly in the face of other policies in the economic field. For instance, and this is a trivial one perhaps, we have a television industry in Kitchener which produces television sets which sell for $200 to $300 more in Vancouver than they sell for in Seattle, Washington. Now, I realize that a television set is not an essential ingredient in the life of anybody, but it is strange when we are concerned about the prices that people have to pay for

things that we should have a tariff policy which produces a situation like that. As I say, I do not think it is very iimportant but I use it as an example. Similarly I notice according to the paper that in the cost of living which rose to some extent last month, they attribute some 40 per cent of the increase to an increase in clothing prices. But at the same time as that has been happening, the Senate in its Banking, Trade and Commerce Committee is considering the question of textiles and measures which are intended to be protective of textile prices in Canada. Now these things conflict. I am sure there are many other examples of this in every country in the world. Therefore my question is this: Which country or countries do you think have the most sophisticated systems of economic management, and if you have any specific country or countries in mind, could you comment on it and tell us a little of how it works. In other words, where can we go to learn about this?

Dr. Lipsey: I hate to appear reluctant, but that is a very big question. There are more fundamental reasons why I do not want to give an off-the-cuff answer. You see, part of the answer depends upon what you are trying to do. For example, you think of French management and French planning, but I do not think you can just say categorically that that is something you want to copy or that you do not want to copy since it depends so much on what kind of a society you are working towards. So therefore just to say blankly that countries A, B and C are the most sophisticated and have something to teach us is something I would really rather not do. I would not mind doing so in private discussion.

Senator Grosart: You might have to say that Mainland China has the most sophisticated and effective economic management.

Senator Nichol: I can understand Dr. Lipsey's problem, but it is still a situation which this country has to face.

The Chairman: Do you want the doctor to comment on Canada's tariff policy?

Senator Nichol: No, I do not think it would be fair to ask that.

Senator Cameron: Mr. Chairman, I was late in coming to this committee and you may have discussed the question I have in mind already and if so you may disregard it. But in the light of what Dr. Lipsey has said about controls not working, I am wondering how we can reconcile the conflict which is developing. On the one hand, we have the auto workers who are highly productive and who are getting a large share of their productivity in increased wages. On the other hand we have the civil servants—and here in Ontario today they are invoking rotating strikes because the government has said it is going to impose a limit on increments of 5 per cent. Now if we cannot have controls because they do not work, have we any justification for saying to these civil servants, "We are going to hold you down to 5 per cent"? How can we reconcile this contradiction under circumstances where you say—and I am not disputing it at all—that the controls are not working?

The Chairman: Dr. Lipsey has indeed dealt with that, senator. I do not think it would hurt to have him go over it again though.

Senator Cameron: I do not want him to go over ground that has been gone over before, but it has been bothering me and I am sorry if I missed it.

Dr. Lipsey: It came up in many points, so it would be hard to really get it all out, but I suppose that in a nutshell what I would say is one of the real dangers of trying your controls is you do just that, you do hold the line in the Civil Service at X per cent and you do not elsewhere, and before long you not only have an unhappy, rotating-striking Civil Service, but a very much lower quality one, because if it extends over five or 10 years you lose the attraction for good people to come in. One of the real dangers—and I think it is manifest in Britain, and I refer to some experience there—is that when the Government does that for 10 or 15 years they do really severely diminish the attraction of the public service, and then they are in trouble, for obvious reasons, in the failure to attract the right quality. Oh, of course, you fill a job, but you do it by downgrading. You do not have the job actually unfilled, but you have lower quality people.

The Chairman: We have achieved here today what is now known in economic circles as the Lipsey transfer effect, and the principle is that in a normal economy wages and prices will increase faster than productivity.

Senator Grosart: Where is the transfer?

The Chairman: The transfer being, presumably, from the relativity of wages—that a man working in a non-rising production industry will demand relatively the same wages as one working in a rising production industry.

Senator Grosart: That is probably more of a trade-off than a transfer?

Dr. Lipsey: For the record, I must say that this is misnamed. After all, it is a small variant of a well-known theory of inflation by Schultz, in the States, which as a major cause of the price level increases was dismissed, so that when I answered you that I thought for these various reasons some inflation would be inevitable, in the investigations made in the States it certainly did not appear to be the main cause of the price level increases they had. But with some variations you are really on to Schultz's theory. It is laid out and it has been investigated to some extent.

The Chairman: And the evidence does not support it?

Dr. Lipsey: As a major cause.

Senator Grosart: I wonder if I could ask Dr. Lipsey to make some comment on the controversy that has gone on, to some extent—or perhaps I should say the discussion—between total and selective income controls. There are those who say that even if the total controls will not work, selective controls will.

The Chairman: We had gone over that while you were out of the room, senator.

Senator Grosart: I am sorry.

The Chairman: Have you another question?

Senator Grosart: I was going to ask Dr. Lipsey if anyone has put numbers in the Canadian Historical Statistical Series to the average rise in the inflation rate. And has it been compared to the average rise in incomes—or, more specifically, wages and salaries?

A few years ago economists used to say, "The long-term average rate of inflation is 2 per cent, which we can live with." Now we seem to be saying maybe it is 3 or 4 per cent. What is the long-term rate now?

Dr. Lipsey: I am sorry, but it is not a figure I carry in my mind. You do not carry it in your mind, by any chance?

Senator Grosart: No, I do not.

Dr. Lipsey: It certainly exists, and I could look it up in here, but I do not carry it in my mind.

Senator Grosart: The reason I asked the question is that it has often been said that some degree of inflation is a function of what we sometimes call prosperity. In other words, you have deflation concomitant with a depression invariably.

Dr. Lipsey: At a wild guess, looking at this chart of the cost-of-living index; 3 per cent. That is a wild guess, but it would be much better to look up someone who has carefully calculated an average from that.

Senator Grosart: It would be interesting to compare that with the long-term rate of increase in wages and salaries.

Senator Sparrow: Speaking about comparability in wage increases, you referred to using the average increase of the Gross National Product for the comparability figures in the non-productive sectors. If you used the figure of the average increase in Gross National Product to the non-productive sectors, over a period of, say, 20 years would the relative position of these people working in these non-productive sectors have increased their economic position above the average, or decreased it in relation to the other sectors of society?

If, in fact, it would remain level—and I say this in relation to some sectors which will make splurges up, then drop and so on—would that average out over a period of time where, in fact, you could use that comparability figure of the average of Gross National Product increase?

If you could use that, then perhaps it would not matter if there was inflation, as such. Perhaps the rate of inflation would not matter if the comparability aspects in fact worked out; and in those comparability aspects you included the one that Senator Laird was worried about, the old age pensioners, and so on, if you used the same figure for those as the ones in the Public Service, and so on?

Dr. Lipsey: There are two situations you must envisage. The first one is, if the price level were constant and we gave them this increase equal to the average rise in productivity, but from your question I think you were thinking of a situation where there was some inflation as well.

Senator Sparrow: Of course.

Dr. Lipsey: Quite clearly, if you give them a rate of increase of money incomes that is equal to the productivity growth, the real productivity in the economy . . .

Senator Sparrow: Including inflation and productivity.

Dr. Lipsey: Yes.

Senator Sparrow: Of course, I meant the two figures.

Dr. Lipsey: Well, we need a little of the back-of-the-envelope calculating. I suspect it is not going to be exactly that, but close to it. That is, you want the figure that will maintain their relative position, on average, with the rest of the economy, and I do not think it will be exactly the national average rise in productivity. It would depend on many assumptions, such as hours worked in various sectors, because, after all, productivity is what is happening to output per hour. The pie to be divided up is the total output of the economy, and to come up with a number that would maintain their relative position in the economy would take a little scribbling on the back of an envelope. My guess would be that it would not be equal to but close to that national productivity average figure, but I cannot come any closer, unless you had something more specific in mind.

Senator Sparrow: If they come close or to the average, do price and salary increases and inflation, in fact, matter, if you are looking after all the other sectors?

Dr. Lipsey: No. If the inflation does not explode, if it is maintained and you find a formula to look after the people in the unproductive sector and the totally unemployed, it should not matter. In principle or in theory you ought to be able to get the cost to zero, but I suspect that human wisdom is not that good and we would have difficulty in getting the rate firmly for everybody. Some harm would be done. But I see no reason why we cannot get it down to a low number if not exactly zero. The whole idea is to do that sort of thing in those sectors that do not automatically go ahead with the progress of the economy and with the inflation.

Senator Nichol: If we follow along with what you have been suggesting, that we accept a gradual inflation so that we do not become non-competitive in our export markets, if we are really going to protect the people who would suffer from it in the long run, is not this going to mean pretty strong or radical changes in the spending priorities of governments? If we say we are going to accept a rise in inflation and we are going to protect people who cannot protect themselves, does it not mean that we have to look at the way in which the state—and when I say state, it includes everything . . .

Dr. Lipsey: I agree with you, but consider the implication? All we are saying is that we are going to take enough money out of other forms of expenditure and

stop these people from positively being hurt by our inability or the Government's failure to stop prices from rising. Alternatively, if we do not do it we are saying that we ought to rob, tax, or whichever way you want to put it, those people who cannot protect themselves in order to get our expenditure in other lines. So it seems to me, although I completely agree that it would require change in priorities, that on any social count we should consider the implication of alternatives.

I should like to comment on the other point, namely that if people say when you start building in hedges to protect people this will accelerate inflation. Let us say that they are right. Then you are saying we are stopping accelerated inflation by taxing these groups who cannot protect themselves. That seems to me to be something that we will not take without fighting. If the cost of protecting you and me with good jobs is to have some unprotected people hurt, that seems to me to be something which we ought to avoid. Whether we accept it or not we ought to stop people being hurt by it and see if we can live with the consequences.

Senator Nichol: If, as many people believe, the tax burdens across the country are getting close to some sort of limit—I am not talking about inequities, because obviously there are some, but in broad terms—then this means a reasonably important shift in expenditure of public funds from non-human into human directions.

Dr. Lipsey: I think that is right. I am not here pleading that we ought to double the rate of inflation to go into the new world. I am saying let us accept what has been happening to see if we cannot design the world a little better from what experience tells us we have to live with. Our attempts to avoid it so far have not been successful. We need to accept what we have and design a little better world around it. One very easily gets tarred with the brush of mad inflationists.

Senator Nichol: Those who have not been hurt by inflation in the last 20 or 30 years have been greatly helped by it in economic terms, in terms of real dollars that they have had to spend. The people who could protect themselves have done extremely well in an inflationary system; is that correct? Have not wages and salaries gone up much more than the cost of living over the past 20 years?

Dr. Lipsey: That is so. As a start, if you assume that the productivity increase is not much affected by the rate of inflation, then the real position of these people would have gone up anyway. You cannot lay their improvement as a credit to inflation. The improvement in the average living standard is a credit to productivity, to new methods, more capital, et cetera. What happens is that unanticipated inflations do redistribute income haphazardly to some extent, and some people cannot help losing and some cannot help gaining. Some people are better off from inflation, but the most gain is from the productivity growth.

The Chairman: I think your point is well taken. Do you have any idea of how much inflation would result from protecting those who cannot protect themselves?

Dr. Lipsey: No.

The Chairman: It is a serious matter.

Dr. Lipsey: It is almost the very next step from the position that I am in now. There are two steps, really: one, to rethink the question of who gets hurt. The traditional wisdom is about unanticipated inflations. If we anticipate a 3 per cent inflation, we have to think about who will be hurt by it. The next step is to calculate how much it would cost us to stop them from being hurt.

The Chairman: What contribution would you make?

Dr. Lipsey: I cannot make any guess, because I have not thought about it.

Dr. Gillies: Studies of the British economy show that if there is no excess demand the application of income policies can in fact be inflationary.

Dr. Lipsey: Can.

Dr. Gillies: Is that theory transferable, that if we are in a situation in Canada where we have no excess demand, the application of firm income policies somewhat like those in England can in fact be inflationary?

Dr. Lipsey: It could be, yes. The reasons for it seem to me to be fairly general. I would not be surprised to find them duplicated here. We could hardly assert that we would do things in exactly the same way. I would rather suspect that they would be duplicated here. One of the things that really disturbed me about the commission was that it was certainly said, and said publicly, that we are going to do part of the job with an incomes policy and the rest of the job by depressing the demand by traditional measures. It is at least a possibility that that buys you the worst of both worlds. If the incomes policy bites at all, it removes any of the effect that the demand measures would have had. If you are then operating with a fairly significant floor you are actually worse off. So that the package deal could conceivably be the worst thing you could do.

Just to finish it, if we were in a shortrun jam and really at peak employment, then I would say you might well suppress price-wage inflation for a year or two by temporary measures. By "suppress" I mean slow down a little bit.

Dr. Gillies: The second point is that you reject the proposition often put forward that a small amount of inflation is an essential condition for real growth.

Dr. Lipsey: No. I express skepticism on it. I mentioned that I tried to study it myself and got inconclusive results. However, if you want me to give an opinion, it would be that a small amount of inflation is likely to be the best growth climate in which to operate rather than fight for a really stable price level or a very rapid inflation.

You cannot be unequivocal, as you know, about the very rapid inflation. It all depends on what it does to profits and to distribution of income and so on.

Dr. Gillies: My third point is, there seems to be a great debate between those who argue that the central bank should have discretion about changing the rate of increase in the money supply and those who say rather that the money supply should be increased at a constant rate in relation to the gross national product, and that in this way you would avoid some of the bigger swings that occur in the economic activity. Do you have a brief opinion about that?

Dr. Lipsey: There is the glib answer, of course, that you are always better with discretionary policy, if it is good, and you are better with the other policy if your discretion is bad.

Speaking for Britain, and I think for Canada—but again I do not stick my neck out on Canada, this rule would mean a total change in the way the Bank of England views its role in the economy, because the money supply is not a target variable for the Bank of England. The Bank of England is more concerned with ordering the financial markets in what it calls its support duty, and this has implications for the money suppliers, whether it is buying or selling in the market. I suspect that it is not totally without application in Canada. I think that to go over to the nondiscretionary rule would certainly change greatly the role of the central bank, and also, of course, in a country with a fixed rate it has certain problems about the management of the rate.

Dr. Gillies: Would you say, sir, that the action of the Bank of England in the post-war period has been essentially inflationary?

Dr. Lipsey: Well, you know you are drawing me into a controversy about causes of inflation. I guess so. I guess their activities along with other target variables in view have probably expanded the money supply more than would have been the case had they not done these other things.

Senator Grosart: Dr. Lipsey, you state in your brief that up to the mid-1950s inflations were generally regarded as a demand-pull phenomenon. You suggest a change took place somewhere around the mid-1950s. I would ask you first of all are you describing a specifically Canadian or a universal experience?

Dr. Lipsey: I was describing the state of mind of the economists who were diagnosing the inflation. I think the first real experience was the heavy unemployment in America and the gradual creep-up of the price level there.

Senator Grosart: You are not suggesting that there was any actual change but merely that the economists suddenly found a way of breaking it into two components.

Dr. Lipsey: I would have to say a little bit in defence of the economists. There are two points. First, there was no doubt in anybody's mind that the major cause of post-post-war inflation was demand. Then, when the slower inflations persisted over longer periods of time, a doubt came into the minds of economists as to how much was demand and how much was cost. It was not just an arbitrary change among economists. Experience was that price levels changed.

The second point is, if you go back into the history of it, that the debate about cost-push and demand-pull has been fought for the past 150 years. There was enormous debate among classical economists on this very subject. But Iam talking about a very short historical period when the major inflations following the first and second world wars seemed clear to everybody. I do not think anybody has had cause to change his opinion on that.

Senator Grosart: Is there a possibility that the distinction we are emphasizing so strongly now between demand-pull and cost-push is what somebody has called part of "Shuffle of the shibboleth"? Is there really no difference? For example, if demand decreases cost will decrease. In other words, the market mechanism of supply and demand will become operative so that the two become really one. Is there really this polarity between the two types of pressures?

Dr. Lipsey: I think you are right, if we want to get more subtle, to say that it is not as clear as I have drawn it. I think there would be some difference among economists if we talked to them. The reason I would maintain some distinction is that it seems to me that it is something that is possible—you cannot rule it out as being impossible, but you just cannot describe it as demand-pull inflation. That is a long involved way of saying it.

Senator Grosart: Perhaps you could describe it as the result of demand-pull or a component.

Dr. Lipsey: Let us just imagine an example. Let us say we have 10 per cent unemployment and that there is a great slack in all the major industries. But the unions come along and say they want a 10 per cent wage increase. The employers, taking leave of their senses, say yes. If nothing else happens and if incomes do not go up across the board, this, of course, may further reduce demand. But let us say the Bank of Canada steps in, in the interests of supporting interest rates or something else, and expands the money supply. It would be quite possible for the price level to rise indefinitely at 10 per cent a year, or minus the productivity increase, by this form of behaviour. You may think that is totally unlikely, but the real question is, if it will not happen at 10 per cent with a totally slack market, will something like that happen at 5 per cent.

Senator Grosart: But is not the demand for higher incomes in either the fixed or unfixed sectors inevitably linked both inherently and historically to inflation? It is always the reason given. People want more money. Whether it is the pensioners, the civil servants or the labour unions or the entrepreneurs who want more profit, they say it is because of the inflation. I do not ever remember hearing another reason given for the demand.

Dr. Lipsey: Well, I have two answers. The first is that I do not accept that. You see people grab whatever argument they can find in a negotiation, and that is always the most convenient and most easily understood argument, and I do not think one can infer too much from

what people say. But to try to attack your historical statement, all through the 19th century or at least throughout the greater part of the 19th century, the price levels in most countries were constant or mildly declining. This certainly is true of Britain and is true of most countries. There were increases in wages and in unionization and in demands for increases in wages, so that as an historical statement I would not accept that peoples' demands for higher wages have inevitably been linked to inflation. It is a demand for a better standard of living.

Senator Grosart: But you are speaking of aggregate inflation. If you disaggregate your inflation, I think my statement will hold up. If you take the price of bread or the price of foodstuffs, yes, they will result in these demands. But if you take your aggregate, then the picture is different, and my statement is, I think, historically true.

Dr. Lipsey: I can only say I do not agree.

Senator Langlois: If I have understood you correctly, although you may not have said so specifically, when you speak of the costs of fighting inflation, you include in these costs the resulting increased unemployment resulting from such measures. Now my question is, is the cost of this a component of some of the costs of fighting inflation and I have in mind particularly unemployment?

Dr. Lipsey: Let me say this, and then we will know if I am dealing with the point you make. One of the great attractions of an incomes policy and one of the things that first attracted me to it was the fact that one might be able to do just that, maintain a higher level of employment without the element of inflation that has historically been associated with it. Indeed if an incomes policy worked, you could reduce inflation without having any unemployment cost, and I think that is why it is so attractive, or it is one of the reasons. As I say, my objection to an incomes policy is not what it could do if it worked, but what it does if it does not work at all or if it does not work well. But you see the other way that I see of fulfilling these policies—I do not know what scope there is for them but they have not been investigated in a big way, certainly not on this side of the Atlantic—would be labour mobility policies of all kinds and sorts, policies of retraining to reduce the pool of frictional and semi-structural unemployed, and then if those worked, they ought to allow us to have a lower level of unemployment without any higher inflation. People have dabbled in this, but I think looking into all this sort of thing as a major expense is certainly something that should be done.

Senator Grosart: If I might just make an explanation of my former remark, the point I was making between aggregate and disaggregated inflation is that in the 19th century everybody did not think that they were entitled to have a carriage, but today everybody believes they are entitled to have an automobile.

The Chairman: Dr. Lipsey, the hearings we are conducting are on growth, employment and price stability. Can you tell me how important it is for a country like Canada in your judgement to try to achieve full employment? Is that something that perhaps we should not be trying to achieve? Are we taking on our back costs that are far in excess of the benefits?

Senator Nichol: That depends on who you are.

Dr. Lipsey: Well, I think the big unemployment problem in Canada as in many other countries is of course the sectoral imbalance in the unemployment picture, and really heavy unemployment in some sectors combined with nearly full employment in others, is, I would have thought, one of the serious problems that needs further work. But you are thinking, I assume, in terms of an overall average amount of unemployment across the country?

The Chairman: Well, we have Senator Croll here and he is Chairman of the Poverty Committee which is concerned about the examination of a guaranteed annual income. In other words, have you any views on whether we should, in what is obviously or hopefully an ever-increasingly productive country be considering a structural unemployment of, say, 5 per cent, 7 per cent or 10 per cent which would be supported by some sort of guaranteed annual income?

Dr. Lipsey: Well, there are always some social goals that you accept without much thought and there are some that you think a lot about. I suppose I have accepted and still do accept the goal of a job for any one who wants one and is able to do one as a major social goal. Since it seems so self-evident to me, I would have trouble saying much more about it unless someone wanted to press me with the other side of the case.

The Chairman: Which is no job for people who do not want work.

Dr. Lipsey: Oh, no. A job for everyone who wants one and who can do it does not imply no job if you do not want one. That is a separate question—what to do with people who do not want to work. But I cannot myself see an argument against the policy which I have suggested as a social goal. Now if you ask me can I conceive of a situation where the cost of attaining that becomes prohibitively high, the answer is I suppose I can. In the same way one can say that the cost of no social goal of the kind we are considering in the economic sphere is desirable whatever the cost. I think my ingenuity is such that if I tried for ten or fifteen minutes, I could imagine situations in which it became prohibitively costly to come anywhere near that. Indeed, in certain depressed areas, if you want to go back to regions, it is almost like that now. But the tools of fiscal and monetary policy, if we are thinking of increasing employment, tend to be fairly low cost, except for any trade-off they give you against inflation. Tools of retraining, mobility, doing things for people who lose one job so that they can take another tend to be costly and it is certainly imaginable that the economy could change so fast and in such fundamental ways that it was just agreed to be cheaper to retire people at the guaranteed annual income age rather than to move them

or retrain them at the age of 55. But that is something I would want to see demonstrated. It seems to me that the presumption is that a job when you want one is the usual concept, and we would abandon it only when in such cases we found the cost became inordinate.

After all, if people lose their jobs through economic growth and we say, "Look, we cannot afford to compensate you adequately," then we are denying the basic idea that a gain is only desirable when those who win can compensate those who lose. That is the well-known Pareto's optimal conditions in economics. It has always seemed very odd to me that the people who gain by economic growth stop by merely exhorting those who lose to collaborate with the inevitable and do not get in the way of productivity changes, especially when they lose their jobs at the age of 50. If we cannot give them the preferred alternative, it seems to me that growth is a bad deal. It may be that there exists a money bribe such as people would be prepared to collaborate in the growth and not work. If there is a money payment, then, fine; but my suspicion is that for most people the price would be another job. However, if we cannot foot that bill, then it is a gross mistake, by the simplest comparison that the gainers must be able to compensate the losers.

Senator Croll: You have answered the question I wanted to ask. You will forgive me, because I was not able to be here sooner.

Speaking on employment, I may not be absolutely certain but as I recall the figure, we have to place 200,000 people in jobs each year to stay even. We speak in our public statements and in unemployment insurance of 4 per cent being the acceptable limit of unemployment. I understand that you said earlier, before I came in, that some provision has to be made for those who are unable to obtain employment for whatever reason, assuming that it is the federal Government's responsibility to make the environment such that jobs are available. If they are not available, what is the alternative? There they are. What is the social responsibility, as you see it?

Dr. Lipsey: Unless you have something else in mind, it seems to me just what you said. We must accept it as a responsibility to try, within the limits, of course, of human imagination and intelligence, to provide jobs for this group of people.

We have to be careful when we talk about 4 per cent unemployment. We do not mean 4 per cent of the people unemployed forever. The great bulk is frictional unemployment, with people moving between jobs. When the unemployment rate goes up, a great deal of it is because a little longer is taken moving between jobs. That kind of movement is inevitable, and there is not much we can do about it, except easing the transition with unemployment payments.

The more serious problem arises with regard to people displaced by the process of economic change later in life, and so on, who are really seriously harmed. It seems to me that until the costs become really exorbitant, the responsibility is to offer major retraining and moving schemes that give those people who want it an opportunity to get a job.

Senator Croll: Today—and we are now in 1971—where as a result of some steps we have taken to fight inflation we create considerable unemployment, what does that man do? What is his position? Government policy has brought upon him unemployment. The Government says so itself; I do not need to tag it with that. What do we do with him?

Dr. Lipsey: I am sorry, but I did not understand the question. I see very little that can be done if Government policy is that a certain level of unemployment is necessary or is going to be endured in order to fight inflation—other than supporting him.

Senator Benidickson: It is largely done by deliberate monetary policy.

Dr. Lipsey: I am not sure there is any disagreement. You have said that these people will bear the costs of the other people avoiding inflation. You just transfer the cost of inflation, which is felt to some extent by all of us, to that group of people who are now unemployed. If you want my opinion, it seems to me to be a darned bad deal; it seems a little unfair. One of the reasons why I have been trying to advocate that we accept some inflation is that we do not have to do that to people. But we will always have to have some policy about the level at which to run the economy. It is always possible to cut the unemployment rate a little more, but we have to stop somewhere. We do not want wild inflation in order to get down to zero unemployment. It is a decision that every government has to make: how much of one for how much of the other? I have no doubt where I go. I go to fight a fair amount of inflation in order to get rid of the unemployment and other problems, and then I build in hedges to stop people being hurt from inflation.

The Chairman: Thank you, Dr. Lipsey.

Honourable senators, that concludes the testimony this morning, if there are no further questions.

On your behalf I would like to thank Dr. Lipsey for being what can only be described as a superb witness. I suppose I best express the feelings of the committee when I state, Dr. Lipsey, that you have spent most of your life as an economist in England, and we are tremendously glad that you came back to Canada. Thank you very much.

The committee adjourned until 2.30 p.m.

Upon resuming at 2.30 p.m.

The Chairman: Honourable senators, continuing with our hearings we have with us this afternoon as a witness Dr. John Crispo, who is the Director, Centre for Industrial Relations, University of Toronto. Dr. Crispo received his doctorate from the Massachusetts Institute of Technology in Industrial Economics. He has served as consultant to many groups, including the Economic Council of Canada. He was a member of the Prime Minister's Task Force on Labour Relations, Chairman of the Industrial Union Management Council and Director, Social Planning Council of Metropolitan Toronto.

Dr. Crispo is the author of *International Unionism; a study in Canadian-American Relations*. He is editor and co-editor of several other books, articles and marketing journals. Dr. Crispo is a leading Canadian economist, an expert in problems of labour and productivity. He has recently provided lectures and paper on "Inflation Guidelines, Facts and Fantasy", and his arguments have been summarized in the autumn issue of the *Business Quarterly* for 1970.

His paper covers four parts, the first commenting on organized labour and the causes of inflation, the second highlighting wage and price guidelines—and for that matter controls and why they are unworkable—the third dealing with how this country should come to grips with inflation, and the fourth being the short-term outlook.

You have Dr. Crispo's paper before you. It is not our practice for the witness to read his paper, but perhaps Dr. Crispo would comment on his paper as he feels free and on other subjects that come to mind and then we will commence the questions.

Dr. John Crispo, Director, Centre for Industrial Relations, University of Toronto: Mr. Chairman and gentlemen, I suppose I should begin with a word of appreciation and of apology: appreciation for the opportunity of appearing before you. I was honoured by the invitation, as in fact I say here, and I am very concerned about the issues with which you are dealing.

I suppose if an apology is in order it is with reference to the material now before you. I did not have the time to put it in the learned style of some of your previous witnesses, but it is presented to you as something that you can follow. I should like to cover a good deal of this material because I think it leads up to, and makes my conclusions defendable. I invite comments along the way and I hope that I will have a chance to comment on much of this material.

The Chairman: Is it agreed that Dr. Crispo give his dissertation, and that we withhold our questions until he has finished?

Hon. Senators: Agreed.

Dr. Crispo: Firstly, I have a note here regarding reference to me as one of Canada's leading economists. With some pride I took this to my colleagues at the University of Toronto and told them that they never recognized me for what I am. Quite honestly I cannot be classified in that category and I am not sure that I would want to be. My field is in industrial relations. As I pointed out, I do not think this minimizes the contribution which I can make to your deliberations. It merely indicate a different perspective from the one suggested.

You have already heard an outline of my remarks. It would be best if I begin very briefly by referring to an overriding assumption that underlines everything I say on any subject but particularly on collective bargaining: I still believe in our collective bargaining system, not necessarily as a means and an end in itself, except in perhaps the sense of providing a degree of industrial democracy. It is not the best of all possible worlds, but whenever I go abroad, particularly to western Europe where developments are reasonably comparable to ours, I come back rather grateful for the system that we have here. Others have problems that are more acute than ours, and when we compare our system with theirs it is the least of the evils and it may even be something beyond that.

I firmly believe that our collective bargaining system and our free labour movement are an essential and indispensable part of the hierarchy of values and institutions that I refer to here. If we tamper with either the free labour movement or the free collective bargaining process, we are tampering with other things that are of equal importance to us. It is harder to defend collective bargaining than it used to be. My commitment was at one time rather emotional or idealistic. It is no longer that kind. It is rather an intellectual commitment for the reasons I have stated.

My concern is that those who like to criticize or detract from our system seem to fail to realize that it is tied in with the social-economic-political systems, and seem completely oblivious to what is going on in every so-called free country where collective bargaining has been threatened.

I suppose it is only fair to say that I began with a preconceived notion, a prejudice, a bias, if you will. I believe firmly in our collective bargaining system for reasons that are defensible.

I go on to comment on the public interest in collective bargaining and to point out that this public interest which I have mentioned is one three very important interests which the public has in collective bargaining—the first being the preservation of industry and the extension of the system as part and parcel of those hierarchy values that I refer to.

Beyond that there are two other public interests. As for the first, it is public interest in the procedural results of collective bargaining. By that I am referring to the problem of strikes, lock-outs and lost time due to labour disputes. Our record in this respect is one of the best or worst in the world, depending on how you look at it.

People compare us with Britain and suggest that our record is worse than theirs, that we lose more time because of strikes. But our strikes are organized. We know when they are coming and they are not half as disruptive as the kind of wildcat irresponsible unannounced strikes that the British industry is plagued with, particularly in the engineering industry.

This is the problem, and governments have to concern themselves with protecting the public health, welfare and safety when there is a strike or lock-out of major proportions. I suggest that you should be very leery of those with simplistic answers such as compulsory arbitration which will not work on a standing basis. It may well be that we will have to resort to such desperate means on an ad hoc basis as a lost resort when all else fails and the public health and welfare and safety is truly jeopardized. Other than that we should refrain

from resorting to that kind of tactic which for many reasons will undo rather than improve our collective bargaining system.

Let us now turn to what I think is the central area which you would like me to discuss, namely, public interest in the substantial record of collective bargaining. I want to focus on the relationship between collective bargaining and inflation. Here, and understandably, the focus has been on unions, collective bargaining, wages, and inflation, and the so-called trade-off among stable prices, full employment and our other national economic and social goals.

It should not have to be repeated that unions and collective bargaining are ready targets or scapegoats in this charged area. Unions demand and get more and sometimes, as in construction, a lot more. Moreover, they do their handiwork in public and often in ways that attracts a great deal of attention. This makes them highly vulnerable to their general detractors and those who wish to distract attention from their own contribution to the inflationary process.

My point in saying this is that as far as I am concerned—and I have been saying this over the past three or four years and I will continue to say it whenever I get a chance—I am convinced that labour has borne and is bearing more of the blame for inflation than it should. The attack on labour continues to be simplistic, misleading and unfair and essentially inspired by political and public relations considerations. I cannot emphasize that enough.

I acknowledge, I know, because I live in the collective bargaining arena, that unions are after everything that they can get. They are still following the tradition of Samuel Gompers who told them they should pursue more and more and more. But tell me somebody who is not pursuing that same goal in this acquisitive society of rising expectations fed by the merchants of discontent, the advertising and marketing professions.

I would add that management taught us the capitalistic aim of charging what the traffic would bear. That is what our system is all about. But I continue to defend it. It is a free enterprise system, a capitalist system in which you charge what the traffic will bear, and management hardly has clean hands in this exercise.

Professionals, as we know from the recent record of medical income tax, are doing their bit. They are also into the pie for all they can get out of it, and governments have compounded the problem with their inappropriate fiscal and monetary policy, which is something to which I will return a little later.

I get somewhat tired of this talk about irresponsible behaviour on the side of labour. It exists on all sides. I do not think it serves much purpose to berate labour. I think it gives rise to certain political advantages which obviously inspires a lot of support in some quarters. Although it does give rise to certain political and public relations advantages which obviously inspire a lot of support in some quarters.

I think it is intellectually dishonest, but more important it does not begin to solve the problem. How do we solve the problem? How do we cope with the challenges that are involved? As I see it there are three challenges. First, we have to try to understand what actually causes inflation. Second, we have to take a look at what our recent experience with guidelines shows. Third, and most important, we have to try to figure out what is a viable anti-inflationary strategy.

Let us first of all turn to the matter of sorting out the causes of inflation. When I want to be simplistic, and I must confess that in this terribly complicated world I resort to this sort of thing very often myself, I basically come to the conclusion that the problem of inflation comes down to our inability to begin to agree on how to divide the national pie—the spoils, if you want to call it that.

As I point out here, we are all engaged in a never-ending scramble for a bigger piece of the action. This has put us on what I like to term "an inflationary treadmill to nowhere". I know this is what concerns many of you. To be more academic, intellectual or theoretical, it seems to me that what we are up against here is a constantly shifting mixture of causes of inflation. I can only touch on these, but I think it bears out the complexity of the situation and why it is so dangerous to engage in these kinds of naive attacks on one group or another as the major culprit. Monetary policy frequently fuels or validates the inflationary process largely because the alternatives seem even more unpalatable to the central bankers. I understand their problem. I am firmly convinced that if the Bank of Canada wanted to stop inflation in this decade it could probably do so, but I would hate to think of the disastrous side effects in terms of unemployment and slow rate of growth and so on and so forth. But nonetheless they do at times fuel and validate the inflationary process.

Demand-pull, whether it be general and/or sectoral, is often involved whether the source is expanding consumer outlays, increased demands for our exports, investment booms, rising government expenditures or some combination of these forces. And cost-push, which is the one so many of us want to focus on these days, whether it is general or sectoral, is often present whether it derives—and let us be clear on this—whether it derives from wage-, salary-, fee-, interest-, import-, tax- or profit-push. There are all sorts of cost-pushes abroad in the land. I cannot emphasize that point repeatedly enough.

To repeat, then, it is the complex interaction of all of these sources that makes it so difficult to assign responsibility to any one or more of them at any particular time. There are no simple explanations. Correspondingly, there are no easy answers.

Let us now look, having said as much as I can say about the causes of inflation, to what we can learn from Canada's futile experience with wage and price guidelines. I may say, and I can say this without fear of contradiction, that I am not saying something out of hindsight. I said it before it began. I said it during the

exercise and for once in my life I knew I was right. But like other deceptively appealing measures such as compulsory arbitration, which I mentioned earlier, wage and price guidelines do have quite a coterie of advocates. After all, they are fair, just and involve no compulsion! If people did comply, we would certainly solve a lot of problems. The problem is that they will not work for a number of reasons, most of which are cited by the Economic Council of Canada in its Third Annual Report. I hesitate to mention that body because I gather it is in the dog house in certain high places in this country, but it did in a very excellent review point out just why wage and price guidelines and controls would not work. Everybody in high places seems to want to ignore that report. But more important, let me single out my primary reasons for being so dogmatic and even arrogant, if you will, on this subject. Guidelines have not worked elsewhere, except perhaps, and I underline the word "perhaps", on a short-term basis. Even then they have almost invariably—I think I could say invariably—been followed by a wage-price explosion.

Most significant in this comparative experience is their failure in countries where for a variety of reasons they should have had a better chance at working than they would here. If you look at the list of reasons which I provide I think you can see the contrast between ourselves and some European countries in particular which have tried income policies or guidelines. First of all, and some people take exception to this, most European countries that have got into this crazy business have had governments that are more sympathetic to labour. They have had social democratic governments. This country has never had anything resembling a social democratic government. It is no wonder that labour does not respect the edicts of government, because it has no reason for having that much confidence in government. So this is a basic consideration. They have more unitary states. They do not have the federal-provincial constitutional problems that we have. They do not have the division of authority in this area. They have more centralized union and management arrangements. They have much more centralized union bodies and they have much more centralized and powerful employer organizations.

We have shadows at the top. The CLC and the CMA, the Chamber of Commerce and most other groups that you can mention are not significant in terms of the issues we are here to discuss. They are little more than lobbies, spokesmen for those they purport to represent. But let them try to represent them on a gut issue like wages and prices and they will quickly discover that their affiliates are not behind them. They have, finally, more centralized collective bargaining arrangements. All of these things, it seems to me, would suggest that incomes policy guidelines, or whatever you want to call them, should have worked there. Nonetheless, they did not. Mind you, I was in Europe last summer and the best summary description I have heard about the state of guidelines in incomes policy in Europe was provided to me by a British labour attaché—I had better not name the country or you will really pin him down. When I asked him about this he said "income policies are in a state of shambles in western Europe". I have been in most of these countries and I can attest to that fact.

Finally, even if the CLC and the CNTU had chosen to go along with the guidelines, which they did not, and I say here and I mean, "for good and valid reasons," they could not have delivered. I come back to what I said a few minutes ago about the nature of the CLC. It is a monolithic myth, as I have said on other occasions. It does not speak for anybody when it comes to such issues as collective bargaining and wage determination. They cannot commit Denis McDermid of the United Automobile Workers or Bill Mahoney of the Steel Workers. It is a joke to even contemplate that they could. The CLC has nothing to do with these things. The affiliates, either national or international, are autonomous in the field of collective bargaining. They are not going to listen to any kind of instructions or edicts from the CLC. Even if the auto workers and the steel workers and so on were willing to listen to the CLC, do you really think that their locals would pay much attention to them? There are international union representatives in this country who are not even allowed to attend local union meetings. They cannot get into those meetings because the local union members will have no truck or traffic with them. And this, of course, reflects the third consideration. Even if the steel workers' locals listened to the steel workers and the CLC, do you think the rank and file really listen to their officers these days? If you do, you are not aware of the number of union officials at the local level that are being thrown out of office; you are not aware of the failure to ratify collective agreements; you are not aware of the general restlessness and militancy of the rank and file, which is in some ways even more intense because of the inflationary problems. So they could not have delivered. Guidelines could not possibly have worked in this country and for anyone to presume that they could—well, I should not say what I want to say, but it illustrates a degree of naïveté, if not ignorance, that appals me. It appals me that it should exist in high quarters.

Having said this, I know you will want to know what the devil you do do about inflation. You might say, "You are a very negative young man. You are very presumptuous. Have you anything to offer?"

I believe I have. I have got nowhere talking to those who determine these matters. I do not even know how I got into Ottawa. If there was any way of keeping me out, certain individuals would certainly have done so. But is there a viable anti-inflationary policy? I firmly believe there is. But unfortunately we have nobody with enough courage and sense to implement it. There are no ready and easy answers. When I go down this list of approaches I think you will realize that. But there are a variety of possibilities, considerations and strategies that must be borne in mind. I have several points. I will try to go through them as quickly as I can, because I know you want to get at me. I am used to my students so I am prepared for that sort of thing. So let me try very briefly to go down these points.

First—and this is terribly important, although I do not want to give the impression that I have ranked these in

order of priority—there may be some logic to the way in which I have ranked them, but they are not in order of priority—there is this pressing need for perspective. Inflation has posed and continues to pose a serious problem in this country. No one can deny that. But some highly placed individuals chose to make an obsession of it, a mania, a phobia and developed an almost extraordinary preoccupation with it. And this despite the fact that our available indices if anything overstate the degree of inflation we have. Our indices are not as accurate as we would have them and I am sure you are hearing from others more able than I am who tell you about some of the defects in the cost of living index, but more important, others, including our major trading partners, if you want to call them partners, or competitors, if you prefer to call them that, have had considerably more inflation, so that our competitive position, if anything, far from deteriorating has in fact been improving, and this is probably the single most important consideration that we should bear in the long run, once we take care of the second point which I wish to raise with you. That is the whole matter of who bears the burden for inflation and what should be done about it.

The sad and really horrifying thing is that those who are hit hardest by inflation are those who are least responsible for causing it. I refer, of course, to the so-called widows and orphans and others on low-level fixed or quasi-fixed incomes. All of our basic security measures should be placed on full escalators. I would again emphasize that point, including, as I say here, our minimum wages. I know that in doing this we will aggravate the inflationary problem, but nothing less will do in a society that purports to be in any way, shape or form a just society. It is nothing less than a disgrace and a tragedy that the people who do least, and let me repeat this, to cause inflation bear the greatest penalty for it. We have at our disposal a government with a strong enough majority that it could implement policies that would take care of these so-called widows and orphans that we hear so much about but that so little is done about.

Third, and related to the first point, we must remain mindful of the extent to which our inflation is imported. We are highly vulnerable to import cost-push and export demand-pull especially from south of the border because we are a major trading country, and an inflationary international climate reduces the amount of control we have in this area. That is what we are up against; there is inflation abroad in the world, as you know. But because of this we must be careful that we do not pay too high a price in pursuit of a partly, if not largely, futile goal.

Let me move to my fourth point, again moving through these things awfully quickly. Let us try to become a little more aware of the cost of so-called wars on inflation. Some of the costs are very real, such as the incomes foregone and the unemployment deliberately induced in order to further this war on inflation. I am not competent to tell you how much loss we have suffered in terms of growth and income but I understand that Firestone from the University of Ottawa, I believe, has estimated that in the last year 200,000 jobs and $2 billion were lost in fighting this futile war on inflation, and he is a very conservative economist. I find it striking that he would come up with figures like that. Other costs are more nebulous such as the psychological damage suffered by those who have been thrown out of work which I sometimes feel that people in high places have no awareness of, or the deleterious effects of the guidelines on the relationships between the federal Government and the unions representing its employees.

Now presumably—and I stress presumably—and again I must emphasize that expression, but presumably somebody in high places thought that the benefits of the war on inflation more than outweighed its cost. But where is the evidence? This is something that you gentlemen might well demand of certain people. Where is there even a sign of an attempt to work out the relative cost and benefits of more unemployment as opposed to more inflation. That there is no such sign is, to use language that I used earlier, a disgrace and a tragedy. If there is a trade-off between more stable prices and fuller employment as the government apparently has been assuming and to which to a certain extent I subscribe, then the means should be developed to make an intelligent assessment of the most appropriate combinations for which to strive. But I am convinced that there is nothing like that available in this city, and that is, as I said, a disgrace and a tragedy.

Fifth, and of as much consequence as ever, we must have more appropriate fiscal and monetary policies. The unduly—and this is mild language, really—loose fiscal and monetary policies of the federal Government during the mid-sixties and the late sixties had as much to do with our recent inflation as everything else, and all I can say is that we have to avoid repeating anything like that kind of exercise again.

Sixth, we must continue to stress our anti-bottleneck strategies. Even if we had the most adequate of fiscal and monetary policies, this would not suffice, and these would not be enough in and of themselves. We must have what has been termed in the United States "a vigilant pressure-point strategy" aimed at both bottlenecks and what I like to term boat-rockers which I shall come to later. As for the bottleneck problem or strategy, or whatever you want to call it, the most outstanding example we have in this country is to be found in the field of our so-called active labour-market policies, which are directed, among other things, to relieving manpower shortages through upgrading and retraining and relocation programs. But as I am sure you are all aware, we have a long way to go in this area and we have to develop a variety of other strategies and so on all aimed at bottlenecks in our economy.

Seventh, we must develop more effective anti-boat-rocking policies and I say here because I am troubled by the way my students think and feel that there may be something inherently wrong with the competitive pursuit of self-interest on moral and ethical grounds. I must confess I am not sure any more, but I understand the concerns of my students. They think it is immoral and unethical, but economically it is hard to quarrel with the

efficiency of this approach as long as there are sufficient checks and balances either market or institutional in nature among the various contending interest groups. What we have to avoid are unrestrained power blocks, be they in labour, management, the professions or indeed government. Otherwise they will be able to extract monopolistic and/or monopsonistic returns thus whetting the appetites of others for less realizable but perhaps equally inflationary demands.

This brings me, and it has taken me too long to get here, to a useful role for a prices and incomes commission. Now before I can outline what a prices and incomes commission could do if it wanted to be constructive, it is essential to review why our prices and incomes commission went astray. Essentially it is because, for reasons which I do not fully appreciate, although you will get an impression that I have some idea, it chose to virtually ignore its original mandate to find out the causes of inflation with a view to proposing appropriate remedies and instead preferred to adopt the American "job-on" approach well after the Americans had discarded it as a failure. I find this intriguing; after it fails in every other country in the western world we take it up. Granted the approach chosen was colourful, flamboyant, headline-attracting and politically shrewd. I will grant you all of those things. For a while Mr. Young even upstaged the Prime Minister which is quite an achievement. But for reasons already stated it did not begin to solve the problem and in that sense it was worse than futile; it was anything but constructive, in fact it was the reverse, it was destructive. Moreover—and this is the critical point—it completely undermined the Commission's credibility with labour and eventually with a lot of other people who were not deriving political or public relations advantages from its singling out of labour as the primary culprit.

Now, what should the Commission have done? To begin with, it should have thought in terms of the pressure-point strategies I referred to above. It should have been identifying those areas of the economy where we have serious bottlenecks and serious boat-rockers. Then it should have—and this is far more important—figured out how to come to grips with them, and finally it should have raised public hell—and I mean that—until something was done about its recommendations. This would have been a useful and viable approach to the problem, but it would have required a completely different emphasis. In the first place, the Commission should have been a joint federal and provincial body, since so many of the problem areas lie within provincial jurisdiction. I have already mentioned construction and the professions. They are within provincial jurisdiction. This should have been—and it has to be, if it is ever going to be useful—a joint federal and provincial body. It would have had, in addition, to place more emphasis on research leading to hard and specific public policy prescriptions in identifiable trouble spots. Once it moved in on construction and certain of the professions, instead of preaching guidelines it should have said, "Where the devil did these groups get the power to get away with this kind of wage-, salary- and fee-gouging?" Indeed, they could look at a few corporations in the same light. But it could not have played a role as a political handmaiden of any government. Indeed, at times it would have had to be just as critical of various levels of government as it would have of any other groups.

Admittedly,—and I must stress this—this approach is based on certain assumptions that should be made explicit in order to avoid misunderstanding, because some of you are going to say that I am just as naive as some of the others I have been talking about. Indeed, I would have to admit that these assumptions are heroic.

This approach assumes, of course, that bottlenecks and boat-rockers do present serious problems, be they in any of the groups I have mentioned before. I am firmly convinced that this is the case: we know we have bottlenecks; we know we have boat-rockers.

It also assumes that unduly strong and out-of-line groups in all of these areas have powers and engage in activities that they would not like to see subjected to public scrutiny, let alone control. It further assumes that after a cross-section of such offending groups did have the "skeletons in their closets" exposed for what they are and dealt with, others would think twice about continuing, or taking, measures that would invite similar treatment.

Essentially, this whole strategy assumes that the best way to ensure that such groups behave in the public interst is to make them acutely aware that it is in their own self-interest to do so.

Mind you, there are two other assumptions implicit in all of this that should be recognized, and perhaps these are the most heroic of all. One is the assumption that we can find sufficiently competent, diligent, dedicated and non-partisan personnel to man such a revitalized commission. The other more heroic assumption is that the two levels of government could find enough political courage to appoint such a group, provide it with ample resources and complete discretion, and follow up on its counsel and advice.

Now, the immediate outlook. As for the outlook on the inflation-fighting front, I am dubious, to say the least. If one is to judge by the Prime Minister's utterances, one is left either confused or troubled. A year ago the New Year, we were told that inflation was public enemy number one. At the New Year we were informed that the primary villain was unemployment. More recently—and I am afraid that I have not allowed for the comments of yesterday—he and some of his colleagues have been threatening selective or general wage and price controls to cope with the potentially serious inflation that obviously continues to confront us. Actually,—and thank God I sent this in to you before this latest series of figures on inflation came out, but anyone with any brains knew it would happen—the inflationary threat never really subsided, although the rate of price increase did diminish sharply. The point is that the threat remained, and remains, as latent and potent as ever, just waiting for enough of an upturn in the economy more fully to reassert itself.

Perhaps the mental gyrations—and my secretary said that I should not have said that—of the Prime Minister

and his associates were, and are, politically designed to mislead us into believing that, having defeated one brand of inflation, which we did not do, we now have to tackle another. After all, a new problem requires new remedies! Hence the threat of wage and price controls.

As for this unrealistic and unworkable suggestion, whether selective or general, the least one can express is disbelief. I stress this despite, if not because of, the widespread appeal of such controls, according to the public opinion polls. Suffice it to say that almost every criticism that can be made of guidelines applies also to controls. Moreover, except in the form of a short-term emergency freeze, they are not only unworkable but incompatible with our existing socio-economic-political system. Yet, inspired by Galbraith—God bless him, I hope he stays south!—further misled by the Ottawa mandarins—they seem to like being called "mandarins," so I use the term although I have never really understood it—and consistent with their astute political instincts, this is the direction in which our leaders are threatening to move. Heaven help us, and them, if they have their way!

To conclude, I am both pessimistic and optimistic. Pessimistic because of the immediate outlook and the obvious bankruptcy of ideas in Ottawa in terms of a viable anti-inflationary policy consistent with our other values, institutions and goals. Optimistic—and it is hard, but I am at times—because I am confident that we do have the makings of such a policy which in time somebody in power will have to recognize, accept and implement. Such a policy revolves around the seven points I outlined earlier.

In summary—and I think this is important—note that they included emphasis on perspective, equity and priorities, and stressed the over-riding importance of appropriate fiscal and monetary and related policies, as well as the critical significance of an effective pressure-point strategy aimed at both bottlenecks and boat-rockers.

Finally, let me return to my opening theme about the continuing interplay among the three competing public interests in collective bargaining. You will recall that these were the public interests in the preservation of the system, in its procedural results, and in its substantive results.

What is to be stressed is that preoccupation with the adverse consequences of the procedural and substantive results of the collective bargaining process could lead us to take steps inimical to its survival and all that goes with it. With respect to the issues before us, this is why it is so important to adopt a viable anti-inflationary strategy consistent with the other public interest in this area. Otherwise, we could end up with desperation measures that in toto would do far more harm than good.

In conclusion—and this time I mean it!—I would maintain that there is a practical set of steps that could be taken to cope with inflation and related problems that would not jeopardize the collective bargaining process or the rest of our existing socio-economic-political system.

The real problem is to find someone in political power with enough sense and courage to get on with the job.

Thank you, Mr. Chairman.

The Chairman: Honourable senators, you have heard the submission by Dr. Crispo. Undoubtedly you will have questions relating to it. I remind you that our original concept was not so much to find blame as to be critical of methodology, and hopefully in as disinterested a manner as possible to see if we could arrive at a more workable system. I hope that as much as possible we can adhere to that concept, because I think that in a search for the truth of a situation it pays not to get too much involved in personalities.

Having said that I now open the meeting for questions.

Senator Nichol: Dr. Crispo, starting with your seven points, which I suspect is the core of the paper, item one seems to be absolutely understandable as does the second one. I agree with item number three and also with item number four. My question concerns item number five. You say we must have more appropriate fiscal and monetary policies. Everybody agrees with that. You also say, in item six, that there should be better anti-bottleneck strategies. In item seven you say we must avoid unrestrained power blocs. These points come up throughout our discussions last week. I am wondering if you could be more specific as to what you think should be done about item number five, namely, more appropriate fiscal and monetary policies, also item number six regarding anti-bottleneck strategies, and item number seven, how to avoid unrestrained power blocs?

Dr. Crispo: The first five points were essentially designed to show that I was not looking at the problem of bottlenecks and boat-rockers in a vacuum but in the context of a better approach.

You will have more competent witnesses who will appear before you to discuss this. One of the references which your committee has been given is a book edited by Smith and another name that I cannot at this moment recall. There is an excellent article in that book on Canada's fiscal and monetary policies since the war and which spells out in much more detail than I can some of the inadequacies in the late sixties when we were running a moderate to substantial deficit when we should have been running moderate to substantial surpluses.

The Chairman: You are referring to the publication on stabilization policy in the post-war period.

Dr. Crispo: Yes. I would urge members of the committee to take a look at the earlier articles in the book. I am a Keynesian and I believe in anti-cyclical fiscal and monetary policies. When we have full employment in this country we should be running a substantial surplus particularly at the federal level, because the provinces and the municipalities not having sufficient taxing power are almost invariably in a deficit position except where they have oil wells underneath their lands, and even there they have problems now. But it is particularly important that the federal Government should be operating an anti-cyclical fiscal and monetary policy. Beyond that I do not think I am competent to say any more. I would, at the risk of showing how incompetent an economist I am, suggest that I can appreciate the Government's problem. The economy is coming back up and a lot of people

including the labour movement are saying "cut taxes. There is too much unemployment in the country." But to cut taxes too much, maybe a moderate amount, might get us moving up too fast. We have made quite a mess in the last few years and maybe we are coming out of it. If we come out too fast maybe we will go the other way. It will require far more astute attempts to forecast what is happening, and I gather that you will have a Professor Wilkinson of the University of Toronto who will talk about these problems.

Let me repeat that we are in an area that is beyond my day to day competence.

Senator Nichol: Before you leave item number five, the question of unduly loose fiscal and monetary policies, I would like you to speak about the expansionary fiscal policies of the government in the 1960s. I think a large amount of federal Government money that was spent, and where the expansion came, was almost entirely on what would be broadly described as welfare.

Dr. Crispo: And education.

Senator Nichol: Education, Medicare, assistance programs, Canada Pension Plan and things of that nature, which turn out to be, in a way, almost the sort of thing that we are looking for in item two which says we must reduce the burden of inflation for those least able to protect themselves.

Dr. Crispo: There may be a political dilemma, I suppose. I am one of those few Canadians that does not resent paying income tax even though I have not yet paid mine this year. I do not resent paying income tax. I am lucky to be living in this society and I resent those of my neighbours who are always complaining about taxes. But they should have raised taxes. If they thought that social priorities were so important, they should have raised the taxes; but that is a political decision that requires the kind of courage that I am talking about, and we do not have it.

Senator Lamontagne: I should like to come back to item five, where you say that most of the inflation that we now have is due to the unduly loose fiscal and monetary policies of the federal Government through the mid and late 1960s. In what way were we unduly loose at that time? How do you account for the high level of unemployment that we had starting in the middle of 1957 through 1961 which was still accompanied by rising prices?

Dr. Crispo: Well, you have got me off guard if I go back that far. Firstly, I think you misconstrued what I said. I said that the unduly loose fiscal and monetary policies had as much to do with our recent inflation as anything else. I did not say that they were primarily responsible for it.

Senator Lamontagne: But you say "more than anything else". That was quite important.

Dr. Crispo: Yes, but so was the American inflation. We cannot dismiss Vietnam and what that did to the Americans when they had to have bread and guns at the same time. We got some of that because it flowed over the border. I will not dismiss the cost push pressures coming from unions and other quarters. All these things are involved. You ask what I meant by unduly loose fiscal and monetary policies. I can only repeat that at that time the federal Government during the period of full employment should have been running at a moderate or substantial surplus, but if anything they were running at a moderate or substantial deficit.

Senator Lamontagne: Not in the mid and late 1960s.

Dr. Crispo: At that time the federal Government in this country had a deficit. We had deficits that were beyond what were called for to have full employment.

Senator Lamontagne: In the fall of 1962, just before these new expansionist fiscal policies were thought of, we were almost on the verge of another recession. We had a substantial surplus and we were far from being in a full employment situation at that time.

Dr. Crispo: My reference was to the mid-sixties and late sixties, senator. My reference was to the period starting 1965 to 1969. By then we are into the serious inflation problem.

Senator Lamontagne: I wish you would check the figures for the late sixties.

The Chairman: I am getting the figures now, senator. When they come I will give them to you.

Dr. Crispo: I am loathe to comment on 1957 to 1961 because I do not think it would be a very informed comment. I am gain driven to refer senators to the first, leading item in this reference that you have on your order paper or whetever it is. In the Arthur Smith submission there was a very useful exposition of Canada's general fiscal and monetary policy during the whole postwar period.

Senator Lamontagne: Roughly between 1958 and 1960 we had an increase of about six points in our over-all movement of prices.

Dr. Crispo: And we also had unemployment. This is your question. Well, there is raging debate going on and I guess I am in on that. Some of my colleagues tell me the trade-off problem is not what we thought it was. They tell me that we do not have a trade-off between fuller employment and stabler prices. I cannot quite agree with them. I say that what we are discovering is that trade-off is even more miserable than we thought it was. Unfortunately, I am not in public print on this but if only some of my students of past year were here and could recall anything—which is probably an even more heroic assumption than some others I have made—I think they would testify that in sitting in my class I did not buy the Economic Council's trade-off curve because it was based on past history and we have not had a past history with a sustained level of employment at 96 to 97 per cent. If we had sustained that kind of full employment, I don't think their trade-off curve would be worth the paper it is written on, because we would not hold the level of

inflation to 3 per cent. With that degree of full employment we would have gradually had a higher rate of inflation. I think current experience is suggesting, not only here but in the United States and elsewhere, that the trade-off is even more miserable than we thought. I do not think we have completely escaped the trade-off. It may not be as precise, acute and sharp as we originally thought it was, but we have not escaped it. We are up against a much more miserable situation than we thought we had.

The Chairman: We will continue with Senator Nichol's question.

Dr. Crispo: All right. I think it is more important that I talk about the anti-boat-rocking policy than about the anti-bottleneck policy, because I think in some ways we are on the right track in respect of the bottleneck, particularly in the manpower area where we do have resources, even in the millions of dollars, going tinto the manpower and immigration department. Presumably, although I am not as sure as I would like to be, that is having the desired effect in terms of coming to grips not only with those who are unemployed and don't have skills but with measures designed to equip them to move into areas where we have shortages. In that sense we have an operational anti-bottleneck strategy in the labour market.

Senator Nichol: And you are calling for more of the same?

Dr. Crispo: I don't know whether I am calling for more of the same. Here it might be interesting for someone to find out what kind of return we are getting on those dollars. I don't know. I just raise the question. But the intent, the spirit is there. Whether we are getting the results, I don't know. That is the kind of thing I am talking about. Now, as for anti-boat-rocking policies, there are so many groups that bother me in this country that I don't know where to start. Let us take three.

First, the construction unions. I am not trusted by the construction unions—and for good reasons. Next, some of the professions—with their self-licensing and self-regulatory and self-fee-setting powers—fantastic! Walter Reuther said that if he had a fraction of the power of the American Medical Association he would not care if there were ten Taft-Hartley Acts in the United States and oh so right he was! And then, third, some of these companies with quasi monopolies like Inco. So let's take the three areas. The construction unions. I have spent a lot of time working with Carl Goldenberg, first on a royal commission and then on a special centennial study for the Canadian Construction Association in which we tried to figure out what could be done to rectify the dreadful imbalance of power that existed in that industry. The construction unions, and I have said this repeatedly and I continue to say it, have too much power—far too much power.

Senator Benidickson: What is Nixon proposing to do with this?

Dr. Crispo: Nixon is playing a little game of politics, which does not surprise me when it comes from the White House. He did threaten and did temporarily rescind the Davis-Bacon Act—which is an act like our Fair Labour Standards Act—on government contracts which, in effect, would mean that non-union shops—which are now called merit shops in the United States because we always try to find tricky little catch phrases to describe these things—could bid on government contracts at rates lower than union rates. And since a number of government contracts in the United States—I believe it is between 25 and 35 construction contracts, although it may be higher than that—are directly or indirectly under the federal jurisdiction, this meant that a whole new area opened up for non-union firms to allow them to undercut what are, by any stretch of the imagination, out-of-line wage rates. Well, a heck of a row broke out in the United States. This was sacrilege according to the AFL-CIO. So Nixon called in John Dunlop, who reconvened the construction labour management panel in the United States. Now they have what is supposed to be a self-pricing mechanism. They are going to have panels in each of the different trades which are supposed to oversee collective bargaining developments at the local levels for each of these different trades and which are supposed to monitor the settlements and to say, "That is too high. You cannot have that much."

They are suggesting 5 per cent. These guys have been used to 15 per cent. I can't wait to see what happens when they take on the electricians in New York city. "We know you can get 15 per cent, but we have decided in the national interest that you can only take 5 per cent."

I don't have much faith in Mr. Nixon's present measures. I will say this, though, that at least Mr. Nixon recognizes they have a problem in the construction industry, a serious problem, and that they have to come to grips with it.

The worst thing about what is going on in construction industry—well, there are so many things. The direct costs are atrocious, but the indirect cost in terms of what it is doing to collective bargaining in our basic industries in both countries is terrible. How can the steel workers ask their skilled labour to restrain themselves when they are !3 or $4 behind trades just out the door, who may even be putting an extension on the factory they are working in? How can the machinists and the air lines settle for what they are settling for when they see what the construction workers are getting? These things are so far out of line that it is upsetting the whole collective bargaining system.

To be fair, Ontario, to its credit, is trying with the recent amendments to the Labour Relations Act to come to grips with this, but they have not gone far enough.

I don't know how far you want me to elaborate on these things. I will elaborate briefly on the kind of things that have to be done. What they have recognized is that there is this imbalance of power. They have not had the nerve to take away the union hiring hall, which they should do. The hiring hall should go to Canada Manpower Service and it should be tripartite. The unions should not

have control over the hiring hall, which they use very viciously to punish contractors who get out of line. They send them all the wood butchers. They call for a finish carpenter and they send a form man who completely wrecks the house. Well, even the finish carpenters are doing a good job of wrecking the houses that are being put up these days. They can kill a contractor with this hiring hall viciousness.

The Chairman: We are trying desperately to keep personalities out of this.

Dr. Crispo: I am not trying to get racial. That was "finish"; not "Finnish".

They did not come to grips either with that or with the apprenticeship system which the unions control. They have not got the nerve to weaken the unions. That is political. Ten thousand hard hats appeared in front of Queen's Park one day and the government retreated into its chambers and said, "Don't bother them. They have got votes." They think the construction workers are NDP supporters. Such bandits could not be NDP supporters. But they refuse to tackle the unions.

They have now created this thing called Employer Association Accreditation. I know this well because Harry Arthur is a professor at Osgoode Hall Law School and he and I are the fathers of this concept. In effect it creates a union of employers. One of the advantages in the construction industry that stands out grows out of the fact that contractors hate each other more than they do the unions, and they will do anything to cheat—perhaps that is too strong a word—to undercut each other, and you have very reputable firms which I will not mention, Mr. Chairman, who will have side deals with the union which say that they will never be struck on any of their projects and in return they guarantee to pay whatever the other contractors are eventually forced to cough up as they fall apart as these guys abandon their associations. So the Ontario law is designed to force contractors to stand together. There is a flaw, of course. They do not have to take a strike or lock-out if the Contractors' Association deems it necessary to do so, and until they have the power to do that as they now have in Quebec under the Corporation of Electricians and the Corporation of Mechanical and Plumbing Contractors systems in Quebec—in the by-laws of those Associations if the Association orders a strike or lock-out, every contractor has to take that strike or lock-out or go out of business. Now that begins to give contractors enough power to compete with the unions. So that is an example, and I apologize for the skeletal treatment I am giving you of these things. I lived with this stuff for two years, and I do not want to get involved any more because it is a sickening, despicable industry, and you end up by saying a plague on both their houses because what they are doing is jointly gouging the rest of us. If you look at the sheet-metal settlement in London, Ontario of a few weeks ago, you will see that it is just scandalous. The employers' offer was $2.25 and then they came up with another 50 cents to show their good faith. Oh, my God, this is ludicrous; these guys are going to get $7 to $8 an hour. Then we are going to go to the steel workers and say "Now, leave INCO alone, and just take five." Well, it is impossible, and this is the kind of thing we are dealing with. Now, the medical profession—perhaps you do not want me to deal with that because it is getting too close, but the professions—I did a study for the Prices and Incomes Commission. Jack does not acknowledge that I did it and I do not usually admit that I did it. They never published it, and I am supposed to be revising it, but I do not suppose they will ever publish it. You can ask him when he comes. It was a worthwhile research project. I am not saying the quality was any good but it was an example of what they should have been doing. They said to me "You want to go and study fee setting in the professions, go to it." So I did. I went out and I did a survey across the country to see what these characters were up to. It is not as bad as I thought it was. Let me be fair to the professions. I thought they were real robber barons and that they would make the construction unions look like pansies. But they are not. They are more responsible than I thought they were. But they still have too much power, and I recommended more public participation in the licencing function, in the regulatory function, in the disciplinary function and in the fee-setting function where under such things as Medicare they are not now collectively bargaining with the government. If there is an offsetting power, I do not worry, and the doctors are up against it now. They have to deal with governments that are trying to figure out how to get more dollars for other purposes, and when they see doctors in Ontario earning more than $200,000 a year, gross—I know it is all going into their expenses—but when they see these figures, they get upset, and they say to the doctors, "Justify your fee increases." So they are feeling the heat. But all the professions should be brought under similar checks and balances.

Now what do you do with these companies with monopolies? I had better be careful because there may be Board member of one of them here.

The Chairman: I would not think so, not in the Senate.

Dr. Crispo: Now INCO was losing its monopoly because of Australia and now it only has a quasi-monopoly. But, you know, we want them to get all the foreign exchange they can—maybe not right now, but there we were having a little bit of balance of payment difficulty. At that time we wanted INCO to get every little bit of money that foreign trade could command. But that made them very profitable. And for Jack Young, excuse me, for the Prices and Incomes Commission to go the steel workers and suggest that they restrain their demands in dealing with INCO, well, I hate to think of what they probably told them in private. I could have written the comments for them and "fuddle duddle" must have been an appropriate term. But in any event they are not going to restrain themselves when they see INCO commanding the kind of profits it does. Yet, we as a nation want INCO to make all that it can with foreign sales. What do we do with that kind of an outfit? Do we have a special foreign-profits tax? I do not know. I do not know the answers to all these things, and I do not pretend to. You see, I am

very pragmatic. I have had some terrible fights with my good friend Jack. We still talk and join issues. He says to me, "Well, how do you decide where to go after these guys?" And I say, "I would be very pragmatic; I would look at what is happening to wages in the country and I would see wages going up at about 8 or 9 per cent on the average." But here is a bunch of guys that are getting 15 per cent or 16 per cent—the construction workers. We will find out what they have that gives them that kind of power. And we will take it away from them. I would be that pragmatic. I would just look at out-of-lines groups. The same thing in terms of professional incomes—which professional incomes are going up the fastest? Is it a bottleneck problem or is it a boat-rocking problem? Then which company's profits are to go up the fastest and why? Is it because they are innovative and breaking new ground in terms of products and technology? If so, leave it alone. But if it is because they are in a bidding ring or they are using some sort of monopolistic practices, crucify them. That is what you have to do.

Senator Lamontagne: In what way?

Dr. Crispo: If there is a tariff, eliminate it. And if it is a combine, get the Combines Investigation Branch to do something useful.

Senator Nichol: Are you not in a dilemma here? Assuming what you say is correct about the construction industry and assuming what you say is correct about the importance of maintaining collective bargaining in the broad sense which runs as a thread through your whole presentation, is not what you have just said in conflict with what you have to say about free collective bargaining and not destroying the collective bargaining system?

Dr. Crispo: No.

Senator Nichol: In one case you are speaking in favour of collective bargaining and in the second case you are saying "collective bargaining, but—".

Dr. Crispo: We have free collective bargaining within the context of labour relation acts which are designed to bring about something resembling a balance of power between the parties. That is the preseumption on which our Industrial Relations Disputes Investigation Act at the federal level and the Labour Relations Act at the provincial level are based. We decided long ago that corporations had too much power vis-a-vis their employees and therefore we should put in acts like corporation acts but for trade unions and we called them labour relations acts. Now it stands to reason that just as in the United States when they put in the Wagner Act, they discovered they went too far and they had to swing back again with Taft-Hartley, and then again with Landoum-Griffin. I am simply saying that we have free collective bargaining but it is within a context of the rule of law and I am simply saying that that rule of law at times becomes obsolete and develops or allows to develop disproportionate relationships where there is a terrible imbalance of power, and when that happens you should correct it. There is nothing in our society that is free or that is not subject to law. And I did not mean to speak of free collective bargaining in the sense of anarchy. We have free collective bargaining within rules of the game that governments determine are appropriate. I am suggesting that in some industries the law is no longer appropriate because there is this disproportionate imbalance of power.

Senator Manning: Mr. Chairman, my initial question did revolve largely around these points, and in view of the discussion which has taken place, I shall restrict myself to just one observation. I find myself in very substantial agreement with the witness, with much of what he said about the nature of the problem, its causes and the reasons we have not been making too much progress towards the solution. But where I am in difficulty, Mr. Crispo, is when we come to the part of your submission which deals with an alternative to what is being done today. Of your seven points, I think it has been indicated through recent questions and through your answers that the first four of these seven are really nothing more than statements of fact which most people would accept but which really tell us nothing about what has to be done to correct the problem. The latter three on which you have commented are so general that as one member of the committee I find them almost valueless in coming to a conclusion as to precisely what we might recommend in the way of new techniques to control inflation without wrecking the economy.

As you perhaps know, I spent 25 years of my life as head of a provincial government in this country. If I had asked my advisers for answers to the problem of inflation and they came in and said, "Well, we need more appropriate fiscal and monetary policies, we have to strengthen our hands and develop more effective anti-inflationary policies," I would have said fine, but I would have been exactly where I came in. I would have asked, "Precisely what does this involve, how do we go about it, and what do we have to do?"

I appreciate in your answers that on an occasion like this you cannot begin to cover matters of this breadth in the time available here, but could you indicate to us as a committee, how we might best pursue these things, to get the information that is needful to come up with some firm recommendations, assuming that the ultimate decision was that these three things are valid and we ought to make recommendations with respect to all three. How do we go about getting what we need to have in order to make such recommendations?

Dr. Crispo: With respect, senator, can I start with a quick reference to the first four points you suggested were largely background and factual. In the main I agree with that, although I think the first one is more important than that. I really think it is essential that our goal must be price stability.

Senator Manning: I agree with you, and I am not quarreling with your first point at all.

Dr. Crispo: All right. As long as our goal is something that is in reasonable relationship to what is happening in the rest of the world, then it is manageable, but if we try to do better than the rest of the world then I think we have a real problem.

As for specific approaches, first of all it would be more than presumptuous of me to begin to say that I know where all the problems are, let alone what should be done with respect to all these problems. My concern is that we have lost two years with a joke called the Prices and Incomes Commission that chose to ignore its original mandate to search out and ferret out these problem areas and come up with very specific recommendations as to how we could come with grips with them.

Senator Lamontagne: Do you not think that this is only a partial answer to the whole situation, and that to complete the answer you should also add, since you are a Keynesian, that part of the story was that we followed the Keynesian approach in fighting inflation during that period.

Dr. Crispo: That is where you and I disagree. I hope the figures have arrived—and I will probably be proven wrong, and it will not be the first time. We were anything but Keynesian in the late 'sixties, as far as I am concerned.

Senator Lamontagne: I have here a chart showing that in 1964 we started to make a budgetary surplus which climbed up until 1970.

Dr. Crispo: At the federal level?

Senator Lamontagne: At all levels of government.

Dr. Crispo: I would be very interested in having this. Where is this available? What is that called?

Senator Lamontagne: The Economic Council of Canada, September, 1970.

Dr. Crispo: I would like to see this, because I and my colleagues have been in error.

Senator Lamontagne: In terms of the national accounts.

Dr. Crispo: Well, here you are getting me. Again you are out of my area. You can talk about a full employment budget, a cash budget, and a national accounts budget. Obviously, it depends on which one you look at.

I thought, and I may be in error—and I have been reading and therefore those I have been reading have been in error—that at least on a cash basis we were not.

Senator Lamontagne: If you are a Keynesian you should accept, in terms of Keynesian analysis and income policies, that the national accounts approach is much more appropriate in so far as guiding economic policy than the mere, traditional approach to budget making.

Dr. Crispo: I am not sure whether I am an obsolete or a reformed Keynesian now. You have put me in a very awkward position because it was my firm impression that our fiscal policies were not in order during the mid- and late 'sixties, and what you are citing is suggesting that I was in error.

Senator Manning: Mr. Chairman, I wonder if I could come back to this other point. As you can appreciate, doctor, as a committee, we are instructed by the Senate to try to come up with some practical, workable, positive recommendations with respect to how the problem of inflation can be controlled without creating havoc on the economy we are suffering and the price we are paying in unemployment, and so on.

My point, relating to your seven specifics, is: Can you give us any indication of the avenues that we might or should explore in order to come up with precise information that we need to make that kind of recommendation, assuming that we accept these as premises?

Dr. Crispo: In terms of my own area, I would single out for attention the last thing I dealt with, and what I was building up to all along the line, the role of what I would prefer to call an incomes and costs review board, because I think that is a more appropriate focus.

You have a real dilemma. If I may presume to guess what you would not do, you would not recommend the what you would not do, you would not recommend the abolition of the Prices and Incomes Commission, which I frankly believe should be abolished.

Senator Manning: Why not?

Dr. Crispo: Just let me say what is in my mind. If I had my way we would chuck the thing and start all over again, because it has so discredited itself. But how do you do it? You have to give it a respectable burial and you have to wait a little while to put something in its place to do what it was originally supposed to do. There is politics involved; there are personalities involved. I do not know how you do this, but that would be my way of thinking. There is a role for an incomes and costs review board. It is the body that should give you the specifics you are talking about. It should provide both the federal and provincial governments with advice and counsel on groups that are really out of line and which are setting these targets that the rest of us shoot at. I mediate the odd dispute. I do not "arbitrate" because I do not choose to play God, but I mediate the odd dispute and I get into things like the teachers. All they talk about is the construction workers. The police, all they talk about is the construction workers. Then there are the steelworkers. I do not want to name names, but talk to some of the senior steel company executives in this country or the senior steel union executives, and all their members are thinking about is, "Look what the construction workers got!" And perhaps even the Teamsters are saying, "Well, look what the construction workers have got!" I do not know, but I believe that there are trouble spots in this economy that stand out so obviously that for a research-based incomes and costs review board—not an academic body that spends 10 years coming up with a report that nobody pays any attention to, but an action-oriented body that moves quickly and moves inward, that sees people out of line and really does not try to preach guidelines—nobody will listen to those—but says, "How the devil did that group get the power to extract that much more than the rest of us?"

Senator Manning: If we are going to make meaningful recommendations as a committee, and let us assume just for the sake of the argument that this kind of body was

one concerning which there was agreement should be established, surely it is essential in making that kind of recommendation that the specific areas, responsibilities and powers of such a body have to be spelled out. Otherwise you will come up with another body to which no clear direction has been given, and you will be saying exactly the same as you are saying today.

I come back to our task as a committee. How do we go about getting the information needed, if we decide to make such a recommendation, if that recommendation is precise enough, that the body set up is going to do the job effectively and is not to become something that is just a constant repetition of what you are speaking of now.

Dr. Crispo: That is a very good question, because the present body had a mandate that it chose to ignore, whether under instructions or not, I do not know. I will never know that, or I am not likely to.

Senator Benidickson: Did it ignore its instructions or was it backed up?

Dr. Crispo: I am sorry, but I do not understand what you mean by "backed up".

Senator Benidickson: Well, it had no legislative authority.

Dr. Crispo: I would not give it that. I do not think you can do that. I did make the statement at some point that I was assuming that we could find the kind of personnel to man such a body who would be unafraid to move into these situations and would be bound to no interest group, to no political party.

Senator Lamontagne: But with no authority.

Dr. Crispo: No, I did not mean to imply that at all. I think they should have full authority to subpoena records, to require testimony, and to ferret out any kind of information they think appropriate.

Senator Benidickson: Where does the authority come from, except from the Cabinet?

Dr. Crispo: Ultimately, in the parliamentary system it can come from nowhere else but Parliament, through the Cabinet. I am counting on such a body having able enough personnel and doing astute enough research that when it issues its pronouncements publicly—not privately, but publicly—these documents will carry enough weight and influence that Parliament, at the federal and provincial levels, will pay a great deal of heed to what they are recommending and will implement a great deal of what they have to say.

Senator Lamontagne: And if this means control?

Dr. Crispo: I do not believe that controls will work.

The Chairman: We can come to controls. You may deal with that, but I would like you to come back to Senator Manning's question. You have the concept of this commission. Precisely what powers does it have, what does it do?

Senator Manning: No government or Parliament is going to set up such a body without knowing what powers are delegated to it, what the areas of operation are going to be. If this approach is going to be considered seriously as a result of any recommendation of this committee, then that recommendation will have to be specific enough that Parliament can look at it and say "We agree with this, and this is what we will do." How do we get the necessary information to make such a recommendation when that is the decision?

Dr. Crispo: I do not think that I may be as helpful as I should like to be. You are asking for specific terms of reference for such a body. I cannot give you that for reasons that I will explain. But it must be federal and provincial in character. Some of you will say that is impossible. I would not care if any of the provinces did not come into it. I would like to see at least Quebec, Toronto or British Columbia in it. It will have to be a co-operative undertaking. It will be advisory; it will offer advice. It will not have any legislative authority or sanction. It has to be independent. It has to have people, as I described in my notes, who are competent and dedicated and non-partisan. I mean non-partisan not only in the sense of not being associated with a particular interested group, but also not associated with any party. It has to be something quite unique and different, almost like the Supreme Court.

In terms of its powers, I would give it unlimited powers of investigation. That is the important thing. They have a discretion. You might want to have it mandatory to investigate any situation which any Parliament at any level chose to ask it to investigate, although I have grave reservations about that. Politically it would be too convenient to refer everything to it. That would be a little dicy because it could overburden it and it could not do useful work. It must have the capacity and the power to search out those groups that are clearly out of line, and have the power to subpoena, to require testimony to do whatever is necessary to fully investigate the powers of those groups and what can be done to curb its powers.

I must take up your point of controls. I have no thought in mind of this body imposing or trying to impose or even elaborating on guidelines on controls. Guidelines deal with the symptoms of problems. I want to deal with the problems. The problems are of groups that have too much power.

Senator Lamontagne: Suppose that we have that commission. I am sure that it would be quite easy to write the terms of reference for that commission. Give them all these powers of investigation. Let us hope they will be unbiased and they will be competent and will come up with a good solution to a particular situation or problem. They then come to the conclusion that such a situation, for instance, in the construction industry should be stopped. Where do we go from there?

Dr. Crispo: If it is under provincial jurisdiction you will have to relate the responsibility ultimately to Parliament.

Senator Lamontagne: Where do you go in terms of parliamentary action? What action would you suggest?

Dr. Crispo: I think we come back to Cabinet responsibility, whether federal or provincial.

Senator Lamontagne: What does the Government do? Do we eliminate the construction industry or control it?

Dr. Crispo: I said that one of the things that I might recommend is to take away the hiring hall. That would do a lot of good. If I might use language that is not parliamentary, the answer is to flood the bastards, crank out more journeymen, crank out more doctors. In some areas that is the solution. It is a bottleneck more than anything else. It should have the maximum discretion in terms of advice. It will be up to Cabinet to come to Parliament and say "We have looked at the advice and we want the following things implemented."

Senator Lamontagne: But you started by saying that you did not accept this as a solution or that as a solution. What do you accept as a solution?

Dr. Crispo: You say the politicians say that?

Senator Lamontagne: No. You said that you were against general controls. You also said that you were against a freeze and against other things.

The Chairman: Dr. Crispo said in connection with construction unions that he would remove the hiring hall, that he would make use of tariffs wherever necessary, and if a combines policy was effective he would make use of it.

Senator Lamontagne: How can you make a combines policy effective with the present jurisdiction of the federal Government, which has no civil remedy at all?

Dr. Crispo: I have emphasized over and over again that we have a constitutional problem. That is why this body must be federal and provincial in character. What I think you are really saying is that my approach is vulnerable in the final analysis in the same way that everything in this country is vulnerable, to the inadequacies of our present Government and Parliament to come to grips with groups who have too much power. I confess that in the final analysis we are dependent on the good judgment and discretion of Parliament. I concede that fully. That is one of the crosses that we have to bear. Nobody has the guts to come to grips with these groups. They are frightened of them. I do not know why. I do not understand it. I should have gone into politics but nobody will have me and I do not like any of the parties. I can assure you that the present Government would not put me in the Senate.

Senator Manning: You spoke about the matter of dividing the spoils and you argued that everyone was trying to get everything they could. Let us concede that that is perhaps generally true. My question is, do you think there would be any merit or that it would be practical if we could develop some meaningful productivity industries in this country, at least to do part of the dividing of the spoils to both management and labour, by relating it to a productivity industry? Is there some area in allocation of the productivity of the country which could reasonably be apportioned between shareholders, management and labour by relating it to productivity increase, where increased productivity would bring an increase?

Dr. Crispo: Far be it from me to suggest that we do not need more adequate data for measuring productivity across the board in different industries. We clearly require that. We do not have it on an accurate basis. If I might mention Professor Wilson, this might be something that he will be talking about. If we had this data and we knew that productivity was going to increase by 2 or 3 per cent a year, this would have educational value and it would be very useful to any review board or any national body concerned with economic policy. But in terms of giving us anything viable by way of an anti-inflationary strategy, I am dubious, because this was the basis of the American guidelines. They figured out that productivity was growing by roughly 3 per cent in the States and they said "Now if everybody will just take 2 per cent we will not have inflation." But then they added, even before the war started over the guidelines, "Of course there will be equity in our allocation problems. If we limit everybody to 3 per cent we are assuming that the present distribution of income is fair and just", which is not what most groups in this country are willing to concede. So they immediately had to decide on equity. This group should take a little less than 3 per cent because they are ahead.

This group should take a little less than the 3 per cent, because it is ahead. And then they had running against the equity considerations in some instances the allocation problem—'We are short of labour over here; we have to attract more labour so we have to give them more than 3 per cent. We have got too much here, so we will give them less." And often the equity in the allocational things is in conflict. But the problem of devising a formula is bad enough in itself without beginning to contemplate how the devil you get it accepted.

I say to you—and you may say I am sounding negative—that it is important for us to have this information. But to assume that the availability of such information is going to give us much by way of a viable anti-inflationary strategy, I don't think follows.

Senator Manning: I was thinking of this more on the basis of something which would be applicable to each individual industry or productivity plant. So far as the industry is concerned, what management is concerned about is, if the workman in his plant plus technological progress and so on increases productivity of that particular industry, where he is going to generate more income. He has a greater portion that can go either to shareholders, management or his labour. Never mind what is happening in the rest of the country. I agree you will never pour these things into a common mould. Maybe I am digressing, but I wonder if you thought it was practical to consider productivity indices related at least to the major industries of Canada and gear some portion of the allocation of wages by that means instead of by the bargaining table.

Dr. Crispo: In that sense it frightens me to death for the reason that I hate to contemplate what you would do to your wage structure. If we based relative wage increases in any way, shape or form on relative productivity improvements we would have the most skewed wage structure imaginable.

The Chairman: I might mention, senator, that Dr. Lipsey today pointed out that in certain industries such as farm machinery where there have been large advances in productivity, they have not had similar increases in demand. Whereas, in the service industries where there have been limited increases in productivity, the demand has gone up enormously. So he pointed out that it becomes very difficult to relate increases in wages or increases in price to productivity on account of the demand factor. He then went on to say that you would get into enormous distortions.

Dr. Crispo: This is my concern, because by the very nature of the type of work that is involved in different industries, they have differing scopes for productivity improvement. You could say, "Well, you are a fine one to talk; you are in one of those sectors where the productivity improvement is not that noticeable. No wonder you are skeptical." I suppose that might motivate me. I read an article last night that universities are becoming less and less productive. I am astounded that a lot of my colleagues are obviously boon-docking, because I have been at the University of Toronto for ten years and in one of my graduate courses I started with 12 students and I now have 45, and in one of my undergraduate courses I started with 40 students and I now have 200. I am about to go back and propose a piece-work system at the university. Judging by the size of some of my colleagues' classes, I come out on the top of the heap.

Senator Laird: Could I ask a very practical question, Dr. Crispo? You have, and rightly so I think, stressed the desirability of maintaining collective bargaining. Is there any merit in trying to improve the mechanics of collective bargaining to make it more objective? For example, could this be of some help in the construction industry?

Dr. Crispo: This is where one of my worst features comes out. I am very cynical. If I had the power and ability, I think I would get out of collective bargaining, because it makes one very cynical about everything. It is a power struggle. It is an adversary system. It is a confrontation process. You know, equity has little bearing on the thing.

Senator Laird: That is the point.

Dr. Crispo: That is right. But that is our society. I mean, you may take offence at this, but it is a dog-eat-dog rat race for the most part.

I remember that Abe Raskin, an editorial writer for the *Times* and a very astute labour reporter until he took on that position, addressed the Canadian Manufacturers' Association and they loved him. His address was entitled "Collective Bargaining: A Race to Nowhere". I had to speak after him and I just chucked out my address. I suggested to him that I didn't mind his saying that collective bargaining was a race to nowhere so long as he was willing to concede that North America was in a race to nowhere.

Collective bargaining, like education, cannot rise above the environnment in which it finds itself. This is something we are often prone to forget. But this system of ours has generated more wealth and more productivity and will continue to do so more than any other system known to man. But we pay a price.

Senator Laird: You see no real hope of improvement?

Dr. Crispo: If you are talking about equity, I don't see that many opportunities. But if the parties to collective bargaining knew that if they got far out of line there was a watchdog around that was going to figure out where the two of them got so much ability to get out of ilne...

Senator Lamontagne: Out of line with what?

Dr. Crispo: I told you I was going to be pragmatic. Well, I would simply look at the average rate of wage increases in the country. They are too high in terms of the inflationary problem, but I wouldn't worry about that. Everything is going up 8 or 9 per cent. But which are the groups that are consistently leading the pack? Let us start with them. Start with them and bring them down and the whole average goes down. There would still be somebody leading, but gradually I would go after that man and before long, according to my thinking—it may be academic although I don't think it is, because it is very practical—gradually groups would get to realize that if they got out of line somebody would be coming after them, taking a good look at how they got the power to get out of line. In their own self-interest they would be looking over their shoulders and saying, "We had better watch ourselves. We had better show some restraint." In that sense we might get a little more objectivity, if "objectivity" is the word.

Senator Molson: On the fifth point, it seems to me that no one can quarrel with your statement that there were loose fiscal and monetary policies, Dr. Crispo. But do you not think that, coupled with that, one has to recognize the fact that we really hardly have the requisite tools?

Coming to the fiscal policy first, you were talking about uncertainty in your point of view as to whether tax cuts were in order now. If so, to what extent? Perhaps if the tax cuts were too great they would just trigger again the rapid increase of inflation. But do you not think that perhaps in the area of taxation alone, one of our great difficulties is our regional disparities? For example, if you have a certain level of tax relief, it has not the same impact in Ontario as it has in Nova Scotia. Am I not right in that?

Dr. Crispo: Yes. I fully appreciate the question, senator, but again for me to really comment on how we could better adapt our fiscal and monetary systems or any of our other systems to these regional disparities is so far beyond my competence that it would be ridiculous for me to attempt to answer.

Senator Molson: Let us leave that, then, and come to monetary policies. Canada has chosen in its wisdom to limit its capacity to essentially regulate its monetary pol cy. There are so many organizations outside of the banks which are susceptible to some controls that really we have a very sluggish, awkward monetary control system. While admitting that the monetary policies have been partly to blame for our problems, I again suggest that we have not really equipped ourselves with the best tools.

Dr. Crispo: In general I am in agreement with you. For example, I carry around in my wallet a bunch of credit cards. What are you going to do with me?

Senator Molson: So does everybody else.

Dr. Crispo: At one point the bank promises to give you a red-convertible loan, but in the next breath, when appearing before a parliamentary committee, they say that people are spending beyond their capacities.

I have not really the competence to answer, but from what I have read I am led to believe our government should have more stand-by policies in terms of tax policies; and there should be more discretion in the hands of the cabinet, so far as I am concerned, to change the tax rate within limits. I really think there should be more discussion so that they can move fairly quickly when they see a problem coming that requires attention. I am also very much enamoured personally by what they call the investment reserve, I think, in Sweden, which is a device whereby in a period of boom they say to corporations, "If you will agree to set aside some of your profits in an investment reserve account, we will not tax you on those profits provided you agree to spend them when we tell you we want them spent for investment purposes." So, when the economy is booming, they say to corporations, "No taxes if you put the money aside" and then, when the economy turns down, they say, "You spend them." Your point is very well taken. There are so many imaginative things we could be doing. I spoke of the bankruptcy of ideas, and it is not just in the area of inflation. I feel it is tragic what is not going on in Ottawa in terms of new and refreshing thinking. So I sympathize fully.

Senator Lamontagne: I wish you would expand your severe criticisms against the mandarins in Ottawa.

The Chairman: Senator Lamontagne, I will come back to you after hearing from Senator Molson. It sounds like you are getting on to a new tack.

Senator Molson: I think the questions I would have asked on six of the seven points have been covered so I will stand.

Senator Lamontagne: When you talk about the mandarins as being responsible for most of our evils, I think I know most of them and I am sure you know them too. We do not agree on our criticisms, all of them, because I think that they have been in the last few years much too Keynesian, and you would probably say that they have not been Keynesian enough.

Dr. Crispo: I am confused as to where I am now.

Senator Lamontagne: Secondly, while I think that while we might accuse them of being void of new ideas, I would extend that criticism also to a very large extent to the academic community.

Dr. Crispo: Oh, oh, by George, if you want to get on to that subject—but you don't. These guys, many of them are a product of academia, and they are still using the ideas they were given when they were there, and some of my colleagues are still using the ideas that they were teaching them when they were there. So I have sympathy with your concerns. I am tempted to take up this little piece of paper which has found its way before me but I do not know how to read it any more.

The Chairman: I might point out for the record that this is the estimated high employment surplus or deficit for all levels of Government combined in Canada from the year 1956 to the last quarter of 1970. It is on a national accounts basis.

Senator Lamontagne: I am sorry, but I was not basing my contention on that sheet of paper, but rather on this figure here which appears at page 49, because this one, of course, is quite unofficial in the sense that it is the kind of thing you would need to have in order to get a high level of employment. But I am looking here at this other line on page 49, the solid line which shows the actual surplus or deficit, and we started to develop a surplus in terms of national accounts in 1964.

The Chairman: For the record we are referring to Economic Council of Canada Report entitled *Performance and Potentials* chart No. 16 on page 49.

Dr. Crispo: I don't know what to say. It reminds me of the problems we have with our unemployment figures. You can select whichever set of data suits you, whether seasonally adjusted or unadjusted, whether it comes from DBS or the unemployment Insurance Commission or from somewhere else. I think I would first of all have to sit down with some of my colleagues before I tangle with you again because you have got me into trouble. But I would encourage you, and this is really nasty to one of my colleagues who is extremely competent and up to date, Professor Wilson—who else is coming? Has Grant Reuber been here? Those are two gentlemen far more qualified than I am to come to grips with your question. I am going back to find out, and if I find out that I am closer to the truth than I have been made out to be then I will be corresponding with you or at least with the committee. I am still convinced I am right but you have made me wonder.

Senator Nichol: I would like to get back to collective bargaining. I have had no experience of this in Ontario, and I hesitate to ask a question of Senator Lawson. Assuming you have this organization which you describe and which sounds like the Prices and Incomes Commission with a difference or with different people and with more teeth of some kind, and if, as you said, they disapprove of some wage increases or think they are wrong,

and violation of some standards or others, and therefore they go after, say, the Carpenters Union for violating the standards set by these people. Now we start from that premise that the Carpenters Union do not agree with the standards that have been set. Now this body says that the government commission standards are correct and the Carpenters Union standards are incorrect and they say that they are going to go against this organization in order to force it to accept the standards set by the Commission through various forms of legal harassment of some kind. What happens then? My thought is that in B.C. what would happen would be that the movement, broadly speaking, across the province would be up in arms. So my question is, do you think they would agree with this principle of yours or do you think they would object to it. In answer it is not adequate to say that it is a political question.

Dr. Crispo: No, I would not say that. If you do not think I am answering your question, I wish you would come back and nail me.

Senator Nichol: It would have political consequences, of course. But what do you really think would happen in those circumstances?

Dr. Crispo: Well, first of all let me make it clear, because I drew an implication from your question, which frightened me, that I was not suggesting that this Commission should have the power to roll back any wage or price increase.

Senator Nichol: But to stop them before they occurred.

Dr. Crispo: No. All right. Let me be very explicit about this. What I am saying is that it views the wage and price increase as a measure of whether or not it is a group it should be looking at. Now it does not touch the wage or price increase. That is impractical. After a group of workers has won 15 per cent, you cannot go out and say, "Sorry, you are only going to get 5." That is just unrealistic.

Senator Nichol: Let us say it is over a period of time and the negotiation has been going on, say, for a year. Then the result is this contract.

Dr. Crispo: Then I have to live with the contract. I am using that as a measure of the fact that have too much power and I move in then to see where they got the power so they cannot do it again. The damage for the moment is done and I concede that.

Senator Nichol: You cannot interfere with an existing contract.

Dr. Crispo: You cannot. It is impractical. In the United States at one time there was the suggestion that Walter Reuther at one time had won too much and that he should take less. But it had already been announced what he won, and to announce to his auto workers that having won 8, they were only going to take 4—it is just unbelievable that anyone could contemplate that. You might pull that on corporations because they are a little different; they are not democratic institutions but they are not supposed to be. If you pull it on a union, it just won't work. But you want the answer to the political question. Let me say this directly in answer to your question. Labour publicly—how do I put this? You have somebody coming from the labour movement. Do indeed ask Mr. Bell who is Research Director for the CLC what his alternative is to the present anti-inflationary strategy, and really go after him on that. My own view of what labour would do is as follows.

Senator Nichol: I did not know that Mr. Bell was coming. Are you implying that he would agree or disagree?

Dr. Crispo: The poor devil, I don't know what he would do. He is a servant of the Canadian Labour Congress and he has to go back and get his bread and butter from them. I don't know what he will say. We are not under oath, you know. Russ Bell is a great guy, but he has problems. The CLC has a problem. It condemns present government strategy but what is it offering as an alternative? That is my major criticism of the labour movement. Are they prepared to concede that just as certain professions may be out of line and just as certain firms may be out of line, so also certain unions may be out of line? Publicly I do not think they would concede that, but privately there are many industrial union leaders in this country that would love somebody to step on the construction workers because they are making life miserable for them. They cannot get the kind of gains that the construction workers have got and yet they are up against a membership that insists that they do. Now in B.C. you know what is going to happen. The Fed is going to have a fit and it is going to say, "You are not going to do it," and the NDP presumably is going to back them, but if I know anything about the B.C. Government, they will make political hay out of that because I think it would wash well in B.C. If I know anything about the B.C. government they will make political hay out of that because I think it would wash well in B.C. By the way, I am not a politician!

Senator Nichol: I would not say that. I think you are doing very well.

Dr. Crispo: To survive in academia it is difficult these days.

The Chairman: Do you want to continue on this line of questioning, senator?

Senator Nichol: The only thing I want to know is what is "Monopsonistic return"? A new word a day!

Dr. Crispo: The senator is not here to give me a bad time. A monopoly is a situation where as the seller you have undue control over your market. In other words, you are a single or only one or two sellers. You have a monopsony power if you are the exclusive buyer. Have I defined that clearly?

Dr. Gillies: That is correct.

Dr. Crispo: Thank you!

The Chairman: In operating your commission—the name of which has escaped me...

Dr. Crispo: You just need a new name; that is all I was suggesting. Anything will do.

The Chairman: How would you handle the power of a multi-national corporation that is entrenched both in Canada and all over the world, that is enormously wealthy and you are faced with this problem of your assessment? The commission assesses the price increases enjoyed by this firm are beyond the norm and this firm ought, first of all, to be exposed and governments ought to be called upon to take action. What sort of action do you envisage being taken against this multi-national firm?

Dr. Crispo: May I give you an illustration of the very problem you have raised, in the context of Britain, where the government has tried valiantly to hold the line on public service salary increases and has been embarrassed by the settlements made particularly in the auto industry by Chrysler and Ford?

Far be from me to really know what led Chrysler to do the dreadful thing it did to the British government by caving in and giving them, I have forgotten, 15 per cent a year for two years or something—you will have to check those figures.

As far as I am concerned, and this is my reading of the situation, although some of my British colleagues assure me this is exactly what happened, Chrysler had to get the Cricket—is that what they call their mini-mini? They wanted to make sure that they got part of the mini or sub-compact market in the States, but they were counting on the British plant for the Cricket. The British workers were quite aware of this situation and said, "If you want the Cricket, you give us money!" The British Government said to Chrysler, "Don't give in! We are holding the line at about 10 per cent." The workers said, "To hell with your 10 per cent. You want the Cricket, give us more." What did Chrysler do? They gave them more.

I have never been as troubled by the presence of multi-national corporations and what they can do to countries than I have been by this instance.

The Chairman: Then what should have been done? What would your commisson do now? What action would you recommend?

Dr. Crispo: Let me be honest with you. May I make a reference? I know of one character who is ingenious enough to figure out the answer: Jack Young. That is the sad thing. Jack Young was the chairman of my commission as well as his own, because he has a fantastic mind. First of all, he has energy the likes of which I have never seen in my life; he is dynamic and articulate. He could probably give you an answer. I cannot; ask Jack when he comes.

I will tell you what I would have to do. I would have to figure out what special privileges Chrysler has in Britain. I dare say there are certain things Chrysler has by government policy or by local discretion, or by one means or another, but I would take it away from them. I would make them pay. You might say, "Well, Chrysler might pull out." I would say, "To hell with Chrysler, let them pull out." You are going to say, "Well, that is a fine attitude. With 90 per cent of our oil industry in foreign hands and 50 per cent of our manufacturing, the whole country will disintegrate if you adopt this strategy." But if you just let it go and you say, "Well, it is a multi-national concern, we had better not touch it," you have really lost the ball game.

Clearly, gentlemen, this is where you are going to say, "He is evading the issue." How can I give you an answer to that? I have indicated that I am worried, but if you have the kind of commission I am talking about, it would bring together enough expertise to begin to figure out what to do. They might finally say to the Government, "We don't know what to do; it is impossible," and then the game is up, but I cannot believe it is that bad.

If I had the time and the resources I am sure I could figure out a way, if I was in Britain, how to get Chrysler. I would make a public example of Chrysler, and then other multi-national corporations, before they did such a thing, would think twice about it. That is all I have got to say.

Now, I can tell by the sceptical looks around the place, "Ah ha, he hasn't got the answer!" All right, you give me an answer; you are the legislators of the land.

The Chairman: No, it works the other way.

Dr. Crispo: Oh! I just refuse to believe that man's ingenuity is so limited that we could not find a way to come to grips with any party in this country, any organized interest group that has too much power.

Senator Molson: You say that to prevent this Chrysler situation you would get someone to devise a way to get Chrysler. Supposing you get Chrysler, but they do not say, "All right, we will pull out," but supposing as a result of your getting Chrysler the Cricket is a flop and you cannot sell it or give it away or run it, or something like this, then you have a whole lot of good workmen who really get the crunch from your action, and Chrysler might say, "Well, that's the Cricket down the drain"—and they have had other bad ones before—but the 8,000 or 12,000 workmen would be out of work.

Dr. Crispo: I am a rather hard and callous individual myself. They are the ones who asked for what I would say by current British standards are exorbitant wage increases, and they can damn well live with the consequences of having done so.

The Chairman: I think what Senator Molson is referring to, although he used the Chrysler example, is a situation in which the problem was not created by the union but was created by the multi-national corporation. They crunch the multi-national corporation and it says, "All right, we will close the plant!"

Dr. Crispo: I would not want to trespass on another committee's jurisdiction. I understand there is a report in the works on how to handle multi-national corporations

in this country. You are taking me far beyond the terms of reference that I came here to discuss.

Senator Molson: Yes, but you got into the Cricket business. I have never even heard of it.

Dr. Crispo: By the way, may I just say for the record that this is my cynical interpretation of what motivated Chrysler. I am sure that if you brought the President of Chrysler International here he would have a most intriguing and appealing explanation that had nothing to do with what I have said. I would not believe him, but I am sure that he would have another version of the same story. So let us be clear, this is my jaundice version. It happens to be right!

Senator Beaubien: When I came in you were talking about the International Nickel Company. I am not a director! What were you saying about inflation with regard to them?

Dr. Crispo: I do not know where INCO is now because there is more competition, although I gather they have a piece of Australia, so that gives them a piece of the new competition; but INCO has in the past generated rather handsome profits.

Senator Beaubien: How does that hurt the economy?

Dr. Crispo: Oh no, no. What I am saying is that if you want to urge the steelworkers—and this is the context in which I got on to that—to restrain themselves in terms of their demands on INCO, or the gold miners or anyone else, if those particular companies are earning profits well above the average for manufacturing or mining, they are going to be loath to do so, because they are going to say, "You ask us to restrain them, but you are letting them earn substantially more than the average in their industry, and they have been doing that for some time."

Senator Beaubien: It is equal workers that you think are getting highly paid?

Dr. Crispo: I am not here to play God. I think construction workers are overpaid relative to other workers. I think many professional workers are overpaid relative to other workers. I would not think that INCO workers are overpaid in relation to either of these groups. But these are value judgments. We must remember, when we come to value judgments that the Pope long ago talked about just wages. They still do, but they do not know what they mean. The Papal guard was on strike last fall. They did not actually leave; they refused to cash their pay cheques. Here was a group who supposedly was getting just wages. You are asking me to say who should get what. This goes back to the question of Senator Manning, if we had more measurement could we work out...

The Chairman: It raises the question that will have to be faced by your commission as to who should get what. Senator Manning, Senator Molson and Senator Beaubien have been asking you how do you make that judgment.

Dr. Crispo: This is how you make the judgment. Obviously I will not satisfay everyone. I have had bad luck in Ottawa, so I am not surprised. May I use a case in point. I said, with respect to wages, that they look at the average and they say "who is leading the pack?" They say,"Is it just this year or are they ahead consistently," as those in the construction industry have been for the last five years? They say "Let us look at those figures", and the beggars say, "But we don't work regular hours", and they give some preposterous figure. We should subpoena the hiring hall records and find out how many hours construction workers do work, and we would find that they have a full working year as workers in other trades. Another thing you say is "All right, here is the level of skills that they have got." What about other workers who have roughly the same scale such as the machinists looking after our air lines, who perhaps have more skill. What about workers in the wool and dye industry? Does it not give an impression that something is wrong? I could tell you what to do with the construction workers, but nobody will do it. We come back to the political problem.

Senator Croll: Then tell us something that we can do.

Dr. Crispo: I believe in the democratic process, but like many students that I have to contend with I am troubled with the failure of governments to come to grips with problems all over the place. Tell me what you are willing to do and I will tell you if it is any good. I believe that you should be doing some of the things that I am suggesting that you should be doing. If I can be personal we have right now a Prime Minister with a large majority, and it was shown on certain occasions and in certain areas that he has a lot of guts and courage and conviction; but when it comes to this issue he is willing to deal with the labour problem as an amorphous group and say labour is out of line. But that is easy, relative to taking on groups within labour that are really the problem within labour.

The Chairman: Let me ask you this question, not in the sense that your idea is not worthy of investigation, because indeed it is. What checks and balances would be on your commission, or your association, or whatever you name it? What is its name?

Dr. Crispo: I call it the Incomes and Cost Review Board.

The Chairman: What checks and balances would be on the Incomes and Cost Review Board that would not make it into a catheter type of institution that can expose people? We live in a democratic society. There has to be some protection. On the other side of the coin there is a review board that is causing all sorts of upset and unfairness in the sense of the rule to law, that capriciously can go ahead and say "We can examine you and subpoena your records." Can you imagine any protection that the individual might have against that sort of operation?

Dr. Crispo: No. I realize that this is a terrible answer. What do you do with a judge of the Supreme Court? He can be removed, can he not? I guess the ultimate check

on a body like this would be Parliament. If it gets out of line and Parliament thinks it is abusing the rights of individuals, they will have no choice. Parliament is supreme in these things. I can give no other answer. I would like to think that there are people abroad in the land who could be counted on using the kind of power I am suggesting, that they should have with wisdom and discretion, knowing full well that their advice will not be acted upon. If they fail to do that they are not showing much judgment and should not have been named to the body in the first place. We name people to bodies where they have to use not quite so broad discretion but a lot of it. The labour relations board is in a controversial area, and it uses a lot of discretion. I doubt if I am satisfying you. I have to say that in the final analysis if they bungle the job there is only one thing to do, and that is sack them.

The Chairman: I suppose that is something that the act creating the commission can take into account.

Dr. Crispo: The alternatives in the minds of some people in Ottawa, who frighten me to death, are selective wage or price controls or general wage or price controls. Who are you going to endow with that kind of power? Who is going to control God? I am very concerned. If you try to control my wages, my salary, you will not get away with it and I will be at the barricades with labour. When you try to control some of their salaries and you do not control every other type of income in our society it is most inequitable. If you are going to control anybody's income you have to control everybody's income. That is the logic of it. Right now we are on the path. This is not hindsight. I told this to the commission and to the whole world. When that thing began and they got on this ridiculous guidelines kick they were taking us down the path.

Senator Croll: How are you going to select construction workers?

Dr. Crispo: The best measure I have got is the fact that their wage increases have been outstripping general wage increases over the past five years by a substantial margin. That indicates a situation that is worthy of investigation. It could be that demand is going up rapidly and we are not training enough of them, that they are not using the power they have, unwisely or unfairly, that we should be concentrating on training more, or it could be that they have too much power and they are squeezing the rest of us for too much. That is what this body would have to determine.

Senator Croll: You said that from guidelines you move over to selective control, and you stopped there.

Dr. Crispo: The logic of this reasoning is positively frightening. They say Guidelines do not work, so let us try selective control. That is the brilliant answer of prices and incomes commissions.

Senator Croll: Do you not think there is a feeling for selective control in Government areas at the moment?

Dr. Crispo: Unless I am wrong, the Prime Minister has mentioned this possibility, as has Mr. Drury and Mr. Benson. Mr. Rasmisky has been talking about it for five years. Mr. Reisman has not said so publicly but I have reason to believe that privately he has some ideas on this. Mr. Young has been very explicit about what he wants to do next. He is not satisfied with guidelines. Now he wants controls so that he can say "you get that and you get that." And you worry about the power of my little body! You wait until you get the board to decide on these wages and price controls.

The Chairman: On a point of order, we are not comparing the power of your body to selective price controls, but your evidence would indicate that you might think that this committee might come out in favour of selective price controls. To read your evidence again would indicate that you might think this committee would come out in favour of price controls, but there have been no determinations made in that direction.

Senator Croll: I spent the morning listening to Mr. Benson. If there is anything he does not have any use for it is control, selective or otherwise.

Dr. Crispo: Well, I am very pleased.

Senator Croll: I was there most of the morning so I am surprised at that.

Senator Bourque: Mr. Chairman, as I had not been here for all the meetings, last night I read all the current submissions to this committee. I am not an economist. I am just one of the workers of Canada. There is one thing I found after reading all the papers: they were theoretical. It was all theory. There was nothing practical. There was nothing practical you know, with your feet on the ground.

If seven million workers had sat down and read all those papers, I wonder how many would have understood them.

I believe in practice, so I went out and bought some articles to make a demonstration for you. I have covered the trademarks in order to avoid any publicity for anybody. Now, article A here and article B are exactly the same, and until about six months ago you could buy the product anywhere at drug stores or supermarkets at a cost of five cents. Now, after 20 or 25 years at five cents, the same article, with the exception that they have added three of them, has been put out with the price raised to ten cents. That is, mind you, a 100 per cent raise.

These other two articles, C and D, are identical products. They have been selling for 20 years or more for ten cents.

Now, you may say what has that to do with this affair. To me it is the fundamental principle of finance. The working man, the pensioner, the person who has to live on very little money, if he goes to the store and buys this one he pays ten cents for it. He pays ten cents for this other one as well. But if instead of having a raise from five cents to ten cents we could have a 2½-cent raise by virtue of having a 2½-cent penny, the price might be

raised instead to 7½ cents, which would only be a 50 per cent raise.

I think we are now unfair to the whole Canadian population by not having a 2½-cent or a 7½-cent figure. First of all, you would save in the minting. You would not have to have so many coppers to pays eight cents. Moreover, they could have it two for 15 cents.

To seven million workers it would save a cent and a half to two cents a day, which would run into millions of dollars. Immediately those on pension and with lower incomes would be saving a lot of money on many goods. I have only illustrated four items, but there are hundreds of items on the shelves of the stores that this would be applicable to.

If we were to adopt a 2½-cent penny as part of our currency, then instead of pricing up from five cents to ten cents right away, it could be done with a certain leeway.

The Chairman: Dr. Crispo, do you have any comment on that?

Dr. Crispo: I do not really know what to say to you, senator. What you are saying is that when inflation gets rampant something happens to the value of the units of currency that we have used and that at some stage you change the units of currency because they are so insignificant in terms of what has happened to the over-all price level that you must reconsider the units of currency that you issue. I cannot quarrel with that notion. I am not sure about the specifics, but I understand what you are getting at.

Senator Bourque: It applies not only to these things but to any kind of drinking product, for example, such as soda water, and so on and so forth. On these articles the price is raised immediately from ten cents to 15 cents, whereas, if a 2½-cent unit were available, the price could go to 12½ cents or the price could go to 7½ cents. That would help to settle the problem. As it is now, the dealers are forced to raise the price by 100 per cent. It does not take a great mind to think that out, because it is a very simple affair.

I thought illustrating this would more clearly indicate the practical significance of it. It means a 50 per cent increase to the person who can least afford it. After all, the man going to buy a mink coat is not going to quibble over whether it is $1,950 or $2,000. But to the poor man who depends on very nickel he gets and has to decide whether he can buy a cup of coffee, it would mean a lot of money. It would mean a lot of money for the population and I am speaking now for the seven million people who are working and who are trying to feed their families. If the worker has to pay 50 per cent more on every little item, then it might mean the difference of millions of dollars over a period of a year or two years.

Senator Nichol: Mr. Chairman, I should like to go back to the question of the commission Dr. Crispo has suggested and to the question you asked about the powers of that commission and what checks and balances there might be. As I recall, Dr. Crispo suggested that if it was created and turned out to be a monster, its powers could be clipped or it could otherwise be disposed of. But it seems to me in the light of history that that is rather hopeless, because historically, commissions of all kinds, once they have been created, and particularly if they are powerful, have tended to extend themselves rather by Parkinson's law; by force of their own powers they have tended to extend themselves forever and ever. Perhaps this is a political question, but it becomes extremely difficult to defrock a commission once it becomes very powerful, particularly if it becomes too powerful. The more powerful, the more difficult it is to get rid of.

Dr. Crispo: I am afraid I cannot give you the kind of definitive, precise and satisfactory answer you would like, but you must remember that the powers I am talking about are investigatory powers. Quite frankly, the more we know about what different institutions in this country are doing the better off we will all be, because there are a lot of things that are going on that should be in the public domain.

With respect to the commission I was referring to, they would not have the power to go beyond investigation, to subpoena individuals and records to find out what a particular group is doing that enhances its power to the point of allowing it to extract the kinds of gains it has been extracting. I am not that fearful of a body which has only investigatory powers. It may well be that administrative tribunals that make decisions are very often awesome and fearsome creatures, although my impression is somewhat different from your own. I have heard a lot of criticism of the Labour Relations Board, which is something I am familiar with, but by and large I do not think they have abused their powers. I can only say in response that (1) the power is investigatory, and (2) if they get out of line even in that limited sense, they can be chopped off.

Senator Nichol: But if the power is investigatory, it means the power of public relations. You said to investigate and make the findings public. Would you have a sort of tribunal or court before which the union could come if it has been found guilty? Because if it is found guilty at the court of public opinion, it can hardly save itself.

Dr. Crispo: Let me say this; your point about the union is well taken. The union would not have a court to go to; it would have a cabinet and a parliament to go to. It would have to utilize the traditional devices we associate with lobbying to explain why it thought the Commission was in error. But it would be forced, as I think it should be forced, to prove that the decision made, the investigation and the recommendations offered were in error, and I think they should be put in that position and it should be in the public area.

Senator Nichol: You mean in some form of labour court or some form of review court?

Dr. Crispo: No.

Senator Nichol: In an informal way?

Dr. Crispo: No, not in an informal way, because if such a body is to be effective, it is going to be making recom-

mendations to Parliament or to provincial legislatures with respect to measures they should take to bring some of these groups down to size. At that point, if the cabinet sees fit, they are going to bring some legislation to those parliaments or legislatures and presumably there is going to be a hearing and there is going to be full and ample opportunity to explain why they think it is wrong. In the meantime, you know better than I do what they are going to be doing. They are going to be busy badgering the devil out of the government not to do anything, and they are probably going to have more effect doing it by back-door methods than doing it by front-door methods. But I see all sorts of avenues for a group that feels it has been abused by this body to justify its position before anything harmful is done to its interests.

Senator Nichol: Well it seems to me that the deck would be stacked against the person or the union or the corporation who was attacked by the institution in the way you say. The Commission would be saying ,"You are doing something bad," and the other guy would be saying, "No, we are doing something good," or, "We are not doing anything bad."

Dr. Crispo: All right, but if in their analysis they are proven wrong, or if they are wrong in their facts in building up to whatever conclusion they come to, that can be shown. And if that body can be shown to be wrong, governments are going to lose confidence in it and it is going to have to be very careful to be sure that is right or it is going to lose its influence and it will lose whatever power it has. I mean I cannot give you a sure-fire method of keeping this body in line because within certain limits I do not want it to be kept in line; I want it to have scope and discretion, because as I have pointed out, and you may have failed to note because I did not emphasize it, I firmly believe there are a few things that governments do that this body should feel free to investigate.

The Chairman: I think one of the things that is worrying us is the fact that we are trying to seek a solution to this problem with the least possible proscription of freedom. Obviously there are simplistic methods if you just want to bring down the guillotine on everybody, and I think that at the back of these questions is the concern that it becomes too easy if all you are trying to do is proscribe freedom, and I do not think that is what you had in mind. What we are trying to get at is a better definition of what we think you have in mind.

Dr. Crispo: Let me put it this way; the challenge before this committee and before all governments in this country is to come up with a viable solution to the trade-off dilemma, and I have stressed the inflation side of it but there are others. There is really some kind of a trade-off here, but the critical challenge is to find a viable solution to this problem compatible with out existing values, institutions and goals. Right now I see three major alternatives. In fact there are several. One, just live with the inflation, let her go. But you cannot do that. You cannot just let it go. Especially if it gets out of line with other countries.

Two, kill it with a heavy dose of unemployment which to me is socially and politically intolerable as an alternative. I must say I agree with Harrod on that aspect of his testimony, although he went a little bit wild after that. But ethically he was right.

Three, guidelines. They won't work. We have found that out.

Four, selective and/or general wage and price controls, neither of which will work, and in the effort to try to make them work, we are likely to destroy what is left of free enterprise and democracy in this country because there will be a great big octopus in Ottawa presiding over a lot of people's incomes. Just look at the experience during World War II when we tried to do this and we had the whole nation behind us. It was breaking down by the end of the war. I am told there are 15,000 prices alone in terms of basic steel products. Now who is going to sort out those things? Yet Mr. Galbraith and Mr. Young tell us we should have selective controls in the industrial heartland. I presume that includes the steel industry. Who is going to make that kind of decision?

Five, something like what I have been recommending. I really think when you look at those five choices, something like I have been recommending—not in all the details; the questions you are raising are perfectly appropriate and I do not have all the answers. I acknowledge that. But of the five alternatives—and I challenge to name another one; there probably is another one but I am doing this off the top of my head but I have thought about this a great deal and I think it is a fairly complete list—but of the five alternatives, I frankly believe that the last one, the one I have been talking about, is the most viable and compatible with our existing system.

Senator Croll: I share your view on the first four. So now let us get to the fifth, the investigatory power. Is not that what we have tried for a great number of years in our Combines Investigation Act, and there is not one man around this table, including yourself, who is satisfied that the Combines Act is doing what it ought to do. But now you are saying to us that is the course for us to take.

Dr. Crispo: Well, first of all I am not an expert on our Combines policies. You should talk to Professor Gideon Rosenblut—or one of a number of people across this country who know something about our combines legislation, certainly more than I know. But I can say as a citizen that I do not think it has been as vigilant as it should have been. I do not think it has been as effective as it should have been. I share your reservations about that. I would remind you, though, that in Britain before the last government was defeated, and more particularly before Mr. Wilson decided to let the lid off so he could be re-elected by letting everybody go on a wage and price binge and make hay for six months before the election, he did have a proposal that the then existing Prices and Incomes Board be linked up with their equivalent of a Combines Branch. I think one of the implications of what I am saying is that we might well be advised to not only get rid of the Prices and Incomes—oh, God, I am alienating everybody in this city—not only get rid of the Prices

and Incomes Commission which has got to go, but perhaps in whatever creation we replace it with, combine it with the Combines Investigation Branch. Now immediately I am in trouble with Mr. Basford and his whole Consumer and Corporate Affairs.

Senator Croll: You are in trouble with me because the Combines Act in Britain does something altogether different from what we are set up to do here. It encourages the combines whereas we don't. That is the great difference.

Dr. Crispo: But surely there are areas in this country where we would be well advised to encourage combines at the same time as we eliminate tariffs.

The Chairman: I do not think we should get into that subject at the moment.

Dr. Crispo: But it is relevant.

The Chairman: Yes, it probably is relevant but I think it will carry us too far.

Senator Croll: Mr. Chairman, the subject was investigatory because he did indicate that there were four methods. Now I don't know whether anybody else shares his view, but I share his view that they are not acceptable, and I do not want those four. But I well recall when we started with the investigatory process we said, "We will expose it, we will bring it out, we will show it to public opinion, we will go in and grab the books," but nobody seems to be hurt and nothing has happened and the combines are combining and continuing as they formerly did. Now the professor who really knows this, because in his own field he is quite eminent, must have given this some thought and must realize that for 20 years we have been playing around with this with no results.

Dr. Crispo: I must confess I have not given it as much thought as you have obviously given it. In fact, I have not given it enough thought. Maybe this Commission would say in the odd case that the Combines Investigation Branch should get off its butt and go out and take a look at what has been going on under its very nose in this industry. Maybe that is what it would do. We must remember that there are so many things that such a body could recommend. It is so important for this body to have scope, flexibility and discretion.

Senator Croll: McRuer, who is looking into this sort of business, is saying just the opposite from what you are saying.

Dr. Crispo: I am afraid I do not agree with the good Justice McRuer, especially in what he has to say about labour relations boards, but you are going to get me into another area. I just cannot believe that anybody can possibly for a minute believe that our courts are competent to deal in some of the areas where a great deal of expertise is required. I do not mind appeals on a body going beyond its jurisdiction or ignoring—what do you call that?—"due process" or the opportunity to be heard, but for courts to be able to review every administrative tribunal's views on the merits is to say, "Get rid of the administrative tribunals." I think the judges want more work! I do not understand them.

The Chairman: Senators, the hour is growing late. I could perhaps hear from any senators who have final questions, and recognize Dr. Gillies.

Dr. Gillies: Just one quick question to which I would like a "yes" or "no." If we had an effective anti-combines policy would you bring the labour unions under its jurisdiction?

Dr. Crispo: I cannot give you a quick "yes" or "no". I say "no", and for this reason, that there seems to be a failure to recognize that we do have an anti-combines policy in this country with respect to unions. It is in our Labour Relations Act, which precludes unions from striking during the life of a collective agreement, precludes them from bargaining in some cases on a multi-plant, let alone a multi-form basis, denies them secondary boycotts and secondary picketing, and in all of these senses and in many more that I could give you, restrain unions individually in terms of how much power they can exercise.

Our labour relations acts are not only acts that provide for the existence and indeed the growth of unions, but also ensure that they are kept within certain limits and are bound within certain checks and balances, which are not always adequate, as I have made clear, but we do have a combines policy for unions.

Dr. Gillies: I have a supplementary, a critical question that would be encountered in the countervailing powers: Would you outlaw the union shop so you could increase labour supply in a certain area if you felt this was essential?

Dr. Crispo: Now you are getting me into another area.

Dr. Gillies: I really do not mean to.

Dr. Crispo: No, no, this is a valid question and some interesting things are happening. I do not think I am opposed to a closed shop; I am opposed to a closed union—and there is a major distinction to be made. I have no objection in certain trades where you primarily have your employment through the union or through a hiring hall, of everybody having to belong, unless that union is closed. That is one thing I have taken a very strong position on. There should be adequate appeal machinery and, by the way, the task force of which I was a member recommended certain things to the Government of Canada which will shortly be bringing forward a draft bill to amend the Industrial Relations and Disputes Investigation Act, and I would be very interested to see whether they have the nerve to take this one by the tail, but we recommended very strongly that there be adequate measures to ensure that individuals be allowed into these institutions and that closed unions be prohibited. I could elaborate on this, but I think that is the critical issue. Are they using their powers to exclude people?

The Chairman: If you were the chairman of the commission and you found on investigation a union was

abusing its powers, under the terms of your reference would you go so far as to recommend it not have closed shop privileges in a certain situation?

Dr. Crispo: I do not think I would have to. If I thought that was the only solution, I would recommend it—and I really believe that unless this body is freewheeling, innovative, pioneering and unafraid of anybody, it is not going to come up with the kind of approach that I have in mind.

May I just say one thing in conclusion? I am frustrated, and my frustration grows out of the fact that I know that you will hear from the-powers-that-be when those of us who disagree so violently with past and present policies will have no opportunity to challenge them. Some of these individuals will not appear on public platforms with me. Influential groups have tried to get me on the platform with them and they decline the invitations, and it is very frustrating to know you live in a society where those with power who are making the decisions cannot be confronted publicly by people who know damned well they are wrong and they cannot defend their positions. So give them a hard time for me!

Senator Croll: We gave you a platform and you did well.

Dr. Crispo: But we are not joining issue with the people who are responsible.

Senator Hays: You should join us, Dr. Crispo. It is quite easy to do.

Dr. Crispo: I would if I had a chance.

The Chairman: Honourable senators, I think I reflect the view of all honourable senators here when I thank Dr. Crispo for a most provocative and well articulated presentation.

Dr. Crispo, we might have cringed at some of the things you said, but we are not in any way sorry for having asked you.

Thank you very much.

The committee adjourned.

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THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 8

THURSDAY, MAY 13, 1971

Fifth Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses:—See Minutes of Proceedings)

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STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
	O'Leary
	Paterson
Gélinas	Phillips
Grosart	Sparrow
Hays	Walker—27.
Isnor	

(Quorum 7)

**Ex officio Member*

Orders of Reference

Extract from the Minutes of the Proceedings of the Senate, Tuesday, March 9th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said *Estimates* reaching the Senate.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Tuesday, May 4, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relation thereto.

The question being put on the motion it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Minutes of Proceedings

Thursday, May 13, 1971.
(8)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10:00 a.m. to consider the question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett, (*Chairman*), Beaubien, Benidickson, Croll, Desruisseaux, Flynn, Grosart, Hays, Isnor, Laird, Langlois, McLean, Methot, Molson, Nichol and Sparrow. (16)

Also present but not of the Committee: The Honourable Senators Cameron, Carter, Fergusson, Haig, McNamara, McGrand, Molgat, Thompson, and Smith.

In attendance: Mr. James Gillies, Director; Mr. A. B. German, Administrator; and Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Heard as witness: Mr. J. Douglas Gibson, Consulting Economist, Toronto.

At 12:40 p.m. the Committee adjourned to Wednesday, May 19, 1971, at 10:00 a.m.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Thursday, May 13, 1971

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 10 a.m.

Senator Douglas D. Everett, *Chairman,* in the Chair.

The Chairman: Honourable senators, we resume our hearings on the subject of growth, employment and price stability in Canada. We are fortunate in having with us today as our witness, Mr. J. Douglas Gibson, former Chief General Manager, Deputy Chairman and Executive Vice-President of the Bank of Nova Scotia. He has very wide experience in Canadian business life being a director of many Canadian companies, including Imperial Life, Consumers Gas, Harding Carpets and many others. The list is extremely long.

Mr. Gibson was on loan from the bank as Chief of Economic Research in the Wartime Prices and Trade Board from 1942 to 1945, so he has special knowledge on the subject of wage and price controls which I think will be extremely interesting to the committee.

Mr. Gibson is also visiting professor at York University. He has wide experience in the field of economics, and has been the editor of the *Review* of the Bank of Nova Scotia. He is widely known as a top businessman, a writer, and an economist. As I said, we are very fortunate in being able to hear his evidence this morning.

Mr. Gibson has filed a brief with the committee and as is our custom I shall ask him to start off by reviewing that brief with us, and then submitting to your questions.

Mr. J. Douglas Gibson: Mr. Chairman and honourable senators, I am honoured to have the opportunity of appearing before you and I shall endeavour to answer to the best of my ability any questions you may put to me, recognizing that I may not know the answers to all of the questions or, indeed, to most of them. Many of them, in fact, do not have answers.

This document which I have submitted is really not a brief; it is simply a statement of a few ideas that I have tried to express in a reasonably provocative manner. There are two key points I wish to make. The first is that we have in Canada the most rapidly growing work force in the world, a point which I am sure Dr. Smith made very clear, and therefore we must have a rapid rate of economic growth if we are to absorb these people. The second point is that we have an open-type economy which means it is hard for us to deliberately plan and control it because we are subject to pressures from outside. In my comments I have gone on to suggest certain policies which I think might be appropriate to our current situation.

I have gone on in these comments to suggest certain policies that I think might be appropriate to the current situation. I think our most serious problem at this time is, of course, a high level of unemployment. But we also have this continuing cost-push inflation. The problem is to work out policies that make sense in terms of these two underlying problems. In other words, to try to devise policies which will help the economic growth and recovery of employment or speed up the increase in employment, because we have been having increased employment. The problem is it has not increased enough. The problem also is to do that without increasing the inflationary pressures and giving this cost-push inflation a further push.

This is a very difficult problem. I do not think there are any obvious answers to it. My own thinking is to suggest what would be appropriate at this time to reduce taxes to give the private portion of the economy some stimulus through both spending and corporate investment. Corporate investment in this country in real capital goods is not high enough. We need a higher level of capital investment.

One of the obvious reasons why it is not high enough is that profit margins are down. We need more stimulus in this area. I think we need more stimulus in the consumer area and a tax reduction would help accomplish this.

Admittedly tax reductions would mean a larger deficit than is presently contemplated, at least for the time being, and this in a sense is inflationary. But if it led to an increase in the capital investment program and improved employment, using up a utilization of resources which are not now being amply utilized, this might very well offset the inflationary effect. I think it is worth trying.

It would also help us with another very major problem that we are facing today, namely, the exchange rate, which in my opinion is too high in the interests of Canadian economic growth. It we get more consumption, more investment, we would have more imports and this would reduce the pressure on our exchange rate. At least, it ought to work this way. In short, I think it would work that way. We ought to be paying more attention to the

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possibilities of foreign invesment by Canadian firms, partly because it is desirable in itself and also because foreign investment would help to reduce the upward pressure on our exchange rate. This is very important. But I do not see any simple way of putting the exchange rate down, as I make clear in my remarks.

Senator Beaubien: Mr. Gibson, when you say foreign investment, you mean Canadian investment outside the country, not foreign investment coming in?

Mr. Gibson: No. For the moment the problem is the other way around.

Senator Isnor: Which do you favour? Do you favour investment outside or inside Canada?

Mr. Gibson: Both. We need more investment at home. We need a larger investment capital program in Canada. These things take time to get rolling. You will not get your capital investment program in Canada shooting up in a few months. It will take a year and a half, anyhow. In the meantime you have got an exchange rate that is too high. If there are opportunities for foreign investment, then these are to our advantage, particularly if we can gear them in with export opportunities. A lot of the export business that we do in this country does necessitate investment abroad, sometimes in fabricating facilities and sometimes in distributor facilities.

Senator Isnor: You emphasized imports a moment ago. Do you think it is a good policy to encourage imports?

Mr. Gibson: At this time I would like to see more imports, yes. I would not say yes or no to your question. If you can use the imports, then they are a good thing if you need them. At this particular time our imports are down because our capital investment program is down. A capital investment program normally has a big machinery and equipment content. This part of it is down, and that is why our imports are low. That is one explanation of why the exchange rate is so strong. If we had an adequate capital investment program we would have more imports and a less strong exchange rate. I am not saying that imports are either a good thing or a bad thing. I am just saying that is the way it is.

Senator Isnor: Do you advocate them?

Mr. Gibson: I would like to see them go up if they went up for the right reasons. It would expand the capital investment program. The point is that imports that are not coming in now are things that generally we do not make in this country. I am talking about capital equipment, a lot of which is of an advanced nature.

The Chairman: Perhaps we might allow Mr. Gibson to make his opening statement and enlarge on his points, and then come back to this matter after he has concluded.

Mr. Gibson: I should like to make a few general comments that are not contained in the material that I circulated. What I circulated was quickly put together. You may say to yourself, well this guy has not straightened out his own thinking, but has given us something that is conflicting. I have indicated here that I am concerned about inflationary tendencies in our society and I also think that the exchange rate is too high.

This may sound like an inconsistent view, because how can you have it both ways? Would not a lower exchange rate encourage inflation? I think I should try to answer that question. I do not think it would, in the present circumstances, because the exchange rate on the Canadian dollar is high in relation to prices and costs when comparing this country with the United States.

It is not as though we already had a competitive exchange rate. We have moved from 92½ cents to almost $1. What we are talking about is not competitive currency depreciation, but, first, to prevent that rate from going any higher than it is, and, second, if it were possible to get it down a few points, to get it part way back to the 92½ cents. I do not think it is conceivable that we can get it back to the 92½ cents. So we would probably end up, even if we got a little lower exchange rate, with an exchange rate which was still not all that competitive. It would have the great advantage, if it went down a bit, of strengthening production in a large part of our economy and strengthening our investment. The pulp, paper and lumber industry, for example, are not going to fall over themselves in investing money in plant and equipment under these circumstances, and we know they are not. Their type of industry has been most affected by this high exchange rate.

I should like to say one or two words about the questions that Dr. Gillies sent around, which may open room for discussion between us. I read those questions with very great interest and they brought a lot of things to mind. I should like to mention those things about them that stimulated my critical faculties or raised questions in my mind. One thing that I was worried about was the close linking of monetary and fiscal policy in most of the questions. In most of the questions one was asked whether monetary and fiscal policies, if taken together, were appropriate for this or for that.

I believe very strongly that monetary and fiscal policy should be co-ordinated. If they are not there will not be an effective national economic policy. However, they are quite different instruments, with different potentials, different capabilities and, indeed, different managements. The management of monetary policy is quite separate from that of fiscal policy.

A well co-ordinated national economic policy, in which these are just instruments, will often involve monetary and fiscal policies working in quite different time sequences. In other words, we may be thinking an immediate term basis on monetary policy and a short term basis on fiscal policy, or vice versa, depending on the circumstances.

The emphasis in the two areas of policy may be different and at times monetary and fiscal policy may be moving in different directions, and appropriately so. This is not necessarily wrong but sometimes it is. For instance, in 1962 during an exchange crisis we tightened up on monetary policy and kept an easy fiscal policy. This was the right prescription at the time because it was a tempo-

rary situation. We did not want to affect our domestic economy, but we wanted to affect the capital movements outside. We did that through monetary policies. They are different instruments used in different ways and should be thought of as being very different.

Experience in this country, to a lesser degree than that in the United States and Britain, has indicated that monetary policies present major difficulties as an implement of short term economic stabilization. The lags between the need for a policy change and the effects of a changed policy on the economy are frequently so long as to reduce the usefulness of monetary action. They are sometimes so long as to be counterproductive. In other words, the time between a policy being decided upon and ultimately affecting spending and investment in the economy may cause a situation that is quite inappropriate at that time.

As you know, much work has been carried out with respect to the business cycle, particularly in the postwar period, and we have a whole new picture in this business of short cycles. Based on this experience, monetary policy runs the very real risk of not being effective and quite often of pushing the wrong way when it does become effective. This is because the downward cycles have averaged 12 or 14 months. If an attempt in made to stimulate the recovery, the lag in the effective monetary policy runs from 6 to 18 months and decisions are not made for several months after there has been a change, it is possible that a restrictive policy will come into effect when the economy is turning up again. This is not inconceivable; it has happened.

Senator Benidickson: Has it happened recently?

Mr. Gibson: I am not sure; I do not think so, but this is a real point. This is one of the real problems of monetary policies and it is not an exaggeration if the lags are long. They are not always long; if there is the courage and those in the political system are willing to put up with very strongly applied monetary policy, shorter lags can be achieved. However, I doubt very much if we are prepared to do this sort of thing. The Japanese do it to a degree, but the results can be unpleasant. The manner in which we and the Americans run monetary policy causes the lags to tend to be very long. This being the case, monetary policy ought to be concerned more with the underlying trends in the economy than with the short cycles. In other words, it should be concerned with whether the underlying push or trend is strong or weak. It should lean the other way to that trend, either to encourage a weak situation or discourage a too strong situation.

This all sounds very sensible and these are the kinds of conclusions to which the Royal Commission on Banking and Finance, on which I sat quite a few years ago, came. Whether they are sensible or not for Canada I am not sure. They are sensible for the United States, but we should take a medium term perspective with respect to monetary policy rather than a short term one. It would be sensible for Canada if we could apply this kind of policy here. The question is, because of our open economy and dependence on external development, can we apply it?

Monetary policy in this country has to roll with the punches, which can be heavy and frequent at times. Whether our central bank can emerge from the buffeting of the external environment on the right monetary course, pointed to the medium longer term, is a very real question. It is not at all clear that it is possible. There may be times when we have to put much more money into the system than we wish and we cannot take it out again.

The reverse situation may be true, but the external aspect is so important in Canada that we just cannot plot a nice, desirable course and go ahead with it, because external events and developments will prevent it at times. We should aim at monetary policy in a medium to longer term direction, but I am not sure how successful we could be.

If you accept the view that I have been putting forward, that monetary policy should not be much relied on for short term economic stabilization, then we must rely more on other policies to even out the business cycle. Here fiscal policy can be more helpful than it has been. I also have to point out that fiscal policy can be very unhelpful so far as economic stabilization is concerned. From a positive point of view fiscal policy, which means handling the tax expenditure system, can stimulate or restrict spending and investment. It is more direct and prompt in its effects than monetary policy.

In this respect, again the royal commission in 1962 did some work. The evidence presented to us indicated that fiscal action was considerably more prompt and could be pointed more directly than monetary action. So when considering the stimulative side, tax reductions and tax allowances, depreciation allowances and that sort of thing, can give significant impetus to the private economy. Also considering the stimulative side, increased Government spending has an obvious direct effect on the economy and it also promotes other kinds of spending.

On the restrictive side, tax increases can help cool off a boom if they are applied reasonably soon and not left, as I am afraid they usually are, until inflation has pretty well taken over. The record suggests that we very slowly increase taxes in a boom and tend to do it too late. Fiscal policy may be more effective as a stabilization device.

One of the portion of the Royal Commission on Taxation, the Carter Report, that I think has been quite seriously overlooked, is the work they did on the use of fiscal policy as a stabilization device. It is not a finished job at all, but it is very interesting and I do not think it has been pursued nearly as far as it might have been. There are much greater possibilities in this area than we have yet found. There are obvious problems; the business of having an annual budget makes it difficult to make fiscal policy a good stabilization device, but various steps could be taken. There could be some leeway for changing certain taxes left to the administrative staff. Many steps could be considered; more frequent budgets, as far as that is concerned. Of course, we do have more frequent budgets at times.

I said fiscal policy could be very unhelpful to stabilization, and what I meant there was—and we have had quite a few examples of this here and elsewhere—that if an inappropriate fiscal policy is pursued it can also bring about inappropriate monetary policy changes. For instance, the most familiar example of this is that by running increasing deficits at a time when things are booming and savings are scarce a government virtually forces an increase in the money supply because the Central Bank cannot stand aside and see the Government unable to finance itself, and this tends to force increases in the money supply at the worst possible time, when you have an inflationary situation on your hands anyhow. There are all sorts of examples of this in many countries.

Another situation, the other way around, would be when a government, through fiscal policy, does not provide enough stimulus to promote recovery and thereby increases demands on the Central Bank to increase the money supply, perhaps more than is appropriate to the circumstances. Anyhow, the two things fit together and one can undo the other, so to speak.

The other thing I want to say about fiscal policy—and this is an area that I do not think has had nearly enough attention—is that we ought to give reasonable room in our society to the private economy. I am talking from my own beliefs, because I think the market system is a highly efficient system and gets very good results. But if Government is going to move increasingly and take a larger and larger proportion of the national product you are going to narrow the area in which the private economy can operate and you are going to reduce the amount of resources, the amount of real savings which are available to the private economy. This is a capital intensive world and the private economy needs lots of savings, so we have to think more, I think, in terms of how much it is reasonable for a government to take and still have an efficiently operating private economy. I think this is one of the most important questions we have to look at. It leads to the question of priorities in our society—priorities of the shares between the Government and the private sectors.

Then there is the question of what are the important things in the government area. There are obviously many important things that have to be done in the Government area. This makes it all the more urgent that we should have a good system of priorities and do the things that are most important because we cannot do them all, and if we try to do them all we are likely to wreck the whole works, in my opinion.

Now, you have a whole series of questions on regional matters. I just have two comments there, and perhaps they will not be very popular. The first is that I do not really think there is much sense in efforts at regional monetary policy. Money does flow and, surely, we want it to flow in the interests of an efficient economy. When you say that money cannot move to the place where it gets the best return, you are sort of saying, "We do not like the way the market system works." To some degree we have to say this in terms of social problems in a particular area, but the more we say this the less effectively the market system is likely to work, and I think we must always remember this. Monetary regionalization, or efforts to move in that direction, would be a backward step, and I do not think it would work. We have already a fair amount of decentralization in our financial system. I know something about the banks, and the banks are quite decentralized, immensely more so than they were 10 or 15 years ago. They are rather responsive to area demands, or they are much more responsive than they used to be, and this increasingly decentralized system—and I think this is true of other financial institutions, too—does provide to some degree for regional differences and characteristics; not as much as a lot of people would like, but we should not forget that the system has become more decentralized.

The other comment I would like to make is on the question of fiscal matters, and this again has to do with the regional question. It is that there is no reference in your questions—I have not read all of the evidence, but I have read some of it and I have not seen anything yet which goes to the question of co-operation between the federal and provincial authorities in fiscal policies. I think it is a question of very great importance.

We are a federal state; some of the provinces are relatively large in that state—two of them in particular. The trend, in my view, is towards greater decentralization and not towards centralization. We have been watching a serious lack of co-operation with striking differences in view between the federal and provincial authorities in respect of tax reform. We have been watching this for a long time, but lately it has become more than obvious. If we do not achieve a better record in federal-provincial fiscal co-operation our regional policies have small chance of being effective and our national policies will be further weakened, and I think this is a very important subject.

Perhaps I might end by making one comment on price and wage controls, and this is not a very cheerful comment either. It is often said that last year's efforts at voluntary price control were successful while the policy of wage moderation was not. In a sense this is true. I just wonder whether it was worthwhile because, to the extent that price control was successful, it worked to narrow profit margins, and reduced profit margins have been working against an adequate level of capital investment. I think our most serious problem today is an insufficient level of capital investment, and if we were to go into a price control system now, whether formal or informal, it would simply make the problem of capital investment more difficult than it is today and add to unemployment.

As for concern about sufficient competition in our society, the high exchange rate we have and the relatively open economy I think provide a lot of competition to protect the public interest. Thank you, Mr. Chairman.

The Chairman: Thank you, Mr. Gibson, for a forthright and very clear statement upon which I am sure the senators will have many questions. I will begin with Senator Molson.

Senator Molson: Mr. Chairman, just at the end of his remarks Mr. Gibson actually answered, in part, one of my questions. I was going to ask about fiscal and monetary policies, which have already been mentioned here quite frequently and which he touched on.

With regard to fiscal policy, Mr. Gibson mentioned the problem of regional effect. I was going to raise that not only from the point of view which he mentioned but also with regard to the effects of fiscal policy in this spread-out country of ours. The effects are so very different between different areas that surely we have a more complicated problem than a great many areas in the world to deal with inflation and unemployment, just because of our geographical shape and relationship. Would you care to comment on that first?

Mr. Gibson: I agree, senator, we have a more complicated problem. The differences are great and monetary policy has very little selectivity that is practical, partly because it is dealing with money, which is so fluid. Fiscal policy can be much more selective, particularly on the spending side, and is. We do have reasonable spending programs; we transfer taxation on a substantial basis. I would have thought this was the area where there should be the flexibility to deal with reasonable problems.

There is still a problem here though, because whenever something is done that the market system would not have done, it seems to me you should be pretty sure it is reasonably sensible, because otherwise you can be left with things that turn out to be lamentable failures, and we have lots of them across the country. This is very difficult, because in any area there are always things that certain people want to do, and they may not make economic sense if you look at them from a broader point of view. The force is applied largely through political pressures, and the judgments are made on the political and social basis, perhaps even more than on an economic basis, so all I say is that there is a problem here, and you should not overlook the economic side.

Senator Molson: With regard to monetary policy, as you said, it already has a good deal more regional implication than perhaps people generally think. For example, in our banking system, which is discussed so frequently, and its performance in this regard, I do not think people realize that quite often in a certain region the loans far exceed the deposits, and this sort of thing. I do not think this is taken into account. Surely again with regard to monetary policy we have a rather imperfect instrument in the control of monetary policy, because there is such a mixture of banking and non-banking organs involved. Is this not again a complication in trying to use a monetary policy effectively?

Mr. Gibson: Yes, I think it is. I think what it means is that it is very hard to use monetary policy in a selective way. This does not mean it cannot be used in a broad way. In a sense this is what I was trying to say, that for short term purposes, stabilization purposes and selective purposes monetary policy is not a very good instrument. It is a good instrument thinking in terms of the kind of broad economic climate you think is appropriate looking some distance ahead, if you can use it that way in Canada, if external events allow you to use it that way.

Senator Molson: That and the fact that the central bank has not got as much control as it has in some other parts of the world.

Mr. Gibson: Not nearly, no. After all, nobody has all that control. Look at the problems the Americans are having today. The external world is impinging on their economy, and even the Americans cannot do what they like.

Senator McLean: My question relates to your remarks concerning exchange. We in Canada are considered an exporting country. We cannot use all we can produce. I would cite our wood products, which are in trouble; similarly with chemicals, chemicals related to wood; the Maritime provinces are experiencing difficulties in exporting potatoes, fish and apples. If a purchaser has to buy Canadian dollars, it means those industries are not in a competitive position, because a year ago this month the Canadian dollar was unpegged. What do you see as the future for Canada? Where might our dollar go? Unless there is some help in relation to the dollar by having its rate dropped again and pegged at a certain level, I do not see any help for Canadian industries such as wood products, or those of fish or apples in the Maritime provinces, whatever they have to export. Throughout the Caribbean market they have to buy Canadian dollars, so they are paying more Canadian dollars, and the other countries come in and take the markets. Some economists said they thought the Canadian dollar might be pegged at 96 and float from 92 to 96. What do you see happening there?

Mr. Gibson: I agree. This is a very tough problem. As I said, I think the exchange rate is too high in terms of our interests in economic growth, because it affects a lot of major industries in a very unfavourable way. I believe it is optimistic to think we could peg the Canadian dollar at 96 and have it float between 92½ and 96; I think the pressures are still too great.

There is an interesting situation with respect to exports. It is rather disturbing in a way. Some exports are suffering quite a lot, wood products particularly and some of the minerals. Some are not. We have suddenly realized on this continent that the oil and gas in Canada are fairly scarce commodities, and these industries are growing. There are significant offsets to the things that are declining, and this is one of the things that has kept the exchange rate as high as it has been.

The other big thing that has happened is that our imports have stayed low, which is why I put so much emphasis on the importance of getting the investment program going in Canada again, because it seems to me these are consistent pieces of a whole fabric; if you can get the investment program moving, then you will import goods, which have to be imported because most of them are not made here; there would be a demand for more capital equipment and machinery to expand the capacities in the country. This would reduce the pressure on the

exchange rate, and it would then become more practicable to have a somewhat lower exchange rate than we have.

The other problem with the exchange rate that has not yet been discussed is that our strong exchange rate is partly not our strong exchange rate, it is a weak American dollar. Americans like our money better than they like their own, or some of them do, and there is a tendency to move money over here more readily than there was before. Short term money moves in here very fast from Europe too sometimes. There is all this short term money in the world and these dollars are floating around, and they can move very quickly. This is the other factor of strength in our dollar, which is really most unwelcome but it is hard to do much about it. The only answer to this problem is that the Americans should get their affairs in order, but that is easy to say.

Senator McLean: I take it you do not see any immediate relief for these products that depend on the exchange rate, which has put them in the trouble they are in today?

Mr. Gibson: Not immediate relief. I would be hopeful that the situation would improve in the next twelve months, but I am not at all sure.

The Chairman: I have a supplementary question on that point, Mr. Gibson. If you attempted to reduce the value of the Canadian dollar in terms of world currencies, would you not have to inflate the money supply at an extremely dangerous rate, and would you not find yourself in the position the British found themselves in at the beginning of the Wilson era, where you were defending a very much undervalued dollar? Would you not then suffer the consequences that the British suffered in attempting to defend that dollar and be eventually forced to make a tremendous adjustment?

Mr. Gibson: I think, Mr. Chairman, you put your finger on the real problem. This is the reason why we cannot put the Canadian dollar down through monetary policy.

We could create many more Canadian dollars, and sell them and push the Canadian dollar down, but in the process we would have a proper inflation. The central bank has to somehow or other balance its view. They would not say so, but I am sure they must feel the dollar is at a high level. They must balance the dollar against concern for inflation, and they would have to allow a very substantial increase to the money supply. It is not as though they are holding the lid down. In the last twelve months the money supply has been increasing sharply. If you buy a lot of Canadian dollars, that trend continues. Then you would be in trouble. I think your analogy with the British situation is a sensible one.

The Chairman: I will not belabour that point but, to carry on, you have suggested that the way around this is through fiscal measures to encourage Canadian investment in foreign fields, and Canadian investment that would require the importation of foreign capital to finance the machinery that is required for the investment. Would this change the equation and would this make it possible to put a downward pressure on the Canadian dollar, without inflating the money supply?

Mr. Gibson: I do not really think so. I think it is good to move in this direction, but I do not think that you would get results quickly enough in this area to have a major effect. I think it is important that we think in terms of investing our money abroad to develop our export industries. That is what the Japanese are doing now, what the British have done long ago, and what the Americans have done. You just have to do this if you want to develop a major export of manufactured goods. We must do this if we want to have adequate secondary industries.

If we do not have adequate secondary industries, how are we going to absorb all these bright people we are turning out? It seems to me that we have to move in this direction. It is a healthy direction.

As for producing results in six months or a year, no. I see it as a long term program.

The Chairman: What about the investment in Canada? I think you stated that fiscal measures should be employed to increase investment in Canada, the objective being in part, that you would be put in a position where you could buy American machinery.

Mr. Gibson: That is not the objective. That is a desirable secondary effect. The objective of the sort of thing I was suggesting, which was a program of accelerated depreciation, is to encourage people with programs to think they can make profits and get ahead with them. This would increase investment in Canada, which I think is the most important thing to do to cope with the unemployment problem.

Senator Benidickson: And you also said by tax reductions?

Mr. Gibson: It would seem to me any tax reductions are socially, politically and probably economically desirable to the person at the lower end of the scale. I would have thought the business stimulus would be more appropriate in an accelerated depreciation approach at this time.

The Minister of Finance really has a revenue problem. He is not looking at a balanced budget, so there is a difficult balancing act here. In a way he is saying the conservative thing now, or seems to be. They have done it quite a lot, and I do not know if they want to run a larger deficit. What I am saying is that perhaps for the time being you should run a larger deficit to try and get the economy rolling.

Senator Hays: Mr. Gibson, you have spoken about a reduction of taxes which would be helpful. I should preface my question with this remark, that if you are operating a municipal government or provincial government—this is more applicable to a municipal government—you have a certain formula that you can use in comparing with other cities. For instance, you would have a formula that you would never use more than 16 cents out of every tax dollar for the servicing of the debt.

If all of the cities were using that amount it would be a good criterion. Then if you could keep all your municipal services in line with those of other cities, you would make your city more competitive in so far as its being a fertile ground for industry, and that sort of thing.

What percentage of the tax dollar do you believe would be an appropriate amount for servicing the debt of Canada? Most of the payments have been made by the erosion of the dollar through inflation, and that sort of thing, and very seldom, in any event, have these debts been paid off completely, and then only in small amounts. Over the years the total has been eroded by two, three or four per cent. What do you think is a good percentage of the tax dollar to be used for the servicing of the debt, or how high can we allow the deficit to get, and still compete with other countries we are dealing with?

Mr. Gibson: I could not answer that question. I really do not know. I wish we were living in a world where you could set out some criterion on the basis of experience, and say that this is a good way of doing it. I do not think, with national finance, we are living in that kind of world. I am afraid we are living just about from hand to mouth. Problems are almost getting out of hand, and you have to do the best you can in the hope that you can get more control over them.

There used to be views about the proportion of the revenue dollar that should go to debt servicing. The proportion allocated by the federal Government, even today, is not very high when compared with the interest charged. That does not worry me all that much, but I find the thing you said earlier very disturbing. The poor people who bought these securities over the years are really being robbed. This is true of all the Western countries. They have all treated people who bought Government bonds very badly. It is a pretty shocking thing. Until we get more idea of what our national objectives are, and where we are trying to go in developing some criterion based on those objectives, I do not see how you can get any very sensible standards. I find this very disturbing, but that is the way it is.

Senator Hays: We have equalization, between the "have" and the "have-not" provinces. We do have some equalization there.

Mr. Gibson: Also between the provinces and municipalities.

Senator Hays: Then, so far as cities are concerned, if you want to have a good viable city, and you do not compare it to other cities, which you can do, should there be some thought given to using some criteria as to where you get into trouble, and where you do not get into trouble? I think we are using approximately 12 cents of the tax dollar now to service Canada's debt. What you are saying is that we should be using more, and lowering taxes?

Mr. Gibson: For only a temporary period. I would hope that the lowering of taxes is associated with a rising national product. If you project existing tax rates any distance into the future, on the assumption that we have a reasonably good utilization of resources, you get tax increases which are much greater than the increases in the national product. These are revenue increases; not tax increases. The revenue goes up faster than the national product, because these taxes are related to a progressive scale and they are also related to corporate profits. So you catch up; you get a recovery, providing you do not then go off the deep end and spend a lot more money.

Senator Hays: On this percentage matter, this committee put these questions before to witnesses. Let us assume all government in Canada are using 34 or 35 per cent of the gross national product, and Canada fairs fairly well in this regard. If we use this sort of a criterion and watch it closely, then do you not think there would be room to look at some percentages?

Mr. Gibson: Sure. I think what you say is highly desirable. I am not sure that at the national level it is practicable. At the municipal level, it is very important to have these comparative standards, and to use them. The federal Government has a responsibility to act as a moderator here, or to try to influence the economic climate. I think that is the overriding responsibility at this time.

Senator Hays: My other question is in regard to the money supply that you spoke of. It would be useful for me, and perhaps for some members of the committee, to know from a banker how the money supply is handled. you are a pretty tough banker, I happen to know.

Senator Beaubien: He would not give you a loan, would he?

Senator Hays: I would like to hear it explained.

Senator Molson: Those terms are not all mutual.

Mr. Gibson: Senator Hays, what do you mean—how is it increased?

Senator Hays: Yes.

Mr. Gibson: Basically, it is increased by the central bank buying something. It usually buys securities. When the central bank buys securities, it pays for them by a cheque on itself. This is the creation of new money. The cheque on itself is new money. That cheque finds its way into a chartered bank, sooner or later, and goes into the chartered bank's bank account with the central bank. That is an addition to the cash resources of the banking system. The banking system works on a ratio. We have two cash ratios now, one for demand deposits and one for time deposits. I suppose it woul would average out at about 5½ or 6 per cent, cash to total Canadian liabilities.

That cash will move around from bank to bank, to be spent, invested, until the ratio comes down to 5½ or 6 per cent, or whatever the legal requirement is at the time. That is how you get your increase in money supply. This happens very quickly. If the central bank puts, say, $50 million more into the system, by buying some security or

treasury bills, that goes right in. It takes only a day or so to get into a bank, because even if you buy from an investment dealer or an individual, that person will deposit in the bank, so the bank gets the cash.

The banks always work to keep cash fully employed. They do not leave any idle money around. That is the essence of banking. You have to use the money to make the earnings; you have to put the money to work. Usually, if you cannot find anything, you put it right into the money market, to make sure it is used that day. Then you look around for other things. If you find that you are fairly flush, you may buy some longer term investments. You would probably increase your loans, if you are fairly flush—if people want loans.

You get a response right away in the securities channels. So you get the increase in the money supply from chartered banks deposits, which is the heart of the money supply. It comes very quickly. It all happens in a few days or a few weeks. This piece of machinery works well and works promptly. Once you put it in, it is hard to take it out, though.

Senator Grosart: Mr. Gibson, I would like to ask you about consumer spending at the present time. The pick-up in consumer spending seems to have been postponed several times and much longer than most economists expected. Do you see any reason for that, other than the inflation phobia which you deal with in your brief?

Mr. Gibson: I do not think that concern about inflation is holding down consumer spending. This would tend to increase it. What slowed up consumer spending is the fact that there is more unemployment than there was, there is less overtime than there was, which means some people do not have the incomes. Nevertheless, incomes are well up over those of a year ago.

There is an atmosphere of uncertainty. Some people do not know what will happen. Some people think they might lose their jobs, and so they keep their money in the bank and will not borrow any money on a consumer credit basis. There is probably quite a bit of this in the environment. There is some feeling of insecurity, and a lot of people are waiting.

Senator Grosart: Do you think it is partly psychological?

Mr. Gibson: Well, yes—but "psychological" covers almost everything. If by that you mean you cannot put a mathematical formula on it, yes. I do not think you can. I think it is a matter of attitudes, the way people feel. If you want to use some of the financial economist's favorite terms, you would talk about "liquidity" and "the feeling of liquidity". People feel liquid and spend more money. If they do not feel so liquid, they do not spend so much. The simple application of that to the present situation is that many consumers do not feel so liquid because they are not so sure about the future. They are not quite as ready to spend as they were, even if their incomes are just as good, or better. This applies only to some people. It does not affect everybody in the same way.

Senator Grosart: Some economists seem to see other reasons for it, such as lack of aggressive marketing in Canada, insufficient attractiveness in the goods offered, particularly in terms of sophisticated technology. Have you observed any of these factors in your studies?

Mr. Gibson: No, I would not know enough about it to express a view on that. I am not sure that consumer spending is all that weak. It is better than a year ago. The April material that has come in just recently, on some aspects of it, shows that automobile sales and housing starts have really changed. They went up very sharply in April. It is hard to tell these things from month to month. There are big seasonal changes in this country. It looked in February and March as though the housing starts were lying up a bit, but in April up they go again. The automobile point looked a bit weak for a couple of months in the winter, but now sales have gone up sharply again. Therefore, it may be that consumer spending is reviving fairly well.

Senator Grosart: I think that is so, but the lag that I am speaking about seems now to be about a year old. I am thinking of the espectations of 18 months ago?

Mr. Gibson: I do not really have anything very profound to say about that.

Senator McLean: I have a supplementary question in regard to consumer spending. You say the income is up, but in what sector is the income up? It cannot be up in labour, because the labourer spends everything he makes. So the income must be up in the area of Senator Grosart and Senator Beaubien, and people like that.

Senator Beaubien: They are getting more per hour.

Mr. Gibson: Senator McLean, are you not talking about savings rather than income?

Senator McLean: No, I am talking about consumer spending.

Mr. Gibson: Well, labour income is up. At least, our figures tell us that that is so.

Senator McLean: Then it is not up the way these fellows mean, if consumer spending is down.

Senator Grosart: Yours will be up shortly, too.

The Chairman: The point is, Senator McLean, that the savings rate is up, and that accounts for the difference.

Senator McLean: If it is up, it is up among the steel workers but it is not up among the fishermen.

The Chairman: Our statistics are not all that refined, senator, but if we can find out we will let you know.

Senator Grosart: Perhaps we can get an economist to "dis-aggregate" it for you. There is a new word for you.

Mr. Gibson: We can find that out. Labour income can be broken down, because statistics will show a breakdown by trades and so on.

Senator McLean: It would be interesting to know where income is up, if it is up. Just what are the sectors?

Senator Grosart: Mr. Gibson, just to change the subject, at the start of your brief and in your remarks you stressed the fact that our population of working age is growing more rapidly than in any other country. Is there a unique relationship in the Canadian work force or labour force to population compared to other countries?

Mr. Gibson: Yes. When I said "any other country", I should have said, if I did not, "any other more or less advanced country".

Senator Grosart: Well, I think that is just about what you did say.

Mr. Gibson: Yes, it is unique. We had a very great increase in our marriage rate, and the consequent birth rate, running from a couple of years before the end of the war through until about the middle of the 1950s or a little later than that, and this is the group of young people who are turning up now. Their arrival has been delayed to some extent by longer years in education. More of them have finished high school and more have gone to university. But here they are, and proportionately they are a bigger group. This is different from any other country.

In the United States they have the same phenomenon on a smaller scale, relatively speaking. If you take the figures which the Economic Council worked out, despite the fact that they are badly out-of-date now, they do show you the story. The Economic Council estimated that from 1965 to 1975 our work force would increase by 50 per cent, whereas the American work force would increase by 30 per cent. I am talking to the nearest round figures. The American figure was the next highest among the advanced countries. So we really have a unique problem in Canada. There is no question about that.

Senator Grosart: So you are saying that not only is it increasing on a year-to-year base at a high percentage rate but also it is increasing as a percentage of the total population.

Mr. Gibson: The working force?

Senator Grosart: Yes.

Mr. Gibson: Oh, my, yes, and it will until you get into the late 1970s. But when you get into the middle 1980s, or the late 1980s, you will have almost the reverse situation.

Senator Grosart: Is this a special factor in our current kind of unemployment?

Mr. Gibson: Yes. The unemployment problem in Canada today is different from that of most other countries in that we have rising employment but it is not rising fast enough to take up the increase in the working force.

Senator Grosart: And it is a young work force by and large.

Mr. Gibson: Yes. It is getting younger all the time. It is interesting to note that the work force is getting a little older at the far end but is getting much younger at the bottom end. On the average it is a much younger work force.

Senator Grosart: Can you predict the effects of that ahead to 1980, for example?

Mr. Gibson: We are going to have a large increase in the working force until the late 1970s. It will be far above the average increase. Then, after that, the pressure will lessen to some extent.

Senator Grosart: Does any other country have the problem in a similar way at all?

Mr. Gibson: Yes, the United States does, but it is not as sharp in degree. Australia also has the problem to a degree. Actually, you know, in a way it is not a problem. Having a lot of able young people is an asset. This is what countries are built out of. If you have energetic, able young people and if you can use them effectively, you will have a much better country. In a way we should regard this as a challenge rather than as a problem.

Senator Grosart: The problem the Japanese are running into now is that they have suddenly discovered their population control is going to build them up a very old work force.

Mr. Gibson: Yes, they are running out of people. That is quite right.

Senator Molson: Mr. Gibson, are there not some quite serious implications in this age grouping you were speaking about a minute ago in the requirement that there will be for capital expenditures for things like schools and so on when this shift occurs, which might have a very large effect on our government spending policies? Is this so, Mr. Gibson?

Mr. Gibson: Certainly, the pressure at the primary level is lessened. It is levelling out at the high school level and it is still enormous at the university level. If you carry that ten years ahead, you will see that it begins to flatten out at the university level. Frankly, Dr. Gillies knows these things much better than I do. I can only speak in a general way now. I would much rather have him answer that question.

Senator Grosart: Mr. Gibson, on the question of the public sector's pre-empting certain areas of the economy that were previously generally regarded as more appropriate to the private sector, can that be rolled back, or would it be desirable to roll it back? For example, in the health field we are suddenly discovering a problem, the symptom of which is the extraordinarily high incomes of some doctors. The problem would seem to be caused by the fact that there is no market mechanism going here. The doctor does not have the control of what a patient can pay.

You see, up until now the situation has been that of the total of all government expenditures 50 per cent has been redistributed in health, welfare and education. That

is 50 per cent of the $25 billion or so. Is this going to continue? Economists predict a rise in the total of all government take from the GNP from the present 35 or 36 per cent that Senator Hays mentioned to 40 per cent or 42 or 43 per cent. Are we going to be able to live with that? I realize some other countries have a higher rate.

Mr. Gibson: I do not think you can go back. We have a welfare system. It seems to me what we want to do now is to improve the welfare system and make it more efficient. I do not think you are going to remove the welfare system in any sense. There are a lot of new things that are emerging on the horizon. For instance, there is our increasing concern with the kind of places people live in, particularly in the urban areas; there is our increasing concern with the environment and so on. These are obviously major areas where much more government money is going to be spent. You cannot get round that. It is going to happen. But I do not think you can cut back the welfare program. But what this means to me is that we must be sure that we are choosing our new expenditures carefully and put the money into the most urgent things, and we must make sure that the big things we are spending money on now are being handled efficiently. The problem is that we do not know much. Again, Dr. Gillies could say much more about this than I can. But I say we do not know much about how efficiently the government handles money. There is no market check on that at any point. People say that because the purpose of this expenditure is good, then it must be all right. But this is just a lot of nonsense. It may be grossly out of proportion.

Senator Grosart: That is exactly my point.

Mr. Gibson: And I think this is one of the areas where we really have an enormous amount of work to do in teaching good management, establishing clear objectives and programs that are related closely to those objectives with people who are taught to appraise what they are doing and with good evaluation procedures as you move along. We have an enormous amount to do in this area. If we do not, we will demand so much through government that the private economy will not work efficiently, and we must remember that it is the private economy that is providing a very large portion of the basic resources you need to do all these things. The two things fit together; you cannot have one without the other.

Senator Grosart: Are there any studies that would indicate how the efficiency of overall government spending can be improved? I know there are sector studies. A good example, of course, is the discussion now going on in Ontario about education spending. This has become not only an economic question but a political question.

Senator Benidickson: And they are dealing with health.

Senator Grosart: They are dealing with health also. Do you see any mechanisms anywhere on the horizon?

Mr. Gibson: Sure. The Treasury Board here in Ottawa under Mr. Reisman—and I understand you are going to have him here as a witness—has established a new set of procedures for looking at any proposals for spending. These procedures are modern. It is really a question of developing this kind of thinking and making it work through. There are many areas that it will not affect at all. Another real problem in the cabinet system of government, which is our basic system, is that ministers try to show that they are doing things and that in turn means spending money. They also tend to be pretty charitable to the other fellow's expenditures because they know they will want money themselves. So it is difficult to put the brakes on in a cabinet system of government. And this applies to the provinces and to the federal Government. You can see this all the time. What we have to do is to devise more checks and methods of getting after this, and the most important thing psychologically to get people thinking properly about this is to say, "Well, what are you doing these things for? Get your objectives clear, and then relate your programs to your objectives." Then you have to ask, "Are these programs accomplishing these objectives in the most efficient way? Take a look at what you are doing now."

In the Province of Ontario—and I happen to know a little about this because I am on the Ontario Economic Council which Dr. Gillies is going to head up—we had a look at what the government was doing because we wanted to find out what their programs were. It was quite sizable when they compiled it. The amount of overlapping as between departments is just incredible, and yet I think the Province of Ontario is run pretty well, as governments go in this country. But, as you know, there is just an enormous amount involved. That just involved taking an inventory and we found ourselves saying, "All right, we are doing all these things, but does it make sense that four departments should be engaged in the same activity?" Of course this is not its main purpose, but this is what happens. I took a look at one department to see how much overlapping there was as between the Ontario government and the federal Government because there did not seem to be any rhyme or reason as to why the Ontario government and the federal government should both do the same thing, which is frequently the case. This is hard, painstaking work, and it must be promoted from very high up or it just will not work. But now you have a movement here in Ottawa in that direction, and Mr. Reisman has a great deal to do with it, and you have the same thing going on in Ontario where they have a new section trying to appraise programs.

Senator Grosart: Do you think the PPB system is really going to improve the situation? I ask that question because I do not.

Mr. Gibson: I would rather you asked Dr. Gillies that question.

Senator Grosart: He has been wise enough not to get himself into the position where he can be called as a witness.

Senator Desruisseaux: I would be curious to know what you think of ceilings on debts where there are such high expenditures involved.

Mr. Gibson: You mean like the American debt ceiling?

Senator Desruisseaur: Yes, something like that. It could be improved upon, of course.

Mr. Gibson: Well, senator, the idea does not appeal to me philosophically, but you have to do the best you can and this might be an effective way of checking spending. I do not know that I would be against it.

Senator Benidickson: But they move their ceiling.

Mr. Gibson: Let us say they have bent it more than moved it. They have twisted it. But the pressure was so great that it had to be moved and I think perhaps it may have slowed things up a bit. It does not seem to be illogical; it seems to be the sort of exercise you would devise for grade 3 school children or something, but maybe that is what we need.

Senator Beaubien: Mr. Gibson, our corporation tax at roughly 53 per cent I think is very high. Would you like to comment on that? That is in comparison to our trading partners.

Mr. Gibson: Yes, I think it is high. It is high in relation to the United States, and that is the most important comparison. Now I do not know if you are asking me whether I think it ought to be reduced or whether you are simply asking if I think it is high.

Senator Beaulieu: You said it would be very hard for the Minister of Finance to reduce taxes very much, and within that context I understand. But apart from that, all things being equal, do you think it should be reduced, and, if so, by how much?

Mr. Gibson: If there is latitude, I think 53 per cent is too high. It is high comparatively and it makes the checking of expenditures more difficult too. I do not think it is a particularly desirable situation, but there it is, and the Minister has to collect revenues. So at this time I think you have to say, "What are the things that would be most useful in promoting a healthy recovery?" And I do not think I want to use the rather limited leeway he may have to produce the corporate tax. I would rather find some incentive that would encourage people who figure they could make some profits to go ahead and make the investments necessary.

Senator Langlois: But, Mr. Gibson, you prefaced your answer by saying "If there is latitude". What do you mean by that?

Mr. Gibson: As I understand it, at present the federal Government is looking forward to a cash requirement of $80 million, $90 million or $100 million. I do not think it will turn out to be that big. Recent figures have not supported that high an estimate. But there is a big potential. We are looking at a big deficit. There is no latitude in terms of a balance. It is a question of how large a deficit you can run reasonably, in the circumstances. I would be willing to run a somewhat higher one now because I think it would help recovery. With the kind to tax system that we have, as we get recovery our revenues will rise quickly.

Senator Benidickson: This is what Ontario has done within the last budget.

Mr. Gibson: Yes, in a moderate way.

Senator Nichol: We have had a great deal of evidence, particularly from Arthur Smith, which has been reasonably negative, about the whole proposition of price and wage controls in a broad sense operating in a peacetime economy, without all the psychological paraphernalia which go with price and wage controls in war time to support the system. We have had people talking about selective controls, but I am not quite sure what it means. I assume they mean selective controls regionally and also within industries, and so on. I suppose you would have to include in this credit restrictions of various kinds, because this has been mentioned recently as a possibility in the "battle" against inflation. How do you feel about the workability of selective controls? Do you think they can survive on a selective basis or do you think they would automatically expand until we embrace all the other factors such as rationing, foreign control and everything else?

Mr. Gibson: It depends on what kind of selective controls you are talking about. If you are talking, for example, about some form of credit control, I would think that might be desirable, such as consumer credit controls, for example. If you are talking about selective price controls and selective wage controls, I suppose there might be circumstances when they were desirable. But having spent five and a half years, not only helping to put them on during the war but taking them off afterwards—I spent two years afterwards helping to take them off...

Senator Nichol: That is why I asked the question.

Mr. Gibson: We had awful trouble with some of those controls even with all the heat and patriotism of war, and to think that people would now behave in the way they did then is too ridiculous. They would not. They do not. It is now a different story altogether.

Therefore people say "Well, let us have something selective if we cannot do the whole thing." The trouble with the selective approach is that it ends up that you pick out some of the big companies and the big unions and try to control them. I am concerned that that is the way it would end up.

If you effectively controlled the big companies you would reduce the rate of investment, because you would reduce their profit margins, and also the prospective profit margins which are more important, and they would invest less. I do not think you can apply selective controls to big unions. I do not think it is practical or possible.

I know that Mr. Galbraith has geen talking this way in the United States, but to me it does not add up. I do not think it would work.

The Chairman: You have given us your views on both selective controls and all-embracing controls. Would you be prepared to make a flat statement, taking into consideration your experience with the Wartime Prices and

Trade Board, that in a peacetime economy all-embracing wage and price controls would not work?

Mr. Gibson: Yes, I would be prepared to say that. But one never knows the circumstances that one finds oneself in. Here is something that could happen, although I hope it never does. Suppose the American economy gets itself into a really very bad inflation. These are circumstances where I think we would say "By golly, we have to have foreign exchange controls and capital controls and so on." We might have to do that under certain circumstances.

The Chairman: I was referring more to the answer that is being proffered today, that wage and price controls on a continuing basis may be the answer.

Senaotr Molson: An emergency situation.

The Chairman: I was talking about long-term controls, and whether Mr. Gibson can say whether in the present general economic situation they would not work.

Mr. Gibson: Human beings are awfully flexible and somehow or other they struggle along. I guess we would still be alive and somehow or other we would get by. But the sort of thing that happens is that if you start applying controls, particularly price controls, in an economy, then the people that have the controls applied to them regard this, quite naturally and correctly, as a threat to their future profit margins. They are not as keen to invest money, and so there is not as much employment. The Government is then apt to say "These guys are not doing their duty, they are not investing money the way they should do, and so we had better do more"; and so Government moves in with some kind of Government spending program. This is the way I think it tends to work.

We have a market system here. We have tampered with it a lot, but it is still there. If we look at the record of that system since the end of the war we will find it has been a good record in terms of productivity. Look at the standard of living and the general improvement in economy. Materially it has done a good job. All I am saying is, this is a very important part of the basic machinery of our society. Do not tamper with it unless you know what you are doing and you are sure the results are likely to be almost as good.

This is what scares me about the idea of price control. I think you affect the level of private capital investment, and that is very bad. This is the most important sector in our economy today. We need more of this to give us the growth that we need in this decade.

Sneator Langlois: Do you think we could repeat today our wartime price controls performance, even under wartime conditions?

Mr. Gibson: I think that is too far out for me.

Senator Langlois: I also have my doubts on that.

Senator Nichol: Getting back to effective price and wage controls and the problem of keeping them on, can you comment on the difference in the employment picture between 1943-1944 and 1970-1971? During the former years we had a tremendous demand for people to work in every capacity, in the armed services and in supporting industries. There was real shortage of labour at the time of those price controls. Now we have exactly the opposite situation. What effect does this have on the possible application of price and wage controls?

Mr. Gibson: It is the absolute key. During the war we had desperate shortages of people and employed many who were quite unfit to work. Today we are attempting to develop a society which will absorb the work force in employment that makes more sense in their terms and those of society. The amount of growth we are experiencing makes this a difficult proposition.

We have plenty of material resources and there could be a much higher standard of living for all than in the past. However, this is not our goal; we are attempting to use the potential and the capabilities of the young people coming along. If we can do that effectively we will have a very effective society with high material standards and be in a position to do something about our environment. However, we have to use these people and one of the keys is to have enough real capital and savings to back them up with capital and equipment. Even in the service industry today, whether doctors or hospitals, the amount of capital behind people is enormous. There are no more handicraft industries, or very few. Therefore we have to produce that capital and the incentives to invest it. Savings and incentives to invest are the most important items. Price controls move away from that process.

Senator Sparrow: At page 6 of your paper you say:

> Somehow or other we have to develop policies which will encourage growth and check inflation at the same time. I don't know if this is possible in the sort of world we are living in, but we must try and try hard. The immediate and urgent task is to encourage economic recovery without adding to the inflation problem any more than can be helped.

I read your paper very carefully and wish to make sure that I interpret it correctly. As I understand it, you feel that a massive shift in public policy to one of really increasing productivity in the broader sense, including massive capital investment in productive industry, will in itself, by the increase in productivity, keep the inflation problem in check. In other words, you feel that your proposal will not by itself generate the type of inflation which we have had, or nothing worse than that, if we could achieve this productivity without a violent form of inflation.

Mr. Gibson: I hope so. My suggestion is to help real investment, which would improve productivity in the future and thereby reduce the inflationary danger lurking ahead. However, I cannot say that this will work, because I do not know what other demands will be made on the economy. We may make so many demands on the economy that we just do too much, or the Americans may have the problem of inflation. We must attempt to encourage a high level of capital investment and a good level of savings in this country to back it up.

The Chairman: Dr. Lipsey in his evidence stated, if I understood him correctly, that we should not be too much concerned by a reasonable amount of inflation, so long as we are prepared to protect those who cannot protect themselves against it, that is those on fixed incomes or who are incapable of reacting to inflation. He might be prepared to accept a creeping inflation of 2 or 3 per cent per year.

The natural question arising out of that is, does that create an inflation psychology which would develop a runaway and dangerous inflation? He suggested that long term fiscal and monetary policies could be used to prevent that type of inflation. He stated that during the last 20 or 25 years in Canada we have endured a creeping form of inflation extremely well.

Would you care to comment on Dr. Lipsey's approach?

M. Gibson: Yes, Mr. Chairman: I think we have endured a creeping inflation quite well. The Japanese have endured one extremely well and Germany is somewhere in between.

I am more concerned, from your quoting of Dr. Lipsey, than he regarding a 2 or 3 per cent annual inflation in the future. We are now living in a different kind of world. For the first time a very large part of the population believes in permanent inflation. I do not think this was true up until just a few years ago. There was some evidence that this idea was developing in the late fifties, but it died away in the early sixties. We have never in this country lived in an environment in which the majority of the people believed in permanent inflation.

We had inflation during two wars; the Americans had it during the Civil War. However, the record from the Napoleonic wars until the early fifties amongst the advanced countries is that inflation was associated with war and its aftermath. People thought that when these conditions were over we would no longer have inflation. That is not so; we think we have inflation as a permanent condition. When people think this they act differently; they protect themselves in a way they never did before. The success of many countries in the postwar period, with 2, 3 or 4 per cent inflation, is partly based on a little fraud. People did not protect themselves and were taxed in this hidden way. They are now certainly going to protect themselves. The attitude of labour unions is just one example of this, but it is seen everywhere.

If we intend to protect all the weak people, first of all let us remember that the labour unions, the businessmen and all those with a good bargaining position will protect themselves. Then government decides to protect all those who are ground down in this unpleasant business. However, all that will accomplish is the speeding up of the inflation and soon we will not be considering only 2 or 3 per cent. This scares me; I am not sure of this, but I feel it is not good enough to say we can put up with this, because the basic psychology is now different. It is not a Canadian phenomenon; it is American and European. That is why I do not think that we can establish an effective system of wage control. Why would the labour unions, who were after all organized to protect the interests of their members, agree to give up those rights in a society they believe to be permanently inflationary? I do not think they would.

We have a more basic problem in this regard than we have ever had before.

Senator Hays: Would escalation related to inflation in so far as Government bonds are concerned tend to stabilize inflation? We hear this said occasionally.

Mr. Gibson: No, I think it makes it worse. There we are, assuring people that they will not lose any money due to inflation. This means that we must secure more revenue to back it up. All these protections against inflation make it less objectionable to those protected who, therefore, feel they have no responsibility to support an anti-inflation policy.

Senator Hays: How do we protect the bondholders?

Senator Beaubien: We do not.

Senator Molson: We do not.

Mr. Gibson: We have not. We have this interesting illustration of what I have tried to say today. Money has been pretty easy lately; the short term rates have gone way down, but look at the long term rates. They went down for a time, but they have gone up again now. We are now talking about 8½ per cent to 10 per cent again. These are the highest rates we have ever heard of and we have them in a time of easy money. It shows that people are not as gullible as they were.

The Chairman: I wonder if I could ask a supplementary, and I apologize for doing this, but it has been on my mind for some time and there may be no answer to it, but it is directly on this point. Is there any danger in long-term rises in interest rates? You may have seen levels that go up and down, but if you project there is a long-term rise that we have been involved in which has taken us up, as you say, to somewhere between 8½ to 9½ or 10 per cent. Does that long-term rise eventually by itself create a slow down, or is there an inevitability about it, or is it something that is entirely relevant and that we should not concern ourselves with?

Mr. Gibson: I think it interferes seriously with the operation of our kind of society which up until now, anyhow, has been based on having available very large amounts of fixed capital at reasonable costs. Our housing system, our Government system, our utility system, are all based on this assumption, and these high rates make this though. I mean, look at what has happened in housing. The housing situation is difficult. This just happens to have been associated with building costs which were going up disproportionately rapidly too, but the increased cost of money has been a seerious problem there. My feeling is that what this does is build inflationary tendencies into your economy, because people that pay high interest rates on mortgages, governments that pay high interests rates on debt, with growing demands upon them, really become more and more dependent on inflation because otherwise it is very hard for them to pay off as they go along. You think of a young man who buys a house today with the repayment charges on it. In many

cases I say to myself, "Well, gee, you cannot afford that, not unless we have a continuing quite rapid inflation and your income goes up," because I am afraid we are building that sort of thing in. But this is a system of inflation—high interest rates—and I wish I could do something myself. I think we ought to take a closer look at what has been going on in some of the big countries in Latin America because they have been living with this kind of horror for a long time. I do not suggest that we are in the same boat, but they know their societies have been societies where inflation has always been accepted as a permanent thing, and they do not work very well, at least not in my view.

Senator Desruisseaux: But it does attract foreign capital into Canada, does it not?

Mr. Gibson: The high rates of interest?

Senator Desruisseaux: Yes.

Mr. Gibson: Well, yes. Basically, you have an interest rate structure in our kind of economy, so long as it is fairly open, which is sufficient to attract in whatever monies we need. We do not need them now, so relatively our interest rates are not quite as high as they were in relation to the United States.

Senator Nichol: I am getting back to this question of whether or not a massive and deliberate sort of green light policy or expansionist policy would get things which we want without inflation? I would like you to comment on this, if you would, sir. There has been a movement, which I have picked up from several places although I may have misinterpreted it, that somehow we should move our interest away from capital intensive industries into high labour content industries; that we should be in some way wary of what we have normally thought of as efficient methods of production and should look backwards to ways in which we could give people work instead of buying machines. I have heard this put forward seriously by a number of people. I suppose the extreme of this would be that you would end up selling all the street-cleaning equipment in the municipalities and have people out with brooms at dawn every morning, which I understand they do in some Russian cities.

Senator Beaubien: We might get back to horses too.

Senator Nichol: I think this type of thinking is nonsense, but I would like to have you confirm it.

Mr. Gibson: I entirely agree with you. I think it is a lot of malarkey. We do not live in that kind of world. We are not going to send people back to digging ditches. That is absurd. Sure, let us have handicraft industries in a modest way; they are nice to have; and maybe things with a high design quality would be good. Scandinavians do quite a lot of this, and I think it is fine. As for moving back to high labour intensive industries, no, you cannot do this. We are a capital intensive economy, not a labour intensive economy. It is only in comparison with the United States that people start talking about our being labour intensive. We are capital intensive compared with almost anybody else.

The Chairman: Which would be preferable, the development, as DREE is doing, of small manufacturing businesses that are sometimes difficult to sustain, or the development of, say, a medical centre, such as the Mayo Clinic, which is highly labour intensive and has an exportable quality because of the fact that people come from all over the world to that centre?

Mr. Gibson: What I would say is that you want to use your resources as best you can in the circumstances. We are in a capital intensive kind of society. Even hospital resources are highly capital intensive. For instance, doctors are the most highly capital intensive form of labour, let us say; they cost an incredible amount to turn out. This is one of the reasons I find this approach so hard to follow. We are spending so much on turning out people who are educated to a much greater degree, both technically and, to some extent, broadly than they ever were before that you cannot ask those people to go into some kind of a handicraft industry. They need a challenge, and in this world that challenge implies the use of a good deal of capital.

If we can find certain things to do—and I am sure we will—where it is just the entrepreneur or a man with a lot of skill who does something and can sell services for a good return, that is fine. You may call that labour intensive, but I still think that is rather capital intensive. I am a consultant. I guess I am capital intensive because I spend a very long time trying to learn about things. It is not the amount of machinery you have to have; it is the amount of effort that has gone into training people and the amount of capital needed to support them.

The Chairman: I know I agree with you, but I am just thinking of the Churchill forest industry situation, where there has been an attempt to develop what is either a primary or secondary manufacturing industry, I suppose primary. I understand the expenditure was $77,000 per job. One is constrained to wonder if the same amount of total capital could not have been better used in developing an exportable service industry.

Mr. Gibson: You see, in that area all you really have are some trees and some minerals. If you want to develop that part of the world, that is the way you have to do it. There is the secondary side of it, which is that these big primary and processing industries spend a great deal of money, buy a lot of supplies and use a lot of facilities.

I saw a job done by Hedlin Menzies, I think it was, on Manitoba and Saskatchewan, on the secondary effects of expenditures by the mining industry in those two provinces. They had a multiplier of six on this calculation. In other words, for every person employed directly in the mine or smelter they claim trere are six other jobs somewhere in Canada. Quite a lot of them are around Winnipeg, and quite a few in the industrial east. However, sooner or later there is a big multiplier. I think this applies to pulp and paper too.

Senator Thompson: I noticed you placed a lot of emphasis on federal-provincial relations in respect to fiscal policy, and you pointed out the effect two major provinces could have in the economic arena if they were

divergent to the federal Government. I was wondering whether you had examined other federal states, whether it is inherent in this to have some divergent intention within federal states, but also whether they have certain mechanisms you might see that we could apply. The first suggestion that comes to my mind would be if we could synchronize the timing of elections so that they came in the same year.

Senator Flynn: You mean federal and provincial?

Senator Thompson: Yes.

Mr. Gibson: I think your point is very well taken. However, I do not know enough abort other federal states. I do not think the American experience is too relevant. The Australian experience has some relevance to the Canadian. They have a national wage arbitration system, which might be worth taking a good look at, although I have never taken a look at it. Our country is a little odd, I think, in the sense that it has two provinces who each count for about a third of the whole works. This means you are not dealing with one federal government and a lot of little provinces; it is just not that way. It has now got to the point, I think, where if you do not get some reasonable degree of co-operation between federal Government and Ontario and Quebec it will be hard to work out sensible and effective fiscal policies.

Senator Benidickson: You mean some unified fiscal policy?

Mr. Gibson: It does not have to be unified. It would help if they were aware of what the other fellow is thinking, if there were some communication. There is very little communication in this area. They have meetings at the deputy minister level, but even there—and I have seen a little of it—the communication is not high. There are all sorts of funny things here. For instance, I understand the federal people feel that there is a danger of breaching budget secrecy in discussing these things with the provinces. Maybe there is and maybe there is not; I do not know; but these are very major issues, and I do not think that is a good enough reason for not having serious discussions.

Senator Benidickson: Even on the white paper there was a suggestion that there should be collaboration.

Mr. Gibson: That was the context of my comment.

Senator Molson: It might even be a question of politics from time to time.

Mr. Gibson: Could be.

Senator Beaubien: Perhaps a little bit would creep in.

Senator Molson: I do not think I know quite how to ask this question, so perhaps you will bear with me a little. What is bothering me is the very great importance and hopes we pin on an increase in productivity to help our economy, our social existence and so on. It seems rather self-evident that for greater productivity we need greater capital investment, as has been pointed out several times, and in some cases this requires enormous sums per job. The more we suceed in that, it seems to me, the greater difficulty we will have in placing our excess manpower.

I wonder if Mr. Gibson would fumble around with that a little bit for us, and try to put this question more in perspective. To me it is a bothersome idea. That is why my question is so poorly worded.

The Chairman: If I understand you correctly, what you are saying is that as society becomes more productive, it becomes increasingly difficult for society to find jobs for the people who need them.

Senator Molson: The more you are successful in one aspect, it seems to create more difficulty in the other. That is what I am trying to say.

Mr. Gibson: You have used the word "fumble". I think that is a good word.

Senator Molson: I think I was doing the fumbling, Mr. Gibson.

Mr. Gibson: I see your dilemma. It is perfectly obvious the high productivity and resource of the manufacturing industry is only going to take up a moderate number of all of these people that are becoming available.

The reason I attach a great deal of importance to these industries is that they are the key industries in the economy. They produce the kind of material things we need both for our own welfare and for trade with other countries. It is terribly important that we be efficient in these industries if we are going to keep our costs down. To be efficient we have to be internationally competitive. This means we have to have high capital investment. If these industries are efficient it will tend to make the mass of distributive and service industries more efficient.

The service industries and distributive industries are becoming more efficient. They have been rather slow, but there are increasing applications of new technology in this area and more people will be absorbed here. It is not just service and distribution in the normal sense. Think of all of the people getting into the health area, for example. These people are not productive in the sense of turning out immediate goods, but they are productive in maintaining the health of the people in the society. That is most important from a production point of view.

I think more and more people will go into these secondary areas. Some will be concerned with conservation, a lot will be concerned with government and cities.

If you do not have this efficient industrial corps in your society, I am afraid you get led into all kinds of protective policies because you will not be able to face competition from abroad. This will weaken your whole economy. It seems to me if we can keep the central part of the thing on the right track and keep it efficient, then we have a good chance of having the rest come along reasonably well.

I agree with you that there are some awful problems here and I would not want to have to look too far ahead. I am not sure it would be productive.

Senator Molson: I am just thinking of what you said about the health services. As a supplementary remark I

would say that the more healthy we keep people, the less jobs we have available for others. The same is true of our great success in the field of mortality. We have kept people alive so much longer that we have less jobs to offer the boys coming up.

The Chairman: I have a supplementary on that: If our economy becomes more productive, there will be certain segments that are highly productive, and others for which the demand may be very great but which are not as productive, and the tendency will be that those working and investing in the highly productive industries will demand a greater reflection of this increase in productivity. Therefore, they will, and quite rightly, achieve a higher wage and price level. Those working in the less productive industries that are subject to great demand will say, by reference, we are entitled to the same return for our labour. Does that then mean that in such an economy there is no way of escaping inflation?

Mr. Gibson: I think you have put that very well. This is a fearful dilemma. People will fight for getting as much of the productivity of the efficient industries as they can.

This has been one of our major inflation problems—not just in Canada, but in Western society. They get it and the other people have to get it, too. A lot of the service industries cannot possibly afford it in terms of production.

Sure, this is one of the really big problems, and it is not right because a lot of the extra productivity comes from the application of additional capital and not the application of additional labour. A lot of it is due to better organization.

The Economic Council has done a lot of interesting work along these lines. I would hope that we could, perhaps, narrow the argument down a bit by saying, all right, the improved productivity that comes from labour is only so much, maybe this kind of device could be used to say, that is a fair deal, in this highly efficient industry, because a lot of that productivity probably did not come from that.

This is very difficult and I know that any good labour man would just sneer at you for saying a thing like that. But, as you say, you cannot go on having the most productive industry set the pace for wages for the whole society, and this is the way it tends to work now.

Senator Desruisseaux: I have two questions that relate to the future of Canada. For many years in the past we had the pegged dollar, up to about a year ago, when it was decided that it was too costly for Canada. Then the change was made to the floating dollar. With the very recent trends of some countries to go off the pegged situation, and back to the floating situation, what would be the repercussions for Canada in the immediate future, in your view?

Mr. Gibson: What would be the consequences?

Senator Desruisseaux: Yes, for us, in Canada?

Mr. Gibson: I suppose if the franc and the mark and the guilder go up relative to the Canadian dollar, that proves our healthy position in Europe a bit, but I do not think it is important. What is important is the relationship of the Canadian dollar to the United States dollar, and, to some extent, to sterling, and I do not think that is changing.

Senator Desruisseaux: Would it be forced to change eventually, if the situation continues?

Mr. Gibson: You mean, if the mark is floating?

Senator Desruisseaux: Yes.

Mr. Gibson: I do not think we are going to have floating exchange rates yet, although it may come to this. The trouble with the floating exchange rate is that, taking it from a Canadian point of view, it is fine if the exchange rate is at the level that we find helpful from a growth point of view. But if it at the sort of level it is at right now, we do not like floating exchange rates state. This is the problem, yet we were pushed off the fixed exchange rate because we could not hold the 92½-cent level without permitting simply enormous inflation. We were not prepared to go that far.

Senator Desruisseaux: Thank you very much. I have another question, which relates to something that has been happening recently. The White Paper on Tax Reform has been criticized quite generally, because of its social philosophy. I have some views on it, and I wondered very often what were the views of the economic people, and what bearing it had on corporations and individuals, and generally on our economy in Canada.

Mr. Gibson: Senator, that is an enormous question.

Senator Desruisseaux: I know.

Mr. Gibson: It may be I could best answer it by saying that I thought a lot of the comments in the Senate report on the White Paper were extremely sensible. I do not know if you were on that committee or not, sir.

The Chairman: Yes, he was.

Senator Langlois: He was just looking for that.

Senator Desruisseaux: Not exactly. I am concerned about the future of Canada. That is my main concern. I am trying to find out the views of all the important people.

Mr. Gibson: Since you made your report, we have realized that we are in a moderate business recession, let us say. In my view, this environment makes the White Paper proposals even less appropriate. As to a complete revolutionary change in the tax system, at a time of recession, involving quite a lot of increases in rates, a completely different way of taxing corporations and individuals—even if I agreed with it, I could not think of a more inappropriate time to bring it into effect. A series of proposals which, in effect, would reduce the level of saving in this country even more, just does not seem to me to add up, at this time.

Senator Desruisseaux: Thank you.

Senator Carter: Mr. Chairman, I had a supplementary question based on Senator Nicol's question about productivity as a partial answer to inflation, and then Senator Molson asked the question I had in mind, and he got a partial answer. I would like to follow it up a little bit. We have been trading off in the past. We have got to the point where we think in terms of trading off employment against inflation. The first part of my question is: How long can we keep on doing that? The second part is: Are we coming to the point where we will be trading off productivity against unemployment?

Mr. Gibson: Senator, I did try to intimate in those brief notes I sent around, that I think the trade-off is getting somewhat silly now. In effect, we have got an underlying increase, in the price level, of around 3 per cent per annum now.

It is true that our cost of living index does not show such a big increase, but this is due to the accident of the supply of grain and the lower meat prices. This has now, fortunately, been corrected. The rest of the price level has been going up at about 3 per cent per annum. We have a rate of unemployment of about 6 per cent. We are really trading 3 per cent inflation for 6 per cent unemployment. How much inflation do you need to get that down to 4 per cent? I do not think this really makes much sense any more. Ultimately, I suppose that if you traded enough, you would get people to buy things, in order to get rid of their money, and this would bring about some immediate temporary balance; but you are not going to get a balance based on a reasonable level of capital investment and good productivity.

I now come to the second part of your question. I think you would trade off productivity very quickly, if you go very far down this line, against inflation.

Senator McGrand: I have a short question, in two parts, on wage drifts. We have been told several times that one objection to wage control is that certain employers would, by the use of a bonus or of overtime, break the wage ceiling in order to keep certain employees in their employ. I can understand that this would happen in times of full employment, but it is difficult for me to believe that this would be a serious objection to wage control at the present time.

I want to follow up with the second part of the question and you can answer both at the one time. Would you comment on inflation in Canada and the loss of export markets due to inflation, if we get more inflation? In the United States, Britain, France, Germany and Italy, the gap between wage increases and productivity is widening. Would this offset the danger of inflation in Canada—that is, if the gap between wages and productivity continues to expand in other countries as well as in Canada?

Mr. Gibson: Answering the second part of your question first, yes, I think that if other people are inflating as much or more than we are this helps our competitive position. There is no doubt about that. Our high exchange rate is really our most serious problem here.

As to the first part of your question, it depends on the level you are talking about. I must say I think at the higher levels people would be very loathe to lose good men. If they thought their competitors were finding ways to pay them more, they would be quite concerned.

Senator McGrand: It would not occur more often than one in every 1,000 employees, would it? Perhaps even less.

Mr. Gibson: I think the competition for able people is still pretty keen.

The Chairman: On the question of the exchange rate, Dr. Lipsey stated that it is only through a reasonably correct level for the exchange rate and possibly a floating exchange rate that we can achieve any independence of the pricing policies of the United States. You are suggesting that because of our export position we should lower the value of the Canadian dollar on the world market. In your judgment would this seriously affect our independence?

Mr. Gibson: No. Mr. Chairman, I should like to see the dollar lowered, but I am afraid I came to the conclusion that it was going to be difficult to do and perhaps not practicable. If we could get it down to 97 or 98 cents, which I am doubtful about, I don't think that would have any effect on our independence.

The Chairman: That is on the independence of our pricing policy or our economic policy.

Mr. Gibson: Yes, but it seems to me that, if we are going to have efficient secondary industries in this country, we must gain much more access to the American market for manufacturing, because that market is right beside us and it is a huge market. In order to do that we want an exchange rate that does not make it doubly difficult, as the present one does. I think there is a lot to be said for a fixed exchange rate if you can have it from that point of view, because people can make calculations on the basis of a fixed exchange rate, particularly when they are investing a lot of money in a new plant to get into the American market. You cannot hedge against that in the foreign exchange market. You are just betting that there will be enough margin and if the exchange rate changes maybe you have not got that margin any more.

I do not think I have answered your question. I have just said it is difficult.

The Chairman: I think you have answered it, thank you.

Dr. Gillies: Mr. Gibson, I was interested in your views that monetary policy takes a long time and it should really be directed towards the long-range goals of the economy. Given that situation, what is your view about removing the discretionary powers from the bank and fixing the money supply to constant changes in the growth of the gross national product?

Mr. Gibson: Well, Dr. Gillies, perhaps I did not express myself clearly enough on this. I said I thought monetary policy ought to be pointed at what we regard as the underlying trend in the economic climate. In other words, if it looked as though the trend was going to tend to be a

bit inflationary for the next four or five years, then veer a little toward the restraining side; if it looked as though it needed some help, then veer a bit to the expansive side. But I did say I have grave doubts as to whether you could really apply a policy like that to Canada because it is such an open kind of society.

I think there is quite a bit in the Freidman approach which you mentioned, in that we like to have these changes more even and less erratic and more weighted to the real changes we hope to have occur. This is not a new idea. It is a very old idea, I think. In Canada this is just not applicable. We have too open an economy and we are pushed around too much. We just could not apply a Freidman-like policy in my opinion.

Dr. Gillies: If you floated your exchange rate, though, Mr. Gibson, and took your foreign adjustments in exchange rate, could you not isolate some of those forces from outside the country?

Mr. Gibson: You could in theory, but in practice we have a floating exchange rate now and we are not happy with it at all. We do not like the exchange rate. We want to get that down. In other words, that is forcing us to increase the money supply more than we otherwise would, because we think the exchange rate is too high. All I am saying is that the happy theory that was worked out in this country, that all we need to have an independent appropriate monetary policy is a floating exchange rate, is just not so at all because the exchange ra'e at times becomes a more important objective than the current monetary policy. Sometimes you feel that the exchange rate is just inappropriate and you have to do something about it, and this guides your monetary policy rather than what you think is appropriate for the domestic economy.

The Chairman: I am not sure how you distinguish between your approach to monetary policy and the monetarist approach.

Mr. Gibson: What do you mean? A sort of Freidman approach?

The Chairman: Yes.

Mr. Gibson: I think you should have as a guide in monetary policy what you think is practicable in terms of expansion in real production and real resources. This is one of the important things. Therefore I agree that there should not be big changes if you can avoid them, but to say that in Canada just does not make any sense at all, because we live in the world, we have an open economy and our central bank has to do things it would not think of doing if there was no world around us. We have to keep adjusting ourselves to this world, and what they are trying to do is to try to lessen objectionable impacts from the outside world on the Canadian economy.

As I say, they have to roll with the punches. This gets them a long way from the sort of monetarist approach you are referring to.

Senator Nichol: Near the beginning of your remarks, Mr. Gibson, you mentioned that the Canadian banking system had become much more regionalized in terms of the authority of the regions and so on. During the course of these hearings the question has risen several times whether there really is such a thing as a viable national monetary policy. I will not bother to repeat the arguments here.

When I was in the lumber business 15 years ago we had a fairly good-sized company which required logging trucks that cost about $65,000. There was a limit that the local banking people in Vancouver could not pass, and we would send people to Toronto on the old North Stars to discuss the possibility of getting, say, a $100,000 loan. This meant, frankly, that in some cases we had to talk to a person who did not know a logging truck from a fishing boat. I admit that that situation has changed now. But, in terms of the regional monetary policies or lending policies around the country, would you compare our banking system with the banking system in the United States where they have regional federal reserve banks and individual small banks, operated by local businessmen in many instances, closely attuned to the economy of the area? Could you compare those, and how do you think we do with our system in a country as diverse as Canada?

Mr. Gibson: Well, I guess I am a bit bit biased, senator, because I think our system is better than the American one. I think it is greatly improved, and our decentralization has resulted in a tremendous improvement over what we had before. It is now a stronger system and I think it can do more at the regional level. You hear about the American system being extremely decentralized with local businessmen doing the job in the locality, and, of course, this is true. But they cannot do the big jobs because they do not have the resources and they are also much more likely to get into trouble because of lack of diversity of resources. In effect, for the big jobs they bring in the big banks, the Chicago bank and the New York bank, to make the big loans. Now we have a national system which has been greatly decentralized, and this is the most important thing that is happening in banking in Canada today or in fact that has happened in the last 50 years. There is competition between the regions and there is competition in job performance right from the top man in a region who is comparing himself with people in other regions. Then we have our manager system whereby a manager is judged by the amount of business he gets, and he adapts himself to the community he is in and does the best he can in that community. Sometimes he is not regarded as knowing much about the community, and, indeed, sometimes this is the case particularly if he has not been there very long. But in any event he understands the system, and he understands his job. If he is a good manager—and I should point out that there is only a limited number of good managers but you will find them in the big branches—he understands that it is his job to get business and if you want business you must go after it and you have to take some risks. I think there is a pretty marked improvement in this regard in the Canadian system. When you invest a great deal of money in a branch, as banks do across this country, then that branch has to produce and the way to

produce the most returns is by loans. And this is what your big branches do best.

So I think it is a pretty fair system, and I think the decentralization has improved it a lot. I was getting into the banking part of the business when people from Alberta and particularly B.C. used to raise the devil about the way things were done from Toronto and Montreal. But now I think it has improved a lot.

Senator Isnor: Under our system we do not have the failures that they have had in the States.

Senator Nichol: But the banking failure rate in the States has been pretty good since the 1930s.

Mr. Gibson: I think you also have a more even availability of money in this country than you have in the United States, because the availability of money in a particular area is not dependent on the strength of that area; it is dependent on the bank. So that in a sense you can say that in Canada the big cities, or the centres, to some extent support the outlying regions, because the rates and the availability are not much different as between the big cities. In the American system the lowest rates are in Chicago and New York while in Canada they are much more uniform across the country. I don't know whether you think that is a good thing or not, but I think there is a tendency in that direction and I think it has some merit.

Senator Nichol: In the United States I suppose the biggest bank is the Bank of America. Then in California you have the Bank of California and the Bank of America. Have they been the major supporters of the big industrial expansion in the State of California, or do you think this is a mathematical question to which you may not have the answer? Or has it been the Chicago and New York banks or has it been the regional banks that have contributed to this expansion?

Mr. Gibson: I am not too well informed on that. I would think that the big California banks have had quite a large part to play in this, but I think you ought to ask Dr. Gillies because he has a real background in that.

Senator Desruisseaux: I was wondering about the international role of the banks, and whether that is not highly important to Canada now, and whether it could be accomplished by a strong system of banks such as we have rather than the other systems? In the United States the work seems to be done mostly by three or four banks. Would that be a correct assessment?

Mr. Gibson: Yes. I am not quite sure what your conclusion is, but I think I agree with what you are saying.

Senator Desruisseaux: I am asking for an expression of your views on the role that banks have to play internationally and whether regionalized small banks can play a part as well?

Mr. Gibson: No; it is much more difficult.

Senator Nichol: I am interested in this question of a regional monetary policy, which boils down to the policy of the regional banks towards industry. Regarding this change that has taken place, and I agree with it, do you think the driving force towards that change has been competition between the major chartered banks, or do you think, as I suspect may be the case, that it was the result of the injection of, first, the Mercantile Bank and, second, the threatened injection of the Bank of Western Canada and the Bank of British Columbia, into the system? I suspect that might have been the case. Suddenly businessmen could go to somebody who was on the ground and get some answers.

Mr. Gibson: I think that is a sensible comment. It all rolls up into the one thing. Banks have to think of their competitive position. They are competing among themselves. They have to pay attention to the views of people in the areas where they operate. These views are expressed quite clearly at times, as you no doubt remember. They have to pay attention to potential competition from outside or new competition that may emerge from inside. All these things affect their attitude. They want to adjust themselves to it in order to beat the competition.

Senator Grosart: Try harder!

Mr. Gibson: A lot of people do not realize how much potential competition there is between American and Canadian banks. A lot of American banks are not represented here, but they still have business representatives that wander around and are close to some of our larger companies. Canadian banks cannot help but be aware of this. Money is not easy these days—at least, it has not been up until recently. This competition has not been that much of a problem to Canadian banks, but at times they have been very much aware of it.

Senator Isnor: That includes also trust companies.

Mr. Gibson: Thinking in reasonable terms, yes, trust companies were part of this picture. They are an important source of mortgage funds. I think they have tended to decentralize a little bit too.

Senator Molson: That was my point, that there are all these other near-banks, that are doing banking business, that have quite an effect on the competitive picture.

Senator Grosart: It seems to me that a current Canadian problem in the very broad field of management of the economy seems to be the comparatively high level of conflict and confrontation between business, industry, the banks and Government. Judging from what is happening in other countries such as Sweden, Switzerland, West Germany and Japan, it seems that we have an unhealthy degree of conflict. At one time there was a general impression that the banks and business tried very hard to get into bed with the Government, or vice versa; I do not know which. Today there is continual evidence to the contrary in the financial pages. There is name-calling between Government and business.

Is there a reason why at this particular time this should be, in comparative terms, such a unique Canadian phenomenon?

Mr. Gibson: That is a very broad question, Senator Grosart. I agree with you that there appears to be more conflict in this area than existed in the past.

Senator Grosart: Is it merely because Government is moving more into economic management?

Mr. Gibson: I think so; much more is expected of Government now than ten years ago. Therefore Government is more sensitive to criticism of lack of performance in the economy and more apt to intervene or express opinions, which are sometimes not altogether fair. However, these are the pressures that work in our society.

Senator Benidickson: Do we hear more of this because of the establishment of such bodies as the Department of Consumer and Corporate Affairs?

Senator Grosart: But other countries seem to have a much higher level of co-operation in the management of the economy? How do they achieve it?

Mr. Gibson: With respect to Japan, they have an enormous degree of co-operation; even Germany has some. The United States has some in some respects, in other respects none.

When it comes to research applied to the American economy, they have a lot of co-operation between industry and government. However, in other areas they do not seem to have much. They have a fair and developing amount of co-operation in terms of the problems centred in the larger cities between business and Government. I agree that there is quite a little conflict here, which is not very reassuring.

Senator Grosart: I have heard an amazing number of criticisms lately from economists and economic researchers regarding secrecy at the federal Government level. At a meeting recently three economists complained that they could not get economic information from Government departments. Have you found this to be an unusual situation in Canada?

The Chairman: I think, senator, we should give the witness a fair amount of leeway in answering that question.

Senator Grosart: I did not suggest that he should not have lots of leeway.

Mr. Gibson: I am well aware that such comments are made. I have very little direct personal experience with it and anything I might say to you would be more hearsay than a professional answer.

Senator Grosart: I think what you are saying is that you have not had the problem.

Mr. Gibson: If you want a comment on it, I do not think the federal Government has been nearly forthcoming enough on the subject of tax reform and discussion, particularly with the provinces. That is an area with which I am familiar.

The Chairman: Honourable senators, if there are no further questions, I would like to comment on the evidence we have heard. Mr. Gibson has proved that in combining uniquely the qualities of the academician and the businessman he is able to talk persuasively in both the realm of theory and pragmatic business. This has been refreshing, Mr. Gibson, and extremely useful to the committee. On behalf of the committee I think you very much.

Honourable senators, we meet again at 10.00 a.m. on Wednesday to hear Dr. Okita, the President of the Japanese Economic Research Council.

The committee adjourned.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 9

WEDNESDAY, MAY 19, 1971

Sixth Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses:—See Minutes of Proceedings)

23843—1

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
	O'Leary
Gélinas	Paterson
Grosart	Phillips
Hays	Sparrow
Isnor	Walker—27.

(Quorum 7)

**Ex officio Member*

Orders of Reference

Extract from the Minutes of the Proceedings of the Senate, Tuesday, March 9th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said *Estimates* reaching the Senate.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract form the Minutes of the Proceedings of the Senate, Tuesday, May 4, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relation thereto.

The question being put on the motion it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Minutes of Proceedings

Wednesday, May 19, 1971.
(9)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10.00 a.m. to consider the question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Grosart, Isnor, Manning, McLean, Methot, Molson and Nichol. (8)

Also present but not of the Committee: The Honourable Senators Inman, Kinnear, McNamara and McGrand. (4)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. W. Neville, Editorial writer; and Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Witness heard: Dr. Saburo Okita, President, Japanese Economic Research Centre.

At 12.30 p.m. the Committee adjourned to 4.00 p.m.

At 4.00 p.m. the Committee resumed.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Croll, Desruisseaux, Hays, Langlois, Manning, Martin, McLean, Molson and Nichol. (11)

Also present but not of the Committee: The Honourable Senators Carter, Haig, Lamontagne, McGrand, McNamara, Petten and Rattenbury. (7)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Witness heard: Dr. Anthony Scott, Professor, Department of Economics, University of British Columbia.

Also present but not heard as a witness: Dr. Ronald A. Shearer, Professor of Economics, University of British Columbia.

At 6.00 p.m. the Committee adjourned to Thursday, May 20, 1971.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance
Evidence

Ottawa, Wednesday, May 19, 1971.

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 10.00 a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, in continuing our hearings on growth, employment and price stability we are very honoured today to have as a witness Dr. Saburo Okita. Dr. Okita received his doctorate in economics from Nagoya University. He has been chief of the research section of the Economic Stabilization Board of Japan. He was a member of the United Nations Economics Commission for Asia and the Far East; Chief of the Economics Co-operation Unit, Economic Planning Agency; Director of the Planning Bureau; and Director of the Development Bureau. He is presently the President of the Japanese Economic Research Centre and Special Adviser to the Minister of Economic Planning.

Dr. Okita's publications include *The Future of Japan's Economy; Japan's Post-War Economic Policy; Economic Planning; Conditions for a Developed Nation; Japanese Economy in the Asian Setting;* and *Future Vision for Japanese Economy.*

It is apparent from Dr. Okita's experience and writings that he is uniquely qualified to tell us some of the reasons for the Japanese economy being so vibrant and progressive. Perhaps we can learn from lessons learned in Japan and apply them to the operation of the Canadian economy. As is our custom, I will ask Dr. Okita to make a brief opening statement.

Dr. Saburo Okita, President, Japanese Economic Research Centre: Mr. Chairman and honourable senators, it is a privilege and a great honour for me to appear as a witness before your committee. As stated by the Chairman in his introduction, I have been involved in various aspects of postwar Japanese economic recovery and growth. In recent years I have been increasingly involved in various problems in the international economic field, in particular the programs in underdeveloped areas. Two years ago I was a member of the Pearson Commission and worked very closely with Mr. Pearson in producing the commission's report.

I was asked today to speak of our experience in growth, employment and price stability. The case in my country is somewhat unique or peculiar, in the sense that we have been able to maintain a rather high rate of economic growth for the past 15 to 20 years. You will see from Table I of the summary that the value of the gross national product has increased from U.S. $25 billion in 1955 to a level somewhat over U.S. $203 billion today. In these 15 years we have experienced a very sharp increase in our economic output.

Table 2 indicates the rate of growth, indicating about 10 to 11 per cent annual increase in total output in real terms. This very high rate of economic expansion has enabled us to quickly absorb surplus labour. Until about 10 years ago we had a problem of serious underemployment with chronic overpopulation in the country, especially in rural areas. However, thanks to the very rapid economic expansion, especially in industry and to a certain degree the services, labour has been absorbed into the growing sectors.

Table 4, headed "Employment", shows our total labour force as being approximately 50 million, with about one per cent of the total labour force unemployed. This is due partly to special structural differences in our labour force as compared with those of Western societies. We have somewhat close public relations. There are people to look after and provide work for the unemployed, although sometimes their income is not sufficient. For this reason the number of totally unemployed appearing in labour force statistics is lower than actual. However, even with this consideration, we have enjoyed in the past 10 years nearly full employment conditions. We have a very sharp outflow of labour from agriculture to industry. Some 15 years ago 40 per cent of our population was in agriculture, but last year that was reduced to 17 per cent.

We have also a somewhat peculiar or unique historical background, in the sense that we started as one of the latecomers in the industrialized world. The major national aspiration of our government leaders has been to catch up with more advanced countries. Moreover, the country has a narrow land area, often described as being equal to that of the State of California, supporting a population of about 100 million, which is approximately half that of the United States, and about five times that of Canada. Naturally, therefore, government and business have become used in our economy to the constant endeavour to expand in trade. "Export or perish" is more or less the national consensus. Our government and business leaders are dominated by that thought and the policy of matching resources. In order to expand our economic output and raise our living standard we must import materials to produce manufactured goods.

Partly because we were a latecomer to the industrial world, the government has taken rather strong leadership in modernizing the economy, establishing new industry, and promoting trade. At the earliest stage we did not have much private entrepreneurship to speak of. Many industries were initiated by the government, and at a later stage were gradually handed over to private man-

agement. This has been one of the important factors that characterizes government-business relations in our country, where there is a rather close relationship. Even now, when industries have developed to a very high degree, the government sometimes exercises a sort of leadership. Relatively close relationships between government, industry and business have been maintained.

Another question to be examined is the price movement. Almost every country in the world is having difficulty containing the inflationary trend of their economies. Japan has experienced a rapid and sharp rise in price levels. Again, however, there has been a somewhat unique movement in prices, some of which are indicated on page 3 of the summary. Table 3 there deals with prices, from which it will be seen that while the wholesale price index has been relatively stable, taking 1965 as 100, last year the wholesale price index was 111.3 per cent; since the summer of last year there has been a drop in the wholesale price index, partly because of the somewhat recessionary conditions of our economy, with some slowing down of the expansion rate. It has not been a very serious recession, but there has been some slowing down. As a result, we have seen a decline in wholesale prices.

It will also be seen that there has been a very sharp increase in the consumer price index. Although it is not given in the table, the latest monthly figure for the consumer price index was about 7 per cent above the figure for a year ago. We have had 5, 6, or 7 per cent annual rises in the consumer price index for the past several years. It was relatively stable until 1960; there was not much price increase up till then. However, after 1960 we entered a period in which there was a rather sharp rise in consumer prices.

This difference in the trend of price movement of the wholesale price index on the one hand and the consumer price index on the other is somewhat unique. In many industrialized countries those two indices move more or less in parallel, but in our case there is a divergence between those two price indicators. Many economists have attempted to explain this phenomenon. The prime reason may be that the wholesale price reflects mainly the price ex-factory, and an improvement in productivity among manufacturing industries is usually reflected in the wholesale price index.

In the case of the consumer price index, however, what is reflected is more or less the cost of labour. A factory produced product will go through many stages—the wholesale trade, retail trade, processing and distribution, in which it is not easy to achieve a rise in labour productivity. In manufacturing industries, especially modern industries, productivity has been rising sharply, but in the distribution and small manufacturing industries productivity has not risen very much. This is partly why there has gradually developed a stable wholesale price index but a relatively sharp rise in the consumer price index.

The Chairman: If I might interrupt you there, Dr. Okita, Table 3 indicates that the consumer price index has risen from 68.6 per cent in 1955 to 135.9 per cent in February, 1971, and possibly higher with the 7 per cent increase over last year that you have mentioned. Is it your judgment that Japan can live with that? In other words, can they accept that sort of inflation of 5, 6 or 7 per cent per year and compensate those who are hurt by it? Can they live with that over a continuing period of time?

Dr. Okita: This is a very controversial issue, both politically and economically. It may be somewhat difficult to live with a continuing rise of 6 or 7 per cent. The government has been trying to reduce the rate of inflation of the consumer price index to, say, round 4 per cent or so. However, so far the government has not been successful. There are divergent effects. The rising consumer price index is reflected in the rising wages; the wage increases will be reflected in the wholesale price index, because there will be an effect on production costs. So far the productive industries are rising more or less in parallel with the rising wages. The cost of production has not been very much affected, and because of this there are exports from Japan. Prices have been relatively stable.

On Table 3 you will see the export price index which has somewhat strengthened the competitive production of Japanese commodities in the world market. So far I should say we have been able to live with that much of a price increase.

The Chairman: Are there any groups in Japan that are being hurt? If we take 1965 as the base year in which you have 100.0, you have had a 35 or 36 per cent price increase since then. Are there any groups in Japan that you can say have been hurt by that inflation?

Dr. Okita: Yes, I should say the old age pension people and some people who are on a fixed income are hurt, but so far they are relatively in the minority. A very large portion of the population are factory workers and farmers. Although they are affected, because their savings are devalued year after year, their current income is increasing somewhat faster than the rise in prices. In this respect, although there are people affected by inflation, especially in respect of their savings, I should say that generally their current revenue and income is increasing faster than the price rise.

Now, to come to some of the monetary and fiscal aspects of the topic. There have been controversies as to what type of policies should be pursued in order to bring down the rate of increase of cyclical prices. There are the advocates for reducing the increasing rate of demand by monetary measures, and by fiscal measures. In fact, in the past we have had repeatedly to tighten money policy by raising the industrial bank rate, and sometimes by trying to compress the Government expenditures. Sometimes the monetary and fiscal measures were combined together. Our anti-cyclical policy so far has been more or less related to a cyclical balance of payments deficiency. Every time we saw a balance of payments deficit the Central Bank raised its discount rate and the Government introduced a somewhat tight expense policy. After some time we saw an improvement in the balance of payments, and then such controls were relaxed and the economy started booming again. Two or three years back we entered into a state where we did not have a financial

payments program. We would rather have a reserve program of accumulating for next year.

Last year we introduced again a tight money policy. When the balance of payments position was not in danger and was in good condition, this was more or less the fastest way of introducing anti-cyclical measures. So far our anti-cyclical policies have not been affected. This may be because of our international structure. When the Industrial Bank raises the discount rate, they usually do so in parallel with the change in the bank rate and the control over the volume of supply of money. We have a special expression in regard to this measure, and the literal translation is, "Operation through bank windows." Here the implication is to regulate the supply of credit of leading city banks with the guidance from the Central Bank. This was effective in regulating the supply of credit to industry.

The major factor which reduced the cyclical change fluctuations has been the level of investment in private industries, and liberal investment in building new factories and in new equipment. The total amount has been about 20 per cent of our gross national product. If this investment in private industry fluctuates it creates cyclical changes, which call for anti-cyclical measures, concentrated on the regulation of credit supply to those industries.

Another feature of our economy is that many of the industries are very heavily dependent on loans from banks. The proportion of home capital of Japanese enterprise is below 20 per cent. That means they are very heavily dependent on borrowing from banks. The regulation exercised by the central bank will affect the volume of credit supplied to industry. This will affect development investment. This is a somewhat unique system, but we feel that sometimes changes in the interest rate that do not bring about a sufficient regulation of the level of economic activity. Their economy is very much in an expansion area, and we need some total flow of credit supplies to industry. This may also be one of the unique aspects of our monetary fiscal policy.

The Chairman: I wonder if I could interject for a moment, doctor? In Canada a corporation would be loath to put itself in a position where 80 per cent of its requirements were financed by the bank, because essentially that would be short term credit. Is there anything specific that the Japanese banks have done to create a situation in which Japanese corporations would put themselves so much in the hands of the banks? I think corporations here would tend to do a lot of their financing on an equity basis or a long term debt basis. They would only be prepared to put themselves in the hands of the banks to the extent of only 20 or 30 per cent. It would be interesting to know if the Japanese have taken definitive steps to create that confidence in that sort of bank financing.

Senator Isnor: Is there not another point, Mr. Chairman, that the banks here would not advance the 80 per cent?

The Chairman: I think that is probably true.

Dr. Okita: Yes, Mr. Chairman. Foreign observers sometimes look at the balance sheets of our industries and companies, and say "very unsound", because they are so heavily dependent on external borrowings. Partly because this was backed by a kind of confidence about the future, industries have been borrowing from external sources and, in fact, the resulting expansion is about 10 to 15 per cent per year. The internal source is usually not sufficient to meet the need for expanding treatment and output of the companies. So there is a transfer of private savings through bank deposits and through bank loans to industries.

Our capital market, raising industrial capital directly from the personal savings, is still relatively underdeveloped and a very large part of personal savings is flowing into the banks in the form of bank deposits. The banks in turn supply medium term, short term, and long term capital to industries. So if there is a very serious fluctuation in the business cycle, because they are so heavily dependent upon borrowing and the financial position is inflexible, it may create a rather serious problem for industries, but fortunately so far we have not faced very much of that problem.

In 1965 we had a year of recession. Quite a few companies went into bankruptcy. One of the security companies also went into bankruptcy. The central bank came to the rescue, in order to avoid the spread of the crisis to the entire economy. This was again a somewhat unique case, that the central bank went to the rescue of one private security company. The central bank also set up a security fund to buy up some of the surplus stocks to support the security price. That means the central bank took some part of the risks, in the form of the setting up of the security fund. After three or four years the economy has regained its energy and those stock prices have risen very much, so this security fund produced a very large profit.

The other idea is that the relatively close relationship between the central bank and the industries may be one of the factors for giving confidence in industries. They feel they can depend heavily on external borrowings.

Senator Grosart: To what extent does the central bank, or the Government through an agency, guarantee these industrial loans in advance? Supplementary to that, may I ask to what extent does the central bank, or the Government, in effect approve or encourage the lending of private banks? We often hear that this is the secret of Japanese financing of industrial expansion.

Dr. Okita: There is not a procedure of official approval. The central bank does regulate the total flow of credit. These regulation measures are not so explicit, but there is some kind of consensus or agreement between the central bank, industries and commercial banks, regulating the total supply of credit in accordance with the cyclical changes.

Senator Grosart: Could I put it this way? Would it be normal for a private bank, being approached for a loan, to refer the matter to the central bank and perhaps, in certain circumstances, for the central bank to refer the question of the viability of the loan to the Government?

Dr. Okita: There are some such cases, if the cases involve very big loans. As I mentioned earlier, partly because of historical background, sometimes the Government exercises leadership in some of the issues. In this process we sometimes come across such cases as you have mentioned.

Senator Grosart: I asked the question because one of the things we want to find out about the Japanese miracle is how the Government provides this leadership? In every country in the world there is pressure for government leadership, and in this the Japanese pattern seems to be the one that has worked best.

Dr. Okita: In fact, we have been criticized very much sometimes because of government leadership, especially in the field of export trade. In most of the industrialized western countries, the private sector remains private, and governments usually do not intervene very much. That is because of the historical background of western society. Private enterprise developed on a private basis and government was accustomed to take charge of only minimum responsibility in foreign affairs, apart from diplomacy and defence.

As I mentioned earlier, we started as one of the latecomers. Our policy, I sometimes feel, may be related to that of some of the newly developed countries where the government has to take the leadership in modernizing and developing the economy. Now we are facing a kind of dilemma in such a policy. In promoting economic growth and increasing export trade, the result has been rather remarkable. For over a century since we opened the country to the outside world in 1868, we have been more or less following that policy. Because of our success, we have now reached a stage where we have to dismantle the old established policy, and to liberalize trade and investment, even monetary transactions, with the outside world.

The government has followed a policy of liberalization of imports and capital transactions. We are sometimes criticized because this process is rather slow. However, in the past year or so it has been accelerated. On the other hand, because this was more or less established as rather a successful policy, it is difficult to depart from the traditional policy of strong government leadership, and close relationship between government and the private sector.

Probably in the future there will arise in many industrial countries the necessity of a mixture of government policy and private market mechanism. With complete control by private market mechanism the economy might not work very efficiently. Limitations on the market process are increasing. Public control and government intervention is sometimes necessary to bring about stability in the economy, increase unemployment, and accelerate economic growth. Although our policies are more or less the result of historical background, we feel sometimes that we have this combination of market forces and public or government control.

The mixed type of mechanism of our experience may even be recommended to more developed economies to combine effectively government control and the market mechanism.

The Chairman: Have you completed your statement, Dr. Okita, or is there anything you wish to add?

Dr. Okita: I will now answer questions.

Senator Isnor: My question relates to Table 3 regarding Wholesale Price Index, Consumer Price Index and Export Price Index. The wholesale prices would naturally be based on the manufacturing costs; is that right?

Dr. Okita: Yes.

Senator Isnor: The consumer prices would be based on the wholesale, or retail, price?

Dr. Okita: The distribution cost will be included, yes.

Senator Isnor: Would you enlarge on your policy with regard to export prices? I ask that question because the export prices for 1966 to 1970 are lower than the wholesale prices in Japan. Is that because of your policy to increase exports?

Dr. Okita: Those price increases are composed of various items and commodities. The export prices reflect items exported to outside markets, which are usually items in which productivity is rising very quickly and in which the production cost is more or less reduced. We have a strong competitive position in the external market. Therefore the export price indices usually reflect those sectors in which productivity is rising faster than the economy as a whole.

The export price index rises somewhat more slowly than the wholesale price index. This is because the export items are substantially products of the automobile and electronics industries, which are enjoying very rapidly increasing productivity.

Senator Isnor: Yes, but your export prices are lower than the domestic wholesale prices. In other words, you are placing export business ahead of any other.

The Chairman: I think, Senator Isnor, that that may or may not be so. It is an index of prices. In other words, the increase in export prices has been less than the increase in wholesale or consumer prices.

Senator Isnor: I wanted the doctor to explain that.

Dr. Okita: The coverage of commodities is different in the case of wholesale price and export price. Wholesale price covers a whole range of goods produced and consumed domestically, whereas the export price index contains only exports.

For example, the wholesale price index includes agricultral commodities produced in Japan, which are not exported. Those prices are not included in the export price index. Actually, the price of agricultural commodities such as vegetable foods is rising very quickly. The export indices relate mostly to industries which are undergoing a very rapid process of modernization, which creates an advantage.

Senator Isnor: Is it because of the labour situation that you are able to export as you do, your wages being 94 cents per hour compared to an average in Canada of $2.79?

Dr. Okita: Table 5 relates to wages. One of our concerns is a rather accelerated wage increase in recent years. As you will note in this table, some 10 years ago the average annual increase in wages was below 10 per cent per annum. Last year it was 17.6 per cent. So far, thanks to improved productivity and efficiency, a large part of the wage increase has been offset by increased efficiency. That was why the export price or wholesale price has been gradually stabilized. We now have about a US$200 average monthly wage for 1970. We do not measure in terms of hourly wages.

Senator Isnor: The fact is that your average wage is 94 cents per hour.

Dr. Okita: The figure for 1970 was 71,000 yen, which is about US$200. The number of hours worked per month is somewhere around 170, if I remember correctly.

Senator Isnor: I figured 190. That is $49.50 per week, taking it at 360 yen to the dollar.

Dr. Okita: For which month and which year?

Senator Isnor: I took the average.

The Chairman: Where did you get the hours worked, senator?

Senator Isnor: I took 1970, divided 360 into 71,447, to get the dollar value.

The Chairman: That is $200.

Senator Isnor: I make it $198; about $200.

The Chairman: I was wondering where you got the hours worked to get the figure of 94 cents.

Senator Isnor: I want to get the average.

The Chairman: I think Dr. Okita said there are 170 hours worked per month on the average.

Senator Grosart: It is about right.

Dr. James Gillies (Study Director): Is there any government policy to subsidize export prices?

Dr. Okita: We have no government policy of that nature. In the past, because of the basic government policy to promote exports, there was sometimes a lower discount rate for export credit. This has been raised, and the difference from the ordinary discount rates has been greatly narrowed in recent years. There were also export promotion measures, with a tax allowance for the export industries. This also has been reduced. The whole of the government machinery is somewhat geared to the promotion of the export trade. We still see here and there the development of the past policy, but the recent emphasis has been on the promotion of imports rather than the promotion of exports, otherwise we may accumulate a surplus of foreign exchange. The promotion of imports will be effective in reducing the price rise, especially a consumer price rise—that is, if we liberalize the importation of consumer goods, not only food items but also some manufactured items.

We have seen a very sharp rise in textile imports into Japan from other Asian countries where they have a labour surplus. The total imports of manufactured textiles into the Japanese market from other Asian countries increased from US$8 million in 1966 to US$68 million in 1969, an eight-fold increase in three years. Many of our traditional export items, such as raw silk, cotton, yarn and others are now changing into import items one by one.

Senator Grosart: To what extent would that increase in the import of textiles and other goods be the result of Japanese capital investment in other East Asian countries, so that it is really money coming home?

Dr. Okita: There are different forms of co-operation with Hong Kong, Taïwan, Korea, sometimes Pakistan. Sometimes there is co-operation through the supply of machinery with technical guidance being given; sometimes there is joint enterprise; sometimes just technical advice services on a contract basis. There is a mixture of different things. The higher wages and the labour shortage in Japan have stimulated those labour surplus countries to develop their industries more or less similar to ours some 10 or 15 years ago.

Senator Isnor: That has only taken place in the last two or three years, has it not?

Dr. Okita: Yes, this has been a rather new thing.

Dr. Gillies: When you said exporters get a different discount rate, does that mean they could borrow from the bank at cheaper interest rates to finance their operations?

Dr. Okita: That is the case.

Senator McNamara: Still dealing with export subsidies, is it not the case that with some agricultural commodities it has been necessary for the Japanese government to heavily subsidize exports? I am thinking particularly of rice. Have they not heavily subsidized rice exports?

Dr. Okita: That is true. Up until recent years we were one of the major rice importing countries. We now have accumulated more than 10 million tons of surplus rice, and sometimes the government exports to countries such as Indonesia, Pakistan and South Korea at international market prices. The domestic price is about twice as much as the international price. There is certainly an element of subsidy there.

The Chairman: Following on Senator Isnor's question, when talking about exports we always think of the Japanese miracle as being based on the tremendous amount of their production that goes into exports, yet I note from looking at your figures that in 1970 the estimated GNP of Japan is $203 billion and the total exports are $19.36 billion. It follows, if I have interpreted those figures correctly, that roughly 10 per cent of the Japanese GNP is attributable to exports, whereas 24 per cent of the GNP of Canada is attributable to exports. Does that mean in examining the Japanese situation we are overemphasizing the value of exports to the Japanese miracle, and does it mean that in fact we should be paying

more attention to the very large population of Japan and the meeting of those consumer needs in Japan?

Dr. Okita: Yes, that is rather an important aspect, Mr. Chairman. Our dependency of GNP on the export rate is now about 10 per cent. This has been rather stable throughout the postwar years and it was about 20 per cent before the war. The tendency has been reduced by half since the war. This was partly because of the changing industrial structure. Before the war we depended very heavily on exports of cotton textiles. In that case we had to import raw cotton and process the exports. Now, we are exporting more sophisticated production and the value added in the domestic economy is much higher. The consumers' participating powers are also expanding heavily to about 15 or 16 per cent, so the domestic market accounts for about 90 per cent of the total participating powers.

Japan will become more and more a market for the outside countries, including other Asian countries and the developing industrial countries. So far we are enforcing agricultural products and raw materials, but in the past two or three years we see an increase of manufactured items and this trend will continue into the future. According to some of our projections, by the end of this decade or 1980, the size of the Japanese market may be similar to that of the United States economy two or three years back. I feel Japan provides a very large market for outside countries and their export products.

The Chairman: We will probably go into that later. Did you complete your questioning, Senator Isnor?

Senator Isnor: Perhaps I did in regard to labour conditions and wages. There is a group in Canada which is opposed to foreign investment in Canada. I notice that Chrysler and Ford have for years been trying to become financially interested in Japan's car industry. You are opposed to that, as a country, are you not?

Dr. Okita: Foreign investments and direct investments in the automobile industry is under control by the Government. This again is partly because of our traditional policy of exporting and promoting exports, and economizing on imports by developing domestic industries. We do not have very much resources and we have to depend very much on imports. We have to encourage such a policy for promoting exports and economizing imports, especially of industrial manufactured items. Also, we do not have historically much direct foreign equity investment. Our traditional policy was to import technology and know-how, and apply it with Japanese money and Japanese capital. This has been more or less the policy we have followed so far. Partly the Government forced the domestic industries until they became competitive. That was the reason why the direct investments from the foreign automobile industry were not encouraged. Now the Government has lifted this regulation, and they will come into Japan.

Senator Isnor: They will come into Japan?

Dr. Okita: Yes, in the near future.

Senator Isnor: What do you mean by "the near future"?

Dr. Okita: There are two or three negotiations going on between foreign automobile companies and Japanese automobile companies. Some of the negotiations are near conclusion.

Senator Grosart: One was announced the other day in regard to Chrysler.

Senator McGrand: You mentioned limited national resources. Now, what part do foreign products play in the Japanese economy? I understand that about 40 per cent of the Japanese land area is forest-covered, and this wealth is increasing. Could you give me some idea of the number, and the percentage of the population, employed in the production and manufacturing of the Japanese native—not imported—forest products?

Dr. Okita: I do not remember that figure offhand, but roughly about one per cent of our labour force is employed in forestry. Several years back we were self-supporting in the supply of forest products, but because of the sharp increase of demand for the consumption of forest products, including paper and pulp, we became very much deficient in supplying those products from domestic resources. Now, we are practically independent for half of the total consumption of forest products in Japan. The other half of the consumption now comes from foreign countries.

Senator Isnor: But, your forest industries in Japan have increased tremendously in the last number of years, have they not?

Dr. Okita: If the forestry industry includes paper and pulp, then that is true. The cutting of trees in Japan is not increasing very much, partly because of the high cost of labour and because of the age of trees. Our paper and pulp industries feel that the cost is much higher when they depend on domestic forest resources.

Senator Isnor: You can import it cheaper?

Dr. Okita: Yes.

Senator Isnor: I have one short question. You mentioned that labour is company-oriented. Would you just describe briefly what is the relationship between labour and management, which seems to be so successful in Japan?

Dr. Okita: I am not sure we have been so successful. One factor is that our labour unions are modest company unions—enterprise unions. Their negotiations are on the basis of company union and company management. We have some somewhat paternal employment practices, and many workers stay on with the same companies for a long period. There is some kind of common ground between the management and the workers. They share a sort of responsibility, or they have some kind of affection for the company. Even the ordinary worker maintains some kind of affection for his company. This may be one of the factors in not having very serious labour disputes in our country.

But this may readily change. We see more and more a movement of workers among industries, among companies, in recent years. So increasingly we may face somewhat similar problems of western countries.

Senator Molson: This is supplementary to Senator Isnor's question. I would like to ask Dr. Okita if in Japan they distinguish between foreign investment and foreign ownership or foreign control. I know he said that controls had been lifted recently, in speaking about negotiations for foreign investment. Is there any distinction held between a simple equity investment and an equity investment which carries with it control or free ownership?

Dr. Okita: There is some limitation on the buying of equity shares, over and above 20 per cent of the total. In fact, we do not encourage very much the buying up of companies by foreign investors. The idea is to maintain the balance of the control of industries by the nationals. We also encourage foreign participation on a 50:50 basis of joint enterprise—50 per cent by foreigners, 50 per cent by local citizens. Of course, we are gradually reducing that part and widening the part where foreigners can even own 100 per cent, if they start new business.

Our case is one of gradually liberalizing the hitherto very strict control over foreign investment, to more a state of less control over foreign investment. But the movement is relatively gradual. Sometimes we feel the harmonious operation of a foreign enterprise in a foreign country may demand very much the co-operative efforts of both sides. Sometimes the management, representing local citizens, may have an advantage in labour industrial relations; may have an advantage in negotiating with government and others. Foreigners may have more advantage in the marketing abroad, the supply of technology, and so on. So the desirable thing may be the sharing of responsibility between foreigners and local citizens.

Senator Grosart: Dr. Okita, you mentioned the high rate of Japanese productivity increase—the increase in productivity per capita. The latest figure I have, I think, is for mid-1969 to mid-1970, which is an 18 per cent increase. In the same period the Canadian increase was 1.1 per cent. As indicated by an OECD survey of 19 countries, Canada was the fourth worst. Strangely enough, the three countries that were worse were the United States, the United Kingdom and Italy. Can you explain this discrepancy in terms of Japanese industrial or trade policy?

To put it another way, what are the factors, other than the psychological and social disciplines that you have indicated, that may have been responsible for this very high rate of productivity growth per worker?

Dr. Okita: One factor is the migration or shift of labour from a low productivity sector to a high productivity sector. As I mentioned earlier, we had some 40 per cent of our labour force in agriculture 15 years back. A very large number of agricultural labourers moved into industry. Industry has an average of about three or four times higher productivity than agriculture. So when the surplus labour is gradually starting to be absorbed into high productivity modern industries, then we have a sharp rise in published productivity of the economy. This is one of the factors which contributed to the high rate of productivity increase.

There may be a number of other factors, such as the importation of foreign technology, applied to domestic industries. Especially when you undergo a period of transition from labour surplus economy to labour shortage economy, usually you see a very sharp rise in productivity. For example, when you have surplus labour you do not use much machinery. But as wages go up, then for companies the introduction of labour saving machinery becomes very profitable. So they start using mechanized equipment to save labour.

Because of this process, for example, the United Kingdom or Canada may have many economies but there has not been much room to reduce poor productivity employment, to shift labour force from a low productivity sector to a high productivity sector. In our case there has been much room for moving labour from low productivity to high productivity sectors. Those are some of the reasons, I think.

Senator Grosart: By looking at the middle column of Table 3, the consumer price index, and the righthand column in Table 5, the annual rate of increase, and taking the period 1965 to 1970—which are the only years in which there is an exact comparison—I see that you have had what is in effect a 30 per cent increase in the consumer price index and a total increase in monthly wages in manufacturing of 73 per cent. The comparative figures would be a 6 per cent mean rise in the consumer price index, and a 14.6 per cent mean annual increase over those five years in wages. In your international studies, on OECD examination teams and so on, have you found a causal relationship between inflation and wages?

The Japanese experience seems to be the very opposite of the normal; your wage increases are a little more than twice your consumer price index increase.

Dr. Okita: Yes, wages have doubled in the past five years while consumer prices rose by 30 per cent. That reflects especially improvement in the standard of living of workers, together with productivity. As opposed to this, in some industrialized countries while productivity increases slowly, because of inflation wages rise very quickly. This creates difficulties for the economy; their industries become less competitive in the world market, which encourages imports. In our case, although we have had a rather sharp increase in the consumer price index because of rising productivity, we have been able to stabilize our wholesale and export prices.

We are somewhat concerned with the continuing trend to a wild inflationary tendency. We would very much like to see other economies introduce more discipline to stabilize prices. However, we live in a more or less inflationary world so we may have to consider adjusting ourselves to that somewhat more inflationary condition.

The Chairman: In fact, is it not true, Dr. Okita, that the Japanese economy is inflating considerably faster than either the American or Canadian economies at this stage?

Dr. Okita: If you measure in terms of the consumer price index.

The Chairman: Yes.

Dr. Okita: If you measure in terms of the wholesale price index, we are much less inflationary than other countries.

Senator Grosart: Or if you relate it to wage increase it has gone up much less.

Dr. Okita: Yes.

The Chairman: Or the effect of it is much less.

Senator Grosart: Yes; it is much less in absolute terms. How important in the Japanese economic development during the postwar period has been your very low level of defence spending? Has this been an advantage, or a disadvantage, having in mind the American experience, in which spending has been a great spur to the economy?

Dr. Okita: I should say it has been definitely an advantage. We spend somewhat less than one per cent of the GNP on defence. This has enabled our industry to employ the best brains for civil production, whereas in countries with very heavy defence expenditure the best brains of engineers and scientists are sometimes absorbed into the defence sector. I personally am of the opinion that our success in electronics, for example, has been partly due to a relatively low demand from the defence sector, which has allowed a large proportion of the brains of scientists and engineers to be employed in civil industries.

The Chairman: What percentage of the gross national product is attributable to government expenditures? I refer to all government expenditures.

Dr. Okita: Including both central and local government, it accounts for approximately 21 or 22 per cent of GNP.

The Chairman: Have you ever compared that with the Canadian experience of approximately 36 per cent?

Senator Grosart: Bear in mind that 36 per cent is hardly realistic, because 50 per cent is a federal transfer.

The Chairman: We were speaking of all governments; Dr. Okita is comparing central and local government, so I think we are comparing the same figures.

Dr. Okita: Excuse me; there may be some difference. We do not include this transfer.

Senator Grosart: That is what I meant; there is a distinct difference between these two statistical series.

The Chairman: I asked you for the figure of all government expenditures.

Dr. Okita: We include exactly the same transfer on the basis of tax revenue, but do not include transfer in terms of annual contributions to social insurance and medical services.

The Chairman: Nor does our 36 per cent.

Senator Grosart: Oh, yes it does, very much so. Thirty-six per cent includes that. As a matter of fact, of the figure of $25 billion of all-government expenditures $12½ bilion represents expenditures in health, welfare and education alone. Much of that is federal-provincial transfer.

The Chairman: But we are discussing all governments, senator, so that the transfer effect is taken into consideration. In other words, we are speaking of federal, provincial and municipal governments.

Senator Grosart: Dr. Okita, what has been your experience with restrictive antitrust or anticombines legislation? The trend around the world seems to be to liberalize it.

Dr. Okita: Anti-monopoly legislation was introduced after the Second World War. So far our enterprises have experienced severe domestic competition. Some two years ago there was considerable controversy in connection with the merger of two large iron and steel companies. The university economists were against such a practice. On the other hand, there was a feeling both among business and government that when we liberalize our imports we must achieve greater output so as to enjoy economies of scale. Therefore, at a certain stage government more or less followed the policy of encouraging mergers.

However, the policy has now been somewhat reversed. The idea is that we should encourage the maintenance of a competitive climate in the economy. If the monopolistic practice gets stronger, their competitiveness also becomes weaker. This is a controversial issue and public opinion has not been very decisive. There are some who say that the prices of products of large industries do not reflect sufficiently their productivity increase; that the share of profits from rising productivity should be distributed amongst consumers, producers and workers. There is now that argument in our country. On the other hand, statistics show that the price rises are mostly for the products of small enterprises and agriculture, and prices of products of large enterprises are not rising very much, partly because in the larger industries the productivity rise is more dominant compared with the smaller industries and agriculture.

Generally, our industrialists feel that we should not introduce a strict anti-monopolistic policy. Enterprises often say they have excess competition. My personal view is that we may need some strengthening of anti-monopolistic regulations, particularly because of the necessity of preventing consumer price rises. Monopolistic practices affecting consumer prices should be discouraged as much as possible.

Senator Grosart: What is the present level of your corporation tax?

Dr. Okita: For larger enterprises, 36 per cent; there is some discount for very small enterprises. To be precise, it is 36.75 per cent. In addition there is 16.74 per cent local tax. Including central and local taxes in amounts to 53.5 per cent. This is a figure my friend Mr. Fukuda of the embassy supplied me with this morning.

Senator Grosart: The chairman mentioned the figure of 36 per cent as, in simplistic terms, the total "take" of all

governments out of our economy. What would the equivalent Japanese figure be?

Dr. Okita: Total "take"?

Senator Grosart: That is total government revenue as a percentage of GNP. Some of us call it the "take".

Dr. Okita: It would be around 21 per cent of our national income.

Senator Grosart: Twenty-one per cent compared to 36 per cent?

Dr. Okita: Including local tax.

Senator Grosart: Finally I come to the inevitable question, Mr. Chairman. How and when will you revalue the yen?

Dr. Okita: Oh, this is a somewhat touchy question.

Senator Grosart: Everybody wants to know.

Dr. Okita: A week ago I was passing through Europe when the German mark was floating. I did not know how much to pay in a Swiss hotel. We are accumulating foreign exchange reserves. A week or so ago we passed the level of US $6 billion foreign exchange reserves, which compares with the foreign exchange reserves of Germany amounting to nearly US$15 billion. US$6 billion is still too low. Canada has around US$4.7 billion, I think. Our GNP is about 20 per cent larger than that of West Germany. The government will still develop the present foreign exchange reserve.

Another consideration is that we have been somewhat under pressure to liberalize commodity and capital transactions, and the government is pressing forward towards that policy. However, there is very strong domestic resistance, especially respecting agricultural commodities; the farmers do not want liberalization, they want protection. Some other industries take the same view. In order to weaken resistance against liberalization, the increase in foreign exchange reserves gives the government something to use to persuade protectionists in Japan to agree to a general liberalization policy. The idea is to use the accumulating foreign exchange reserve to persuade politicians, industrialists and agriculturalists to become more liberal, to accept more readily foreign products and foreign capital.

The Chairman: How would they use these reserves to liberalize?

Dr. Okita: For example, if we accumulate a surplus in our foreign exchange transactions. So far the Ministry of Agriculture and Forestries has insisted that we cannot liberalize imports of agricultural products, that we would have a balance of payments crisis, and to avoid such foreign exchange deficit we should maintain a domestic agricultural production as much as possible, even if the prices are higher than imports. We now have a surplus in the foreign exchange account, so this argument is no longer valid, and we can exert more pressure on protectionists because of the surplus.

As well as trying to liberalize, including imports, the government is also trying to step up overseas investment and foreign aid to developing countries, but in spite of those combined efforts, if we continue to see the accumulation of foreign exchange we may have to face a program of liberalization, although I cannot say when.

For example, the total flow of resources to the other developed world increased by 40 per cent last year—at least 0.93 per cent of the GNP and one per cent of GNP is the international commitment. We are rapidly approaching that level. We also expect a very sharp increase of private investment going out from Japan. In the 1960s we were mostly an importing country and in the 1970s Japan is probably going to be one of the major exporting countries. The outstanding foreign private investment at the end of March last year was about $2.6 million. In the course of one year, the estimate is $1 billion additional of foreign private investment. There are estimates that by the end of the decade the total private investment from Japan may reach around US$20 to US$30 billion.

Senator Grosart: Your invisible or non-commodity trade deficit would be very low by international standards.

Dr. Okita: That may be partly because of shipping.

Senator Grosart: And because of your local level of foreign investment?

Dr. Okita: Yes, that is on Table 7.

Dr. Gillies: Do you apply the anti-trust laws or anti-monopoly laws equally to the export industry?

Dr. Okita: If I remember correctly, there is some exemptions clause for export in the industry.

Senator Inman: Dr. Okita, in regard to inflation, your consumer price index has risen by 7 per cent annually for the past three years, which, while a most serious economic and political problem for the Government, is not unreasonable in the face of the kind of economic expansion that has been achieved. How high do you consider the consumer price index could rise before becoming a very serious problem? This may be rather loaded. What action do you think your Government may take to control the consumer price index, should that happen?

Dr. Okita: In fact, there is a seven per cent rise in consumer index. It is a rather serious political problem. Economically we may afford to get along with that much. Politically it is a rather serious problem. We had local elections for governors of Tokyo and Osaka and the opposing party, the Socialist Party, won the elections. We have had an opposition governor for the last four years and this candidate now goes up for a second term. It is the first time in Osaka that we have a governor from the opposition party.

The consumers in the large cities are very sensitive to price rise which is combined with a housing shortage and urban problems. There is an increasing discontent in the

big cities. In the local cities and rural areas the conservatives are still very strong. Therefore, I feel the price rise is affecting politically some of the people in the big cities.

The Government is rather serious in preventing price rise. The Government set up a price policy advisory council several years back and this council has been producing recommendations for various aspects of price stabilizing policies. One of our difficult questions is the distribution network, which is very outmoded and there are various sorts of vested interests in this sector. There are commodities such as vegetables, fruits and meats which are rising very sharply. That is my observation.

Senator Inman: This is a question, of course, which I must ask. What is the difference between wages paid to women workers and those to men?

Dr. Okita: The differences are very much reduced, especially for young men and young female workers. Many women leave their employment when they get married. In regard to the average wage of male and female workers, the female worker is paid much lower, partly because of the wage structure of workers, but for the age of, say, 20 years the difference is not very much.

Senator Inman: I have a supplementary to Dr. McGrand's question. I was very interested in your labour management. I wonder to what extent, generally, is the involvement of labour with management?

Dr. Okita: There have been several articles on this written by foreigners. Many foreign observers of Japanese economy and society are of the opinion that labour management relations are rather unique compared with Western society. It was probably the social traditional background which affected the industrial relations in Japan. Generally, this uniqueness is diminishing as the people become more urbanized. Their paternalistic employment relations are gradually weakening, but still we are somewhat maintaining traditional aspects. Dr. Okun is predicting a relatively high rate of economic growth for Japan as compared with other Western industrialized countries. He says that the Japanese society is still preserving work-oriented mentality over achievement-oriented mentality as compared with other Western society. I agree with the point that we may gradually reduce this advantage in the course of ten or fifteen years when the younger generation gradually comes along. So far, maintaining the labour-management relations is one of those cases.

Senator Grosart: Are you undertaking some experiments in "guaranteed lifetime employment?"

Dr. Okita: Experiments?

Senator Grosart: Yes. I was reading an article recently that indicated that Japan, either in the private sector or in government, was encouraging guaranteed lifetime employment.

Dr. Okita: In fact, this is not quite legally a guarantee of employment, but the practice of many enterprises is that they recruit the workers and their employees from among the fresh new graduates from the various levels of schooling, and many of them stay with that company until retirement. This has been our practice. Especially in the case of the white collar people, they are recruited from among the university graduates, and many of them stay with the same company until they retire. Sometimes, even after retirement, the company may arrange for some other positions in affiliated companies.

For workers, there is growing mobility. So far, because in industry every enterprise could grow rather fast, there was not much need for dismissing employees. They could just move the workers from one place to another. In the future, we may have more problems in that respect.

Senator McLean: My question is on the same line as that of Senator Grosart. The first part of his question was in relation to labour, and this could be considered a supplementary. I notice in your agricultural field that you are using one-third less labour than you did in 1960. Does this mean that that sector is highly mechanized now and you are producing just as much or more, or are you using the labour in some other area and lessening your production in agriculture?

Dr. Okita: Our agriculture has been somewhat overpopulated, compared with the arable land area. The average cultivated area per farm household is about two acres. Even including the somewhat different conditions in the area of Hokkaido, the average of the whole country is about 2.5 acres per agricultural farm household. I guess that Canada has a much larger average area of cultivation. So we are traditionally having very labour-intensive agriculture and the mechanization process was relatively slow.

Only in the last four or five years have we seen very rapid process in the production of mechanized farming. Because of the size of the farms we have difficulty in introducing large farm machinery. Also, one solution is that members of a farm household are depending more upon local agricultural living. That is partly because of the size of the country. Now many industries, electronics and others, are moving into rural districts. The companies are breaking up the size of the factories to, say, 100 or 200 employees, and they are related to the mother factory. Those factories moving into rural areas can make use of surplus under-utilized labour. Because of the size of farms and the increasing use of machinery, the partially surplus labour for individuals is existing there. Industries are trying to take advantage of partially surplus labour for manufacturing. So our agriculturalists are more and more depending on non-agricultural sources of living income.

Senator McLean: Production is still going up in agriculture?

Dr. Okita: It is still going up, at the rate of 3 per cent, or so. We are gradually moving away from staple production. Recently, in the last two years the Government has introduced discouragement of rice production. There is an incentive to reduce rice production. Subsidies are given to those farmers who have stopped growing rice and switched to other crops such as vegetables and other agricultural products.

Senator Manning: Dr. Okita, does the Government of Japan employ arbitrary wage and price controls in any areas?

Dr. Okita: Yes, this is another topic. That is an incomes policy, in the broader sense. Generally, we do not consider we have reached such a critical stage of necessitating direct control over wages. As I have mentioned, productivity is rising rather rapidly and offsetting the effect of wages rises. On the other hand, there is growing concern about the accelerated rate of increase in wages. Last year there was an increase of 17.4 per cent. There are many talks about the eventual necessity of introducing an incomes policy.

The labour unions are rather opposed to the idea, especially the left wing labour union. We have two major labour unions—one is Domei and the other is Sohyo. The Sohyo is more radical. They are very much opposed to any idea of incomes control policy. They say this is to control, to depress wage values.

So long as wages and prices keep pace with the productivity rise, personally I do not think there is a serious necessity to have an incomes policy or control over wages as such. We may eventually reach a stage of some sort of control, but it will take some years. At least for the time being we do not think there is any need of controlling wages.

Senator McLean: In regard to both wage and price controls, are they considered by the Government of Japan as an effective means of controlling inflation, if this trend goes on that you have already spoken of?

Dr. Okita: This is somewhat unnecessary in the educative sense. Responsibility for public education to bring about better understanding of possible repercussions of wage drives on the future course of the economy falls upon management and unions. So far the government has repeatedly announced that it does not intend to introduce wage controls. There will be incomes policy in a somewhat broader sense. It has undertaken to make the public more aware of the inter-relationship between wages and the market or economic situation.

Senator Manning: You spoke earlier of the heavy involvement of Japanese banks in financing industry. Is there much actual government money invested in industry in Japan, apart from that invested by banks?

Dr. Okita: Government investment has not been very substantial in the private sector. We have, for example, the Japan Development Bank, which is 100 per cent government financed. Sometimes their lending is coupled with private lending and gives some orientation to the field of priority investment. Otherwise, direct government investment in private industry is not very substantial.

We feel that in the decade of the seventies we should follow a more positive policy in increasing expenditure and investment in order to improve the environment in cities and step up construction of houses. In the past we have rather concentrated on expanding direct production facilities, such as factories and power stations. The general economic climate now is increasingly leaning to improving our environment and living conditions and spending more resources for such purposes. I personally feel that we have reached the level at which we can afford to do this.

Senator Manning: You referred to management-labour relations in this regard. Is any concerted effort made to encourage employees to attain an equity position in the industries with which they are associated? You mentioned profit-sharing; is there an endeavour to actually have them attain equity as individual employees?

Dr. Okita: This is done in some companies. I should say, however, that it is not a very widespread practice. Some companies encourage their employees to deposit personal savings in the company, which will reduce their dependency on bank borrowing. Usually the company gives a higher interest than the bank's rate for deposits of their employees. However, the government considers this to be a somewhat dangerous practice. Should the company face financial difficulties, the deposits of their employees may also be affected.

Senator Manning: Those deposits would not represent an equity position in the company?

Dr. Okita: No, they would not.

The Chairman: Dr. Okita, having, as you do, a consumer price index which is rising at a rate of 5, 6 or 7 per cent per year, and the bulk of the savings of Japanese deposited in banks, I expect at fixed rates of return, why have you not had a psychology amongst Japanese savers that would cause them to go into equity investments in order to protect their savings against erosion?

Dr. Okita: The public has had experience in buying securities, but they also have experienced the sharp drop in stock prices. The laymen, who are inexperienced investors, tend to lose rather than gain from the fluctuations in stock prices. The social tendency to deposit surplus savings in bank accounts is very strong. This, coupled with uncertainties with respect to stock prices, encourages a very strong tendency to save.

The Chairman: So you think it is a social tendency rather than a means of self-protection?

Dr. Okita: So far this has been very strong tendency.

The Chairman: Are the banks by virtue of this in the classic position of borrowing short and lending long? You say that 80 per cent of the funds required by business is supplied by bank borrowing; does that not put the banks in that position?

Dr. Okita: The total of 80 per cent is not necessarily borrowing. There is some 10 per cent in the form of debentures and funds. In any event, a large proportion do borrow from banks. They are borrowing short and lending long?

The Chairman: You said earlier that part of the credit extended by banks was both medium and long term and also that if the banks support industry to that extent,

even short term borrowings become long term borrowings, because to pull them out would tumble the whole structure.

Dr. Okita: A very large proportion of the deposits are in the form of time deposits for six months or one year. I do not know whether you would consider that to be short or long term.

The Chairman: I would say that in relative terms that is still short. If you refer to 10 or 20 year money, you would have to support these industries to the extent of at least 10 years.

Dr. Okita: They repeat lending, renewing their loans. There are not many 10-year loans from the commercial banks, but they continue renewal of credit.

The Chairman: That must put the banks in tremendous control of Japanese industry.

Dr. Okita: Yes, the banks are in a rather strong position in controlling industry.

The Chairman: Do you think that that is a good thing?

Dr. Okita: In the long run we do not think so basically. However, when we go through the period of very rapid expansion and arrive at the point of gradually decelerating our rate of growth, companies will begin to accumulate internal resources and the necessity to borrow from outside will gradually be reduced. Therefore my prediction is that when the Japanese rate of economic growth starts declining there will be less dependence on the part of industry on bank borrowing. So long as we maintain a rather rapid rate of expansion, industries may have to continue to depend upon borrowing.

Government policy is gradually tending to encourage direct investment from individual savers, direct transfers from individual savers to industries, rather than through the bank. There is a well established practice. Although this direct investment portion is gradually increasing, there is still a substantial part coming from the banks.

The Chairman: If there were a slow-down in the rate of expansion, or even a slow-down in the Japanese economy, with the amount of liquidity in fixed obligations could not there be a disastrous result?

Dr. Okita: Yes, this is a problem of confidence. Sometimes the government feels obliged to take measures in case there is a crisis. Industries are still confident about future expansion. Personally, I do not think the present rate of expansion will continue for a very long period in to the future. Many of us feel that the present rate of expansion is probably the maximum, and that there will be a gradual slowing down in the tempo, in the rate of expansion in the future. Sometimes the banks give discretionary treatment to their borrowers by putting off interest payments for a certain period. Sometimes the bank will send some of their staff into the management of the borrower enterprise when there is some financial difficulty. In general, compared with other industrialized countries, especially compared with North American practices, our banks have rather strong links with industries.

Dr. Gillies: I should like to turn to a different subject. One of the engines in the growth of Japan has been the great amount of capital formation and reinvestment in capital. What is the rate of depreciation allowed for tax purposes on plant and equipment, roughly?

Dr. Okita: The rate of depreciation is not very different from other countries. Depreciation is worked out on the basis of each piece of equipment, whether buildings or machinery. There is provision for some accelerated amortization for certain branches of industry, to stimulate the modernization of equipment. There are three or four dozen legislative provisions to allow for accelerated amortization.

Dr. Gillies: Would it be as much as, say, 40 per cent a year in certain industries?

Dr. Okita: This acceleration?

Dr. Gillies: Yes.

Dr. Okita: I do not remember exactly. I have a book at my hotel, to which I can refer if necessary and let you know.

Dr. Gillies: Thank you.

The Chairman: One last question from me, Dr. Okita. How much has long term planning had to do with the Japanese success?

Dr. Okita: I was directly in charge of this long-term planning in the government for many years, so I must not claim too much for the merits of planning in our economy. On many occasions the actual growth overtook the planners' estimates. We do have five-year plans, which are indicative plans, shifting ahead every two or three years. In the process of preparing overall economic and social development plans we invite people from private business, private industries, the banking community, labour unions and university professors to participate. We consider this is a good opportunity to achieve a more co-operative climate for dealing with economic policy matters.

Although the planning agency is a relatively weak organization, the finance ministry and the ministry of international trade and industry are powerful industries. The planning agency can provide a forum or a meeting ground of various different interests representing the ministeries, the private sector and labour unions.

There is also a fairly large staff in the government who make current analyses and studies of policy alternatives. The government planning agencies produce regular annual economic surveys and monthly economic surveys, which are discussed at cabinet meetings. On the whole there are rather expanded activities for economic analyses within the government, and to a certain extent outside the government as well. The overall co-ordination is provided by the planning agency, especially in the process of formulating medium term plans, inviting not only people from other ministries, but also industrialists, bankers and labour union people in the formulation pro-

cess. I think this is one of the measures for bringing about policy co-ordination, or planning the policies.

The Chairman: And stabilization?

Dr. Okita: Stabilization is more the short-term aspect.

The Chairman: Does long-term planning contribute to short-term stabilization?

Dr. Okita: Yes, because the medium term plan indicates some preferable and desirable policy measures to reduce cyclical effects. Monetary fiscal policies may not always follow the lines indicated by the plan, but often it is a means of bringing about the kind of consensus over the policies to be followed. The planning agency provides a current analysis, which gives some guidance for the necessary policy measures on a short term basis as well.

The Chairman: Does the Government pay close attention to the recommendations of your planning agency? In other words, is the rapport with the Government good?

Dr. Okita: I should say yes and no. Compared with the earlier stage of planning in this area there is growing interest and concern with overall planning. The ministries have a somewhat increasing interest in the process of planning. We have a strong Minister of Finance and Budget Bureau. They have some independent power for decision-making in regard to overall plans. Sometimes they can disregard the overall plans. The relationship between the annual budget formulation and formulation of a medium term overall plan is getting much closer in recent years.

The Chairman: Honourable senators, if there are no further questions I would like, on your behalf, to thank Dr. Okita. I can imagine, although he is extremely articulate in English, how difficult it must be to deal with this complicated subject in another language. I think we can thank Dr. Okita for being extremely clear and very open about some of the problems he faces in Japan. He has made a very worthwhile contribution.

Thank you, Dr. Okita.

The committee adjourned until 4.00 p.m.

—Upon resuming at 4 p.m.

The Chairman: Honourable senators, we resume the hearings. We are honoured this afternoon to have as our witness Dr. Anthony Scott, who received his M.A. from Harvard University and his doctorate from the London School of Economics. He has had a very distinguished career in economics. He has been on the staff of the Royal Commission on Canada's Economic Prospects. He was the Lilly Faculty Fellow at the University of Chicago.

He is the author of a number of economic treatises, including *The Economics of Conservation,* the *Manual of Benefit-Cost Anlaysis, The Common Wealth in Ocean Fisheries,* the Canadian edition of Dr. Samuelson's *Economics,* and, of course, numerous other papers and documents on this subject.

Dr. Scott is presently Professor of Economics at the University of British Columbia and is one of Canada's leading economists.

Dr. Scott, it is our mode of operation to ask you to make an opening statement on your brief, and following that to open yourself to questions from honourable senators.

Dr. Anthony Dalton Scott, Department of Economics, University of British Columbia: Thank you, Mr. Chairman.

Honourable senators, I should say at the beginning that the joint author, with myself, of the brief which is in your hands is my colleague at the University of British Columbia, Professor Ronald Shearer, a specialist in monetary affairs and banking, and, like myself, a textbook writer. He sends his apologies that he cannot be here today. I wish to acknowledge his help in preparing the remarks that I want to make to you.

Professor Shearer and I, on receiving the invitation from the Senate committee to appear before you, felt that it was clear that the central issue in Canada today is the appropriateness of relying almost exclusively on monetary and fiscal policy instruments applied centrally. There are two baffling questions with which we are all concerned, stemming from this issue. First, are these two policy instruments sufficient to deal with both uenmployment and inflation? Secondly, whatever the answer to that first question about their adequacy is, should we, for regional reasons, use additional regionally selective policy instruments?

Our conclusions, as set forth in our brief, can be summarized as follows. Not only these two instruments, that is, fiscal and monetary policy, but even the three—that is, fiscal, monetary and exchange rate policies—are all, either separately or in combination, inadequate to deal with both unemployment and inflation. So that we do need another policy instrument such as an incomes policy, of which your committee has heard. But, as you have also heard, we believe that no such needed instrument is yet known or available.

Another conclusion to which we come is that regionally selective monetary and fiscal policy is not to be recommended, but, if the public or if the government feels that regionally selective or discriminating policies are imperative for humanitarian or political reasons, these selective regional policies should be fiscal rather than monetary in their nature.

Mr. Chairman, to back these conclusions up, Mr. Shearer and I both being textbook authors, I should like to go back to the textbook for just a minute and remind senators, as they have doubtless heard from other witnesses, about the theory of what is unfortunately called aggregate demand or aggregate spending. The greater the aggregate demand or aggregate spending in our country, the greater is the level of employment and the greater is the pressure for prices to rise, especially when we are close to full employment. Both policies that I have mentioned earlier, fiscal policy and monetary policy, through

manipulation of government spending, levels of taxation, the open market, operations of the Bank of Canada or by other monetary means, can effectively and with a lag, to be mentioned in a few minutes, influence aggregate demand in the third direction.

This is something we have known for a long time. It is something that J. M. Keynes perhaps first told us, and it is part of the policy of all parties to recognize this possibility. But since the days of the Carter Royal Commission on Taxation and the earlier Porter Royal Commission on Monetary Policy, on Banking and Finance, studies have shown decisively that both monetary and fiscal policies work on aggregate demand but they work with a lag—that is, a period of months, sometimes lengthening into a year or more, which has the further disadvantage that the length of the lag, as we technically call it, is a variable, is unpredictable and, let us be honest about it, is unknown.

That is bad enough, but at least we know the direction in which monetary and fiscal policy will work. These two commissions, as well as subsequent research, have shown furthermore that the effect of these policies on prices and wages is lagged even further, so that we have one lag between monetary and fiscal policy and aggregate demand, and then we have a further lag between the change in aggregate demand and wages and prices.

The result is that with respect to the time path of wages and prices we are almost justified in saying that that path has a life of its own. It is independent, or nearly independent, of the events which accompany it in time. That path of prices and wages is a delayed reaction, a mysteriously complex reaction to policies and private and international actions which have gone on in previous quarters and, indeed, in previous years.

A further complication stems from the fact that Canada, being an open economy, has a balance of payments problem or an exchange rate problem which may itself become an objective of government monetary and fiscal policy. The flexible exchange rate which we had before the early 1960s and which we now have, has cut us loose from the responsibility of using our monetary and fiscal policy to achieve some sort of external result. Now we can allow the exchange rate not only to detach our prices from the movements of outside prices but also, if it be our wish, and if we give a high priority to it, to permit our prices to work in the opposite direction from outside prices. That would be an extreme objective, but that would be possible technically. For example, we could achieve that result, should we wish to, by using monetary policy in such a way that the yield on securities and investments in Canada was increased so as to attract fluid capital from abroad, thus bidding up the price of the Canadian dollar in world markets vis-à-vis other currencies.

Every time our dollar goes up in world markets we have neutralized the effect of world prices by one notch on our own domestic prices. So that to take a limiting case, which neither Mr. Shearer nor I recommend, a continual rise in the external value of the Canadian dollar can be used to neutralize continual inflation abroad so as to have no effect on Canadian prices via our imports or via our exports.

Now, even if we should single-mindedly, however, pursue such an objective, we would still have one of the central dilemmas of Canadian policy with us, and that is that much of our inflation is not imported but, as I suggested a few minutes ago, has a domestic life of its own stemming from past events and sustained by continuing expectations in government, in business and in trade unions. Any amount of neutralizing foreign prices cannot deal with this domestic self-propelled price increase.

The Chairman: In other words, what you are saying is that, if you have a purely domestic inflation, variation in the exchange rate is not adequate to deal with it.

Dr. Scott: That is right. You can think of our annual price increase as being made up of two components: the injection of price increases through imports and exports, plus a self-propelled internal inflation. We can neutralize, by the exchange rate mechanism I outlined, the foreign component, but that still will not solve our self-propelled domestic price increases.

I think, Mr. Chairman, at this particular stage I can save your time by reading directly and then come back to my informal remarks. I refer now to page 5 of my brief.

We conclude from this analysis that government manipulation of aggregate demand through monetary and fiscal measures, even with a flexible exchange rate, is not sufficient to guarantee full employment without inflation. If we are to bring the price level under control in the region of full employment, we must have another domestic policy instrument—an instrument directed explicitly at the domestic price formation process. That is precisely the purpose of an incomes policy. If it is to work, such a policy must prevent the development of the inflationary expectations which contribute so much to the apparent short-run independent momentum of the domestic price level.

Unfortunately, as you have heard from many witnesses, in the forms in which they have been implemented, incomes policies have not been notably successful in bringing the price level under control. Various new forms of policies have been proposed, ranging from direct controls over prices and wages to complicated taxation schemes. We cannot be sanguine about any of these measures. Direct controls create a severe risk of long term distortions and impaired efficiency in the economy, and taxation schemes create imponderable, to put it mildly, administrative problems.

Such schemes should never be implemented lightly. The failure of a policy measure of this type seriously erodes the credibility of government and hence impairs its ability to implement any broad range of other policy measures.

We then go on to say, as I have said earlier, that we cannot suggest to you an alternative to the kinds of incomes policies which have already been suggested to you, but we would like to distinguish, for what it is worth, the absence of such a policy to which we can now turn from the need for such a policy. We cannot say that this instrument or that, or this kind of thing that is being

done in the United States or Japan or the United Kingdom, is exactly what we should do. Nevertheless any amount of technical inspection of the monetary and fiscal situation in Canada indicates that we have not enough measures, enough tools in our armory to deal with the number of problems with which we are trying to cope, and one more policy instrument is needed, something like an incomes and wages policy.

Mr. Chairman, I turn now to the question of regional policy. Professor Shearer and I insist, as does the Economic Council of Canada, that it is important to distinguish between the long-run problems of the various regions of this country, such as the Atlantic provinces, the Prairie provinces or British Columbia, which are often called structural problems, from what in our brief we have called cyclic or short-run or stabilization problems. It is clear that the main concern today in Canada as a whole is with what I usually call cyclic questions, that is short-run problems of unemployment and inflation, and in turning to regional matters we are also directing our attention to the regional manifestations of these short-run questions. We are not presenting a brief to you about what should be done about the poorer regions of Canada in the long run.

Nevertheless it is obvious that any short-run proposals made to you must be consistent with, and must not work against or destroy, long-term measures and policies which are being implemented to deal with poverty or unemployment or slow economic growth in the poorer regions. The growth in the poorer regions is fragile, and short-run policies can occasionally be very powerful. It is possible in dealing with short-run matters completely to reverse the direction and damage, therefore, the impact of the long-term measures.

While it is not our business to tell you what our long-run policy is or ought to be, we conceive of it as including assisted mobility from the poorest counties and regions of the various provinces to the more successful and growing regions of those provinces, and from those regions to central Canada. That is the positive part of the policy. A neutral part of the policy is to acquiesce in such migration and mobility when it takes place, as it does at a high rate in good times and bad.

Other parts of the policy have to do with assisting investment, education, health and so forth in the various regions, not to mention public works as a part of the infrastructure of those regions.

With that background, let me briefly turn to the short-run aspects of regional policy. Having both thought a great deal about the problems of the Atlantic provinces and British Columbia, and having examined at various times the statistics of these regions, Professor Shearer and I are concerned—

Senator Isnor: You are not putting British Columbia and the Maritimes on the same basis?

Dr. Scott: No, sir. In fact, I think that much of what I am going to say will be more relevant to the Atlantic provinces than to British Columbia. In fact, in preparing these remarks a couple of days ago, Professor Shearer and I were afraid that you would be concerned that we, coming from British Columbia, were not more prepared to speak about its particular problems. In any case, we have focused our attention on the Atlantic provinces.

We feel that for the short-run problems—only short run in economists' jargon—which are problems of unemployment and inflation, although it is tempting to argue that these problems are felt most seriously in the Atlantic provinces and other slow-growing regions, nevertheless the emphasis for policies should be on Canada as a whole, via the big levers of monetary and fiscal policy, and in particular to, as it were, sharpen the argument, the emphasis should be on Ontario and Quebec.

We have several reasons for making this point. Firstly, there is the obvious point referred to on page 7 of the brief, that the number of unemployed in Canada is overwhelmingly dominated by the unemployed of Ontario and Quebec. So that any regional policy which might weaken the thrust of an overall national policy is going to hurt many more people than it will help.

Firstly, we should keep our eyes on where the suffering is greatest, and that is in Ontario and Quebec. However, our basic concern is more fundamental. The regions are not isolated. The demand for their products stems from outside regions, largely in central Canada, so that policies which help central Canada are probably policies which in the long run will help the slow-growing regions as well.

More profoundly than that, or shall we say in a more novel way than that, much unemployment in outlying regions is an illustration of the principle of the lengthening queue. The mobility of families and workers to high-income areas is greatest when employment in Canada as a whole is highest. When there are few jobs to be found in Ontario or Quebec, people stay at home in the Atlantic Provinces. They show up in the Atlantic Provinces in the statistics as unemployed.

Moreover, recent research has shown that when jobs are scarce in Ontario more people tend to return to their home areas, for example in the Maritimes, partly because the administration of unemployment insurance makes it more rewarding for the unemployed to locate themselves in low-income areas than in the central provinces. We suspect this is also true of other social measures. The Ontario queue for jobs has simply lengthened back to Halifax, Saint John and St. John's.

It follows that the surest way to raise the employment level in the regions is to raise the employment level in the nation as a whole.

The Chairman: You talk about recent research. Can you direct this to the empirical data?

Dr. Scott: Yes, sir. I referred to mobility studies which are partly under the sponsorship of the Economic Council of Canada. I believe Dr. Ostry has already spoken before the committee. She is one of the directors of this. One of the chief authors of this research on mobility and its fluctuations over the business cycle is Dr. John Vanderkamp, now at British Columbia but who will soon be at Guelph. I can refer you to several studies of his on this score. He finds that in a given time, people are moving out of Halifax to central Canada and from central

Canada back to Halifax. So, when we hear about migration from one region to another, we are really hearing about the net figure, the big flow minus the smaller flow back.

What happens over the business cycle is that when there are many jobs to be had in Ontario the flow from Halifax to, say, Toronto is large and the return flow is relatively small. As the business cycle turns adverse in Toronto—not in Halifax, but in Toronto—the relative size of those two flows changes and the return of people who had previously migrated to Toronto becomes considerably larger, while the outward migration becomes smaller. Thus people who could not find, hold or retain jobs in Toronto find themselves better off if they go home, and they join the ranks of the unemployed in Halifax. It is that to which we refer as the lengthening queue. They are really lined up for jobs in Ontario, but they find the best place to line up is in Halifax.

I am not pointing to any particular individual. I am speaking statistically of net averages.

An hon. Senator: Is this true of British Columbia as well?

Dr. Scott: No. It is true that earlier research by Mr. Gillies' colleague, Professor Montague, now at York University, and Dr. Vanderkamp found some of this going on in British Columbia in earlier business cycles, before 1960 and in the 1950s. There is a net flow towards British Columbia which is quite heavy and which I can only ascribe to climate, which dominates that flow. It is true from the Prairie Provinces, either to British Columbia or to the central provinces.

If people feel that a regional short-run policy is necessary in order to deal with the hardships that unemployment and low income undoubtedly inflict on those who are suffering from it, the question then becomes not, "Should there be a policy?" But, "If there has to be a policy to help people out, then what should it be?" It is often suggested that monetary policy, or some variant of it, involving the Bank of Canada and its financial powers, should be used in a regionally differential or discriminating way.

Senator Isnor: Is that possible?

Dr. Scott: Our opinion is that it is not possible. We speak against this as something that, no matter how desirable, is not a starter; it would not work.

The leakages of funds out of the region are much more fluid than the leakages of people. Even if funds are earmarked for special purposes in the region, they displace other funds which then move elsewhere, and it is almost impossible to use regional policies.

There was some discussion of this in the report of the Porter Commission some time ago, which looked into these matters rather more thoroughly than I am able to do today. They came to this conclusion. Common sense and experience would lead us to that conclusion right away.

That leaves fiscal policies. Of the various kinds of fiscal policies which can help to relieve regional hardship in the short run, we come back to the old favourite of economists, which is public works instead of tax reductions, because public works are immediately job-creating; that is, they are job-creating just as fast as the public works can be organized. Our chief concern is that the lags may be very great.

Other kinds of fiscal policy to do with social assistance are also to be encouraged in the short run if some policy is to be used. The trouble with social assistance, however, is that in its administration it tends to fix people in whatever they are doing or wherever they are living. In fact, they often become ineligible for continuation of this assistance, unless they stay in the position they were in when they first received it. So occupational mobility or inter-regional mobility becomes impossible.

Mr. Chairman, to conclude these remarks and to give senators a chance to discuss them, let me say that with respect to national policies one of our main themes has been that even an ideal combination of monetary and fiscal policies is insufficient to maintain both full employment and price level stability. Another policy instrument is needed. Unfortunately, incomes policies have been unsuccessful; but at the moment there seems to be no alternative on the horizon. As we look at the economy today, we see that inflation is imposing many hardships, but that we have no instrument to prevent it. We conclude that while more effective instruments are being studied, there is a good case to be made for temporary measures to relieve the suffering of those who are on incomes fixed in dollar amounts.

I have not touched on this in my verbal remarks this afternoon. This approach leaves the Government free to deal with the hardships arising from unemployment. We have also developed the theme that large-scale regional policies to deal with cyclical unemployment in the regions of Canada are not called for. The attack on unemployment must be primarily at the national and central level. However, if regional selective national policies are to be adopted, special measures must use fiscal rather than monetary policy.

Let me conclude by expressing our pleasure that this committee has undertaken the task of carefully evaluating Canadian economic policy and exploring alternatives. This is a most valuable public service.

Speaking, sir, as a former president of the Canadian Economic Association, of which Professor Reuber, who you are going to have before you tomorrow, is another former president, we and all economists hope that this valuable public service of public scrutiny of public policies will continue and expand.

The Chairman: Thank you very much, Dr. Scott.

Senator Nichol: Dr. Scott, I am fascinated by what you did not say, or by the place where you stopped and quite honestly stopped. You said particularly on pages 5 and 6 that you are very distrustful of the way in which fiscal and monetary policy could solve the dilemma of inflation versus unemployment, and that you are also distrustful of incomes policies as a solution to this dilemma. Then you said, as I say, quite honestly, that a new instrument is needed and that such an instrument is not available. You did the intellectually honest thing, I think, and

stopped there. In a way, this is where we are starting. Of what sort of directions are you thinking? This is speculation, I suppose, as opposed to logical economics, but what sort of new instruments have been proposed? What sort of directions are there in which people could look? I realize that if you had had them you would have included them, so it is a tricky question.

Dr. Scott: If you ask an economist a question he says he needs a colleague to help answer it. If you have two economists, they give you three answers and if you pin two of them down, or three, they say that more research is necessary. I am going to cut that short by turning to the last one right away: More research is necessary.

You have heard economists, and you will hear more, discussing this subject. I mentioned to you, for example, the textbook answer. This may give you the impression that an awful lot of research has taken place on inflation, but that is not the case. We must consider the effect of various events on prices and especially the lags that arise in prices. Particularly important are the expectations that arise when a certain price increase is in position, for example in circumstances such as those referred to by Dr. Young. The amount of research on that subject in Canada is negligible and has mostly been carried out by Dr. Young's colleagues or the two royal commissions I have mentioned.

We all know the problems are there, but we are burdened with exchange rate questions, unemployment and various kinds of stabilization questions. If you ask an economist, for example, just how much does a price increase in vegetables from the United States imported into Canada in the winter time find its way into our general cost of living, he can give you an answer based upon the cost of living index. He can say that vegetables played such-and-such a part in the cost of living index, but that is all. Anyone can do that; you do not have to be an economist. The real touch research of following these things has a long way to go. Dr. Young's group, to which Professor Reuber belongs, has done some research for the Economic Council of Canada, and they are almost the only people to work on this.

I am sorry to labour that point, but when I say more research is necessary, I am not asking for another research grant so that I can go back and have the same idle life I have had for the last five years. We have not even started on this. People who have started on incomes policies in other countries such as Britain, Sweden and Holland, have started from scratch, with no research, and have gone by the seat of their pants and in most cases have not got very far.

It does look to me as though the steam has gone out of the annual increases in the price level. We will be getting a breathing space. There will be a creeping, but not exponential or sweeping inflation in the next year or so. Let me urge senators, the Government of Canada and whoever else can take a role in this, not to let the research flag because the immediate emergency or crisis seems to be out of the way. This is the time to look into causes and effects and especially time lags and expectations. "Expectations" is, of course, a technical reference, which economists utilize.

Senator Beaubien: Do you mean you do not think that wages will keep on increasing?

Dr. Scott: I think the rate of increase, which has been going up 4 or 5 per cent per year in the frontier or leading wage bargains, will not become larger and larger, which is a mercy in itself, and may conceivably become smaller. I refer to that as a breathing space. We must avoid a sort of South American crisis, where things are going ever faster. If we can live with that for a while and, as we say in our written remarks, by social assistance help those to whom this is a special hardship, the people who really suffer from inflation, those on fixed private incomes, then there will be time for research and investigation, and for brains-trusters and so forth to come up with ideas.

I think, for example, the proposal that was put before this committee by Professor Bellan of Winnipeg has the virtue of being an enterprising idea. Looking into it, I do not think it has much percentage.

Senator Beaubien: That is the system under which, if a man earns a little more, it is taken away from him fast.

Senator Molson: The more you earn, the more you pay.

Senator Beaubien: Well, you do not earn any more.

Dr. Scott: It is a new idea.

The Chairman: I think I read in your brief that taxation schemes create imponderable administrative problems.

Dr. Scott: Yes.

The Chairman: And that is essentially Professor Bellan's scheme.

Dr. Scott: To make myself clear, I do not recommend the tax scheme he put forward, nor any that has been plugged by such publications as *The Economist* in Great Britain, which some of you may have seen. Any known tax scheme has so many hairs on it that it is not worth adapting for Canada. I was just saying that one thing about Professor Bellan is that he had an idea that had not been discussed in Canada before, or indeed in the United States very much, and let us hope some more people have brainwaves that can be tried out, not so much on the committee but in the laboratory, as it were, and see what they are good for.

Senator McLean: Why do you think the unions will be easier to deal with in future over wage increases?

Dr. Scott: In making their demands, I think unions are impelled by their own intestinal fortitude a bargaining which is what you are referring to.

Senator McLean: Right.

Dr. Scott: They are also impelled by their membership to awareness of the increase in the cost of living, and by the increases of other groups who are not necessarily unionized. In British Columbia the International Woodworkers Association sometimes mentions the salaries of

academics as one reason why woodworkers' wages should go up. It is not always the unionized sector on which expectations are based. As what union members perceive tapers off a little, especially in the cost of living, their demands on their own leaders to shoot, not for four, five or six per cent, but for eight, nine or ten per cent are abated, and the union leaders are empowered to use some of their own judgment.

Senator McLean: The unions really set the pace, or have been setting the pace across Canada. If your theory is right, we probably could be on, as you say, plateau for a while.

Dr. Scott: Whether they have been setting the pace or not is one question. The statement I made was that the union leaders have been impelled from behind at a very rapid rate by their own membership, who have been seeing the grocery bills going up at a terrific rate. This is what they are not going to be impelled by so much. Whether the absence of this push from behind by their anxious membership and their members' wives will abate their demands is a matter of opinion. My own opinion is that it will.

Senator Nichol: I would like to come back again to, and go a little further, if I may, into the question of, the new needed instrument. I gather from what you say—I am not attempting to paraphrase, but I am trying to understand—that the new needed instrument may in fact be a more, I was going to say, sophisticated use of existing instruments, particularly on the question of lags, and the effect of fiscal and monetary policies in the economy. If we really do not know the effects of fiscal and monetary policy, not only what they will be but how long and how deep they will be and the implications of them, the pursuit of this in itself would turn out to be perhaps an extremely valuable instrument. To use a specific example, do we know the effect of, say, a change in interest rates, a dramatic shift from 5 per cent to 8 per cent or from 8 per cent to 11 per cent in bank money? Do we really know the effect this has on the economy and on specific segments of the economy, and therefore on employment, and so on and so forth? Do we know that, or does someone know that; or do we not know it?

Dr. Scott: We know a little about its effect at the first stage; that is, the effect on business spending, aggregate demand, business borrowing, installation of new capital goods, raising of inventories and so forth. It is what we do not know from thereon that is particularly bewildering, where we need a lot of help. If a rise in the interest rate from, say, 7 per cent to 11 per cent has certain effects, say, on the housing market and businesses, what goes on after the businessmen have made their decision to invest, with respect to employment and prices and the wages people involved are going to demand, is something we do not know nearly enough about. We just have not any idea of the orders of magnitude or of the time lags involved.

Senator Nichol: As our tax structures change, the effects of all these things are quite different, are they not?

Dr. Scott: That is very true. You may feel that if you know what happens when the interest rate moves from 5 to 6 per cent, then you know what happens when it moves from 10 to 11 per cent. If you do not feel that, I am pleased that you do not, because it is quite clear that whatever it is I am talking about, is curved; that is, what happens between 5 and 6 per cemt is almost in a different world from what happens between 10 and 11 per cent. All research has been able to tell us is what happened in past experiences in the 1950s, with various kinds of monetary policy, with the interest rate being jacked up or down. There are only two or three of those experiences; that is, there are only two or three of those episodes, which is a better word. Therefore, that is all we know about that. Modern statistical techniques—on which I am not personally a master—can generalize a little from those few episodes, but we have a long way to go.

Mr. Chairman, may I just deal with the introduction to the question that you just asked me, when you referred to the need for an independent policy analogous to an incomes policy?

Incomes policy and monetary policy are certainly different. We know that they work in the same direction, and we know fiscal policy, for example, very often works partly through the fact that it is changing the money supply at the same time. These two policies are not, therefore, really independent of each other. Tinbergen, a great economist who won the Nobel Prize about four years ago, enunciated one great truth, which is like the other truth that there is no such thing as a free lunch. His truth was that if you have two or three objectives, you need two or three independent policies to deal with them. We really have only one policy—fiscal and monetary policy, which almost work together; they are not independent of each other. We therefore have two objectives, to control the price level and to control unemployment. We need another independent policy instrument. Incomes policy is such a one, but it does not work.

The Chairman: When you say they work together, you are not necessarily talking about working in the same direction. On page 5, you envisage an expansionary fiscal policy and a restrictive monetary policy.

Dr. Scott: Yes, the levers can be pulled in different directions.

Senator Carter: I was interested in what Dr. Scott was saying about the flow of workers from one area to another. I found it a little hard to accept that. If I understood you correctly, you said it was based on some studies. Were you talking about transients, about people with families? Surely, people with families do not move their families back and forth like this?

Dr. Scott: Yes, sir, they do. A recent study by Courchene at the University of Western Ontario has gone into that a little. More important than Courchene's research is the source of almost all we know about mobility in Canada, between census years. We have landmarks in the census years, but in between we lack data, except from one source. That source is the give-away. The way we

learn about interprovincial migration is from family allowance data. So it is families that move, because that is how we learn about mobility. It is not from the national canvassers of manpower, following workers from place to place; it is from the family allowance people who, of course, are rapidly informed by family allowance recipients when they have moved, so we are able to keep quite a close tag on mobility.

Professor Vanderkamp, whom I mentioned earlier in my remarks, has made outstanding use of this data in order to find these flows. So, in answer to your question, senator: Yes, the backwards movement with families is apparently in about the same proportion as the outward movement with families.

Senator Carter: In talking about the lag, the trouble with the fiscal and monetary policy is the terrific lag. Is this lag related to geography? Is it greater in Canada because of our greater size, or would that be true in Canada if it were a more compact country?

Dr. Scott: Senator Nichol mentioned honesty. I cannot understand that question. I do not think anyone knows whether the lag that ensues between an increase in Government spending, shall we say, and the subsequent employment or subsequent increase in wages—whatever lag it is we are talking about—is longer or shorter in one part of the country or another, or in Canada or the United States.

There are a few measurements to that last point, of course, but I do not think that they are significantly different. To the extent that they are known about, there are lags that occur with something called the Phillips curve, of which you may have been informed by other witnesses. Professor Reuber, who will be appearing before you tomorrow, can inform you especially about the differences between Canadian and American time lags.

Senator Carter: Our problem in the Maritimes is that no one gets excited and everyone is quite happy as long as the average runs round about 3 or 4 per cent unemployment, but by that time Ontario has got down to 2 per cent and in the Maritimes it is up around 8 to 10 per cent. By the time you get to do something about the 2 per cent in Ontario we are just beginning to recover, and then we are retarded again because the policy you apply to Ontario affects us too. We have a totally different problem. We have deflation when Ontario has runaway inflation.

Dr. Scott: It is true that the unemployment in the Atlantic Provinces began to increase in the middle '60s, well before it began to increase in the central provinces; and to that extent I agree completely with your observation. On the other hand, it has to be pointed out—something of which we have not made very much in our paper—that the percentage rate of increase in unemployment in the central provinces in late 1968 and especially 1969 and 1970 is two or three times greater than in the Atlantic Provinces. That is partly, as you say, because unemployment was already high in the Atlantic Provinces. I concede you that, but there are obviously more reasons than that. I have already given you my explanation that it has not to do only with the unemployment but also with the size of the labour force itself, and the labour force has gone on rising in the Maritime provinces when at least there would have been one escape for that unemployed labour in good times in Ontario, and that was by outward migration.

The Chairman: I have a supplementary on that. At the top of page 7 you take the view that:

> ...in the long-run it is desirable for manpower and young families to move from poorer to wealthier regions of the country. It would be unfortunate if short-term stabilization policies impeded such longer-term adjustments.

Then you talk later of the lengthening queue principle, in which you state you can employ people probably by moving them to the central regions, and that if demand falls off in the central regions then they will move out to the relatively poorer regions. But by following your policy, are you not going to effectively destroy this country? Because if you followed the policy to any reasonable conclusion you would concentrate everybody, to start with, in Ontario, Quebec and British Columbia.

Dr. Scott: I understand your point. I have not the numbers before me, but I can assure you that full implementation of the policy I have mentioned would not lead to that unhappy result, that is, the depeopling of certain regions down to zero. Far from it. To give you some purely hypothetical numbers—and I must stress that I am making these numbers up as I go along—we are talking about a labour force which, shall we say, is increasing at 5 per cent per year in a certain region which has consistently a 2 per cent unemployment level higher than the rest of the country. It follows that, if that 2 per cent migrated to Ontario, the labour force would still be growing at 3 per cent a year and the regional population would still be increasing. So we are merely talking about the size of one possible flow out of the ranks of the unemployed out of the labour force to reduce the impact of unemployment. We are not talking at all about reducing the basic labour force itself down towards a zero labour force or a zero population.

The Chairman: I would make two comments on that. First, it would seem to me that structurally, over a period of time, by following that policy you would build up a more efficient structure in the stronger provinces and you would accelerate the movement from the weaker to the stronger. Secondly, would it not be better social policy to try to build up over the long-range the economic viability of the weaker element?

Dr. Scott: Yes, sir, I agree with both your objectives. We are getting into the long-run, but I would be delighted to hold forth on these matters.

The Chairman: I do not want you particularly to hold forth. I just want to know if you are in favour of the long-range.

Dr. Scott: It is a mistake to believe, and nothing in our economic statistics confirms the belief, that when migration takes place, it is the best people who leave. That is simply not true, and I am sure the senators from the Atlantic Provinces can confirm it. The people who get up and go are, by definition, people who get up and go, and that is all that it means. The people who are most able are those who stay behind. We have very little information about this in Canada, but we have information on it for international migration, and it certainly is not true in international migration that the people with the highest I.Q.'s or the most education leave Europe and come to North America. I do not want to tread on anybody's toes here, but it is the people who are, as it were, in the next cohort down who leave. It is a mistake to think that in a region which is growing, like Canada's Atlantic Provinces, that all the people with enterprise and ability leave because there is out-migration. That is simply not true. None of our statistics suggests that that is the case.

Senator Hays: Are you then intimating, doctor, that the foundation of North America was built on the ones who just could not get along in Europe?

The Chairman: I think that is what the doctor was intimating, without getting himself into any political difficulties by doing so.

Dr. Scott: They were people who found they could do better by leaving. Let us put it that way.

Senator Desruisseaux: Dr. Scott, I cannot help thinking back to what I have seen and read of the European economic situation. These conditions have existed especially in Germany, where they now have a million and a half imported workers from Italy and elsewhere. I cannot help wondering what made a country such as Germany so prosperous while still respecting private enterprise, and what enabled it to achieve what it did and more consistently than has been the case in North American countries. What basic economic principles have they used to bring about this situation, and what have we been missing here? Have you ever studied that?

Dr. Scott: You are pointing now, in particular, to the growth of the poorer regions of Europe, are you?

Senator Desruisseaux: No, I am pointing to the more prosperous regions and I am wondering what economic principles they used to make them prosperous and to keep them prosperous to this day. As I say, Germany has a million and a half imported workers.

The Chairman: I do not wish to intervene in your question, but it may be that Dr. Scott will want to plead that his particular expertise is not in that direction.

Senator Desruisseaux: Well then, I would like him to say so himself.

The Chairman: I might add that Dr. Girsch is coming from Germany, and he will deal with that particular question.

Senator Lamontagne: The witness does not need protection.

Dr. Scott: I do so plead, Mr. Chairman. However, referring to the brain-drain and the international migration of the most educated level, together with the million and a half workers that you mention—if you have any questions about them I can follow the line, but as to the question of the general prosperity of Europe, I must defer to others.

Senator Desruisseaux: As a layman I do not know, but I was curious to find out if their methods are applicable here. They have been very successful over a decade or so.

Dr. Scott: I must defer to exports other than myself.

The Chairman: Are there any other questions?

Senator Lamontagne: Just to follow up on this last question, do you not think that these three countries have been the most innovative societies in western Europe in the post-war period, that this might be one reason why they have developed much more than others?

Dr. Scott: No doubt you are right. The aftermath of the Second World War threw down all the inflexibilities that had existed in the Common Market area, for example.

Senator Lamontagne: They are not in the Common Market, except Germany. Switzerland and Sweden are not in the Common Market.

Dr. Scott: I thought you were referring to the low countries and to France. They were free to start again. The habits of past centuries had left them, as you say, a mixture of their educational policies and science policies, a rapid public and private investment in their industries, the opening of doors to capital from other countries, as in the Marshall Plan and also privately through the Eurodollar market, and the opening of doors to migrant workers. These all changed the pattern completely. But their incomes are lower than those of most parts of Canada. They have not achieved our levels yet, except in the case of Sweden, but, starting from a lower level they have certainly moved immensely and quickly.

Senator Lamontagne: The Swedes have told us that by developing new technology to fight pollution they will be able to finance their own national program against pollution. I do not think there are many countries which are prepared to do that. The innovative capacity of these free countries has had much to do with their post-war development.

Senator Desruisseaux: Also economics, and the stability of their governments.

Senator Lamontagne: You were saying that unions would become more responsible in their demands, because of the rank and file. I have not made a survey on this, but my feeling is that we are moving in the opposite direction, that as a result of the development of the affluent society and the frustration which accompanies and which has been created by that kind of society, the rank and file are becoming more and more irresponsible in their individual demands. While a few years ago labour leaders were in complete control of their unions

and their demands, they are now losing that control. Labour leaders will very soon have to choose between being responsible or remaining leaders.

Dr. Scott: If I may use the word "model," your model and mine are the same one. There is no question about that. All we have to argue about is the timing, what is happening right now. That is the only thing that is between us. I have seen the same things that you have seen. I have with me a number of studies made in other countries relating to cost-of-living increases and other annoyances and frustrations to subsequent wage demands. My own observation is that while I have seen the same thing, the pressures which are on the membership now to demand more—I will not use your words "responsible or irresponsible"—are based upon their expectations and on what they have just experienced. What they are experiencing right now is not nearly as frightening to them in terms of their real standard of living as it was months and years ago. As these expectations feed into union meetings for the next round of bargaining we can, in my opinion, expect that the pressure on union leaders will be more moderate. This is what the British are also finding.

Senator Lamontagne: There is another aspect of this question that you have discussed, with which I do not completely agree. I had the courage to express it to a group of labour leaders a couple of years ago. That is that I think the union movement has forgotten the poor people, the poverty problem. They started when poverty was general, the membership was poor; but now it has become more affluent and they have continued to defend and support the cause of their membership. However, the non-unionized people have been left behind and completely forgotten, I think, by the labour movement.

Dr. Scott: I agree with that, sir. Your observation points to the conclusion that people who have no interested groups to look after them should be a special concern of the Government. If the union movement will not take them under its wing, then someone else must. Those on private or public pensions are probably most vulnerable in this respect.

Senator Carter: Is that not because industry now has become more capital-intensive and it is much easier for the labour unions to put pressure on such capital-intensive industries than on the labour-intensive industries?

Dr. Scott: That applies to the industries you mention, but at the same time we have new unions in the non-capital intensive sector, in the Public Service itself, in school teaching. It is that half of our labour force known as the service sector and this applies particularly in the Maritime Provinces.

Senator McGrand: My question results from those of Senators Carter and Lamontagne with regard to wages and salaries, if you can distinguish between them. I remember that when a committee of the House of Commons and the Senate was studying prices six years ago we were told by several union leaders that professional people should set an example to labour and not ask for such high salaries. I think you said that the push for higher wages has been to some extent due to the increase in salaries and the wish to keep up. University professors, teachers, engineers and nurses have received major increases in recent years. This has always been justified as being catching up to the cost of living. But which is going up the faster, union wages or professional salaries?

Dr. Scott: I am afraid I cannot help you on that.

Senator McGrand: You have no suggestions?

Dr. Scott: I recognize the question. I cannot help you.

The Chairman: We will ask our researcher to look into that if you wish, senator.

Senator Petten: Dr. Scott, if I understood you correctly, you said we have now reached a plateau, that there is not this great, rapid increase in demands of unions. How can you relate that to the construction industry which, if my figures are correct, accounts for about 25 per cent of the labour force? In my own province of Newfoundland just recently the plumbers and electricians gained big increases, all tied into construction. They were healthy increases. How can you say we have reached a plateau?

Dr. Scott: Sir, I did not say we had reached the plateau. Please!

Senator Petten: Was there a levelling off and not such a rapid increase?

Dr. Scott: I predicted a levelling off on the basis of the failure of the cost of living to rise at an ever faster rate, so that people's expectations and their fears about their standard of living being squeezed by their wages, on the one hand, and the cost of living, on the other, are no longer as serious. The wage increases to which you point are based upon the episodes of the past that led those people to demand something, either to keep ahead or to resume a position they had had in the more remote past.

Senator Lamontagne: But you are referring now to the old cycle, where at the end of a recession wages tend to rise less rapidly than profits, and then it is the other way round when they start on the road to recovery. This is not a new phenomenon.

Dr. Scott: No, sir, it is none the worse for being old.

Senator Langlois: Dr. Scott, you made reference to the non-unionized labour force. What is your latest figure for the percentage of the labour force that is not unionized, organized?

Dr. Scott: I would have to ask your own staff to help me on that. Perhaps I should not even give you a guess. I think I had better opt out of that one.

Senator Molson: We have had it suggested here that increases in wages and salaries greater than the productivity increases have been a major factor in inflation. We have also been told that too much stress should not be laid on this, that some of the other factors are just as important in causing inflation. I think the preponderance of the views has been that increases greater than productivity have made a contribution to inflation. I would like

to ask if increases which seem to be higher than an average, or say in keeping with productivity, in any way contribute to unemployment, in your view?

Dr. Scott: To unemployment?

Senator Molson: To unemployment, rather than inflation, which we have discussed.

Dr. Scott: If I put the question to my students and said, "Show how this could be the case?" the answer they would have to give would be that, chiefly through cutting ourselves out of export markets, ever higher wages leading to ever higher prices would diminish our export markets, unless the exchange rate were flexible enough to give that back to us. Your question asks me how important that phenomenon is, rather than what the mechanism would be. I would say that in recent years in Canada—that is, since the middle 'sixties—it would be wrong to look to inflation as the chief cause of the unemployment we have. We have a mysterious phenomenon of these two things going on together, but we do not believe that one is causing the other. As I say, the inflation seems to have a life of its own, and the employment is more amenable to our policy instruments.

Senator Molson: One witness here, Mr. Chairman, stressed the fact that he felt very keenly and in fact, was convinced that the wage increases in the construction industry were highly undesirable—in fact, disastrous. If that point of view has any validity, is it possible that by being excessive they have reduced the amount of construction and therefore contributed to unemployment?

Dr. Scott: Certainly, in particular industries this sort of thing is noticed. To put in in the terms of a very small industry, people can overshoot in their demands and they can be sorry. But we aree talking about the country as a whole, about the aggregation or adding together of all these labour markets, which makes it very difficult for economists to believe that this could be an important phenomenon. Undoubtedly, mistakes are made by those who demand too much, and then they have to go and lick their wounds, because the demands are not met. This is the micro situation. The other is the macro situation, and with that sort of thing it averages it out.

Senior Molson: That is what we are worrying about.

Senator Lamontagne: I would refer to students we had last year at the University of Ottawa. We had a Brazilian student who did an M.A. thesis on growth and inflation in this country. They certainly are experts on inflation there. He showed, I think quite conclusively, that when there was in inflation in this country there was complete stagnation, so inflation coincided perfectly with the long-term period of growth.

Dr. Scott: The real question is to go on from there, Senator Lamontagne, and ask: Was the inflation necessary to get to growth?

Senator Hays: Dr. Scott, in the short run, with unemployment as high as it is, do you feel that the present policies of Government are taking care of these people until we do get them into the work force, or do we have policies that will absorb these workers? Are we looking after them well enough? And if we are not: In your opinion, how should we look after them?

Dr. Scott: Professor Shearer and I have asked ourselves this question in preparation for these hearings. What you are really asking for is a survey of all the kinds of aid and assistance that are available to people who are out of work temporarily or at the time they first entered the labour force. This is available to us. We did set to work to try to get a statement or answer for you on that question, but I am afraid it is too big for us. I cannot really tell you how people are making out in their various predicaments, in any way that would be a balanced statement.

Senator Hays: You would not have any suggestions as to whether the Government is doing a competent job in so far as this is concerned?

Dr. Scott: You are asking about unemployment insurance, manpower and so forth?

Senator Hays: Yes.

Dr. Scott: The people to whom we have drawn your attention are those who are most aware of this; that is, those suffering from inflation at the same time, who perhaps are retired and are out of the labour force altogether. I think they are in a pretty pickle at the present time and a bit more help to them would be useful, especially if they are not chiefly relying on Government pensions but are relying on industrial pensions of some kind or another, from some of our bigger industries. They are the people we have to be worried about. But that is not an authoritative statement.

Senator Hays: Do you feel that this particular group we are not looking after well enough? That is your opinion?

Dr. Scott: I think they are the next in the queue for special attention.

Senator Isnor: Dr. Scott, I was wondering as to whether you heard Mr. Douglas Peters, the chief economist of the Toronto Dominion Bank, who told the Pacific Basin Economic Co-operation Council:

> In the coming months the good news will outweigh the bad, where we are beginning to see the effects admittedly, with some lag, of the Government policy pursued in 1970.

Did you happen to hear him?

Dr. Scott: No, I did not hear him, senator. If you are asking whether I agree with that—

Senator Isnor: Yes.

Dr. Scott: Yes, I think I do. I think that is a fair statement.

Senator Isnor: That is good news.

Dr. Scott: That is part of our position.

Senator Isnor: I was going to ask a question, Mr. Chairman, but before doing so may I get the reaction to a statement I am going to make. Dr. Scott, British Columbia was perhaps the greatest villain we had in the country in respect to increases of wages a few years ago. They came to Ontario and other provinces, stole the skilled men, took them out there and paid them very high wages. Do you recall that?

Dr. Scott: Yes, senator. I know what you are speaking of.

Senator Isnor: It was a bad thing, looking back, was it not?

Dr. Scott, would you be good enough to expand a little on the question or unpegging our dollar and the effect it is having on our export business? You touched on that earlier.

The Chairman: Do you have a specific question in that regard, senator?

Senator McLean: Mr. Chairman, you could take all the Maritime products, really: fish, apples, potatoes—any of the Maritime products, if you want to deal with the Maritimes.

Senator Isnor: Yes, the effect it is having on our export business in the Atlantic provinces is what concerns me.

Dr. Scott: Well, senator, the line that Mr. Shearer and I have taken on this is to say that we have one enemy, the whites of whose eyes we can see, and that is unemployment. Let us use fiscal policy to deal with unemployment. At the same time, we have a flexible exchange rate. We can use the flexible exchange rate in two ways. We can reduce the value of the Canadian dollar by manipulation in the Bank of Canada and by monetary policy in such a way as to aid exports. That is one thing we can do. Alternatively, or going in the other direction, we can increase the value of the Canadian dollar in such a way as to ameliorate the inflationary impact from other countries. Obviously, we cannot do both at the same time; we have to make a choice.

Senator Isnor: If you did the latter, that would have an adverse effect on exports.

Dr. Scott: If we go for cutting ourselves loose from foreign inflation, yes, we are going to have a bad impact upon exports, and vice versa. That is obviously a quandary. Our policy recommendation is to keep that lever in our hands at all times and to try to strike a balance between those things, and, as the inflationary danger is seen to be less serious, to push that lever in such a way that the exchange rate can be of as much use as possible to the export industries to cheapen Canadian goods in foreign markets. I do not need to tell you, senator, that such a policy would be a "beggar-my-neighbour" policy. If we pull the lever hard so that our dollar becomes cheap quickly, we are just going to be met by retaliation in our markets by other countries doing the same thing, or we are going to be met by having our goods excluded by tariffs, quotas and so forth. But a little leaning on the lever is certainly within our power and may be a useful policy in the period that Mr. Peters, whom you quoted, said is coming. I hope that is encouraging to you, sir.

Senator Beaubien: I should like to ask Dr. Scott about our flexible floating rate, but he has already answered it fairly well. I would comment, however, that we would now give our eyeteeth to get the dollar down and we cannot do it. We find it hard to keep it where it is. How could you arrange to get it down, if you so wanted?

Dr. Scott: Well, exporters and those employed by them and their suppliers would give their eyeteeth to get it down, but not the housewives.

Senator Beaubien: But they do not have much say in getting it down. I am thinking of the mechanics of getting it down.

Dr. Scott: They have as soon as the inflation takes off. There is more room then.

Senator Nichol: I would like to come back to where we were a little while ago. Talking about this need for new instruments to solve these problems, the question which bothers me is this: Assuming for the moment that by some miracle some organizational group of people could come up with what appeared to be sensible and useful needed instruments, we have in Canada innumerable municipalities and ten provinces who between them spend about 60 per cent of the tax dollar, while the federal Government spends about one-third. Within the federal government structure itself, and here I am not speaking of government in the narrow sense, we have the Economic Council of Canada, the Department of Finance, the Bank of Canada and the chartered banks with some degree of freedom. Now the question I want to ask is this: How much of our problems of economic management do you think lie in the organizational inefficiencies—and maybe it is an organizational inefficiency which a democracy must have, of its very nature, but how much of it lies in this field? If you did have a really clear idea of what should be done, would the system let you do it?

Dr. Scott: Looking for errors and omissions?

Senator Nichol: And conflicting policies and conflicting needs.

Dr. Scott: There is no doubt about it, senator, that the provinces, in their fiscal policies, and the municipalities also have turned this problem over to Ottawa. In fact, they have never assumed these problems, so that within the total range of government there is any amount of conflict, and just when it would be desirable to cut down government spending, let us say at the peak of total spending in the country, private and public, that is just the time we find all the municipalities and provinces planning their swimming pools, esplanades, centennial projects, and so on. So very often government itself, taken as a whole, is perverse, and government spending is perverse, and when it should be counter-cyclical it tends to be cyclical. That is what I mean by "perverse".

May I refer you to one question that has been raised? The provinces can control the municipalities, or they

have some chance of doing so, but how are you going to get the provinces and the federal Government to move in step with each other? That is one of the possible errors or perversities that you are worried about. It is possible, in my opinion, to do better than we are doing. I think that by a little cutting in of the provincial government and federal fiscal timing, by "nuts and bolts" conferences, agreement can be reached between the various levels of government as to how much capital spending will go on this year, how much next year, and so forth.

It means a little delegation of power in these matters from Ottawa to the provinces. There is no reason why the provinces should agree to a timing regime unless they have some voice in it. So far Ottawa, perhaps rightly so, has been unwilling to take a step in that direction, and the Bank of Canada and the Department of Finance have said, probably rightly, "We have the responsibility and we will have to call the timing or the tune or the harmony, as it were, of this whole thing." I do not see how you can get the provinces to move in step to that tune unless they have some voice, however minor it may be.

The Chairman: Are you thinking of any particular vehicle?

Dr. Scott: Yes. I referred to this before. I would refer you to a discussion of this very problem in the financial report of the Royal Commission on Banking and Finance, the Porter Commission, in 1963-64. It consists of only two or three pages. They suggested a federal-provincial council of premiers and finance ministers, and were particularly concerned with the timing of public works.

The Chairman: Would you go further than that?

Dr. Scott: I think that is the place to start.

The Chairman: Would you extend it into other fields of planning?

Dr. Scott: It could be, but there are many problems here. If we could get this in connection with public works we would be going way beyond what is now possible. We would be ahead of countries such as Australia and other federal countries. It would be possible to get some bait for this from the Bank of Canada, if they were dealing with this group or instrument as a whole rather than with particular provinces.

Senator Lamontagne: I am sure you are aware of the fact that we have had a committee of finance ministers meeting annually for at least the last four years to discuss fiscal policy in general, but it does not seem to have produced much in the way of results.

Dr. Scott: I suggest to you that the reason it has not shown results is because there is no particular reason why the provinces should agree. There is nothing in it at the present time. They say to Ottawa, "Constitutionally the problem is Ottawa's, and Ottawa should look after it." I presume that what has been happening is that we have been preaching to the provinces, and we need something better than preaching. There has to be some quid pro quo in this matter.

Senator Nichol: There does not seem to be any problem, if the federal Government wanted to, to delegate power to the provinces. The problem seems to be, in a sense, to delegate responsibility to the provinces. The federal Government is involved in spending one-third of the national pay cheque, and the provinces and municipalities are spending the other two-thirds. Yet the provincial governments have no direct authority or responsibility in any sense over the value of the dollar, the strength of the monetary system, the rate of inflation, and so on. Responsibility is laid with the federal Government and the provinces and municipalities are perhaps in many ways more responsible than is the federal Government.

Dr. Scott: Public works is more and more a provincial responsibility. Various provinces are known to be considering hydro-electric works of various kinds through both private and provincial hydro-electric companies. This group, as a group, can say to the provinces, "Look, now is the time to go ahead. If you go ahead we, as a group, including the federal Minister of Finance, will help you with the financing of those works, in a way that we will not if you delay those works until conditions are more attractive. We will recommend to the Government of Canada and to the Bank of Canada, jointly, not separately to you as a province, that some financial assistance or credit-worthiness should be given if those works are accelerated immediately."

I have taken Hydro as an example, but there could be many more minor works of more diverse nature than big dams.

Dr. Gillies: Would you go so far as to say that the Bank of Canada should be the fiscal agency for the provinces?

Dr. Scott: No sir; this is what I would argue against. The usefulness of the Bank of Canada to do what it is now doing would be lost if it were put into a role in which it had to say "Yes" or "No" to the provinces. It has to have one master; there cannot be 10 or 11 masters; and if it becomes the fiscal agency in the sense of acting as a trust company that, of course, is a minor role. However, it should not be in the position of having to say "Yes" or "No" to a particular province.

Dr. Gillies: Do you think they should be willing, if agreement had been reached, to buy the bonds of the provinces as a last resort?

Dr. Scott: Yes, in a highly structured body. I am not referring to some informal group, but to a highly structured body in which the role of the provinces, the federal Government and the Bank of Canada would be clearly spelled out. This may only be part of the total public works effort in Canada. Start small and see where it goes.

Dr. Gillies: Would this be the way to guarantee that you had co-operation?

Dr. Scott: Yes, that would be a part of the body, to use a word that I mentioned.

Senator Lamontagne: Before we move into that new system, should we not attempt to provide a better short-term forecasting system? We have failed in the last 20 years or more to forecast a recession. It is all very well to meet with the provinces and tell them they have to reduce or increase their expenditures, but if the time is not appropriate and they are told to increase in an inflationary period there is no great value in the exercise.

Dr. Scott: I agree with you completely, senator.

Senator Lamontagne: When you speak of lags in the sense of Senator Nichol's question a moment ago, I think that if we could improve our short-term forecasting system we could win quite a number of months in fighting against the movement we wish to oppose. We have not done so since we started, in 1946, to establish a short-term forecasting system.

Dr. Scott: I agree with you. If you interpret that also, Senator Lamontagne, to perfect our knowledge of the time lags, and so forth involved in the inflationary process as part of it, I would agree with you even more.

Senator Lamontagne: At least, we could shorten the lag in our short-term forecasting system.

Senator Nichol: I did not express my question very well; it relates to the efficiency of the present system. I do not know who does the forecasting today. Certainly, the Economic Council has been charged with some responsibility in this area, but not directly related to Government policy. The Bank of Canada has some responsibility; the Department of Finance has some and, perhaps, the primary share; the ten provinces have some. However, surely there must be a central economic core organization which pools all these diverse opinions and arrives at perhaps the wrong answer but at least at something that seems to be structurally sound?

Dr. Scott: I think that many economists in Canada would even go further than you, Senator Nichol, and say that there is a gap, a hiatus in our institutional set-up.

Senator Nichol: That is a good term for it, "institutional set-up."

The Chairman: For short-term?

Dr. Scott: Yes. Here in Ottawa the Economic Council of Canada, as Mr. Smith has undoubtedly told you, or will tell you, is concerned with something called the medium run, which is important; we should not take them away from that; that is their job.

Senator Lamontagne: And the long-term?

Dr. Scott: And the long-term.

Senator Nichol: With these lags you are talking about, we are not sure what is long-term and what is medium-term.

Dr. Scott: That is true. If the short-term has any meaning at all it is the length of these lags that the short-term runs over. It is now thrown, as you say, to the Department of Finance, or the Bank of Canada primarily, to look at these things, and there should be a lot more horsepower there. I have no criticism of the horsepower they now have, but there should be a lot more. When I said earlier that economists were delighted to see your committee in operation, I hope that either in its annual manifestations, if that becomes possible, or in some other way, its results will lead to more horsepower at this short-run end of things in forecasting in Ottawa. I rather mixed my metaphors there, but you see what I mean.

The Chairman: Could the Bank of Canada fulfill that role?

Senator Lamontagne: No.

Dr. Scott: Well, it is certainly doing a lot, but it has to go beyond the Bank of Canada. They have their own fish to fry. There are other problems than theirs.

Senator Hays: Are you suggesting there is anybody who has enough knowledge to predict a recession, short-term or long-term, or prosperous periods? If you do, I will make a lot more money than I have, which is not all that much. This is what life is all about.

Dr. Scott: We could do better than we do. That is what I am saying.

Senator Nichol: I want to ask another question, if I may, connected with something that has been coming up at all these meetings. Basically, since the New Deal we have been constructing a system that controls markets—labour markets, money markets and all other kinds of markets. We now have a system that is in some ways rather constipated. How much has this structure, which has a sound, sensible base in welfare and humanity, to do with the heavy hand that needs to be used today in fiscal and monetary policies without getting any results in terms of inflation or deflation?

Dr. Scott: I recognize the big question you are leading to. Perhaps I can helpfully make the following comment.

Senator Nichol: Maybe you can ask it better than I did.

Dr. Scott: If you rely on monetary policy, your intervention into the working of the economy is minimized; you are changing the money market and little else, and people are responding to both signals and the availability of credit, and so forth, in their own businesses, but you are not intervening in taking over what you might well feel they ought to be doing. It is objective, it is detached, it works through bank managers and many decentralized people, and the preferences of any government are not necessarily biasing anything that is going on in the economy, except more activity or less. That is all monetary policy does for you.

At the second stage we can talk about fiscal policy. Here you have the government sector itself expanding and contracting, which really may spoil the competitive structure of the economy as you were referring to it a minute ago, if I understood your question. Certainly, much of the opposition to fiscal policy in the 1930s was simply that it could not work unless there was big gov-

ernment rather than small government, and that is certainly one of the aspects of fiscal policy.

If you go on further and talk about incomes policy or a guaranteed job for people, or other sorts of radical movements which you may turn to when there is a real crisis, then you are really muzzling enterprise altogether, because the government is in there second-guessing everybody all the time. It is very hard to dismantle that kind of thing. The British have found that they are still dismantling the very effective apparatus that was set up in the second world war. They are stuck with an effective Board of Trade, an effective income group, and so on. It is very hard to dismantle it if we once put it into permanent operation.

Therefore, if we are to think only of the criteria that you are suggesting, any economist will say that in order to minimize the intervention in the health of the business sector of the economy, stick with monetary policy, from that point of view alone. Secondly, if that point of view does not work, try fiscal policy. Then, only, thirdly, go to these direct intervention steps. I do not know whether that was the sort of thing you were talking about.

Senator Nichol: A fascinating thing is happening now, for instance, in the United States. The stock market, in the last while, at least, has not been reacting to business conditions at all. It has been reacting almost entirely to its estimate of what the Government's fiscal and monetary policy is going to do. So some bank in some small town in Pennsylvania changes its rate and the Dow Jones goes up 10 points, but it has nothing to do with what is happening in the real world.

Dr. Scott: It works, too, on that lag. There is very little parallelism between what happens on the stock exchange and whatever else is going on in the economy.

Dr. Gillies: Dr. Scott, in your analysis of regional operations, and so on, it seems to me there is an implicit assumption that all the institutional structures within which the price system and monetary system operate in Canada, are reasonably fair and equitable among regions; that is, that the banking system works as well in the Maritimes as it does in Ontario, when railroad rates are equitable, etcetera. In other words, it seems to me implicit in what you are saying that if you go for fiscal policy, there are certain things in the region that could be changed, that would make that central policy better. I am referring to the institutional framework. Do you follow that? I am not wording the question very well.

Dr. Scott: From the point of view of the impact of those kinds of phenomena—rail rates, social assistance, manpower, trade unions, banking policies, or banks to banks themselves, and so forth—I would think they do work equally well in the various provinces, when we are looking at these questions that we have picked out for discussion here—unemployment and inflation. Whether they muzzle enterprise from the point of view of long-run growth is a different question altogether, and I would then review and, I think, encourage investigation as to whether rail rates and other things are a discouragement to particular regions. That I classify as long run.

Dr. Gillies: As a supplementary, do you feel that the banking system, for example, is not discriminating against regions?

Dr. Scott: No, sir, I do not; and furthermore my colleague, Professor Shearer, who knows more of these matters than I do, would agree with my answer in that respect. He would be very vehement and say that if you turn to the working of the banking system for a solution of any of these problems, you are barking up the wrong tree altogether.

Senator Lamontagne: I do not want to put this as a proposal, but in this precise field there is quite a difference between the American banking system, which is much more decentralized than the Canadian banking system, so that the American system naturally should favour the more remote regions, than would ours.

Dr. Scott: I understand your point. I do not agree that that is what happens in the United States. I spent a year in Chicago five years ago, at a time when enormous efforts were being made by the federal, state and city governments to deal with urban problems in that city. This was done by regional efforts, by helping small industry, and so forth. There were provisions in the legislation to turn to the banks, and the banks were supposed to help on certain terms. In almost every case the banks that were turned to were not banks in that region. They went to the head offices of the big banks in New England and New York and got far more co-operation. I do not want to interpret a situation that I did not study very deeply, but you could almost say that the local bankers were too close to the situation, that they were too concerned with their depositors. They were playing safe on their portfolios in a way which worked against local investment.

Senator McLean: Senator Nichol, when you referred to the new deal, were you referring to the Roosevelt "New Deal"?

Senator Nichol: Yes, Senator McLean. I was searching for a Canadian example, and I think the Roosevelt "New Deal" was the psychological beginning of the whole thing. Of course, there was the Bennett new deal as well.

Senator McLean: That is right.

The Chairman: Honourable senators, if there are no further questions, I shall adjourn the meeting. However,

before doing so I wish to thank Dr. Scott. It is obvious, Dr. Scott, that the Senator's interest could keep us here all night. The hour is late, however, and it is time to adjourn. I should like to thank you very much for your articulate presentation and for answering the questions that have been put to you. Thank you, doctor.

Dr. Scott: Thank you, Mr. Chairman.

The Chairman: Would you also thank Dr. Shearer on our behalf?

Dr. Scott: I shall.

The committee adjourned.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 10

THURSDAY, MAY 20, 1971

Seventh Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses:—See Minutes of Proceedings)

23845—1

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
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Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
	O'Leary
Gélinas	Paterson
Grosart	Phillips
Hays	Sparrow
Isnor	Walker—27.

(Quorum 7)

**Ex officio Member*

Orders of Reference

Extract from the Minutes of the Proceedings of the Senate, of Tuesday, March 9th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said *Estimates* reaching the Senate.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wesnesday, April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Tuesday, May 4, 1971:

"With leave of the Senate

The Honourable Senator Langlois moved, seconded by the Honourable Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relations thereto.

The question being put on the motion it was—
Resolved in the affirmative.

Robert Fortier,
Clerk of the Senate.

23845—1½

Minutes of Proceedings

Thursday, May 20th, 1971
(10)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10:00 a.m. to consider the question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett, (*Chairman*); Beaubien, Desruisseaux, Grosart, Isnor, Langlois, McLean and Nichol. (8).

Also present but not of the Committee: The Honourable Senators Carter, Connolly (*Ottawa West*), Haig, Inman, Kinnear, McGrand, McNamara and Smith.

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Heard as witnesses: Dr. Grant L. Reuber, Professor, Department of Economics, University of Western Ontario and Dr. R. J. Batkin, Dean of Social Science, University of Western Ontario.

At 12:45 p.m. the Committee adjourned to Tuesday, May 25th, 1971, at 4:00 p.m.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Thursday, May 20, 1971.

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 10.00 a.m.

Senator Douglas D. Everett (Chairman) in the Chair.

The Chairman: Honourable senators, we will continue with the hearings on employment growth and price stability. We have with us today Dr. Grant Reuber, Professor of Economics and Dean of Social Science at the University of Western Ontario. Dr. Reuber received his doctorate from Harvard University and did research at Sidney Sussex College, Cambridge University.

In the course of his career he has been with the Bank of Canada and the Department of Finance, a staff member of the Royal Commission on Banking and Finance, and a consultant on international trade, the National Council of Applied Economic Research in New Delhi. He is past President of the Canadian Economic Association.

His publications include *Britain's Export Trade with Canada, The Growth and the Changing Composition of Trade Between Canada and the United States, The Cost of Capital in Canada,* and a very important book entitled *The Objectives of Monetary Policy,* which was prepared for the Royal Commission on Banking and Finance. His publications also include *The Takeover of Canadian Firms,* and *Capital Transfers and Economic Policy.*

Dr. Reuber is an expert on international capital movements, monetary and fiscal policies, with a specialized knowledge of the relationship between inflation, unemployment and international trade.

With Dr. Reuber we are honoured to have Dr. Ronald Bodkin, who received his doctorate from the University of Pennsylvania, and is presently Professor of Economics at the University of Western Ontario.

Dr. Bodkin has been a consultant to the National Bureau of Economic Research, the U.S. Bureau of Labor Statistics, the Economic Council of Canada, the Department of Manpower, and the provincial Government of Ontario. He is on the editorial board of the *Canadian Journal of Economics* and the *International Economic Review.*

His publications include *The Wage-Price-Productivity Nexus, An Analysis of the Trade-Offs Between Full Employment, Price Stability and Other Economic Goals, Price Stability and High Employment: The Options for Canadian Economic Policy: An Econometric Study, Real Wages and Cyclical Variations in Employment,* and *Wages and Price Formation in Selected Canadian Econometric Models.*

As senators read the very lengthy brief which has been filed with the committee they will quickly realize that the two witnesses have devoted an enormous amount of study and research to the problem with which we are dealing and which we put to them. It is indeed a very complete and well-written paper, for which on your behalf, senators, I wish to thank our witnesses.

In accordance with our custom we will ask Dr. Reuber to lead off by reviewing for a few moments the paper that he has filed with the committee.

Dr. Grant L. Reuber, Department of Economics, University of Western Ontario: Thank you very much, Senator Everett. Honourable senators, you have had the brief which we submitted. During the next 20 or 25 minutes I would like to review the main points and take you through the table of contents. Essentially it consists of three parts. In the first part we attempt to examine the principal factors that have accounted for the rapid rise in prices in Canada over the last five or six years. Within the last few years that rise in prices has been combined with high and rising levels of unemployment.

In the second part of the brief we review a set of policy options which we believe this country might consider. We attempt to bring to light some of the implications of each of those options.

The final part is pot-pourri in a sense. It attempts to look at a number of issues related to the first two parts and also address itself to some of the points raised by your staff.

As far as our explanation of the phenomenon of rising prices in combination with high and rising levels of unemployment is concerned, we feel that there are a number of factors which might be particularly emphasized.

Senator Beaubien: With what kind of prices are we dealing?

Dr. Reuber: The brief basically deals with consumer prices, but we take the view that price movements across the country are not that heterogenous. While there might be regional variations in prices, or variations between the wholesale prices index and the consumer prices index, by and large we are looking at the trend of prices over the period since 1965.

One of the factors which must be recognized right from the beginning when discussing unemployment is that during the last decade the rate of increase in the labour force in this country has been quite rapid. While that has to be welcomed in many respects, the fact remains that in labour markets that may not be functioning perfectly a rapid increase in the supply of labour very easily causes the supply of unemployed to back up, at least in the short run. If, instead of considering the unemployment rate one considers the number of new jobs created, our economy in the past five years has behaved very well and better than many European economies. At the same time, given the heterogenous nature of the country and its regional characteristics, the imperfections in the labour market and the pressure of the rapid increase in labour supplies, not surprisingly in our view has been reflected to some degree in the unemployment rates.

Another basic element in the examination of this period of history is, of course, the external price movements. I am sure you have heard all about that. The fact is that when we were on a fixed exchange rate during the period up to 1971, price movements in this country were linked very directly and closely to those in the United States. In 1971, partly because of the exchange appreciation, partly because of the developments in the food industry, partly for other reasons such as contractionary policies that have been followed, price experience in this country has been substantially better than in the United States. However, unless there is a continuation of those developments, it is just unrealistic to believe that over the long run this country will have a price experience which is fundamentally different from the international experience, especially that of the United States. That is a fundamental point that can hardly be overstressed. It is old hat; it has been said many times, yet it is fundamentally important. The minute you lose sight of that in discussing inflation in Canada it seems to me that you have lost sight of the major point.

Another element to which we point is the possibility that some of our product markets have not performed as well as they could have. One would normally expect in cases where a certain amount of slack develops in the country that some prices might go down. That has not been the experience in most markets, with the major exception of food, of course, in the last year. My own view is that perhaps one of the effects of monopoly power, or market imperfections in the product market, however you wish to say it, is that it is not so much that this monopoly power pushes prices up, but rather that it keeps prices from retreating when slack develops in the economy. I think this has been a factor and it has been of some significance.

Senator Grosart: What is the nature of that monopoly power?

Dr. Reuber: I think in the case of the service industries you would find some monopoly power simply in terms of restricted entry to some of the areas of production. In some cases it rests on regulations regarding imports. For example, the tariff clearly tends to support monopoly power in product markets. There are other aspects of it. I am not pressing very hard the notion of monopoly power; I am simply saying that it is not a valid view of the economy to view it in the light of a totally competitive system, in which whenever slack develops in the system prices recede and the markets are cleared.

Senator Grosart: You are not using the expression in the restrictive sense, for instance, of the Combines Investigation Act?

Dr. Reuber: No.

Senator Grosart: It is a generic term for the constraint forces?

Dr. Reuber: That is right; there may be some element of that in it, but I not suggesting it is a widespread phenomenon that has to be attacked face on.

The Chairman: Would you say hospitals are a monopoly power?

Dr. Reuber: They are in a sense; the monopoly is usually the public health service of a province. Public utilities are regulated, but there is obviously not much competition. You are correct in your suggestion that it is a generic term summing up all these imperfections, rather than an expression intended to bring into play the monopolies commission.

I am really using it as a term which suggests that when slack develops in the system we do not get this market adjustment in prices which would be expected.

Senator McGrand: Are you including big business?

Dr. Reuber: Yes.

Senator Carter: And big unions?

Senator Beaubien: With the ever-increasing labour costs, how could anyone reduce prices?

Dr. Reuber: It happens in agriculture. There is a competitive model and I am suggesting the reason it does not happen in other sectors of the economy is that there is not the same kind of competition.

Dr. Ronald G. Bodkin, University of Western Ontario: In particular, in the labur markets, with the various forms of labour organizations, trade unions and professional associations, the response to slack is not to reduce wages and prices for a particular type of service, but rather to hold on and even increase.

Senator Beaubien: That is quite true.

Dr. Reuber: The next item to which we refer is the rapid growth in the size of the public sector in the period from 1965 to 1969. The public sector in this country was, of course, a large public sector, but it grew very rapidly. We argue in the brief that the very rapid rate of growth in the public sector had inflationary effects on the economy. Demand management policies can always be adapted to changes of this kind, but it is hard with such a big sector moving fast. We are really pointing out that during this period the public sector, which was large,

increased at a very rapid rate, which complicated greatly the problem of demand management adapting itself to this growth in the public sector.

Senator Grosart: When you speak of growth in the public sector, have you attempted to distinguish between real growth in that sector and mere transfer from the private sector?

Dr. Reuber: We take it as a ratio of GNP. It is true that some of those transfer items are included in our figures, but transferring a dollar from the private sector to the public sector is not just a simple accounting procedure. Other developments also take place. One is that the service sector increases in the economy, usually at some expense, at least, to the other sectors. The country's propensity to consume is probably increased. There is obviously an accounting identity that can be considered. However, underlying that other things are happening that have to be taken into account when considering stabilization policy and attempting to level out the rate of increase in prices and the level of unemployment.

Senator Grosart: The sort of thing I had in mind could be exemplified by, say, the transfer of health services from the private sector into the public sector, where you have both real growth—that is more people availing themselves of the health service—and also a transfer from the private sector.

Dr. Reuber: We have not made that distinction, but I think it is a valid distinction. We would argue that both of those elements will need to be adjusted to by the aggregate demand policy devices, but they obviously are separable and different in some characteristics.

Senator Grosart: I think it is a real problem, and I have never seen a study of it. What is the effect of this transfer in terms of the economy? Is it a good or a bad thing in terms of national economic growth? I do not know.

Dr. Reuber: I think that is another issue. What we are arguing is that if you are talking about stabilization policy you are trying to keep the policy running on a reasonably even keel; to suddenly have this big sector grow at a very rapid rate means the central bank and the finance department and so on have to compensate. This is an area where everything is fairly uncertain, and just getting that all right is tough, so that the speed with which it grows is an important element in the picture. There are other issues involved, such as the effects on the rate of growth and so on. We have not really considered those here. There is a large discussion on that and it is an important aspect. From the stabilization point of view, I think it is adapting our demand management policies smoothly to this shift in the size of the public sector, which is not that easy.

Dr. Bodkin: There is another aspect that is worth considering, which is the idea of the size of the public sector with demand management growth in that you would expect an increase in taxes. What sort of taxes are you going to raise? If you raise excise taxes, that is very likely to be affected in the price indices, because such excise taxes are usually passed on in the first instance. Even such things as corporate income taxes and personal income taxes may very well be passed on, because trade union leaders and professional associations are not unaware of the tax bite that comes out of the income their members nominally earn.

Senator Grosart: These transfers from the private to the public sector would greatly minimize the extent to which normal marketplace functions would tend to be an automatic stabilizer. This is the point, and it does not seem to have been studied.

Dr. Reuber: I think you are right. I do not think there has been that much study of the relationship between the size of the public sector and stabilization policy. I think you are dead right on that point, and it should be looked at more carefully than it has been.

The Chairman: We will make a note of it and see if we can get some empirical data on it.

Dr. Reuber: The next item to which we refer in accounting for this phenomenon is the lag in prices and wages behind the appearance of a very strong level of aggregate demand in the 1965-67 period. Chart 3 shows that prices and wages have tended to lag behind this development of some aggregate demand pressure. We think if you are going to talk about price movement in 1969, 1970 and 1971, you have to recognize that you are still picking up some of the pressure that was generated in the earlier period—1966, 1967 and 1968. It is unrealistic, in my view, and I think in my colleague's view, to believe you can sort of turn the tap off and on and everything will follow in very tight sequence; that is just not the way the world is.

The Chairman: Do you go further and say this is a case for not reacting too strongly, then?

Dr. Reuber: Yes, we do.

Senator Nichol: Mr. Chairman, on a matter of procedure, do you want questions on this material as Dr. Reuber goes through it? How would you like us to proceed? Would you like us to write down questions and come back, or would you like us to interrupt with questions as we go along?

The Chairman: The committee can proceed in which ever way it wants. I would think probably the easiest way, and the suggestion I would make, would be to allow Dr. Reuber to go through, but if as he goes along with his narrative there are areas that senators do not understand and on which they feel they need a clarification, I think we could have an interruption. Beyond that I would hope we could probably go through to the normal question period. Is that agreed?

Senator Beaubien: We had better go straight through.

Senator Grosart: A Solomon decision.

The Chairman: I hope so.

Dr. Reuber: The next item to which we refer is the exchange depreciation in the early 'sixties. We feel that that was probably a mistake, that in any event going on the fixed rate was questionable, that if we had stayed on the free rate we would have had adjustment in the exchange rate sooner, which would have provided us with some relief earlier during the period of the 1960s.

On monetary and fiscal policies, we argue that during the period 1965 through to the present, one can criticize them in terms of being out of phase, as it were, with the requirements of the day. We are not in any sense saying this was sheer wrong-headedness or mismanagement. There were real constraints on policy during that period; there were external constraints; we had a series of crises; there was another constraint in the form of a fixed exchange rate, which we have already mentioned. However we do think that if one had to relive that period it seems evident that one would probably want to do it rather differently; that the fiscal policy followed probably should have been somewhat tighter during the period 1965-68, and somewhat easier since then; that the monetary policy should have moved within a somewhat more limited range; that we should not have had this variation from one quarter of one period, increasing the money supply at rates exceeding 20 per cent on an annual rate to another period, where we were reducing it in absolute terms.

That summarizes some of the factors to which we point as explaining the picture we have. One of the points to which we would like to give some emphasis is that we do not believe it is all that uncertain why prices have continued to rise since 1968 at the same time as unemployment has risen to over 6 per cent. We are not saying we understand it perfectly at all, but I think there a number of comments being made that this is just outside man's past experience, that it is outside the powers of analysis that we have, and that we need to chuck everything we know and start out all over again. We do not accept that. We are not saying we understand exactly what happened or exactly what to do, but we are saying that within reasonable limits one can understand why since 1969 we have had high levels of unemployment and at the same time fairly rapidly rising prices. In the next section, section 3, we look at a variety of policy options. If you are going to talk about policy, it seems to us that you must have a framework of what you expect to happen in the world. We say there are probably going to be three things that will happen.

First of all, the demographic trend is probably going to be such that the labour supply will continue to grow very rapidly up to about 1980 anyway, based on the forecasts of the Economic Council.

Secondly, again using the data of the Economic Council, we accept the proposition that the public sector is likely to grow some more, perhaps not as fast as in the past but it still is likely to grow.

Thirdly, we accept the proposition that external prices are likely to continue to grow. As you know, there are strong inflationary pressures in Europe and Japan. Furthermore, there will be an American election coming up in 1972, which will tend to provide an incentive for expansionary policies and that will further underwrite rising prices in that country.

With that kind of background, it may be we shall see a continuing rapid increase in the supply of labour, continued pressure for the public sector to grow, and continued pressures for external prices to rise.

I think that is the framework with which we then approach the question of the kind of policy options which are open to this country.

I will just review these quickly. I am sure you may wish to come back to them in your discussion. The first one which we emphasize is labour market policies. It strikes us that there is a variety of imperfections, some of which we refer to here, which prevent the adjustment of labour supplies to labour demand at the present time. The kind of thing we have in mind are regional immobilities, seniority provisions, minimum wage laws, union restrictions, and so on.

Getting these things changed we fully recognize is tough. We are not suggesting it is an easy job. But it is also true that something can be done. I think that, if we are really serious about the problem of trying to deal with unemployment and at the same time rising prices, we have to grasp some of these tough problems. That is part of the problem. We have done everything else, but they are really the tough nuts which remain untouched. That is one thing which we would emphasize. A considerable amount of effort is being put into labour market policy, retraining programs, and so on.

At the same time, we would argue for competition policy, and here we really endorse the proposals from the Economic Council, which you are familiar with. We think those proposals should be acted upon fairly quickly and we think they might be helpful.

We would also argue, in this context, that there is a case to be made for using the tariffs in order to bring greater competition in certain markets where there seems to be some element of market power.

Another area that we argue for—and again it is not a new one—is this. We feel, as I am sure many others do, that there is need for much closer co-ordination of public policy, outside the realm of monetary and fiscal policy, with the objectives of stabilization policy and, of course, further efforts for increasing efficiency in the public service.

When we talk about public policy, we have more or less said that there are basically three or four areas. One is the area of food and agriculture prices. We have a deficiency payments scheme, which is preferable certainly to a price support scheme but even there it is tied to import restrictions.

Another type of public policy we have is concerned with fostering development in particular areas or in regions. Again we would argue that that has to be integrated into a national stabilization policy, and that has not always happened.

The third area is the social welfare programs. There is some evidence that the programs we have in fact inhibit labour mobility and that creates problems in stabilization policy.

We have also got the problem where we initiated public programs in the past, it leads to an increase in the demand for service but nothing much was ever done to provide the supply of that service. Predictably, the price goes up. If you are going to initiate a large public program which provides services free to the community, then presumably the demand for that is going to go up and then something has to be done on the other end of the line to get the supply up as well, otherwise it is almost sure that the price is going to go up.

Another question is the matter of efficiency—that is much discussed and we will not say much about that. On page 14, we have made three suggestions in order to try to improve co-ordination. We suggest that the Bank of Canada and the Department of Finance might review some of the development and welfare programs that are now in existence in this country, to see just what the implications are for stabilization policy.

We also suggest that the functions and capabilities of the Treasury Board might be extended, not only to consider the questions of efficiency and expenditure and so on, which they do now, but to feed directly into that context the question of stabilization, and co-ordinating that objective with all those other desirable objectives.

The third thing we suggest is that in future it might be a good idea, if some departments or ministries come up with proposals to initiate a particular program, that they should accompany that proposal with some documentation as to what the implications of the proposal are, not only for employment and unemployment but also for prices. Frequently in the past, when we have had these proposals, everyone was saying it would create so many jobs, and so on; but if you take the view that it has other implications as well and furthermore it may have implications nationally, not just regionally.

If it could be made a sort of principle that when a department comes up with a proposal to do this or that, that inherent in or as a part of that proposal, there would be an argued rationale or a careful assessment of the implications of that proposal for employment, unemployment and price stability in the country, I think that would have a certain sobering influence on some of the suggestions that arise.

Senator Grosart: You mean, on some politicians?

Dr. Bodkin: That is what I would like to say, sir.

Dr. Reuber: Perhaps. Another item which we mention here is exchange rate policy. Basically what we are saying is that we endorse the floating rate. We would argue we should stay on the floating rate. We would further argue, I think, that we should allow the rate to float, and that apart from day to day fluctuations, we should not interfere too much with the rate which is attained.

Senator Isnor: What is your argument in that category?

Dr. Reuber: The argument essentially is that if we depart from the floating rate it makes it very difficult to have an effective monetary policy in this country, as it was indeed the case during the late '60s.

We would argue, furthermore, that if you have a floating rate you get continuous adjustments and therefore probably less adjustment is required than if you have a fixed rate, hold it, and then, after the dam is about to break you suddenly shift gears and then you really get an adjustment.

Dr. Bodkin: It gives you a bit more independence of developments outside Canada—not total independence, but somewhat more.

Dr. Reuber: The next item to which we refer is general monetary and fiscal policy. I think we really have two points here, which are italicized on page 17 and secondly on page 18.

The first item is:

> Given the openness of the Canadian economy to external and especially U.S. price developments, it seems evident that any attempt to achieve significantly greater price stability in Canada than in the U.S. and elsewhere over any extended period of time is likely to entail very high levels of unemployment even if various policies are adopted to improve the trade-off relationship.

In other words we say, that, with the best will in the world, and lots of action in these areas, it is going to be extraordinarily difficult for this country to have a pattern of price behaviour which is different from that of the United States.

Senator Grosart: How would you define the phrase "extended period"?

Dr. Reuber: Two or three years. The second point we make is that given that circumstance we feel the authorities in this country should pretty well set their sights on a target of about 4 per cent unemployment, averaged out over two or three years. When unemployment is tending to go below that level we would argue that there should be expansion, even if prices are not immediately rising because of this lag effect. On the other hand, if unemployment is going above that level we would argue that there should be contractionary policies, even though prices may be rising at a fairly rapid rate. We would argue that on the basis of historical experience, and assuming the kind of international environment that we have had, 4 per cent is a reasonable target. When we start pushing beyond 4 per cent we get big unemployment and not much in terms of price stability. When we go below 4 per cent in terms of unemployment we get some real action on the price front. So 4 per cent, so far as we can tell from the evidence, seems to be the area to aim at.

Furthermore, it seems better to aim at that kind of target, which I know is a modest target compared to what some people are saying. We would be much better off if we aimed at 4 per cent and sort of stayed at that, rather than having it grow from 3 per cent to 6 per cent and running that kind of a range. If we could narrow the range by not aiming quite so high at times I think we might be better off.

Senator Grosart: Would you regard 4 per cent as full employment?

Dr. Reuber: No. I would not. I would say that given the structure of this country and given the markets we have and given our external relations with other countries, 4 per cent is about the best we can hope to achieve in this country without having some really substantial domestically inspired price inflation. Now, if we get the labour market policy and the competition policy and everything else, maybe that target is no longer quite so realistic and we can aim lower. But on the basis of historical experience up to now, since during the fifties and sixties, for example, whenever we go much below 4 per cent we have a lag; we do pretty well for a while and then pressure builds up and in order to meet the rising prices we run it up the scale well over 4 per cent.

What we are arguing is that if we could sort of focus in a little more sharply on 4 per cent we might be able to avoid these variations.

Senator Grosart: But can you really compare unemployment percentages over a historical series?

Dr. Reuber: Well, that is a leading question.

Senator Grosart: It seems to me that unemployment today and unemployment 20 years ago are different kinds of animals altogether.

Dr. Reuber: I would agree, if you take it back far enough. I would argue, however, that there is some evidence to suggest that this relationship between prices and unemployment is not that unstable. Secondly, I would argue that the effect of external price movements in this country is such that when we get over 4 per cent and we try to defeat international inflation with domestic unemployment we are pushing on a string.

I think when you get under 4 per cent, given the regional structure of the country and the problems in labour markets and so on that I have referred to, then bottlenecks develop and you get some domestic pressures.

The Chairman: In short, you are not attempting to solve the political problem but rather the stabilization problem.

Dr. Reuber: That is right. The political problems are interesting, though. At this point we are not arguing for a rigid 4 per cent day-in and day-out. We are looking at it over a two- or three-year period and we are saying that if we could focus on the 4 per cent level on unemployment, then when it goes over that we could draw back and when it goes below we could push the lever forward. In that way we would hope to narrow the range of variation in unemployment. That might provide a more suitable sort of posture for policy than a policy which simply runs along until the price index starts to go up fast and everybody jams on the brakes and we swing in the other direction.

Senator Grosart: What would you regard as full employment?

Dr. Reuber: In the context of this country I regard 4 per cent as the target I would aim at. If you want to say full employment in an ideal sense, it is zero, but that is unrealistic.

Senator Grosart: Economists have said 3 per cent.

Dr. Bodkin: I would accept that as minimum frictional. There is always going to be some unemployment in our kind of economy just because it takes time to change jobs. If a person quits a job in one region and moves somewhere else, he is unemployed for a short period of time. I think 3 per cent would be what one could regard as the statistical counterpart of frictional unemployment.

Senator Connolly (Ottawa West): It would appear that if there is such a thing as a halcyon day for employment in an industrial economy it will never be the absolute of unemployment. We will always have unemployment, and the question is what is the minimum that is reasonable in circumstances.

Dr. Reuber: We are suggesting in our brief that it is 4 per cent. We suggest that is a realistic target in this country.

Senator Connolly (Ottawa West): The point is that even if unemployment is only seasonal it becomes a very serious matter when it goes as high as 7 per cent owing to all the human suffering and privation attendant upon it. It is a serious matter not only for the economy of the country but for the social fabric of the country as well. Ultimately, economics should contribute to the build-up of the social fabric of the country. That is the reason for economic studies, I assume. In your opinion must we accept a certain amount of unemployment because we have a growing industrial economy, that is, an economy that is growing in industrial development?

Dr. Reuber: Following upon my colleague's point here, I would say that in this country, with its regions and so on, 3 per cent frictional unemployment will be a very bare minimum. I would argue further that probably, if you are averaging out over time and given the vagaries of the circumstances and so on, you would need another 1 per cent to keep a grip on the system.

I think as the country develops there is no particular reason why that figure should get larger. I believe you are dead right in suggesting that when we get over 4 and 5 per cent unemployment the social and political tensions in the country become acute, especially in view of the country's regional character. I think it is a very serious national problem. It is an economic problem but it is also a political and social problem of major dimensions.

Senator Carter: You have stressed the abnormal growth rate we have had in our labour force, and you have said that 4 per cent is geared to that rapid growth. If the growth of labour force were to stabilize at a certain point, would you still feel that the 4 per cent was the correct figure?

Dr. Reuber: Such a stabilization might relieve the situation somewhat. We are framing these policy options in the context I outlined at the beginning, and one of the points we made had to do with the environment in which policy is going to be made in this country over the next

five to ten years. We believe that environment will, in fact, be one of rapid growth in the labour force. That is one element in it, as we see it. If indeed the labour force growth stabilized, it might very well be realistic to think of a different target.

Senator Carter: Have you any figures or graphs to show when it might stabilize?

Dr. Reuber: No, we have not. The forecasting on this was done by the Economic Council basically up to 1980. If you look at the first table of the appendix you will see their projections of the rate of growth. The rate of growth, as you can see, is tapering off, but it is still relatively rapid compared, for example, to the 1950-1955 period.

Senator Inman: What was the average of unemployment during the years 1940 to 1956?

Dr. Reuber: Well, during the war it would have been very low, possibly below 2 per cent for all I know. I am told it was 1.2 per cent. Then during the period 1945 to 1950 it was still very low, possibly 3 per cent less but then from 1950 to 1956 it was over 3 per cent on an average. But in many senses during the war period the circumstances were very different.

The other item which we considered, and I shall not say too much about it, was that of selective fiscal policies. It is our view that these measures which we used to use back in the 1940s and the 1950s have been more or less abandoned and are out of fashion these days. We suggest that perhaps the time has come to reconsider the possibility of selective fiscal policies—financial arrangements on certain types of purchases—there are all kinds of suggestions in this area—tax holidays, double taxes, if you need that, and so on. We also refer, and I shall not mention them further, to proposals to levy taxes on wage earners. We do not think much of that.

We have another proposal here by Professor Weintraub that would in effect tax corporations additionally if they granted wages in addition to the guideline level. Here we have some difference of view, as a matter of fact. I would be skeptical of that, but my colleague thinks that in desperation he might be willing to try it.

The important point we want to emphasize here, I think, is that we really advocate stand-by fiscal powers to be exercised within a limited range on a discretionary basis. We fully comprehend that you can always change the taxes through the budget and Parliament, and so on, but it does seem to us that some attention might be given to the idea of arming the Government with stand-by discretionary power to change taxes over a certain limited range without going through the whole parliamentary apparatus.

We are also suggesting implicity, and this is a point which is quite important, that we believe there should be more flexibility in fiscal policy relative to the flexibility we now have in monetary policy. Fiscal policy in this country is a fairly rigid kind of instrument while in the area of monetary policy if you look at the variations in money supply, they go up every quarter and so on. We are suggesting that perhaps we have relied too heavily on flexibility on the monetary side without providing more flexibility on the fiscal side, and if we could provide in one way or another for greater flexibility on the fiscal side, our armaments might be somewhat improved.

Senator Connolly (Ottawa West): This is a revolutionary idea. It is contrary to the whole parliamentary system. What you are saying in effect, I gather, is that if they have discretion in government on the monetary side, then they should at least look at the possibility of having discretion on the fiscal side.

Dr. Reuber: That is exactly it. Of course I am not an expert on parliamentary arrangements, but I should have thought a law could be framed which would within a range provide for flexibility. We are not saying that you should throw it wide open and that the government could do anything it liked with the tax overnight; we are saying that there could be opportunities provided for the government to impose consumer credit restrictions or to provide tax holidays within a limited range and perhaps justifying it to Parliament after the event in some way.

Senator Connolly (Ottawa West): There is a jurisdictional problem here when you come to the question of prices and wages.

Dr. Reuber: I agree that this not a simple solution, but the general import is in fact that we do this now through the monetary side. After all, we have other areas of discretionary policy; that is not the only one. In principle the precedent has been bent very badly anyway, and we feel that by providing greater flexibility on the fiscal side we could perhaps provide greater leverage to run the economy. Furthermore, we would argue that whatever leverage is provided through both monetary and fiscal policies should be run within a sort of orderly framework basically geared to long-term prospects, and we should not have these large variations which in some cases we seem to have had on the monetary side.

The final two options we consider are direct controls, and we do not think much of them which probably will not come as much of a surprise. In large measure we think that that may be substituting one kind of problem for another. Obviously if there was a war, it might be necessary to do that. Secondly, if you have exhausted everything else and you cannot get a grip on the system in any other way with unemployment high and prices going through the roof, then you may have to do it. But within the range of other things we possibly could do and given some of the potential problems with direct controls, we feel it should be regarded as a third or fourth option and should not be at this stage considered too seriously.

There may indeed be sectors of the economy which for one reason or another one might regard as being just outside normal market forces, and if you can identify them and if you know what to do having done so, then in principle, of course, you should do it. But, of course, that is easy to say. It is not so easy to identify what those sectors are, nor is it easy to say exactly what you should do after you have identified them.

A voluntary incomes policy is the last option we consider, and we are very sceptical about that. We think that is the worst of both worlds since it involves neither controls nor non-controls—it is in fact a mirage in many respects. If you are going to run a controls system, well, then, face the music and have controls. But do not delude yourselves that by asking people to be nice guys much is going to happen so far as stabilizing prices is concerned. This is not just our view. The experience around the world has been that these things are established, there is a lot of action for a while, and big discussions, and nothing much happens. I might mention here a comment by Eric Jacobs who was on the British Prices and Incomes Board and his general conclusion was that it is all a waste of time. I think we would argue in the light of the work by David Smith and others that the prospects of getting much out of that exercise are very, very small.

There is another section in our brief that I would like to mention, namely, the question of trade-off relations. There is a big argument about that, as to how stable it is. We take the view that in the short run there is a relationship between price stability and the level of aggregate demand in the country. We recognize that over a period of time you might get expectations develop, and that if you ran the economy continuously at 3 per cent or 10 per cent unemployment everybody would adjust and you might not get much extra employment out of it.

There is a very important point to be made in this connection, and we come back to the old point about external price level. Expectations about price changes in this country are as much geared to what is happening to price levels in the United States and in other areas of the world as what is happening in this country. We take the view that it is just hopeless to try to deal with expectations and everything else coming in from outside, trying to hold the line when all this pressure is coming in. In some sense, if you are willing to recognize this very fundamental point, so far as Canada is concerned, then it seems fairly evident that there is a limited trade-off. On the other hand, there is some when you get up to fairly high levels of unemployment.

The Chairman: Do you make the same point with a free and floating exchange rate?

Dr. Reuber: Yes, we do. We do not believe that it makes that much difference in the long run whether you are on a free or floating rate. We argue the advantages of a floating rate for short-run adjustments.

I would be willing to argue that in the long run it would be the same, but in the short run, when you have this extra flexibility, you can adjust.

There is, however, a theoretical point that if you are willing and ready to take the wraps off and to really let the rate go all over the place, then in principle you could conceive of a more independent policy. There are a variety of reasons why that does not happen in this country, but we can talk about that later. Our case for the free rate is not really the case that we would argue, that we would have a fundamentally different price pattern in this country. Our case is really the short-run adjustment case.

When we look back over history, back to 1923 or whenever was the beginning point, through that whole period we have had a fixed rate on a flexible rate. We keep bobbing in and out. The degree of similarity in price movements over that whole period is really very impressive. I argued at one point that the variations in price between Canada and the United States over that period, taken as a whole, are less than the variations within the United States in the rate of price change.

Senator Beaubien: You mean in different parts of the United States?

Dr. Reuber: Yes, when I compare Canada to the United States and the different parts of the United States to see whether there is much of a difference in pattern.

Senator Beaubien: That has continued since the war.

Dr. Reuber: I think so, yes. Regarding the regional question which has been raised, this is one of the really tough questions. It would be delusion on my part to suggest that we have the answer. What we argue essentially is that we can think of no regional policy that would be as helpful, from the standpoint of developing the regions and assisting the regions, as a high level of demand and employment nationally. If you adopt regional policies, which may be quite valid and satisfactory, and those regional policies have to push against a national level of demand that is inadequate, they will have a very hard time of it. To get the most out of your regional policies you need to have a generally prosperous country. Without that you have problems.

Senator Grosart: Is that not the very opposite to what happens politically? It is when you have a depressed economy that you have pressure for regional incentives.

Dr. Reuber: You are probably right. The pressure backs up into the regions that are having problems. Then the pressure mounts to require regional policies, which brings me to the second point.

Although it is mysterious as to what a good regional policy is in this country, we would argue that the objectives of our regional policy have to be clarified. When we design a regional policy we have to integrate that regional policy into our national stabilization policies. It is not clear whether some regional policies are in fact in conflict to a certain degree with some of our national policies. Again that is very easy to say. We are coming back to the co-ordination point.

Senator Carter: When you say "regional policy", are you thinking of the policies of provincial governments or the regional policies of the federal Government?

Dr. Reuber: We are thinking about both, and certainly the latter, which is within the federal ambit.

Regarding regional policies of the provinces and the federal Government, we think that is an important area for co-ordination. I did not hear Professor Scott, but I gather that he referred to certain devices which might be

brought into play to integrate these, and I would endorse those. We have had consultative machinery, and we have intergovernmental transfers, and so on, which are intended to assist. It may well be that we need some additional machinery such as that suggested in the Porter Report to integrate more tightly the policies of the provinces and the federal Government.

This is an extraordinarily tough area. I can only apologize that I cannot say more about this matter that might be useful to you. If I had the answer I assure you I would be the first to let you know. This is an area where a great deal of research is now going on. It represents the heart of our difficulties, and is an area where very substantial additional efforts are required.

Another area to which we referred is that of wage determination, which is central to this whole discussion. We do not think that labour markets across the country are working that well. Obviously labour wage rates do respond to aggregate demand, but there is some evidence that in some areas at least it is not entirely a demand phenomenon. There are pressures, and consequently we suggest that this is not only an area where you might want to do more research and get greater clarification, but is an area in which we have to come to grips with labour policies, to find out what these imperfections and power structures are. When we have discovered them, someone has to do something. Professor Crispo, for example, suggests that the union hiring halls may be a field for consideration. I know there are difficult problems, but facing the question of rising prices combined with unemployment involves not only difficult problems, but difficult solutions.

The next to final item to which we refer is the matter of lags. We put it forward as an explanatory point, saying that there are better things and information that might reduce lags. However, there should be no misapprehension on the point that there will be lags in the system. We argue, therefore, that one should perhaps operate the levers over a more limited range, not jam them back and forward too hard, in order not to overshoot or undershoot the targets by too wide a margin.

The final section is where we put our neck on the block a bit and discuss current policy. Again, we feel that in discussing policy a view of what the world is like, the environment for which the policy is intended, must be kept in mind. We accept the view that the economy is in an expansionary phase. Prices are likely to continue to rise, less sharply, but nonetheless continue. Without change in policy we are not likely to reduce the unemployment rate below 5 per cent in the next year or so. In those circumstances we argue that there is probably a case to be made for some moderately expansionary policy. We vote more or less for some reduction in personal income tax and indirect taxes.

Then we go on to discuss briefly some of the effects that might have on the exchange rate and the feed-back on the economy. We argue that on balance it would have an expansionary effect of moderate dimensions and would assist the economy to move towards what we feel is the appropriate target of around 4 per cent.

Thank you very much, Mr. Chairman.

The Chairman: Dr. Bodkin, do you have anything to add to Dr. Reuber's presentation?

Dr. Bodkin: Mr. Chairman, let me be very brief, because I know the senators are eager to get to the substance of their questions. I would like to comment first of all that it was very nice of you to provide a blackboard for us.

The Chairman: We wanted you to feel at home.

Dr. Bodkin: We academics just do not really feel at home unless we have a blackboard. While I will put aside the temptation to cover it with equations, I cannot resist the temptation to at least put a graph on it and restate some of my colleague's points in terms of that graph. This graph is substantially that on page 16 of our brief, and is related to the trade-off between the goals of full employment and stable prices. This is the rate of change in prices level, P dot on that vertical Axis. This is the rate of unemployment. That is the numbers unemployed as a percentage of the labour force.

I would like to return to the question of Senator Connolly (Ottawa West), why must we accept 4 per cent unemployment? Basically the answer is one must accept something other than zero unemployment, because if we do not we will have a very rapid rate of inflation, which will also put strains on the social fabric. Indeed, the question as to the unemployment rate from 1940 through 1956 should be broken into two periods. The war period contained a special set of circumstances, of course, with a wide-ranging set of controls to hold the lid on while the principal effort of defeating the Axis was carried forward. In the immediate post-war period, 1946 to 1956, we had low unemployment rates. However, we also had fairly rapidly rising prices once the price controls mechanisms were dismantled. So we believe that this relationship exists in the economy. It is not fixed and immutable; it does jump about, because other factors influence it. Indeed, it deteriorated in 1968-69 and early 1970. Then it shifted upward; there is more unemployment and a more rapid rate of inflation at the same time.

Then, with the depreciation of the Canadian dollar beginning last June, it again shifted downward temporarily, which resulted in a pretty good price performance, although we believe it is likely to be temporary. However, there has been some debate in the profession as to how stable this is. We take the view that it is fairly stable through a medium-run period, five to 10 years. Maybe in 20 or 30 years it will become vertical, but we think policy must have a somewhat shorter-run focus than that. That is one point.

Indeed, if you will permit me, I might even tell a story. The existence of trade-off is a fact of everyday life. I would like to tell a personal story, which I think illustrates this point to a large extent. One night after my wife and I had a big evening she indicated that she was pretty tired and would like to sleep in the next morning and would I kindly take charge of our three active, dynamic youngsters, ages 1½ through to six. At 7.00 a.m. they bounced up enthusiastically, I somewhat less enthusiastically. Downstairs we went. I was mindful of her directive the night before: "Do not order them from

my door; that upsets them. Divert them and play with them". I went down and gave it the old college try and more or less kept them away and reasonably happy for about an hour. At breakfast my wife congratulated me on my effort and somewhat incredulously asked, "How did you do it?" I said, "They do tend to like cookies in the morning and we usually say no; I gave in on that point". She looked at me rather ruefully and said, "Daddy is a trade-off man".

This is a fact of life; often our goals conflict and we have to decide what shortfalls in perfection in policy we are willing to live with. Sure, 4 per cent unemployment is not ideal; frictional unemployment is 3 per cent or maybe even 2½ per cent. However, the strain on the social fabric of 4 per cent unemployment is not that great. You will find that most of the unemployed will get a job within four to six months. Those with more difficulties, such as secondary wage earners, who have other family income to fall back on, will be covered by our social income maintenance machinery. However, when there is 6 to 7 per cent measured unemployment, the real problem is probably a little greater than that, because there are involuntary short time unemployed and people who no longer count as unemployed because they have dropped out of the labour force. This indicates a tremendous social cost and a straining of the social fabric.

I would like to comment briefly on and add to my colleague's comments on incomes policies. We really do not think much of these. I suppose one can argue that perhaps Canada had to have a try at this, just as other countries have. We tend to be very critical of this, because really what are you doing with incomes policies? If they are to work you have to tell people with the power to set their own prices, or with some power to negotiate wage or salary increases, to refrain from using their power to the utmost, to shift income from themselves and their families to the rest of the community in what is regarded as the national interest: the sort of community chest approach to economic policy.

In other words, you are asking people to be nice guys for some vaguely defined social goal, and they have no assurance that the other people in the community will do this. In fact they can guess, on the basis of past experience, that they probably will not do it. In this context I really think Leo Durocher, the baseball player-manager put it very aptly: "Nice guys finish last". In that context, who wants to be a nice guy? In fact, that is why I would say if you really think there is a basis for doing this, for goodness sakes pass a law so that you can count on other people's adhering to the social convention. Trying to count on general goodwill for solving economic problems of this sort is not realistic.

Turning to the question of price controls, I endorse what my colleague says, that you may well solve some problems but you will make other problems. I have taught courses in comparative systems. I have never been to the Soviet bloc countries, but I am very eager to go some day and see some of these things first hand. The stories you get of such economies are fantastic. Sure there is full employment, but the unemployment may be disguised, and people may be sitting around doing nothing; they may be responding to the wrong sorts of stimuli. I am critical of this. I would still say probably price controls would beat a situation where there is a régime of 8 to 10 per cent rates of unemployment.

The Chairman: Thank you very much, Dr. Bodkin. We are now open for questions.

Senator McGrand: I have two questions, and I will ask the second one first because we have just been discussing the 4 per cent rate of unemployment. If we should stabilize unemployment at 4 per cent and salaries and wages go up another 50 per cent, could we not end up with a kind of stabilizer of 6 per cent unemployment? Even if it went to 100 per cent, we may have 10 per cent unemployment. That is my question, but I now want to make a statement.

We are aware that we have an open economy, with great open spaces in the Arctic and so on. We are different from compact countries such as Denmark. The native people and the white people who live along the Greenland coast have a higher standard of living that the natives and the white people who live on our Labrador coast, yet they fish the same waters. Denmark, Norway, and New Zealand are small countries with limited natural resources, yet their unemployment rate is low and they have very little poverty. Is there any connection between my statement and my question?

Dr. Reuber: If you are talking about Denmark, the Netherlands and some of the European countries you are talking about countries which have a totally different structure. After all, they are small countries, with homogeneous labour markets, with mobility and so on. They are also countries in which the labour supply is growing at a much slower rate. It is not surprising that in those countries there is a lower level of unemployment than in Canada.

As far as your question on stabilization is concerned, when we say we are aiming at 4 per cent unemployment we are really saying in the context of the curve we have shown that the curve becomes virtually flat at 4 per cent, it runs out straight. Given the international environment, we do not think you will get much more price stability by running up the unemployment rate. We would therefore say that if you aim at the 4 per cent unemployment target, that does not necessarily imply that five years later you will have a 10 per cent unemployment target.

Senator McGrand: But if wages and salaries go up another 50 per cent?

Dr. Reuber: It is true that if indeed wages and salaries go up 50 per cent unrelated to what is going on in the economy, then you may be stuck with the situation my colleague was talking about, where you may have to go for controls. I guess at this stage we feel, however, that would really be indicative of substantial problems in the labour market, and that before you get around to direct controls, and all kinds of other things that will really cause trouble in other ways, the first thing to examine is what is the difficulty with the labour market. After all, if there is unemployment in one area and wages

are going up by 50 per cent in another area, it is not clear to me why a fellow cannot move from area A to area B and get a job.

Senator McGrand: My question and what I had in mind was this. There are these small countries with limited natural resources, with low income, low poverty, as opposed to a country such as Canada where wages and salaries are going up rapidly, where we have a high rate of unemployment of between 4 and 6 per cent, which may go up to 8 per cent. This is the point I was trying to clear in my own mind. What is the connection between rising wages and salaries and a high unemployment rate compared to these smaller countries with fewer resources, who are perhaps better organized.

Dr. Reuber: If you are making the point that there is a highly imperfect market, that wages sort of march up on their own and that therefore creates more unemployment, I think that is a valid point in some respects. However, I rather think that is the wrong focus, that what one needs to look at is why those wages keep up when there is all this unemployment. I am not talking here about regional unemployment particularly. Why is it you can get unemployment rates in Toronto over 5 and 6 per cent at the same time as wage increases in the construction industry and so on, in which some trades are skilled but others are not very skilled? How do you explain the phenomenon of these rapid increases in wages simultaneously with fairly extensive unemployment? Why does not the market work? That is the question. If you can answer that question, maybe you can do something about it.

Senator Grosart: Is not the market really working in a non-conventional way? In other words, when you have unemployment, have you not a new trend altogether, where, to use your term, the monopolistic element in the labour force is then demanding higher wages because they are not working all the year round?

Dr. Bodkin: Because they are partially unemployed.

Dr. Reuber: That is right. It is certainly true...

Senator Grosart: There is a market force but it is not working the way we always assume that supply and demand works, but it is working and it is the market.

Dr. Bodkin: The purely competitive mechanism is no longer applicable. They have considerable market power, because they have the power to control the supply, but there are lots of unemployed individuals with either similar skills or who could acquire them in short order, who would act as a check on this power to raise wages were the opportunity to work there open.

Senator Grosart: But that is part of the market. That is one of the market forces.

Dr. Reuber: But it is a market protected by some device.

Senator Grosart: Economists seem to use this term "the market forces" as though the only market forces are laissez faire free forces.

Dr. Reuber: No. That is not what we are saying. We are saying if you have a market, and we are quite prepared to recognize all kinds of imperfections in that market, restrictions on entry into it, and so on.

Senator Grosart: When you use the phrase "imperfections" you are saying that anything that is not a free market is therefore imperfect, whereas it may not be so.

Dr. Reuber: Perhaps it is a technical use of the words that I am using. If you want to use another word, well and good.

Senator Grosart: It is a bad word, because there are so many assumptions behind it that are challengeable. When the word is "imperfect", there are assumptions there.

Dr. Bodkin: There is a certain value...

Senator Grosart: It is not just a semantic tag to pull out of the air. You use that because there are certain assumptions you have there, that the market would be more perfect if there were not some of these forces.

Dr. Reuber: Perfect in the terms of allocating labour in a more efficient way. In that sense, it would be more perfect. It is imperfect in the sense that it maladjusts the efficient allocation of that labour. Now, that is a definition of it.

Senator Grosart: Except that I would still have to question your use of the word "efficient".

Dr. Reuber: Efficient, in the sense that you absorb the labour supply.

Dr. Bodkin: Or efficient in the sense that out of a given labour supply and other resources, you get more output. These things not only have inflationary implications but they mean there is less total product produced out of a given set of resources. Do you agree that is inefficient?

Senator Grosart: No, because I would say that efficiency in the labour market is qualitative as well as quantitative.

Dr. Reuber: What is that?

Senator Grosart: That is, in price. You are saying that you can employ everybody if you have this competition and therefore the rates come down, and you say that is efficiency in the market.

Dr. Reuber: We are not saying the rates come down. They just do not rise as fast.

Senator Grosart: It is the same thing.

Dr. Reuber: No, it is not. It is different.

Dr. Bodkin: They do not rise by 20 per cent per year when there is 25 per cent unemployment in that particular sector.

Senator Grosart: But who is to decide that 20 per cent is not efficient; is not perfect?

Senator Beaubien: I would say that 25 per cent is not efficient or perfect in anything, in any sense.

Senator McLean: An economist looks at unemployment and inflation. They are not supposed to go together. Is not that right? Our past experience on inflation shows that higher prices came with low unemployment. This time we have inflation, high prices and high unemployment. Is this a different situation from what we had before? Right?

Dr. Reuber: No, I do not think so. I think we had much the same experience back in the late 1950s.

Senator McLean: In 1957 and 1958?

Dr. Reuber: Yes. We had rising prices during part of that period. We are suggesting the lags in this situation are such. If you look at this Chart 3, on page 40, which we have produced here, the first line there gives you an idea of the level of deviation of demand from that sort of average.

Then, the next is the deviation of prices from the trend and the next is the deviation of the labour share from the trend. There is about a 2 or 3 year lag. You put the pressure on and you get demand going, and by the time wages and prices adjust two or three years have gone by. It takes two or three years to work through the system. We are really arguing that one of the elements in the picture is this lag element. We are also arguing that a major element in the picture is the international price level.

Senator McLean: The situation in Canada today just does not add up as far as business goes. We have rising prices, inflation, and still have very high unemployment —6 per cent, 7 per cent, sometimes 8 per cent.

Dr. Bodkin: The price performance was not so bad over the past year. It was approximately 2 per cent, year to year to 1970-71. Compare that with 5 per cent in the United States, 7 or 8 per cent in Britain, 5 or 6 per cent in the Common Market areas.

Senator Grosart: It was the best in the world.

Senator McLean: In the last survey, it has not gone higher than it has in the past two years.

Dr. Bodkin: The year to year figure is still only about 2 per cent. It has accelerated on a quarterly basis. We are starting to recover now.

Senator McLean: We all recognize the fact that if we have full employment, we have to have some inflation.

Dr. Reuber: Yes.

Senator McLean: That is recognized fairly by economists and business.

Dr. Reuber: Yes.

Senator Grosart: Not all.

Senator McLean: In this situation here, with high unemployment and rising prices, the businessman is . . .

Dr. Bodkin: But, remember the country is not an island and, with an economy as open as the Canadian economy—open in the sense that it is open to external influences where prices are rising rapidly abroad, overseas and in the United States—you could just expect some inflationary pressure from that regard. I would agree that it would be puzzling if prices in the rest of the world were stable, but they are not. This country has had the best performance on inflation in the past year, at the expense of close to the worst performance on unemployment.

Senator McLean: My understanding of inflation, over years in business, is that with low unemployment there were more dollars chasing fewer goods and, of course, we had inflation, and rising prices. But in this situation today it is not working that way.

The Chairman: I think what the witnesses are saying is that in effect it is working except that due to the lags in external price influences it is not working quite as fast as we would like it to work.

Senator McLean: In other words, they do see a cure?

The Chairman: They say that the only possibility that they can see is to do such a thing as setting the norm at 4 per cent unemployment, and that is your trade-off; that you accept 4 per cent unemployment, and your stabilization policies are built around that 4 per cent.

Senator McLean: Then, 4 per cent is recognized as healthy for this country?

The Chairman: No, they are saying that with 4 per cent you can get a fair trade-off; you can stabilize.

Dr. Reuber: We are saying essentially that 4 per cent we think we could live with, with the price implications of a 4 per cent level of unemployment. That might mean a fairly rapid increase in prices if the United States is inflating at 5 per cent a year. We are sure it would. If, on the other hand, the United States price level is stable, then we think that a 4 per cent level of unemployment in this country would probably result in fairly stable prices in this country.

Senator Nichol: Dr. Reuber, I have two questions, which are connected. The first one is on the question of lags. It seems to me to be right at the very crux of the whole problem. The debate which is going on in the country always is as to what our economic policy should be. It has its base, I suspect, in the problem of identifying where we are. You have been very specific in your suggestion of 4 per cent as a means of overcoming this lack of knowledge, perhaps, that we have about the lags. In other words, you identify this as a point about which we can operate regardless of what may appear to be extraneous forces. So, the first question I wan to ask you is: Accepting a 4 per cent point as a base point about which we operate fiscal policy, and perhaps monetary policy, what else can we do about identifying these lags? How ignorant are we of these lags, and how they work?

Dr. Reuber: I think we are fairly ignorant. The 4 per cent point, I agree, is an arbitrary point. It is not a number just pulled out of the air.

Senator Nichol: I did not mean that.

Dr. Reuber: If you look at the evidence over the past that seemed to be a point where, if the rest of the world was stabilizing, we could stabilize, and vice versa. So far as the lag question is concerned, I think one needs to distinguish between the so-called inside lag, which is the lag of getting the whole policy machine unravelled, and the outside lag, which, once you have taken an action, is how long it takes for anything to happen out there in the bushes.

Senator Nichol: That is right.

Dr. Reuber: I think you have to have a separate attack on both ends of that. On the inside lag, as we suggest in the brief, this is really a matter of having better economic information more rapidly; it is a matter of having improved and sharpened-up administrative procedures so that when information comes in it is fed in very directly, and somebody is there to do something with it. This ties in with our idea of discretionary powers for fiscal policy. You do not have to sit down and prepare a budget speech and all the rest of it as now. You can act.

With all that you are still going to have an inside lag. It is just undeniable. On the outside lag, we suggest there are two factors. First of all we would argue that by setting a more predictable policy framework, that in itself will reduce the outside lag. If the public and everybody concerned knows what the target is and sort of knows how you operate the framework within which you operate more clearly, then expectations by the public are going to work with you. That in itself will reduce the lag.

We would also argue that sometimes our policies are of a nature that they increase the lag. To the extent that the incomes policy had any effect it probably increased the lag. In other words, you slowed down price increases in certain sectors for a while only to find subsequently that you got not only the current shot on prices but you picked up all the past that had been more or less deferred. Another way in which we may increase the outside lag is when, for example, we restrict interest rate changes or exchange rate movements by sort of smoothing things out over a long period of time. Instead of letting the market really move we stretch things out and blunt the effectiveness of the market in bringing about the changes that are sought. Again, as with the other kind of lag, you are still working in a world where everything does not happen simultaneously.

I think, however, that with some improvements it is still realistic to think in terms of a discretionary policy. In other words, we do not support the notion that you want a kind of automatic pilot, where you set the money supply at 5 per cent and fiscal policy at whatever per cent you wish, and you go on holidays and let her run. The basis of the automatic proposal is that with the discretionary proposal you are wrong as many times as you are right and, therefore, with the automatic system you could not do any worse. That is more or less the argument. We do not accept that argument. We argue that you are not going to do a perfect job with a discretionary system, but that at least there is hope that you will do better with the discretionary system than with the sort of automatic formula type of policy.

The Chairman: Are there any automatic stabilizers such as consumer credit controls which would have to come into play at certain levels?

Dr. Reuber: We would not argue that those should be invoked automatically.

The Chairman: Would you never have any automatic controls?

Dr. Reuber: The words "automatic stabilizer" refer to certain built-in stabilizing factors such as unemployment insurance which becomes operative when people become uemployed.

The Chairman: I think what we are talking about here is fiscal measures that would be employed automatically on the happening of certain events so that there will be no decision lag.

Dr. Bodkin: We have something of that in the tax system already, where tax collection occurs automatically.

The Chairman: I realize we have that in different forms already, but I am talking of the imposition of policies that are strong fiscal measures.

Dr. Reuber: We would not argue in favour of setting up some kind of formula according to which, if something happens, a light goes on and consumer credit controls are suddenly applied. That is not what we are arguing for at all. Really, we are arguing for an intermediate position, a position between the present system and a really automatic system. We would like some limited discretionary power to be made available to the Government so that at the Government's discretion it could invoke some fiscal measures over a limited range to give a little more flexibility to the fiscal lever than it now has.

Senator Beaubien: But, Dr. Reuber, the Government has every discretionary power now. Any minister of Finance can get up in Parliament and say, "With effect from today this is the law". There is no doubt that he could put on a special tax or reduce a special tax. So far as "fiscal" is concerned, the Government has every discretionary power now.

Dr. Reuber: You are quite right. They do have that power. What we would like to see is that power highlighted so that it is visibly there. We hope that would provide an incentive for them to use it on occasion.

Dr. Bodkin: On Senator Nichol's question concerning lags, there are two points I should like to add to my colleague's comments. One, it may well be that the lag on the so-called real side—that is, price level deflated output and unemployment—is somewhat shorter than the lag on the prices side, and that is going to complicate your problems of designing efficient policy.

The other point I would add is by way of analogy. You could compare using the lag system to driving an automobile: when you press the accelerator you get a pretty quick response; when you step on the brake you also get a pretty quick response. But if you designed an automobile

so that for some reason when you stepped on the accelerator it took a long time for the acceleration to build up, and similarly when you stepped on the brake, and just to make life interesting the lags were not quite the same—and perhaps there was even a random number generator in there—then, if you are driving that sort of car you would want to drive it with rather more caution than you would drive your ordinary automobile. In a sense that is why we are saying that when you focus on a target rate of unemployment you may focus on some short fall from full employment because if you skate too close to getting there in the minimum possible time you may fall into a few ditches on the way.

Senator Grosart: To carry your analogy through you should have said "skid" instead of "skate".

Senator Nichol: If you are collecting analogies on this question, I might repeat one that I heard from an economist not long ago. He suggested the situation is like a man who takes a rock and ties an elastic band to it. He throws the rock as hard as he can and when he sees that it is just about to disappear from view he starts to pull back hard on the elastic. The rock starts moving back towards him and eventually he sees that the rock is coming extremely quickly so he starts to push on the elastic. It does not work, so his only alternative is to duck and watch the rock disappear the other way whereupon all he can do is start pulling on the elastic again.

Dr. Bodkin: That is a nice analogy. I had not heard that one before.

Senator Nichol: I should like to go back to the question of the two kinds of lags and deal first with the question of the inside lag. We have been told by one of our witnesses—I think it was Dr. Ostry—that the Canadian system of economic statistics was as efficient, as good and as up to date, as any in the world. Let us assume for the moment that that is so. How far are we off the mechanical and statistical systems which we need to identify our point in time on this question of inside lags. After that I want to ask you a question on outside lags.

Dr. Reuber: I think I agree with what you have been told about our statistical service: I think they are doing a very good job. But I think they would be the first to agree that there is always room for improvement. I think the advent of the computer, and putting a lot of our data on the computer and being able to regurgitate it very quickly and in readable form, has been a very, very substantial change. Now I am not quite sure that we have exhausted all the possibilities along that line. I know, for example, in terms of forecasting there is a great deal of work going on in Ottawa developing models, trying to get a grip on the outlook, and I think you really have to do that if you are going to cut back on the lag. You cannot just look at what is happening today; you have to look at what is going to happen two days from now or two years from now.

I think the other thing that has to be recognized in this context is that in some sense you have to gear your level of expectations about policy to the kind of system you are in. I think anybody who expects this country to walk along a tightrope of 4 per cent or 3½ per cent or any other per cent is just wasting his time. That is just not going to happen, and we have to allow for variations. My personal view is that we have made great strides forward in improving our statistical data and our understanding of it and so on, but there still remains much to be done.

Dr. Bodkin: Indeed in one specific area where I do not think one could give the DBS the highest mark is in preliminary estimates of national income. I understand it takes about 13 or 14 weeks between the end of the quarter and the preliminary estimates while in Washington it is done in three or four weeks.

Senator Nichol: I remember in the fall of 1969 asking five automobile dealers whom I knew in different parts of the United States how the automobile business was, and they all replied that it was terrible and that they could not sell cars. The same day there was a major newspaper story which gave very good statistics about the automobile industry. This was a lag, and it is a specific instance of where the statistical system was away off what was really happening.

Dr. Reuber: I think there is work to be done. I think by surveying more you would get more current information. I think there are a variety of things that one could do to improve our information, but we must keep in mind that it is a matter of resources. I am not referring just to money, but also to the question of people to do this. If we did more surveying of what is happening and if we had more highly mechanized computer systems for handling information and if we were willing to develop more models which could project forward on the basis of a month or two months or three months on the basis of very limited information I think we could cut down on this lag. But we could not eliminate it.

Senator Nichol: Could I move for a moment to the outside lag? I want to ask more or less the same question. I think it was widely assumed in recent years—and you may correct me on this—that if, as you have been saying, a lot of people were out of work, the market would operate and wages would in extreme cases fall. It seems to me to be obvious that with the strength and the bargaining position in political terms and in business terms of the unions—and I am not being critical of this because that is what they were set up to do—a great number of people will go out of work before wages drop. What is the degree of sophistication of our measurement of these types of lags? When a monetary policy is introduced which, for instance, restricts the construction of housing and then people predict that housing starts will drop from D to Y, is there work being done or do we know what effect, if any, this will have on wages and how long it will take to come in? How sophisticated are we in this type of thing?

Dr. Reuber: We have limited sophistication.

Senator Nichol: It is obviously extremely complicated.

Dr. Reuber: I think the whole area of lags—let me explain first of all that the way this whole business is

measured now, the outside lag, is really through some very mechanical statistical procedure in most cases, and while that is useful and gives some indication, it is not sufficient in the sense that it is mechanical and that it does not give you much insight into the process in many cases. So that in some of the work I did early in the 1960s, the kind of lag 2 was coming up with in the relation between unemployment and wages—by the time the total thing had exhausted itself—was of the order of two or three years which was more or less consistent with this chart. There have been reports recently by, I believe, Arthur Smith which indicated that if you look at the collective bargaining agreements you see that the so-called front-loading arrangements on these are such as to indicate that the big increases in wages are at the beginning of the contract period and at the end they taper off. This suggests that unemployment in fact is having effects on those agreements. I would argue on the basis of these impressions that we are talking about two or three-year lags. I think, however, that this is an area where we have not really done that much work in terms of hard-nosed research at a very detailed level.

Dr. Bodkin: Of course there have been a number of econometric studies that have focused on this issue and attempted to measure the lag, but, as my colleague says, they are fairly mechanical and they are sensitive to the choice of the statistical form in which you carry out the estimation. A number of people have built a number of econometric models in which they have tried to answer this. I think the general consensus is that it is of the order of two to four years, but there is some divergence of opinion. One area where the consensus is coming down, I think, is that in this outside lag, the lag on the price and wage side is longer than the lag on the employment, real economy, real output side, and that complicates your problems enormously of demand management.

Senator Grosart: Has anybody attempted to put time numbers on the different kinds of action that could be taken? You say two to four years. You are referring to controls or action in the aggregate. I am referring, for example, to the difference in time lag between foreign exchange controls, retail credit restrictions, money supply action, and dollar flotation. There must be different time lags on these things empirically.

Dr. Reuben: I am not aware of any studies in this country that have attempted that. There may be some in the United States.

Senator Grosart: We hear a lot about tax reduction. There must be some that will have a much shorter time lag than others, which would be an important consideration.

Dr. Reuber: There is evidence on taxes.

Dr. Bodkin: In some of these statistical macro-economic systems that one attempts to estimate empirically, you can run the economy. Of course, you cannot run the economy in a test tube, but you can run your statistical system in a test tube and hope that it represents an economy well enough to draw some lessons. In that regard you can measure the various lags. For the simulated system you can measure the various lags for expenditure policy, tax policy and monetary policy.

The general consensus is that tax policy works a little more rapidly than expenditure policy. Monetary policy is very sensitive to how you model the monetary side of the economy, although the view of the Chicago school in the early sixties was that monetary policy had a long and variable lag. Generally this does not seem to hold up in these econometric models, and it seems that the lag in monetary policy is more like the traditional view, that it seems to work fairly rapidly.

Senator Nichol: In talking about the identification of these lag problems and the effect on policy, first, there is the question of where we are, secondly, the question of what we should do, and thirdly, how we should do it. The question I want to ask is basically the same one that I asked Dr. Scott, namely, the mechanics of putting an economic policy into effect in Canada. We have municipalities, provinces and the federal Government. The federal Government is responsible for overall welfare of the Canadian economy. Yet we have a federal Government which is spending only a third of the total money that is spent in Canada and the municipalities and provinces are spending two-thirds.

Within the federal structure we have the Department of Finance, the Treasury Board, the Economic Council of Canada, which is a subsidiary organization, the Bank of Canada, and so on. How much of our problem, in all the things we have been discussing, lies in organizational inefficiency of the structure? In other words, we have all kinds of people studying different economic problems. We have heard from many people, all of whom are working in slightly different fields. How can we solve this problem unless we have some sort of efficient central economic organization operating in Canada? Is such a thing possible, and, if so, what sort of structure would you envisage?

Senator Isnor: Why do you say they are inefficient?

Senator Nichol: I mean inefficiency in the sense that the organization is so complicated and so many people all across the country are working on the problems of Canadian economics. Even if the problems, the lags, and the policies could be identified properly, how could they be put into effect in our system?

Dr. Reuber: You have two problems of co-ordination. One is within the federal Government and one is across governments. Within the federal Government there are, as we suggest in our brief, a number of steps that could be taken which we believe would integrate more tightly the objectives of stabilization policy with the other objectives that these policies are intended to serve. Whether that is the whole story is not clear, but if something along that line were done it would improve the situation.

We have to recognize that whenever you get a governmental structure as large as it is federally and nationally you will inevitably have problems of co-ordination. That is part of the beast. Those are the steps that we would

suggest as a start towards closer co-ordination, within the federal structure between governments in the country.

We have not been very imaginative in pursuing some of those lines that were suggested in the Porter Commission and which Dr. Scott suggested in his discussion. I am not sure that it would work. We have relied very much on consultation and we have had bigger and better consultation as time has gone along. We have used intergovernmental transfers as part of the apparatus. If we could link up stabilization policies more directly with some special kind of structure, such as were proposed in the Porter Commission, it would be quite helpful.

There are a number of other things that might be considered. For example, the Senate committee is probably a very significant development, and I hope it will continue and develop into a forum where some of these things might be aired on a national basis, where you could hear not only academics and federal civil servants, but you might also want to bring in the provinces to have their say on how they see stabilization policy in this country. This could be done on a regular annual basis.

This is not the first time this has happened. There have been other parliamentary committees. But I think this is a fairly new departure, as far as I know at least. It is to be welcomed and it might make a useful contribution in terms of getting ideas on the table. You may scrap 99 per cent of them, but one idea every year is not so bad in this area.

Within provinces I suspect there will inevitably develop as we go along a more sophisticated approach to economic policy generally, and certainly to the question of stabilization. It is true to say that in the past the provinces have not felt that this was in their bailiwick. This has been very much on the back boiler. That was for the "feds" to look after, and they look after some of the other things. There may be a change in that view, especially when it gets connected up with regional problems and with the central provinces where a lot of this unemployment occurs. There tends to be a certain amount of banter back and forth in which governments tends to blame the fellow afar for what is happening in this particular area.

As provincial governments develop in sophistication and so on they should be brought more closely into the framework of discussion, at least, of stabilization policy. I appreciate that that is all very general, but it is how a very tightly co-ordinated stabilization mechanism is organized in such a federal system as ours. The whole point of being a federal country is that it allows some scope for regional autonomy. Obviously we are not a unitary state: I do not have to remind anyone in this room of that. However, it is also true that we could initially, through discussion and somewhat greater co-ordination, hope to develop somewhat tighter machinery than we now have.

Senator Beaubien: Professor Reuber, I would like to take you back to the devaluation of the Canadian dollar in 1962. I know that the Government of the day was very, very reluctant and were very surprised at the amount of pressure on the Canadian dollar. Do you suggest that we should have had a floating rate some time before that?

Dr. Reuber: Well, we had a floating rate before that and went off it on to a fixed rate. From 1950 to 1960 was a fairly muddy period of Canadian economic history. There was a great deal of difficulty between the Government and the Central Bank.

Senator Beaubien: But we could not keep the money up.

Dr. Reuber: We did not have to go to a fixed rate in 1962.

Senator Beaubien: That was after the event; our money came down from $1.05 American.

Dr. Reuber: It came down in a very strange way; we sort of talked it down.

Senator Beaubien: I think if talking had been of any use it would have stayed up. You will remember all the remarks about the "Diefenbuck". I do not believe the Government had a desire to see it go down, at least not that far.

Dr. Reuber: The Government had a desire to see the rate come down, because it had an unemployment problem and was interested in seeing some depreciation of the rate in order to stimulate employment at the time. That was one of the reasons to attempt to talk it down by making snarly noises and so on.

Senator McLean: Why would that not work again now, to talk it down?

Dr. Reuber: I do not think for one moment that we could run an exchange market with hot air. We obviously have to operate on the basis of market price. The experience of talking the rate down in the sixties was not all that ominous for the effectiveness of that instrument. However, there was no doubt that in many ways it was felt desirable in view of the unemployment in the country to have a depreciation of the exchange rate. I am not objecting to the exchange rate being depreciated at the time; I really do question going off the rate. After all, we could have let the rate go; that might have meant it would have gone to 90 cents for three or four months, or even a year.

Senator Beaubien: Were we not really forced by our trading partners? They have always tried so hard to peg everyone's rate.

Dr. Reuber: They have tried, but we have shown that we are willing to shift quickly on our feet in response to that pressure. We never really have been restricted by the IMF rules in the matter of a fixed or free rate.

Senator McLean: You are very strong on the point that the rate should not be fixed down. Why?

Dr. Reuber: Because a free rate allows us greater independence in the short run to follow a somewhat independent policy. Secondly, it makes for smoother

adjustments in line with changing economic developments over time. If we had had a free rate in the sixties I think there would have been a somewhat different pattern of price movement.

The Chairman: Suppose there were a free rate, without any intervention to control the rate at which it moves, and all countries were to adopt the same policy. Have you given any thought to the implications of that situation and the possibility that it might lead to international chaos?

Dr. Reuber: Sure I have given thought to it, but I do not think that when we talk about Canadian exchange rate policy we necessarily have to assume that the whole world has to go on a free rate. We are not that important. Whether you wish to term it a free or fixed rate, one of the problems we have had in the last decade internationally has been to inject somewhat greater flexibility into the international monetary system. We have just seen an experience where, after everything else more or less was tried, eventually some countries have adopted a freer rate. If I were to make a guess, I may be quite wrong, I would suggest that the trend for the next decade is likely to be toward greater flexibility in exchange parties.

Dr. Bodkin: We do not object to day-to-day stabilization operations to iron out daily or possibly seasonal fluctuations. However, we think that anything beyond that may postpone adjustments to the point where pressure builds up and something dramatic has to be done, which also involves dramatic rewards to speculators.

Senator McLean: We are an exporting nation. Therefore, with the floating rate up to 99¼ or 99½ cents, Canada is not competitive in the export field. Dr. Okita illustrated in his table that the government of Japan subsidizes that country's export commodities. How are we to again become competitive in the export field with the dollar value at 99 cents? When it was down to 92 cents it gave us 7½ to 8 per cent which, of course is a very good profit in any business. How are we to obtain this 7½ to 8 per cent in order to make ourselves competitive in the export field?

Dr. Reuber: I think we are competitive in some fields. It is certainly true that our current account balance has looked pretty good, and does even now. We must recognize that if exports are increased it is inflationary and it draws off resources. One of the areas that will have the effect of helping to slow things down is a slight withdrawal from exports. That is not to say wipe them out.

Senator McLean: But Canada cannot consume all she produces; we must export.

Dr. Reuber: But we are discussing marginal variations, not huge swings in export trade. We suggest that with modest adjustments in the exchange rate we can achieve modest adjustments in the international balance which, in turn, will help give modest adjustment in the level of aggregate demand. We are not speaking of wild swings all over the place, but marginal adjustments.

Senator McLean: The economist sees one side, the businessman the other, but he has to do business. How can he when he is 8 per cent behind the eight-ball before he starts?

Dr. Reuber: What he loses on the merry-go-round he makes up on the swings. He has to take a longer view.

Senator McLean: That is no answer.

Senator Inman: What influence, if any, do the witnesses consider welfare policies have on the whole area of unemployment? Since you gave examples, I will give you one that I have. For a couple of months I wanted to hire a housekeeper. The salary was perfectly satisfactory; she was delighted to come. It was an easy job, one person and a few guests here and there. When all the arrangements were made she asked, "Now, you keep toursts?" At one time the place was used as a private tourist home. I replied that I was sorry, but no, because I used to have the family from home sometimes, and that was my mistake. She then told me she could not take employment anywhere where she could not get unemployment insurance stamps, because she did not intend to work all winter. That is one example.

The other example was when I had to have repairs done on my house at one time and hired a carpenter. I was away in Ottawa for a couple of months, but when I got the bill it was for three men. I questioned that, of course, and the man I originally employed said that to get unemployment stamps he had to hire two people so there were three of them, because he did not intend to work in the wintertime.

Senator Beaubien: Did you pay the bill?

Senator Inman: There was not much else I could do about it really.

Dr. Reuber: There is some evidence that the social welfare policies are adding to the problem of high levels of unemployment. This is an area that, I must say, has not been examined all that carefully by means of objective research. Examples such as that are cited, and there is some economistic and statistical evidence to support them, showing, that this is a significant phenomenon in the country. The problem is how to design a social welfare program which does not have that effect. I do not know the answer to that, and I am not sure that anybody does.

We suggest in our brief that that is one of the questions that might be examined to see whether some modifications could be made in the social welfare programs, to provide a somewhat greater incentive for people to work, even though they are still provided with these welfare programs. One argument in the past, which had some legitimacy, was that people want to work, and the fact they can get welfare will not deter them from that. I think that argument is wearing a little thin, especially when the return on not working may in some cases be quite comparable with the return from working. As you know, in the United States a great deal of attention has been given by the present administration to redisigning their welfare programs to remove the disincentive to

work. I am not sure what has been done in this country, but I am not aware that it has been examined in as great detail, and I think it is certainly an area where there is some room for study, and perhaps policy changes.

Dr. Bodkin: In the instance you cite, Senator Inman, if there were a sort of universal welfare program so that participation did not depend on working in a home servicing tourists or requiring three men instead of one, if there were a sort of minimum floor so that by working you earned more, in the two instances you cite that disincentive to work would be absent. It is a real problem, because part of the reason we need a welfare program is that we do not operate the economy at full employment, so therefore we need something to ease the social strains when there is unemployment. Of course, we may need it for people who are unable to work, such as the deserted mother with young children and the physically incapacitated.

Dr. Reuber: Another aspect is that with a universal welfare program we tend to get fairly standard rates of pay for welfare, and those emoluments may have quite a different purchasing powr in some parts of the country compared to other parts of the country, partly because of the way families are organized, the way they live, partly because the purchasing power of the dollar may differ from one part of the country to another. It is a fairly complicated subject, and one that we really must come to grips with now that we have large welfare programs.

The Chairman: What you are saying is that all those policies should be examined and re-re'examined on the basis of their effect on stabilization policies generally?

Dr. Reuber: This has not been totally ignored; I am not suggesting that. I am suggesting that in the past our welfare programs have been designed and put together without too much emphasis having been given to the stabilization aspect. I think time may be due for taking a hard look at how they could be modified to make them somewhat more consistent with the objectives of stabilization policy.

Senator Grosart: How valid is the assumption of this implicit relationship between unemployment and price stability? There seems to be an assumption running through all the discussion that wage levels are a component of instability in prices, yet Dr. Okita yesterday told us that in Japan in the five years to the end of the fiscal year 1969 the consumer price index had increased 7 per cent, whereas wages had increased by 14.6 per cent over the same five years.

Dr. Bodkin: Is that on an annual basis in both cases?

Senator Grosart: An average.

Dr. Bodkin: An average annual basis.

Senator Grosart: In one case it was taking the consumer price index in 1965 as 100, and in the other a straight percentage, and if you divided the total percentage of the five years by five you got 14.6 per cent. How can you relate the two?

Dr. Bodkin: That I can explain very easily.

Senator Grosart: You are a good man if you can.

Dr. Bodkin: Japan has had a growing economy, with about 7 per cent productivity growth, a 14 per cent wage increase gives you roughly a share in the national economy which remains stable, as it tends to, and you have about an expected rate of inflation of 7 per cent. What was the consumer price index increase?

Senator Grosart: It went from a base of 100 in 1965 to 134 in 1969. It averaged out at about 7 per cent.

Dr. Reuber: Japan has had this very rapid increase in productivity, which has allowed wages to rise much more rapidly than prices. The other aspect that could be argued is that Japanese wages have in some sense been catching up; they started from a low level with high profits, and then they have been infringing on those profits over time. Even without a productivity change there is a wedge there that they could infringe upon.

Senator Grosart: My question was why, if you have this 14 per cent average wage increase in manufacturing, there was not a concomitant increase in the consumer or price index.

Dr. Bodkin: Primarily productivity changes.

Senator Grosart: Well, yes, over the same period there was 18 per cent per labour capita productivity increase.

Dr. Reuber: Far higher than almost any other country.

Senator Grosart: Ours was 1.1, although not in that period. A year ago it was 1.1. Why is that? Why is our productivity so low?

Dr. Reuber: That is a sixty-four thousand dollar question.

Dr. Bodkin: There are a couple of answers to the question. It is not the level that is so low. The level of productivity is still higher in this country than in Japan.

Senator Grosart: What do you mean by "level"? The aggregate level? I am speaking of per capita.

Dr. Bodkin: The output per man, the amount of actual real physical output in this country is still higher than in Japan, but it is growing more rapidly than in Japan. Why has it been growing more rapidly in Japan? There are a number of factors. The proportion of national income devoted to investment there is the highest anywhere.

Another phenomenon is that they started from a very low base and of course this source—

Senator Grosart: That is not the point. I realize the reasons for the Japanese miracle, as we call it. Why is ours so low? Why was it that in the period from mid-1969 to mid-1970 the lowest countries in the OECD world were Canada, the United States, the United Kingdom, and Italy?

Dr. Bodkin: Because those were the countries that were deflating at the time. When there is a short run phenomenon and when you step on the brakes, you do

not get very much productivity gain in measured terms. It is part of the statistical artifact that when you cut back on demand, real output falls; you cut back somewhat on unemployment but not too much, at least initially, so that output per employee does not go up very much, because you are holding on to some labour in hopes that the economy will improve.

The long run productivity growth scale in the decade of the 1960s in this country was much higher than 1.1 per cent. It was much closer to 3 per cent. That is a short term phenomenon. When you restrict aggregate demand and step on the brakes in this way, you are going to get poor productivity performance in that particular year.

Dr. Reuber: Another element in the picture, I think, is the growth of the service sector. There are two problems. One is that measuring productivity in the service sector is extraordinarily difficult. I am not sure we really know what has happened to productivity in the service sector.

Senator Grosart: Probably none, in most cases.

Dr. Bodkin: We would argue it may be better than measured. For example, we measure productivity in, let us say, medical services, by numbers of hours doctors spend, by office visits, or something like that, but really what you are interested in is the advocacy of the service. Hospital stays, for instance, have really trended down dramatically in the last 15 years for similar sorts of illnesses.

Senator Grosart: You are back to advocacy. What about women's hair dress?

Dr. Reuben: There are two problems. One is the measurement problem in productivity. The second problem is that if you have a large service sector—let us assume that the measures we have are not too far off and that it is true that productivity in the service sector is low and rises slowly, then you would expect that to have an effect on the overall trends of productivity.

In the development of the public sector, which I referred to, I think it is true to say—I am not necessarily saying it is inefficient—that because of the service nature of the sector productivity growth is slower as that sector gets bigger in the economy, and that will have a drag on national productivity trends.

Dr. Bodkin: And similarly in the universities.

Senator Grosart: What worries me is that it is counterbalancing the other trends that should show—for example, capital investment, transfer of economic activity into more sophisticated technological products, and so on.

Dr. Reuber: It is true, but in the manufacturing sector—I am not up on the latest data—I think you have a cyclical phenomenon. If you just look at productivity in this country in the last year or so, I think you are picking up a large cyclical aspect of productivity, which is not really related to the longer term trends of productivity.

Senator Grosart: But you have to look at it and find out why.

Dr. Reuber: I do not deny that.

Senator Grosart: Why did it happen, what has caused it, and what can be done about it? That is our whole operation here. It does not help the unemployed to say the long-term picture is not too bad. The man who is out of work does not buy that argument.

Dr. Bodkin: If he is out of work, he is not directly concerned with productivity, anyway.

Dr. Reuber: I think that you can have slow growth in productivity and full employment. Where the productivity comes is in how much the differential can be between the rate of increase in wages and the rate of increase in prices.

Dr. Bodkin: Yes.

Dr. Reuber: If you get a very low rate of increase in productivity, then the rate of increase in wages is going to be restricted relevant to the increase in prices; and that is where the real crunch comes.

Senator Grosart:

How're we gonna get them back on the farm
After they've seen Paree.

Dr. Bodkin: Exactly.

Dr. James Gillies, Study Director: In regard to the question arising between the provinces and the federal Government, do you think that the Bank of Canada might try a more important role in helping the provinces with their fiscal policy goals; that is, that they should be permitted to buy the bonds of the provinces?

Dr. Reuber: I cannot be wildly enthusiastic about that proposal. I guess I would have honestly to say that I have not examined it and cannot really discuss in any informed way.

I think that injects into the political policy structure of this country some very major complications. I think we have other ways of making funds available to the provinces which are already established. I guess, without having examined it in detail, I would prefer to use the established channels in preference to imposing still another complex factor on the Bank of Canada, which already faces a very complicated task in terms of stabilization policy.

If the Bank of Canada is going to get involved in that, then I think the focus becomes even broader. They then become concerned with regional policy and a variety of other things, which I should have thought would enormously complicate their task.

I think that, perhaps in addition to using established channels, there may also be things which the provinces on their own can do, which might be preferable to trying to get it done through the Central Bank. For instance, it might be the setting up of their own financial institutions of one kind or another which might pool risks, and in that way provide somewhat greater resources to the community.

Senator Beaubien: They already use the pensions funds a lot to absorb their bonds.

Dr. Bodkin: Yes.

Dr. Reuber: I think one can impose too many tasks on one institution. The Bank of Canada has a very complicated task; and to ask it now, not only to be concerned with the exchange rate and monetary and fiscal policies generally, but also to involve itself in some sense into financing the provinces—I would myself very much prefer to explore alternative ways of achieving that without getting the central bank into that act.

Dr. Gillies: Of course, one could argue that they could remove part of the problem of the Bank of Canada by removing some of the discretion which they have in changing the money supply.

The Chairman: Would you repeat the question, doctor?

Dr. Gillies: I notice that you say in your brief that one of the problems with inflation and one of the causes of inflation is a rapid increase in the money supply—which I think is an implicit assumption that the Bank of Canada does not act as effectively as it might. But then you reject the Friedman approach. I wonder why you reject Friedman so out of hand.

Dr. Reuber: Well, because there is obviously a difference, it seems to me, between arguing that you want to put the bank more or less on a formula basis on the one hand and, on the other hand, arguing that it is desirable to really move the money supply over a very wide range. But all we are really arguing is that in our judgment the bank should manœuvre the money supply over a more limited range of variation and in that way establish a more stable policy framework.

Dr. Bodkin: Instead of zero to 20 we would like to see four to eight, or four to nine; something like that.

Dr. Gillies: Would you pass a law requiring that?

Dr. Reuber: No, I do not think so. That would not be possible or desirable in my opinion. On the other hand, to implicitly or explicitly ask the bank to increase the money supply come what may at 5 per cent per annum, or whatever figure you want, is just not acceptable. I cannot accept that as a reasonable thing to do.

The Chairman: If you use 4 per cent unemployment as the norm around which your stabilization policy turns, it would seem to me that you are going to run into a creeping inflation situation, or you are going to have an ever-increasing price level. Taking into account that one province's inflation may be higher than another's, that the overheating may be higher in some provinces than in others, do you not create an inflation psychology which then distorts your curve even more and indicates that the stabilization has to take place at 6 or 8 per cent unemployment?

Dr. Reuber: You can argue that at two levels. One is a sort of theoretical level and I think there the argument is at the moment uncertain. I think that in the short-run it is generally felt that there is this trade-off, but there is a great dispute whether, if you continued this for 20 years, you would not just end up with a line straight up and down. That is in general. If you are talking about Canada, then that argument is different. If you are talking about Canada, then you are talking about a country which is going to have a price pattern which probably conforms fairly closely to the international price pattern, and in that context I do not think it is valid to say that we necessarily would have developed an inflation psychology in this country. Even suppose that by some miracle the United States and the rest of the world managed to stabilize prices, I don't think we would have any problem running the system at 4 per cent.

The Chairman: Even with the built-in protections for those who cannot protect themselves against inflation?

Dr. Reuber: We would have problems. I am not saying that we would be in Utopia. We would have problems, but the problem of inflation psychology would not be, in my opinion, nearly the problem it is. On the other hand, if you have the rest of the world inflating at 5 per cent per annum...

The Chairman: You would be stuck with it anyway.

Dr. Reuber: You would be stuck with most of it. If you are really willing to run the thing up the pole and have large unemployment and really jam on the brakes, you might be able to moderate it somewhat. If the rest of the world is inflating at 5 per cent, you might be able to get it down to 4 or 3½ per cent, but you are paying a very heavy penalty in terms of output, employment and all the rest of these things, to get a fairly marginal change in the price level from what it would otherwise be.

I read a speech the other day that was delivered by John Young in which he talks about precisely the question you have raised. Nowhere in that speech is there any mention of the international price level, and I think that just leaves out the main actor.

The Chairman: We will ask Dr. Young about that when he appears before us.

Honourable senators, are there any further questions?

Dr. Reuber: Mr. Chairman, I should like to make two more comments, if I may. First of all, I should like to say on behalf of my colleague and myself that we appreciate very much the opportunity of appearing before this committee. We believe this is a very useful forum. We hope it develops as you go along.

Secondly, I should like to suggest that as past president of the Canadian Economic Association I would hope you, Mr. Chairman, or some member of your committee might have some discussion with the present chairman, John Graham, who, I understand, will be appearing before your committee. I can assure you that the association would be delighted to co-operate in any way possible to facilitate hearings of this kind.

Thank you very much.

The Chairman: Thank you very much for that suggestion. When Dr. Graham appears before us, and subsequent to that, we will discuss this matter with him.

On behalf of the committee I should like to thank you, Dr. Reuber and Dr. Bodkin, for appearing here this morning. Your brief is extremely complicated, but you have presented it without falling into the trap that so many economists fall into, that of resorting to jargon as a means of obfuscating your remarks. You have made your points very clearly. One committee member who read your brief said it was so good that we could put covers on it, and make it our final report. We do not intend to do that. I can assure you, however, that it will have great influence on our findings.

Thank you very much.

The committee adjourned.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 11

TUESDAY, MAY 25, 1971

Eighth Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses:—See Minutes of Proceedings)

23873—1

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
	O'Leary
Gélinas	Paterson
Grosart	Phillips
Hays	Sparrow
Isnor	Walker—27.

(Quorum 7)

**Ex officio Member*

Orders of reference

Extract from the Minutes of the Proceedings of the Senate, of Tuesday, March 9th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said *Estimates* reaching the Senate.

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wesnesday, April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Tuesday, May 4, 1971:

"With leave of the Senate

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the ballance of the present session and that Rule 76(4) be suspended in relation thereto.

The question being put on the motion it was—

Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Minutes of Proceedings

Tuesday, May 25, 1971.
(11)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 4.00 p.m. to consider the Question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Croll, Flynn, Grosart, Hays, Isnor, Laird, Methot, Molson and Nichol. (11)

Also present but not of the Committee: The Honourable Senators Casgrain, Kinnear, Kickham and McGrand. (4)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. W. Neville, Editorial Writer; Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Witnesses heard:

Dr. John H. Young, Chairman,
Prices and Incomes Commission.
Mr. George E. Freeman, Commissioner.
Mr. George V. Haythorne, Commissioner.

At 6.20 p.m. the Committee adjourned to Wednesday, May 26, 1971, at 10.00 a.m.

ATTEST:

Gerard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Tuesday, May 25, 1971.

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 4 p.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have with us today a man who is well known to us, Dr. John H. Young, the Chairman of the Prices and Incomes Commission.

Dr. Young received his bachelor and master degrees from Queen's University and his doctorate from Cambridge University. He has been associated with the Defence Research Board, the Faculty of Yale University and the University of British Columbia, first as a professor, then as head of the Department of Economics and Political Science, and later as Dean of Arts.

Dr. Young has been engaged in studies for the Royal Commission on Canada's Economic Prospects, and was Assistant Director of Research for the Royal Commission on Banking and Finance in 1962 and 1963. He brings with him two of his commissioners, Mr. George E. Freeman and Dr. George V. Haythorne.

As you know, honourable senators, much of our testimony so far has been directed to the viability of incomes policies, their application and workability. It is therefore germane that at this time we hear from Dr. Young who, as Chairman of the Prices and Incomes Commission, probably has as much experience in this subject as anyone in the Dominion of Canada.

In a moment I will ask Dr. Young to make a short introductory statement on the subject of his brief, copies of which you have in your possession. May we agree that as far as possible Dr. Young be permitted to make his introductory remarks without interruption, following which we will proceed with questions?

Hon. Senators: Agreed.

Dr. John H. Young, Chairman, Prices and Incomes Commission: Honourable senators, I think I can make my introductory remarks short enough that no one will be impatient.

As honourable senators know, the Prices and Incomes Commission was appointed June 19, 1969, with terms of reference extending to Dec. 31, 1971, "to inquire into and report upon the causes, processes and consequences of inflation and to inform those making current price and income decisions, the general public and the Government on how price stability may best be achieved".

During the two years in which the Commission has been in operation much of what we have had to say in public on these matters has been directed to those making current price and income decisions. We now are in the process of drawing on our operating experience and the results of our research program in putting together a report to the general public and the Government on the subject of inflation and on the part which might be played by a prices and incomes policy in the management of the economy.

This work is still going forward and we are not yet in a position to offer your Committee a set of firm conclusions. The Committee may, however, find it useful to know what we regard as the central issues which need to be resolved, and might also be interested in having some preliminary observations on prices and incomes policy based on our experience to date in this area.

As we see it, the central problem is how this country can achieve and maintain an acceptable level of employment without the kind of cost and price increases which prevent this level being sustained. That, as we see it, is the problem—how to get and hold an acceptable level of employment without cost and price increases occurring which prevent that level being sustained. We have failed twice, if you like. On two occasions since the early 'fifties, we have come out of a period of recession and have tried to get on a sustainable path of economic expansion: first, in the period 1954 to 1957; and, again, in the mid-1960s. On both occasions we over-reached ourselves and generated cost and price increases, which then called for remedial action that involved a prolonged and painful detour.

If you have a problem like that—how to get an acceptable level of employment without cost and price increases, and it looks as though there is a dilemma between employment and price stability—one way to escape that is to say, "Let us forego one of those objectives." I notice that some of the witnesses who have appeared before this committee have adopted that solution. They have said, "If you cannot reconcile a low level of unemployment with price stability, then why not give up price stability and accept a level of cost and price increases higher than we have been accustomed to having in non-inflationary years in the past?"

That is the question to which we address ourselves in the first several pages of this brief. We argue that while that appears to be a simple solution, it is really no solution. Temporarily it is possible to push demand on the system and accept cost and price increases, and thereby achieve a somewhat improved employment performance. However, that only lasts as long as the general public and those making price and income decisons do not grasp what is happening. As soon as they do and anticipate a continuation of that kind of cost and price increase, then it will no longer be possible to sustain that gain in employment.

Those who have made the case for inflation as a way of avoiding this dilemma do not argue, I think, that there are theoretical grounds for believing you can do that, because it is obvious in theory that if you accept a higher rate of inflation and the public anticipate that, then all the decisions are just marked up by that anticipated rate of inflation and the situation is no better; you are no better off in terms of the possibility of gain in employment than you would be under conditions of reasonable price stability, and you have the consequences that follow from allowing the rate of inflation to ratchet up in that fashion. What those who argue that you should follow this course of action must mean is, not that these are theoretical grounds for accepting that this is a good way to run the economy, but that it is possible that the public will not catch on to what is happening and there will be an inadequate adjustment to it, and it may be possible to achieve a somewhat higher level of employment without the consequences to which I have referred.

They have some basis for arguing that in the earlier post-war years we had some bouts of inflation. There was a bout in the immediate post-war period and another around the time of Korea, and there were no obvious signs that people were anticpating a continuation of that inflation. Why was that? I think because they were both temporary; they were war-induced; moreover, the shadow of the great Depression was still on people's minds, and they thought that though prices might be going up, remembering their experience of earlier years, they thought they might well come down again.

It really was not until as late as 1958, 13 years into the post-war period, that the first sign appeared that people were anticipating the possibility of future inflation, and long-term interest rates began to reflect that, as did other indicators of expectations. That, as you know, rather frightened authorities, both in this country and in the United States, and rather vigorous action was taken to suppress that inflation—in retrospect I think most people would say excessively vigorous action—and for a while the inflationary expectations were laid to rest.

However, while, when we went into the early 'sixties, not many people were anticipating a rapid rate of price increase; that earlier experience had left its imprint on people's minds.

When, therefore, inflation broke out again in the mid-sixties it did not take people very long to react rather sharply and to show evidence that they were anticipating future price increases. How else, as early as 1968, can we explain these high level of long-term interest rates, or the fact that even with those long-term interest rates some borrowers found it necessary to attach equity participation or extendable or retractable features to bonds in order to sell them? How else explain how people could accept the level of wage and salary increases of that period without anticipating that those increases would be floated off by future price increases? I think as early as 1968 it was becoming quite evident again, that people were catching on very quickly and were anticipating inflation.

The question then is: Did it make sense for the governments of Canada and the United States to act fairly decisively in 1968? I think the answer is that even in retrospect it is hard to see what else could have been done. To have allowed that expansion to go on unchecked would have meant an acceleration of inflation. While there are some who are prepared to advocate an upward ratcheting of price increases and to tolerate that, there are not very many who have the nerve to say, "Let us go from 2 to 5 to 7 to 9 to 15 per cent." Yet that might well have been the consequence of continuing that expansion. Alternatively, you might have attempted to suppress that inflation more gently. You would still have required quite substantial demand restraints and significant levels of unemployment, and would have had the upward ratcheting of the price increase anyway.

It seems to us that it was right for the governments of Canada and the United States to take the stand they did regarding the problem that had to be dealt with. We are all aware of the kinds of difficulties that have arisen as a consequence of that, and I will refer to them in the course of the discussion.

What we have concluded, however, is that, as far as we can see, it would be a very risky course of action to base policy on the assumption that the public do not have the ability to learn from experience. If you then give them 5 per cent inflation for, I would think now, a very short period, it will not take them long to catch on to what you are doing and to respond to it, and thus prevent your achieving any long-run gains in employment as a consequence. Our conclusion, therefore, is that if you have a dilemma between achieving an acceptable level of unemployment and a reasonable level of price stability, and not having cost and price increases that prevent your sustaining that level of employment, you cannot escape from that dilemma satisfactorily by accepting inflation. Many of your witnesses have argued that you could. That is a point on which there is room for difference of opinion. Our opinion has come down quite firmly on the side that that is a very risky policy to follow.

If you cannot do that, one other possibility is to forego the employment objective. I do not think I need discuss that at any length. We have discussed it at great length in the paper. I do not recall any of your witnesses having urged that there should be a reduction in the level of employment, or that there should be a high and sustained level of unemployment. We do not advocate that either. It is our view that it is quite right for Canadians to expect a better performance than we have enjoyed in the past couple of decades on the level of employment.

We do point out in the course of the brief that our experience so far is not too encouraging; that on both occasions to which I referred earlier, in which we recovered from a recession and entered a period of expansion, we ran into cost and price increases rather early in the game, quite uncomfortably early, while the level of unemployment was uncomfortably high.

We explain in the paper why there are some reasons to expect the Canadian performance to be less satisfactory

than that of some other countries. We have serious seasonal problems; we have serious regional problems. Incidentally, we also have quite serious problems of the age distribution of unemployment. We point out that in 1970 the age group 14 to 24 accounted for 45 per cent of unemployment, while it constituted only 26 per cent of the labour force. We have not been able to find a way which leads to such low unemployment rates of leading young people into the labour force as have many European countries. As we see it, you cannot escape the dilemma by accepting inflation, and no one is in favour of solving the problem by tolerating a high level of unemployment.

So the question is: where do you turn? One place you can turn is the long-term policies of the kind that have been discussed before your committee and which have received a fair amount of attention from varius agencies of the Government. These include policies designed to bring about a more ready adaptation of supply to match the pattern of effective demand: manpower policy, for example, through training, counselling. and placement, improving mobility; regional economic expansion, which seeks to move things in the other direction—that is, if the people will not move to the jobs, then move the jobs to the people.

There are also competition, tariff and other policies, designed to lower the level of prices in particular industries. We had an example of that with the advancement of the Kennedy Round tariff cuts. There are also selective demand policies, intended to reduce demand in areas where it is excessive and to increase it in areas where it is less buoyant. We have had some examples of that: the measures taken to discourage commercial construction in major urban centres of Ontario, Alberta and British Columbia. There are also other policies, concerning consumer affairs, things to encourage productivity growth, all of which can make a contribution. What they often cannot do is offer significant and early results that will deal with the problem.

You have a dilemma. You try to escape it by moving one way and say, "Let us accept inflation". That does not seem to work, so you think of the possibility of going the other way, but in a country that normally has as high a level of unemployment as this country does, the unemployment route is not an acceptable one. You may say, "Perhaps we can improve the working of the economy." That is true, but that is a slow and painstaking process, as we have learned in a variety of areas, and there are limits to how quickly that can be expected to work.

I think it is because the area of choice is so narrow—there are so few directions in which to move—that people look at prices and incomes policy as a possibility to help in solving this problem. What do we mean by prices and incomes policy?

We put a narrow definition on it. We think of that as an attempt to use some form of direct public pressure to influence decisions on prices and incomes so that they will conform more closely with national economic objectives. That is what we see in a prices and incomes policy, in the narrow definition, as meaning: an attempt to use some form of direct public pressure. That pressure can vary all the way from persuasion of the most gentle kind, from voluntary agreement, with surveillance and reviews, to the use of tax measures or to the use of a mandatory system. All these are forms of direct pressure, to influence decisions on prices and incomes so that they will conform more closely with national economic objectives.

As you know, we have had some experience in working with prices and incomes policy. We thought there was a good case for trying something, in the period 1969-70. You will recall what the situation was. The general measures of demand restraint had been applied, but we and the Governement knew that this inflation had developed enough momentum, enough forward movement, that it was going to be very hard to unravel. It was the knowledge that it was going to be difficult that led us to feel that it was important that we should make an effort currently to try to assist in the bringing of the economy out of that inflation. So, as you know, we made an attempt to get a general agreement, a form of prices and incomes policy, a general agreement which would help to scale down price and income increases directly, rather than wait for the long and indirect process of the grinding down of price and income increases through market forces alone.

Many people have misunderstood what we were trying to do and have thought that we were concerned with a scheme which would be voluntary in its operation as well as in reaching for the technique of agreement. That was never our idea. We were never naïve enough to believe that merely asking people to do something would necessarily lead to all being prepared to follow the criteria that were established. So we were quite clear, when we discussed this with the parties involved, that we were interested in agreement but we were also interested in a form of surveillance and review, so that, once we had a consensus about how price and income behaviour should conform to national economic objectives, techniques would be found to ensure that that was generally applied. So we have never been of the view that the appropriate way to deal with this problem was simply by persuasion.

As you know, we were able to achieve only partial agreement, but that partial agreement had those characteristics. We obtained the agreement of a portion of the business community, that if the business community were called upon to follow a set of rules on prices, they thought the business community would respond. We got that appeal endorsed by the first ministers, we put it to the business community as a whole, and we administered that price restraint program on, if you like, a non-voluntary basis.

It is true that it would not have got anywhere had we not had voluntary agreement. But we did not operate on the assumption that those who wanted to pay the voluntary tax could pay it, and that those who did not want to, need not to. That has never been our conception, and it is not our conception now. We do not think you can accomplish much down that particular route.

We also have not been able to see clearly the logic for the selective versus the general approach. Our experience has led us to believe that the problem is widespread, and that it is not localized in a handful of large enterprises or large unions. As a result, we have not seen the economic basis for having a selective system. We have thought that any system of price and income restraint or price and income control should be general in principle.

It is true that in administration, as in the case of a number of other governmental schemes, more attention can be accorded large enterprises and large units than can be accorded every small unit in the economy. Indeed, the accounting practices of some of the smaller units make it very difficult to do this. Nevertheless, in principle, we think of any effective price and income control scheme as being general in application.

There are many problems and limitations in prices and incomes policy. Relative price or wage changes perform an important function. There are many prices and wages that do not lend themselves very directly to forms of control.

As we were putting together the agreement of 1969 we found that we had to make use of a variety of other techniques, including the coercive powers of government, to round out the arrangement, because it was impossible to expect meaningful commitments on the part of some parts of the economy. So we were aware of a variety of limitations on the operation of prices and incomes policy.

At the same time, we keep coming back to the point that this is a highly intractable problem, one that is general throughout the world. I think it could be said without exaggeration that in its fundamental nature the problem of inflation is more serious today than at any time in the modern history of the world. It is a very serious problem that we are encountering.

Various suggestions have been made as to how we can get out of it. The difficulty is that those suggestions either will not work, as in the case of accepting inflation, or are unacceptable, as in the case of higher unemployment, or are very long-run and not entirely certain in their results in terms of some of the longer-run policies; and so you are just driven to the point of asking what to do. Can we forego an instrument of policy such as a prices and incomes policy, which is by no means costless in economic terms? Is it not possible that such a policy could serve as a useful supplement to other policies? It should not be impossible to devise such a policy, and further effort and innovation in that direction would be justified.

Thank you very much, Mr.Chairman.

The Chairman: Thank you, Dr. Young. Doctor, in the penultimate paragraph of your paper you say that:

> ..the introduction of a prices and incomes policy should be supplemented by appropriate use of governmental fiscal or regulatory powers to ensure a fair sharing of the burden of restraint.

And then in the final paragraph you say:

> ...the Commission is of the view that an effective and acceptable form of prices and incomes policy in Canada, though by no means costless in economic terms, could serve as a useful supplement to other policies,. .

It seems to me that there is a contradiction in terms there. I wonder if you could resolve it for me.

Dr. Young: We think of prices and incomes policy as a supplement to the policies of monetary and fiscal restraint. We think of monetary and fiscal policies, the management of demand, as being the principal instruments in this business of managing economic activity in an economy.

We think, therefore, of an incomes policy as coming along to play a role in company with these policies. However, we also find that as you apply incomes policy there are some areas of the economy that do not lend themselves to the application of either a controlled system or a voluntary agreement. There are auction areas of the economy, for instance, where prices are moving regularly, which makes it difficult for the auctioneer to sell something if somebody has established a floor or a ceiling on what he has been doing.

There are other prices in this economy that are determined outside the country. For example, no one has enthusiasm for holding down export prices. We would be inclined to want export prices to reflect world supply and demand. If they go up, that is a welcome source of revenue. But can one then stand back and say, "Well, export prices have gone up but they are determined elsewhere and have nothing to do with domestic economic restraint"? I do not think you can say that, because they are a very important part of the economy, and certain consequences follow from that. So one needs to use, or finds the need to use, therefore, government fiscal or regulatory powers to help round out an agreement or an arrangement. That is the sense in which it is used in the penultimate paragraph.

Senator Nichol: Dr. Young, you say on page 1 that the work is still going forward, but that you are not yet in a position to offer the committee a firm set of conclusions. Then on page 27 you say:

> ...the Commission is of the view that an effective and acceptable form of prices and incomes policy in Canada, though by no means costless in economic terms, could serve as a useful supplement to other policies, that it should not be impossible to devise such a policy, and that further effort and innovation in this direction would be justified.

What is the progression of severity that you see within the wide framework of prices to incomes policy? Let us take what you have been doing up to now and go from there to a complete wartime price and wage control system, with foreign exchange controls, rationing and everything else that goes along with it. What is the progression through that system?

Secondly, you referred to the "slippery slope" of inflation—a very apt phrase which brings me to my second question. Is there not a slippery slope here on which we might find ourselves?

Dr. Young: Let me talk a little about the progression through various forms of prices and incomes policy. I suppose the weakest thing you could do would be just publish analyses of what is happening in the economy in general, by saying, "You will observe that wage levels are going up like this, and it should not surprise you that price levels are going up like that, and these are two related things. And the profits share is moving like this," and so on. So you can make some general observations. Then you can put a little more point to those observations by relating them and saying, "This is what is happening in the economy." Then you can move on from that, to say what is happening in the economy is not entirely satisfactory and people should show more restraint and there should be lower price and wage increases. Then you can move on from that, to say rather more precisely what that should be, and you still have not done very much except talk about what should happen. There are some people around the world who have some confidence that that will yield some results. I think that people who have not tried that have more optimism than those who have. We never thought there was very much to that.

The next thing to do is say, "All right. Now we are going to try to put it together. We are not just going to talk about what should happen and call upon people to follow certain rules. Let us try to get a consensus in the community that that set of rules should be followed."

That is what we set out to do in 1969. We tried to gather together some of the major decision-makers in the area of prices and incomes and ask them what kind of combination of commitments would make sense; what kind of price restraint policies would have to be followed in order to encourage organized labour to provide some leadership in wage restraint; or what amount of wage restraint would lead businessmen to accept certain forms of price restraint; what actions in the private community would lead governments to make certain commitments; and where there would be uncontrolled elements that would upset that, where the powers of government would need to be brought in to round it out.

As we developed that arrangement, we found it necessary to draw upon rather wide coercive powers in order to round it out. To those who are concerned about the slippery slope of intervention in the economy, even a voluntary agreement, if it is going to be a workable one, gets you quite deeply into direct intervention.

That can give you as comprehensive a system as any, but it is still a system which is being implemented through the use of informal powers of government, because you do not have legislation. If that kind of arrangement is put in place with legislation, I guess that is the progression to the next stage. Then there are a variety of ways in which that can be done. As you know, some people have urged the use of a tax device as a form of penalty; others that the system should be mandatory. However, there are varying degrees of detail and strength in a mandatory system. Some mandatory systems can be more flexible and bear on the economy less heavily than others. You used as an example the Wartime Prices and Trade Board's experience with accompanying foreign exchange control and rationing, and that is, of course an extreme example of the application of this kind of policy, and perhaps not a very appropriate one since the circumstances in which that was implemented were so different from those existing today. What it is doing is implementing a price and incomes policy because one senses that the economy is not performing in the way it should relative to the existing level of demand. One is looking at it and saying, "At that level of demand, it is true that this may result from expectations as to what is going to happen in the future, but there is no excess demand in the system." Here is an economy which does not seem to be under demand pressure and yet prices and wages are rising very rapidly, just as though the system were under demand pressure. What can be done to deal with that? The question of rationing really does not come up because there is not a shortage of goods and services, but there is a type of economic behaviour which is inappropriate to the market conditions. So rationing would seem to be a form of policy that would not really be required under those conditions because that is not where the difficulty lies. The difficulty is not a shortage of supply relative to demand. In any event, a rigid, overall ceiling supported by subsidies on a variety of products, backed up by foreign exchange controls, and so on, would be a very extreme example of a prices and incomes policy pushed to its extreme.

Dr. James Gillies, Study Director: I have a supplementary question on that. From your studies, Dr. Young, are you able to quantify this at all? For example, given existing demand conditions in Canada today, would you state that if prices were rising at an annual rate of 5 per cent we should have price and wage controls?

Dr. Young: I do not think there is a mechanical way you can look at this. I think it is quite clear that this is a very serious decision to take. In our view it is not an irreversible decision; it is not even a permanent decision: it is a decision to intervene temporarily, decisively and effectively to deal with a problem. As I say, there is a variety of ways of doing that. Ideally it is done by agreement, by consensus, by discussion, and is implemented rather informally. That is the most appropriate way to do it and that is the way it works most successfully. But if that is not possible and you feel that this situation is serious enough, then you may elect this other route.

Dr. Gillies: I do not want to press this unduly, but I am very interested in this problem. What would be the indicators that the problem was serious?

Dr. Young: I think you are quite right in attaching importance to the rate of price increase and to the rate of cost increase in particular. As you know, for example, in the Consumer Price Index we had a very impressive performance in 1970 which arose from a variety of factors: the exchange rate, the slack in the economic and market conditions—hopefully, to some extent by our efforts—but towards the end of the year very much dominated by a fall in food prices. However, it would

have been unwise to get too excited about that or to have made too much fuss about it. When we were asked at the end of the year as to how impressive we found that, we went to some trouble to point out that there were some rather special factors there which, when they reversed, would lead to some rather significant results. We have already seen that. We have seen a very sharp upward movement of food prices. That is related to market conditions, but there are many other special factors in there. So you would want to be very careful in basing anything on a mechanical reading of something like the Consumer Price Index. You need to look behind it and ask: What is food? What is non-food? What are the cost increases? What is the movement of profit shares and farm prices? How is this thing shaping up? So you would want to look rather deeply at both the cost and price indicators to make sure that you are dealing with the fundamental problem. That is what you would be looking at.

Dr. Gillies: I know that is what I would be looking at, but I would not know when or where.

Dr. Young: Well, the "when" is not going to be a decision on the part of the Commission. This is going to be a difficult decision for government, if the occasion arises, and a judgment will have to be applied.

Let me be a little more specific. I suppose that one important factor would be the way in which the public viewed this. can one conceive of taking a serious step like this without widespread public support? I do not think so. So, if the public and, indeed, other governments were quite calm about what was happening, I would be inclined to think it would be a little difficult for a government here in Ottawa to be very forehanded on it because you need public support to make this a workable proposition.

The Chairman: On what conditions, though, would the Commission advise the government to intervene?

Dr. Young: Well, we would be inclined to look ahead and to be concerned about the way things were going.

The Chairman: But the government might even ask you for your opinion.

Dr. Young: Well, we give advice now, and we will be giving advice. But, as I say, this is not our decision; this is a decision which I think will be to a great extent in the hands of the public too, because if the public show very considerable concern with the problem and agree there is not an easy alternative, then I think that the march of events will have its influence on everybody's thinking.

The Chairman: But is there any point at which you, as a Commission, would make the recommendation?

Dr. Young: We do not approach our task mechanically. I would not give you a number. We are looking at the situation currently, and will continue to look at it, and will continue to express our concern about it until things look more encouraging. But let me make no bones about the fact that we believe that the goal of reasonable price stability which has been accepted in this country for some time now, namely, that in general we should be aiming for price increases of a rather marginal kind, 2 per cent or less. We are of the view that that is the appropriate way to run this country. If you look at the United Kingdom economic activity over the years you see the upward ratcheting of price increases in that economy; and the same applies in a number of other European economies. We are not in favour of getting on to that slippery slope of watching a gradual upward ratcheting, which then leads to the anticipation of further upward ratcheting. Therefore, we think that there is some sense, if you are close to your starting-point, to try to stay close to your starting-point. This means that we are not prepared to be very calm about any rate of price increase over a modest one.

The Chairman: Just 2 per cent?

Dr. Young: In the area of 2 per cent. We have pointed out in the paper the unfortunate fact that this country does run into cost and price increases at rather high levels of unemployment. We have before. We point that out not as something to be welcomed but as something to be deplored and to be acted upon.

Senator Croll: Perhaps part of my question was answered. I understood you to talk about inappropriate behaviour of market conditions and rising prices being artificial. You said you had to look behind it. You came up with the answer that about 2 per cent was the sort of recommendation that you would make or go along with. Is that correct?

Dr. Young: People often say that the Economic Council recommended one-half to 2 per cent as a price objective for this economy. They were not the first ones to do that. The Porter Commission and the Carter Commission were of the view that in an economy such as that in Canada some degree of flexibility on the price side is required in order to adapt the economy so that a marginal increase of that kind, given the imprecise measures, is nothing to get unduly concerned about. We do not see any reason for altering that objective.

Senator Croll: As you were answering the question you spoke about some unused capacity and unemployment. You then referred back to the time immediately after the war, 1958 and other times when to some extent we solved our problems of inflation by having some unused capacity or unemployment. That was the substance of your statement. I follow this up by saying that now we have considerable inflation and considerable unemployment. How did we get into that jam?

Dr. Young: My brief answer would be to say, by inflating in 1965 and 1966, and by taking very modest measures in 1966 and 1967 which proved to be inadequate and therefore, having a long period of inflation in which generated a very substantial momentum, extricating yourself from that kind of inflation does leave you in a period such as this in which you are getting the worst of both worlds, in which you get unemployment and you are still concerned about inflation.

Senator Croll: How do you get out of it?

Dr. Young: Many people hope that we are going to get out of it without the necessity of direct intervention in the form of a prices and incomes policy; that this degree of slack in the economy is going to lead to a sufficient moderation of cost increases which is going to go far enough and be soon enough to be consistent with reasonable price stability; and that we are going to press forward with this economic expansion under conditions of reasonable price stability.

We think that is an optimistic assumption—not impossible, but optimistic. We fear that the degree of moderation of cost increases, and particularly wage and salary increases, will not go far enough and soon enough to make that possible. If that is the case, we fear that we are going to encounter cost and price pressures in the course of this economic expansion which will call for remedial action.

What, in effect, we are saying here is that if it comes to remedial action in those circumstances, if it does not make any sense to tolerate that inflation, and if it is unacceptable to go the unemployment route to deal with it, then what do you do? What is there left to do, except some form of direct pressure on price and income increases?

Senator Croll: Would reduction in personal taxes help the situation?

Dr. Young: I would not have thought so. That will help to stimulate the economy. I am pointing out the pessimistic outcome, and I am inviting you to consider what you are going to do under those circumstances. It will not make sense for you to tolerate inflation. That will not get you anywhere for very long, and you will slide down the slope that we have discussed before. You will take the first step from the two to the nine by going to five or four. That will be the first step, and the public may well anticipate that that is not the last step you are going to take. If you cannot do that and you do not want to go for unemployment, what do you do? It is under those circumstances that one is prepared to take some risk on the slippery slope of prices and incomes policy.

Senator Croll: That is why we hired you. That is why you have come here today. You have the experience and knowledge. Give us at least some inkling of what we might expect. I have suggested tax cuts, but you say, "No."

Dr. Young: I do not want to discuss general economic policy. You ask whether I think a personal tax cut would deal with the situation that I am describing, which is that you are in an economic expansion and cost and price pressures are developing which you are not prepared to tolerate because you can see where they will lead, and you have to take some action. If you suggest that a cut in personal income tax will solve the problem, I would not think so. I was not discussing the general question there should be a general cut in personal income tax now. The Minister of Finance will be here later to discuss that problem.

Senator Nichol: Let us accept all these assumptions, with which I agree—the ones you have made about inflation, employment and the escalation of expectations. What I would like to do then is to go back to the congression of policies which might be used under these emergency situations which you envisage. The first four or five suggestions you made were basically in the realm of psychology—attempt to find consensus, attempt to find agreement on the type of thing with which you have been struggling so hard since your Commission began. We then are led to the final system which is complete price and wage control, with or without everything that I described—and perhaps I went too far. This leads us over a scale of ten, with the area between, let us say for the sake of argument, seven and nine, and this is the area in which we are operating now for the purposes of this discussion. I think most people would not disagree that something in the area of seven and nine would be very useful. The problem is that no one really knows what they are. I would like to ask what you think they are.

The Chairman: That is the area between voluntary agreement—

Senator Nichol: Yes, assuming that the public has often said in public opinion polls that it will accept price and wage controls. It is a widely accepted fact that people will, but whether they will or not is quite another question. If you put the total price and wage control package during wartime aside, what type of policies will work on that slope without sliding all the way into the other thing?

Dr. Young: It is easy to envisage a mandatory price and wage control system which is not very different from a voluntary agreement with a proper review and surveillance system. In 1969 we were looking for a very comprehensive deal, which would have involved a wage restraint program placing a ceiling on wage and salary increases.

Senator Nichol: Do you mean enforced by law?

Dr. Young: No, it would have been interesting how that would all have turned out had we included the total system—all governments, businesses and organized labour. This has happened in other countries, where the labour movement has made commitments to hold salary and wage increases below a certain figure provided a whole range of other regulation is applied. This includes price and rent restraints, various tax arrangements in relation to firms which would escape the price restraints scheme, and independent professional people who might well escape its full rigors. Negotiation of a set of arrangements such as that becomes very comprehensive. It is made evident that there is no use in discussing voluntary application; too much is at stake. People make commitments and will lose their heads if those commitments are not honoured by others. Therefore, they insist on safeguards and gradually the coercive elements become an important part of the so-called voluntary agreement. A consensus of that nature, reinforced by the coercive forces of the state in a variety of areas, comes close to a mandatory wage and price control system. That

is nothing more than that type of arrangement incorporated in law, rather than a voluntary agreement. We can conceive of a mandatory price and wage control system which is not very different from that at which we were aiming in the summer and fall of 1969, only now formally embodied in legislation.

Senator Grosart: In what countries have there been voluntary labour agreements by organized labour?

Dr. Young: Sir Stafford Cripps achieved that in the early post-war years in the United Kingdom.

Senator Grosart: But in the current picture?

Dr. Young: It has been done in Austria, Finland and Holland. Some Scandinavian countries have done it from time to time and have got into lots of trouble later.

Senator Grosart: But they have all had a much higher rate of consumer price increase than we had in 1969 and 1970.

Dr. Young: They have had much more inflation over a much more extended period than have we. In a sense, this is one excuse that is easy to make in this country. We have run our affairs in such a way that we are not very far away from the experience of reasonable price stability. It is very easy to say, "We are doing better than others. Why should we bother?" However, one of the reasons they are in trouble and have so many intractable problems is that they have gone so far that now to win their way back to something that looks like reasonable price stability is so hard that they can hardly contemplate it. In our case, we are so close to where we want to be that it would be most unfortunate to take the first step away from it. At the same time, it is not always easy to get the public to see that.

Senator Beaubien: Would you not say that in the price stability we have we are lucky in many cases, in view of the way such things as nickel, copper, lead and zinc came down last year because business was so bad?

Dr. Young: That was where the luck came in, if you like.

Senator Beaubien: So we should get very few marks. Our wages have steadily gone up for four years at just about 8 per cent per year.

Dr. Young: We do not get very many marks for what has happened on the cost side. On the price side we did get a general moderation over quite a wide range of the economy.

Senator Beaubien: It was simply because business was bad.

Dr. Young: That was a major factor, together with the appreciation of the exchange rate and the fact that we were in there messing around with the price restraint program, carrying out investigations and reviews. However, one reason for the spectacular performance of 1.5 per cent, which was very unusual, was the rapid run-down of food prices at the end of the year.

Senator Beaubien: Could we possibly have any kind of controlled wages, if the United States did not? In other words, if the steelworkers obtain a large settlement this year, could we ever control the fast growing Steel Company of Canada and Algoma Steel? Are we discussing something that is really at all feasible?

Dr. Young: I would say so, yes.

Senator Beaubien: Even though the United States did not follow?

Dr. Young: Mind you, senator, Canada is a country; we have a central bank and a currency. If we elect to follow a different course of policy than our neighbours, we can do so.

Senator Isnor: What is that course?

Dr. Young: We may be unprepared to accept the rate of inflation generated in the United States, for example. After all, in the last hundred years we have looked at the performance of the United States economy. We have not seen, apparently, sufficient reason to diverge substantially from them over an extended period. However, in the event it became our conviction that the rate of wage and price increase in the United States was one which was inappropriate for us, then it would be possible for us to take action in this country to deal with our own problem.

Senator Laird: Consider the wage problem in the automobile industry.

Dr. Young: All of these constitute problems, but they are not insurmountable. Had there been a wage and price control policy, then there would have been a divergence in the results of settlement in the United States and Canada. It would have been illegal to grant increases in Canada at the American level, and that is that.

Senator Laird: But that makes your ultimate sanction mandatory.

Dr. Young: Or if there were agreement. Why does one want large wage increases? It is to offset large price increases. Are you any better off with an 8 per cent wage increase and a 5 per cent cost increase than with a 5 per cent wage increase and a 2 per cent price increase? You are not; they are the same thing.

Senator Molson: Many people think they are getting a bigger cut.

Senator Beaubien: We already have the big wage increases.

Dr. Young: Temporarily, yes; at the cost of a very substantial profits and farm prices squeeze, which is not sustainable.

Senator Hays: Why do you want to cut the farm prices all the time? Food is going down.

Dr. Young: That did occur.

Dr. Gillies: In the trade-off, in comparison with other countries our performance was better in prices, but in employment it was not very good.

Dr. Young: It generally is not. We have our own special problems with the seasonal and regional components of unemployment rates. However, even with the corrected European figures, which we all know need correction, it is a little uncertain and we ordinarily do not have a very satisfactory performance.

Dr. Gillies: This is not the critical issue in comparison with other countries. We can have slow increases in prices and still do not have to have high unemployment. What is your opinion of that trade-off?

Dr. Young: It has occurred to me that I have colleagues whom I have not asked to speak. When they pass me notes, I know they wish to say something.

Mr. George E. Freeman, Commissioner, Prices and Incomes Commission: It is very hard, when one looks around the world, to see any systematic pattern of association between average rates of unemployment and price increases. There is the case of the Germans to explain, who win on both counts. They have more price stability and lower unemployment than anyone else, and both at the same time. There is the Canadian case, as you mentioned, which is very much like the American, as I think you will agree, where over time, by European standards, there appear to be relatively high average rates of unemployment associated with relatively moderate rates of price increase. There are many other varieties of that association too, of which I think you will be aware. In Europe there are countries like Belgium and Switzerland next door to a country like France, which is their big partner, and over the past twenty years the internal price level in those two countries has risen a great deal less than it has in France, yet which of those three countries has been most successful in keeping its economy reasonably fully employed most of the time is hard to say.

The Chairman: Honourable senators, we started with a question from Senator Nichol and supplementaries were asked.

Senator Nichol: I think I have asked supplementaries to my own question.

The Chairman: Probably you have by now. I have a note that Senator Kinnear has a supplementary question. I assume that is on Senator Nichol's original question.

Senator Kinnear: I think it has strayed a little. Mine is a short question. On page 11 of the brief you say:

> persons aged 14 to 24 accounted for 45 per cent of unemployment, though they constituted only 26 per cent of the labour force.

I am wondering why on earth you count 14- and 15-year olds in the labour force, because I do not know from my experience that there are very many people working at the ages of 14 and 15.

Dr. Young: That is the way the statistics come out.

Senator Kinnear: What percentage of 14- and 15-year olds are in the labour force?

Dr. George V. Haythorne, Commissioner, Prices and Incomes Commission: In these statistics there would be relatively few in either the unemployed or the labour force. You are quite right. There are relatively few today, particularly because the school-leaving age is now 15 and 16 in most provinces, who would be either in the labour force or unemployed.

Senator Kinnear: I think it would be more accurate to take the ages from 16 to 24.

Dr. Haythorne: I think you are right on that. This is just a category that happens to be the convenient period of ten years that they take right through the labour force.

Senator Nichol: If I may, I should like to come back again on this question. It is not clear in my mind. To me, the term "price and wage controls" perhaps implies a body of law in the broad sense, which does not permit increases in prices, wages and salaries, rents or anything else, without the permission of the government or some government body. When you move from voluntary controls to involuntary controls, how can there be a middle ground? I think, Dr. Young, you were describing some sort of middle ground. I do not quite see how that works. I do not see how you prevent people raising their position in the economy without forcing them to do it. Are we talking about forcing them to do it or are we not?

Dr. Young: You are talking about forcing them to do it, but there are ways and means of forcing them.

Senator Nichol: That is my question.

Dr. Young: All I am saying is that if you are a protected manufacturer and you have raised prices beyond the appropriate level—there does not have to be a freeze; there can be permission to raise prices and wages but within a restrained level; there can be a rate of increase—as a protected manufacturer you are part of a general agreement on wages, prices and rents.

Senator Nichol: Which all people of the country presumably have signed?

Dr. Young: On which consensus has been reached. It is less important that they sign than that they indicate their willingness to follow it. The government implements it, and they are called upon to follow this set of rules. Suppose, as a protected manufacturer, you do not follow this set of rules and you charge too high a price for your product. You are reviewed and are found to have charged too high a price. You are brought in and are invited to reduce the price but you say you will not reduce it. The government tells you that in that case they will reduce your tariff, and then you will reduce the price. The general experience is that such a manufacturer will reduce the price before that action is taken. That is force. That is not a formal form of price control, but that is the use of government power to enforce an agreement. That is the kind of commitment that governments in this country made to support the price restraint pro-

gram. They said they did not want to have to use sanctions, but if occasion arose they would in fact take steps of that kind, and when the occasion arose they did take steps of that kind.

Senator Nichol: Then this would be on a continuous basis, presumably for companies and unions.

Dr. Young: No, you decide what the period is.

The Chairman: What is the period?

Dr. Young: We were going for 1970 at that time. When we were trying to get the 1969 agreement it was for one year.

Senator Nichol: This could presumably operate only on a temporary basis?

Dr. Young: That was certainly our thought, of going in temporarily, because we were trying to extricate ourselves from a particular inflation. We did not rule out the possibility that during the course of that year we might seek an extension of that agreement, were it working effectively and that we would get that kind of support and carry forward the agreement long enough to get ourselves back to reasonable price stability at less cost in terms of unemployment.

The Chairman: Using what means?

Dr. Young: Using the techniques I have just described, of having an agreement—

The Chairman: No, no, to bring us back, as you described.

Dr. Young: Having scaled down wage and salary increases to a moderate level—and we were talking in terms of 5 per cent...

Senator Molson: How?

Dr. Young: We were seeking an agreement.

The Chairman: By the agreement, senator.

Dr. Young: We were seeking a consensus.

Senator Molson: We were dealing a moment ago with a tariff on prices. Now we have switched to wages and salaries, which is not the same.

Dr. Young: That is right. That is much more difficult now.

Senator Molson: How?

Senator Nichol: Do you think it would be possible to get such an agreement without there being a law saying there had to be such a one?

Dr. Young: It has been in other countries. In this country people have said it is not possible to get an agreement, that the business community is too fragmented, that the governmental apparatus is too fragmented, that the labour movement is too fragmented. It is our experience that it was not a structural problem that stood in the way. We found that we could get the business community to act together, and that we could get governments to act together during that period when we were seeking a general agreement. We did not think it was a structural problem that prevented organized labour acting. It was not simply because there was a federation or two federations and sets of affiliates, and so on. It is true that in some countries there is a more tightly organized system of organized labour, but those countries run into difficulties because attempts are made to dictate from on top to a variety of unions, so they have run into great local difficulties. It is therefore not obvious to us that it was the structure of the labour movement in this country that made such agreement inpossible; it was the lack of conviction on the part of those involved that this was a useful approach to the problem.

Senator Molson: Has the international control of most of the unions any bearing on it?

Dr. Young: I think it would be fair to say that was not our impression.

Dr. Haythorne: I would say, very little bearing. That element played a very small part.

The Chairman: Is it not a fact, though, that you are dealing with the history of the matter and that, on the basis of that history, if you tried today you would not even get an agreement from business or government?

Dr. Young: You certainly would not, unless you could make it comprehensive.

The Chairman: That is right.

Dr. Young: There are different views on how likely it is that a voluntary agreement could be reached now.

The Chairman: What is your view?

Dr. Young: I would have thought that it was not obvious that it could easily be reached.

Senator Nichol: Of course, I agree with you, Dr. Young, that if this could be done it would be fine, but on the basis of the experience during the critical period in prices a few years ago, it was found to be impossible. It seemed to be equally difficult. I do not quite see how it can be done without real law and real enforcement, in which case I do not see how you can avoid going the rest of the way. You see it the other way round?

Dr. Young: No. I hope I am not misunderstood. I pointed out that if one could get the consensus, there is one answer.

Senator Nichol: Say one cannot?

Dr. Young: If you cannot, then the only route available is the other one. Then the question is: What does that scheme have to look like? There is a variety of ways of approaching price and wage controls. It seemed to me that the proposition you put was an extreme one, that it is not necessary that prices or wages be frozen, or that there be rules under which prices are increased and rules under which wage and salary increases occur. The thing could have a measure of flexibility.

Senator Nichol: Control does not imply fixation.

Dr. Young: No. Controlled restraint.

Senator Nichol: Controlled restraint, operated by a government body of some kind which says that you may or may not do this.

Dr. Young: Exactly.

Senator Nichol: So we are really almost right down to the under ten, or very close to it?

Dr. Young: As I say, some people exaggerate the nature of the scheme that might be necessary to deal with this type of problem.

The Chairman: Would it be true to say, doctor, that if you impose the kind of restraint you are talking about, the longer you hold that restraint in operation the closer you move to the old wartime prices and trade board restraint? Each year or each month you would be forced to a greater and greater initiative.

Dr. Young: I think that is not unlikely. I think that a system like this would sit very uneasily. That is why I guess I am not as concerned as Senator Nichol with the slippery slope. If you are under conditions of peacetime, when it is a serious problem that people are prepared to have dealt with in a serious way, it nevertheless would not take very much experience with that to realize how uncomfortable even a flexible straitjacket of that kind was for the economy.

Therefore, it seems to me unlikely that one would be piling on more and more restrictions. It seems likely that there would be anxiety on the part of the public to have done with it in as rapid a way as possible; that it would be necessary to hold in for a significant period in order to accomplish what one wished to accomplish.

Senator Nichol: Then it becomes a psychological weapon.

Dr. Young: As I say, I think there would be a good deal of opposition to its continuation. Let me say that the decision on how far such a system would need to be continued depends on your analysis of the problem. I said we cannot give you final solutions today, but we do not think that the facts are inconsistent with the view that we have a problem, and a serious problem, in this country in extricating ourselves, in avoiding the renewal of inflation, if you like, or extricating ourselves from this continual cost inflation that we have experienced. But it was, after all, only five or six years ago that this economy was running quite satisfactorily. It is true that we have come through a period of quite high unemployment, but we were getting back to satisfactory levels of employment and we did not have a permanent, serious, deep-seated problem. We ran into a temporary problem. It is quite possible that a temporary solution can be found to deal with a temporary problem and that one can emerge, at the end of a control period, into a system where demand and supply are in reasonable equilibrium, without the kind of unfortunate experience many countries had when they attempted to put a control system on in the face of excess demand. When they take off the controls, away she goes. That is not the way you could possibly do it, but it is not impossible that it would work that way.

Suppose that that is too optimistic a view, then there is no question: we are into a very serious problem indeed. If we are not able to extricate ourselves safely from that kind of situation, then our problem is indeed a rather deep and fundamental one, and we really have to worry how to get out of it.

Senator Hays: You were speaking about percentages. Would you say an increase in wages of 4 or 5 per cent a year would be satisfactory, if that were the ceiling?

Dr. Young: Yes, that is the rate of increase we have had during the years when we have had reasonable price stability. Increases of the order of 4 or 5 per cent are consistent with price increases of 2 and under—as we had in the 'fifties and 'sixties.

Senator Hays: So you would live within ceilings, under a sort of control?

Dr. Young: That is one way of approaching the problem. That is the way we tried to deal with it in the 1969 agreement, and that is the way we approached the problem in 1970. There are other ways of doing it, but that was one way.

Senator Hays: I think that your restraints were very effective, probably much more effective than you think they were. People did observe these guidelines and they did try to live within them—or many people did. What would have been the situation if we had 10 per cent more inflation during this period? What would have been the result? Would we have had full employment?

Dr. Young: It depends on what you define as "full employment."

Senator Hays: If you had been going for the holding back? You say you cannot have both, so we have unemployment and we have curbed inflation. If we had had 10 per cent inflation, would we have had full employment? Was that the real reason?

Dr. Young: As I say, if you had said in 1968, "Let it roll, let it run. You can steal a bit from the future"—that is why we are in the difficulty we are in now, because people tried to steal from the future, four, five or six years ago. We are paying the price of economic policy decisions that were taken back in 1964, 1965. 1966. It might be possible to seize a short-term gain, by letting it go, instead of allowing it to accelerate. The extent to which the public had become sensitive to that in 1968, 1969, suggests you would not have got away with it for very long. They would have anticipated it very quickly. So your gains would have been very short lived. You might have got away with something for a year or two, but it is not much of a way to run economic policy.

Senator Hays: Let us say that from 1962 to 1970 we doubled our Gross National Product. If you remember,

part of it was done on a policy of, "Let's get the economy moving again!"

Dr. Young: Exactly.

Senator Hays: So the money was poured in, and it was effective.

Dr. Young: I guess it would be our view—and my colleagues can differ from me if they like—that if we had handled that thing a little more carefully we might have been able to find our way through this whole decade, when you look back at it and think of the foregone opportunities to have sustained economic expansion, by allowing that thing to get away in the mid 'sixties. It was very hard to avoid, because the Americans had their war and their special circumstances, and it was difficult to forecast the situation. It is easy in retrospect to say these things.

The Chairman: What would you have done, Dr. Young?

Dr. Young: If there had been more caution shown in approaching the level of employment—we are all guilty of saying, "We have had enough unemployment, let's get the thing rolling and let's not pay much attention to where the danger points are." Many people were guilty of that, and some of us were guilty of it, too. We all got impatient during those early 1960s. Too bad, because if we had been more patient and had played that a little more carefully, in those years 1963, 1964 and 1965, conceivably we just might have found our way through this whole period.

It would have required a change in the exchange rate earlier, if the American performance had been what it was. But it would have been really quite something if this country could have found its way, in a substantially non-inflationary way, right up to the present, through rather more careful demand management in the middle period. That is water over the dam now, but I think we could have had substantially as good an economic performance and ended up just as well without it as with it. It may be my colleagues would like to add something.

Dr. Haythorne: I should like to make one comment, coming back to Senator Nichol's question about progression. We are saying in the document that incomes policies are supplement to fiscal and monetary policies. You have to keep that in mind when you are thinking about the progression. Coming back to Senator Hays' question about the mid-1960s, had we again the sort of situation we faced in 1963, 1964 and 1965, with appropriate fiscal and monetary policies, that might have been enough. We would not have needed to call upon an incomes policy at that stage.

Much depends upon existing circumstances, and particularly the use that you make of your fiscal and monetary tools, as to how you bring in an incomes policy, if you do.

Senator Isnor: Going back to the 1967-69 period, which came first and which was the more important of the two factors that entered into that period of price increases and unemployment? Was the main factor unemployment, or was it price increases?

Dr. Young: I am not quite sure I understand the question.

Senator Isnor: Then let me enlarge upon it. From a business point of view, retail prices are governed by the prices one has to pay for the goods one is going to sell. The prices that one is charged are those brought about by the manufacturers because of employment. Now, which is the bigger factor?

Dr. Young: Bear in mind that we had had a burst of price increases in 1965-66. In the latter part of 1966 and into 1967 you might say that an attempt was made to bring the economy around in a rather careful, gentle kind of way, in order to avoid any serious run-up of unemployment. What I suppose we learned from that episode was that if you have as much push in the economy as we developed in 1965-66, as much momentum in the inflation, then that kind of gentle easing out of it will not work. It will not work because what happened was that we went right through that period with some moderation, but very, very slight, and when it picked up again in 1968 we were still in the inflation and on our way again. That is what I think was the principal lesson of that particular period.

Senator Hays: We did achieve full employment, and that was one of the great problems at that time.

Dr. Young: Yes, we had high employment during that period, but remember that unemployment was creeping up a little in the early part of 1968.

Senator Isnor: Rates of employment went up, but that factor affected the prices to the consumer.

Dr. Young: It certainly did in 1965 and 1966 and it continued to do so in 1967, yes. The degree of restraint was rather modest.

Senator Isnor: Now, having said that, which do you consider the more important factor at the present time, price increases or wage increases?

Dr. Young: I find it very difficult to answer a question like that. The other day I was quoted as saying, "Inflation remains Canada's No. 1 problem". I did not happen to put it that way. I spent most of the interview arguing about the nature of the inflationary problem. I pointed out how deep-seated it was, how widespread throughout the world, and how it was the outstanding problem of this era of history. That could well be interpreted as meaning it was our No. 1 problem, but I do not see a way of saying that, "This is No. 1 and this is No. 2." I think we all agree that we have a high level of unemployment and that it is desirable that steps be taken to deal with that. Steps have been and are in the process of being taken.

Senator Isnor: There is a base for both of them, and I am asking which is the more important.

Dr. Young: What we keep reminding people is that while they are dealing with the unemployment problem they had better remember that there is another problem here. It does not mean calling it No. 1. They had better remember there is a problem. They had better remember that that spectacular price performance in 1970 was rather ephemeral and some of the underlying stuff is more serious. Then, looking carefully at that, people wonder how things are going to turn out and how quickly they are going to be faced with a situation in which what they want to do on the economic expansion side is going to be frustrated by cost and price increases. Our task is really to remind people of that. If that means saying that inflation remains a problem, then that is what we are doing. It is really to remind people that they had better keep their eye on that side.

I hope that that is an answer. I am afraid I cannot do it sort of, "1...2..."

Senator Molson: Mr. Chairman, I should like to ask Dr. Young and his associates if there is a possibility or a probability, with the march of time, business having become bigger business, labour having become bigger labour and big government very definitely having become bigger government, that this has caused conditions which apply to change so much that many of the points of view that used to apply are no longer really valid; in other words, that so much inflexibility has been created by this relationship that ideas have to be changed in thinking through the potentials, possibilities and options for action that are open.

Dr. Young: We are spending a lot of time analysing that problem, so I think it is fair to say I cannot yet give a definitive answer to it. I can give this kind of tenative answer, that apparently the structural changes in the economy of the kind to which you are referring did not make this economy unmanageable six or seven years ago. I am not aware that the changes have been so dramatic in the last little while. We were able to run this economy as we came out of the recession in the 'sixties without encountering special problems, and that is a point that everybody who argues that we are in an entirely new world needs to remember. They have to remember how recently this economy operated fairly effectively before we developed inflationary expectations which led to the consequences we are seeing now.

All I can say is that we approach that hypothesis with a good deal of caution, and that we consider that one has to be very careful in saying that we are in a new world, because of the structural changes, because you have to ask yourself how many of these structural changes have really occurred.

At one time I had a colleague who was put by his professor to the task of studying the question of whether the monopoly has increased in the United States. It was a common talk in the 1930s and the 1940s in the United States that the American economy was gradually becoming monopolized; that there were more and more monopolies everywhere and all the analyses of the previous periods did not apply. His professor had done some work on the back of an envelope and thought that he could see that trend, so he put this fellow to work for two years on the subject. His answer was that there was as much of a monopoly in the United States in 1901 as there was in 1937 or thereabouts. Then one of his students continued to work through to 1954-55 and he, too, could not find an obvious change in the structure of the economy. They were relatively big firms, relative to the size of all firms back in 1900, and they are now. There are just a lot of small organizations in this economy as well as large ones. But I can assure you that this is a matter which will receive a great deal of attention from the research staff of the Commission, because it is obviously something that many people think is crucial, and it cannot be dealt with simply by giving a casual reply.

Senator Molson: We can see certain signs that government is becoming bigger.

Dr. Young: There is no question about the size of government.

Senator Laird: Dr. Young, as I understand it, you seem reconciled to a modest amount of wage increases and a modest amount of price increases. If that is so, what are you going to do or suggest about that very important segment of our population which is on a fixed income? Here I do not mean those who are on old age pensions; I mean people who have been thrifty and who have saved money and figured that they could live out the rest of their days on what they had saved. What would you suggest doing about them?

Dr. Young: I think it is fair to say that long-term interest rates have adapted to a considerable degree to very modest changes in prices. Indeed, if you look at many of the long-term interest rates, it is fairly apparent that they have adjusted to an even more than modest increase. So, if somebody has been thrifty and can get the Government of Canada to pry 8 per cent for it, and we can hold the level of price increases at 2 per cent, then I do not think we should worry unduly because they are getting 6 per cent real interest on their money. That is no small amount.

Senator Molson: But that is 20-year money.

Dr. Young: Demand money in Canada Savings Bonds. We are not concerned, senator, with those people who have so much money that the limits on holdings of Canada Savings Bonds are unduly restrictive to them.

The Chairman: You are talking of real returns.

Dr. Young: That is right. These rates of 7 or 8 per cent for demand money are really very favourable rates; that is, if you have reasonable price stability. But they do not look like much if you have 5 or 6 per cent price increases. However, I think I am safe in saying that various pension schemes and other things have been gradually adjusting to the notion that it is not entirely likely that the rate of price increase will be zero. There will be a modest increase.

Senator Nichol: If the inflation rate were settled in this country to public satisfaction at 2 per cent and people

believed that it would remain there, do you think that pensioners would be getting interest rates such as you have suggested on their securities?

Dr. Young: That is right. That would be reflected in the bond markets. But, senator, what is our experience for the last 18 years? We have had 2.1 per cent on the Consumer Price Index. Some people would wish it had been zero while other people would wish it had been minus five, but a 2.1 per cent average for the last 18 years is an impressive performance, even by international standards, and I do not think it is realistic to ask for anything better.

Senator Hays: Can we live with a 10- or 12-year payout on investment? Is this possible when you are talking about 8 or 9 per cent?

Dr. Young: On long-term interest rates?

Senator Hays: Yes.

Dr. Young: Again, it is like the income price business because long-term interest rates in an inflationary environment can be quite high, and if you can assume you are going to get price increases to float them off, then you can live with them. But our preference would be for lower long-term interest rates and lower prices.

Senator McGrand: On page 12 you say:

> Most of those becoming unemployed do not remain unemployed for more than three months—and for many it is as short as one month. Many enter the ranks of the unemployed by joining the labor force, or by leaving their present jobs, not by losing their jobs.

After reading that, I get the impression that unemployment is not as severe as the unemployment figures indicate at the present time.

Mr. Freeman: I think what the paragraph is meant to remind people of is that this is substantially changing group of people, and many people do not realize that there is a very high turn-over.

Senator McGrand: You mean that a person could become unemployed two or three times in the course of a year?

Dr. Young: I remember an amusing incident when I was in Toronto on a panel with some union leaders and there was a vigorous, bearded young gentleman in the audience who called for a militant organization of the unemployed. The union leader had to point out to him that that had been tried frequently before in this country and that one of the difficulties was that the executive of the organization of the unemployed kept becoming employed and it was so hard to hold the outfit together. That I think is something that people need to keep in mind.

Senator Beaubien: Dr. Young, is it true that in many cases where people are afraid they are going to lose their jobs the wife goes out and applies for a job and this creates the impression of greater unemployment; and then, of course, if the man loses his job, the wife will be looking even harder. So, because one person loses a job, you have two persons looking for work. Have you seen any evidence of that?

Mr. Freeman: The unemployment rate for women is typically lower, on the average, than it is for men.

Senator Beaubien: Has it gone up much lately?

Mr. Freeman: It has gone up along with the men's rate. But, typically, the rate for women is lower than that for men. This is because sometimes if a woman loses her job, she will say, "Well, I might as well go back to the house," There is more part-time work and a looser attachment to the labour force.

Senator McGrand: Then on page 24 you ask if we should aim at freezing the existing pattern of income distribution for a limited period, or whether we should aim deliberately at effecting certain changes which are regarded as socially desirable. You have already discussed that for quite a while this afternoon, but I would like to know what would happen when the freeze period is over.

Dr. Young: Let me say that that particular freeze we are talking about there might be quite consistent with a flexible mandatory price and wage control system, but you have to ask yourself: What is the level of wage and salary increase allowed? What is the level of price increase allowed? And what are the other components of the system? In the course of the period of restraint will that lead to a change in the shares, or should it be aimed to lead to a change in the shares? You will be trying to make that as consistent with underlying economic conditions as you can, so that you will be moving with the economic forces. In other words, it is a freeze of the shares but not necessarily a freeze of individual prices and wages.

The Chairman: Dr. Lipsey made the claim that an incomes policy of that nature was actually inflationary by virtue of the fact that most productive sectors of the economy achieved a high wage rate and the less productive sectors, especially those that were the subject of high demand, demanded the same wage rate; and that you created a situation in which you invited people to raise their wages to that level—that you are constantly making those adjustments.

Dr. Young: I am not sure that I follow the logic of that. One of the problems with any form of wage restraint is that you set a limit on it. Some people have argued that the consequence of setting a limit is that it becomes a floor. If that limit is set too high, you can be counter-productive.

The Chairman: That is the same reasoning that existed during the war, that rationing in its initial stages caused greater consumption than had occurred before rationing.

Dr. Young: This is a common problem. Everyone has recognized that there are situations in which the exis-

tence of a ceiling is interpreted by many people as an appropriate floor. That is one kind of problem that you encounter.

Senator Casgrain: Perhaps my question is not orthodox, but you say that we accept a 2 per cent raise in wages and in prices. But do they ever put a ceiling on profits? It seems that the consumer is always paying at the end of the line.

Dr. Young: In 1969 there was a limit on prices; then a much higher limit on wages. There was a provision for increase in productivity to yield increases in real wages, and then the price restraint program, which was going to achieve this low level of price restraint, was operating on the margin between costs and revenues. It was operating on the profits of firms. In that sense, it was coming under control. It is true that there were situations in which there were limits as to how far a control system of that kind would operate, and we then found the need for other devices to deal with those problems.

Senator Casgrain: Each time you buy something and it is more expensive, they say, "Yes, but it is because of higher wages."

Dr. Young: Yes, and higher profits and higher incomes and higher everything, once the thing gets rolling. We found, when we first looked at the problem, that people said, "Go out and seize the culprits and tell them that they are doing evil things." We said, "Where shall we go?" They said, "Take the banks and the doctors and the this-and-that." We said, "But what about this-and-this? They are just as bad." And they said, "Make an example of some." The reason we did not approach the problem that way was that we did not find it very easy to identify.

There are certain sectors of the economy which are more serious than others. The way we tackled the problem was that we could see that the consequences of the step that had been taken were going to lead to a high level of unemployment. We thought, and we think now, that if we could have intervened at that stage with a form of direct price and income restraint brought about by consultation and co-operation, we could have avoided some of the unemployment from which we are now suffering.

Some of you may recall that when I was before the House Committee not long ago I was accused of helping to generate unemployment. I tried to make clear at that time that the whole purpose of our exercise had been the very opposite, to accomplish the anti-inflationary objective which we thought then and we still think is right, but to do that at less cost in terms of unemployment. Whenever this Commission gets branded as a commission that is in favour of generating higher unemployment, understandably we get a little crusty on the subject because that is the whole purpose of our exercise, just as it would be if occasion arose to intervene during this expansion with a form of prices and incomes policy. The reason for doing so would be to avoid the kind of policies that would generate unemployment. That would be the purpose of it. If the Government took the line that it was not going to tolerate inflation and was going to deal with it, then there would be only two choices, unemployment or a prices and incomes policy. Those ar the short-run choices.

Dr. Gillies: If I understood you correctly, you said that you would put in prices and incomes policies, or let us say price and wage controls, on a temporary basis. Is it your feeling that this is to buy time so that other things can be done, or can and do price and wage controls by themselves prevent inflation?

Dr. Young: If the problem is temporary, a temporary solution will deal with it and you may not have to seek permanent changes. But if the point that Senator Molson made is valid, that you have fundamental structural changes in the economy, I think that point of view has to be approached with considerable caution. If that were the case, you have really to look very seriously at those during the control period.

Dr. Gillies: What is the purpose of having controls? I presume it is to stop the prices and costs rising. But it does not do anything about the fundamental forces that are causing those costs to rise.

Dr. Young: It may be that the fundamental forces are past price and wage increases which have developed expectations of a continuation. If you do not continue, you do not have the expectations.

Dr. Gillies: Your argument is that you do not have to change the anti-trust policies but rather to stop the expectations?

Dr. Young: I do not want to commit myself to a firm view on that. It is quite clear that we have to deal with the problem of expectations, and the extent to which there are more fundamental problems which make the economy unmanageable is something that we are studying very carefully. We will continue to study it and will reach some conclusions shortly. All I am saying now is that the view that there are some permanent characteristics of this economy which make it unmanageable must confront the fact that this economy was not unmanageable a scarce half dozen years ago, so that it needs to be looked at with considerable care.

The Chairman: I would like to continue to pursue that point with you. As I understand it, you do not see much hope in selective controls?

Dr. Young: It is not a matter of hope. It is a question of whom do you select? Who has the magic formula for saying, "It is these fellows, but not those fellows?"

The Chairman: You have answered the question by asking a question, so I will ask the question again. If you answer your question you must come to the conclusion that there is not much hope in selective controls, because you are going to run into a process of misalignment of investment resources.

Dr. Young: One would say, "What is the economic logic?" Why control steel workers and not professors? Professors have done better than steel workers. Why should the non-unionized, although faculty-association

professors, be allowed to run free and steel workers be controlled?

The Chairman: So, we can dismiss selective controls?

Dr. Young: We certainly do, in principle. We do not see the basis for it.

The Chairman: Coming back to Senator Nichol's point, that you go from the suasion, the first four or five on this scale, and then move forward to the almost mandatory Wartime Prices and Trade Board approach, you went on to say that there would be a tremendous pressure to remove any sort of controls imposed at the upper end of the scale, where any imposed would be. It seems to follow from that that this is a temporary measure.

You point out there probably is no structural difference in the economy from ten years ago, nothing that would indicate that these measures should be permanent.

Dr. Young: Please do not over-state that, senator. Our present view is that that should be looked at carefully; we are in the process of examining the data.

The Chairman: Obviously, you have to interpose some forces during this temporary control period. You do not see such controls being the permanent answer. We are interested in knowing what stabilizing forces you want to see interposed at this point.

Why do you think that what was done in the last six or eight years created the situation?

Dr. Young: I will answer first with respect to what happened in the last six or seven years. We generated the worst peace-time inflation in our modern history, certainly since before the First World War. Anyone who tought it would be easy to get out of that was living in a fool's paradise. That was going to be a hard inflation from which to extricate ourselves, and we have therefore encountered serious problems in so doing. People who have seen the number of years of substantial wage and price increases are inclined to think that they will see their continuation and base their actions on that assumption. Market conditions are then changed and quite strong pressure is brought to bear on business enterprise substantially to reduce the rate of price increase for a variety of reasons. That removes one important element in generating cost increases, namely, it achieves a lower level of price increase. However, that so far, plus unemployment and the whole situation, has had only a very modest effect on cost increases.

Now, is that because the world has changed from 1963-64, or because we have had quite an extended period of inflation? If we overcame inflation for a period, would we then return to a reasonable level of cost-price increases? If we then proceeded cautiously with demand management to avoid over-heating the economy, at the same time endeavouring to arrive at as low a level of unemployment as possible, could we not then run the economy under conditions of reasonable price stability? Would it not be much better to do that than to start down the path of accelerating price and wage increases? If we took the first step now to 5 per cent price increase and 8 per cent or 9 per cent wage increases, and the next time we got into trouble took the next step, would we find ourselves somewhere down the track having finally to dig in and deal with the problem, being faced with the same situation as the United Kingdom, where they have 9 per cent price increase and the highest rate of unemployment since the war? That is the kind of objective to which you have to look in following that path.

Senator Nichol: That is the slippery slope.

Dr. Young: That is right. So, to think that anyone enthusiastically advocates this type of direct intervention in the economy is quite wrong. There is no reason to suppose that direct price and wage controls are anything but very uncomfortable indeed.

The Chairman: So you would avoid at all costs, then, suggesting these be imposed on a continuing basis as a structural part of our economy?

Dr. Young: We do not see that as a need on a continual basis. We consider it to be a very serious decision to accept them at all, and we are only prepared to contemplate them because of the narrowness of the alternatives. The only thing I sometimes have to criticize in the view taken by some other people on this is how relaxed they are, how easy they think the choices are, how they think they can brush aside this form of direct intervention without realizing how few alternatives there are.

There you are. You are in an expansion, cost and price increases are rising at a level which promises further acceleration. What are you to do? Unemployment or direct intervention? What else is there? There are some long-term policies, but they take time to operate. Someone raised the question of anti-trust policies. There are competition policies which are in the process of changing; there will be a new set of arrangements, presumably, a new board and new efforts, but how long can one expect to have? That will take some time to have effect. That will not happen overnight. If you are faced with this problem in the near future there are not very many places to turn.

Senator Nichol: Dr. Young, I wonder if we could go one step backwards, behind what we are talking about. We have spent a lot of time talking about prices and incomes policies, how they should be used and how they should work. What about fiscal and monetary management? I do not want you to think I am asking for comment on the quality of fiscal and monetary management in this country or any other country. The reason we are talking about prices and incomes policies at all is because the fiscal and monetary management system has, I suppose, failed to do its job properly. Throughout these hearings of the last few weeks there has been one recurring theme, which has been the question of lags. It has come up over and over again. It is a problem not only of knowing what to do but of knowing where we stand so that we can look at what to do. How big a problem is this question of lags in the application of fiscal and monetary policy? How close are we to knowing the effects of what we do and the time frame in which they

will happen? And what can we do to improve it? How many questions is that?

Dr. Young: I can give a short answer. The problem of lags is a very serious one. Lags do not remain fixed. I am now talking of some work that some of us were involved in some years ago when we studied this. On the monetary policy side it is easy enough to see why the lags will alter. It depends where the monetary policy strikes. If it is effective on housing, the lag will be a short one; if it affects utilities the lags will be very long. You can have lag effects on monetary policy five years down the track if you affect electrical utility planning. If you study and learn the lags that apply to a particular episode of monetary policy, for example, that may not be a very accurate guide to the next episode.

Senator Nichol: Even on the same segment of the economy?

Dr. Young: It is likely to strike in different ways. You may have changed the institutions, as we did in this country. You get one sort of reading of the lags, then you alter the institutions and get another one. Mind you, I do not want to suggest that all this is unknown. I am just saying it is a serious problem, and it is very hard to get hold of it accurately and get a reading, which first of all is clear enough, and which will remain fixed through time. There is variability here. This does not mean you should not learn as much as you can and then apply, in as knowledgeable a way as you can, the experience gained from the past in dealing with the next episode.

Senator Nichol: Is this in part a statistical problem? Perhaps that is a silly question, because obviously it is, but how much is it a statistical problem?

Dr. Young: Yes, it is, and it is structural. The nature of the economy does not remain stable. You have a very strong effect on monetary policy on housing because there is a fixed NHA rate; you change that institution and have that move with other rates, then you have a different result, and monetary policy has a different impact. Sometimes it depends on what foreign exchange rates you have. The monetary policy will have one effect if you have a fixed rate, and will have another effect if you have a flexible rate. You can learn all sorts of things about that process and then you can apply them, in as intelligent a way as you can. It is just that it requires a fair amount of artistry as well as science to do so. One should not over-estimate the degree of precision with which it could be done. I think you will find that the practitioners of the art take that view themselves, that one should not over-estimate the degree of precision that can be applied. Perhaps someone might like to supplement that.

Senator Nichol: This is a real problem. The crux of the thing is, how do you approach a more efficient or responsive system? This has come up several times in the hearings here. There have been accusations made here that we have always been shooting away behind the duck, overshooting or undershooting, or whatever phraseology you want to use. Do you think our pattern of performance is getting better over the years?

Dr. Young: Perhaps those who practise this art have more humility than those who make comments. It is a comparatively short experience we have had in managing the economy in this way, when you think of it. We have been at it for only about ten to fifteen years.

Remember the intervention in monetary policy in the 1950s, 1956? It was pretty well the first time that the instrument had been used very aggressively. There have not been very many times that fiscal policy has been used. We are pretty early in the game, as most countries are. I would say people are learning things about it. They are also learning about the difficulties. There are lots of people who thought it would be very easy to forecast, that it was just a small thing.

If you want to forecast Canadian economic performance, it is just as well that you know what is going on in Ho-Chi-Minh's mind six or seven years ago. You can see how widespread the effects can be. The whole world bears upon an open economy and there are many things to be taken into account if you are going to forecast accurately.

Dr. Haythorne: I think that one of the important things is to try to put a finger on the indicators of excess demand, in the economy generally and in those parts of the economy where it could have some serious consequences. One area here is our broad investment policy, in the country generally. It comes back to construction. We have these ups and downs in the construction industry, which has given a great deal of pressure, at certain times and in certain places, which still has really serious spill-over effects. What you do about this is not easy to lay out always in advance. At least, perhaps we need to have more forewarning about it, more ability to beforewarned about these things coming up.

Senator Hays: How do you co-ordinate these problems? I am thinking of the spill-over you were speaking about, over-building and vacancy factors, in the construction industry?

Dr. Haythorne: These are the things hopefully you are able to work out with them—a carefully developed fiscal and monetary policy, your fiscal policy, related to more knowledge about what is brewing, what is ahead of us. We need much more information on a lot of the signs. This is not always easily acquired.

Senator Nichol: I was not suggesting it was easily acquired. I was wondering what the standard of the art was.

Senator Hays: I have another question, which is not related to this. How far out are we in our inflation problem with our trading partners? How far away can we get, if we are going to sell and they have to buy, and so on?

Dr. Young: If we are erring on the side of being better than they are, then we are going to bring down costs. It is easy enough to err on that side. If you err on the other

side and you have a fixed rate, then you are brought back by balance-of-payments problems. We have often said in this country that if you are going to err, then do better than your neighbours. Do better and have smaller cost increases than your neighbours.

Senator Hays: Dr. Young, in that regard we were speaking earlier about agriculture in terms of keeping the cost down. In my opinion, the situation is that we have done rather a good job of keeping costs down. That is borne out by the fact that the demand for imports in other countries has increased just in the last few months, and I would cite as examples Red China, Russia and Europe, where the price of meat is double what it is here, and Japan, where it is three times as much as it is here. This could readily cause a shortage here, because consumption and production are just about even at this point.

Dr. Young: In other words, you can see problems of foreign demand dragging up our prices in particular areas?

Senator Hays: Yes. Is this as a result of our not having enough inflation or did we keep the reins a little too tightly?

Dr. Young: It is certainly true that the rate of price increases in a wide variety of countries exceeds the rate of increases of prices in this country, but that is not to say that we have to follow them. We do have an exchange rate, and that can adapt through time to changes in the price performance.

When people say that one country is necessarily tied to another, they sometimes forget that at one time there was a Belgian franc, a Swiss franc and a French franc all worth roughly the same price before the First war. In the mid-1950s their ratio of value was 1 to 10 to 100. One Swiss franc would buy ten Belgian francs, and 100 French francs. That is how far three neighbours had managed to diverge from each other over that period, which had meant successive French devaluations and successive Belgian devaluations as against the Swiss franc.

Senator Hays: How did it affect the standard of living in the three countries?

Dr. Young: It was by no means obvious that France did any better than Belgium or Switzerland. Indeed, in looking across their border the Swiss would say that it was fairly obvious that they had done better than the French.

Senator Molson: Mr. Chairman, perhaps not enough emphasis has been placed on government participation in our business problems of prices, wages and costs. In the course of various hearings here we have seen a fair amount of comparison between the government slice in this country and the government slices in other countries. The Canadian Government is taking more from every dollar the consumer spends and more from every dollar's worth of production that comes out of a plant than is the case in many of the countries we consider neighbours and friends. Nevertheless, that fact is hardly ever mentioned. It seems to me, if we have a problem of getting public understanding and support, then this is something that should be mentioned. I should like to have Dr. Young's comment on that. First of all, am I right in making that statement?

Dr. Young: It is fair to say that in this country today governments take a large slice, and have been taking a substantially increasing slice in recent years. Part of that, of course, is a flow-through of funds, a diversion of funds which are used for one purpose in the private sector and are just being passed through governments, which is much less important than a government taking over the real resources and making use of them. But there has been a substantial growth of government activity in this country over an extended period of time.

Senator Molson: They take more out of a great many businesses than the shareholders do—most businesses, almost all businesses. When all the questions of costs or profits are raised, however, it is very seldom that that phase is mentioned.

Another thing I should like to comment on is that in all these discussions today on inflation, unemployment and our economic problems, we keep referring to cost increases, but we never seem to think of the millennium as being cost reductions. We rarely mention that at all. We speak of small increases, but in fact both prices and costs should in many cases be reducing in a country such as ours and in an economy such as ours. We seem to accept the fact that small increases are inevitable and that, even if we double or triple the size of our plants, there will never be a day when we can produce an article at a lower cost.

Dr. Young: Fortunately, there are some examples of that still in our economy. When new products come in we do see occasional examples of that. But it has been true that one consequence of inflation as vigorous as the ones we have had is that all sorts of durable goods, that are manufactured, which would ordinarily at least be expected to remain stable, have been rising in price significantly, and that is where the reflection of the virulence of this particular inflation is seen. There have been all sorts of goods for which productivity increases are very rapid, but nevertheless we have to have price increases.

Dr. Gillies: Dr. Young, you have pointed out our unhappy dilemma in having to take unemployment or controls, but every witness who has been here has said that socially we will not take unemployment, and practically every witness who has been here has said that controls will not work, that in an open economy such as Canada's, and with its relationship to the United States, and so on and so forth, you simply cannot make them stick in peacetime. I am sure you must have been looking at that problem, because it is a huge question, but what do you feel about it? Dr. Reuber's evidence last week was that we depend so much on imports from the United States; and there was Mr. Gibson's testimony that even in wartime, at the end of the war, they had a hard time making these things work. Many of the witnesses have

said flatly that price and wage controls will not work. John Crispo said that there was no way the labour force would accept this, even if the leaders did agree. What do you feel about these observations?

Dr. Young: First, I feel that if they were true, it would be very unpleasant. Look where it would leave us. We would have no solution. But we are not prepared to accept that this is a no-solution situation. The public of this country are going to have to understand how narrow the choices are and how difficult the problem is. Then you are going to have to ask the question whether, if the public can understand that, they are going to take the view that it is impossible to deal with the problem in this way. If we get that degree of public support, then we can do it.

Then, if you succeed in doing it, one consequence will be that having your own currency, there will be some passive response on that side. So the view that we are inextricably tied to the American price level is not true. We have just made a very substantial divorce of our price level from the American price level by a movement of the exchange rate, and one of the consequences of a different price level over an extended period of time is that adaptations do occur such as I have just talked about in connection with Switzerland, Belgium and France. That is not to say that they occur instantaneously or entirely smoothly, so that these consequences do follow. Remember, there were people who said we could not do better than the Americans last year. Yet we had 1.5 in one country and 5.5 in the other. It was rather apparent that over the short run you cannot diverge, but we could have diverged even with a fixed rate. In fact, we were still diverging even while we had a fixed rate. So, over the short run it is possible with a fixed rate; and over the longer run, whether you have a fixed rate or not, there are revaluations and alterations in the exchange rate to reflect a difference in the cost and price performances of the two economies.

So our answer is that while it is not easy and while, in fact, it is extremely difficult, it reminds me of the World War I cartoon, "Do you know a better 'ole?" We are stuck with rather narrow-range choices.

The Chairman: Are there any further questions? Do you or your colleagues have anything to add, Dr. Young?

Dr. Young: No, thank you, Mr. Chairman.

The Chairman: Dr. Young, on behalf of the committee I should like to thank you very much for your forthright testimony. It is testimony that clearly will be the subject of much discussion during the remainder of these hearings, probably starting tomorrow with Dr. Harry Johnson. To say that it will be the subject of much controversy is probably to understate the point. You have been most helpful to us. We thank you for the trouble that you have taken in preparing your excellent brief and for coming here today and giving us your very open testimony. I should like also to thank Mr. Freeman and Dr. Haythorne for joining us. Thank you.

The committee adjourned.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 12

WEDNESDAY, MAY 26, 1971

Ninth Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses:—See Minutes of Proceedings)

23875—1

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Isnor
Beaubien	Kinley
Benidickson	Laird
Bourget	Langlois
Bourque	Manning
Croll	*Martin
Desruisseaux	McDonald
Everett	McLean
*Flynn	Méthot
Fournier (*Madawaska-Restigouche*)	Molson
	Nichol
Gélinas	O'Leary
Grosart	Paterson
Hays	Phillips
	Sparrow
	Walker—(27).

(Quorum 7)

**Ex officio Member*

Orders of Reference

Extract from the Minutes of the Proceedings of the Senate, of Tuesday, March 9th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said *Estimates* reaching the Senate.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Tuesday, May 4, 1971:

"With leave of the Senate

The Honourable Senator Langlois moved, seconded by the Honourable Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relations thereto.

The question being put on the motion it was—
Resolved in the affirmative.

Robert Fortier,
Clerk of the Senate.

23875—1½

Minutes of Proceedings

Wednesday, May 26, 1971.
(12)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10.00 a.m. to consider the Question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Benidickson, Croll, Grosart, Hays, Laird, Langlois, Manning, McLean, Molson and Nichol. (12)

Also present but not of the Committee: The Honourable Senators Cameron and McGrand. (2)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics; Mr. W. Neville, Editorial Writer.

Witnesses heard:

Dr. Keith Acheson,
Professor of Economics,
Carleton University.

Dr. John F. Chant,
Assistant Professor of Economics,
Carleton University.

At 12.45 p.m. the Committee adjourned to 4.00 p.m. today.

At 4.00 p.m. the Committee resumed.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Benidickson, Desruisseaux, Grosart, Hays, Laird, Langlois, Manning, Martin, McLean, Molson and Nichol. (13)

Also present but not of the Committee: The Honourable Senators Burchill, Cameron, Haig, Kickham, Lang, McGrand and Molgat. (7)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics; Mr. W. Neville, Editorial Writer.

Witness heard:

Dr. Harry G. Johnson, Professor,
Department of Economics,
University of Chicago, and
Professor of Economics,
London School of Economics and
Political Science.

At 6.30 p.m. the Committee adjourned to Thursday, May 27, 1971, at 10.00 a.m.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Wednesday, May 26, 1971.

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 10 a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have with us today Dr. Keith Acheson and Dr. John Chant, who have filed an extremely comprehensive brief with appendices entitled, "Monetary Instruments and Objectives."

Dr. Acheson, who is now Professor of Economics at Carleton and was formerly at Queen's University, obtained his doctorate from the University of Toronto. He has been with the Economics Department of Queen's University; has worked in Uganda for the East African Development Board of Control under a CIDA contract; and has published articles on international monetary theory in the *Canadian Journal of Economics* and the *Journal of Political Economy*. Especially well received has been his paper to the Canadian Learned Societies on "The Bank of Canada—A Study in Bureaucracy."

Dr. Acheson, along with Dr. Chant, has carried out intensive studies on the manner in which the Bank of Canada operates, and has put forward many interesting suggestions for improvement. His work on public policy, monetary theory and international monetary theory provides invaluable insight into the issue of inflation and unemployment currently challenging our policymakers.

Dr. John Chant is Assistant Professor of Economics at Queen's University. He received his doctorate from Duke University, and has taught at Edinburgh University, Duke University and Queen's University. Additionally, he has spent one year with CIDA in Tanzania.

It is with great pleasure, that I welcome Dr. Chant and Dr. Acheson, and I will ask Dr. Acheson to proceed to outlined in a brief statement the subject that is before us.

Dr. Keith Acheson, Professor, Economics Department, Carleton University: Thank you very much. Both Dr. Chant and I are honoured to be here, and I hope we can be of some help.

The brief we have prepared reflects the result of a couple of years' work which started with a paper we gave last year, as the Chairman mentioned, at the Canadian Learned Societies. We have appended to the brief the detailed results of our research and have made a summary of those results in the brief itself. I would like to go through that summary and try to clarify some of the points we have made in there, as well as I can.

The method we have used to approach the behaviour of the Bank of Canada has been one to try to set up a simple theory of what might motivate the behaviour of that institution. We have felt that the institution may have objectives of its own, and we have summarized these as reflecting the prestige of that institution and its desire to preserve itself over time, both because the people involved in the institution feel that its functions are important ones and ones that should be continued to be served over a period of time, and also because of the self-interest of the members of organization.

We used this approach, not that it explains all aspects of the behaviour of the Bank of Canada, but because it explains aspects of that behaviour that we were unable to explain using more traditional approaches. So we see this approach a augmenting other approaches, which I am sure will be reflected in other people's briefs to this standing committee.

The approach was used on the Bank of Canada not because that institution is more Machiavellian than other institutions—indeed, I think it probably is not—but because we have a teaching interest in the Bank of Canada, and questions put to us by students directed us to looking at this institution in detail. We feel that the same approach would throw light on university administration, departments in universities and departments of Government.

The areas that we were able, I think, to throw some light on were: the choice of instruments by the Bank of Canada; the choice of policy objectives; and the priorities that the Bank of Canada gave to various policy objectives that it has responsibility for. For the purposes of this committee we have also used this approach to try to determine whether it would be a good idea to give the Bank of Canada responsibility for ameliorating the regional impact of national economic policies.

Considering the instruments of monetary policy, the types of questions we could not answer using traditional approaches to monetary policy were: Why do central banks maintain a battery of instruments, many of which have technically similar effects? And was: Why is there an operational emphasis on covert instruments...

Senator Beaubien: What kind of instruments?

Dr. Acheson: Covert instruments. By "covert instruments" we mean instruments that do not leave a statistical trail, instruments which it is difficult, unless the Bank

of Canada acknowledges their use, for the outside observer to know in fact are being used.

As an example of a convert instrument...

The Chairman: Excuse me. Were you having a problem with that thought at all, senator?

Senator Beaubien: No, I think I understand what the witness is saying.

Dr. Acheson: Concerning the characteristics of the different instruments that were available to the central bank, we felt that the central bank would view as desirable some characteristics that perhaps society and groups to which the central bank is responsible would not view as desirable.

We felt that at times the central bank would like to make it more difficult for other people to know what in fact it was doing, and both the use of a multiplicity of instruments and the emphasis on covert instruments, we think, make it more difficult to know what the central bank, as an agency of Government, is in fact doing at various times. As we mentioned in the brief, by combining instruments in different degrees, and sometimes in different directions, the central bank can make it more difficult to assess its performance. You have to be technically more proficient really to know what is happening in monetary policy.

We feel that at times there is no real justification, no real need, for the use of so many instruments. As an example of that, at times the central bank affects the cash reserves of the chartered banks by moving Government deposits back and forth between the bank and the chartered banks. At the same time it may be performing open market operations where it affects cash reserves of the chartered banks through buying or selling bonds. It may be changing secondary reserve ratio and it may be exerting moral suasion. With all these instruments occurring at the same time. some of them in fact pointing in different directions, it confuses the outside observer and is often unnecessary.

Senator Beaubien: Who are the outside observers who understand anything about it now? Who are the people who would be affected or misled? I do not know what you are aiming at?

Dr. Acheson: I take it that with the hearings here people are interested in making these institutions perform as well as possible, and I would think there are people who interpret the behaviour, the economic policy of the Bank of Canada and the Government. It is important that they have information which allows them to interpret that behaviour as accurately as possible.

Senator Beaubien: Would it not be important for the bank to have them not know what it is really up to?

The Chairman: I do not want to preclude discussion, but I wonder if we could let Dr. Acheson complete his entire thought and then come back to questions.

Dr. Acheson: The second thing we would predict from using this approach is that there would be in the operation of the central bank an emphasis on the more covert instruments available to it, of which moral suasion is in our opinion the most covert; and there would be more of an emphasis than the bank usually reveals in its publications and speeches by the governor or in the annual report of the governor, or in speeches by higher officials of the Bank of Canada.

We looked at moral suasion. We felt that this would be so. We tried to document the use of moral suasion by the central bank. We did that an Appendix A of our brief. The table that we present in Appendix A is not an exhaustive list but it is as exhaustive as we could make of the use of what we would call formal moral suasion.

Formal moral suasion would be moral suasion which the bank after the fact has revealed in one of its annual reports or in speeches by the officials of the bank, and in our opinion it has been used very frequently. At least every two years there is an act of moral suasion. And some of these have been lifted. Some of them have been in effect for a considerable period of time. So we feel that by the bank's own after-the-fact admission it does use this instrument quite often. One of the problems with moral suasion is that one is not sure how often it is used and not revealed. That is a problem for the people who are trying to make an institution responsible for its behaviour.

As well as formal moral suasion there is continuous interaction between the Bank of Canada and the financial work. The Bank of Canada, through its security operations, is constantly in touch with the market and there is, as we have documented in the appendix, a continuous flow of information in both directions. There is evidence that the Bank of Canada continuously tries to influence the behaviour of financial institutions. Again this is not necessarily a bad thing. There is evidence that it occurs quite frequently.

For instance, one act of moral suasion that has not been disclosed by the Bank of Canada, that we were able to apply by the portfolio behaviour of certain financial entities, the money market dealers, was that the Bank of Canada seemed to be putting pressure on dealers to limit their holdings of bankers' acceptances.

These dealers have access to lines of credit at the central bank and that access allows them to borrow at a very low rate from the chartered banks day-to-day loans. They can use these day-to-day loans to either finance holdings of treasury bills or bankers' acceptances. Since bankers' acceptances have very little risk to them and have a high rate of return, it was hard to for us to understand why the money market dealers did not hold more bankers' acceptances.

We implied from this that there was moral suasion being exerted in this area. After we had done that analysis we received information that moral suasion had been exerted over a period of time and it had culminated in a directive to certain money market dealers to limit their holdings of bankers' acceptances.

We have tried to imply that within this set of operational choices that the Bank of Canada has, it will move

in the direction of choosing what we call covert instruments. We also feel that over time an agency of this sort would be in favour of an institutional environment which would allow it to choose fairly secretive methods of operating because we feel that would be in that agency's interest.

As a result of that kind of analysis we would predict that the Bank of Canada would have a certain attitude to the type of system in which it operated. Moral suasion, we feel, is a very attractive instrument from the Bank of Canada's point of view and therefore we feel that an institutional environment that was amenable to the use of moral suasion would be the type of institution and environment that the bank would want.

This view is backed up by the attitude of the Bank of Canada towards concentration in the banking system, that moral suasion works when there are very few entities to influence. The greater the number of different institutions you are trying to influence with moral suasion the less the renegade can be identified and the less he can be punished for not acting in the social good as viewed by the Bank of Canada.

So that we feel that the Bank of Canada would not actively support the view that entry into the banking system should be easier than in fact it is now—it requires an act of Parliament—and that the bank would not advocate suggestions such as that made by the Porter Commission, that entry into the clearing system for the banks be allowed for every situation accepting liquid deposits. We also feel that this explains the attitude of the Bank of Canada and other central banks towards the present international montaery ararngements.

After analysing the Bank of Canada's attitudes, and its means of operating, the question is what are the policy implications of this analysis? We feel that visibility and simplicity of operation, where it does not penalize the institution, is a desirable thing from society's point of view. If you are a manager and you are setting up somebody to do a particular job, you like to have information flows that allow you to judge whether or not that job is being performed. However, the same attributes are not desirable from the point of view of the central bank, and we feel that policy should then take this predic able bias in behaviour into account, and the options of operating available to the central bank should be limited so that the central bank cannot use covert instruments unless there is an explicit reason for their using them.

We conclude in that section that general monetary policy should be carried out in as simple and open a manner as possible.

We applied the same type of approach to the objectives of the Bank of Canada. Here is an organization which is set up to achieve a number of different objectives. Now, society probably has a view as to which are the most important objectives in that set of objectives of economic growth, full employment, price stability, balance of payments, equilibrium, et cetera, that are the objectives of the Bank of Canada. We feel that the operational priorities of the central bank may sometimes not reflect the priorities of the society at large, and we feel that in cases such as that there should be policy changes considered at least. We found that we could not get very much mileage from our approach in distinguishing the main objectives of the Bank of Canada and we could not make predictions about those. But we did find that we could make predictions about two subsidiary objectives of the Bank of Canada.

The Chairman: Excuse me, doctor. I do not wish to start a line of questioning, but I need some clarification.

Dr. Acheson: Certainly.

The Chairman: I could not understand this in the brief. You say that no light was shed on the relative running of the main objectives of monetary policy in this approach because of their similarity with respect to these characteristics. I am afraid the meaning of that escapes me. When you just discussed it it escaped me again.

Dr. Acheson: I just skipped over that, I must admit. When we viewed the objectives we asked: What characteristics do we think, given our approach, the Bank of Canada would be interested in? And we felt that the Bank of Canada would allocate its time and energies to those objectives which were most visible. That is where attainment was reasonably clearly defined. That is where there was a statistical indicator, such as a price index or unemployment figures, as to how they were doing in that objective. Whereas sometimes you have intangible objectives, or objectives where there is no consensus as to what those objectives really mean, such as the quality of life . . .

The Chairman: And whether you can achieve them.

Dr. Acheson: Yes, and whether you can achieve them. Nevertheless, the more visible the objective, the more the Bank of Canada is going to try to achieve that objective, because the Bank of Canada cannot, by redefining the objective, rationalize what, in fact, they did do. That is, the performance can be judged in a way that it cannot be judged if it is a more intangible objective. We thought that was one more characteristic the Bank of Canada would be interested in, in determining how it would allocate its efforts.

The second thing is how important this objective is to the groups to which the Bank of Canada is responsible. We feel that there are two broad groups the Bank of Canada is responsible to. One is the public at large and the other is the Government. The Government has better information about what the Bank of Canada is doing than the public at large, because there is a member of the Department of Finance who sits at the board meetings of the Bank of Canada. In general, there is a flow of information there that is not available to the general public. So we felt that goals that were important to the Government would be goals that the Bank of Canada would be sure to try to achieve because of the direct power that the Government has over the Bank of Canada, and that would make it in the bank's interest to do this.

The identification of the bureau with the objectives was the other characteristic we thought the bank would take into account. That is, if responsibility for this objective were fragmented over a number of different groups, then the bank would always say, "We did our bit. It is the fault of the fiscal policy or of the regional expansion department or somebody else for a poor performance in this area."

So those were the things we thought would be important in determining how the Bank of Canada would allocate its time.

Now, so far as price stability, full employment and economic growth are concerned, all of those have regional statistical indicators. There are problems with all the statistical indicators, but the problems are the same with respect to them all. We thought the visibility was similar between those, and the responsibility for its achievement was spread over the same general groups. The Government's priorities between those different objectives should not be very different from the public's. So we did not feel that our analysis allowed us to say that the bank would favour any one of those.

People have said in the past that the bank has had a concern with price stability that was greater than other agencies'. But we could not predict that from our approach. So we really could not say anything about those objectives. But we could say something about the subsidiary objectives of minimizing the Government debt or of creating a broader money market, which would allow financial institutions to adjust to changes in monetary policy more readily.

The Chairman: Because they were clearly alone in that field.

Dr. Acheson: Because they varied with respect to visibility of the priorities of the Government. For instance, take minimization of the Government debt. A fairly important item in the budget is the interest charges on the public debt, and we feel that the Government has a real political interest in trying to keep that low. Therefore, the priorities of the Government would be such that it would put that as a fairly high priority objective. We feel that they would not be so concerned with the objectives of the money market. We feel that the problems of the financial institutions go to changes in monetary policy. So far as visibility is concerned, both are intangible things to measure. So with respect to the identification problem, the Bank of Canada is the agent in debt management of the Government, and it has explicit priority for that objective. Developing the money market is an objective which is not as solely confined to the Bank of Canada in our opinion. So we felt for those reasons we would predict the Bank of Canada would pay more attention to minimizing the Government debt than would appear from its published accounts or that the general public would put on that objective.

The Chairman: Thank you, doctor.

Dr. Acheson: Now, we looked at the steps that were taken in the 1950s which were justified at the time as attempts to broaden the money market in order to make it easier for financial institutions to adjust to changes in the monetary policy of the Bank of Canada. These actions included: the setting up of money market dealers with lines of credit at the central bank; giving preferential access to these money market dealers so that the banks would in fact discount through the money market dealers, so that they would use these day-to-day loans that were set up at this time; and the reduction of the liquidity of treasury bills at that time to make day-to-day loans more attractive to the banks. They also put on a secondary reserve ratio which was justified partly to control the chartered banks' selling of securities in order to move into loans at a time when the Bank of Canada wanted to impose credit restrictions.

If that was the true objective of this policy, it seems to us that the secondary reserve ratio would have been changed more frequently in the 'fifties; but, in fact, it was not changed at all. All these actions were taken shortly after the passing of the Bank Act, and all of them were taken through the use of moral suasion.

We tried to look at which objective the Bank of Canada was in fact achieving by these operations, and in order to test which objective was being achieved, the minimization of the Government debt or the establishing of a broader money market, we looked at the holding of treasury bills. If the objective of the Bank of Canada was to minimize the cost of the Government debt, it would like to increase the holdings of treasury bills by the chartered banks and the public together; it would not care which group held these treasury bills. On the other hand, if its objective was to develop a more viable money market to allow institutions to adjust their cash position to changes in Bank of Canada policy, then it would want to have broader holdings of treasury bills by the non-bank public.

When you look at the holdings of treasury bills at this time there is very little expansion at all in the non-bank public holdings, and there is a tremendous expansion in the holdings by the banks themselves, and we feel that the evidence clearly indicates that the minimization of the cost of the Government debt was the objective of these steps, and not the development of the money market.

The Chairman: Was the same thing true of longer term securities?

Dr. Acheson: We did not look at them, because the money market steps that were taken were focused largely on the short term. However, I would suspect so, but we did not look at it, although it would be worth while looking at.

The Chairman: The development of the money market was more in the short-term area?

Dr. Acheson: It would be an attempt to do that because the banks would adjust their liquidity position by selling off the most liquid or the most marketable assets.

So we felt that the policy implications, that arose from this approach concerning objectives, were that if the

priority revealed the minimizing of cost of the Government debt by the Bank of Canada, it is not reflecting society's ranking of this objective, that the bank is putting a higher priority on this objective than people in general feel it should, then the bank should be constrained to change its operational priorities; or, alternatively, in order to change those priorities, you could remove the bank's responsibility for debt management, put it with another agency and have these agencies coordinate their policies but have responsibilities clearly allocated to different agencies.

If it was broadly felt that the Bank of Canada's priorities were the right ones, that minimizing the cost of the Government debt was important, then I think less secretive ways of achieving this purpose could be framed. For instance, the names of the money market dealers are not published. The Minister of Finance, in answer to a question in the house, would not state what their names were. The extent of their lines of credit, which is quite a valuable asset, are not known. The criteria for becoming a money market dealer are not generally known. We feel that all these things are, to us anyway—and they might not be to you—undesirable characteristics of the present way of achieving this objective.

The third area we looked at particularly for this committee was the question that we feel is more and more being asked, and that is that national economic policies have different impacts in different regions, and whether the institutions that set national policy should themselves be concerned with trying to ameliorate these regional disparities.

We noticed that in the questionnaire you sent out a number of questions were concerned with the regional aspects of national policy. We thought that many economists might in their testimony say that monetary policy would not have any bite on regional policy, but we felt it would be worth while trying to spell out why certain economists would feel this way.

We did that in the third appendix that we produced for the committee hearings. In that appendix we tried to look at different reforms to the structure of the Bank of Canada, to see if these reforms would give some leverage to the regional problems which would accompany the general stance of national economic policy.

The first regime we looked at was one which involved reasonably mild reforms to the Bank of Canada, reforms which would focus on making the general instruments that are now available to the Bank of Canada apparently, anyway, specific to regions, so that they would have a regional bite. For instance, open market operations could be performed in provincial securities, instead of as they are at the moment, in Government of Canada securities. And we looked at changes in other instruments. You could have reserve ratios varying between regions. You could have different discount rates, or discounting from different regions in Canada.

If we take as an example open market operations in provincial securities, the Bank of Canada has the power to perform open market operations in provincially guaranteed securities now. The question that has to be answered is whether this would have any regional impact at all. In our opinion such a change in the operations of the Bank of Canada would not have any impact on regional disparities, and it would be a mistake for the Bank of Canada to become involved with this objective because of its lack of leverage on the problem.

For instance, if you have an open market operation in provincial security, so that you designate certain provinces as having greater unemployment than other provinces, the purchase of the security of a province may in fact be made by an institution that is resident in another province. If that is so, the high-powered money, the cheque that the Bank of Canada writes to buy that security, gets deposited in a financial institution in a region other than the region that you are trying to have an impact on.

Even if the security is bought from an institution, or an individual resident in the depressed region, the cheque will be deposited with a chartered bank. The chartered banks do not distinguish in their lending policies where the sources of their cash reserves are, as they have made explicit at various times in submissions to royal commissions. They act on commercial principles and they pool their reserves. We have a quotation in Appendix C from the chartered banks on how they perform.

What essentially happens is that their reserves are pooled wherever the cheque from the Bank of Canada was cashed and they may lend in those regions which it is most profitable to lend in. So that the lending policies of the chartered banks which could influence spending patterns would not be affected at all by the sources of high-powered money.

Even if you had an institution whose lending policies were affected by the fact that high-powered money was created specifically in a particular region, this would only affect the expenditure financed by that institution. When the people who borrowed from that institution spent, and deposits were made in other institutions, money would flow again into other regions through the interregional mobility of capital.

This interrigional mobility of capital does not depend just on flows within financial institutions. A corporation, for instance, that has operations across Canada may find that money that it used to borrow in the Toronto area can now be borrowed, because of regional policy more attractively in the Maritimes, the corporation can move its borrowings to Maritimes and still not reflect where it actually spends its money. That is the thing that will impact on jobs, and growth in the area is where the corporations spend their money.

Again interregional mobility of capital can come about through actions of borrowers as well as actions of lenders. In short we tried to spell out in some detail in Appendix C where we feel that these types of changes would not have any considerable impact on regional problems.

We feel that adding the responsibility for an important objective, or an objective that we think is important,

such as different regional economic performance or variations in regional economic performance, to the existing responsibilities of the Bank of Canada would be a mistake because it would not have any leverage on it, and it may in fact perform less well in its traditional areas, because it would have to be concerned about an objective which it cannot in fact easily influence.

We have looked at other types of institutional set-ups which would be slightly more radical. One would be a central bank which lent to regional development banks and got high-powered money into the system in that way. There would be again little impact or reduced impact by this type of set-up because of interregional capital flows. But the impact, to the extent that there is an impact, depends on the behaviour of the development bank and there is no reason why development banks should be tied to the central bank or tied to general monetary policy.

We feel that the issue of whether development banks should exist or not should be handled on its own, that it should not be interconnected with national monetary policy, that there would be costs of interconnecting these to objectives in terms of greater difficulty of pinning responsibility for achieving these different objectives.

The policy implications, as we see it in this area, would be that narrowing regional disparities is desirable. There is a tendency for every agency to say "Well, we have to do something about that problem." We feel that is a mistake, that the goal should be pursued with those instruments that have the greatest impact.

The responsibility for achieving objective should be clearly demarcated, so that you can go see how you are doing and try to learn from what you have done, so that in essence you can do better in the future.

In our opinion it would be a mistake for monetary policy to be included among the means to achieve regional balance.

The Chairman: Thank you very much Dr. Acheson. It is a very clear explanation on an extremely difficult subject.

Senator Beaubien: The central bank or the Bank of Canada is responsible to the Minister of Finance, who is responsible to the public. On the other hand it is responsible to the chartered banks. How could they be responsible to the public at large and act for the social good? I cannot understand how in any conceivable way they could have anything to do with the public at large. If the central bank is not providing enough funds, or whatever it may be, the Minister of Finance is always there to point that out if need be. Ever since Mr. Coyne's demise or departure from the bank, there has been no question of who rules the roost. I do not see how the bank in any way can be responsible to the public or how the public could ever understand what the bank is doing, using covert or not covert instruments.

Dr. Acheson: I am amazed how newspaper coverage of economic affairs has widened in the last 10 years. To teach an economic policy it is relatively easy to make that course appear relevant. There is a large section in daily newspapers dealing with some aspect of Government economic policy.

Senator Beaubien: I agree.

Dr. Acheson: It seems to me that the public is interested or newspapers would not publish these types of analyses of what the Government is doing. It seems to me that if that is the case, the newspapers themselves are interested in getting as much information as possible without making it impossible to undertake Government economic policy, and that the public has an interest in getting the best information. That coverage in the newspapers expresses the fact that people have a taste for knowing what is going on in these areas.

Senator Beaubien: Do you think the public should be consulted, to tell the bank what they should do?

Dr. Acheson: I would have thought those agencies of Government are set up to perform certain objectives, objectives that at some time would be deemed desirable by people at large who voted in the parties who established those agencies.

Senator McLean: The public has no pipeline to the Bank of Canada. They have to go through a government agency.

The Chairman: Is that not the basis of the submission we have here?

Senator Grosart: I do not think so. The basis of the submission is that some economists have not been able to find out what is going on. The blame may be on the economists.

Senator Beaubien: We have had very tight money in the past, but there is tight money in the United States and all over the world. There was not much the Bank of Canada could have done to bring down interest rates at that time, was there? When mortgages were 11 per cent and that sort of thing, naturally the public was very upset about it, but there was nothing the Bank of Canada could have done about it at the time, was there?

Dr. Acheson: I think they have some scope.

Senator Beaubien: The bank has very limited action, really, in many cases.

Dr. Acheson: There is constraint on the bank's behaviour, but I think it has a lot of discretion in what it does within those constraints. The Bank of Canada's own report goes into detail on what they did or did not do under certain circumstances. I would assume that they had options that they are defending in that report.

Senator McLean: Interest is starting up again. Where do you see that going?

Dr. Acheson: I wish I knew clearly. I do not honestly know. Economic prediction is a very hazardous profession.

The Chairman: Doctor, you are concerned about the multiplicity of instruments. I refer you to page 50 of the

Bank of Canada Annual Report of the Governor to the Minister of Finance for the year 1970, in which the Government says:

> In a climate of buoyant expectations about the trend of bond prices and with a rapid expansion in the volume of Government market securities outstanding, the Bank of Canada exercised some considerable restraint from mid-November through January 1971 on the amount of cash reserves available to the chartered banks in excess of the minimum requirement. Nonetheless, monetary expansion was unusually rapid during this period and the banks' Canadian liquid asset ratio rose to well over 30 per cent by January 1971.

That would indicate that here was a case where, as you point out, the bank was using two instruments in ways that were opposing to each other. On the other hand, in the light of what was happening to the bond market it is probably right to say that their action was correct at the time, or could have been correct.

This raises two questions in my mind. First, is it not necessary for the bank to have a number of instruments? After all, it is not as simple as saying that we will raise or lower the money supply. Sometimes you have to have policies going in one direction for over-all effect and then, for underlying effect, you have to have them going in other directions. So the question is, is it not necessary to have a multiplicity of instruments? Secondly, if it is not necessary, what instruments would you do away with?

Dr. Chant: I think this ties in with a lot of the questions that have been raised. In talking about the Bank of Canada and high interest rates, one wants to have an idea as to what extent high interest rates in Canada are a result of forces beyond our control, that are outside the scope of the Bank of Canada, and to what extent these are the result of policy that is being carried out by an institution that is responsible to the Canadian Parliament through the Minister of Finance, and whether this is something that is not an important part of over-all policy.

The thing we are trying to get at, really, is for people to interpret this and for people to be able to have an awareness of how we are making use of the leeway we have. There is some leeway. How we are making use of that leeway is the question. The more complicated the process, the more one thing goes up while another thing comes down, the more difficult it is to know the extent of that leeway.

The Chairman: I agree that that exacerbates the problem, but are you saying, "By all means we should have all those instruments, but tell us what you are doing"? Or are you, as I read your brief and the evidence that has been given by Dr. Acheson, saying, "No, you ought to cut down the number of instruments that you have available so we can understand it by just looking at it"? If so, the natural question is, what instruments would you do away with? What would you say the bank should not operate with?

Dr. Chant: To start at one end, I would not want to say that the bank should never be allowed to use moral suasion.

The Chairman: Could we stay away from moral suasion at the moment? We are just dealing wtih the specific instruments at this point.

Dr. Chant: One instrument that might be redundant is the shifting of the Government's deposits. Most economists would say in terms of effect that this is much the same as open market operations, the buying and selling of securities. The Bank of Canada does not have the power now to change the primary reserve ratio. I would think that many economists would believe that the secondary reserve ratio probably should be a seldom-used instrument.

The Chairman: Did the Bank of Canada not use the secondary reserve ratio at the time of the floating of the exchange rate?

Dr. Chant: At that time it was one of those cases where the bank rate came down, which traditionally by itself would be a signalling of an easing of policy and the secondary reserve ratio—the amount of Treasury bills, day-to-day loans that the banks have to hold—went up. There was an issue of securities—an increased issue of Treasury Bills at the time, I believe—which, in fact, the raising of the secondary reserve ratio or the liquidity asset ratio absorbed at the time.

The Chairman: Would you disagree with the use of the three or four different tools that were at the disposal of the Bank of Canada at that time in that crisis?

Dr. Chant: I really do not see that clear a rationale for using them all in that combination.

The Chairman: What would you have done?

Dr. Chant: Well, not being a central banker, I would have thought that the same sort of effect could have been obtained by using open market operations at the same time as this issue came.

The Chairman: That would be more covert than what the bank did. The bank openly announced everything that it did in that case. It was a classic case of the bank being open in advance.

Dr. Chant: Except that it was to many people confusing.

The Chairman: Confusing, perhaps, but as against covertness...

Dr. Chant: That is quite right. I think that, traditionally, when you look at monetary policy, the explanations of monetary policy in terms of textbooks and what students learn is that open market operations are the main instruments. To an extent that is the economist's wishful thinking, because the economist finds that in a system such as we have most of the things we want to do can be carried out by open market operations. I should not say all economists, but a good many economists feel that way. The rest is really a redundancy of instruments.

The Chairman: Would you not agree that the bank was very heavily in the open market at that point? They were astonishingly involved in the open market. The money supply had increased by about $1 billion, had it not?

Dr. Chant: I am not sure of the figure.

The Chairman: I am not sure either, but there was an incredible amount of money added to the supply at that point. Is it not a fact that they continued open market operations after they floated the rate?

Dr. Chant: I am not sure on that.

The Chairman: On examination, I think you would find that that is true.

Dr. Chant: Whether they did or did not, most of the effects they wanted to achieve, with the exception perhaps of some very subtle effects, could have been achieved through the use of open market operations.

Senator Grosart: Is there any substantial difference between the Canadian central bank and other central banks in the matter of the use of this "battery of instruments"? Or to put it another way, are any of these instruments not used anywhere else in the world?

Dr. Acheson: I am not an expert on the banking systems elsewhere, but my impression is that in the United States moral suasion is much more difficult to use because of the multiplicity of banks.

Senator Grosart: You are confusing two things: the battery of instruments and moral suasion. They are not the same thing.

Dr. Acheson: Moral suasion is one instrument that is used, senator.

Senator Grosart: But you speak of the specific instruments as a batery of instruments, and I am asking whether they are used elsewhere or are we unique in the use of any of these instruments in Canada.

Dr. Chant: We are pretty close to the British model in the powers that the central bank has. I would say on the whole, however, that the American central banking system is somewhat easier to understand and has a smaller group of instruments.

We were searching around last night to get the publication *The Economist,* because the British central bank has just made an announcement of potential changes that it is going to make in its operations. To the extent that I understand these changes from the very short summary statement of them, I would say that these changes would tend to be in the direction that we suggest. I think they are going to use their operations in security markets more towards general economic conditions and less towards providing support for the government bond market. But this remains to be seen.

Senator Grosart: I will put my question again. Are any of these instruments not being used by other central banks?

Dr. Acheson: The secondary reserve ratio is not used in the United States.

Senator Grosart: By any other central bank, I said. Are we unique?

Dr. Chant: Is this what you are asking? Is there any one instrument that we have that no one else has? The answer to that would be that every one of these instruments would be found elsewhere.

Senator Grosart: Is there something unique in the Canadian combination, then? Is there nobody else who combines a substantial number of these instruments?

The Chairman: You mentioned the use of secondary reserves, Dr. Acheson.

Senator Grosart: We are talking about a battery of instruments, Mr. Chairman. That is their phrase.

Dr. Chant: The battery exists and the various combinations and permutations of the instruments can be found in some central banks in the world similar to those found in Canada.

Senator Grosart: So your criticism, then, is directed to central banking systems rather than to the particular system of the central bank in Canada. Is that correct?

Dr. Acheson: Our analysis is that it would be applicable to almost any central bank, yes.

Senator Grosart: Then your placing of the problem in the context of bureaucracy is equally applicable to other countries.

Dr. Acheson: Yes, I would think so.

Senator Grosart: That, I think, puts a new complexion on your paper, because you do not state that so far as I can see. You have not dealt with international comparisons, but monetary policy is international. That seems to be a bit of a gap in your paper.

Why do you use the words "moral suasion"? What is moral about it?

Dr. Chant: That is not our word.

Senator Grosart: It is your word, because you use it.

Dr. Chant: It is an accepted word. That is an accepted word that refers to certain initiatives taken by central-banks. The Bank of Canada certainly would have a section in its submissions to the Porter Commission describing the use of moral suasion. Economists use the word. I do not know the precise background of the word, but it is an accepted term and I do not think one should place too much—well, I guess the emphasis on "moral" is that you are trying to say to them, "We have a problem. We have no specific instrument to make you do this right now, but could you help us solve this problem by acting in this particular way?" I think that would be where the word "moral" comes from.

Senator Grosart: There is nothing moral about that. It can be immoral persuasion. In fact, your brief suggests that it is immoral persuasion.

Senator Nichol: No, it is amoral persuasion.

Dr. Chant: In my opinion, the word "Suasion", without any modification, would be entirely appropriate, except perhaps in terms of conventional useage.

Senator Grosart: Let me indicate to you why I asked the question in the first place. I find some examples of purported moral suasion on page 9(a) of Appendix A. Running from the year 1946 to 1969 there is a heading, "Use of Moral Suasion by the Bank of Canada: 1946-69". I see here the following words: limit; limit; limit; limit; limit; encouragement; ceiling; ceiling; accommodation; request; agreement; request; request; ceiling; special regard for borrowers; and special attention.

Now, words like "limit" and "ceiling" and so on do not seem to suggest "suasion". There are, however four that are requests. Would you distinguish degrees in the element of suasion? Perhaps I could put it this way: what happens if nobody responds to the suasion in some of these cases?

Dr. Chant: Although we have not really looked into this, in some of these cases I am sure you would find that they did not meet the central bank's request.

Senator Grosart: Let us take the limits. "Limits" does not sound like suasion. It sounds like what you call an imperative in your brief.

Dr. Chant: Yes. So far as I understand, it has no legislative or legal basis.

Senator Grosart: Excuse me. A moment ago you put all these things in the powers of the central bank. That is the word you use. Now, have they the power to do this? Let us forget whether it is legislative or legal in that sense. Have they the power to do these things?

Dr. Chant: They do it and I imagine many of them are effective. Certainly, if we look at 1955, the minimum liquidity asset ratio—the second one in 1955—was a request to the banks, and in fact there was an exchange of letters between finance minister Fleming and Mr. Coyne over that matter as to the status of this. The banks agreed to this. I do not think it was their preference. They agreed to it and it remained for 12 years with them adhering to it. So it would seem in that case that there is a very effective power.

Senator Grosart: Yet you list this as one of your examples of suasion. This is what I do not understand. If the bank has power and it puts a ceiling, which would be the majority of your cases, why do you call this suasion?

Dr. Chant: Let us look at the existing status of the Bank of Canada. It is in either the Bank Act or the Bank of Canada Act that it can say to banks, "Look, on the basis of so much notice you have to hold, in addition to your cash reserve requirements, secondary reserve assets, Treasury bills and day-to-day loans and excess cash, and you have to hold these at 8 per cent. There is no question of this. This is not something you are doing "because we wish you to and you are co-operating. This is something you have to do because it is laid down in either the Bank Act or the Bank of Canada Act, or both." On the other hand, when they say to the banks, "Look, how about not making any long-term loans higher than $2 million to corporations?"—let us say in 1958. There is nothing in the Bank Act or the Bank of Canada Act that says they cannot do that. In fact, this is not enforceable by the terms of an act. That is the difference, as I see it.

Senator Grosart: Surely, this is a completely inconsequential distinction to try to make? If they have the power, it is legislative power. I mean, they have been given the power. If they have the power, it does not matter whether you can cite a specific act: they may have it by Order in Council; they may have it by regulation under an act. What I do not understand is why you make so much of suasion when we are talking of ceilings of 90 per cent.

Perhaps I can help you straighten me out on this by asking you: In these examples, did the banks ever say "No" to the central bank?

Dr. Chant: They may have said "No" privately.

Senator Grosart: But did they ever act contrary to this suasion or power, or whatever it is?

Dr. Chant: If you will take this as pure speculation, in that I do not know, I would say that undoubtedly at times they found these requests burdensome and did not adhere to them.

Senator Grosart: I find many requests from the Government, suasion and everything else, highly burdensome.

Dr. Chant: Yes. I think our view on moral suasion would be like the now secondary reserve requirements, the liquid assets ratio. The Bank of Canada should anticipate the sort of request it is going to make to the chartered banks; and, in fact, when the Bank Act revision, the Bank of Canada Act revision occurs, they should say, "We would like this power to be able to say to the banks, "Term loan ceiling. No term loan above $2 million. We would like this power, we think it is an important part of monetary policy, and we think whether we have this power or not should be dictated by the people who have the ultimate responsibility for economic power"—presumably, the Government and Parliament—"and they should decide whether we should have this power." This would be our view—or, perhaps, I should let Dr. Acheson express his view.

Dr. Acheson: I think that the sanctions are not explicit in these as to what would be done if a bank did not do what it commercially thought was not in its best interests, but I think there are in the relationships of the Bank of Canada to the chartered banks many possible sanctions that could be used if a particular bank did not co-operate.

In a recent Select Committee on Nationalized Industries study of the Bank of England, which is interesting from the perspective of our study, with reference to moral

suasion by the Bank of England—which they called, "Doing good by stealth"—they said:

> No responsible financial institution would carelessly incur the Bank's displeasure by its behaviour. The Bank might withhold re-discount facilities for discount houses it considered to be weak (as it did in the 1930's to encourage consolidation into stronger units). In its dealings with the accepting houses, the Bank's willingness to discount their bills and to do so at the "finest" (i.e. lowest) rates is both a valued cachet for these houses and a potential sanction—if withdrawn—to ensure their compliance with Bank wishes. Most banks also are anxious to be recognized as authorized dealers under the Exchange Control Act—a privilege which could be withdrawn. For the clearing banks, the ultimate sanction is the threat to withdraw their right to hold a balance with the Bank.

I think it is akin to sort-of arm twisting by the executive—for instance, when Kennedy tried to intervene with steel. Had I been a steel magnate or a steel executive, I would have been thinking about the possible things, through Government contracting and so on, that the Government could do to hurt me if I did not consider carefully the request of the Government. I think that is moral suasion, where sanctions are not explicit but are implicit in the power relationship of the agency to the other groups.

Senator Grosart: Surely, you are not suggesting that these powers of the executive or the Government vis-à-vis the private sector should be made explicit through the whole spectrum of relationships between the Government and the private sector? For example, take the so-called voluntary import controls. There is a very clear sanction there: "If you do not agree voluntarily to control your imports of textiles we will put on a $2-a-shirt surcharge." This goes all the way through, As you said in your steel example. There is nothing unique in the bank situation in itself, is there? If you put all the sanctions of the power of Government into legislation, you would have a volume 10 feet thick.

Dr. Chant: I think there are certain undesirable features—as you heard in other briefs—about voluntary price and wage controls. One is that as long as you are one of the few who do not honour them, you gain in that you are able to change your wages and prices, and everyone who honours them loses. Once the people who do not honour them become a substantial part, then something like you say, the $2 import charge on shirts, is imposed on all and it creates a rather strange incentive.

To go back, I would have thought that the Bank of Canada could anticipate fairly well circumstances in which it needs formal powers beyond the formal powers it has right now, and I would not have thought we would have many extra volumes as a result.

The Chairman: Are you against all examples of moral suasion by the Bank of Canada? Do you take a blanket approach to it, that there should be no such thing as moral suasion?

Dr. Chant: I cannot go quite that far, but one could go in two directions: first, try to anticipate the circumstances in which moral suasion could be used; and, second, where moral suasion is used, perhaps have some sort of lapsing term on it and perhaps have some sort of explicit ratification of it beyond this lapsing term, or something like that.

The Chairman: I note that in section 5a, when you deal with the regional policy, you come to the conclusion that the only hope is in the area of moral suasion.

Dr. Chant: I think moral suasion might have an impact but it has gradually become eroded for the reasons that voluntary price wage controls have become eroded. You say we can be enlisted to co-operate for so long, but after a while we wonder whether the costs of co-operation is not now higher than the costs of non-co-operation. In other words, I think the economists tend to feel that moral suasion will be effective when there is an appeal to national interest—a short run appeal during a foreign exchange crisis, or something like that. If moral suasion becomes a continuing day to day policy without this sort of appeal, its effectiveness in most uses probably will be considerably eroded.

Senator Beaubien: Dr. Acheson, you said a little while ago that the Bank of Canada controlled the Government deposits with the chartered banks.

Dr. Acheson: It can shift them back and forth.

Senator Beaubien: Is that not your answer to moral suasion? If a bank does not co-operate then the Bank of Canada just shifts the Government deposits.

Dr. Acheson: There is a formula for distributing these deposits among the chartered banks.

Senator Beaubien: But the Bank of Canada does not have to adhere to the formula.

Dr. Acheson: As I mentioned, and I think it was implied in the questioning before, implicit in the power relationship itself there will be power which can be exercised.

Senator Beaubien: Yes, there is a formula but not in the Bank Act or the Bank of Canada Act.

Senator Grosart: Are we not confusing suasion with sanctions here all the time?

Dr. Acheson: I do not think suasion is possible without ultimate sanctions. I do not think suasion is very effective unless ultimately the institutions which are being persuaded feel that some sanctions can be applied against them if they do not co-operate. That is why I do not think moral suasion is very successful in the United States. Because of the fragmented banking system it is very difficult for the central bank to impose sanctions on a particular unit bank somewhere in Utah, which does not co-operate.

Senator Grosart: The main objection in your brief then is not so much to suasion as it is to the fact that the sanction is not visible.

Dr. Acheson: Visibility is, I think, the key to our criticism. This is just our opinion, but we think it would be better if we could tell more often what, in fact, was being done, and we have tried to suggest ways in which we feel that could be achieved.

Senator Grosart: There is a sense of frustration in this I think. For example, you say that this suasion aspect is an important as it is, but it does not appear that way in the textbooks. Is not this because the economists could not identify it and therefore they brushed it off in the textbooks? This is a dreadful criticism of the textbooks and economics.

Dr. Acheson: There is a lot of criticism that is possible in that area. I would think that the problems of people teaching economics is of secondary interest, as compared to the problems with those people who want to make these institutions responsible, because they are supposed to achieve very important social objectives.

Senator Grosart: It may not always be true, but it is a good point.

Senator Manning: Mr. Chairman, I would like to explore two areas for just a few moments. Dr. Acheson, you appreciate that the committee here is concerned with a specific situation that has developed in Canada where the fiscal and monetary techniques, which are the main instruments that have been used to try and curb inflationary pressures, have not only been considerably unsuccessful in curbing those inflationary pressures, but in the process, have created economic dislocations and unemployment. What we are looking for primarily is some new techniques that would be more effective in control of inflation without creating these adverse effects. My specific question is: Do you see, from your knowledge of the Bank of Canada's operation, roles that the Bank of Canada might properly play within its present structure to assist in a more effective control of inflation without the social dislocations? Is there something it is not doing that it could do, as it is now structured?

Dr. Acheson: I think there are a couple of things that are important. One is that I do not think anybody has the answers to reaching a blissful state with no controls, a zero price inflation, and no unemployment. I think we require to learn as we go as to what we ought to be doing. I think that where our suggestions might have some pay-off would be in the fact that we could assess what was happening and that both people in government and people outside of the Government could assess what is happening and analyze what is happening in such a way that we might understand it better in order to get better performance in the future. That is where we feel our research allows us to be confident to say something about it. Whether I would run the Bank of Canada and make the exact decisions that they made as to what the money supply would be—well, it is a lot easier with hindsight to say what the changes in money supply ought to have been.

Senator Benidickson: And when.

Dr. Acheson: Exactly. All I am saying is that I think things could be changed so we would have a better chance of improving things in the future by understanding better what is going on, if some of the suggestions we made were adopted. I do not have explicit answers to your question, other than I think there should be some specializations in the briefs that appear before you. We have taken a particular approach and tried to throw some light on it. I think you will have some people, such as Professor Johnson this afternoon, who will be here this afternoon. He can perhaps answer that question better, because he has had more experience.

Senator Manning: I wonder if you have felt there are any obvious changes in either the legislation or the role of the Bank of Canada, as the central bank for this country, that you would recommend in order to make it more effective or give it some more meaningful role in this great national problem we are facing today.

Dr. Acheson: I think it is a natural thing when you have a feeling that something is wrong, and that we have a problem which should be met in some way, such as the regional disparity question, to have every agency fire out and do what they can in that area, and I think that is wrong. I do not think the Bank of Canada should get involved in is the regional disparity problem. In my opinion, that problem is better attacked through other institutions, and our analysis, which we have tried to detail in one of the appendices, would indicate to us—and it may be that we are wrong—that we would not get much leverage on regional problems through using monetary policies. It would be a mistake to try and do so. You should try to think the problem out carefully, and if you are going to use grants to designated areas to make the responsibility for mitigating the effects of national policies on the regions fall on relatively few agencies so you can then assess the performance.

There is such a divergence of opinion as to what is meant by regional disparity. Does it mean regional economic growth; does it mean regional unemployment levels; does correcting the problem allow you to depopulate a region and move people out of a particular region or is there a constraint against that? There may be the constraint that for political reasons that you do not feel a region should be depopulated? All these types of things should be thought out. All we have done is try to say that we should not get the monetary authorities involved in this problem. It is not important problem, but attack it with something that is going to have leverage.

Senator Manning: The regional disparity problem has a relationship to this particular question of inflation, but it is a separate issue. I think our main concern as a committee revolves around this problem of inflation itself and its effects. My second question is related to your last comment. I do not know if you accept the premise that one of the causes of the period of high interest rates we went through, and which apparently we have moved back into, is the severe competition in the market between industrial and commercial borrowers on the private sector, and the very heavy borrowings of recent years by all levels of government, which has overloaded the

market and is certainly one of the things that has made it necessary in Canada for both the private sector and governments to borrow from foreign sources. Would you see any merit or wisdom in the Bank of Canada assuming some role in the capital borrowings at least of governments, with the idea of relieving the pressure in the money market of this very severe competition between the private and public sector which has this upward pressure on interest rates? In other words, perhaps this gets back to a regional thing, but with the advantage of the reduction of the pressure on the money market that could result from the Bank of Canada having at least some powers to purchase provincial or municipal debentures which are competing in the money market with industry, commerce and so on?

Dr. Acheson: There is a limit to the extent that the Bank of Canada can directly purchase any securities, because it has an effect on the money supply which would lead to infiflationary tendencies. The Bank of Canada has made it easier for the Government of Canada to borrow through moral suasion or amoral suasion, whichever which way you want to look at it, because when it forces the banks to hold a greater portfolio of government debt that means the banks can hold a smaller portfolio of private debt. It would seem to me that there has been some easing of the provincial securities market through Canada Pension Plan purchases within the last of couple of years. That will be eased further in the future, I think. I do not think the Bank of Canada can do all that much, and I do not think they ought to.

Senator Manning: This is what I am interested in.

Dr. Acheson: I do not think they can without inducing infiflationary pressures and, secondly, I think the private sector should compete against the government. If the government finds it harder and harder to borrow, then perhaps they should cut back on their programs.

Senator Manning: It is easy to follow the argument that if the Bank of Canada, for example, purchased provincial or municipal bonds this would increase the money supply and contribute to the inflationary pressure. But, is that true, when the money market dries up to the point where governments and the private sector start borrowing from foreign sources? Let me give a hypothetical illustration. If the Government borrows $1 million from the public of Canada, all you do is shift $1 million out of the hands of the Canadian people to the Government, which spins it back into the hands of the Canadian people. And to complete the cycle taxes to get it back in order to pay it back to the people when the securities mature. This all in turn, and it does not alter the money supply one iota. If because of the drying up or the high competition in the money market the Government goes and borrows $1 million on a foreign market such as the New York market, you do not decrease the buying power in the hands of the Canadian people. You expand the money supply by the money you borrow in a foreign market.

What is the difference between that, as far as its effect on inflation is concerned, and the buying of those debentures by the Bank of Canada which would have the effect of increasing the money supply? Is not the effect the same when the comparison is between the purchase by the Bank of Canada and the purchase in a foreign market? Today we have hundreds of millions of dollars being borrowed on foreign money markets, which is certainly not decreasing the money supply in the hands of the Canadian people at the time the purchase is made.

Senator Beaubien: You borrow American money, which must be converted into Canadian money.

Dr. Acheson: It is converted in the exchange market and that involves the Bank of Canada. If you are on a fixed rate and the balance of payments was in equilibrium before this transaction, then the borrowing from the United States would lead to an increase in the supply of foreign exchange and the Bank of Canada, to keep the exchange rate pegged, would have to buy that. That is the quivalent of their buying a bond, as far as the effect on the money supply is concerned. The Bank of Canada ultimately would have to buy it. I think with a fixed exchange rate there would really be no difference eventually in the impact. The bank would still get involved and there would be an increase in the money supply.

With a flexible exchange rate, the exchange rate would appreciate with the additional borrowing. That would lead to deflationary pressures, because our exports would become less competitive than before. Imports would become more competitive, and this would lead to a slackening of demand for Canadian products, which would be desirable if the Bank of Canada was concerned about the size of the money supply in the first place, and it might allow them to expand it a little further than before because of this deflationary effect of the exchange rate.

Senator Grosart: May I ask a supplementary question to the question raised by Senator Manning. Taking his situation when the borrowing is internal, where would the Bank of Canada get the money?

Dr. Acheson: The Bank of Canada can print money and write a cheque on itself.

Senator Grosart: Leaving aside the printing of money, where would it get the money?

Dr. Acheson: That is how it operates. It writes a cheque on itself which the chartered banks then deposit. If I borrowed from the Bank of Canada I would take its cheque to my chartered bank, and they would then take it back to the Bank of Canada, which would then increase their cash reserves by that amount.

Senator Grosart: You are increasing the internal money supply?

Dr. Acheson: Yes.

Senator Grosart: And that is inflationary.

Dr. Acheson: Yes, that is the point I wanted to make. As soon as the Bank of Canada starts to support government borrowing, it loses control of the money supply.

Dr. Chant: I think in England during the post-war period they opted for a policy of cheap money, and found out very quickly that this led to a policy of inflation. I think in answer to your first question, the concern for the level of interest rates and bringing them down may cause one to sacrifice other primary objectives.

Senator Hays: Doctor, I wonder if you have explored the pegging of interest rates. During the late thirties and the depression interest rates gradually increased until they were up around 8 or 9 per cent. At a later time, and I do not know just when that was, we pegged the interest rate.

The Chairman: Is this the bank prime rate that you are talking about?

Senator Hays: No, this was the amount of interest the bank may charge its customers. Senator Manning knows a good deal more about this than I do. During the thirties his government decided that the interest rate was too high, and cut it in half. This is the amount of interest that a person was obligated to pay. In the forties this looked like a very good move; at least, history tells us it was a good move. Later on the bank rate was pegged at 6 per cent. During the expansion in the sixties we had a pegged bank rate of 6 per cent. We did not seem to get into any trouble until we permitted this bank rate to float. Today there still seems to be a problem. I am wondering if you have done any studies of that. Perhaps we should be pegging interest rates?

Dr. Acheson: Personally I have not, but the Porter Commission looked into this in some detail. I would think that would be a source of information on that problem. Their recommendation was to lift the ceiling on the bank lending rate.

Dr. Chant: I think one of the things which economists tend to feel about it is that it had an effect, but not what its proponents had anticipated. They felt this would lead to cheap loans for the general public. One of the ways in which the borrowers compete with less risky borrowers is by paying a higher interest rate to compensate for this risk. When the banks were restrained by the 6 per cent ceiling they were forced to choose between borrowers. If I were a banker and had to choose between a very stable corporation which was wanting to borrow at 6 per cent, and a corporation which might have some potential but which was very risky, I would choose the very stable corporation.

Many economists would argue that it forced the less-inclined borrower to other financial institutions than banks; that it produced an alternative and forced them to other financial institutions. Such a borrower might have got a loan from the bank at 7½ per cent, whereas he is forced to go somewhere else where he has to pay 11 per cent.

Senator Hays: Then the near banks supplied this risk capital and in some instances they became wholly-owned subsidiaries of the banking system. The near banks were not controlled by this interest rate, and were lending it at 15 or 16 per cent. So you have the rich borrower borrowing at a low rate, and the poor borrower borrowing money at a high rate. If these rates had been pegged we could not have competed on the international market, and the ceiling would have been raised to 7 per cent, and in the near banks to 8 or 9 per cent, to take care of the situation. Have you done any work on this?

Dr. Chant: No I have not.

Senator Hays: Is not that inflationary?

Dr. Chant: My opinion comes from a feeling rather than research. My feeling would be that re-implementing such a ceiling and extending it would be undesirable.

Senator Molson: It was not and still is not possible to peg the rate of the so-called near bank, as constitutionally it presents a problem. In fact, the pegging of interest rates in the banking sector was, as Senator Hays said, increasing the proportion of business done in the higher interest rate sector, and was building up the volume there at a very rapid rate during those years when the pressure was there, and the recommendation came to lift the ceiling.

The Chairman: Do you have any comment on Senator Molson's remark?

Dr. Chant: No, except to agree that in fact it is a form of a tax on the banks and maybe it could be done in a more direct way than is felt desirable.

Senator Beaubien: When the 6 per cent ceiling was on bank loans, the banks insisted on borrowers keeping a certain percentage of the money they borrowed on deposit. If you borrowed $1 million you had to keep $200,000 on deposit. You would pay 6 per cent on $1 million, but you only got $800,000.

Senator Molson: It was not universal, and it was the American system.

Senator Beaubien: Are we going to stand up for different banks now?

Senator Grosart: You also had service charges on consumer loans which raised the interest.

Senator Hays: I have one other short question. You mentioned that money should be spent where it is generated. This presents a problem insofar as regional disparity goes. This is happening, and we know it. In many provinces in Canada certain institutions have a plus insofar as deposits are concerned, and they take this money and dispense with it in other areas because they think the investment is better. Do you think there should be a certain amount of control to ensure that it must be spent, if you have regional disparities, where it is generated?

Dr. Chant: I think our position would be that using monetary policy, and influencing the banking system as an instrument in working towards these regional goals, would be offset by these sorts of forces. I do not think it is desirable, but I think if you try to structure something to obtain this goal of money being spent where it is generated the first direct effect would be quite small, if this were successful—and I question whether it would be

really successful. In a couple of the briefs the economists did not have too much hope for regional monetary policy. I think in our Appendix C we attempted to spell out why the economists tend to dismiss it, and we took more than a sentence or two. I think we are pessimistic about such a prospect, and we want to think a little bit deeper about it.

Senator Hays: There is no way of resolving this particular problem.

The Chairman: I think Appendix C comes to that conclusion, that for various reasons—one of which is the free flow of funds—it would be virtually impossible, in the judgment of these two witnesses, to achieve that, except that they leave open the possibility of moral suasion.

Senator Grosart: Would the witnesses tell us how effective or otherwise was the suasion of the central bank in 1959 on the banks to ease the situation in regional borrowing, which was, in effect, both a money shortage and a high risk factor. Was it effective?

Dr. Acheson: It is impossible for us to tell. The chartered banks perhaps could tell, but they do not publish information on their regional portfolios. It is impossible for us to tell.

The Chairman: Perhaps we could ask Mr. Rasminsky.

Senator Grosart: Do you have any information on the regional disparity in rates?

Dr. Acheson: You can look at the quotations on the provincial government bonds. On private borrowing, the banks claim they use the same principles in every region and I have no reason to doubt them, but I have not done any specific research on it.

Senator Grosart: The same principles would have very different effects.

Dr. Acheson: It all depends how they assess risk in the different regions.

Senator Grosart: You have no information as to the magnitude of the disparities?

Dr. Acheson: It is very difficult to get information, for obvious reasons, on the internal decision-making of the banks and on how they allocate their lending portfolios.

Dr. Chant: Large corporations might borrow at their head office for purposes of projects in other regions. I think it is a very complex issue and I do not think you would get much valuable information on it.

Senator Nichol: I would like to refer you, Dr. Acheson, to page 23 of your Appendix B where it seems to me you come to the crux of your paper as it refers to the problems which we are working on here. You are dealing with the dilemma that exists between problems of full employment and the problems of having no inflation or a controllable level of inflation. In our discussions over the last few weeks there have been two separate problems mentioned. I think one was the problem of identification of policy, involving the question of lags and the question of where we are in the business cycle, if you want to use the broad term—in what cycle we are, and so on.

The second problem that has come up is the mechanical operations of such a policy. In other words, assuming that you knew where you were and assuming you understood the lags, how could such a policy work in a system which has within the federal Government a Bank of Canada, a department of finance and an economic council. Then there are ten provincial governments and the municipal governments all involved in operating in different directions. It is on this question of the mechanical operation policy, once it has been identified, that I wanted to ask you two questions.

Going back to page 23, you say:

> The theory of bureaucracy used in this paper suggests that a central bank cannot be assumed automatically to pursue its goals in the same priority as society would desire. Some characteristics of goals which are relevant to the central bank as a bureau are not relevant to society's ranking of the goals.

You enlarge on that and express it in different ways as you go down through your paper. The questions I want to ask you are: How would you describe the existing relationship between the Bank of Canada and the Government in terms of its independence as an organization, and its independence of the goals of the Government which we hope are the goals of the people? Secondly...

The Chairman: Do you want him to answer that question?

Senator Nichol: No, I want to put them together, because I am not quite sure that they can be separated.

Secondly: What do you think that relationship should be? I gather from your comments here that you have some criticism of the relationship as it is now. I am sorry that the question is so long but it had to be in order to make sense.

Dr. Acheson: I think what we have suggested in the policy implication section of the brief itself was that as open methods of operation and as simple methods of operation ought to be used, if they are technically efficient, and that moral suasion be curtailed in its usage, and that there should be no shifting of government deposits. We have suggested that in terms of the priorities of the Bank of Canada it be carefully considered whether minimizing cost of government debt should be treated as importantly as we feel the Bank of Canada has treated it. If it is considered that the Bank of Canada has put too much emphasis on this, then steps should be taken to de-emphasize that objective.

As far as co-ordination with fiscal policy goes, one of the interesting things to us in working in this area was that in the Coyne affair one of the issues was the initiative taken by Mr. Coyne to impose a secondary reserve ratio. This was treated in two or three letters, which were later released, between the Minister of Finance, Mr. Fleming and Mr. Coyne. The Minister of Finance claimed that Mr. Coyne was usurping the power of Parliament in

acting in this way. One of the things interesting to us is there was really no change in the Bank of Canada's ability to do this after the Coyne affair, that really the Bank of Canada operates in pretty well the same way as it did before. This issue, although it was an issue at one time, got buried and never got treated, and we think it possibly ought to be treated. In areas where you can anticipate there may be problems, there should be contingency legislation to deal with those problems, and there should not be resort to moral suasion at the time. In general terms, that is how I would answer that question.

I think the use of covert means implies something you would expect a department of economics or any bureau to emphasize, and I think government departments would at times tend to use covert instruments. In terms of fiscal policy, and the operations of the Department of Finance, I would think a careful analysis of the operations of that department, which we have not done, might indicate increasing uses of these types of instruments. We have not done research in that area. I am just speculating when I say that.

As far as co-ordination is concerned, it is very difficult to tell. There has apparently been no serious rift between the Bank of Canada and the Department of Finance as to the directions government policy should be taking.

Senator Nichol: Perhaps I can ask that question a little differently. If the government is to be responsible for the economic well-being of the country, and if the Bank of Canada shares a considerable part of that responsibility, how independent in your opinion, should it be of the government? Do you think it is too independent or not independent enough in terms of what it does?

Dr. Acheson: It is a function of the options that are available to the institution. As we conclude in Appendix A, we feel the issue is not whether the Bank of Canada should be a government department with all the same options, or whether it should have the semi-independent status which it has today, but if it were a government department with the same options, I do not think there would be any change in behaviour. There should be, by Parliament or by the Government a concern with the options available to this agency. We have tried to outline how we feel those options should be limited. The Bank of England, for instance, is technically less independent than I think the Bank of Canada is, but in factual operational terms I do not think it is any less independent. I think it has the same scope of options.

Senator Nichol: Is the independence of the bank for government policy real, in your opinion, or a myth?

Dr. Acheson: I think it is real, because it has all these options of using moral suasion in a number of areas.

Senator Nichol: In other words, you think these covert management techniques are ones which are known only to the bank and not necessarily to the government, that the government might be going in one direction, and the bank's public policy might be supporting the government and its private policy might be in another direction? Is that the suggestion?

Dr. Acheson: I think the suggestion is they are probably both. Covert action is taken by the Bank of Canada sometimes in implicit collusion with the Government, if the Government wants to achieve a certain purpose and feels that this is the best way of doing it. Sometimes I would think there is a particularly informal moral suasion in the sort of day-to-day communications with the banks and other financial institutions as to where they think they are going. That goes on all the time and no one else is explicitly aware of that.

Senator Nichol: I would like to try to make a distinction. There are overt and covert policies of the Bank of Canada. This refers to technique. I am not questioning just for the moment whether those techniques are moral or amoral. What I am trying to find out is how close those techniques are, in your opinion, to what the government wants to have happen, whether they choose to use overt or covert techniques to move in a certain direction in terms of fiscal or monetary policy.

Question B is as to the technique they choose, and Question A is: Is the bank, in your opinion, normally doing this on its own? How independent is it of what the Department of Finance wants it to do, and how independent should it be? How effective a combined instrument of economic control is the Department of Finance and the Bank of Canada, or are they flying in each other's face? I do not know, and perhaps you do.

Dr. Chant: There is a large group of economists who do not subscribe to the view that monetary policy is so important that it should not be left to legislators. In the United States it has sometimes been summed up as: Monetary policies are too important to be left in the hands of the legislators, so let us have an independent central bank.

Senator Nichol: Which is not what you say in your brief?

Dr. Chant: Some economists in the United States say: "No, we don't see that. Defence is important too. Do we take that out of the hands of the Government as well?" They say that economic policy is something that governments are increasingly taking more and more responsibility for. What they argue is that it is reform of the structure of the central bank that is required to change the situation, to make the central bank responsible not only to the legislators, but responsible to the people beyond the legislators so that the people's preferences can be expressed. Our point is that that may be desirable, but we really feel the responsibility of the central bank for these very important policies that it has would be clearer if, in fact, the interpretation of the actions of the central bank were more open to the public at large—to the financial press, and even university professors and senators. Then one can make a valid judgment, a knowledgeable judgment, and not be shooting in the dark about what is going on with this very important policy instrument.

Your other question was: Does the central bank work against the Department of Finance at times, and for it at other times? I would really say that I do not know. I would say my hunch is, by and large, that it works in co-operation with it. I think some of the things we have identified, provided with some leverage, may or may not be used, but they are there. Our value judgment is that this sort of leverage is something which an institution responsible to the people should be looking at. One should look very carefully and ask: Is this the type of leverage we want them to have? As we look down this list of uses of moral suasion I think the legislators should be able to ask: Is this a power the central bank should have? Should the central bank be able to admonish the chartered banks to have special regard for borrowers in less prosperous areas of the country? Should the central bank have the power to have an agreement on maximum interest rates on term deposits by the banking system? I think our views are quite obvious to you now. This is something that we feel a wider group should look at to decide whether these powers are desirable.

Senator Nichol: May I ask a direct question connected with this list of instances of moral suasion? Do you think that those instances, which are of very specific actions, originated in the Bank of Canada or in the Government? I know you do not know, but what do you think?

Dr. Chant: I would think it would be unfair to the Bank of Canada to answer that question, because there is such a large chance that I am away off base.

Senator Nichol: It is a quite important point, is it not?

Dr. Chant: Yes, and you will have an opportunity again to ask that question.

Senator Nichol: I will not pursue it, but you obviously have an opinion and I do not see what damage would be done by your giving it.

Dr. Chant: No, I am pleading sheer, ignorance on this point.

The Chairman: My supplementary question is twofold. If it were demonstrated by the Bank of Canada that there was a real need for a multiplicity of instruments and for moral suasion, would you be satisfied if they were to use these instruments in an open fashion?

Dr. Chant: In regard to the multiplicity of instruments argument, many of them are open, such as the bank rate, the minimum reserve ratio, and the minimum of government deposits.

The Chairman: They are sometimes open after the event. I am talking about being open at the time they are used.

Dr. Chant: Moral suasion would be the one. I think there is the question of interpretation which makes it more difficult to interpret. I am not sure what moral suasion is entirely. Lord Norman who was Governor of the Bank of England said that moral suasion is a raised eyebrow.

The Chairman: But you are not going to legislate raised eyebrows.

Dr. Chant: No.

The Chairman: So that will continue. I am asking if they demonstrate the need for it, either by showing that it is necessary or that there is just no other way of doing certain things, would you be satisfied, and do you think it would answer your critique? Can a case be made for that, and that alone?

Dr. Acheson: It ceases then to be moral suasion. If you say that the central bank should be able to tell the chartered banks there should be a limitation on particular types of loans, then you make that an explicit act in the legislation give the central bank the power to do that. I think you should also require them to publicize it, but then it ceases to be moral suasion.

The Chairman: Using your definition of moral suasion, I think not, because really you say moral suasion is the ability to cause some-one to do something without the direct effect of the law behind you, but with a peripheral effect of the law. This would still be the use of peripheral force to achieve a direct objective, but it would be open instead of covert.

Dr. Acheson: I just do not see how you can legislate that it be open in that case. You almost have to anticipate what the sanctions are and preclude their use, and also make it known to the institutions on which this power is being used that they should reject its use.

The Chairman: That leads me then to my second question. If you feel that you have to take actual steps to reduce the multiplicity of powers and to reduce the use of moral suasion—accepting your approach and assuming that you achieve your approach—is there still a case for the Bank of Canada being more open in the enunciation in its policy? Is there a case for the Bank of Canada to openly disagree with the policy of the government at any time—going along with it but nevertheless indicating that they believe it is a wrong policy?

Senator Grosart: This has happened.

Dr. Chant: On the latter point, I feel there is certainly something to be gained by having the alternatives laid before you on this. There is the power now, I believe, for the Minister of Finance to issue a directive. There is the power the other way, for the Minister of Finance, when he does not believe monetary policy is appropriate, to issue a directive to the governor.

The Chairman: We are not arguing the ultimate power of the Government in this matter, but asking: Should the Bank of Canada be critical of Government policy while recognizing that the power eventually lies in the hands of the Government.

Dr. Chant: That is a very difficult question to the extent that you have the Government going one way and the Bank of Canada having a belief that another way is appropriate and possibly going that way, yet with the

absence of a directive from the Minister of Finance saying, "Change your direction". I am afraid I have not thought of the issue in the terms of when it is the responsibility for a governor to speak out and say, "This is appropriate."

The Chairman: How about you, Dr. Acheson?

Dr. Acheson: I have not thought about it either. My opinion would be that he ought not to in the everyday course of activity. If he feels strongly enough about something and cannot persuade within Government circles then he should resign, but it seems . . .

The Chairman: Would you answer my question? If you achieved what you suggest in that reduction in use of the multiplicity of powers and moral suasion, would you still like to see the bank more open at the time?

Dr. Acheson: Yes.

Senator Beaubien: I understood you to say a little while ago that you thought that the Bank of Canada should not be concerned with the cost to the federal Government of servicing its monetary debt. Did you mean by that that the Bank of Canada tended to keep the interest rates lower than it should?

Dr. Acheson: As we tried to document, we feel that the steps taken to set up the money market dealers with their lines of credit at the central bank, to impose a secondary reserve ratio, were steps which led to a proliferation of chartered bank direct and indirect holdings of Government debt, more Government debt than the chartered banks would otherwise have held. We believe that is in effect an implicit subsidy on Government debt that was brought about through the moral suasion of the central bank.

Senator Beaubien: If the banks are holding more Government debt, that would tend to put up the interest rate; it would not put it down.

Dr. Acheson: That would drive up other interest rates, but not interest rates on Government debt. It would tend to drive it up, as you say. The portfolios of the chartered banks have more Government debt and less private securities, and the private interest rate would tend to rise.

Senator Beaubien: Then Government bonds go down and the interest rate on Government bonds goes up.

Dr. Acheson: I would have thought the effect would be to increase the differential between the two interest rates, to lower the interest rate on Government debt as compared to private securities.

Senator Beaubien: It certainly was not the case a year ago.

Dr. Acheson: I do not understand your point. What I am talking about is the differential between private and Government debt. Government interest rates have not changed. I think the government interest rate would have been higher if the chartered banks had sold Government of Canada securities which they otherwise would not have held.

The Chairman: By causing a pressure on the market?

Dr. Acheson: Yes.

Senator Grosart: Surely one of the issues here is whether the Bank of Canada is acting beyond its powers, overtly or covertly. Can it have any powers other than those derived from the Bank of Canada Act?

Dr. Chant: We are back into the battle of words. Definitely it cannot act beyond its existing *de facto* powers. Whether all the powers it in fact exercises have been anticipated in Bank of Canada acts and by legislators in defining those Bank of Canada acts, I am not sure.

Senator Grosart: That is entirely a different question. That is why in many acts we give power to the Governor in Council to make regulations. I am asking if it can have any powers other than those that derive directly from the Bank of Canada Act.

Dr. Acheson: I do not quite know how to interpret the question because, for instance, the army in Uganda, where I spent last summer, had powers which it used to overthrow the government. There are powers implicit in setting up an institution that are not used, and there is a range in which society has to be careful that in fact this power that is implicit in setting up the institution is not used in particular ways.

Senator Grosart: Would you agree that under our system any use of power beyond its authority is subject to judicial review? In other words, the principles of *intro vires* and *ultra vires* apply here, do they not?

Dr. Chant: In other words, what we are saying is that it is probably quite clearly understood what the *de facto* powers of the Bank of Canada are, and there is on the part of those who understand them implicit acceptance of those powers. Our position is that we feel that a hard look at those powers should be taken. Now, there is a large group of people who understand the powers of the central bank as they are today and approve of them.

Senator Grosart: I am not speaking of public acceptance. Let me put the question another way. In your view, are any of the powers exercised by the Bank of Canada *ultra vires* of its parliamentary authority?

Dr. Chant: I am afraid my knowledge of constitutional law is not the best.

Senator Grosart: That is not the point. You have examined the powers given to the Bank of Canada. The thrust of your whole brief is on this very question. First of all, is it in any way going beyond the powers granted by Parliament?

Dr. Chant: Implicitly, moral suasion was anticipated. Our feeling is that it should be re-examined. We would think that in one's financial system there are prospects for the central bank guiding one's monetary and financial system in different and, in our opinion, more desirable ways. If in fact the powers of moral suasion were more

specifically defined in terms of where they are and where they are not, that would be to the good.

Senator Grosart: Are you then saying that the central bank is now acting *intra vires* the powers granted by Parliament, but that those powers are too broad?

Dr. Chant: That would be a more acceptable statement than the one we were discussing previously. The powers of the central bank ought to be looked at and reviewed. There is, of course, the decennial revision of the Bank Act, and I think one should take this quite seriously.

Senator Grosart: You are not satisfying me when you say merely that it should be reviewed. That is meaningless unless you say that it should be reviewed to a particular end.

Dr. Chant: Yes...

Senator Grosart: But you are saying that the powers are too broad now, are you?

Dr. Chant: ...to considering defining where moral suasion can be anticipated to be necessary and appropriate, and possibly to looking at the multiplicity of instruments very throughly and ensuring that every one of those has a rationale which puts the benefit of doubt in its favour.

Senator Grosart: Would you take away any of the existing powers that it is exercising?

Dr. Chant: The question of the placement of Government deposits might be one issue.

Senator Grosart: You would narrow them to some extent, then?

Dr. Chant: Yes.

Senator Nichol: Mr. Chairman, on page 12 of Appendix A there is a reference to money market jobbers. The reference is as follows:

> In fact, both the Bank and the Minister of Finance have refused to divulge to the public the name of the jobbers, the size of their lines of credit, the terms for qualifying as a jobber and the criteria for determining the size of the line of credit for a jobber.

And then Mr. Benson is quoted on the subject. Who are these jobbers? Are they investment dealers?

Dr. Chant: Yes. There is an unofficial list in D. H. Fullerton's *The Blind Market in Canada*. I am not entirely sure, but I think the issue that Mr. Benson was speaking to at that point was the takeover of a Canadian investment house by an American firm, and the question was asked whether this investment house had this line of credit at the Bank of Canada. Apparently there are 15 such jobbers. The privilege they have is that they have a line of credit at the Bank of Canada, and this allows them to borrow under certain conditions from the Bank of Canada.

Senator Nichol: They borrow directly from the Bank of Canada, and not from a chartered bank?

Dr. Chant: They can. Also, to the extent of their line of credit at the Bank of Canada, they are permitted to borrow on day-to-day loans from the chartered banks. These day-to-day loans, unlike other loans, are countable by the chartered banks in their liquid asset ratio, and these day-to-day loans are among the most liquid assets that the banks have.

Senator Nichol: Am I correct in saying that the banks have instant call on those loans?

Dr. Chant: Yes. The banks get the funds from day-to-day loans a day or two earlier than they would from a sale of treasury Bills. The reserve position then reflects the calling in of the day-to-day loans earlier than the sale of treasury bills would. These day-to-day loans, by their nature, are among the very lowest in the yield spectrum of the assets held by the banks. These have the lowest yields. As a result, to the extent that it has a line of credit, as I say, the unused part of the line of credit with the Bank of Canada can then be borrowed at the chartered banks. So this is really a limit of combined borrowing power from the chartered banks and the Bank of Canada at these quite favourable terms. I do not know if that answers your question.

Senator Nichol: Not exactly. How much money are we talking about? There are 15 companies doing this business. How much business is done in total?

Dr. Chant: The maximum amount that has been outstanding is probably a little over $300 million.

Senator Nichol: At any given time?

Dr. Chant: Yes.

Senator Nichol: It is obviously a pretty good thing is you can get on the list.

Dr. Chant: There are conflicting reports.

Senator Nichol: Are they providing a service that could not otherwise be provided?

Dr. Chant: I think the stated purpose of it was to ease the jobbers' holding of inventories of short-term government securities, which would lead to a broader market in government securities and as a result would make adjustments of the chartered banks to reserve shortages easier.

Senator Nichol: It is a sort of cushion.

Dr. Chant: This would develop a holding by the public of the securities and then when the chartered banks unloaded their Treasury bills it would not have such a great impact on the security markets. There would be a broader market and that would have a greater absorption power, and the central bank would not have to intervene as often.

Senator Nichol: Are you critical of this system or merely of the secrecy that surrounds it?

Dr. Chant: I think we show that in fact the Canadian money market experiments. Those are notations, because a lot of people talk of the Canadian money market

experiment in the sense that Canada is perhaps one of the second generation central banks, and other countries throughout the world would look to it. These money market arrangements that were set up in the early 'fifties led to a considerable expansion of outside holdings and treasury bills. By outside holdings I mean outside the central bank and chartered banks. There was considerable expansion up to around the late 1950s, I think.

Senator Nichol: This had to do with the rates primarily. Is that right?

Dr. Chant: I am not sure.

Senator Nichol: In competition with other banks.

Dr. Chant: That would be part of it. One of the things that has happened since then is that the general public's holdings of short-term treasury bills are not very much larger, and at times have been smaller than these day-to-day loans outstanding to finance them. These day-to-day loans are available to finance treasury bills and short-term governments, and also bankers' acceptances. It is hard to know the degree to which these day-to-day loans are used to finance short-term governments, but in terms of expansion in the treasury bill market, where I think people had anticipated and outside observers felt where this experiment was headed, what has happened is that these outside holdings are not now much larger than the indirect holdings. Before that the banks might have held them. Now the banks lend on a day to day loan market, and the jobbers hold the securities. We tended to call these, in shorthand, indirect holdings by the banks. The expansion of the market really has not kept up at its level of the late 'fifties. I do not know whether that fills in some of the gaps.

Senator Nichol: Yes, it does.

Senator Grosart: I should like to ask one short supplementary question on the question of the jobbers. You quote Fullterton as saying that the central bank has here used the re-purchase instrument as a method of evading the limitations on the bank under the Bank Act. Do you agree that this is a straight evasion, a device to circumvent the limitations?

Dr. Chant: On what page is that sir?

Senator Grosart: Page 13, the following page to the one that was just quoted.

Dr. Acheson: You commented before on the use of moral suasion. If you feel that in setting up the legislation and allowing the use of moral suasion, anything that was acceptable that could be achieved by moral suasion was implicit in the act and therefore within the terms of the act, then I guess it is not evading the intent of the act. If you feel that a section in the act said explicitly that the central bank could only lend to certain institutions, of which these money market dealers were not one, that it would be a circumvention to use moral suasion to avoid that explicit provision in the act, then it would be an evasion. It depeds on the interpretation and scope of activity you feel was allowed and anticipated by the legislators when they allowed the bank to use moral suasion.

Senator Grosart: This has nothing to do with moral suasion. This is a device to circumvent the limitation in the act.

Dr. Acheson: All they did was use a different name for lending to...

Senator Grosart: I do not care what it was. I am asking whether it was a device to circumvent the act. Yes or no?

Dr. Acheson: Fullerton called it such, and I would tend to agree with him on the basis that if something is written explicitly in the act and the Bank of Canada avoids it, even if it holds to the letter of the law—if it avoids what I will call the spirit and my interpretation of the act, although I am not a lawyer—I would say yes, they are avoiding it.

Senator Grosart: So you might qualify the former answer that all powers being exercised may not be entirely *intra vires.*

Dr. Acheson: In my opinion, if I understand the terms correctly, yes.

Dr. Chant: They may not be outside the legislative intent possibly.

Senator Grosart: No, it has nothing to do with intent, because you cannot argue the intent of the legislature in court.

Senator Cameron: I find myself in sympathy with what has been a very lucid presentation of this case. The thrust of it was to give a broader spectrum of the public information on which to make judgments, which I think is desirable. This has some implications, and this question can be answered very quickly. Will the ability of this wider spectrum of the population being able to make judgments on monetary and fiscal policy not depend on two things, first a more sophisticated monitoring of what is going on through statistics, and, secondly, the speed with which those statistics are made available? I would think this is vitally important. That is all I want to ask.

Dr. Acheson: That is very desirable, yes, as an adjunct.

Senator Cameron: Do you think our existing machinery for providing this information is adequate at the present time?

Dr. Acheson: I would think we could provide statistics that are not being provided now, which would be helpful in the interpretation of policy.

Senator Benidickson: When I indicated a desire to ask a question we were at a point when we were having a very sophisticated discussion of not only national central banking but international central banking. I think Senator Manning's first question satisfies me. It was the question of what specifically could we do in the changing of our central banking legislation that would come to the gist of what is the centre of our interest in this commit-

tee, which is the range in unemployment and inflation. I am satisfied, Mr. Chairman.

The Chairman: Dr. Gillies?

Dr. James Gillies, Study Director: I have no questions, Mr. Chairman.

The Chairman: I have one question. It has been put to us on several occasions that there should be more co-operation between the different governmental levels on stabilization policies. It has also been put to us that perhaps the Bank of Canada by the purchase of provincial government debt could provide the reason for the provinces so co-operating. Do you believe that that might be a sound policy for the Bank of Canada?

Dr. Chant: I guess my answer at this stage would have to be somewhat pessimistic. From a layman's look at co-operation among different levels of government, I do not anticipate this would be the leader. I cannot elaborate on that.

The Chairman: Honourable senators, on your behalf, I would like to thank our witnesses. It is not very easy to take on what is basically a criticism of the operation of an extremely well established institution. It takes a lot of fortitude to do it, and it is rewarding to see it done in a reasoned manner, which these gentlemen have done.

We would also like to thank you very much for the special study on the regional effects of monetary policy. That is an area in which many questions are being raised and your study will probably be definitive as far as this committee is concerned. So, on behalf of the committee, I would like to thank both of you very much.

The committee adjourned until 4 p.m.

—Upon resuming at 4 p.m.

The Chairman: Honourable senators, we have with us today a man who is, of course, extremely well known to you, Dr. Harry Johnson. Dr. Johnson is Professor of Economics at the University of Chicago and Professor of Economics at the London School of Economics and Political Science. He divides his time between these two extremely well-known institutions. His education took him to Cambridge University, the University of Toronto, Harvard University and Manchester University; and he received his doctorate from Harvard University. He also holds an honorary doctorate of laws from St. Francis Xavier.

I could go into his career; I think we could consume the whole period of the hearings if I dealt with the ramifications of an incredible career. I think you know Dr. Johnson too well to wish me to do that. He is recognized as one of the world's leading economists and a man in whom Canada can take great pride.

It is with great pleasure that I introduce to you Dr. Harry Johnson.

Dr. Harry Johnson, Professor of Economics, The London School of Economics and Political Science, and the University of Chicago: Thank you, senator. I have circulated a brief statement, although it is not as brief as I would like it to be. The issues are more complicated than I can reduce to extreme simplicity.

With respect to my views regarding inflation, I have considered it primarily from a world point of view. I have become concerned in this problem in the past year or so because in the United Kingdom, the United States, Canada and the European countries there has been a great deal of concern regarding inflation. Therefore, this committee, in a sense, is conducting hearings which are paralleled in other countries.

There are two views on the temporary world inflation: one is that it is a series of accidents in a number of different countries, each to be explained by special sociological, economic factors. That view is espoused by the OECD, but I completely disagree with it. I think that we are facing a world inflation, or at least a western world inflation which has common causes. The main common cause is the inflation in the United States, which has been going on since 1965. This inflation communicates itself to the world because in the modern world the only real force putting pressure on governments to control inflation is the balance of payments. The United States does not have to worry about its balance of payments and, as long as it runs a deficit, no one else has to worry about theirs. In a world system of fixed exchange rates every country must endure, sooner or later, the US inflation.

I remark in my paper on various arguments relating to that proposition. I think that is necessarily true, though the OECD and other commentators seem to think it is not. I would in this connection point out that it is very important for Canadian thinking on these matters to distinguish between what happened up to the beginning of June last year, when Canada was on a fixed rate, and the circumstances now with Canada on a floating rate. I will argue that the maintenance of a floating exchange rate is the only underpinning Canada has if it wants to pursue an anti-inflationary policy.

One of the things that you undoubtedly have been told, and I know you have from reading the testimony of Sir Roy Harrod, is that somehow we face a new sociological situation, in which somehow unions have become more grasping, employers weaker, and so on. Therefore, all of a sudden, we have a collapse of a system. I think that is not true. I think that we can explain the upsurge of inflation in the last two years in the various countries with which we are concerned by lagged expectations, plus special factors which one can list for the various countries.

As I review the world system to the mid-, sixties, it was stablized by price stability in the United States. That meant that other countries could have a certain amount of inflation, but it was limited by their ability to compete with the United States in world markets. Since 1965 the United States has had an accelerating inflation, which has meant that everyone else must also have that inflation. As I view it, it is not possible for a small country, and I would include the United Kingdom in that—being a Canadian, I look at the United States as my example of a big country—to fight inflation by the traditional tools of

monetary and fiscal policy. As long as we have a fixed exchange rate we will have the world inflation. All we can accomplish by monetary and fiscal policy is to have more unemployment. That is perhaps exaggerating; you can, within limits, contain your inflation relative to world inflation, but you must have the world trend.

In particular, monetary restraint is likely to attract an inflow of capital, which will pose an insuperable problem for the central bank of a small country. In fact, the floating rate in Canada is exactly the result of that problem. If you want to have the benefits of relatively liberal trade and capital movement with the rest of the world, without inflation, you must have a floating exchange rate. That problem cannot be solved simply by revaluing from time to time, because that injects an element of disturbance; it is a transitory benefit, but it will not last.

If you have a floating exchange rate, and only then, you have a possibility of divorcing your price trend from the world price trend. I would emphasize it is viewed in the context of a closed economy, so it is either a policy for the world as a whole or for a country on a floating exchange rate.

The question is how to operate monetary and fiscal policy. I would agree with most Canadian economists, and those elsewhere, that the monetary and fiscal policy has been operated so far on far too much of a stop-go basis, which injects a lot of disturbances. It is probably bad for long run economic growth and it would be better to have what I would think of as a framework policy, a framework for stable, economic growth. This involves not switching the budget from deficit to surplus year by year and not changing the rate of growth of the money supply rapidly year by year. Instead, it provides a long-run framework within which the business community can make projections of where the system is likely to go.

One proposal which you have heard already is for a stable rate of growth of the money supply geared to the economy's potential growth of output. The only point I make with reference to that is that you must recognize that only a flexible exchange rate will permit that policy to be pursued. It is no good recommending a stable monetary growth in an open economy; the monetary growth will be determined by your policy, plus your balance of payments. If other countries' policies are more or less inflationary, you just do not have control of domestic money supply.

One of the questions is: Why is price stability desirable? I would argue that, aside from the balance of payments, the only argument for it concerns the stability in the value of money and the redistributions of income that go with inflation or deflation of an unexpected kind.

To take up the first point, the balance of payments argument is not an argument for price stability; it is an argument for having the same rate of inflation, or deflation, as everyone else. In Canadian history, for most of the interwar period we had a floating rate. We went back to a floating rate for the 'thirties, the reason being that we could not stand the world inflation which we would otherwise have had to face. We went back to a floating rate again in 1950 and again in 1970, because we could not stand the inflation that the world system was imposing on us.

If we are to have a fixed rate of exchange, we must accept the world rate of inflation. That, I think, makes nonsense of any proposal for incomes policy. It is one thing to say we should have an incomes policy to stabilize prices. If there is a fixed exchange rate there cannot be stabilized prices; you have to accept whatever price trend the world imposes on you, which means that you might have to have a very severely inflationary incomes policy. In the modern world you would have to have it. The Germans tried it and they had to take a floating rate instead.

It might possibly be argued that it is possible to have an incomes policy which governs wage increases by the rate of productivity increase. However, to say there must be an incomes policy which makes wage increases equal to productivity increases, plus a guess at how much inflation we should have to fit world circumstances, is something quite different. I cannot see any administrative mechanism that could give that kind of policy.

Supposing there is a floating exchange rate so that you do not have that problem of having to inflate or deflate with the rest of the world, what are the arguments for avoiding inflation? One is to maintain stability in the value of money; the other is to avoid arbitrary redistributions of income and wealth.

With regard to the stability of money, all the evidence we have from any number of inflations is that any inflation within the bounds of possibility is something the public can digest pretty well. The market system will enable them to avoid it. As far as redistributions are concerned, the major redistributions that must be worried about are essentially redistributions of income between people on fixed, government-determined social security benefits, pensions or salaries and other people. It would be a lot easier and more efficient to make adjustments in those benefits, pensions and salaries than to try to stop inflation by deflationary policies.

I come to the argument for an incomes policy. This argument, I have no hesitation in telling you, seems to me to be absolute nonsense. It is the kind of argument people who are unable to face economic reality like to propose as a means of transferring responsibility from the elected representatives of the people to the people themselves, and therefore it seems to me to make no democratic sense whatsoever.

There are two kinds of argument of this kind, one of which is popular in North America and the other in England. I would remark that I have spent, off and on, 25 years of my life in England, and every year somebody wants an incomes policy. They have tried it about four times, and each time it has failed. But it is the old "Maginot Line" mentality: find out where the enemy is strongest and then try to overwhelm him by superior numbers. Every time the incomes policy has failed a new generation comes along and says it has failed, not because it is a nonsense idea, but because the last bunch of guys did not have the guts and determination to push

it through. If you see something fail four times you may perhaps start to think it was not a good idea to begin with, but that is not the way people react.

One of the arguments is that inflation is caused by the graspingness of trade unions, monopolies and so forth. That idea makes no sense at all to me. Monopoly is a bad thing; trade unionism is a bad thing from the economic point of view, because it raises the wages of some small group of workers by excluding others from the opportunity to have the jobs. But that is a problem society has to cope with; it may decide trade unionism is a good thing and monopoly is a bad thing, or vice versa. Different societies come down on different sides of that question.

Whatever it is, it is a question that is there all the time; it is not a question that comes up only when there is inflation. If I have monopoly power I want to grab the most I can, and I want to grab that every minute; I do not wait for an inflation to decide, "Now is the time to grab." Instead, when an inflation starts I realize it is eroding my monopoly power and I have to restore it by raising the money price of my product. So rises in prices by businesses and trade unions are not a cause of inflation, they are a reaction to inflation by people who have monopoly power and see it being undermined by the inflation. You cannot blame inflation or unions or big businesses; they are reacting to the environment created by whatever is producing the inflation.

The other argument for an incomes policy is that, on the average, people can only get increases in real incomes to the extent that productivity is increasing. If they ask for wage increases or price increases higher than productivity increases, they are fooling themselves. Why don't we just tell them, "Look, boys, for the good of the country don't ask for more than you can really have, and keep wage increases in line with productivity increases, keep prices constant," and so on. After 25 years in England that seems to me to be a misapplication of the public school spirit. The headmaster can call the boys into chapel on Monday and tell them, "Boys, for the good of the school you must eat less tuck; you must satisfy yourselves with shepherd's pie instead of steak," and so on and so forth. He can enforce it because he has the moral authority to do so.

However, that is not the way a capitalist system works. We do not have a headmaster in a capitalist system; we have competitors, and they are out for their own benefit and they are reacting to their own market situation. What we are trying to ask them to do is to ignore the evidence coming to them through the markets which says, "You can have a 20 per cent wage increase this year, and if you do not ask for it you are being foolish because that is what you can have." It says to the employer, "You can afford a 20 per cent increase this year because there is lots of demand, you need the labour. If you don't give them the increase you are going to have a strike on your hands and then you won't sell the goods," and that is the information they have; it is their own market situation.

What an incomes policy tries to do is tell them, "Forget about the 20 per cent, regardless of the evidence of your own eyes."—on both sides, because it takes both sides to make a bargain—"Three per cent or five per cent is what we tell you from Ottawa you can have." What Ottawa will be trying to do in that circumstance is to persuade these guys to ignore the evidence of their own eyes and to take the words of a bureaucrat that this is the way to do it. I do not think our system works that way. Maybe in Europe they can do it, although all the evidence is that every time they have tried they have failed. I do not see that our system works the way that system might work.

The committee's paper, which I received some time ago, makes special reference to regional policies. I say flatly that I do not see any possibility of a regional monetary policy, unless you could isolate the provinces and regions from each other, close the capital markets and erect barriers. I do not see that would be good for the country. We might pretend to have a regional monetary policy in the sense that you could subsidize mortgages or factory production loans, or something like that in particular parts of the country. But, as I see it, that is not a monetary policy: that is a fiscal policy; it is a subsidy policy.

You could have a regional fiscal policy, in the sense that any province could borrow money and spend it in order to increase employment in its own territory, but I think there are strong limits to that, because in a highly integrated economy most of the money will wind up as demand for products from some other province or region, and the extent to which you can redistribute a given amount of demand between provinces and regions by this kind of policy seems to me very limited. There I base myself on a large number of studies made by Canadian economists of this possibility; while there is something in it, it is not very much.

There is one point with which I want to conclude. I am becoming more and more suspicious of this whole question of the need for regional policies. In Canada the Maritimes have been what we thought of as a depressed region for over 100 years. Oddly enough, in the United Kingdom, Scotland has been the same thing, and it has been peopled by the same racial stock as the Maritimes for the same period of time...

The Chairman: You are being very brave—to say that in the present company!

Dr. Johnson: I can afford to be brave; I am taking a plane out of here tomorrow.

The Chairman: But you are here tonight.

Dr. Johnson: Well, I am relying on you for protection.

It does seem to me that these regional differences in unemployment may represent, not some sort of disequilibrium that needs to be secured by public policy, but instead a sociological economic adjustment to the facts of the situation. It is not everybody who wants to spend all his week working in a factory. We do have different industries in any place. One of the examples I think of is freelance journalism, in which people work for high pay for a short period of time and then "rest," as they call it, and they count as "unemployed" in the periods of rest-

ing, but essentially they are satisfied with what they are doing.

Having lived in various kinds of rural environment, I feel quite often people like to have a low probability of employment when the environment offers them activities that interest them. I have noticed this kind of thing in Wales, Scotland, Northern Ireland and the Maritimes of Canada. So it does raise in my mind the question whether this emphasis on trying to level out unemployment rates across the country, and to make my former compatriots the Nova Scotians as fully employed as the average Toronto citizen, is a desirable objective of social policy. The person who lives in Toronto has to work hard, to support his mortgage, to support his wife and children, his yacht, summer cottage and so forth. If you live in Nova Scotia in a small village, you get all these things pretty cheap. Why that fellow should be forced to work full time, in order to come up to some standard of Ontario morality, is not an easy question for me to answer.

Senator Grosart: Mr. Chairman, as I think you know, I am going to go very easy on Dr. Johnson, because a week or so from now he will be the commentator on a paper that I will be giving. So I am going to be very careful.

Senator Molson: Chicken!

Senator Grosart: I am chicken on that point.

The first question I would like to ask you, Dr. Johnson, is for clarification really. In paragraph 5, about halfway down, on page 2, you say:

> Central banks have a preference for a fixed exchange rate because it gives them political power over a government.

Then, at page 3, in the last line of the top paragraph, you say:

> With a fixed exchange rate the Central Bank has control of the money supply only for a short run.

First of all, how does the fixed exchange rate give the central bank this power over government and what kind of power is it?

Dr. Johnson: Senator, I can explain that fairly easily, and mostly on the basis of British experience. In 1964 the Labour Government came into power with a tremendous program of moving the country ahead, providing full employment, providing economic growth, all that kind of thing. But they came in with an over-valued exchange rate and the first decision they made, without any consultation with their economic advisors, only on the basis of consultation with the Bank of England, was to hold that exchange rate. The result was that they had to give up every single policy that they were in favour of: they had to have more unemployment; they had to raise taxes; they had to put monetary restraint into effect. That was because they had to deflate the economy to avoid a balance-of-payments deficit. They were not successful on that, but they spent three years throwing out every single aspect of socialist policy that they had been elected on, in order to maintain that exchange rate.

To quote another thing. In the second Labour Government, in 1931, when the Labour Government got "busted" and the coalition government came in as a national government, one of the ministers, after they devalued, said, "They never told us we could do that." Instead, they were busy, cutting social security benefits—a labour government cutting social security benefits, cutting government salaries. The reason is that if you have a fixed exchange rate you have to deflate the economy as far as necessary to hold that rate.

The other way round is what we have had in Canada up to the middle of May, 1970. You have to inflate the economy as fast as everyone else is inflating it. Who is your advisor on policy? Who is your advisor on the balance of payments? It is the central bank. They come to you and say, "You may want to avoid inflation; or you may want to avoid unemployment, but you just have to have it because otherwise the balance of payments is going to go bad and we are the experts and we will tell you. Nobody elected us; we came up through the banking community; we have a proper contempt for you democratically elected members of parliament; but we are telling you that you have got to do what we say—or else!"

That is where the power comes from. There is a definite historical pattern. Up to 1931 the central banks of the world were riding very high; democratically elected governments were subservient to their central banks. After 1931 the central banks had lost all credibility and the treasuries took over. We had a period of 15 to 20 years in Canada of cheap money, which is what the politicians wanted and what the public wanted—because the central banks had lost credibility and the treasuries took over.

Since then, the system has been reconstructed, fixed exchange rates, and the central bank dictates the policy. Interest rates in this country are not what you want, or what any Canadian citizen wants: they are what they have to be in order for the central bank to manage the money supply and the exchange rate.

Senator Grosart: Is it not normally one of the major responsibilities written into the act setting up the central bank that it protect the status quo of the exchange rate?

Dr. Johnson: It is. It certainly is, senator; it is exactly that. But the question is: What are you asking them to protect?

Senator Grosart: It is in our Bank Act.

Dr. Johnson: It is in most countries' Bank Acts, but this is a division of responsibility which is not necessarily desirable. If everyone else had stable prices, that would be good legislation. If other people sometimes have tremendous depressions, such as we had in the 1930s, and at other times have big inflations, such as we have had since 1965, defending the exchange rate as a prescription for deflating the economy in the one circumstance, at whatever cost in employment, human misery or whatever, and in the other case of inflating the economy regardless of what the public wants, the question is: Who

is responsible? If your government is not responsible and everyone else's is, then it is good legislation to say, "Make our government conform to the others." If your government is responsible and other people's are not, as has been the case in those two historical periods, legislation which says, "Our government has to be subservient to other people's responsibility," that is bad legislation.

Senator Grosart: We had a discussion this morning on what is the realistic relationship and what should be the proper relationship between government, as represented by the Department of Finance, and the central bank. Do you see a central bank as having any independence whatsoever of political power?

Dr. Johnson: There are two questions there. One is: Do I see them as having it? Yes, I see them as having it. Secondly: Do I approve of it?

Senator Grosart: I meant it in that sense.

Dr. Johnson: The answer is: No, I do not. We went through that, if you remember, in the late 1950s and early 1960s, when the governor of our central bank deflated the economy and gave us an even worse depression than the Americans were having. The new governor, whom we still have, took office on an explicit statement that the treasury, the Minister of Finance, and not he was responsible for policy. As always happens in human affairs, the problem is, if you delegate somebody with responsibility for an operational role, you may say that you are his boss, but he acquires an expertise which may enable him to be boss, even though you think you are.

My view of the matter would be—and in this I am not presenting a unique view, because a very eminent Canadian economist at that time made the very same point—that the central bank ought not to be regarded as a crown corporation; it ought to be an explicit operating department for the ministry of finance. And that is the way I think it should be.

Senator Grosart: In that case the politicians unfortunately seem to have been the loser.

Dr. Johnson: I do not care whether the politicians gain or lose. I am concerned about the Canadian public, which is the loser all the time.

Senator Grosart: I would say I did at that time, because I am Conservative.

The second part of the question related to this other statement:

> It is usually insufficiently emphasized, however, that this policy is only feasible if the exchange rate is left free to float. With a fixed exchange rate, the Central Bank has control of the money supply only in the short run.

Dr. Johnson: Right.

Senator Grosart: If it only has control in the short run, what happens then? Who takes control? Does the politician take control again?

Dr. Johnson: No, if you have a fixed exchange rate with other countries, to put it in a technical fashion, the public can acquire money by selling goods abroad, or by not importing, or by borrowing abroad, or it can dispose of money by the opposite procedures. If you try to restrict the money supply, you do it by raising interest rates. This has two effects. On the one hand it reduces the domestic activity, which tends to stimulate exports and reduce imports, so you get a balance of payments surplus; and although your interest rates are higher than other people's interest rates you get a capital inflow as Canadians borrow abroad or foreigners try to invest in this country.

We have had two examples of that in the last year. One was the Canadian situation last April-May, where efforts to control domestic money supply here led to a big capital inflow which the bank could not handle. We also had the German situation this year, which was the same sort of thing; their efforts to stop domestic inflation by monetary restraint led to a big capital inflow for them, which they could not handle. That is really what I mean by saying that you only have control in the short run. In the short run you can have tight money, but the consequences automatically will be that money will flow in and you will lose control.

Senator Grosart: Again on page 3, paragraph 7, towards the end, you say:

> Wage increases equal to productivity increases, when they should be equal to productivity increases plus a guess at the appropriate rate of inflation for the country relative to others, would produce increasing balance-of-payments surpluses and inflationary pressure on the domestic economy, which would eventually break the policy.

This is a hypothetical situation that you suggest, and you say that you see no mechanism by which this can be made to work. Has it been tried anywhere?

Dr. Johnson: No, it has not. The other policy has been tried and has failed.

I had an argument, at the end of March in Paris, with people from the OECD. Their view is, I think, completely uneconomic. The sign of an economic scoundrel is that he resorts to sociology to explain something he does not understand. The idea of an incomes policy is a very simple idea, but it applies entirely to a closed economy. The idea is, if you have wages rising faster than productivity, prices have to rise. Nobody is better off. It is a lot of waste motion. Why not stop it? We will all agree to keep wage increases equal to productivity increases. Prices will be stable. Everybody will get the same thing out of it as he would have otherwise, and we do not have inflation. That is true for a closed economy in which you do not have any foreign trade or foreign capital movements, but if you have foreign trade and foreign capital movements, then many of the prices you are dealing with are determined in foreign markets, and, if the foreign markets are suffering inflation, those prices are going up, and your producers find that they can sell their exports at rising prices. They can afford to pay higher wages

over and above the productivity increase. Your industries competing with imports can afford to charge higher prices. They do not have to keep wage increases down to productivity increases. So you find yourself with an inflation.

If you were to try an incomes policy in that period, the incomes policy would have to be productivity increase plus the rate of inflation that would keep us in line with foreign markets. That is, in modern times, but suppose you had thought about it in the 1930s, then we would have had to reduce wages by the world deflation minus the rate of productivity increase.

Well, I can see a target of price stability as something you might possibly be able to administer, although my friend John Young is much more sanguine about that than I am. But I cannot see a government saying, "Well, this year, chaps, you can have productivity increase plus 5 per cent." And then next year turning around and saying, "Well, you have to have productivity increase minus 2 per cent." I just cannot see any way you could administer that. If you tried to maintain prices as stable as the Germans have been doing, when everybody else is inflating, you would find yourself with a balance-of-payments surplus, capital inflow and foreign reserves coming in that you could not handle. Eventually, either you have to arrange to cope with those surpluses in capital account and current account, or else you have to revalue the currency, or else you have to do what the German did, which is to float up—up. Canada had that problem last year and Canada wisely decided to let it float, because we could not hold Canadian prices down when the Americans and everybody else were inflating. That is what that paragraph is supposed to say.

Senator Grosart: The Economic Council is making a great deal of the productivity potential line. How valid is that?

Dr. Johnson: That is a rather vague question.

Senator Grosart: Let me put it this way: How close to exactitude are these projections of national productivity potential?

Dr. Johnson: Well, I have seen many of those for many countries, and they are fairly close, because productivity change is not something that bounces around all over the place. Taking the average for the economy, you do tend to have a fairly stable rate at least for a few years. There are big differences between countries in the rate of increase. We all admire the Japanese and the Germans for the rates of potential productivity increase they have had, but these things seem to be accounted for, to a large extent, by things that economists do not really know about. That is, I do not see how we could move the Canadian economy up to a Japanese growth rate. We do not know how to do that. We do know that the Canadian economy's growth of productivity has been reasonably stable. So, as a framework for policy-making, that is a reasonable framework.

Senator Nichol: Dr. Johnson, yesterday Dr. John Young was here. I do not want to over-simplify his testimony, but in effect he said that there were three alternatives: basically, we could accept a level of inflation, we could accept a level of unemployment, or we could move to a prices and incomes policy. He then went on to say that he really meant some sort of enforced prices and incomes policy, because he more or less said that a voluntary one did not work too well.

Let us put aside the enforced prices and incomes policy and put aside unemployment and talk about inflation for a minute. Let us say we accept a certain inflation rate and that the Government says, in effect, that it will accept this rate and that it will introduce compensatory legislation to help the people who suffer by being unable to bargain in the market, such as pensioners and so on. Dr. Young says, the effect of this is to create a spiraling cycle of expectation of inflation. He says that the Government, having said, "Okay, we will accept 4 per cent," or whatever per cent it is, the people will say, "Ah hah, they will accept 4 per cent," and this becomes the base. Then next year, as I think he said, you get 6 per cent, 9 per cent, and on and on. He also implied that the other alternative is for the Government to adopt such a policy but not to tell the people what it is doing. In other words, in order to correct the psychological hopscotching, to pretend that it is looking for a non-inflationary policy but, in fact, to accept some compromise. What do you think about this point?

Dr. Johnson: Well, there are several remarks to be made about that. First, there is the question of whether or not you have a fixed exchange rate. I do not know whether that is a basis to start the argument on or not. As I have said, in thinking about Canadian problems we have to distinguish pretty sharply between the situation before June, 1970, and after. Only if you have a floating exchange rate can that kind of possibility arise, because otherwise you have to keep your inflation rate in line with the rest of the world, and your businessmen and your unions will know that. That will come up in the bargaining. If they try to raise money, wages and prices faster than the world average, they will lose markets and they will be subject to competition.

The Chairman: I think Dr. Young did say that through the use of the floating exchange rate and other measures Canada could isolate itself.

Dr. Johnson: Well, supposing it could? Then the doctrine is that inflation always must accelerate. We have no historical evidence on that whatsoever. If the Canadian Government were to say, not that it would accept a certain rate of inflation but that we were going to keep unemployment at 3 per cent, no matter what, then it might well be that 3 per cent unemployment was too low and that you would get accelerating wage demands. It might be that if the Government insists that that is where it is going to stay, it is going to have to validate those wage demands by monetary inflation and through a depreciating exchange rate. But that is fixing the target in terms of the unemployment percentage and also fixing it at a level which is inflationary. Contemporary empirical analysis and theory suggest that you would in fact get accelerating inflation under those specific conditions.

If, on the other hand, the Government said, "We will tolerate 2 or 3 per cent inflation rate, but if you guys try to jack up that rate you will have to put up with the unemployment that we will create,"—in order words, "We will provide the fiscal and monetary framework for that rate of inflation but no more, so you have a choice between faster wage and price increase and less unemployment," then I do not see why it whould accelerate. As I say, again most of our evidence is that runaway inflation is very difficult to produce.

Senator Lamontagne: It might accelerate under a new Government.

Dr. Johnson: Well, that is a question of when you start this policy. Given the parliamentary procedure where you have an election every four or five years, then you may be able to pull off a reasonable deal, which is what the Heath Government in England is trying to do and what Nixon hoped he could do but ran out of time on. That is, you have the deflationary pressure and you teach them the lesson the first two years, and then they are so grateful for having been taught the lesson that they vote you back into power the next time an election comes up.

The Chairman: I think Dr. Reuber suggested that 4 per cent unemployment might be the fulcrum around which the policy turned. Does that change your view on using unemployment as the test?

Dr. Johnson: The question of what percentage unemployment should be regarded as socially undesirable is a rather complicated one. First of all, as I understand from the Council's reports and from the documents produced before this committee, we have had a very rapid rate of growth in the labour force, with many young people coming on the labour market. Young people coming on the labour market may not be too much of a social problem, in the sense that at the beginning of a career you do spend a fair amount of time looking around at the opportunities, and that is a cost that you or your parents can bear, but your real problem is married heads of families, with children, becoming unemployed. Young people usually have a fall-back position of some sort so they are not really a tremendous social problem, except to the extent that you have so much unemployment that they wind up with dead-end careers.

Of course, that was the problem in the 'thirties. It was a problem here and in the United States in the late 'fifties and early 'sixties, that young people just did not get their foot on the ladder to begin with. But I would not regard the growth of the young part of the population seeking work as so serious a problem as the unemployment of established people with families. What is a serious problem in all our modern societies is the discharge of people in the forties who have great difficulty getting work again. But it seems to me those are problems that can be coped with by various kinds of social policies. Some of them we create by industrial practices. We do have in North America particularly, but also in the United Kingdom, the idea that once you are 40 you are dead and done for, unless you become a professor, senator, or business executive—and one of those jobs you can be fired from!

Senator Nichol: Which one?

Dr. Johnson: Neither yours nor mine, Senator Nichol. We do have a society that does tend to shelve older people, and I think that is a bad thing. It is in great contrast with previous societies, where the older you were the wiser you were. Now it is the younger you are the wiser you are, and once you get past 40 you are a dodo. But those are problems which can be coped with by various kinds of policy.

So I would not want to try to put a percentage on it, regardless of, on the one hand, the nature of the growth of the labour force, and, on the other hand, the social policies you have—social security, retraining, mobility of labour policy, subsidization of migration from one place to another. I do not think the percentage is the proper way to go about it, given that we do have a great deal of expertise. The Department of Labour here particularly has spent a lot of its time studying these problems, and I do not think you can reduce the answer to a single percentage, no "ifs, ands or buts."

Senator Beaubien: Dr. Johnson, I would like to ask you two questions.

Earlier on in your statement you said that inflation was not being caused by prices being raised or by salaries being increased; but you did not say what it was being caused by.

Dr. Johnson: Take an analogy, which may not be too good. You see a traffic accident in which someone is knocked over by a car. You say the reason why he was knocked over was either because he stepped off the pavement at the wrong time or because the driver was careless. If you think about it, you may come to the conclusion the real reason was that you did not have proper traffic control, with pedestrian crossings, speed signs, and so forth, and that the real problem is not that somebody did something but that there was no social arrangement whereby he was directed to do what he should do to avoid the accident.

In the same way, if we look at price increases, obviously prices increase because someone increases them. Wages increase because someone increases them. If you ask, "Why do they increase?" the answer is because the people who have the decisions to make decide that this is in their own interests. Business decides that its price is too low relative to its costs, relative to the demands for the product, relative to its capacity. If you think about wages, then the union figures that it deserves and can get an increase of a certain amount. It may make a claim which will not be accepted, and they go on strike. We had that in England in the postal strike, which lasted six weeks. The union militants thought they could get a certain increase; the union leadership itself knew they could not but it had to go along; so they had to have a strike to convince the members that they could not get that increase.

In other circumstances, and again English experience, the motor companies have been giving 20 per cent

increases. The reason is the unions want them because they figure they can get them, and management is prepared to give them because it is worth their while to give them rather than go through a strike, and they figure that the demand for the product will support it.

The question is not who decides it, but why he decides on that particular magnitude of increase. The answer has to be that when he looks at all the factors influencing his situation, he figures that is feasible and better than the alternative.

The question is: Why is it that sometimes you get very small wage increases and price increases, while other times you get large ones. The answer has to be that in some periods people feel that if they try raising wages and prices there will be a loss of sales, loss of employment, under-utilization of capacity; and at other times, if they do not make these increases, they will find themselves with more orders than they can handle and not enough labour to produce the amount they can sell. So we get back to the question of what is the demand situation.

My argument is that you have to look at the demand situation. Many people argue as if anything a union demands it can get. We have lots of experience of unions which thought they could get something but could not get it, and so you had long and costly strikes ending in complete defeat. We also have some evidence of managements trying to set prices which resulted in a big flood of imports, slack capacity, and all that. So there are mistakes made. But the main thing is that, in general, these increases are in response to the environment of demand that these people face.

Senator Beaubien: The second question I want to ask you, Dr. Johnson, is: We have a floating rate now and our dollar has gone up in terms of the American dollar, and the paper industry is just on the borderline as to whether it is going to go bust or not in Canada. If our dollar goes up a little more the chances are rather good that it will go bust. What happens then? Then you have a great deal of unemployment in the industry.

Dr. Johnson: Senator, I would never take an industry's word on the point at which it will go bust. The paper industry in Canada has been on the verge of going bust ever since I was a school child, but all jobs did not disappear. What happens mostly is that the capital gets revalued. The company may have to go into bankruptcy and take a loss, but we are still exporting paper.

Senator Beaubien: We did that in the 1930s.

Dr. Johnson: That was a world depression.

Senator Cameron: On the question of young people, Dr. Johnson said that situation was not serious because they were just coming on to the labour market, but would it not be serious if the period of depression was prolonged? For much of our highly-trained talent it becomes a dead end. This changes the picture a little.

Dr. Johnson: I view the problem somewhat differently. I make this remark on the basis of some studies that I did some seven or eight years ago at the time of the launching of the US war on poverty, the other war that they did not win. The real problem is the so-called unskilled people who leave high school and do not go to college or vocational school. These people are very dependent on getting a job which will give them training which will enable them to move up.

In the nineteenth century there were all sorts of novels by Charles Dickens and others to show that it was very important to get a job with the right firm, that you got training on the job and you gradually moved up from being an office boy, to clerk, to chief clerk, and then you might become a partner. There were all sorts of success stories in the nineteenth century of that kind.

In the contemporary world, people who go through formal training which equips them with a talent usually wind up with some degree of adaptive capacity. I have seen this all over the world. People take a degree in classics and they become journalists or something like that. It is not a career that I would regard with a high degree of esteem but it pays pretty well.

People who have been through the formal educational system have a flexibility which enables them to latch on to the system when the opportunity comes. The real problem that the poverty study shows is that these unskilled people with minimal education missed their chance. You can hire an office boy aged 15, but nowadays it is difficult to hire one aged 30. These people really miss out on the opportunity. That is the real problem.

It is not the formally educated people who are the problem in, the long run, when the economy gets back to a high level in employment. It is those who have a definite ladder ahead of them on which they missed the first step, and then they get into blind-alley occupations, dead-end jobs, checkers in supermarkets, and things like that, where you learn nothing that fits you to be the manager of a business unless you work your head off for the next 30 years.

Senator Cameron: Continuing with this, they graduated about 80,000 this spring. Take chemical engineers, for example. Forty per cent of them cannot get jobs this year. This might not be serious in terms of one year. This slow-down is for one year. But do you not think it would be rather serious for people of that skill, granting what you said about adaptability, if it went on for, say, two years? Many of them may get into dead end jobs. Many PhDs cannot get jobs.

Dr. Johnson: That raises two different kinds of question. One concerns what these people do. My argument would be that providing the economy gets back to a reasonable degree of employment, sooner or later these people usually manage to make out all right. I find this in my own trade, that you get people who spend three or four years as high school teachers or low-grade Government employees, and when the market picks up they can reinsert themselves into the market. The other part of the question is whether the allocation of training facilities really fits Canadian needs. That is very doubtful. The academic establishment is not a market-oriented one; it is scholarship oriented.

In British Columbia, for example, and at the university of Toronto when I was there, they turned out many aircraft engineers without an aircraft industry in Canada for them to go to. There has been a big trans-Atlantic to-ing and fro-ing of aircraft people, depending on who is busy placing contracts for aircraft development. Some years ago the British were complaining about a shortage of aircraft engineers. They were all out on the west coast, in Seattle. Now they are all trying to get back to England, and the British have an embarrassment of riches in aircraft engineers.

So, part of it is a question of the nature of the academic establishment itself. Part of the student problem in recent years has been that we have a tradition that a man who is doing research in sociology ought to be a professor and not have students in sociology. They get attracted to the subject because they are social misfits or are critics of society, and they find the only job they can get is in the advertising business.

This is a very traumatic experience. We do have supplies of people coming from universities who are not well matched to what the economy can provide. The thing gets aggravated when we have a recession or a policy-induced downturn, because we have different rates of expansion of demand for these things. Much of it is Government. Part of the anti-inflationary policy in most countries is a cut in government expenditure. A private market does not have outlets for these people.

Further, the university system tends to specialize far too much. Even if they have a 40-year period ahead of them to fit into the economic system, they say, "This year society needs aircraft engineers and therefore we will train you in that and nothing else. If you want to change to something else, you will have a hard time because we will not tell you how to do it." That is part of the problem.

Senator Laird: Since we are going to have to face up to this problem shortly, would you be willing to comment on the part that taxation policy plays in the matter of inflation?

Dr. Johnson: Well, one can comment on that at several different levels. Ignoring the connection between Canadian and US inflation, which is an important abstraction and looking at it only in terms of the Canadian economy, then you can say inflation in Canada is, in part at least, a consequence of the balance between demand and supply in the Canadian economy.

If you have a high demand relative to productive capacity, then you have a strain on resources which tends to reduce inflation. The Government can cut down on that demand in the Government sector by reducing the level of Government expenditure. It can cut down on that demand in the private sector either by raising interest rates, by making it more difficult to get money, or by raising taxes so that people's incomes are lower than they would otherwise be, and thereby draining resources out of the private sector so that what is left over for exercising demand is reduced.

There are some important questions about that. If you start using taxes year by year for this purpose, one would expect that the average citizen would get used to the idea and figure that he has spending power according to his average net of taxable income. Just because the Government raises taxes this year, that does not make him permanently poorer and less able to afford things. Next year they will cut taxes again.

This is a very important point, because much of Keynesian theory rests on the assumption that people judge their wealth and spending power only by this week's take-home pay. But most of us do not do that. We buy homes on mortgages, we plan for our children's education, we buy our automobiles and other things, not on the basis of this week's or month's salary but on the basis of what we think we will have to spend over a long time ahead. If Government reduces or increases taxes this year and we know they are going to reverse that policy later, it is not all that clear that we will suddenly decide not to buy a new car, or to move to a cheaper house, not to buy the wife a fur coat or whatever it may be, just because of that one year's tax policy.

There is a serious problem, that the more you try to use this technique of control, the less effective it is going to be. The public knows taxes will go up and down year by year, but they will hit an average and they will spend according to that average.

Another aspect is discussed a great deal, the issue which has just begun to be debated by professional econists around the world. It is the notion that taxes are regarded by business and labour as a cost. In Sweden, for example, unions are beginning to bargain for net wages, after taxes. In addition to that, professionals are beginning to bargain in the same way. If that becomes a habit, then the power to affect inflation by this has been lost. In fact, an attempt to stop inflation by raising taxes would cause price increases without a deflationary impact.

Senator Molson: My first question, Mr. Chairman, was the same as that of Senator Laird. I intended to ask what part big government plays in inflation. Doctor Johnson had said that big labour and big business are not the causes.

My second question goes back to that of exchange, floating and free, and whether the ability to operate in the exchange markets has been affected in recent times since they started reburying the gold. By "recent" I mean fairly modern times.

Dr. Johnson: The reburial of gold is a very ancient ceremony. It has been going on since the 'thirties. The essential point is that while people who write about this sometimes pretend we are still on the gold standard, we are not in any manner or fashion whatsoever. The final death knell of gold, not in terms of burying it for some purpose, but burying it for good and wishing it a happy life in the other world, came in 1968 with the two-tier system.

Essentially the world now is on a US dollar standard and gold figures not at all. As you can see if you look at

the monetary crisis since 1968, movement on the gold market has had no influence, so gold is a "has been." The real question is whether to stick with the dollar. If we do, we are going to have the inflation of the United States. That has been the problem everywhere. The only way you can get around that, as I say in my paper, is to float against the dollar and float upwards. That is a trickier proposition than you might think, because central banks always want a fixed rate. If they do not, they cannot go to the politicians and tell them they must do such-and-such, otherwise there will be a balance-of-payments deficit and lost reserves.

The problem in the modern world is that we need more exchange rate flexibility and we need it really to make the liberal trade system and payments system work. We have crises because money moves from an overvalued to an undervalued currency, but gold has nothing to do with it. The question is: What is the relationship between other exchange rates and the exchange value of the US dollar?

Senator Hays: If everything is based on the United States dollar, why should we worry so much with regard to inflation?

Dr. Johnson: One of the questions asked in the paper is: Why should you be? I do not really figure inflation is all that much of a problem. I have been in this business a long time. You experience waves of public opinion which are connected partly with the fact that the central bankers of the world are a pretty tight community. During the post-war period, when I was trying to live on a salary of $1,800 from the University of Toronto, and government was inflating the hell out of me, no one worried about inflation; they were all worried about employment.

In the late 'fifties, all of a sudden, just as the United States and Canada were beginning a period of very important slack, the central bankers began worrying about inflation. I experienced this when travelling from England through the United States to Canada. It was all the same talk and exactly the same language. It was all because these guys had lunch with each other pretty often.

Senator Hays: They were just getting ready to retire.

Dr. Johnson: That is one of the problems. People who make policy decisions are generally on fixed salaries, with a pension scheme. If they were only entrepreneurs investing in land, they might worry less about it. Consider the case in Canada of the generation of civil servants of my age and a little older, who went into the war and became pretty important people in government. They had lots of courage and guts and understood Keynesian economics. However, when they were in their late 'thirties, early 'forties, and became 45, they began to worry about their pensions.

I studied this whole matter when I was working for the Royal Commission on Banking and Finance in 1962. I read Governor Coyne's speeches. For a little while he was the only intelligent central banker in the world. He said inflation is not all that much of a problem. Someone converted him. I guess they invited him down to Washington for lunch, or sent some one up here to talk to him at his expense. Then he switched around and began to fight inflation. We had 7½ per cent unemployment in Canada during that period. It was completely unnecessary. With a floating exchange rate, we could have resisted the US recession. However, instead we exaggerated it and had a bigger recession than they did. It was all based on his idea that inflation was the biggest problem.

Senator Hays: In your opinion, will we have inflation in perpetuity ?

Dr. Johnson: I think we will for a long time to come, because President Nixon would rather be re-elected than serve the interests of those who do not like inflation. He has made that clear in recent months.

In a country such as Canada, first of all we have to ask ourselves why we have to fight inflation. Most people can get used to it; the markets can get used to it. You can cause more damage once you have inflation running by trying to stop it than by letting it run its course. All our evidence shows that it does not start galloping; it may trot or gallop, but it does not change pace unless someone kicks it in the side. It tends to stay where it is. You can cause more damage by attempting to stop it, particularly when the world is having it and you have to have it because you have a fixed exchange rate. But I would say that the world as a whole is going to inflate for quite a while, because we have started an inflationary force which is very difficult to stop.

I do not know how many of the members of the committee have looked at the December OECD report on the current problem of inflation. If you look for their remedy, they do not have one. They propose that everyone should have an incomes policy, but even they realize that that is nonsense. So, being written by Englishmen, that report is rather sanguine on the question. If you think about the problem as I would think, there must be concerted action by all the world central banks to restrain the growth of the money supply and impose deflationary policies.

In fact, a more recent OECD report shows that the European central banks have been aggravating world inflation because the Eurodollar market has had a growth of something like $5 billion-worth of dollar holdings. The real reason is that each one of them attempts to kick the dollars out, but each of them has them on his books. Therefore, you get this $5 billion over-representation. So I would say inflation is going to continue.

The questions for Canada are, I think; How far is Canadian inflation really part of the world inflation? —which we have to accept. How far are there extra-inflationary factors? How much are we prepared to pay to kill to those extra factors? And are we prepared to stick with a floating rate and not with the world inflation, or do we want to go back on a fixed rate and have the world inflation?

The Chairman: We are still on the floating rate. Dr. Gillies, did you have a supplementary question on that?

Dr. Gillies: Yes, I did. If you stand the floating rate, how much of the world inflation can you keep out of Canada?

Dr. Johnson: Well, I am sorry I have to be exposed to questions from professional economists, who always ask harder questions than I can answer. It is really two questions. How much could you, and how much do you want to? It seems to me that you have an inflationary process going on, and a wise policy might be to try to taper it off, but not to try to kill it. That is, when the horse is running down the road, do you try to trip it, or do you let it slow down and try to slow it down by gentling it? It seems to me that the evidence of the past few years is that, once an inflationary process gets under way, it is pretty hard to stop it without an awful lot of social disturbance. A wise policy for Canada might involve having at least some of the world inflation, at least for the next year or two, rather than go through the process of trying to kill it off, which involves lots of unemployment, and would involve a very substantial increase in the foreign exchange value of the dollar.

I would divide it up into two phases. One is: What do we do now, given that we have had this runaway? What is the best way of slowing it down? Then the question is: Having got things under control, where do you want to go? My answer would be that you could avoid all the world inflation with a floating rate. In theory, there is nothing to stop you doing that. But, as some economists have already argued before this committee—and we had a quotation from the Economic Council, for example—it might well be the Canadian economy will function more smoothly and without great public protest with one per cent, two per cent, three per cent or four per cent inflation than with an effort to make prices absolutely stable. But that is a question, really, not of how much you can do but of how much you want to do.

As you know, in Paul Samuelson's textbook—which is the most popular textbook in the world, it may have outsold the Bible by now, for all I know, without making any more converts—he started with something like a five per cent inflation rate as being what was tolerable, and then over the 'fifties it gradually fell to two per cent. I understand now it is back up a little more.

It is very much a question of what the public will stand. Who protests against inflation? Everybody protests against inflation if he thinks his salary is going to go up as it has been, but he does not want prices to go up. That is unrealistic. You only get wages going up because prices are going up. The people who really protest are those who have invested in the past in assets fixed in money terms on the expectation of stable prices, and then they find inflation. We financed quite a lot of the war that way, robbing all those people who saved money in the low-interest-rate 'thirties by inflating against them by a factor of two. But that was something you could do in wartime which you cannot do so well now, because people can re-contract; interest rates rise and they get protected. It is really a question of how much inflation you think is reasonable for the Canadian economy to function well, assuming, as you have posed the question, that you had the floating rate. If we go back to a fixed rate, then we are in for whatever inflation the rest of the world has, and we might as well forget it and get used to it.

The Chairman: Is the control of that inflation, when you are on a floating rate, the subject of management of the rate?

Dr. Johnson: No.

The Chairman: Or do you believe that a floating rate should be allowed just to float?

Dr. Johnson: I think a floating rate should be allowed just to float. The evidence we have on the 1956-62 experience, the Wonnacott study and the Stykolt and Eastman and others who wrote about it at that time, is that the Bank of Canada did not know what it was doing anyway. How do you manage something? You can only manage it if you know what you ought to be doing. If you do not know what you ought to be doing, you are just throwing monkey wrenches, or to use a more Canadian analogy, you are throwing your pitchfork into the threshing machine, so you do not know what you are doing. I understand from the press reports of the Reuber-Bodkin paper that they have considerable doubt whether what the Bank of Canada has been doing since the rate started to float has been useful or not.

It is very easy to think, "I am just going to stabilize things." Until you know what stability looks like, you do not know what you are doing. So it is not a question of managing the rate. Where we went wrong in 1960, 1961 and 1962 was by switching from letting the rate float to take up the slack, to trying to manipulate it.

The Chairman: So you do not control the amount of imported inflation by a management in the rate?

Dr. Johnson: You do not manage the rate. You aim for domestic policy with price stability, if that is what you want, or limited inflation, whatever it is you want, and you let the rate take up the slack; but you do not manage the rate, because if you try to manage it, first of all you do not know what you are managing. Suppose, for example, the Bank of Canada decides that dollar for dollar is the right thing for the dollar. You could maintain the semblance of a floating exchange rate but you are back to a fixed rate. If you do that, you are going to have United States inflation sooner or later. You had a temporary reprieve from letting it go from 99½ cents to $1, but then you are back on a fixed rate, and you just have to put up with what you get.

Senator Lamontagne: I am a bit mixed up at this stage because of what Dr. Johnson has just said. I got the impression from the text made available to us that he thought the problem of inflation was one that really started in the mid-sixties, and we were more or less at the end of the process at the moment. That is what I read from his paper. Now I am much more satisfied to see that he feels we have had inflation for most of the post-war years, so that there are forces there which are present that were not present before.

I also feel more at ease when he says we should more or less try to design our fiscal and monetary policy to the growth rate of the economy's potential output, which means, in my own mind at least, we should try to have long-term monetary and fiscal policies. At the same time, he advocates for Canada at the moment, at the end of a recession, not at the beginning of one, that we should now have an anti-deflationary policy.

The Chairman: Did you have a question on that?

Senator Lamontagne: I would like to have some comment on it.

Dr. Johnson: I will try to respond to the question in the same rambling way it was put.

Senator Lamontagne: I will say that I did not catch that.

Dr. Johnson: I said in the paper that, as the OECD report says, there has been a new phase in the evolution of world economy, namely a doubling of the rate of inflation in the period since 1965 as compared with the period from 1960 to 1965. I did not say we had reached the end of that. On the contrary, I think that will go on, precisely because it is connected mostly with the inflationary policies, or perhaps I should say the lack of anti-inflationary policies in the United States following the escalation of the war in Vietnam. While the Nixon administration did start with a deflationary policy, it did not work very well or very fast, and there has been a reversal now for the reason that President Nixon wants to be re-elected. So, in that part of it, you are half right and half wrong. I said there was a new phase in 1965, but I did not say we had reached the end of it.

Senator Lamontagne: Then we had it before, too.

Dr. Johnson: I sent along a paper, which apparently has not been distributed. It is a more extended version of this one. I would ephasize that whether you worry about inflation or not, it is really a question of public decision. As I said earlier, we had lots of inflation in the post-war period, in the immediate post-war period in North America, without anyone worrying about it too much. It wiped out a lot of pensioners but no one seemed to worry about it; they were happy that they had full employment.

After that was over, the people we were talking about earlier, who were in their forties in government and in the central bank, became worried about inflation so they imposed an anti-inflationary policy, at a time when we were already hitting a period of economic slack. So we got a very slack period, from 1958 to about 1962 or 1963. That really represented a change in public opinion, sparked by these particular individuals. Then we had a reversal of public opinion after that—full employment and growth were important. Kennedy had a lot to do with that. I think we were able to have a period of fairly rapid expansion, towards full employment, partly because of the slack that came before. We were able to expand the economy without generating inflationary pressure, because the previous slack period had meant that people were expecting price stability and the people acted on that.

Then, beginning about the mid-1960s, we were beginning to get inflation without further reduction of unemployment. I regard this as being a fairly long lag expectations phenomenon.

The post-war period was based on the 1930a, where everybody expected permanent depression, so you could have expansion without inflation, or whatever inflation went on was accepted. Then, after that period had gone on long enough, people began to worry about inflation. Then we had stagnation for a while. Once they got used to that, then you could have expansion again. We owe the five years of the early 1960s, expansion without major inflation, to the previous stagnation. But we ran out of that as the United States Administration tried to increase its military expenditure and its overseas expenditure without adequate tax financing, and with the monetary policy of expansion we got inflation, and that is what we have had and that is what got built into the system.

On my recommendations for Canada, I was very careful to say that while I thought it possible the time had come for re-flation—Roosevelt coined that term. It is like the saying, "We do not want higher prices for bread; we do not want lower prices for bread; we want national socialist prices for bread." Roosevelt coined the term "re-flation," so as to avoid the idea that expansionary policy was inflationary. He did not want deflation; he did not want inflation; so he used "re-flation" instead.

I am suggesting that possibly the time has come for re-flation of the Canadian economy. I was careful to say that this committee has to take the advice of Canadian economists, much better judges than I, of whether those inflationary expectations have been killed off sufficiently so that you can have a re-flation.

The problem that modern monetary theory is coping with—and this is something which has come to the fore in the last two years—is this: Suppose you try to expand the economy by expanding demand—a monetary policy, a fiscal policy, either one. There are two possibilities: one is that you just get more inflation without more employment; the other is that you can get more employment without more inflation. We do not know the answer to that. It seems to work out differently in different historical periods. So the real question is: What is the state of the Canadian economy right now? Can you expand demand and actually have an increase in employment and output, rather than just raise prices? My very tentative guess was that probably we have arrived at that point, given a floating exchange rate.

Senator Lamontagne: But do you not think it would have been preferable to start with this new orientation of fiscal and monetary policy in the spring of 1970, when the recession started?

Dr. Johnson: It is very difficult to tell. I certainly would not want to instruct the Minister of Finance, in

the light of hindsight, on what he should have done. I would say that, without the floating exchange rate, you would not have had any control over inflation, anyway. You have this problem in all three countries I know. In the U.K. ever since last autumn there has been a very large number of people arguing for reflation. They produce arguments which I do not think have much strength but which are appealing, namely, that if you increase demand then overhead costs fall, prices will not rise so much, labour will be satisifed because its real income is rising,—and all sorts of arguments like that.

I am not sure that those things have too much to do with the rate of inflation. In the United States, as we know, the Nixon administration's policy of deflation to stop inflation was defeated by the political problem of getting Nixon re-elected.

What the case is for Canada is really a tough question, because you get the same arguments. The question is: How much can the Canadian Government's policy do to restrain inflation here, if inflation is going on in these other countries? On a fixed rate, that would seem to be a very marginal calculation, and one that it is very difficult to make. There is the danger that you have United States inflation, only more so, and then you find yourself with a balance-of-payments deficit. That is one angle of the problem.

The other one is that, if you are successful temporarily in restraining inflation, you may find yourself with more unemployment and other things than you want, and with a balance-of-payments surplus which might be embarrassing. With a floating rate, you have much more freedom, but you still have the internal problem of these expectations, which will determine how far reflation would add fuel to the flames of inflation, or how far it would mean more employment, more output and more satisfaction to the average Canadian.

Senator Lamontagne: Again going back to your summary—and I am sorry I did not read the longer paper . . .

Dr. Johnson: You did not have it, so you could not have read it.

Senator Lamontagne: It seems to me that the thesis you are proposing to us, in this short paper, rests really on three main recommendations. You may correct me if I give you the wrong interpretations. First, we must have a floating rate of exchange. With this I completely agree. Secondly, you say that we should have monetary and fiscal policies designed not so much to deal with short-term instability but geared to the potential of our economy. Then, to build the rest, more or less, because I do not see anything else, you rely on the competitive forces of the market. Is this a fair summary?

Dr. Johnson: Let us say, the first two points are certainly a fair summary. On the third point, I think I would want to put a more complex point. If we could start wherever we wanted to, that is what we should be doing. The trouble is that we are not starting from square one, so to speak. We are starting after a series of policy decisions, a series of developments which have got us in a situation which is by no means easy to cope with.

The other papers have referred to excessive expansionary policy in the late 1960s and then to a tight clamp down of monetary policy. We have had here what has gone on in the United States and the United Kingdom as well, and which also seems characteristic of European countries, and it is quite a puzzling thing from some points of view. You find yourself trying to fight inflation by traditional measures, by deflation; but you find you do not really stop the inflation—at least, not within a period of time which seems politically satisfactory; and at the same time you have much more unemployment than you thought you would have. Given that situation there are two lines of analysis you can take. One is the OECD-Roy Harrod-type of analysis, which says this is an unprecedented sociological situation connected with student unrest, anger about the distribution of income and all sorts of things that you cannot do anything about except pray. Nobody these days does that much praying.

The other alternative is to say that we are faced with a pretty complex economic phenomenon which involves, say, a speed-up in the rate at which people come to expect inflation and a change in the environment such that they are not really convinced that the Government is capable of stopping it—or not so much capable as willing to stop it. The United States experience, I think, is evidence on that side that Nixon was just not able to keep up with the policy long enough. At least as long as the experts told him he should. In the U.K. there is the same problem, although the government there has a longer life ahead of it than the Nixon administration. So they can hold the line. Mr. Barber has made many speeches in the last few weeks saying he is not going to give in to those who want reflation.

But the view I have of Canada is that, if we could decide to start the country off where we want it, that is, with stable prices and a high level of employment, and the question was asked, "What shall we do next?" Then I would say, "We will have a floating rate and pursue a policy of stable environment." But that is not the problem this committee is concerned with or the Government faces. The problem is that we have had overheating and then a tight clamp-down and we have inflation going faster than we expected and unemployment higher than we expected.

The question now is how we move from that position back to a position from which we can start this ideal policy of a stable environment plus a floating rate.

Senator Lamontagne: But then when you come to your proposals, as I say again, it seems to me that you rely very much on the competitive forces of the market. Thereby you ignore not only the sociological factors which are really at work and which you do not seem to accept—because I think a post-industrial society will pose new problems in this respect—but you seem also to minimize the effect that the growing monopolistic conditions in quite a number of internal markets have on the redistribution of income if not inflation.

At some other stage you say, for instance, that monopolistic practices may contradict and nullify the effect of a proper regional policy of development.

Dr. Johnson: First of all, I do not believe in sociology. Sociology is the last resort of second-rate economists who cannot think about the economy.

Senator Lamontagne: Thank you very much.

Dr. Johnson: I do not classify you now as an economist, senator, so that was not intended as an insult.

Let me say that not that long ago I convened a conference in the United Kingdom on the wage explosion. All the way through the autumn the British were talking about this wage explosion, and this conference was held to consider it. Various observers—not my gang, of course—settled for the idea that suddenly the unions had become more pushful. That was their explanation. Now, why is that? Well, frustration. That was it. We had developed a new hypothesis to explain why the Phillips curve did not fit any more. The hypothesis was a frustration hypothesis. The workers had suddenly become frustrated. Well, if you say that the workers suddenly became frustrated, you have to ask yourself why and how, because people can become very frustrated. Was it Thoreau or Emerson who said that most men lead lives of quiet desperation. If you just substitute the word "frustration" for the word "desperation" you will have an accurate description of contemporary society. But why frustration or desperation should lead suddenly to wage increases becoming twice as big as they were the previous year does not explain anything. So I do not believe in psychology.

Senator Lamontagne: I think it explains a lot.

Dr. Johnson: I do not think it explains a lot at all. It describes a phenomenon you do not understand in terms your constituents will listen to but which do not tell them anything. So I do not believe in sociology. You do not find economists in times of stable prices using sociology as an explanation. It is only when they do not think they can explain things by economics that they resort to this explanation. Then any time I find people calling in acts of God and things like that to explain things they are not able to explain, I figure they have just given up. But they have not retired. I can understand people saying, "I don't understand the world. Therefore, I'll stop talking about it." But if they talk twice as loud and twice as fast about sociology, which they do not understand because they have never studied it, instead of talking about economics, which they are supposed to understand, I get suspicious.

I also went to Paris with the OECD. We had a panel discussion in Paris on inflation, and the OECD people were talking about sociology. Well, I can understand that. They are second-rate economists, to begin with, and their job is to study countries as cases, without any real demonstration that a country is an economic unit that is worth talking about.

Mind you, the matter of inflation is a world phenomenon, and I do not accept explanations that say that, "In 1968 the French had the events of May, in 1969 the Italians had a wage explosion, and in 1970 the British had a wage explosion. It is all sociology; we cannot understand it; and, unfortunately, it all happened at the same time, so that is why we have world inflation." I do not believe that.

The second thing is the question of competition. There is no evidence whatsoever that monopoly or oligopoly, whatever you want to call it, has been increasing. The explanation I give in my paper is that, for the appearance of price stability, these guys keep their prices constant and everybody accepts that. When you have an inflation they put their prices up. They are unpopular to begin with. In Canada a lot of them are American companies so you fasten on them and you say, "The reason we have inflation is because these guys are exercising monopoly power." They have been exercising monopoly power all the time. It is a failure of Canadian government policy of great magnitude that our anti-combines policy has been so weak and inefficient. But we only get a call to use it when we have inflation. Actually, most of the evidence we have on the role of oligopoly and inflation is that they hold prices down rather than push them up. It takes them a long time to get round to changing their list prices and reprinting their catalogues. So that explanation of inflation makes no sense at all to me.

There is a lot of evidence on that too, but the main point is that there is no evidence whatsoever that monopoly power suddenly in 1969 in the Canadian economy became important when previously it was not, or that it became far more important in that year than it was before. And unless you can produce evidence to the effect that suddenly monopoly broke out in the Canadian economy, or that our policy was effective up to 1969 in making it wholly, atomistically competitive but that all of a sudden for some unexplained reason monopoly developed and that is the reason, then I cannot see that.

Senator Lamontagne: Mr. Chairman. We have had inflation for quite a long time. As a matter of fact, except for four or five years, we have had inflation during the whole post-war period. It was precisely also during that time that unions became more and more powerful, during the whole post-war period.

Dr. Johnson: I disagree with you on the facts, senator. To start not with unions but with industrial concentration, the evidence we have for both Canada and the United States is that industrial concentration is more or less where it was in the early part of the century, so that explanation does not work.

If we take union power, the great increase in union power occurred in the 1930s, both in Canada and in the United States. My father used to work for Mitch. Hepburn, and I remember Hepburn getting elected on the campaign promise of keeping the CIO out of Canada. That promise lasted precisely two months—after the election, of course! So the big increase in union power came in that period. If you look at the statistics on union membership as a percentage of the labour force you will find that has been declining.

Senator Lamontagne: On union membership, but you have to make a distinction between union membership in young unions...

The Chairman: Gentlemen, I think you have both put your cases in, and we will leave it to some other judgment and perhaps go on to other questions.

Dr. Johnson: May I make just one other comment on this question of post-war inflation? It is true, as the senator says, that the world has had inflation more or less ever since the Second World War. The point I was making earlier was that we were concerned with it at some points and not at others. We were not concerned with it for the first 12 years or so after the war. We were happy enough to have the inflation because we were having high employment. We became concerned about inflation in the late 'fifties, and that led to policy changes which I think on the whole were not good, in the sense that they resulted in lots of unemployment superimposed on a tendency towards slack anyway.

We then had the 'sixties in which we also had some inflation, and one has to distinguish between what happens in the United States and other countries because rates go at different rates. Up until about 1968 no one was concerned about inflation either in that period. It was only after the inflation really got under way that policymakers began to worry about it.

I would say the thing is that concern about inflation is a political phenomenon. It is not an economic reality; it is a political phenomenon. People can stand inflation in Latin America. In Latin America they have rates of inflation of 30 to 50 per cent a year, they live with it and do not bother. Mostly it is a question of a change in the rate that causes the political concern. No one is worried too much about a 2 or 3 per cent rate of inflation, but if you accumulate that over a period of 40 years that is a pretty big cut in the value of money. We mostly get concerned about it when its speed changes. We get concerned about inflation when the speed of inflation rises, and we get concerned about unemployment when the speed of inflation falls and we get unemployment associated with it.

Senator Molgat: My question has to do with the spiralling effect. I think the fear of Canadians, if they knew it would stay at 4 per cent we might buy it, but we have always been told that inflation feeds on itself. You tell us today that is not so, but what proof is there of this?

Dr. Johnson: There is all sorts of proof. There was a big study done by A. J. Brown, published in about the middle 'fifties on the great inflation in 1939 to 1951. He found that countries had been able to have rates of inflation up to 100 per cent a year and pulled out of it; that in order to hit that spiralling business you had to get well above 100 per cent a year.

The main point is that the countries that have had this kind of hyper inflation—and there are about eight major countries on record: Germany, post World War I and post War II; Hungry, post World War I and post World War II; China post World War II, and a few others whose identities I cannot recall...

Senator Lamontagne: And Brazil?

Dr. Johnson: Brazil and all the Latin-American examples you can think of have not had hyper inflation. They have had very high rates and have come within the 100 per cent a year margin. Chile has had eight decades—it is now nine decades, since the last time someone looked at this—nine decades of inflation. The rates have been anywhere between 20 per cent and 60 or 70 per cent a year, but it has not been a spiral in the sense that it has got out of control. Where you have it getting out of control, typically what you have is what you had in China...

The Chairman: What do you mean by "getting out of control"? Do you mean the rate has been 30 per cent per year, going on and on?

Dr. Johnson: Maybe 30 per cent one year, 40 per cent the next year, 50 per cent the next year, and then down to 40 per cent and 30 per cent—that kind of thing. It has not sort of shot up into the stratosphere. Where you get these hyper inflations typically is where you have had a defeated government in a major world war—the war, on the one hand, depriving it of economic resources and reducing the taxable capacity; on the other hand, the war producing a socialist or left-wing government with a program of large-scale expenditure. Then, in order to finance the expenditure the only resource they have had has been to issue money in ever-increasing quantities. The theory of inflation, as worked out by a large number of theorists, is that there are limits to how much you can raise by inflation. In fact, I was reading a thesis from John Hopkins just this week on this question. The thing is that there is a limit to how much real resources you can raise by inflation.

Supposing your aspiration or political commitment is to raise more resources than that and you do not understand this point, then you keep increasing the rate of inflation. You do not raise more resources; you raise less, and so you step up the rate of inflation. This has been the case in these hyper inflations. The government has set a target for inflationary finance beyond what it could achieve.

You can think of this in terms of any tax you want to think of. Suppose you decide you want to finance, say, hospitals for the cure of alcoholics by putting a tax on alcohol. It could be that the money you raised by the tax would never be enough to pay for the hospitals, and you could go on raising the tax and taking in less and less money, and then you would raise the tax some more. You would never catch up. The effect would be the tax would just keep escalating.

Senator Beaubien: You would cure the alcoholism though.

Dr. Johnson: Not necessarily.

Senator Nichol: You would knock off all the second raters!

Dr. Johnson: Well, let us put the tax on milk, to make the example, because inflation is a tax on everyone and not just a tax on alcoholics.

The Chairman: On that point, we have had evidence that if we accept the inflation or rate of inflation, the expectations cause the Phillips curve to move away from zero, and then instead of having a trade-off of, say, 4 per cent unemployment for 3 per cent inflation, you have a trade-off of 6 per cent unemployment for 3 or 4 per cent inflation. And all you have created is just a lousy trade-off.

Dr. Johnson: That has been a major argument in the theory and practice of this subject for the last four years or so, since Freidman gave his presidential address to the American Economic Association. Indeed, there was a conference held at the New York University in January, 1968 which went into this matter with Solow and Cagan, the two major Keynesian and quantum theorists, respectively.

On the pure theory of the thing the argument is pretty irrefutable that if people know inflation is going on they will adjust for it in their behaviour. That is, wage earners will demand wage increases big enough to compensate for past inflation as well as to match the productivity gains, and businessmen will be wlling to give wage increases, and they do this on the basis that they figure they can raise prices in line with the inflation.

So the theory of the thing certainly says that and, in fact, the extreme theory of it, as Freidman puts it, implies that in the long run you do not have any trade-off and you get the same unemployment which he calls the natural rate of unemployment, whatever the rate of inflation, so all you have is inflation versus no inflation, which is no trade-off at all.

The Chairman: That is when the curve becomes a straight line.

Dr. Johnson: Yes, but the empirical evidence produced by various people—and I will say that in the Phillips curve business Canadians are real experts in this game, particularly Reuber's group of Western Ontario who have been in that business for a long time. When this argument first came out Reuber summoned all the evidence he could collect from something like four or five countries on Phillips curve analysts and claimed that he could not find any trace of this expectations effect. It was also suggested that while there was an expectations effect it was not big enough to turn the curve into a straight line. Any expectations effect would mean that the trade-off was worse than it would be without the expectations effect.

But according to the evidence, as I interpret it at the present time, this is a rolling game. New evidence can come in at any point. Statistical methods can be improved. The data can be massaged so that they do not cause you the fiscal problems that you started with. New evidence could come in, but the evidence so far is for the purpose of short-run policy making. That expectations effect is not strong enough to wipe out the Phillips curve trade-off. It makes it worse than you might think at first sight, but it does not wipe it out.

One might argue against that, that from the evidence we have of the three countries that I am familiar with, they have all had this experience of a higher unemployment rate and a higher inflation rate than fits on any Phillips curve. That would suggest that there is something wrong with the analysis. It is pretty strange that in three different countries with three different groups of estimators . . .

The Chairman: Is that over a long period of time or just a short period?

Dr. Johnson: The evidence from 1969 on does not fit the Phillips curve that you get from previous periods, even if you confine yourself to the post-war period.

The Chairman: Maybe it is a sociological problem.

Dr. Johnson: I would not say that it was. There are good economic explanations. I have mentioned very briefly some of them in the paper. There have been some institutional changes. In the UK, for example, they changed the social security laws. If a worker in the UK goes on strike he gets a refund on his previous taxes. His taxes are based on his accumulative pay. If he spends a week without pay his taxes are refigured on his total pay to date over the extra week, which means that his average pay is lower, his tax is lower, and therefore he gets a refund.

A more important thing is that social security benefits were increased, so that a worker who goes on strike is certain that his wife and children will get benefits at a level which is adequate to support them.

In Canada and the United States there is this question of the growth of the labour force, the increased proportion of young workers who you could expect (a) do not have much influence on wage bargaining and (b) can be supported by their parents, which means that their economic position does not have much influence on wage bargaining.

The point I was making basically is that the Phillips curve in all countries, as traditionally fitted, does not fit what has happened recently. I would put a lot of weight on the expectations which have not really been recaptured in the previous work. Aside from that 1968 symposium, expectations really have not been worked into that analysis. You can work expectations in. From a technical point of view you have two kinds of expectations. You have productivity expectations which have not been worked into the Phillips curve analyses at all. You would expect workers would want to pay increases that would give them real increases proportionate to the increase in productivity. You would also expect them to have an expectation about price increases. Suppose you have workers wanting pay increases which would give them a certain rise in the real standard of living? Suppose you hit them over the head with a very restrictive

policy so that they become unemployed or partially unemployed. They do not work overtime as they used to. They will suffer a decline in their real standard of living even if wage rates stay the same. It may be that they will demand wage rate increases to compensate them for the fact that they no longer have the overtime. I am not saying this is the case. But it is a hypothesis which has not been tested. On the basis of amateur sociology and other kinds of ad hoc explanations, this is one line on which work could be done.

The Chairman: How do you, in your scheme of things, control short-term instabilities, or in your judgment is it worthwhile to control them?

Dr. Johnson: There are two ways you can go. In general economic theory and policy opinion I think we suffer a great deal from a very primitive stage in economics, which was the period of the Keynesian revolution. The policy idea there was that the difference between security and misery was having a job. Either you are employed or you are unemployed. If you are unemployed, misery; and if you are employed, bliss. There are many different policies which the modern Government pursues which modifies that choice. In particular we did not have in the 1930s pretty comprehensive social security. We also have much higher levels of wages in real terms, so that it is more possible than it used to be to expect people to make some provision for their own support in times of unemployment.

We do have some careers where that is the case. Entrepreneurs, small businessmen, are accustomed to having income high one year and low the next, and to average it out. We have actors, freelance journalists and all sorts of people who live on the average of their income and who absorb fluctuations through saving and not saving. They build up nest eggs in good times, and they use them up in bad times. With a fairly high level of income for the average working man you can expect that the average guy will have more capacity to cushion himself. I would put more stress on the social security aspect and also on more sophistcated policies, labour market mobility policies, better employment exchanges, assisted migration from one place to another.

There are two ways of reducing misery. I can guarantee everybody an income through employment or I can guarantee him a cushion if his employment income fluctuates. The emphasis on Keynesian policy has been on guaranteeing income through employment. That means fine tuning and all sorts of other things, and there is a tremendous outcry if you have a little increase in unemployment.

It seems to me that given our extreme difficulty in managing overall economic policies, fiscal and monetary, so as to produce this stability of income, we ought to be looking more towards the cushioning and insurance aspect of things. Rather than try to walk a tightrope accurately and perfectly, we might put a net underneath so that if a guy falls off he does not bash his brains out on the circus floor. We have been spending a lot of our time trying to learn how to walk that tightrope and falling off and hurting ourselves, when a little investment in nets might make life a lot easier.

Senator Nichol: would like to go back to Dr. Young's testimony. You made it very clear about how you feel about enforced price and wage controls. He suggested that he was an advocate of such controls over a long period of time. As you said a little while ago, it was important to the Canadian economic system to get a grip on itself, to establish some sort of base, a consolidated position. He would use enforced controls. I do not think that was his term, but I think that was what he meant—to put the lid, shall we say, on the pot. Then he would turn down the heat with fiscal monetary heat. When the heat was down he would remove the lid, which would give us this stability.

The Chairman: I think, interestingly enough, he used the same term time and again of temporary price control or incomes policy.

Senator Nichol: To find a level from which to operate.

The Chairman: To get rid of expectations.

Senator Nichol: Yes, to get rid of expectations and to perform some kind of lobotomy on everyone.

Dr. Johnson: Referring to the theme of the lobotomy first. Norbert Wiener, the great cyberneticist, in his book *Cybernetics,* the *Science of Control Mechanisms,* had a few paragraphs on lobotomy. He said the case for frontal lobotomy is to quiet the patient; he would be a lot quieter if you killed him. One of the things that surprises me, not a lot really, having been born, brought up and trained here, is the extent to which we rely on imported, second-rate ideas for our thinking. That idea of putting a ceiling on things temporarily, because you would cool off the economy and everything would stop, was put by Robert Roosa to the American Economic Association meeting a year ago last December. It was also put by Arthur Burns as part of his inaugural rituals as chairman of the Board of Governors of the Federal Reserve System.

The same thing was tried in England in 1966 as a way of staving off the devaluation of the pound. The English experience was that they had a period of freeze, then a period of extreme voluntary restraint and the result was that they go right back where they would have been without it.

It must be looked at administratively. You can't freeze everything. It is like the man who had a frogleg farm and a method for freezing the water. He would go out to the pond, bang a drum and the frogs would jump in. Then he would freeze the water and mow their legs off with a lawnmower. Maybe you can do that with the Canadian economy; I do not know.

Senator Nichol: How is his business doing? Maybe the CDC could grab that.

Dr. Johnson: He could easily freeze everything, sure.

The Chairman: The first purchase for the CDC; a great idea.

Dr. Johnson: The first time I was in Ottawa I was working for the Wartime Prices and Trade Board, which Dr. Young in his talk to you yesterday regarded as irrelevant. My business was to measure the underwear shortage; it was entirely women's underwear and the shortage was obvious if anyone walked around Ottawa in the summertime. This was a consequence of this type of freeze. They had frozen the prices and it happened that the price they froze at put a high profit margin on children's underwear and a very low profit margin on women's underwear. The result was that all the manufacturers produced children's underwear and there was a great shortage, as I observed for myself, of women's underwear.

The economy is never standing still at an equilibrium position. There are some prices which manufacturers will move up, or wages which are going to be moved up at the next contract round. These changes are always made in the light of a long time horizon. Wage contracts are made not just with reference to what the manufacturer can afford to pay this year, but over the period of the contract. The recent American contracts, as you know, have tended to have a big front loading on them and a low rate of increase in the next two years. This is a forecast.

Suppose you start freezing right today; you are going to catch some people before and some after, which will be very unfair and the resultant price structure will lead to inefficiency. Therefore you can only have a freeze for a very short period of time, unless you are prepared to go the whole way to policing the whole business. Every one who thinks it is unfair can appeal for an increase. However, you will then have an army of civil servants.

Senator Nichol: To be honest, I do not think Dr. Young suggested a freeze. He was quite specific in not doing so.

Dr. Johnson: Unless he suggested a freeze, he is suggesting nothing.

Senator Molson: He suggested limitations.

Dr. Johnson: What sort of limitations? Suppose I say that any price that goes up more than 5 per cent is unpatriotic? Suppose I have a manufacturer who has just introduced a process which enables him to cut his cost by 50 per cent, or even 5 per cent? He can quite happily put his price up 5 per cent and obtain a 10 per cent effective increase in his price above his cost.

Take another guy who is faced with one or other cost conditions—imported materials or something like that—and he is told he can only have five per cent; his material costs go up by 10 per cent and he is being obliged to reduce his price effectively by 5 per cent. If you are to police that kind of thing you have to have a bunch of people who can assess all the data—and they will not get any help from the manufacturer, for sure, unless it is a question of raising the price above the 5 per cent. Nobody will come along and say, "Gee I don't want the 5 per cent. I am going to cut by 5 per cent." He is not going to say that. So unless you have a freeze you have got nothing.

The Chairman: You mean if you go further than a freeze you are into trouble?

Dr. Johnson: You have got to have a freeze to begin with, otherwise you have got nothing. Voluntary restraints, or anything like that, is nothing. If you are going to have price stability, some prices have to go down and some go up. Productivity increases are uneven over the economy. Unless you have a freeze, you don't know where you are at, you don't know what you are doing. If you have a freeze, you can only go back a little while, and then you have to start policing it. We have had too much in Canada over the past 15 years of moving good economists out of universities into stupid government research jobs. Moving them into administration would be even worse. We do not have that much talent. Nor do I think the average taxpayer ought to be asked to support an army of bureaucrats. In the government modern world there are too many people stopping other people from doing useful things. They have tried this in England.

The other problem is that you can have a policy of intervention which could be useful, which is to look into these monopoly situations and these decisions and insist on productivity agreements, all sorts of things. The British Prices and Incomes Board tried to do that. But you cannot combine that with an anti-inflationary policy. You cannot have fair prices and an inflationary environment, because you do not know what fair prices are. If money means something and you can calculate in terms of money, then you can look at efficiency, productivity, restraint of trade and all these things. But you cannot do it combined with an effort to stop money prices from rising.

Senator Nichol: I have a question on another subject. I do not know if anyone has any other questions on this subject.

The Chairman: On that subject, in your judgment does even a freeze have any viability?

Dr. Johnson: Viability is an easy question. If the government legislates it, it can have it—until it gets thrown out of office. Viability is easy. You can do any sort of injustice of any kind for some period of time with enough muscle behind it. It is not a question of viability. It is a question of usefulness. Would it be a good thing to do? My answer would be no; I do not see any purpose to be served by a freeze.

To go back to the previous question, Roosa produced this proposal for a temporary freeze and there is a tidy amount of logic in it, which is the following. Suppose the government decides it wants to stop inflation and is prepared to use all the muscle it requires in terms of fiscal and monetary policy. Then there is a case for the government telling people that is what it is going to do, and giving the public its judgment that if they try to raise wages or prices to levels inconsistent with the policy they will be in trouble. The argument for a freeze is that this is a quick and easy way of telling people that. It all depends on your putting the muscle into it.

Senator Nichol: That is right. It is muscle, isn't it?

Dr. Johnson: It requires muscle. If it works, they will say, "Thank you very much, senators, for telling me last December that I could not have more than a five per cent price rise, because now I find that I even have to cut below five per cent in order to sell my stuff because you have deflated the economy so much that I cannot make it with the five per cent." But that requires the policy to back it up. The trouble with a lot of that stuff is that it is usually either presented by people who recommend it or taken by the legislators as a substitute. I think there is a big problem in any modern society, that wage and price decisions are taken in the environment of particular markets. The information these guys get about overall economic policies is what filters through. It is quite possible that a particular market, say, for hot dogs will be booming, when everything else is slumping, because people are switching down from steaks to hot dogs. In that market the information is that hot dogs is great, raise the price. These guys are getting a biased sample of information of what is going on in the economy.

There is a case for the Government providing all the information it can about where it is going to make the economy go, not about where it thinks, because it is a favourite trick of government to try to persuade people that there will not be inflation, when there will be, in the hope that they will somehow act so that there will not be, and they will be passing the buck back from the people responsible, who were elected and paid to be responsible, to the poor victims of the democratic process. So you have to back it up with a real policy. There is a case for government announcing its intentions, if in fact its intentions are intentions and not just pious hopes.

Senator Nichol: Speaking of poor victims of the democratic process, and going back to something you said a little while ago, you talked about financing the war by borrowing at one time and paying back in another.

Dr. Johnson: Yes.

Senator Nichol: You were talking about the base force of inflation. How much of the base force of inflation is the accumulation of debt in the government's you are inflating? You get arguments as to how, and whether its debt is more or less of the GNP than it was in 1918. Is it a constant pressure to keep on paying off?

Dr. Johnson: No. The real inflationary pressure that comes from the government debt is through what Charles Kindleberger told me many years ago was the desperate ambition of treasuries to be loved by the public. By which I mean that they would like the public to buy government debt at low interest rates. Courchene had a remark about this at one time. He was recommending people to go to mutual funds and he said, "Some people may think it is unpatriotic of me to tell people to go to mutual funds instead of on to government debt, but I say it is unpatriotic of the government to pay such a miserable rate of interest on the public debt that it is worth people's while to go into mutual funds." The real problem is not the debt, but the fact that the governments always try to sell at lower interest rates than the market will stand. To do that, they try to give it a superior liquidity status, by standing ready to buy, or to cushion the market against big fluctuations in prices.

If you were standing by with a central bank, ready to buy up government debt as price falls, you are in a position of generating inflationary increases in the money supply and inflationary money market conditions. This gets particularly serious in an flationary period. You may have noticed in the papers that the Bank of England just issued a thing on competition in credit. The British problem is vastly aggravated in the whole post war period by the fact that their central bank—and they have even said so once in a report they issued—regarded its main function not as stabilizing the economy but as holding down the interest rates on government debt. If you have an inflationary period, when interest rates are tending upwards and debt prices are tending downwards, the Central Bank is always in a position of buying up debt and easing money conditions. That is something I know we have had in the United States and Canada, and in the U.K. in recent years, with worldwide inflationary tendencies and upward tendencies of interest rates.

That kind of "make the public love me" policy of debt management means inflation. The British finally got around to realizing this. It took us only about ten years to persuade them that this was the case—and of course some of our guys defect to the enemy. When they get a 50 per cent increase in salary for working for the government, they begin to figure suddenly that this is good policy. Finally they got persuaded, and they changed the policy. They let the government debt market go where it wants to, and not cushion it.

It is not the size of the debt, but the effort to keep the price of it higher than the market will pay, through this policy of support, that gives you the inflation.

Senator Nichol: On the same subject of debt, you talked about Keynes a few minutes ago. Has there ever been a country that has gone from deficits to budgets to deficits under this system?

Dr. Johnson: Lots of countries have done it. In fact, you could say that Canada, the United States and the United Kingdom generally, in the post-war period, started the post-war period with surpluses, and then they went into deficits. But the British did in the 19th century repay quite a substantial amount of government debt.

But there are some complicated issues involved there. When I was a student at Harvard, Alvin Hansen used to give us some lectures—and I am not so sure I would want to repeat those lectures myself these days—in which he used to argue on the necessity for a large government debt and a continuing growth of government debt, the argument being that you have a whole bunch of financial institutions, insurance companies, banks and so on, which want that kind of security and that their customers, the people who buy insurance, would be hard done by if you eliminated government debt and made these institutions go into holding equities.

Actually, I think that that is the reverse of the truth as it stood at that time. Those who were in equities did

much better than those in government debt. But you do have a problem that the growth of the economy involves people saving and accumulating assets. They want assets of different kinds and government debt is a particular kind of asset. The precise amount of government debt you want outstanding at any time is obviously a question of determination by a whole combination of considerations. Certainly, the question is one of optimizing the supply of securities from the standpoint of outstanding debt and from the standpoint of the budget it is a question of balancing demand and supply in the economy in the most satisfactory way.

I used to have arguments about this in Canada and the United States in the early sixties, when people were preaching the doctrine of orthodox budgeting. The standard line that we used, those of us who were protesting this, was that "General Motors doesn't mind going into debt if it's got a good asset to invest in. Why should the government mind going into debt if what it is doing is creating social capital in the form of hospitals, schools and other things which increase the productive capacity of the economy?" That really is the kind of consideration you need to take account of.

The Chairman: I think I quote you correctly as saying that monopoly power is not a short-range inflation problem. In your brief you have not mentioned the words that almost everybody else uses today as almost a convention, namely, cost-push inflation.

Dr. Johnson: I do not mention it because I do not believe in it.

The Chairman: So when you talk about monopoly as not being a short-range problem, you just do not believe in cost-push inflation at all.

Dr. Johnson: There was a lot of work done on that in the early 1960s, particularly in connection with the commission on money and credit. It is impossible to devise any statistical test that would tell you the difference anyway; but from a theoretical point of view, you can have the appearance of cost-push without there being anything there at all. Suppose, for example, there is a big increase in demand for automobiles. Manufacturers fix their price for the year and they sell the automobiles more or less to demand. They produce a batch of them and ship them out to the dealers and refill the orders as they come in. Now they are committed to sell those automobiles at a particular price and they guarantee to supply those automobiles at that price. But suppose that all of a sudden for some reason, say, connected with a big government expenditure program or something like that, the public becomes rich and wants more automobiles and demands more automobiles, and the manufacturers find themselves with big orders on their hands and have to go out and hire labour; well, then, the union gets the message that there is an excess demand for labour and they then put in a claim for a big wage increase. The manufacturers know they need the labour and they are prepared to pay the wage increase. And next year they put the increase in wages they have granted into the price of the automobiles. It looks as if automobile prices have gone up because wages have gone up, but, in fact, the start of the whole thing was that the demand for automobiles went up and labour became scarce and you got the wage increases. So it is a circular process, and you cannot tell where it starts. The way I have set it out here means that it looks as if this year's price increase was due to last year's wage increase, and last year's wage increase was completely arbitrary, but there is no means of telling.

If you look at data always you are going to have some sequence between wage and price increases. It is chicken and egg, or any other kind of problem you want to make it, but you can always cut in somewhere and say, "Well, forget what happened last year before the wage increase. We just know there is the wage increase, and then this year there is the price increase so, therefore, it is cost-push." It may well be that this year the demand for automobiles is way down and the number of workers employed is way down, but the sequence started with an increase in demand the year before last.

Senator Lamontagne: I was wondering if you had made a study, or if there was any recent study, as to whether or not there is a gap, which might be cyclical or otherwise, between the movement of wages among non-union workers as opposed to union workers, and the same kind of study as between the movement of prices in monopolistic sectors as opposed to competitive sectors.

Dr. Johnson: I do not know of any recent studies on that. I expect there will be some, but these things sort of go cyclically in relation to policy interests.

There was much study of that back in the early 'sixties based on the late 'fifties, and the argument which—Who was it? Someone produced a theory of administered price inflation. Do you remember, Senator Lamontagne? Anyway, there was a lot of investigation. When I was editing the *Journal of Political Economy* in the early 'sixties I published a whole lot of studies on this, whether prices rose faster or wages rose faster in these so-called oligopolistic and concentrated industries, and the evidence turned out to confirm the "now" hypothesis. If you took account of time lags and things in the adjustment you did not find any difference.

Of course, theory would tell you you should not expect any difference, because if you did get a widening gap you would get movements of labour in the market which would be a desequilibrium situation.

However, to the best of my knowledge—and this does not, I repeat, refer to any recent studies on this—there probably will be some because in Canada, for example, if many people are going around saying inflation is due to monopoly, and so forth, undoubtedly some Ph.D. student in some Canadian university will find this to be an interesting study—and two years after we need it we will have the information!

Senator Nichol: The question I would like to ask Dr. Johnson is this: Talking about liquidity and the near crisis or crisis that occurred roughly at the time Penn Central got into trouble in the United States and the

drop in liquidity in the banking system, and also in the non-banks, combined with the liquidity crisis in corporations and the failing current ratios throughout the whole system, I do not know that this is correct but some people say that there has been a long-term liquidity crisis running from the late 1920s right through, and that we are now at the upper end of a liquidity cycle which can only end in serious deflation to correct it. What do you think of that?

Dr. Johnson: I do not accept that at all; I do not believe it, not with any tremendous investment of time and energy in finding out about it, but it just does not make sense. The case of the Penn Central is something like the case of Rolls Royce in England or of the Merseyside Dock Authority, that you have a quasi public corporation whose rates are regulated and which is assumed to have the status of a public corporation.

Senator Nichol: The question would have been better without the specific example.

Dr. Johnson: It would indeed. I do not really think you can find any evidence of the liquidity shortage generally in business. It is probably true that businesses would be able to run more efficiently and make more profits if they could get money for nothing instead of paying interest rates on it.

Senator Nichol: Including consumer debts and the whole structure?

Dr. Johnson: Yes.

The Chairman: Honourable senators, Dr. Johnson's more detailed brief is now in our hands. It will be mimeographed and distributed to honourable senators and to the press probably in the next day or so.

Dr. Johnson, the fact that we have an interest in your testimony is attested to by the fact that we have sat long beyond our normal adjournment hour. It is obvious that questions could go on for many hours to come. I thank you very much for coming. I am sure that your testimony will be the subject of discussion throughout the rest of the hearings. Thank you.

The committee adjourned.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 13

THURSDAY, MAY 27, 1971

Tenth Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses:—See Minutes of Proceedings)

23877—1

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
	O'Leary
Gélinas	Paterson
Grosart	Phillips
Hays	Sparrow
Isnor	Walker—27.

(Quorum 7)

**Ex officio Member*

Orders of reference

Extract from the Minutes of the Proceedings of the Senate, of Tuesday, March 9th, 1971:

"With leave of the Senate,
The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said *Estimates* reaching the Senate.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,
The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, April 28th, 1971:

"With leave of the Senate,
The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Tuesday, May 4, 1971:

"With leave of the Senate
The Honourable Senator Langlois moved, seconded by the Honourable Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relations thereto.

The question being put on the motion it was—
Resolved in the affirmative.

Robert Fortier,
Clerk of the Senate.

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Minutes of Proceedings

Thursday, May 27, 1971.
(13)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10.00 a.m. to consider the Question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Benidickson, Desruisseaux, Hays, Laird, Langlois, Manning, McLean, Méthot, Molson, Nichol and Sparrow. (13)

Also present but not of the Committee: The Honourable Senators Denis, Haig, McGrand, Michaud, Molgat and Smith. (6)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Witness heard:

Dr. C. L. Barber,
Professor of Economics,
University of Manitoba.

At 12.20 p.m. the Committee adjourned to Tuesday, June 1, 1971.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Thursday, May 27, 1971.

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 10. a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, in resuming our hearings we have with us today Dr. Clarence Barber, who is head of the Department of Economics at the University of Manitoba. Dr. Barber obtained his doctorate from the University of Minnesota. He has had a wide experience in the Field of economics. Most recently he has been head of a royal commission on the subject of farm machinery, the results of which were published and very well received in the last two weeks.

Dr. Barber has been with the Dominion Bureau of Statistics, McMaster University, Queen's University and McGill University. He has been associated with the Royal Commission on Flood, Cost benefit, in Manitoba, and a special adviser on national income to the Government of the Phillipines.

His publications include: *Inventories and the Business Cycle, The Canadian Electrical Manufacturing Industry* (in connection with the Royal Commission on Canada's Economic Prospects), and *Canadian Tariff Policy.*

He has been a Vice-President of the Canadian Economics Association. Dr. Barber's learned studies are supplemented by practical experiences of a wide variety, and his researches and views on regional development as it concerns employment and inflation are of particular and immediate interest.

Honourable senators, you have Dr. Barber's brief and, as is our custom, I will ask him to review the brief with you at this time.

Dr. C. L. Barber, Department of Economics, University of Manitoba: Mr. Chairman, honourable senators, it is a great pleasure to be here and given this opportunity to discuss a very important topic. I think that this committee is doing an extremely valuable service for the country in examining what is a very important problem, which is to some degree world wide, and one to which we are going to have to give an increasing amount of attention. It is, in particular, the problem of operating the economy at a high level of employment, low levels of unemployment, and yet avoiding inflation, or at least keeping inflation down to acceptable limits. One of the first points I tried to make in my paper is that to create unemployment deliberately, as a method of checking inflation, is a method which is essentially very expensive. I cited something which the economists have called Okun's law, after Arthur Okun, who was recently Chairman of the Council of Economic Advisors. I think he was a professor at Yale at the time he first put forth this proposition. The proposition in general was that each one per cent increase in the unemployment rate costs you something of the order of 3 per cent of gross national product. He worked this out using United States data, more or less over a range from 4 to 7 per cent unemployment for the United States. It does not necessarily hold outside that range and we do not know whether it applies precisely this way in Canada. But if it did, I suggested that the difference between 4 per cent unemployment and 6 per cent unemployment would be a cost equal to three times the increase in the unemployment rate, three times two, or six per cent of the gross national product, which at current income levels runs to $5 billion. I am not trying to say that that is the precise figure.

This may not work out quite the same in Canada, but the main point is that it is a very great cost. The reason that the total loss is higher in proportion than the unemployment is because as the unemployment level increases, productivity typically declines. Some people who would come into the labour force otherwise may get discouraged. You often find an increase in the number of people remaining on the farm rather than coming into the urban labour force. So there is a certain concealed unemployment there. There are more people on short time. There is less overtime.

Since the evidence also seems to be that an increase in the unemployment rate has a rather uncertain effect on inflation, my general view is that we need to learn to develop better methods for dealing with this problem. I do not have any to advance at this point,—I make some suggestions later on but my main point is that we have a great deal more to learn about this. To learn it we are going to need a fairly sustained program of economic research over a period of years.

I would like to suggest that the way Canada has been examining this problem in recent years has been a little too intermittent, and a little too casual. You remember that in the summer of 1965 there was a flurry of interest in inflation. I think there was a steel price increase, and there was a reference to the Economic Council of Canada. They were asked to examine this and report on it, and they did a year later. That sort of meant they were expected, in addition to their regular jobs, to go out and get some additional staff to try and study the problem, report back within 12 months, and find a solution.

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They did report back; they said a number of useful things, but in that time they could really only begin to examine the problem.

One of the main recommendations of that report, as I recall, is that they came out flatly against an incomes policy. I had some reservations about that recommendation at the time, because I did not think they really had enough evidence one way or the other. They pointed mainly to western Europe as evidence that incomes policies break down, but at that very time in the United States there was a set of wage and price guidelines that were working fairly well. If you like, we could discuss incomes policy later.

I think incomes policy always tends to break down if demand ever gets excessive. But there may be a role for incomes policy, provided one can develop perhaps other methods to strengthen and reinforce it.

A year later the Government set up a task force on labour relations, which again reported within something like 12 months. We now have a Prices and Incomes Commission which has a research arm, which I am sure is doing very good work; but again they are expected to report within 15 or 18 months. One just cannot turn research on and off like that. I contrast the position of how we learned to put a man on the moon. If we had approached that job the way we approached the problem of dealing with inflation, we would not have him even one foot off the ground yet.

I would like to go on and say a little about the regional problem. One of our difficulties in Canada is that unemployment is so unevenly spread across the country. At the moment, it seems to be particularly high in Quebec, in the Atlantic Provinces and, within the past year, also in British Columbia. This has always been true. There has been this unequal impact.

I would like you to think for a moment what the situation would be if, instead of five different regions of Canada, all within one country, you thought of each of the regions as a separate country with its own currency, bound together in a common market. What would happen in the current circumstances, if you set those currencies free for a while to equilibrate? I expect you would find the Quebec dollar depreciating and the Atlantic dollar depreciating, and this would encourage an expansion of exports from these regions and discourage imports, and would stimulate the regions. We are all one country, and we have to learn to solve some of our regional problems more effectively than we have thus far.

While there is no simple answer, several years ago I wrote a monograph which was published by the Ontario Committee on Taxation entitled *The Theory of Fiscal Policy as Applied to a Province*. What I argued there essentially was this, that many of our provinces in Canada are larger than individual countries in western Europe. They are larger than Denmark, for example, and in some cases Holland or Belgium. Yet we always assume these countries will have an independent fiscal policy. Why, then, should not a province have an independent fiscal policy? I went ahead to examine that question. Of course, there are limitations, but all our provinces will have to learn to think more in fiscal policy terms than they have in the past, especially when you think in terms of fiscal policy in sort of broad stabilization terms—maintaining high employment and price stability. Many of the problems dealing with labour come within the province's jurisdiction.

There is a good deal more capital expenditure at the provincial government level than there is at the federal Government level. These are particular borrowing problems that limit what a province can do. If we think about these it may be that we can learn to deal with them also. I would be glad to expand on this in the questions.

There has been quite a bit of discussion on the whole question of wage and price controls. I did not say anything specifically about that in my paper. You have to ask yourself, when you introduce a policy on wages and prices, what you hope to gain from a longer run point of view. As Sir Roy Harrod pointed out, it may be a useful device for a short period, to give you time to work out another problem; but it does not solve anything from a longer run point of view. On the other hand, there may be merit in working out some devices that will check excessive wage settlements.

Professor Weintraub, who teaches at the University of Waterloo, recently published an article in the Lloyd's Bank Review. He proposes something called an "excess wage settlement tax". I believe there are problems connected with it, but essentially what he proposes is this: Let us assume we are determined to hold the line at 5 per cent as the maximum salary and wage increase to be authorized by any business firm. We would say that if any firm grants more than that they will have a tax imposed on the corporate profits, and that would force them to resist more strongly this wage settlement.

Of course, if you introduced this in a period of relative wage and price stability it might work, but one of the difficulties here is that one of our problems in Canada at the present time, about which we do not have nearly enough information, is that there is a lot of unhappiness about wage differentials. One group gets a large wage settlement. It immediately makes a lot of other groups unhappy and they then want increases. So we are getting a kind of wage-to-wage spiral more than a wage-to-price spiral. It is just partly a matter of getting an acceptable pattern of wage differentials. I suggest this somewhat tentatively because no one has really gone out and talked very much to the workers about it. If the nickel workers in Thompson turn down what seems like a very good settlement or just accept it by a vote of 51 per cent, then one ought to go and really find out what it is that determines their attitude. Why do they think they need that much? There has been very little research into this whole area.

When you come to impose a freeze or if you are thinking of imposing any kind of freeze on wages and prices, the only thing that makes any sense is some kind of freeze on incomes, because we have such an impact on prices from the outside, through imports and exports, and probably the most difficult area to deal with is profits because profits are much more sensitive to the capacity at which a firm operates. Profits fall off sharply as volume goes down, and you may have the same margin

of price over wages and salaries. At one time it may yield quite a good profit—I was almost going to say a handsome profit—and at another time it might yield a much lower profit.

Just to make one final point that I did not make in my brief, there is in the longer run at least one major consideration which is favourable to more price stability than we have had. We have had a problem related to the age structure of our population. There has been a real shortage of trained people in the population between the ages of, let us say, 25 and 50 and 55 and 60 at a time when demand has been expanding rapidly. The rapid growth in our school systems and then in our universities has sort of focused the demand on people with skills as has the growth of new government duties. But in the longer run there is going to be a greatly increased supply of these people. What has happened is that a lot of people in my own age group are probably now earning incomes which are higher in real terms that what economists call the long-run supply price. They are higher than the real income that will be maintained over the longer run. That means that as this increased supply of trained people becomes available and you get this competitive effect being felt throughout the labour market, that is going to be a favourable factor on the price side.

If you just calculate the sharp increase in the birth rate which came about in 1946, just after the boys got back home, which is just 25 years ago now, you will see that that group is just beginning to move up into the area where they are trained and are just starting to get experienced, and, increasingly, they will be coming into the labour market and will be starting to affect the competitive position there.

Thank you, Mr. Chairman.

The Chairman: Thank you, Dr. Barber. You have raised a wide number of points on which I am sure there will be many questions.

Senator Molgat: Dr. Barber, one of the economists we had before us yesterday suggested that inflation was going to be with us and we should learn to live with it. That is a simplification of what he said. A number of us on the committee expressed a fear of the spiraling effect of inflation, which, according to what I have been taught, is a traditional effect. But the view presented yesterday was that there is no proof, no real indication of this spiraling effect. It is something we are afraid of that does not really exist. Have you any particular views on that subject?

Dr. Barber: I would take the view that we do not really know. I do not think we can rule out the answer either way. If you look at what has happened in Canada—and I did review the price history over the past 20 or 25 years in my brief—you will see that it is only in the last four years that there has been a sort of basis for developing an expectation of continuously rising prices. Before that the price change was always so intermittant that there were interruptions and people would begin to forget.

But now, partly because there has been this sustained expansion throughout North America that has lasted pretty much through ten years—and this is partly because we have learned to manage the economy better and that situation is likely to continue—we are likely to continue to operate at higher levels than in the past so that we are likely to be facing the inflation problem.

The Governor of the Bank of Canada, I know, takes the view that it may accelerate; that if you try to operate at 4 per cent unemployment you may have 2 per cent inflation to start with but then a few years later it may be 3 or 4 per cent and then a bit later it might go to 5 or 6 per cent.

I do not think we know the answer. My view is that we must be prepared to try to attack the inflation and to develop new weapons for dealing with it. I do not think we can assume that it will not accelerate.

If it were just Canada alone, one thing that would keep the inflation from accelerating is the effects of other countries. To some degree in Canada the rate of inflation in the past has never moved too far from what has been happening in other countries. Again this could change. I would have to fall back simply on the point that we do not know and we are going to have to be prepared for that eventuality. We are going to have to develop new weapons to deal with it.

Senator Molson: It was also said yesterday, Dr. Barber, that in conditions like those obtaining in South America people have learned to live with a very high degree of inflation. There inflation is not far from constant; it is recurring inflation, but, in fact, it has never taken off in the hyper-inflation spiral. By our standards their inflation has been just enormous from year to year, but it has remained within certain limits. The theory is that people can get accustomed to live with that kind of inflation and to cope with it. Would you subscribe to that theory?

Dr. Barber: I am sure that after a country has been experiencing that kind of inflation, which may range anywhere from 20 to 50 per cent a year or more, all sorts of changes must occur in interest rate contracts, and so on. At the same time there may be lots of people who will suffer, such as old-age pensioners and others. It is also true that in Germany in the 1920s a lot of people in the middle-income group were wiped out completely by the hyper-inflation, and who knows what that laid the stage for later.

I would have thought western Europe was a better model to look at because throughout western Europe they have had more inflation on the average in the past 20 years than we have had. In most cases they have kept it down to a range of 3 or 4 per cent per year. Because of balance of payments considerations, they have frequently had to adopt what they call a disinflation policy for a period. But the way they operate they think that if they slow it down to a 2 per cent price rise for a period they think they have achieved something and then they go back and reflate. But so far you cannot see that it has accelerated. You look at countries like Sweden and France and many other countries that have had considerably more inflation than we have had in Canada since 1950 and they have operated at considerably lower levels of unemployment.

Senator Nichol: Dr. Barber, when Dr. Lipsey was there last week, he differentiated between types of inflation which he called expected and unexpected inflation. This is what he says:

> If I can add one other academic point, the textbooks have a lot of traditional wisdom about the harm that inflations do. I am guilty of it in my own textbook. All of the textbook discussions that are rather casual talk about unanticipated inflation. This is what would happen if suddenly, as in Germany after the first war, a price level changed dramatically and no one expected it. The consequences and harm done by the expected inflation are clearly different. I also expect that quantitatively the harm is less for the obvious reason that if people expect a 3 or 4 per cent inflation they invest their money in inflation-hedged investments—

And so on. I would like to know if you see such a differentiation between two types of inflation and whether you think one can be reasonably sanguine about one kind without expecting it to turn into the other kind.

Dr. Barber: I think he was simply making the point that if we had 3 per cent price rise per year, and if we could be confident that it would not accelerate, we could in time learn to live with it. I would agree with that, but I would emphasize that "in time". "In time" covers a long period of time because in the meantime all the pension contracts you might have been accumulating in the last 25 years are not going to be protected—but from this point on if the interest rate carried an inflation premium, your future contributions will be protected. But you see there are two points there. Firstly, we do not know whether it will in fact accelerate, and even if it does not, it takes a long time to fully adjust to that anticipated inflation.

Senator Nichol: You see, the crux of this debate—we have several cruxes in what is going on before this committee, but one of the deeper and more basic arguments is this one, because some people come here and say that we cannot tolerate inflation levels such as we have had because if we do it is going to accelerate to 9, 15 and 25 per cent and we are on a treadmill to oblivion. Others say that this is an unfounded fear and we do not need to worry about it.

Dr. Barber: The answer is, we do not know. We have to be prepared to cope with that kind of a problem if it develops. We have to develop new kinds of weapons for dealing with inflation.

Senator Laird: What weapons?

Dr. Barber: I suggested one—ingenious proposals such as Professor Weintraub's excess wage settlement tax. That is just a proposal. There may be problems with it, but it gives you an idea. Perhaps you can adapt it and use it in different ways. Perhaps you could put a straight payroll tax on excess wage settlements which you could argue would help deter them.

The point of Professor Weintraub's proposal was to try to put the pressure on employers to resist wage increases. I think that would work better if you could somehow introduce it in a period of wage and price stability and perhaps combine it with a prices and incomes policy.

Wage and price guidelines in the United States did seem to be working for awhile and perhaps, if the United States had not got into the Vietnam War, so that you suddenly got excess demand occurring, they might not have broken down. I do not think anyone knows that. All of these kinds of guidelines do break down if you develop excess demand. But if you can pull up short of that, and if you had some supplementary device like an excess wage settlement tax to try and reinforce the guidelines, some combination might very well work.

The Chairman: On the same question, as the expectations rise we are told by some that the trade-off moves away from zero and you may achieve a situation in which you are now contemplating 6 per cent inflation, but the unemployment rate moves back to 6 or 7 per cent. In the short term you have inflation. You reduce the unemployment, say, to 3 per cent frictional unemployment and as time goes on you still move back to the same problem, except that the number of chips in the game are higher.

Dr. Barber: Some economists argue that there exists what they call the natural rate of unemployment, which they define as the rate of unemployment that gives you wage and price stability—presumably wages going up on the average at the rate of productivity gain. But economists are split on this question. I do not think the evidence is really very clear. If there is a natural unemployment rate, no one knows what it is exactly.

The Chairman: If expectations rose over the trade-off, do you think they would become more severe or, on the other hand, that we would achieve a level...

Dr. Barber: They would argue that trade-off would not change. They would say...

The Chairman: I am asking you what your view would be.

Dr. Barber: I do not think there is any reason to think that the whole curve necessarily shifts. I am not convinced, really, that expectations accelerate either.

The Chairman: You are not of the opinion that the curve would shift, that if you accepted a degree of inflation you might achieve a lower rate of unemployment over a longer period of time?

Dr. Barber: We know there is always uncertainty about Government policy. We are never sure what the Government is going to be. One of the problems is that we do not have any measure of the anticipations. I would like to see a province bring out a bond on which they had a guarantee of the capital. In other words, they would agree to repay at the end of the period their original capital plus the rise in the consumer price index, and test the market and see what interest you would have to pay throughout those kinds of bonds. If some provinces did that we would have a measure of what the market expected in the way of inflation.

Senator Desruisseaux: Is that not being done in France?

Dr. Barber: I think it has been experimented with in some countries. I am not sure about France, but someone told me that Israel is doing that. But we are really concerned about expectations in our own country.

Senator Desruisseaux: I was informed that pension plans were on that basis in some European Countries. Would that be right?

Dr. Barber: I am sorry, but I do not really know about pension plans in Europe. I would endorse the general proposition that as long as we are in fact experiencing some inflation, and we know that the cost of unemployment is very high, we should be prepared to protect the lower income groups, the people who are getting squeezed in that sector.

Senator Hays: Would that not be inflationary?

The Chairman: There are two supplementaries. May I come back to you?

Dr. Gillies: I would like to follow up this question of expectations. Assuming that we do not know whether inflation would go to a recycling, and so on, on reviewing the evidence would you be willing to suggest that we should go for an expansionary policy to get full employment even though it may cause some inflation? This is really the question that has to be answered. It seems to me that we do not know but we have to make a judgment. What would be your judgment as to what to do on that particular question?

Dr. Barber: My judgment would be that we ought to move the economy back to around 4 per cent, that there would be some danger, as the Economic Council has pointed out, in pushing it back too quickly. One of the things that happened in 1965-1966 is that the whole level of demand in Canada moved up so rapidly that it pulled wages up and opened up wage differentials which, like ripples or large waves, continued to move through the economy long after.

There must be some explanation of why wages have been going up faster in Canada than in the United States, certainly in manufacturing, for the last five years, even though at the present time price increases are lower in Canada and the unemployment rate is quite a lot higher.

If we move back to 4 per cent, we must be perpared to develop new tools to tackle inflation. There is always going to be some price rise, but on the other hand the consumer price index probably does understate improvements which take the form of better quality. I remember noting several years ago that one of the larger price increases over the past 10 years was the cost of admission to the movies. Of course, the reason that price went up was that everyone was at home watching them on television. That is in the consumer price index, and it measures. However, the sort of gains obtained indirectly are not incorporated and they may very well add up to an amount of one per cent or 2 per cent. Therefore a 2 per cent price rise is nothing to be very worried about.

Senator Nichol: In relation to expectations and the problem of measuring them, part of the present problem is that the strength of the grip of inflation psychology on the people is not known. Witnesses here have expressed the concern that if they loosen things up too much again people will say well, there it goes again, and off goes the system spiralling again.

How much use is made of public opinion analysis in this kind of work? I suppose in some way it has a slightly sinister sound, but it is very effective and accurate in some fields in determining public opinion. Is this used in the field of economics?

Dr. Barber: Until very recently there was very little money available to support economic research in Canada, I was a member of the Social Science Research Council in 1962 and reviewed applications in Ottawa. We had approximately $25,000 to allocate to all the social sciences for one year.

Senator Nichol: Which organization was that?

Dr. Barber: It was named the Social Science Research Council. There just was very little money available. There has been already a very considerable improvement, but I think that there has been much too casual an attitude towards the importance of social science research.

To cite another example, I have sometimes said that the view of the Bank of Canada towards the importance of research can be judged by where the director of the research department fits into the hierarchy.

Senator Nichol: Where does he fit in?

Dr. Barber: I think he ought to be above the level of a deputy governor. However, the bank is full of former heads of the research department who have been moved up to some position of adviser. I can think of five or six.

Senator Nichol: How does the amount of money spent on economic research by the federal Government compare with, for instance, defence research?

Dr. Barber: It is very much smaller. It is hard to know how much real research there is within the Government as opposed to sort of pulse-taking and monitoring. If a patient's pulse is continually taken and his heart monitored there is no research into his basic health being carried out. It is only recently that there has been an increased emphasis on research within the Canadian Government. There are a great many able young economists within Canadian universities now, mainly because enrolment has increased, who in time will make an important contribution. However, I think it is important that their research proposals are financially well supported.

Senator Nichol: The first aspect is that of having an adequate amount of research, funded properly. You have mentioned that as a specific suggestion in your report. Then you mentioned an economic adviser type of proposal.

The other point is to have the results of the research applied in a useful manner. This is something we have touched on throughout these hearings.

How would this council of economic advisers which you suggest function? What would be its relationship to the Economic Council of Canada, the Bank of Canada and the Department of Finance? Many good ideas have just never been developed. How can that technical or mechanical gap be bridged?

Dr. Barber: I can tell you how it has operated in the United States. The council there advises the President of the United States directly.

Senator Molson: Has it been successful?

Dr. Barber: Over the years it has really been extremely important. When it was first established it was not very clear, but over time and particularly in the last decade it has made a very major contribution to economic policy.

They have brought in some of the very best economists in the American universities. They have also appointed junior people in a supporting role. It has always had a fairly modest budget and has been kept small, but it always has the ear of the President and advises him directly. Their annual reports are usually very informative. Arthur Okun, who developed Okun's law, was at one time chairman of that council. In comparison I do not think the Prime Minister of Canada has anything near it in the way of advice.

Senator Nichol: Not even the beginnings of it?

Dr. Barber: No, not really.

Senator Manning: Dr. Barber, you referred earlier to the regional nature of the economic dislocation. You gave a parallel or illustration of what the situation would be if these were separate countries operating on their own. Having regard to the fact that we are one nation with one currency and we have constitutional circumstances which prevent the regions from dealing with or interfering with trade flowing between provinces, could you enlarge on what you feel the provinces could do in the field of fiscal policy to help correct the situation we face today? Would you also comment on the extent to which that would need to be co-ordinated with national fiscal policy?

I am sure that you are well aware that in many cases in the past the provinces have felt that efforts on their part to deal with regional problems through fiscal policy have been neutralized or even destroyed altogether by a counter policy operating at the national level.

Senator Benidickson: And vice versa.

Senator Manning: Or vice versa.

Dr. Barber: I think if the federal Government were doing its job properly in terms of endeavouring to maintain a fairly high level of employment overall and a reasonable price stability within that context, each province then would have to work out what its own problems were. I think the Government should deliberately judge whether it ought to be a deficit or a surplus, relative to its position in national context. That is a cyclical problem. That is assuming the swings of the cycle hit different provinces to different extents. Maybe in one year it will hit one province and at one time another, depending what industries are being affected.

There is also the longer term structural problem, and that may be more difficult to deal with. We do have a Department of Regional Economic Expansion. You cannot think of any country in western Europe that would have tolerated the level of unemployment that has existed in the Atlantic Provinces over that long a period. I think we have to improve our methods of dealing with that. I do not really know what success the Department of Regional Economic Expansion is having. It is new and just beginning to tackle that job.

I think the provinces can think more in fiscal terms. I think traditionally, and even among economists, the feeling has been that fiscal policy is something for the federal Governent to think about. I think the provinces must learn to think in terms of fiscal policy, also, and perhaps have to adapt within the context and hope that the federal Government is running its show properly.

Senator Manning: We have had opinions expressed that fiscal policy is not a satisfactory instrument to use on a regional basis. What I am concerned about is that we are faced with this specific problem in Canada today of trying to get this level of unemployment reduced, and at the same time curb the pressures of inflation to a reasonable degree. This committee, I think, is anxious to make some specific recommendations that will achieve that objective.

My point is: How far should we be directing our thoughts to what should be done at the provincial level versus the federal level, or do these things have to be tied up in package?

Dr. Barber: I am surprised that you say people thought fiscal policy cannot be adopted regionally. I think this is true of monetary policy. Money flows so readily from one place to another.

I think fiscal policy can really comprehend a great range of different measures and you may be able often to achieve the effects of monetary policy through fiscal devices. You can put more money into housing through fiscal devices or more money into municipal public works by various devices of this kind. I would distinguish the structural problems. If unemployment has been high for 10 or 15 years, that is clearly a structural problem. It has something to do with the structure of the country and it is something that you are going to have to try to change and reorient. You have either to develop new industry there or encourage the people to move elsewhere, although generally they do not want to and that means that somehow you have to find industry for them there and develop it.

It is a job for an organization like the Department of Regional Economic Expansion. The swings affect provinces differently at different times because they are all dependent on somewhat different industries, and industries have their ups and downs, and within an overall national total the province has to try to adapt its fiscal measures and budget in dealing with this.

When I wrote this monograph which is entitled *The Theory of Fiscal Policy as Applied to the Province,* my feeling was that most of the provinces had not thought very much about that and many of them were not staffed to think in these terms. I think there has been a considerable improvement since that time.

The Chairman: Senator Manning is probably the man who has more knowledge than anyone else in Canada in the operation of fiscal policy by a province. I wonder if he wants to pursue that point with Dr. Barber, as to whether or not the provinces do take an interest in fiscal policy?

Senator Manning: I would have to agree with Dr. Barber that there has not been the attention and emphasis given to that in the past that there should have been. Certainly in the last few years it has become much more an issue of concern. I think in the view of many of these provinces there is a great deal of concern, no matter what the fiscal policy is that they develop within a province. Its benefits or success in attaining the objectives for which it was developed can be seriously circumscribed, or even neutralized altogether, by the overall national monetary policy. This creates not only an atmosphere of frustration, but a lot of disagreements that are detrimental to the country as a whole.

I will use a very simple illustration. Some of the developments we try to stimulate in Alberta are certainly aided by the fiscal policy, and then the national Government decides this is a hot area of the economy and ought to be closed off. There are sanctions then imposed on certain types of development which have grown up as part of the effects of local fiscal policy. Why should you spend money and effort to try to develop a place—and this happened to be in the construction—then find you are penalized because this is a hot area and ought to be cooled down. They made some adjustments in the completion of construction in a few areas such as Ontario, British Columbia and Alberta. This is the type of conflict that has developed in that field.

I wonder if you have some specific thoughts this committee may consider as to how this could be avoided in the future and we could get more effective co-ordination between National and provincial policies in this field.

Dr. Barber: The only specific suggestion I can make is that there is need for the federal Government to plan their development of policies carefully, and support them with more analytical research to begin with.

The government began this business of supporting regional development and it is my impression that they have changed their policies a number of times over a very few years. One of the difficulties was that they decided they wanted to do something and sort of rushed ahead and did it very quickly, and did not have the depth of research and an analysis of what the effect would be to begin with. It is, perhaps, just another illustration of the general lack of research strength in the federal Government supporting the development of policies that are in the national interest as a whole.

Senator Nichol: On the subject of regional development, how do you feel in general about the policy of forced growth industries, of subsidies, tax incentives, construction of interest structures and so on? What do you think our track record is going to be in the long run on this type of thing when we locate a business where perhaps it naturally would never be.

Dr. Barber: You can think of some horrible examples, as we both know.

Senator Nichol: We can think of some successful ones also, can we not?

Dr. Barber: Yes. It is a pretty new field—regional economics of growth and development. I think there have been some pretty successful areas. I can remember when New England, in the United States, was very worried about what was going to happen. Their textile industries and leather industries were moving into the southern United States. They have subsequently developed a lot of pretty successful high technology industries, many of them growing around the university complex and M.I.T. at Cambridge and the whole nature of that economy has changed, and perhaps changed toward the higher income status.

Senator Nichol: They went through 10 or 20 years of the textile industry dying and moving into cheap labour, and moving out of that whole bout. Then it was slack for a long time and a lot of those factories remained empty, but when they started filling up again when the electronics and instrument industries and all the other sophisticated things began to come, did they come through the forced draft sort of thing or come there because this is a pretty sophisticated work force? What I am asking is: Did these industries come there because of a forced growth situation, or was it a natural outgrowth of the labour and educational system of New England?

Dr. Barber: I think, perhaps, more the latter. In other words, I think quite a bit changed during the war. There was war industries that developed, but I think the development came to a considerable extent because there was quite a lot of money put into those educational institutions and a lot of research oriented to defence going on, and there were a lot of skilled people who left the universities and set up businesses of their own, and over time this whole development took place. I do not think it was planned quite that way, but I think this illustrates one of the bases upon which you can get successful growth.

Senator Nichol: What I am trying to find out is whether these things really solve unemployment—that is the forced growth type of thing. When Professor Scott was before us he referred to the lengthening cue. When you go into an area that is naturally, physically and geographically wrong for industry and force an industry there, do you really provide jobs or are you just sort of creating another vortex around which people would move from other places, and create disorganization in the market rather than doing anything creative?

Dr. Barber: For what it is worth, if you look at the last annual report of the Bank of Canada, they have charts of the unemployment rate over the past decade or more. It is fairly obvious that relative to the Canadian total, the Atlantic provinces unemployment rate has improved very significantly. It is still higher than the Canadian average. We know there has been a lot of attention devoted to sponsoring development in the Atlantic provinces. This would suggest that there has been some improvement.

The Chairman: Or movement.

Dr. Barber: There has always been some movement out. Moving the people out does not always improve the situation and some times it makes it worse.

If you have unemployed people there who are drawing welfare benefits, some of them paid by the federal Government, if they go and are no longer spending their money there, there may be more unemployed people.

The famous Swedish economist, Myrdal, argued that we think too much in terms of equilibrating situations; some of them can be disequilibrating.

People move out, and the people who are left are even worse off. You have to stop there and stabilize it somehow.

Senator Benidickson: Mr. Chairman, this is a less politically minded body than, perhaps, a committee of the House of Commons. On the other hand, a lot of us have had experience in the political field. We talk in terms of policy or planning and yesterday Dr. Johnson, I think, emphasized that this planning should be on a longer term basis. The Chairman complimented Senator Manning for his knowledge in the field of provincial fiscal policy-making. He, perhaps, was more fortunate than most leading the Government, in that he was in less danger of being upset in a shorter period than is customery in the country.

How does the federal group form policies when their term of office, under our system, is relatively short, the maximum being about four years? We have, of course, the Economic Council now, which commands a fair amount of respect, and you mentioned in 1962 the setting up, with very small resources, of a group to give economic and social advice. How permanent is any policy? Does it not require a longer period to be effective than the normal term of a government?

You have a Government that accepts a policy and you have an Opposition who says, "I am going to change that policy and do it differently." In fact, it is likely to do so, and upset something that fiscaly may be quite sound, but requires a fair length of time to make it effective. How do you get planning and policies, if some time is required to make them effective, under our democratic system of periodic, and sometimes frequent, elections?

Dr. Barber: I do not see as much conflict as you suggest. I think all parties have a very considerable interest in seeing that the economy will work well. I think they may sometimes have different values. One party may put more emphasis on the old age pensioner than another, but if we want to take a specific example, in my judgment, one reason why the Conservative administration eventually lost office was that the unemployment rate was too high for too long. In other words, people do not have views on whether one policy is better. The average citizen does not know whether a free exchange rate or a fixed rate is best for Canada, but he can judge if the unemployment rate is too high, or other day-to-day things are difficult. I do not think there is that much difference in the kinds of policies that benefit the Canadian people, on that different parties have that much difference in interest. I think there is an interest in all parties in getting a better economic effort all around.

Senator Laird: As you are well aware, the Opposition is suggesting a lowering of taxation as a means of promoting more employment. For the moment, at least, there is variance with the existing Government and, since we have mentioned taxation what part, in your opinion, does it play in this problem of inflation and unemployment?

Dr. Barber: Are you talking about the general fiscal effects or monetary effects of taxation, or of specific tax devices?

Senator Laird: I am talking about specific tax devices such as the lowering of the corporate rate of tax, and the lowering of personal income tax. In your opinion, Dr. Barber, what effect would that have on first, employment, and, secondly, inflation.

Dr. Barber: I have been out of the country for nine months, so I would hesitate to offer an opinion on what particular policies would best move the country back to 4 per cent unemployment. and at the same time minimize inflationary effects. Thax changes can have enormous effects, though. I think one reason that the whole North American economy has been as prosperous as it has over the past decade was that the Kennedy administration first proposed, and the Johnson administration carried through, a major tax cut when the government was running a substantial deficit and there was quite a heavy unemployment. That had the effect of moving the whole economy back to a higher level of operation. Having got back to the lower tax rate, the yields were so much higher that they ended up, in the long run, with lower deficits.

I think tax changes have enormous potential, but I cannot at this point suggest anything specific.

Senator Laird: I am not asking you to. You have made the general statement, and that is what I was interested in.

Senator Benidickson: Dr. Barber mentioned the effect of the fiscal policy of President Kennedy, which was followed up by President Johnson. Yesterday, more than once, Dr. Johnson indicated that fiscal policy in the United States at the moment was predicated on the short-term and, particularly, the re-election of the current president. In a democratic country, is that not an inferential thing, and does it not upset the best of plans and the best of policies?

Dr. Barber: I would agree that under the American system of government fiscal policy is harder to use effectively, and this is partially because they have an election

every two years, and also that the President cannot count on getting his policies implemented. Congress may debate them endlessly at times. One reason inflation became fairly widespread in the United States was because Congress refused to pass the tax increase which the Council of Economic Advisors and the President recommended.

I do not think we face quite that kind of problem in Canada. I think that fiscal policy can be used more promptly and more effectively here, partly because we have the Cabinet system of government, parliamentary democracy, as opposed to the divided powers they have in the United States system.

Senator Hays: One of the questions I wanted to ask is in connection with interest rates. For many years in Canada we had a pegged interest rate insofar as banks were concerned. Around 1966, or the fall of 1965, it was allowed to float. Do you see any merit in the pegging of interest rates? It is something we know something about and it has been done before. Does this control inflation, or does it not?

Dr. Barber: I am not quite sure what you are referring to.

Senator Benidickson: The change in the Bank Act.

Dr. Barber: There was a ceiling in the interest rate the banks could charge at one time.

Senator Hays: Yes; 6 per cent.

Dr. Barber: I think that ceiling worked because the whole rate pattern in that period was lower. I think it would have broken down anyway in the sort of move to the higher interest rate level. Monetary policy and interest rate is a pretty complicated kind of issue and I don't really see much scope for trying to peg rates. I think that it immediately gives a competitive advantage to other financial institutions if you peg it in certain areas, and it is pretty difficult in Canada, living so close to the large U.S. capital market, to try and insulate our market from theirs.

I think a free rate gives us a little more scope in monetary policy and, through the traditional monetary weapons, to bring interest rates down. I have some special views on monetary policy, but they are fairly technical and I do not think it would be useful to pursue them.

Senator McLean: The pressure was from the banks to lift that control at that time because they were losing business to the other financial institutions.

Dr. Barber: They argued that it would produce lower interest rates.

Senator Hays: That is right.

Senator Beaubien: It did not quite work out.

Senator Hays: They were pegged after the depression and we lived with them for 25 or 30 years.

Senator Beaubien: We had ways of getting around it.

Senator Hays: We had two rates, and we still do—one for those that do not need the money, and a high rate for those who do.

Senator Beaubien: Dr. Barber, in the United States the President picks the Secretary of the Treasury, and he picks a man he thinks is a pretty good businessman to run the finances of the country. In our system the Prime Minister has to pick somebody who has been elected, and it could be, I suppose, that there would not be any man there who would be qualified. Would you like to discuss the two systems, and do you have any suggestions to make?

Dr. Barber: I really feel this is the kind of question that a political scientist should be dealing with. I am an economist. I am not really sure that without any expertise I am qualified to answer that kind of a question.

Senator Michaud: My question is more related to the local situation in the Maritimes. You made the statement a while ago that moving the population from a depressed area was not necessarily the best solution. The particular riding I am interested in is that of Kent. Traditionally it is a rural and farming community. In 1941 there were roughly 320,000 acres of what they call total area of census farm land. In 1971 I think we can expect that it would be down two-thirds, to 100,000; this is a loss of 200,000 acres. In 1931 the census population was 18,000. Presently they are making a special study of the economic situation in that particular area through the establishment of a New Start project and their aim is to further reduce the population to 15,000. In other words, we are completely disregarding the agricultural aspect of the situation as it exists there, and the farm as an enterprise is going to disappear completely.

I was just wondering whether that is a rational way to look at the particular problem? In the meantime, I might add, there is no industry of any sort outside of those primary resource industries of farming, lumbering and fishing.

Dr. Barber: As you know, senator, agriculture, in particular, all over the world, has been subject to strong competitive pressures and the impact, as much as anything else, of new farm technology which enables one person to do a lot more work than any number did when I was a boy growing up on the farm. If you compare a self-propelled combine with the kind of outfit that ran a steam thesher in the early 1900s, you know there has been a very great revolution. I do not know enough about your riding to know what kind of potential it has. The point I was making about moving people I would not apply to a very small area. I was saying it may not be the best thing for the Atlantic provinces as a whole to try and move large numbers out. I think within the Atlantic provinces you have to pick the areas that have the most potential for growth and develop them. I think people will move fairly readily short distances within the area with which they are familiar.

It is apparently true that the people in the United States are much more willing to move than Canadians. Some end up working 40 miles from their home, and

commuting every day. Canadians, I am told by industry people, are a little more reluctant to move and I think this is one of our problems.

Senator Michaud: I realize that the population we had in rural areas cannot remain as such. That has to be reduced in the face of modern technology. The point I was mostly concerned about is while we admit the rural population must diminish, must we also admit that the area of the arable lands must diminish when we consider that it is our main source of potential productivity?

Dr. Barber: I do not quite know what is happening there.

Senator Michaud: It is disappearing altogether. It will be totally wiped out.

Dr. Barber: Is it going to urban use?

Senator Michaud: Wilderness.

Dr. Barber: Apparently no one considers it is competitive at present time to use it in world markets. It is difficult to do anything about that.

I would like to make one further point about this movement of a large number of people off the farms. I think society has some obligation to ease that transition and I think that we have not paid enough attention to that in the past. We benefit from the improvement in technology that has made our agriculture more productive. In the process people, and sometimes older people, have had to leave the farms and find a job as best they can in the city. One of the recommendations in my royal commission report is that the Department of Agriculture ought to have a small unit to make it a continuing concern to try to ease the transition where technology makes it quite clear that people are going to have to leave small farms.

The Chairman: Dr. Barber, coming to another subject, those who argue against the idea of accepting a particular rate of inflation say that it would be dangerous if the government were to compensate those who cannot protect themselves against the inflation. Would it make sense for the government to take the attitude that whether or not there is going to be inflation, they are going to protect those who cannot protect themselves on the grounds that it would, first of all, be a protection to those who cannot protect themselves and, secondly, it would be a spur to the Government not to inflate the economy or allow the economy to inflate.

Dr. Barber: I realize this argument is often advanced, but I have never seen any one really try to support it with quantitive data. Supposing we did tie our pension plans to the Consumer Price Index, and some of our other welfare schemes particularly affecting the lower income groups?

The Chairman: Or our bonds.

Dr. Barber: The bond market, to some extent, adjusts itself.

The Chairman: That is right. We will leave it where you were.

Dr. Barber: If you think that is going to add additional inflationary impact, you could easily counter that somewhere else in your fiscal policy. I think that is a fairly weak argument and I do not think people who make it have thought it through or tried to support it quantitatively. I am not sure you can show it is all that an important inflationary influence.

Senator Beaubien: Dr. Barber, the revenues of the federal Government have gone from $6 billion in 1962 to $14 billion, and a great deal of that would be due to inflation. In a way, the Government has a tremendous interest in continued inflation, has it not?

Dr. Barber: Governments, I suppose, have different interests. One of their interests is to get re-elected. If people are too worried about inflation they may not be elected.

Senator Beaubien: That is a short-term objective. In the long term how can we ever meet our commitments if we did not have inflation? We over-spend and because the money goes down in value, we are able to meet our costs, and the Government has enough revenue to meet the costs that it is going to incur.

Dr. Barber: There is some evidence, with the kind of income tax structure we have, that a 5 per cent rise in money income because of prices may give you more than a 5 per cent increase in Government revenues, and perhaps less than 5 per cent increase in expenditures, generally. Perhaps, if we were compensating those hurt by inflation in the Canada Pension Plan, there would not be quite that differential.

Senator Beaubien: The Government would go bust right away.

Dr. Barber: No, I do not think so. Governments take a lot of ruining and countries do also. People are prepared to write them off much too lightly.

The Chairman: We were talking earlier of regional development. I wonder if it would be true to say that we have been carried away in our regional development by the myth that we have to develop secondary manufacturing industries across the country. Would we have been better to have tried to develop industries of a sort of exportable service nature that would employ more people?

One of the things that impresses me in looking at these figures is the fact that you find that there is an expenditure of thousands of dollars to employ eight or ten people and you wonder whether, in trying to develop a secondary manufacturing industry, we are not making a dreadful mistake.

Dr. Barber: I would agree that people who get involved in regional development problems often look too exclusively at secondary manufacturing.

I did a little work in Manitoba when the committee on Manitoba's economic future was working, and one of the

things that struck me is that in Manitoba one of the more important industries is really the financial services industry. You have head offices of several life insurance companies and a large mutual fund there, and maybe you ought to be thinking about supporting and developing that industry just as much as secondary manufacturing or any other. I think your point is well taken, that the service industries are rapidly growing from the standpoint of employment. I do not think that you should look exclusively at any particular area.

In my view, the only theoretical point in economic development is, if you are going to expand your base of support you either have to export additional goods and services or you have to produce services and goods you were formally importing. It always struck me as a little odd that organizations such as the committee on Manitoba's economic future, where they are worried about the future of the economy, should quite often go out and import a lot of expert services.

The Chairman: As a result of improved communications and computer techniques in Canada over the last few years we have seen a gradual drawing-in of the head office control of large corporations to Toronto, Montreal and, to a lesser extent, Vancouver.

Senator Nichol: Much less.

The Chairman: I suppose Toronto would very much lead the parade at the present time. This has been made possible by communications, and yet a rational look at it would indicate that the further improvement of communications indicates that the head offices of many companies could be in many different parts of Canada, and they could use communications to decentralize the country and, of course, they would take with them numerous services such as those of lawyers, accountants, and so forth. Senator Nichol says that I am dreaming and I probably am, but I wonder if you could dream along with me for a moment and give us your view on whether there is a policy direction there.

Dr. Barber: This is a rapidly developing and changing field. I do not really feel qualified. I think Professor Gillies would be much more expert in this field, and would be more able to advise you on that.

Senator Nichol: The reason I said you are dreaming, Mr. Chairman—and I didn't mean to be impolite—was that I was referring to the system that has been operating in Canada since 1867 and that and shows very little sign of modification. It may be in your grandchildren's time there will be something like that happening.

I wanted to get back to the two points that Dr. Barber made: one about the council, and the other about the need for putting more money into economic research. Over and over again on quite important problems about which we have asked our guests to comment during the last three weeks, the answer came quite honestly, "We wish we knew that or could study that" or, "This is being studied by Professor so and so as the University of such and such." In a quite disconnected way, some of these things are occasionally answered. To discuss fiscal and monetary policy as an instrument, when you do not know the structure, then to know where you are and how you should use such an instrument, if it were effective, seems to me so basic. How much work would have to be done before you could find such a mechanical system which would be workable in this country? I am thinking of the federal sphere alone; let us not complicate it by talking about the Constitution at this moment.

Dr. Barber: When I was at the University of Manitoba, with my tongue in my cheek I once suggested that we should replace the Governor of the Bank of Canada with a computer. I do not think that I could offer a real judgment. One of the points I made is that I think we are going to need a sustained research effort. It has to be a point of continuing concern over time, and that means that in the Government, itself there is going to have to be more depth in the research.

I made the point, I think, that the Department of Finance, considering the complete range of its responsibilities, has never had the depth of research. There are a lot of very able young people now taking economics in graduate schools and they will be getting training. For a period of time there was a shortage. I think within the last eight years there has been a considerable improvement. The Economic Council has not been with us very long, but in that time has turned out a lot of studies. We are making progress, but I think we still have a long way to go.

Senator Nichol: I proposed this as a layman, but I have become more confused the longer we carry on here. We have the Department of Finance here and we have the Bank of Canada here, both with groups of economists. The relation between the two is ill-defined. Here we have the Economic Council quite clearly defined, but with no mechanical connection whatsoever, to put it politely, between itself and the Department of Finance or the bank.

This seems to me to be a marvellous structure for economic argument, but it does not look very efficient. Is it a pretty good system, or do I misunderstand the system?

Dr. Barber: I must admit that I have not thought very much about the problem of the structure of research within the federal Government, so I am not sure that I can give you a good answer on that. I think for a long time there was just a real shortage of people. For quite a while the Public Service of Canada, in recruiting economists, tended to recruit too many at a junior level, and not get the very best who have gone on to graduate schools and have their PhD, many of whom often ended up by staying at the American universities where there were good research funds and an exciting intellectual atmosphere. We are just beginning to change. I think there will be a lot of opportunity in the years ahead because there are a great many young people just coming into the university and now in graduate schools who, in time, will be able to make a very considerable impact if their research is supported.

Senator Hays: In that context of whether they are doing a good job or not, may I ask you the question:

What country in the world has done a better job than Canada in the last 20 years?

Dr. Barber: If you want to look at objective criteria, it depends upon what your gidelines are.

Senator Hays: Let us say standard of living.

Dr. Barber: In terms of level of unemployment, we come pretty close to the top. We have, for some reason, accepted a much higher unemployment rate than most European countries. We have had a slower rate of price increase. Maybe this suggests that Canadians prefer it that way. I think, we are changing our views. We are not prepared to accept as much unemployment. Our growth has probably been slower than that of many of these countries but, on the other hand, you can argue that it is harder to grow rapidly when you are already almost at the head of the pack. These other countries come along and adopt the techniques that have been developed elsewhere and it is easier to grow rapidly there. I think Canada's growth record has been really quite creditable.

Senator Hays: What about exports and competitive position?

Dr. Barber: Well, you know, much is due to the fact that we have a lot of natural resources and this has generated a great deal of growth.

Coming back for a moment to Senator Nichol's question where he pointed to the people in all of these departments, it is my impression that for quite a long time many of these people were busy just coping with day to day problems, rather than having sufficient people to really look ahead and do research and explore some of the implications of where they were going.

Senator Nichol: Professor Scott and a lot of other people who have appeared before us support what you have said. We spent quite a lot of time asking about lags, and how much was known, when a certain policy at C.M.H.C. was adopted or the interest rate changed about what happens to the housing industry and to construction wages, and how long it takes to happen. Simiarly, in different industries there are different types of lags, inside and outside, and so on. The answer was that they did not know and had not done much work in that, and yet that is the key to the game, is it not?

Dr. Barber: I am told that when the Governor of the Bank of Canada and his staff were on the witness stand before the Carter Commission they were asked how much research was done on these questions, and they admitted that they really did not do that kind of work, and they had spent more of their time in improving the information available and having a good set of data to know where the economy was and where it was going, but it is only since then that they have begun to do some research.

Senator Benidickson: That was in 1964?

Dr. Barber: I think the hearings were somewhere about that time.

Senator Nichol: It takes quite a bit of courage to make a tariff change, a tax change, or an interest rate change, without any knowledge of what is going to happen when you do it. It is frightening.

Dr. Barber: Perhaps we are courageous people.

Senator Nichol: Perhaps we are. We usually survive.

Dr. James Gillies, Study Director: Yesterday Dr. Johnson said there was no such thing as cost-push inflation. What do you think of that?

Dr. Barber: Well, I would like to see his evidence. I would like to hear him explain why wage rates have been going up faster in Canada than in the United States for the last five years, even though our unemployment rate has been higher. I really think that because of strong demand pressure in a certain period you get some large wage settlements that open up wage differentials between different groups. You then create a lot of dissatisfaction. You get pressures to catch up. That is a kind of wage push and it may continue a long time after the demand that initially started it has stopped. In relation to that, I think one of our problems in Canada, perhaps, is that because we are a supplier of basic materials to the North American economy, our economy is subject to pretty wide swings, and you see this particularly in the construction industry and business capital spending. I think we have to work out some method of moderating those swings.

I think I cited in my paper some statistics on the percentage increase in business capital spending as a percentage of your national product. I was just checking what happened in 1965-66. Between the first quarter of 1965 and the last quarter of 1966, which is about 18 months, business capital spending in Canada for plant and equipment increased one-third. This is in real terms, constant prices. That is a very large sudden increase in a short period of time and that is the period, also, in which the whole pattern of wage settlement suddenly moved up to a higher level and it has sort of continued with fluctuations since then.

Senator Hays: That is when we took the bank interest rate off.

Dr. Gillies: Do you think that the Bank of Canada should buy the bonds, debentures and so on of the provinces so that they could effectuate their fiscal policies and also know that they have a buyer of last resort for their debt instruments?

Dr. Barber: I discussed this question to some extent in this monograph I wrote on the theory of fiscal policy, and I took the view that the borrowing position of the Province of Ontario and Province of Alberta is really not that much different from the position of the Dominion of Canada, in the sense that if the Bank of Canada is pursuing easier money policies, generally, it benefits both equally.

I do not think that particular proposal has a great deal of merit. It may be that the Government, as a whole, might want to have a policy of supporting the borrowing of provinces that are subject to unusually high rates of

unemployment and I see nothing wrong with that, but I think that is a decision that has to be made by the government as a general policy, and that should not come within the scope of the Bank of Canada in its day-to-day management or year-to-year management of monetary policy.

The Chairman: You mentioned, at the start of your brief, Okun's Law. We will have Arthur Okun here to expand on his law. Do you know whether it is applicable to Canada?

Dr. Barber: After preparing this brief, I was reading one of the Economic Council's reports and they make a somewhat similar estimate on using conservative approaches, and arrive at a lower figure. I think it is something in the range of $3 billion or more. I think the law applies. It is a question of fact, how large the amount is.

The Chairman: That means that the ratio is different?

Dr. Barber: The ratio might very well be different in Canada.

The Chairman: I mean in order to arrive at the figure of $3 billion.

Dr. Barber: They did not explain how they did it. They just said that using "rather conservative methods" they had arrived at this estimate.

The Chairman: What figure did you arrive at?

Dr. Barber: I arrived at $5 billion, applying Okun's law. Canada is regionally spread out and whether it would work out the same way here is debatable, but undoubtedly the same kinds of considerations are operating.

Senator Nichol: Dr. Barber, when Dr. Young was before us we were talking about the scale of mechanics of things which lie within the phraseology of prices and incomes policy, all the way from the more modest and quite types of discussion through the things which the Prices and Incomes Commission has been doing here, all the way down through to full-time price and wage control, which hides under many different names. You have to struggle pretty hard sometimes to find out exactly what some of them mean.

How do you feel about the possibility of selective controls? You have mentioned the tax in here. How do you feel about it and the theory that once you get into the business of enforcing price and wage controls, the system escalates until you arrive at a complete system, and how does it apply to the problem we have right now?

Dr. Barber: An eminent British economist has argued that it is really probably easier to prevent inflation getting under way initially, than it is to deal with it after it is under way and has acquired some momentum.

Senator Nichol: Where are we now?

Dr. Barber: I think we have built up some momentum—we had certainly by the end of 1969 or early 1970. I am not familiar enough to know. The unemployment rate has risen rapidly. We have had some special factors bringing down the price increase. We had one of the lowest price increases in 1970 of any major country. It was under 2 per cent on a 12-month basis. Whether the wage settlements have begun to moderate or not, I do not know. The Bank of Canada in its report in February could not see much evidence of it.

When you bring in these sorts of wage and price controls the question is: How much of a problem is this wage differential problem? How much of what is going on is simply the fact that you have developed a pattern of wage differentials in respect to which some labour groups regard their position as quite unacceptable relative to other groups? If this is the problem then I think you have to look at that directly and see if you can work out some method at arriving at an acceptable pattern. I do not think that sort of selective wage and price controls is the answer to that kind of problem.

Senator Nichol: It has been widely suggested by different groups on different platforms all over the country.

Dr. Barber: I think what you have to ask when you introduce them is where does it get you aside from the effect over a short period of time. If the problem is that certain groups regard their wage level unacceptable relative to other groups, you can freeze that for a while. Once you take the freeze off you are back to where you were.

I read a report on the British experience which cited a group that for ten or 15 years had been feeling that their position had been depressed and as soon as they got a chance they made an effort to get back to what they regarded as their rightful place.

The Chairman: Following that for a moment, if the productive sectors of the economy are entitled to a wage raise, and if the demand in the unproductive sectors of the economy cause wage earners in those sectors, because of this relativity, to demand the same wage rates, does that mean that inflation of wages is inevitable or that there will always be an inflationary element in the total wage bill?

Dr. Barber: The wage and price guidelines set forth originally in a report of the Council of Economic Advisors in the United States said all industries ought to pay a wage increase which was at the level of productivity generally. In other words, if productivity is going up on the average of 3 per cent per year, then everyone gets a 3 per cent wage increase. If one industry does not have any productivity gain, that means it has to put its price up because it does not have any productivity gain to offset that 3 per cent wage increase.

They argue that others that may have 6 per cent productivity gain should also pay the 3 per cent wage increase and their prices ought to come down. It never works out quite that well, but the theory is clear enough.

Senator Molson: You put one out of business and give the other...

Dr. Barber: No, this treats everyone fairly. The hairdresser whose productivity does not change—the prices of these things go up, and perhaps the prices of television sets come down. In a rough sort of way, this does work out for relative prices. The prices of some of our durable consumer goods have been, up until recently, the most stable in the whole economy.

Senator Beaubien: If your price is limited by world price, what do you do? You cannot put it up because your wages go up?

Dr. Barber: I think that this question of how the world price imposes itself on your country is different to some degree whether you have a fixed or flexible rate. In theory, a flexible rate can adjust to moderate the impact of prices and wages from outside. If workers here judge what they want partially on the basis of what workers are getting in other countries, then there is an expectation element that comes in which is quite apart from the price of the imports and exports as such.

Senator Molson: What do you do if the productivity of one part of an industry increases 5 per cent, and the average increase is 3 per cent, and the people involved ask for their share of the increase? That is what I meant when I say some businesses disappear and others get more business.

Dr. Barber: These are guidelines and, in practice, some firms do go out of business if they cannot pay competitive wage rates.

The Chairman: I do not know if you answered my question. I think you got to the point where you said that the theory was perfect.

Dr. Barber: Perhaps you would repeat it. I have lost track of it.

The Chairman: It seems to me that industries which are highly productive will probably have wage increases relative to that productivity, but demand does not always follow productivity and there may be greater demand for those industries that are not increasing their productivity.

As a result of the relative effect of wages, those in less productive industries or industries which are not increasing their productivity, because of the demand for those services or goods, will ask for the same increase in wages. *A fortiori,* you must, it seems to me, have an inflation in wages; there must always be, unless the economy is severely depressed, an inflationary element in wages. You answered by saying the theory is that the productive industry will take less.

Dr. Barber: You are right. I think there is a bias because it works, to some degree, both ways. I think that industries that generate high productivity growth find it easier to pay wage increases and the workers demand and get larger wage increases there. It is also true to some degree that industries with no productivity growth or low productivity growth will likely resist wage increases more, and may in practice pay somewhat less, but I think that, on the average, there is likely to be something of a bias towards inflation. My general view is that we simply try to keep our price increase down to within somewhat reasonable limits, 3 per cent or less, and try to prevent it from accelerating, if there is any evidence that it is going to accelerate.

The Chairman: It was interesting to me to hear that even John Young accepts a 2 per cent inflationary level annually.

Senator Langlois: Dr. Barber, following what you have just said regarding the influence of wage increases on the economy, am I right in assuming that we have been hurt, not so much by the wage increases, but by wage increases coupled with loss in productivity, resulting from wage increases coupled with an excessive demand for shorter hours, or as we have experienced, for example, in the shipping industry, wage increases for cargo handling coupled with demands for larger work gangs and less sling loads, even though the gangs were not even called to touch the cargo due to mechanization? Is that not really the source of the problem?

Dr. Barber: I think that kind of problem has been with us for a long time. I think the hand loom weavers did not like it when they brought in power looms several hundred years ago, and I think that this kind of problem, where a union proposes what is sometimes called featherbedding—you maintain the demand for labour at a higher level than needed—is likely to be much stronger in a society where the unemployment rate is high. If you can keep unemployment down to minimum levels, and the workers see that they can get a job elsewhere, they may accept changes that improve productivity. I think our productivity record has been fairly respectable over the past 20 years and it is my impression, having lived for six months in the United Kingdom, those attitudes are not nearly as prevalent on this continent as in England.

Senator Langlois: Would you say we have had an increase in these unreasonable demands in Canada in recent years?

Dr. Barber: I do not know. I would guess that as the unemployment rate rises there is more concern about the effect that a technological change is going to have on the jobs, and if they are worried about whether they are going to be able to get a job you are more likely to get these kinds of demands.

The Chairman: On that subject, if I read Mr. Kierans correctly, and also Dr. Reuber . . .

Senator Langlois: Is it possible?

The Chairman: . . . they both expressed a concern about tax subsidies being directed towards capital intensive industries, and stated that these subsidies should not be employed, and if there were to be subsidies they should be directed toward labour intensive industries.

One economist who came here—and I cannot recall who it was but the committee may be able to recall—said that this, after all, was what . . .

Senator Nichol: I have it here. It is on May 4.

The Chairman: I will let you ask the question then, senator.

Senator Nichol: The conversation the Chairman is refering to is one which took place between Senator Lamontagne and Sir Roy Harrod, in which Sir Roy Harrod came awfully close to calling Senator Lamontagne a Luddite. What he actually said was, "I am not a Luddite myself!"

Is that the exchange you were speaking of, Mr. Chairman?

The Chairman: I think so. There was another exchange involving Doulgas Gibson, who followed up that point. I may not be quoting him correctly, but he said that after all that is what we were attempting to do, "to improve the productivity of man and to take steps to reduce the cap tal intensification of our industry". Really, it was to go against the whole stream.

Dr. Barber: Well, I think the issue is where you are trying to develop certain areas as part of your regional policy. This is where this has come in, has it not? I think there has been a change of emphasis within the Government. I think initially some of the attempts to promote employment in what were regarded as high unemployment areas took the form of capital subsidies. There were also tax incentives. For example, when Massey-Ferguson built its combine plant at Brantford there was some kind of incentive scheme. My understanding is that the Department of Regional and Economic Expansion have a different formula which is more oriented to the amount of employment created in an area.

Really, it comes down to what your objectives. are. I agree with Douglas Gibson that overall in the economy we do not want to try to promote low productivity. But, if you really are concerned about providing jobs in an area where the unemployment rate is high, and these people otherwise are not doing anything, then the employment becomes a matter of concern in these policies. The alternative may just be that the labour is not employed, if it does not move readily out of the area.

Senator Manning: Mr. Chairman, is not this theory that the resources industries or low-employment industries can be divorced in matters of this kind from the high-employment industries which are the service industries? Is not the fallacy that in most cases these two things are inseparably related or lined together? You do not get the one without the other.

I think particularly of the situation in the petroleum industry. So far as resource development is concerned, that is not a large employer of labour, but it generates a fantastic number of service industries, and these are very large employers of labour. But for anyone to talk about having the service industries, and not direct his attention to what is needful in order to develop the resources industries is ridiculous, because if one declines the other declines in proportion. If the resource industry goes down 1 per cent so far as employment is concerned, then the service industry attached to it probably goes down 10 per cent.

The Chairman: Senator, you talk of the primary industries and of the service industries. What about the secondary industries?

Senator Manning: There again many of the secondary industries have a very close relationship with the primary industries because they are the sources of raw products. My whole point is that I do not see how you can divorce the one from the other by just putting them into compartments and saying that the service industry should be stimulated without paying attention to either the primary or the resource industry.

I do not know whether you agree with that, doctor.

Dr. Barber: I would certainly agree that there is often this complementarity. Several years ago when I was looking at rates of growth of non-farm employment it was quite clear that Alberta had had the most rapid growth of any country in Canada, and I do not think that that is generally recognized, because people look at the total employment growth and the farm-agricultural part of Alberta has been losing labour.

Senator Manning: We have never quite regarded ourselves as a country.

Dr. Barber: I am sorry, did I say "country"?

Senator Nichol: He was only being complimentary.

The Chairman: Did you wish to continue?

Dr. Barber: No. I would just agree that there are often these large complementary territories. I was making the point earlier that people who get concerned about development in an area may look too exclusively at certain kinds of industry. They should canvass the whole range and really try to assess where the potential strength is. Sometimes, as you say, the development of natural resources may generate a whole complementary range of industry.

Senator Nichol: Yesterday morning we had Messrs. Acheson and Chant from Queen's who gave a very long paper. In essence they criticized the Bank of Canada on the secrecy of its techniques and the ambiguity of its goals. Would you like to comment on that? Have you seen the report in the newspaper on what they said?

Dr. Barber: I did not see that particular piece in the paper.

Senator Nichol: Then I will withdraw my question. It would be unfair to ask you to comment on something that you have not seen.

Dr. Barber: There is fairly popular support for criticism of central banks.

The Chairman: Does the question relate to your concepts of changes in the monetary policy that you mentioned earlier?

Dr. Barber: My feeling would be that people sometimes expect too much of monetary policies. The lags are fairly long. I agree to some extent with the views expressed by Douglas Gibson, whose testimony I read, that you have to think well ahead when implementing a monetary policy.

On the side of secrecy generally there should be more vehicles whereby the research that goes on inside the Government could be published in a form available to outsiders. There is this gap. University economists publish their research findings and exchange them. There is quite a lot of research—not enough, but an increasing amount—going on inside Government.

There may be legitimate argument that more of that should see the light of day. There should be some kind of journal in which it could be published. There are quite a few articles in the United States written by members of government organizations, who publish their views based on their own research. We need more public discussion of these issues. We need some kind of a journal on current economic policy which would provide a better vehicle for publication of these views.

The Chairman: Honourable senators, if there are no further questions I would like, on your behalf, to thank Dr. Barber. I know what a sacrifice he has made in coming here. He has just returned from nine months overseas, and has just published a massive document on the subject of agricultural machinery. Despite this, he has been able to come here and give us a very outstanding presentation. For that, Dr. Barber, I thank you.

The committee adjourned.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 14

TUESDAY, JUNE 1, 1971

Eleventh Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses:—See Minutes of Proceedings and appendix)

23879—1

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
	O'Leary
	Paterson
Gélinas	Phillips
Grosart	Sparrow
Hays	Walker—27.
Isnor	

(Quorum 7)

**Ex officio Member*

Orders of Reference

Extract from the Minutes of the Proceedings of the Senate, of Tuesday, March 9th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said *Estimates* reaching the Senate.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Tuesday, May 4, 1971:

"With leave of the Senate
The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relation thereto.

The question being put on the motion it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

23879—1½

Minutes of Proceedings

Tuesday June 1, 1971.
(14)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 4.00 p.m. to consider the Question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Bourque, Croll, Grosart, Isnor, Laird and Molson. (8)

Also present but not of the Committee: The Honourable Senators Haig, Inman, Kickham, Kinnear, Rattenbury and Smith. (6)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

It was *Agreed* to print as an appendix to these proceedings a letter from Dr. John Crispo, Director, Centre for Industrial Relations, University of Toronto, addressed to the Chairman, relating to his evidence given before this Committee on May 12, 1971.

Witness heard:

Mr. Russell Bell,
Research Director,
Canadian Labour Congress.

At 6.20 p.m. the Committee adjourned to Wednesday, June 2, 1971, at 10.00 a.m.

ATTEST:

Gerard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Tuesday, June 1, 1971

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 4.00 p.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, first may I say that I have received a letter from Dr. John Crispo who was a witness before this committee. He asks if we would place on record some additional information which relates to the testimony he gave here. With your permission, I will table this letter and ask that it be printed as an appendix to today's proceedings. Is it agreed?

Hon. Senators: Agreed.

(See Appendix p. 14 : 22)

The Chairman: Honourable senators, we are fortunate to have with us today Mr. Russell Bell, who is Research Director of the Canadian Labour Congress. Mr. Bell received his M.A. in political economy from the University of Toronto. He was research director of the Co-operative Commonwealth Federation (CCF) Party from 1953 to 1958. He was associate research director of the Canadian Labour Congress from 1958 to 1964. He was with the Economic Council of Canada in 1964, under the chairmanship of Mr. John Deutsch. In 1969 he was appointed research director of the Canadian Labour Congress.

It is important for this committee to hear the views of organized labour during its hearings. Therefore, it is a real honour to welcome one of the very fine minds in the field of economics, whose discipline tends very much towards the labour side. Having introduced Mr. Russell Bell, I now ask him to give a short summation of his brief.

Mr. Russell Bell, Research Director, Canadian Labour Congress: Thank you very much, Mr. Chairman.

Honourable senators, first of all, I would like to compliment the committee on having launched what I consider to be an extremely important inquiry into economic matters of the highest importance to this country. I say this particularly in view of the fact that we have had in this country now for the past several years some very bad economic policies which have led to disastrous consequences. I say that, not for the purpose of implying guilt regarding anyone in particular, but I think it is important to bear in mind that, unfortunately, we have adopted policies that have led to severe unemployment, severe economic and social costs for the purpose of combatting inflation, when those policies have had only a minimal influence in bringing about a reduction in the rate of price increases. Therefore, it is extremely important that there be committees such as this for the purpose of looking into these policies.

As I have indicated in my short brief, it is my hope that this will become a permanent institution, in the sense that it will conduct periodic reviews, as is done by comparable institutions in other countries.

In my brief, I concentrate to a very large extent on incomes policies, from the point of view of examining these policies as possible complementary tools to conventional economic stabilization policies.

While I was invited here in an individual capacity, it is natural that, because of my association with the Canadian Labour Congress, my remarks will be cast in the mould of the kind of background experience I have had with the Canadian Labour Congress in discussing these particular policies with the Prices and Incomes Commission.

Honourable senators, as you are undoubtedly well aware, we have rejected outright the kind of incomes policy that has been espoused by the Prices and Incomes Commission. As you will recall, the Prices and Incomes Commission attempted, at the very time it was set up, to get agreement among the various parties on a so-called voluntary restraint program. This became more specifically defined later on as a 6 per cent wage and salary guidelines program. We rejected this out of hand, for a number of reasons.

First of all, the commission itself had never undertaken to do any inquiry into why price inflation had taken place. Briefly I would like to read the terms of reference which were set out for this commission, which I think everyone will regard as the mandate that the commission was to carry out—which it did not carry out.

I am going to quote verbatim from the terms of reference set out in the Government White Paper entitled "Policies for Price Stability", which was issued in December, 1968. Under those terms of reference the commission was

charged with the responsibility for conducting studies of price and income developments in Canada and for producing regular reports on its findings.

The purpose of the commission will be to discover the facts, analyze the causes, processes and consequences of inflation and to inform both the public and the Government on how price stability may be achieved.

The body with which I am associated—I want to emphasize this fact—expressed the view that there was a definite need for a full inquiry into the underlying causes of escalating prices.

The Canadian Labour Congress emphatically expressed this point at the very time the Prices and Incomes commission was set up. It was our belief that research into inflationary causes—undertaken by an independent body of experts whose impartiality and objectivity could not be challenged, and with the right to give the widest possible publicity to its findings—could make a significant contribution to the public's understanding of inflation.

Certainly according to our understanding, this body was not set up as a royal commission. A royal commission has a temporary period of tenure for the purpose of inquiry into a specific problem. Once that problem has been inquired into and the recommendations have been made by that royal commission, that body naturally folds up. This was not to be the case with the Prices and Incomes Commission.

The Prices and Incomes Commission was to be a continuing body, to keep its eye at all times on price, cost, income and productivity movements in the Canadian economy. Unfortunately, the commission was no sooner set up than it turned itself into an operational body.

Before having undertaken the necessary inquiry into ascertaining why prices had escalated, it jumped to "solutions"—and I say solutions in quotation marks. Consequently, it had no information on the problem to communicate to the parties concerned; yet, at the same time, it attempted to involve those parties in the so-called "operational solution." In other words, it was a quick, facile gimmick for the purpose of attempting to bring off something dramatic which even it must have known it could not have achieved.

I would make one other point, too, which undoubtedly has been made before your committee by other witnesses. The commission ignored the thorough work that has been undertaken by the Economic Council of Canada, which in considerable detail has gone into the reasons why an incomes policy in a country like Canada is unfeasible. Moreover, an incomes policy has been proved to be generally unworkable in other countries. This point has been well documented in other studies. Bear in mind that an incomes policy is more feasible for countries that are much more homogeneous than Canada. We have all kinds of obstacles in Canada which do not obtain in other countries. But even where obstacles in other countries have been less than those in Canada, an incomes policy has not proved to be successful in terms of having any significant effect in reducing the rate of over-all price increases.

Senator Croll: Where has an incomes policy been tried, Mr. Bell?

Mr. Bell: It has been tried in the United Kingdom, Senator Croll. As a matter of fact, in that connection, the Prices and Incomes Board folded up just a few months ago because it was completely unable to bring off any kind of effective guideline. An incomes policy has also been tried in the Netherlands and in Sweden.

Senator Croll: Please, do not say "Japan". Anyway, it was not really tried in the United Kingdom; they passed the act and then they walked away from it.

Mr. Bell: Oh, but it was tried in the United Kingdom. I am sorry to differ from you, but I must point out that it was tried in the United Kingdom and failed. It definitely failed even though it was tried over a considerable period of time.

The Chairman: I think, Senator Croll, that there was a freeze and, if I recall correctly, an attempt to enforce that freeze by virtue of the incomes policy.

Senator Grosart: On that point, Mr. Chairman, I wonder if Mr. Bell has made a study of the three classic cases in recent times: Britain, Sweden and the Netherlands.

Mr. Bell: This was very clearly documented in Professor David C. Smith's study for the Economic Council of Canada in connection with the reference from the Government to that council. The result of that reference was, of course, the Third Annual Review which went into considerable detail.

On that particular point I should like to refer to what Professor Smith had to say. I will not read all that I have quoted in my submission; I will just pick out the cardinal points.

Senator Grosart: Perhaps you could just summarize it. There are five main points made in that reference, are there not—publicity, discrimination, rigidity, group pressures and inequities? Is that not correct?

Mr. Bell: Yes, that is right. The important point that is made here is this:

> Some argue, for example, that a more fundamental set of policies to deal with the recurrent British balance-of-payments problem would have been adopted sooner if the hope of large effects from an incomes policy, based largely on moral suasion, had not been continually encouraged in the past. It has been argued in the case of the Netherlands that stronger deflationary measures would have been easier to introduce following the out-break of serious inflationary pressures in 1963 if there had not been a belief that incomes policy would make these measures unnecessary...

I continue the quote:

> Second, a period of restraint that has some effect in the short run has frequently been followed by a

wage and price explosion. This was the case in the Netherlands after 1963, in Sweden in the early 1950s and in the United Kingdom following the 1948-50 period of restraint. Thus, the pressures are often only stored up to be released at a later time.

We will talk about the longer period of time in a moment, but the big disadvantage of applying an incomes policy over a relatively short period of time—that is, over a year or 18 months—is that it has the danger of eventually causing a wage and price explosion because people adopt the mentality, whether you like it or not, that they have to catch up for what they have lost during the time that policy was in effect.

Senator Croll: Just to clarify that particular point, Mr. Chairman, can Mr. Bell tell us whether the circumstances in those countries he mentioned were similar to the circumstances in our country, namely, over-production rather than seeking for goods? I think it is a different story. Are we talking about the same set of circumstances in those countries?

Mr. Bell: No, we are not talking about the same set of circumstances. My point was that being smaller countries, they are in so many respects so much more homogeneous than Canada. Having more homogeneous labour markets, being more centralized in their institutions, therefore, an incomes policy would be more likely to succeed in those countries than it would in a country like ours, where we are highly decentralized so far as collective bargaining institutions, political institutions and business institutions are concerned.

The major reason—it is not the only reason but it is the major reason—why we rejected an incomes policy is that it is inherently inequitable. It is inherently inequitable because not all forms of income can be made to comply with the guidelines or guide posts, or whatever you wish to call them. In our discussions with the Prices and Incomes Commission we never received any convincing evidence that non-wage forms of income—namely, salaries, profits, rents, interests, professional fees, unincorporated business income, and so on—could or would effectively comply with any voluntary restraint policy.

I say that this is hardly surprising because it is simply impossible for anyone to give any such guarantee. The administrative and political complexities involved in securing a restraint on many forms of non-wage income make an income policy absolutely and utterly impractical. Therefore, speaking from a trade union point of view, I say in as emphatic terms as I can that no trade union leader could guarantee those whom he represents that these non-wage forms of income could effectively be brought under restraint. No trade union leader could guarantee that under such a policy there would not be a diversion of labour income into other forms of income. No trade union leader could ever give any assurance to his constituents that voluntary sacrifices made by them would be at all equitably shared by other forms of income. It is just not possible. An incomes policy simply cannot be made equitable, even with the best of intentions on the part of those who sponsor it.

Coming now to the 6 per cent wage and salary guidelines—which were proclaimed a year ago today, if I recall correctly—these were so patently inequitable that virtually nobody took them seriously. Why were they inequitable? They were inequitable because a 6 per cent ceiling applied to a $6,000 income, as against an income, of, for example, $30,000, makes for two very different things.

There seems now to be general agreement—and even the Chairman of the Prices and Incomes Commission indicated this to your committee when he appeared before you—that a voluntary restraint program cannot work, and I say that is the present stage in this game of madness on the part of some who advocate mandatory controls of a selective nature. I think this is the ultimate inequity. This would mean that certain economic elements would be singled out and would be required by law to make sacrifices on behalf of the rest of the country. This is so preposterously discriminatory as to boggle the mind. I think our society has enough internal stresses and strains, without the need for sitting up all hours of the night inventing new ones.

To sum up, I think that income policies, whatever their shape and form, whether voluntary or of a mandatory nature, simply will not work because they are so transparently unjust to the vast majority of people. I think there might be one exception, as I have indicated in my brief, an that would be under circumstances of a national emergency such as war. But apart from the gross inequities of such policies, they have other major disadvantages which have been cited in the quotes in my brief. For example, if applied over a long period, they would result in major distortions in market forces, yielding nothing but misallocation of resources, which would eventually seriously impede the attainment of important economic and social goals. If applied over the short-run, and I have made reference to this before, the likelihood is that such temporary restraint would be followed by a wage and prices explosion such as has happened elsewhere. Consequently, I do not think we can gain anything by the application of an incomes policy either over the short run or over a long-run period.

People want to know what are the alternatives to the general monetary and fiscal stabilization policies, if you rule out an incomes policy. I think that there are positive measures which should supplement general fiscal and monetary policies in promoting economic stabilization. These are specific supply policies which should be employed to deal with specific price and cost pressures which may arise in particular sectors of the economy and which are generally immune to demand-restraint policies. Better policies are needed for dealing with bottlenecks and product and service methods; that is to say, in improving the relationship of supply and demand in these important markets.

Likewise there is a definite need for more effective manpower and labour market policies to improve labour mobility, to improve facilities for training, retraining and upgrading of members of the labour force in line with changing technological conditions, as well as an improved

capacity on the part of manpower authorities to anticipate bottlenecks in labour markets. These supply and other complementary policies have been described in considerable detail, in about 28 pages, by the Economic Council in its Third Annual Review, and it is my impression that these policies have not been given sufficient attention by Government. As a matter of fact, I do not think they have been given sufficient attention by your committee to date.

However, one has to be honest and admit that reconciling the goals of full employment and reasonable price stability is difficult, and that the achievement of these goals simultaneously has eluded virtually all industrialized countries. I think the great tragedy is that Canadian authorities have attempted to deal with inflationary pressures as if Canada were an isolated country with a closed economy and immune from the external inflationary forces which are so widespread. The result, as everybody well knows, is that the anti-inflationary policies have had relatively little influence in checking inflation but have had tremendous economic and social costs. These policies have been responsible for creating economic slack, for hundreds of thousands of unemployed Canadians, for mounting welfare costs to municipalites, for billions of dollars lost in unproduced goods and services, and for hundreds of millions of dollars lost to governments in tax revenues. While the rate of price increases has been slightly reduced over the past year, even this comparatively small reduction may be more the result of our floating exchange rate, which went into effect a year ago, than of the tight fiscal and monetary policies which were used to combat inflation.

It is my view that we should rid ourselves of this obsession with fighting external inflationary forces which are clearly beyond the control of our domestic policies. We should have expansionary policies which are geared to the longer term potential growth rate of the economy, and turn our backs forever on erratic "stop and go" policies which invariably are implemented in this country. We should ensure that the principal sufferers of inflation are protected by cost-of-living adjustments. These adjustments could be financed from the higher tax revenues which automatically flow to governments when the economy is operating at or close to potential.

This has been brief and inadequate, Mr. Chairman, but I have attempted to sum up some of the points which I thought should be brought to the attention of the committee.

The Chairman: I think it has been very useful to the committee, Mr. Bell. Now we are open to questions. Senator Croll.

Senator Croll: Mr. Bell, I share your view completely on controls, but not your reasons. Let us see if we can get into some of these. By the way, you are associated with the labour group. and the new political party that has been launched in Canada says that twenty Canadian super corporations and twelve strong unions control the economy of this country. How close are they to the truth?

Mr. Bell: I am sorry, I did not hear what you said.

Senator Croll: About twenty super corporations and about a dozen or so strong unions control the economy of this country. That is statement No. 1 of the new party.

Mr. Bell: I take it that you are referring to Action Canada?

Senator Croll: Yes, I am.

The Chairman: To set the record straight, if I read the ad correctly, I do not think it was designated as a new party.

Senator Croll: A movement. What have you to say on that, Mr. Bell? It is more than a mere surface statement.

Mr. Bell: I presume that the advertisement was inserted in all major newspapers across Canada. I have not read all those papers, but I have read a number of them. I think the advertisement was an attempt to create the impression that, to use their words, the giant corporate interests and super union czars were responsible for many of our economics ills.

This is a blatant falsehood; it is totally inaccurate. It may very well convince a number of people who are not at all familiar with the role of trade unions in this country, people to whom this movement is attempting to appeal, but those people are not at all the downtrodden people. If I recall the advertisement correctly, there was a reference to doctors, lawyers, dentists and others. I have nothing against such people, but they are not "the downtrodden people."

The average industrial wage in this country amounts to $6,200 or $6,300 per year. We do not know for sure what is the average industrial wage of union members, but hopefully it is higher than that.

The Chairman: I think Senator Croll was asking whether the statement of Action Canada, that the economy is controlled by a small number of very large unions and corporations, is correct.

Mr. Bell: No, it is absolutely incorrect. Certainly, it is absolutely incorrect in so far as labour unions are concerned, and I would say it is incorrect in so far as business organizations are concerned.

We could carry on this conversation for some period of time, but I say specifially that the people who are responsible for policies are government people. For example, they are responsible, for our stabilization policies. I have said consistently, time and time again, both privately and publicly, that the private parties do not create an inflationary situation, and that presumably is what we are talking about, because this is one of our economic problems. They respond to an inflationary situation, but they do not create it. It is physically impossible for any of the private parties to create an inflationary situation.

I do not want to give the impression, because it would be a grossly misleading one, that Government policies have been altogether responsible for our economic instabilities. We have to take into account external factors, which have been very strong, which have had a

pervasive effect on the Canadian economy. Canada has an open economy.

My criticism of Government economic policies focuses very largely on the fact that those policies are designed as though we were a closed economy and as though we were immune from external sources of inflation. We are not. This has been brought out very well by others who have appeared before the committee, so perhaps I am repeating ad nauseum what you have already heard.

Senator Croll: The second statement that concerns me is that dealing with controls. The distinction was made between wartime controls, controls in the days of scarcity, and controls imposed today. We tried controls in those days and they had some effect. In some respects they were not too bad, but they were not successful. These days we are not dealing with scarcity. We are dealing with something entirely new, something else. In that light the same groups say that controls may be very effective, useful, and in fact, essential.

To differentiate between the need for controls under one set of circumstances and another, you did say that in an emergency you could see merit in having controls, and I agree. What is there to the argument that controls today are for a different purpose than they were in days gone by?

Mr. Bell: The only argument behind the advocacy of controls today is that it is a simple panacea to a complex problem. There is a certain attractiveness about it because it is a simple thing. If you talk about 6 per cent wage and salary guidelines, everybody can understand it. It has a certain attraction because of its simplicity. But precisely because of its simplicity it is unworkable, it is no good, because you cannot devise a highly simplistic formula to deal with highly complex economic processes.

Senator Croll: That was not the question.

Mr. Bell: But that is my answer.

Senator Croll: That was not the point. That is not the argument that they made.

Mr. Bell: Who are "they"?

Senator Croll: I am talking about the movement. These are two important arguments about which we are concerned at the moment. That was well publicized across the country. People pay attention to it. There are a great number of people in this country who believe that to a great extent the large corporations and unions have control over the economy. Perhaps not a great number of people, but some people think that controls might be useful in these circumstances. It appeals to them for reasons which they express. My question is: Are conditions which exist now different from those which existed in days gone by; and under these conditions are they likely to be more acceptable?

Mr. Bell: Conditions are always different from those in the past. Conditions today are obviously considerably different from those which obtained in the 1930s or during the Second World War.

You refer, Senator Croll, to when we did have controls. That, of course, was during World War II. In my remarks I pointed out that in that type of national emergency controls would undoubtedly be invoked and probably sanctioned by the public at large.

Senator Croll: The emergency was due to shortages, was it not?

Mr. Bell: It was a question of a very large part of our economic resources being directed towards a war effort which, of course, does result in shortages of civilian goods and services.

Senator Grosart: It was rationing.

Mr. Bell: Precisely, and under those circumstances I would be the first person in this room, as a matter of fact, to advocate not voluntary controls, because they never work under any circumstances, but mandatory controls right across the board, such as we had in World War II.

However, my point is we have no national emergency or crisis. In so far as economic instabilities are concerned, I have to admit that they are relatively slight in comparison to those of other countries. In light of this, I cannot find a rationale to justify any form of controls; the situation just does not exist.

Senator McDonald: During wartime, of course, we had shortages, not only of goods and services, but also of labour.

Mr. Bell: That is right.

Senator McDonald: Perhaps the situation could be likened to that which prevailed in The Netherlands, Japan and Germany. They suffered high inflation, but certainly not high unemployment. How is it that many in Canada believe that unemployment is a necessary factor in the fight against inflation, yet there is virtually no unemployment in the three countires I mentioned?

Mr. Bell: I will choose my words carefully. I do not know how many believe it, but the reason certain people believe that it is necessary to fight inflation with the type of measures we have been using is that they lack an understanding of the working of our economic processes and the fact that Canada is part of a world community. When I say "world community," I refer to the industrialized west, which has been experiencing a considerable degree of inflation. They also lack, as I pointed out in my brief, the understanding that policies which are available to us cannot effectively combat inflationary forces which originate outside the country.

One must always bear in mind an obvious point, but sometimes the obvious is ignored, that Canada's is a relatively small economy compared with that of the United States. Our economy is very closely inter-related with that of the United States through our trade, capital movements, and so on. When that country goes through any kind of major economic trend, whether inflationary or deflationary, we are exposed to the same experience.

We should start with how inflation started in the first place. Tracing this over the last five years, during which we have become particularly seized with the importance of this problem, we discover that certain decisions made in the United States brought about inflation. These decisions were transmitted, as undoubtedly they would be expected to be transmitted, to our own economy.

Senator McDonald: Mr. Bell, is it not true that maybe not identical but similar policies have been used in Canada to combat inflation to those that have been used in The Netherlands, Japan and Germany? Yet in Canada the result is mass unemployment, whereas in Japan, The Netherlands and Germany they experience overemployment. One of their largest problems today is that they have not enough people for the work available.

Mr. Bell: I want to make two points: first of all, we applied very tight fiscal and monetary restraint at a time when we did not have full employment—in other words, we did not have excess aggregate demand working in the economy. In my view that was one of the real follies of applying that type of tight restraint. It was applied when we still had economic slack and unemployment. We also had a rapid increase in our labour force. This is a major difference between this country and those we are discussing. It should always be borne in mind and, from my point of view, it is one of the major aspects of the situation to be borne in mind. Our average annual increase in the labour force is 3 per cent, which is very much higher than that of any of the European countries referred to by Senator McDonald. It is also higher than the increase of the labour force in the United States. In view of this, the policies we applied were really stupid and piled up unemployment on top of that already existing.

Senator McDonald: And you say that when the monetary and fiscal policies were applied in The Netherlands, Japan and Germany they had a problem of shortage of labour?

Mr. Bell: Yes, there is an important difference here, closely inter-related with the point I made previously. Had we experienced a problem of excess demand, the need would have been indicated that some form of restraint should be applied through general stabilization, monetary and fiscal policies. However, these policies should not be applied to the degree that they were on the restraint side when we did not have excess demand at work in our economy.

Senator Rattenbury: Mr. Bell, apart from the Chairman's outline of your activities, I notice that you have always been connected with some commission or labour congress. You have never been a parliamentarian nor, I gather, in business. Perhaps this accounts for the fact that I term the brief negative. You have torn everything down and have disagreed with wage restraints. You explained why, in your opinion, our economy is different from those of Japan and the western nations mentioned by Senator McDonald. I do not think it is different. We are an exporting country and must live on our exports. However, be positive for a minute. If you were a parliamentarian, what would you do to correct this situation?

Mr. Bell: Senator Rattenbury, I have indicated, very briefly admittedly, in this short brief...

Senator Rattenbury: At pages 10 and 13.

Mr. Bell: At page 11, positive measures. They are not products of my imagination; they have been detailed after considerable investigation by the Economic Council of Canada in its Third Annual Review. I refer to the fact that these policies are detailed in approximately thirty pages in that review. These and supplementary policies are long-run, and if effectively implemented will not produce short-run results. They are long-run policies, but if they were implemented I think they would avoid to a considerable extent specific price and cost pressures that arise from time to time in particular sectors of our economy in the absence of such effective policies.

Senator Rattenbury: In effect, a long-term policy is, what this Government, or any government probably in this situation, is aiming for. You talk in your brief about "stop and go, stop and go." Emergencies arise and sometimes temporary measures have to be taken to look after those emergencies. I do not call the remarks you make on page 11 an answer to the situation in which we now find ourselves. Senator McDonald pointed out that we have high unemployment, as opposed to over-employment in Japan, for example. We are interrelated with all exporting nations, I agree. I disagree with trying to tie the economy of Canada in with the economy of the United States, as your congress is trying to do by wage parity. It is not economically possible.

Mr. Bell: The congress is not responsible, sir, for collective bargaining.

Senator Rattenbury: Well, it is labour, and the congress is labour. If we do not bandy words about but look at an overall policy, I think you must agree with me, if you are fair. It is not possible to try to tie 20 million people in with 200 million. I cannot sit here and be happy about reading and listening to a brief of this nature, which is tearing apart our economic development but offering no solutions.

Mr. Bell: There is no intention whatsoever of tearing apart our economic development. The intention is to tear apart economic policies that have been unfeasible, given the nature of the problem and the conditions we are attempting to grapple with, and to offer alternatives over a longer run period. Those alternatives are briefly indicated in the brief. The only reason I did not go into great elaboration is because they are set out in great detail, as I have said several times already, in the Third Annual Review of the Economic Council.

The Chairman: I wonder if I might ask a supplementary there. Apropos the need to, as you say, deal with bottlenecks, what role do you think the unions should

play in dealing with bottlenecks? We have had Dr. Crispo here, who mentioned such specific union problems as those of the construction unions, with special hiring hall practices that apparently, in his judgment, constitute bottlenecks. Indeed, he used the term "bottleneck." What obligation does the union movement have in the removal of bottlenecks?

Mr. Bell: So far as the role of the unions is concerned in certain industries, I would like to be very frank and say that restrictive practices should be looked into. As a matter of fact, labour leaders are on record as having indicated this before. In the much larger sense of examining the difficulties in the construction industry, I think one has to recognize that this is a very unstable, volatile industry; it always has been, and I believe there is a very important role for governments to play in bringing about a greater degree of stability in this industry. If this role were undertaken, I think many of the problems that arise in the construction industry would be resolved. As long as the construction industry operates on this volatile basis, all kinds of problems, both on the labour and management sides, will occur. We have pointed this out ourselves on a number of occasions in the past.

Senator Rattenbury: What do you feel brings about this instability of the construction industry?

The Chairman: I wonder if I could just follow up on that line? I am not sure what actions you think the government should take in reference to the construction industry to remove this instability.

Mr. Bell: Perhaps I could elaborate on that. There is a definite need for all three levels of government—because all three levels of government are involved in the construction industry in the public sector—to co-ordinate their policies for the purpose of bringing about a more stable demand growth in the construction industry. We have had very little stability in the construction industry because there has not been any effective planning by governments to ensure that what I would call demand growth for construction is put on a stable basis. Let me put it very bluntly. Until that is done, I do not think there is much the private parties in the construction industry can do that will be very effective.

The Chairman: Let us assume for a moment that the government did what you suggest and created, as far as it could, stable conditions. What, in your judgment, is the obligation of the union movement? That comes back to my original question, giving cognizance to the point made by Dr. Crispo, that indeed the construction industry would never achieve stability until we get rid of the hiring hall, I think he said.

Mr. Bell: I do not think the hiring hall is a very important problem at all. The point that my good friend John Crispo overlooks is the fact that most of the problems that arise in the construction industry are due to the instability of that industry. The instability of that industry will continue as long as there are the severe ups and downs in demands for construction in this country.

Senator Beaubien: What do the figures show? Do they show tremendous differences in construction from one year to another?

Mr. Bell: Yes, and also during the same year as a matter of fact. The construction industry is very sensitive to ups and downs in the economy. One of the ways to bring about stability in the construction industry is to make sure that we have a more even type economic activity all round. Until that is ensured, the construction industry will be highly susceptible to this kind of overall economic instability that now exists.

Senator Croll: Is a 10 to 15 per cent variation really that important? That is about all we have had, you know, in the past five years—about 117,000, or 90,000. Is it that important? Can that much cause so great a difficulty?

Mr. Bell: I would say this, Senator Croll, that in so far as the internal points of pressure build up in our economy from time to time, they are probably to a large extent due to the volatility of the construction industry.

Senator Beaubien: Is the Government building itself—because we are talking about Government intervention now. What can affect the private sector is the Government end of it. Of course, there are three levels of government.

Mr. Bell: That is right, there are three levels of government—federal, provincial and municipal. The public sector of the construction industry is very important.

Senator Beaubien: Yes, of course it is.

Mr. Bell: If the public sector of the construction industry could be stabilized, it would have a very important effect in so far as the overall construction industry is concerned. It can make a major contribution to eradicate what I call the specific points of pressure, bottlenecks and so on, that do build up in our economy and give rise to price and cost pressures.

Senator Beaubien: Are you saying then, Mr. Bell, that if the private sector is building a lot, the Government should build less; and if the private sector goes down, the Government should take up the slack? Is that what you are saying? You are not thinking overall in that way?

Mr. Bell: Not exactly in those terms. If the Government planned over a fairly considerable period of time—which the Government can do, much better actually than the private sector of the construction industry...

Senator Beaubien: Yes?

Mr. Bell: And if it planned its major construction projects over a fairly considerable period of time, and indicated that it was definitely going to stick to that kind of schedule, and when I say "government", I mean all governments—this is where co-ordination of policies comes in...

Senator Beaubien: It would be difficult, but I can see it.

Mr. Bell: It is difficult, but not impossible. Then I think that much of the price and cost pressures that arise from the construction industry could be averted.

Senator Haig: What you are suggesting is a planned development, over a period of ten to fifteen years, of public works, in all fields.

Mr. Bell: In fields of health, education, road building, all the things that come under the public sector for which governments at the three levels are responsible.

Senator Rattenbury: I disagree with Mr. Bell in his statement that more government intervention is good for the country. Basically, I think we have too much government intervention now. If the economy is allowed to run the natural course of events, we would probably get further ahead faster.

Mr. Bell: On this particular point, Senator Rattenbury, you said I said more government intervention in the economy. I was not talking about more government intervention in the economy. I was talking about the need for governments doing something about what they are already engaged in doing—that is, in the public sector of the construction industry—but doing it much better. Governments have not been efficient, on the whole. There are exceptions, but governments on the whole have not been efficient in planning their public expenditures in that important sector of the economy. That is all I am talking about.

Senator Rattenbury: We have been talking long enough and we finally agree. I agree with that statement.

Senator Grosart: Could I ask Mr. Bell if, in his opinion or judgment, business and industry have lived up to the commitments they made to the Young Commission?

Mr. Bell: My answer to that is "no." I would like to elaborate on that. One has to turn back to the February, 1970 conference, where business and industry were represented—we were not—and the outcome of that conference in itself indicated that there would be no tangible fulfilment of the kind of things that the Prices and Incomes Commission wanted. The conference statement itself, as a matter of fact, indicated all kinds of exclusions, which we documented in our submission that year to the federal Government.

Senator Haig: Did you boycott that conference or were you not invited?

Mr. Bell: We were not invited, sir.

Senator Grosart: My question was not whether the hopes of the commission were lived up to, but whether the commitments made by business and industry had been lived up to.

Mr. Bell: There were really no commitments to be made at that particular point of time.

Senator Grosart: There were no commitments made by business and industry?

Mr. Bell: There were no commitments to be fulfilled.

Senator Grosart: Were they made, even if they were not to be fulfilled? Were all the papers in Canada wrong when they said—and Dr. Young himself said—business and industry had agreed to a 6 per cent ceiling?

Mr. Bell: There was no such 6 per cent ceiling adhered to at that point in time. The 6 per cent ceiling was suggested four months after that conference.

Senator Grosart: I am not talking about the conference. I am asking: at any time, after the setting up of the Young Commission, did business and industry make a commitment with respect to ceilings?

Mr. Bell: I find no evidence of it.

Senator Grosart: They never made it?

Mr. Bell: First of all, the 6 per cent ceiling was not to apply to business; the 6 per cent ceiling was to apply to wages and salaries.

Senator Grosart: I was not asking that. I am asking if business and industry made any commitments whatsoever to the Young Commission.

Mr. Bell: At that conference?

Senator Grosart: At any time?

Mr. Bell: I can only go on the basis of the conference itself. The conference statement contains their "lip commitments," which I have never taken very seriously.

Senator Grosart: I am not asking you, Mr. Bell, whether you took them seriously or not. I am asking you a simple question, whether, in your judgment, business and industry made any kind of a commitment whatsoever to the Young Commission.

Mr. Bell: A verbal commitment.

Senator Grosart: I said any kind—I did not say verbal, written or telegraphed. I am asking you: In your judgment, did business and industry make a commitment?

Mr. Bell: They never carried out any commitment.

Senator Grosart: That is not what I am asking.

Senator Beaubien: That is an understatement, Mr. Bell.

Mr. Bell: I cannot tell you, Senator Grosart, what they said to Dr. Young, the Chairman of the Prices and Incomes Commission.

Senator Grosart: I am not asking you whether you can tell me. I am asking you whether, in your judgment, they did or did not make any commitment.

Mr. Bell: My guess would be that they made no commitments—and if any commitment was made it was not carried out.

Senator Grosart: Well, "They made no commitments, but if they did..."!

Mr. Bell: No meaningful commitment. I can promise to give you a million dollars...

Senator Grosart: I am not asking whether it was meaningful.

The Chairman: I think, Mr. Bell, what Senator Grosart is saying is: Even if it was a commitment that might not or could not have been carried out. Was any commitment made by industry to the Prices and Incomes Commission? And it is my understanding that indeed a commitment was made.

Senator Grosart: If it was not, then the papers must be wrong or I do not know how to read English.

Senator Croll: It is the second part of that, Senator Grosart.

Senator Grosart: All right. We will leave it. I take it, then, what you say is that, as far as your judgment is concerned, business and industry made no commitment.

Mr. Bell: I would just enlarge upon that by saying that business is so organized—or not organized, perhaps, is a more appropriate way of putting it—that individual businessmen cannot make commitments on behalf of employers in this country.

Senator Grosart: They can, but they may not be able to carry them out. You are still not answering my question. However, I will leave it. I know why you are not answering it. I must say I do not find your answer, or your evasion of my question, very satisfactory, Mr. Bell. I am sorry to say that.

Mr. Bell: To pursue this point, obviously we are not communicating very effectively.

The Chairman: That is probably an understatement at this point, Mr. Bell.

Mr. Bell: I cannot say whether or not a particular employer made a commitment because I was not there. I do not know.

Senator Grosart: And you do not read the papers. That's all right.

Then on page 12 you make the statement, speaking of government anti-inflationary policies, that "they have had relatively little influence in checking inflation but have had tremendous economic and social cost." Do you find that somewhat contradictory to the OECD statement that from the middle of 1969 to the middle of 1970 Canada had the best record of cost control in the world?

Mr. Bell: I do not find any conflict there at all.

Senator Grosart: But you said it had little influence and the OECD says the influence was the best of 22 OECD countries.

Mr. Bell: I have said time and time again, perhaps *ad nausam,* that Canada's rate of price increases has been extremely favourable—perhaps that is exaggerating a little but it has been quite favourable by comparison with a number of industrialized countries, but that performance has not been the result of the application of these particular policies. I think if you want to measure the effect that these particular policies had on our price performance, you have to examine the price index before those policies were put into effect and after those policies had their run. If you examine, for example, the Consumer Price Index, which may not be all that good a means of measurement, or if you look at the gross national product price index, you will find that the rate of decline in the increase in any of those indices was very small, and it may very well be, as a matter of fact, that the floating exchange rate that we went on had more to do with that small rate of price reduction than these particular policies.

Senator Grosart: We are not in the same time period. I am talking about mid-1969 to mid-1970 and I will give you the relative figures. You said you would like to rely on consumer price indices. In Canada it rose by 3.3 per cent, in Germany 4 per cent, United States, 5.8 per cent, France 6 per cent, Japan 6.2 per cent and the United Kingdom 6.7 per cent and so on. There is the evidence. And this was before the floating dollar.

Mr. Bell: That is all right, but you are making a comparison between our rate of price increase and theirs. I am making a comparison between the rate of price increase in Canada before these policies were put into effect and after they were put into effect. And I find there has only been a relatively small rate of price reduction.

Senator Grosart: But a moment ago you said we are influenced largely be external factors and I am giving you the record of the external factors in other countries who were not able to hold it down as we were able to hold it down.

Mr. Bell: We had high unemployment.

Senator Grosart: I am not talking about that. I am talking about the one statement that our anti-inflationary policies have had little influence in checking inflation.

Mr. Bell: That is right. At the present time the rate of price increase on an annual average basis is 5.5 per cent.

Senator Grosart: But here is the effect over a period, and we are not into that kind of thing yet.

Mr. Bell: Oh, yes, we are.

Senator Grosart: What is the current rate? What is the rate over the last year?

Mr. Bell: For 1970?

Senator Grosart: Would you give us the rate of the increase in the Consumer Price Index relating it to the anti-inflationary policies and show us what has happened.

Mr. Bell: Our rate of price increases in 1969 if I remember correctly was 4.5 per cent.

Senator Grosart: I have just given you the figure from mid-1969 to mid-1970 as 3.3 per cent.

Mr. Bell: In 1970 it was reduced to about 3.6 per cent, I think. Now one of the reasons why the Consumer Price Index came down as low as it did in 1970 was because between August of 1970 and December of 1970 the food prices declined by 4½ per cent and the reason for that was primarily due to the supermarket price war. Now if you substract the food component from the Consumer Price Index, you will find that the rate of decline from 1969 when these policies were really in effect was from about 4.5 per cent to about 3.8 per cent.

Senator Grosart: But why pick that out of the aggregate?

Mr. Bell: My point is that that is a very slight reduction in the rate of price increase to pay for the very heavy economic and social costs.

Senator Grosart: I am not arguing that point at all. I am questioning the accuracy of your statement. You have answered my question by giving me the figures and saying that the rate, even in the period when you say it was 5 or 6 per cent, was still the best in the world. However, I will leave that. And now I come to unemployment. What do you see, Mr. Bell, from your experience, as the size percentage-wise of all incomes on inflation. What percentage would you say it accounts for?

Mr. Bell: I don't think that wages account for inflation any more than I think that business practices account for inflation.

Senator Grosart: Are you saying that the level of incomes in a country such as Canada has no effect whatsoever on inflation of prices?

Mr. Bell: I have said time and time again that wages and other forms of income respond to the economic environment that obtains at a particular point of time. Wages are highly sensitive to economic conditions.

Senator Grosart: I agree that they respond but I am asking if they are a causative factor in any way.

Mr. Bell: They are not a causative factor and they are not an independent factor as many people think they are.

The Chairman: I have a supplementary question on that. It has been put to us by many economists, Mr. Bell, that there is such a thing as cost-push inflation. Are you saying there is none?

Mr. Bell: I think whatever cost-push inflation exists would have a very minimal influence on the overall inflationary rate that has taken place.

Senator Grosart: Would that include profits? We were talking about incomes. Would you say that business profits had no effect on inflation?

Mr. Bell: I would say at the most a very minimal effect. I just do not believe that private parties are physically capable of creating an inflationary situation. They can sustain it to a certain extent by the kind of response they make, admittedly, but they cannot create it.

The Chairman: Why do you talk about bottlenecks?

Mr. Bell: That is a different matter altogether.

The Chairman: Is it a different matter?

Mr. Bell: You can talk about bottlenecks in the labour market or about bottlenecks in the product and service markets, and these bottlenecks undoubtedly do create a certain amount of inflationary pressures. These bottlenecks that exist have existed all along, even when the overall rate of price performance has been quite good.

I come back to the point that in so far as it is necessary to iron out bottlenecks in product and labour markets, they do give rise to occasional inflationary pressures. All these particular policies, special supply and complementary policies, could probably be effective in avoiding that kind of thing. We are dealing with an inflationary situation which is to a very large extent beyond the control of those, or of any of our other domestic policies, because most of the inflation comes from abroad. Because we are a highly exposed open economy it is virtually impossible to deal with that kind of situation.

Senator Grosart: From the evidence that we have had here, and from what I have heard elsewhere, I am inclined to agree with Mr. Bell that any kind of an incomes policy, whether mandatory, voluntary, general or selective, is not practicable in Canada at the present time. Like Senator Rattenbury, I am having a little difficulty in following Mr. Bell's reasoning, although I have read his brief carefully. However, I will go back and read the Economic Council's Third Report, which I have not read for quite a while.

Senator Croll: If it is not labour or industry, and only some of it is imported, who is causing all the inflation in this country?

Mr. Bell: To a very large extent the inflation that we have experienced in the last few years has been imported inflation. In 1965 the economy of the United States was operating pretty close to potential at a time when the Johnson administration made a critical decision. I am not arguing the merits or demerits of the Vietnam war, because I do not wish to get into that subject, but at that point in time, which was July, 1965, the decision was made to escalate America's commitment in the Vietnam war.

As you will recall, at that time the United States had relatively few troops involved in the war. The decision was then made to increase very substantially America's fighting commitment in the war, at a time when the American economy was operating at very close to its potential.

Economists within and outside the administration argued that some fiscal measures should have been adopted in order to offset those substantially increased expenditures associated with the military commitment. They were arguing a 10 per cent surtax, or whatever it was. The administration refused to do this, presumably

because an increase in taxes is never a politically popular thing to do.

The Johnson administration placed that tax before Congress, if I recall correctly, in August, 1965, but Congress was reluctant to implement it and it did not go into effect until July 1, 1968, which was exactly three years after this large increase in military expenditures had begun. It was far too late. The inflationary forces had already—long since, in fact—begun to work, and then, because of the close economic interrelations that we have with the American economy, they pervaded our economy as well.

In my view, and it is one shared by many others, it was a mistake that precipitated the kind of inflation that we have sustained. That does not explain all of our inflation, but it does explain a large part of it. Had other offsetting measures been introduced in the United States at that time, I do not think we would be sitting here today discussing inflation.

Senator Croll: Earlier you said there was a lack of understanding in this country of the cause of inflationary tendencies in this country, that people who were responsible did not catch the point that you made a few minutes ago, or did not understand it. The Government has called upon the best possible people it can obtain—we have heard many of them here—as did the United States Government. The President had the capacity to call on very many people. Yet at the present time, when we find ourselves in this unusual predicament, do you seriously suggest that we can get out of it by policies dealing with supply and labour mobility, training manpower, and bottlenecks—that that is the answer to our present problems?

Mr. Bell: No. I did not suggest that, Senator Croll. I said that where inflationary pressures arise in broad sectors of our economy, as a result of bottlenecks et cetera, that these policies could be effective in avoiding that kind of situation from developing. But these policies could not be effective any more than any of our major economic stabilization policies, fiscal and monetary, could be effective in dealing with a universal inflation.

Senator Croll: I have one further question. Mr. Bell, be practical. Tell us an instance of the bottlenecks you refer to.

Mr. Bell: I am thinking in terms of bottlenecks, for example, in labour markets. You get bottlenecks in labour markets where you have an imbalance in supply and demand for labour in those particular markets. There may be a demand on the part of employers for skilled manpower that is simply not available in a particular labour market. That will have a tendency to artificially raise wages unless something is done. We need a policy—and here I am speaking specifically of manpower and labour market policies—that would prevent that situation from arising, that would prevent that kind of cost pressure from arising. The same could be said about product markets where bottlenecks exist.

Senator Laird: I notice with interest that your President, Donald MacDonald, suggested, according to yesterday's newspaper, that one means of creating employment would be to lower the rate of personal income tax and do away with surtax. I assume that you agree with that proposition. What would you say about going the whole hog and lowering the corporate tax as a means of creating employment?

Mr. Bell: We suggested a reduction in income taxes in the lower income brackets; that is not an across-the-board proposition.

Senator Laird: Why not?

Mr. Bell: There is a good social reason, but I will concentrate on the economic reason because we are speaking in an economic context.

With regard to the unemployment problem, those in the lower income bracket who receive additional income in the form of an income tax reduction have a greater propensity to spend money, which would be a quicker and more effective means of bringing about an increase in employment. This is a short-term type of proposition..

Senator Laird: I realize that.

Mr. Bell ...as distinguished from long-term means of dealing with the unemployment problem.

Senator Laird: But by the same reasoning could you not attract more money for productivity by lowering the corporate rate of tax?

Mr. Bell: No, because at present we have considerable under-utilized plant capacity. More purchasing power is required in the hands of consumers with the greatest propensity to spend. This would increase the demand for goods and services with, in turn, a stimulating effect not only in creating employment but increasing the utilization of capacity of plants.

Senator Laird: Then do you agree that in all likelihood that would create an inflationary pressure?

Mr. Bell: No, I do not, for this reason, we have too much slack in the economy. Because of that I do not believe this would have any significant influence on prices. As long as our economy is operating as it is, well under potential, we do not risk much danger in that direction.

Senator Laird: Again in connection with the problem of inflation, there is a fairly substantial segment of society which lives on fixed incomes. You dealt with that particular group in so far as you mentioned old age pensions and so on from Government sources. What about the group of thrifty people who have managed to save enough upon which they hope to be able to live for the remainder of their lives?

Mr. Bell: You have to make a value judgment, as I do here. That judgment is that those who are dependent on social security in the form of pensions, unemployment

insurance benefits, and so on, or those whose income is below subsistence levels, should be relieved by cost of living adjustments. I do not think it is necessary to protect those who do not need the protection.

Senator Laird: Yes, but those I have mentioned certainly do need protection, which they can only obtain from additional Government funds. How do we raise those additional Government funds?

Mr. Bell: As I say, senator, these adjustments could be financed by higher tax revenues which automatically flow to governments when the economy is operating at or close to potential. All three levels of government have lost hundreds of millions of dollars in tax revenues because the economy has been operating well below potential.

Senator Laird: I am afraid that still does not answer the problem of the person on low fixed income, so I will pass.

The Chairman: Mr. Bell says he makes a value judgment between those on low fixed incomes and those who have savings. At page 13 he says there should be some form of subsidy for those on low fixed incomes and it should come from tax revenues derived from full employment policies.

Senator Laird: I have already read what was said and realize it would come from increased taxation.

The Chairman: No, in fairness to the witness, he is not suggesting increased taxation but the rate being the same and in fact being reduced in certain cases. By virtue of the economy being at full potential the tax revenue would increase.

Senator Laird: Somehow or other it never seems to work that way.

Senator Rattenbury: No.

Dr. James Gillies, Study Director: There is a body of thought among economists that inflation goes through two stages, excess demand and rising prices. There is also the view that as time goes by the causes of inflation shift because higher incomes are needed to meet higher prices. This results in wage increases higher than increases in productivity. Do I understand you essentially reject the idea that there can be cost-push?

Mr. Bell: No, I did not say that, Dr. Gillies. There can be at particular stages of the business cycle.

Dr. Gillies: Do you think we are in that stage now?

Mr. Bell: I think that there may be some of this. It is extremely difficult to measure. If you are referring, as I suspect you are, to the fact that some wage settlements are in excess of productivity increases, my observation is that whenever we go through a phase such as we have recently, wages do begin to catch up and take the lead. They take the lead over profits in the early part of the business cycle. In the early part of 1961, when we started to get out of the trough, wages for a long time lagged well behind profits and other forms of income. This has been well documented by the recent OECD report. As a matter of fact, one of the reasons I do not favour an incomes policy is precisely because whenever one is applied, depending on what part of the business cycle we are going through, it can unfairly lock in some forms of income. I think this was one of the greatest criticisms—not the greatest but one of the major criticisms—that could be made against an incomes policy.

To get back to your point, the fact that wages now are climbing faster, is nothing more than the way the traditional business cycle has always functioned. In the early part of that business cycle, wages lagged far behind, but this is the way the system works, and we are not responsible for the system.

Dr. Gillies: Would you not think that there may well now be in the economy considerable cost-push inflation, particularly in hospitals, education, the service trades? Therefore, my question is, would it be truly inequitable—it would have some inequity, but what would your position be about having an incomes policy that is a freeze, so that we have time to work out the bottlenecks and other signs that are now in the economy? If we just froze things, could you argue that that would be terribly inequitable—to give time to work through some of the bottlenecks in the labour force and problems which you are suggesting are causing inflation?

Mr. Bell: I do not think it would work, in the first place, because as I have said I guess ad nauseam by now, an incomes policy will not work. But, just for the sake of argument, if we assume that people would accept an incomes policy, to do the kind of thing...

Dr. Gillies: A freeze, just a freeze.

Mr. Bell: I do not think they would accept it, but this, to my way of thinking, would be a very unfair way of going about dealing with these particular bottlenecks that you have just alluded to. It would mean freezing—to use your own term—wages and salaries of many people, at the very time when they had been lagging behind.

Dr. Gillies: Yes, but I thought the point was that they had caught up.

Mr. Bell: In other words, the implication of this kind of approach is to impose sacrifices on all kinds of people who had not had a chance of catching up. Therefore, again I come back to the point, that any attempt to apply an incomes policy is inherently inequitable.

I make the same argument against the so-called mandatory selective wage and price controls. Without doubt, that kind of proposition is the most inequitable of all, because in effect we would be asking certain people, certain economic segments, to accept sacrifices on behalf of the rest of us.

Dr. Gillies: I do not wish to argue against my convictions, but I am troubled by this, because what you are saying is that we are now getting wage increases greater

than producivity; that this is an inflationary force in the economy; that we can only stop inflation of this type through structural changes in the economy. But I do not see that that is going to happen in the short run, so I guess you are saying we must live with inflation for quite a while.

Mr. Bell: I do not think these are having, though, any significant effect on inflation movement within Canada. That is my first premise.

With respect to the domestic pressure points, we do not know too much about them, admittedly, and we do not have enough data really to make any certain judgment on them or on what their significance is; but I would venture to say that they have only a relatively small effect on the over-all inflation rate in this country, and I think that by adopting policies of that kind we would create more problems than we would solve.

Senator Kinnear: Mr. Chairman, in the first place Mr. Bell said that 3 per cent of new people are coming into the labour force in Canada, whereas "much less" were coming in in other western countries. How much is "much less"? I like to be specific.

Mr. Bell: It will be around 1 per cent, on the average, increase.

Senator Kinnear: That is not much. In the last paragraph on page 10 of your submission I found the language difficult to follow. I should like you to explain every bit of it in simple language and to name just who the "some" are that you refer to. You use that word "some" quite freely. You say that:

> it would seem to be overlooked by some that people in the Canadian labour force are quite intelligent.

Mr. Bell: I was referring specifically to the Prices and Incomes Commission. They were responsible for levying the so-called 6 per cent wage and salary guidelines.

Senator Kinnear: I thought that was a strange sentence:

> It would seem to be overlooked by some that people in the Canadian Labour force are quite intelligent.

Most people in most places are intelligent.

According to an article in the Ottawa *Citizen* for today, June 1, Sidney Weintraub of the University of Pennsylvania, who has been a visiting professor at the University of Waterloo for the past year, would seem to be in disagreement with you, Mr. Bell. For example, you were talking about housing and numbers of houses, and in that connection there is in this article a quotation attributed to Sidney Weintraub which reads as follows:

> For to cut the total (of unemployed) in half, to about 350,000 for all of Canada, would have involved some 35,000 new houses and about 750 new public works expenditures in the $1-million range, or some equivalent plant and office construction. For Quebec, figures of about one-third of these are entailed.

When he said that Professor Weintraub was speaking in Montreal. I will just finish the quotation:

> Prof. Weintraub said modern wage-based inflation derives partly from the strength of unions, partly from the fact that high unemployment no longer depresses wages, partly from the fact that substantial immigration no longer exerts as much restraint on inflation, and above all from the material hopes of people in an age of affluence.

Would you comment on that, please, Mr. Bell—because it seems to me that that is in direct opposition to your way of thinking.

Mr. Bell: Could you just refer to the first point again?

Senator Kinnear: I can give it to you.

The Chairman: You are referring to the first paragraph?

Senator Kinnear: To the last two paragraphs.

Mr. Bell: Well, he says:

> "When one considers the magnitude of the problem, of the relatively small economic effort required to eliminate Quebec's unemployment, for example, one can only express some distress and ask: Why is not more being done?"

I think, insofar as our policy-makers are concerned, that why more has not been done is because they have this phobia about inflation.

Senator Kinnear: I know that. But if you read the heading, you will see he is telling us how well Canada has done. However, I am asking about the last two paragraphs.

Mr. Bell: That is where he says:

> For to cut the total (of unemployed) in half, to about 350,000 for all of Canada, would have involved some 35,000 new houses and about 750 new public works expenditures in the $1-million range, or some equivalent plant and office construction.

Senator Kinnear: Then he tells how he thinks inflation occurs, and that is what I want you to read.

Mr. Bell: And the last paragraph:

> "Prof. Weintraub said modern wage-based inflation derives partly from the strength of unions, partly from the fact that high unemployment no longer depresses wages, partly from the fact that substantial immigration no longer exerts as much restraint on inflation, and above all from the material hopes of people in an age of affluence."

I disagree with this analysis, for the reasons I have already given to the committee.

Senator Kinnear: We are having contradictory evidence all the time from witnesses and it is hard for me to choose which is right. It is hard to decide whether you or Professor Weintraub is right. I have my own ideas, but I do not have to give them here.

Senator Croll: Did I hear anything about corporates in there?

Mr. Bell: There is no reference to corporates.

Senator Inman: Has the multiplicity of welfare programs and policies any effect on the economy of a country such as we have with 20 million people?

Mr. Bell: You say the duplicity of welfare programs?

Senator Inman: Of welfare programs and costs.

Mr. Bell: I have long been of the view that insofar as our welfare programs are concerned, they should be far better organized than they are. That is a very popular view and I do not think many people would disagree with it. They could be much more efficiently and effectively implemented than they have been to date.

Senator Inman: But can you tell me what effect it has on the economy?

Mr. Bell: Insofar as inflation is concerned, I think we are spending dollars through some degree of duplicity that could be more effectively spent to help more people than are being aided at the present time. Let me say this; I do not think that doing the things we need to do in this country to aid distressed people is going to have a significant inflationary effect. That is precisely the point I would like to make on that.

Senator Kickham: Do you support the Canadian labour unions' demands for an hourly rate of wages equal to that received by their counterparts in the United States?

Mr. Bell: You mean wage parity?

Senator Kickham: Yes.

Mr. Bell: I think in those particular industries that have sought wage parity, there is justification on the grounds that the productivity in those industries is comparable to productivity in their counterparts in the United States, so I see no reason to oppose it.

Senator Kickham: From my reading of the subject, I see that the Canadian worker does not produce on a par with the United States worker, on a per unit basis. Is that correct?

Mr. Bell: On an overall basis?

Senator Kickham: On a per unit basis.

The Chairman: What the witness was saying was that there should be parity in those industries where productivity is the same.

Senator Kickham: My question is that if there is disparity in one industry, naturally all members of Canadian labour unions would naturally want the same wage rate per hour.

Mr. Bell: I do not think there is any problem there. They would not get it. Do not look at the union bargaining structure as homogenous; it is not. The bargaining power of unions differs very considerably from one union to another. Industries which have sought wage parity have been very high productivity industries, and consequently there is justification for that kind of demand. I do not see any reason for opposing it.

Senator Kickham: Are you worried at all that the demands from Canadian labour unions are excessive and that we are placing ourselves at a disadvantage on world competitive markets?

Mr. Bell: I do not regard them as excessive or as threatening.

Senator Kickham: Some industries have been subsidized to compete with the clothing manufacturing industry in England and Japan. We must subsidize, otherwise industries in Canada will go out of existence.

Mr. Bell: We have to make a distinction between demands. Demands may not be excessive; you may have all kinds of demands that may be excessive. The important point is wage settlement.

Senator Kickham: Wage demands are excessive and are jeopardizing many of our Canadian industries. Our labour unions are killing the hen that lays the golden eggs.

Mr. Bell: What evidence do you have of that?

Senator Kickham: The evidence is that many of our industries are in a very dangerous situation competitively in world markets.

Mr. Bell: I must refer you to the fact that in the past few years we have had a tremendous upsurge of exports in relation to our imports. The result is that for some time we have had a very favourable international balance of payments position.

Senator Kickham: You are more or less downgrading our economy. There have been tremendous mistakes made. You are now contradicting yourself. I think we are doing very well economically.

Mr. Bell: I have said time and time again elsewhere that I find it extremely difficult to justify policies to fight inflation when we have not had any balance of payments problem, when we have had no problems with our exports, and when, on the contrary, we have had a very favourable export position.

Senator Kickham: That is because of the Government's having contributed thousands of dollars to research projects emanating from universities. We have had large contributions from the Government and we have highly sophisticated mechanical and automatic equipment. Many union members are deprived of work because of this sophisticated equipment. That situation will remain for many years to come and we should reduce tax incentives for mechanized and automated equipment. That would be one method of giving our people employment.

You mentioned that the reason for the consumer price index moving downwards was because of the develop-

ments in the supermarkets. Coming from a farm, my contention is that it is because of farm food prices. Dressed pork from Canada Packers and Swift's went from 18 cents to 21½ cents per pound. Lower prices to farmers is the cause of lower prices of food. You are billed as an economist and should be versed in all those things.

Mr. Bell: I am fully appreciative of the situation in which primary producers find themselves.

Senator Kickham: Would you like to see a copy of this statement?

Mr. Bell: Yes.

Senator Kickham: I will send you a photostatic copy.

Senator Croll: What industry in this country has parity?

Mr. Bell: I do not believe there is one.

Senator Croll: Of course there is not.

Senator Inman: I learned the day before yesterday that our exports have fallen off.

Mr. Bell: I was speaking of our overall export situation, which has been very, very favourable and continues to be favourable.

The Chairman: Mr. Bell, you say that the floating rate of exchange has not been effective in insulating us from inflation from the United States or the world market, although it has had an effect of lowering our price level; is that correct?

Mr. Bell: I did not say that our floating rate of exchange had not been effective. I think that our floating rate, which went into effect a year ago, has probably been more effective in bringing about a reduction in the rate of price increases than anything else.

The Chairman: In your judgment, does the floating rate insulate us from world inflation?

Mr. Bell: No, it does not insulate us, but I think that it provides us with a better means of dealing with inflation than a fixed exchange rate. It gives us a more independent monetary policy and makes our stabilization policies more effective in dealing with inflation than if we were at a fixed rate.

The Chairman: Does it insulate us from world inflation?

Mr. Bell: No.

The Chairman: Then you say that we are the subject of world inflation?

Mr. Bell: Right.

The Chairman: You also state that in the latter stages of a demand-pull inflation caused by world inflation we have a cost-push inflation, but that we should not use any temporary freeze or incomes policies to control that. We should actually accept that inflation and build in safeguards against its depredations.

We have not had a meeting in which I failed to mention the Phillips curve, so I want to keep up my score. Would we not, in effect, move the Phillips curve away from zero? Would not we create a very devastating trade-off? In fact, would we not have to suffer an inflation of expectations that would really be crushing?—that is, if I follow your reasoning. We have had economists before us who say, "Ah, but we can do this. Here are the short-range options we have open." What you say is that we have 28 pages of very long-range options proposed by the Economic Council, but that we have no short-range options open at all; the floating exchange rate is not effective to control the importation of inflation; the policies of the Government can only be used to increase unemployment, and therefore they are not effective to combat that inflation, so the Government's policies cannot be used to control inflation; and you say that we should not use incomes policies. It seems to me that then you will create a situation in which you get an inflation that you cannot control at all, and you have no real policies for controlling it.

Mr. Bell: There are no effective short-run policies for dealing with an inflation that is largely outside our control. That is the main point I want to make. Once inflation has been reduced in the outside world, primarily in the United States, then we ourselves will come under control.

The Chairman: Could you repeat that last sentence?

Mr. Bell: Once inflation has been curbed in the outside world, primarily in the United States—in other words, once we are no longer exposed to this universal inflation—then we will come under control. But, as I said before, our policies, whether we are talking about fiscal or monetary policies, or any other policies that one cares to mention, are relatively ineffective in dealing with an inflation that is to a large extent a universal inflation. If I may again repeat myself, this is because we are a very highly exposed economy. To emphasize the policies we have emphasized in the past would simply, I think, result in the creation of more unemployment, without having any effect on the price side.

The Chairman: I understand that, but then you have policies for insulating the economy against the effects of inflation. You say that we do not have policies to control what is essentially a world-wide inflation.

Mr. Bell: Apart from those inflationary pressures that may arise in particular sectors of the economy, and that is why emphasis has been placed upon these supply policies to deal with these particular pressures that arise from time to time. But, then again, as I said, they can deal only with relatively small domestic inflationary pressures; they are not going to touch those inflationary pressures that are imported from abroad.

The Chairman: I understand that, Mr. Bell, but you go on to say in your penultimate paragraph:

> We should have expansionary policies which are geared to the longer-term potential growth rate of the economy, and turn our back on erratic "stop and go" policies which invariably are implemented in this country. We should ensure that the principal sufferers of inflation are protected by cost-of-living adjustments—

and so on. Your policies are directed towards an economy that is essentially inflationary in nature.

Mr. Bell: I do not agree that our economy is essentially inflationary in nature. I do not agree with that at all. In reference to the penultimate paragraph, Mr. Chairman, that reference is spelled out in terms of developing policies that will be geared to the longer-term potential output of our economy. We have not discussed unwise use of fiscal and monetary policies in the earlier years that were not geared—and have not been geared, as a matter of fact—to the longer-term potential output and which, because of that, resulted in creating certain inflationary pressures within this country.

Dr. Gillies: As a supplementary, do I understand properly that, if there is worldwide inflation, even with the use of the most farsighted and best monetary and fiscal policies, in your view we would still have inflation within this economy—if there is worldwide inflation?

Mr. Bell: If there is worldwide inflation, given the fact that we are a highly exposed economy, then we are going to have inflation. That is all there is to it. I say the same thing for the European countries too, because they are not as closely inter-related economically with the United States, nevertheless when the United States is in an inflationary situation they too, like us, will suffer as a result.

Dr. Gillies: This is a question of fact to which I do not know the answer. Were the average weekly earnings of the labour force in Canada higher or lower in March, 1971 than they were in March, 1970?

Mr. Bell: They were higher. I have not the figures here.

Dr. Gillies: I cannot recall the figures. If they were higher, what I am puzzled about is: Why is it, with such an increase in unemployment, that wages have not come down?

Mr. Bell: They are coming down.

Dr. Gillies: But they have not come down, as yet.

Mr. Bell: They may not be coming down as fast as some people would like. If one looks at the base rates, which are compiled by the Department of Labour, and these are base rates for companies of 500 employees and over, they have been coming down since the third quarter of 1970.

The Chairman: A number of the economists we have had here have been terribly concerned about what they call price expectations. That is, if the public at large accept the expectation of price increases, they will react accordingly, to protect themselves. How do you view such an outlook?

Mr. Bell: I think there are some people like that. It is very difficult to measure. This is the theory, and I accept the fact that there is possibly something in the theory, but it is very difficult to say just how much weight should be attached to it.

The Chairman: If there is such a thing as price expectation, what in your policy would tend to control those expectations?

Mr. Bell: In my policy, or the Government's policy?

The Chairman: Your policy? We are going to have witnesses from the Government, to ask them what their policy is.

Mr. Bell: To the extent that we are capable—I am repeating myself ad nauseam here—of dealing with those pressures in the economy, the bottlenecks we were talking about before, that do give rise to some inflationary pressures—I have to emphasize that once universal inflation does come under some control, and it is beginning to appear to be coming under some control—this will have a much more important influence with regard to the whole question of price expectations than anything we can propose here.

The Chairman: I am not very far away from you, except that I do not know who brings this universal inflation under control.

Mr. Bell: Well, I do.

The Chairman: You say that the Canadian Government can do nothing about it, except from a very long-range point of view. Well, which government is it that does something about this?

Mr. Bell: As a matter of fact, you had expert evidence presented to you by Harry Johnson on precisely this point the other day.

The Chairman: The evidence that was presented to us by Dr. Johnson was that by accepting a floating exchange rate Canada could insulate its economy against outside influences and could pursue an independent policy. That argument is in complete contrast to your argument.

Mr. Bell: I am surprised that he would put it that strongly. A floating exchange rate is certainly a very useful device in helping to insulate ourselves from some of these strong inflationary pressures abroad, but I do not think that in itself it is the sole solution to the problem.

The Chairman: I do not say that Dr. Johnson suggested it as the sole solution. He suggested that it did insulate the Canadian economy.

Mr. Bell: To a certain extent.

The Chairman: And then allowed Canadian policy to be effective in order to create the conditions that were desirable. But what you say is that even with a floating exchange rate, while you may make policies a little more

effective, you still are the subject of imported inflation, and there is nothing you can do about that, so why not relax and live with it. It seems to me that such a policy would raise expectations to the point where you would have a pretty frightening trade-off after a while.

Mr. Bell: I disagree with that. With all due respect, you are attaching too much weight to price expectations in terms of their generating significant inflationary pressures.

The Chairman: You do not think they are terribly important?

Mr. Bell: No. As I said before, they may have some effect, but I do not think the effect is all that important.

Senator Beaubien: Mr. Bell, on the question of expectations and outside influences, did you realize that this morning it was announced that Alcoa signed a contract, as did Kaiser Aluminum, which is more inflationary than the 31 per cent that was granted to the canning industry at the beginning of this year? It was in the *Wall Street Journal* this morning, so there is an increase of over 30 per cent in the aluminum industry. That, of course, is bound to have an influence here.

The Chairman: I do not think that Mr. Bell has a comment on that.

Mr. Bell: I would have to look into that.

The Chairman: Are there any further questions, honourable senators?

Mr. Bell, on behalf of the honourable senators, I would like to thank you very much for acting as our witness today and giving us the benefit of your views. I am not certain that your views have been greeted with unanimity and, as you are aware, senators did not rise to their feet and cheer when you made some of the statements you made. Nevertheless, you have contributed greatly to the work of this committee and we thank you very much.

The committee adjourned.

"APPENDIX"

UNIVERSITY OF TORONTO
Centre for Industrial Relations
Office of the director
Toronto 5, Ontario
May 26, 1971

Douglas D. Everett, Esq.
Chairman
Standing Senate Committee on National Finance
140 Wellington Street, Room 403
Ottawa, Ontario

Dear Senator Everett:

In my appearance before your Committee, you may recall that Senator Maurice Lamontagne challenged my assertion that the Federal Government's fiscal policies were too loose during the mid and late nineteen-sixties. I was, and remain, disturbed by his inferences and implications, and promised at the time to try to clarify our differences. Although I now have even more reason to doubt that this is possible, I shall endeavour to do so.

Our conflicting interpretations arise partly, if not largely, from the different ways in which one can assess the budgetary position of the Federal Government. In this sense, it is rather like the situation with respect to the measurement of unemployment, where at least two sets of figures are available, with many groups and individuals stressing only those figures that give the most aid and comfort to their point of view.

With respect to the Government's budgetary position, one can obviously treat the various levels of government as separate entities or combine them in some way. Beyond this form of selectivity, there are essentially two ways in which one can assess the over-all budgetary situation at one or more levels of government. Historically, government budgets have, more often than not, been assessed on a national accounts basis. More recently, emphasis has also been given to a cash flow form of analysis, focusing on actual inflows and outflows. The latter approach may, of course, also be visualized from a full-employment point of view, in which case the government's net cash flow is expected to be in a deficit or a surplus position, depending on what is appropriate to offset developments in the private sector of the economy in order to ensure reasonably complete utilization of the labour force.

It should be added that each of these methods of government budgetary accounting is further complicated when such major variables as contributions and benefits expended under the Canada and Quebec pension plans are taken into consideration. I doubt that the implications of including such variables in the Government's budgetary accounting are yet fully appreciated, although they may have some profound ramifications.

Rather than elaborate further by correspondence on these various approaches to the impact of the Government's budget, I would like to take advantage of a suggestion I made to the Committee at the time of my presentation. On June 8th next you are scheduled to hear a brief by a group from the Institute for Policy Analysis at the University of Toronto, who are much more conversant with these matters than I. On checking with them, I have learned that they will be dealing with these issues, and I would urge you to take full advantage of that occasion to clarify the questions involved.

Speaking only for myself, but having checked my views with many colleagues, I stand firmly behind my assertion that the Federal Government's fiscal (and monetary) policies were inappropriate during the mid and late sixties. However you measure the Government's fiscal position at that time, it was clearly not exercising sufficient restraint on the economy, thus enabling it to gather too much steam. I said before your Committee, and I repeat, that this shortcoming in the Government's fiscal management of the economy had as much to do with the ensuing inflation as anything else.

While I am writing, I should clarify at least one other point. During my testimony I was guilty of misconstruing the position of the Prices and Incomes Commission with respect to a study which I undertook for them. Apparently they are still seriously contemplating the publication of the study, and are now awaiting the final draft, which I was not rushing because I thought they had lost interest. This was a misinterpretation on my part, and I apologize to your Committee and to the Commission for the unfair innuendo I left in the wake of my testimony.

I would appreciate it if this letter could be included in the official record of your proceedings.

Best of luck to you and your Committee in its continuing deliberations!

Warmest personal regards.

Yours sincerely,

John Crispo
Director

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 15

WEDNESDAY, JUNE 2, 1971

Twelfth Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses:—See Minutes of Proceedings)

23881—1

STANDING SENATE COMMITTEE ON
NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
Gélinas	O'Leary
Grosart	Paterson
Hays	Phillips
Isnor	Sparrow
	Walker—(27).

(Quorum 7)

**Ex officio Member*

Orders of Reference

Extract from the Minutes of Proceedings of Tuesday, March 9th 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, PC.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said Estimates reaching the Senate.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Wednesday, April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Tuesday, May 4, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relation thereto.

The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Minutes of Proceedings

Wednesday, June 2nd, 1971.
(15)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10.00 a.m. to consider the Question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Desruisseaux, Isnor, Laird, Langlois, Methot, Molson and Nichol. (9)

Also present but not of the Committee: The Honourable Senators Cameron, Denis, Inman, Kinnear, McElman, McGrand, McNamara, Rattenbury, Smith and Thompson. (10)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics; Mr. David McQueen, Economic Consultant.

Witness heard:

Dr. Raymond J. Saulnier,
Chairman,
Department of Economics,
Barnard College,
Columbia University.

At 12.35 p.m. the Committee adjourned to 4.00 p.m.

At 4.00 p.m. the Committee resumed.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Bourque, Croll, Isnor, Laird, McDonald, Methot, Molson and Nichol. (10)

Also present but not of the Committee: The Honourable Senators Carter, Haig, Lafond, McElman, McNamara and Smith. (6)

In attendance: Dr. James Gillies, Director; Mr. A.B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics; Mr. W. Neville, Editorial Writer; Mr. David McQueen, Economic Consultant.

Witnesses heard:

Mr. René Leclerc, President,
Canadian Bankers' Association.

Mr. R. M. MacIntosh, Deputy Chief General Manager,
Bank of Nova Scotia.

Mr. R. E. Currie, Vice-President and
Economic Adviser,
Bank of Montreal.

Mr. J. E. Morgan, Deputy General Manager, Royal Bank of Canada.

Witnesses present but not heard:

Mr. J. H. Perry,—Chief Executive Director General of the Association.

Mr. S. Sarpkaya,—Economic Adviser of the Association.

At 4.55 p.m. the Committee suspended its hearing in order to permit the members to attend a vote in the Senate Chamber.

At 5.10 p.m. the Committee resumed.

At 6.25 p.m. the Committee adjourned to Thursday, June 3, 1971, at 10.00 a.m.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Wednesday, June 2, 1971

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 10:00 a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, we are fortunate indeed to have with us this morning Dr. Raymond Saulnier, who really needs no introduction as far as honourable senators are concerned. Dr. Saulnier is the Chairman of the Department of Economics, Barnard College, Columbia University. He received his doctorate from Columbia University, and, as you know, has a worldwide reputation as an economist.

Dr. Saulnier was Chairman of the President's Council of Economic Advisers from 1956 to 1961. That was a notable period in the economic history of the United States, for it was a period that was marked astonishingly by stability and growth, and a period that I suppose this committee seeks in its examination. As Chairman, Dr. Saulnier was intimately involved with the policies that gave rise to that growth and stability at that time.

It is with great pleasure that I introduce him to you and ask him if he would quickly review with you some of the material that you now have in your possession.

Dr. Raymond J. Saulnier, Chairman, Department of Economics, Barnard College, Columbia University: Thank you, Mr. Chairman.

Honourable senators, I am delighted to be here and to have this opportunity to talk with you about problems of economic stabilization. Lord knows, we have difficult ones everywhere in the world. I have supplied the committee with two papers prepared with respect to activities of mine. One is an unpublished paper on the wage explosion in the United States, and the other is a statement of the economic situation in the United States and the near-term outlook for the United States economy.

I would be happy to discuss with you and state, just as fully as you wish, the view that I have about the near-term outlook for the United States economy, because I know it is always something of interest here in Canada. I happen to be one of those who take the view that the United States economy is not only already in a recovery, but that that recovery movement will continue through the rest of this year. I think it will continue through 1972. I doubt that we will see a GNP as large as the administration has been talking about, but it will be a large one. My own forecast for 1971 has been a GNP of $1 trillion and 55 billions. Now, this may seem like a very cheerful kind of prognosis for the United States economy, and on balance, I think it is cheerful, but I must tell you that I feel anything but happy about many developments in the United States economy.

We have got a recovery going, but the quality of that recovery leaves very much to be desired. If we reach $1 trillion and 55 billions it will not be because we have had a big increase in fiscal output. Those big numbers are, in the main, simply a reflection of the fact that we have a highly inflationary economy. The faster the inflation, the bigger the numbers, so no one should be all that happy about big numbers, because to a considerable extent they merely represent an acceleration of inflation. Enough of that; I will be glad to return to these questions if the committee wishes.

The second paper that I have here pertains to wage inflation, or call it, if you will, wage explosion. It is going on, as we know, all round the world. I have occasion to stay rather close to developments in western Europe, as well as here in North America, and to developments in South America. I have sometimes felt that we ought to import some South American economists because our economic problems are getting to be rather like the kind they have had in South America for so many years.

In the United States what we are up against is this: New settlements for wages are being made that involve a cost to the employer of something between 10 and 15 per cent per annum. The settlement that was made only a few days ago in the aluminum industry involved, as you know, an increase of 31 per cent, spread over three years, but that 31 per cent does not include the costs of some changes in working hours and vacation rights, et cetera, which are also a cost to the employer. So the real cost that the aluminum industry people will have to absorb over the next three years is, I am sure, greater than 10 per cent, or somewhere between 10 and 15 per cent.

I am on the board of several industrial companies, and I know from my own experience that their settlements have been made around 13 per cent. When you have labour costs rising—let us take 13 per cent as a fair representation of new settlements—the productivity improvement that can be achieved will vary, of course, from one industry to another, but in the United States economy the average, which is sort of par for the course, is three per cent per annum. Let us say that we have an industry that does better than average and is able to improve productivity by 5 per cent. If you have labour

costs going up 13 per cent and productivity going up 5 per cent, what is implied is a rate of increase of prices that will have to approximate to 8 per cent. The arithmetic is very simple. It will have to approximate to 8 per cent if profit margins in that industry are not to be diminished.

I think you have observed that, when the aluminum companies settled their contract recently, they announced at the same time an increase in prices of 6 per cent. What we have is a wage inflation at a rate which implies chronic price inflation.

The rate of that price inflation, in my judgment, cannot be significantly less than 4 per cent for any extended period of time. We have a situation which implies a base rate of inflation of 4 per cent and, in many cases, probably more than that.

This is not unique to the United States economy. I do not present myself to you here as one who is altogether familiar with Canadian economic developments; but I know enough about Canadian economic developments to know that the United States has no monopoly on wage inflation, and you have your own case. Shortly I am going to Germany. There, and throughout western Europe, there is wage inflation—actually, rather more serious than we have in North America right at the moment. That is the key problem; that is the crucial problem. The question is, what can be done to overcome that, to bring labour cost increases down to the point where they would be consistent with, and broadly equal to, productivity improvements, so that we can have a reasonably stable price level? It is my view that economic growth can be achieved satisfactorily only in a context of relatively stable prices.

Honourable senators, I have made some suggestions here as to what I think is the best strategy for approaching this problem and trying to re-establish stability of cost and prices in our economy. I expect my views on this are of a rather orthodox character. Believe me, I make no apology for that. I believe that what we need more than anything else is a good strong dose of orthodoxy. I am prepared to accept the possibility of some contribution being made by the so-called incomes policy; but I do not come before you as a great admirer of the incomes policy approach—and I would be glad to explain in more detail my reservations about it.

If I have one suggestion to make to you for you consideration, it is this. In my judgment, overcoming the inflation problem means that, first of all, you must have a proper fiscal policy. The federal Government, the provincial governments, must operate as closely as possible—at least, this must be their goal—to a balanced relationship between income and outgo. That is No. 1. I put fiscal policy first because fiscal policy is the government's business. This is the government's own financial housekeeping, and if they do not keep their own finances in order they cannot very well expect anybody else to do it. Therefore, I say, that, just as an example to the whole community, there must be a proper fiscal policy.

Secondly, it is absolutely impossible to overcome inflation unless there is a monetary policy which is compatible with reasonably stable prices. That does not mean a money policy in which you have no increase in the money supply, but it certainly does mean a money policy in which increases in money supply are geared to a return to stable prices. Given the right kind of fiscal policy and the right kind of monetary policy, the next step, in my judgment, is to be sure that all the programs and activities of the government are used systematically and very deliberately to avoid any worsening of the inflation problem, to help produce stability. Let me explain what I mean by that.

In the United States we have defence expenditures of about $80 billion a year. That is 7 or 8 per cent of the whole Gross National Product. If you put all federal spending together, it comes to $200 billion a year, including trust funds, expenditures, and the like. So the United States federal government is an enormous factor in the economy.

A contract is let, let us say, in California, to produce military hardware. The contractor goes out to hire labour. If the labour market is tight—it does not happen to be tight in California today—he pays what he has to pay to get that labour. The bill goes to the Defense Department, which underwrites that wage settlement. We had a guideline for wage increases in the United States of 3.2 per cent, which was supposed to be the limit. He pays 5, 6, 7, 8, 9, 10, 11, 13, 15 per cent, whatever is necessary. Then anyone else in California who wishes to hire labour has to meet his wages, which are underwritten by federal payments.

I say that, unless the federal Government utilizes its programs to help achieve some stability, we will never stabilize costs and prices. I have used procurement as an example. We have vast credit programs, the whole business of the pay of federal employees. If we had nationalized industries, then they would be utilized to help advance stabilization purposes. You know as well as I that in Great Britain wage and price inflation has been spawned within the nationalized industries just as much as within the private sector. Therefore I say that the Government must utilize its own programs and activities to help stabilize the economy.

In recapitulation, given the right kind of fiscal and monetary policies and the proper use of governmental programs and activities, what is left? I say presidential leadership. The political leadership of a country is where the major educational effort has to be made. Political leadership must say the right things and talk frankly, candidly to the people. It must talk to the leadership of business and labour. I believe that in the United States two, three or four years ago the President should have been calling the leadership of labour and business in and, as I have put it, talking turkey to them. Instead we got a standoffism, and unwillingness, to intervene, and the situation regularly worsens. I will leave the statement there: fiscal policy, monetary policy, a proper, deliberate and systematic use of all federal activities and programs and strong presidential leadership.

Now, needed beyond that, believe me, is patience, political courage and a willingness to stick with a program even when it hurts. I do not present this to you as a program that will necessarily be politically popular.

Unfortunately and unhappily, it is just not possible to be politically popular and at the same time right in economic policy matters when economic conditions are as badly out of joint as they are today.

I have been asked many times, "Would it not be bad politics to push for a policy of this kind? Is unemployment not bad politics?" It certainly is, but so is inflation bad politics, and we can get ourselves into a situation in which we experience both heavy unemployment and rapid inflation. This, of course, is the worst of all possible worlds politically, but that is where one can arrive. We are rather deep into that in the United States today, I am sad to say.

I will leave my comments there; I would be glad to discuss these points.

The Chairman: Thank you, Dr. Saulnier. It might be helpful to the committee if you were to review that section of item B at page B-5 headed "How inflation was Overcome in the Fifties".

Dr. Saulnier: When I became Chairman of the Council of Economic Advisers, which was in December, 1956, we had an inflation problem. I thought it was a very difficult one which it was for those days. Labour costs were rising a little over 6 per cent a year; prices were rising approximately 3 to 3½ per cent a year. As I say, I thought it was difficult, but it looks pretty attractive when compared to the present problems.

We were determined to overcome that inflation. What were our objectives? Firstly, we wanted to work back to a situation in which labour cost increases would be about equal to productivity improvement. That meant we had to have labour cost increases, not of 6 or 6½ per cent, but of 3 to 3½ per cent, because that was the kind of productivity improvement we could achieve as a general rule. We felt that if we could bring price increases down to around 1 per cent a year, it would represent virtual stability. Finally, our third objective was that we would achieve a surplus in our trade accounts of about $5 billion a year. This would make it possible for our overall balance of international payments to be roughly balanced up.

By 1961 we had achieved all these goals. In a moment I will describe how it was done. Unfortunately, in the process regrettably, and not by design believe me, we had gone through a sharp recession in 1957-58; we had a small recession in 1960-61, and the Republican candidate for the presidency in November, 1960, was defeated. Believe me, the loss of that election was not part of our design! I was not there to stabilize the economy for the benefit of my friend Walter Heller. I had others in mind. Nor was it any part of our purpose that we would go through the mini-recession of 1960-61, but we did. The unemployment rate, which in the 'fifties was around 4½ to 5 per cent, rose by about two full percentage points.

Now, what were the policies? Well, they were exactly the policies I have outlined here this morning. In the first place, President Eisenhower would say again and again, "There is only a limited amount that the President of the United States can do. He cannot dictate what labour settlements should be. He cannot dictate what monetary policy should be, because we have an independent central bank. But there is one thing I can do, and that is send up to Congress a budget that will help to stabilize the economy and overcome inflation, and that I will do." And that he did, so fiscal policy was the first pillar, so to speak, of this edifice.

The second pillar was money policy. I have gone back and calculated what happened to the money supply while I was chairman of the Council of Economic Advisers. I was chairman for four and a half years, a longer period than anybody else has ever been chairman. While I was there, the average rate of increase of the money supply was 0.5 per cent per annum. I have told my students, whom I like to give all the advice I can, "If you are ever going to be chairman of the Council of Economic Advisers, try to be chairman in a period in which the money supply is rising faster than 0.5 per cent." This is a monetary straightjacket. That is what it was, and I would say rather tighter than necessary. Believe me, by that I do not mean it should have been going up 10 per cent a year, because 10 per cent a year is a formula for achieving 5 to 6 per cent a year inflation, just as sure as shooting.

We had, let us say, an austere fiscal policy. We had a pretty tight money policy. Thirdly, the President used every opportunity he could get to speak out on the necessity of holding wage payments in line with productivity improvement. Believe me, I had to do some educating of the public and my professional contemporaries on this subject.

Let me tell you parenthetically that the first economic report I had to write was in January, 1967. If you look at that economic report you will find a section dealing with the problem of wage inflation and how labour cost increases have to be kept in line with productivity improvement. We have a practice in the United States of seeing that everybody has a chance to comment on the economic report before it is published, so it goes out for what we call an agency review. As part of that agency review I had a visit from a delegation of the Labour Department. They came four or five strong from the secretary's office to protest what I was saying about labour cost increases. They said, "In the first place, this is bad economics. Labour costs really don't have anything to do with inflation. Furthermore, it is bad politics." I replied, "Look, boys and girls, don't you worry about the politics. The politics we will take care of across the street"—"across the street" being the White House—"It is the economics that is my business, and I am here to tell you that this is good economics." Five, six, seven years later the whole concept of the relationship between wages and productivity as part of the inflationary process has been, so far as I know, thoroughly accepted in academic economics. There are still a few who like to think that wages do not have anything to do with it, but it is strictly a minority position now. We had some educating to do, and the President was behind us in physical policy, money policy and leadership on the wage price relationship.

In 1959, once we were out of the 1957-58 recession, let me modestly say that I had a fairly heavy hand in establishing two committees in our government and I wrote the titles for them. One of them I christened The Cabinet Committee on Price Stability for Economic Growth and I hope you will reflect over those words—"Price Stability for Economic Growth." It was not price stability just for the sake of having stable prices; it was having stable prices necessary in order to achieve growth. The Vice-President, the incumbent at the time being Mr. Nixon, was the chairman of the Cabinet Committee on Price Stability for Economic Growth and it became known as the Nixon Committee.

My object, incidentally, was to try to get a committee at the Cabinet level where you could have regular discussions in depth about economic policy questions. The second committee I carried myself and the title, which I also wrote, was Cabinet Committee on Government Activities affecting Costs and Prices. Believe me, when you get representatives from all the Government agencies, sitting around the table, whose activities affect costs and prices, you have a large group and you need a sizeable table.

I would get my troops, as I used to call them, together and we would have the Defense Department, Post Office Department, housing agencies, small business administration, and all of these various groups. The object was to be sure that what they were doing would help us in our stabilization efforts and not embarrass us in those efforts.

One of the principal things we had to work on was the Labour Department. I do not know what the situation is here in this fine country, but in the United States the Labour Department sets minimum wages for all kinds of crafts. We have a national standard of $1.65 an hour, which is paid to newsboys. The Labour Department will go into, let us say Portsmouth, New Hampshire, and they will decide in the shipyard that the going wage for steam fitters is going to be $5.50, $6.50, $8.50, or whetever it is per hour, and that is the minimum. If you are going to work on a federal contract, that is what you have to pay. They set it there for a while, and then they return in another few months and find that somewhere along the line a settlement has been made that raised the rate from $8.50 to $9.00. They will then say that $9.00 is the minimum, and that is applied throughout the community. Therefore, in a kind of a ratchet process, these craft payments are moved up and up and up. This is all done under what we call the Davis-Bacon and Walsh-Healey legislation.

In my small committee I said, "We are going to try to do something about that. We are not turning the clock back on these things, but the ratchet process has got to stop." A newspaper-girl came in to see me and I had the usual frank discussion with her. She said, "What are you going to do?" I said, "We are going to do a lot of things, including something about the Davis, Bacon and Walsh-Healey legislation." She trotted over to the Labour Department and reported to them what I had in mind and I was, to all intents and purposes, locked out of the Labour Department. I would have to say that that committee was less than a complete success, but I am here to say that it was aiming to do the thing that needs to be done, and we simply have to learn how to be successful at this. If I had had a little more time, I would have been successful, but time ran out on me.

In 1961, as a result of these efforts, we had finally brought price increases to 1¼ per cent a year. Labour cost increases were about 3½ per cent, productivity was 3 per cent, the trade balance of the United States was at 5 billions plus—$5 billions positive, I mean—and we had weathered a gold crisis. I would say that we had achieved economic balance. The blemishes in it all were that we had gone through a mild recession in 1960-61 and we had lost an election.

The Chairman: Thank you, Dr. Saulnier. We are now open for questions.

Senator Nichol: Dr. Saulnier, could I ask you two technical questions pertaining to your paper, which has bothered me, not being a professional economist?

Dr. Saulnier: If I may interrupt to say that may very well be an advantage for you.

Senator Nichol: On page 2, in the third paragraph, you refer to "diffusion indexes." That is a phrase which I do not understand.

Dr. Saulnier: We have in the United States a method of following developments in the economy which involves the use of, among other things what we call, leading economic indicators. If you watch those indicators, you get advanced clues of what the economy is going to do. One of them is the average length of the work week. We take figures on the average length of the work week and we divide them according to industry. We may have figures for 50 industries, in which we have the average length of the work week in each of those 50 industries.

A diffusion index is an index that tells us what per cent of those 50 sub groups is rising. It may be that 60 per cent are going up and 40 per cent are stable or are going down. You watch what is happening to the index of the average length of the work week, the leading indicator. That tells you something. You then look at the diffusion index of that leading indicator and it gives you some hints as to how the leader is going to operate, is going to change. So you may say that a diffusion index is a device for forecasting what will happen to a leading indicator, which in turn forecasts what would happen to the economy generally.

Senator Nichol: I am glad I asked that question, because it leads me into the second question. I was really only asking for specific information there, but it does lead me to the other question. We seem to have been dealing, over the last two months with, I guess, three aspects of the whole problem. The first is really: What is the problem, where are you in the cycle—or, more accurately perhaps, where are you in what cycle? Secondly: What do you do about it?—which is what you have been dealing with mostly today. Thirdly: How do you do it in technical, mechanical terms, in your own particular governmental structure? In your case it is federal, state, municipal relationships; in our case it is federal, provincial, and so on.

The part I want to argue about is the first part, the part about telling where you are, assuming that you know what to do. It seems to me that part of our Canadian problem has been to know, to put it in its simplest way, which is the enemy—unemployment or inflation—or which goal should we be after. I think this has resulted in varying monetary and fiscal policies; and, in some instances, serious over-correction, without a proper understanding of the lags, of the timing and so on. If you would be good enough, I would like to ask you if you could talk about this question of lags for a moment and the question of how you tell where you are in the cycle.

Dr. Saulnier: I am speaking now of the United States economy. I would say definitely that we have passed what we call the trough or the bottom of the 1969-70 recession, that we are in a recovery period. I would say that we are about one-third through that recovery. I would measure recovery by the distance between the trough, the low point of the cycle, and the point at which you get back to what you may call the path of potential growth. We are about one-third along that journey.

We are moving. People like to say we are going slowly, but it is not really all that slow, by the usual standards. I expect to see us move further along that path in 1971 and 1972; but I do not expect us to have completed the recovery by mid-1972, which, as I understand it, is a kind of political objective in the United States.

Senator Nichol: Perhaps here, too.

Dr. Saulnier: Perhaps here, too. I doubt that that will be achieved. That goes to your question; Where are you?

Now, how do you follow it? I do not know whether you are familiar with this document here. It is a magazine. It has a little bit of history. It is called *Business Conditions Digest*. It has a pretty fair price on it, $15 a year. I would still say it is the outstanding publications bargain in the United States. It comes out every month. It is a full compendium of these leading indicators, diffusion indexes, GNP numbers, the whole lot.

I had something of a hand in this myself. In 1957 I realized we were moving into a recessionary period. I did not have really as much control over the statistics as I thought I needed. I got a chap by the name of Shiskin. He is, in my judgment, one of the great statisticians of our time. Julius Shiskin got all the economic series; we put them on tape, we put them into a computer. Every month we would bring these materials up to date, and we simply ran this stuff off. When I was in government I had an internal document which put all the numbers together. This is what a council of economic advisers should be doing. In my judgment, a council of economic advisers is an essential part of government machinery. It should be an essential part of government machinery.

We would put these together. Every month I would discuss this at the Cabinet, and personally with the President, as the numbers came along, day by day and week by week, keeping him informed on this.

When the Kennedy administration came in, they decided that this document ought to be published. I was not all that sure that that was a good decision—but it was. It is now published. This goes to the second part of your question: How do you keep yourself informed? Just by getting the full battery of economic statistics and keeping them up to date. I would be lost without a document on our economy of that kind.

Senator Nichol: Do you then think, sir, that the United States Government is in a position to identify the spot at which it is at any given time in the business cycle with reasonable accuracy?

Dr. Saulnier: Yes, I do. The economy is full of surprises and one has always to be prepared to be taken by surprise. However, a pretty good job can be done by approaching it with sufficient objectivity, not trying to find in the numbers what we wish to find in them, but simply studying them for what they have to tell. By being objective and detached, a good job can be done.

Senator Nichol: Something springs to mind. I remember an economist named Pierre Rinfret speaking in British Columbia last year.

Dr. Saulnier: Yes, he happens to be one of my favourites.

Senator Nichol: At the time he made the speech the then President, Nixon, said that he anticipated a budget deficit in the United States of $3 billion. Rinfret at that time said that he just did not believe that; he said it would be $17 billion, $18 billion or maybe $19 billion.

This is the dilemma: how does this sort of thing happen? It turned out that Rinfret was right. Is this because the economic forecast was wrong or because events changed, or, I should say, events forced the Government to change its position?

Dr. Saulnier: Which budgetary defiicit was he discussing?

Senator Nichol: I think it was for 1970.

Dr. Saulnier: I think he was referring to the fiscal year 1971, the estimates for which were put forward in late 1969 and January, 1970. The administration was talking of a deficit in the order of $3 billion, $3½ billion or $3.6 billion. Just about everyone outside the Government at that time was sceptical of that number. My own figure was $18 billion; we will probably have a deficit of around $21 billion in this fiscal year.

Why was the administration putting that number forward? It was an expression of hope and political aspirations, so to speak, rather than an objective judgment as to what in fact would happen in the economy. You know, political candour is not really one of the hallmarks of politics, yet candour is something from which we can all benefit. We do not have half as much of it as we could use.

Senator Cameron: The witness said that a pretty sophisticated statistical program was instituted and in spite of it something went wrong and it was not borne out. Are you satisfied with the quality and speed with which your statistical program is available today?

Dr. Saulnier: There are many improvements which could be made. We need more weekly figures. I have here the issue for April, which contains data through March. The date today is June 2. True, the Chairman of the Council of Economic Advisers has always in front of him an updated version containing the very latest statistics. I used to have what I called my black book. I still keep a black book at home with weekly and monthly data kept up to date. However, it is still behind the times, which is very dangerous.

I used to think of it as if I were a medical man asking for a patient's temperature and being told that I can only learn what it was last week. That is not good enough for me; I want to know what it is right now. There are many improvements to be made. I consider our statistics to be good, but they can certainly be improved upon. Primarily, it means bringing them more nearly up to date. The area in which the figures are least satisfactory is that of labour cost increases.

Senator Cameron: I have felt for a long time that in Canada we need to improve our statistical system by speeding it up and making it more accurate.

Dr. Saulnier: That is right.

Senator Cameron: In the light of what you say this morning, you had up-to-date statistics but still something went wrong. In other words, my law of the unexpected has entered the picture somewhere.

Dr. Saulnier: The patient may die even if I know his temperature. Knowing what his temperature is is no assurance that he is going to live, but I still want to know. The next question is; How do I treat him? The mistakes that we make are not that we do not know enough about the economy, but that we either do not understand what to do about it, or do not have the courage to do what intellectually we know should be done. I could document that; I will spare you.

Senator Inman: My question concerns women. I was a young married woman in the years when it was unheard of for a woman, whose husband earned an adequate income and who had young children, to go out to work. Of course, the war almost forced them out during the forties. If my figures are right, I believe in Canada 45 per cent of the labour force are women, and almost 30 per cent are married women. What effect do you think married women in the labour market have on unemployment, and hence on the economy of the country?

Dr. Saulnier: I cannot speak to the situation here, but I know it is not all that different from the United States. Incidentally, I speak as one who has spent a fair part of his life trying to improve the position of women in professional careers. I have been a member of the faculty of a women's college for 33 years, and many of those I like to call my girls are out doing important work today.

It is very difficult to forecast the impact of women on unemployment. Women tend to move into and out of the labour force more than men. After all, you are not in the labour force unless you tell whoever is gathering the statistics that you are either working or wishing to work. If economic conditions are bad, it is hard to tell whether the reaction of women will be to remove themselves from the labour force on the ground that there are not enough interesting jobs, or jobs that will pay them enough, so they stay away rather than seek employment. When they react in that way they tend to reduce the unemployment rate. On the other hand, they may react to adverse economic conditions by deciding to take a job to help with their family budget, in which case unless they get a job—and they may not get one at once—the unemployment rate goes up.

Much of the movement of the unemployment rate in the United States is attributable to this shifting of women into and out of the labour force. It is complicated and essentially unpredictable. I am not saying women are unpredictable by nature, but in their role in the labour force they tend to be a little unpredictable.

Senator McGrand: I have two short questions. On page B-1, when you are discussing wage inflation in the United States, you say at the bottom of the page:

> If wage increases lead to still more rapid price inflation, as they threaten to do, government will be forced to "put the brakes on" again. This would mean another credit squeeze, almost certainly more disruptive than in 1969-70.

What were the disruptive results or consequences in 1969-70?

Dr. Saulnier: They were many and very serious. The most serious of all was, I would say, that when interest rates rose sharply there was a tendency for funds to flow out of the thrift institutions into other uses. There was a shortage of financing for housing, so there was simultaneously a sharp increase in the cost of mortgage credit and a reduction in the amount of that credit available, and building dropped very sharply. I would say the first disruptive effect is on the housing financing, home building industry.

Senator McGand: Do you mean that if the government were to put on the brakes again you would repeat the disruptive results of what happened when they put on the brakes before? Is that what you mean?

Dr. Saulnier: I do indeed. I do not want to say too much. We just cannot have a policy of restraint ever again. I am just saying that you do not put the brakes on too hard. When I was in government I remember a cartoon showing a fellow saying, "Look, you showed us you can put on the brakes, but don't throw us through the windshield." That is what can happen, so you have to put on the brakes not so sharply as to be disruptive.

Senator McGrand: My second question follows on from there. Is it possible to have selective controls over wages and prices in key industries? This has been sometimes described as putting a fence part way around your property. Would it end up with complete controls? Would partial controls in selective areas end up as complete controls? Can you go part way?

Dr. Saulnier: I think the answer to that depends on the kind of fiscal and monetary policy you have. If you have

an expansionary fiscal and monetary policy, no direct controls will do you much good, whether they are selective or general. If they are selective they will very soon become general. They will not do you any good, because you try to suppress wages and prices and all the time you are building up pressures in the economy through an expansion of the money supply, and somewhere along the line it breaks out and you get these results. You will recall my formula here: (1) the right kind of fiscal policy; (2) the right kind of monetary policy; (3) the right use of government programs; (4) presidential leadership. You go beyond that: if you want to do some job boning, get the fellows in and talk turkey to them. I am all in favour of that, but people who think they can institute something, which they call, in a dreamy way, an incomes policy, never stopping long enough to tell you what they mean by it, they think they will get an incomes policy and this will be a sort of shield behind which they can stimulate the economy with an expansionary money policy. Believe me, this is a road to disaster and will lead to nothing but failure.

Senator Thompson: I am particularly interested in your statement that in the third quarter of 1970 the first year increases for construction workers was 22.1 per cent. I would just like to clarify one thing, which is the Bacon-Healey legislation with respect to federal contracts. Does this mean that the highest wage rate in a local community must be accepted within a federal contract?

Dr. Saulnier: Correct.

Senator Thompson: I understood you were amending that.

Dr. Saulnier: There are two pieces of legislation: One is the Davis-Bacon and the other is the Walsh-Healey. Between these two pieces of legislation, we say that anybody who is doing federal procurement in any governmental operations, such as an arsenal or shipyard, and is employing construction labour to build a house that is being financed with a government insured mortgage, must pay a wage, which is determined by the Labour Department to be the going wage in that locality. Therefore, they have a corps of inspectors going round the country determining what these wages are. Every time there is a new contract the wages gets jacked up a little, thus raising the rate for all the employers affected by these two statutes. It is a kind of ratchet and it constantly jacks the wages up. I maintain they are not following the parade, but are, in many cases, leading the parade. I think these programs ought to be scrutinized and that they should be administered so as to help stabilize the economy rather than exacerbate the inflationary process.

Two months ago the President stated that he was suspending the Davis-Bacon legislation, but then they reinstated it when they had some kind of an arrangement with the construction workers and, in my judgment, that was a mistake.

Senator Nichol: I appreciate that answer. Looking at it from the point of view of the construction industry in Canada, I think I can say for many of them that they consider the Government is using them for a yo-yo and a sort of feast or famine, and that the Government through both direct and indirect means can turn the construction of houses on or off, and so on. I think many of the construction people feel that Government is creating an instability—I will not say an hysteria, but an apprehension which tends to encourage labour to make an excessive demand because they feel this is the period of feast and say "Let's get in on it!"

You have focused on the very large increase in construction. Could you speak a little more on that, because I am wondering if construction in our country, in many ways, is not a barometer of the employment picture and of the economic health of the country.

Dr. Saulnier: Wage inflation is worse in the construction industry than anywhere else. I have cited some numbers which are a little hard to believe, but they are correct; they are taken out of official statistical reports. In the last quarter of 1970 new settlements in the construction industry involved first year increases of 22 per cent. At the same time the unemployment rate was higher in construction than any other industry. This is where you have a real mystery and puzzle. I thought that some real progress was going to be made when Davis-Bacon was suspended. The Government did step in, in a kind of selective way, to try to monitor wage settlements in the construction industry. They announced 6 per cent as the ceiling rate, but of course, it is impossible that they could ever have a 6 per cent rate. If they got 10 to 12 per cent they would be lucky. I think that is the way the settlements have been made.

Senator, when things get as badly out of joint as they are now the most that you can expect is to work back gradually to some stability. I would say that if we were to set a goal of getting labour costs and increases down from the 10 to 15 per cent level, to not over 10, and from 10 to 8 and from 8 to 6, over a period of time we could move back to something that would be consistent with relatively moderate price inflation, but it will take time.

In the United States the administration is saying that we are going to overcome inflation without a recession by the middle of 1972. In my opinion, this is impossible. Why not be candid about it and say "Look, we have a bad situation. I make you no promises, but I will do the best I can. I am going to start moving in a direction that I think is right and I want to move as fast as I can, but I cannot do it overnight." I think if you take that kind of line people will go along with you.

The Chairman: Does that complete your questioning?

Senator Molson: I would like to come back to the question of money supply. I was very impressed by the figures Dr. Saulnier gave us, of point 5 per cent over 4 or 5 years.

Dr. Saulnier: It was 0.5, 4½ years.

Senator Molson: I would like to ask him what 15½ per cent over 12 months sounds like to him. Those are the Canadian statistics, as we have them from April 1970 to April 1971, the increase is about 15½ per cent—if my information is correct, and I think it is. It seems to me an

extraordinary increase and it seems to be again over-reacting. Would you comment on that?

Dr. Saulnier: It is just exactly that. It is bound to be an inflationary increase. Here is a place, incidentally, where the statistics are far from adequate. We have different definitions of what we mean by money supply. I am not sure that I know just what particular money supply that 15 per cent refers to.

The Chairman: Would you tell us the one that you like to use? I notice that you use both here in your summary.

Dr. Saulnier: I am an electic about these things. I do not have any one particular number that I use. I want to look at regularly the narrowly defined money supply, which is adjusted demand deposits and currency in circulation.

Senator Molson: These figures I am referring to are currency and chartered bank deposits.

Dr. Saulnier: Would it include time deposits, as well as demand?

Senator Molson: I think not overwhelmingly . . .

An hon. Senator: Just chequing.

Dr. Saulnier: Then it is what we would call the narrowly defined money supply; and our money supply, so defined, has been rising of late, 8 to 10 per cent. Sometimes a little below 8 per cent.

Senator Molson: Excuse me, doctor. At that rate, or would that be a 12 months' change?

Dr. Saulnier: That is over a fairly extended period of time.

Senator Molson: Thank you.

Dr. Saulnier: Let me say that a non-inflationary rate of increase of the money supply, thoroughly non-inflationary, would be between 4 and 5 per cent a year. So, if you have 10, what you have is a money policy which implies a 4 or 5 per cent price increase. And if it is 15, and if it is continued at 15 for any period of time, believe me, you are asking for trouble—because it is an inflation rate of over 5 per cent.

The only hope that it would avoid being that is that the money that would be created and somehow be held inactive in balances. But, let us say, that is a thin reed on which to be relying. My reaction is that it is a thoroughly inflationary rate of increase.

Senator Molson: Could I ask a question, Mr. Chairman, about wage inflation, which is set out at some length in Dr. Saulnier's paper? We have had one witness—I think it was Dr. Harry Johnson—who stated categorically that labour should not be blamed for the inflation in which we found ourselves, that big labour was the popular whipping boy, but should not be blamed. I think I am right in that?

The Chairman: Yes, I think that is what he said.

Senator Molson: It is not that he said that labour is blamed too much—I think a lot of people can agree with that—it is the fact that he stated so flatly that it was in no sense to blame. At least, that is the way I understood it. Would you care to comment on that?

Dr. Saulnier: I would not agree with that at all. My position would be this, that the inflationary situation in the economy basically is caused by monetary or money supply increases. This is the necessary basis of inflation. Does that mean, therefore, that you can assign all the responsibility for inflation to the monetary authorities? I say no. You may get your budget so badly out of balance that you have a governmental financing job to do which can only be done by having the central bank assist the government in the purchase of securities which will have an inflationary effect on the money supply. So, who is to blame? The monetary authorities, or the fiscal authorities? I would say they are partners in the crime, they are both in it, accessories.

All right, now you get the thing started and prices start moving up, and the working man finds that he is behind again. It is only natural that he says he has to get a higher wage. He comes in, with a strong union and says he wants—as we got in the automobile, General Motors, settlement—10 per cent. He gets the 10 per cent because, after all, he has power. There is power in organized labour to enforce that. He gets the 10 per cent. What are the monetary authorities going to do? Keep the money supply so tight that the price increase which a 10 per cent wage increase implies cannot be obtained in the market, and you get an increase in unemployment. So the monetary authorities say they will validate those wage settlements with an appropriate increase in the money supply. If they do not do that, you have unemployment.

Therefore, the fiscal authorities, the pressure of organized labour, and the monetary authorities, all are caught in a process in which jointly they are producing inflation.

To reach into that and say one is the guilty party mistakes the nature of the process. It is a co-operative process, in which they are all accessories. They all feel that they are victims, that is the interesting part of it; nobody thinks that he is initiating anything, it is a community of victims. They are all compromised, and to a certain extent that is true.

How do you break out of this process? I think that political leadership has to be the answer to that.

Senator Molson: And the response would have to come from all sides.

Dr. Saulnier: The response must come from all parties. General Eisenhower and I had a term, which I repeat in this paper. He used to refer to "the shared responsibility". That is the responsibility which in a democratic society we all share to do that which is compatible with stability. In the absence of that sense of responsibility a democratic society will move in an authoritarian direction. He did everything he could to preach that doctrine of shared responsibility. By the time we wound up our affairs we had done pretty well. I would have preferred to have had a little different election result. Mind you, I

have received no credit for it, but we had done pretty well.

I think that the fifties proves, senator, that it can be done. At least, it could be done from where we started; whether it could be done from where this administration started is an open question. You will remember that old story of the fellow who stopped to ask directions of a Vermont farmer. He asked, "How do I get from here to Norwich?" and the farmer replied "Well, if I were going to Norwich I would not start from here." But you know, the first rule of economic policy is that you must start from where you are and not from where you would like to be. Starting from where this administration started was not an easy journey.

Dr. James Gillies (Study Director): Dr. Saulnier, you said in your comments that an economic advisory council is an indispensable tool for any government. Could you elucidate slightly on that, in view of the fact that we do not have a council of economic advisers in this country such as that in the States?

Dr. Saulnier: It is an indispensable tool of government. There is no guarantee that the Council of Economic Advisers will give the right advice. However, at least it is a mechanism, and one can hope for the right results.

The council can give the contribution of professional economists, as economists, which is different from what is obtained from the head of the central bank, the head of the Treasury, the Finance Department or the head of the housing agency. There we are talking about people with operating responsibilities. I am thinking of an advisory council agency which can be provided through a body such as the Council of Economic Advisers working very closely with their head of government. The council must have the support of the head of government. I always felt that we had the support of the President; I know we had the support of the President. I worked closely with him, day in and day out. We attended every meeting of the cabinet. I probably made more presentations to the cabinet in the four and one-half years I was there than any other member of Government, because the economy was always on the agenda. I attended all meetings of the National Security Council having to do with economic matters. I honestly do not see how you can get along without such a council.

Senator Molson: Did you have any difficulty in speaking with one voice for the council when you were chairman?

Dr. Saulnier: I did not, no, I am glad to say. My colleagues and I would debate within the family but once we had decided on a line, that was it. Furthermore, we did not do all that much talking, which is something that I would recommend as a policy.

Senator Molson: That is difficult to achieve.

Senator Nichol: Was the President in receipt of conflicting advice on economic policies from other committees, boards or organizations?

Dr. Saulnier: Oh, yes; of course.

Senator Nichol: So you were fighting for your ideas within this framework?

Dr. Saulnier: Yes, absolutely.

Senator Nichol: There were other advisers, directors of budgets and so forth, who had conflicting ideas.

Dr. Saulnier: Certainly; most of this argumentation is not conducted in the President's office. It had to be conducted in the White House complex with the President's staff. We had a committee known as the Advisory Board on Economic Growth and Stability, ABEGS. ABEGS had in its membership the Under-Secretary of those departments having major economic or financial missions. That board met every Wednesday afternoon in the office of the Chairman of the Council of Economic Advisers, under his chairmanship, throughout the Eisenhower administration until the last week. That is where we would thresh out these questions.

If the Treasury, for example, was off on a tangent of its own, lengthening the average maturity of the debt and wrecking the housing industry in the process, we would have a little debate and try to settle our differences right there. If we could not settle them there, we would go across the street and if we were not successful in the office of the Assistant to the President, who was first Sherman Adams and afterwards General Persons, we would go to the Oval Room, where the process stopped. The President would decide the matter.

I did not have very many issues that had to be taken to the Oval Room, but some were. I used to meet regularly over at the Treasury at lunch, which is the time when this business is carried out, with the Secretary of the Treasury, the Chairman of the Federal Reserve Board and the Under-Secretary of Economic Affairs at the State Department. We would discuss financial matters. I was regularly in contact with the Chairman of the Federal Reserve Board, Martin, during my period there. I would go over there at not longer intervals than every other week. Martin as chairman, the vice-chairman of the board, myself and one other member of the Council of Economic Advisers would sit down together and discuss money policy. That afforded an opportunity for me to be sure that the Federal Reserve Board knew what we thought money policy ought to be, and in that I was acting for the president. That is the machinery we had, with the council, these meetings at the treasury, meetings at the Federal Reserve Board, and out of this process policy was shaped.

Senator McElman: In this process, what was your batting average for the propositions you put forward?

Dr. Saulnier: Well, you win some and you lose some. I think the batting average could have been better. We came out pretty well in the end, and I have described where we came out. After all, a situation in which prices are rising 1¼ per cent per annum is not too bad, and that cannot be so unless labour costs are rising roughly in proportion to improvements in productivity, which we had. We had a surplus in the trade account of $5 billion. Our balance of payments was roughly in balance; there

was a relatively small deficit. I would say in those respects we came out pretty well.

We could have done better. I have stated publicly that I think we probably pushed a little too hard on the monetary brakes. It was not my business directly; that is the federal reserve system; 0.5 per cent is pretty tight for four and a half years.

Secondly, I think our debt management policies left something to be desired. I believe we pushed too hard on an extension of the maturity of the debt. In 1959 we issued the so-called magic files, which I thought were a disaster. They pulled money out of the thrift institutions and just delivered a terrible blow to the housing industry. Well, that was the enthusiasm of the treasury officials. You know, they think about their own affairs; the Council of Economic Advisers has to think about the whole ball of wax, and I thought that went too far. I had some arguments over that which I lost. I also had some arguments that I won, and in the end we had the thing pretty well straightened out. We had laid the basis for high level non-inflationary growth in the United States economy, and we had it until 1965, when it got off the tracks again, needlessly, but the foundation was laid.

Senator McElman: That is what I am getting at. The record of that period was good.

Dr. Saulnier: I think so.

Senator McElman: What I was trying to get at was what the input of a council such as yours was when it came down to the gut decisions.

Dr. Saulnier: I think it was a very important input. The president looked to us, and always looked to us, for advice on these matters. Whether it was the budget, financing policy, the whole management of the housing business, with the setting of rates on insured mortgages and the like, no one of those decisions was ever made without our knowing about it and having a part in it.

Dr. Gillies: I should like to turn to a different topic. What do you think will happen to the American balance of payments? Do you think they are going to get so severe that there will be some sort of deflationary trend?

Dr. Saulnier: I think this is a very serious matter. In my judgment, the crucial issue here is the possible impact on the United States economy of an unwinding, a reversal, of the flow of funds that brought about the dollar crisis to begin with. I hope that can be unwound without having a disruptive effect on the United States economy, but I am not sure that it can be.

The Chairman: Do you think this might create some very heavy inflationary trends as the reversal takes place?

Dr. Saulnier: Yes. You see, the problem is this. When we had our credit squeeze in 1969-70, the United States banks borrowed heavily in Europe, in the Eurodollar market. This drove Eurodollar interest rates up. When the squeeze was over the United States banks repaid those loans; Eurodollar interest rates dropped. As those rates dropped, primarily in the London market, there came to be a differential between the interest rates that you could get in the German market, for example, as against the Eurodollar market, so funds began to flow towards Germany. As they flowed towards Germany, it meant dollars being exchanged for D-marks; the dollar dropped to the bottom of its support level and people began to feel that the dollar was on the ropes, that the D-mark would be revalued upwards, so they felt they had to move in and get D-marks, which they did. The German central bank thus came into possession of a massive amount of dollars. They just do not sit there with dollars; they have invested them in the New York money market, in treasury bills. The problem is what happens when that money begins to flow from D-marks back into dollars.

In order to supply those dollars the German Industrial Bank will have to disinvest in treasury bills, and if they do that abruptly and in a big way you could get an escalation of short-term money rates and we would be back in the disruptive money market conditions of 1970. That is what we are faced with. The only way to avoid this is prayer and a little bit of arm-twisting and hope, as well as charity on the part of our allies and friends in the world, and a realization on the part of everybody that we all have crockery to be broken in this business and nobody can afford to throw his weight around too heavily.

Finally, it can be avoided by a Federal Reserve policy which will support the bill market in time of need. The trouble with that is that it is an inflationary solution. That is where we sit and I believe, in this situation, that what we really need more than anything else is to all sit down and have a long, hard, confidential talk about international monetary machinery, and to put together some machinery that is more adequate. The present machinery is not adequate, in my judgment.

The Chairman: Dr. Saulnier, I have a supplementary on that. In putting together this machinery, can the Eurodollar market be brought under control? Should it be, and how would it be?

Dr. Saulnier: I do not know how it is going to be, but it has to be. When I was chairman of the Council, one of the fellows had an expression: "You know, government is like a big ship; it has a lot of loose cargo in it. It gets moving around and it can be very destructive." These amounts of dollars in Europe are like loose cargo and they get moving around in the hold of the ship. You do not know where they are going and you have no control over them; they are just banging around. Believe me, one of these days they are going to go right through the bulkhead, and I say we have to have better machinery to control the movement of these funds.

It is helpful to be sailing on a quiet sea and then, if you have loose cargo, there is no problem, but when you have a rough voyage and loose cargo, believe me, you are in trouble.

An Hon. Senator: They were not a factor when you were chairman?

Dr. Saulnier: No, they were not.

Senator Beaubien: Dr. Saulnier, do you think that Canada can have a very much different result, as far as inflation is concerned, from the United States, in view of the fact that our economies are so meshed?

Dr. Saulnier: The economies are so closely meshed that I am sure it is not only difficult, but probably impossible for them to go on clearly different paths. That possibility is minimal, because the United States economy is the larger of the two and it is bound to have the greater influence in the total situation. We have to work together and harmonize our policies, without a doubt, and I think we do that less than perfectly.

Senator Nichol: Doctor Saulnier, on page 6 you are very specific about direct price and wage controls. There are a lot of people in this country calling for price and wage controls by various names and the semantics is confused. You do not really know what people mean when they say "incomes policy", until you sit down and talk with them, and then they finally say what they mean. I would just like you to enlarge on what you have said here in paragraph 3 about price and wage controls in the long-term sense and price and wage controls in the short-term or emergency sense.

Dr. Saulnier: The talk about incomes policy worries me, because the fundamental and essential measures for overcoming inflation and for preserving stability in prices are monetary and fiscal. In the absence of adequately non-inflationary fiscal and monetary policies, these wage and price controls will get you nowhere.

If you have the right fiscal and monetary policy, then it is conceivable that some direct intervention will help you get back to stability and will make it possible to get back to stability rather faster than would otherwise be the case. I do not close the door to some sort of direct intervention, but what concerns me is that people think that, because they have wage and price control, they can have an expansionary money policy. As a matter of fact, you will find in this morning's press a statement by Sir Roy Harrod, which represents, to my way of thinking, a totally erroneous notion about economic policy. He was asked whether he thought income policy had to be accompanied by tight monetary and fiscal policies. His answer was that he did not agree with that at all, and that incomes policies should go along with expansive general economic policies. What Sir Roy is saying is to put the stopper in the boiler and then build up steam. The thing has gone up a lot and that is all that can happen; it will blow up. I am not against putting a stopper in the boiler, but I want to be sure that the pressure is kept to the point where it will be possible to hold a stopper in place. People get misled by incomes policy. In the first place, it is a sort of dreamy, fuzzy, mushy concept which they do not really define, and, second, they think, as apparently this distinguished economist believes, it can be a shield behind which you can have an expansionary money policy.

You can have an incomes policy, believe me, until the cows come home; and if the money supply is going up 10 or 15 per cent a year you have inflation one way or another. You know what happens. I remembers that during World War II we had price controls. There was a Hershey bar and it was 5 cents in those bygone days. They said it could not go above 5 cents. Well, costs went up, wages went up; so what did they do? The Hershey bar gets smaller and smaller—but it is still 5 cents. Finally, it gets so small that they have to put in a cardboard, to give them something to wrap up. The ultimate of this is that you get nothing but cardboard.

Senator Nichol: Which is much better for your teeth!

Dr. Saulnier: It may be better for your teeth, but this is price control. This is price control not accompanied by an adequate disinflationary money policy. These are the rudiments of economics, but somehow or other they do not seem to be well understood.

Senator Nichol: This is a question on another subject. I have a graph here which I will bring over to you in a moment, if I may. It is headed "The Monetary Prices Cycle, 1929 to 19?". It shows various curves—bond yields and interest rates, velocity of demand deposits in New York City, corporate liquidity, inverted, which makes the curve go the same way. Some people draw pretty depressing conclusions from these curves, saying that from 1930 through a low of, say, 1945, on all of these curves, all of these things have been steadily increasing, at an ever-increasing rate since then, and that eventually this cycle, this super-cycle, is going to come unstuck, that each of these inflations by world governments, such as the one that is occurring now, where money supply is being pumped hard, simply prolongs the day of reckoning, in a sense. Could you comment on that? May I pass this chart over, Mr. Chairman? I am sorry it is so small.

The Chairman: Thank you. This is the *Bank Analyst*, June, 1971, Volume No. 12, Chart on page 27.

Dr. Saulnier: I do not wish to diminish at all the seriousness of the monetary and credit developments that are described here. They are very serious. We live in a highly inflationary world. Our policies, I am afraid, are at present such as to continue that inflationary bias in our economy. In a very inflationary world, we are continuously vulnerable to financial and credit squeezes, liquidity squeezes, if you will. We had one in 1966, we had another in 1969-70—and there are those who think that we have the makings of another today. There are people who preach a kind of apocalyptic view. Sometimes, you know, people would rather hear about impending disasters than anything else; it is, after all, you know, rather exciting, and it is a merchandisable story. I do not happen to be a member of the apocalyptic school. I think we can avoid the crises, these crises that are being described so often in these terms. However, if we do not get control over inflation, we are going at some point to be victims of just such a disruptive financial event.

I am not by any manner of means, I hope, at all sanguine about all of these things. I hope I take them very seriously. There are people who actually look to me for a little help in these matters and I have to have a

view on what is going to happen in the bond market, in the stock market, in the money market and in the economy as a whole. There are those who take a very very dreary, dim view of the bond market today. I am not one of them. I think we can avoid another credit squeeze, a liquidity crisis, and I do not look for one in 1971, 1972.

Senator Nichol: Dr. Saulnier, what is bothering me is that these curves show a long-term credit squeeze of sorts. Putting that aside for the moment, if we are to avoid it, how is it avoided without increasing the money supply.

Dr. Saulnier: It is not easy. It may be that it is not even possible. Once you get into a squeeze type situation. . .

Senator Nichol: Your options drop.

Dr. Saulnier: Your options narrow very much and you are almost forced into a monetary policy which is essentially inflationary. That is the situation we got into in the middle of 1970, and we could get into another one in 1971-72, for the international reasons that I sketched earlier.

You have to do what your reason tells you is right, and hope for the best. I am quite serious with you when I say that, in my judgement, another liquidity crisis can be avoided. Avoiding it will have some tendency to prolong the inflationary bias in the economy. That is unfortunate, but I would rather have that than financial collapse. So too, I am sure, would our monetary authorities.

Senator Nichol: There is a tendency all over the world for corporations, particularly large ones, who have to some extent at least mismanaged their affairs and let their current ratio dribble away, spent all their money on fixed assets or have been unprofitable, to turn to Government and say, "We are in a liquidity crisis; you must help us because we provide employment," and so on. Do you think government should involve itself in the business of saving big companies, or small, that get themselves into these jackpots?

Dr. Saulnier: They have to. After all, we live in a domino-like world. You pull one out here and many others can drop. Government has to recognize this and take the necessary steps to keep this process from starting. If that means helping a large company with a liquidity problem, it has to be done.

Senator Molson: In some cases government creates the problem. Examples are the aircraft and aerospace industry.

Dr. Saulnier: Absolutely. Consider the railroad industry. After all, there is not an industry in the United States in which Government has become more deeply involved, yet try to find an industry in which conditions are worse, financially or otherwise. I observe these things and ask myself, "What are these fellows talking about who want to solve all the problems by getting the government more deeply into it?" It is my observation that where the government is most deeply into the picture the situation is the worst.

Senator Cameron: Mr. Chairman, in terms of the advisory machinery to the executive, what is the relationship between the Council of Economic Advisers and the Bureau of the Budget?

Dr. Saulnier: It is very close. The Director of the Budget would be a member of ABEGS. He would be in the office of the Chairman of the Council of Economic Advisers every Wednesday afternoon. Therefore, we were constantly together; there is no question about it.

Senator Cameron: Is his role the implementation of policy formulated by the Council of Economic Advisers?

Dr. Saulnier: Oh, no; I would not say so. If he is the kind of fellow you want as Director of the Bureau of the Budget he will have some ideas of his own as to what budget policy should be. If he does not have those ideas, then you need a new budget director. Those ideas are put side by side with those of the Secretary of the Treasury and the Chairman of the Council of Economic Advisers and what the President in the end thinks the decision ought to be, and in the inner family an administration position is reached.

In a certain sense all are equals in this, except that the budget director comes to it as an operating officer. I would come to it as an economic adviser, which is a very different status. Finally, a decision is made by the President.

The Chairman: The hour grows a little late, so I do not wish to enter a new line of questioning. However, many economists have appeared before us in the course of these hearings saying that we can achieve growth and accept a certain degree of inflation, maybe 3 or 4 per cent. You made the statement that growth is only possible in an atmosphere of reasonably stable prices. Would you tell me why that is so in your judgment?

Dr. Saulnier: The statement I made, Mr. Chairman, was that sustainable high-level growth is possible only in an environment of stable prices. Those who consider that we are all right with 3 per cent a year inflation are off the track. The trouble is that the dynamics of the economic process are such that 3 per cent tends to become 3½ per cent; 3½ per cent tends to become 4 per cent. Those who say they are satisfied with 3 per cent do not understand the internal dynamics of the economic process, which will tend to accelerate. Therefore, I say you start off with an inflation rate of between 5 per cent and 5½ per cent, which is the present situation. We cannot reduce it to 1 per cent overnight, but we must start in that direction. We ought to try to gradually move ourselves down to an inflation rate of what I consider to be par for the course, 1½ per cent. Why 1½ per cent? Because the statistical indexes are sufficiently imperfect that they will register 1½ per cent but in fact prices are *de facto* stable. That is where we were and what we had from 1960 to 1965, 1¼ per cent.

Senator Nichol: What was the unemployment rate during that period?

Dr. Saulnier: It was going down steadily. For one month in 1960 it was 7 per cent, but for the year as a

whole, 1960-61, the average was between 5½ per cent and 6 per cent. Then it drifted down. By 1965 it was down to about a 4 per cent level. That is when we got off the track, and we did not need to get off the track.

The Chairman: You say in 1965 the inflation rate was 1¼ per cent?

Dr. Saulnier: Yes.

The Chairman: Against an unemployment rate of 4 per cent?

Dr. Saulnier: Right. This is the sort of golden age; this is the best of everything: a low inflation rate and a gradual drifting down of the unemployment rate. In that environment you can begin to do the structural things that you need to do to correct unemployment, namely, job training, lifting the productivity of people so that they can be hired because they will be productive enough to be hired at the going wage rates.

The Chairman: At what rate was the GNP expanding, do you recall?

Dr. Saulnier: The GNP was expanding at between 3½ and 4 per cent, a very high rate. It would never have happened had it not been that the groundwork was established, which was a painful process. That was the second half of the 'fifties. Once that groundwork had been established you could have this good performance. Of course, my friends the Democrats came in and they took credit for everything. I know politics, I guess, as well as the next fellow, and I do not expect anything other than that. But I say as an economist—and I hope I am trying to be objective about it—the groundwork was set, and it is in that environment that you get high growth. Now what have we got? We do not have anything. There is high unemployment, high inflation, low growth.

Senator Laird: I should like to ask a supplementary to that. It interested me to hear you say it might be desirable to import some South American economists. Do you infer they are doing a better job down there, with their very substantial kind of inflation, than we are doing up here?

Dr. Saulnier: Well, they have had more experience with it! That was a semi-facetious observation. The fact of the matter is that they are not doing too badly. In Brazil and Argentina the inflation rates are receding and the growth rates have been fairly high. There, when they get down to 15 per cent with a 20 per cent per annum price increase it is a great success. It is, after all, a lot better than 80 per cent, which every now and then they have, or have had in the past.

The Chairman: Honourable senators, on your behalf I want to thank Dr. Saulnier for contributing so much to our hearings, and no doubt the final report. I especially want to thank him for something that is unique, which is that he gave us an extremely enjoyable morning.

Hon. Senators: Hear, hear!

Dr. Saulnier: Thank you all very much.

The committee adjourned until 4.00 p.m.

Upon resuming at 4:00 p.m.

The Chairman: Honourable senators, we now resume our hearings on growth, employment and price stability. We are honoured today to have with us the Canadian Bankers' Association, represented on my right by Mr. René Leclerc, its President, who is also Chief General Manager and Vice-President of the Banque Canadienne Nationale. With Mr. Leclerc are representatives of the various members of the banking community. On his right is Mr. R. M. MacIntosh, Deputy Chief general Manager of the Bank of Nova Scotia; to Mr. MacIntosh's right, Mr. J.E. Morgan, Deputy General Manager of the Royal Bank of Canada; on Mr. Morgan's right, Mr. N. E. Currie, Vice-President and Economic Adviser to the Bank of Montreal; and to Mr. Currie's right, Mr. J. Harvey Perry, who is well known to all honourable senators, Executive Director of the Canadian Bankers' Association. Sitting next to Mr. Perry is Mr. Suleyman Sarpkaya, Economic Adviser to the Canadian Bankers' Association.

Honourable senators, you have the brief from the Canadian Bankers' Association before you, and I will ask Mr. Leclerc to give us a resumé of that brief.

[*Translation*]

Mr. René Leclerc, President of the Canadian Bankers' Association: Thank you, Mr. Chairman. Honourable Senators, as President of the Canadian Bankers' Association, I would first of all like to thank you for having invited the Association I represent to testify before your committee within the framework of its important inquiry.

As you undoubtedly know, the Canadian Bankers' Association comprises Canada's nine chartered banks. Its executive council is made up of the chief executive officers of each of the banks, and it is on their behalf, as well as my own, that I am speaking to you today and submitting the Association's brief.

The colleagues accompanying me were introduced a while ago by the Chairman and I shall not name them again.

Now, to summarize our brief; it explains in what way monetary policies must pass through the banking system in order to influence the economy; it also studies the suggestions made from time to time for facilitating the application of a monetary policy which would take regional disparities into account.

[*Text*]

We indicate that while a significant part of the flow of savings into investment is direct, from the saver to the user of the funds, a very large part of the total lending and borrowing in the Canadian capital market is channeled through financial intermediaries. We point out that there is a constraint on the banks' ability to achieve growth in their Canadian dollar deposits that does not apply directly to other financial institutions, for the maximum amount which the banking system can hold is determined, for all practical purposes, by the central

bank, hence the extent of financing they are able to do is effectively prescribed by the central bank.

We go on to state that the extent of a bank's lending operations depends primarily on the demands of borrowers, and that where a market exists, the banker is anxious at all times to lend to any businessman who has a reasonable proposition to make.

[*Translation*]

We then review the process whereby funds are distributed among the banks. We show that the two factors in determining the volume of loans granted by the chartered banks are, on the one hand, the demand for funds for various purposes throughout the country and, on the other, the total deposits within the banking system as determined by the policy followed by the Bank of Canada at a given moment; this amounts to saying that monetary policy, insofar as it affects banks, determines only the total amount, and not the distribution, of deposits throughout the country.

The breakdown of their use either as loans or investments is determined basically by the clients, and monetary policy alone cannot fix the money supply in a given region or the amount of bank credit in that region. In fact, these are essential elements in a national money market which, like ours, uses a single currency.

[*Text*]

In discussing suggestions concerning the pursuit of monetary policy by different regions we repeat our previous assertion that to a large extent, in a national economy having a common currency and a reasonably unencumbered capital market, funds will flow from where they are generated or saved to where they can be employed most usefully as a result of the individual decisons of many borrowers and lenders. We shall, nevertheless, examine the feasibility of achieving such a diversion by the mechanism of regionally different cash reserve ratios. We do not believe that any such system, in fact, would induce a shift of funds from one region to another, or that such a shift would have any real significance in economic terms.

We reiterate that the actual location of deposits in a branch banking system is of little relevance since funds tend to be employed where the opportunities for their use are greatest.

[*Translation*]

Theoretically, if cash reserve coefficients taking regional disparities into account brought about lower interest rates in a given region, the result should be economic advantages for that privileged region. However, we do not believe that this can be realized in practice.

Our brief also deals with the experiment of the Common Market, where an attempt is being made to get down to the use of a single currency. It seems that this would prevent the drawing up of any regional monetary policy. This inevitably leads us to conclude that it is neither possible nor desirable to set up in Canada a monetary policy centered on regional disparities.

[*Text*]

Notwithstanding that, we state our firm opinion that the banks can still play a useful and constructive role in building up the slower growth regions. We point again to the fact that the great and proven strength of our present banking system is that funds can flow freely from where they are generated to where they are needed.

[*Translation*]

It goes without saying that the banks are very much aware of the acute problems existing in certain regions and of the necessity for establishing a better economic balance throughout Canada. Despite the fact that there is nothing forcing them to do so, the banks are paying special attention to the residents of the disadvantaged regions and, insofar as possible, are lending them assistance. Even though interest rates on loans are comparable throughout the country, the banks often grant privileges with respect to the maturities of loans and the guarantees required in such regions. This attitude is the result of both an awareness of their social responsibility and the sometimes keen competition with which they must cope.

Thank you, Mr. Chairman.

[*Text*]

The Chairman: Thank you, Mr. Leclerc. Do your colleagues have anything to add, or would you like to go straight into questions? We are now open for questions.

Senator Nichol: I scarcely know where to begin, because there are so many questions to ask about all of this as it bears upon what we are pursuing in this committee. You have made a strong case for there not being the imposition of cash reserve ratios in the various regions. My own inclination is to say that your argument is absolutely valid. Are the amounts of loans by regions, and the cash reserve ratios by regions, made public now under the Bank Act or in bank statements, and so on?

Mr. Leclerc: No.

Senator Nichol: Do you think it is a good idea that they should be kept the way they are, or do you think there would be any advantage in having them published?

Mr. Leclerc: For my bank it does not matter too much, because we are operating mostly in the Province of Quebec. I can ask my colleagues if they have anything to add.

Mr. R. M. MacIntosh, Deputy Chief Manager, Bank of Nova Scotia: Senator Nichol, may I just make one opening comment? There are no regionally published statistics of the banking system. There are none collected, to my knowledge, and there are certainly none published. I do not think there are any collected on banking loans as a whole. There is only one cash reserve ratio.

The problem that exists, I suppose, is that every region in the country and, more specifically, every province in the country, would, I think, tend to feel that it should have a net inflow. It is difficult to imagine any provincial authorities that anything but a net inflow would be desirable for that province or that region. On balance, clearly there cannot be a net inflow to every province, and there are, in fact, probably some relatively small transfers from the well-to-do provinces to the others. In principle, I would think this is what happens, because the

savings rate is higher in those provinces which have higher income. On the whole, I think transfers would tend to go in that direction.

Our position is that information of that kind would, first of all, be highly misleading, because in many instances loans may be booked in a particular location, such as a head office location, with respect to a national corporation. The funds, however, may be used in widely divergent parts of the country. For instance, a large mining company with its head office in Montreal may well be using the money in British Columbia, and in some cases, specifically, they are. The flows of money within corporations and the flows of money of depositors would be so difficult to trace that it is almost impossible to draw any meaning out of figures that were merely based on representations of what is on the books in head office, for instance.

Senator Nichol: The question arises, because when money gets tight, of course, people who are farthest away from head office are the prople, specifically, who are having difficulty in getting loans or are having loans called or having other forms of conversation with bankers and—I am from British Columbia—somehow the money is being drawn back from the defenceless citizens in the outports and is used to increase the liquidity of the companies in the east. I suspect that is not true, but the feeling is there. Maybe some sort of public statement of the banks' operations in the various regions might do something to remove that feeling. It still exists in spite of all the changes that have come in banking across Canada in the past years.

Senator Isnor: You said, "in the east"; you mean in central Canada.

Senator Nichol: Senator Isnor, since you have one of the large chartered banks in Nova Scotia, I did not feel I should include you.

Mr. Leclerc: If you have a loan made by us, it would be in our books in Montreal and the other part of the loans made by another bank would be in the books of this bank in Toronto, so the figures could not be very accurate if you have figures by region or branches.

The Chairman: Do you have a supplementary to your question?

Senator Croll: For years in the House of Commons the charge has been made exactly as stated, that you took the money out of the west and out of the Maritimes and brought it down to the holy places in Toronto and Ontario. But time and again the banks have produced statements before various committees in the House of Commons indicating the distribution in many instances was actually more favourable to the western part of Canada, under some circumstances, than was otherwise acknowledge. You, sir, from the Bank of Nova Scotia, say there are no such figures, but I have seen them time and again produced by the Bankers' Association, which is perhaps the only body that could have produced them, broadly setting out that position. Does not anyone on that front bench recall any such figures?

Mr. MacIntosh: Senator, I think that individual banks would have a fair idea of their own figures. There are no industry figures of that kind. I think any comments which bankers have made were probably based on their general experience.

With regard to the question of when money is tight, which I think is relevant to what both you and Senator Nichol were alluding to, the thought that the smaller borrowers in the outlying regions are squeezed first, I do not think would tend to be borne out by the statistics of what has happened to large loans and smaller loans during the last two or three years of tight money, because the statistics for the system on large loans of $5 million and over, for loans of $1 to $5 million and on loans under $1 million are published. I think it would be true to say that no bank during the period of tight money which we have gone through would ever have called loans under $100,000 or $1 million for reasons of tightness. They might have had individual situations where credit, of course, was inferior, and they might have called it for that reason, but not for reasons of putting pressure on a borrower to reduce his loans in order to improve or protect the liquidity of the banks. If that happened, it would apply to the large borrowers. It is the large borrowers in the last two or three years that the banks brought pressure on to go to the public market, because those are the people who have access to the public market. I very much doubt if there is any evidence that a bank puts pressure on the type of borrower who has no access to the public markets at all.

Senator Croll: I did not say that, and that was not my question.

The Chairman: I think the question that Senator Croll was asking was whether the Bankers' Association or the banks had ever amassed the figures on the distribution of loans. I suppose there is a logical question that flows from that: Could it be done? It might not be healthy, from the point of view that you expressed, that one region would have to have an outflow and anotther an inflow. I think he is interested in whether it has been done; and if not, whether it could be done?

Mr. MacIntosh: As a short answer, it has not been done. The answer to the question, "Could it be done?" is, "Yes," but if it were done it would not add to the sum of human knowledge because it would be highly misleading in terms of the fact that the booking of the loan by location would not reveal where the funds are actually employed.

Senator Croll: I think your answer to my question was contained in the last couple of sentences, when you said that in the last two or three years the situation has changed. I think it has with respect to banking, as between the various parts of Canada, but I will get back to you later.

Dr. James Gillies, Study Director: In reference to that question, I was wondering what the exact meaning of the last sentence is on page 9 of your brief:

> However, the actual location of deposits in a branch banking system is of little relevance since funds tend to be employed where the opportunities for their use are greatest."

What is the definition of "opportunities for their use are greatest"? What does that mean?

Mr. J. E. Morgan, Deputy General Manager, Royal Bank of Canada: Dr. Gillies, I think the simple answer is: Where the demand for loans is greatest.

Dr. Gillies: As demonstrated by interest rates?

Mr. Morgan: As demonstrated by requests for loans.

Senator Molson: I want to come back to that question. I would like to ask the representatives of the banks, or a representative, if it is not a fact that they know where their deposits are regionally; that they know where their loans are regionally; and if they have not a very good estimate as to the distribution of their loans individually. I would be very surprised if the banks were to say that there is no information on where their deposits are and where their loans are, and if so, I am afraid I am rather bothered and puzzled and, may I say, disturbed.

The Chairman: Perhaps we could ask Mr. Perry if he would like to comment on that.

Mr. N. E. Currie, Vice-President and Economic Adviser, The Bank of Montreal: I do not think this is particularly my field, but in further amplification of what Mr. MacIntosh was saying, it is not of particular relevance in which office of a bank a loan is booked or where the deposits are. We surely know that and it is not of any particular relevance, because the spending of the funds may take place in relation to a project remote from the location of the branch where the loan is booked.

The Chairman: I think senators are aware of the fact that loans once made could be spent in other regions of the country. I think the specific question is: Do you have the information?—although you say, and maybe quite justifiably, the use of those loans may be something quite different from their location. I think the question is: do you have the information on the location of the loans?

Mr. Leclerc: We can say "no" on that, from our point of view.

Senator Croll: The answer is "no"?

Mr. Leclerc: My answer is "no", for us.

Mr. MacIntosh: For us, the answer would be "yes," that we know where our deposits are by province and we know where our loans are booked by province and, therefore, by region. I would like to point out that in the case of some deposits, a location in a particular place is not really relevant to where the depositor is. For instance, some of the provinces and the Crown corporations of provinces, even in the west, book wholesale deposit transactions at the head office, because that is where the head office happens to take the wholesale money market operations, which are probably, for the most part, booked technically in Toronto and Montreal. It is not really relevant that the provinces, themselves, have access to those funds. When they ask for bids from banks and other people they take the highest bid, wherever it may be, and very often that location is not within the provinces and very often not within the banks, but within a finance company or a commercial paper issuer, who may be in any part of the country.

Senator Molson: May I ask a supplementary? If I were to ask a banker if his deposits exceeded his loans, or if his loans exceed this deposits, in the Province of Manitoba, would I get an answer, "We do not know"?

Mr. MacIntosh: Could I give you some figures on that point, senator? The Province of Manitoba, in fact, recently published some figures whose sources I am not aware of, and I do not know how the figures were constructed. I am not sure if they are accurate, but, roughly speaking, the figures were that the deposits of the banking system, in Manitoba were about $1 billion, 250 million. The loan figure which was quoted—I am quoting figures that were published by the Minister of Trade and Industry in the Province of Manitoba—indicated a total bank loan of $850 million.

I am not sure what the system figures are, in fact, but let me take you through the arithmetic, if I may very briefly, of what the banking scheme would look like if you were to take all the deposits in Manitoba and call that one bank, one regional bank. I am only citing this case, not with a view to saying that the banks have a view on regional banks, because as such they do not. In fact, some of our members are regional banks and, therefore, the association certainly does not oppose the existence of regional banks, nor does it oppose competition from new banks. I am only giving this by way of illustration of what the asset liability structure would be.

If you took deposits of $1 billion, 250 million—and I am simply using the figure that the Province of Manitoba suggested—if that were one bank, you would first have to allow for about 30 per cent of major liquid assets of those deposits, which is about the average requirement of the banking system as a whole at the present time. I do not think any individual bank would depart too far from that figure. Part of that is a statutory requirement. 15 per cent of that figure I have just mentioned would be a legal requirement of cash and secondary reserves, and the other 15 per cent is the normal liquidity back-up which a bank would have. Therefore, if you took 30 per cent off $1,250 million you would be taking off $375 million.

It happens that at the time cited by the Province of Manitoba, the loans to the Wheat Board were a little over $500 million. In addition, there were very large loans to the grain trade, in the order of $700 million to the grain dealers, apart from the Wheat Board, at that time. I do not know how much of those grain dealer loans would be in Winnipeg, but I suggest a large proportion of them would be. If you allow for $250 millions out of $700 millions being grain dealer loans and the rest of them being in the Alberta, the Saskatchewan Wheat Pool and so forth—there is another $250 million. You have to allow another 10 per cent of your deposits to take care of mortgage loans, provincial securities and municipal securities, because any bank operating in any part of the country would undoubtedly have a significant percentage of assets in that area. There you have another $125 million, and we might calculate now what we would have left for all loans, other than Wheat Board and grain loans. That comes to $1,200 million, which would leave you $50 million for all loans for all purposes in the Province of Manitoba, out of deposits of $1,250 millions.

I might say that I am not theorizing. This would be the actual structure of a bank in a province like that, given those deposit figures.

One can say, of course, that the Wheat Board loans in Manitoba should be financed not wholly in Manitoba, but nationally. We would agree with that. In fact, that is undoubtedly the case. The savings from the rest of the country supply a significant degree of financing for the Wheat Board and grain loans in the province. My point is simply that if you applied that, not to the Wheat Board but to any corporation in any part of the country, you would see the same thing, that is that there are massive transfers here and there across the country, depending on the location of the bank.

May I conclude with one illustration, not in Manitoba but in Quebec? The banks have allocated, I believe, $150 millions for the Churchill Falls financing in Labrador, which has not yet come to fruition. Those authorized loans exist. At that particular time and place it might be that there would be transfers within the province, conceivably from some other province, who knows, but my point is simply that you cannot regionally segregate a balance sheet and make sense out of it.

Senator Nichol: This may answer the question I asked before in regard to the feeling in the outlying regions of the country I have described—and I am not saying it is right or wrong, but I think it exists. Is some of that due to the fact that as you move away from the centres of industry and finance and move towards companies and smaller industries—which because they are small and often new, are companies using every cent of their cash and have no current ratios at all, or current ratios of zero or less—do you feel these people in these types of industries and locations tend to be, not because of the location, but because of the type of business they are conducting, because of their small size, tend to be more susceptible to the squeeze when the squeeze comes? I heard the argument many times in Vancouver during the recent tight squeeze that small businessmen were having blocks put to them by their bankers when the large businesses were not. I do not know whether it was true or not. I now they were having the blocks put to them, but I do not know whether that accusation is true. That is not a question, but a sort of half-baked statement. Possibly you could comment. The argument which is made, incidentally, is that a regional bank such as the Bank of Upper Rubber Boot, Idaho, which, if it existed, would not do such a cruel thing.

Mr. Morgan: It might not have the resources either. Really though, this comes up frequently. As you say it is always said in general. Our problem is trying to get specific examples. Very rarely can we find the specific examples. So it is a difficult thing for a bank to answer, because unless you say it was such-and-such a company and under these circumstances, how can we answer?

Senator Nichol: Yes, that is right.

The Chairman: You have a question, I believe, Senator Bourque.

Senator Bourque: Senator Nichol quite properly informed us that he is from the province of British Columbia.

Senator Nichol: I tried not to show it too much.

Senator Bourque: Perhaps I can say that I come from the province of Quebec. Now we are on an even keel. Mr. Chairman, I should like to put one or two questions in French to Mr. Leclerc so that we can get on record the fact that we do speak both English and French in this committee.

The Chairman: By all means, Senator Bourque.

[*Translation*]

Senator Bourque: Mr. Leclerc, I would like to ask you just one question concerning the last bank, I believe, that failed in Canada; it was the Home Bank, I believe, in 1923?

Mr. Leclerc: In 1923.

Senator Bourque: The only bank whose trustees made money?

Mr. Leclerc: About 25, 30 per cent.

Senator Bourque: Since that time, there has never been a nickel lost in a bank which may have failed. It was absorbed or something?

Mr. Leclerc: If I may add, neither by the depositors nor by those who held bank notes at that time.

[*Text*]

Senator Bourque: I can now go on in English, if you like, Mr. Chairman. The total loss for depositors and everybody in 1923 was 25 per cent.

Mr. Leclerc: That is for depositors only, senator.

Senator Bourque: But the round figure was 25 per cent. The point is that there are people who put their money in the bank instead of buying stocks or anything else, and they are practically assured that their money is approved, because the proof of the pudding is in the eating. Is that not right? If I understand correctly, the Government guarantees a deposit in the amount of $25,000.

Mr. Leclerc: The amount is $20,000, senator, and this is for a single depositor.

Senator Bourque: Is it not a fact that the banking system in Canada is one of the best in the world? During the depression we had many years ago the United States banks were toppled over one after the other and yet we maintained safety for the depositors in banks in Canada to such a degree that very few people lost money. They may have lost money through transactions which they should not have entered into, but they always received their 100 per cent on the dollar so far as the banks were concerned. Is that not right?

[*Translation*]

Mr. Leclerc: It is so true that the banks did not agree on paying for the insurance on the first $20,000 which had been required for each depositor. Then, if you look at the United States—I do not have the figures in front of me—but I do know that, even last year, a fairly large

number of American banks closed their doors; this is not counting the years from 1930 to 1933, which you certainly remember, when hundreds of American banks closed their doors at that time. The depositors lost a part of their deposits also. I do think that we are of the opinion that the Canadian banking system is about the best in the world, from that aspect. If you travel around the world a little, you see that other banks have failed in other countries of the world. I mean in countries that are free, if you like.

Senator Bourque: But here, at the moment, we are speaking of present things, of things we have experienced, not probabilities. I do not think that would have happened, but those are things we have lived through.

Mr. Leclerc: That is right.

Senator Bourque: The sale, it is an accomplished fact.

Mr. Leclerc: For 50 years, nearly 50 years.

[*Text*]

Senator Beaubien: I want to ask a supplementary, Mr. Chairman.

The Chairman: Certainly.

[*Translation*]

Senator Beaubien: Mr. Leclerc, what happened to the shareholders of Home Bank at that time?

Mr. Leclerc: If I remember correctly, the shareholders of Home Bank lost the money they put up.

Senator Beaubien: Only the money they put up?

Mr. Leclerc: I believe that there was double liability at that time. If my memory serves me correctly, they must have lost double their investment, although the holders of bank notes lost everything. If I remember correctly, I believe that was it.

[*Text*]

Senator Isnor: As I understand it, Mr. Leclerc, there was only one failure in Canada compared to many, many failures in the United States during that depression period.

Mr. Leclerc: The last failure in Canada was in 1923. It was the Home Bank of Canada. That was the last one. We had bank failures before that, but since 1923 we have not had any.

Senator Isnor: Concerning loans made locally at the present time, is the policy now to allow the local bank managers to make their own loans to the extent of 99 per cent?

Mr. Leclerc: It depends on what bank you are talking about. On the whole I think that is what we say in our brief. It may be 75 per cent in one bank and 99½ per cent in another bank, but on the whole the bank manager is authorized up to a certain amount and that depends on the branch. In an important branch, such as a main branch in Montreal, the amount would be higher than in a small branch in Saskatchewan or a small branch in Quebec.

Senator Isnor: Is that a new policy?

Mr. Leclerc: No, it has been in effect for many years, but we have raised the amount that the manager is allowed to lend. We raised that amount many years ago, in fact. The amount is now much higher than it used to be.

Senator Isnor: But you say in your brief that only 1 per cent of the applications for loans must be referred to the head office.

Mr. Leclerc: Some of the banks—not ours, because we are only in Quebec—have regional offices so that they do not refer their loans to the head office.

Mr. McIntosh: If I may just add a comment here, Mr. Chairman, and this refers back to what Senator Nichol was asking about earlier concerning the size of loans, first of all I should like to point out in that connection that in the period of tight money—and I am referring to the Bank of Canada's statistical summary for May, 1971, at page 354—the loans under $100,000 to business increased in the two years ending March 31, 1971, by $242 million.

Senator Nichol: Could you give me that again? I did not quite get the increase in loans.

Mr. MacIntosh: Individual loans under $100,000 increased from $1,747 million to $1,989 million during that two-year period, which pretty well spans the last two years of tight money. That is an increase of $242 million.

In the same period for loans of $5 million and over, which are the very largest loans in the system, the increase was $295 million, going from $2,408 million to $2,703 million. As you will see, that is a smaller percentage increase than the loans under $100,000 showed.

So I think on the face of the evidence the percentage increase of the smaller loans was greater than the percentage increase for the biggest loans.

If I might turn to Senator Isnor's question with respect to the number of loans, which is also relevant, again going to the same source, the Bank of Canada's statistical summary, the number of loans at September 30 last, of amounts less than $100,000 in Canada, was 213,804 loans. That amounted to 92.7 per cent of all business loans in Canada by number. Then there were 6.3 per cent of the loans which fell between $100,000 and $1 million. Just to finish it off, .8 per cent of the loans were between $1 million and $5 million. In the largest category of $5 million and over, there were only 547 loans altogether. If you take those two largest categories, that is, $1 million to $5 million, and $5 million and over, you have about 2,500 corporations in Canada, and those are the biggest borrowers in the country, of course.

Senator Isnor: That is the biggest in dollar value, is it not?

Mr. MacIntosh: Yes. In dollar value there are more that are relatively large, but in numbers there are only 2,500 of them. Those 2,500 would almost certainly be referred, in a well-managed organization, to somebody with a sufficient degree of seniority to confirm a credit of that size.

In the category of $100,000 to $1 million I suggest that the bulk of those would be dealt with locally. So the fact is, you are probably not talking much over 1½ per cent in number of loans which would be dealt with beyond the most senior regional management level. Of course, in dollar terms, those loans account for large amounts, but one is not going to make a $20 million loan to a major mining company without the most senior officers of the bank and the board authorizing it.

Senator Nichol: Taking the figures that you used, of individual loans under $100,000, and of the large loans, this perhaps goes part way towards explaining the problem, because people in the $100,000 and less category have virtually no alternative means of financing. If pressure is applied through the banking system in roughly equal amounts to both the large and small borrower, the large borrower moves into alternative means of financing, either to debenture issues or mortgages of other kinds, to equity sales, bonds, or whatever else he can do. The other fellow under $100,000 has no hope of doing this. If these things are equal the pressure is obviously felt much more severely by the small borrower than the large borrower. Is that correct?

Mr. MacIntosh: No. I would say that is not correct. I do not think any bank would bring pressure to bear on any loan under $100,000. In the first place, as a matter of administrative management it would be very inconvenient to try to improve your liquidity by going after 15,000 borrowers instead of 50 borrowers.

During that period of tight money, while it is true that some of those big borrowers could have had access to the market, in actual practice many of them backed up into the banking system and would not go to the market because they did not like market conditions. So, in fact, that increase of $295 million would have included some considerable borrowers who intended to go to the corporate market and who, since March, have probably gone to the debenture market.

I would argue that there was pressure on the banks with respect to that, which the banks did not particularly appreciate. I would state pretty flatly that I do not think any bank would have brought pressure on any borrower under $100,000 or even under $1 million.

Dr. Gillies: I gather that only one per cent of the loans are referred back to head office. Is it the policy of the banks to set broad regional lending policies? For example, would it be the policy of the bank to say that not more than 7 per cent of the loans in the Maritimes should be on mortgages?

Mr. MacIntosh: No.

Dr. Gillies: Do I make myself clear? Do you understand the question?

Mr. MacIntosh: I think every bank would have to answer that for itself. In our case certainly that would not be the way we would do it. We do attempt to estimate and to forecast the kind of assets which we are going to have, but any estimated mortgage loans for the Maritime Provinces would have come from the Maritime Provinces.

The Chairman: Honourable senators, we are required for a vote in the Senate. As a result, I have to adjourn the meeting. I apologize to our witnesses. It will take 15 minutes or less.

(Short adjournment)

The Chairman: Honourable senators, the hearing is resumed.

Senator Molson: In the hearings we have had to date, I think it is safe to say that if there has been any consensus it has been in the direction of saying that in coping with inflation and unemployment, unquestionably fiscal and monetary policies are two of the weapons that have to be used, and well used. There is some doubt about the efficacy of the monetary methods in coping with the requirements of these boom and bust cycles, partly perhaps because the monetary authorities do not have complete control over the system, and perhaps because of other weaknesses. I wondered whether our witnesses would care to comment on the role of monetary policy in the effort to control inflation and unemployment coincidentally.

The Chairman: I guess the Canadian Bankers' Association does not have a policy on that, so I think it might be worth while to ask that question of each of the individual witnesses. I take it I am correct in assuming you do not have that policy. I think we could start with you, Mr. Leclerc. Have you any personal thoughts on that, or Banque Canadienne Nationale thoughts?

[*Translation*]

Mr. Leclerc: If monetary policy—if I understood Senator Molson's question correctly—monetary policy, where our bank is concerned, well, we do not have an actual monetary policy because, in the final analysis, we are subject to the restrictions which may be placed on us by the Bank of Canada, anyway. Furthermore, even if we have a loan policy today and if in two or three years the Bank of Canada requires us to hold a further one or two per cent in secondary reserves, and if we are entitled to hold Canada savings bonds in reserve, then that means that in our own bank, as in the entire banking system, one per cent may be 250 million less or 500 million less. Therefore it means that as such time it is a type of restriction which may be imposed on us by the Bank of Canada and, as has already been said, if certain restrictions are imposed on us, we must of necessity take into account the commitments we have to our clients, and often dispose of securities in order to be able to meet them. Therefore, as regards monetary policy, we pretty well have to follow what is imposed on us, in my opinion. I do not know whether Mr. McIntosh has something to add to that, on the monetary policy of any particular bank.

[*Text*]

Mr. MacIntosh: Mr. Chairman, perhaps I might take off my Bankers' Association hat, and also my own bank's hat, because I do not think we have a corporate view on monetary policy. I doubt if it is possible for a corporation to have a concerted view. There are about eight views, I

think, in any individual organization on these matters. I will therefore speak only as a professional economist.

I would tend to share the view of the Bank of Canada which has been expressed by the governor from time to time, that the sort of Friedmanite rules that are popular in the United States right now, and which you have heard expressed by a number of witnesses, that you can fix the rate of growth of your money supply at a fairly standard steady rate and maintain that, are not very feasible. You have also heard that view expressed by a number of Canadian witnesses, including the chairman of the Economic Council, I believe.

The first problem you run into, and one which I do not think the monetarists in the United States have really come to grips with, is the fact that you have to define what you mean by the money supply. This is a very slippery thing to define. In the United States in recent years there have been some very significant parts of the liquidity of the economy which are not money as defined by the federal reserve; that is to say, their narrow definition M-1 of current accounts in the banking system, and their M-2 definition and so forth.

There are times when very large flows have taken place out of the commercial banking system of the United States into commercial paper, finance company paper, international transactions; there have been major inflows of funds from the Eurodollar market which have been competitive with internally generated deposits in the United States. Sometimes these flows have been really massive.

In the United States last year, after the Penn Central crisis the volume of commercial paper and bank related paper went down from $40 billion to $35 billion, a decline of $5 billion in a few months. That $5 billion flowed into the commercial banks, because people were frightened of the credits of the people they had been placing money with, so they simply transferred their money out of the commercial paper market into the banking system. Bank deposits of that kind went up sharply. Is one to say that the money supply was increasing at an undue rate? If you look strictly at the narrow definitions used in the United States it was, but if you look at what is really going on, the fact is that you were just transferring some types of corporate assets from one to another, and changing only their character, not the total volume.

The same problem exists in Canada. Here we have, in addition to the money supply as we conventionally define it, which is bank deposits, trust company instruments, commercial paper, sales finance paper, provincial treasury bills, swaps, which are these transactions into United States dollars hedged forward; approximately—and I am guessing—$4 billion of short-term liquid assets held mainly by corporations in Canada, which from time to time can move back into the banking system.

In the last six months there has been a massive move of those types of liquidity out of commercial paper and finance paper into the commercial banks, into the chartered banks, the reason being that the interest rates on such instruments competing with bank paper have fallen sharply, and some people have preferred to put their money back in the banks. There has been a very rapid rate of growth of that type of deposit. If you look at the money supply, people may say the money supply has gone up too fast. But if you look at a comprehensive definition of all types of liquid assets in the economy you get a very different picture of the rate of growth of the money supply.

Therefore, I am saying that the monetarist view of the matter is based on far too narrow a definition, and they themselves abandon it when it comes dowon to brass tacks. The Federal Reserve Bank of St. Louis, which is the classic case of the monetarist view, as can be seen from their publications, when it comes down to brass tacks, talking about the state of liquidity in the economy, abandon the definition of money supply that they usually use and start saying that account has to be taken of these other forms of liquidity.

I am no supporter of the view that you can fix a rate of growth of 5 per cent per annum in the money supply and just leave it there, because you cannot do that unless you can talk about transfers in and out of different types of assets. That is particularly true in Canada with an open economy, where much of this transfer is an international flow. I am afraid that is rather a long answer.

Senator Molson: As a supplementary, let me ask this. In our concern with trying to cope with inflation and unemployment, are we using a weapon that is really no good? Are we trying a sort of nail-jelly-to-the-wall exercise?

Mr. MacIntosh: I think monetary policy is a useful instrument. In the final analysis it really depends on the judgment of the central bank, so in the final analysis it can depend on human error and human fallibility. As far as it can do so, I think the central bank has to adjust to unexpected eventualities.

Senator Molson: But is it ill-equipped? That is what I am really asking.

Mr. MacIntosh: No, I think they have sufficient instruments.

Senator Molson: Or are we ill-equipped? Is the Canadian Government ill-equipped? Are the Canadian people ill-equipped?

Mr. MacIntosh: I do not think we are ill-equipped with financial machinery or monetary policy, no, sir. I think we have adequate policy. However, I think the monetary authorities can be pushed by the sort of requirements they are subjected to by government, because in the final analysis government and fiscal policy can put the central bank in an untenable position, and has final authority as we know.

Senator Molson: What about the near-bank?

Mr. MacIntosh: I think the view of the chartered banks in general is that some of the near-banks have escaped effective control through monetary policy. That is true. In some respects it might be more comprehensive.

Senator Molson: They are outside monetary policy?

Mr. MacIntosh: Yes, sir.

Senator Isnor: I would think from your answer that you are in accord with the policy of the central bank up to the present time?

Mr. MacIntosh: Speaking personally, I am, sir.

Senator Beaubien: Mr. MacIntosh, you said that in cases like that of the Penn Central failure, and so on, people who had lent money on notes on that sort of thing got worried and therefore they called this paper and put this money on deposit in the banks. But supposing that an "ABC" company had borrowed $200,000 on commercial paper and then the lender got worried, got the money back and deposited it in the bank, the "ABC" company had to get that $200,000 from the bank and it would cancel out, would it not?

Mr. MacIntosh: Yes, Senator Beaubien, and very often, of course, the borrowers who were in that market are relying on umbrella lines of credit from the chartered banks. So my view is that we do not charge enough money for that umbrella.

Senator Beaubien: No, no, but it would cancel out. You said that it had the effect of increasing the bank deposits, but actually it would cancel right out, would it not? I lend $200,000 to "ABC", I get worried, I call the money; I put it in the bank. The bank deposits grow by $200,000. But the "ABC" company has to get the $200,000 and the only place that "ABC" can get it, if people are not lending on the Street, is by going to the bank, so it would cancel out, would it not?

Mr. MacIntosh: You are absolutely right, in the sense that not only would the liabilities of the banks rise but their assets would rise, too. They would go up very fast. It would not change liquidity, but it would change the appearance of the total volume of bank assets and liabilities, the gross figure.

The Chairman: Mr. Morgan, do you have any views on monetary policy?

Mr. Morgan: Mr. Chairman, I find myself between two professional economists, and I am not a professional economist.

Senator Molson: You are in good company. Do not feel lonely.

Mr. Morgan: Honourable senators, I would have to say that there is no official policy or attitude in the Royal Bank. We argue about this daily or weekly. My own personal view could be summed up, in layman's language, by saying I really do not believe that you can expect monetary policy by itself to achieve the Valhalla of an acceptable rate of employment and an acceptable rate of inflation.

I think it is the duty of the Central Bank to operate its monetary policy as it sees fit, to keep the economy operating in a proper and reasonable state. If those actions cause undeserved hardship to certain segments of the economy, obviously some amelioration or some other method must be used to offset the unavoidable bad effects. That is probably very bad economics, but that is the way I see it.

The Chairman: Mr. Currie, do you wish to make a comment?

Mr. Currie: Thank you, Mr. Chairman. Honourable senators, if I may, I would like to shift the emphasis a little. On the question of Friedmanism versus any other approach to monetary policy, I am speaking personally and not for my bank. I do not disagree in essence with what Mr. MacIntosh has just said, so I will not go over that ground again.

Returning to half of the question which Senator Molson asked—"Are we equipped to deal with this kind of situation that we find ourselves in?"—this conundrum of unemployment and inflation, I have read newspaper accounts and some of the reports of the proceedings here. It appears that quite a few of the witnesses who have been before you have more or less given up on trying to control inflation. That is one view in regard to controlling it, learning to live with it. Another sort of view is: Yes, you must control it but you cannot control it with the big levers of monetary and fiscal policy. You have to control it by some kind of specific control mechanism, an incomes policy, a mandatory price and wage policy, that sort of thing. I would like you to give me a moment to back up a little from that.

I do not think that the traditional—traditional in the sense of Keynesianism, modified over the years—approach to demand management in the economy has failed, or it is not yet proven that it has failed. I just do not think it has been used properly.

There has been a great deal of talk as to when did the Canadian economy, for instance, get overloaded, when did this all start. Figures are produced about the public sector going into surplus at about the mid-1960s—which would, according to the theory, have been about the right time, because this would have been restraining the economy at the time it was reaching its full capacity.

But in actual fact, as we all know, the influences of fiscal policy and monetary policy have substantial lags in them. The movement towards surplus on a national accounts basis, whether conscious or otherwise, did not in fact take place until well after the Canadian economy had reached the peak of its capacity. This becomes even more apparent when you look at the figures and consider that in 1966 you began seeing in the national accounts a figure of receipts in the Canada and Quebec Pension plans. This is part of the surplus on a national accounts basis, which was developed at that time.

I am no longer an academic economist, and I do not have time to work out models and all that sort of thing. I am rather disappointed in the academic community, that they have not really got to grips with this problem of an institutional change which effects nothing in real terms but gives the appearance of producing a surplus in the public sector.

At the moment, for instance, you have about $1 billion of receipts into these two pension plans, which are not

disbursed to individuals but which are loaned to provincial and municipal authorities, by and large.

Just by a stroke of the pen—that is, a legislative stroke of a pen—funds flow through the public sector which previously went from the private to the public, or the private in another way; but now it goes through the public sector. It is suddenly counted as a surplus. I am not quite sure whether that is a valid way of looking at it, but if you do subtract the surpluses of those pension funds from the figures, you find the following rather curious anomaly. The total public sector was in deficit in 1967, it was in deficit in 1968, and suddenly in 1969, which is a little bit after the time when unemployment was beginning to loom as an important problem, the public sector switched strongly into surplus. Then, of course, the thing changed the following year and that surplus is now lower.

In my view, the timing was not right, in terms of the broad demand management kind of approach that people have talked about and some people appear to have given up on.

I just do not think we should give up on the use of these broad tools of management of the economy through fiscal and monetary policy, and start tinkering around with individual types of control. One might put a lid on something in one spot but it bounces out somewhere else. **I just do not think that, as a country,** we should start seriously experimenting with that kind of thing.

The Chairman: Do you have an opposite argument to fine tuning with that sort of thing?

Mr. Currie: I am talking about the main thrust of policy. The demands that were being put on the economy starting about the mid-1960s were just in total too great for the economy to bear. This applies to the neighbouring economy in the United States also. The result was that **inflation was an inevitable consequence.** Once you have inflation, it is very difficult to control. But I shall also say the other thing and that is that inflation, once you have it, is going to cause unemployment in due course. Whether you attempt to control it by conscious policy or let nature takes its course, inflation will bring about unemployment in due course, and this was in fact happening in Canada before the levers of policy changed to try to put the lid on the inflationary forces.

The Chairman: But you do tend then to move towards the monetarist view in the application of fiscal and monetary policy. You probably find yourself somewhere in the middle.

Mr. Currie: I am not too sure, Mr. Chairman. I think if you have big swings in demand in the economy both financial and real partly as a result of activity in the public sector, the monetary authorities are going to have to adjust to that and so you have some pretty large swings in the volume of money available and that kind of thing which complicate the situation in the ways that Mr. MacIntosh mentioned. But with a slightly steadier run at the fiscal side of things, the monetary side could be steadier too, but I do not for one moment subscribe to the view that you can set money at some relationship to the potential growth rate of the economy.

The Chairman: But you are opposed to the use of short-term specific fiscal measures, I gather. You would rather rely on the broader instruments.

Mr. Currie: I think this could be a very long discussion. I do not think I am suggesting that specific fiscal measures cannot be used to achieve particular results regionally or industrially or sectorally. But I am suggesting that you need to have some flexibility to do that sort of thing which you cannot have if all you do is keep adding one thing on top of the other—greater and greater demands—and of course these come back to the rest of us in taxes. In classical theory taxes are deflationary, and they are in a sense, but when you get into inflation, higher taxes are in fact inflationary operating through wage negotiation mechanisms.

Senator Beaubien: Mr. Currie, you said that inflation would cause unemployment. When you say that, do you mean more inflation than your trading partners are having?

Mr. Currie: That is one argument.

Senator Beaubien: Because so far as inflation is concerned, if everybody were going up at the same rate, and let us say the cost of steel goes up in the United States and here, our competitive position would still be the same and we could still sell it.

Mr. Currie: But there you are talking about a particular commodity.

Senator Beaubien: Well, taking any commodity or anything that is produced.

Mr. Currie: Well, I think if Canada were the only country in the world and did not trade with anybody else, if it was self-sufficient and made everything it needed and did its own washing, I think inflation in due course would lead to an increase of unemployment because of frictions in the system. You get to the point where you cannot pass your extra costs on and you try to economize on certain elements of cost, and labour constitutes some of those elements of cost. So you try to find ways of economizing on labour and you have unemployment. Now I know that is oversimplified, but that is the essential cause, the frictions in the system. If everything moved up exactly at the same rate, this would not be true, but it is true when there is stickiness in the system.

Senator Isnor: Mr. MacIntosh, in the brief you refer to the serious problems of some of the regions, and further on you say that you make concessions on terms and risk standards in the less developed areas. What are those areas to which you refer?

Mr. MacIntosh: In the last number of years, the banks have been very conscious of the degree of concern in the country about the more underdeveloped parts of the country, and I think they have responded. In fact, they were already tending to grant credits in the hinterland, shall we say, of the country on terms which were com-

paratively more favourable than they would have granted those same credits had they been in the central provinces. In general it is the case that in Canada the banks will lend a higher ratio on a balance sheet and at the same going rate of interest on the ground that the less developed parts of the country generally have business firms with a shorter history and less equity in them. I cannot speak for the other banks, but specifically in talking to my own colleagues my experience over the years is that in the non-central provinces credit standards are generally easier.

Senator Isnor: You are the first witnesses to come before us who favour areas other than the central provinces.

Senator Molson: The first bankers.

Mr. MacIntosh: I can cite another instance, senator. In the case of my bank, and I think it is true in the case of quite a few banks, mortgage lending policy tends to be directed to the individual family unit, the single family dwelling, rather than multiple family dwellings, so I think you would tend to find bank financing of housing in Canada by and large outside the big city areas, the central metropolitan areas, and somewhat more heavily in secondary cities and towns in the country.

Senator Isnor: Would you care to go a little further and name those areas which you have in mind?

Mr. MacIntosh: I do not think I would care to disclose our business to our worthy colleagues here. But I know in our case for instance we have had a tremendously heavy demand for housing in parts of British Columbia. Now British Columbia is not perhaps what you would call an underdeveloped area, but the population growth is very high and the demand is very great. The same would be true of certain parts of the hinterland. We have substantial mortgage loans in places like Thompson Lake and so forth.

Senator Isnor: I am trying to get you to say that you would be more favourable in your treatment of the Maritimes than to other parts of Canada.

Mr. MacIntosh: In our case that goes without saying, senator.

Senator Nichol: It is in effect, Mr. MacIntosh, a sort of regional policy, is not?

Mr. MacIntosh: Yes, in a qualitative sense I think it is true that banks tend to try to find viable propositions in the less well developed provinces. They search more diligently for them there, but that does not necessarily mean that they find them. It is one thing to say that you are making credits really available in, for instance, northern New Brunswick. It is quite another thing to find businessmen who wish to borrow in order to locate a plant there standing on its own feet, finding its own markets unless other elements, such as provincial guarantees, are introduced. However, I am referring to an open market; the banks tend to lean towards an easier credit view in the hinterland, but they cannot necessarily make borrowers borrow.

Senator Nichol: How much of this is due to the central policy and how much to the natural aggressiveness of bank managers who live in these areas? They have to be that way or they just do not get to got into the beer parlours on Saturday night.

Mr. MacIntosh: Every manager is judged on his own performance and in Canada that generally means he is judged on his ability to make good loans. A good loan to him in a small town is $10,000 or $12,000 and he will reach for that business if he can. The organization of the system is very much based on an intensive structure. His success will be reviewed in terms of his ability to make loans. Therefore he will always reach to support the local community. I have never heard of a bank manager who did not.

The Chairman: To what extent does moral suasion on the part of the central bank have an effect on the attitude of the banking community to its regional obligations?

Mr. MacIntosh: The Governor of the Central Bank has told the chief executors and general managers of the banks on more than one occasion in recent years to have a special regard for the underdeveloped provinces. I believe he was only reinforcing something that the banks were tending to do.

Another point I consider to be worth remembering is that many senior bankers in this country came from small towns and provinces which are not among the richest. My experience of them is that they have a pretty sensitive regard for the areas which they know well.

The Chairman: How do you feel with regard to moral suasion by the central bank?

Mr. MacIntosh: I think moral suasion of that character is legitimate. Chartered banks in general might tend to feel that some of the actions that have been required of them by the central bank could have been put on the record so that the public was informed of the situation. There have been periods when we were under constraints and the banks felt that this should have been made clear earlier than it was. I speak with special regard to the period when we were asked to hold down our deposit rates of interest.

In an open society such as ours, on the whole the monetary record should be spelled out, not only for the private knowledge of the banks, but for the whole business community and, indeed, the public.

The Chairman: Should that be done at the time the bank takes the action?

Mr. MacIntosh: Yes, I think so, although there may be very special cases, such as a foreign exchange crisis, where the central bank has to proceed in secrecy in order to achieve a purpose. However, by and large, yes, when an action is taken.

That is my own view; I do not know if I speak for all the banks in that regard.

Mr. Morgan: I certainly agree; I think that all central bank orders, with the exception of such a foreign exchange crisis, should be made public, even if only for the reason that the central bank should accept full responsibility for its policies.

The Chairman: In the specific area of regional development, in your judgment is moral suasion by the central bank an effective tool to cause banks to go further than they would if they were left alone?

Mr. Morgan: I doubt it; I think the banks go, and have the inclination to go, as far as they can with prudence in this area without any persuasion.

The Chairman: I am not arguing the correctness or incorrectness of the bank's course; I am saying if it were assumed that it was the central bank's or the Government's wish for the banks to go further in regional development, would moral suasion be an effective tool?

Mr. Morgan: To make them go beyond the limits that they regard as prudent?

The Chairman: That is right.

Mr. Morgan: I doubt it. In this area we are really discussing a situation in which the Government is asking for an unbusinesslike decision. I do not think an officer of a bank, who is responsible to his directors and shareholders, could do that.

Senator Nichol: "Could" do it, or "should"?

Mr. Morgan: Could do it. In the past, as you well know, when the Government wished a bank to make unbusinesslike loans, they usually established a guarantee system. The trouble was that half the loans we were going to make anyway would get in under the guarantee, which we do not like too much.

Mr. MacIntosh: When the Department of Regional Economic Expansion takes specific action it would have more impact on the actions of banks, as would certain provincial policies. However, those policies sometimes can also lead into major disasters. We have had some of these in Canada in recent years, where in the name of industrial diversification in provinces we have done some very wasteful things with the savings available to the economy.

Dr. Gillies: Two economists who appeared before the committee recently suggested that there was far too much moral suasion in the system and that many of the things that are done under moral suasion should be put into legislation. Would you have any views on that issue?

Mr. MacIntosh: Dr. Gillies, I would say, further to what the Chairman asked a short time ago, that my own view would be that, in general, actions by the monetary authorities should be at least on the record. Whether they need to be legislated is an open question. Perhaps in some cases they should be.

I do not think the number of instances of the use of moral suasion are numerous, if that is the suggestion that was made by the professors from Queen's. There are a few specific cases.

The Chairman: They listed 20-odd cases.

Mr. Morgan: Over what period of time?

The Chairman: I am not entirely sure.

Dr. Gillies: They had about twenty in the last decade.

Mr. MacIntosh: I have not seen the evidence of that session as yet, but I do not think there would be many that were really critical. The one that was involved the ceiling on deposits and was perhaps the most important. In that case we would agree that the matter should have been on the record.

We would not necessarily agree that it should have been locked into the statute, because including a provision in legislation is one thing, removing it afterwards when it ceases to serve the purpose for which it was created is quite another matter. I cite the American system in this regard; they tend to do absolutely everything by statute and cannot remove the provisions. The Americans still have a ceiling rate on their national debt instrument of 4¼ per cent. That has been there since the early thirties. It was amended only this year. This has created enormous difficulties for them because they could never get it out again.

So I would not necessarily agree that everything should be built right into the law, because you lose flexibility that way. I would tend to agree that you should get it on the record at any rate.

Senator Beaubien: You will remember, Mr. MacIntosh, that we had a lot of trouble getting rid of the 6 per cent here.

Mr. MacIntosh: Yes, sir.

Senator Nichol: Mr. Chairman, my question is addressed to Mr. MacIntosh and Mr. Currie as economists rather than as bankers. This committee has been pursuing the question of monetary and fiscal policy. There has been considerable criticism from certain witnesses concerning the way in which fiscal and monetary policy has been applied. More accurately, there criticism has been levelled at the timing, the place in the cycle at which these controls have been applied.

To the end of determining how to apply the poliy correctly we have asked many questions concerning time-lags and how much we need to know about lags, how efficient our statistical system is and so on.

I gather from what Mr. Currie said a few minutes ago that we could do better on the question of indentifying the point at which fiscal and monetary policy should be applied.

Do you think that the failures in the system have been caused by lack of knowledge and confusion or by lack of statistical data on the part of professional economists? Or do you think that the professional economists have known what should be done but that they have been overridden for political reasons over the years?

In other words, do economists really not know and so do not say; or do they really know and do say, but what they say is overridden for political reasons?

Mr. Currie: There is still a real problem with identification of lags, senator. The basic problem is society itself, in my opinion. Taking the total complex of society as manifested through the political mechanism it does not really appreciate that you cannot get more out of the "bloody" economy than you put into it. This sounds like a condemnation of democracy, and I certainly do not want to sound like that, but there is a real educational problem here as between the people and their elected representatives and appointed representatives as to what can be expected of an economy. You get a whole lot of built-in pressures on the economy which are very difficult to reverse, if you have programs which are automatically going to escalate in relation to population or some other measurement. I do not know what the answer to that is, except courage at some time at the political level which may not be as evident as it might be sometimes, I guess.

Senator Nichol: On the subject of courage at the political level, how does this work in a society where the federal Government is responsible for the stability of the dollar, and has the over-all responsibility for foreign trade, the welfare of foreign exchange and all the other problems including regional growth to a certain extent, while the provincial and municipal governments spend two-thirds of the tax money in the country? How can this work? You have expansionist political stragegies in all of the provinces and you have restrictions, if that is the proper word here, in the policies of the Government because of its responsibility for the dollar. How does it work?

Mr. Currie: I do not have an answer for that, senator. I am sorry.

Senator Nichol: I think you are not alone.

Mr. Currie: This is one of the crucial problems of the federal system. How do you work this all out? We are right in the midst of a debate about that very issue right now. Certainly, you must have enough flexibility, and the revenue expenditure balance must somehow stay at the centre; but what is enough? I do not know the answer to that.

Senator Nichol: I suppose the question is three-fold. Do we know what to do? If so, will we do it? If we will, can we do it? We keep going round in a vicious circle. I guess that is not a question. It is a confused statement, Mr. Chairman.

The Chairman: We will leave you in your confusion for the moment, Senator Nichol.

Senator Isnor: Mr. MacIntosh, do you have any idea how long we will remain in our present state of inflation and unemployment?

Mr. MacIntosh: To answer that, senator, would be a perfect illustration of Senator Nichol's problem. I could only add to the confusion you are experiencing here. You have had a good number of eminent economists appear before you. I think you could be excused, sir, if you were confused by the upshot of all the evidence you have heard. I would have to say that while economists know quite a lot about how an economy works, it is self-evident that they are better at telling you what has happened than what is going to happen. I am afraid I would have to join that group right now with regard to what is going to happen.

I might say that the problem of unemployment we have today is a very deep-seated and intractable one, and will be for a period of years because of the demographic structure of this country. You have heard this view expressed to some extent by Dr. Smith. It is quite fundamental to an understanding of our economy that we know we have a tremendous wave of young people coming into the labour force; and while we have been able to absorb the first part of the wave, it is beginning to crest over us now. It is going to take time to really absorb into the labour force this huge wave of people, given the population structure we have. I am not very optimistic about an early solution to the problem.

With respect to inflation, despite the views expressed by my friend Harry Johnson to the effect that second-rate economists resort to sociology, I do think there have been some important changes in social organizations and social institutions in the last 25 years which economists have to take into account when prescribing to politicians and governments just how they should run the economy. Certain constraints are really severe. Industrial organizations of all kinds in the country put severe constraints on what you can do.

I noted in reading the evidence that has reached me from your sessions that very often the advice given to you depends on the degree of importance which you attach to various political factors, and some of the academic economists simply underrate, in my opinion, the variety of constraints which in fact do fall on any government in power. I am not speaking specifically with regard to this Government. Any government in power is faced with a variety of political constraints, such as the federal-provincial problem, and it is not all that easy to see your way through to a clear and simple solution. Generally the witnesses who have appeared before you have given more ready solutions than I can, because they are like a consultant in a corporation who does not have to stay there and live with the result afterwards, or in the case of governments, get re-elected afterwards.

Senator McLean: I was wondering if Mr. MacIntosh could possibly identify for us some of these major changes in our society that he referred to, which have occurred over the last 20, 25 years. Does he identify major changes in trading with the percentage of the labour force unionized over that period? What changes in the political structure, for example, have occurred over that period which basically have affected our problems of economic stabilization?

Mr. MacIntosh: You just mentioned one. It is not so much the percentage of the labour force that is organ-

ized, although that has grown somewhat, but it has tended to reach into things like the Public Service where it did not exist before. Also the strength of closed shops or union shops is so great that, as you heard in the case of the construction industry, there is no entry to the industry no matter how large are the rates of increase in wages. That is an institutional problem which did not exist 30 or 40 years ago.

In the case of the relative strength of the provincial governments, and of their activities, it has already been mentioned by the chairman that a very much larger proportion of the gross national product is going through their activities. Some of the things that they do are not subject to very ready flexible monetary or fiscal policy changes at the federal level. They are built into their own local problems, especially when we have had so much social capital to build up.

We take a much longer view of capital investment than we used to do. We are now looking way down the road at things like the Fundy tidal basin. We take a very long view of these things, and we have had a very much bigger open economy with the rest of the world in the last 20 years.

Senator Beaubien: I would ask Mr. MacIntosh if he would not add that probably the most important factor affecting inflation in Canada is what happens below the border. Mr. MacIntosh mentioned our open economy. If prices and wages in the United States keep going up, it will certainly set the pattern as far as we are concerned and there is nothing that we can do about it.

Mr. MacIntosh: We are also influenced by developments in the European Common Market. Twenty years ago we in this country had comparatively little regard for short-run monetary and fiscal changes in Europe. We have to take them into account on the money market in Canada.

Dr. Gillies: It has been suggested that it is useful to control periods of inflation by the adoption of various types of credit controls. Have bankers any views on that, as to their effectiveness?

Mr. Currie: I do not have a very well thought out view on credit controls, except to say that to the extent that they might be considered useful for particular purposes and at a particular moment in time, if the authorities decided on this mechanism of deciding who was going to have what and what should be used, it would have to be arranged in some way that it went across all lenders or all borrowers.

It is very difficult to work this out so that a lid put on one spot does not burst out somewhere else. A lender does not necessarily know what is the end use of the funds. Some business loans are used for personal purposes, and some consumer-type loans may be used for businesses in a small way. With the development of credit instruments of one kind or another, universal-type credit instruments, interchangeable credit cards, and so on, there is an additional complication that did not exist a few years ago, because if you are trying to control a particular kind of credit in the sense of its end use, what do you do? Do you change your repayment schedules?

I am not sure how you work it out, but you do not really know, when someone puts one of those little cards into a thing in a department store or a gas station, or whatever it is, what it is being used for. In fact, people use them for getting cash. What is the cash being used for?

It is tremendously complicated administratively. However, in a general way I would say that if one were to consider some kind of credit control mechanism, great care would have to be taken to make sure that it applied evenly across all lenders or all borrowers of that type; otherwise the thing is useless, because it pops out somewhere else.

Mr. MacIntosh: I agree in general with what Mr. Currie has said, that consumer credit controls may have a place from time to time as a temporary measure where they are used selectively to constrain any particular area on a short-term basis. Our view in the banking system as a whole is that such contraints should be generally applied to all types of lenders. From our point of view the unfortunate situation is that some come under federal authority and some come under provincial authority. We would prefer to see a situation in which provincially-incorporated organizations come under the same degree of constraint as we do.

The Chairman: For a moment, leave aside the problem of jurisdiction. We would like you, in considering your answer, to ignore that, although it is very germane to the final decision that is taken. You get nothing on the record if you just say it is a constitutional problem. So let us assume for the moment that there was no constitutional problem, and come back again to your answer.

Mr. MacIntosh: If the economy were heavily overloaded; if there were a combination of capital investment demands, housing demands and government spending demands, and consumer demands were such that we were going way over the top of what we could spend and still balance our income, I would think there could be times, if consumer credit were going at a very high rate, where you might want to introduce a high down payment rate and restriction as to the term of repayment for a temporary period. I think we nearly got to this point about two years ago, and then at the last minute it was pulled back because it was not consistent with the condition of the economy. You have to be very careful about using that type of instrument, because it is all very well to say you do not want people to buy cars when at the same time you are helping finance an expansion of the automobile industry to convert it to greater Canadian production. It does not make sense on the one hand to say we are not going to allow people to borrow money to buy cars and on the other hand try to expand the automobile industry at Ste. Thérèse, St. Thomas or what have you. You have to be consistent, and I am saying there are times when constraints on capital investment might be accompanied by constraints on consumer credit of a temporary character.

Senator Isnor: On consumer credit, both Mr. Currie and Mr. MacIntosh more or less cried down the credit system. I cannot understand that, in view of the fact that on June 1 of this year certain banks entered into Chargex as I think they call it...

Senator Beaubien: They are in there now.

Mr. Morgan: We invented it.

Senator Nichol: Even my dog got a card!

Senator Isnor: Everybody has a card. All you have to do is go to a bank. They will give you a card, you present it to the store and get your credit.

Mr. Morgan: I guess I am the target here. I do not think my colleagues were crying down the credit system.

Senator Isnor: Consumer credit.

Mr. Morgan: Cards like Chargex are a very small part of the consumer credit field. As a matter of fact, as of this date I think it is safe to say of all the four banks who are in it the chief function Chargex is performing is really an accounting and billing system for small retailers. The amount of credit that arises from it so far has been very small.

Senator Isnor: They have only been in it a short time.

Mr. Morgan: It does not make us happy, because obviously the real money in a thing like Chargex is the resulting expansion of consumer credit. There is no doubt about that in the long run. We feel this kind of system is compatible with the type of banking and payments system we will have in the next 25 years. Therefore, we might as well get in there now before somebody else closes the door on us. As you kow, in the States there are two major universal card systems. Oil companies have cards now. With a couple of oil company cards that I carry around, for some disloyal reason, I can buy almost everything I buy with my Chargex, judging by the kind of mail I get. It is almost like Eaton's catalogue these days. I do not think Chargex is the villain in this area. We are a follower here; we have to get in before the door is closed to us, because it is a banking function.

The Chairman: You may find the oil companies quoting your evidence before a Senate committee!

Mr. Morgan: Probably.

Senator Nichol: I should like to change the subject. In the last ten years the American gold reserves have been dropping, and dropping steadily.

Senator Beaubien: A dozen billion dollars.

Senator Nichol: They are $9 billion now; they were $19 billion or $20 billion a few years ago. Their liabilities, foreign liabilities and so on, have been going up during that period. They now have a policy of pretty strong expansion of the money supply in the United States. They also have the war in Vietman still going on, and it will be very expensive in dollars, even if it becomes less expensive in men to the Americans. There has been a recurring series of monetary crises, one just recently and another one not too long ago. Where is the end of this? If the United States continues to lose gold, continues to be inflationary and continues to operate all over the world in the expensive fashion which it has been doing, where does this end? I do not know whom I am asking.

Mr. Morgan: Not me, I hope.

Mr. MacIntosh: If I am unlucky enough to have to answer that, Senator Nichol, I would think that the gold is going to be gradually demonetized, and the SDR system—this is a personal opinion—will gradually replace gold as a monetary reserve.

At the same time, I think a somewhat more flexible exchange rates system in the world will be a necessary reform that will have to be introduced. We have seen enough evidence in the last two years, or going back longer, for the last decade, that a rigid exchange rate system, a comparatively rigid system, leads us into one crisis after another. We have one every six months now, in some part of the world. To some extent that is due to the fact that the Bretton Woods machinery of 1944 was created to deal with a world in which there were not large capital movements, short term capital movements and there was not a free exchange, in most countries in the world of short term balances that there is today.

We simply have not devised yet a monetary mechanism, an international mechanism, for stopping those big flows from country to country for speculative purposes. I am pretty sure the monetary authorities will have to come to grips with that. They are trying to do so now, to stop this large washing of money back and forth from country to country, because it is going to spill back into trade matters. Already the United States is beginning to threaten to change its trade policies vis-à-vis Japan and the Common Market, because they are concerned that those countries are not opening their borders to the free flow of goods.

Senator Nichol: Are we not going backwards? Bretton Woods was considered a reform at the time it came in. Is not what is actually happening is that the international monetary system, the Bretton Woods system is breaking down, in the face of economic nationalism? So if we continue to get away from the Bretton Woods system and let everyone go their own way on a floating exchange rate, do we not get back to where we were, with trade wars and economic wars and all the rest of it? Is there not a danger of a regression, to move away from Bretton Woods?

Mr. MacIntosh: I think it is a question of modifying Bretton Woods rather than of moving away from it. It was conceived in a world in which there was only one viable economy and that was the North American economy. Now we have strong economies in Germany, Japan, Italy and many parts of the world. The Bretton Woods system simply was not built to cope with the capital movements we have today. It was built for making possible a greater flow of trade. Certainly, reform is needed, but I do not think that reforming the Bretton Woods agreement would be moving away from it or backwards.

The Chairman: I think what specifically is probably worrying Senator Nichol is the idea of going to floating exchange, a series of floating exchange rates all over the world ...

Senator Nichol: The trade wars were brutal in the old days, so one would not expect to go back to them.

The Chairman: ... rather than have large streams of relative exchange rates.

Mr. MacIntosh: I think the evidence of the Canadian experience in the last year is that the floating rate has served us extremely well. Had we, at any time in the past year, attempted to fix an arbitrary rate, I think it would have led us into tremendous difficulties, no matter when it was fixed. Nobody could have been so wise as to see exactly where the dollar would get to. I think the wider band of exchange rates, and more frequent movement of rates, is a necessary cushion. It has certainly helped to cushion our economy against great flows, not only from the United States but from the Common Market.

Senator Molson: But you are saying limited movement of the rate.

Mr. MacIntosh: I do not think it is politically on to expect to have really floating rates everywhere in the future. It is just not politically on because some of the countries of Europe take a strong stand against it and so do the Japanese. But a wider band and more frequent small movements is, I think, a viable proposition.

Senator Beaubien: Well, that is pretty well what happened, is it not, Mr. MacIntosh? The mark went up about 4 or 5 percentage points and then came down to 3.

Mr. MacIntosh: The Germans have not agreed in principle that they should float. They have done so to withstand the pressures of the big inflow. But a general agreement to have a wider band, perhaps plus or minus 2 per cent, I think would be a tremendous reform of the monetary system.

The Chairman: Are there any further questions, honourable senators? Any further comments?

On behalf of all honourable senators, I would like to thank our witnesses from the Canadian Bankers' Association very much. It is encouraging to see, gentlemen, that you disagree with one another as much as we disagree with one another; that the economists disagree and that there really is a little confusion everywhere. However, you have helped us to reduce our confusion slightly.

Thank you very much.

The committee adjourned.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT
1970-71

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 16

THURSDAY, JUNE 3, 1971

Thirteenth Proceedings on the Question of
Growth, Employment and Price Stability

(Witness—See Minutes of Proceedings)

23883—1

STANDING SENATE COMMITTEE ON
NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
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*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
Gélinas	O'Leary
Grosart	Paterson
Hays	Phillips
Isnor	Sparrow
	Walker—(27).

(Quorum 7)

**Ex officio Member*

Orders of Reference

Extract from the Minutes of Proceedings of Tuesday, March 9th 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March 1972; in advance of Bills based upon the said Estimates reaching the Senate.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Wednesday, April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada maybe exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Tuesday, May 4, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relation thereto.

The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Minutes of Proceedings

Thursday, June 3, 1971.
(16)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10.00 a.m. to consider the Question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Benidickson, Croll, Desruisseaux, Isnor, Laird, Molson, Nichol and Paterson—10).

Also present but not of the Committee: The Honourable Senators Carter, Haig, Kinnear, Lafond and Smith—(5).

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Witness heard:

Dr. Herbert Giersch,
Professor of Economics,
University of Kiel,
West Germany.

At 1.10 p.m. the Committee adjourned to Tuesday, June 8, 1971, at 4.00 p.m.

ATTEST:

Gérard Lemire,
Clerk of hte Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Thursday, June 3, 1971

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 10.00 a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, we are honoured this morning to welcome Dr. Herbert Giersch of West Germany. From 1964 to 1970 Dr. Giersch was a member of the German Council of Experts on Economic Development. He is Director of the Institute for World Economy and is Professor of Economics at the University of Kiel. He received his doctorate from the University of Munster in 1948. His doctoral dissertation was entitled: "Compensation for War Losses".

Dr. Giersch was a Fellow at the Development Centre of the OECD from 1963 to 1965. His writings are extremely numerous—almost too numerous to mention—among which are *Fundamental problems of Regional Policy; Objectives of Structural Policy; Acceleration Principle and Propensity to Import Regional Income Distribution;* and various articles on moveable exchange rates and demand management.

As you know, the German economy has been one that has been the envy of the world. Some of the experiences that they have had are not comparable to the Canadian economy, but nevertheless some of the experiences in the planning that has taken place in Germany in later years does pertain germanely to the Canadian economy.

For these reasons, I think we will find that Dr. Giersch has a great deal to contribute this morning. He has filed a brief with us and I would ask him to begin by giving us a short verbal summary of that brief.

Dr. Herbert Giersch, Department of Economics, University of Kiel: Thank you very much Mr. Chairman for inviting me to this hearing. It is a great honour and a great pleasure for me to come to Canada for the first time in my life. I apologize for not being able to speak English as well as I should like to, but I hope that I can make myself understood sufficiently so that you can raise your questions and I may be able to answer them.

The topics about which I am going to speak relate to growth, employment, inflation or the goal of price level stability, anti-cyclical demand management, the relations between inflation and growth, the role which incomes policy can play, and some questions of co-ordination of anti-cyclical or stability policy.

In my statement I have started with the objective of economic growth, because I think that this is the basic problem, if you really understand by economic growth the growth of supply. In economic literature as well as in policy discussions, growth is quite often identified with demand. If you do that you easily end up with the conclusion that to stimulate growth you must expand demand and that growth will then be immediately associated with inflation. I take the opposite point of view. At least I want to stress that growth means the growth of supply.

Of course you have referred, Mr. Chairman, to the tremendous rates of growth which the German economy experienced in the early fifties when we had an excess supply of labour and a shortage of capital. At that time economic growth was stimulated by the existence of a surplus supply of labour. The capital accumulation took place rather quickly as a result of the fact that the excess supply of labour meant low wages and fairly high profits, and capital accumulation could take place to a large extent by auto-financing. Capital accumulation therefore resulted from high prices and it meant, of course, that capital formation took place in a way that benefited those who had retained their property, and the share of households and wage earners in capital formation was very small.

One of the basic objectives of German economic policy at the moment is to raise the share of wage earners in total capital accumulation by promoting savings as a means of promoting economic growth. Furthermore, while Germany in the early fifties and later had a rather elastic supply of labour it, and particularly skilled labour, became scarce at the end of the fifties and there has been a marked wage push as a result of the increased scarcity of labour as compared with the earlier period. So, apart from employing foreign workers, we had to shift in our growth policy to measures to improve the skills, to retrain people and to make them move from areas where there is unemployment to those where there is an excess demand for labour.

I think also there is some similarity between Germany and Canada in that we have to take into account that we are talking about an open economy which attracts labour from abroad and which also imports capital from abroad. It is not only the domestic accumulation which plays a role, but also the importation of capital and the employment of foreign workers.

When talking about economic growth in Germany, we also take account of the regional aspects of it. There are areas which have had in the past a high rate of growth,

and there are areas which have been lagging behind and also areas where pockets of unemployment had existed for a long time. Now the regional and local authorities are keen on attracting industries so that they can raise the level of employment in their areas including the level of employment of foreign workers and so raise real wages in the area in order to increase tax receipts and to improve the well-being of the population there.

So, growth policy to a large extent is structural policy with regard to the training and education of workers, the building up of an infrastructure in the various regions, particularly in those regions which are lagging behind the centres of agglomeration.

The German economy has been an open economy, and we think that economic growth has been stimulated by making the economy more open, first of all by liberalizing imports and going ahead of other countries in liberalizing imports by reducing import duties and pushing within the framework of the European Economic Community for lower tariffs on imports from abroad.

How far is this growth policy? Now I think that economic growth is being stimulated by the existence of intense competition, and in an open economy competition is to a large extent competition from abroad. You can make competition from abroad more intense by opening your markets to the products of other countries. But competition is also a function of the exchange rate. For quite a few years Germany has had an undervalued currency which means that domestic industries are to a large extent protected from foreign competition by the undervaluation on the one hand, while on the other hand exports are being subsidized through that same undervalued currency. This certainly has for a considerable period of time contributed to high profits and also therefore to the accumulation of capital. The revaluations which we have had to some extent had to do with the foreign balance, but on the other hand they were considered as a contribution to the maintenance of price level stability within Germany. They have also been, I believe, a contribution to the economic growth in West Germany to the extent that they have been shocks of more intense competition from abroad which is something that has always, of course, been opposed by businessmen and by producers in general—and even by trade unions—but which in the medium and long-run has been beneficial to the economic growth within the country.

Now I am coming to the problem of employment. After the structural unemployment which was due to the influx of refugees immediately after the war had been absorbed by, on the one hand, capital accumulation and the corresponding increase in total demand by the end of the fifties, we experienced in West Germany a fairly high level of employment. Within the last five years or so, the average unemployment rate has been about 1 per cent. This seems to be surprising when compared to both our experience in the inter-war period and the experience of other countries. There have to be particular explanations for that.

Now the point I want to stress is the behaviour of the trade unions. My general point would be that the level of employment is largely determined by the real wages which are being asked for by the trade unions. In Germany the trade unions were not aggressive in the first instance because they had to pay attention to the need for creating jobs to absorb the structurally unemployed. Millions of Germans from East Germany had come into West Germany. The trade unions had to be open-minded therefore vis-à-vis the influx of workers from beyond the West German borders including later on foreign workers who came to West Germany after the influx of refugees from West Germany had ceased. So, the West German trade unions could not adopt a protective attitude; they could hardly adopt a monopolistic attitude and they had therefore to pay attention to employment as one of their targets, and could hardly pursue for a long time a policy of raising real wages at the expense of employment.

Within this period which I have described, real wages have been to some extent lower than they might have been if the German trade unions had been protective and had raised the level of wages to the extent that there would have been no demand for foreign workers. As a matter of fact, locations in Germany were attractive to capital, and capital to a large extent, apart from some capital exports, moved into Germany because German locations were considered to be favourable to capital. There has also been at the same time, as a result of the creation of such jobs, an influx of workers from southern Europe. This is how you raise the rate of growth and the level of employment within a certain area by having an open economy and by having a wage level which is lower than it could have been if you had dealt with a closed economy, and if the trade unions had maximized real wages even at the expense of employment.

Also with regard to the regional structure of West Germany's economy there is the problem of how large inter-regional wage differences ought to be. Similarly, there is the question of what inter-regional wage differences would be necessary within the European Economic Community to maintain a regional structure of industries.

You can have an agglomeration of industries within the centre of a large area at the expense of the periphery if you have an artificial equalization of real wages over your whole area; which means that real wages may be too high in the peripheric regions where you have locational disadvantages due to high transport costs.

Unless wages in the peripheric regions are lower than in the centre, to the extent that productivity is lower than in the centre, you will create unemployment in the peripheric regions.

It means, of course, that this unemployment will be both counted as national unemployment and on the other hand, it will lead to a movement of people from the peripheric regions to the centre, so that the locations at the centre are being benefited by it—economic growth is higher there—and the peripheric regions become depressed regions.

In order to prevent that from happening you can subsidize the jobs in the peripheric regions by means of an equalizing fiscal system. You can also try to educate the trade unions that if they want to have high employment in a certain region they have to accept lower wages to

the extent that productivity is lower than in the centre regions.

This is of some concern in the discussions for the creation of a full European economic union, including monetary union, and it may be of some relevance to Canada, if Canada is considered to be a part of the North American economy. It may have locational disadvantages compared to the growth centres of economic activities which may lie a bit more south on the North American continent.

I say this in order to stress that the level of employment within a certain region or country is dependent upon the level of real wages. If we have had within Germany in the 1950s a tremendous increase in employment and growth, this has to a large extent to be ascribed to the behaviour of the trade unions who, as I said at the beginning, could not behave protectionistically or monopolistically for the reasons stated.

If I compare the German trade union system with the British trade union system, it is quite different in that our trade unions are organized on industry lines and not on professional lines; so that, apart from some exceptions as in aircraft and air transport you have collective bargaining for whole industries. It means that for the period of the contract, for one year or one and one-half years, you have industrial peace in that particular industry and no profession is able, as it may do to some extent in the United Kingdom, to interrupt production of a large industry if there is trouble within one small professional part of the labour force employed.

When Germany increased the level of employment to absorb structural unemployment in the early 1950s we found that real wages rose less than productivity. It was only when structural unemployment was absorbed at the end of the 1950s that real wages increased somewhat faster than productivity, in order to catch up and to have a new balance between real wages and productivity.

To explain the low level of unemployment in West Germany, we have to take into account the fact that we count only those who are unemployed residents of Germany; but the supply of labour comes from areas outside Germany as well as inside. Therefore, to some extent the frictional or structural unemployment, which may have to be set against the employment in Germany, includes also some of the unemployment in southern Europe from which we can selectively import those workers which we need. "Selectivity" means that we import only those whom we need and we do not count those who are unemployed there.

This is equivalent to a very high mobility of labour. There are hardly any bottlenecks in the labour force or in relation between supply and demand for labour in Germany, because these bottlenecks, instead of being removed by mobility within Germany, can be removed by importing selectively those types of labour that we need.

According to my experience, and from my reading of recent West German economic history, there has, with very rare exceptions, been no prevalence of cost-push inflation. I think we have had, for most of the time, demand-pull inflation. It was not the domestic demand which created excess demand, but to a large extent foreign demand. Therefore we can say that the type of inflation that we have had, and which we have had to an increasing extent, with a rate of increase in the consumer price level of almost 5 per cent in 1971, is due to imported inflation.

I do not know, of course, whether there would have been situations of cost-push inflation in the absence of excess demand including excess demand from abroad. I do not know whether imported inflation or demand inflation just disguised the cost-push inflation which we otherwise may have had.

The Chairman: Do you have some thoughts on it?

Dr. Giersch: My thought is that in the absence of demand-pull inflation induced from abroad, we would have had an increase in the price level from one to 2 per cent resulting from indigenous forces. I think that this is largely due to the fact that the wage mechanism only works upwards and not downwards. Therefore any changes in the structure of employment in a market economy which requires wage increases when more labour is needed means that the wage level has to go up. It may have gone up more than the 4.5 per cent increase in productivity which we have actually had in recent years but cannot expect for the future. I suggest that in the total picture we might have had an increase in the general wage level of 6 per cent or so.

I should, of course, add a comment with respect to the cyclical nature of the wage inflation problem. I should be quite specific in this respect when discussing its cyclical nature. An analysis of the pattern of the business cycle in Germany illustrates that the first pull of demand comes from abroad. Then there is an accelerator mechanism of induced investments at home to satisfy the increased demand.

There is first, therefore, the expansion of demand. In the early upswing wages do not increase as much as productivity plus the small price increase which may exist at the beginning of the upswing. Therefore labour unit costs tend to fall at the beginning of the upswing, or at least do not rise as fast as in the trend. This means that there is an increase in profits in the early upswing until a wage wave develops, resulting in the delayed adjustment of wages to the market conditions. This is known as the wage lag and is quite noticeable in West Germany. In the recent cycle, which started in 1967, we have had the longest wage lag observed in the history of the West German economy since the war. This may be related to the market recession which we experienced in 1967. At that time I spoke with German trade union officials. In 1968, for example, I asked them why they did not press for higher wages, because by doing so they would contribute to smoothing the upswing and preventing a profit explosion. The answer was they had to consider their bargaining position which is weak at the beginning of an upswing when jobs are still quite insecure and prices do not yet rise.

German trade union members are quite sensitive to the insecurity of the job on the one hand and price increases on the other. Public opinion polls in West Germany have

shown that workers might be prepared to have constant wages if there were no price increases. They would therefore even be prepared to ignore the possibilities of wage increases resulting from productivity increases. Perhaps they do not know much about productivity, but their main concern is that when prices rise they fall back and therefore have to catch up.

The second point is a distribution argument, the existence of profits. As long as it appears that firms do not make abnormally high profits, there is little wage pressure. But in a period such as the year 1969, when the boom gained momentum, if wages have lagged behind a profit explosion develops. The balance sheets are open and the trade unions, who have representatives on the boards of firms as a result of co-determination, know what has happened. Then they are bound to exert wage pressure, which means catching up by carrying out the aggressive wage policy which would compensate them for a previous wage lag. That period was immediately before an election. The trade unions were not yet pursuing an aggressive wage policy. We had at that time wildcat strikes as a result of the fact that effective wages were much higher than negotiated wages. Trade union members at that time knew that they could obtain wage increases by pressing entrepreneurs without the support of the trade unions and the employers granted wage increases of 10 per cent and more without much resistance.

As a result, the trade unions had to pursue an aggressive wage policy in order to show that they were still active on the wage front and that the rank and file needed the union organization to press for higher wages, incomes policy and a policy of preventing wage push in that later period of the cycle when demand is not expanding as rapidly as before. However, when the counterpart of the wage lag develops it means the wage push period with the profits squeeze. As a result of the profits squeeze investment falls. To prevent that the wage lag in the early upswing must be reduced.

That is exactly what the German Council of Experts attempted to sell to the German Government, trade unions and public early in 1968 in the form of a two-year plan for stability and growth. This involved a forecast estimate of the rate of productivity if demand expansion were to follow the path necessary to reach full employment within the two years. In 1969 we could estimate that on the basis of experience and forecast rates of growth of real GNP of approximately 12½ per cent for two years, or 6.2 per cent or 6.3 per cent for each year.

The public at that time did not believe this forecast. General opinion at that time was that the rate of growth could not be higher than 4 per cent because this was nothing else than extrapolating the experience of the low rate of increase of real GNP during the slowdown of the economy and the recession. Therefore the employers' associations rejected it as unrealistic.

On the other hand, the trade unions, who are in favour of high productivity increases and a high rate of growth, said they really did not wish to agree to such a common formula. They insisted on the autonomy of their wage-setting procedure. The Government at that time, at least the Minister of Finance, was not prepared to underwrite the estimate of demand expansion. It was felt that it would have required a reduction in taxes and much more public spending to achieve the demand expansion necessary for the anticipated productivity increase. Therefore, there was no agreement on the path the economy would take. Hypothetically, if we had agreed that this was a desirable and realistic path for the economy to take, it might have influenced, not perhaps explicitly, but implicitly, the wage negotiations at that time. Even if the trade unions had formally disagreed with it, they may have pressed for higher wages, and if the employers associations had anticipated the rate of increase of GNP and employment they might have said they were prepared to do that.

My view is that wage negotiations take account of the recent past and not the foreseeable future, so they reflect the employment situation in the recent past. They were therefore extrapolating the market conditions of the recession, and the expansion or the upswing came as a surprise to them. This is the basic reason for the wage lag in that period. If you want an incomes policy you have to start when it is really not needed. You have to start at the beginning of the upswing to shorten the wage lag and orient people's thinking to the future path of the economy, rather than to the situation of the past. The situation of the past is what makes for the wage pressure after the boom has reached its height. Then people still think they may have the productivity increases they have recently experienced, that they can have high wage increases without suffering unemployment as a result. If you consider not the foreseeable future but only the recent past, there is immediately a wage pressure, but it is then certainly too late to introduce an incomes policy, because at that time an incomes policy will mean that trade unions have to exert wage restraint. Their reaction is: "We may do it, but who is at the same time controlling prices?" If you can introduce an incomes policy when you do not need it, at the beginning of an upswing, then you may demonstrate to the trade unions and all groups participating in it that everybody may be gaining in employment or in price level stability, if a medium run view is taken and not only a short run view based on recent experience.

Of course, an incomes policy must in any case be combined with a compatible demand management. There is no sense in any incomes policy which merely represses the rise of wages and prices and at the same time lets excess demand develop. It can only reduce the pressure against the real demand of wages and prices. Both have to be compatible. They also had to be compatible in the German case, which I quoted, with a certain view of the future development of the Germany economy.

Senator Isnor: You were speaking of 1969, were you not?

Dr. Giersch: I was speaking of early 1968 and then the development the German economy took in 1968 and 1969. I think a lesson can be drawn from that for the future. The trouble with incomes policy in Germany in the past was to a large extent connected with the existence of a fixed exchange rate, which made it impossible for the German government to control total aggregate demand.

For example, in the discussions we had with the German trade union association on whether they would agree to some form of incomes policy, we were met with the argument. "How can you control imported inflation? We agree to some guideline for wage increases, but if demand is much in excess of that we have rising prices and effective wages which are far above negotiated wages. Therefore we feel that we have given something away, and we no longer play an active part in the wage-setting procedure. How can you control total demand so that it is compatible with the wage formula upon which we may agree?"

In Germany our experience has been that with fixed exchange rates and full convertibility—that means no restrictions on capital imports—there can be no effective demand management as far as monetary policy is concerned. There can be little effective demand management by means of fiscal policy, because in order to be effective fiscal policy, has to have an impact on the quantity of money. That means that if taxes are raised, the additional amount of money has to be deposited with the central bank in order to contract the quantity of money. If the quantity of money is contracted in an open economy with fixed exchanged rates and full convertibility, there is at the same time an increased demand for the importation of capital from abroad. Any restrictive policy is self-defeating if there is an excessive demand from abroad, and you can only have demand management with fixed exchange rates if your objectives are identical with the objectives and measures taken abroad.

We therefore thought that for any kind of anti-cyclical policy, or even incomes policy, changes in the exchange rate have to be included. That is the reason why in Germany we pressed very hard for revaluation of the Deutsche Mark early in 1968 and then in 1969, and even quite recently, because we feel that any incomes policy in an open economy is bound to be a failure if there is excess demand from abroad and the demand management cannot be geared to the formula or guideline for wage policy that has been adopted, or which you want to sell.

We hope at the moment that after we have set the exchange rate free the central bank will be in a position to manage demand. We had a quantity of money and this may improve the possibility for a very liberal incomes policy, of the kind I have implicitly described.

As regards the relationship between inflation and economic growth, there are, of course, two schools in Germany as well as elsewhere. I do not hesitate to say that I belong to that school which believes that inflation does not promote economic growth, and I will tell you why. I am taking not the very short run view; I am taking a longer run view.

I cannot see that inflation can promote economic growth. It can do so, perhaps, only by increasing the supply of capital through increasing profits, but this would be not a very social or equitable kind of growth policy. It would, of course, be a growth policy at the expense of wage earners. Growth through inflation can work only at the expense of real wages, and for the benefit of profits. It works only to the extent that there is a wage lag, as I have described it; but you cannot have a wage lag for more than a period of one or two years. Then you get the opposite of it; you get what some economists are calling wage pressure, a cost-push inflation, which is, in my view, only a secondary effect of the demand-pull inflation which you have had before.

In that period, when you have the wage pressure, you get the profit squeeze as a counterpart of the growth promoting profit explosion which you have had before, but withins the period of a cycle—that means four to five years in Germany—it cancels out. Then, if the trick is to work for the second time, you have to increase the rate of increase of prices, so that actual prices are increasing faster than price increase expectations. At least, the price expectations of the trade unions must be surpassed. So you get a wage lag again.

The Chairman: Would you say that last part again, please?

Dr. Giersch: If the trick is to work, you have to expand total demand so that actual price increases are higher than expected price increases were at the time when the wage bargains were made, so that you again get a wage lag. That means that you have to deceive the trade unions by having price increases which are higher than the price increases that they had antic pated.

I do not know how long this kind of money illusion which is necessary to deceive the trade unions will exist. At least, after some time, the acceleration of inflation will be anticipated, and then you will have to have an acceleration of the acceleration of the price increases, if the trick in economic growth promoted through inflation is to work again. I just cannot believe that in an economically enlightened world trade unions are likely to be deceived for more than a very short period.

There may be another explanation. It may be that inflation may be at the expense of the savers. That means that if the rate of interest does not take account of the price rise there is, of course, an interest lag. But after some time you will feel that. You will see—and I think we observe it in the world in which we live—that interest rates are getting higher and higher to take account of the rate of inflation.

When you want to stop the acceleration of inflation you get a situation of quasi-deflation, so that price increases are decelerating but incurring their debts for investment. Firms have already paid high interest rates, taking account of the rate of inflation in previous time, and they now feel they have too high a debt in interest payments, and therefore they think it is necessary to have an investment pause. If there is an investment pause you are bound to have a kind of recession. You will have this recession although the price increase has not gone down to zero. You may have a price increase of 3, 4 or 5 per cent and even more; and if you start, you can have all that from any level. It may start with a zero price increase, and the next cycle may start with a 3 per cent increase, and you may start the third cycle with a 6 per cent increase. All this can happen on any level of inflation. It is very difficult then, after you have adjusted to a

5, 6 or 7 per cent inflation, to get down to a 4 per cent or 3 per cent one.

Senator Benidickson: Or 9 per cent?

Dr. Giersch: Or 9 per cent, yes.

Mr. Chairman, I think I have talked for too long.

The Chairman: Not at all.

Dr. Giersch: I had better leave it to you now to raise questions.

The Chairman: Are there any other points you wanted to make?

Dr. Giersch: I could talk about the institutional arrangements for demand management, and the kind of incomes policy or attempted incomes policy of which we talk in Germany.

The Chairman: I think that would be appreciated by the members of the committee.

Dr. Giersch: In 1963, a law was passed by the federal Diet to establish a group of experts for the overall economic development—the council of experts of which the Chairman talked when he introduced me. This law stipulated, first of all, the general objectives of economic policy—which you all know, because they are universal. They are price level stability, high level of employment, equilibrium in the foreign balance, and an adequate rate of growth of the economy.

The council of experts, which as then actually set up early in 1964, has to write an annual report and submit it to the Government and to Parliament by November 15. This report is published after a delay of eight or ten days. The council is not permitted to make recommendations but—and this amounts to almost the same thing—it is to describe how, with a given situation, the objectives laid down could be reached, and they have to be reached simultaneously. This is the question put to the council.

Since they are rare situations, only in rare cases can you devise a scheme, or two schemes or three schemes, to achieve within a limited period of time the specified goals simultaneously. You quite often end up with one solution, because there is not much between which you can choose. This, of course, then amounts to a recommendation. If it includes, for example, that you have to change the rate of exchange, then that document becomes the centre of a heated public discussion, as it has several times so far.

After this report is submitted to Parliament, the Government within a period of eight weeks has to write its comments, and to lay down how the Government thinks that the economy will behave within the next twelve months. This is therefore the Governments' reply to the opinion of the council of experts and it is a formulation of the government's policy for the next 12 months. Both documents are being discussed in the Parliament and, of course, more is being said about the government's declaration of policy than the council's report behind it.

In 1967 the federal Parliament also accepted another law—a stability and growth law. This stability and growth law requires that federal and state budgetary planning shall cover a period of five years. It is a kind of medium-term planning which is being required there, taking account of the rate of growth of potential output, and it shall include medium-term investment programs. So that demand management, through public expenditure policy, can become more effective if investment programs for the five-year period are being laid down as a basis of a five-year period of financial planning.

Senator Isnor: That is something new, doctor.

Dr. Giersch: Yes, that was new at that time.

Now, the law also provides for a compensatory fiscal policy of the federal government, the state and the local governments. But so far it has not been possible to include the local governments in any kind of program. There are more than 20,000 local governments and so far one has not been able to influence very much the expenditure policy of the local governments, which is procyclical rather than anti-cyclical.

An important counter-cyclical device is that the government is in a position to raise taxes and to lower income tax, including the corporate income tax, by 10 per cent both in the upper direction and in the downward direction, and this specifies a maximum period of one year but the federal Diet and the second chamber, the Senate, must give their explicit consent, otherwise the measure cannot become effective. But the government can take a lead and then there is a consent by the federal Diet so that it need not be a law which is initiated in the Parliament. This is supposed to shorten the time-lag of tax measures. But as a matter of fact it has not yet worked. It has not been applied. When it was supposed to be applied in 1970, the party in power was afraid the tax increase might be unpopular in the face of an election in the most important state, North Rhein-Westphalia, and therefore postponed it. Then immediately after the election they raised the taxes, but not by using this stability and growth law and the provision giving some powers to the government; rather, by a somewhat different measure, a 10 per cent increase was initiated, but it was said that it was to be repaid before 1973. The repayment provision is not included in the stability and growth law, but the repayment provision was considered to be necessary to get popular support for the increase.

On the other hand you may ask whether a tax increase with a repayment provision is very effective, because it just means that the government is taking a loan without paying interest on it, and people, feeling confident that the government will repay, may incur debt and may not reduce private expenditure. As a matter of fact, we are not quite sure whether this tax measure had any effect at all on total domestic demand. One may argue, and it has been argued, that in so far as the government reduced the quantity of money by that measure, it induced at the same time an inflow of funds from abroad, thus contributing to the increase in foreign holdings by the central bank. It may therefore have contributed to the foreign exchange crisis—if you can call that a crisis, because there is speculation in favour of revaluation.

But this, of course, again shows the dilemma of demand management in an open economy with full

convertibility and fixed exchange rates. What you can do, what you may do, amounts in the end to a measure which has its effect mainly on the balance of payments and you just cannot control it. So we hope that after the freeing of the exchange rate we will be more able to influence the course of the economy and even make more use of the stability and growth law to which I have referred.

The Chairman: There is one last point which you dealt with generally, Dr. Giersch. In regarding taxes and the discretion given to the federal government, your final paragraph deals with an accelerated depreciation and a tax credit.

Dr. Giersch: That is right.

The Chairman: Do they have more discretion in that?

Dr. Giersch: Yes, that is right, they have.

The Chairman: Do they make use of t?

Dr. Giersch: Yes.

The Chairman: Is it effective?

Dr. Giersch: It is difficult to judge, because we do not know the alternative course of it. The limitation of the accelerated depreciation ended at the end of last year, and that may have contributed to the increase in investment which we have observed in these first months of 1971. I would guess that it has had some effect. At least the ending of the limitation to accelerate a depreciation has had a positive effect on investment.

The Chairman: Thank you very much, Dr. Giersch. You have certainly given us all sorts of material to question you on. Senator Beaubien will open the questioning.

Senator Beaubien: Dr. Giersch, you started off this morning by apologizing for your English. I should like to inform you that you could very likely get a job teaching English in one of our universities, if you wanted to stay in Canada.

Dr. Giersch, I am interested in your remarks about capital formation and the accumulation of capital. Would you describe the corporate income tax that you have in Germany? Is it just federal or is it also state so that we could compare it to our own?

Dr. Giersch: It is federal.

Senator Beaubien: What is the rate of tax, doctor?

Dr. Giersch: About 50 per cent.

Senator Beaubien: It is as much as that?

Dr. Giersch: Yes.

Senator Beaubien: Do you make any concessions for amounts which would be earmarked for dividends?

Dr. Giersch: No.

Senator Beaubien: Does the shareholder get any kind of credit for the tax that corporations pay?

Dr. Giersch: No, but that question is being discussed now.

Senator Beaubien: At the moment?

Dr. Giersch: At the moment, yes.

Senator Nichol: I have a supplementary question to Senator Beaubien's. Speaking of corporate income tax, the debate in this country at the moment revolves around depreciation rates under various names, depletion allowances and so on. How do you think that compares with the situation in Germany?

Dr. Giersch: I only know that German businessmen complain about having worse depreciation rates than businessmen in any other country.

Senator Nichol: Our businessmen complain that ours is worse.

Dr. Giersch: I know. This is a universal complaint. I cannot make any comparisons there because it deals with a very specific period—it can be a 10-year period or a 15-year period—and also I am not sufficiently familiar with it.

Senator Molson: Dr. Giersch, I should like to go back to the earlier part of your remarks when you were speaking about stimulating growth and ask you about two different things, first of all the question of imports and secondly the question of unions. In mentioning that the increased imports provide considerable stimulation to economic growth, do you think, Dr. Giersch, that this experience is or can be translated from, say, Germany or, indeed, from the Continent of Europe to North America—Canada and the United States. Do you feel that this is a fairly universal thing?

Dr. Giersch: I personally feel it is a universal principle that competition promotes economic growth, and by competition I do not count the number of sellers in the market but I count the feeling of uncertainty about the future existence of the firm, its future profits, the feeling of uncertainty which can be reduced by action to invest and thereby improve and strengthen the firm in competition. So, competition is a factor forcing the firms to have higher investments, better products, lower costs than they might otherwise have and I would call this competition the opposite of the kind of monopoly which Professor Hicks in the United Kingdom described when he said that the best monopoly profit is a quiet life. The kind of competition I mean therefore is the kind of life where you have to fight for your profit by being very active. Competition within the country may not be sufficient; it is the foreign competition that plays an important role particularly for export industries, and the major impetus for economic growth comes from the export industries—at least in Germany it has come from the export industries. I don't know how far this is comparable to the Canadian experience, but the principle applies equally.

The Chairman: We are informed that 24 per cent of the Canadian gross national product is devoted to exports. Could you give us the comparable figure for Germany?

Dr. Giersch: It is about 25 per cent, so it is reasonably comparable.

Senator Molson: My second question relates to the subject of the unions and the effect they have on wages in Germany and secondly the effects on employment. As related by Dr. Giersch, I find it quite hard to relate any Canadian experience to what he explained to us as existing in Germany, and it sounds to me that there is a greater percentage of workers in the unions in Germany than we have here. Is there a high percentage of labour unionized?

Dr. Giersch: About 40 per cent.

Senator Molson: That is high. The other impression I gather is that there is a large body of unions. I think you spoke of an association of unions.

Dr. Giersch: The Federation of Unions.

Senator Molson: Is this able to speak generally for labour in Germany?

Dr. Giersch: Well, it is very difficult to describe. There is a Federation of Trade Unions, but the real power is vested with the industry unions. For example, the union for the metal industry, which is the biggest union, has about two million members so that the strength of this particular union within the Federation is very important. I should perhaps say that the Minister of Economic Affairs has regular meetings, open meetings, with the trade unions, trade union leadership, with representatives from industry, with the Central Bank, and with the group of experts which I have mentioned. At these meetings the government explains its policy and the other groups also explain how they see the future of the economy.

Senator Molson: All these groups meet together?

Dr. Giersch: They all meet together, and there are representatives of the Federation of the Trade Unions, but the major individual unions are also represented. This is an indication that the Federation of Trade Unions is not really a policy-making body but is very much dependent on the views of the stronger unions which are represented also at this round-table discussion which takes place about every three months—apart from emergency situations—and, as I say, this shows that real power is not with the Federation but with the individual unions.

Senator Molson: In addition to this you have union representatives on the boards of directors of large companies which would make for a much closer liaison.

Dr. Giersch: That is right.

Senator Molson: It sounds also from what you have said that your employers' associations are much more viable, stronger and perhaps more representative than anything we have in this country.

Dr. Giersch: That may be.

Senator Molson: Do they speak with a voice?

Dr. Giersch: Yes, they speak with a voice. They are also represented in round table groups or discussions. They have a fairly strong voice, but not so diversified, sometimes, as the trade unions may speak. It largely depends on whether or not the Secretary General is a strong man. The employers' association have a strong point of view which they can explain. They also have some influence on public opinion.

Senator Laird: Do you have the problem in Germany of the closed shop plus the union hiring hall, which is the subject matter of a lot of complaint here?

Dr. Giersch: No, we have not.

Senator Croll: Do you have minimum wage laws?

Dr. Giersch: No.

Senator Croll: At any level?

Dr. Giersch: No.

Senator Carter: It appears to me, Dr. Giersch, that in the set-up that you have described, with the three elements, the unions, the government and the industry, there seems to be a much greater amount of mutual confidence and trust than we find over here. Can you tell us if that is so, and, if so, how that is achieved?

Dr. Giersch: The problem of mutual confidence is, of course, a basic problem for any kind of incomes policy.

I do not know what kind of mutual confidence exists here. At least, in West Germany, they talk to each other. Apart from the round table meetings with the Minister of Economic Affairs, about which I have been speaking, they have their own mutual meetings between the employers' association and the trade unions.

When I said an incomes policy, in terms of a co-ordination of activities of various groups which contribute to economic policy without being responsible for it, that kind of incomes policy should start in the early upswing. It is in order to create mutual confidence. When the council of experts submitted plans for an incomes policy we said that after one year there should be a review of the situation, as to whether or not it could be or should be prolonged. This was in order to increase confidence.

It is very difficult to measure confidence, but I have the feeling that public opinion, to some extent, is pressing for the kind of understanding among the big autonomous groups in the economy, because public opinion is very sensitive to price rises. It is felt in Germany that if there is not such a stability pact, about which we are talking, it will be very bad for the German economy.

I do not know how to compare confidence, but I think that enough confidence exists which one can build up if one starts at the right time.

Senator Carter: At least they listen to each other. They do not condemn each other before they start talking?

Dr. Giersch: No. They submit their estimates in terms of national accounts statistics and indicate how they view the future of the economy within the next year. However, they may not unite at one set of tables. They never did so; but by exchanging views there may be some kind of convergence of thinking.

Senator Nichol: On this question of mutual confidence, co-operation and stability, and the pressure of public opinion behind it, do you not think that a good deal of the contrast between the psychological background in your country and that of this country could be traced to the tremendous destruction caused by the inflation of the 1930s, followed by the complete destruction of the economy during the war? This gives people, perhaps, a sense of the importance of these stabilities. In this country we have had, frankly, neither of those things. Could you comment on that?

Dr. Giersch: Yes. I completely agree with you. The hyperinflation after the First World War and the repressed inflation after the Second World War certainly increased sensitivity to price increases in Germany. I think the sensitivity threshold for public opinion is when the consumer price index is about 3 per cent above that of the previous year. At least, this is the present psychological situation. Perhaps in five or 10 years we can say we will not be confident if we have a 5 or 6 per cent increase. Perhaps we can bring the rate of increase in the inflation down to that; but this I do not know.

There is some evidence for your hypothesis. It is that the attitude vis-à-vis inflation is very different in the age groups. Older people with experience are much more sensitive to price increases than are young people. However, historical memory may not be the only explanation compatible with age differences in the attitude towards inflation.

Young people, of course, have less savings and therefore are less sensitive to losses through inflation. Also they have a different combination of goods which they want to buy, while older people buy more services which increase faster in price than do industrially produced goods. Therefore older people feel price increases more than young people.

But although it would not be affirmed evidence for your hypothesis, the observation concerning the attitude of age groups towards inflation, of course, supports it. I think the attitude is changing in Germany and people are less sensitive vis-à-vis inflation than they were a couple of years ago.

Senator Nichol: It is very important, because it provides the background against which the politicians are operating in their attempts to control it. They may see the right direction, but they may not be able to do it and survive as politicians.

Dr. Giersch: That is right. At the present moment stability is the policy objective number one. The government feels strongly that unless price increases can be brought down from almost 5 per cent to, say, 3 per cent, or somewhat less than 3 per cent, they will suffer severe losses in the 1973 general election. So that Schiller, the Minister of Economic Affairs, who is considered the man in the government who is most in favour of stability, is now ranking very high in public opinion and now has a strong position with the government because he has been entrusted with the Ministery of Finance. The Government considers this objective to be most important for the next two years. It can be explained only by the fact that the rate of unemployment is so low and the rate of inflation is higher than it has ever been since the Korean boom.

Senator Nichol: Speaking of low unemployment, Dr. Giersch, how flexible is the wage situation in Germany? To take a hypothetical case, if the labour demand were to drop in a certain trade such as carpentry or plumbing, would wages stay up and workers leave the labour force, or wages drop and employment remain unaffected?

Dr. Giersch: In 1967, with an increase in unemployment to 2 1/2 per cent, we actually observed wage reductions. This applied to effective but not negotiated wages, because there is a strong wage lift. One of the main problems for the future is to explain to the public and the trade unions that a slight wage reduction may be the best alternative to losing the job. If that could be conveyed to the workers and trade unions it would be a great advantage.

I emphasize the point of view that employment depends upon real wages. This is fairly unorthodox, even in Germany, where most economists assert that responsibility for full empllyment lies with government and that it is for the trade unions to set the wages, at whatever level. Unless that full employment guarantee is withdrawn or made conditional there will, of course, be a continuous upward pressure of wages and a tendency to expect full employment for most of the time.

In 1970 the federal Chancellor made it quite explicit that the present Government would not allow the level of employment to go down and felt responsible for it. Many economists and journalists stated this to be a very dangerous declaration. In the meantime, the Chancellor has modified it. It may have to be modified to a full employment guarantee dependent on the wage-setting behaviour of the trade unions. A deal could then be made in macroeconomic terms providing that if contracts do not surpass a certain limit full employment will be maintained. In the event wage increases move above the guideline the Government would not be responsible for full employment.

It is therefore a matter for negotiation and something which in any discussion of incomes policy should play a prominent role. At least part of the responsibility for employment lies with the trade unions and, of course, also with the employers' associations.

Senator Molson: Is there a very high conciousness of job status in Germany? Are people very reluctant to go into certain classes of work? Could there be unemployment and yet a large number of vacancies in certain types of occupation?

Dr. Giersch: The problem is minimized in Germany because those occupations which are disliked by German workers are filled by foreign workers.

Senator Benidickson: Mr. Chairman, Senator Carter's question and the informative remarks of our excellent witness answered my first question.

Towards the end of your exemplary outline of the situation in Germany, a country which has done very well economically and in my opinion socially, you made a reference to the exchange rate. I do not think you said whether you favour, under the International Monetary Fund or some other arrangement, a fixed rate of exchange or a floating rate. Would you care to enlarge on that?

Dr. Giersch: Thank you very much for that question; I definitely favour a floating exchange rate. This is a precondition for the effectiveness of monetary policy. With a fixed exchange rate and full convertibility, a country's price level is completely dependent upon that of what may be referred to as the dominating country. There cannot be a different price level and rate of inflation in the medium and long run that exists in the rest of the world as long as there are fixed exchange rates and full convertibility.

Senator Benidickson: Can you do much basically on a fixed rate?

Dr. Giersch: No, practically you cannot do very much on the basis of a fixed exchange rate. For example, Germany had the most stable price level in the world in 1967. However, this was in combination with a recession. To put it in general terms, there is a strong interdependence of prices between various countries which are connected with fixed exchange rates. Although the connection is not as close as that between regions within one country, it approximates that closeness, particularly with respect to international integration. This is true of the EEC. The Austrian, Swiss and Dutch price levels are very much dependent on that of Germany. In the long run the German price level with fixed exchange rates cannot move differently from that of the United States. There is a direct inter-relationship of prices through the arbitrage mechanism. If you are a cheap country more will be bought from you, which will raise prices. Furthermore, there is the interdependence through the money markets, so that you cannot control your own quantity of money with a fixed exchange rate and convertibility, and therefore cannot follow a different inflationary course from the rest of the world.

In recent years and months it has become quite plain in Germany that we are actually living on a dollar standard as long as we have a fixed rate of exchange for the dollar. Our recent experience has been that the United States, by the theory of benign neglect of the balance of payments position, can create the dollars, and if we are prepared to hold them and explain to the United States that we will not ask for gold—

Senator Benidickson: But this is United States currency.

Dr. Giersch: That is right.

Senator Benidickson: Not gold.

Dr. Giersch: That is United States currency, and if we do not ask for gold the United States will have a deficit in their balance of payments as large as they consider is compatible with their domestic policies. We of course, by buying these dollars, increase the quantity of money at the same pace as foreign funds.

Senator Benidickson: Which we did a year ago.

Dr. Giersch: With a fixed exchange rate. That is the basic reason why we went off the fixed exchange rate, which means we went off the dollar standard, and I hope we will not go back on it in the foreseeable future.

The Chairman: I should like to ask a supplementary on that. You have dealt with the independence that the floating exchange rate gives. In a country that has roughly one-quarter of its GNP devoted to exports, does the floating exchange rate also increase the control or the stability? Is it a stability measure in itself beyond the independence it creates because of the large percentage of exports?

Dr. Giersch: I am not sure I properly understood the question. Let me make myself clear. Of course, the floating exchange rate increases your independence in the field of monetary policy. Was your question whether it is a measure of independence in itself?

The Chairman: No. I may not be able to articulate it too well because of a lack of understanding. You have explained very well the independence the floating rate gives in the setting of general stabilization policies. One-quarter of the gross national product of Germany is devoted to exports. Does the fact that the exchange rate is flexible by itself increase the control over stabilization, just by the use of the flexible exchange rate?

Dr. Giersch: Flexibility is not enough; flexibility is necessary, but it is not a sufficient condition for independence. You must also be prepared to pursue a policy that leads to changes in the exchange rate. If you want to have more stability than in the rest of the world, you must be prepared to have an upward revaluation of your own currency.

Senator Benidickson: Giving or taking in your decision. You might make a sacrifice or you might take an advantage in that decision.

The Chairman: Perhaps we could let Dr. Giersch complete that thought, then we will come back to that, senator.

Dr. Giersch: There is one important instance where a floating exchange rate gives you independence in wage policy.

The Chairman: Perhaps I can put it another way, because I do not think I have put it too well. We found that the Japanese exports were 10 per cent of their gross national product. We find that Canada and Germany's exports are 25 per cent of the gross national product. Leaving aside the independence that a flexible exchange rate gives, does a floating rate become more important to Canada and Germany than it is to Japan, and can you do more with it in stabilization policy?

Dr. Giersch: The greater your dependence on the rest of the world through the contribution of your exports to GNP, the more important it is to have a floating exchange rate if you want independence in the stability policy. A floating exchange rate is important in itself, but it is more important for a country with a large relationship of foreign trade to domestic trade than for a country which has such a small relationship of exports to imports as the United States, for example. The more dependent you are the more independence a flexible exchange rate gives. I do not know whether that answers the question.

The Chairman: Would you characterize it in terms of dependence or independence only?

Dr. Giersch: Let me add one thing. With regard to using the exchange rate as an instrument for stabilization policy, I would draw your attention to the possibility of an international co-ordination of wages policy. I know of an industry in which it seems to be likely that there is international co-ordination of wages policy, so that if the German trade unions asked for, say, 10 per cent, they may get the 10 per cent because they know that the foreign competing firms will also have to grant 10 per cent; all the firms competing with each other will be subjected to the same kind of pressure, and will therefore yield to that pressure. This has become quite important, I think, in some industries. It means it will have to be made quite explicit to your own trade unions that you are going to change your exchange rate, and this change in the exchange rate will have to be taken into account in national wage nagotiations. For example, in Germany there is an official voice saying, "We will go back to the old parity."

Senator Benidickson: That is true here.

Dr. Giersch: If you say you are going back to the old parity, it is not necessary to have a flexible exchange rate, because then the old parity will be taken into account in the wage negotiations and there will be the same pressure on wages as if there were a fixed exchange rate. You must say, "No, we want to have more stability than abroad." This implies revaluation in the course of that period of flexibility. That means the competitive position of domestic firms will deteriorate and jobs will become insecure unless the increase in the value of your money vis-à-vis other currencies is taken care of in the wage negotiations. If you say you are going to revalue by 3 per cent in order to have 3 per cent less inflation than in the rest of the world, you should make it clear to the trade unions that they would have to deduct the 3 per cent from their wage claims, otherwise jobs will be made insecure.

You have to make it clear that this is your course of action. Unless you are determined to pursue that .

The Chairman: You use the exchange rate as a weapon?

Dr. Giersch: I use it as a weapon and say we are going to pursue a stabilization policy which will result in a 3 per cent revaluation within one year. This means there will be 3 per cent in the longer run—3 per cent less inflation than abroad. A 10 per cent wage increase therefore means, in real terms, more than without that kind of revaluation and more inflation. So you have to deduct the 3 per cent revaluation, which will be the result of your monetary or stabilization policy, from your wage claim. If you do not do it, you endanger your jobs. Unless this is done and is made explicit for the future, the other co-ordinating factor which I mentioned, namely, an international agreement amongst trade unions, will be stronger. Then you will have, as a matter of fact, the same wage increases, and you will never be able to change your rate of exchange.

Therefore, it must be quite a determined policy, to say that we are moving towards more stability than in the rest of the world, something which will mean an upward revaluation of your currency, something which will mean a reduction in the nominal wage claims; but it will not mean a reduction in the real wages. Unless a flexible exchange rate is made clear to the public, in view of the situation and international wage co-ordination, it will not help you. Therefore, I said a flexible exchange rate may be a necessary condition, but if you do not make use of this instrument it will not be a sufficient one.

Dr. Gillies: When the West German Government went to a free exchange rate, it suggested that it would try to go back to partity. Would you care to forecast whether or not it will in fact go?

Dr. Giersch: If you pressed me very hard, I would say it will not go back to the old parity. There is, of course, some kind of promise to go back to the old parity because in the negotiations in Brussels, the German Government had to indicate that it might go back to the old parity. There is, of course, strong pressure on behalf of the business community to return to the old parity, in the belief that this will mean higher profits. If it means higher profits, it will also mean higher wage increases and therefore the same profits as if we did not go back to the old parity. But since at the moment the government is embarking upon a stabilization program, it amounts to saying that two times two is five, if the government at the same time says that it is going back to the old parity.

Only a very unlikely combination of circumstances—a recession in Germany, combined perhaps with a remarkable slowdown of price increases in the rest of the world—would permit us for some time perhaps to go back to the old parity.

If one went back to the old parity, while the stabilization program had success, it would immediately mean an inflow of speculative money, which would press for a change in the parity; and it would be just a comedy in international monetary affairs, if one returned to the old parity to change it in the next twenty-four hours.

Senator Nichol: Dr. Giersch, we have had a number of very sophisticated witnesses come before this committee. Several times, the opinion has been put forth that a certain amount of inflation is essential to the economic wealth of the country, and that it is something of which we should not be too afraid.

Dr. Harry Johnson, for instance, came here and drew a line between escalating inflation and constant inflation and he specifically referred—and I will just read this to you, if I may. He said:

> Brazil and all the Latin American examples you can think of, have not had hyper-inflation. They have had very high rates and come within the 100 per cent a year margin. Chile has had eight decades—it is now nine decades since the last time someone looked at this—it has had nine decades of inflation. The rates have been anywhere between 20 per cent and 60 or 70 per cent a year, but it has not been a spiral in the sense that it got out of control.

My question is in two parts. The first part is, could you comment on that?

Dr. Giersch: Harry Johnson and myself would probably be quite able to live in a world of 100 per cent inflation within a year. Everybody here in this room would be able to make the necessary calculations to live within such an inflationary equilibrium, as I call it. It means that nominal wage increases will have to be 100 percentage points higher than they would otherwise be, and the rate of interest would be 100 percentage points higher than it would otherwise be. We might all be able to figure out what price expectations we would have in this kind of inflationary equilibrium. That means, of course, it would not have any negative, social or allocative effects.

Senator Benidickson: Or that type of growth?

Dr. Giersch: But it would be frightfully troublesome in making these calculations. I think it would not give any benefit, but it would just make it more difficult to calculate. With modern computers, of course, we could live with that—and also with 1,000 per cent inflation. But all this implies that it is a concentrate of inflation; that it is a rate of inflation which has existed in the past and is anticipated in the future.

Since in this situation the real proportions are likely to be the same as with zero inflation, we might also choose zero inflation. I do not know what the advantage is of 100 per cent inflation over zero inflation, if there are no allocative effects. I think there are allocative effects of this, particularly if your institutional framework is not geared to 100 per cent inflation.

I know of some legal restrictions, for example, in West Germany, which make it impossible to raise the rate of inflation by more than, say 5 per cent. Otherwise, it will be felt. If you have fixed income earners, they suffer from it. You may have an institutional arrangement that it is fixed plus whatever the price increase will be. It makes it a bit more complicated. If you do not have it, then they will suffer from it.

Then there is the problem of depreciation from the purchase value. In the German tax law, you depreciate from the sum you actually invested in the past; but this depreciation will not permit you to repurchase the same investment good in the future, so you have to change that again.

The next question concerns income tax on interest earned. If your interest rate is 5 per cent plus 100 per cent inflation, that means that part of the nominal interest is nothing else than a compensation for the losses of inflation; but if you subject it to the income tax you actually tax the substance of it and therefore you get an allocative effect. Furthermore, you need a store of value, something which people can use as an asset which is free of the danger of inflation.

In Germany, at least, we observe that after the D-mark, where a 5 per cent rate of inflation is no longer considered to be a reliable store of value, there is a sudden increase in the demand for land, and, therefore, a frightful increase in the price of land. This disturbs the housing market and raises rents and causes social disturbances. The market for flats may be a commodity market in usual terms, with a zero rate of inflation or a 1 or 2 per cent rate of inflation, but if there are rent increases every year, or a higher rate of inflation even in shorter terms this affects the market. The contracts really are very short-term contracts, but people want to have the security of living in their flat for a year, two years or three years without being exposed to receiving notice and having to change flats or renegotiate again. So there is a mounting criticism of the free market in housing and in flats, and the demand for rent control is increasing with the rate of inflation. Moreover, since there is not a sufficient and reliable store of value, people buy or build flats in holiday resorts without using them. If the rate of increase of prices and building costs and so on is about 10 per cent, you earn 10 per cent interest on that if you just have such a flat in a holiday resort without using it; that is more than you get when you put your money in a savings account. Actually this means that resources are being used in order to produce artificial gold. Concrete gold, to put it another way. It is a reallocation of resources which is certainly not conducive to economic growth in the sense of increasing potential output or productive capacity. Therefore, you have a number of negative allocative effects which means that inflation is not conducive to economic growth.

If you talk about 1 per cent inflation up to 3 per cent inflation, I may be indifferent. I said at the beginning that a 1 per cent rate of inflation or a 2 per cent rate may be necessary to create or to permit the changes in relative wages which have to take place in order to let the wage mechanism work, if there is no possibility of downward adjustment of wages.

On the other hand, if the consumer price index rises by 1 or 2 per cent you may debate whether it has risen at all in view of the changing composition of your basket and in view of the changes in the quality of the products. That means that there is uncertainty whether there is inflation and whether that kind of inflation should be included in wage contracts and so on. But once the rate of inflation is much higher, there is no room for debating about it. It means that there is no longer any money illusion. And it means that there cannot be any beneficial effects, in my view, in an enlightened society. And if there are no beneficial effects of inflation, but you have just to tolerate it, then I come back to my original

argument that I rather prefer to calculate with a zero rate of inflation than with a 100 per cent rate of inflation.

Senator Nichol: Going on from that, Dr. Giersch, a few minutes ago you made a very clear and definitive description of the interwoven cycles of profits and wage demands. You went through the cycle of rising prices, profit explosions, high wage and high labour demands followed by erosion of profits, followed by unemployment, followed by reinflation, followed by profit return and so on.

Dr. Giersch: Yes.

Senator Nichol: And you were discussing the lags that exist between these various interwoven cycles.

I might say incidentally, that we have not before had as clear an explanation of this as you have given today. Part of the debate that has been going on here is whether this cycle which has been operating in this country for some years now can operate with a constant inflation rate, or will the cycle carry with it the certainty of an escalating inflation rate?

Dr. Giersch: I do not know whether I have your question correctly. May I ask you this in return? Does your question imply that we would not have such a cycle, if we had no inflation? Or does it imply that in order to reduce the rate of inflation you would have to smooth the cycle?

The Chairman: Or does it imply, rather, that because the cycle exists there is an inflation that is inevitable?

Dr. Giersch: That is right.

Senator Nichol: No. I will go back again. The cycle has in it as causative factors a lot of psychological factors. Therefore, can this cycle operate without an inflation rate which is escalating—in other words, going from 4 per cent to 5 per cent to 6 per cent to 7 per cent, to keep the cycle operating—or can it operate with a constant rate of inflation of, say, 2 per cent?

Dr. Giersch: I think it will also operate within a constant rate of inflation of 2 per cent.

Senator Nichol: It could operate.

Dr. Giersch: It could operate, but it is likely to be absorbed with an increasing rate of inflation from cycle to cycle.

Senator Nichol: That is what I meant.

Dr. Giersch: Yes.

Senator Nichol: I did not explain it properly. I meant from cycle to cycle. Take it from profit explosion to profit explosion. That is what I had in mind.

Dr. Giersch: This is a cycle in the rate of capacity utilization and the rate of employment. When you say it starts with the upswing, it starts with a rather low capacity utilization. Then you get the upswing and the upswing is an increase in the capacity utilization and in the rate of employment—the absorption of workers in the production process. And later on, then, the slow-down is again associated with a reduction in employment so that when you want to raise the level of employment through the cycle you try not to stop the upswing, so that you get a full utilization or over-full employment. And you may even start with a new monetary-fiscal expansion, shortly after the height of the boom, in order to maintain an excessive level of employment.

If you do that, it means that you raise the average level of employment within the cycle. You will certainly get an acceleration of the rate of increase from cycle to cycle. But if you let the economy reduce the rate of utilization of the productive potential so that the period of overfull employment is being compensated later on by the lower level of employment, then you may be able to maintain the rate of inflation. So it is the choice of the level of employment which is determining whether you have an accelerating inflation or not. It is the rate of employment which you are aiming at, but which you need not achieve in the medium run, because it may not be possible even with an accelerating inflation to compensate for the aggressiveness of the trade unions. Insofar as acceleration of inflation is a measure to compensate for the aggressiveness of trade unions, it may not be successful because after some time trade unions will include the rate of inflation, and then you are in a different situation. But if you are aiming at higher levels of employment as is compatible with the aggressiveness of your unions, then you are bound to have an accelerating inflation from cycle to cycle. I do not know if I have made that sufficiently clear.

Senator Nichol: There has been little debate here as to whether fiscal or monetary policies work as economic controls, and the debate has been not so much on their efficacy as on the question as to whether to apply them and how to identify the time and place you have reached in this combination of cycles. One of our witnesses, I think it was Dr. Reuber, suggested that fiscal and monetary policies should be tied to the aim of a 4 per cent unemployment rate and that the goal should be to keep as close to that as possible, and to use this as a signal point regardless of what other indices in the cycle might show. How would you feel about that type of navigation?

Dr. Giersch: My experience in Germany is that the unemployment rate is a laggard variable and if you use it as an indicator, you are bound to come too late with your measures. I mean by that that the rate of employment is lagging behind other variables which therefore are a better indication of where the economy is moving to. For example, the rate of increase in incoming orders, particularly in investment goods industries, is a sufficiently early variable or early indicator, and you have to use an early indicator for your measures of monetary or fiscal policy because there is a time-lag involved both in fiscal and monetary policy. You know, of course, that there are several parts of this time-lag, but what is important here is the time-lag in the effect of a measure after it has been adopted. The monetary time-lag is a variable. I would guess from German experience, if there is an effectiveness at all of monetary policy in an open economy—there may be some instances where we can say it

had some effect—then the effect came about six months later. That means we cannot use the unemployment rate because we have to use a very early indicator, as I explained to you.

Senator Nichol: Could I ask you, Dr. Giersch, what are the indicators, other than the one you have mentioned, which set the system working in your country?

Dr. Giersch: These are the incoming orders.

Senator Nichol: That is overall incoming, wholesale and retail?

Dr. Giersch: No, in the investment goods industries—the capital goods industries.

Senator Nichol: The capital machinery industries.

Senator Benidickson: Which is low at the moment here.

The Chairman: What we would call capital goods orders?

Dr. Giersch: Orders for capital goods, yes.

Senator Nichol: They specifically keep an eye on this particular indicator?

Dr. Giersch: Yes.

Senator Nichol: And it is sufficiently close that it really works?

Dr. Giersch: This, of course, is very difficult to judge. It is difficult to judge the figures. Usually one wants to wait for 2, 3 or 4 months in order to be sure that one has the right tendency.

Senator Nichol: This is the inside lag as we call it.

Dr. Giersch: That is the diagnostic lag. You must be sure of it. In one month, for example, there may be a sudden increase in the orders, and you do not know whether this is an accident, whether there is a particular explanation or whether it is of cyclical importance. So you say to yourself, "Well, I am not quite sure and instead of adopting measures now, I will wait for another month to see whether this trend is being followed," and you may have lost already the second month. Yet again you may wait for a third month in order to be quite sure.

There is a difference between monetary and fiscal policy. Monetary policy in Germany can be carried out by an independent authority which is not dependent on public opinion. There is a lag of public opinion behind events, and if demand management has to be in conformity with public opinion, as is true, for example, for thax policies—you have to sell them to the public—then you are bound to be very late and you may intensify the cycle rather than smooth it. So, my preference would be for monetary policy, if monetary policy is effective, which is true only under flexible exchange rates, and if monetary policy can be carried out by an independent body which is not dependent upon lagging public opinion.

Senator Nichol: Is there such a thing as an independent body, that is independent of political pressures, in Germany?

Dr. Giersch: Well, there was a time when the central bank was more important and had more influence on public opinion than the government. In 1966 and early 1967 the central bank was heavily criticizing the fiscal policy of the government and early in 1967 it said, "We are not prepared to finance your anti-recession program until you have passed the stability and growth Law." This is a unique situation and if it had lasted for a couple of months, it might have led to a hot debate as to whether the central bank should be autonomous or not. Actually the central bank yielded early enough to avoid such a crisis. But this was a clash between the central bank and the government. As regards the relationship between the central bank and public opinion, I think the central bank is considered to be a reliable guardian of financial and monetary stability, and there is less of a credibility gap between the public and the central bank than there is between the public and the government.

Senator Nichol: Does the bank operate very publicly? Do the officials of the bank speak through the newspapers?

Dr. Giersch: Yes; almost too much.

The Chairman: How publicly does it operate?

Dr. Giersch: It has monthly reports. When bi-weekly meetings of the governing body are held, communiqués are issued and the president of the central bank appears on television to explain what has or has not been done. The central bank also collects newspaper articles, reprints them and distributed them. It has quite an influence, therefore, on what is being written in newspapers, because it is considered a sign of excellence if articles of a journalist are being reprinted quite often.

Therefore the central bank can exert some influence in newspapers on the interpretation of its policy. Moreover, there are public speeches made by the president of the central bank, although the current president does not speak as often as did his predecessor.

In 1966-1966 the president of the central bank preached a return to puritanic principles in public finance and monetary policy, which actually contributed to the development of a recession.

The Chairman: You have dealt with the public attitude of the bank. How great is its independence from government control? Obviously this has been an issue, and it is trucated to a certain extent—

Dr. Giersch: Yes. At the moment there is a clash between the government and the central bank on the return to the old parity. I do not know what future developments will be, but in view of the strong public support which the central bank receives, and the criticism which is levelled against the government by the opposition party, but which is never levelled against the central bank, the central bank is in a fairly strong position with regard to public opinion.

The relationship is such that the central bank is by law bound to support the government's policy; but this is open to interpretation. There can be a debate. At the present moment there is a debate on what kind of exchange rate policy, intervention in the foreign exchange markets, the central bank is to pursue. The Minister of Economic Affairs and Minister of Finance is attending the meetings of the central bank explaining to the governing body what are the government's objectives and what strategy should be pursued.

I suppose that in the medium run, in spite of the insistence on autonomy, the central bank will support the government's strategy.

Senator Molson: I suppose there could be a lag there, on the question of support?

Dr. Giersch: Yes.

The Chairman: Without going into detail, would you characterize the operations of the central bank as being open or rather more—the term that was used here was covert?

Dr. Giersch: Could you explain that to me?

The Chairman: It has been suggested here that the central bank in Canada uses what is called moral suasion to cause the banks and other financial institutions to do certain things. It has also been suggested that at the time this moral suasion is used it is often not a matter of public record, that certain things that the central bank does are not a matter of public record, and there are those who believe that it should be.

Dr. Giersch: I am not sufficiently informed about talks between the central bank and the private banks; but the situation as we have had it would at least indicate that the influence of the central bank on the private banks is very small. The central bank has certainly tried to prevent the private banks from borrowing from abroad and increasing therefore the foreign exchange holdings of the central bank. As a matter of fact, the private banks have largely exploited the opportunities of the market instead of following advice from the central bank. Therefore, moral suasion in that respect may work if the margin of profit is very small; but if there is a wider discrepancy, then I am sure they are following the opportunities of the market rather than the words of the central bank.

The Chairman: The bankers indicated that to us yesterday. Maybe they have the same attitude.

Senator Carter: I have three very short questions to put to Dr. Giersch. You mentioned earlier about the stability and growth law. Does that stability and growth law require any balance between capital intensive industry and labour intensive industry. Is there such a balance? Is such a balance necessary?

Dr. Giersch: I think this is a problem of the long-run growth and structural development of the economy. In order to have steady growth, if your supply of labour does not increase sufficiently, you will have to increase the capital intensity of your overall production. This may take place in each firm and in each line of production; but it may also take place in terms of a change in the structure of your industries. It means that you may have to abandon industries which are not capital intensive enough and where labour cannot be saved by using more capital. These industries come under the pressure of foreign competition.

The institute—which I am directing or misdirecting—is now embarking upon a study to find out what structural changes will be necessary in the West German economy in order to take care of development in the less developed countries, where you have less capital intensive industries or more labour intensive industries, and where labour intensity is necessary in order to take care of the employment problem in less developed countries.

If we grant capital assistance to the less developed countries, but do not permit the products of labour intensive industries to enter our domestic markets, this will be self-defeating. Without any guidance given as to what industries will be established in future under the pressure of more intense competition from less developed countries, we will have to make some research or and investigations into what the export potential of the less developed countries with regard to whether certain products, when they enter the market, will be competitive, and whether it could not be wise to advise the entrepreneurs in those industries to withdraw from the market instead of making defensive investments which may turn out to become too costly and unsound, particularly from an overall point of view.

So there will be structural change and if it does not take place smoothly enough in the process of economic growth, it will have to take place in periods of recession. There is an argument against smoothing the cycle, that the structural change necessary for long-run growth cannot be brought about in a period of expansion. It is said that the change in the structure only takes place when competition becomes so intense under the pressure of excess supply that firms break down and release resources. These become available for the growth industries which need them in the long run.

The argument for steadiness in economic growth is that steady growth implies that this structural change takes place also in periods of expansion, but that can only be the case if expansion is not excessive. If the profit explosion to which I referred occurs, then no firm or industry will feel sufficient pressure to release resources for the structural change to the benefit of the growth industries.

We hope that, perhaps through international coordination of research, we can obtain sufficient information to indicate what might be done in terms of structural change in the developed countries to help both then in their process of growth and the less developed countries in their economic development.

Senator Carter: I was interested in your description of the relationship between the wage and productivity increases in Germany. I got the impression that usually there is a lag, that the wage increases seldom catch up with productivity increases and when they do it is only

for a short time. Is that a correct interpretation of what you said?

Dr. Giersch: Yes; within the last few years real wages have increased somewhat more than productivity, as a reflection of an increased labour shortage. In the earlier years there was a lag in real wages as compared to the increase in productivity. I am now referring to real wages and productivity in real terms. In the cycle there first appears an increase in productivity when the rate of capacity utilization rises. This may take place when price increases and nominal wages lag behind it. Later on the period of wage pressure arrives, which is about as long, according to our experience, as a period of wage lag. So that there is a full compensation over the cycle and the growth-determined lag of real wages ceases.

A profits squeeze and an increase in real wages as compared to productivity was felt from time to time during the first half of the sixties. In the last cycle we felt that there may have been a change in the rate of increase of the capital output ratio, if this means anything to you. It is the relationship between the stock of capital and total output. This increases, of course, if production becomes more capital-intensive and capital has to be substituted for labour. However, if automatic labour-saving devices become less expensive, then the capital output ratio will not increase as fast and may even decrease.

This means that the capital costs per unit of output do not increase as fast as previously, or may even go down. If capital costs per unit of output go down as a result of capital-saving innovations, there will be room for wage increases that are faster than productiviy increases. This means an increase in wage costs but a reduction in capital costs. The increase in real wages as compared to productivity is thus obtained without a profits squeeze.

After a period of increasing labour shortage more and more emphasis must be placed on automatic devices and cheaper production so that the capital costs per unit of output, if they have risen for some time, will go down.

It appears upon investigation of the German economy, the increasing labour scarcity in the first half of the sixties and some kind of reduction of capital costs in the second half that wage increases could be faster in real terms than productivity increases. This does not go on indefinitely. However, it appears to have been a factor over the last two or three years. Otherwise, the wage explosion which we have experienced would not have been understandable.

There has also been a tremendous increase in real wages above productivity increases. There are two possible consequences: either a tremendous profits squeeze or a fall in capital costs per unit of output. I think both have taken place. Therefore the profits squeeze is not quite as strong as one would gather from the figures of wage increases.

Senator Carter: You discussed cycles as coming back to the same point. I tried to visualize how it works in Canada. All your elements must start at the same time. Your Government, labour and industry get together and everyone starts, apparently, at the same time. In Canada the Government will budget for certain unemployment growth. The steel industry will start a cycle by bargaining for a very high increase. Probably six months later another powerful group does the same thing and that interrupts the cycle. So we never really get a cycle; it is interrupted all along the line until something drastic, such as inflation, occurs or unemployment becomes intolerable. Apparently you avoid that in Germany because all the elements in the cycle get started at the same time.

Dr. Giersch: I do not think this is quite as I meant it. I gave, of course, a very simplified picture of the development of the German economy. Therefore I omitted these sequences which you describe.

Of course, it would be useful for managing the economy if, for example, most of the wage contracts were made at the same time, simultaneously with Government budgetary planning, and this could be co-ordinated. That would, of course, be an advantage. But it is not like that in Germany, and if I gave that impression I apologize.

Senator Carter: I did not get the impression that it was so simple as that. Trying to compare it with what happens in Canada, it seems that your cycle was much more of a cycle, or had fewer interruptions than the ones we have in Canada, so the cyclical forces can more or less work together and impinge on each other at the same time without extra forces being impinged throughout the cycle, which seems to happen here in Canada.

Dr. Giersch: I would not be able to compare it with Canada, since I know so little about your country.

Senator Carter: In Germany do you have an income distribution policy?

Dr. Giersch: Yes. We have one, of course, in terms of progressive income taxes; in terms of subsidies granted to agriculture; in terms of unemployment benefits; in terms of various kinds of subsidies that are granted. What the net effect of it is I do not know. Whether income distribution does become more equal as a result of this, I am unable to explain. There are, of course, at the moment increasing tendencies for redistribution of income through wage pressure. At least the trade unions think that by increasing wages above what they otherwise would be they can redistribute income in favour of wage earners. This is the philosophy.

In my opinion, the actual effect is that you can increase the share of wages in national income only at the expense of employment. We know from the cyclical data we have that the share of wages in national income is lowest when employment is highest, and that in a recession the share of wages is high and the share of profits is, of course, low. When the share of wages in national income goes up tremendously, as it does at the end of the boom, this is a sign that the economy is bound to slow down if investments are dependent upon the rate of profit and the possibilities of auto-finance.

Senator Carter: Can you say whether in Germany labour's share of GNP is going up?

Dr. Giersch: Labour's share in GNP is rising. This can be explained to a large extent by the fact that self-employed people become dependent workers. There is a squeeze in agriculture and handicraft, and so on, so their former incomes which were counted as incomes from entrepreneurial activity and property are now wages. If we deduct that we do not find a remarkable increase in the share of wages in national income. But the share is somewhat higher than it was in the early period when we had structural unemployment. We find that in all countries the share of wages in national income has gone up. It is higher now than it was in the 'fifties, particularly in the early 'fifties. In explaining the share of wages or profits in national income one has to take account of the structural composition of industries.

Let me make that clear by means of an example. If you have in your economy many growth industries with well managed firms that face a high income elasticity of demand for their products, there is then likely to be a low share of wages in national income. If you are a depressed country, or for that matter a depressed region, which has only structurally weak industries that do not make profits, which are perhaps being subsidized, which are bound to disappear after some time, there are low profits and, of course, a high share of wages in the national income. So a high share of wages in national income may not be a sign of justice, it may also be a sign of weakness of your economy. This goes far to explain the difference in the share of wages between, say, West Germany and the United Kingdom where the share of wages in national income is definitely higher than in West Germany.

Senator Isnor: Many of the questions I had have been more or less covered. I had one dealing with the central bank, but that subject was brought up earlier and considerable time devoted to it, although it was not as definite as I would like. I would like to ask what control your central bank has, and the effect it has on the economy of the country.

Dr. Giersch: The central bank, after the move to convertibility in 1958, still believed it had control over the economy. It could exert some control over the economy in periods when the domestic situation required similar action to that taken in other countries with which we had strong trading relations and a common monetary market. During that period the belief was upheld that the central bank had strong control over the economy and could be the guardian of monetary and price level stability.

In recent years it has become more and more clear that with fixed exchange rates and full convertibility the central bank actually had no control, although this view was confined at first to a very small group of economists who were considered to be heretics in this respect, and were considered to be tearing down the reputation of the central bank. In the meantime, and at least in the last couple of months, it has become clear that with fixed exchange rates the central bank is practically powerless. A group of the board of governors of the central bank actually wanted to have some kind of control on the inflow of capital from abroad; but others, including the Minister of Economic Affairs and Finance, thought that controls of that kind would not work; we do not have the bureaucracy for control, and we think that if the divergency between the control mechanism and what the market offers were too large it would not work.

That is the reason why we introduced the flexible exchange rate. Now, after the exchange rate has become flexible, the government actually has, I would say, full control over the supply of money, and therefore over the economy, provided that the central bank does not intervene on the spot and forward markets for foreign exchange.

Senator Isnor: What do you mean by saying the government does not use the central bank to set interest rates?

Dr. Giersch: The government has little influence on the central bank as regards interest rates or control of the quantity of money.

Senator Isnor: You spoke of controlling import labour. What did you mean there?

Dr. Giersch: Not controlling.

Senator Isnor: You discourage import labour?

Senator Nichol: "Selective" was the word he used.

Dr. Giersch: The word "selective" means that when a labour shortage in some profession or some area is being felt, then it is the initiative of the employers to get labour from abroad.

Senator Isnor: From abroad?

Dr. Giersch: From other European countries. We import the kind of labour we need when the need is being felt by the entrepreneurs, the employers. So far, it is selective. We do not count those unemployed in the countries from which we get the labour which we need.

Senator Isnor: You say you import only the unemployed?

Dr. Giersch: No, I did not want to imply that. We, of course, import any kind of labour which offers itself for employment in Germany, whether they are employed or not employed. I think we would not even know, as a result of the statistical evidence we have, whether they have been employed before or whether they have been unemployed.

Senator Isnor: That is what I was wondering—how you could possibly do it.

Dr. Giersch: We cannot. We cannot discriminate, but it is the activity of the employers which is determining which kind of labour we import. Therefore, it is a means of getting rid of domestic bottlenecks.

Senator Desruisseaux: This is possibly by contract for a definite period of time and it could be renewed if necessary.

Dr. Giersch: That is right.

Senator Carter: I would like to inquire about the wages. If these people come in, do they get the standard wages, the same as a German would get?

Dr. Giersch: Yes, they do.

Senator Desruisseaux: The questions I had in mind have been answered, but I think it may be useful to have a clarification. You stated the policy is to stimulate growth of potential output and one of the policies is to stimulate the growth of capital imports. Has that led the country to foreign-owned industry and, if so, to what extent?

Dr. Giersch: I do not know of any percentage figure to indicate that. A number of well-known firms have fallen into the hands of foreign firms, and there has been some complaint about it, although those complaints have been fairly modest.

The whole oil refinery industry, for example, is foreign-owned; a large part of the car industry is foreign owned. There has been aversion against this, although much less than in other countries. One reason, of course, is that economic nationalism is not very fashionable in Germany at the moment, because we had excesses of that in the prewar period and in the war period; so we have to compensate for that. Another reason is that one may suspect that foreign ownership does not hurt very much. It may hurt managers, who are appointed by foreign owners, and who have a smaller market when more firms owned by foreigners bring their own managers with them.

Apart from that, there has been open-mindedness, particularly since part of the policy is being carried out by provincial governments, who try to attract whatever firms they can, in order to raise the level of industrialization in their areas. They are quite happy if a foreign firm comes in, although of course the indigenous entrepreneurs are quite opposed to it because these foreign firms raise the level of wages and, therefore, make it more difficult for the indigenous firms to exist there, and they meet more competition.

One factor which is, perhaps, relevant in this connection, is that we are in the midst of forming a European economic community. Therefore, we have within the European economic community the freedom of choosing the location of firms from one country to another in the European economic community.

Of course, I know that in France, for example, there is more concern about American firms than in Germany. It sometimes happens that American firms who want to locate in France, and who find it difficult, to get into France, immediately move to Germany to find there some Land government which says that this is just what they want in order to raise the level of industrialization in their area and, therefore, the level of wages.

So, if there is some competition amongst policymarkers there cannot be a cartel against foreign investors. This competition for growth amongst provincial and Länder governments is one of the reasons why there is so much openness of the German economy with regard to foreign investment.

Senator Molson: Do you also gather the international unions with the international corporations?

Dr. Giersch: That is a problem I was talking about some minutes ago, when I said there may be international agreements. We have no foreign dominated unions, but we may have more co-ordination between German unions and foreign unions.

Senator Desruisseaux: You mentioned subsidization of exports and also the subsidization of jobs in the peripheric areas of operation. Could you expand on that a little?

Dr. Giersch: Subsidization of exports is a paraphrase of the undervaluation of a currency. If the German mark is undervalued as it was for a couple of years, then at least to my judgment that means that exporters have it easier to sell abroad. They have it easier than they would have had, and actually had after the revaluations we had. So this is subsidization through a fixed rate of exchange. But after we have a flexible rate of exchange there cannot be and will not be any more subsidization of exports.

As regards subsidization of jobs, in peripheric regions it takes the form of regional policy. Along the frontier to East Germany there are locations which are hurt by the fact that the market network is completely interrupted. These locations suffer from that, and therefore the investment in those areas is being subsidized by means of regional policy to the extent of about 10, 15 or 20 per cent, depending upon various forms and so on. Also there is a regional program for the development of backward regions which are not peripheric in that sense of lying along the frontier to eastern Germany. The tendency now is to concentrate these subsidies in some locations which can be developed and which can be the nucleus of a self-supporting or self-sustained industrialization process in that particular area.

They are not being distributed equally, but they are preferred locations which provide the sufficient infrastructure. So then in addition to that the subsidy really becomes effective.

Senator Desruisseaux: If I understand well, this is not done by the federal government.

Dr. Giersch: No. It is done by the regional governments, but the federal government provides for the law and gives the framework and also the financial means; but it is carried out through the Länder governments. They have to grant the licence and to determine the individual case.

Then there is also competition among the local governments in providing cheap land for firms who want to locate there. This is a kind of subsidy which is very difficult to judge, since you do not know how cheap the land is compared to what it would be otherwise.

Senator Nichol: I believe you have already answered this question, but the Canadian people are being subjected to some very simplistic proposed solutions to a very complicated problem on this whole issue of stability.

The overall suggestion which comes forward from some people is that we can have an expansionary money policy, low interest rates, full employment, pegging the dollar to support our export industries, and then control the whole thing with price and wage controls. What do you think of that?

Dr. Giersch: It would be a disequilibrium system, making for wages which would be lower than the equilibrium position, profits higher than they would be otherwise and some excess demand to draw additional resources into the process of production.

Such a disequilibrium system, if it were a stable one, might do the trick of increasing the rate of growth. It would be to some extent similar to what West Germany had in the early 1950s—fairly low wages and high profits.

But of course I do not talk about the mechanism of control, and as a disequilibrium system I wonder whether it can be a stable one, whether controls can be strong enough, particularly on the price front and even on the wage front, to be effective. If the actual prices or the control prices deviate little from the equilibrium prices, the controls may work, but they will not be very effective then. But if the difference between the controlled prices and wages and the equilibrium prices and wages becomes sizeable so that it becomes really important for economic growth and having employment higher than it would be otherwise, then I wonder whether it could be effective in Canada. It could not be effective in Germany. I am sure about that.

I say that because if there is demand for labour, you may be able to control negotiated wages but you cannot control effective wages. You must have a strong cartel of the employer associations, and if the firms have a high demand or an excess demand for their products, they will compete on the labour market and they will be prepared to pay higher wages than those which are the effective wages, the negotiated wages, which you can control, and this would actually mean that the wage drift will increase.

I cannot imagine any system of price control which would work, for example, in West Germany. I do not know if the situation is different in Canada, but I am very sceptical about whether it could work, and if it does not work then it may hurt the economy more than it benefits it. At the present time you may be able to say that if there is not an agreement regarding wage restraint, then we have perhaps the weapon of price and wage controls. That may be effective; I do not know. But once you have used the weapon and if it has not worked, then you cannot even use it as a threat.

Senator Nichol: I have just one more question to ask, Mr. Chairman, even though I know it is late. Dr. Giersch, you were talking about this capital goods order index. The question I want to ask is where in the cycle is that point. Let us take the profits cycle. Where in that cycle does that capital order index make its signal?

Dr. Giersch: It falls somewhat together with the profit cycle.

Senator Nichol: At the top of the profit cycle?

Dr. Giersch: At the top of the profit cycle because there is a strong correlation between profits and orders for investment.

The Chairman: Dr. Giersch, there are two things which I should like to get on the record regarding the statement of the Council of Economic Experts. You say:

> In its annual economic review, which appears in the late autumn, the Council is expected to report on how to achieve price stability, high employment, balanced trade and economic growth during the coming year. The government must table the annual review in both houses of parliament without delay, and within eight weeks must state its position on the review and set out the measures it intends to take in consequence.

Dr. Giersch: That is practically correct.

The Chairman: You continue:

> . . .that where the government had followed incorrect economic policies it was wrong to criticize either industry or labour for the resulting imbalance in the economy.

Dr. Giersch: That is a statement of the Council of Economic Experts.

The Chairman: Do you have anything further to add?

Dr. Giersch: No.

The Chairman: We have gone somewhat beyond our normal time, which is an indication of the tremendous interest that senators have had in your testimony. I am quite sure we could continue for a considerable length of time. I want to point out that in my own case I generally make notes on ideas that come to mind as the witness speaks. While I do not wish to make a comparison between other witnesses I have to say that the number of ideas that I have received from you is between four and five times as many as I have received, on the average, from the other witnesses. We wish to thank you. It was a most provocative paper, and a very worthwhile and useful presentation.

The committee adjourned.

THIRD SESSION—TWENTY-EIGHTH PARLIAMENT
1970-71

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 17

TUESDAY, JUNE 8, 1971

Fourteenth Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses—See Minutes of Proceedings)

23885—1

STANDING SENATE COMMITTEE ON
NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
	O'Leary
Gélinas	Paterson
Grosart	Phillips
Hays	Sparrow
Isnor	Walker—(27).

(Quorum 7)

**Ex officio Member*

Orders of Reference

Extract from the Minutes of Proceedings of Tuesday, March 9th 1971:

"With leave of the Senate,
The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, PC.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said Estimates reaching the Senate.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Wednesday, March 19th, 1971:

"With leave of the Senate,
The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Wednesday, April 28th, 1971:

"With leave of the Senate,
The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates last before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Tuesday, May 4, 1971:

"With leave of the Senate,
The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relation thereto.

The question being put on the motion, is was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Minutes of Proceedings

Tuesday, June 8, 1971.
(17)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 4.00 p.m. to consider The Question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Aird, Bourque, Croll, Grosart, Isnor, Laird and Molson. (8)

Also present but not of the Committee: The Honourable Senators Carter, Inman, Kinnear, McGrand, McNamara and Smith. (6)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Witnesses heard:

Department of Quantitative Analysis, University of Toronto:

Dr. Thomas A. Wilson, Professor;
Dr. Gregory V. Jump, Professor; and
Dr. John Arthur Sawyer, Professor.

At 6.15 p.m. the Committee adjourned to Wednesday, June 9, 1971, at 10.00 a.m.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Tuesday, June 8, 1971.

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 4 p.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have with us this afternoon three gentlemen from the Institute for the Quantitative Analysis of Social and Economic Policy at the University of Toronto. On my immediate right is Professor Thomas A. Wilson; and on his right are Professor G. V. Jump and Professor J. A. Sawyer. These gentlemen are experts in the operation of econometric models, an area in which we must be interested and with which we must acquaint ourselves. The brief is long and there is quite an amount of supporting material, so I now ask Dr. Wilson to proceed with his verbal presentation.

Dr. Thomas A. Wilson, Institute for the Quantitative Analysis of Social and Economic Policy, University of Toronto: Honourable senators, I should mention that the three colleagues with whom I am associated here developed the three econometric models used in some of the work underlying this brief. In addition, they have prepared some background papers, as well as working with me. My third colleague, who is not here today, is Professor J. W. L. Winder.

The title of our brief is "High Employment and Price Stability: Policy Options in an Open Economy."

Over the past year Canada has achieved an enviable record—at least in comparative international terms—of price stability, at the cost of a slowdown in real economic growth and a severe increase in unemployment rates. We feel there is reason to believe that deliberate policies pursued in the latter part of 1969 and the first part of 1970 should be given some of the credit for the marked improvement on the inflation front. These same policies also had the effect, of course, of slowing the real rate of economic growth and worsening the unemployment situation.

Nevertheless, the government today remains on the horns of the inflation-unemployment tradeoff dilemma. Present official policy may perhaps be described as an attempt to resolve this dilemma by cautious expansion in order to restore the real growth of our economy and to erode gradually the high levels of unemployment, without moving so quickly as to trigger a new round of demand inflation.

While we describe the current overall economic policy stance as, on balance, modestly expansionary, we feel it is noteworthy that the main role in the expansionary policy, at least within 1970, has been assigned to monetary policy. From March, 1970 of this year the money supply grew at the rate of 14.7 per cent. In contrast, expansionary fiscal moves have been more cautious, at least until the beginning of the year. Indeed, we estimate that at full employment the national accounts budget of all levels of government should show a surplus of $1,084 million in 1970. Moreover, the level of this surplus hardly changed between the first and second halves of 1970, indicating that expenditure increases were offset completely by the growth in revenues at full employment. However, the sharp increases in expenditures that occurred around the turn of the year may signify that a stronger expansionary fiscal policy is now in effect.

Senator Grosart: Excuse me. May I ask a question at this stage? You have confused me a little. You say, "were offset by the growth in revenues at full employment." What do you mean there?

Dr. Wilson: What we mean here is that we are estimating what the budget would look like if there were full employment—this being a 4 per cent unemployment rate. This involves adjusting the revenues of the Government to the yields that we would anticipate at full employment, as well as adjusting the unemployment insurance payments on the expenditure side for what you would expect to be the out payments at full employment. We feel this is a more adequate measure of the effects of fiscal policy than looking at the observed budget, because that is affected by the degree to which the capacity of the economy is utilized.

Senator Grosart: For a layman like myself it might read, "growth in revenues, if at full employment"?

Dr. Wilson: Yes. This is a hypothetical concept.

Another quasi-expansionary policy has been the attempt to lessen the rate of appreciation of the Canadian dollar since the abandonment of the fixed exchange rate last May. I might add that we have done some other work, not reported here, which suggests that the appreciation which did occur had a substantial impact on lessening the inflation rate. The point we are making here is that it would have appreciated more without official intervention in the exchange market. Since that time official reserves have increased by about 19 per cent. This was from the base of a very healthy initial level of reserves.

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If the forecast prepared by my colleagues are in the right ball park, these policies will indeed help to improve the real growth rate of our economy. According to the lastest projections based on this Institute's two quarterly models, the real growth rate within the current year will be slightly more than 6 per cent, a considerable improvement over last year's 3 per cent performance, although some of that is caused by the effects of the auto strike at the turn of the year. This resumption of reasonable real rate of growth, however, appears consistent with continued maintenance of relative price stability. We project that the GNP deflator will rise 2.1 per cent and the personal consumption deflator will rise 2.4 per cent within the year.

By contrast, the projected situation on the unemployment front is extremely disappointing. We project that the unemployment rate will decline by only 0.25 per cent over the year. I might add that we have not updated these projections since the recent sharp increase in the unemployment rate. We are referring here to the base at the end of the previous year. We were projecting at that time that relative to the fourth quarter of 1970 the unemployment rate at the end of this year would be ¼ per cent lower than it was then. We have adjusted it for this recent increase.

The costs, in terms of real output lost, of this unemployment and under-utilization of capacity in the economy are substantial. We estimate that over the year 1970 total output was at least $2.8 billion below the level achievable at 4 per cent unemployment. By the last quarter of the year this gap had widened to $3.5 billion or about 4 per cent of Gross National Product.

In view of the current un-acceptable high unemployment rate, and with the prospect that there may be little improvement relative, to the first quarter, over the coming months, we must ask whether this performance is the best Canada can attain without running the risk of a renewal of serious demand inflation.

Our central argument is that we can indeed do much better; that there are policy instruments which can be used to move the economy ahead more rapidly without increasing—and, indeed, perhaps reducing—the rate of price inflation in the short run. Hence there are policy options to achieve a faster rate of real growth and a lowering of unemployment rates which will maintain the climate of price stability so important for future wage negotiations.

Let me now ask whether the inflation of the recent past represents a new phenomenon. In view of the large wage settlements achieved during 1970, when unemployment was high and rising, it is tempting to assert that we are now facing a new kind of inflationary situation, one that cannot be tackled by traditional policies alone, since we would argue that appropriate combinations of traditional policies will move us a long way towards a satisfactory situation.

Briefly, I want to discuss our reasons for questioning this view. In contrast to the severely restrictive monetary policy introduced in early 1969, monetary policy over the preceding years was strongly expansionary. In the first quarter of 1967, for example, the economy was roughly at full employment, yet over the next two years the money supply was allowed to expand 31½ per cent. This rate was far in excess of the expansion required to finance the real growth of the economy at full employment and, indeed, was even greater than that required to validate the then existing rate of inflation.

Since, under conditions of high utilization of potential output and low unemployment rates, the bulk of any expansionary policy's impact is felt on the price level rather than on real output and unemployment, we conclude that this strongly expansionary policy brought us very little real output gain at the cost of seeding three more years of inflation.

The assessment of fiscal policy over the same period is more complex. While the full employment surplus at all levels of government rose during 1967 and 1968, this rise was largely the result of the inflation that occurred, rather than a discretionary fiscal action designed to fight inflation. Also, this period was characterized by a very rapid rate of expansion of public expenditures. We therefore conclude that fiscal policy was, on balance, expansionary in those years, thereby playing a companion role to the strongly inflationary monetary policies.

The Chairman: There would be a deflationary effect by the fact that a surplus was achieved?

Dr. Wilson: More deflationary than if you had wiped the surplus out, yes.

The Chairman: That would be an automatic stabilizer?

Dr. Wilson: Yes. In a sense, this is the operation of the automatic stabilizing effect of the budget. Regarding the point of making expenditures, it is the general view that if you have a balanced increase in both expenditures and tax revenues with the same budget surplus, on balance this has an expansionary effect, with a very large expansion of expenditure, as you know.

We also want to emphasize the importance of developments abroad during those years. Unlike the case of the inflation of the mid- to late 1950s, during the 1960s a floating exchange rate did not exist to insulate our economy from strong inflationary impulses from abroad. We conclude that the inflation of the past three years could therefore be explained by the expansionary monetary and fiscal policies, coupled with the maintenance of a fixed exchange rate when inflationary pressures in the United States were very strong.

In the light of the history of inflation, the wage settlements achieved during 1970 are hardly surprising. Even before the emergence of trade unions, wage rates tended to lag behind prices and employment. The existence of multi-year contracts has tended to increase these lags. Hence unions renewing two- or three-year contracts in 1970 would be attempting to recoup the inflationary losses of preceding years. These are some of the conventional explanations of inflation.

We feel, however, there are two less conventional factors also at work. First was the development of the

widely held inflationary expectations which tended to increase the rate of inflation that would occur at any given level of unemployment or aggregate demand. We feel that this development is the logical outcome of four to five years of continued inflation at the end of the longest business cycle expansion in our history.

Second, the very rapid expansion of the public sector and the price inflation itself gave rise to substantial increases in tax burdens. Discretionary personal income tax and sales tax increases occurred during this period. Perhaps more important, the inflation of money incomes continually increased the real burden of taxation.

There is reason to suspect, however, that the bulk of these tax increases fell upon labour income. A simple calculation highlights this. Between 1964 and 1969 average weekly wages and salaries in industry rose 6.3 per cent per year. Whereas, if you look at a married man with two dependents, calculate his real after-tax income, you will find it only rose 1.3 per cent per year, about half of the trend rate of growth of labour productivity for the economy as a whole of 2.5 per cent.

This underlines our conclusion that it is not surprising that the representatives of workers were bargaining particularly hard for large wage increases in 1970.

We turn now to an examination of the effects of various policies at the present time. First, we thought it would be worthwhile to look at the straightforward type of expansionary policy upon output. We feel that the results here would apply just about as well to an expenditure expansion as to an income tax reduction. Both our real econometric models—we have an annual econometric model developed by Professor Sawyer and a quarterly econometric model developed by Professor Jump—imply that the bulk of the impact of an expansionary policy of expenditure increases or income tax reductions at the present time will be on output and employment with very modest effects on the price level. As an example of such a policy we have analysed the effects of 10 per cent across-the-board reduction in personal income tax rates. We find that one year after the cut the models predict that unemployment would be reduced by ¼ per cent and real output would increase by 0.8 per cent. The price level effects of these policies would be quite modest and prices would rise only 0.2 per cent higher than they otherwise would.

We therefore feel that if these were the only policy options available they would still be worth pursuing under current circumstances. However, there are other options available which can enable us to expand output and employment while actually slowing down the rate of inflation. As we have already noted, the mix of policies in late 1970 consisted of a weakly expansionary fiscal policy, a strongly expansionary monetary policy, and an attempt to hold down the value of the dollar by accumulating official reserves.

This mix of policies is the opposite to what is required. First a policy of fiscal expansion through tax reductions should be instituted. Second, the growth of the money supply should be reduced to a rate consistent with the realization of an improved rate of growth of output and a slow rate of inflation of prices.

Finally, and most important of all, the exchange rate should be allowed to be determined primarily by market forces without persistent official intervention on the scale experienced over the past year. It is obvious that it should not be pegged again. That would be our strongest recommendation of all.

Given these proposed fiscal and monetary policies and the expectation of some continuation of inflation in the United States, the floating rate of exchange will likely continue to appreciate, thereby insulating or partly insulating our economy from inflationary pressures from abroad. The net effect of these combined policies will therefore be to stimulate the expansion of employment and output while slowing the rate of inflation which would otherwise occur, or at least hold the line on inflation.

Some might argue that a policy which is consistent with an appreciation of the Canadian dollar would hurt our export sectors. While the immediate effects of any exchange appreciation will hurt exports, the export sector will also benefit from any subsequent resulting slowing down of inflation, which would otherwise occur. Since sales taxes are shifted forward onto buyers, reductions in sales taxes put direct downward pressure on price levels at the same time that they provide a stimulus to increased real expenditures—private expenditures. Policy simulations using our two quarterly models, the econometric model I mentioned before and a model of financial flows, indicate that a 50 per cent reduction in all federal sales and excise taxes, excluding the tax on building materials, would increase real output by 1.5 per cent and reduce unemployment one-half of a percentage point over a period of one year. At the same time these tax reductions—provided they are passed on to consumers, which I emphasize as a big proviso—have a substantial negative effect on the price level of 3 per cent. A policy of sales tax reduction would also have a number of side benefits, in that those who have suffered most from the inflation of the recent past and those currently suffering from unemployment will directly benefit from it.

Our third macro-economic policy consideration has to do with the variability of policies over time—particularly the variability of monetary policies. The experience of the past few years underlines the conclusion that destabilizing policy movements not only give rise to inflation at the time of their implementation, but also can have more lasting effects through their impact on price expectations.

As a result, a considerable period of slack demand may be necessary to erase the inflationary expectations generated by inappropriate policies in a previous period of strong demand. Hence both the average unemployment rate and the average rate of inflation experienced over a period when policies were erratic will be higher than during a period in which such policy errors were avoided.

An examination of the behaviour of the money supply over recent years suggests that we would be better off

avoiding the large swings in the money supply which have occurred. This will, of course, be impossible if we re-establish a fixed exchange rate, since monetary policy must of necessity become an appendage of developments in the exchange markets under those conditions. With a floating exchange rate, however, it should be possible to improve vastly the performance of monetary policy.

There are a number of other issues on which we should comment, and I will deal with them as briefly as possible in turn.

First, what should we do if a fixed exchange rate is re-established? After all, there are international pressures on Canada to re-peg the rate. Under those circumstances, the maintenance of balance of payments equilibrium—by that I mean the overall balance, including the capital as well as the current account—must, of course, replace the avoidance of inflation as a policy objective. While in the short run the effects of inflation abroad may be mitigated by domestic policies or by general tariff reductions, in the long run the rate of inflation would have to be the rate consistent with balance of payments equilibrium, unless we have periodic revaluations. Any attempt to maintain rates of inflation persistently below, or above, those in the United States would probably prove to be fruitless in the long run.

We must emphasize that it is our view that any system of selective or general controls would be particularly inappropriate under a fixed exchange rate system where the inflationary pressures are coming in from abroad.

The second issue on which we wish to comment is the protection of fixed income recipients. One of the prime reasons for reducing the rate of inflation is to eliminate its effects on low fixed income groups. Inflation amounts to a tax on such groups; as such it has been referred to as the cruellest tax. A partial solution to this problem is to institute full escalation of all federal Government pension and certain other transfer payment programs. The main objection to doing this is that it might reduce built-in stability. There is also the tendency of the budget to move into surplus when inflation occurs. However, the implication of our models—and indeed of all published econometric models of the Canadian economy—is that the built-in stability of our economy is so great that we could afford the small reduction that such full escalation would entail. Furthermore, any effect on built-in stability could be eliminated by linking the escalation of pensions to the escalation of contributions.

Thirdly, is the question whether we can expand employment at the cost of increasing inflation? Of course, there remains the possibility that even if we pursue what we might term an ideal macro-economic policy, we nevertheless might find ourselves in a situation where unemployment is unsatisfactory and inflation is proceeding.

If this proves to be the case, can we choose to "trade-off" more inflation for less unemployment, or will any resulting inflation tend to accelerate indefinitely? The latter question has been answered in the affirmative by various persons. It is therefore important for us to point out that the empirical studies of inflation carried out to date for Canada and for the United States are consistent with the view that inflation will not accelerate indefinitely under the unemployment conditions we have today. The evidence suggests that—so long as involuntary unemployment exists—it is possible to attain a reduction in unemployment through an increase in prices. While a subsequent increase in the rate of inflation will occur as inflationary expectations develop, this process will not expand without limit, unless the economy is operating under forced draft demand conditions at low unemployment rates.

Finally, we ask whether there are other appropriate policies? Inflationary pressures may persist at unsatisfactory levels of unemployment after appropriate macro-economic policies have been put into effect. Such pressures could reflect the existence of imbalances between demands and supplies in different sectors such as regions, industries, labour markets, et cetera, of the economy. In that event, policies to reconcile demands and supplies in the sectors should be considered.

The imposition of general or selective price and wage controls will likely do more harm than good, since such controls will blunt the resource allocating effects of the price system, which tend in the long run to reconcile demands and supplies in different sectors.

However, it is possible that inflation, remember we are discussing inflation in a situation of excess unemployment, under conditions of deficient aggregate demand would reflect the exercise of discretionary market power in product and labour markets, rather than sectoral imbalances. Let us consider the possible policy implications of this phenomenon.

Since discretionary market power does not exist in all markets of the economy, the application of general wage, price, and income controls would be inappropriate. The application of such controls to competitive sectors of the economy would create shortages, necessitating the establishment of quantity rationing and other direct controls if the price and wage controls are to remain effective. A system of general controls therefore logically leads either to the replacement of the price mechanism by bureaucratic planning or to the erosion of the effectiveness of the price controls through the development of black markets and other forms of control evasion.

If market power is the cause of the inflationary difficulties, two types of policies may be considered: policies to reduce market power; and policies to limit the exercise of market power.

The effect of market power on the price-unemployment trade-off provides an additional reason for the vigorous pursuit of policies designed to increase competition. However, while such policies are also desirable for other reasons, and we might add and also are limited by certain constraints, namely the need to utilize economies of scale and so forth, their effect in reducing market power will be gradual at best.

The imposition of selective wage and price controls in markets where discretionary market power exists is an

example of the second type of policy, to limit the exercise of market power. The effects of such a policy in halting this type of inflation could be quite immediate. However, since the causes of the problem would not be dealt with by such a policy, such controls and the associated bureaucratic machinery of enforcement would have to be permanent. Moreover, the political pressures for extending these controls into sectors where they would do great harm, for example rent controls, would be difficult to resist. Finally, since many relative adjustments of prices and wages should and do occur in the sectors with market power, the enforcement of selective controls weakens the resource allocating effectiveness of the price mechanism.

An alternative approach that achieves some of the advantages of selective controls, but which comes to grips with the sources of the problem and avoids the other difficulties of selective controls, involves the establishment of wage and price guidelines—with the appropriate exceptions as noted in the original U.S. proposal put forward by the Council of Economic Advisors in 1962. In other words, we do not want a rigid formula here; there has to be a certain amount of flexibility in it.

Unlike a system of formal controls, guidelines do not require a large bureaucratic establishment for their implementation. Such guidelines serve an important educational function to the public, and also serve to limit the government's own role as a possible arbiter in favour of inflationary wage settlements. However, a system of guidelines which relies solely upon the goodwill or social conscience of those who set prices and bargain over wages is bound to collapse sooner or later. The enforcement of the guidelines must therefore involve companion policies which encourage compliance or which work to reduce or eliminate the market power which is the source of the problem.

The government agency charged with responsibility for the guidelines should therefore have investigative powers which enable it to carry out the research necessary in particular instances to determine whether a violation of the guidelines has occurred, and to recommend appropriate policies designed to reduce market power in the sector concerned.

In our open economy, a convenient instrument in many sectors is the tariff. Tariff reductions applied to problem sectors would serve the dual function of encouraging future complianece and of injecting additional competition into the market, thereby weakening the market power of both firms and trade unions in the sector. In some sectors, of course, the tariff would not be an effective instrument, but in those other policy tools could be used. For example, in some instances one could think of using selective changes in procurement policies.

We put this forward very tentatively. If one pursues appropriate macro-economic policies and still finds difficulties, these are the kinds of policies we think should be considered rather than considering direct controls. However, we must emphasize that we feel the establishment of an appropriate combination of macro-economic policies is of overriding importance at the present time. The adoption of an expansionary fiscal policy through tax reductions, especially sales tax reductions, and the gearing of fiscal, monetary and exchange rate policies toward the objective of expanding output and employment, while limiting the rate inflation of prices, should not be delayed while other policies are considered and debated. With appropriate macro-economic policies, other policies may indeed prove to be unnecessary. Without appropriate macro-economic policies, other policies will prove to be ineffective in achieving the goals of high employment and price stability.

The Chairman: Thank you very much, Dr. Wilson. Have your associates anything to add to your submission? ... Then we will proceed to questions.

Senator Grosart: My first question concerns the continual use of the word "policy" throughout the brief. Whether it is macro or a series of micro policies, this would seem to assume that there is some kind of consensus at the government level, so the government looks at these problems and says, "We are doing this to do that." You speak of monetary policy and fiscal policy, of tariff policy at the end of your brief, and of tax reduction policy elsewhere. Do you really mean policy in the sense of, let us say, a Cabinet decision, or things that just sort of happen by departmental initiative, and so on?

Dr. Wilson: I think we mean the net effect of the combination of things that the government does.

Senator Grosart: That is scarcely "policy." You say you mean the net effect. That is why I raise the question.

Dr. Wilson: If we take, as we have said, monetary policy, mainly we are using the money supply or the growth of the money supply as a gauge of the net effects of the various actions that the central bank and other government agencies are taking. It may well be that the growth of the money supply is not a result of deliberate decisions on their part; it may be it is compelled by developments in the economy. I think that if we had a fixed exchange rate this would probably be our view about monetary policy, that really we lose control over our domestic money supply under a fixed exchange rate.

My colleagues may want to comment on this, but I believe the financial model developed by our missing colleague, Professor Winder, shows that one can indeed predict the behaviour of the Bank of Canada quite well from developments in the economy and interest rates in the United States. In other words, the monetary policy is indigenous; it is not a discretionary thing on the outside, over the period in which you studied the economy.

Dr. John A. Sawyer, Institute for the Quantitative Analysis of Social and Economic Policy, University of Toronto: Could I add something to that? If we look at the recommendations in our brief with respect to macro-economic policy, we are saying that at the present time the exchange rate should be left to float; that fiscal policy should be expansionary; but that monetary policy should be used in such a way as to dampen down what would otherwise be the inflationary effects of fiscal policy used by itself. I think this clearly implies that a group of

people have to sit down together and work out the effects of a particular fiscal policy, of a particular monetary policy, in relation to a set of goals that have been agreed upon, and keep experimenting with alternative calculations concerning the effects of different monetary and fiscal policies, until they find that mix that will do the job better than any of the alternative mixes that might be used. It would seem to me inconceivable that we could try to operate an economic stabilization policy successfully without having a group of people who were making decisions relating to both monetary and fiscal policy.

With respect to tariff policy, if we suggest that this be used if necessary to counteract market power, clearly that would be a sort of subsidiary policy consideration one would have to look at in terms of these general questions. I think it would come down to the fact that one must have a central group formulating what is really a single economic policy with many components.

Senator Grosart: Do you think it is possible for the policy-maker at this particular moment to sit down and make this mix of which you speak and predict its many effects with resonable accuracy, or do we just have to continue experimenting?

Dr. Sawyer: I think we have enough knowledge now of the structure of the Canadian economy and the way in which these policy instruments will affect the behaviour of the economy, price changes, unemployment and so forth, that we can make reasonably good approximations of what the effect of different policies will be. Much more economic research is necessary before we can be more accurate in forecasting what the effects of these changes in these policy instruments will be. We do have a considerable amount of knowledge, which has been accumulated by econometric work, both within and outside the Government over the past ten years, which I submit would enable us to do a much better job than we have been doing.

Senator Croll: May I ask a supplementary question? When you say, "We have the knowledge, and our knowledge has improved over about ten years"—beyond all question, the Americans have the knowledge as a result of research. Where have we failed?

Dr. Sawyer: If I may continue the answer, Mr. Chairman, in part, we have been a late starter on this. The type of econometric research that we have been talking about, which is really an attempt to measure the effects of changes in economic and other variables, started much later in Canada.

In the United States, econometric work was done on a large scale during the 1950s, and it flowered in the 1960s. In Canada we did make a start as early as 1947, in the old Department of Reconstruction and Supply, which preceded the Department of Trade and Commerce. Econometric work was begun in 1947, but it continued with a very low level of resources allocated to it. It was not really until about the beginning of the 1960s that we started allocating more resources to this type of economic research in Canada.

I think it is fair to say that, although Canada and the United States may have started about the same time, at the end of World War II, we are really about ten years later in getting this kind of work going in Canadian universities.

Senator Croll: Despite the ten years' head start of the Americans, and many of them are coming before our committee, their condition today is worse than ours.

Dr. Sawyer: I would agree with that, senator. They have a complex task in the United States, because of the position of the United States dollar as an international reserve currency. That limits very much what they can do with respect to monetary policy. Canada is fortunate, in a sense, in being a smaller country, one that is less important in terms of the importance of its dollar in international money markets, that we can let our foreign exchange rate freely float, which the United States is not able to do. I would argue that it is this that gives us the flexibility that can in the future enable us to do a much more effective job.

Senator Croll: Mr. Chairman, I would be glad to follow that up, but I do not understand that aspect. He threw me off a bit when he entered into the question of the American dollar and the fixed rate of exchange. I do not know enough about that to question him on it, but my overall question is, is that the only difference that we have, is that the great difference between our economies and our present situation?

The Chairman: Senator, I am inclined to think we are getting into a new line of questioning. Could I come back to you on that?

Senator Croll: Unless he would like to finish it now, and then I will quit. While I have him on that point, I would like to hear his answer, and then I will step away.

Dr. Wilson: As I mentioned, the United States has been happening over the last five years, but there is war. I am not, and I do not know if my colleagues are, enough on top of the American situation, and what has been happening over the last five years, but there is something connected with the war and the way it is financed and various policies pursued in relation to that. They are now going through a period in which they have a large inflation rate, which is expected, and they are now getting high unemployment rates, they are now getting up to the level we have and they will probably have to run a period with high unemployment rates, in order to break the back of those inflationary expectations.

There is always, of course, a small amount of "Monday morning quartebacking" when one criticizes the policy of the past. We are really doing this, not to be critical *per se*, but to let us learn from the lessons of the past. When we see the expansions of the money supply that occur from positions of full employment of the order of magnitude we observe, we have to say, could one not do better than this. The fact that one has a fixed exchange rate, does limit the freedom of choice of domestic monetary policy, is terribly important in this respect. This is

confirmed by the econometric work, as well as by other kinds of work—I do not want to put too much emphasis on econometric work, as other types of work are also important.

The Chairman: I think what Senator Croll is asking, if I understand him correctly, is that if the Americans are so far ahead of us is econometric work, why is it that they are not doing as well as Canada in the control of their economy; because, indeed, when you talk about future policy you have a group that looks at the objectives that the nation wants, and then tries all the various mixes.

Senator Croll: Mr. Chairman, you could not have put it better.

The Chairman: And does this bring into doubt whether the econometric study approach is a valid approach? I think that is the question.

Senator Croll: Mr. Chairman, my point could be put this way. Dr. Sawyer made a point of the fact that we lacked information and our research was not good. He is perfectly right about that. I know what he is talking about and so does everyone else. But the Americans do it well, they have money there, they have facilities, they know how to do this sort of thing. It is a fact that the chairman and the committee have invited a great number of Americans who are experts and who come up and say, "I advised Eisenhower," "I advised Johnson," and "I advised So-and-So"—and they got into trouble as a result of their advice!

However, we now get to the point. I say, if they knew all this, if they were that much ahead, and had that information, why were they not able to do better than we are doing at the present time. So my friend turns me off on a different point and gets into a monetary complex which I do not quite understand—I do not know who does. I want to know why they did not benefit from this accumulation of expertise that they had, far in excess of ours.

Dr. Sawyer: Let me try to make a couple of short comments on that. First of all, I was commenting that we had lagged somewhat substantially behind the United States in developing economic research in Canada. However, I think we have made remarkable progress in the last five years or so, and there is not that much difference now between the state of economic research in Canada and that in the United States.

With relation to this point on the foreign exchange rate, I think this gets very crucial, to understand the difference between the two economies. The United States cannot float its foreign exchange rate, because it does not have a foreign exchange rate in the same sense as Canada has. What the United States has is an agreement that the Federal Reserve Bank in New York will buy all the gold offered to it, at $35 an ounce, coupled with an agreement that, at least for international monetary transactions, liabilities in American currencies of the American government—that is to say, the paper money of the American Government—is convertible into gold. As you know, there is a very large stock of gold kept in Fort Knox, Kentucky, as a gold reserve behind the United States currency.

Therefore the United States must watch its balance of international payments very carefully because, if it runs large deficits on its balance of international payments, then foreign countries obtain claims on U.S. currency which in fact become claims in U.S. gold. There is a limited quantity of gold available in the U.S., so that it must be very careful that its liabilities do not exceed those that it could meet under reasonable circumstances, if this paper currency or the paper liabilities of the United States Government be converted into gold.

That, therefore, puts a restriction on what the United States monetary authorities may do. The United States monetary policy at the present time must be carried on primarily with an eye on the balance of international payments, the effects of interest rate changes on capital flows in order that the value of the U.S. dollar in world currency markets be protected.

Therefore, they are deprived of the use of monetary policy for what I have termed stabilization policies—that is, policies designed to combat unemployment and too rapid rates of increase in prices.

One can have all the technical knowledge, the econometric knowledge, the economic research of what effect particular changes in variables will have on the economy, but one may not be able to use certain tools of policy because there are constraints, or restraints, imposed on the use of those. My argument was simply that the U.S. international currency position really prevented their using monetary policy. This constraint, however, does not apply to the Canadian economy because our currency is not an international reserve currency, and the freedom we have with the floating exchange rate gives us an additional tool of policy. So we are not restricted only to using fiscal policy. We can use an appropriate mix of the two, because we do not have this overriding concern with balance of payments problems.

Senator Molson: I am a little puzzled by what you have said with regard to the American liabilities and the amount of gold they have available in Fort Knox. The Bundesbank has more than the gold reserve in American dollars; there is something like $60 billion in Eurodollars in Europe, apart from other liabilities. If the Fort Knox fund is down to $11 or $12 billion, how is this relationship maintained? How does what you say remain valid, that the backing for the American liability is in the hole in Fort Knox, when that is actually less than what is in the German national bank and is only a fraction of what is in Europe and of the liabilities that are all over the world? How is the relationship or the validity of this maintained?

Dr. Sawyer: Of course, it is clear that if the European countries in particular lost confidence in the value of the U.S. dollar and demanded that their dollars be converted into gold, the whole system would collapse immediately. The system rests, therefore, on some faith in the purchasing power of the American dollar being maintained so that people are willing to hold claims on the U.S. dollar.

Senator Molson: It is like an ordinary bank's liquid assets, then, against a run on the bank, against their total liabilities.

Dr. Sawyer: It is exactly the same principle.

Senator Molson: Thank you.

The Chairman: We are back to Senator Grosart.

Senator Grosart: And I hope back to Canada. At the top of page 9 of your brief you make the general statement that the mix of policies in late 1970 were precisely the opposite to what, in your view, is required.

Dr. Wilson: Yes.

Senator Grosart: We had econometric models in late, 1970: the Government had them; everybody had them. They were available. Is there any difference between the data that was available, the analysis and the assessment of the analysis that was available in the late 'sixties and that which is available now, as of the date of your paper?

Dr. Wilson: In terms of what the available models would show, I do not think there would be any significant change.

Incidentally, I regard the increase in econometric knowledge as important, but many of these things are confirming views that are quite reasonable on theoretical grounds as well.

The important point we are making is basically that if you expand the economy through an expansionary monetary policy, it has a different effect on unemployment relative to prices than if you expand it through fiscal policy. In other words, there is not just a given fixed trade-off between inflation and unemployment and an open economy, even when you just consider those two simple, broad-gauge instruments.

Therefore, it becomes possible under the circumstances to use a combination of policies where one is expansionary and the other is somewhat contractionary in order to move you to a higher level of employment and a low level of unemployment. There is less inflationary effect—or perhaps no inflationary effect—than would be the case if you simply used one of the instruments alone.

Senator Grosart: That is not my point. I appreciate that you have come up with a mix of policies that you would recommend. So has almost everybody who has come before us in these hearings. What I am concerned with is why it is not possible for the policy-maker, the one who makes the mix at any given time, to come up with something which is not, as you say, precisely the opposite of what is required. This is your statement. You say the policy mix so far is "precisely the opposite to what is required."

Dr. Wilson: This is in terms of mix. This is saying that the overall policy is expansionary, or modestly expansionary, and if you look at the composition of that it looks to be quite strong expansion in the money supply, with, until quite recently, not much on the fiscal front. Remember that this is also coupled with attempts to hold the value of the dollar down and not allowing it to depreciate as much as might otherwise occur.

I do not know the reasons behind that or why the decisions were made. However, we are saying that if you took the opposite tack and had, on balance, a stronger expansionary policy overall—by increasing expansionary fiscal policy through tax reductions combined with less monetary expansion and, most important, combined with not pegging the dollar and, indeed, not intervening on such a persistent scale as we have witnessed over the past twelve months in the exchange market—this would put you in a more favourable position with respect to these two objectives of unemployment and inflation.

However, you may have other objectives. You may decide you are not prepared to tolerate the temporary effects on the export sector. There is no denying that in the short run this kind of policy would hurt the export sectors, whereas, in the longer run they would benefit from the slowing down of the inflation.

Senator Grosart: I am still concerned with the fact that you have come before us, as others have, and have told us what should have been done a year ago. We have had econometric models. I have not the same faith I had in them before I read Mr. Leontieff's annual presidential speech to the American Association of Economists, where he blows them up and says that all you are dealing with is numbers and that if anybody wants to put in any empirical knowledge you just write him out of the club. I am sure you have read that speech.

Dr. Wilson: Oh, yes, and the point is that this is the type of empirical work that is going on. We do not want to overstate the precision of these things. What these models really contribute, as I see it, is that they enable you precisely to come to grips with the question of offsetting combinations of policy. People know that if you expand the money supply it does different things to output on the one hand and exchange rates and prices on the other than if you expand through fiscal policy. But it is only when you can build these in the context of a complete model which takes into account the interaction between the various components of the economy that you can really come up with an answer to that. Now, it may not be a precise answer; there may be a margin of error. But, of course, that is true of all kinds of analyses. If you ask, "Well, should we tighten up simply on fiscal policy?" you make some kind of prediction. When the Minister brings down his budget, in part he is going to be basing that on various kinds of estimates. I would just say that probably the kinds of estimates made with an econometric model are at least as good as estimates made with other techniques, and perhaps better. They do have this advantage of enabling you to deal with more complex combinations of policies that other techniques might enable you to do.

Senator Grosart: My only concern is, if you and Mr. Benson were able to implement this paper tomorrow, whether or not a year from now we would not be hearing another group of economists saying that what was in this paper and what was done was precisely the opposite

of what was required. This is the great problem. How do we get precision?

Dr. Wilson: I think we learn as we go along. I think we are inevitably going to make mistakes. Perhaps I should make it clear that in terms of recommendations we are not talking about what should have been done like "Monday morning quarterbacking." I think right now it would be important to adopt this kind of policy, in other words a policy of fiscal expansion combined with less expansion on the monetary front.

Senator Grosart: Would you say that this is the policy which should have been adopted in late 1970? You say the mix of policies adopted in late 1970 is the opposite of what is required.

Dr. Wilson: The return towards ease really came around March, 1970, I believe, and in calculating the growth in the money supply we are talking about the policy of expansion as adopted at that time. Again, Monday morning quarterbacking, I would say that it would have been better to have tax reductions and less expansion in the money supply, particularly sales tax reductions, if you were putting them into effect last March. I am also prepared to say that given the unemployment situation and given the situation on the inflation front, we feel that these would be appropriate now.

Senator Grosart: So, to some extent these are corrective?

Dr. Wilson: We feel it would enable you to reduce unemployment while holding the line on the rate of inflation. We do not think the current rate of inflation is that serious. We have achieved perhaps the slowest rate of inflation of any of the industrialized countries.

The Chairman: I have a supplementary question on the line of questioning that has been going on. You make the very valid point, I think, that if you have a fixed exchange rate, this seriously interferes with the independence of monetary policy. But you then go on to say that part of your policy would be to have a tax reduction, and you mentioned two reductions, one of 10 per cent in income tax and the other of 50 per cent of sales taxes.

Senator Croll: If passed on. Don't forget that.

The Chairman: If passed on. The proglem I am having difficulty with is that if you had a reduction in the taxes of a substantial magnitude, you say that you would have a slightly restrictive monetary policy along with that. Now would it not make it rather difficult to have a slightly restrictive monetary policy if you had a major tax reduction? I am talking about the present situation. In other words, would there not be a necessity to increase the money supply fairly substantially?

Dr. Wilson: Why? Because of the effects of the debt increase of government borrowing?

The Chairman: That is right, Government cash requirements.

Dr. Wilson: I think it really depends on the kind of policies. By the way, these were illustrative policies and I would want to go on record as saying we are recommending both the 10 per cent reduction in income taxes and the 50 per cent. These are illustrative calculations. I think the effects of the consequences of sales tax reduction may be quite different depending on whether you are talking about an income tax reduction or a sales tax reduction.

The Chairman: I am not talking about the effects as shown by your econometric model. I am talking about the cash requirements of the Government and how that affects the money supply.

Dr. G. V. Jump, Institute for the Quantitative Analysis of Social and Economic Policy, University of Toronto: Well, the cash requirement could be met by borrowing from the general public. The cash requirement that would be entailed by cutting the taxes and augmenting the deficit could be met by selling securities to the public, and no increase in the money supply is required for this. Maybe you are trying to anticipate that this will cause a rise in interest rates, and in the case of the income tax cuts, it probably would. But, so be it. That is part and parcel of what we are recommending. It probably would not be that much. We have made some estimates on the magnitude involved and they are in one of the supporting appendices. In the case of the sales tax which all three of us would prefer to see cut, we think interest rates would actually fall, in the first year or so anyway, even with the increased deficit that this would entail.

The Chairman: Do you think this, or does your model show that this would happen?

Dr. Jump: Both.

The Chairman: It seems to me that if you determine to finance the additional cash requirements by way of selling securities and not increasing the money supply, there would be an increase in interest rates which would seriously affect the exchange rate.

Dr. Wilson: That is a big "if".

The Chairman: Would you not be in very great danger, with Canada with 24 per cent of its Gross National Product in exports, of seriously slowing down the economy by increasing the value of the Canadian dollar relatively?

Dr. Wilson: Let me first come back to the sales and income tax cuts. The thing about the sales tax is that although the money supply in nominal terms is not being changed, if, and it is a big if, the sales tax were passed on to the consumer, then the real value of the money supply—and that is the money supply divided by the price level—has increased and the amount of transaction requirements for financing the volume of expenditures in the economy has gone down. That is what offsets and more than offsets, according to the models, the effects on interest rates of the Government's own borrowing.

If we talk about income tax, it is unambiguous that the interest rates would go up, and this would cause some appreciation of the dollar, and that has a deflationary offset to the expansionary or inflationary effects of the fiscal policy. Now, as a matter of fact, if we just say, "Expand fiscal policy and do not do anything else," it will be expansionary. The offset is quite important because the appreciation of the dollar lowers import prices, and as we have seen from analyzing the effects of the appreciation which occurred, that helps to keep the rate of inflation at a given level of unemployment down, which is what you are trying to do. If you found that that is so large that it is going to have strong effects on the export sector, then that is introducing a third policy consideration, and you may say, "Well, then, monetary policy might have to expand a bit to prevent that kind of appreciation occurring." If you find that it is so large that it will have a strong effect on the export sector, then that is introducing a third policy consideration. You may say that monetary policy might have to expand a little to prevent that kind of appreciation occurring. Then you face a trade-off, and in order to protect your export sector in the short run you are prepared to accept a little more inflation in the economy as a whole. You are then introducing a third objective.

The Chairman: You will admit that you cannot, as you appear to do here, isolate those three segments. You talk about macro-econometric policies and you seem to talk about them in isolation from one another. You say you can have a certain fiscal policy, a certain monetary policy and a certain exchange rate policy. It seems to me that if your model showed anything, it would show that they are inexplicably tied together, that one affects all the others.

Senator Carter: When Mr. Benson brought down his budget last December, everybody was urging him to cut taxes. His answer was that he would like to cut taxes but interest rates were high, and if he cut taxes and did not get the revenue, the federal Government would then have to go on the money market and borrow, and would then drain the money market of the supply that the provinces wanted to borrow from. He was therefore in a bit of a bind. What would have happened if he had followed your policy?

Dr. Jump: I think he overstates the case with regard to provincial and municipal governments. The federal Government would cut taxes, and it would increase the tax revenues.

Senator Carter: You think he would not have lost revenue?

Dr. Jump: He would have lost some but, as times goes on and the economy expands, part of it would be recouped. But the provinces and municipalities stand to gain immediately, since they are not having any cut at all, and they would be experiencing higher incomes and associated tax receipts involved with higher income taxes. Their borrowing needs would actually be reduced under this policy.

Senator Carter: He was already budgeting for a deficit, was he not? He would still increase the deficit by the short-fall in revenue.

Dr. Jump: At the federal level, yes.

Senator Grosart: Along the same lines, I would like to ask if you have put various proposals of tax reductions—corporate tax, personal income tax, sales tax and others—into your model to assess the economic consequences on either inflation or unemployment, or both? You appear to have come up with an opinion that the sales tax would be the most appropriate area of reduction. Is there a reason for that?

Dr. Wilson: It has to do with the fact that the sales tax is at least as expansionary for a given dollar of revenue as the income tax. More importantly, when the sales tax is increased, the reverse is the case. Here one could argue—if you are worried about it, and there are grounds for worrying about it—that this could be a possible role for the Prices and Incomes Commission. The income tax reduction would have positive effects.

Senator Grosart: Corporate or personal?

Dr. Wilson: Personal. We have not analysed the corporate income tax reduction.

Senator Croll: What is the total sales tax we collect at all levels of government in this country?

Dr. Jump: The policy we are talking about here is at the federal level only.

Senator Croll: You were talking about the effect on municipalities. We are now talking about sales tax. I would like to know if you have a total sales tax collected, if there is such a figure?

The Chairman: We can get that for you, Senator Croll. The illustration that these gentlemen gave in their paper was a 50 per cent cut on federal sales tax.

Dr. Jump: Yes, $1.2 billion.

Dr. Wilson: This is an illustrative calculation not that we are recommending a cut of that magnitude.

Senator Croll: The federal is $1.2 billion?

Dr. Wilson: The figure I give is the amount of the reduction, 50 per cent of sales and excise taxes, excluding building material taxes, custom duties and special excise duties on tobacco and alcohol. It includes the excise tax on alcohol and on other things.

Senator Isnor: Are you talking about retail sales tax?

Dr. Wilson: The federal taxes at the manufacturers' level.

Senator Isnor: If you are talking about the sales tax in the real sense of the sales tax, you are slowing up business by your proposed solution. You are slowing up business, less revenue, less income tax by the proprietors of the stores. I cannot follow you.

Dr. Wilson: It is called a manufacturers' sales tax at the federal level. In reducing this tax and with the

resulting price level reductions which we assume would occur, you are obviously increasing the purchasing power of a given individual's income so that it is an increase in his real income, and we can assume that he will increase his spending as well.

Senator Isnor: We are only increasing his spending power if you use the term "sales tax increase."

Dr. Wilson: Decrease, not increase.

Senator Molson: It is very hard to count on that sort of tax being passed all the way through, is it not?

The Chairman: These gentlemen are trying to show that if there were such a reduction, their models show that there would be an increase in real output of 1½ per cent and a reduction in unemployment of ½ per cent. I am not trying to interfere with your question, Senator Molson, but I want to make it clear that as a matter of policy they are not suggesting necessarily that that be done, but that their model shows that if it were done this is the effect it would have.

Senator Molson: I appreciate that. It is also conditional on ability. Part of the problem with some of these things is that with the best will in the world you sometimes run into awkward situations in trying to carry them out.

The Chairman: I do not imagine the model would tell you that.

Dr. Wilson: We are using an equation in the model which has actually looked at the effect on prices of changes in sales taxes in the past.

Dr. Jump: In the past they have always gone up, and when they have gone up there has been no hesitancy on the part of businessmen to add that on to the price. There is no reason that there would be any hesitation. Our best estimate is that the thing would work in reverse. If it does not, this might be a new role for the Prices and Incomes Commission to make sure that it does get passed downward.

Senator Molson: Regarding one product with which I have had a fair amount to do, if, for example, the price went up 15 cents a case, the retailer promptly added one cent per bottle, amounting to 24 cents per case to the consumer. This is true of taxes and other increases. I am quite sure that the lag we have been discussing exists in other economic senses, in the reduction of prices, with the exact reverse of this behaviour.

Dr. Wilson: If such pyramiding exists that, of course, also presents the prospect that the effect could be larger, because I believe your model is consistent with roughly 100 per cent?

Dr. Jump: I get a 20 per cent pyramid.

Dr. Wilson: In those sectors where the prices are constrained by the point at which imports would flood in, a reduction in the sales tax will lower that price.

You must also remember that in the context of the present situation, where there is excess capacity, we might be more willing to think these would be passed on. If we are discussing strong demand conditions, as in 1967, then it could be argued that there might not be any shifting at all. It depends critically on what type of companion monetary policies are pursued.

Senator Carter: Have you made any studies of what happens when the tax on drugs is reduced?

Dr. Wilson: No, I have not made any specific studies along those lines.

Senator Carter: What is its effect?

The Chairman: The witness said he has not made studies of that nature.

Dr. Wilson: I made a study some time ago of tax on equipment and how rapidly the taxes on capital goods were increased. They seemed to be passed forward very quickly, within two quarters. However, that was an increase; I have not considered such decreases.

Senator Grosart: Towards the end of the paper there is a suggestion that the tariff might be used as an instrument of control of the economy, particularly the working of the price system. Is this not rather reactionary?

Dr. Wilson: We do not recommend tariff increases. This is an illustration within the context of a guidelines policy. If we have a problem of so-called market power and inflation with a wage-profits spiral, what do you do about it? All we say, essentially, is that we must attempt to make those sectors of the economy comply with the guidelines. If they do not it is important to attempt to come to grips with the problem, which is really the fact that there is not sufficient competition in the sector. If there is a tariff protecting that sector, a reduction in it does serve to introduce additional competition. While we do not wish to wipe it out completely, it also serves to show that the Government means business and that the next time around another tariff reduction can be used. Therefore those concerned are more likely to comply with the guidelines in the future. So it serves the dual function of a deterrant, something with which the non-compliers can be punished and which, over time, tends to correct the problem.

Surely we can say that, for whatever reasons we wish to protect the sector from foreign competition, if the result of that is that the sector has excessive wage and price increases, it has demonstrated that it does not require that level of protection and it could be reduced. However, that is not the only policy instrument that is available.

Senator Grosart: But if every nation used the tariff as a system of rewards and punishments, would we not be back to square one, before GATT?

Dr. Wilson: I do not suggest it should be used as a reward; there is nothing to prevent unilateral reduction.

Senator Grosart: If it is a punishment for one, it is a reward for others. If it is a punishment for bad behaviour, it is a reward for good behaviour. As a matter of fact, you say that yourself.

The Chairman: The witness suggests that his policy does not advocate raising tariffs; he would even reduce them.

Senator Grosart: Consider the Textile Review Board; this is the sort of thing that seems to be behind that. They say voluntary restraints will be imposed on certain importers for a while, but not for very long. If the domestic industry does not bring their competitive level up in the domestic market they will allow imports. I suggest that this is a highly reactionary manner in which to use the tariff.

Dr. Wilson: I do not know whether that label is deserved; I really do not know what it means in this context. Essentially, we are emphasizing that the tariff affects the structure of the industry. A reduction in tariff would make it more competitive.

There are other policies, but the tariff might be very easy to use, being quantitative. If we really consider a sector to be causing a problem of inflation, this is an automatic method of eliminating some of that discretionary market power.

What should be the tariff on a sector? There might be reasons for reducing tariffs and arguments for the protection of industry, the various objectives. One of the points that should go in the balance in favour of tariff reduction is whether in that sector there is a discretionary market power which is being exploited through excessive wage and price increases. This is just one additional factor. There might be other reasons for reducing tariffs.

The Chairman: It has been suggested to us that there is a danger in using the tariff policy as a means of controlling inflation. It is not always known whether the inflation is a sectoral imbalance or the result, as you pointed out earlier in your paper, of improper government policies. If competition and tariff policies are to be used as an instrument, they should be used constantly, whether inflation is a problem or not.

I believe Professor Giersch and Dr. Johnson gave testimony in this regard, to the effect that to use these as part of an incomes policy is really to use them too late in the cycle and they should be used all the time.

Dr. Wilson: There are many who favour tariff reductions generally. I believe this to be common among professional economists. Nevertheless, the tariffs are with us and they are a fact of life. If Professor Johnson's remarks are to imply that if we had free trade we would have this particular type of problem...

The Chairman: No; you say that the tariff should be used as a means of eliminating market power.

Dr. Wilson: A means of reducing it.

The Chairman: That is right, reducing market power. You examine market power in relation to inflation as a matter of incomes policy.

Dr. Wilson: That is correct.

The Chairman: Dr. Johnson and Dr. Giersch say that it has nothing to do with incomes policy; it is a competition policy that goes on whether an inflationary cycle exists or not and we must always try to eliminate market power, there being a danger in an attempt to tie it to an incomes policy.

Dr. Wilson: I might be prepared to say, "Yes, we should do that", but, in fact, we are not. That is an additional reason. If, for some reason, we were prepared to tolerate the existence of unexercised market power, which is not exploited, there is no harm. If we find it is exploited in a particular episode I would say that is the signal that the time has arrived not to tolerate as much as in the past.

Certainly, when it comes down to a choice between taking steps to reduce the market power, or applying controls and creating a bureaucratic machinery which I think in the long run will lead to a lot of trouble, I certainly favour the adoption of those policies. It may well be that I would like to see them adopted anyway. In fact, they are not.

There are other policy objectives taken into account. The Government may have specific regional policy objectives which are concerned in keeping protection on a particular industry. Therefore, the tariff remains. However, if a particular industry subsequently exhibits wage and price behaviour which violates the guidelines in the context of this kind of inflation—and, remember, this is the second line of policy—we are not saying that such policies are necessary, but if it comes down to the crunch that after you have got better performance of macro-economic policies there remains a problem of inflation and high levels of unemployment, and we attribute part of it to market power, then we would rather see policies which are oriented to prevent it. These policies combine some of the virtues of selective controls. Insofar as the weapons exist to back them up, through tariff reduction procurement policies and others, they might have quite a quick impact, which could be quite important if inflationary situations develop, whereas the simple announcement that henceforth you will be a little more vigorous in the pro-competition policy might take years to have any effect.

Senator Molson: Was any study made of any possible impact on the acceleration of the Kennedy Round reductions that we made in Canada? Were not changes put forward in two years for tariff reductions?

Dr. Wilson: That was, of course, in the context of other tariff reductions occurring. We have not made any study. I do not know whether Michael Denny has. I am familiar with the Economic Council's study, which indicated that when you get down to talking about effective protection these things did not really have that much of an impact.

Senator Molson: They do not have much impact?

Dr. Wilson: Not effective protection, so the nominal rates were reduced. We have not carried out such an analysis as to what would be the consequences.

Senator Grosart: The witnesses seem to have a good deal of confidence, under certain circumstances, again at the secondary level, in guideline policies. The general impression seems to be that guidelines have not worked anywhere. I do not want to go into it in any great detail, but could you indicate how you see guidelines being effective?

Dr. Wilson: I do not think there is a general consensus that they have never worked. My recollection is that in the experience of the wage-price guidelines in the United States in the early to mid-sixties, the evidence was that they were having some effect. It is also true that guidelines, once you get into a situation of strong demand inflation, cannot work. With inflationary macro-economic policies, in fact, a guidelines policy could do harm, because the government tends to rely on the guidelines too long without putting its macro-economic house in order. In the context in which you have excess supply or deficient demand in the markets, I think a guidelines policy could work. I do not think the American experience is that it did not work.

Senator McGrand: What would be the difference between the guidelines you would propose and the guidelines proposed a year and a half ago by the Government, which the provinces ignored, which business recognized in principle and labour refused to have anything to do with? How would your guidelines work? What guidelines would you suggest?

Dr. Wilson: We are not suggesting that guidelines be put into effect at the present time. We are suggesting that the first thing to do is to take these steps on the macro-economic front. The second, of course—which would depend on the kinds of research that come out of the studies carried out by the Prices and Incomes Commission, and so on—is to analyze the extent to which any remaining problem could be attributed to the imbalances between sectors, in which case policies to reconcile demands and supplies could be looked at, and the extent to which it may indeed reflect market power in certain markets. If at that point one wanted to enunciate a guidelines policy, basically I would carry out a similar kind of analysis for data on Canada to the one the Council of Economic Advisors did in the United States in terms of formulating overall guidelines. I think what is different here from the policy which was experimented with is that that was a policy relying on voluntary compliance without a clear understanding of the kind of remedies that might be put forward in the event that there were violations. What we are proposing is that basically the remedy is to try to find policy means to reduce market power if there is a sector on which you are prepared to put the finger.

Senator Grosart: So it is really something more than guidelines, something a little tougher than guidelines?

Dr. Wilson: It is a guideline backed up by a positive policy to try to reduce market power in sectors which violate the guideline.

Senator Grosart: It is a guideline with sanctions?

Dr. Wilson: With sanctions, but sanctions not of the direct control variety, but sanctions of a "let's get the market working" variety.

Senator McGrand: A while ago you were talking about tariffs, and on page 17 of the brief you mention a selective procurement policy, which I think has something to do with tariffs. Can you add anything to that, or have you already explained it to Senator Grosart?

Dr. Wilson: I just think that there are other policy tools that could be used in particular instances. This may in some cases require the co-operation of the provinces, if such co-operation is forthcoming. In other cases you may have to throw up your hands and say there is not much you can do about it. For example, a procurement policy could be used. There are illustrations of this. In the United States, again during the period of the guidelines, procurement policy was the policy used to ensure compliance in the steel industry. If there is a situation in which some firms may be tending to wobble over whether they will go along with a particular price increase, the government's willingness to make clear that its own purchasing will be directed towards those who do not go along with this could be a factor in preventing such a price increase. Whether it would be much of a factor in preventing an excessive wage increase would be another matter.

Senator Croll: I should like to return to the sales tax. You indicated a considerable amount of faith in what could be done in that respect. This time I am on ground that I know as well as you do, so we will discuss it for a moment. The only experience we have in Canada of a reduction of sales tax within the last ten years came in the drug industry, in the last six or seven years. You said you had not studied that. That being the only example in existence up to the present time, to my knowledge—and I have a fair knowledge of these things—how can you be so sure of what you are saying about the sales tax, when in the one instance where we practised it we found that the drug people put the money in their pockets and threw the crumbs to the people?

Dr. Wilson: I am not sure. That is why we state it as an assumption, assuming these things are passed on. It is not just empirical evidence. I think there is some theoretical ground for expecting that on average it would be passed on. By the way, there is also now the illustration of the removal of the sales taxes on equipment, so one can look at that as well. I am not denying that in particular instances these things may not be passed on.

The fact that a sales tax is reduced and is not apparently passed on may not be grounds for suspecting that on the average it would not be. There may be other special factors explaining that. Increases might otherwise have occurred under those circumstances. We do state it as an assumption. I think there are grounds, given the low levels of profit in the economy at the present time, where firms might indeed be tempted to absorb that, but here is where we think there could be an appropriate role for the Prices and Incomes Commission in those sectors where the possibility of imports coming in is not

a sufficient incentive for them to be passed on right away.

Dr. Jump: I made a statement that prices went up, when I was talking about the machinery and equipment tax, which was put on in 1964 and taken off in 1967. There is evidence here that when this tax came off the prices did go down by the amount of the tax. Here is one instance where I have seen the empirical evidence.

Senator Croll: The income tax?

Dr. Jump: The machinery and equipment tax.

Senator Croll: You never heard the debate in the House of Commons, then, about how they said time and again that they increased the prices on them, and did not reduce the tax, and screamed about it. The last report we had was on farm machinery. It was written by Dr. Barber, and he did not agree with you, either. I happen to know that. There is not much I know, but I know that.

The Chairman: I must reiterate that if you turn to page 10, the witnesses say, "provided the tax decreases are passed on to the consumer". It is an illustrative point, and they are making that provision in their oral evidence time and time again. They have reiterated that this is the provision.

Dr. Wilson: In the supporting document, we mention explicitly that there might be a need for a special role for the Prices and Incomes Commission, in making sure such a policy is effective.

Senator Laird: How are they going to do that?

Dr. Wilson: By developing price change guidelines for the particular sectors. This is not that difficult to calculate.

Senator Laird: What sanctions would they eventually employ? Would you reconstitute the Prices and Incomes Commission along the lines John Crispo suggested to us—that is, give them powers to subpoena people and to bring in documents, and create a lot of publicity covering a specific situation which seemed outrageous to them? Would you recommend that sort of thing too?

Dr. Wilson: At the present time the commission is there, if one were putting the policy in. A certain amount of publicity could be brought out with it. In some sectors, as I mentioned, where foreign competition is a very important factor, one would expect these prices to be passed on quite quickly. In others, one may indeed want to have publicity on the magnitude and what the consumer may be expected to pay.

Dr. Sawyer: Might I make an additional point there? I want to point out that if there is a feeling that there is some uncertainty about the effect of a reduction in sales taxes, in terms of implementing the general cost of our proposals, it might be better in the short run to fall back upon income tax reductions, because clearly income tax reductions would not have that objection applied to them.

Senator Croll: You suggest that might apply to personal income but not to corporate

The Chairman: It referred to personal income tax.

Senator Croll: And I asked, "Why not to corporate?" That is my question.

The Chairman: I think they are suggesting that it is a question of consumption to increase demand.

Senator Croll: Then, someone might answer the question.

Dr. Wilson: We should make the point that this is an illustrative calculation, but there is the possibility that the tremendous increases in direct taxes on labour income, that have occurred over the last five or six years, may have something to do with the pace of inflation. The second round effects of personal income tax reductions on wage demands may be deflationary, at the same time that the reduction in employment that occurs has a somewhat inflationary effect. That is something that is much more speculative.

Senator Croll: You have to be right on one point, anyway.

The Chairman: You calculated that the sales taxes, exclusive of the building materials tax, would be $1.2 billion. That means the reduction is $600 million?

Dr. Jump: No, that is the reduction.

The Chairman: The reduction is $1.2 billion. What is the 10 per cent of the income tax, comparatively?

Dr. Jump: Around $900 million.

The Chairman: So the effect is far more pronounced in the case of the sales tax, even taking the comparative difference in size?

Senator Croll: Mr. Chairman, I cannot hear the point you are making.

The Chairman: The point I was trying to get was to determine how much the difference in cost was between the two illustrative suggestions, and what the effect was, relatively, between the two of them.

Senator Croll: What was the difference in cost?

The Chairman: The sales tax reduction would be roughly $1.2 billion, and the 10 per cent of the personal income tax reduction would be roughly $900 million.

Senator Croll: The question is: Which would be more effective?

The Chairman: Yes, which would be more effective. They point out in their brief that, in the case of the income tax, unemployment would be reduced by one quarter of one per cent, as against a half of one per cent in the sales tax reduction; and the growth would be increased by $\frac{8}{10}$ of one per cent in the income tax reduction, as against 1.5 per cent in the case of the sales tax; but that prices, in the case of the income tax reduction, would increase by $\frac{2}{10}$ of one per cent, whereas if

the reduction in sales tax was passed on, which of course would be necessary to make it effective, they calculate that the price level would decrease by 3 per cent.

Senator Croll: I do not know what those figures are, but I take them to be so; but there is something else, while we are at it. On the psychological effect between reducing taxes 10 per cent and reducing sales tax—as a politician, which one would you take or do?

The Chairman: Are you asking me?

Senator Croll: I am asking the witness.

Dr. Wilson: I thought you were asking the Chairman.

The Chairman: The witness is not here to give us his political views. If, as an individual, he chooses to answer the question...

Dr. Wilson: I would be hard put to say what the effect would be. It would be a question of what wins more votes.

The Chairman: It is a good political answer, if you stop right there.

Senator Croll: Oh no, how do you explain it to your wife—if you choose sales taxes as againt the 10 per cent personal income tax reduction?

Dr. Wilson: When it is passed on, I would go over the grocery bill with her. There is one point I want to make in this connection. The idea of price decreases is so bizarre these days, in the context of a background inflation of about 2 per cent of 2.5 per cent. If we are talking about 3 per cent, what we could be saying is that it is not as effective, over a period of time, as the prices have changed very little. Even initially, there does not appear to be a shifting of the thing, but profit margins are widened. However, subsequently, if prices do not rise as much as they otherwise would, you still gain benefits from this kind of policy. The same pressures which stop them from raising prices right now can be expected to encourage them eventually to pass on the sales tax.

The Chairman: Doctor, who has developed econometric models in government?

Dr. Wilson: My colleagues can comment on that. There is some econometric work going on at the Bank of Canada. This is, perhaps, the most prominent. They published one complete econometric model. They are about to publish a new model. Also, there has been econometric work going on in the Department of Finance, which is work that originally was carried out in the Department of Trade and Commerce. I think Professor Sawyer can comment more on the history of that. Then, there is an interagency econometric project, Project CANBE, in which several agencies are supporting the development of a longer term model, with some industry detail.

The Chairman: The information that these models make available, is that made available to people like yourselves?

Dr. Wilson: In the banks' case, certainly the banks' models are published. They have co-operated with us in providing data and access to their models. The models are put in the public domain. In the case of the work going on in Finance, currently, I do not think any of it has yet come into the public domain. As far as the interagency project is concerned, there are plans for co-operation between ourselves and the project.

Dr. Sawyer: At this stage of the model development the only types of experiments or simulations comparable to the ones that we have done are those that have been done with the first version of the Bank of Canada model, and those were publicly distributed by the Bank of Canada. That was the smaller model and was somewhat inadequate. Over the past year they have very substantially improved that model. But they are not quite at the stage yet where they are able to do those experiments. I would think that in another six months or so they will be distributing the results of some of the things they have been doing.

Dr. James Gillies, Study Director: Mr. Wilson, we have been told over and over again that by going to a floating exchange rate the Canadian economy can be protected from importing inflation. Is there anything in your model that tells you how much protection you get with the floating rate or, if you have a floating rate, can you develop any domestic policy that will eliminate inflation altogether—that is, you do not have to worry about what is happening in the rest of the world if you have a floating rate? What is the band that we are working in?

Dr. Jump: I have made some estimates as to what the floating of the rate last May has done to the rate of inflation we have had in the past year and as to what it will do over the next year. That information is contained in the supporting appendix, "Policy Option for High Unemployment." I cannot remember what the contribution was for 1970. For 1971 the floating rate would reduce the rate in the GNP deflator by about $\frac{6}{10}$ of 1 per cent. that is, had it not been floated but had remained pegged at 92½ cents American. For 1970 it was $\frac{4}{10}$ of 1 per cent.

Dr. Gillies: In looking at page 10 of your brief, according to the policy that you recommend, the reduction of the rate of unemployment is very disappointingly small. It is a half of 1 per cent over the year. If those policies were expanded for another year, would the rate go down appreciably more?

Dr. Wilson: If you just put the policy into effect and let the economy run for another year you get a larger impact. Again, I think they are contained in the tables here.

Dr. Jump: We stopped at seven quarters. I think it was 0.9 after seven quarters. It would be close to double that size after that.

The Chairman: After seven it would be almost double this rate? You are talking about the reduction in sales tax?

Dr. Wilson: Yes. In two years it would get you roughly a full percentage point on the unemployment rate.

The Chairman: Would that be the same ratio on income tax reductions?

Dr. Jump: It would probably be; it might even be a little more.

Dr. Wilson: We were talking about 0.26, and at seven quarters it is 0.41. So it would be $\frac{1}{10}$ of 1 per cent. This is just an illustration, remember. When you have a lot of slack in the economy—and remember that average hours of work have dropped off, so that when expansion occurs there is quite a lag in responsive employment to the stimulus of real output—it takes time before firms will actually believe that that is really expansion and will then start to hire workers. They will first work extra hours. Productivity can be expected to improve when we start off with a situation where there is a lot of underutilization and we are turning towards full employment.

The Chairman: How long will it take under those policy prescriptions to go to 4 per cent unemployment?

Dr. Wilson: Well, we were talking here of starting off on the basis of about 6.2. This is not taking into account second-round effects on investment. Would it eventually give more than that or would one have to have further sales tax reductions?

Dr. Jump: These things keep accumulating for two or even three years, because the investment effects lag substantially and they do get rather large. I cannot really answer how long it would take to get to 4 per cent.

The Chairman: What happens to the price level over the longer period of time?

Dr. Wilson: The longer you go on, the more inflation will occur.

The Chairman: So it is accelerating.

Dr. Wilson: To some extent, but not indefinitely, as we have indicated. It would take quite a long time under the sales tax stimulation before you would end up with a higher price level. As we ran it out for the seven quarters, although the negative price effects were beginning to be reduced, as you can see in this graph where they are beginning to turn up, they are still substantially negative at the end of seven quarters.

When you are dealing with the sales tax aspect, you have a transitionary element which is, in a sense, deflationary. In the long run you get more inflation, which is the consequence of reducing the unemployment rate. But if you believe that we are under some special problems at the moment with respect to the danger of renewing inflationary expectations, then this is a particularly timely kind of policy to adopt.

The Chairman: Have you any way of quantifying inflationary expectations?

Dr. Wilson: Some of our colleagues have worked on the questions in terms of trying to measure expectations and derive measures of real interest rates. Unfortunately, he is the one who is not here. However, if there are any questions you want answered, you could pass them on to him in writing and we would ask him to answer them.

Senator Grosart: What do you mean by "quantifying inflationary expectations"? Do you mean quantifying their effect on inflation as a component of inflation?

Dr. Wilson: The Chairman was the one who asked that.

Senator Grosart: But you said some work had been done on it. How do you quantify expectations? Or is it the effect of expectations?

Dr. Wilson: We do not have data in Canada. There are some spotty American data on what price expectations are. These are based on going and asking people what they think is going to happen to prices. Usually these attempts are to build models in which one tries to get at the inflation by incorporating past values. One could then say all right within the context of the model, and I am not talking about a large-scale model but a small-scale model, what would be within the constraint of the model, what would be implied for the rate of inflation—that is the kind of work people have done. It usually involves saying that if people will develop a rate of expectation of inflation, then that will affect interest rates. Then, how would we expect that expectation to be developed? It is probably a function of the recent past, so we would introduce the recent past values of inflation rates in the model and we would study their impact on interest rates, and so on, and try to infer from that. It is indirect. Therefore, it is perhaps not as reliable as the right kind of direct evidence might be.

Senator Grosart: You are trying to quantify the expectation as an effect, then, and, as such, as a component of ongoing inflation.

I was going to ask a supplementary to Dr. Gillies' question. Assuming the optimum implementation of your macro policy, with whatever ancilliary assistance it might need from time to time from the micro policies, the overall effect you describe as follows at page 9:

> The net effect of these policies will therefore be to stimulate the expansion of employment and output while slowing the rate of inflation which would otherwise occur.

Do you see any kind of time interval that you can put on this? I mean these policies will stimulate employment and slow down inflation, but how long would be the time function of your suggestion here before we have a manageable economy?

Dr. Wilson: I am having difficulty with the question. I think the economy is not unmanageable.

Senator Grosart: Well, it has to be unmanageable if we have an unacceptable rate of unemployment and an unacceptable rate of inflation. At any rate, it is unmanaged.

Dr. Wilson: There may have been some unanticipated developments or bad management. But we have done some experiments in terms of what particular policies would do over a particular period of time. We have not run these out indefinitely. I think one could say that you would get a considerable amount of pay-off from either

the sales tax or the income tax reductions in terms of stimulus to the economy within a period of a year. Some of that pay-off will start to come in in three quarters in terms of the unemployment rate, but you will have lasting effects. I think it is important here not to become over-enamoured with models and try to achieve perfection right away in the sense that you could say, "Well, gee, you are only to get half a per cent in one year, so why don't we have a double and abolish the sales tax?" But the only trouble there is that you are sowing the seeds of even greater future effects, and since our forecasting abilities are quite limited, we may find that just as we look at the past and find monetary policies fluctuating too widely, the next group of students of the problem may say that fiscal policy over-reacted to the unemployment situation, so maybe one should be a little on the conservative side.

Senator Grosart: Our exercise here is an attempt to find out what mix of policies will achieve, in the shortest possible, time a socially and economically acceptable rate of unemployment and inflation. Can you give us any hope? If Mr. Benson took your paper and said, "I am going to give this optimal treatment in my budget next week," how long would it be before we would get to the stage where we would have a socially and economically acceptable rate? Do you see it happening in a year or two years?

Dr. Wilson: I do not like to waffle on any question, but I do not think we can really say the macro, because we do not know. The macro-economic policy combination may be sufficient but then again it may not be sufficient. So we really cannot say that it alone will enable you to get to that stage.

Senator Grosart: But I said the entire thing, the macro and the micro, everything.

Dr. Wilson: I am convinced that you can move a long way in terms of reducing unemployment through almost any combination of policies. If we are talking about a 6½ per cent unemployment rate, roughly, certainly one can say that we can get that down one percentage point by any normal expansionary means and I think the modest effects on inflation are not going to be of a variety that will lead to an accelerating or a renewal of the inflationary expectations problem. What one should be concerned with, if you try to move faster than that, is that you could renew inflationary expectations before full employment is reached simply because of the sheer momentum of trying to close the gap too quickly. In looking at our discussions I think you should bear that in mind. I think you could try to move too quickly. What we are suggesting is that if you do move, that for the speed with which you move there are certain advantages in sales tax reductions and certain tax reductions relative to other policies generally, in terms of limiting or slowing down the rate of inflation, that occur for a given amount of employment reduction.

We are not in the same situation that we were in in 1967, when if you stepped on the gas you got a lot of price increase. He if you step on the gas you get a lot of output increase.

Senator Molson: In getting the perfect combination of policies, the time lag, which would differ so much in effect in each type of policy that was changed, would probably be one of the key difficulties in trying to arrive at the optimum use of these weapons, would it not?

Dr. Wilson: The evidence, such as it is, is consistent with there being a longer lag in response to economic activity to monetary policy than to fiscal policy. Fiscal policy on sales and income tax reductions would probably have the shortest lag in terms of where the decision is taken, from the time when you think about taking it to the time when you actually take it, compared to a monetary policy. If you are wanting to iron out short-run fluctuations, given that difference in lag structures, one could make a case that the primary emphasis should be upon tax adjustments and that monetary policy should be geared towards the longer run target of a steady potential rate of growth with whatever amount of inflation we are prepared to tolerate.

In one of our papers we suggest that, given all the errors and problems in a price index, perhaps 2 per cent inflation is clearly acceptable, just as, given to problems of frictional and structural unemployment, perhaps 4 per cent unemployment is acceptable. Professor Sawyer even suggested tolerating a zone of 2 to 3 per cent inflation and maybe up to 5 per cent unemployment. But clearly beyond that point we can be using macro-econometric policies to get us inside that zone.

The Chairman: Has your examination indicated that there is any way to reduce these lags? I am taking a specific lag such as a lag in monetary policy. Obviously, what you are suggesting is by a mix. How can you reduce the effect of lags? In taking each individual policy, have they indicated that there is any way, in exercising those policies, that the lag for that policy could be reduced?

Dr. Wilson: You are dealing with the structure of the economy, how firms react, the timing of investment positions, and so on. In fiscal policy, the inside lag is recognized to be longer. We have not done any specific work on that. There were recommendations in Volume 2 of the Royal Commission on Taxation, which appears to be the most neglected volume. It deal with fiscal policy and a macro-econometric policy, with standby authority and this kind of thing, the requirements of the Government to make a statement when the economy did not achieve certain targets. One of the proposals talked about was where there might be some automatic changes which could have an effect. Unless the Government tabled a statement—in other words, got rid of the inertia of saying "Things are uncertain. We do not know what to do, so let us do nothing." If the indicators are signalling a certain change, and if you decide to overhaul it, you have to explain why. For one thing, relying on taxes rather than on expenditures for the purpose of ironing out short-run fluctuations would be another way of reducing the lag, because expenditures may take a lot longer to put into effect.

Dr. Gillies: It appears from your paper that strong variations in the money supply have an undue effect on the operation of the economy. Would you favour relating changes in the money supply to changes in the volume of output?

Dr. Wilson: Do you mean the Friedman rule?

Dr. Gillies: Precisely.

Dr. Wilson: There might be some disagreement among the four of us, including the gentleman who is not here, as to how far we should go in that direction. I would prefer, given the choice between the fluctuations of the curve and the Friedman rule, to take the Friedman rule. However, I am not sure I wish to be shackled to it.

One strong feeling shared by all three of us is that we wish to preserve the options of using combinations. We can agree, but we agree for different reasons. I would not wish in the future always to adhere to the Friedman rule. If necessary, I want to be able to use discretionary monetary policy precisely because of the opportunities provided by an economy on a floating exchange rate.

The Chairman: You made the statement earlier in your evidence that there should be a group to consider and examine the goals for Canada, with a view to discovering the means by which they should be achieved by different mixes of policy, and project them forward. Have you any suggestions as to what group should do that?

Dr. Sawyer: I am really not familiar with the general structure of decision making within the federal Government. However, one would assume that the key person in this respect would be the Minister of Finance. The Governor of the Bank of Canada reports to him and can operate the monetary levers. The Deputy Minister of Finance is concerned with the fiscal side, and the flow of research and advice would then come through the Department of Finance and the Bank of Canada research staffs, ending up at the Minister of Finance. Then he, with other appropriate senior officials, such as the Governor of the Bank of Canada, would establish a policy to be recommended to the cabinet.

The Chairman: You make the point that:

> However, the implication of our models (and indeed of all published econometric models of the Canadian economy) is that the built-in stability of our economy is so great that one can afford the small reduction that such full escalation would entail.

There you are referring to the...

Dr. Wilson: Escalation of pensions.

The Chairman: You go on in section 3, on the same page, to say that inflation will not accelerate indefinitely.

Can you tell us what evidence you have that brought you to this conclusion?

Dr. Wilson: There are two sets of econometric evidence. I think it is fair to say that the work has been proceeding in the United States since the publication of the important articles by Friedman and others which put forward this view. The evidence is quite consistent that price expectations do develop and do matter. However, basically they do not develop in precisely the way they are formulating. They say that when inflation enters the wage equation it only comes in with a partial effect. This points out that the long-run trade-off is quite different from the short-run. In other words, if you consider only the short run, there is a certain amount of unemployment with a little inflation; in the long run there is some subsequent adjustment. So that if an attempt is made to maintain that level of employment there will be a higher rate of inflation. It does not go on indefinitely and explode into a sort of Latin American situation. I would qualify that by saying within the range of historical observations, both of inflation and, of course, the unemployment rate. I think if you get down to a very low unemployment rate and you get rip-roaring demand inflation, you can get accelerating inflation develop, which might lead to hyper-inflation.

In Canada many wage models suggest that you do get a full effect of price expectations on wage behaviour. On the other hand, when you look at the termination of prices you find you do not have a full effect of wage changes and price changes. This is partly because of the openness of the economy again. So in both economies, if you in a sense solve these models to show what happens, you do find a different short-run from a long-run trade-off, but you do not find you are just stuck with a single so-called natural rate of unemployment.

I think there are also grounds for believing—and I think one of the articles did have a qualification at the end—that if there is involuntary unemployment in the system—in other words, those who want jobs are prepared to work at the existing real wage, and perhaps at a lower real wage—that puts a dampener on the mechanism. It can be rectified only after there is enough demand in the system to wipe out these dampening mechanisms, which could also under the present system, of course, include the poor old-age pensioners, because they are the ones who are in part being hurt. In a sense, this acts as a dampener, just as the progressive tax system acts to some extent as a dampener.

You clearly cannot go to zero unemployment, no matter what you do in monetary and fiscal policy. You can try it, but you will not get there; you will just get an ever-expanding rate of inflation. We certainly feel you can go from 6½ down to 5½ to 5 per cent, and perhaps lower, without running into that kind of problem.

The Chairman: Honourable senators, on your behalf I would like to thank Drs. Wilson, Jump and Sawyer very much. There is a prodigious amount of material filed as supplements to this brief, which I am sure honourable

senators have not yet had an opportunity to digest in full, but I am sure that we will. We thank you very much for the tremendous amount of effort you have put into it.

The committee adjourned.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 18

WEDNESDAY, JUNE 9, 1971

Fifteenth Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses—See Minutes of Proceedings

24116—1

STANDING SENATE COMMITTEE

ON NATIONAL FINANCE

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Grosart	Phillips
Hays	Sparrow
Isnor	Walker—27.

**Ex officio Member*

(Quorum 7)

Orders of Reference

Extract from the Minutes of the Proceedings of the Senate, of Tuesday, March 9th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said *Estimates* reaching the Senate.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Tuesday, May 4, 1971:

"With leave of the Senate

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relation thereto.

The question being put on the motion it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Minutes of Proceedings

Wednesday, June 9, 1971.
(18)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10.00 a.m. to consider The Question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Aird, Beaubien, Grosart, Hays, Isnor, Kinley, Laird, Manning and Molson. (10)

Also present but not of the Committee: The Honourable Senators Inman, Kinnear, McElman, McGrand, McNamara, Smith and Sullivan. (7)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics; Dr. David McQueen, Economic Consultant.

Witness heard:

Dr. John F. Graham,
Professor and Chairman,
Department of Economics and Sociology,
Dalhousie University, and
Past President of the Canadian Economics Association.

At 12.40 p.m. the Committee adjourned to 4.00 p.m.

At 4.00 p.m. the Committee resumed.

Present: The Honourable Senators Everett (*Chairman*), Aird, Beaubien, Bourque, Hays, Laird, Langlois, Manning and Molson. (9)

Also present but not of the Committee: The Honourable Senators Casgrain, Inman, McGrand and McNamara. (4)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics; Dr. David McQueen, Economic Consultant.

Witness heard:

Dr. André Raynauld,
Professor,
Department of Economics,
University of Montreal.

At 6.00 p.m. the Committee adjourned to 8.00 p.m. to consider the Main Estimates laid before Parliament for the fiscal year ending March 31, 1972.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Wednesday, June 9, 1971.

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 10 a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, we are honoured to have with us Dr. John F. Graham who was Chairman and is at present Professor of the Department of Economics, Dalhousie University. Dr. Graham is the immediate past president of the Canadian Economic Society. He received his doctorate from Columbia University. He has had a wide-ranging career as both teacher and consultant in the field of economics, and is well known to many of our colleagues, especially to those from the Maritimes.

Dr. Graham brings to this committee the knowledge of his discipline and, particularly, interesting views, as one would expect of a Maritimer, on some of the economic regional problems that confront us in Canada which, of course, are of great interest to this committee.

Dr. Graham, we have your brief before us. Perhaps you would like to begin by speaking on it.

Dr. John F. Graham, Department of Economics, Dalhousie University: Thank you very much, Mr. Chairman and honourable senators. As I mention in my introduction to the brief, I am extremely pleased to have this opportunity of appearing before this committee. I want to commend your committee on taking this initiative. I come here almost directly from the annual meeting of the Canadian Economics Association in St. John's, Newfoundland, and I must say there was tremendous interest in, and support for, this undertaking of the committee. We hope that it will set a new pattern for providing a forum for what I hope will be enlightened discussion on, and contributions to, this particular question, not only by economists but also by others who would have an interest in this and related matters from the academic and related professional communities.

As I informed your chairman in accepting your invitation, other commitments prevented my preparing what I would regard as a proper brief, the kind that I would really like to put before you. I regard the few remarks in this brief as a rather poor substitute. It just happened that the last two months were unusually heavy ones for me. This is about my last assignment in the series, and is one to which I attach a great deal of importance.

There is only one major error which I should like to point out. Paragraph 23 (a) (ii) on page 8 should read:

> by raising the abated amounts on which the portion of equalization payments for personal and corporate income taxes are paid, and

The word "portion" should be substituted for the word "position" which now appears in the brief.

There are a number of other typographical errors, but I do not wish to waste time with those, most of them being quite obvious. I have made a couple of suggestions on what might be done to encourage better submissions at this kind of hearing. Since two of my colleagues, Professor Tony Scott and Professor Grant Reuber, referred to the possible interest of the Canadian Economics Association, and lent their support to this kind of endeavour, these suggestions are that more notice might be given to encourage better preparation of submissions—although I must say there is nothing like short notice to concentrate one's mind on seeing whether one has anything to say on these issues.

It occurred to me that if you knew well enough in advance that there were to be such hearings a number of people could be designated and asked to prepare themselves, taking into account particular economic and other relevant conditions of the day. You might then obtain a rather fuller and more articulate brief than is the case when people are forced to compile them on shorter notice.

My other suggestion—and I hope that you will not mind my presumption in making these—is that you might wish to consider having more than one economist appear at the same time. This would allow issues in which there appeared to be some difference of opinion to be resolved by an interplay between the economists in a manner which is difficult with an *ad seriatim* series of solo performances. For example, it might be rather interesting to have Professor Harry Johnson and Mr. Louis Rasminsky at the same hearing.

Senator Molson: In camera.

The Chairman: It would not even be interesting; it would be fascinating.

Senator Grosart: I would be against it, having in mind my experience last Friday night.

Dr. Graham: On which occasion you more than held your own, I might say, senator.

Having just come from the Canadian Economics Association meetings, and having had the privilege of hearing the address to our Association of the Honourable Eric Kierans, I suggest that this committee might give that quite remarkable address some attention. Many of the issues raised by Mr. Kierans, accompanied by what I

consider to be a very good analysis, would illuminate some of the issues with which this committee is concerned. I do not mean to indicate my agreement with Mr. Kierans in all respects. It would not be useful or appropriate to discuss these questions in this testimony, although if you wish I will do my best. However, I think it is better to consider Mr. Kierans' own documents, as I have to depend on my recollection of an address I heard several days ago.

Mr. Kierans' presentation received very enthusiastic support from the economists present, despite the fact that economists are not noted for being particularly enthusiastic with respect to views expressed by others. More than 300 members present rose as one man and gave Mr. Kierans a standing ovation. This, I am sure, was for what he said, rather than for the more spectacular circumstances surrounding his recent resignation.

I am very concerned by the poor performance of the Canadian economy with respect to what the Economic Council refers to as performance goals. These are: achieving full employment without a high rate of inflation; viable balance of payments; a high rate of growth; a fair distribution of the resulting income. Then there are the related achievement goals. These are objectives we wish to achieve, such as the alleviation of poverty and the abatement of pollution. One could easily give a long list of these shortcomings, which I do in my brief.

I believe it to be technically possible to remedy many of these shortcomings, but I think one of the problems in this country is that we are not really very clear as to what we are attempting to achieve in our society. We do not have a very clear notion of what we think constitutes a good society, nor do we have the kind of continuous dialectical discussion that would help us define the sort of society we desire.

I am impressed by the repeated urgent pleas of the Economic Council of Canada with regard to the need for this kind of national forum through which we might hope to arrive at some definition of what we want to achieve. I would consider that in any definition of the kind of society we want, the worth-while, civilized society that we are capable of achieving the shortcomings we see in our society would be absent or we would want to eliminate them. I refer again to such things as: slow growth in productivity; a high degree of chronic poverty; rapid, poorly planned urbanization that imprisons people in intolerable conditions in nondescript or ugly cities; inadequate housing for many Canadians; chronic regional unemployment and under-employment; inordinately wasteful industrial conflict and alarming contamination of our environment, to name a few.

In item 4 of my summary I support the floating exchange rate to protect the domestic economy from the competitive effects of inflation. I do not say a great deal about monetary policy here; I do not consider myself to be a monetary expert. However, as a general economist I, of course, must have some views on this. Perhaps since I do not include it in by brief, I might make a further comment on the relationship of monetary policy to our exchange rate policy.

In the present situation we have and encourage a long term capital inflow and at the same time we have a surplus of short term capital. It seems to make no sense at all to sell equity to non-resident corporations to generate capital overflow and at the same time have long term borrowing abroad by municipalities, concurrent with short term lending abroad. It is in part this situation that keeps our exchange rate at the present high level, although the short term lending abroad tends to keep it down to some extent. However, this lending is always hanging over the market; these funds can always be brought back in, which would shoot the rate back up again.

There seems to be some indication, therefore, that we would be able to provide a considerable amount more of our own capital requirements, given the situation of having short term lending abroad at the same time as long term borrowing from abroad. Given the difficult position in which many of our borrowers, and I put particularly the municipalities in this category, it would seem that we might consider a monetary policy which would bring down the long term interest rates and reduce that capital inflow. This at the same time, if we maintain our floating exchange rate, would perhaps bring the exchange rate down somewhat and increase the competition of some of our exporters who are presently undergoing difficulties. I refer to such industries as the pulp and paper industry. It would help to support their markets, thereby alleviating unemployment.

I am not suggesting this as a major cure for unemployment. However, I suggest that when we consider such things as advocating the floating exchange rate we ought to relate this to the use of monetary policy. I have simply given an illustration of what I have in mind when I say that.

Senator Isnor: What is the effect of that in the Maritimes?

Dr. Graham: As I understand it, this industry in the Maritimes, as elsewhere in the country, has a problem in maintaining its markets. Of course, the appreciation of our exchange rate, although I think it was a desirable measure and justified on a number of counts, has had the effect of hardening the competitive position of the pulp and paper industry, including that in the Maritimes.

Senator Isnor: I am rather surprised at the statement on page 3 that you favour that.

The Chairman: I wonder, senator, if we could allow the witness to complete his opening remarks. I will call on you for the first question.

Dr. Graham: In the brief I have expressed the view that the Government has been over-concerned with inflation. Incidentally, in rereading my brief I feel that I have been rather too categorical in some cases. There is a tendency often for economists to play too much the game of "on the one hand, on the other hand."

I am trying to express the position I would adopt were I to make a decision. However, I wish you to know that I do recognize that many of these points are arguable.

With respect to the inflation and unemployment issue, it is my view that the costs of inflation are generally far in excess of those of unemployment. I feel that not only the economic waste of unemployment but the humiliating, degrading situation of those in this position far outweighs the, I quite realize not altogether understood, distribution effects from inflation, which could in any case be compensated for if we were to follow another suggestion that other witnesses have made, and which I also make, that the pensions and other welfare payments be escalated at the current rate of inflation so that the real purchasing power is maintained. If we believe that these payments are appropriate, given a current level of output in this country, then we should believe that the real income of those payments should be maintained, and see that they are by taking the necessary steps to make adjustments to accomplish this.

I suggest with respect to incomes policy—and this is not something I dwell on in my brief—that we lack the institutional framework for an effective incomes policy, even if that were regarded as a desirable policy to pursue. I do not say much about this in my brief, but what I have in mind is that, assuming we know what kinds of maximum price adjustments we want, it is important that these not be uniform but be adjusted to take account of the different requirements in different parts of the economy and the different sectors, as a higher rate might be more appropriate in an area that has not had an adjustment for a long time than in one that has recently had one, or a higher rate perhaps in an area where there is a greater shortage of supply than another area.

Given that we want to use this kind of policy, until we have an institutional framework, in that representatives of labour and management, working in concert with the government, can reach agreement that they can make stick with their particular constituencies, then it is futile to talk about trying to implement this sort of policy, to do without the necessary institutional structure.

Item 7 in my summary I have already covered.

We get then to regional matters, the issue to which I have been asked to pay particular attention. Here, although I agree that it is important initially to look at what we are trying to do with the economy as a whole—that is, what kinds of rates of unemployment and price increases we are trying to work within—ultimately we have to look at where the pressures are that generate inflation, we have to look at what the rates of unemployment are in the different sections of the country, and we have then to consider what policies are appropriate in these areas.

If you simply look at the nation as a whole, you are taking an average, overall view that overlooks what is really happening in the various parts of the country, which taken together add up to our overall average.

What I am saying is that to have any real impact with policy you have to look at where things are happening, and these are happening in the different industrial sectors and different regions. It so happens that administratively it is useful to work with the political regions that we have, although these are not necessarily for all purposes the best definition of regions for policy purposes.

We have the old story of fiscal and monetary policies that seem appropriate in the aggregate, given national unemployment rates and changes in the price level, but that are not likely to be appropriate to particular regions. If we find that a restraint policy is necessary because of what is happening nationally—and this will be mainly what is happening in Ontario, which swings so much weight because of both its population and its high output per capita—then we might find that those policies are singularly appropriate to, say, the Atlantic provinces, where there are not the same pressures, and where restraint policy will simply result in additional unemployment over and above the already high rates of chronic unemployment and underemployment.

I suggest that we need policies to deal with both chronic and short-term unemployment, particularly in the Atlantic provinces and Quebec. If I mention the Atlantic provinces more often than Quebec or other regions, it is because that is the region with which I am most familiar, and also the region in which the problem is most acute. We need a long-term policy that will serve to alleviate the chronic unemployment and underemployment there. At the same time, when we have a national policy of restraint we need a short-term policy to deal with the short-term instability or short-term unemployment that is generated by that restraint program.

I was rather concerned that when the Government announced its restraints program it said it recognized that some of the regions, such as the Atlantic provinces, do have some slack and these policies are not appropriate, but that the Department of Regional Economic Expansion program will offset the effects of the restraints policies in those regions. The program of the Department of Regional Economic Expansion is essentially a program of long-term regional development, which should be coming to grips with the problem of chronic unemployment and underemployment. To say that these programs of long-term alleviation and reduction of unemployment and underemployment will offset the short run national restraint policies is, I think, to badly confuse and muddle the two different functions.

This does not mean that some things the Department of Regional Economic Expansion does could have no bearing on short-term policy; it certainly could. They can accelerate the contributions to infrastructure in the growth centres upon which they are concentrating their efforts, and if they do this, this is one of the elements of fiscal policy that generally does accompany a short run stabilization policy. But this should not be allowed to cloud the main function of the Department of Regional Economic Expanson, of developing long-term policies.

On the long-term question, I am rather concerned that, like the other governmental agencies that have preceded DREE, Department of Regional Economic Expansion, it might be too continuously preoccupied with what can be done immediately, such as additions to infrastructure, which are very important. What I am getting at is that, until we have a fully articulated framework of policy for the development of the Atlantic provinces, we will have

to continually fall back on this sort of measure of doing things now because they have to be done, which we are sure will not be very far off base, but which never get at the basic developmental issues. We are then in danger of having the same sort of situation as existed before DREE, which now has the tremendous advantage of co-ordinating effort in the region of having a series of programs without policy.

With respect to regional monetary policy, I think without exception the other witnesses have simply written this off and said that you cannot have regional monetary policy; that we have perfect capital markets; that if you have, say, lower rates in one region than another there are immediately funds flowing out of that region to elsewhere. Perhaps you would have borrowing at a lower rate, but you would have other funds that would otherwise be available locally that would be going out and that would be lent out at the higher rate elsewhere. So you do not add anything in this way.

I am not convinced of this, and while I think we need to know more about this matter, on the basis of work that has been done by Dr. John Sears at St. Francis Xavier University, on the financing of small business in Nova Scotia, there is a suggestion that there is a significant bias on the part of national financial institutions—and I include our commercial banks—in the market, that works against the extension of credit to such business in the Atlantic provinces.

It also appears that the capital market may not be as perfect as is generally claimed—I think it is on the assumption that it is perfect that economists have made this blanket statement that regional monetary policy will not work—and that it might be appropriate to have such imperfection, if it does exist, compensated for by an agency such as the Industrial Development Bank.

I would be all for a rather bold experiment here by letting such an agency lend at somewhat lower rates in the Atlantic provinces, say, for a trial period, and just see how the market works. I do not think this would be a terribly costly experiment. It certainly would not cost any more than the kinds of subsidies which are being paid in other forms—which, incidentally, I think can be very strongly justified on purely economic grounds, provided that they put resources to work which would otherwise be unemployed and wasted, and provided there would not be some other more productive use for the funds so used.

Senator Grosart: When you say "lower regional rates," do you mean lower than, say, the national average, or the Ontario rate, or lower than the existing rates?

Dr. Graham: Lower than the rates that apply elsewhere in the country.

Senator Molson: Lower than the primary.

Dr. Graham: Whatever rate we are talking about. I am really thinking particularly about the problem of providing capital for the small business that is getting going or trying to expand. So when I talk about the rate I am talking about the particular rate that might apply to that kind of business; and I am talking very much about the kind of thing in which the Industrial Development Bank is already involved.

What I am saying is that, while the use of regional monetary policy is rather limited, it may have some role to play and I would not want to reject it out of hand. My colleague, Robert Comeau, at Dalhousie, for instance, has been studying this question for a number of years, and it would be interesting to see what he has to say on this question, as to whether something can be done.

I believe, too, that although it is often claimed that our federal structure makes fiscal policies difficult to apply—and it is, because you may have provinces taking positions that are contrary to what seems to be called for in the national interest, at the national level, and may not even correspond to the interests of the province in question on fiscal policy grounds. On the other hand, we should look at the opportunities that our federal structure provides in coming to grips with regional questions, because we do have provinces that are concerned with the local economy, primarily concerned with that, focussed on that.

Everyone calls for greater federal-provincial fiscal co-ordination—that goes without saying, it is a necessary condition—but in doing that, I think it would be appropriate to make use of the fact that we do have the provinces and their municipalities as important administrative units. Since the provinces and municipalities have not the financial power to apply fiscal policy in the way that the federal Government can, with the kinds of borrowing resources, and so on, that it has, it seems to me that one thing which could be done is to have the federal Government underwrite the maintenance of provincial expenditures and expenditures of municipalities, with allowance for increase in the costs and levels of services. So that when there is a slack in the economy and a slump, these governments are not forced to pull back and they can go on with their programs, which could be justified in the long run interest in any case. So there is no question about resources being wasted by this means. You have funds that are being spent, that result in the production of important goods, social goods, that would not otherwise be produced.

I suggest rather more than that, that with respect to the present situation of unemployment, particularly high levels of unemployment in these regions, there is nothing to lose by supporting a whole range of expenditure activities in communities which we know are going to continue in the future and have a long-run viable future, to support the whole range of educational, recreational, cultural, health facilities, roads, sewers, and so on.

Again, if you can bring resources to work that would otherwise be wasted, you are adding something to the economy. Of course, we always must have regard to whether extra demand pressures are going to be put on areas where factors are in scarce supply and this has to be taken care of, and administratively I might say that this is one of the most difficult areas of the implementation of administration of public policy.

More than that, on the regional question I specifically recommend increases in equalization payments that have both a long-run rationale and a short-run impact, that

would enable low income provinces to provide levels of services commensurate with those in the higher income provinces at comparable burdens of taxation.

It does not mean that the citizens in those lower income provinces are put in a more favourable position, because if they still want to add to the level of services they have to impose heavier taxes to do that, and they are presumably already imposing as heavy taxes as elsewhere, so they have to impose additional levies which would be even higher than those elsewhere.

This can be justified again on economic grounds, which I would be glad to go into: also on ethical grounds that is, that citizens in all parts of the country should have access to the same levels of services; and also on grounds of fostering national unity, to which I would attach a high priority, provided we relate to that a movement towards worthwhile social goals, that will make our society distinctive from other societies that we might otherwise give up the ghost and merge ourselves with.

It would also have a short run impact, if it were implemented quickly, in providing additional funds to governments in that area, to improve the levels of services and provide additional employment opportunities—again with new goods and services coming into being with the employment of the unemployed resources. Professor Barber very strikingly showed what a terrific waste we have at the moment with the present levels of unemployment.

I suggest we might also have catch-up grants for these provinces—which, because of their inferior fiscal resources, lag behind the rest of the country with respect to public services. As an example, I give the financial support from the federal Government to post secondary education under the Fiscal Arrangements Act. One result of this program is that the provinces which have the greatest fiscal resources—particularly Ontario and Alberta—get the greatest benefit from this program, because they put more into it themselves and because, virtually, it is a matching grant. The federal Government pays half of the shared operating costs. They are. therefore, in a better position to benefit from it. And so the post-secondary institutions in these provinces have generally been better supported than elsewhere.

So there has been, not only up to the time of the implementation of the Fiscal Arrangements Act, but long before that, a backlog with respect to development of these institutions which to my mind would be in the national interest as well as the local interest to support since they are indeed performing a national service.

Then I conclude at the point that I have already suggested that in regions of high unemployment which need not be limited to the maritimes we should not be afraid to put funds into community services which are going to provide benefits to our people—probably far in excess of many things that are being done in the private sector. I would not say all things, but many things. So that we would then have the benefit of such services resulting from the employment of otherwise unemployed resources.

If I may in closing just raise one general kind of issue that concerns me very much, I do think that there are problems that economists and non-economists have, in that we tend to carry out our analyses in the present institutional market framework. Often we fail to question whether this framework best serves society's needs. If you look at the order of priorities that results from this market, there may be some things that we would agree upon; that is, that it would be better to have resources used for one purpose than for another. Take, for example, coloured television. Who needs coloured television? We could have got along nicely without it. If we had never had it no one would care very much about it. With the same resources we could have had a fully independent Canadian broadcasting corporation, completely free of what I consider to be degrading commercial advertising. We could have given this nation a really splendid service instead of being faced with the rather half-baked compromises it now has to make.

I realize it is easy enough to make this comparison and that you could say that even if coloured television had been dispensed with there are other higher priorities that the resources could be aimed at. But my point is that given our present framework it is extremely difficult to make this kind of decision and to implement it administratively.

One of the things I tried to do in my recent presidential address in St. John's was to suggest that economists might address themselves to this very important question of how, with the reordering of social priorities, we could have an administrative apparatus that would respond to this and would still maintain our high degree of individual freedom and perhaps increase it. I take this position not with any doctrinaire political position at all. As a matter of fact, in my own view I would not go for any very wide-scale public ownership means of production; I would go for a separation of some of the functions of ownership so that we could retain the kind of flexibility and efficiency on the production side that comes with private ownership and yet ensures that, with respect to other functions of ownership and disposal of property, social interests relating to urban development and rural development and environmental questions and other issues such as distribution of income will be taken into account.

I am not looking, incidentally, on the redistribution of income question for a drab levelling of income. I am not opting for economic equality. That is not my idea of Utopia at all. But there is no reason why with the resources we have we cannot eliminate the widespread degrading poverty we have in this country.

Mr. Chairman, perhaps I have ranged beyond the direct concern of this committee, but I do not feel that you can talk meaningfully about fiscal policy, monetary policy, or exchange rate policy unless you are really concerned with what it is we are trying to do by improving the performance of this economy, and determining what are the particular goals this society wants to achieve.

The Chairman: Dr. Graham, indeed you have not ranged beyond our concern; in fact, you put it very well in item 3 when you say that it is possible to remedy many of the shortcomings but that it is important to be clear what kind of society, and therefore what kind of

economic framework, we want. We are indeed interested in expressing our views in our final report within a framework as to the society we might be trying to achieve.

Senator Isnor: Mr. Chairman, may I add to your welcome my words of appreciation that we have Dr. Graham with us today, coming as he does from Dalhousie.

Senator Grosart: Hear, hear.

Senator Isnor: It is because of men of his calibre that Dalhousie has seen a very marked increase in enrolment and that it will continue to supply brains to the rest of Canada in the years to come.

Dr. Graham, coming as you do from the Maritimes...

Senator Molson: He was born in Calgary.

Senator Isnor: Yes, I know that, but when people come to the Maritimes they immediately become part of the Maritimes.

Dr. Graham: I am a Maritimer of 22 years standing, Senator Isnor.

Senator Isnor: I am sorry Senator McLean is not here to point out the effects that the floating exchange rate has had on the fishing industry in the Maritimes, which is a very important factor of our economy. I notice Senator Burchill is here and perhaps he will speak to you on that. My impression is that, in general, the floating exchange rate has had a bad effect on the Maritimes. I am not sure that that is offset by the good effects it has had in the rest of Canada. Could you enlarge on that, Dr. Graham?

Dr. Graham: Yes, Senator Isnor. It is not the floating exchange rate that has had this effect. It is the appreciation of the exchange rate. I think one has to make distinctions here. Had we not floated the rate, our dollar was under such pressure at the old rate, partly because of our own domestic policies, that the rate would have had to be appreciated anyhow. It would have been moved up to a fixed rate not very far from where it is presently floating. So maintaining a fixed rate would not have had any different effect, or any substantially different effect on these industries that you mentioned, which I agree have been hurt by this move.

This is a difficult issue. I was in favour of the appreciation of the rate and of doing it by floating the rate, because I thought that this was probably the most effective single way of dealing with inflation in this country. I felt that the Government should have done so a year ago, as it would probably have had more effect and we would not have had as high rates as we have had through 1970. As you know from previous witnesses, if you accept their opinion, we are so closely tied to the United States that there is not a great deal we can do by other kinds of domestic policy to offset the inflation that is communicated to Canada from the United States.

One of the difficulties here is certainly that we wanted an exchange rate appreciation to help us deal with our inflation problem. In any case, the Government had pressure on it so that it had to adjust the rate, really whether it wanted to or not.

This comes back to the kind of point I was trying to develop a little earlier, and that is that by encouraging long-term capital inflows, which I do not feel we need in the volume in which we are getting them, we put upward pressure on our exchange rate. This then not only raises the important issue with respect to selling out our resources and control of our industries to foreigners, but it also exerts this kind of pressure on the rate which does hurt some of our industries, particularly our exporting industries.

So this is a dilemma we face. If any change takes place in the economy some industries are going to be hurt. You can hardly have any change taking place without somebody feeling the pinch. The unfortunate thing is that it might happen in a region which needs the pinch the least and which would suffer most from it. If this is expected to be a temporary kind of situation, then one can perhaps argue for special support measures for these industries, although I do not like to get into that because once you do—and the fishing industry is already being supported at a fantastic rate out of public funds—you do prevent economic adjustments from taking place within that industry and you prevent rationalization of the industry, and so on, that ought to take place to make it more efficient.

Senator Burchill: Mr. Chairman, unfortunately I am not a member of this committee, but I am here this morning very much enjoying what Dr. Graham has to say. I hesitate about intruding right now, but as an exporter of forest products, lumber, plywood and so on, my experience is that foreign exchange has been perhaps the greatest problem we have had to face, first with the devaluation on two occasions of the pound sterling which practically put us out of business, and now with the floating Canadian dollar.

If a study were made of the Gross National Product, if I may put it that way, of the Atlantic provinces and particularly of New Brunswick—because these products made up so much of our export business—I think it would be found that we have suffered more in our area of Canada from the floating dollar and from the loss in the premium than any other part of Canada. We cannot reach the market in central Canada, you know, so we have to go east and we have to export. I think that you will find that we have been the victims of this floating dollar, far more than any other part of the nation, and if international currency problems could be worked out—now we have discovered how to go to the moon and to Mars—our Canadian exporters could do a great deal about straightening out our economy. After all, we must remember we are an exporting nation.

Senator Grosart: Dr. Graham, if my recollection is correct, you are the bravest economist we have had before us because you say in the second-last paragraph on page 2 that there is no technical reason why we should have these shortcomings. I think it is fair to ask you what you mean by "technical," because my second question will be: What are the non-technical reasons?

Dr. Graham: Well, senator, I do not know whether this was a brave proposition or a foolhardy one. First of all, let me say that this is probably too a categorical a statement that I have made here, but one that I would, by and large, stand by. I realize that we will never live in a perfect world, that modern industrial society is too complex and man is too inherently corruptible for us to be able to say that we can do anything we want to do with the technical means we have. I do not take a naive sophomoric view on this. What I am saying is that if we look at our resources and at our potential, and even if we accept the measurements given to us by the Economic Council of Canada, which I think has done great service to this nation, there seems to be no reason why we cannot eliminate the series of shortcomings I have mentioned and do it fairly quickly.

I am sure that many of my other colleagues who have testified would disagree, and they would say that the market as it operates, with some modification, is about the best we can hope to do, that we can have some trimming away on this and that policy area, but we will probably never be doing so very much better than we are now. I simply do not agree with this. I think it is going to take a lot of political courage—and I could use stronger language—which might not be forthcoming. So you could say that there might not be any technical reason, but it takes a combination of seeing how to do it technically and having the political courage to do it before it will happen. These two things have to happen. If we take the guaranteed annual income question, for instance, and assuming that this is desirable to eliminate poverty in this country, then there are questions arising out of that that might be considered technical. First of all, there is the problem of effect on incentives and whether it might have such disastrous effects on our productivity that it would greatly erode our output and greatly limit the kind of things we can do. When I say there is no technical reason, I mean we have the resources to do it, and if we have those resources then it becomes a matter of how we administer those resources as to whether we accomplish those aims or not.

On the question of control of our environment, there is no particular reason why we cannot say that we are not going to let certain things happen fron now on, and we are going to prevent certain other things from going on. This is what I had in mind in talking about separating the functions of ownership, that we do not allow owners of property do what they please with them regardless of the social effects. Now, you can say that if we are too hard on this with respect to industries, the cost might be so great that we will lose markets abroad. Perhaps there are some limitations, but let us see what is the maximum extent to which we feel we can go, how quickly we can go there and then ensure that we do go there, rather than talking around the question. I do not say that the Government has taken no action in this area, and I think some of the moves of the federal and provincial governments are very good, but I still do not see the kind of bite that will really make the rather quick impact on the protection of our environment that I think is called for. These are only examples, Senator Grosart.

Senator Grosart: One of the reasons I asked the question was because we have had so much evidence that we are at the mercy of external forces, and these would appear to be technical in the economic sense. Are not the external forces the major technical reason why we cannot overcome these shortcomings as quickly as we would like?

Dr. Graham: Do these external forces compel us to take the sort of attitude we have with respect to development of our natural resource industries, where, with the kinds of incentives that we give for foreign exploitation of these, if Mr. Kierans' figures are correct, only 5 per cent of the income of the petroleum industry is taxed—that is, 5 per cent of the income which it shows for its own purposes—and only 13 per cent of the income of the metal industry, as compared to something like 90 per cent in the service industry?

This reflects a great concern that if we do not give away our resources no one will want our goodies. While I do think that we have to be concerned always about the maintenance of markets, and that we are getting advantages from international division of labour and comparative advantage in our exchange of goods for goods, then given the great demands of other countries, and given the great population increases that we can foresee—and these are things that are working now; we do not have to wait 100 years for them—it seems that we are in a very strong position and in a kind of panic about whether we are going to have markets for these goods; and we are prepared to let them go on what seems to me to be fantastically favourable terms to the outsider at considerable cost to Canadians.

Senator Grosart: Mr. Kierans' figures are highly disputed by the economists in the petroleum industry and extractive industries generally. Is it just this simple? Surely, it is not possible, socially or economically, to suggest to any Canadian company that is selling on the export market—even selling primary resources—"Don't sell them this year. The price is not good enough," or, "You are giving them away," when the whole labour force at the present time is dependent on these sales. Can you make this kind of long-term adjustment in an international market economy? How can you do it?

Dr. Graham: Senator Grosart, you are getting on to what I consider to be very important issues, and I am glad that you are raising these. For one thing, we are concerned not so much about whether we are producing goods for the domestic or foreign market. We want to produce them for all markets and have our resources fully and productively employed.

Incidentally, with respect to the question of economic integration and national independence, and so on, we should bear in mind that even if we had 100 per cent Canadian ownership of our industry, and the control that goes with it, we would still be dependent on foreign markets for a very large part of our development. This means that we will be subjected in some way to foreign control, since we want to maintain those markets. I am very much aware of this point.

Getting back to my original point, we have adopted policies—and this again ties in with Mr. Kierans' address, which is apropos a number of these things and is very topical—that emphasize and encourage expenditure on the investment side and particularly in capital intensive industries. As a result of these policies we have built up, apparently, a lot of excess capacity, which means that we run into high costs as soon as markets fail to support that capacity. It means that we have channeled through our own policy and tax structure resources into the investment side. We have encouraged this at considerable expense to the Canadian taxpayer; whereas we have rather neglected the kinds of things that are provided directly for consumers, which are goods and services which form part of our national development.

We might make ourselves a little less dependent externally if we were to look a little more towards the kinds of development that could take place internally, goods and services that could be produced internally in response to local consumer demand, and, indeed, public demand in the case of social capital which, as a society becomes more affluent, become more and more important—recreational, cultural and community facilities, and so on.

This is the direction in which I would like to look. You are quite right, Senator Grosart, that we cannot simply say, "Well, it would be very nice to be able to do this. We can do everything we want to." We have to have regard for the hard economic realities which this country faces. In making these statements, I can assure you that I am well aware of these difficulties.

While I do not think that we can move overnight to some of the kinds of things I have in mind, unless we think about them now, and think about what are the paths in order to achieve these goals, we will never get there.

Senator Grosart: You have placed quite a bit of emphasis in your thinking of the production of more social goods. Have there been any studies to indicate the relationship between the production of social goods and market goods? Is there any kind of ratio, inverse or otherwise?

Dr. Graham: There has been a great deal of theoretical work on the theory of public goods, which in its way, has been very good work. One thing that is lacking is something that would give objective guides as to where the balance ought to be struck between the private sector and the social sector at any given time. I think Professor Galbraith was right when he emphasized that there is generally a bias in our system against public goods.

Senator Grosart: I wonder if that is so. Let us take a country such as Canada. Our highways, hospitals, schools, transportation, airlines, et cetera, are all social goods, and I think the level is extremely high in Canada. There is also the CBC.

Dr. Graham: We have many social goods, it is true. However, if you look at any large city, or one that is not so large, and see the almost intolerable conditions under which people live, while at the same time they may be very well supplied with durable use consumer goods—this is a subjective point of view—I think there is a bias against public goods generally. Certainly, when the individual is faced with whether he is going to be free to dispose of his income to buy a refrigerator, a washing machine, a holiday, or whatever, he prefers to have his income to do that: whereas when it comes to public goods he estimates a compulsory payment in the form of a tax to provide these, where he receives no *quid pro quo* for them.

There are offsets to this, such as the desire of Government to be popular. They try to provide public goods which are popular. Against that, however, they try to avoid imposing additional taxes in order to increase the public goods. In my opinion those two largely cancel one another out.

Senator Grosart: Perhaps you are saying that there is more than one kind of social goods. For example, your preference for the CBC without advertising over coloured television sets would be a case in point. The public might say they like the advertising, which I think you consider to be too degrading.

Dr. Graham: There are many examples. Another is the red carpet facilities at certain airports, by which passengers walk directly into the airport. It is a rather expensive proposition to provide that facility for every aircraft. This is pleasant on a stormy day, but these resources could be used to provide decent housing for more Canadians. This is a choice which does not come up in our present framework. I think we could have the choice without losing too much individual freedom.

Senator Grosart: Surely, this choice is now made every day by the Cabinet and ministers? They are really consciously making this choice.

The airline apparatus you speak of may have nothing to do with comfort; it may be just to speed up the loading of that plane, which in itself may be a social good.

Dr. Graham: That is as may be, although in my experience it slows down the loading, because there is one exit rather than two for these planes.

Senator Grosart: I do not know the reason for it. I ask these questions because it seems to be germane to this whole problem of what to do about what the economists now term growth cycles, rather than cyclical recessions, and so on, which seem to have been narrowed down from about 40 to 50 months, classically, to something like 10 to 11 months at present. It is the speed-up time in the growth cycles. There seems to be a good deal of "stop-go" criticism of this very point, the decision of a government to attempt to alleviate unemployment by investment in what you would term social goods. Do you disapprove of this as a methodology for dealing with these growth and slow-down cycles?

Dr. Graham: Senator Grosart, I am not quite sure that I have the full point of your question.

Senator Grosart: Let us say public works spending, which is a generic term embracing many other things.

Dr. Graham: I agree that this is an appropriate instrument of fiscal policy. I am glad you mentioned the stop-go question; I do have the statement on page 10, which I would rather like to qualify:

> I should add just as I agree that we should not persist in stop-go fiscal and monetary policies for the nation as a whole, we should plan continuity in policies and programmes to alleviate long-term regional unemployment and underemployment.

I certainly stand by the last part of this, continuity in policies and programs to alleviate long-term structural maladjustments in the economy. However, with respect to the stop-go, I am not so sure.

It is true that there may be areas where we simply do not have enough information to adjust these policies finely enough to be sure that we are adjusting them in the right manner. There is also the problem of lags, which you have no doubt heard of at these hearings. We might have a policy which is appropriate at one point but which, once it starts, no longer has an appropriate effect.

I agree with all this,but I do not quite go along with the notion with respect to monetary policy—for instance, the position of Professor Friedman, that we simply allow a 4 per cent increase in our money supply, assuming that is our expected rate of growth, and not interfere with it. A case in point is my earlier illustration of our receiving capital inflows which are not only embarrassing because of their effect on our exchange rate, but have undesirable effects with respect to our institutional borrowers and selling equity to foreigners. In that case we should use monetary policy to influence the interest rates in order to correct this situation.

The same thing applies to fiscal policy. To say that we no longer make adjustments in these measures is to give up the ghost and say we just stopped trying to guide our economy in a sensible direction.

Senator Laird: One segment of Canadian society seems frightfully important to me. However, most of our witnesses either ignore or say little with respect to it. It consists of those who have been thrifty and by that means have put themselves on a fixed income basis. I think not only in terms of the hardship created to them by inflation, but of the sociological effect of the proposed society on them.

In other words, most of the witnesses have recommended accelerating the rate of old age pensions, which are social welfare payments. What should we do with respect to those I have mentioned?

Dr. Graham: That is an important point. As a matter of fact, at a meeting last night I was discussing this very point with a colleague. He maintained that perhaps we are somewhat cavalier in saying that we can live with a fairly high rate of inflation. We either do not know or do not take into account the distributional effect of inflation such as in the segment of society you mention.

I was also aware of this in writing these remarks. Certain groups of society, such as old age pensioners and other recipients of welfare payments over which the Government has direct control, can be protected. However, what should we do with respect to other types of fixed income? There is both the income effect and, as you say, a broader effect on their general attitude towards saving. Generally this country has had a remarkably high rate of saving. It has been channelled perhaps rather conservatively, but it is certainly not that we have had a low rate of saving. Does continuous inflation not have the effect of people saying, "Why bother saving?" and attaching more importance to present than future consumption? In my opinion, we should be concerned with regard to the social and ethical aspects of this.

I do not believe there is very much evidence that in fact inflation has discouraged saving. This comment does not apply to people who are committed to fixed income security and feel they cannot get out of it. It is partly because inflation is built into the interest rate. Certain inflationary increases are allowed for, plus the real rate of return on investment.

I am afraid I do not have a very good answer to a very good question. It would be very difficult to allow for escalation in all fixed incomes out of the public purse. It is something that could be looked at, but offhand I would say it is probably not something anybody would want to get into. This serves at the very least to suggest that this is one reason why we should be concerned about inflation and not simply write it off as something that we can live with. I believe it is still a much lesser evil, by and large, than unemployment; it is a lesser evil for the housewife to go to the grocery store and find that prices have gone up than for her to want to go there but be unable to because her husband has no pay cheques to go there with. That does not mean you write off the social effects of inflation, of which there are many. This is a very unsatisfactory answer to an important question. I am sorry, senator.

Senator Molson: Dr. Graham, and as a matter of fact other witnesses, have mentioned the fact that we could adjust the old age pensions of those who suffer from inflation, but nobody has mentioned the pensions of the private sector. There are great many thousands of people who would come under that heading. I do not know how the government would be able to supplement pensions other than those under the Canada Pension and Quebec Pension Plans.

Dr. Graham: I think the remarks I just made in response to Senator Laird apply in large measure here. I certainly had this in mind when I gave my answer. This is overcome in some measure by modern pension schemes, where the pension is at least based on the earnings in the last few years of the pensioned person, but that does not take care of subsequent increases in the price level. I do not think it is beyond the bounds of practical possibility to consider even allowing for a public adjustment to this kind of income, with certain ceilings, depending upon the size of the pension we are talking about.

I think, too, as far as the lower levels of incomes is concerned, if we had a guaranteed annual income it would presumably also be adjusted with increases in the price levels. But then there would be groups that are above this, middle-class people, who are probably the

hardest working people in society in many ways, at least some of them are, who have worked very hard throughout their lives to attempt to maintain a comfortable position on retirement, and I would not want to see this group altogether ignored.

Senator Manning: If I may pursue this one stage further, I would appreciate your comments on another group. If old age pensions or other social welfare payments are adjusted to offset inflationary price increases, whenever that takes place you create a situation where the income of those people equals, or in some cases exceeds, the earned income of a considerable sector of the low income wage earners. This is one of the constant problems that governments have, as you appreciate, because you then create a situation where the man who is working is earning less than his neighbour on some form of pension or social welfare. If you start adjusting pensions or social welfare payments to offset inflation and the other man's income is not adjusted—many of whom are the unorganized people in labour, so they do not get the significant increases to offset inflation—you then create a situation where it is financially advantageous for these people to quit work and go on welfare. Of course, it is happening all the time. Do you have any thoughts on that? Wherever you set these figures there will be a borderline set of cases.

Dr. Graham: That is correct.

Senator Manning: This group is getting larger all the time. I wondered if you had any thoughts on how that might be taken care of if you are going to adjust the payments.

Dr. Graham: I do not think I have anything very useful to say on that, except to agree that it is a real problem. There are others who have done a good deal of work on this kind of problem with the guaranteed annual income, which I certainly have not worked on particularly. All sorts of suggestions have been made, such as that people who are able to work are not given benefits if there are jobs available for them. There are obvious difficulties with that. If you adopt the position that everyone should have a minimum income, I think you get into grave difficulties with that kind of thing. All I can say is that I agree it is a problem. It is the kind of thing I had in mind when I said there is the incentives issue related to the guaranteed minimum income, and the related points you make, which would be tied in with the guaranteed minimum income, anyhow of old age pensions and so on, because if there were a guaranteed income you would do away with things like old age pensions, which would be taken care of, and you would be moving to this new kind of system. Even if we are left with our present one you would have this difficulty, not with respect to the old age pensioner so much...

Senator Manning: It is more social welfare.

Dr. Graham: There is competition there. With social welfare payments you certainly would have. There are parts of this country where people call this, not unemployment insurance, but employment insurance; it is insurance against having to be employed. We are always faced with inevitable abuses of this kind of scheme, no matter how supportable it is on general social grounds, and it has serious economic effects that cannot be overlooked. I am sorry, but I have nothing helpful to say on this.

Senator Manning: Perhaps this is pursuing the same thing further, but one of the things that has complicated this is that, of necessity, all forms of social welfare have to take into account the number of dependants, for example, in a family. Very often you end up with the sort of situation that I have seen many times in government, where a couple on welfare with, say, eight children will have the welfare geared to the number of dependants, and their income is substantially higher than that of a childless couple who are working. This interjects the number of dependants factor affecting income coming into the home. It is hard to tell a fellow that just because he has no family his take-home income as a wage-earner should be substantially less than that of a couple on welfare simply because they have "X" number of dependants. All this will affect the annual income idea, too. After all, a guaranteed annual income is nothing more than another form of social welfare. These are important factors. I wondered if anybody had dug through the problems that will arise in deciding who will qualify for the additional supplementary income on any basis of equity.

Dr. Graham: I believe this kind of thing has indeed been taken into account in the investigation of guaranteed annual income schemes. If you like, Senator Manning, I will try to dig up the sources of that information and send it along to you.

Senator Manning: I would appreciate that.

Dr. Graham: It is a very interesting and important point, but it is not one on which I personally have done any work.

Senator Smith: Mr. Chairman, I wonder if that information could be tabled with the committee, because there are some others of us who would be interested in seeing it.

The Chairman: Perhaps, Dr. Graham, you would send that to Mr. German, and it will be distributed to the committee.

Dr. Graham: Certainly, Mr. Chairman.

Senator Laird: As a supplementary thereto, I draw to your attention that you are not the only one who has suggested some sort of accelerator provision attached to social welfare payments like old age pensions. I want to ask you a simple question: Where do we get the extra money?

Senator Beaubien: From those who are still working.

Senator Laird: I should perhaps warn you that at least one answer I recall is that with inflation you will automatically get more taxation and you will not get an increase in tax rates. As far as I am concerned, it does not work out that way.

Dr. Graham: Certainly, our inflation has generated tremendous increases in public revenue. With our progressive tax structure, this certainly has been the result. I am not suggesting this is the source. Well, where do we get our revenue from? Taxes and borrowing.

Senator Laird: And are we not just at about the limit of taxation?

Dr. Graham: This is a question that, as a public finance man, always interests me. Senator, I have done quite a bit of work at the local government and property tax level and provincial-municipal relations in this economic administrative area.

Property owners are constantly crying about the rate of property tax. If you look at any province—the one I was looking at happened to be Nova Scotia—you find that there is a tremendous variation in the rate of property tax, and this is when it is measured on comparable terms, in terms of market value and not in terms of the assessed value, which can be very different. There is a tremendous variation in the rate of that tax. Yet you will find the squawking that comes from where the tax is lowest as great as from where it is highest.

This is, perhaps, begging the question, because there is presumably a point at which taxes become so high that they can, in some sense, be called too high and we can only say that they could not be raised. We can only say that they should not be raised, though, in that the extra sacrifice that is involved, that is required by the taxpayer, exceeds the extra benefit resulting from the expenditure of the tax.

Senator Laird: I think we have reached that stage.

Dr. Graham: I would say that if we are talking about this particular point of adjusting the rather small incomes that are received by the old age pensioners, and so on, to take account of inflationary increases, that the social benefit from that would have a very high value, probably, in relation to the marginal sacrifice having to be made to raise the additional revenues to do it. This is a subjective matter, however, and I do not say that my opinion is any better than that of anyone else on it.

Senator Inman: Dr. Graham, since you have been in the Maritimes for 22 years, I presume you have visited Prince Edward Island.

Dr. Graham: I have indeed, senator, and it was a great pleasure, I might say.

Senator Inman: It is a small province, as you know. During my adult years I have travelled every mile of it, on the highways, and sometimes the byways. However, what I am getting at is this. I cannot see that we have very much hard core poverty, such as we know in the larger urban centres. Our farmers have to import labour to help gather their crops, such as potatoes, while we have a tremendous number of people on welfare. Do you think that we have too much welfare in a province such as ours?

We have a trial going on there now, rather a sad affair. This man who administers the welfare in one of the counties is just up for confiscating over $50,000 of welfare money in a matter of 18 months.

Do you think we have too much welfare? And why are not some of these people put to work, instead of importing people? That is one of my questions. What do you think our government could do about that, without getting its head knocked off at the next election?

Senator Beaubien: That is always important.

Senator Molson: That is the key note.

Dr. Graham: This is a very good question. One hears a lot about the changing work ethic in a very affluent sort of society, where you can attach a lot less importance to work and being employed than we have been accustomed to do. My own view is that we are still a very long way from that position. There are just too many things that need to be done before we can talk in those terms. Anyhow, getting back to the context of Prince Edward Island, it does not apply there by any stretch of the imagination.

I do not know that I have anything helpful to say on this. I can express a personal view, that people who are able to work should be required to work. I have heard the view expressed, in areas of the country—you find this in any province where you have communities, particularly semi-rural communities, where people are not particularly wanting to have full-time employment, and they like a rather leisurely pace of life and they are prepared to work part of the year, and that is all right.

I think this is just fine, as long as they are doing this on their own. As soon as they do it at public expense, depending on social assistance of one sort or another, then it ceases to be what it would otherwise be, quite an admirable choice, and it becomes a parasitic kind of thing, where one is doing this at the expense of other members of the community who are working themselves.

I guess I take a rather puritanical view of this one. I would not mind seeing some kind of effort made to see that people who are employable, where there are jobs available, are required to take those jobs in order to get social assistance. But this is a statement that I make with the greatest hesitation, because there are terrible opportunities for abuse of this notion. While my sentiments are rather that way, I would be very wary about getting into this. Also, one has to try to determine whether the abuses are wholesale or whether they are rather peripheral and occasional. If they are peripheral, I think you can do a lot more harm by trying to eliminate these, by ruining an otherwise socially well conceived scheme, than by putting up with a certain amount of this. In almost any program, you have some abuse. If the abuse is a wholesale, general one in an area or in society, then it does become a matter of concern.

Senator Inman: I would like to see the whole system of welfare revamped, but, of course, I do not know what can be done. I have another question, Dr. Graham. Of course, the Maritimes is considered a depressed area, and Prince Edward Island very depressed. I do not go along with that. One old chap was asked at a church tea, "Why do they say there is so much poverty in Prince Edward

Island? Do you think there is?" "No," he replied, "there is not, but don't tell Ottawa that!"

As to my other question, on importing labour, a farmer has to pay the transportation to and from, which costs him quite a bit of money. I do not approve too much of high subsidies, but do you think higher subsidies would help the situation in the economy, or would it just escalate the problem more?

Dr. Graham: I am sorry, senator—higher subsidies to?

Senator Inman: To farmers, let us say, like subsidizing the wheat in the west, say subsidizing potatoes in our province—which is the biggest produce, after fish, perhaps.

Dr. Graham: I think these kinds of subsidies are extremely irrational as long-term measures. I do not think they can be defended. However, they may be good to take care of short-term catastrophic events, such as a series of crop failures.

However, this is a political area, is it not? These decisions are not made on rational, economic grounds. Ultimately, all policy decisions are political ones. As an economist I recognize that the economic factor is not the most important factor in many cases, and I feel my duty as an economist is to attempt to point out what the economic implications are. The economic implications of that sort of program would be to encourage very inefficient utilization of this country's resources.

Senator McGrand: Dr. Graham, I should like to quote one sentence out of a rather lengthy paragraph on page 4 of your brief:

> Not only does our relatively good price performance negate this argument; but even if our prices were rising more rapidly than most of our competitors, we could be protected from a rise of relative prices by automatic compensatory movements in the foreign exchange rate.

Perhaps the question is out of context, but I get the impression from what I have just quoted to you that the cost of production of goods in Canada is comparable to the rise of costs in other countries and that we would still be in a competitive position so far as the cost is concerned without relying on the use of foreign exchange movements.

Dr. Graham: That is correct, senator. Generally in the post-war period, and certainly in recent years, in spite of fairly rapidly-rising prices in Canada our prices were still not rising as rapidly as they were in most of the other countries with whom we have trade. Of course, if they are rising even less rapidly than they were, our competitive position, given a fixed exchange rate, for example, would be even better. But what I am saying, really, is that this talk about Canada pricing itself out of the market is not actually in accord with the facts. It is certainly not in accord with our trade experience over this period, which was remarkably strong as we all know.

Senator Molson: Mr. Chairman, with respect to "pricing ourselves out of the market," we often hear the thought expressed that we might price ourselves out of the export market. That may be perfectly true and it would be of unquestioned importance for Canada, with its high proportion of export business, not to do so; but it seems to me that the effect of some of the things we have discussed from time to time would be to price us out of our own domestic markets. There would be competition with imports. We should not think solely in terms of doing things that would put us out of the export market. These matters should be discussed in terms of our overall markets, whether they be domestic or export.

Senator Beaubien: Such as textiles.

Senator Molson: I should like to ask Dr. Graham if what I am saying is pure heresy or if it is reasonable. What is his view?

Dr. Graham: Senator Molson, I am not sure whether I agree or disagree because I am not quite sure what you have in mind about our pricing ourselves out of our own markets. If I am wrong, correct me, but I presume you are talking about imported goods becoming relatively more attractive as our own prices rise. Is that what you have in mind?

The Chairman: No. As the exchange rate increases the imported goods become less expensive.

Senator Molson: Dr. Graham, a little earlier you were talking about environment and you said that if enough limitations were placed on it it could affect our ability to compete in our markets abroad. I suggest to you that it would affect our ability to compete in our markets in Canada.

Dr. Graham: Yes.

Senator Molson: In terms of markets we should be thinking of the overall picture.

Dr. Graham: We should be thinking in a global sense about this, yes. That is true.

If you were talking about the appreciation of the exchange rate, then this of course makes foreign goods more attractive relative to our own goods as well. That is the whole idea. This is appropriate when demand pressures are strong, because then you have presumably enough pressure to generate demand for goods domestically and you want to take some of that heat off by directing some of the demand to imported goods.

But if your inflation is of a different sort, if it is more of the cost-push variety, then this will not be appropriate. You may be encouraging the importing of goods where demand pressures supporting domestic markets are not that strong. You simply have to ask what the situation is in fact in a given case in order to help determine what to do.

Senator Beaubien: Dr. Graham, you were talking about the mining industry or extraction industry prospering at the expense of the taxpayer. Look at what has happened at Seven Islands in the last 20 years. I suppose you could

set up some books in which you could figure out that they should pay regularly 53 per cent of their taxable income instead of paying something that I would say is in the neighbourhood of 32 per cent, but which Mr. Kierans puts at 17 per cent. You should see the amount of revenue that that whole development has generated for Canada. It is just unbelievable. Do you think we could have attracted that development? Do you think anybody would have built a railway 365 miles through the most terrible terrain in the world in order to bring out a large quantity of iron ore unless there was some assurance of making a very good profit? Do you think you could have got the money in Canada? If you do think so, why would somebody not put up the $600 million they are spending right now just to increase their output? Do you think they could find that in Canada? I find it very hard to see.

Dr. Graham: On that last point, senator, it is very interesting that as recently as 1968, or thereabouts, out of the over $2 billion that was invested in expansion and new industry by foreign-controlled firms of this country, all but something in the order of $100-plus million was generated internally. That suggests that there is great scope for internal financing of much of our development. Of course, the point here, which I do not want to belabour, since it gets us into another issue, is that a good deal of the increase in foreign control is being internally financed in the country. This is another issue I do not know we want to get into here.

On the first part of your question, of course, I do not know and you would not expect me to know, I am sure, whether that development in Seven Islands would have taken place without the kind of depletion allowances that are permitted. We do not know this for some of our other resource industries, and I think one of the dangers of this sort of argument is that although you can generalize about emphasizing the development of a particular kind of industry, where there is a great and growing persistent demand abroad, by subsidizing that development very heavily, you do have to look at it carefully.

Senator Beaubien: What do you mean by subsidizing it?

Dr. Graham: Through the non-neutrality in our tax system where we allow deductions of income before compilation of tax in a particular kind of industry that we do not allow in other kinds of industry. We are deliberately saying to investors, "Come and develop this kind of industry rather than that kind; come and develop our resource development industry rather than industries involving a higher degree of processing or industries on the service side."

Senator Beaubien: But there is a big difference in the risk element. In all these things there is a big risk element. We seem to forget that.

Dr. Graham: With all due respect, senator, we also forget there is a risk element in other lines of endeavour in this country too, and when you are working on the scale at which this kind of large company does, again, with all due respect, I think the risk element is very much overrated, particularly with the kind of opportunity that this kind of corporate organization has for distributing its risk. I am not objecting to some allowance for exploration and development costs and writing it off against income, but I think that on any rational grounds it is very difficult to defend the extent to which we have gone to support this kind of investment enterprise in this country.

Senator Manning: Dr. Graham, on this matter of our ability now to generate within Canada a greater part of the capital required for this type of industry, I would like your view on this point. If I may use the petroleum industry as an example, because I am more familiar with that in our part of Canada, for a period of almost 20 years in Alberta the actual capital investment in exploration and development of petroleum was about $360 million a year, roughly $1 million a day for 20 years. We are now talking about $7 billion altogether in that investment. My point is this. After all that has been done, we hear the statistics now saying that this industry can generate within Canada capital for further expansion. This may be quite true, and I am not disputing the statements that are made. But is this not rather misleading, because the only reason we can do that today is because of the fact that for 15 or 20 years we were bringing in foreign capital to the tune of $250 million to $300 million a year. This is never mentioned in the statements that I see about what they can do now. Now had we not had that foreign capital initially to build up that degree of development of that industry, it would be futile to talk today about that industry generating enough revenue to do the kind of capital development that is needed. I do not know if this applies to the iron ore industry, but I know it applies to the petroleum industry, which is the one usually quoted.

Dr. Graham: I think the point is well taken, Senator Manning, but I think the real question is whether we had to be as generous as we were to get this development. And whether even at the price of a slightly smaller development, say we had 10 per cent less, we would have been better off in not having subsidized this development to the extent we have. I know Alberta would have liked this very much, but I am thinking nationally, and perhaps even in the long run also of Alberta. This is a hypothetical question in a way, but it is one that perhaps could be answered by some one who has a lot more direct familiarity with that industry than I claim to have.

The Chairman: Then we could appeal to Senator Manning to answer it.

Dr. Graham: I would be very glad to hear Senator Manning on this.

Senator Hays: Dr. Graham, I would like your thoughts on minimum wages. Senator Manning brought up what I thought was an important point. The minimum wage is, say, $1.50 an hour and then he relates four or five children. In our province the minimum wage for welfare is about $3 an hour. A dollar and a half at five days a week amounts to $240 or $250 a month and there are very few of our welfare recipients who are not enjoying more money than this. Then apparently we have one-

third of our workers in Canada organized, working for their members, so we have rich workers and we have poor workers. Have you given any thought to a compulsory minimum wage which workers right across Canada should receive? You are so concerned about the unemployed, but with the social services we have and so on the unemployed are pretty well taken care of other than their dignity.

Dr. Graham: I cannot say that I have, except to this degree, and this is a rather peripheral way, perhaps, of answering your question. I have heard it argued that in the Atlantic provinces, for instance, all we are really concerned about is employment and not wage levels, and therefore we should not try to set minimum wages. We should let wages be driven down to their competitive level, and if we do this it makes the region attractive to industry because of lower labour costs, and then industrial development will come. I do not go along with that argument. It could incidentally lead to a lowering of the per capita income in relation to the rest of the country and increase regional disparities, but more than that the kind of industry that comes in in response to this is the one that can also get out very quickly. If your industrial development program is successful on this basis, as soon as you have something approaching full employment, wage rates go up, and costs go up. The employer no longer has the advantage of low costs, on which he may very well depend, and so he pulls out.

So, on both counts—one, because you are saying that the region ought not to condemn itself to a low per capita income structure, and the other, that the program would be self-defeating, in any case—I reject that sort of solution.

This does not meet your question head on. What we do when we establish a minimum wage is to say, "All right, we in this country are not interested in supporting activities which cannot at least pay this level of wage, and ones that cannot do so should go out of business." This is a social position which presumably is related to some idea of what the poverty line is and what the economic income should be.

I think that, having a minimum wage—and the level of the minimum wage has been fairly low, really, related to living costs—it does put pressure on employers to develop more efficient operations so that they can pay that wage, and it discourages rather low productivity kinds of venture. Beyond that I do not think I have anything to say.

Senator Hays: What do you feel should be the minimum across Canada?

Dr. Graham: I would be inclined to accept the Economic Council's figure for the minimum annual wage, which is, I think, $2,400 for a single person.

The Chairman: I think it was $1,800.

Dr. D. L. McQueen (Study Consultant): I think that has to be escalated a little further, with subsequent increases in the cost of living. It would be above $1,800 for a single person.

Senator Hays: When Mr. Gibson appeared before us, he indicated that the Economic Council, in a study it had done some time in the early 'sixties, predicted that between 1965 and 1975 Canada would have 50 per cent more people coming into the work force than any other developed country, with the exception of the United States which would have 30 per cent.

In 1970 this prediction was pretty well right on target, which would indicate that we have 50 per cent more than most developed countries with the exception of the United States. With our unemployment rate up so high now, what do you think we could have done, having known this, to take care of the situation, which was a unique situation in the world of developed countries? Do you have any figures to indicate what percentage of the total amount relates to this figure of 50 per cent more than other developed countries coming into the work force?

Dr. Graham: I do not have these figures, but as I recall, I think your statement of the order of magnitude is quite correct.

There are two kinds of things that come to mind. This was something that was very predictable. We knew what our population age groups were, how quickly they were moving through the educational system, and so on. We might have emphasized the development of labour-intensive industries rather more than we have done. I mentioned biases in our tax system which had emphasized the development of capital-intensive industries. There is something in this argument.

You ask what I would have done. I would have considered the social priorities we wished to establish and observed many major steps that needed to be taken. This would include urban renewal, environmental control and the development of recreational and cultural facilities. Since one of our great problems has been to adjust the supply side to demand pressure so that there is actually employment available, I would have attempted to channel a great deal of this new labour force into these areas of occupation where the social priorities are very high. In order to attempt to absorb enormous increases in the labour force, I would have made some attempts to train and channel them into providing these extremely important services.

Senator Hays: Could you give a few examples of these particular areas?

Dr. Graham: I think of the whole question of providing decent housing; urban renewal; proper community planning, which would include such major considerations, and this is very important, as proper sewage and sewage treatment facilities. That is mentioning but a few.

Senator Hays: How would you persuade PhDs to work in a sewer?

Dr. Graham: Are we discussing PhDs?

Senator Hays: Forty-five per cent of this group of unemployed are between the ages of 15 and 24 years. They are a highly educated group, apparently.

Dr. Graham: Yes, Senator Hays, but in any one of these projects there exists a hierarchy of skills, such as the natural scientist, the social scientist and the engineer, ranging down to the relatively unskilled worker.

One of the problems, inevitably, is to arrive at a proper match in the distribution of skills and labour opportunities. We have attempted to see that there was some system of matching to the types of jobs that needed to be done.

These are long range problems, which will be worked on for generations to come. I do not consider this to be a complete answer to your question, but you asked if I could think of any steps that might have been taken in anticipation. I think this is one quite major step that could very well have been taken and still could be.

Senator Kinnear: The unemployment situation is, and for a long time has been, my great concern. Do you consider the shorter work week and longer vacation could help alleviate this unemployment situation?

You enumerated some of the social steps you consider could be taken in housing, development of parks, and that sort of thing. Do you think we are lagging in starting new projects?

Senator Hays has observed that 45 per cent of the unemployed are very highly educated. I know that many PhDs are out of work and certainly do not need retraining; they should fit into any pattern. However, do the remainder need retraining in order to fit into the labour force, or should industry institute the shorter work week earlier?

Dr. Graham: I am not sure about the PhD; he is a highly specialized animal and I do not know how adaptable he is.

Senator Kinnear: We have found out from different witnesses and tables we have seen that there are many PhDs out of work in their own field.

Dr. Graham: I think this is true. I just question whether he is the sort of adaptable person that I believe you suggested.

Senator Kinnear: I agree with that for certain people.

Dr. Graham: That is very peripheral, however, to your question. Referring to the shorter work week, if incomes are to be maintained with a shorter work week, it means we are getting less work at the same cost.

Senator Kinnear: I understand people do not spend much more than 50 per cent of their time at work anyway.

Dr. Graham: So you are saying, if that were true, we would get twice as much work from having two shifts, unless the people who work half the shifts still only worked half the time they were there. What I am getting at is that there is a problem of cost, if we think of our international competitive position, whether we can afford this as a jump. We are probably moving towards a shorter work week sooner or later, with people working half a week. As a solution to short term unemployment I do not expect we could jump into this by paying people roughly their same incomes for half the amount of work, because one can immediately see the effect it would have on costs and our competitive position, in both the domestic and foreign markets. I do not really see this as a solution to short term unemployment.

Senator Molson: Might it not increase unemployment because of moonlighting, which is a very common practice in today's work week?

Dr. Graham: If you doubled the number of positions you would at the same time increase the opportunity for moonlighting. You would give people an opportunity to earn a higher income.

Senator Kinnear: Probably that question should be asked by the employer, if the man has two jobs, so as to try to get rid of this high hard core of unemployment, which is a great source of worry to most people in Canada.

Dr. Graham: I think, though, one of the problems here is one raised earlier by Senator Hays, of the rather low minimum wage in some occupations, so that in order to do a little bit better than from being on welfare they pretty well have to moonlight in order to earn a decent income to support a family.

Senator Kinnear: Would you call it moonlighting if they are on welfare and taking a job?

Dr. Graham: Perhaps one could use a stronger term for that Moonlighting would be a euphemism.

Senator Kinnear: I am from a highly industrial area where moonlighting was common at one time but is not now.

Dr. Graham: What you suggest is obviously cheating.

Senator Inman: I read the other day that one firm tried the shorter working week, and after a month or two the men asked to go back to the five-day week. They did not like the shorter working week. Some of them said their wives made them work too hard during the week and they were too tired to go back to work.

Senator Molson: I would like to go back to the early part of Dr. Graham's testimony and refer to regional monetary policy. He made an interesting suggestion that the Industrial Development Bank might make an experiment, particularly because the Industrial Development Bank does deal in most cases with small businesses, which is a very important factor. I am just wondering, if you carried that theory a little further, if we have not already got mechanisms in other spheres that could be applied. For example, we have export credit insurance. Why should we not have regional monetary insurance, or regional credit insurance? Why should not we encourage the provision of credit to those regions that are depressed or underdeveloped, in the same way as we encourage exports? Or, I was going to speak of loans to the Wheat Board, but they are at a very low rate of interest and I do not think we should go into that.

Senator Hays: It would make barley too cheap.

Senator Molson: Yes, there would be two prices.

Dr. Graham: Senator Molson, this is a most interesting suggestion. One thing I would like to consider more carefully is what element of subsidy is involved in differential interest rates and, if there is, if this is the best way of doing it.

I think the point is that if there is indeed a bias in the capital market, plus some imperfections in the capital market, this would be the main ground for having a subsidy. I would be very much in favour of looking at it in your way—which, as I understand it, rather supports the idea of this experiment with the Industrial Development Bank.

Senator Molson: It would be broader, really. The IDB would be subsidizing because it is public finance really and public funds.

Dr. Graham: I do not know whether the IDB operates at a loss or not. Of course, it depends on how you calculate it.

Senator Burchill: They operate at a very good profit, doctor.

Senator Molson: Capitalized.

Dr. Graham: I do not think the Industrial Development Bank should be operating at a profit, if it is doing its job.

Senator Smith: Hear, hear.

Senator Grosart: And at times, at fantastic interest rates.

Senator Manning: What I want to come back to is really the objective of this committee, as you appreciate, to try to make some meaningful recommendations to the Government of Canada on how these inflationary pressures might be contained, without creating as large a mass of unemployment and stifling economic growth.

It seems to me that this gets back to having to recommend some rather specific techniques. You mentioned several times today—and I think this is widely accepted—that this nation has the resources. We have the physical potential; certainly, we have a more desirable economic structure than we are enjoying today. I think one of the things lacking is political fortitude to do the things that need to be done. I would suggest that what is sometimes interpreted as lack of political fortitude is the practical problem that governments face in being certain that they have a technique or set of techniques which will be effective. Because their advisers are very similar to what we have found in this committee, a great deal of virgin opinion as to what is the best technique to use.

To boil all this down, what I am really asking you is: Having regard to our functions and our objectives as a committee, could you zero in on any specific techniques that we could profitably recommend to the Government of Canada, having regard to where we have to start from, the mess we are in today—and that is what we have to work our way out from, not to an ideal society, which you say we can never get to, but something that would be certainly better than what we have now? I am trying to get down to specifics rather than generalities.

Dr. Graham: Yes, Senator Manning. Even if we were able to define the sort of society we wanted, we probably would not be able to move to that very quickly. We would still have to deal with what our situation was at any given time.

I think that probably the major specific suggestion that I have made is the giving of a lot of attention to things that need doing in urban areas, and also to some extent in rural communities, in any case about which there can be very little doubt that we are not in many of these areas in danger of perpetuating something that would turn out not to be viable and not to continue, although it might require discrimination against some communities where there was not this sort of prospect, even making the greatest allowances for maintaining any community that has established itself, and so on.

There are great opportunities here for working, to some extent, through the provinces and through the municipalities to support all sorts of what would generally be agreed as worthwhile projects in the case of educational, recreational and cultural facilities. This would apply particularly in the areas where the unemployment is greatest. Where we are simply providing the necessary financial resources we have administrative structures which could get these funds moving quite quickly through the provinces to the municipalities; to some extent they could be used directly by the provinces.

I have been very much involved in this area, having taken part in the report that led to the reform of municipal government organization in New Brunswick. Just recently I have become chairman of a royal commission in Nova Scotia on education, public services and provincial-municipal relations. I have been involved in a study of educational finance in Newfoundland as well. We are quite clear about many of the kinds of things that need to be done, about which there would not be very much argument. Much of the structure is there and it just needs the funds to be fed into it.

This is the kind of investment that cannot help but support other kinds of investment that will strengthen the industrial base. The community becomes generally more attractive in that way, not only to the people living there but to any sort of industry that might want to expand there or consider moving there.

Incidentally, if I may refer back to a point made by Senator Inman, Senator Inman mentioned that there did not seem to be very much real poverty in Prince Edward Island. This does not apply to all areas of the Atlantic provinces or other parts of the country. Anybody who has been through northern New Brunswick, and other areas that I could mention, would know what poverty there really is there. There has been a development program there that has never really got off the ground, probably because of lack of funding. It seems to me that it was rather well conceived in building towards the development of an economic base as well as being a general face-lifting of the social capital of the area. This is the kind of thing that I would be inclined to look to.

We are getting into an area of fiscal policy, which is the most flexible sort of instrument we have. Our unemployment is always in particular areas. Taxation policy does not hit those particular areas awfully well, but fiscal policy can. It can be made just as regionally sensitive within provinces as we care to make it. I do not think that in this area, as in some other areas, the administrative skills that are required are so lacking.

Senator Manning: If I understand correctly what you have said, this involves a rather massive expansion of public expenditures or expenditures in the public sector, which means a period of perhaps rather heavy deficit financing and so on. Would you have any views as to specific measures to stimulate the private sector such as the merits of tax reductions or tax adjustments to create stimulus to the private sector?

Dr. Graham: I would be in favour of tax reductions as a measure that would work quite quickly, but I think that the kind of measure I suggest would have a tremendous impact on the private sector. And looking ahead, as we become more and more affluent in spite of our present problems, it is going to become more and more important to concentrate on how people are going to occupy themselves. I do not think that having all sorts of little hobbies and making wooden objects in a workshop is the kind of thing that is going to take care of that situation. I think we need to increase vastly our recreational and cultural facilities. For example, the cultivation of music in schools, which is often regarded as simply a frill, I would regard as being one of the most important kinds of thing we can do for people to give them something that is of real value in their lives and from which they can get real pleasure. In promoting this I am looking ahead to see what kind of society we expect to have in the next 25 years, and this is certainly the view I am taking with respect to this royal commission which I mentioned. Let us ask what kind of facilities a community ought to have to provide a good life for the people in it and to take account of the changing life styles we can expect to see. I think it does not take a great deal of looking into the future to see some kind of things that can be done that will help to sustain and support the kind of society that we will see in the future, and that can be done quite quickly.

The Chairman: I wonder if I could ask a supplementary to your question, Senator Manning? In connection with the question that Senator Manning has asked and following on from Senator Laird's previous question as to the financing of this initiative, should we, in your judgment, be making better use of what I will call "consumption taxes" in Canada? Here I am thinking of sales taxes and value-added taxes, with appropriate reductions for those items that are necessities or that are consumed by the broadest number of Canadians, and with a higher rate on those items that could be considered luxuries. Would we be better able to stabilize our economy and achieve the objectives you are talking about by the greater use of such taxes?

Dr. Graham: I think this has real possibilities. Although I am not particularly enamoured of the value-added tax which is an alternative to a retail sales tax, except that you are getting smaller bites along the way rather than one big bite, I think it might be more acceptable on that basis. But I think that although the sales tax is often regarded as a regressive tax, with the kind of exemptions which we generally have for it, it does not stand up too badly in this respect. I do not think that you can look simply at the tax side in any case; you have to look at the balance between the benefits and the tax burden which the taxpayer is experiencing. If you find that those who are in a large measure paying the tax, which will be those in the lower and medium income groups, are also getting very substantial benefits, perhaps more than in proportion to their contribution of these taxes, on balance, taking both the tax burdens and the benefits from expenditures into account, you have what is really a progressive element in your fiscal structure, rather than what is generally regarded as a regressive one.

The Chairman: Especially if you have goods exemptions.

Dr. Graham: If you have not too many exemptions, except for food and a few major basic ones of this sort, then I think by that means you take care of much of the regressivity. I think that Carter was on the right track when he suggested that this is a kind of tax which might eventually be left to the provinces, which the major income taxes, or at least a reasonably large share of them, being kept by the federal Government.

There is a problem of too much transfer of these taxes to the provinces at the expense of the kind of control over fiscal policy which I think the federal Government needs to have. I think it has enough for the moment, but if you had too much more transfered, then that control might be eroded.

There are some opportunities for the use of fiscal policy through expenditure taxes, but I do not think they lend themselves quite so readily as do the income taxes. However, there is some merit in this.

The Chairman: Yesterday Dr. Wilson indicated that in his econometric study, if you could be assured that the reduction in sales tax would be passed on, the effects on growth, employment and inflation—the price level—would be greater than for a corresponding reduction in income taxes.

Dr. Graham: Yes, because there is a more direct impact on consumption. The problem there, as Professor Wilson probably pointed out, is that prices are very sticky in the downward direction, and that would eliminate the lowering of the sales tax.

The Chairman: He thought that might be a function for the Prices and Incomes Commission.

Dr. Graham: What your question leads to is that income taxes are already quite high and they are paid very heavily by the middle income groups. Since this is the group upon which the maintenance of society depends in very large measure, this raises a broader social question, as to whether people want to go on

working their hearts out in this group, which in many respects consists of the leaders and sustainers of society, and whether there is not a real danger of impairing the incentives of this group. If there is, then this, in itself, is an added argument for looking towards somewhat higher consumption taxes as an alternative to higher personal income taxes.

Senator Smith: I hesitate to reopen a subject which was touched on earlier this morning, particularly in view of the fact that I am not a member of the committee. However, I would like to make a few comments with regard to the place of the growth centre concept in regional development. I know that Dr. Graham has done work in this area.

As a background to my question, let me point out that the provincial governments in general in the Atlantic area, and in the Province of Nova Scotia in particular, had been urging the federal Government to recognize the need for extending the incentives program for industrial development to some of the urban areas. It is only in the last few years that the federal Government yielded, and they have now entered into that. It has brought some disparities along with whatever benefits it might bring, and it is disturbing to those of us who live in other parts of the province that some federal grants are now going to such things as the building of both secondary and high schools. In a situation in which investigation reveals that comparable homes in the city of Halifax are paying less taxes to their municipality than are paid in some of the small hamlets, I ask is it all worth while? Will this work out to the general advantage of the whole region?

Dr. Graham: Yes, Senator Smith. On your very last point, I know this is not central to your question, but it must be borne in mind that property values are exceptionally high in Halifax.

Senator Smith: I am speaking of dollars of taxes paid. I have made a personal investigation and find that I pay more than my friends.

Dr. Graham: I am certainly aware of some of these calculations.

Returning to your main point, the theory of the growth centre approach, to which I in part subscribe, is that if we are to achieve industrial development in an area such as the Maritimes in the field, for instance, of secondary manufacturing, which does not have all that much going for it, there is a very strong tendency on the part of firms to favour large centres, such as Toronto and Montreal.

Although Professor Roy George's study on industrial location indicates a preference of firms to locate in Ontario and Quebec rather than Nova Scotia, the advantages are, if anything, very marginal. However, there are non-economic factors that lead them there. Although in the case of many industries the economic advantage of locating close to a large metropolitan market is no doubt important, the theory of the growth centre, particularly with respect to an area such as Halifax-Dartmouth, is that if there is to be any major generation of economic development there must exist something approaching a decent metropolitan area which will provide the necessary labour market and ancillary services.

This will also cause many, to use the economist's term, linkages with respect to other communities and areas in the Atlantic provinces which, by virtue of this development will find other things will become possible. These other areas will then be served by the services, industries, machines and trades developed in the Halifax-Dartmouth area.

I do believe that there is a strong argument. This is the closest we have to a metropolitan centre in the Atlantic provinces. It is very small indeed compared with many other cities in Canada. However, there are great advantages to developing and making it a really viable metropolitan area. It is not a bad thing for DREE to put money into infrastructure and, indeed, schools, if it is going further than that and developing a rational framework for development in that region.

With respect to the last point, I have been unable to obtain any assurance from DREE officials that they are doing this.

Senator Smith: That they are what?

Dr. Graham: Attempting to develop a rational framework for economic planning in the Atlantic provinces rather than simply taking steps that are more or less acceptable now and need to be done.

Therefore, although I think the concentration of growth and growth centres is partly an act of faith, seems to be a sensible thing to do and, in part, is supported by fairly strong arguments, on balance this is where the present push should be made.

Then we come to the second point, that if we have a clear notion of what the potential for development is in the region and a rational structure for planning that development, it will take into account potential of the other communities in the area to relate to this overall scheme. I would be a bit concerned about too great a preoccupation with the growth centre approach, but I think that that in itself, as a part of the story, is one that should be given high priority initially; and I would support it.

Senator Smith: I begin to have some more serious doubts about the effectiveness of the concept when I note that the Michelin Tyre Company, for example, chose to go into two relatively small townships in my province, one in my area and one in Pictou County. They are both labour intensive, and I must make the assumption that they looked in those particular areas and saw other allied industries that were potential suppliers of trained labour. They looked at the vocational schools situation, at the basis, in one instance, of the fishery industry, and of the pulp and paper industry, with their great experience. It must have looked really good to them. If Halifax looks better, why did not Michelin go to Halifax and take advantage of this growth concept?

Dr. Graham: Halifax would not look better to all industry. Of course, there are some that will prefer a location elsewhere, and this is fine. I certainly would not argue for putting everything into Halifax.

Senator Smith: I do not expect you to comment too much on this, but I am also worried about the acceptance of a trend that has been forecast, not too many years from now, which will result in seven or eight million people living in Toronto, another six or seven million in Montreal, another three million in Vancouver. I do not want to see Halifax become another semi- or potential Montreal metropolitan area, when there is a better way of people living their lives.

Dr. Graham: I completely agree. I think the Maritimes have a tremendous amount going for them as people get fed up with being trapped in these places. I could not agree more.

Senator Smith: Thank you very much.

The Chairman: I would like to thank honourable senators for their questions. On their behalf I would like to thank you, Dr. Graham. You have given us a very useful over-view. As I said at the beginning of your testimony, this committee is very interested in the regional aspect of monetary and fiscal policy and stabilization policies generally. Your thoughts on this will be most worth while. Thank you very much.

Dr. Graham: Thank you very much, Mr. Chairman. I would like to say again how very pleased I am to have had this opportunity of meeting with you, and how wholeheartedly I support the initiative that the committee has taken.

The Chairman: We appreciate that greatly.

The committee adjourned.

Upon resuming at 4 p.m.

The Chairman: We will resume our hearings. I should mention to our guest that the number of senators present will increase markedly as time goes on. There is a debate on the rules taking place in the Senate at the present time.

Honourable senators, I would like to introduce to you Dr. André Raynauld, Professor in the Department of Economics, University of Montreal. He received his doctorate from the University of Paris. Dr. Raynauld has very wide experience in the field of economics, and he is of particular interest to this committee because he is going to talk to us about regional growth and the regionalization of monetary policy, an area in respect to which there is a great deal of disagreement as to its workability and one in which we, as a committee, have to concern ourselves, to a great extent. I shall now turn the meeting over to Dr. Raynauld. You have his paper before you, and I will ask him if he will review it with us.

[*Translation*]

Dr. André Raynauld, Professor, Department of Economics, University of Montreal: Mr. Chairman, Honourable Senators, it gives me great pleasure to come and speak to you this afternoon. I greatly appreciate your inviting me to participate in your important hearings. I shall try in a few words to present to you the basic facts of the brief in front of you.

The first point that I would like to raise concerns the nature of regional disparities. In my opinion, we speak of regional disparities in too general terms. Regional disparities take various forms and these various aspects should not be treated in the same way. In particular, I am referring to the disparities which can be described as disparities in income, on the one hand, and disparities in unemployment on the other.

These two categories of disparities should be kept apart because the first really relates to considerations regarding general economic development, to structural phenomena, for example, the demography of the people concerned, whereas disparities in unemployment depend on the situation, are short-term problems and such disparities can be alleviated through stabilization policies.

Since the terms of reference of this committee relate mainly to economic stabilization, I thought it advisable to point out the disparities in unemployment; contrary to what is generally put forward, disparities in unemployment can be lessened by policies which will stimulate overall demand in the various regions of the country. In other words, unemployment is not necessarily structural in nature, and one should not await the end of the world before giving thought to reducing it.

To show that this unemployment is due largely to the existing situation, there are very few studies, but one to which I refer in my text shows that the variations in unemployment are of comparable scope throughout all regions of the country so that when unemployment increases across the country it increases in the main regions of the country and, inversely, if unemployment increases in a region, it is because unemployment is increasing generally throughout the country. Therefore, there is a very close relationship between the variations in the unemployment rate from one region to another. Until now, emphasis has always been placed on the differences between unemployment rates. Great stress has been placed on the fact that in the Atlantic Provinces, for example, the unemployment rate may practically always be three per cent higher, for example, than the national average. Similarly in Quebec, the custom is to stress mainly the differences in the levels of unemployment and usually this is done in terms of the Province of Ontario, and we observe that such disparities have been relatively constant through time, and that they range from two to three per cent.

Moreover, this disparity has increased by one per cent during the sixties. Thus, disparities have been stressed during the sixties. Because unemployment has been presented in this way, the conclusion is generally drawn that such disparities were of a structural nature and that unemployment could not be reduced in the depressed provinces, so to speak, of the country, by stabilization policies. On the contrary, when this problem is raised, we fall back on manpower policies, on changes in the industrial structure. Obviously such disparities are explained also by the differences in the level of training of the labour force, and so on.

On the other hand, if unemployment rates vary similarly from one region to another, for me, this is an indication that when we take two years and when we

compare unemployment, in one province, and when we observe that in the first period, during the first year, let us say, I am taking 1956, and when we find that the unemployment rate in the Province of Quebec was let us say, three per cent and when we find that in 1971 the unemployment rate was eight per cent, we forget that this unemployment rate could perhaps be reduced from eight to three per cent if, in the past, we were able to do so during a period of economic expansion. If this is true, it means that unemployment depends on the economic situation and if we have not been able, so far, to reduce it further, this is perhaps because the stabilization policies are not adequately effective, and that consequently the emphasis should, if you like, be placed more on short-term stabilization policies.

Consequently, this observation whereby this unemployment would be sensitive to stabilization measures, is that, when we observe the well-known Philipps curves at the national level, it is obvious that these Philipps curves are influenced by disparities in unemployment and that, if we calculated these curves for given regions, the shape of the curves, and where such curves are situated on an appropriate graph, we would see that the curve is much closer to the origin and, consequently, that the conflicts between inflation and unemployment are less acute than it appears when you calculate those conflicts, or this relationship between prices and unemployment at the national level.

In other words, if we notice that unemployment is greater in one province than another, when we take a national unemployment level, the high average is higher than it would be otherwise if unemployment were more equally spread out and, consequently, we find ourselves stressing this famous conflict which is bothering us a great deal at the present time.

Moreover, this is not a new idea since Professor Lipsey has already advanced it. He has shown precisely that the greater inter-regional disparities in a country are, the more the objective conflicts might be accentuated. When we examine, not unemployment, but the evolution in prices from one province to another in Canada, we observe that the differences and disparities are much smaller. Prices are spread, the variations in prices are spread much more quickly from one province to another because, obviously, a much more homogeneous market is assured when we speak of a product such as aluminum, or mass-consumption products, we are part of a much more homogeneous market than the labour market.

This is why I have concluded that stabilization policies regarding prices should of necessity be a national policy.

With regard to unemployment, since their markets are much more distinct, it would perhaps be advantageous to examine the existing possibilities for regionalizing full-employment policies to policies on stimulating overall demand.

What are the possibilities for intervention where stabilization is concerned?

Let us say, first of all, that it appears to me that it is difficult to regionalize monetary policy, at such time, if the monetary policy is defined in relatively simplistic terms, such as the management of the money supply or, even, the management of interest rates on liquid assets and cash reserves.

In fact, it would be difficult to imagine that with the considerable mobility of capital—and I mean the regional mobility of capital—it would be difficult to imagine that this regional intervention policy, directly, would not be cancelled out by capital flows which would precisely attempt to profit from the disparities which would exist in the interest rates, and in the supply of short-term liquid assets, in financial institutions.

However, I mention in my text that I am slightly less categorical than most observers on the difficulty in regionalizing the monetary policy at such time, because I observe that the interest rates are not necessarily the same from one region to another—because I observe that the mobility of capital is total, and that in certain sectors, on the contrary, I observe substantial disparities. The interest rate on mortgage loans, for example, are interest rates which are not uniform across the country, probably because the type of capital, the type of savings in that sector, it is a sort of capital which is less mobile than, for example, bank deposits and liquid assets in large national enterprises.

Be that at it may, despite the reservations I may express on that so-called total mobility of capital—despite that reservation, I am not in favour of any attempts to regionalize the monetary policy.

On the other hand, I would not rule out certain attempts being made, such as I mentioned in passing, but I confess not having studied it thoroughly—the formula which was proposed to modify, on a regional basis, the coefficients of cash reserves in banks. I say, a priori, that I do not find that idea absurd; I think that, insofar as such a formula lowers the costs of bank credit, that we should have some positive effect, even if I believe that such effects would be weak and perhaps even negligible.

Therefore, it is not in this area that I seek effective intervention tools; I seek more effective intervention tools from the taxation aspect. First, I want to express my surprise in seeing that such effective tools as taxation by the provinces have not been used in the past for stabilization purposes. The provincial governments have always been regarded as governments whose behaviour is anti-Canadian, or ante-Canadian—where they have not learned that a budgetary deficit can stimulate economic activity—and they leave this responsibility entirely up to the federal government. At a time when the federal government no longer raises more than half, and even a little less, of the taxes in Canada, it would be advisable to review this notion, and to try to review taxation by the provinces with a view to close co-ordination with federal policies.

In order to see the importance of this intervention tool in a federal system, we need think only of a unitary system. There would be no other levels of government with taxing and spending powers and there we would observe that the central government would be placed in a much more difficult position for regionalizing its intervention machinery, which is not the case in a federal system like ours.

This said, there are two other reasons why the provinces have never used taxation for stabilization purposes, and neither of them squares with a fundamental opinion, as to the possibility, in a provincial economy, of applying stabilization policies through taxation.

The reason advanced for doubting the effectiveness of a taxation policy at the provincial level is that the provincial economy is too open to external pressures, and that any intervention in a province's spending goes out to other provinces and that, consequently, it is useless to try to stimulate the economy of one province without stimulating the neighbouring province at the same time.

A paper has just come out on that, which I mention in my text here, which shows that, on the contrary, it would be possible to use provincial taxation to stimulate the province's economy, without incurring as substantial losses as they say.

Quite on the contrary, arithmetical examples are given in the text; it is possible to show that if there is an increase in expenditures in a region, like the Province of Quebec, leakages out of the province represent a relatively small fraction of the increase in the initial expenditure.

On page 11, I show that if expenditures such as those were made in the Province of Quebec, 72.6 per cent of the increase in revenue would remain in the Province of Quebec and only the difference would represent increases in revenue outside the Province of Quebec.

It is even possible to show, inversely, that if you increase expenditures throughout the country, but excluding the region about which I am speaking, the effects of this increase in the rest of the country are very, very minor in the regions which concern us, this essentially means the Province of Quebec and the Atlantic Provinces; the effects are very minor; they are so minor, according to that study, that personally I am not absolutely certain that the figures given can be accepted. But, even if those figures were not correct, following a more thorough analysis, the fact remains that the effects are going to remain much weaker than one imagines, than one imagined, and that one supposed, in Canada, in the past.

This makes short work of an argument, once again, which I describe as fundamental, because it is quite certain that if one could not imagine taxation policy at the provincial level, or a federal policy which would regionalize, as a result of the fact that leakages are too great from one province to another, it is well understood that it would probably be necessary to be satisfied with the substantial differences observed today in the unemployment rates from one province to another.

But if, on the contrary, those results are valid, then that indicates that there is a good possibility, and one can be optimistic about the possibilities of stimulating demand in a region, without necessarily stimulating it in another region and, consequently, it seems to me that such results are very interesting.

The last point that I raise in the text deals with another difficulty which the provinces have always had, of applying a fiscal stabilization policy. The difficulties the provinces have had, and still have, are that they cannot readily finance budgetary deficits and which they might, moreover, want to do, to stimulate the economy in the province, or inversely; they cannot have budgetary surpluses as large as they would like, to restrain expansion in a province—because, financially speaking, the provinces are placed in a situation which is entirely different from that of the federal government, and this situation, obviously, refers to access to what can be called the ultimate sources of liquidity—which is the Bank of Canada.

The federal government, when it has a budgetary deficit, and when it, by the budgetary deficit, stimulates the economy as a whole, can finance its deficits when it deems it advisable, by an injection of new money, by the sale of its securities to the Bank of Canada and, in so doing, is stimulating the economy of the country even more, as a result of that injection of money.

In the case of the provinces, when they have to finance their deficits out of the market, they counteract, to some extent, the expansionary effect of the budgetary deficit. Consequently, the provinces say, "Why have budgetary deficits? As a result, I have a higher debt, and I have not stimulated the economy of the province; I counteracted it by selling securities on the provincial market; therefore I wiped out the liquid assets of the province's economy in exchange for a higher debt."

That is a very well known problem, and it seems to me, if we want the provinces to apply a stabilization policy in the future, we must find a solution to that difficulty.

Senator Beaubien: At the federal level, there is much the same problem; this year the federal government is going to have to sell at least two billion. Well, it is well and good to put all that in the bank, but they nevertheless have to find an enormous sum. Is it not the same problem with the provinces?

Dr. Raynauld: No, the problem is very different, because there is the possibility of having its bonds financed by the central bank; the possibility exists. When I am told that it is not advisable to sell, I would say that I understand that it is not advisable to sell all the securities, without going to the market, that is entirely correct; but the possibility exists, in the federal government's calculations, when it decides to apply a certain fiscal policy.

As for the provinces, since such access to the central bank does not exist, each time a province decides to increase its expenditures, without raising its taxes, at such time it must ask itself the question, who is going to buy the securities of the province in question—and the securities are purchased by the economy of the province as such; at such time, the government has cancelled out its expansionary effect, which it wanted at the outset. I would be the last to think that access to the central bank is a universal panacea—and we can come back to that shortly, if you like; but I think that the fact is there at the outset.

Personally I am not in favour of the provinces having direct access to the central bank; I am not in favour of the sale, in other words, of provincial bonds to the Bank of Canada; I am not in favour of that for two reasons;

first, such sales of bonds by the provinces, to the central bank, would raise serious policy difficulties; that would raise policy difficulties because there is a very close link between the financing of bonds of a province and the over-all financial obligations of that province—and it would hardly be conceivable for the Bank of Canada to purchase such securities from the provinces, without ever giving any opinion to the provinces concerned on the state of their economy, on the state of their finances. Then, it would be difficult also to indefinitely conceive of the provinces who sold securities to the Bank of Canada not raising the question as to whether they should not have representatives on the board of directors of the central bank since the board of directors of the central bank would affect them greatly in their financial management and, consequently, in all their fiscal policies.

Senator Langlois: Do you not think, Dr. Raynauld, that the time has come when they are beginning to exchange this kind of information between federal and provincial agencies? Without that, it is a case of the deaf speaking to the deaf?

Dr. Raynauld: Yes, of course. In addition to that, I think that a second reason why I am not in favour of provinces having access is that there is a technical reason; it is very difficult for the central bank to decide on purchasing provincial bonds without asking questions on many other aspects, and it is not certain that, in order to regulate the money supply throughout the country, the Bank of Canada have anything to do with the purchase of provincial securities.

It does not have to purchase provincial securities in order to regulate the money supply in the country and, for that reason, that still seems like a decision which was taken not for technical reasons but for political reasons. I do not think that it is sound. Consequently, I thought of creating an agency which would be a kind of intermediary between the central bank, the federal government and the provincial governments, an agency which I would call a regional stabilization fund.

With your permission, Mr. Chairman, I think that I would prefer to read what I have prepared here, so that there will be no ambiguity on the precise characteristics that this regional stabilization fund would have.

Senator Beaubien: What page is that?

Dr. Raynauld: On page 13. The first component of this fund...

[*Text*]

The Chairman: One moment, please. In the English text, it would be page 11 and page 13 in the French.

[*Translation*]

Dr. Raynauld: Well, once or twice a year,—excuse me the first component of this stabilization fund would be as follows: first, once or twice a year, the provinces and the federal government would together make an analysis of the economic trends for the next 6 or 12 months. This analysis would deal with the economy as a whole and with that of each of the provinces.

Secondly, the provinces and the federal government would submit their views on what kind of fiscal surplus or deficit would be appropriate to the circumstances, for the economy as a whole and for that of each of the provinces. One might say, for example, that there should be a federal deficit of $200,000,000 (this is an example) if we stick to general conditions in the country, the provinces should have, one a deficit of $50,000,000, another a surplus of $20,000,000 (these are still examples) having regard to the conditions in each province.

For the first two stages, we propose that the provinces and the federal government meet together, but we have avoided saying that they should come to an agreement. The truth is that it is not necessary for the functioning of such a fund that the provinces agree on anything at all nor even, if it comes to that, that they should meet together. Policies could be analyzed and oriented by experts, whether or not they represent the parties concerned, or even by the federal government acting alone.

Thirdly, a federal fund is set up which buys the short or medium-term securities of those provinces which it has been agreed must run up deficits. The securities must mature in not more than five years. The amount of securities bought is also equal to the size of the deficit judged desirable, and is determined in advance by agreement between the province concerned and the stabilization fund. As a result the province is left entirely free regarding the other aspects of its fiscal policy, just like the federal government. If a province wants to run up a larger deficit than what has been planned, it must finance this deficit by ordinary means.

Fourthly, the federal fund issues its own securities and sells them, either on the market or to the Bank of Canada. The first year, the fund's securities would probably be sold entirely to the Bank of Canada because they would correspond to a need for net additional liquidities. In subsequent years, however, the provinces, which would be obliged to refund their securities only when surpluses are judged desirable, will have to issue new debentures to replace the first, and the fund will do the same in its turn. Depending on the market conditions, the fund would then decide...

[*Text*]

The Chairman: Could you explain that last sentence a little more fully:

> In subsequent years, however, the provinces, which would be obliged to redeem their securities only in the event of surpluses considered desirable, will have to issue new bonds to replace the original ones, and the fund will do the same.

[*Translation*]

Dr. Raynauld: Yes; suppose we've reached the sixth or seventh year of operation of this fund. The province, which sold its securities to the fund earlier on, sees its securities maturing. That year, it happens that the province should have, not a budget surplus, but a deficit, because conditions in the province so indicate. Consequently, that province will need net additional liquidities, say of $50,000,000, but will have to repay the $50,000,000 it borrowed a few years earlier. Consequently, that prov-

ince will in that case have to issue $100,000,000 worth instead of $50,000,000 worth, and $50,000,000, of it will be the net additional liquidities. In that case, the stabilization fund is not obliged to sell $100,000,000 worth to the Bank of Canada, the need for liquidities being $50,000,000.

So, the fund could sell those securities on the market.

Senator Beaubien: $50,000,000?

Dr. Raynauld: The $50,000,000 that represents only the debenture renewals. I'm simply saying that generally, the stabilization fund will decide itself to what extent it should go to the market and to what extent to the Bank of Canada, and this will be done in the same way as is now done between the federal government and the Bank of Canada. So, I'm saying that once again, according to current conditions, they can decide that it is advisable, and the Bank of Canada makes that decision, that the bank buy part of the bonds issued in this or that week, and it would be the same thing for the stabilization fund. Consequently, the fund..

[*Text*]

The Chairman: Do I gather from that, that when the refunding occurs, the stabilization fund must accept the refunding issue unless the province is in a surplus position?

Mr. Raynauld: Unless the province is in a surplus position.

[*Translation*]

If that isn't accepted, then in that case, again, the operations are cancelled. I think that what the fund should obtain from a province is that, when it is judged that that province's fund should not have a deficit, the province must repay the loans it has made with the fund. Now, such a situation is no different from that of the federal government today. Today, the federal government decides, according to conditions, whether it is advisable to repay a debt or not to repay the debt.

Senator Beaubien: Doctor, would there be only one fund for the 10 provinces?

Dr. Raynauld: Yes, sir.

Senator Beaubien: Only one fund?

Dr. Raynauld: Yes, only one fund.

[*Text*]

Senator Beaubien: It would just be another step for the Bank of Canada which would...

The Chairman: I understand what the fund is about. What I am having difficulty in understanding is what happens on the refunding of the securities.

Senator Beaubien: He is making a point that one province would, after the caisse had been running for five years, have $50 million in bonds which would be coming due. If it was decided that the provinces needed extra cash then the province would sell $100 million to the caisse populaire which would in effect roll over $50 million, and they get $50 million new cash.

The Chairman: The way I defined that was if the province was in deficit at the time of a refunding then the fund would have to accept the refunding issue for another five years.

Senator Aird: Could I simplify what I think is on your mind, and certainly on mine. Does this mean the fund stays at $200 million, or does it increase?

The Chairman: That is right. Also, a similar question to that is: Does it mean that when a province is in surplus after having borrowed from the fund the surplus must be used as a first charge to pay off those issues that are maturing at that point?

Senator Beaubien: I think Dr. Raynauld makes the point that the province and the bank, after discussion, would decide what was the suitable thing. If the province needed to have the money, because it had a lot of unemployment, then it would get the extra money; if, on the other hand, they wanted to cool down the economy then, of course, they would, and the province would have to use the surplus money to pay off the bonds.

Senator Aird: Senator Beaubien, the point he makes in the last sentence is that the fund would then decide. This, I think, is what the Chairman and I are concerned about. This discretion lies in the fund, whether or not to decide to go to the market or to the Bank of Canada. What I would like to know is: Does this fund stay at $200 million or does it increase?

[*Translation*]

Dr. Raynauld: Mr. Chairman, about that point, it goes up. It doesn't stay at $200,000,000. The example I gave there is only a point of departure, and it could very well go up for the previous years. However, I wouldn't want to lay down strict rules about the functioning of that fund. I think it should be an independent fund and should manage its funds in the same way as any financial institution. There should be an agreement made between the borrowers, as in any financial institution, and such a fund could have much greater resources if it were,—if the administrators of that fund consider it advisable to do so. There wouldn't be, in the beginning, any written rules saying: "You can't do this, you can't do that, it should be automatically paid at that time." That would be against the idea of the fund, which is that that body provides liquidities, and provides some provinces with the resources, should they judge it desirable to do so. Of course, if one said automatically, when the security falls due, automatically and necessarily the province must repay: if we are in a year in which that province should be in a deficit, in that case we would cancel a fund like that, and in that case it couldn't make any repayment, or what is called a refunding.

Senator Beaubien: Who would decide?

Dr. Raynauld: The fund.

Senator Beaubien: Not the Bank of Canada, but the fund?

Dr. Raynauld: The fund, and the province is a borrower from the fund, and the fund is independent.

Mr. Chairman, I was coming to the end of my presentation, and I would simply like to thank you for your attention to my presentation. I'm now available to answer your questions.

[*Text*]

The Chairman: I want to thank you on behalf of the committee for your most provocative suggestions. I am sure there will be many questions on the leakage question. Senator McGrand will commence the questions.

Senator McGrand: Mr. Chairman, I have spent all my life in rural New Brunswick and our guest is familiar with the problems of the Lower St. Lawrence in Quebec, and the regional disparity and unemployment that go hand in hand. Much of the employment in New Brunswick, and I believe in the Gaspé area of Quebec, is due to the poor development and underdevelopment of the natural resources in the area. I am thinking of the forests and forest wealth.

If these resources were at a maximum development, as they are in the Scandinavian countries, we would have very little unemployment or poverty. These resources are under provincial management. What success has been obtained through regional development, as carried on by the federal Government, in its fight against unemployment and regional disparity?

[*Translation*]

Dr. Raynauld: Yes, Senator, your question is very general, and certainly very important. I don't know whether I'm in a position to adequately reply to that question, but the remarks I would make would be as follows: first, generally, many natural resources come under provincial jurisdiction, but it is not at that level, personally, that I see problems concerning the stabilization of natural resources. What I have tried to show in the analysis I have just given, is that good part of the disparities that exist at the present time are in fact due to the management of the short-term economy not being as efficient as it should be, and that it would be possible to stimulate demand in those depressed areas, so that this stimulated demand can narrow those disparities and can permit a more efficient exploitation of the natural resources of those areas.

That policy falls mainly to the federal government.

Secondly, I would say, with reference to the distinction I made at the beginning of my analysis, between income disparities and unemployment disparities, that adjustments in the economy, although they are not incomes, have to be made by quantities, as we say in economics, and in that case, if we try to maintain incomes in the depressed areas at a high enough level, at as high a level as in the developing areas, in that case the disparities are going to appear much more in the form of unemployment; personally, (it's probably a quite personal judgment I'm making there) let them make adjustments in incomes and prices rather than in unemployment and employment, I don't see any disadvantages there. Consequently, that second observation brings me also to the importance of the stabilization policies aimed directly at reducing unemployment, even at the risk of keeping the income disparities. I think it would be much less serious to have income disparities, if people could work when they want to. The income disparities that we've chiefly tackled in Canada are very hard to reduce. They involve unemployment or migration, and such adjustments are very painful. Such adjustments are also very hard to make, and because they are hard to make, we see that after a good many years, the disparities are still as accentuated as they were, perhaps, at the time of Confederation. That doesn't mean that the federal policies were completely ineffective. Maybe the disparities would have been even greater than they are today, but it's a sure thing that these income disparities haven't been narrowed, and it would seem advisable to me to try to take our attention away a bit from these income disparities to attack unemployment more directly.

[*Text*]

Senator McGrand: Both New Brunswick and the Gaspé are about 85 per cent forest-covered. Some years ago a royal commission in New Brunswick made a study of the forestry in the province, and it reported that if the 29 per cent of the forest land, which is now owned by the small land owners, was given the care it should be given, it would provide 300,000 man-days of work a year. That is in respect of only for 29 per cent. This would have a tremendous effect on unemployment and poverty at the present time, and would build up wealth as a long-term policy for future generations to use. This is what I was trying to bring to your attention.

[*Translation*]

Dr. Raynauld: I thank you for drawing my attention to that. I think that it would be speaking in generalities to say that. That would be speaking in generalities, but of course, one cannot be opposed to a better administration of resources by the provinces, if that is possible. I would be, if you like, perhaps the last one to be satisfied with a situation which could be improved at the present time. However, to be more specific than that, I would have to study the problem in particular, which I have not done.

Senator Bourque: I had two questions to ask you, at the start, Dr. Raynauld. First, an explanation of the stabilization policy for the provinces, which you suggest or which you recommend, but after Senator Beaubien and Senator Aird, both of whom are bankers, I believe that you have answered their questions satisfactorily. Now, there is a matter that I noticed. I have a habit of reading all the Montreal and Ottawa French- and English-language newspapers and, undoubtedly, I must have missed one of them. This morning I read in *La Gazette* "The Future of the French Language is Alive but not Progressing". It went on to say, and I translated it. It is a translation of an editorial which appeared in *La Presse* this week by editorial writer Jean Pellerin, "English The Universal Language". I am going to take only a few paragraphs.

[*Text*]

It says:

> The French language, it's true, no longer bears the prestige which it had in the last century, but neither is it a dead language that a few souls enjoy decrying. It is spoken (more or less correctly,) by some 200 million people.
>
> Even here in Quebec it is becoming more and more rare to find, not even children, but even educated persons capable of expressing themselves and writing properly in French.
>
> Incidentally, and by a strange twist of irony, the only country where French is considered a second language is England. Even in France, 80 per cent of the students learn English as their second language.
>
> More than a billion people today speak or understand English.
>
> To circumvent this burdensome difficulty, there remains for the Common Market, as for Quebec, a plan of compromise: equality of these two languages in official matters. President Pompidou remarks again and quite rightly, that French and English remain the "two languages which claim international use". English, he adds, has the advantage of being able to adapt more easily to the rapid evolution of technology, while the French language remains one which cannot compare in prevision and clarity.
>
> The man who speaks, or at least understands French and English, has more and more cause to consider himself a citizen of the world, and this is a comfortable feeling for which western peoples, in ever-increasing numbers, are starting to strive.

It is a long article, of course, and it mentions many things, but I would say that to the average citizen it is a difficult decision. I would like to have had time to refer to *La Presse* and read it in French. I am just wondering, professor, if you could give us your views on the subject.

[*Translation*]

Dr. Raynauld: Senator, your making me put on another hat when you ask me a question like that.

[*Text*]

The Chairman: I think we are a trifle off the main stream of this inquiry. It is always a germane question. If the witness feels he can answer it without consuming the rest of the hearing time then I think he should be free to do so.

Senator Bourque: Perhaps it has a bearing on economy. After all, we are studying what we can do to alleviate all the things we are troubled with. Judging from the professor's paper, he evidently seems to have a wide knowledge of all existing problems, and that is why I am asking him.

The Chairman: That is right. I did say, senator, that this was only a trifle off the main stream. Dr. Raynauld, since we have on record Professor Harry Jonson's attitude to economists who fall back on sociology, perhaps we should hear what you have to say in your defence.

[*Translation*]

Senator Bourque: Now, Mr. Raynauld, you don't need to answer, it's as our chairman has just said.

Dr. Raynauld: No, no, I'm going to answer the question, but I must tell you first,

[*Text*]

The Chairman: I have directed that the witness can answer your question.

Senator Bourque: I just told the professor that if he preferred not to answer the question that I was not insisting on it.

The Chairman: I think he is just itching to answer it if we would only let him get to it.

[*Translation*]

Dr. Raynauld: I must tell you that I was associated with the Bilingualism Commission for six years and that consequently, I've had a chance to think a little about this kind of problem that has just been raised.

My answer is going to be relatively short about this matter. I think the future of the French language in Canada is assured, and for a very simple reason. It has been demonstrated that the chief factor that determines the viability of a language is the density of the population speaking it. This density of the population speaking it is constantly increasing in Canada, it has always been increased, and if it is true that it is the chief factor that determines the future of that language, then it is obvious that the future of the French language has never been as assurd as now, quite simply because the French-speaking population in Canada is growing, and has constantly grown.

So, that would be my reply to the question.

Senator Langlois: Doctor, when you determine your density of people speaking it, are you excluding those who speak it poorly?

Dr. Raynauld: I'm no judge of linguistic quality; I limit myself to the number.

[*Text*]

Dr. D. L. McQueen, Study Consultant: Mr. Chairman, I wondered if you would permit me to ask just a brief technical question about Dr. Raynauld's federal-provincial fund.

[*Translation*]

Mr. Raynauld, you say that in the first year, the fund would sell all its securities to the Bank of Canada in order to provide, as you say, necessary additional liquidities; but, does not this purchase of securities by the Bank of Canada provide a multiplier effect on the banking system, by supplying in this way an excessive increase in liquidities?

Dr. Raynauld: We have multipliers every time we decide to use that kind of instrument, and when we determine the desirable deficit, whether at the federal or provincial level, when we define the desirable deficit, we take the multipliers into account. Consequently, we would have undesirable effects from too great an increase

in supply, but only if we calculated poorly, right off, the desirable deficits in each of the provinces, and nationally. If you mean to allude to the fact that such multipliers would not be multipliers only for the area, as such, but that they would have effects on the other areas, why then, I think that is likewise a question to be considered when the initial amount is determined.

Now, it is correct that it is not necessary, even in the first year, that the fund sell all the securities to the Bank of Canada. It is not necessary. What would be necessary, would be that the fund either sell its securities to the bank, or else sell them in the areas with surpluses, if we can identify the areas with surpluses, when talking about selling securities. But suppose, for example, that it was said that in the Province of Ontario it would be desirable to have a budgetary surplus, in Ontario, and Ontario would be disposed to arrange it, this budgetary surplus, and, let's go beyond that, suppose Ontario would be disposed to deposit excess liquidities with the fund, either as deposits or by buying securities directly from the fund; in that case, it would be conceivable for the fund not to sell its securities directly to the central bank, but the idea is that the securities shouldn't be sold on the market, on the same market where there was an attempt made to stimulate demand, since in that case, the operation is cancelled.

This being said, since it's hard to imagine that those provinces with surpluses will first create surpluses and then want to buy securities from the fund, since it's hard to imagine that, I was thinking that it was more convenient to say that the first year, since we have to have additional net liquidities, the securities should be sold to the Bank of Canada. But that's not necessary.

Dr. McQueen: It's clear, for the moment, that I was talking about the multiplier, not about the Keynesian multiplier, the fiscal multiplier, but the other multiplier, because of the fractional reserves of the banking system.

Dr. Raynauld: Of bank credit.

Dr. McQueen: It seems to me that to sell such an amount of securities directly to the Bank of Canada would give the economic system a pretty big expansionist jolt.

Dr. Raynauld: Yes, but when the operation is done by the federal government, and the central bank decides to buy securities from the federal government, it takes into account the bank credit multiplier. Why wouldn't the fund take it into account? It seems to me that the only real trouble along those lines is that the multipliers can go to work—we're talking about regional multipliers, there are leaks in such a regional multiplier. So, that could be one problem, if you will, but in that it doesn't seem hard to me, should the fund decide that it would be desirable to buy securities from such a province, that it will take into account the fact that there are bank credit multipliers. I don't think it's—the central bank does it every day. I hope so, anyway.

[*Text*]

Senator Aird: Dr. Raynauld, I should like to refer to your brief at page 7, and inquire about, and in fact challenge, some of the statements you make there. I draw your attention to this passage:

> In the first place, the provinces have until now completely avoided any responsibility for unemployment and inflation, whereas the federal government has satisfied its self-esteem by assuming this responsibility even though it collects less than half the country's tax total.

I consider this to be a quite damning statement. I presume you are concerned about the credibility of your brief and whether or not the committee will accept its contents. I wondered whether or not you still stand behind a statement of this nature, which to me is patently incorrect.

[*Translation*]

Dr. Raynauld: Senator, I think that evidence to that effect would be found in the papers prepared for the reform of the Constitution. I'm referring in particular to the papers called "spending power" and "taxing power". I think that in those two papers, it can be seen that the federal government fully accepts the responsibility for stabilization, and that it wants to keep that responsibility for stabilization in Canada.

As far as the provinces are concerned, I haven't examined the papers from all the provices. I would simply like to say that that statement refers to stabilization, as such. I don't know of any declaration by the provincial governments that the responsibility for unemployment belongs to them. I don't know of any. So, that's why I wrote that sentence. I say: "the federal government has that responsibility". It wants to keep it. I don't know of any documents in which the provinces (again, I haven't examined them all; I haven't done any intensive research on it) but I don't know of any documents in which the provinces recognize that it is up to them to control unemployment, and to play a role in fighting inflation through a fiscal policy.

[*Text*]

The Chairman: I suspect that Senator Aird is referring to the last half of that statement.

Senator Aird: As a matter of fact, I am referring to both. I notice that in your reply, Dr. Raynauld, you did not include the words "satisfied its self-esteem". Maybe I lost something in the translation from the French, but in English I certainly find it offensive.

I have another question, Mr. Chairman, if you would like me to close out this one.

The Chairman: Dr. Raynauld also dealt with "although it collects less than half of the country's tax total".

Senator Aird: Yes, I believe he did. Dr. Raynauld, I would like to take you to page 12 of your brief, where you say:

> The forecast and the general direction of policies could be arrived at by experts, who might or might not represent the parties concerned, or they could be determined by the federal Government acting alone.

Once again it comes down to the wording of your brief in regard to the stabilization fund. Should it, in fact, be established? Would you regard this as a political possibility, in any sense of the word—because I do not.

[*Translation*]

Dr. Raynauld: I don't know whether I got that, Senator, what is it you don't think is possible, that the federal government can act alone when doing that? Is that the question?

[*Text*]

Senator Aird: No, I do not think so. My comment is that the general directions could be arrived at by experts who might or might not represent the parties concerned. I just cannot believe this is a political possibility. I think there will have to be representations, and I really cannot believe that the federal Government acting alone could do it. I think they would have to act together with the provincial governments.

[*Translation*]

Dr. Raynauld: Yes, it's clear, the way the text is written, that I imagine this as a last resort. I don't think it's a desirable measure. On the other hand, I look at it from the technical viewpont, and I say, from the technical viewpoint, it isn't necessary for it to be provincial representatives; it may very well be, from the political viewpoint, that it is absolutely not possible. In that case, we come back, if you will, to the general proposal. The general proposal was that the provinces and the federal government should work in agreement, and that's my proposal: that they work in agreement on it. However, I say that technically, it isn't necessary, but I'm well aware that, politically, that would be hard to imagine.

[*Text*]

Senator Aird: Thank you very much for your answer. I refer you to page 6 of your brief. Perhaps this is not quite as critical a question, but it is one to which I would like to know the answer. In the second paragraph you say:

> For these reasons we believe that it is a good idea to introduce regional cash reserve coefficients in the chartered banks.

Can you tell me what "regional cash reserve coefficients" are?

[*Translation*]

Dr. Raynauld: Senator, I was referring, when I wrote that, to a brief that was submitted to you, I think, by the Canadian Bankers Association, that expressed an opinion on it. Those regional cash ratios are reserve ratios that exist nationally, and are imposed by law on the chartered banks. So they say: "You must keep a proportion of the deposits of the Canadian public in the form of cash", and the proportion here would be,—instead of having, at present, there are two ratios: one for demand deposits, and a second for savings deposits. Those two ratios are national ratios. They are uniform for the whole country, and the suggestion here was that one can imagine that ratios, we have for those two categories of deposits, regional ratios for Canada. It seems to me that if we pursued the idea a little further, the suggestion would be that there should be two: one for the Eastern Provinces, probably , and another for the Western Provinces.

Now, these ratios could be changed, as was the case before; they could be changed by decision of the central bank, within the limit permitted by law. Does that answer your question?

[*Text*]

Senator Aird: Yes, I think I will pass it.

[*Translation*]

Senator Beaubien: Professor Raynauld, I want to return to your stabilization fund. Wouldn't the fund have to be a kind of branch of the central bank? Who should fix the deficit that, shall we say, is desirable? Surely the Bank of Canada would have some part to play, if the fund were to decide to allow a deficit of 500 million between the ten provinces; that would then increase the money in circulation. Then, if the Bank of Canada was of the opinion that it was necessary to reduce the amount of money, it seems to me that the people to decide if a certain deficit was allowable for the ten provinces would be the Bank of Canada. It seems to me the Bank of Canada would have its part to play in the thing.

Senator Langlois: He proposes that it be the provinces and the Federal Government.

Senator Beaubien: But, no! the professor said above all that the bank would decide entirely, that it was the fund rather which would have to be decided on; isn't that what you said?

Dr. Raynauld: Yes, but it would make a decision following,—I have called it a diagnosis,—an appraisal of the situation, and that appraisal would be made ideally by the levels of government concerned so that the one thing relates to the other; this appraisal of the needs is called coordination of fiscal policies, it's a joint effort, or a combined appraisal of the needs of the fiscal policy during the next year.

There already are some conferences going on at the moment at that level. These conferences would be, at that time, much more definite, if I may say so, and they would lead to decisions which would be equally much more definite than now, yet it would be simply a conference whose beginnings are seen, for example, the meetings of the ministers of Finance of the Federal and provincial governments.

I think it is obvious that the Bank of Canada could and should give its opinion in those conferences and in the appraisal which is made. I believe it could be conceived, on the technical plane, that this fund rests, may be one—it's essential that the fund does not rest with the Bank of Canada, pardon me, but it may be a service, if you like, whose management is assured by the Bank of Canada. Moreover,I would not see any objection there. I would not see any objection in that. But, I believe that the appraisal has to be made at the level of fiscal policies, and this, it seems to me, has to be by the Federal

and provincial governments; within the appraisal, or following it, the fund retains all the while its full autonomy.

Senator Langlois: Dr. Raynauld, this question from Senator Beaubien leads us, I believe, to what would be the ideal conception of this stabilization fund; how do you envisage it?

Dr. Raynauld: Frankly, I have not examined the administrative forms which would be appropriate. I have submitted the idea, I have already made mention of it several times previously, but I have not examined in detail what the composition of this fund ought to be, what board of administration would be set up, but I believe ideally at least, the fund ought to be comprised of representatives of the Federal and provincial governments and perhaps the representation be equally split between both the Federal government and the provincial governments, but all this is only some thoughts a bit off the cuff, because I have not examined in detail by what, or how this fund could be administered.

Senator Beaubien: But, Dr. Raynauld, wouldn't it be the same thing if the Bank of Canada were to buy debentures, it seems to me the provinces—it seems to me that, on the whole, the fund would have to act with the bank, and then after all it's the government that directs the Bank of Canada.

Dr. Raynauld: There would be important differences. First, there would be preliminary stages which there are not in a central bank. These preliminary stages are precisely this appraisal of the economic situation. Next, a joint effort of the fiscal policies of the Federal and provincial governments, that are to precede the action of the fund. That feature, if you like, will be new.

In the second place, the management of this fund would be obviously different, completely different from that of the bank. There would be as I said just now, at first sight at least. This fund would be administered by people representing the administrative authorities of the fiscal policy.

In the third place, the fund is not meant to be subjected, if you wish, to all the constraints that a central bank can have. For example, that fund has absolutely nothing to do with the management of external reserves, has nothing to do with exchange rates, and just think of it, if the provinces could sell their securities directly to the central bank, the central bank would be within its right to request contributions from the provinces when it has to buy foreign currency, because it buys foreign currency with Canadian dollars; if provincial securities were bought, then at that time, the Bank of Canada could demand that the provinces bear part of the burden of the purchase of foreign currency. The fund would be free of that. In consequence, there are even so, I see, three major differences between this fund and a direct admittance to the central bank.

[*Text*]

Senator Hays: But doctor, would you not accomplish the same thing by the having the Goverment buy the provincial bonds after they had decided that the province needed them? They in turn would float a loan through the central bank, and this would then increase the money supply. Of course it would be inflationary, but could you not reach the same end today by this method rather than by setting it up the other way?

[*Translation*]

Dr. Raynauld: Yes, Senator, and I am very happy you make this remark, because it's quite correct. It's quite correct, and it would not be indispensable, moreover, to attain the ends one wishes, to go through this intermediary of a fund. It's correct that the Federal government, by the way it did it in December 1970, the Federal government can make loans to provinces, and the formula adopted in December, is a formula which bears close similarity as far as the objectives to be attained, bears close similarity to the objectives of this formula, because the distribution of these loans amongst the provinces is based on the level of unemployment existing in the provinces. In consequence, they are very similar. It is quite correct to think that the Federal government could itself very well make loans to the provinces, and afterwards to finance these loans in the way it wants, if you wish, likewise to its own general financial operations.

If I propose a fund rather than simply loans by the Federal government, there are also two reasons. The first is that this fund would have a certain independence of the Federal government. It would be an entity unto itself, and it would have, again at first sight, representatives of the provinces in the decision that would be taken. That's a major difference in my opinion.

In the second place, a fund such as this if it is set up, has immediately something permanent about it that a decision which is taken, such as that one made in December, has not. The Federal government could still decide the following year not to make loans to the provinces. It decided to do it in December 1970. If it is an arrangement which should be continued for a longer period as is said, then I think that this operation should be institutionalized, if you like, in the form of a fund. Yet, getting back to the question, I find that it's quite correct, on the technical plane, the Federal government could do that itself without going through any intermediary.

Senator Langlois: The factor of communication between the various levels of government is not a factor in your suggestion?

[*Text*]

Senator Hays: I cannot see it. The keeper of the "kapoo" always calls the tune, but you are saying that the federal Govenment does not want to have the responsibility of telling the provinces what to do. This is why you think it should be institutionalized, as I understand it. But I cannot see any difference in setting up this fund if the federal Government is going to be responsible. After all, the municipality is a creature of the province, and the province is a creature of the federal Government. In any event, if they were to default on these they would be responsible anyway, would they not?

[*Translation*]

Dr. Raynauld: I am not expert on legal or constitutional affairs. I don't know if the Federal government would be responsible for a default in payment by a province. I have never given that kind of a question much thought.

It remains that the participation of the provinces in the decisions of this fund, in the form of some kind of an administrative board, represents even so a major difference, a considerable difference from a decision made by the Federal government alone as to lend or not to lend to the provinces.

[*Text*]

Senator Hays: Mr. Chairman, I just cannot see where there would be any difference no matter how you set it up. If the federal Government had to purchase the bonds, you are suggesting that under either system they would not feel responsible to the taxpayers of Canada to see that they had something to say as to how it was spent.

The Chairman: I guess you would get the same answer again, Senator Hays.

[*Translation*]

Senator Langlois: I believe that my question has been answered, if we have made the record; I do not know whether it was taken down in shorthand, but I believe that the Doctor has answered my question.

Dr. McQueen: The liaison officer factor between the two levels of government enters into your suggestion?

Senator Langlois: That is correct.

[*Text*]

Senator Manning: Mr. Chairman, my question is also on the stabilization fund. For such a fund to be effective for the purpose proposed, would you envisage the need for restraints of some form to be imposed on the provincial governments with respect to their freedom to engage in deficit financing and to borrow money on the market as their normal practice, and also with respect to the broad nature of their expenditures? I ask that question because by variation of provincial expenditures, the provincial government can readily decide whether it is going to end the year with a deficit or a surplus, and that comes right back to the relationship to this fund.

I am wondering also whether in what you envisage here, doctor, you are thinking of anything similar to the recommendation of the old Rowell-Sirois Commission which decided that there would be a need for something in the form of a loan council with powers to supervise the degree of borrowing a province could engage in, and also its major expenditures before it would be eligible for stabilization from a fund of this kind.

[*Translation*]

Dr. Raynauld: Senator, this is a very important question which you raise also. I would like to avoid interference into the budgetary policy of the provinces, in the operation of a fund such as that.

A basic supposition is that the provinces are responsible for their budget. The governments undergo elections, as in every country, as the Federal government, and it seems to me that it ought to be supposed that the provinces are responsible for their operations.

As to what could perhaps be called a privilege; but that I would not like to call a privilege—but the power to borrow from a fund as this—it seems to me that there also, there must be a certain responsibility of the provinces, which is ascertainable by the state of accounts at any particular moment. It seems to me that if a province must surrender its own appraisal of its financial needs, it must nevertheless have freedom to finance its deficits, or not to finance them, and to undergo the constraints of the market first, but not to be subjected to further constraints which would go beyond what all creditors would demand of a province. After all, it's the province which is going to have to repay these loans; the credit of the province will be affected by these loans from the fund, but I have difficulty in seeing how a province could become irresponsible, and how a judgement might have to be imposed which would be final.

There is another point also: these loans from the fund, in my opinion are loans which will ever be a small part of the total debt of the provinces. After all, there is much more need in the long run, in good public finance, for financing by loans, than there can be deficits judged desirable, for the purpose of the accounts at a particular moment.

In consequence, these loans from the fund should not become a very big proportion of the public debt, and for that reason it seems to me the province should be able to keep the freedom it enjoys at the moment, to carry out financial operations relative to its public expenditure. In consequence, I'd see to it that as few restrictions as possible are imposed on the provinces following the creation of such a fund.

[*Text*]

Senator Manning: Mr. Chairman, there is just one comment I want to add, if I may. I agree with the professor that it is simply politically unrealistic to think that provincial governments across Canada would agree to having their responsibilities and freedoms in how they handle their budgetary matters circumscribed by restraints imposed nationally. This was one of the rocks on which the Rowell-Sirois recommendations foundered because they did propose a considerable degree of that kind of restraint. Would not the alternative which I gather you favour—where the provinces would voluntarily exercise certain restraints because they wanted to participate and gain the benefits of this fund—carry with it some rather serious inplications even into the field of national unity?

I ask that question for the reason that while provinces might voluntarily subscribe to certain ground rules that would undoubtedly be necessary in the financing of these loans and so on, there must be a considerable degree of federal responsibility and obligation assumed for the success of this thing. This, in a sense, becomes a liability on all Canadians, and the thing I would fear in this is that you would get some areas which are not prepared to subscribe to a certain course, but then are critical because there is a certain national obligation imposed on them as citizens of Canada for something which has been worked out between a fund of this kind and other areas that have voluntarily agreed to it. I am sure you appreciate that one of our problems today is that a lot of regional assistance programs generally lead to some bad relationships and feelings between segments of our society and people. Do you see than danger in this type of a program?

Dr Raynauld: I see some difficulty in managing this fund. There is no doubt about that in my mind. The kind of difficulty I see is that it may be possible—

[*Translation*]

I think I should speak in French. I see difficulties in the operation of a fund such as that, and the main difficulty is that it is unlikely that adjustments for the stabilization of the entire economy might be shared equally between depressed areas and areas which are growing. It is a little like the situation as that of two countries with two different currencies,—where one is in deficit and the other, necessarily in excess, and where the country in excess is going to try to put off all depreciation of its rate of exchange—this forces the country in deficit, which has more urgent needs, to depreciate its money, and to depreciate it perhaps more than would be desirable, if the two countries had participated in the operation.

I see the same kind of difficulty in the question of stabilization. It is unlikely that the provinces that should exercise some restraints in the expenditure of the province, for the purposes of stabilization, would do so, and in consequence it is possible that the depressed provinces might have to generate more activity to compensate for the fact that there is no restraint in the neighbouring province. In consequence, this difficulty is real.

On the other hand, I do not see how all the responsibility for the policy of stability, in Canada, falls on the shoulders of this fund. That fund is a contribution to all the other instruments that already exist and, to my mind, that fund is not a major instrument; It is a contribution,—and the Federal government will continue to carry as it undertakes it now, as it does it now, the heaviest weight in the policy of stabilization across the country.

In consequence, it will still be possible for the Federal Government to compensate for the lack of cooperation, if it should happen, by its own policies of stabilization,—and its own policies of stabilization are not neutral, regionally speaking. In so far as it's Federal government, it already has an influence on certain regions, and federal measures were introduced deliberately two or three years ago, which have varying regional effect,—and this is going to continue in the same way, so the fund, again, would not bear the entire burden of the adjustments for the purposes of the accounts at a particular moment.

Senator Langlois: Dr. Raynauld, in your scheme, you suggest at the outset two first stages, whose operations would be the responsibility of a regional stabilization fund, ideally speaking, of mixed management, or of mixed composition,—and the goal of these first two stages consists, if I rightly understand your scheme, only in establishing diagnoses of the economic state of affairs, and in establishing fiscal deficits or assets. Once these two operations are completed, you hand over the execution of all that to a fund which, to my way of thinking, if I rightly understand your scheme, would be an entirely autonomous federal fund which would look after the issuing of securities and their distribution, their sale on the market.

At that time, wouldn't it be necessary to return to the Bank of Canada, and wouldn't this communication that existed initially be lost, in the appraisal of deficits, in trying to excel the economic state of affairs that has existed, by having a mixed management of stabilization funds? Wouldn't it be better to leave these two stages to a mixed agency?

Dr. Raynauld: The agency is still mixed; the fund, I think, is still administered by representatives of the provinces and of the Federal government although, here again, I express the same reserve, I have not really thought out this part of the proposition; but if you allow that this fund be administered by representatives of the provinces and of the Federal Government, the communication between the provinces and the Federal government would still exist within the fund.

Senator Langlois: Even in the federal fund?

Dr. Raynauld: Yes, within the federal fund; there are not several funds, there is only one sole fund, for all the provinces.

Senator Langlois: Is it like that, if I understand rightly, in your third stage, where you speak of a federal fund, do you mean all the while a regional stabilization fund? isn't this a different fund?

Mr. Raynauld: Not at all,—it is still the same fund.

[*Text*]

The Chairman: Dr. Raynauld, I would like to thank you for coming here today and giving us your testimony. I do not know that we can say that your concept of the fund will be endorsed by the committee. However, you have raised the issue. It is one that we will examine, and one which we will probably examine very closely with the Bank of Canada when its representative appears before us. It gives us a line of questioning that is most important in that direction, and in our questioning of the Minister of Finance.

We are further indebted to you for the data that you have given us on leakages and lack of leakages, and the effect of regional stabilization policies. On behalf of the committee, I thank you very much.

The committee adjourned.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS

OF THE

STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 18-A

WEDNESDAY, JUNE 9, 1971

Complete Proceedings on the Estimates

laid before Parliament for the fiscal year ending March 31, 1972

REPORT OF THE COMMITTEE

(Witnesses and Appendix:—See Minutes of Proceedings)

23914—1

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
	O'Leary
	Paterson
Gélinas	Phillips
Grosart	Sparrow
Hays	Walker—27.
Isnor	

**Ex officio Member*

(Quorum 7)

Orders of Reference

Extract from the Minutes of the Proceedings of the Senate, of Tuesday, March 9th, 1971:

"With leave of the Senate,
The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, 1972, in advance of Bills based upon the said *Estimates* reaching the Senate.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,
The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, April 28th, 1971:

"With leave of the Senate,
The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Tuesday, May 4, 1971:

"With leave of the Senate
The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relation thereto.

The question being put on the motion it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Minutes of Proceedings

Wednesday, June 9, 1971.
(18A)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 8:00 p.m. for consideration of the Main Estimates laid in Parliament for the fiscal year ending March 31, 1972.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Grosart, Hays, Isnor, Laird, Langlois, Manning and Molson—(9).

Also present, but not of the Committee: The Honourable Senators Argue, Belisle, Burchill and Macnaughton—(4).

Witnesses from the Treasury Board:

Mr. G. Osbaldeston, Deputy Secretary (Program Branch);

Mr. B. A. MacDonald, Director General, Budget Coordination.

On request of the Honourable Senator Hays, the Treasury Board undertook to Table how the distribution grant of $77,000,000.00, for bilingual program to the provinces, would be distributed and what formula is used.

It was agreed to print as an *appendix* a letter from Mr. MacDonald, dated May 19, 1971, giving information on the special development loan fund to the provinces and another letter from Mr. MacDonald dated April 8, 1971, giving information on the cost to the Department of National Defence, of providing guards in Ottawa during the recent emergency in Quebec; and further particulars on the Public Works—Vote L29G, Loan for the construction of an oil terminal wharf at Come-by-Chance, Newfoundland, relating to Supplementary Estimates "C" on Thursday, March 18, 1971.

At 10:15 p.m. the Committee adjourned to Thursday, June 10, 1971.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

Report of the Committee

Thursday, 10th June, 1971.

The Standing Senate Committee on National Finance, to which were referred the Estimates laid before Parliament for the fiscal year ending March 31, 1972, has in obedience to the order of reference of Tuesday, 9th March, 1971, examined the said Estimates and reports as follows:

1. Your Committee was authorized by the Senate, as recorded in the Minutes of the Proceedings of the Senate of 9th March, 1971, "to examine and report upon the expenditures proposed by the Estimates laid before Parliament for the fiscal year ending March 31, 1972 in advance of the bills based upon the said Estimates reaching the Senate."

2. In obedience to the foregoing, your Committee held one meeting on the Estimates and heard evidence from Mr. G. Osbaldeston, Deputy Secretary, Programs Branch, Treasury Board, and Mr. B. A. MacDonald, Director General, Budget Co-ordination, Treasury Board.

3. The Main Estimates for 1971-72 amount to $14,352 million as compared with 1970-71 when the amount was $13,438 million. Of the total of the Main Estimates for 1971-72, $7,091 million are statutory in nature while $7,261 million represent funds for which Parliament is being asked to provide authority. In addition to these amounts, there are $988 million of non-budgetary items.

4. Those departments which account for the largest percentage of the increase in the Estimates are National Health and Welfare, $256 million; Regional Economic Expansion, $62 million; Secretary of State, $109 million and Department of Transport, $46 million.

5. Your Committee examined the operation and increasing efficiency of the program, planning and budgeting method and was especially interested in the possible use of this method as a means of assessing the effect of federal programs on the general stabilization policy of the government. Your Committee was also interested in the attention that was focused by the Treasury Board on the efficiency of existing programs as compared to new programs. Your Committee was assured by the officials of the Treasury Board that as new expenditures are required for old programs the program is reassessed, however, your Committee is of the opinion that the assessment of existing programs under the program, planning and budgeting method should be enhanced.

6. Your Committee undertook specific examination of the bilingualism development program and requested further materials on this program from the Treasury Board, and these materials, when received, will be tabled with the Committee. Your Committee also examined the Regional Economic Expansion program and made a note to further examine this program at a later date in order to determine the method by which grant programs are budgeted by both the Department and the Treasury Board. It is felt by the Committee that a comparison of the budgeting method used in grants programs with the actual expenditures in the case of this department would be useful.

Respectfully submitted.

D. D. Everett,
Chairman.

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Report of the Committee

Thursday, 10th June, 1971.

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3. The Main Estimates for 1971-72 amount to $14,382 million as compared with 1970-71 when the amount was $12,438 million. Of the total of the Main Estimates for 1971-72, $7,091 million are statutory in nature while $7,291 million represent funds for which Parliament is being asked to provide authority. In addition to these amounts, there are $388 million of non-budgetary items.

4. Those departments which account for the largest percentage of the increase in the Estimates are National Health and Welfare, $256 million; Regional Economic Expansion, $62 million; Secretary of State, $100 million and Department of Transport, $40 million.

5. Your Committee examined the operation and increasing efficiency of the program, planning and budgeting method and was especially interested in the possible use of this method as a means of assessing the effect of federal programs on the general stabilization policy of the government. Your Committee was also interested in the attention that was focused by the Treasury Board on the efficiency of existing programs as compared to new programs. Your Committee was assured by the officials of the Treasury Board that as new expenditures are required for old programs the program is reassessed, however, your Committee is of the opinion that the assessment of existing programs under the program, planning and budgeting method should be enhanced.

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The Standing Senate Committee on National Finance

Evidence

Ottawa, Wednesday, June 9, 1971

The Standing Senate Committee on National Finance, to which was referred the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, met this day at 8 p.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, we are gathered tonight to examine the Estimates for the fiscal year ending March 31, 1972. We have with us two old friends of the committee, Mr. G. F. Osbaldeston, Deputy Secretary of the Treasury Board, Program Branch, and Mr. B. A. MacDonald, Director General of Budget Co-ordination.

Senator Isnor: Are you going to take minutes of this meeting?

The Chairman: Yes we are, senator. Did you have any thoughts on it?

Senator Isnor: I wonder if we would be quite as frank as we would otherwise be. Perhaps a stronger term would be, "not quite as honest".

The Chairman: Perhaps we can begin in open meeting. Then, if it is desired by the meeting at a later stage to go into camera, we could consider that.

Senator Isnor: I was just wondering.

The Chairman: I think we might be subject to criticism if we did not, at the opening stages in any event, record the meeting.

Senator Isnor: You are not going to take note of my remarks, are you Mr. Chairman?

Senator Grosart: Perhaps for the record it should be said that Senator Isnor has never been inhibited by the fact that it is on the record.

The Chairman: That has certainly been my impression. I think I should say at the outset that because we are having a set of hearings on growth, employment and price stability in Canada, which involves some 28 separate hearings and originally started as the Senate's examination of the Estimates, this examination of the Estimates will probably be rather short.

I am predicting that; I am not saying that it necessarily will happen because, of course, we are subject to the will of the committee. However, we had originally intended that our examination of the Estimates would in fact be an examination of growth, employment and price stability in Canada. It became apparent, however, that we could not complete, and report on, those hearings prior to the appropriation bill and if we continued it would delay the appropriation bill until after the summer recess. So it becomes necessary to consider the Estimates at this time and hopefully to refer and report on them to the Senate. Then we shall continue with our examination as it was originally constituted. That is the reason for the change.

With that preamble I will ask Mr. Osbaldeston if he has an opening statement.

Mr. G. F. Osbaldeston, Deputy Secretary of the Treasury Board, Program Branch: Thank you, Mr. Chairman. If I may, I will make a very brief opening statement.

The Main Estimates for 1971-1972, contain $14,352 million in budgetary expenditures, and $989 million in non-budgetary expenditures. The latter are the loan, investment and advance items for which authority is sought in appropriation acts.

I might mention that there are other types of non-budgetary expenditures that do not at present appear in Estimates. Authority for these others is contained in some continuing legislation. For example, there are the loans to the Central Housing and Mortgage Corporation authorized under the National Housing Act. Taking another point of comparison, that of 1970-71 expenditures with these Estimates, it will be found that as usual more than half the increase is accounted for by increases in statutory items, in particular, public debt charges and contributions and shared cost programs with the provinces. Larges changes will be found in certain non-statutory items as well. In particular, in expenditures for regional economic expansion, occupational training for adults, Indian and Eskimo Affairs, bilingualism development, northern development, grants to industry by the Department of Industry, Trade and Commerce, and citizenship development.

This is the second year, as honourable senators will recall, in which the Estimates appear in the new form adopted by the Government as one of the steps taken in the implementation of program budgeting. There is no change of substance that has been made between this and last year's Estimates in terms of format. I could note, however, that my predecessor, Mr. Cloutier, when he met with you on the 1970-71 Estimates somewhat more than a year ago, found himself having some difficulty referring to page LXXVIII, and at the suggestion of this committee you will find that the Roman numerals have disappeared, God willing, forever more. I am happy to report that we have changed to a rather simpler numbering system.

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With those few remarks, Mr. Chairman, I will conclude my statement. I would like to be of as much assistance as I can to your committee. Obviously, I am limited in my overall knowledge of the Estimates, but if there are any questions senators have that they would like fuller amplification on than I can give this evening, I would be delighted to provide that.

The Chairman: Thank you, Mr. Osbaldeston. I should explain to honourable senators that the minister was quite happy to attend our meeting. It was at my request, because of the breadth of the other hearings we were having, that he did not attend, but rather sent his two officials. Are there questions, honourable senators?

Senator Grosart: Perhaps we should start by asking Mr. Osbaldeston to give us a little broader picture of the Estimates that are before us, the $14,352 million, by asking him to relate them to last year's Estimates, to indicate what the increases in statutory items are, and what the comparative situation is in regard to budgetary items.

I might say here that I would be delighted to have an explanation of this phrase "budgetary items." It seems to be used in several different senses in federal Government documents. Sometimes we speak of everything in the Blue Book as budgetary items, and at other times this is broken down to "budgetary" and "statutory" items. There again, we have in the reports that appear from time to time in the *Canada Gazette* another and entirely different use of this phrase "budgetary" and "non-budgetary."

First of all, to wrap up my whole question, I would very much appreciate some comment on paragraph 25 in the foreword, where we have for the first time a very interesting summary of the kinds of votes—the program expenditure votes, the operating expenditure votes, the capital expenditure votes, the grants and contribution votes, and the loan votes.

The reason I ask this is because we are in the second year of this new system with this new jargon and new terminology, and I think it would be very helpful if we could have an explanation.

Mr. Osbaldeston: Perhaps I may speak to the first point you made, which I believe was the comparison because 1971-72 and 1970-71.

If I may direct the attention of the senators to page 1-22 of the main Estimates, there is a breakdown there of the voted items and the authorized items in 1971-72. You will see at the bottom that the total "to be voted" in 1971-72 is $7.3 billion.

Senator Grosart: Excuse me, if you will. You are now using a new phrase, "authorized by statute". Is this synonymous with "statutory".

Mr. Osbaldeston: In the case of "Authorized by Statute" that you have before you, these are payments authorized in the Appropriations Bill.

Excuse me, I wish to correct that. In the case of the "To be voted", these are authorized by the appropriations bill. In the case of "Authorized by statute", obviously these payments are authorized by another statute.

Senator Grosart: Is "authorized by statute" synonmous with "statutory items"?

Mr. Osbaldeston: Yes, that is correct, sir.

Senator Grosart: Thank you.

Mr. Osbaldeston: The total in 1971-72, as I mentioned, is $14.4 billion rounded, compared to a total for 1970-71 of $13.4 billion, rounded.

Senator Grosart: An increase of about $1 billion.

Mr. Osbaldeston: That is correct. That gives a comparison between 1970-71 and 1971-72. The distinction between "budgetary" and "non-budgetary" is a difficult one. The senator is aware, as he mentioned, that this discussion goes on. In the case of the non-budgetary, I believe the theory is that, in the non-budgetary, one acquires an asset or makes an investment; that in effect, one acquires a good in terms of economics. In the case of the budgetary, again the rather purer view is that one is making an expenditure. In between those two definitions —it has not remained that way—in the non-budgetary you certainly do have items which are primarily described as expenditures, and in the budgetary items you certainly do have items in which, in effect, you acquire an asset. But the first point I have made is that that is the ordinary distinction in the theory of budgeting. Mr. MacDonald may assist or amplify on my remarks.

Mr. B. A. MacDonald, Directeur General of Budget coordination, Treasury Board: Mr. Chairman, I think the more fundamental approach is that we have a class of revenues which are called "budgetary revenues", which are the taxes—the income taxes, corporation taxes, excise taxes, duties. It is expenditures which are charged against these that are accordingly called budgetary expenditures. They are, as Mr. Osbaldeston has said, those that do not represent themselves as being loans, investments or advances.

Loans, investments and advances are set up as to be repaid by the Government. There are also other non-budgetary transactions of almost an accounting nature. Reserves set up for unredeemed cheques is an accounting transaction on the non-budgetary side. And I believe there are the transactions involving the exchange funds, which are non-budgeting in nature.

Senator Grosart: The question that arises in my mind is this. Are there not two kinds of usages one a distinction between budgetary and loans, advances and investments; and the other between budgetary and statutory expenditures? Are there not two different usages here?

Mr. MacDonald: No, sir. As you say, the loans, investments and advances are the larger part of the non-budgetary expenditures. The proper use is that there are statutory expenditures which form part of the budgetary expenditures, and the distinction between these is the

one we have attempted to make here, budgetary expenditures that have to be voted through the appropriation acts and budgetary expenditures that are authorized by continuing statutes.

Senator Grosart: You are now pointing up the distinction in terms here. In one sense you use "budgetary" to include voted expenditures approved in Appropriation Acts plus ongoing expenditures under the statutes. In the one sense you call all of these budgetary. In the other sense you do not. You say "budgetary" and "statutory".

Mr. MacDonald: Mr. Chairman, we would say "statutory" and "to be voted".

Mr. Osbaldeston: There would comprise the budgetary.

Senator Grosart: But you use the terms "budgetary" and "statutory" and then "loans, investments and advances" over again. Perhaps it is merely confusion in my mind, but sometimes "budgetary" means "budgetary" as distinct from "statutory." Would you agree, Mr. Chairman?

The Chairman: It is difficult to comprehend sometimes. Perhaps you would go through it again.

Mr. Osbaldeston: I think it is true to say that there are statutory items on the non-budgetary side. Therefore, the problem is one of definition. If you are talking about the budgetary expenditures, you have two classifications. If you talk about statutory, broadly, you would then have to bridge the gap between budgetary and non-budgetary, because there could be statutory on the non-budgetary side. That gives rise to confusion. If you are talking about non-budgetary, there are two elements. Once you start talking about statutory, you could be talking about budgetary and non-budgetary.

Mr. MacDonald: There may be additional confusion because these Estimates contain some non-budgetary expenditures. Loans, investments and advances that have no other place to find their authority are contained herein. We hope they will become more comprehensive.

Senator Grosart: I am quite sure these are very good answers, and I will read them later.

Senator Molson: Mr. Chairman, to come a little closer to home in an attempt to try to define some of these things, may I refer to page 18-4, "Parliament A—The Senate, Estimates, Proposed", for 1971-72 showing Vote 1 as $3½ million-odd and Statutory as $1,681,000. Then they come up with the words "Total Budgetary Expenditures". So it has statutory and budgetary totalled up to the total budgetary expenditures.

Mr. Osbaldeston: If I may, Mr. Chairman, Vote 1 is, "To be voted". "Statutory" obviously in statutory. Then the sum of the "To be voted", Vote 1, and the "Statutory" add up to "Total Budgetary Expenditures."

Senator Molson: A minute ago they were separated.

Mr. Osbaldeston: We separate them for two reasons. In the first place, the "To be voted" must be separated in order to be voted by the House of Commons and the Senate. In the second place, we separate them to display quite clearly that one is statutory obligations and the other is to be voted by Parliament.

Senator Grosart: How would you define "budget"? I mean in the context of saying that Mr. Benson will shortly present a budget to Parliament. And how would you define "budget" in the context of the Estimates or of the Blue Book?

Mr. Osbaldeston: What we have in the Blue Book is the expenditure budget of the Government as we describe it. The problem is to draw this distinction between the budgetary and non-budgetary, in reply to your question. If you like, there is a budgetary expenditure budget and there is a non-budgetary expenditure budget. This is in essence, senator, obviously what we have.

Senator Beaubien: Very interesting!

Mr. Osbaldeston: In growth terms, in the public account sense, you have them both joined and you have a total budget displayed. I suppose, it depends on which budget we are referring to as to how I would define "budget".

Senator Manning: On page 1-6 of the Foreward, reference is made to the fact that there is a radical change in the form of the Estimates for 1970-71 and some reasons for that are given. Item number 4 says:

> The decision of the Government of Canada to adopt a system of budgeting by programs, a "Planning, Programming, Budgeting System," with its emphasis on defining program objectives and showing the full costs for each program, was also a determining factor.

My question is as to the extent to which the Government has adopted what is usually understood by the term "program budgeting". This term is rather loosely bandied around these days, and I would be interested in knowing precisely what definition is being put on this term in our budgeting?

Mr. Osbaldeston: Mr. Chairman, in terms of the form in which the Government receives proposals for expenditure from departments, in terms of looking at the organization of government departments and in terms of setting priorities, I think I can say that the Government has fully implemented program budgeting. By that I mean to say that the form of these Estimates sets out an objective, sets out the activities to achieve that objective, both in written and in dollar terms. It does not simply deal with what we call standard objects such as the amount of postage, but rather these Estimates deal with the amount of postage that would be spent, susing as an example my own branch, by the Programs Branch of the Treasury Board in pursuit of its objective which is the development of this country's budget. So in terms of these Estimates, I think we have adopted it fully.

Secondly, when the Treasury Board is reviewing the proposed organization of departments, we are concerned

with and do receive from departments a statement of their objectives, both overall departmental objectives as spelled out here, and also a statement of the objectives of the various activities, and then we try to interrelate the organizational—perhaps I can describe this by the little boxes on the organizational chart—we try to relate that with the activities described and with the objectives described to make sure that there is inherent logic in the organization vis-à-vis the objectives of the department.

Senator Isnor: When do you receive that?

Mr. Osbaldeston: In terms of the budget, we have a planning program and budgeting schedule. For 1972-73 we receive what we call the "base A budget", which is the cost of the ongoing operations of the Government. We receive that at the end of January for 1972-73. We then receive proposals for new programs by the end of April of the same year, in fact the end of this April. We then marry these two, the ongoing cost of Government, less productivity gains, less activities stopped, with a new proposal, to come up with an expenditure budget for 1972-73.

In terms of the organization chart, we receive that when department objectives change. An example of that is, say, the Department of Fisheries and Forestry where you have a changing objective not related to fisheries and forestry but rather a broadened one to include the environment, with new units coming in such as water units from the Department of Energy, Mines and Resources.

You then have to define a new objective for that new department, which is both an amalgamation of the old units plus the broader objective. We then look at the organization. We do not simply add things on, just mix them together as they arrive at the new department, but we reorganize the units in keeping with the objectives, in keeping with the new department, and in keeping with the activities that the department will carry out.

Therefore in those terms, and from looking at organizations, we have arrived at full program planning and budgeting.

However, the real key to program planning and budgeting is the clarity and precision with which you define objectives. That is both an imaginative task and a task in logic. When you get to that point, the follow-on step is the determination of the effectiveness—how effective are your programs and expenditures in terms of your budget; and inherent in that of course, is the question of efficiency. You may be very effective, but are you using a cannon to swat a fly?

In those two terms we, like all other governments and other organizations, have a great deal to learn. We have certainly lanched effectiveness studies and we are well involved in efficiency studies. That aspect of program planning and budgeting will be with us forever.

Senator Manning: Is this program advanced thus far to the place where there is any significant emphasis on monitoring, which gets back to measuring your cost-effectiveness of these factors?

Mr. Osbaldeston: We are doing two things relative to the monitoring of the effectiveness and efficiency. The first thing we are endeavouring to do is that when a new program is prescribed or a new activity proposed which requires a new allocation of resources, we have built into that objective a new technique of evaluation. If someone says they require new resources to achieve a certain end, we are becoming more demanding in terms of how you are going to measure whether you meet that need, the efficiency factor and the effectiveness factor.

The second thing we are doing is in the older programs which, because of population increase, have a tendency to grow. Before we would agree in the Secretariat to provide more money for the ongoing program, we are saying "What are your indicators of efficiency? Why have you not got a productivity gain over the last year? Why cannot you, from your own resources of 1971-1972, cover 2 per cent increase in population? Surely, your efficiency has improved to that degree?" Those are the two direct methods of building-in, if you like, creating an atmosphere where efficiency indicators are required.

The third technique which we use in our planning branch of the Treasury Board Secretariat is simply to select programs because of the demands on public funds that these programs have, or, because of the importance of the programs, simply to select a program and tune in to develop efficiency indicators and to begin work on the question of effectiveness.

Those are three ways, senators, that we attempt to get at the problem.

Senator Manning: As that monitoring proceeds during the year to which the Estimates apply—and I am not quite clear from your answer whether the monitoring is a responsibility with which the individual departments are charged or whether there is an overall monitoring apart from the departmental monitoring—what machinery exists today to follow up any indications, that arise from that monitoring, that there is a lack of efficiency or you are not achieving good cost effectiveness in the program? Does that just run on during the year, or is there a corrective process during the terms of the Estimates?

Mr. Osbaldeston: The responsibility for good management always resides in the management. There is no question in my mind, nor, I am sure, in that of the Government, that that is so.

Senator Grosart: Who is the manager?

Mr. Osbaldeston: I am speaking of the deputy head and certainly the minister, but in particular the deputy head. Equally, however, there is responsibility on the secretary of the Treasury Board for the good managerial practice of the public service generally. Therefore the question of efficiency and effectiveness is a shared responsibility.

Perhaps more important than either of these distinctions in theory is the fact that the talent available in this field is limited. Therefore it can be shared more readily by having it located in a central agency. That is the fact at the moment with respect to the question of effective-

ness when you really get into some of the esoteric techniques they use.

As to whether or not the efficiency is permitted to run on to the end of the year and is only checked when more resources are requested, the answer is no. The manager, first of all, has a responsibility each and every day to ensure that his operation is as efficient and effective as possible. Secondly, the President of the Treasury Board and his secretariat have to share that same responsibility.

I might repeat that we have these points of check: when they require new resources or organization; we just select new programs ourselves in the secretariat and have a look at them.

The Chairman: In our examination of growth, employment and price stability it has been suggested to us that it will be essential to examine the various programs of the federal Government in terms of their contribution to stabilization policies. Can you tell me whether in the program planning and budget system there is any examination of the present Government programs in terms of their stabilization effect and, if not, whether in your judgment the program could be made to do just that, or has that capability inherent in it?

Mr. Osbaldeston: Mr. Chairman, I believe probably the general answer to your question is that the programs of the Government are considered in terms of the stabilization effects, or the generalization.

However, I must make my meaning clear. In terms of the Government process of establishing an expenditure budget, the Government is guided by the Department of Finance in terms of an economic policy. They receive advice from the Department of Finance relative to the economic situation. Having received that advice, the parameters of expenditures are thereby set and the Treasury Board acts within them. That is their first effect, which is certainly to establish the parameters.

In addition to that, as you know, Mr. Chairman, the Department of Finance and the Department of the Treasury for many years were one department. We still reside in one building and, fortunately, our relationships are good. In addition to that we have constant communication on a daily basis, back and forth, relative to the major elements in the programs of the Government. We are not suggesting to you for a moment that every two man-year increase is a matter of discussion between the Department of Finance and the Treasury Board. Certainly, all the major issues are a matter of discussion.

Secondly, obviously when the Government is considering new policy positions in the economic field, both the Department of Finance and the Treasury Board are present through their representatives and both contribute, and at that point again I suggest the Department of Finance brings forward questions of stabilization.

The import of my answer really is to say that I believe it goes on. I see it going on. I am not as conscious, not being in the Department of Finance, of it happening at a point of time or in a certain process. I think Mr. Reisman could probably describe that process better than I, but I see it happening relative to my own sphere.

The Chairman: Are you talking of the overall budgetary effects or are you talking of individual programs? I think you were talking about the dairy program earlier. Certainly I can understand the Department of Finance being concerned about the overall effect of its budget, the cash requirements and what effect the budget has on stabilization generally. Indeed, we have dealt with that. What we are being confronted with now is the individual fiscal effect of a program such as the dairy policy. Is it contributing to the general stabilization policy of the budget, or is it drawing you away from that policy?

Mr. Osbaldeston: I find it difficult to answer that, because I am not sure of all the processes that occur in the Department of Finance before or after a discussion with the Treasury Board on the merits of a particular program. This is the reason why I hesitate. Certainly all these programs are discussed, and the relative merits and de-merits are discussed with us. Obviously the conversation between the Treasury Board and Finance officials takes place relatively frequently on the program merits. Other considerations no doubt are in the minds of Finance. Certainly on occasions these are very evident and come forth very clearly. I can therefore only assume that across the whole range of program consideration the Department of Finance deals with concerns on those particular issues.

The Chairman: It would be in the hands of the Department of Finance?

Mr. Osbaldeston: Let me put it this way. They are certainly aware of, or participate in, all the individual decisions relative to program allocation, either at the policy stage or at the program budgeting stage when the budget is made up. They are aware of all these; they participate in them, and I assume they do some micro-analysis, if you like, of the total expenditures and their effects, but I am not a party to that.

The Chairman: Would the Treasury Board be equipped to do that? In the program planning and budgeting would it be equipped to do that?

Mr. Osbaldeston: I would suggest that the Department of Finance would be better equipped to do it rather than the Treasury Board.

Senator Grosart: On this same point, could you tell us in rough, broad terms how many programs have been terminated as a result of PPB examination over any representative period of time?

Mr. Osbaldeston: I do not know that I can. I think very few would be terminated as a result of an effectiveness study. I think there would be very, very few.

However, what really happens here is that we have a living creature in terms of the budget and the allocation and many programs are absorbed into and drastically changed during the course of that absorption. If I may give you an example of that, senator, I had some experience with the creation of the Department of Consumer and Corporate Affairs. There a determination was made that all the retail inspection services of the Government

should be located in one department, previously having been located in the Department of National Health and Welfare, the Department of Agriculture, the Department of Fisheries, and the Department of Industry, Trade and Commerce.

In a sense, none of the programs was terminated as a result of planning, programming and budgeting. What did happen, as the result of planning, programming and budgeting, where the Government saw as an objective a retail inspection service, these four units were drawn together, interwoven, amalgamated and instead, in effect, of having four retail inspectors visit one shop, one general inspector visits the shop now.

That is why I hesitated for a moment. I would not want to say to you that those four programs have been terminated. On the other hand, as a result of planning, programming and budgeting, you have a great efficiency and effectiveness. All four programs continue, in a sense, but in another form, under another guise.

Senator Grosart: I realize that you have not had a very long experience with the PPB system. Could you give us some kind of an indication of the kind of quotient of efficiency that might have been achieved—not necessarily in terms of termination, but in terms of amalgamation, coalescence, transfer, and so on?

The point of my question is that in the PPB System you lay out the objectives, then you have sometimes sub-objectives, then you have program descriptions. My understanding of the essence of the system is that you relate these finally to the accomplishment, in terms of those terms of reference. What has been your experience? Has it worked? Have you really been able to say you have found a number of programs that have not reached their objectives, a number of program descriptions that have proved to be unrealistic in terms of achievement during the year. I am a believer in PPB with some reservations, because it seems to me it is a kind of poor man's systems analysis.

The Chairman: It might be better described as a rich man's system—a very rich man's system.

Senator Grosart: It is a poor man's system of technical auditing and systems analysis but I believe it is the best under the circumstances and I think it is a great thing that we initiated it. Could you give us some picture of the success it may have achieved in this short period of time? Really we have only one year's experience of it.

Mr. Osbaldeston: That is correct, sir. Since you have asked a general question, perhaps you will permit me, sir, a sort of personal commentary, because it is not susceptible to a hard answer. Therefore, if I am to be permitted to make some personal remarks, they are from my own experience.

I only took on this position in the department a year ago. This year I was faced with the full exercise of trying to determine, in the terms of recommendations to the Treasury Board, what the appropriate levels of funding were for each program, item by item, and what would be appropriate recommendations to make to the Treasury Board relative to new programs. I suppose, in simple terms, I do not understand how anyone could do that. Never having been faced with it, I simply do not understand how anyone could do that, using standard objects, which was really the alternative or the old method.

Senator Grosart: Yes.

Mr. Osbaldeston: The fact that a department wanted a 10 per cent increase in postage, in isolation from any other information which was really the case, seems to leave one in a totally arbitrary situation as to whether they need a 10 per cent increase in postage or not.

My experience in the last four months in reviewing the total budget for 1972-73 would indicate to me that PPB is extremely successful in pointing out overlapping activity, because they have to describe in words what they are going to do. They cannot just do it in postage. So in words you can see an overlap. It is there in the program forecast of department "A" and department "B". They are describing the same thing and you only recommend to the board that they fund one activity and you go on further to recommend that consideration be given to melding the activity. And so it comes out.

The second fact, in going through this, is that when they describe in words what their objective is, even in the absence of an indicator on their objective, you could make, I would suggest, a pretty good subjective decision as to whether or not they are successful, because the facts are probably fairly self-evident in the economics of the country or in the social life of the country.

Relative to that latter comment that you can make some pretty good subjective decisions in terms of making recommendations to Treasury Board, we all hope that the PPB will then go the next step to indicators of efficiency. We certainly have advanced from even last year, senator, in terms of work-load indicators—the sort of lower level of the efficiency measure. We have advanced to performance indicators. To use an example which does not apply, we may not worry about the cost of issuing licences to drivers, but perhaps we worry about the number of drivers who are issued licences who then later prove to be defective in eyesight or something else. There you really have an indicator of the performance of the system giving rise to the issuance of the licence.

So I would say, senator, from these very personal observations in the last four months, that it is enormously helpful and unquestionably saves large amounts of money in terms of stopping duplication and in terms of amalgamating units that clearly should be amalgamated because the two units are reputedly doing the same thing. And there are any number of cases where we will be recommending to the Government, and when I say "any number of cases" I am speaking in the order of tens—ten, twenty, thirty cases, where we would be suggesting that the PPB system has shown merit in some sort of amalgamation or some sort of change in organization. And I think that each year that is going to increase.

The Chairman: I have a supplementary to your question, Senator Grosart. Is there a large amount of duplication in the systems analysis work that is being done by

the departments in order to satisfy the program planning and budgeting of the Treasury Board? In other words, is there a whole area in each department or in many departments that is in a sense a duplication?

Mr. Osbaldeston: Well, I should be clear on my own resources. I have 40 officers in my own branch. I want to make that quite clear. And therefore in sheer numbers the possibility of duplication becomes rather small.

The Chairman: I was not talking about your department.

Mr. Osbaldeston: You mean, between departments?

The Chairman: No, but whether, say, National Defence, in order to satisfy the requirements of the Treasury Board have a whole system of systems analysis that feeds upon itself and grows into a major bureaucracy that is, perhaps, unnecessary.

Mr. Osbaldeston: Well, Mr. Chairman, first of all I would hope that no one in this government undertakes any aspect of program planning budgeting simply to satisfy the Treasury Board. The only sense in program planning budgeting is that it permits the manager of that department to carry out an efficient and effective operation. If I were of the opinion that my branch was asking departments for information and material not pertinent to the management of that program, I would try to stop it, because it would make no sense at all on two counts. One, if it is not pertinent to the manager and it has nothing to do with his view of his operation and it does not relate to the efficiency or effectiveness of his operation, I do no know why I would want the figure. That is the first and the last problem I would have. I think it would have no meaning to me just as it has no meaning to him. Secondly if he as a manager and the Treasury Board secretariat centrally controlled with management are asking the same questions, we are overdoing our demands relative to the payoff. It always strikes me that program planning budgeting is akin to cost accounting. The same rules apply, as I recall from my days in university, namely that you should not install a cost accounting system that does not have the possibility of a greater benefit than the initial cost, otherwise it is sheer waste of money because there is no way to get that money back.

To be specific as to whether or not I believe we are now doing that, I must answer no, and I believe we are a long way from doing that. The problems in doing good work in effectiveness are simply enormous. I do not believe that we have the talent now to do all that should be done or could be done, and I do not really believe it is available in terms of gross numbers—people competent to do that work.

Secondly, I do not believe we should initially expend enormous amounts of money without having drawn up the techniques. The techniques themselves are simply being developed now; they are not in all cases present here and now. They are simply being developed, and if we are experimenting and testing, we should do that on a selective basis.

The Chairman: The point I am getting at, and I may be missing the point entirely and if I do, please correct me. In order to present their budget to Treasury Board, it presumably has to be presented by the departments in a certain form. That obviously because of the emphases that you put on certain goals causes them to be involved in systems analysis, and I just wonder then if they are involved, whether the individual departments are not letting their systems analysis go beyond into self-sustaining organizations and doing things that Treasury Board in fact should be doing.

Senator Grosart: Has any department any kind of systems analysis operating?

Mr. Osbaldeston: I would not want to use the word "systems analysis". That is a better defined and more rigorous discipline. There are a number of departments that have planning branches, project branches, or research, and they are doing their program analysis, as I will call it. I am not aware of any of those units which I would call overexpanded. I pause to mentally review in my mind some of the ones that I know of.

Mr. MacDonald: I might add that one of the areas in these program reviews that the Treasury Board has looked on most unfavourably has been in the administrative areas, in which the program analysis takes place.

The Chairman: I think that answers the question.

Senator Hays: In connection with this planning, I was wondering how closely you are looking at old programs in various departments? The new programs get a thorough overhauling when they are introduced, but it is the old ones that we get into trouble with—the continuing programs which have not reached their objective and are not going to. Do you, in your department, have an opportunity of bringing in people from the private sector to look at a certain program and say "Is this program going to be good for what it was originally intended to do?"

I can think of many programs, that when I was in the Department of Agriculture I thought should be looked at, and which had been operating for 25 or 30 years. If we introduced a new program, everybody took a whack at it. Once you got it on the books it was not very hard to keep it there.

The Chairman: Perhaps you should tell us about the time they tried to cross the buffalo and the cow. Is that still going?

Senator Hays: No. This was a program whereby we were going to develop an animal called a cattalo, a cross between a beef animal and a buffalo. The program started in 1960. We accumulated thousands of acres to propagate these animals. The buffalo is not a very fertile animal. We did not seem to achieve much, but it was a pretty costly program. Nobody had ever taken a look at this program. Each year there was so much put in the Department of Agriculture's estimates to carry on the program. That is just one example.

There are all sorts of examples. I wonder how you approach the old programs? It seems to me that the old programs are the ones with which you have the problem.

Mr. Osbaldeston: I agree entirely with what you say. The established programs in a sense are more difficult to deal with, in simple terms that they have been there for a long time, the people running them have been there a long time, and it is more difficult to come to grips with. When someone requires a funding for a new program, enormous attention is focused on the new program. However, even the old programs need more money just to stay abreast, to stay even.

The Chairman: And that raises the issue.

Mr. Osbaldeston: And that raises the issue. Therefore in these days even the oldest program comes forward seeking 4 per cent increase, just to stay even.

Senator Hays: Of course, you generally chop that off by saying "We will start off with a 10 per cent reduction on all departments."

Mr. Osbaldeston: On occasion that also is a healthy process.

The Chairman: That is when the PPB method fails, you just say "chop 10 per cent."

Mr. Osbaldeston: We are creating in departments an independent capacity of the program manager to look at old programs. In other words, a man whose livelihood and reputation is not riding on that program. He is an independent person, attached to the deputy minister's office and can usually look at the program coolly and calculatingly.

It is to the benefit of the department in many cases if they can switch funds under this program planning aid budget system, move money within a department. Therefore there are benefits to the overall management of the department, if they can locate a slow program, to move it into a program which is far more effective. So there is reason for them to do it.

Secondly, we are creating in the secretariat a capacity to select an old program and look at it from the point of view of efficiency.

Senator Hays: You just spotcheck them and say "We will look at 'X' number of programs within the department."?

Mr. Osbaldeston: That is correct.

The Chairman: Can you give us an example of an older program that you have by virtue of this examination caused to discontinue?

Senator Hays: The *Bonaventure.*

Mr. Osbaldeston: In terms of efficiency, we now have sent teams for the planning branch into twenty different departments. I can think of two offhand which come to mind. This has been in co-operation with the department; they are always done with the assistance of departmental personnel. In both the Unemployment Insurance Commission, when it was an agency, and in the Department of Veterans Affairs, we saw declines in requirements, even though demand was increasing, because they established efficiency performance indicators.

One of the things which we are doing in this area again is relative to regional operation. It is very difficult to compare the efficiency of a department with any other organization, because there is only one Department of Veterans Affairs and it does a very unique job. It is very difficult to find out how effective or efficient it is in the absence of a standard. We can compare the efficiency of their Toronto operation with that of their Vancouver or Halifax operation and if there is a discrepancy in that regional interoffice comparison, at least we can ask the question, why? There may be very good reasons for that discrepancy in efficiency between offices. So we have had success, as I mentioned, and I see it in the figures when this money is requested to do the same thing, because they now have performance indicators and are demanding higher performance of their managers. It is rather encouraging to see that sort of thing.

Senator Hays: Are we going to consider any of the various programs in the Estimates tonight?

The Chairman: You are free to do so if there are any on which you would care to question.

Senator Hays: I refer to page 23-14, on bilingualism. Last year we budgeted for $54 million and I see it is up to $78 million. We took quite a long look at this last year and I suppose the name of the game is to teach people that speak French, English and those that speak English, French. This should be a pretty easy program to determine whether you are getting through or not.

How many people speak French now in western Canada, or are we using new methods? We have been teaching French in schools since I was a boy. We do not know how many people in English-speaking Canada speak French and in French-speaking Canada speak English.

Mr. Osbaldeston: To my knowledge, there has not been an assessment such as you speak of to determine precisely the effect of these expenditures on the creation of bilingual Canadians. Quite frankly, I think it is a little early to make that sort of an assessment. If I may be permitted a personal minor assessment, I do know that my own children in their own school can have a half day in French, starting in kindergarten. Certainly, if I may make another personal reference, if you will excuse me, they can speak far more French than I ever could at their age. I think it is a little early to make a formal assessment of the success of that program.

The Public Service Commission is engaged on a somewhat similar exercise for the public service, and Mr. Carson has given statistics, as I recall, on the success they have had with their schools. I think he has been not as satisfied as he might have hoped to be at this point, but equally I think it is quite clear that they are creating more bilingual civil servants. If one can extrapolate that

experience to the broader Canadian scene, one could perhaps be hopeful, but we simply have not done the sort of work you suggest, and I think it is a little early to do that.

Senator Hays: You probably do not have this information, but perhaps the committee could have it. How will this $77 million be distributed among the provinces? What is the formula?

The Chairman: Mr. Osbaldeston tells me he could provide that information. Would that be satisfactory?

Senator Hays: Yes. I realize you probably do not have that now.

Mr. Osbaldeston: I do not have that information with me.

Senator Hays: What I would like to know, and what I think would be useful to the committee, is what do the provinces of British Columbia, Alberta, Saskatchewan and Manitoba receive of this $77 million? How is it distributed?

Mr. Osbaldeston: If it is agreeable to you, senator, I will endeavour to secure that from the department and convey it to you.

The Chairman: Is that satisfactory, Senator Hays?

Senator Hays: Yes.

The Chairman: I would suggest then, Mr. Osbaldeston, if you send a copy to Senator Hays and a copy to the chairman, I will table it at the appropriate time.

Senator Grosart: We had that question last year.

Senator Laird: Did we get the information?

The Chairman: I do not recall an undertaking. There are some items here that I have to table later in the meeting from previous meetings, but they do not include that.

Senator Hays: We asked for some information on education of Indians.

The Chairman: Yes, and we got that. I sent that to you.

Senator Hays: We received that. I do not know that we asked for this information in connection with bilingualism.

Senator Grosart: It does not matter.

The Chairman: There were questions on the bilingualism program. If you recall, at that time we had the Secretary of State here, or officials from the Department of the Secretary of State, and at that stage they had not finished their negotiations with the provinces.

Senator Grosart: That is right.

The Chairman They were loath to give us information for fear that it would seriously affect their negotiations with the provinces, and I think at that stage we agreed we would not ask for the information. I think that is why we have not got it.

Senator Hays: I think it is distributed on a per pupil basis. I believe this is a program that certainly your department will have to watch very closely, because this figure can be up to $500 million very quickly. It has jumped from $53 million to $77 million in the first year.

I have another question on Air Canada. I hoped to ask it last year. Many of us purchased Air Canada credit cards, for which we paid $400 or $500 some years ago. We never received any interest on that. Now we can get the CP credit card for the asking. Air Canada are still holding that deposit. There must be thousands of dollars on these air credit cards. I was wondering what the policy of the Department of Transport or Air Canada is in connection with this?

Mr. Osbaldeston: Mr. Chairman and senator, I would have to seek more information on this, because I do not know the facts surrounding it. If I may, I will secure the information on it.

Senator Grosart: It may be that they only charged for bad risks.

Mr. Osbaldeston: Senator, I do not have one of those cards.

Senator Hays: This is a nice piece of business; if you can get away with it for a long time, you are doing pretty well.

The Chairman: Will you endeavour to give us the same information on that?

Mr. Osbaldeston: Yes.

Senator Isnor: I was going to ask the witness about his staff of 40. Are they divided up into certain departments? What is the procedure there?

Mr. Osbaldeston: Senator, I have a staff of 40 officers. In total, my staff is 86, including stenographers.

Senator Isnor: Including the 40 officers?

Mr. Osbaldeston: Yes, including the 40 officers. I want to be accurate. There are 40 officers who are divided on a planning, programming and budgeting basis, interestingly enough, at the beginning of this year. When I say that, I have five divisions, each headed by a director. If I could use one of the divisions as an example, it is this. I have a director of industrial and natural resource development. He has, below him, two group chiefs: one is responsile for all of the programs of the Government as set out in this Book, program by program. One is responsible for all of the programs of the Government relative to industrial development. His responsibility crosses departmental lines. He is responsible for the northern development program of the Department of Indian Affairs and Northern Development. Whereas, one of my directors responsible for social programs has responsibility for the Indian and Eskimo program of the Department of Indian Affairs and Northern Development. So, in effect, we have taken

the programs of the Government, regardless of department, and divided them up amongst my people on a functional, or, if you like, program basis. There, each director has a responsibility probably for the parts or the whole of about 15 departments or agencies of Government. Does that clarify it sufficiently?

Senator Isnor: That is far enough on that. Dealing with one particular section of your audit branch, Regional Economic Expansion, nearly every day, senators, members of the house, receive circulars saying that grants are being extended to so-and-so and so-and-so. Have you any control over those at all? Is there any accounting to you, or is that done just by the ministers?

Mr. Osbaldeston: By "the act", I believe you are referring to the industrial incentive grants under the IRDIA Act. The minister has the authority to make grants up to certain limits within the act, limits relative to the amount of the grant, in terms of the number of people likely to be employed and, secondly, limits relative to the total capital to be invested in the particular plant.

Secondly, of course, the minister has the limits imposed by the statutory vote, by the Appropriation Bill, in the gross amount of money which he can expend or commit. As to each individual transaction, senator, the Treasury Board secretariat or the Treasury Board is not involved in those day to day transactions.

Senator Isnor: That is ministerial?

Mr. Osbaldeston: That is correct, sir.

Senator Isnor: That is direct ministerial?

Mr. Osbaldeston: That is correct, sir.

Senator Isnor: Why I asked that, Mr. Chairman, is that you may have noticed, and I feel senators may have noticed, that there is a list sent, every day or every second day, on these grants. The grants centre around two provinces in particular, and there are two or three loans in other provinces. It does not look as if care has been exercised to spread as much money as possible through the whole country. That is what I have in mind.

Mr. Osbaldeston: Mr. Chairman, I should point out that these industrial incentive grants, to speak to that group of grants under the Minister of Regional Economic Expansion . . .

Senator Grosart: Are those not found under the Department of Industry, Trade and Commerce?

Mr. Osbaldeston: There are other types of grants, senator. The dip grants and the peak grants, but I was referring to the industrial incentive grants under the RDI Act.

I was going to mention that those grants are restricted to plants located in designated areas of the country. By definition those areas do not cover all of the country. In particular, the designated areas are located in the Maritimes and parts of Quebec and very small areas of Ontario and so on across the country. But they are designated areas, senator. Therefore, you would not, I believe, expect to see what I would call an even distribution. They were designed to assist the Government in overcoming regional disparities. Therefore, selected areas were designated to benefit from those grants.

Senator Laird: That would be government policy.

Mr. Osbaldeston: That is correct.

Senator Isnor: And those decisions are made by the minister.

Mr. Osbaldeston: That is correct, sir.

Senator Grosart: When you come to the end of the year on the activities of the Department of Regional Economic Expansion, how close do you think the Public Accounts will come to the Estimates in terms of described programs? On the point Senator Isnor is making, one gets the impression from these almost daily press releases that the thing is pretty well on an ad hoc basis. That is not necessarily a criticims, but the program descriptions do not seem to be very exact in the Blue Book.

The Chairman: What page is that, senator?

Senator Grosart: It goes from page 22-1 on. There are some very specific grants in there.

Mr. Osbaldeston: Senator Grosart, Mr. MacDonald has pointed out one way of checking on the accuracy, if you like, of the forecasting of the Department of Regional Economic Expansion. On page 22-7 in the middle column you will find the forecast expenditures for 1970-71, and the total there is $263,225. That is the second column in the middle column. But on page 22-4 under "Estimates, Approved," for 1970-71 you have that which was voted in the 1970-71 period of $270,793,500. Therefore, their forecast of expenditures for 1970-71 came very close to what was actually approved in that year for expenditure purposes.

Senator Grosart: That is in general terms, but my question was; when you come down to the specific programs, the ones that seem to be announced on an ad hoc basis, almost from day to day, how close will these come to the detailed forecasts given to Treasury Board? There must be more detailed forecasts than there are in here. This is not a critical question; I just wondered how close you can come in looking at so vast a problem as regional incentive programs.

Mr. Osbaldeston: In terms of how close you come, it really is a question of forecasting expenditures against a prior commitment. This is really what you are involved in, because you enter into a commitment today to fund a new enterprise perhaps starting in six months in terms of construction and receipt of grants, and it is going to be in construction for perhaps a year or two years or maybe even three years, and therefore it is a question of how good you are at expenditure forecasting relative to a commitment. The experience we have had with the Department of Regional Economic Expansion is that they are quite good in the gross, and in that gross forecast obviously there are many changes, I would imagine, but

in the gross they are quite good at the expenditure forecasting.

Senator Grosart: They would obviously stay pretty well within their gross.

Mr. Osbaldeston: That is correct.

Senator Grosart: But what I am wondering is how close are they coming in their forecast project by project or program by program within the regions.

Mr. Osbaldeston: I cannot really answer that because I have not gone through it myself project by project. So I cannot answer it from experience, and I have not seen a figure on the individual projects and check-marked "yes" or "no" and had a tabulation done as to whether they were correct on individual projects. I have only seen the gross figures.

Senator Grosart: Would there be any publication of a comparison between the proposals and the actual projects accomplished? The reason I ask this question is that economists keep telling us that they cannot get the information they need from the Government to assess the accuracy or the validity of Government planning. This comes up also, of course, from the regions; Nova Scotia thought it was going to get more and New Brunswick thought it was going to get more. This particular area assumed that a project would go ahead. One assumes that there are going to be many changes in the course of a year as projects and priorities are assessed, but it would be very interesting to know just how close actual performance is to forecast in these very large expenditures.

Mr. Osbaldeston: I really think you would require the Minister or Deputy Head to answer that question properly for you. Clearly they have been quite good in the gross amounts, but how many switches and changes were made within that I really could not comment on.

The Chairman: Do you ever look at that even on a spot-check basis.

Mr. Osbaldeston: My officers look at it in order to determine the expenditures, if you like, for the Department of Regional Economic Expansion likely to occur for 1972-73, and you have to look at the commitments they have already entered into for that year, the commitments they are likely to enter into in the coming year to arrive at a figure. In that sense we look at them.

The Chairman: That is proposed expenditure.

Mr. Osbaldeston: The commitments they have made. The budgeting in advance.

The Chairman: Do you ever go back?

Mr. Osbaldeston: We have not. We are presently trying to look at this again, to see what was thought to be the expenditures arising in 1971-72, and what was the real experience. Again, we would not look at those item by item, as there would be so many. We would rely upon the departmental staff to give us subtotals broken out the way we want them to be broken out.

Senator Grosart: Is this public information, forecast versus performance?

Mr. Osbaldeston: I do not think it would be a problem of forecast versus performance. I think that question should be put to the minister. I would have thought that so many of these commitments are with private firms, and as to whether or not private firms did or did not proceed might be considered confidential by the minister.

Senator Grosart: In view of the tremendous controversy that is going on as to the efficiency of our regional economic expansion program—it is an honest controversy—it would be very interesting to have some kind of data from which we could assess the regional analysis of the needs in one year for expansion in an area against what was actually done. It would help to evaluate the validity of the policy. In the normal course, are these two sets of figures published? I am not asking if they are available. Are they published in the annual report of the department?

Mr. Osbaldeston: To the best of my knowledge, they are not.

Senator Isnor: I feel that they are published, Mr. Chairman. I think every circular that comes out gives us the amount and the number of jobs that it is estimated it will cover.

The Chairman: That is correct, senator. At least, the contract that the department enters into is given. I think it reviews its undertakings after a certain length of time to see if they have been lived up to. I think you are quite right, that there is from time to time a release of the grants which the department has made.

Senator Grosart: Again, this is ad hoc. This is not what I am asking.

The Chairman: What Senator Isnor is saying is that as far as the expenditure is concerned, the information is there. So it adds to your point that that end of it could be put together. Those are project by project figures—entered into—agreed upon. That could be brought together, as Senator Grosart wants, and compared with the figures on which they prepared their budget in the first place.

Senator Grosart: Yes. It is very important to be able to assess the validity of the judgments of the department in asking for the original gross figure. Anybody can spend it and anyone who is reasonably wise can stay within it.

The Chairman: That might be an area of investigation that the committee might consider.

Senator Grosart: It would be an interesting one.

Mr. Chairman, I would like to ask an overview type of question. In looking at the Estimates I find, first of all, that the estimated increase is $913 million and the expected further supplementary Estimates is a decrease of

$40 million. This appears at page 1-23, at practically the bottom line. Expected further supplementary Estimates, 1970-71, then there is a comparison, 1971-72, 1970-71 and the decrease is shown at $40 million.

What is the present status of that figure?

Mr. Osbaldeston: The $40 million indicates what the Government expected to come up by way of supplementary Estimates in 1970-71 after they had tabled the main Estimates in the House. So up until the time they tabled, or this book was printed, the expenditures approved were $13.4 million. The Government anticipated further supplementary of $40 million in the final supplementaries, so they print it there. In the case of 1971-72 we do not print expected supplementaries because when we table the book we hope to have everything inside the book. Our hope is not always borne out in the event, but that is obviously what one tries to do.

Senator Grosart: It is a pious hope.

Mr. MacDonald: There was some discussion previously with respect to forecasting. It so happens we were not all that bad that time. The actual supplementary Estimates to be voted we tabled for 1971, after we said it would be $40 million was $29.9 million. It was better than our usual accuracy.

Senator Grosart: Yes, it was a very good record last year. On the increase side, leaving out loans, investments and advances, $913 million, four items take up $473 million, which is almost half. This is at pages 1-21 and 1-23. The four main increases are $256 million, National Health and Welfare, $109 million, Secretary of State Department. Just above it is $62 million, Regional Economic Expansion and over on the next page, the top item, $46 million.

Could you explain why in these four departments there are these very large increases?

Mr. Osbaldeston: I think we would have to go to the detail if we may, Mr. Chairman, to see what the items are.

Senator Grosart: I am just saying that these four items take up $473 million of the $988 million.

Mr. Osbaldeston: On page 16-2, to deal with National Health and Welfare, Mr. Chairman, if you read about halfway down the page, there is an item in the line entitled "Hospital Insurance and Diagnostic Services Act Contributions" and in the third column, "Change," that item increased by $91.6 million. Directly below that is "Contributions to the Provinces under the Medical Care Act," which increased by $110 million, representing an increase of $200 million.

Following the "Change" column right down to the bottom item before the heavy print at the bottom of the page, you will find an item of $47,848, which is the Canada Assistance Plan payments, which increased by $47.8 million.

Senator Grosart: Wy did the Hospital Insurance and Diagnostic Services Act contribution go up $91 million?

Mr. Osbaldeston: We are paying 50 per cent of both of these items on a share cost program. If you simply take into account the increase in salaries and wages involved, in effect the medical fees, or schedules established, in the case of the hospitals the cost of staff, you come out with quite large figures on that basis alone.

Senator Grosart: It would have to be little more than just demographic increases, would it not?

Mr. Osbaldeston: Yes, they would be more than that.

Senator Hays: You do not have control of that.

Senator Grosart: It is open end.

Mr. Osbaldeston: Yes, it is a cost share program.

Senator Hays: The provinces do the spending; you just do the providing.

Mr. Osbaldeston: That is correct.

Senator Grosart: Under the contribution to the provinces under the Medicare Act, which again is an open end, $110 million. I am just asking why these federal contributions to health care have gone up as substantially as they have.

Mr. Osbaldeston: In the case of the contributions to Medicare, more contributors joined in that year, and that accounts for that rather large increase over the base of $550 million. You mentioned some others.

Senator Grosart: The Canada Assistance Plan. That is the same reason; that again is open end.

Mr. Osbaldeston: That is correct. The other one you mentioned was?

Senator Grosart: The Secretary of State, $109 million.

The Chairman: There is one before that, Regional Economic Expansion $62,550,000.

Mr. Osbaldeston: That one, senator, relates in large measure I believe to the industrial incentives program, page 22-2. In the "Change" column, moving down to the third item from the top, "Grants and contributions", you find an increase of $57.8 million. If my memory serves me, that relates to industrial incentives. Mr. MacDonald says $45 million of that relates to the increased industrial incentives program.

Senator Grosart: Just to give us a little exercise in reading the Blue Book, would you guide us from that item in the general summary of $57 million to the detail?

Mr. Osbaldeston: You find on page 22-4 under the "Change" column, Vote No 10, where we now start to get closer to the detail, there is a description here as to the item. Then further on you have a grants in contribution table . . .

Senator Grosart: Excuse me. We do not get very much closer to the detail, because the summary figure is $57,826,000, and the Vote 10 figure is $57,825,800. It is almost

but not quite the same figure. I could hardly call this detail.

Mr. Osbaldeston: I am just going on. I do not think we will come right down, but we can certainly get closer in terms of an explanation. On page 22-12, looking at the grants and contributions table, you have a better description under the contributions of the items involved, or a description of what the contributions are for. Then you have a break down of how much goes for development planning and administration, industrial incentives, infrastructure assistance, and social adjustment and rural economic development. That, senator, I should point is then set out in written detail on 22-8, where in words we have a description of development planning and administration, industrial incentives, at the bottom lefthand corner, which describes in more detail the purposes of the allocation of this.

Senator Grosart: My problem is still that, if I take the only detail that you seem to have given me, which is on 22-12, where I find the proposed Est mates 1971-72, are $293 million and the forecast expenditures 1970-71 are $231 million. The difference I find here is $62 million, which is about the amount we are talking about. But this is pretty broad. Development planning and administration, an increase of $4 million. Industrial incentives, a large increase. Infrastructure assistance, $7 million increase. Social adjustment and rural economic development, $9 million. This is hardly detail. Where do I go to find out, for example, what the intention of the department is in spending from an increase from $73 million to $114 million in industrial incentives? Where would I go?

Mr. Osbaldeston: You would have to go to such places as the annual report of the department, and supplementary material, senator. Given the size of the Estimates as they presently stand, the detail, which I know the senator will appreciate, is greater than in previous years but still not sufficient to answer that sort of question.

The Chairman: It sounds as though you are laying the groundwork for an investigation.

Senator Grosart: No, no, not at all.

Senator Hays: We have that sent to us, if you so desire. It comes to my office every time there is a new program, as to where the location is, and so on. I have it all.

Senator Grosart: That is not my point. This is what goes on on an ad hoc basis. If I want to find out why the department wants this very large increase in the industrial incentives program, what I am interested to know is, can the department tell you, as of the moment that they put those in the Estimates, exactly what the industrial incentives programs intend to spend that money on. This is because perhaps of the experience from the science policy side and technological forecasting, I would like to find that.

One of the measures of management efficiency is to relate forecasts of expenditures to actual expenditures. I do not find much opportunity here. Although I must accept your word that the Blue Book now gives us more information, it certainly has less votes, far less votes, than in the old Blue Book. I suspect that there was a little bit of a snow job done on Parliament when this PPB System was put in. There certainly was a very large decrease in the individual votes. It may not have been as good as the PPB System but in that sense there was mo more detail and certainly more control, in the sense that expenditures could not be transferred except within the votes.

Mr. Osbaldeston: If I may, relative to the first part of the senator's question, on providing detail in advance in a forecast, I think in a program such as this, where you have an Industrial Incentives Act, which is dependent upon the application of a private individual for benefits under the act, it would be extremely difficult to forecast in February, 1971 those people who would be coming forward in 1971-72 and making application under the act in a specific location.

The Chairman: But what Senator Grosart is sort of probing for is the information that you received from the department on which these raw or gross figures are based. He understands as well as anybody that in grant programs you cannot be sure what exact grants are going to come up. But he would like to know whether the figure is, I suppose, pulled out of the air or is based on real figures. I do not know whether you can give us those figures.

Senator Grosart: I am interested in that because I suspect that whatever the amount is it will be spent. Mr. Chairman, this would apply to almost any department in which there are grants.

Mr. Osbaldeston: Wherever you have grants that can be applied for, yes.

Senator Grosart: Yes.

Mr. Osbaldeston: As I mentioned earlier, Mr. Chairman, one of the basic elements in the figure for 1971-72 is the commitments entered into, and those figures are fairly hard figures.

Senator Grosart: They are ongoing figures.

Mr. Osbaldeston: That is correct, and they form part of the figure that is in this book. They were already committed before the book was committed and before they made their program submission to us.

Senator Grosart: They would have been provided for in the earlier Estimates, would they not?

Mr. Osbaldeston: No. If it is a program requiring funding over a three-year period, part of it may have been funded in 1970-71 and part in 1971-72, but we would know there was a commitment outstanding relative to 1971-72 and we would add up all the commitments.

The second element of trying to develop the proper figure here is to forecast what commitments are likely to be entered into, given response from the private sector.

Senator Grosart: That is right.

Mr. Osbaldeston: And what level of commitments one would hope to achieve or attract, if I can describe it that way, relative to the objective you have in certain areas; and that figure is one which you can only arrive at in terms of an overall strategy as to what you try to achieve and, secondly, an estimate of how much investment money you can attract under the program.

Here again the Treasury Board secretariat deals in gross figures. Certainly, as I deal with it in my review I can only call it a gross figure. You are dealing with the addition of the anticipations relative to the overall plan.

Senator Grosart: That is a beautiful phrase. What was that again?

Mr. Osbaldeston: At the level of the program force we are working at, you are dealing with the departments' anticipations of what they will attract under this program, and they put that against what they wish to do in a region or within this whole total program. In other words, you can ask for one of two things: what your plan would call for, given that you want to achieve that sort of input in an area; and secondly, you may wish to achieve that but may not be able in your judgment to achieve that amount of private participation. So therefore you would be asking for something less. So therefore it is the marriage of these two things: your program and what you hope to achieve by way of attracting the private sector.

Senator Grosart: This is really what I am getting at. If we want to assess the validity of the whole concept of regional economic expansion from the Blue Book, how can we get a look at departmental policy?

Let us take the Maritimes for example. Is it concentrated on a growth centre concept. or is it concentrated on development of rural regions in northern New Brunswick and so on? How can we find here what the department intends to do with this money at the start of the year when we are looking at it, and Parliament is saying, "Yes, you can have the money." Where do we go beyond the Blue Book if we want to know? Senator Isnor wants to know if you are going to develop Halifax as a growth centre, or Truro. What is your concept? Then at the end of the year it will be tremendously useful to the department itself and to Parliament to see how close this came to your concept, and not in any critical way.

Senator Isnor: There is no way you can do that. These requests are coming up daily because of conditions at the present time.

Senator Grosart: I agree, Senator Isnor, but the Treasury Board has looked at this and said that this is a valid amount. What components do you put in?

The Chairman: As Mr. Osbaldeston has said, they do it on a gross basis.

Senator Grosart: I do not believe for one minute that they do it on a gross basis.

Senator Hays: They could add a supplementary Estimate if it was not enough.

Senator Grosart: I do not believe that Tom Kent comes in and says, "Look, fellows, we need another $50 million. Will you give it to us?" That is a gross basis. You say to Tom Kent, "Tell us what you want the $50 million for."

Mr. Osbaldeston: Well, you are dealing with a number of things; you are dealing with the objectives they have under the program and we have knowledge of that. You are dealing with trends in the past and how successful they have been in achieving in the past. You do not want to over-fund them. They may want to do something but they have not been able to do it. So, you are dealing with trends and you are dealing with expectations as to the state of the economy in the coming year. So when I said "gross basis", I do not mean to say that you just take a figure out of the air, but you are dealing with factors which lower or raise the amount of money, and that amount of money is built up from trend experience, from opportunity experience and a number of other things. When I said "a gross", you certainly arrive at a gross from those inputs, experience inputs, forecast inputs and that sort of thing. When I used the word "gross" I was trying to distinguish as between the concept of project by project or town by town or country by country. We just do not have that capacity.

The department, I would think, would undertake that kind of review in projecting trends and seeing how they have done historically and in trying to assess what they can do in the future. That is the sort of analysis I would expect them to go through. They would then present that to us in a more global way, because we could not do it ourselves. We certainly could not handle that amount of detail ourselves in the secretariat, along with the 79 other departments and agencies we have to deal with in a relatively short period of time. So we are relying on them, senator, to do a great deal of this initial work.

Senator Grosart: I am disappointed that Treasury Board does not go a little further than that myself. Perhaps I am getting into an unfair questioning area because I am really getting into policy. It does seem to me that the Minister of Regional Economic Expansion must have more to go on than trends and the advice of his officials who say, "Well, it looks like 50 million dollars more this year." Surely the minister will say, "What are you going to do with the $50 million? What do you expect to do with the $50 million?" If you say that the Treasury Board relies on the minister's judgment, then that is all right. But I come back to my original question, which is that if an economist, parliamentarian or interested party said, "I would really like to have a look at this." Where could he get this forecast in some kind of detail? He might say, "Fine, you have decided not to spend $14 million on sewers in Halifax. You have decided to fund a shoe factory in Truro instead." This is the kind of information that we need to assess the judgment of a very large program like this which we hope will be a tremendous success.

The Chairman: Surely, a lot of those grants would not refer to sewers in Halifax. They would refer to a general amount required for grants for the program, and could

not be defined any further than that, except maybe in terms of the region into which they were perhaps going to go.

I would be interested in having the same information, but I am inclined to think that when they are estimating since it is a grant situation and since each grant has to be negotiated—and, in fact, they have to wait until they get applications—it seems to me that those figures would not be broken down much more than into regions.

They might be broken down as to so much for infrastructure programs and primary and secondary resource programs—and now they have a tertiary resource program.

Senator Grosart: On page 22-12 we read "Development Planning and Administration". That does not excite me as to detail. There are "Industrial Incentives", "Infrastructure Assistance", and "Social Adjustment and Rural Economic Development".

Mr. Osbaldeston: There is a better description on 22-8 relative to what those single line entries mean, but I do not think it gives the detail that you have been inquiring about.

Senator Grosart: That is just a point of interest and not of criticism.

The Chairman: It is a very germane point and perhaps one that we should consider for the future. Certainly it would be worthwhile asking the Department of Regional Economic Expansion at some point.

Senator Isnor: Just yesterday I heard of two items, one from Yarmouth and one from Halifax, in regard to assistance brought about by conditions.

Senator Manning: For what it is worth, I would suggest that these amounts are arrived at by Government when the program is originally initiated, after judgment is passed on the merits of the program and its desirability. In the light of their other obligations, responsibilities and priorities, the Government decide that to initiate the project they can appropriately decide on "X" dollars. That is pretty arbitrary. From there on, these figures are usually arrived at primarily in the light of experience of the previous year. If the applications are far in excess of what they initially thought, there is consideration given as to whether the Government should increase it. If it roughly meets what was approved after it was analysed, it stays about the same. If it was more than demanded, it goes down.

Senator Grosart: That is obviously the voice of experience, Mr. Chairman.

The Chairman: It certainly is. Perhaps we should leave that on that note, and move on.

Senator Grosart: The next one was Secretary of State, $109 million increase, at page 1-21, the Summary.

Mr. Osbaldeston: If you refer to page 23-2 and follow the "Change" column there is an entry of $25,168,000 which is the Bilingualism Development Program. Farther down, under the "Education Support Program, Post-Secondary Education," is an item of $85,800,000. As the senators know, that is the cost-sharing program.

Senator Grosart: Post-secondary education payments to the provinces.

Senator Hays: Is it vocational schools?

Mr. Osbaldeston: That is the university level.

Senator Grosart: On what basis is that? Per capita?

Mr. Osbaldeston: Fifty per cent of total cost.

Senator Grosart: Oh, yes; that is the 50 per cent. That is the one to which we add research grants to pretend it is not education.

Mr. Osbaldeston: The final one you mentioned was Transport, which is on page 26-2. Running your eye down the "Change" column, you will see "Air Transportation Program," $22,739,000, which is the major item; $62,179,000 Airports Revolving Fund relevant to development at the major airports such as Ste. Scholastique.

These are really the major items giving rise to the change.

Senator Grosart: What is the reason for those two?

Mr. Osbaldeston: The air transportation program really reflects the increased traffic in our airways, which calls for increased air navigation aids, such as radar.

Money is provided under the Airports Revolving Fund to complete the Ste. Scholastique and the new Toronto International Airports.

Senator Grosart: There are a few decreases, but not many. Are there any outstanding examples of decreases due to departmental efficiency? I think one of the largest seems to be $24 million, against Industry, Trade and Commerce, strangely enough. There are also $46 million and $35 million decreases. These are three fairly large ones. Is there anything significant in any of those?

Mr. Osbaldeston: I think the table at page 1-68 may be of more assistance, since it breaks that down more. The $38.5 million is a reduction in contributions to vocational training schools capital. I will pick out some of the other large items. There is a decrease on page 1-70 in Unemployment Insurance Commission on the coming into force of the new act of $53.6 million. The Veterans Welfare Services program, Veterans Affairs, on page 1-68, $9.6 million, which is simply a reduction in the number of demands on the program.

Senator Grosart: There are no abandoned programs there?

Mr. Osbaldeston: I should point out a decrease in he Government contingencies program of $5 million towards the bottom of the page.

Senator Grosart: I will not get into the contingencies program tonight.

Mr. Osbaldeston: I will not say abandoned.

Senator Isnor: It is 10 o'clock, Mr. Chairman. How much longer are we going to be?

Senator Grosart: I am through. I am sorry to have been so long.

The Chairman: Not at all. Are there any other questions? I just have one short question, and then a couple of items to table. The items to be voted are $7,260 million?

Senator Isnor: What page is that?

The Chairman: I am on pages 1-22 and 1-23.

Mr. Osbaldeston: Right.

The Chairman: Statutory items, $7,091 million?

Mr. Osbaldeston: That is correct.

The Chairman: A lot of $14,352 million?

Mr. Osbaldeston: That is correct.

The Chairman: In addition to that, non-budgetary items of $988 million?

Mr. Osbaldeston: That is correct.

The Chairman: I think that covers it.

Honourable senators, I would like to table certain information in reference to our examination of Supplementary Estimates C for the year 1970-71: a letter from Mr. MacDonald dated May 19, giving information on the Special Development Loan Fund to the provinces; a letter from Mr. MacDonald dated April 8, 1971, giving information on the cost to the Department of National Defence of providing guards in Ottawa during the recent emergency in Quebec; and further particulars on the Public Works Vote L29C, loan for the construction of an oil terminal wharf at Come-by-Chance, Newfoundland.

This was requested by senators at our hearing on those Supplementary Estimates on Thursday, March 18, 1971. I request that these be printed as an appendix to today's proceedings. Is that agreed?

Hon. Senators: Agreed.

(See Appendix A)

The Chairman: Honourable senators, if there are no further questions, may I report to the Senate on the Estimates for the year ending March 31, 1972?

Hon. Senators: Agreed.

The Chairman: Will you leave the report in the hands of your chairman, if he carefully checks it with Senator Grosart first?

Senator Grosart: That is not necessary.

Hon. Senators: Agreed.

Senator Grosart: I hope you will extend our thanks once again to our witnesses for a most useful and informative evening, and for their tolerance of the kind of questions they were asked.

The Chairman: I will indeed. I also extend the chairman's thanks both to our witnesses and to honourable senators for staying so late at night on behalf of the country.

Mr. Osbaldeston: Thank you very much, Mr. Chairman.

The committee adjourned.

APPENDIX «A»

Ottawa, Ontario,
K1A, OR5
May 19, 1971.

Senator D. D. Everett,
The Senate,
Room 572-S,
K1A OA4,
Ottawa, Ontario.

Dear Senator Everett:

Further to my letter of April 8, 1971, I now have available up-to-date information in response to the questions raised on March 18 by the Senate National Finance Committee about the special development loan program. This information, supplied by the Department of Finance, is attached.

Yours sincerely,

Bruce A. MacDonald,
Director General,
Budget Coordination.

SPECIAL DEVELOPMENT LOANS TO THE PROVINCES—SUPPLEMENTARY ESTIMATES (c) 1970-1971

Number of provinces who have participated and drawn funds

As of May 3, 1971 all provinces except Ontario and Saskatchewan have applied for and received approvals for loans to the full amount of their allocations from the Special Loans Program in the following amounts:

Newfoundland	6,300,000
Prince Edward Island	1,000,000
Nova Scotia	4,000,000
New Brunswick	5,000,000
Quebec	70,300,000
Manitoba	8,000,000
Alberta	6,400,000
British Columbia	37,000,000
Total	$138,000,000

Saskatchewan has advised it does not intend to use its allocation of $5,000,000. Ontario has announced its intention to borrow its allocation of $17,000,000 for distribution on a loan basis to its municipalities, but no application has yet been received. Actual loan disbusements made to date total $21,800,000, all to the Province of Quebec.

Number of persons employed

The additional direct employment being created has been estimated on the basis of information received from the provinces as follows:

	Man-Years
Newfoundland	774
Prince Edward Island	98
Nova Scotia	477
New Brunswick	286
Quebec	6,515
Manitoba	575
Alberta	864
British Columbia	2,661
Total	12,250

It is also estimated that the indirect employment being created nationally from purchase of materials, equipment, supplies and engineering services will total about 16,900 for a direct and indirect employment effect of 29,150 man-years. No estimates are available as to subsequent employment multiplier effects.

Interest Rate

The interest rate on disbursements made to Quebec has been 6.8%.

Nature of the work done

The projects on which there is information available to this date vary greatly in nature from road construction through street paving and installation of street lights to municipal buildings, sewage treatment and storm drains to take a few examples. They vary also in cost from a few thousands of dollars to over a million dollars.

OTTAWA, K1A OR5,
April 8, 1971.

Senator D. D. Everett,
The Senate,
Room 572-S,
K1A OA4,
Ottawa, Ontario.

Dear Senator Everett:

When the President of the Treasury Board appeared before the Senate National Finance Committee on March 18 relative to Supplementary Estimates (C) for 1970-71, it was agreed that answers to some questions would be supplied later.

I am enclosing answers to questions regarding the costs of providing guards in Ottawa during the recent emergency in Quebec; particulars on the construction of an oil terminal wharf at Come-by-Chance, Newfoundland; and economic stimulation measures included in the Supplementary Estimates. You will recall that you suggested sending a copy of the answer to the first question mentioned above direct to Senator Phillips and this I have done.

A number of questions were asked concerning the program of special development loans to provinces in amount of $160 million. I have still to gather more information relative to this question and hope to forward you the data requested by members of the Committee some time later this month.

Yours sincerely,

B. A. MacDonald,
Director General,
Budget Coordination.

Encl.
c. c. Senator O. H. Phillips

RESPONSE TO REQUEST FOR INFORMATION
SENATE NATIONAL FINANCE COMMITTEE
RE: SUPPLEMENTARY ESTIMATES (C) 1970-71

Subject: (Page 3.23 of proceedings)

The cost to the Department of National Defence of providing guards in Ottawa during the recent emergency in Quebec.

Answer:

The Department of National Defence provided the following information on the estimated cost to DND of carrying out activities outside the Province of Quebec relative to proclamation of the War measures Act:

Vehicle operating costs	$162,800
Rations provided to personnel not normally on ration strength	153,600
Additional civilian manpower costs	95,300
Temporary duty costs (travel warrants, meals and lodging obtained through commercial outlets, etc.)	67,600
Minor construction (mainly installation of extra sanitary facilities in various DND buildings in the Ottawa area)	55,000
Consumable materials (cleaning supplies batteries, toilet supplies etc.)	52,000
Commercial transportation and communications	30,400
Other miscellaneous	6,900
Total estimated costs	$623,600

These costs were incurred mainly but not exclusively in the Ottawa area. It is not possible to entirely isolate the costs for Ottawa.

Subject (Page 3.24 and 3.25 of the proceedings)

Further particulars on Public Works Vote L29c, loan for the construction of an oil terminal wharf at Come-by-Chance, Newfoundland.

Answer

The recipient of the loan is to be a Province of Newfoundland Crown Corporation.

Annual payments are to be made in the form of "rent" which will in effect amortize the capital over 25 years at 7 percent.

The federal government would retain ownership until the loan was repaid.

Subject (Page 3.22 of proceedings)

Economic stimulation measures in Supplementary Estimates (C) 1970-71.

Answer

Finance, Vote L13c	
Loans to provinces for the purpose of assisting in the creation of employment.	$160,000,000
(Replaced $150,000,000 loan in Supplementary Estimates B)	
PUBLIC WORKS, Vote 28c	
Loan to Burgeo Leasing Limited for the construction of extension to a wharf.	240,000
RCMP, Vote 25c	
Purchase of three aircraft engines	150,000
VETERANS AFFAIRS, Vote 45c	
Renovations at the Ste. Anne's Hospital Mental Infirmary, Ste. Anne de Bellevue, Quebec.	380,000

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 19

THURSDAY, JUNE 10, 1971

Sixteenth Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses:—See Minutes of Proceedings)

23916—1

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
	O'Leary
Gélinas	Paterson
Grosart	Phillips
Hays	Sparrow
Isnor	Walker—27.

**Ex officio Member*

(Quorum 7)

Orders of Reference

Extract from the Minutes of the Proceedings of the Senate, of Tuesday, March 9th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures proposed by the *Estimates* laid before Parliament for the fiscal year ending the 31st March, in advance of Bills based upon the said *Estimates* reaching the Senate.

The question being put on the motion, it was . . .
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Tuesday, May 4, 1971:

"With leave of he Senate

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relations thereto.

The question being put on the motion it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Minutes of Proceedings

Thursday, June 10, 1971.
(19)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10:00 a.m. to consider the question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett, (*Chairman*), Beaubien, Grosart, Hays, Laird, Manning and McDonald—(7).

Also present, but not of the Committee: The Honourable Senators Casgrain, Inman, Kinnear, McElman and McGrand—(5).

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Heard as a witness Dr. Beryl Wayne Sprinkel, Monetarist and Senior Vice President, Harris Trust and Savings Bank, Chicago.

A statement by the Chairman at the beginning of this hearing was read into the proceedings concerning a correction of the testimony of G. Herbert Giersch, given on June 3, 1971, which is No. 15 of our proceedings.

At 12:20 a.m. the Committee adjourned to Wednesday, June 16, 1971.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, June 10, 1971

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 10 a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, we will resume our hearings on growth, employment and price stability. However, before we do so, may I say that we have received a telegram from Dr. Herbert Giersch of West Germany, asking if he could correct a statement that he made in his testimony in answer to a question from Senator Beaubien, in which he stated that the general level of corporate taxes is 51 per cent. He makes the point that the tax on profits distributed as dividends is only 15 per cent.

Senator Beaubien: You had better read that over again.

The Chairman: Whereas he make the statement that the general level of corporate taxes is 51 per cent...

Senator Beaubien: No, he said 50 per cent in his testimony.

The Chairman: He says he said 51 per cent.

Senator Beaubien: No, 50 per cent.

The Chairman: He did say 50? Well, he says now that it is 51 per cent.

Senator Beaubien: Yes.

The Chairman: But the tax on profits distributed as dividends is only 15 per cent. In short, what he is saying is that there is a tax dividend credit, and the effective tax on all profits—that is, presumably, those retained and those distributed—is about 22.6 per cent.

Senator Beaubien: That makes it even better than Japan; at least, the tax is not as severe. That is a tremendous difference from our tax of 53 per cent.

The Chairman: One of the areas in which we are very interested in the course of our investigation is the operation of the money supply, and one of the schools that we have heard from, and a leading school, of course, is the monetarist school.

We are honoured to have with us today a leading advocate of the monetarist school, and also a gentleman who is a world authority on the problem of lags. He is Dr. Beryl Sprinkel, who is senior vice-president of the Harris Trust and Savings Bank in Chicago. Dr. Sprinkel received his doctorate from the University of Chicago, and has had an outstanding career in that university and in the business world. He has written such books as "Money and Stock Prices," "Destabilizing Policies in a Stable Economy," "Monetary Growth as a Cyclical Predictor," and, most recently, "Money and Markets". I welcome Dr. Sprinkel to our hearings.

He has filed with the committee a brief statement of his remarks, but I would ask him to make a verbal introduction to his remarks, and then we will throw the meeting open for questions. Dr. Sprinkel.

Dr. Beryl W. Sprinkel, Vice-President, Harris Trust and Savings Bank, Chicago: Thank you, Mr. Chairman. I am indeed honoured to have the privilege of testifying before this distinguished committee of the Senate of Canada on economic matters of great concern to all governments in the free world.

My remarks will focus on the role of monetary policy in encouraging non-inflationary economic growth and its relationship to fiscal and exchange rate policies. I have no special expertise concerning the Canadian economy, except perhaps the location of some good fishing spots.

The Chairman: Senator Beaubien has...

Senator Beaubien: Not the monopoly.

The Chairman: ...knowledge of some better fishing spots, so get together with him afterwards, and you can increase your knowledge as we increase ours.

Dr. Sprinkel: I am hopeful that my remarks will have relevance to your problems and your opportunities.

As a monetarist, it is my judgment that the demand for goods and services and assets is determined primarily by prior changes in the money supply.

In most modern governments the money supply is subject to the control of the central bank. Hence the opportunity for purposeful policy exists. Growth in the money supply in excess of the capacity of an economy to increase real production, inevitably brings inflation. Erratic monetary growth induces volatile economic activity, characterized by go-stop performance, with attendant inflation, followed frequently by bouts of unemployemnt and reduced real incomes. Thus it is virtually impossible, in my opinion, for a free economy to achieve stable economic growth with reasonably stable prices, unless monetary policy succeeds in promoting the growth of the money supply in line with the capacity of

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the economy to increase real output. To achieve stable and moderate growth in the money supply, the central bank must focus on controlling capital aggregates rather than limiting its action to influencing interest rates only.

Recently many central banks in the free world have shifted their efforts towards controlling monetary aggregates such as the supply of money. This move, in my opinion, offers the first ray of hope that eventually the present world-wide inflation will be brought under control.

I am a monetarist not because I inherited this "religion", not because I was born with this viewpoint, but because the data convinced me that this is the most sensible way of interpreting the events, certainly in the United States and in many other countries that I have examined.

In my judgment, research over the past ten to twenty years has established beyond any reasonable doubt that prior changes in the money supply are the major factor influencing monetary demand for goods and services and for assets.

I included a chart in my paper, to which you might refer, relating changes in monetary growth to changes in the business cycle for the US economy. My interest, as a commercial banker, in this relationship...

The Chairman: Excuse me, doctor. To which chart are we referring?

Dr. Sprinkel: The first chart, "Money, Velocity and Business". My interest in the relationship of money to the economy, as a commercial banker, is the obvious one, that it makes a great deal of difference as to what happens to the economic trends and hence our loan demands; that it makes a great deal of difference what happens to bond prices; and that it makes a great deal of difference as to what happens to stock prices.

This particular chart indicates at least four consistent repetitive events dating from 1920 up to the present. In fact, I have the data much further back than that, but it gets to be too long a chart.

There are four points that I might mention. Point No. 1 is that prior to each of the recessions in the United States there has been a depressed rate of growth in the money supply. Monetarists do not believe this is a casual relationship, but in fact believe it is a causal relationship.

Point No. 2 is that prior to every recovery from recession, including the present one that we are now enjoying, there has been accelerated growth in the money supply, which inevitably has led to increasing spending.

Point No. 3 is that the severity of economic contractions in the US since 1920 has been closely correlated with the severity of the prior change in money; that is, the sharp downward drops in the money supply were inevitably followed by very sharp declines in economic activity, with, of course, 1929-1933 being by far the worst. In that particular case money supply went down 35 per cent.

Point No. 4 is that money works with a lag, and that is exasperating both for policy-makers and for those who must live in the private economy in response to what is happening at the policy level.

Most research suggests that monetary change influences spending in the economy, that is, creation of national income, with something like a six- to nine-month lag. It has some effect in the very short run, and if we move out as far as a year it certainly has a very major effect.

Not only does money influence total spending and, hence, business cycles, but it also influences financial markets. We have been taught for many years that an easy money policy brings us low interest rates. Indeed, I believed that for a long time, but in fact it does not. An easy money policy, continued past the point when an economy achieves null employment, inevitably leads to very serious inflation. Once inflation begins, interest rates begin to discount the actual and expected rate of inflation; so that an easy money policy, rather than bringing low interest rates, in fact brings high interest rates. That is why, around the free world, we have had such very high rates over the past few years. We have had enormous inflation fueled by very rapid increases in money supply in most nations.

Secondly, a monetary change inevitably influences equity prices, at least in our country. I have looked at the Canadian experience, and although the relationsbip is not quite as clear, nonetheless it has an important bearing. There has never been a sizeable bear market in our nation that was not preceded and accompanied by a severe restriction in monetary growth; nor has there been a considerable bull market that was not accompanied by a preceding rise in the rate of monetary growth.

Chart No. 2 attempts to document that evidence, again going back to 1920. You will note, for example, that our money policy began to ease in early 1971. When I speak of monetary policy easing, what I mean is that the rate of growth in the money supply began to accelerate. That does not necessarily mean interest rates go down.

You will notice that with the lag of two or three months, our bear market was reached and, on average, we have been in a bull market since that time.

I mention the impacts on financial markets because frequently monetarists are accused of having a little black box in which they put the money and the spending comes out, no one knowing what happens inside the little box. It is true that we do not understand it perfectly, but it is also true that money works through financial markets which, in turn, impacts spending on the economy and has an important bearing on subsequent economic activity as well as inflation.

Monetarists are also frequently accused of arguing that fiscal policy is unimportant. I would like to assert categorically that I know of no monetarist who argues that. Fiscal policy has a very important bearing upon what happens in an economy. For example, the kind of tax system we have has a significant impact on how resources are allocated within the private sector; that is, whether we spend them on consumption or whether we

save them and spend them on investments. Certainly the rate of corporate tax has a bearing upon this issue.

Most economists—and, I suspect, most of you—believe that high rates of savings and investment tend to promote long-run economic growth in an economy. So fiscal policy has a very important bearing on that issue.

Secondly, it has an important bearing on the issue as to how our resources are allocated between the private sector, on the one hand, and the government sector, on the other. Of course, we have disputes in our country—and, I suspect, in yours—as to whether the private or the government sector can do it better. Again, fiscal policy is the tool utilized to resolve that dispute.

Thirdly, fiscal policy has a critical bearing upon the allocation of resources within the government sector. What kinds of policies will we pursue? So I believe fiscal policy is inevitably a very important tool of free governments.

Let me add, however, that I would content that changes in fiscal policy exert only nominal influence upon changes in money demand; that is, the size of a deficit in our country—and I have looked at many others—is not closely related to subsequent changes in total spending.

The Chairman: I wonder if you would agree that the size of the deficit—as it affects the cash requirements of the government, if they have to be financed by the central bank—would not have a major effect on the money supply.

Dr. Sprinkel: Yes, sir.

The Chairman: It comes back to your original point, that the government's fiscal policy can very much affect the rate of growth or restriction in the money supply

Dr. Sprinkel: Yes, sir. That was the next point I planned to make, that the size of the deficit is not important, but the method of financing that deficit is critical. If it is financed primarily by new money and the deficit gets larger and larger, this means the money supply grows more and more rapidly. If, on the other hand, it is financed by new issue sales to the non-banking sector of the economy, it does not increase the money supply. Hence, you will find that it does not have a major bearing on subsequent spending change.

It is one of the issues that the so-called monetarists and fiscalists are arguing about—and I could name many others—concerning the impact of monetary and fiscal policies.

Monetarists do not deny that fiscal policy is important. On the contrary, they believe it is important. However, they do deny that changes in the budget have an important bearing on subsequent spending trends, but that the method of financing that budget—or if you are running a surplus, which seldom happens in our country...

Senator Beaubien: Or here.

Dr. Sprinkel: The method of disposing of the surplus does have an important bearing.

Let me turn now to the question of inflation. It seems to me that very few economic relationships are as firmly supported by the evidence over centuries of time, between nations—modern times, the last few years versus earlier years—as this relationships between money and changes in prices.

Unfortunately, most modern governments, including my own until recently, have tended to follow Keynesian prescriptions in post-World War II. I am not using that as a derogatory word, though sometimes it might be so interpreted. I am using it to indicate that tax changes and spending changes were the major tools used in an effort to influence subsequent trends in the economy, and they have not worked.

Monetary policy in most nations, until recently, was, at best, subservient to fiscal policy; that is, they created whatever money was necessary to enable them to do what they wanted to do on the fiscal side. Hence, we are all paying the price: we are paying the price of suffering very serious inflation.

Monetarists argue that a rise in the money supply per unit of output inevitably leads to serious increases in prices. This is a testable hypothesis. You need not believe me. I would not believe it until I had looked at the evidence, but we have evidence, and I have selected a small amount of it dealing with the post-war period, clearly suggesting that those nations that have permitted rapid growth in the money supply have inevitably suffered serious inflation. I first chose, in table 1, a group of our southern neighbours.

The Chairman: Excuse me, doctor. You are referring to table 1 on page 5 of the brief?

Dr. Sprinkel: Yes, sir, where I have computed growth in the money supply per real GNP and what happened to prices. These series are independent. You will notice that Brazil in this particular period, 1955 to 1968, had enormous increases in the money supply per unit of output, and predictably they did suffer a very serious inflation —38 per cent approximately; Chile a little better; Argentina; but among the undeveloped countries you will notice that Peru, Ecuador and Mexico promoted very moderate growth in the money supply; that is, money supply per unit of output. They did have inflation, but much less than their neighbours.

So it is not a question of undeveloped countries having serious inflation and developed countries having no inflation. You find variations between them. If you look at the developed nations, including Italy, Japan, France, West Germany, Canada, Switzerland and the UK, there is not a perfect correlation between monetary growth per unit of output and inflation, but clearly there is some considerable relation; that is, Italy, Japan and France during this period had the most rapid growth in the money supply per unit of output, and they had the most rapid inflation.

Canada in that particular period had a very moderate growth in money supply per unit of output; that is, 2.2 per cent a year. It also turned out that you had 2.2 per cent inflation. That, I am sure, is an accident, but it comes out on the nose, and I would not want to argue that the relation is indeed that perfect. However, it tends to indicate that in Canada, when you had moderate monetary growth, you also had very moderate inflation.

The Chairman: Dr. Sprinkel, if I wanted to argue against your hypothesis, I might very well say that the change in the money supply, if I look at this table, follows the event; in other words, that in the case of Brazil there was no option open to the central bank because of other pressures, and that the bank, by virtue of those external pressures and constraints, was required to raise the money supply by 35.3 per cent.

Dr. Sprinkel: Well, that is sometimes the case. Rapid in-flows of money from other nations, central bankers would argue, means they have no option, but this is not to say that no option exists.

For example, in our own country—and, I gather, in yours—we executed the option of tightening up on money to get our accelerating inflation under control. Now, it caused great pain, it is still causing difficulties, and it is causing unemployment, but we have brought the inflation under control. The inflation lagged the change in money, not vice versa, in our nation, and that has been inevitably true each and every time. For example, from 1960 through 1965 we had in the US very stable growth in the money supply per unit of output, and we had very moderate inflation. Beginning in the middle of 1965, our money supply began to grow much more rapidly, and it continued to grow much more rapidly up until 1969. Shortly thereafter the rate of inflation began to accelerate, and it continued to accelerate even after we began to tighten money; that is, it worked with a lag. I agree there is a lag, but I think the lag works in the opposite direction, at least in our nation and, I suspect, in yours, because you had developing inflation, you had a tight money policy for a while, and I understand your prices continued to rise; but the evidence I have seen of late is that Canada has the best record currently on inflation of any major nation in the world. I think we are second, but you have the best pattern at the moment, if the data I have seen is correct.

So my view is that the lag is not from inflation to money: the lag is from money to inflation.

The Chairman: Does this chart No. 1, in your judgment, show that?

Dr. Sprinkel: No, sir, it does not plot changes in prices; it merely plots direction of change in the business cycle against prior changes in money. That is, the shaded periods on the chart are periods of economic contraction as defined by the National Bureau of Economic Research. They just recently defined the last one. At least, the beginning of our recession was apparently, according to that authority—and it is good authority—in November, 1969, and it apparently ended in November, 1970, but it does not plot inflation in that particular chart.

The Chairman: Yes, I see.

Dr. Sprinkel: I do have the book you referred to, and it has a chart extending back over 50 years for the United States, which does month by month plot inflation against growth of the money supply per unit of output. Unfortunately, I do not have it with me.

The Chairman: I think we have a copy of the same set of charts.

Dr. Sprinkel: Now, after looking at that table you would say: "Well, gee, the developed countries do not have an inflation problem", because that was the average rate of price rise for a period from 1955 to 1968. Unfortunately, in the last several years, that is, beginning in the last half of the 1960's, money supplies began to grow much more rapidly, and shortly thereafter inflation became much more serious. So that we should keep in mind that that long period on average was very good, but in the latter part and continuing up until now in many nations, the record became progressively worse.

Now, what do you do about inflation once you have got it under way? There is no easy solution. The only way that I know of that serious inflation has been brought under control is by slowing growth in the money supply, which is inevitably followed by weaker business trends and accompanied by rising unemployment and reduced real incomes. I say this not because I enjoy recessions. I detest them. They create problems, they interfere with business mangement, they interfere with the prosperity of the nation; but we have a chance. If we have an inflation going, we can continue to pump in rapid money and let it get worse or we can tighten up, pay the price, and get it under control. Fortunately, our government chose the latter, at considerable political cost. I gather that you went through somewhat the same pattern a year or so ago.

I mention this primarily because it is critically important that once you have paid this very serious political and economic cost, it is critically important that you not throw away all the benefits.

In our country, for example, many of my Keynesian friends are arguing that we should now forget all about inflation, cut taxes, step up spending, increase monetary growth even more, and worry about unemployment only. I have some sympathy for that point of view, because unemployment is not a very humane way of running a society.

The difficulty of pumping in rapid growth in the money supply after we have begun to cool inflation, is that down the road a year or so we shall be right back in the middle of another serious inflation, and we will have made the sacrifice for nought. Sacrifices for nothing I can do without. Sacrifices that have a pay-off I may be willing to make. Since I do not like inflation and prefer stable prices, I was in agreement that we should make the sacrifice in the United States.

The important point is currently that once having gradually brought an accelerating inflation under control, it is critically important that we maintain a stable rate of growth in the money supply. It need not be absolutely stable each and every day of the year, but something in line with the real growth in total production. Otherwise, if we get the inflation rolling again, we will in a couple of years worry about the inflation and forget about unemployment. Then we will step on the brakes and go through another stop-go pattern, which has been much too characteristic of free governments in the past 10 years. A balanced full employment budget, accompanied by four to six per cent growth of the money supply, in

my judgment is the proper policy for our government at the present time.

What is the relation of these problems to international exchanges? It seems to me that recent events, if we were not already convinced, clearly indicate that independent domestically-oriented national economic policies are absolutely inconsistent with fixed exchange rates. The reason, of course, is that if we fix our exchange rate to-day and suppose it is the proper one, to-morrow it will be improper for the simple reason that we have varying rates of inflation among nations, we have varying rates of economic growth, we have different levels of interest rates, and we have different rates of technological improvements, so that to-day's exchange rate is inappropriate tomorrow.

There are two possible remedies to this problem, that is, the problem of inconsistency between a domestically-oriented policy and fixed rates between currencies. One remedy, of course, is to co-ordinate policies between all nations, or at least large blocks of nations. The other remedy is to have greater flexibility in exchange rates.

Recently, European nations have espoused the argument that they really want to co-ordinate their policies. I can understand the desire to come up with a common currency. For example, we have a common currency in a land mass larger than Europe, with over 200 million people, and it works fine. I am talking about the United States. One of the reasons that it works fine is that we have a common heritage, we have a common government, we have a common set of policies, and it is the same nation. You can have the same currency under those circumstances.

On the other hand, it seems to me that the events of the last several months and years suggest, at least, that we are not close to the point where policies among nations will actually be co-ordinated. That is, any government must formulate policies which respond to its own constituency, not the constituency of some other government.

That being the case, it seems to me it is necessary then to move to the second remedy for the problem, that is increased flexibility in exchange rates.

Adoption of a flexible exchange rate system tends partially to insulate a nation from what goes on in the rest of the world. What I mean by "partially insulates" is that you may have your own policies and some other country may have an opposite set of policies; yet the other country will not in essence dictate your monetary growth, for example. With a fixed exchange rate system, once the market believes that you have an undivided currency, of course, money is going to gush into your country. This creates difficulties politically between nations. It also creates real difficulty for the central bank. It is practically impossible in that set of circumstances to run a monetary policy which is in line with the desire to prevent serious inflation. On the other hand, if you have an over-valued currency—which the dollar is in relation to many currencies around the world—then the opposite kind of problems occur, that money flows out. Now, if the country is large enough, you can offset it; but if it is a smaller country it is very difficult to offset.

I do not mean to say that a flexible exchange rate system completely insulates you from the rest of the world; that is, resource shifts must occur, whether you have a flexible exchange rate system or whether you have a fixed exchange rate system. It is just my judgment that the shift is less painful with greater flexibility than it is with lesser flexibility.

In my judgment, the world has to move in the direction that Canada has already led. They need not adopt freely floating rates. If not that, then we must have more temporary floats. If this is politically impossible, then we should have wider bands. If we can't do that either, then we are going to have more frequent changes in parity values. There is no way that we can conduct an international monetary system locked into an absolutely rigid exchange rate system where each nation decides on its own what kind of economic policies it will pursue.

Since I prefer free markets, since I trust free markets, I much prefer your approach. I am not at all sure that the rest of the world will buy it, but at least you have demonstrated that freely floating exchange rates do not mean wildly gyrating exchange rates, and many people contend that that, of course, is the case.

The Chairman: Doctor, why did we get into the fixed parity in Bretton Woods? Is it purely a reaction to what had happened in the late '20's and '30's?

Dr. Sprinkel: I think so. Of course, I was not there but I have read many of the hearings and there was tendency during the depression to use exchange rate policy as domestic policy. In essence, many countries were trying to export their unemployment to other nations.

In my judgment, we misread that experience. We said that the reason for the chaos was the rapid and frequent devaluations in currency. In my judgment, the reason for the chaos was the lack of a sensible economic policy, especially monetary policy, in most nations in the late 'twenties and 'thirties.

I assure you that if the United States were to reduce the money supply by 35 per cent over the next year, we would be in the middle of another disaster, that is, a depression. That is why the exchange rates kept bouncing around, was because we had unstable economic performance, not only in the US but in most other nations of the world. So I think it was a misreading.

They then decided that they wanted fixed parities, but even the Keynes White Papers recognized that if a fundamental disequilibrium existed, parity should be changed. It turns out that no one could decide what a fundamental disequilibrium was, and nations avoided until the last minute any alteration in parities. In the meantime speculative money flows and other difficulties develop, and it has taken 30 to 40 years to convince more and more observers, in my judgment, that more frequent changes in exchange rates are critically necessary.

I had the pleasure of attending the International Banking Conference in Munich three weeks ago, and I heard

no one argue that we should have rigidly fixed exchange rates such as we have had over most of the post-war. I also heard no one argue that freely floating rates were the salvation of mankind; but everyone did say that increased flexibility had to come in some form.

Let me read my summary, and then I will cease and desist.

Free governments can achieve reasonable price stability, combined with economic growth, provided they pursue stable and moderate growth in the money supply. Once serious inflation becomes the unpleasant fact of life, the battle for restoring stability will be long, painful and sometimes politically costly. Once stability is restored, stable and moderate monetary growth must persist unless the effort be in vain.

Although monetary policy exerts a decisive influence on final demand, it plays a minor role in determining the capacity of an economy to grow in real terms. More basic influences, such as investments in physical and human capital, technological improvements, and the innate capacity of a people to work, produce and save, are dominant. Fiscal policies designed to encourage production and thrift can certainly exert a very beneficial impact.

Pursuit of an independent, domestic economic policy is inextricably entwined with the adoption of a suitable degree of exchange rate flexibility. If economic theory cannot satisfactorily elucidate this principle, then the international exchange events of the past few years have carved it in delibly on our consciences.

The free world can ill afford a repetition of currency crises emanating from an international monetary system which has served us well but is in dire need of repair and improvement.

There is no easy road to economic Utopia, but prudent monetary fiscal policies, in my opinion, combined with a consistent exchange rate stance can make a major contribution to stable economic growth with reasonable price stability.

The Chairman: Thank you very much, Dr. Sprinkel. We are now open for questions. Senator Beaubien?

Senator Beaubien: Doctor, at the beginning of your summary you say that the free governments can achieve a reasonable price stability by controlling money supply, which you explained, and, I think, extremely clearly; but just a little while ago the big aluminum producers signed a contract increasing wages by 21 per cent, or whatever it is, in three years. If the steel workers get a settlement in that range, are we not starting right off again on a new line of at least cost-push inflation? If everybody's wages are going to go up 10 per cent, how can you possibly control prices?

Dr. Sprinkel: Let me just say that eventually, if we are to restore price stability, we must get average wage increases down in line with productivity. They are not there now in our nation and perhaps not in yours, and certainly not in Europe.

Senator Beaubien: Not in ours.

Dr. Sprinkel: The question is: how do you get them there? Many governments want to use what they refer to as incomes policies. This is not a new concept. It may be a new word. We used to call them price and wage controls. They have been tried in nation after nation, including the United States, including most European countries, including Canada; and to the best of my knowledge they have been abandoned after each experiment, with the conclusion that they did not work.

It looks like the easy way out. That is, once you get into a serious inflation, why don't we insist that wages go up in line with productivity? That, in my opinion, represents a misunderstanding of how markets work. We might, with sufficient clout, be able to convince a steel union that they cannot possibly raise wages faster than productivity. I think it would be somewhat unfair, because everyone else is having wage increases in excess of productivity; but even if we did it for the steel union, remember, that is only one union and only one industry, and there are hundreds and hundreds of companies and industries in our country and yours, some in service business where measuring productivity is extremely difficult.

So that an attempt to use an incomes policy as a direct approach to controlling these costs, just does not work. How do we get out of it without that sort of approach? I cannot speak for your nation, but I can say something about the United States, as to how it is beginning to work.

First, we did have monetary restraint; we did create a recession, which was not an end in itself and it is something we wished we could have avoided, but it was a means to an end. We are now seeing some reduced rate of inflation, not as quickly as I would like and not as much as I would like, but it is coming down.

What about the wage front? Wages, on average, in most union settlements in our nation, with some obvious exceptions in the construction industry, have been of the order of 8 to 9 per cent, which is two or three times any reasonable measurement of productivity. Up to the present time, there is no evidence that I have discerned to suggest that that rate of wage increase has come down yet. How do we get out of that sort of trap?

There are two or three things that are going to get us out of it if we do not panic on the policy front. No. 1, contracts in the US tend to be front-end loaded. By that, we mean that the great bulk of the wage increase occurs in the first year, and in subsequent years the agreed-upon wage increase is much less. We are now going through that first year in many industries, and we are beginning to near the end of that first year in many industries—not in steel because this is the first time around for steel in some time.

Secondly, in our country our average productivity improvement is about 3¼ per cent on average over a long period of time, but it tends to get bunched. For example, in the two years ending in the second quarter of 1970, we had no recorded productivity improvement in our nation, so that any time wages increased the unit labour cost went up commensurately. Fortunately, in the last two or

three quarters we are beginning to see significant productivity improvements. For example, the average productivity improvement in the US in the first year of its economic expansion following a recession, tends to be almost double the average; that is, it runs between 5 and 6 per cent, and that is what is happening today in the United States, that is, productivity is rising quite rapidly. This means that a wage increase does not lead to a commensurate increase in unit labour cost.

Finally, to win this battle ultimately we must avoid making the same mistakes we made before. That seems pretty simple, except time after time governments continue to repeat the same mistakes, that is, shooting a lot of money into the economy when unemployment is high and forgetting that down the road a year or so you are going to re-excite inflation again.

The rise in wages, in my judgment, is a response to inflation that has already occurred. Just as interest rates go up in response to inflation, so does any other contract that deals with the future.

In our country, for example, in the early part of this last inflation, non-union wage rates went up much more quickly than did union wage rates. The reason was the union had a contract and they could not negotiate for some period of time. Eventually they did negotiate, and the contract reflected what had happened to prices previously.

So I do not think it is inevitably true that once you get an inflation rolling, you cannot get it under control. It is going to take a long time, and it requires the right kinds of policies. Productivity improvement and gradual reduction in rates of wage increases will occur if you maintain a growth in the money supply in line with growth in the economy.

However, that requires great patience, and politicians sometimes realize that you cannot do much for your constituents if you are not in office, and there is a great temptation to panic, in our nation at least.

Senator Beaubien: That is very interesting.

Senator Manning: Doctor, would you comment on the desirable rate of correction when this situation gets out of hand, as we have seen in the last few years? You indicated earlier, obviously, that when you are in one of these situations you cannot too rapidly either expand or contract the money supply. Does past experience indicate any guidelines that would be helpful, as to the desirable rate of correction? Should it extend over a number of years, does it differ in each case, or what is the picture now?

Dr. Sprinkel: I do not think the relation is so precise that one can be so competent. All I would be willing to say is that it turns out that moderate contractions in monetary growth have led to moderate slowdowns in the economy; severe contractions have led to severe slowdowns.

I can rank them in order. For example, we had a slowdown in 1967 which was not labelled a recession. It sort of levelled out and some sectors slipped a little. It was preceded by a very brief period of monetary contraction, but they turned around and went the other way, and went the other way much too rapidly in hindsight. In fact, I thought so then.

This last recession we had was one of the mildest in the 20th century. It lasted a little longer than post-war average, but it was not very deep, and the contraction was, on average, fairly moderate. We dropped from a peak rate of growth of money supply of something like 7 per cent, if I remember correctly—it might have been as high as 8—down to a growth rate of around 2 to 3. That is, money did not go down; it was just the rate of growth declined.

So it depends on how quickly you want to correct the inflation. The more moderate the decline in economic activity, the longer it is going to take to get the inflation under control. The greater the prior inflation, the longer it is going to take. If you are willing to pay the price—and I would not be—of creating a very serious recession, I am sure we could get the inflation under control much more quickly; but one must obviously balance one good against another. I am very happy with the balancing that occurred in the US; that is, it was a mild recession, yet it is showing results. I suspect the same was true in your country, but I am not as well informed on Canada.

Senator Manning: I was thinking of this thing from the standpoint of an earlier comment you made, that so often governments move in the direction of correcting inflation by these procedures. The unemployment situation particularly becomes so serious it builds up pressures which detract them away from their policy.

I wondered if you felt it was practical, even if it takes twice as long to correct it, if you do it by a slower process: does this result, as a general rule, in a greater ability, for example, on the part of those who are thrown out of work, to re-adjust in your other areas and hold down these other pressures which so often defeat the policy which has been accepted?

Dr. Sprinkel: Yes, sir. I would not want to make a scientific statement that your judgment is correct, but I certainly would suspect that it is. If you react severely, in causing a severe adjustment, the political and economic pressures—not just political—will become so severe that there will be great temptation to go hard in the opposite direction; whereas if you do it very slowly and very gradually, the reactions will be less and, in general, that would be my preference—the latter, not the former. I do not like recessions and certainly I don't like deep ones, for obvious humanitarian as well as economic reasons.

Senator Manning: There is one other point on the first page of your brief where you say:

> Growth in the money supply in excess of the capacity of an economy to increase real production inevitably brings inflation.

This matter of the capacity of the economy to increase real production, would you comment a little on that? It seems to me that there are a lot of gray areas today and a lot of disagreements as to the accuracy of indices to measure the capacity of an economy, and this becomes

pretty pertinent. I think your statement is absolutely sound, but the interpretation that is put on the capacity of the economy will affect what you do to a very considerable degree.

Dr. Sprinkel: Yes, sir. Well, it depends on where an economy starts, where it ends. What I really refer to here: let us suppose we start from approximate full employment, whatever it may be in a particular nation, and we end up at approximately full employment. Then we are talking about growth in labour force, growth in capital supply, growth in productivity, and what kind of capacity do we have to move forward?

In our nation the measures are imprecise, but there is really not much disagreement about it that, as almost anyone you would ask about the US economy I believe would say, that the capacity for our economy to grow from peak to peak is something like 4 to 4½ per cent. This depends on growth in the labour force and how fast productivity improves.

I think technical economists can make a reasonable judgment.

In Japan, I do not understand that economy, obviously, because their real growth is much greater than that. It is in the order of 10 to 15 per cent. Most free nations cannot grow anything like that.

Senator Manning: It started lower down.

Dr. Sprinkel: That is true, but they started from approximate full employment. They haven't had any unemployment problem. Of course, if you start from a recession, like the US is starting now, we can grow faster than 4¼ per cent over the next year or two because we will be picking up slack; but most modern nations, from estimates I have seen, suggest a real growth in excess of 5 per cent is very uncommon over a very long period of time. We are talking of 3 to 5 per cent; in our case, 4, 4½ per cent.

Senator McGrand: A demand for an increase in wages is often the anticipation that inflation is about to take place. Now, if contracts with labour were made on a yearly basis and not on a two or three year basis, would that improve the economic climate between labour and management and everything that goes with it?

Dr. Sprinkel: From that point of view, that is, from the impact on inflation expectations, it might. That is, if a company really demonstrates that inflation is less, and this is in contrast to talking about it, that is, you really show that the rate of rise in prices is less, as it is now in Canada and is now in the US: if contracts came up in a shorter period of time, that fact could be taken into account.

Now, it creates other problems. Most management that I know and, I suspect, most labour unions, would prefer not a re-opening of contracts every year. They have to re-negociate, and it takes lots of times and creates all kinds of ill-will in some cases; so I would not want to say it would be better if we had short term contracts, but from that point of view it would be a little better.

Senator McGrand: I said yearly. I mean on a sort of continuous negotiation basis.

Senator Beaubien: Never ending.

Dr. Sprinkel: Hasn't the UK until recently had that kind of approach, and they have had great difficulties because they could not enforce contracts, and strikes could be called with impunity? I am not so sure; I am not an expert in that field.

Senator McGrand: The question has been repeatedly asked: Which is the greater menace, unemployment or inflation? As I listen to you, I get the impression that you consider uncontrolled inflation is a greater menace than unemployment.

Dr. Sprinkel: No, sir, if I gave that impression I did not mean to. What I argued, in essence, was that with proper policies we can have the best of all possible worlds on those two fronts; that is, we can have relatively low unemployment, on average, most of the time, and relatively low inflation. In our nation, if I had to put numbers on it, I would say it is entirely possible; we have done it for long periods of time, so it is a fact. It is entirely possible to have unemployment, say, around 4½ per cent, which is approximately full employment in the US; and at the same time to have inflation of 1 to 2 per cent. One to 2 per cent inflation does not bother me very much; 6 per cent bothers me a lot.

The major point that I meant to make with respect to batting the unemployment today in your nation and ours, is that let's get it down. It is very important to get it down but let us get it down in a way that it does not restore the inflation which we began to fight in the first place.

Senator McGrand: That is clear to me.

Dr. James Gillies, Study Director: Dr. Sprinkel, I would like to pursue for a moment the mechanics of this operation. What would you do? Would you recommend legislation that required the Bank of Canada to increase money supply at a given rate? What would be the positive, actual way in which you would make this operative?

Dr. Sprinkel: Well, it is a difficult question and I do not have a sure-fire answer. Let me first say that I am sure that every central banker in the world that I know—and I suspect all of those that I do not—would oppose a legislative mandate to regulate the growth in the money supply in any particular way. They prefer independence, and in certain circumstances they clearly need it.

Now, in our nation what we have done, in essence, is by long arduous work among monetarists and others, testimony before Joint Economic Committee hearings, we have been able to get the Federal Reserve to say, or Chairman Arthur Burns to say, that he believes that under almost all circumstances the money supply should grow at a rate somewhere between 2 and 6 per cent. He could not conceive of a situation where it should grow more than 6 per cent on average, and he could not conceive of a situation where it should grow less than 2 per cent. I am not too unhappy with 2 and 6 per cent. That is much less volatility than we have suffered in the

past. I would be even less unhappy if we could get it, say, narrowed to 3 to 6 or 3 to 5 per cent.

I do not think we should put a central bank in an absolute straitjacket, I do not believe it is necessary; but we must in our nation, at least, place more emphasis on regulating monetary aggregates and less on trying to influence interest rates only. If you try to control interest rates, you lose control over the money supply; if you try to control money supply, in the short run, you lose control over interest rates. I much prefer to keep it moderate, and I guess I would not be in favour of a law that forced it.

Dr. Gillies: If I can pursue that a little further, you are very fortunate in having a chairman of the board of governors of the Federal Reserve at the present time, Dr. Burns, who subscribes to this theory.

Dr. Sprinkel: Partly subscribes.

Dr. Gillies: Partly subscribes, but you could well get someone else. I just wonder if you are sufficiently convinced by your theory and your data to suggest that the time has now arrived that it is appropriate to legislate some sort of relationship between the money supply and the rate of growth and unit price.

Dr. Sprinkel: It might be. The main point is that an economy can live with any kind of rate of expansion in the money supply, so long as it is stable. A stable six per cent will do one set of things, but at least it will promote stable growth—considerable inflation but stable growth. A stable 2 per cent, once the economy gets adjusted to it, will promote stability.

So how do you pick what level? I can't pick the level for a particular country, including our own, but something along the rate of growth in real production would be my particular pick. The major points is that we should not go up and down like a yo-yo, as most nations have done, because it causes stop-go performance, and this is extremely costly both economically and politically.

So that if I were to legislate something, I would certainly want it pointed towards less instability in monetary growth, and not be quite so much concerned about the average rate of growth. In my particular choice, I would prefer something around 4 per cent for the US.

The Chairman: I would like to ask a supplementary there. You say you have set the growth in the money supply at, say, 4 to 6 per cent. Is there a set of conditions in which you would restrict the money supply? Let us assume that over a period you set the money supply at the 4 to 6 per cent rate, but over a period of time, because of other influences—you may well say that could not happen, but let us assume there were other influences—and even though a floating exchange rate would not protect Canada from the importation of inflation, is there a case, not for fine tuning but for restricting the growth of the money supply to, say, one or two per cent, well below the growth...

Dr. Sprinkel: On average.

The Chairman: On average, in order to bring the economy slowly back to a level?

Dr. Sprinkel: Well, one case, of course, occurred in the last few years, in your nation and mine, where we already had a serious inflation growing. Now, to let the money supply to continue to grow at 6 per cent meant that inflation would grow a lot longer; so that in both nations they restricted it below what I would consider a long-run objective.

Having restored reasonable price stability, then is it likely that an inflation would get out of hand such as it did in recent years in most nations, and then again require reduction?

One cannot peer into the future with certainty, but I know of no major inflation that got underway with a 4 to 6 per cent rate of growth in the money supply. Theoretically you would not expect it, and you look around the real world to see if you can find any evidence that it actually happened and the answer is "No".

I can think of other reasons. Suppose you are a nation on a fixed exchange rate and, in essence, you let other countries determine your domestic policy because that is what happens when you go on to a fixed exchange rate, especially if your neighbour is much larger than you. If you have a deficit in your balance of payments—or let us put it the other way, that suppose you have a surplus and money is flowing into your nation, if you really insist on a fixed exchange rate you may again be forced to accelerate growth of the money supply, but you do it at the cost of subsequent inflation. You may make that choice literally.

One of the reasons I would be reluctant to write it in concrete for ever and ever about any particular rate, is that the human mind cannot conceive of all possible contingencies into the future.

The Chairman: There may be.

Dr. Sprinkel: There may be. Monetarists do not contend that money only matters; they merely contend that money matters most. So I would like a little flexibility, but much less than we have had.

Flexibility is not necessarily good; it can be bad, and we have had much too much of it in our nation in recent years.

The Chairman: When you say money matters most, you will be pleased to know that you agree with my wife anyway.

I notice in table No. 1 that there is a correlation, although you yourself state it is not exact, between the rate of increase in consumer price index and the rate of growth of the money supply. You say 4 to 6 per cent rate of growth in the money supply. If there were a correlation, this presumably would result in a 4 to 6 per cent increase in the...

Dr. Sprinkel: No, not in prices.

The Chairman: You see this problem in real terms.

Dr. Sprinkel: That is right, and shows the money supply per unit of real output. A 4 to 6 per cent growth in money supply would give you maybe a 1 per cent growth in money supply per real output, which would give you a very low rate of inflation.

The Chairman: Thank you very much.

Dr. Gillies: If you have a situation where a government clearly wants to operate with a deficit and a central bank thinks that inflation is a serious problem, is it the obligation of the central bank, in your opinion, to finance the deficit for the government?

Dr. Sprinkel: This gets into political arrangements between the government of the country and the central bank. In most countries that I know anything about, including our own, the central bank tries to maintain some independence, but ultimately the government wins.

I cannot conceive, for example, of the Federal Reserve pursuing a set of policies over a period as long as a year or two that was completely in opposition to what the government wanted. So this means that in a democracy we must elect responsible officials that really believe that maintenance of price stability is one of the important things; and hopefully the governments will recognize that financing a large deficit with new money will give them something they don't want later. Inflation is politically costly too, we must keep that in mind. We tend to forget it when we are only worried about unemployment. Back a couple of years ago in our country it was a very tender subject, and in fact still is.

I do not know any way out of that. You can say that if we had an all-knowing dictator this might be the best of all worlds, but I do not want to go that route and I am sure you do not either.

Dr. Gillies: Just to summarize this line of argument, then the monetarist's point of view or your point of view is that you have to be very persuasive. You would not legislate it; you have got to really convince people that this is the view.

Dr. Sprinkel: You see, if you legislate it and have them persuaded, they merely change the laws. That is no solution, so you have got to be persuasive.

Senator Hays: Dr. Sprinkel, with hindsight, I am wondering what happend, in your opinion, between the years 1930 and 1937. Have we been close to this situation again? This is a world situation, but now we look back on it I would like to know what you think happened. How did we get into this terrible world dilemma?

Dr. Sprinkel: Back in depression days?

Senator Hays: Yes.

Dr. Sprinkel: I suppose one of the reasons why I ultimately became an economist is because I was on a small farm in Missouri, faced with both a depression and drought. We did not really know we were in poverty, but we were and so were all our friends. I wondered why does the world have to go through these convulsions, and I have spent a good part of my life working on that issue. I am convinced that we got that way with poor economic policies, especially poor monetary policies.

I spoke of the 35 per cent decline in our money supply from 1929 to 1933. I know of no nation throughout the world that experienced declines in the money supply of that order of magnitude that did not experience intense deflation. In our case, we began to reverse policy in late 1932, and 9 months later the economy turned up.

Dr. Gillies: What was the increase in the money supply at that time?

Dr. Sprinkel: Beginning from the low, you mean?

Dr. Gillies: This was sort of under the New Deal, was it not?

Dr. Sprinkel: There was a decrease of 35 per cent from peak to trough. In the years 1934, 1935, 1936 we had a rapid growth of the money supply of about 15 per cent, and the economy was moving up. It was moving up from very depressed levels. By early 1937, just before the second drop-off, we had finally achieved a rate of industrial production equal to the peak in 1929; but unemployment, which had been 25 per cent at the trough, had declined only to 15 per cent just before the second drop.

Why did we have this second drop? Why, after this significant recovery from the low, did we again turn down in 1937 for another severe decline in economic activity?

Again, if you look at that chart, you will notice that the money supply declined from a rate of growth of 15 per cent down to a negative 10. That is an enormous change.

Dr. Gillies: That was monetary.

Dr. Sprinkel: That was monetary. If you go back and read the records of the Federal Reserve they indicate, though it is hard to believe, that they were concerned about inflation even though they had 15 per cent unemployment. So they decided to double the reserve requirements for commercial banks. They said, "The banks have all these excess reserves lying around, they are not using them, and they might create inflation later, so let us take it away from them".

Put yourself in the position of a commercial banker who had finally got through the great depression, and you were still there. The only reason you were still there was that you had maintained a very liquid position, because your friends who did not were no longer in the banking business. We broke about half of them in the United States in that period.

Dr. Gillies: And your customers too.

Dr. Sprinkel: Customers too along with it. It was not just the bankers; it was everyone who had deposits with them. The bankers said, "Look, the Fed. is taking it away from them. We are going to try to get it back". Now, they cannot literally get them back for the system, but any one banker could improve his liquidity by selling loans and investments, because he gets cash, and they did

it en masse. Down went the money supply, and a few months later we went into another depression.

Why did we have that experience? We had it because we had a very volatile monetary policy ranging from rates of growth of 20 per cent down to a negative 35.

We worry today about volatile monetary policies, but let me hasten to add that the degree of volatility, at least in the United States, that we have experienced since World War II, has been much less than anything that we experienced in the 'twenties or 'thirties. That is, we have raised our standards. We insist on government doing a better job than they used to and the central banker doing a better job, and they are. I think they have a way to go.

Senator Hays: This was caused by deflation. Now you are setting a ceiling of somewhere between 2 and 6 per cent on inflation.

Dr. Sprinkel: On monetary growth.

Senator Hays: On monetary growth, and that time we had a billion people in the world and now we have three billion. Japan has had 18 per cent inflation in the last 12 months with full employment and that sort of thing. Do you think that we can hold the horses back a little too hard insofar as this inflation is concerned?

Dr. Sprinkel: Yes, sir. I think it is possible to over-react, but so long as you have flexible exchange rates, as you now have...

Senator Hays: Floating rates.

Dr. Sprinkel: Floating rates, you do not really have to worry all that much about what some other nation is doing. You can attend to your own knitting and realize that money flows are not likely to get in your way, at least to the degree that previously existed.

Yes, I think it is possible to over-react to depressions, and it is also possible to over-react to inflations. Once having an inflation, I think the proper way to do it is gradually over a long period of time, but this is sometimes politically untenable for obvious reasons.

Senator Hays: Doctor, as a banker and living next to Canada, what mistakes do you feel that we have made in the last 4 or 5 years, or what should we be doing in the next 2 years?

Dr. Sprinkel: I have been very careful not to tell Canada how to run its nation, because I really do not know enough about it. The one way to lose one's reputation is to pose as an expert on something you really do not know about, and I really do not know your problems. I read about them, I look at the numbers, but I tend to my knitting in terms of the U.S. economy, where I do speak up when I think it is wrong.

I know that most nations have had volatile growth in the money supply and much too much of it. You can or may not have had, but but we did.

Senator Inman: Dr. Sprinkel, I am interested in what would have happened had the second world war not come along. I was quite close to government affairs in my own province of Prince Edward Island at that time. I know what effect the second world war had on the economies of the countries, but I am wondering, if that had not happened, what would have been the situation.

Dr. Sprinkel: Well, our recovery from the 1937-1938 recession was well underway before war broke out in Europe in 1939 and, of course, had gone a long way before we finally got in the war. My guess is that nations would have recovered from the great depression just as they did, but it might have taken somewhat longer, but hopefully the inflation would not have been as severe as it turned out to be during and following World War II.

I think it is a mistake to argue that wars are good for an economy and peace is bad. I am not talking about human sacrifice, because obviously it si bad for human beings. I am talking about economics; that was is bad for the economy as well as for the people. It means that we waste resources, we spend money on guns and tanks that we could otherwise be spending on improving housing and everything else that human beings like to enjoy.

It might have taken a little longer, but I am convinced that real incomes would have been much higher if we could have avoided that war.

Senator Manning: Doctor, you mentioned that the second reverse around 1937 was due to the concern with inflation at that time. Were there any clearly discernible reasons for the big fluctuation of 35 per cent curtailment of money supply that precipitated the major crash?

Dr. Sprinkel: In our country it had to do with the rules of the gold standard. At one time, not through law but sort of as a mutual understanding, a domestic monetary policy was determined, to a very considerable extent, by flows of gold between nations, because gold was used to settle balance of payment differences.

If I remember correctly, we had started a tighter policy before this occurred, but Britain went off the gold standard, and there was great thought that the same thing would be happening in the US, so gold began to flow out of the nation at a very rapid pace. I used to know the numbers and I have forgotten them now, but we lost something like a third to a half of our gold supply in a few weeks.

Of course, the central bank, that is the Federal Reserve Board, following the rules of the gold standard, began to tighten money even further. They raised the discount rate, they sold securities in the open market, and the money supply collapsed even more.

The Chairman: They just had no option?

Dr. Sprinkel: Well, they had an option if they did not want to follow the gold standard rules. No one follows the gold standard rules today. That is, gold flows do not determine our economic policy, nor does then balance of payments, even through we do not settle with gold, determine our policy. So they had options, but in the context of the times, they perhaps had no options.

The Chairman: As long as they preferred to be on the standard.

Dr. Sprinkel: As long as they wanted to stick to the rules that when gold flows out you tighten money, they had no option; but comparing a desire to stick to a convention versus the ultimate cotas that were incurred, I am rure that if they had recognized money really does matter they might not have done that.

Senator Hays: I read not so long ago, and I think it was Friedman who said it, that for Germany just recently, in American dollars, you would only have half enough gold in the United States. If I remember the figures it was something like $11 billion.

Senator Beaubien: That is what it is now.

Dr. Sprinkel: Germany has had something like 20 or 21 billions of dollars.

Senator Hays: Against $11 billion worth of gold reserves.

Dr. Sprinkel: That is right, to the best of my knowledge.

Senator Hays: In that context, how is money valued now on United States dollars, based on goods and services?

Dr. Sprinkel: Most currencies, in a technical sense, tie to the dollar—not the Canadian, which is floating. Also Germany's and Holland's currencies are floating now. I suppose they are the only three major ones. Most currencies are defined in terms of dollars. That is, the central bank insist on the exchange rate moving only a little within a certain relationship to the dollar.

Why do people want to hold dollars, even though they are tied to them? Well, despite the obvious weakness of the dollar in the last several months in international exchanges, it seems to me fairly clear that the US dollar is still the premier currency of the world. Now, why? It is not because we have done such a good job in the last three or four years certainly, because we had serious inflation, but so did everyone else. We did not do worse than others. It turns out that most world trade, certainly over half of the world trade today, is carried on in dollars.

Now, is there reason to believe that the world will continue to use dollars? In my judgment there is, provided we keep that inflation under control. If we do not, why would they want to hold dollars? I think we are going to do it. I have confidence that we are not going to panic this time; but it is the size of the nation, it is the use of the dollar in international commerce, and it is the fact that despite a bad record from 1965 to 1969, the record over the post-war years, in terms of maintenance of price stability, is better than every other nation I know of, but from 1965 to 1969 it was very bad.

Senator Hays: If this is the case then, that the US dollar sets the pace, Canada's position insofar as inflation is concerned, is that anything we do we have to be pretty well in tune with you. We cannot decide we are not going to have any inflation while you are having a lot of inflation. How far apart can we be insofar as this is concerned?

Dr. Sprinkel: It depends on what kind of international exchange arrangement you are willing to adopt. If you have a fixed exchange rate system, in one sense you can look upon Canada as a 13th Federal Reserve district; that is, you will be directly affected by what happens in Washington in terms of our monetary policy.

Senator Hays: Well, we are now.

Dr. Sprinkel: But if you have a floating rate you are much more free, in my judgment, to decide what makes sense for Canada. You need not be dictated to, either directly or indirectly, by what happens in some other nation. I do not live in a smaller nation, but if I did I think this would be an additional reason why I would want flexibility in my exchange rate. I would prefer to decide my own destiny, and not let governments that had a different constituency decide it for me. So that you have considerably more flexibility, in my judgment, with a flexible rate than you had previously with a fixed rate.

I hasten to add that there is no way, so long as we maintain trade between nations, that any nation, large or small, can completely insulate itself from what goes on in the rest of the world. Resources must shift, but at least you can determine your own monetary and fiscal policies.

The Chairman: Dr. Sprinkel, where does a monetarist stand on the relation of the dollar to the price of gold?

Dr. Sprinkel: Well, there is no religion written that all monetarists must subscribe to, so I cannot answer for all monetarists. My own judgment is that I would be just as happy if we had a completely free gold market, and we have an almost completely free gold market. That is, we have a gold market in London and elsewhere, and each day it moves. It goes above the $35 an ounce—$35 an ounce, of course, being defined by our government as being the price at which we will sell gold when offered dollars.

As you pointed out, sir, Germany alone has more than twice as many dollars as we have gold, so that cannot be a very realistic promise on our part to exchange gold for dollars. This sort of beclouds the issue, and I would be perfectly happy if we had no fixed price of gold at all and we let the market decide.

Senator Hays: You would let it alone?

Dr. Sprinkel: We do mostly. This is not a very extreme proposal I am making, because the great bulk of the gold that is exchanged is exchanged at a free market price. There is very little that exchanges between the US Treasury and central banks, because we do not have much and fortunately they have not asked for much.

The Chairman: But presumably that free market price is influenced by the price fixed by the American government?

Dr. Sprinkel: But not to a very large extent, because if it were there would be more transactions between the US

Treasury and other governments than actually occur. There are not many. Occasionally there is a little but not much.

The Chairman: Doctor, I think one of the questions that is germane to this point that you have been raising is: How does the central bank gain independence, or what are the constraints of the central bank in exercising its independence, to fix the money supply at this programmed increase that you have talked of?

Dr. Sprinkel: You do not mean independence from its government; you mean independence from other forces bearing upon it, is that correct?

The Chairman: Yes, although that could take in, as we mentioned earlier, the cash requirements of the governments which might very well influence them. I am not talking about independence in terms of the fact which sets up the central bank, but rather what the governor of the central bank has to worry about and how really independent he is.

Dr. Sprinkel: All central bankers that I know are very reasonable men, and they have certain points of view, just as I do. The major impediment to trying to control the money supply, until very recently, is the conviction among most central bankers that the money supply does not matter very much; that much more important is what happens to interest rates. They tend to say, "We, therefore, will operate on interest rates". So the major impediment has to do with a theoretical view which was supported and has been supported by practically all Keynesian economists, who tend to emphasize interest rates instead of money supply.

I hasten to add that I was obviously pleased, at this last international meeting a few weeks ago in Munich, to know that more and more central bankers, including our own—I do not want to say they are monetarists, because they would deny it—are saying, "Money really does matter, and we must pay more attention to controlling monetary aggregate changes than we have previously". This implies that they pay a little less attention to controlling interest rates. So it is amatter of conviction. If you insist on operating on interest rates only, you lose control of monetary aggregates.

Unless I am wrong, and I try not to be unfair on this, more and more central bankers are now emphasizing monetary aggregates. This applies to the UK, it applies to Germany, it applies to France, it certainly applies to the United States, it applies to Holland, and I am not so sure about Japan. I have not talked to them about this matter, but I think that the conviction that money does not really matter is by far the most important impediment.

Now, there are other impediments. If you are on a fixed exchange rate, money flows are a major impediment. I am sure any central banker could give you many more. For example, a problem we had in 1970 was a confidence crisis, which it is hard to specify in terms of monetary aggregates, but the financial community felt it, and the Federal Reserve had to do something and they did. They responded by freeing up some markets they had previously controlled—that is, some savings markets—and ultimately confidence has been restored. In the meantime they were putting money into the economy. I think it is primarily a matter of conviction. The question is, "Does money really matter?" and until recently most central bankers have said that it does not matter very much.

Senator Hays: But you say that interest rates matter. I do not believe there has ever been a time in the world, certainly not in this country where the tax gives up to 50 per cent, when a person with a little bit of money could make a terrific amount of money. Can the economy stand this sort of thing?

Dr. Sprinkel: Well, you do not make much money if you have 6 to 8 per cent inflation. You end up about where you were when you started.

Senator Hays: You might own this piece of real property, or you might option a lot of things, and you could live with it. The banker does not go back to 1933 thinking. In 10 years you could own the property.

Dr. Sprinkel: Yes, but they are paying 10, 11 or 12 per cent. Expectation of inflation not only gets into interest rates, but it gets into real estate values. It gets into any kind of a price that involves discounting of the future. The ideal thing, of course, would be to buy before the expectation of inflation occurred, so you get the low rate of interest and the low values, but that is not so easy.

In most nations today everyone realizes they have inflation, and most people believe there is going to be more than I believe there is going to be.

Senator Hays: Some people believe there will be inflation almost in perpetuity.

Dr. Sprinkel: Yes.

Senator Hays: But they have lived with this in Argentina and Brazil over the years, and even the taxi driver knows how to invest there.

Dr. Sprinkel: That is correct.

Senator Hays: If he owns a piece of the taxi, the next day he wants part of the action.

Dr. Sprinkel: It is a good principle that you are mentioning. That is, it is fairly clear that a nation can adjust to any rate of inflation. Contracts can be fixed in such a way that government employees do not get hurt because their salaries will escalate along with the rest. The poor and the old do not get hurt because social security escalates. It can be done. The thing that causes most difficulty is a change in the rate of inflation for the prior expectation.

In the process of going from reasonably stable prices to accelerating inflation, some very unfortunate redistribution occurs. Fortunately most developed countries have not chosen the kind of inflation that South America adopted.

My own preference is to get it down to very low rates of inflation; but a nation, if it is a free market economy, can adjust it. If a nation decides through its political

process, that it wants 15 to 20 per cent inflation a year, it can get it. All you have to do is pump in enough money, and it will not mean the end of the world, but it is not the kind of society that I personally would prefer to live in.

Senator Laird: What about international factors?

Dr. Sprinkel: Well, if you had a flexible exchange rate, you could inflate 15 to 20 per cent a year, even though the rest of the nations are much less. There would be a constant devaluation of your currency relative to other countries, but it could be done. I am not recommending it; please do not misunderstand me. I do not recommend rapid inflation, but the evidence from South America does suggest that it will work. It can be lived with, but it is not to be desired in my judgment.

The Chairman: Dr. Sprinkel, in your paper, when you talk about setting money supply at a predictable rate, you also deal with the problem of velocity, and I think you call it the multiplier effect. Does this have a very grave effect on the central bank in trying to achieve its policy?

Dr. Sprinkel: Well, it is a technical question, but a very relevant one. That is, will velocity change in such a way as to offset whatever the central bank does about the money supply. That has sort of been the argument between the Keynesians and the monetarists in the past—longer than the last several years ago, but it has been heated in the past several years. It is a question of fact. Is velocity perfectly stable? The answer obviously is, "No, it is not." That is, it is conceivable that the central bank could pump in money, for example, in a depression period, and that velocity would merely go down, and that nothing would happen to this country. This was one of Keynes's famous examples. Where you had an infinite demand for liquidity, you pump in money and you merely soak it up in idle hoards and nothing happens. It is conceivable.

Conversely, it is conceivable that in a period of serious inflation, when the central bank wanted to slow down the economy, that they could restrict the money supply but velocity would merely go up and nothing would happen. That is conceivable too. You can understand theoretically how it could happen. But then you have to go back and say: "Is there any record in any nation under any set of circumstances, where changes in money did not induce subsequent changes in spending?" The answer to the best of my knowledge is "No".

This issue has been very closely researched by Milton Friedman, by economists at St. Louis Federal Reserve Board, by Clarke Warburton, and I have done some, and there have been lots of other people that have worked on it. It is certainly conceivable that veloc ty would offset whatever a central bank did, but as a practical matter I know of no example when that occurred.

Senator Beaubien: Dr. Sprinkel, you mentioned there that if the United States kept its house in order, as it were, that the American dollar would continue to be used as a yardstick by other nations. We just have to have a yardstick, don't we, and therefore what could possibly supplant the American dollar? Would it be conceivable that if the common market got together with one currency, whether it be the franc or whatever it might be called, could be the basis then as the yardstick for other nations?

Dr. Sprinkel: I think this is partly the desire of the common market. They would like to offset to some extent, for legitimate reasons to which I am not objecting, the over-powering dominance of the dollar. It is conceivable that if they could work out all the "technical" problems, that ultimately much of the world trade could be carried on in that currency. But then there are some very practical technical problems involved. They had proposed in early June that exchange rates between these nations be narrowed even more than was permitted by Bretton Woods. Now it has been indefinitely postponed.

Why is it very difficult to move in that direction? I spent two and a half weeks in Europe. Its diversity is delightful, and I would not say for a moment that I wished all those nations were like us or that they were like each other; but the diversity also means that they have different tastes in Germany, for example, with relation to inflation than in Italy or in France. They have different desires based on the desires of their people. If they are really going to get a common currency, they must have, in my judgment, common economic policies. That is, they should have the same tax system, they must have the same tariff system, they must have the same subsidy system, they must have the same monetary policy system.

Senator Beaubien: Labour unions would have to work it out too.

Dr. Sprinkel: That is right. I must admit that even though it is a wonderful dream, I am not very optimistic about it coming off in my lifetime.

Senator Hayes: They need a dictator to put it together.

Dr. Sprinkel: They think not, but I am inclined to agree with you.

Senator Grosart: How old is the monetarist cult?

Dr. Sprinkel: If you go back and read David Hume and some of the early writers in the early 1800's and before, you can find forerunners. If you say, "Well, who really did the first important work?" it has to be Irving Fisher. Irving Fisher was a United States economist writing in the late 1800s up until, say, about the depression years, and I guess he died in the early post-war period, I believe. The depression in the United States, as well as world-wide, sent monetarism into an eclipse that really was not changed until the early post-war. The first man in the early post-war, beginning in the late war period and running from 1945 through 1950, was Clarke Warburton. He was an economist with the FPIC, and now retired.

The first academic, I believe, that really did any major work, was Milton Friedman, and his major efforts got

underway in the late forties or early fifties, and they have continued in great quantity ever since.

So it is hard to say where it started, but I guess I would tag it with Irving Fisher first; Clarke Warburton, followed by Milton Friedman, Anna Schwartz, and fortunately most of the world currently. I am not sure it is fair to call it a cult, since so many people are now buying it.

Senator Grosart: I call it a cult for want of a better word. It is a viewpoint, it is a group. What is the opposite then of a monetarist?

Dr. Sprinkel: I do not want to be unfair, but I think it is correct to say that at least the important philosophy and set of economic dogma that frequently collides with the monetarist views are the so-called Keynesian views, that is, the theory of John Maynard Keynes, and it really got started in 1936, when the great classic book was written. Much in that book was correct, but it just happens that much he had to say about money turned out to be incorrect. We really did not use those policies in the United States until about 1960. From 1960 through 1968 we had what we called "new economists" or "fiscalists", and their basic theory was based on the Keynesian general theory. So those are the two points of view, the Keynesian versus the monetarist, and that is a slight over-simplication, because some people are in between.

Senator Grosart: Do you see a particular reason why this emphasis, certainly in visible terms, on monetarism quite suddenly appears? Was it merely a result of more sophisticated economic thinking or was it a change in monetary circumstances around the world?

Dr. Sprinkel: It is quite clear to me—and I know most of the leading monetarists and most of the leading Keynesians and have many good friends in both camps—that these men are equally sophisticated, equally well educated, and equally articulate. Why is it that the Keynesians have been slipping in terms of influence, and the monetarists have increased? I think the answer is not because the monetarists have done a more sophisticated job. The real answer is that the Keynesian policies pursued in the 1960s led to near disaster in many nations, that is, very serious inflation.

When you look around, if you cannot use fiscal policy to do it, what can we use? It so happened there was a body of thought that said: "Money matters; it matters a lot but not only". It was this bad experience with following Keynesian policies that, in my judgment, led to more and more people being willing to look at the monetarist viewpoint.

We have had several severe clashes in our country where fiscal policy was going in one direction and monetary policy was going in the opposite, and on each and every occasion, in my opinion, the monetarist won the argument. The most extreme one was in 1968 when we had a very sizeable tax cut, a $25 billion swing, and the full employment budget, and at the same time, which was a defiationary move, the money supply was going very rapidly. If the fiscalists were right, the economy should have slowed down; if the monetarists were right, the economy should have continued to move with serious inflation. Of course, the latter happened. So I think it was events and this dissatisfaction with prior policies.

Senator Grosart: I am interested to note that you use the term "fiscalist". Would you identify that generally with the Keynesians?

Dr. Sprinkel: Yes, sir, although I know of one Keynesian who does not like the term. He prefers to be called a new economist. I am speaking of Dr. Heller, and if he prefers to be called a new economist, I will certainly call him that. The reason the term "fiscalist" is frequently applied is that the Keynesians emphasize the importance of fiscal change and de-emphasize the importance of monetary change. So the terms "Keynesian", "fiscalist", "new economist", in my mind are the same term.

Senator Grosart: From the government point of view, what kind of linkage do you see between monetarism and fiscal policy? What kind of linkage should there be, perhaps I should put it?

Dr. Sprinkel: Fiscal policy, in my judgment, has its major effects on the allocation of resources, and I spoke of the three ways that it does have a major bearing on the results of an economy.

Another important aspect of fiscal policy is that in many governments on many occasions when you run a big deficit, the secretaries of the treasury or ministers of finance have a great tendency to lean on the central bank and say, "Help us finance it". So that the larger the deficit you run, the greater the danger that the central bank will create excessive money and create a subsequent inflation. They may well have no option there. That is, if they are under the control, or the nominal control of the central government, they may well be forced to create more money than they would otherwise prefer. So that is a very important relation over and above the allocational effect.

Conversely, running a surplus in the federal budget, this seldom happens, but when it does happen you have got to do something with the money, and what you do with the money again, has a bearing on whether the money supply grows or does not grow. So monetary and fiscal policy, in my judgment, must be co-ordinated.

Senator Grosart: You recognize in your paper the short term political problems...

Dr. Sprinkel: Yes, sir.

Senator Grosart: ...involved in a uniform and stable expansion of the money supply. How do you see these being overcome? Do you think political courage is one answer perhaps?

Dr. Sprinkel: Yes, sir, that is correct.

Senator Grosart: But political courage is not much good if you do not get re-elected.

Dr. Sprinkel: That is correct. It is a very real problem. The way it can be overcome once you finally get stable

prices is not to make the same mistake again, but that is not quite what you asked. Starting from a serious inflation which has already occurred, how do you gradually get down to less inflation without serious political costs? I do not know any way. In our country the administration may be having a little luck. With a four-year term, a tight policy brought on early to slow an acceleraitng inflation, then beginning to show some improvement on the price front with an election still a year and a half away; they can now afford to encourage the economy to expand and continue to get some benefits from reduced inflation. But that was sort of an accident in the timing of the election. It is a very real problem. That is why the results in most nations are not stable prices. That is the important reason, because we swing from a recession to worry about getting rid of unemployment. Then we have serious inflation and we worry about inflation, we tighten down, and we create more unemployment. So it has been stop-go in many nations in recent years. To a considerable extent it is because of the political process. It takes not only an astute but a strong-willed politician who is willing to keep a steady hand on the helm when he knows he may lose office in the process.

Senator Hays: This may be advantageous, because I think of some of the countries and their standards of living. That is what it is all about. I think of countries that do not have elections, where you have great mediocracy, and yet you have this stabilization that you speak of. So perhaps the ups and downs are good.

Dr. Sprinkel: Perhaps it is the price we have to pay for democracy, and if it is I am willing to pay it, because I prefer the democratic procedure, but I am hopeful that in a democracy we can still have a sensible economic policy

Senator Grosart: Part of the problem is that political costs are, rightly or wrongly, generally interpreted as spin-offs of social costs.

Dr. Sprinkel: That is right. It is not only political costs: there are economic and social costs. That is, unemployment is a political issue, but it is also a very important economic problem. In an economy when we permit over a long period of time a lot of unemployment, it means we are not performing up to our capacity. That is why I think it is very important that we avoid oscillation in policies so that we can thereby avoid oscillation in economic performance.

Senator Grosart: As a monetarist, do you see any kind of mechanism for the linkage between monetary and fiscal policy? I am speaking now of the battle or argument that goes on over and over again every time the budget comes up: should it be expansionary, should it be a restrictive budget? In our terms in Canada, we sometimes speak of it as the battle between the Department of Finance and Department of Trade and Commerce.

Looking back, over and over again we are told that the problems are in this area of lack of co-operation and co-ordination of monetary and fiscal policy. You have given us one example in the bind of political structure. Do you see anything within this structure that could form a mechanism by which we would have almost automatic correlation.

Dr. Sprinkel: One recommendation that I made to our own Joint Economic Committee, which at least was partially adopted, was that when we talk about a budget as to whether it is expansionary or contractionary and whether it is fitting the problem we are faced with, we should also discuss how we are going to finance the deficit, if there is a deficit; or how are we going to dispense with the surplus, if there is a surplus; because this gets to be a monetary issue and requires intense co-operation. I would argue that from the standpoint of inflation and economic stability, it is by far the more important question than whether a budget is expansionary or contractionary. Yet in very few governments that I know about do they discuss this issue when they are considering a budget. They are merely saying: "Spending is going up more readily than revenues", or, "Is the full employment budget balanced?", or, "Is the actual budget in deficit and how much?" Seldom do they discuss how is the deficit going to be financed—that is, by new money or otherwise—or how the surplus is going to be dispensed.

I would think that in budget hearings it would be very desirable either as a general rule, or at least by insistence of those that are responsible, the elected officials, that this issue be raised and discussed, and this requires the co-operation of the central bank obviously.

Senator Grosart: In the United States what is the nature of the mechanism as between the, let us say, Bureau of the Budget and the Federal Reserve Bank?

Dr. Sprinkel: Well, if you look at the legal relationship, the Federal Reserve Bank is supposed to be independent of the Administration and it reports to Congress. That is the way the law reads. Perhaps I should not say that, but that is what I am told by my lawyer friends. As a practical matter it cannot be. That is, you cannot have a central bank completely independent of the government. So we now have that each four years the term of the chairman of the central banks, his term expires, which means that every president whose term runs four years will have an option of appointing his chairman during his Administration. If he does not have a retirement from the board, which is a 14-year appointment, he may have to pick one that is already there; but if he is lucky and has retirement from the board he can pick not only a chairman, but he can pick a new man. Of course, in Mr. Nixon's case he did choose Dr. Burns. They are close personal friends; they tend to subscribe to the same economic philosophy. They both tend to think money is fairly important, with some people in the Administration thinking it is perhaps much more important than Dr. Burns thinks, but it is an informal coordination.

Even so, Dr. Burns is obviously somewhat independent, because he has been calling for incomes policies, and the Administration position remains against incomes policies. So it is a compromise, and I think that is true of many governments: but ultimately it seems to me that the government is going to have a major influence on any cen-

tral bank. In a democratic society it has to have, but hopefully they can maintain some degree of independence.

Senator Grosart: What are the advantages of having an independent central banking system?

Dr. Sprinkel: Well, if you assume that you have an irresponsible government and you have a responsible central bank, there is an obvious advantage, but I am not so sure I would buy that assumption. The government is elected by the people, and the central bankers are usually appointed by the government. I think they should have enough independence, certainly, that they have got a right to make their case in opposition to what they consider to be a bad government policy, but ultimately it does not make any sense for them to go off in one direction while the government is going off in an opposite direction. That is why they usually have less than 100 per cent independence. It is a matter of compromise, the checks and balances, in our nation, and I think it is true in many others.

Senator Grosart: You could theoretically have a monetarist administration and a fiscalist central bank.

Dr. Sprinkel: To some extent that is what we have in the United States, although Dr. Burns, who is chairman of the Federal Reserve Board, leans towards the monetarist position but not all the way.

Dr. Gillies: It seems to me the monetarists put enormous emphasis on stable pirces. Could you not have an equilibrium position of stable prices with a high level of unemployment, and what would you do then?

Dr. Sprinkel: If that were to happen, I guess I would prefer a little more inflation to having very high levels of unemployment. I am not convinced that this need be the case if we avoid wild oscillations of policy. If we are going to give it great stimulus one day and then a year later give it great restraint, then we are going to run into this inconsistency; but you are asking me my taste, and it is given as a citizen, not as an economist. I do not think an economist *per se* can play the trade-off between unemployment and prices. As a citizen, if I had to accept more inflation to get the unemployment down, I would do so, but I do not think that is a good trade-off in the long run; that you cannot really opt for a little bit more inflation and a little less unemployment. I do not think that is the way it goes.

Dr. Gillies: Do you think, to put the question in shorthand, the Galbraithian thesis of the structure of the economy has a lot to do with whether a monetary policy will really work?

Dr. Sprinkel: Well, if the world were really made up of nothing but monopolies and markets really did not work, I guess monetary and fiscal policies do not matter very much, but I don't believe the world is made up that way. I believe we have some monopoly powers in labour unions and some perhaps in some industries, but on the whole we have a very flexible market, at least in our nation.

Dr. George Stigler has done a great deal of work trying to improve data on prices, and the reason he got into this, I believe, was that Dr. Galbraith and others were arguing that: "Look, these prices are very rigid and they don't change over time. Therefore there must be monopoly power". It turns out that many of our prices are not the prices at which the market actually has a transaction; they are stated prices, list prices. When Dr. Stigler finally got the actual prices, there is much more flexibility in those prices than was otherwise evident.

So I am personally convinced that we have a highly competitive economy, although not perfectly so, and that clearly monetary and fiscal policies have a great bearing on what happens.

Dr. Gillies: Because our two economies, the American and the Canadian, are so inter-related, would you care to forecast the prospects for the American economy in the next few years?

Dr. Sprinkel: Well, yes.

Senator Beaubien: Is the stock market going up?

Dr. Sprinkel: I am glad you asked me. I had the pleasure a few weeks ago of testifying before our Joint Economic Committee, and the big debate there was among the monetarists who were relatively optimistic, and the fiscalists who were relatively pessimistic. As I suggested, they are equally able people. How do they disagree on conclusions? The real reason goes back to theory again. The fiscalists say that the stimulants in the economy can be measured by changes in capital spending and by changes in the full employment budget. If you look at what is happening to capital spending in the United States and what kind of stimulus is being provided by the full employment budget—very low. So if I were stuck with that theory, I would be forced to conclude that prospects are not very bright, because we are not getting very much stimulus, and therefore I guess I would have to argue in favour of increased government spending and reduced taxes, et cetera. But I am not stuck with that theory.

Monetarists argue that the major force causing changes in total demand is the money supply. Now, money supply has not been growing too little. If anything, I am nervous on the other side, especially in the last two or three months; but up until a month ago I could say that the money supply had been growing between 5 and 6 per cent annual rate. Last month it got a little out of control on the up side.

Using the usual relation to velocity changes and changes that occur in the early period of a recovery, I end up with a GNP estimate of an absolute minimum of a trillion-fifty and I really think more than that, up a little bit below a trillion-sixty-five. That is a trillion-fifty-five plus or minus five billion makes me feel less uncomfortable than any other number.

The Chairman: That must make Mr. Nixon feel pretty good too.

Dr. Sprinkel: He is going to win this argument in my judgment. This is not to say we have perfection. The rate

of inflation is gradually coming down, but it is gradual. Unemployment has not yet turned down. The columnists write as if this were something new on the face of the earth. I wish it were new but it is not. Each time that we have hit low in a recession, we had to wait for many months to get the unemployment rate down. I am not happy about that but that is a fact, and the reasons are fairly clear.

When business begins to improve, businessmen in the first place do not believe it. They have just gone through a period of surprises on the down side, and an upswing today does not mean that tomorrow there is going to be another upswing; it takes a while. Eventually they begin to believe it, but they do not rush out and add to their labour force; they use the labour force they already have a little more intensively, and then productivity begins to improve. This again means that you do not rush out and hire labour.

So I do not see any evidence, from the continued 6 or 6.2 per cent unemployment, that the economy is not recovering. It is acting as it has always acted.

This does mean to me that beginning fairly shortly, we should begin to see a gradual, persistent decline of unemployment; not to full employment this year and not to full employment next year, but moving in that direction. So I am expecting a significant expansion in real output this year, a very sharp rise in corporate profits, some modest decline in unemployment.

One additional factor that I forgot to mention is that our labour force is growing at an annual rate of 2 million, which means you have got to create 2 million new jobs before you pull the unemployment down. So I am in the optimistic camp.

Senator Grosart: To what extent is this lag in employment and re-employment an internal function of the labour market, and its peculiarities such as second family earners, wives falling out of the market and not really too anxious to get back in. Are these important aspects?

Dr. Sprinkel: I think that is part of it. That is, the labour force has a certain automatic collapsibility or expansibility. If there are jobs around, they come back into the labour force; if it slows down and there are not very many jobs, they will drop out and do not show up as unemployed. This means, in essence, that in a recession unemployment, if you were to count those people, is a little worse than it appears to be; and it means that the rise in total employment and the decline in unemployment is a little more than it appears to be in the period of expansion.

So there are some built-in factors that make it very difficult to analyze what an unemployment rate or a change in the unemployment rate means; but politically it means that, clearly, we have got to get it reduced in our nation, and I think we are going to get it reduced.

Senator Beaubien: Doctor, the number of employees has always gone up though, has it not?

Dr. Sprinkel: Yes sir. You see, we have a growth in our labour force of about 2 million persons. The total rise in unemployment that has occurred from the low to the present level, I believe, is about 2 million. I have to check that to be certain. So that we have actually had some improvement in actual employment over the last couple of years.

Senator Inman: Dr. Sprinkel, what percentage of unemployed do you feel would not go back to work on account of welfare policies?

Dr. Sprinkel: Well, this is a very difficult question and I do not know the answer. My basic hunch, which is all I could call it, is that most people prefer to work and not draw welfare at someone else's expense.

Senator Inman: I think that is true.

Dr. Sprinkel: I think that is generally true. The important thing then is to see that they have an opportunity to work. This means to me that we must keep the marginal tax rate of that group low. Yet, the way we have our welfare system set up in the United States, in many cases we have a 100 per cent marginal tax rate on someone drawing welfare. I must say if I were working in an environment of a 100 per cent marginal tax rate, I would be known as a very lazy person, because my incentive would be completely removed.

We are trying to move towards a system which will have a much lower marginal tax rate, and I think it is very important if we are to give these people the opportunity and the incentive to move from the unemployed to the employed; but we must have a strong economy as well to give them those job opportunities.

Senator Casgrain: I am not very well versed in financial matters, but you were talking about unemployment. Do you not think, although you have quoted Keynes and Galbraith and all those very fine economists, that we are now in the atomic age, and it is not possible to apply theories that suited the beginning of the 19th century? Now there is a distinct change. I do not know what is going to happen. I was wondering if the monetarists and the people who direct the economy have looked at this problem.

Dr. Sprinkel: Yes, I believe the Keynesian policies did not work in the thirties, forties, fifties, sixties, and seventies, and they will not work in the eighties. That is why I do not really subscribe to the Keynesian policy positions as espoused by Dr. Galbraith, Dr. Heller and others. I believe the monetary policy prescriptions did work in past times, are having greater impact to-day, and will have greater impact to-morrow. That is why, in essence, I subscribe to that point of view.

The Chairman: Did you have a question, Mr. Brower?

Mr. E. J. Brower, Economics Division, Parliamentary Library: Just touching in a peripheral way on the question of economic lags, I know Dr. Sprinkel is an expert on the subject, and I might mention to him that some of our academics have suggested that this might be made a subject for a great deal of study in the future at universities; and that in the present conditions in Canada some people were surprised when money was loosened very

much recently and there was really no effect on the unemployment, but right away we seem to have an effect on the inflation rate, which jumped from 1.9 per cent to something like 5 per cent or more.

Dr. Sprinkel: We do not perfectly understand the length of the lags or the cause for the lags. There has been a lot of work done on it. I think we have made significant progress in terms of the lag between monetary change and its impact on total spending. The range of disagreement has certainly narrowed significantly on that point.

We certainly do not know enough about how long it takes to influence inflation, or even perhaps how long it takes to influence unemployment; and I could not agree more that this is an area for serious and further research.

Let me hasten to add that this inadequate understanding of lags and inadequate measurement of lags is one of the major reasons why we, as monetarists, argue that we should not pursue a fine-tuning policy, because we cannot predict what the impact is going to be. Let us maintain a reasonable stable policy in-put, and then we need not know precisely what those lags are, because we are not keying our policy to the latest wiggle in the leading indicators.

The Chairman: You say in your paper on demand stimulus and physical change, that the best way to measure, which I suppose deals with lags, is the changes in the federal spending and the changes in the narrow money supply. You would define the narrow money supply as currency and demand deposits, I presume?

Dr. Sprinkel: Yes, sir.

The Chairman: What do you mean by federal spending?

Dr. Sprinkel: That statement, as far as fiscal policy is concerned, is related to some detailed research that had been conducted by the St. Louis Federal Reserve, where they attempted to see what fiscal measures were closely correlated to subsequent changes in spending, and they used several different series. The one the fiscal policy proponents usually refer to is the full employment budget. They used that particular series, and found zero correlation—that is, it just did not predict anything. So you do not want a major fiscal policy that way. They tried revenues as a measure, and this had no impact on spending either. They tried the actual deficit, and they got no co-relation. They tried government spending in relation to subsequent changes in income, and they had a very minor relation, but it was a statistically significant one: that is, a one billion dollar change in government spending will lead in six months to approximately one billion increase in GNP. But in the subsequent six months that one billion would be lost, so that over a year's period of time you get no impact or, in essence, no impact.

With the money supply in the same test, they found that a one billion dollar change in the narrow definition of the money supply led to, I believe a $5.6 billion change in GNP, that is, between five and six billion.

Therefore, if I am attempting to measure monetary and fiscal policies I would define those measurements in terms of those series that are most significant for income change; and to the best of my knowledge, changes in government spending and changes in the narrow definition of money supply are the two series most closely related with money supply, by far the more important. That is why I am a monetarist and not a fiscalist.

The Chairman: On that note we might conclude. Honourable senators, we are not meeting next Tuesday, but we are meeting on Wesnesday morning at 9.30 to hear Dr. Arthur Okun.

Dr. Gillies: A fiscalist.

Dr. Sprinkel: A very good fiscalist.

The Chairman: The reason we have to meet at 9.30 on Wednesday morning is that Dr. Okun has to catch a flight back to Washington at noon.

That day we shall have three witnesses—Dr. Okun, Dr. Deutsch, and Mr. Knowles who is permanent director of the Joint Economic Committee of Congress. On the following morning we shall hear Mr. Rasminsky, and on Tuesday, June 29, we shall hear Mr. Benson and Mr. Reisman in the morning, and Mr. Reisman in the afternoon.

Senator Beaubien: Does that wind up our schedule?

The Chairman: Yes, that winds up our schedule.

Dr. Sprinkel, on behalf of the committee, I thank you very much for coming to Canada in the midst of a very busy schedule. I stated just a moment ago that we are going to have as witnesses the Governor of the Bank of a Canada, and the Minister of Finance and his deputy, I think probably you have given us more ammunition for them than probably any other witness.

Senator Grosart: You mean ammunition to be used at them.

The Chairman: No, for them. This is not a confrontation. You have given us many thoughts. Perhaps I should not have used the word "ammunition". I am sure your name will come up many, many times during those two sessions, and I thank you very much.

Dr. Sprinkel: Thank you for inviting me.

The committee adjourned.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 20

WEDNESDAY, JUNE 16, 1971

Seventeenth Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses—See Minutes of Proceedings)

23918—1

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
	O'Leary
Gélinas	Paterson
Grosart	Phillips
Hays	Sparrow
Isnor	Walker—(27).

(Quorum 7)

**Ex officio Member*

Orders of Reference

Extract from the Minutes of the Proceedings of the Senate, Wednesday, March 17th, 1971:

"With leave of the Senate,
The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Wednesday, April 28th, 1971:

"With leave of the Senate,
The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, Tuesday, May 4, 1971:

"With leave of the Senate
The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoon at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relations thereto.

The question being put on the motion it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

23918—1½

Minutes of Proceedings

Wednesday, June 16, 1971.
(20)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10.00 a.m. to consider the Question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Benidickson, Croll, Desruisseaux, Isnor, Laird, Langlois, Manning, Méthot, Melson and Nichol. (12)

Also present but not of the Committee: The Honourable Senators Cameron, Inman, Kinnear, Lang, McGrand and Smith. (6)

Present as a special guest of the Committee: The Honourable T. D'Arcy Leonard, Q.C.

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics; Dr. David McQueen, Economic Consultant.

Witness heard:

Dr. Arthur M. Okum,
Brookings Institute, Washington, D.C.

At 11.55 a.m. the Committee adjourned to 2.15 p.m.

At 2.15 p.m. the Committee resumed.

Present: The Honourable Senators Exerett (*Chairman*), Beaubien, Benidickson, Bourque, Gélinas, Grosart, Isnor, Laird, Manning, Molson, Nichol and Paterson. (12)

Also present but not of the Committee: The Honourable Senators Burchill, Cameron, Casgrain, Carter, Haig, Kinnear, Lafond, Lang, McGrand, Macnaughton, McNamara, Rattenbury and Smith. (13)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Dr. David McQueen, Economic Consultant; Mr. E. J. Brower of the Parliamentary Library, Division of Economics.

Witness heard:

Mr. James Wiley Knowles,
Director of Research,
Economic Committee of the Congress of the United States.

At 3.45 p.m. the Committee adjourned.

At 4.05 p.m. the Committee resumed.

Witness heard:

Dr. John James Deutsch,
Principal and Vice-Chancellor,
Queen's University.

At 6.25 p.m. the Committee adjourned to Thursday, June 17, 1971, at 9.30 a.m.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Wednesday, June 16, 1971.

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 9.30 a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

Senator Isnor: Mr. Chairman, before we hear our witness, may I bring to the attention of honourable senators that we have the distinguished former chairman of this committee, the honourable T. D'Arcy Leonard, with us this morning. I think it would be appropriate to invite him to sit with us.

The Chairman: Senator Isnor, had you not mentioned the fact, I would have done so. I thank you for bringing it to the attention of the committee.

I welcome the Hon. Mr. Leonard. The thought passed through my mind as to how much better these hearings would have been had he continued as Chairman of this committee. We are indeed happy to have him with us, and I now ask him to come forward and sit among us.

Again, sir, may I say how delighted we are to have you among us once again.

Hon. Senators: Hear, hear.

Hon. T. D'Arcy Leonard: Honourable senators, thank you very much. I also thank my old friend, Senator Isnor, for his kind words.

Mr. Chairman, I am terribly interested in the hearings you are conducting. I have followed them with great interest. I think you are doing extremely important work very well, which will make a contribution to the solution of some of the problems with which we are dealing in Canada. I wish you well in your efforts and thank you very much.

The Chairman: Honourable senators, we are having a small luncheon following this meeting, which Senator Leonard will be attending. I hope you can all be present to wish him well.

We are delighted today to have with us Dr. Arthur M. Okun of the Brookings Institute in Washington. Dr. Okun received his doctorate from Columbia University. After a long career in the academic world he became Staff Economist to the Council of Economic Advisors in 1961 and 1962; a Member of the Council from 1964 to 1968 and was, in fact, Chairman of the President's Council of Economic Advisors in 1968 and 1969. His publications are many, including *The Battle Against Unemployment, An Introduction to a Current Issue of Public Policy* and *The Political Economy of Prosperity.*

Dr. Okun is a man who has been very close to the levers of power and can tell us a great deal regarding the subject of this study on which we have embarked. I will now ask Dr. Okun if he would like to speak to you briefly on the subject of his notes, copies of which you have.

Dr. Arthur M. Okun, Brookings Institute, Washington: Thank you, Mr. Chairman. Honourable senators, this committee is facing a set of very hard questions which have plagued governments throughout the western world. I surely have not come here to provide easy answers to those questions. Indeed, if I have any general message for you it is to beware of those bringing you easy answers. One set of easy answers which people sometimes advance is to rely on set rules for either monetary or fiscal policies by maintaining an invariant growth of the money supply or a fixed position of the budget or a full employment budget.

One is tempted to look for such guides and, occasionally, they are useful as guides, but as rules I think they lead us astray. From my experience I am convicted that we can do better in keeping the economy reasonably close to a target by facing the hard tests and making the hard choices, rather than relying on a set of rigid rules. They are hard tests and hard choices of diagnosing and forecasting the path of economic attack, of trying to use our best discretion and judgment to formulate a budgetary and monetary program that stabilizes the load between fiscal policy and monetary policy without requiring either the budgetary or credit policy to carry the full burden of stabilizing the nation.

Then we must take advantage of the inherent flexibility of monetary policy which does permit small and subtle variations in response to changes in economic circumstances, and we must create or preserve flexibility in our fiscal tools, especially in being willing to change the rates of personal income taxes. In the experience of the United States in the 1960s I believe that proved to be our most dependable and most broadly and equably based tool for economic restraint—that is, the change in personal income taxes that we enacted in 1964, and again enacted on the other side in 1968. There has been considerable discussion within the United States as to the effectiveness of the 1968 measure with respect to personal income taxes. I have just completed a fairly comprehensive study of the personal income tax surcharge, and I am prepared to summarize the evidence as saying that while a great many things went wrong in the 1968-1970 period with respect to economic stabilization in the United States, and the personal income tax surcharge was a part of that program, there was considerable success in moderating the growth of consumer demand. All of these matters concerning the operation of fiscal and monetary policy on

the basis of careful diagnosis require a willingness to forecast and a willingness to change.

To repeat, in making hard choices and finding ways to implement them through the political process, mistakes will be made from time to time even if we use our best wisdom, but I suspect that the mistakes will be less frequent than the successes. We will have a good batting average if we follow these principles. We will also have some mistakes, and the mistakes are painful, within the political and bureaucratic processes, and it seems to me in many cases we attempt to escape from hard decisions by relying on bureaucratic rules for our behavior and thus not have to make changes and choices.

Of course, there is a risk on the other side of being trigger happy. I would say emphatically that that has not been the main danger and pitfall in economic stabilization policy. I believe most of the serious errors in U.S. economic policy, no matter who occupies the White House, have taken the form of action that has come too little and too late, rather than too much and too soon.

A second set of easy answers that are sometimes presented deny that there is a trade-off. It is a real problem of choice between maximizing employment and production on the one hand, and achieving the highest degree of price stability on the other. I believe there is a trade-off—that it exists in principle. In much the same way, we cannot have all the speed we would like and all of the safety we would like on the road, and we have to have a compromise there. We must recognize that temporarily we cannot have all the protection in employment we would like and all the price stability we would like, and a compromise is called for there. It seems to me there is an unwillingness to face up to this trade-off.

This agonizing dilemma of compromising between unemployment and inflation is what leads to unrealistic pol c es in too many countries. I think the formula followed in so many instances has been to focus on one objective or the other at a particular point of time. We find the thing that bothers us most at the time, and we attempt to control it. At one point inflation is public enemy number one, so we apply fiscal and monetary measures to stop inflation. In the process we create intolerable unemployment. Then we find unemployment is public enemy number one, and we are determined to do something about it, so we need fiscal and monetary fuel to the system which cures unemployment, but then we find we have intolerable inflation.

In some ways policy-makers throughout the western world have jumped into the refrigerator and found it too cold, and then they have jumped on to the stove and found it too hot, and have never been able to find a place in between. It seems to me that the real danger we are facing, and the problem of improving economic activity, is not in moving too fast, but rather in knowing when to slow down after we have begun moving.

I think in the United States today there is over-concern about the risk of igniting inflationary fines by getting a recovery rolling. The real risk of inflation will come much further down the road. After we get a recovery rolling pretty strongly, we will then be faced with the hard problem of knowing when to slow down. At the present time it seems to me that we have in the United States more than enough slack to ensure that we could get the economy going at a faster clip without risking a recurrence of inflationary pressures. To use words that my good friend Walter Heller used, there is no evidence that prolonging the agony of extremely high unemployment increases the chance of ecstasy in full employment and price stability at a later time. I think the message, when the economy is clearly operating at an unemployment rate that is excessive from the point of view of reasonable targets, is: Get moving.

I would also warn you against the temptation to try and learn to live with and love either inflation or high unemployment, or both. I do not believe either one of these situations is going to be a comfortable one for any Western civilized society.

I am not suggesting that there is no way of mitigating the social course of either inflation or high unemployment. I think there are measures that deserve consideration in respect of improving unemployment benefits, and trying to ensure that unemployment does not get stuck in a hard core group. In the United States this has a very important implication in our problem of racial equality because blacks do seem to be terribly and unduly susceptible to unemployment. There is good reason to want to cushion the blow of unemployment and, similarly, there may be good reasons to want to cushion the blow of inflation and to try to find ways of building escalators into pensions and possibly into bonds so that the people who are tremendously vulnerable to inflation do not get hurt. There are dangers in taking some of these steps to insulate the nation against inflation. A tolerance for inflation may be developed. An inflation-insulated economy may actually accelerate the inflation it is trying to guard against. I do not think there is a comprehensive solution to the trade-off dilemma in the form of providing these cushions for inflation or unemployment, although I think some specific remedies lend themselves to nations faced with this problem.

The final easy answer I would warn you against is that of leaving it to the market place; of suggesting the trade-off dilemma we face is inevitable, and in some cases the by-product of free market societies. It is every economist's predeliction to respond to every problem by saying, "Leave it to the market place." We learned that in graduate school. That is what we like to say. That is where all of our biases lie. I think my temptation for a great many years in the field was to argue that to leave it to the market place was the right answer on wage-price structural problems. I still think it is the right answer in some areas, but it has district limitations.

In most nations, leaving it to the market place does not mean leaving the status quo, because the government is not leaving things to the market place. The government, in effect, is doing a lot of things intentionally by setting floors, for prices and wages, without setting ceilings. When we have import quotas, we are clearly operating in such a way as to prevent the force of foreign competition from moderating price increases. We have a one-way street by which prices are allowed to rise and not allowed to fall. Some of our price support practices in the United States clearly have this characteristic. Some of

our practices with respect to government procurement set minimal wage scales for a particular sort for people working on government contracts, which again sets floors without ceilings, and impart an inflationary bias to the system. To leave it to the market place the government would have to stop a lot of practices it now engages in which do have this tendency to bias the price trend in an inflationary direction. I do not think that is the whole story of inflationary bias in our system. There seems to be more to it than that, and it does not look like the text-book rule on the workings of the market place, that market forces push prices up when the demand exceeds supply, and market forces push prices down when supply exceeds demand.

The first proposition can be confirmed again and again in actual fact. The market works very reliably to produce price increases when excessive demand arises. With respect to the second proposition, when we look around and see the enormous excess supply in the United States in production and labour markets, we do not find prices declining; we merely find them decelerating.

The markets have not operated symmetrically. They have not lead to the declines we saw following the 1958-1964 period. We have been waiting for a couple of years for prices and wages to decelerate significantly in response to market forces in the United States, and we do not see this happening to any significant degree. We see some deceleration in consumer prices, but it is very slow and disappointing. There is no indication that putting the economy through the wringer further and curbing its growth will do the job.

I do not fully understand, and I do not think anyone does, just why prices have turned out to be so stubborn in refusing to respond to change and excess supply. Even employers who have a line of people wanting work at the door, and who have workers who cannot conceivably quit and who belong to weak unions, still feel obligated to offer their workers a 7 per cent wage increase. When you ask why they have increased wages by 7 per cent, the reply is, "I can't be a Scrooge. I have to be a reasonable employer. Everybody is giving at least 7 per cent, and most people 8 or 9 per cent." What I am saying is that we have developed an ethical standard for an acceptable wage increase at the present time. What we are getting is an inflationary effect. Each wage increase seems to follow the one that proceded it, and it has to follow a pattern. We have a wage spiral of corresponding wages following wages rather than prices.

It seems to me that the issue is not one of whether there should be wage norms, but rather which wage norm should prevail. Should they be the wage norms that come from workers who have read about what the automobile workers and the aluminum workers got, or a wage norm that is justified and negotiated in an attempt to provide something more consistent with the public interest. It is not a question of whether there should be wage norms, but of which wage norms. I think the question answers itself in that we have to provide some kind of a means by which we come to a standard for wage increases which does reflect the national interest, and labour and business interest, in greater stability of prices and unit labour costs. Much the same thing is true for prices as well. I believe that they have been influenced by an emulation effect.

What I am saying is that in the United States I am strongly in favour of an incomes policy that attempts to operate primarily by setting guideposts, standards, norms, speed limits—call them what you will—on wages and prices to develop a more equitable and more effective standard of containing inflation.

Let me mention just briefly some objections that I am sure you have heard to any kind of an informal or voluntary incomes policy. First, it is alleged that such a policy has an inequitable impact on big business and big labor, and treats them as villains. That is not my view of it. I do not believe they are villains, but I do believe that in the United States some big business pricing decisions, and big labor and big business collective bargaining decisions, have a major role in establishing the wage norms that we now have, and this wage and price emulation pattern. It is not discriminatory, but rather effective to have the pressure exerted on the key decisions in respect of prices and wages.

Secondly, everyone points to the record and says that no nation has ever had a durable incomes policy. That is true. Every incomes policy has fallen apart so far. That does not necessarily mean they have to fall apart. My argument would be that whether they have held to key points in the past is no test. I believe they have held. Any time anyone points out to me that they have been highly mortal and that they have died, I remind people that Shakespeare and Einstein died too, and the test of their influence has not been whether they were immortal or not.

The third kind of objection raised is that income policies can divert the issue and can lead to excessive reliance on structural policies, and therefore encourage expansion. I agree there is a risk of that. I believe the worst enemies of an incomes policy are those who are overly enthusiastic about it, those who expect too much, and those who think by having wage-price guideposts you can insure against inflation by letting it rip with fiscal and monetary policy. That is not so. You have to continue to be very careful about the dangers of overheating by the use of fiscal and monetary tools. No incomes policy will stand up in the face of excessive demands. That is an argument of caution against mixing your tools; not an argument against the incomes policy in the kit of tools.

My message adds up to saying that if we are willing to face up to hard choices, willing to use fiscal policies and monetary policies and structural policies, including wage-price speed limits, in an effort to get a more tolerable compromise on price stability and prosperity, I think we can improve our performance in most nations of the Western industrial world.

The Chairman: Thank you Dr. Okun. I am sure that there will be many questions on your very provocative statements. Before proceeding to that I suggest that the Honourable Mr. Leonard be included in the list of those present as a special guest.

Hon. Senators: Agreed.

The Chairman: Senator Leonard, as a special guest of the Committee you are entitled to ask questions. If you have a question, you may indicate in the normal way, and I will recognize you.

Senator Beaubien: We had Professor Giersch from Germany before us about 10 days ago. What he explained was going on in Germany is very much what you are advocating. He pointed out that labor, business and government worked very closely together in setting prices and wages and so on, with an idea on the overall economy. Would you like to enlarge upon that?

Dr. Okun: I certainly cannot really comment on the German experience or even upon their institutional arrangements. You have heard from the expert. My impression is that there has been perhaps more effort there than in any other major country in getting this kind of consultative process going and keeping it going. I suspect one problem that the political process in Western Germany has posed is that of making fiscal policy in a flexible way. I think most economists in Germany would have wished they could have done more with the budget than be forced to rely upon mandatory restraint in monetary tools of economic management.

In the past they have managed to combine a remarkable record of growth with remarkable price and wage stability. I am sure Professor Giersch would be the first to confide that there are some advantages in tapping a pool of foreign labor just by creating job opportunities, but in taking account of this, I think that they have had a very fine economic performance which countries on the North American continent would be well advised to study and learn from.

Senator Nichol: I would like to refer to page 5 of your brief, where you speak of inflationary bias. Rather than ask a question, I would like to put a proposition to you and ask what do you think of it. You have discussed the question of why excess supply has almost no effect on the down side. Since the great depression your country and ours have devoted most of our legislative time to building into the system protections against the evils that beset people in the 1930s. Thus we have created a structure that is deliberately designed to prevent the evils of the down side. If we go one step beyond that, we seem to be in a period where governments are expected to protect industries from the evils of the down side. I cite examples of Penn Central, Lockheed, Rolls Royce, and now Upper Clyde Shipbuilders in the United Kingdom.

My proposition is that because of these structures prices and wages cannot really go down to any significant extent unless we have a real economic disaster of some kind, and unless the country in question becomes so uncompetitive in foreign trade that it actually begins to close down. My proposition, in a nutshell, is that because of the structures which we have created it is unrealistic to expect excess supplies to have any real effect. Could you comment on that for me?

Dr. Okun: That is very well taken. A great many of the items on my list of things that the government does in the United States that unintentionally abet inflation have exactly the history you are describing. Many of these were put into practice for very good reasons in the 1930s in an effort to minimize the impact of that disastrous depression. Our whole agricultural price support program dates from that period. The so-called fair trade laws were efforts to protect small business at a time when small business was being viciously attacked by the great depression. Once these things get on the legislative books, it is difficult to take them off. These get small groups behind them which feel very strongly about it. It is a matter of life and death to the small groups, but it is only a matter of pennies to the rest of the nation. It becomes terribly difficult to adjust the legislative structure to the enormous change in the economic environment in the post-war era. In some ways I am optimistic that we may yet adapt to this change and update our regulations and programs so that they are at least symmetrical, and thus not have this asymmetry of always providing the floor and never providing the ceiling.

We have not made much progress in that direction yet. When we try we do run into enormous political obstacles. Fair trade is a perfect example. In the United States there are still 20 states that have laws whereby a manufacturer can determine a minimum price at which a retailer can sell products, and the states and the federal Government essentially permit this under a special law that exempts it from the anti-trust proceedings. It is estimated that this adds something like $2 billion to the consumer costs of drugs and appliances and other items in the states that have these laws.

Every economist will tell you that they do not protect small business. The evidence is that they merely create all kinds of advertising and merchandising costs and are not of benefit to the small businessman. Time and again presidents are urged by their economists to go to the Congress and ask a repeal of this. Because it is a small item to every consumer, but a huge item to the national association of retail merchants, the political processes have never permitted this law to be repealed. I do not not know whether any nation can show the political maturity to remove this type of obstacle and, as you say, there is a real danger in governments getting into a position where they have to insure against the competitive forces that produce bankruptcies and collapses in firms that are either unlucky or inefficient. That is part of the competitive game. If the Government says, "Heads you win; tails the nation loses," the competitive game is not going to operate. I think there is some real warning in the pressures, both in the United States and the United Kingdom today, to provide this kind of shelter and insulation against the competitive process. It has to work in both directions, or else not work efficiently.

Senator Isnor: Is that not protection against the small concerns?

Dr. Okun: The justification is that it is supposed to protect the small retailer against the large retailer. There is very little evidence that it protects the small retailer in any meaningful sense. The states with fair trade laws have somewhat more retailers, but a well-managed small retail business can be just as efficient as a large well-managed retail business, and much better than the large poorly-managed retail business.

Senator Isnor: Except for putting a product out as a feeler, and featuring it.

Dr. Okun: In the experience of the United States, as far as I know, the evidence is that there is very little indication that it has been effective protection or encouragement to small business. It is a discouragement to efficient business rather than encouragement to small business.

Senator Nichol: In other words, to get at this problem of inflationary bias and this protective structure, it would require acts of considerable political courage lying in the face of the whole orthodoxy which has adopted it since the 1930s, and particularly since the war. It is my impression that to some extent at least the government in England is trying to do this. I am not trying to predict anything, but it looks as if they are getting into serious trouble. Do you think any American or Canadian government could effectively move against this structure and survive? We will put Canada aside; let us just speak of United States.

Dr. Okun: It is hard to make that political judgment, especially for an economist who feels a little naive in the political arena. I have never tried to tell any president I advised how to apply politics. That was a game that President Johnston knew far better than I could hope to know. I have given this a considerable amount of thought, and it seemed to me that perhaps the way to do this thing is to gather it up into a big package and be willing to make a crusade at it. The trouble with going after dairy import quotas or agricultural imports or Davis-Bacon Act contracts—the Davis-Bacon Act assures that every worker on a federal construction contract will get special union wage scales, even though they are away out of line with other wages in the community—is that it always looks discriminatory. It seems as if you are picking on a particular group, and you cannot really get a great deal of enthusiasm on the part of the general public. Dairy import quotas may mean two cents a week to the average housewife, and she is not going to write her Congressman and get enthusiastic about his efforts to repeal this law. On the other hand, if you put it all together and have a program claiming to make a reduction of 2 or 3 percentage points on consumer prices, and have enough pressure groups, you could awaken some consumer interest and play on what I think is, at least in the United States, a growing consumer interest.

Then I think perhaps it could be politically feasible. It is a very difficult matter for any prime minister or president. I could well understand their reluctance to wage this crusade. I think that it is terribly important and it is not even clear that we are moving in the right direction on this matter.

Senator Nichol: It goes a long way to explain why the standard methods of fighting inflation do not work in our society today.

The Chairman: Is this problem that Senator Nichol speaks of exacerbated by a reduction in volume, instead of a price decrease it creates unemployment, which in turn is exacerbated by the problem of the size of corporations and unions in today's economic world? It seems that the unions would accept a degree of unemployment rather than a decrease in the wage level. In other words, is it only a structural problem, as Senator Nichol describes it, or is it also a very human problem?

Dr. Okun: I think within the private decision-making process there are these human problems—some psychological and some sociological. It is very hard to make vivid to a rank and file steel worker that he may be jeopardizing his job by asking for a 10 per cent wage increase, rather than accepting an increase of 6 or 7 per cent. The added money in the pay cheque is there. The larger problem of losing a job seems too remote and too distant, unless the firm is really in the process of laying off workers, and he is pretty confident they can pass off the increase on the consumer and get away with it. If this cuts back on steel production, he would immediately urge the government to do something about it; to curb imports of steel.

Perhaps it is hard to dramatize to the individual worker and individual businessman that there is this real trade-off to him between volume and price. He wants to escape that hard choice too, and say, "I want all I can get of wages and I want all I can get of prices" particularly when, in the present environment, everyone can make a reasonable case that he has gotten the short end of the stick.

That is a remarkable characteristic of the inflation in the United States over the last six years. It is difficult to find anyone who has gained from it. Normally there ought to be what one economist called a zero sum game. For every dollar of price increase, somebody gets an extra dollar. You look around and ask: Where has it gone? Real wages are squeezed. Real farm incomes have been squeezed. Every group has this kind of sense of justice, perhaps, which says, "This is only what we are entitled to; we are not doing any more than trying to catch up." It may be, in that sense, justice. At that time they are willing to be a little irrational even if they see the volume-price or job-security-wage dilemma, and say, "There is no reason why this should cost me my market or job; it is only fair for me to catch up." It is one of the most decisive things of inflation in the social fabric. It does lead everybody to feel that he is the guy who has gotten squeezed, and most will put forward a good reason.

I am not sure those random thoughts really throw much light on it.

The Chairman: I think they do. Departing from your term "irrational", I am just wondering whether the tendency is not to have slack create a reduction in wages or prices. Is that a result of the size of the corporate identity today and the labour union identity?

Dr. Okun: My own suspicion is that perhaps that has more to do with the process by this setting of highly visible well known and well publicized norms on wage increases than any other way. I think that everybody seems to have his notions about what prevailing wage trends are, and these come out of reading the newspaper on what happened to automobiles, aluminum and cans, and what is going to happen to steel. It seems to me that

there is a pattern setting effect coming out of big business and big labour decisions where, even though the collective bargaining area in the United States still represents about one quarter of the labour force, its impact on wage decisions is much larger than that. Similarly, I think the small businessman who sees steel price increases of 9 per cent posted, almost feels that he belongs in that parade. It is such good company, how can you stay out? I think perhaps the emulation involved in the large sized firm and the high visibility in presentation of it is what gives this a great deal of leverage.

I had a really fascinating conversation with a businessman a couple of months ago. He was just a small manufacturer with no labour union, in a city with a 10 per cent unemployment rate. His workers were delighted to have their jobs. The year was up, and he gave them 7 per cent increase. His profits were down and his volume was down. I asked him why he offered a 7 per cent wage increase, and he said he had to do it. I asked, "Why? Would they quit?" and he replied, "They wouldn't quit. They have no place to go. All I have to do is put a help wanted ad in the paper for three workers and I can get 300." I insisted, "Well, why 7 per cent?" and he said, "I felt obliged to give them that. Everybody sees everybody else getting 7 to 9 per cent. Construction workers get 20 per cent. How can I give my people less. There will be a day when the labour market turns and I don't want them out looking for jobs and feeling that I am the kind of person who pins them to the wall because I have the upper hand in the labour market." That is not the way the textbook works. That was really meaningful; it was not irrational. He is trying to build a report with his work force. He thinks perhaps of when the labour market gets tight, and he has a little more productivity. It is a type of social ethic and it contributes to wage-price escalation.

Senator Lang: It might keep out the union.

The Chairman: Surely that is an exception.

Dr. Okun: That is not an exception. Union organizations barely slow down in the face of this enormous lack of work opportunities.

Senator Laird: It does not seem to work that way here, from my experience.

Senator Nichol: In this country, Dr. Okun, we have, as you know, a Department of Finance, a Bank of Canada, an Economic Council, and a Prices and Incomes Commission, and out of this mix of institutions, and others, comes economic policy. Part of our work here perhaps is to try and find out just exactly how this system does work in our country. In your country you have a similar string of institutions, and you were the chairman of one of the important ones. You also have the Federal Reserve Bank, the Federal Bureau of Budgets and the Council of Economic Advisers. Could you tell us how it works? I do not mean qualitatively; I mean mechanically. How does it work? Who determines it? I have over-simplified the question to give you all possible scope.

Dr. Okun: I am looking for a way to over-simplify the answer. Let me talk of some of our major institutions. What I am saying may be obsolete. I can tell you much more about how these things functioned between 1961 and January 20, 1969, than how they have functioned since then, but I do not think there have been enormous changes. The three agencies that were primarily entrusted with advising the president on fiscal policy were the ones you mentioned—the Bureau of the Budget, which is now the Office of Management and Budgets, the Council of Economic Advisors, and the Treasury. A not highly formalized but very definite and regular process of coordination and communication evolved between these three agencies, and they became affectionately known as the troika. Three agencies operating as one for the protection of federal economy funds under existing tax laws and programs and existing appropriations, which could discuss whether something was called for in the way of change of budgetary policy, and also the planning of the annual budget. One thing introduced in this system was a quarterly review, which also led to a memo for the President and usually a meeting with the President, and such questions as: Is the budget on track? Should something else be done?

I think the mere fact that there was this formalized process, compared to these earlier years prior to 1960 when there was no such process, meant that nobody had to ring an alarm bell to raise the question of whether fiscal policy was on track. I understand that from the fifties if any economic or financial adviser wanted to argue for a mid-year course correction in fiscal policy there would be an intensive and systematic review, but only if someone called for it and officially, as I say, rang the alarm bell. Here you have it regularized once quarterly. You would look at the papers, take a look at the budget and it is or is not on track, and something has or has not to be done to improve the situation.

Over a period of time the agency pretty well agreed on techniques of forecasting economic activity, on a technique for analyzing federal expenditure and revenue impacts. I think there was quite good coordination and agreement. In a sense the Council's main function is to worry about the impact of the budget on the economy, and the function of the others is to concern themselves with the efficiency of government programs, but at the same time each one took an interest in the appropriateness of fiscal policy. I think this worked very well until we ran into a war on the road to full employment when I think insuperable political obstacles and great uncertainty about the course of the defence expenditures—or at least uncertainty from the point of view of the people making economic policy—made effective fiscal management an almost impossible task.

In that process the Federal Reserve was also involved in a communications sense, but not involved in any sense of actual participation. We have great traditions about the independence of the Federal Reserve. They were always consulted and talked to about their views on the economic outlook, their views on appropriate targets for economic performance, their views on the appropriate mixture on fiscal and monetary stimulus or restraint, and in that sense I think we could make fiscal policy better knowing what kind of monetary policy resistances were likely to come forth.

I would say that on the executive side in a peace-time environment this did produce effective coordination, and the best advice a president could get and a real mechanism for him to act on that advice. The biggest problem that arose was the war. The next biggest problem that arose was in a difficulty which is much more serious in our system than a parliamentary one—the gap between the executive and legislature. Good communications with any organized body on Capitol Hill were never developed. I think our best line of communication was through the Joint Economic Committee. You will hear from Mr. Knowles later today on this activity. The Joint Economic Committee is sharply limited in the fact that it does not have a legislative function. While it is a wonderful way of getting views across, and providing a forum for dialogue, it really does not have the central role, say, that the Ways and Means committee has in respect of operational responsibility over taxes and expenditures. Those committees never did have the kind of economic orientation that permitted a real co-ordination in respect of changing views. I would say as we operated the process and evaluated it that it looked pretty good on the executive side, but the real difficulty was in executive co-ordination.

Senator Nichol: You spoke of the independence of the Federal Reserve Bank. I have two questions about that. One is: How much responsibility does the Federal Reserve Bank have for rates on government debts? I do not really mean how much influence does it have; it obviously has a great deal. How much responsibility does it have for that? Secondly, how real is this independence of the Federal Reserve Bank?

Dr. Okun: I think the concern about interest rates paid by the Treasury did not loom large in the determination of monetary policy in the United States in the 1960s. In fact, I think that its influence is often over-stated in discussions about it. I think interest rates on government securities are viewed largely as a housekeeping matter, and not as a matter of top priority in national policy. I do not think the Federal Reserve was ever terribly constrained by being given a responsibility to make sure that the Treasury could sell its securities at the interest rate the Treasury wanted to pay. I do not mean to say there was no concern, but I think sometimes there is a view that this put the Federal Reserve in shackles. I do not believe that was ever the case.

There are problems of Federal Reserve operations. The Federal Reserve does not want to effect a major change in monetary policy during which the treasury is selling a large number of monetary securities. That is understandable. In a period of very large Treasury issues there will not be a major change in the tone of those markets. That is essentially a way of saying we are not going to confuse the issue but rather that we are going to manage.

An hon. Senator: His policies, of course, do not appear to be acceptable.

Dr. Okun: There has been, until recently, some indication that the Administration would like to see a more actively stimulative monetary policy whereas the Federal Reserve has given some indication—at least individual governors have—that they might welcome a more active fiscal policy.

An hon. Senator: I was thinking of income and price control.

Dr. Okun: That is a very interesting point. I think every governor of the Federal Reserve goes on record as favoring an incomes policy. Speaking out on matters which are so indirectly related to monetary policy, you know it is sometimes said that the first law of bureaucracy is where you stand depends on where you sit. This is illustrated by some of this. It is not at all hard to understand, from the point of view of the Federal Reserve, that it would be nicer for fiscal policy and incomes policy to do the job, while from the point of view of the people responsible for fiscal policy, or who would be responsible for managing a wage-price policy, it would be nicer for monetary policy to do most of the job. "Let George do it", is a great longstanding tradition.

I think the question you are touching on, and which Senator Nichol raised of the real meaning of Federal Reserve independence, is very hard to evaluate. It certainly has meant that the Federal Reserve has shown policies that were not completely consistent with what any Administration wanted during the years. Usually there have been debates about matters of degree and timing. The biggest single confrontation, of course, in the past 20 years between the Federal Reserve and the Administration came in December, 1960 when the Federal Reserve raised the discount rate at a time when the President was very strongly opposed to such a clear indication of a tightening of monetary policy. We were disturbed about the Federal Reserve's action, too, as advisers to the President, and it was more because we felt this impaired the chance of getting fiscal restraint than because we felt that no restraint was appropriate. It was our view that perhaps one could sell a tax increase to the Congress as an alternative to monetary restraints, and once the federal Government showed it was on a course of monetary restraint, it would be hard to accomplish that.

In retrospect, I do not think that was realistic on our part. I do not think we could get a tax increase in 1966 if the Federal Reserve governor, as well as ourselves, stood on our heads on Capitol Hill. It showed a lack of communication on both sides which we worked hard to remedy. I think the misunderstanding of December, 1965 led to many joint luncheons and meetings with Federal Reserve officials, and both sides extremely regretted what was really a misunderstanding of basic objectives and intentions, rather than a concerted difference of opinion on the basic thrust of policy.

During 1966 the federal Government was very tight and we thought that it was quite appropriate for it to be very tight, and there was a tremendous political pressure against tight money. At that point I really changed my mind about the desirability of a federal fail-safe measure. Here was a time when fiscal policy was paralyzed and monetary policy was free to do what seemed to be right, even though politically painful to do so. If the monetary policy be within the political process, and the President had to approve the actions of the Federal Reserve of

Congress, I do not think the Federal Reserve carried out the necessary step of evening off, as opposed to the alternative of just letting it boom through the roof. On the other hand, I think that some of the issues you mentioned called for a re-appraisal of some of the dangers of this independence.

I think this year is the fist time we have had a situation where, at least for a period, both the Administration and the Federal Reserve seem to agree that stabilization policy ought to be more stimulative, but when it comes to deciding who is going to provide that extra stimulus, what you might call passing the buck takes place. Presumably, that could not happen if you had a co-ordinated or non-independent monetary policy of which the Administration was in charge. Then it could not say, "Let George do it," because there would only be one George to do it. There is this risk, which has emerged this year, that the independence of decision-making can lead to a passing of the buck. That is a danger which has recently emerged, really for the first time in the 25 years of the postwar period. On policy, I would say the system can be made to work with this kind of co-ordination, but not dictation, of monetary policy by the Administration.

Senator Nichol: Ho do you think the relationship of the Federal Reserve to the Government of the United States compares to the relationship of the United Kingdom Government to the Bank of England, or that of the Government of West Germany to the Bundesbank? Are those relationships similar?

Dr. Okun: I am familiar with the British system, especially insofar as the Chancellor of the Exchequer is concerned. He has the legal authority to veto actions by the central bank. There is no such veto power in the United States.

Senator Manning: You have indicated that guidelines, or some form of wage and price control, have a meaningful role in attaining price stability. Would you enlarge on your assessment of whether purely voluntary guidelines can be successful, or must they automatically be mandatory to be successful?

Dr. Okun: My proposal is a system which has as its only sanction the force of public opinion, the glare of the spotlight. That is largely the educational task of trying to put the force of public opinion on the side of greater wage and price restraint. It involves public education, to try to convince one's employer friend that, even though others are giving a 9 per cent increase, it might be patriotic to give only 5 per cent. Essentially, the employer then has to try to communicate to his workers that he is not being a Scrooge but, rather, that he is being a far-sighted industrial statesman when refusing to give a larger wage increase.

It is my view that many of our wage and price processes have a subtle character. Things that tilt the scales are very hard to measure, and many things go into the balance in arriving at any price or wage decision. When I was in government, businessmen used to come to me and say, "There was a bitter battle raging within our firm as to whether or not we should raise prices." The sales managers and production managers all wanted to go for big volume and low margins, and the finance people wanted to go for high margins and high prices. "We"—meaning the sales and production people—"won the fight because we had the American flag on our side. We were on the patriotic side."

I do not know how often that has happened, but I do think that public interest, public relations and public appeal exert great pressure, and that both business and labour are tremendously conscious of their impact. That is why we see centrefold spreads by companies such as IBM which say nothing about what they have to sell to the American consumer, but which point out at length what they are doing for the country. I think we can take advantage of that with respect to big business and big labour blocs. Bit labour is always concerned about the legislative process, about their image in the Congress, and the feeling that if they are painted as the villain of the piece there will be legislation narrowing the scope of collective bargaining and weakening the power of the union. It is a combination of carrots and sticks, in the broader sense of incentives and disincentives in conforming to a concept of public interest.

All I am talking about is the present tendency to preach sermons. There is a lot of sermonizing involved. I think it ought to be conducted through a broader consultative process than we had in the Kennedy and Johnson years. Until we ran into the excess demand problem of 1966, our wage and price guideposts were having a significant effect in containing the tendency for wages to out-run productivity and for price increases to out-run unit costs. During the period between the big steel confrontation in April, 1962 and the aluminum confrontation in 1965, there were no unpleasant battles or name calling between the Government and labour. Such a tranquil period did have the kind of effect we were looking for, and I do not know how that kind of situation can be restored. I think one weakness of the situation was that it was persuasion without representation. We did not have wide enough participation in the setting of the guideposts. I would favour something which I believe Congressman Henry Reuss was the first to advance, and which has since received widespread support, namely, the creation of a three-man prices and wages board in the executive office of the President, but having a semi-autonomous role, including the making public of its reports without necessarily having them blessed by the President or his chief advisers. The staff would consist, not of college professors but of those who really had some hard experience in the price-wage determination process and who would be selected by business and labour groups. They would manage a dialogue of what equitable standards might be, and would also become involved in other issues, such as whether help could be gained from special productivity incentives, and as to the role living standards should play. Those are the bones of the kind of system I would like to see being given a good and enthusiastic try. Certainly, before encouraging the possibility of a much more formalized system, I must say that I see all kinds of nightmare problems in legislative mandatory controls, and I think the voluntary system should be given a serious and enthusiastic try before

anyone even raises the question of whether we need to do more than that.

Senator Manning: To pursue that further, a situation rarely remains static. There is initial opposition to those guidelines by both management and labour, and for those guidelines to succeed greater public support must be obtained. Perhaps the outstanding example of this involved the rigid controls proposed during the war, which had the patriotism of the people behind them. Alternatively, if you do not get that kind of response, the longer voluntary guidelines remain which are not being adhered to and which, to an increasing degree, are being ignored, then you have a deteriorating situation and ultimately get to the point where the guidelines are useless. Then you have to make the harder decision, as to whether you scrap the whole thing or impose mandatory provisions.

In Canada for over a year we have had voluntary guidelines which, from the very outset, were completely rejected by organized labour. Management, with considerable reluctance, agreed to conform for at least a year, but over that period of time more and more holes have been punched in those guidelines, until today they are practically meaningless.

What concerns us, in committee here, is whether we should make a recommendation in that respect to the Government, as to whether, in view of this apparent failure of voluntary guidelines, we should scrap the whole thing, or make mandatory provisions, or adopt some other course? Would you care to enlarge on any of that?

Dr. Okun: I think that is a perceptive view of what the prices and incomes policy can be. On the one hand, what one hopes for is the establishing of a program which, if broadly accepted, the Government never has to take a very active hand in. On the other hand, it can fall apart and you are then faced with the issue of doing without it or else toughening it up into something that approaches more of a statutory, direct controls program. The record generally shows that when countries are faced with the latter course, it is usually incomes policies that go into operation for a while, rather than turning to formal controls. The Dutch have had several experiences where incomes policies seemed to work and where something—social frictions or excess demand—led to their ineffectiveness and their falling apart. Then the country operated without an incomes policy for a while, and later tried again. I am always reminded of a P.T. Barnum story about when the great showman was asked how he managed to keep a lion and a lamb in the same cage. He said, "It's very easy. All you need is a large reserve supply of lambs." Sometimes incomes policies are like lambs. You had better have a large reserve supply of new devices in order to put something else in the lion's cage. I think that is the dilemma, and I would be going way beyond my scope in trying to recommend which route Canada might travel in the near future.

Senator Manning: I have one further question on the general concept. If a decision was made on the part of a country to move into mandatory controls, can you envisage a practical course that would permit such controls to be confined to certain key areas, such as wages or prices; or is there always a grey border area which, of necessity, forces you to expand controls in the other area or abandon the ones you have?

Dr. Okun: That, again, is a well put question which really is very hard to answer in principle. Selective, formal controls are very hard to administer because of this grey area problem. There is no obvious breaking point of industries which are critical and those which are trivial. There are industries which are in between. There are firms big enough to have a lot of market power, and others small enough to have virtually no market power, but there are firms in between which have some market power, and there are unions that fall into that grey area also. This does make me very concerned about travelling down the path of mandatory controls because I think a selective, mandatory, formal system is very hard to maintain and to operate. As I see it, the difference between the voluntary, informal system and the formal system is that between trying to define the ideal apple and pick the rotten apple out of the barrel. An informal system's very arbitrariness is both its strength and weakness. You are not forced to deal with every issue. You are not forced to lash out at a 6.2 per cent wage settlement if your standard for the year is 6 per cent. You really can put the focus and can try to exert the pressures on the rotten apples in the barrel, the ones that are really outstanding and the ones that pose serious danger to the national interest. In a formal system you are asked to approve or disapprove everything. As I put it, you are asked to define the ideal apple. It is very difficult to introduce the kind of flexibility that a voluntary system has. There are things in between, like voluntary systems which involve pre-notification and some public-hearings process on key policies. Perhaps these give us some options as to how formalized the system should be, without invoking a "You can go to jail if you do this" principle for violations of the wage or price rule.

Dr. James Gilles, Study Director: I wish to ask you a couple of questions on your views on tax policy. First of all, am I correct in assuming that it is your position that once the economy has slowed down, so that you have perhaps 5 or 6 per cent unemployment, there is then very little to be gained, in terms of stopping inflation, by further increasing the unemployment rate?

Dr. Okun: I believe that is the case, and, indeed, I go further in saying that there is very little to be gained by prolonging a period in which the unemployment rate is clearly above what you consider to be acceptable or tolerable for the long run.

Dr. Gillies: The other side of the question is, if you are at an unemployment rate of 5½ or 6 per cent, other things being equal, would you favour a policy that would reinflate the economy and bring it back to full employment and not worry about this being an inflationary issue?

Dr. Okun: I would certainly favour beginning to move in the direction of full employment, and perhaps put most of the emphasis on not wanting to fix too rigidly an ultimate destination for the trip. I think the time to worry about things is when the unemployment rate gets

down into what has been a dangerous zone in the past, and in the experience of the United States it looks as though the danger zone begins when the unemployment rate is 4¾ per cent or lower. That is not perfect and history can change, but it seems that in the mid-fifties and sixties we began to get into some difficulties. I would hope that if we reinforced our policies with the proper structural and incomes policies we could do better than that. It seems to me that is the time to be very alert as to how fast the economy is going. When the unemployment rate is 6¼ per cent, as it is in the United States today, then I think it is time to get moving. It so happens that we in the United States have scheduled for the next year and the year following two decreases in personal income taxes ,taking the form of increasing the exemption in the so-called standard deduction. Each of these decreases amounts to $2 billion. If we made them fully effective now, without compromising one dollar from our long-run potential, we could put $4½ billion annually into consumer purchasing power at the present time.

I cannot believe that there is an inflationary danger in this, nor is there any danger of putting fiscal policy in the position where it is going to be overly stimulative in the long run because we are going to have these tax cuts in any case. They were legislated in 1969 and, wisely or unwisely, they are there and nobody is going to change them. We might as well have them when they are going to do the most good,and that is now. I think this is very different from the kinds of proposals which were politically popular, to take the public works group to job stimulation, our experience in public works programs is that the lags in implementing them and getting them going is just enormous. They have just been so slow acting that they usually had their biggest effect on the economy at the wrong time.

We made a very serious effort in 1962 to see whether we could get techniques of small types of public works that were supposed to be implementable very rapidly—things like building park benches, rather than building dams. Congress enacted an accelerated public works program in October, 1962 which had $850 million worth of expenditures authorized. We spent less than half the money in the next 21 months. We spent more in fiscal 1966 on that program, when the economy was booming, than we spent in fiscal 1963 when the economy needed that stimulus. It is for those reasons that I would emphasize the tax route as the most dependable and the most reliable way of getting the purchasing power into the system when it will do the most good and turning it off when that becomes appropriate. I think the expenditure flexibility is really very limited in our experience.

Dr. Gillies: A direct cut in personal income tax is the route?

Dr. Okun: The route I find to be most dependable and most confirmed in historical evidence and most broadly based in its impact upon the economy is the personal tax. It happens that in the present circumstances in the United States that plant and equipment spending has held up remarkably well when faced with an enormous excess capacity and in the face of very weak profits. I find very little grounds for wanting to apply a direct stimulus there. I believe American businessmen need stronger markets, and not more incentives for plant and equipment at the moment. To have these foreign markets it could most easily come from acceleration of these tax cuts. Plant and equipment spending will take care of itself.

Dr. D. L. McQueen, Study Consultant: It has been suggested by some witnesses that have appeared before this committee that we may have reached a stage in the industrialized countries where when you use a tax increase as a means of cooling off a booming economy, that people are starting to treat these tax increases more as costs and to shape, for example, their wage behavior and other price behavior to them. Have you any comment on this view?

Dr. Okun: I have heard this expressed. I have yet to see the evidence that this is the case. I think the evidence is to the contrary in the United States; that direct tax increases have not been passed on in the form of either wages or higher profit margins. Obviously, excise taxes will have that effect. If you increase indirect taxes and impose a value added tax as a means of restraint, you must expect that to have a cost raising effect which will be shifted forward to the consumer. It still might, on balance, be helpful, but it will be presumably less helpful than a similar rise in direct taxes. I think the evidence of shifting of taxes is pretty decisive in indicating that on balance, direct taxes do not get shifted forward and indirect taxes do.

The Chairman: Could we improve the control of our economy by a greater emphasis on excise and sales taxes?

Dr. Okun: Not that I can see. Indeed, the disadvantages strike me more immediately than the advantages. For one thing, they have less responsiveness to changes in the cyclical situation. I mean the progresivity and graduation of income taxes means that you get more than proportional automatic changes in these receipts when the economy speeds up or slows down. It is not the case for most excise taxes unless they happen to be on the items in the luxury, high income, sensitivity categories. It has been a long time since any nation like Canada or the United States has wanted to push upward on costs or prices. We always want to keep them down and any imposition of excise taxes does have a cost raising effect. It is greater by far than that of similar revenue raised by direct taxes. Quite apart from equity issues there are stabilization advantages that urge the emphasis on direct taxation. The only case for indirect taxation that is ever made, is the balance of payments issue, the rebating of value added taxes and the like. I do not find this a very decisive factor, either in terms of balance of payment or the general economic stabilization.

Hon. Mr. Leonard: Mr. Chairman, I appreciate very much your courtesy and that of the committee in giving me the privilege of being a guest and asking questions. I have also appreciated greatly the statements of Dr. Okun and the very interesting questions and informative answers. I find that any questions that arise in my own

mind are being answered. While I appreciate the privilege, I should like to continue to listen to the questions of the members of the committee and the answers. So, I defer to the members of the committee.

Senator Cameron: Mr. Chairman, I am sitting beside Senator Manning and there has been no collusion between us, but he raised one of the main questions I have had in mind. However, I am concerned with the implications of Dr. Okun's statement. I would like to preface my question by saying how refreshing it is to have an economist make a presentation without resorting to economic jargon, which too many do. What I am concerned about is this: he said the undiluted laissez-faire or free market economy does not work; in effect, it is not free. There are too many things that interfere with it, such as Government policy and so on. The implication of that reflection on the free market economy as the main tool implies that you have two major choices. You can have mandatory state controls, which Senator Manning raised, and I understand that Dr. Okun says that he would prefer an achievement of control by vountary action. That rules out state control.

Then if we go to the voluntary control, he suggests that voluntary control can be achieved through education. This is, I think, a desirable process but it is also a very slow one. I suspect that we are entering what might be called the age of consumerism and you are going to hear a great deal more about this. In the next few years it is going to play a much more important role than it has ever played before. In the United States you have Nader's Raiders and their related activities, and we have in Canada what some people are referring to as Basford's "bastards" doing the same type of thing. I am concerned about the slowness of any educational program, regardless of how desirable it may be. What machinery do you think could be used in an education program designed to gain acceptance of controls. How would it work? Do you not think that behind it there would have to be the big stick of legislative action within a given time?

Dr. Okun: I suppose I would begin by saying that people seem able to learn the wrong things very rapidly. It is just amazing how pervasive is the attitude towards inflation, towards large wage increases and towards tolerance of price increases that has crept into our system over a period of just five years. If they can learn the wrong things that rapidly, perhaps one should be encouraged that if they are taught properly they may also learn the right things very rapidly. I do not want to claim too much, but it seems to me, to take the case that is clearest in the United States situation at the present time—the big steel negotiations—that the people engaged in that collective bargaining process really have almost nothing to look at except what has been going on recently in other wage agreements. If in some sense one could get into the inputs that go into that decision a public interest component, I think one could help to bring down the ultimate settlement; not necessarily keep it where the guidepost will put it, but at least help to produce some counter-force on the down side. To that extent, I think education can work in a very subtle way and people may walk out of there not even knowing that they have been influenced, and yet the fact that there was a wage standard could make a difference.

I think the plain fact that is most conducive to the success of a voluntary informal control system is that the "big stick" of legislation, as you put it, is really always there in the background. Every assistant attorney general in charge of anti-trust in the past 25 years has said to his boss that he wants to break up General Motors; General Motors knows this. No one has acted on this, on the general feeling, whether the courts would or would not uphold such action, that as long as General Motors performs in a reasonably publicly acceptable way, and the kind of crusade is quick solving, is not an appropriate public policy to test just how many big business firms you can knock off with an anti-trust law. So every assistant attorney general is told to put his "big stick" back into his desk. But it stays there, and it is there. General Motors knows that it survives or, at least, avoids a bitter court contest as to its legality, by performing in a way that suggests that perhaps we cannot do better by breaking it up. I use that only as an example; it is very pervasive.

Labour unions today are terribly concerned about their attitude. I have heard that the British labour movement was very disturbed; they felt that they may have lost a great deal in the long run by their posture in the electricity strike. Every British housewife seemed to blame labour and seemed to be on the side of the Government in that dispute. The lessons have not been completely learned by any means, but I think if we operate in a pluralistic society on the basis of groups wanting their own interests recognized, but also recognizing that they maintain power and viability by behaving with some self-restraint and some enlightened respect for the public interest, then this is really what gives us the handle, and the hope that we may not need to use the "big stick" of legislation.

Senator Cameron: You are more optimistic with respect to the speed with which the educational program can operate than I am, but relating to that I am wondering about the role of management. I think some things have happened in the last few months that have really shocked people. First of all, in Canada we had the Dosco fiasco. The British absentee landlords said that they could not make any money out of Dominion Steel and Coal Corporation in Nova Scotia, so they sold out. The Government had to step in and rescue the operation. Everybody was predicting that this would be another seephole for money, and it has made $23 million in the last two years. Rolls-Royce was a shocking illustration of what could happen. Its implications are still lying the background. Now we have the Clyde shipbuilding situation with 400 shipbuilders hammering on Downing Street this morning. Then we have the Lockheed situation in the United States. These tremendous private operations have great implications, not only for their own industry but for the whole economy, and it seems to me that there is a new role for management here.

Superficially, it looks as if they have had no management at all in Rolls-Royce or in Dosco, but to make the educational program work it would seem to be that you

must have a different approach to management. That is where you start your educational program. How can you get this new orientation, if you like, or this new sense of responsibility in there?

Dr. Okun: I think the fact that the United States government feels obliged to move in the Lockheed case is clearly related to the weak over-all economic situation in the United States. If we had a full employment economy I do not think there would be a chance that the Secretary of the Treasury would be up pleading for a measure to bail out Lockheed. It is the hard reality that there are no alternative jobs for Lockheed workers. Sure there are transition problems and adjustment problems when any one firm pulls out or when anybody goes bankrupt. Looking down the road in the United States, with respect to pollution problems it is clear that measures for pollution control will lead to the shut-down of some firms in certain cities which are important in the overall employment market. I think within the framework of a well functioning economy we could handle those things a lot better through adjustment assistance and through better manpower measures. I want to draw the moral that the particular pain of these bankruptcies and closures is so much exacerbated by the weakness in the overall economy, that perhaps the best thing we could do to help assure that these do not continue to be repeated in a way that forces the government to keep bailing out the individual firms, is to get the economy moving again and assure that there are alternative jobs for labour.

That does not solve this problem. It does seem to me that you have to interpret this recent trend within the context of a labour market that does not offer alternative employment opportunities and alternative uses for capital. In a well functioning economy we can cope with bankruptcies and shifts in demand and we can withstand closures of particular firms without anywhere near the kind of total concern that has been displayed.

Senator Isnor: Mr. Chairman, the ground has been pretty well covered. We have been very fortunate in having a witness that has given us such intelligent replies to the questions asked by the various senators.

I was interested in two problems around which the committee is working, namely, inflation and unemployment. I am going to ask a question in that connection, but before doing so, I would like to make a comment in respect to what the doctor has stated as to why there have been no price declines. I do not see how price declines can take place unless the productivity lessens the cost to the person who is going to dispose of the goods. I want to make that point in fairness to the businessmen who have been obliged to keep up their prices because of wage demands and lack of increased productivity. I throw that out in reply to what I thought was your comment on price declines. The doctor is the author of a book, *The Battle Against Unemployment*. We are dealing with inflation and unemployment. My question is: what do you consider is the biggest factor needed to overcome unemployment?

Dr. Okun: Let me begin by commenting on your remark about price declines. First of all, I really want to focus attention on the fact that neither wages nor prices have behaved in a way that might lead to declines. Let me also say, in case there is any doubt, I am not suggesting that a rollback of the price level would be a desirable wage policy, but merely that the paradox of recent price, cost and wage behavior in the United States has been that not only would one have expected a slowdown, but on a pure text book analysis of how markets are supposed to be operate, one would have expected actual declines, and they certainly have not come about. I am just calling to your attention the paradox, and not really pointing to the blame for either wages or prices in the recent context.

To turn to your question about what is number one on the priority list for reducing unemployment, I would say, using United States figures and experience with which I am familiar, with, that what could get us from 6 1/4 percent unemployment safely down to below 5 percent unemployment is a more stimulative fiscal policy—more action to improve consumer purchasing power, to provide job opportunities. It would create somewhat more confidence on the part of the consumer if the economy is going up, and make him more willing to spend. One of the basic weaknesses in the U.S. economic recovery thus far this year has been that consumers who have not been hit by unemployment in any way have been saving an inordinate fraction of their income. They are still worried about the job market. When you are worried about the job market, that is not the time to go dipping into your savings account or make commitments for instalment payments. It is the anxiety about job security, that is the key factor that is keeping the savings rate high. A little more government display of determination to provide some consumer purchasing power and to improve the consumer market is the beginning of the path to getting unemployment down. I put that in terms of getting rid of a percentage point or more of the unemployment rate.

I think beyond that the big contributing factor is the development of some of these structural policies, and then an effective incomes policy that will provide better insurance that we can move to lower unemployment rates without getting a reignition of inflationary fires.

Senator Isnor: Would you say that the Government should encourage optimism all of the time instead of depression?

Dr. Okun: I think the most important thing in the United States at the moment is to restore the credibility of government. The important lesson in that is perhaps to call things more like they are, instead of what we would wish them to be. There is a great temptation within the bureaucratic process to look at things in a rosy light and to stress optimism. It may be that it is good for the economy in the sort therm, but it is bad for democracy in the long term.

Senator Isnor: In your book I do not think you brought out the main factor causing unemployment and the cure for it. Could you enlarge upon that?

Dr. Okun: I would say purely fiscal and monetary tools are the way to keep unemployment from getting to the kind of inordinately high level we have today. When unemployment is at 6¼ per cent it tells you that there

has been some mistakes in the budget and in the credit policy. The brakes were kept on too long and too hard in 1969—we got into a recession—and the shift to the accelerator has come too slow. The question over the longer run of whether we could do much better than 5 per cent unemployment rates without inflation, I think, turns on a whole set of other issues I have raised about what you can do on wage-price behavior, and what you may do to end the inflationary bias created by government programs.

As I see it, the big issue against unemployment is a two step process: in the short term, it is to get the economy moving again at a good clip; and, in the long term, it is to create the kind of atmosphere where an economy that is prosperous, but not straining at the leash of capacity, need not generate inflationary price increase.

Senator McGrand: On page 2 of your brief I read "Avoid tight money". I take it that you believe that a reduction in taxes would stimulate the economy and employment. We have more than one witness who has said that more money in circulation would give only temporary relief, and would result in greater inflation and greater unemployment two or three years down the road; that pumping money into the economy is not the answer. It is evident to tighten or not to tighten money must be a question of timing and each plays its part. How do you recognize and determine the lags that occur, and when you have to move to overcome them?

Dr. Okun: You are certainly correct that the difficult problems are ones of timing—timing the performance of the economy and timing the impact of any fiscal and monetary measures that we might take. I have no recipe, other than saying that there are a fair number of people in the United States and Canada who have spent their lives trying to diagnose and forecast business activity. They do not do a perfect job, but I think they do a better one in their efforts of diagnosing and prediction than we can get by assuming that things are just going to be the way they are now, by assuming that nature will take care of all our problems, or by making any other simple assumption about the world. I think that we have to face up to these issues and diagnose where the economy is likely to be going. In the context of the United States all the indicators that I know of suggest that we are continuing to be faced with a very modest recovery at a pace that is not sufficient to bring down the unemployment rate, or to create major new incentives for expansion. It is against that background of evidence that I am prepared to say that we ought to do something carefully to provide some additional fiscal and monetary stimulus today, and we have to watch and see how the speedometer registers when we do it, and be sure that we slow down before we run into an inflationary situation.

All of this requires some hard judgments all along the way. There is no escape from these judgments. We are not going to be right all the time. We will make mistakes. I think we will come out better by trying to use our judgment rather than finding any kinds of rules and simple recipes in order to avoid making those judgments.

The Chairman: Dr. Okun, in your answer to Senator McGrand and Dr. Gillies you said that we should attack the present unemployment situation. If we do, will we not run into the problem that you deal with on page 4, "The sources of stop-go"? I will read that to you:

> No government can concede this unsatisfactory compromise and so unattainable goals are pursued. Nations tend to ignore the reality of the trade-off, and aim for a satisfactory price performance or an acceptable full-employment performance. When inflation becomes public enemy No 1, the brakes are applied to achieve a satisfactory price performance. Then unemployment becomes public No. 1 one and the accelerator is used to achieve a satisfactory low unemployment rate. And so we witness the alternating stop-go character of stabilization policies in so many nations.

I am wondering if your suggestion does not in fact mean the stop and go process being repeated all over again.

Dr. Okun: We have had a stop, and I think the time is to go. The time to worry about the purpetuation of the cycle is down the road a bit. As I see it, the inflationary danger does not arise from getting an unemployment figure down from 6¼ per cent to 5¼ per cent, or even down to 4¾ per cent. It arises because when we get to 4¾ per cent we are going to feel just dandy and everything will look fine. People are going to be happy with rising living standards, rising profits and job opportunities, and great job security. The inflationary warning signals often come pretty late, and are sometimes mixed. Sometimes we find all kinds of excuses for ignoring them when they do arise. We love that kind of situation so much that we tend to overdo it. The danger comes later, in an expansion in a recovery period, when you are beginning to approach a situation where there is a genuine inflationary threat on the horizon. I think that is an argument for not wanting to fix and a hard and fast ultimate unemployment target at the present time, when we have had such mixed evidence of where we are trying to go. It is an argument for trying to do things that are temporary in their basic character, that they start quickly and stop quickly, so that we are not building in a stimulus to policy and not going to get the accelerator stuck to the floor, as it were. We will be able to go for the brakes when we need to. I think when we do this properly and then get to a cruising speed, it will level off at that cruising speed without continuing to accelerate.

It seems to me if we are all agreed, as everyone in the United States is, that the economy is proceeding at a pace that is below its desirable course today, it is time to start giving it some gas—not overdoing it, not commiting ourselves for the long run, not getting stuck on what may be unattainable targets but getting moving. Then we have to be alert and cautious as to when we need to level off at a cruising speed so that we do not have to jam on the brakes again.

The Chairman: I do not know whether there is a real difference of opinion, but Professor Freidman, and our witness of last week, Dr. Sprinkel, indicate that by attacking the problem of unemployment vigorously, certainly with the money supply, you could create a poten-

tial for inflation by virtue of the vigorous attack itself. In fact, I think Professor Friedman is saying that unless the Federal Reserve Board reduces the growth of the money supply by 2 per cent immediately, they will have created an inflation potential. It may show up anywhere from 6 months to 2 years from now. Is there not a basic difference, not as between your methods of approach on fiscal and monetary policy, but as between the concept of the speed and the vigour with which you attack the problem? You are suggesting a very vigorous attack, keeping your eye on the indicators, and, when you get to a certain point, reducing the strength of that attack. They are suggesting the very vigour at this point will create a situation that you cannot do anything about, and it will put you back into the problems that you have described so well in paragraph 3 on page 4, "The sources of stop-go."

Dr. Okun: I think that you have characterized the difference very well. One element in that difference is that Professor Friedman and disciple, Dr. Sprinkel put a great deal of emphasis on the growth of the money supply as an indicator for telling the course of the economy. The growth of the money supply has been very rapid in recent months. My own interpretation is that part of that growth of the money supply represents a desire to hold money rather than to accumulate money to spend. What we are seeing is an exercise of a preference for liquidity in a rather uncertain economic and financial situation that makes some people rather reluctant to make long term portfolio decisions, and hence to hold on to cash and see what happens.

I do not see on the horizon the enormous potential for boom in the recent couple of months of rapid money supply growth. Everything elese I know about the economy tells me that there is not a great deal of life in private demand, and I cannot believe that businessmen who are most recently cutting back their capital budgets and still trimming their personnel are simultaneously creating pools of cash to create a new spending boom. They are creating pools of cash, in part because they did not have much cash last year and they are catching up because monetary conditions have eased, and in part because of uncertainty about the world.

There is a basic difference in the reading of the historical evidence on policy. As I see it, the problem and the source of the errors in policy has been not in a propensity to over-react, but rather in a propensity to under-react, by the policy-makers who do too little too late and then keep doing it after it is no longer appropriate. By reacting very late to periods of economic slack we have done things which had their main effects when the disease was over and, indeed, when the opposite disease had already begun. By taking more timely measures, and measures which are self-limiting in their duration, we could have policies which were more appropriate to the current situation. The recommendation that I would make is not for the policy-makers to sit on their hands, but rather to be much more alert to changes in both the upside and downside of economic activity.

The Chairman: It seems to me that you feel that fine tuning . . .

Dr. Okun: I call it sensible steering.

Senator Laird: In that same connection, you have made a most interesting but rather brief reference to the possibility of protecting people on fixed incomes. I do not mean the people who are on social welfare payments; I mean the people who have been thrifty and saved their money and are living on a fixed income. You contemplated some sort of security that was flexible in nature. You even mentioned the word bonds. Would this be of a contractual nature? The interest rate would fluctuate with the rate of inflation?

Dr. Okun: There have been such instruments in continental European countries where the rate of interest on the bond is made to fluctuate with the rise of the cost of living, so that the recipient of a fixed income is assured that he will have some inflation protection. In that way, it does help to reduce the distributive inequities of inflation. The difficulty in instituting that system is that it begins to make people wonder why the Government is doing this. Is it really saying that it cannot stop the inflation, and therefore we have to learn to live with it? It does have some pronounced effect of that sort. It is a highly attractive and, yes, at the same time, a highly dangerous course.

Senator Laird: It also contemplates that the investment would be in this type of bond, which would not necessarily be the case.

Dr. Okun: If inflation is what is worrying you, here is an opportunity to buy insurance against it. Very few private enterprises could credibly offer that kind of guarantee. They have no guarantee that their profits or return on capital is going to move with the cost of living. The government is in a position to underwrite such a guarantee. This really focuses attention on the issue of what is the government saying when it issues this cost of living bond. Is it really saying that we have given up the battle and you had better buy yourself a shield? Thus is the danger.

The Chairman: In your attack on the present situation, what role do you assign to monetary policy and what would you do with the money supply?

Dr. Okun: I think I would put less emphasis on the money supply as a guide to monetary policy. It seems to me that what the Federal Reserve has done in the past year and a half may actually have contributed to some of the instability that we have seen in interest rates. The Federal Reserve has talked as a monetarist would. Its directives have showed a great deal of emphasis on money supply growth as the key target. Yet, when the chips were down, the Federal Reserve did not behave all that like a monetarist. Between September of last year and January of this year, when the conomy was really most sluggish, partly because of the General Motors strike, the Federal Reserve allowed the money supply to grow by only 2 per cent. This is far below what would seem to be their basic target. Their feeling was that there was no reason to push money on an economy that had no appetite for cash. Pushing money on that economy would have meant pushing the short term interest rate to

exceedingly low levels, and possibly a two per cent rate on treasury bill rates would have emerged. That was a sensible judgment on their part.

At the same time this created the anticipation that there is something going wrong with Federal Reserve policy. Why were they doing this? Why were they departing from their target? Had they changed their minds? They had led people to believe that there was a basic money supply course that they were prepared to travel. More recently they have found there was an appetite for money, and they were prepared to accommodate it. They are not sure exactly where the appetite is coming from. The fluctuations from week to week, and month to month, in the money supply are enormous for reasons that we have never understood.

There is no reason why you would expect the volume of demand deposits to show a great deal of stability because there is so much turnover, and so many transactions that take place between short term securities, and all sorts of little events in the system, such as a holiday that may affect the demand for cash enormously. Yet this thing has taken on such a great deal of emphasis as the indicator. The economy is going to a boom today because the money supply rose at a 15 per cent annual rate last week. You multiply a trivial weekly increase by 52, and you get the annual rate. I eat at an enormous annual rate when I am starved, and not at such an enormous rate when I am not eating. The whole process has just given undue emphasis to this as the target.

Financial markets have seen the rapid growth of money supply and said: "We cannot permit this. It has got to tighten." Before the federal government does anything, everybody is wanting to shelter in the bond and bill markets today. I would suspect that I would find it much more reasonable for the Federal Reserve to decide what the treasury bill rate has to be in terms of balance of payment restraints, and obviously it cannot ignore those restraints, and neither can it try to be competitive with the enormous Eurodollar interest rate. It has to try to run money market conditions so that the treasury bill rate is fairly stable for a couple of months, and see what happens to the economy.

What I am basically saying is that instead of determining the production of money, we should determine the price of money for a while and see how many people get in line to take it. Unless and until the economy begins to show an enormous vigor in recovery forces, let us live with a more stable incomes policy for a while. I think that kind of accommodative policy would possibly give us less worrisome growth in the money supply because people would feel more stable about the interest rate situation. There is an enormous feeling in the United States today that whatever relief we have in interest rates, it may be just a valley between two peaks. Everybody is worried about whether and when interest rates will return to their peaks. Every little up tick in interest rates unleashes a lot of people who want to get in line and get money now. I think if the Federal Reserve were prepared to underwrite a period of greater stability with respect to interest rates, it might find the whole thing functioning more effectively from everybody's point of view.

The Chairman: It is probably like asking Nelson Eddy to sing Shortnin' Bread, but since we have you here, Dr. Okun, we should ask you to discourse very shortly on Okun's Law.

Dr. Okun: Okun's law is the luckiest thing I ever did. Ten years ago I pointed out that the history of the fifties seemed to suggest that one percentage point increase in unemployment went along with about a 3 per cent cost in terms of our real GNP in the United States. Basically, unemployment was just the tip of the iceberg in a weak economy, and the same type of situation that produced rising unemployment, also produced shorter work weeks, slowdowns in productivity, people leaving the labour force because they could not find jobs, and hence the impact on real output was much greater than you might think—for example, instead of being one for one, in fact it was one for three. Consequently, there is an enormous cost in tolerating high unemployment. That relationship has worked exceedingly well in the past decade, much better than it has any right to, and it has now been dignified as Okun's law. It is a law subject to constant amendment and repeal. It has even received some attention in other countries. Years ago Bernie Drabble of the Bank of Canada, did some work relating Canadian output and unemployment along the lines of Okun's Law. At that time he reported that it held up reasonably well. I am not sure whether he has updated his findings or whether the Drabble version of the law is still applicable to the Canadian economy.

The Chairman: We will ask Mr. Rasminsky tomorrow? If there are no further questions, I shall tell Dr. Okun that we are delighted to have him here. It is very worthwhile to hear from a man who has had a broad academic and philosophical background, and who also has actually been involved in the economic problems of a large and great country.

Dr. Okun, you have been extremely helpful to the Committee. You have aided us in respect of the questions we will be asking Mr. Rasminsky, the Governor of the Bank of Canada, tomorrow, and the Minister of Finance and his Deputy on June 29.

The committee adjourned until 2.15.

Upon resuming at 2.15 p.m.

The Chairman: We are honoured to have as our next witness Mr. James Knowles, Director of Research of the Joint Economic Committee of the Congress of the United States. Mr. Knowles has been intimately involved with the subject of economic hearings for a considerable part of his life. He was Senior Economist with the Econometric Institute from 1944 to 1950, Senior Economist with the Joint Economic Committee, from 1950 to 1962, and Executive Director of that same committee from 1963 to 1966. He can tell us a great deal about the operation of the sort of hearings that we are having as seen from the American point of view. His paper contains some very interesting things about the problems of growth, employment and price stability. I will now ask Mr. James Knowles to make a brief statement.

James Wiley Knowles, Director of Research, Joint Economic Committee of the Congress of the United States:

Mr. Chairman and honourable senators, it is indeed a unique experience for me to appear before you, having been on the other side of this exercise and having put other people under the gun for some twenty-one years. However, I find it a pleasure to be here. Canada is one of my favourite countries, and this particular subject is a favourite of mine.

Honourable senators, I will not go through this brief, copies having been made available to you, but I want to emphase two or three points and elaborate on a few.

First of all, policymaking, particularly legislative policymaking, as distinct from executive policymaking, is a very patience-trying process. As members of such a body as this, you will appreciate that getting agreement among large numbers of people is not the simplest task in the world. It is much easier to issue orders. Therefore, patience is advisable.

As an economist I can tell you that the economy does not react well to sudden drastic changes in policy. It is like hitting a rubber ball: the harder you hit it the more it bounces.

One of the principal points I wish to make is that the Government of the United States has been making too many and too violent changes, and this has caused more trouble than would have been the case had they followed a more stable and more patient policy.

Dealing with the fiscal and monetary policy section of my paper, I wish to emphasize that there are limitations on what any government can do and still leave any room for individual freedom. This means that a government, by wise choice of fiscal and monetary tools, can create a climate consistent with full employment, stable prices, and dynamic economic growth, but it cannot compel the result. You have to live with the fact that in the country as a whole millions of people between themselves are going to be determining part of the outcome. You have to lead, and unless you can somehow induce these people to voluntarily follow the proper behavior that is consistent with your policy, then to that degree your policy will fail. Possibly the biggest mistake that my country has made is that the modern fixation on unemployment statisics—because of the human suffering they signal—has caused many of us to change policy often in a vain attempt to catch up with changing events and by some quick turn of the screw avoid future trouble. Instead, we generally create more trouble. We have to be a little more patient and rein ourselves in and say to ourselves, "These are some things we can do but there are also some things we are just not going to succeed in doing because we do not have enough knowledge. Here, again, humility is a great virtue.

As far as doing anything about such policies from a legislative side—and this is where I have spent my life—I have suggested in my paper some conclusions of my own. However, I would emphasize that you look for a wide range of viewpoints in order to give you as many ways of seeing the problem as possible. At the same time, you should exercise extreme care in the choice of whom you listen to. You need to get a wide range of views and be willing to experiment in new forms of operation. We are all trying something that has not been done before. It is a new experiment wherever it is being tried. None of us know the final answers. We have tried some unique things and I would be glad to tell you about them if anyone is interested, but they are not the final answer as to how you or anyone else should do it. You are going to have to try again and again until you finally find the best process for your particular institutions.

One last point in this brief summary: we are tempted by the urgency of constituencies and the human problems that they present to a legislative body to try to get quick short-run results. Assuming that we do something that seems right for this year, we should always ask ourselves whether it will leave a residual somewhere, whether it will create a bigger problem to solve next year. The failure to observe this precaution has caused more trouble in the United States than you could imagine. We have an optive policy, and it has often been the right thing. The only trouble is that if you look two or three years ahead you realize that it is going to produce some grave disturbance which will be harder to handle than what you started with. This long-range look at things, constantly keeping in mind what is going to happen a year, two years, three years or five years hence, is the hard part. We can see what is right under our noses. but we cannot easily see the prolonged effects over time. No economist can, no politician can. It is the hard part, but it is essential.

In concluding these few remarks, I would just say that the views I express here in answer to questions are not those of my institution, but are my own, and therefore I can answer freely.

Senator Laird: Might I get down to brass tacks on something that has been discussed here freqqently, that the ultimate sanction is mandatory price and wage control. This was Sir Roy Harris's thesis, for example. Would you care to comment on that?

Mr. Knowles: Always, in any government policy area, whatever it may be, I suppose there is no sanction beyond that of just raw use of sovereign power to command. In this sense, certainly compulsory wage and price controls is the end of the road. It is the ultimate. If you cannot get anywhere any other way with any other policy in regard to inflation and full employment, I suppose there is always available the alternative of command. There may be circumstances in which this is indeed about the only thing you can do. I would, however, hesitate to commend this policy to my own country, much less to any other. As a frequent or general practice, it will break down relatively quickly because of the plain ignorance of the price and wage controllers. They have no way of knowing what is a proper wage-price relationship in some little commodity area in some little town. There is no way to get the information from the area to the controller so that he can make an order which makes sense. If you find some circumstances where you have a particularly short, heavy burst of excess demand and if it is a real emergency and you have to shut off expectations of future inflation or something, you may be able to use this device for a few months as a brake. Or you may be able to use it as a transition to something else, if you have a wise and well-organized operation that can make

the transition from that initial day of controls to the day they are going off. You know the moment you put them on they are eventually going to come off. Of course, if you want to wipe out all private decision making for the future, then you automatically have compulsion.

Senator Benidickson: Mr. Chairman, I think that Mr. Knowles has emphasized more than any other witness the perplexity and frustration encountered by both economic advisers and politicians in this question of long-term planning. I raised this point last week, and just by way of illustration and not in any way to be critical I said that obviously the President of the United States was getting certain advice from the highest economic authorities. I said that he was getting advice from the Joint Economic Committee and from the Federal Reserve Board. Some of that may relate to what should be done about the money supply—to push inflation or whether to be rather worried about further inflation.

I made the point last week that the President, who of course operates under a little different system than ours, but he is a politician like we are, is faced with the difficulty of thinking in short terms. In other words, there might be an election coming up in a year or two or even four years. I am very glad that Dr. Knowles emphasized this difficulty, because my frustration and concern is not only about the differences of opinion between the experts we have been privileged to have before us, but about their relationship to politicians. This morning we had evidence about some kind of bigness, something that I took to involve long-run authority. Despite the value of the education we are getting in economics, I am concerned about how this committee is going to solve this problem and end up with a report. It is a problem that Dr. Knowles, I think, has emphasized more than others, and...

The Chairman: Could you phrase this as a question for the witness, senator?

Senator Benidickson: Yes. Mr. Knowles, can you suggest anything to the Government that would have prestige—something like an economic council—that would likely be accepted by the public and be effective? I was thinking of the great depression and the unity that the general public displayed, which prevailed upon the government leaders to correct the awful evils of those days.

The Chairman: I am having a little difficulty, perhaps the witness is not, just grasping what your question is. You have given us a preamble, senator. I wonder if you could give us the question?

Senator Benidickson: Have you any idea how a complex could be set up that would have such prestige with the public that persons in office now would not be thinking in terms of only two years hence or in terms of something that his successor would toss out the window very easily?

The Chairman: You are asking if in Mr. Knowles' judgment there is the possibility of setting up an agency that would be long term in outlook but would have tremendous force over the decision of the Government.

Senator Benidickson: The word "bigness" was used this morning, in the context, I thought, of having prestige with the public.

Mr. Knowles: I think I recognize the problem. A similar issue was raised when our Employment Act was under consideration in 1945 and early 1946. At one time it was suggested that we have an independent economic commission, sort of like our Federal Reserve Board, that would act as an adviser to the President, to Congress, to the public, and, without regard to politics, say, what the policies would be. My verdict would be that I am glad they did not do it. It may be that I am just not in harmony with some of the present generation's enthusiasms for institutions, but I am a great believer that political systems work by having high-quality political leadership and not because some non-political supreme set of beings—so non-political they do not really understand why people are demanding a policy change—are making pronouncements for them. My experience with one such institution we created disillusioned me, and I lost any enthusiasm for increasing our problems by inventing an economic supreme court. It would seem to me to combine the worst features of law and economics. We have invented enough practices in economics without importing any. I do not think such institutions or managements ever get you away from the necessity of political leadership and political organization.

Senator Benidickson: Subject to change over a very short period.

Mr. Knowles: This does create a very monumental problem.

Dr. McQueen: Mr. Chairman, could Mr. Knowles give us a brief capsule history of the Joint Economic Committee, from its beginning when it had no permanent staff to when it became the respected, well-organized institution it is today. Could I also ask if, in the course of that capsule history, he could tell us just a little about the relationships of the Joint Committee, not only with the legislative branch of the government, but also with the executive branch, the White House and Council of Economic Advisers.

Mr. Knowles: Two experiences started simultaneously. I will capsule the two of them, and I think that will tell you why our experiment was successful. The Congress, in connection with the reorganization in 1946, passed a reorganization act reorganizing Congress. One of the things it did was to cut the number of committees and subcommittees, which were consolidated and realigned, and it created a joint committee on the budget, which still exists, on paper. It has not met since 1951, and I think it met four times in the preceding five years. It did not successfully carry through a budget review and gain its approval in the Congress at any time in its history. Finally it was quietly buried by a judicious dose of legislative neglect, about the time I came to Congress in 1950. That was the last time we tried that experiment.

The Joint Economic Committee started off with a budget and a direction to hire a staff, which they did, and as soon as they had it staffed, which took about a

year, the committee started functioning and it started off with most of the experts saying that it would be a vermiform appendix, if you understand what I am trying to say by that expression, and ended up being one of the most powerful instruments the law had created, in many respects, at times, more powerful than the Council. I think the answer is that the leadership insisted upon quality of membership and on the interest of the members in really applying themselves. They also insisted upon a professional staff that, although small, was of high quality, and a staff with sufficient permanence to learn its business, which was new and a different kind of business from that which economists had been engaged in.

Just a little over a year ago there retired from our staff the first economist we had hired. He had been with us for over 20 years. I have been there 21 1/2 years. This will warn you what you are up against. It takes some time to get to be an expert. We find it takes four or five years really to get to where you can understand this kind of operation well enough to make it really go, from the staff end, and do everything that ought to be done. It is not something that you learn overnight. It is a complex field. The staff must have a reasonable degree of certainty that they are not going to be dragged into the middle of a political operation in which their professional attributes and integrity are going to be at stake.

In answer to the other point, as far as the Council is concerned, our major relationship with all executive branches is really that of critic. In a sense, the Joint Economic Committee is a review board. It has no legislative power; it never considers legislation. It could not report a bill on the floor if it wanted to; it does not handle appropriations. It is, you might say, the most powerless of institutions. Therefore, it is forced to live by its wits, and the strength of its economic advice is what has made it successful when it has been successful; and the lack of it is what has caused it to fail when it has failed. It has no other instrument.

Senator Isnor: You make recommendations to your equivalent of the Governor in Council?

Mr. Knowles: We make recommendations to the Congress, to the public, to the press. We can make recommendations to anybody. We just cannot force anyone to listen, and that means that we really have to be persuasive. We had better be persuasive; we have nothing else to work with. If you issue a report, you know, that is all there is to it. We cannot cause anybody to do anything. I think senators will appreciate that there is a way of reinforcing it, and that is that you can be careful in choosing the members of this committee, when it is a joint committee like ours, and make sure that the appropriate members of the two houses of Congress are on the committee. So we have the appropriations side represented and the tax-writing committee. We have the chairman of the Banking and Currency Committee in the House, the Chairman of the Banking and Currency Committee in the Senate, the Majority Leader of the House, and a few others. So, when we decide to move, there are channels other than our own through which to move.

Senator Nichol: This relationship between your committee and all of these other influential bodies on Capitol Hill, does it give your committee channels of communication to them or does it mean, and I do not want to be uncomplimentary in saying this, that your committee tends to be the captive of these powerful organizations? What does this do to the independence of expression of opinion of your committee?

Mr. Knowles: I think there have been at least two occasions, that I can think of in 21 years, when the majority opinion of that committee, as publicly expressed, has been different from what it would have been had there not been strong outside influences. After all, the members of the committee do not cease to be members of Congress and the public just because they get on this committee. If they had been acting in the way they would have liked to have done, and if the political atmosphere had been different, they would have acted differently. There are party and other political loyalties, that you will recognize as well as I do, and there are times when the majority rules. That is about the way the ship sails. However, I will say that in the main, over the years, the result has been the reverse. We have been a means by which the leadership could get things considered that they could not directly respond to. You cannot expect the chairman of the tax-writing committee to sponsor a motion that may be wild. He just knows that someone ought to be looking at this, and he does not dare let it get out. After all, it might end up in a bill. We have no authority to write any bills. He knows that it is not going any place from us, so he asks us to investigate. It is perfectly all right for him. He knows it is not going any place unless it is all right, and we will see to it. So we come back and say "Forget it. This is no good." Or we come back and say, "This is good. Somebody ought to draft something along this line." In that case he has a freedom of action that he otherwise would not have. As a matter of fact, at times we have acted as the agent of some of these other sources, to investigate things that could not be investigated anywhere else, because it would not have been safe, politically.

Senator Nichol: I would like to ask some questions on page 15 of your brief, where you have four concluding observations. I do not wish to take up too much time, but I would like to ask you about each of those four. The first reads:

> In large, complex, developed economies like the U.S., the extreme variability of government policies, both economic and non-economic, have been a major source of instability for the economy as a whole.

Am I interpreting that correctly, if I read into that statement that what you mean is that unstable government policies have been the source of instability in the economy?

Mr. Knowles: Correct.

Senator Nichol: I do not quite understand what you mean, or it is too obvious for me—one or the other.

Mr. Knowles: Let me give you a precis of one of these examples and one way of looking at it. We have had

alternating recessions and inflations since 1946, when the Employment Act was passed—in 1949, 1954, 1957, a whole string of them. If you go back to each one, I think you will find that since 1946 there has not been a single movement of excessive inflation or excessive unemployment in a recession that was not the direct and immediate consequence of an action by government. The government started the mess by over-indulging in a shift of policy without adequate precaution. This is true of 1949, when they took price controls off abruptly and allowed a speculative swing of adjustment without transitional instrumentality. This brought about an inventory correction. Incidentally, the forecasting team that I was a member of forecast that in 1944, five years before it happened, so it was not an unforeseen happening. It was as a direct result of a plain mistake. In 1954 we got it by a shift in military spending, without something being phased with it to offset the pressing effects on inventories and investment of this cut-back in military spending. I do not know whether they should have raised the spending in the first place or cut it back, but they ought to have done something. We did not have the disjointed consequences in 1950, because in 1950, when we geared up for the Korean military operation, we passed three of the largest tax bills in the history of mankind. In fact, those three tax bills together, at present income levels, would mean somewhere between $30 billion and $40 billion of additional revenue if something similar were applied today. That is not a small action. In other words, we stepped in correctly. In 1954 we did not. In 1957 we did not. From 1957 to 1964 we maintained a surplus of budget such as it would be at full employment, which was so large that we could not get back to full employment, no matter what we did on the monetary end. This was a direct mistake, a predictable, knowable mistake in our situation. It would not be in every situation, but in ours it was. In 1965-66 we started another military build-up, much smaller than before, and we got a much larger and progressive inflation and unemployment. Why? Because we allowed that to go into effect at the same time as a large number of additional civil programs, thus building up the expenditure. In other words, we just did not time things correctly in their relationship, one with the other. It was the government's own fault. They started it. The private economy kept it going, and made a real roaring mess out of it once it got started. Believe me, if you turn an economy as big as ours loose it will create a mess. The federal government started each one of those episodes, not somebody else.

Senator Grosart: When you say "predictable and knowable," predictable and knowable by whom?

Mr. Knowles: Any good economist, in this case.

Senator Grosart: Did the economists at that time predict and know, and make it known, that any or all good economists were opposed to the government's decisions?

Mr. Knowles: If there was any government official who did not know that at least the majority of economists opposed their policy in each one of these instances, I do not know where he was living at the time. We sure made it known. Let me make something very clear: economists do not rule nations and, frankly, as one of them, I am fairly sure that I am glad we do not.

Senator Grosart: Because you do not agree in toto, I am sure it is fair to say that there is no such thing as a predictable and knowable consensus of economists at any time.

Mr. Knowles: In most cases that is perfectly true, but I have spoken of instances where this general predeliction of economists was not relevant. Economists did know what would happen, and the economists did say so, with vehemence. In 1965 and 1966, personally I do not know of an economist, in or out of government, who was not demanding the correct action, the action that was not taken by the government, for understandable political reasons, which I think the word will understand before a few more years or maybe months have passed.

Senator Grosart: Are the monetarists and fiscalists in complete agreement as to the course government policy should take?

Mr. Knowles: In that case they were. They would not be in the present instance. In the present instance you would have trouble; they would not agree.

Senator Grosart: What should the government do then? If the monetarists and fiscalists were right in situation "A" and are divided in situation "B', what course of action should the government take? Flip a coin?

Mr. Knowles: In the second instance, I am not sure what you would do. I suppose that ultimately you would just have to pick your own advisor and decide who you were going to bet on.

Senator Grosart: Is that not what is always done?

Mr. Knowles: Yes.

Senator Grosart: Perhaps we can ask Dr. Deutsch when he comes.

Senator Nichol: You have clearly expressed what you meant in point 1 of your concluding observations. There are three more. Points 2 and 3 deal with lags and the problems which they present. Point 4 deals with the lack of coordination between different policy tools.

You paint a dark picture in these four conclusions Mr. Knowles: firstly, that the government policies were extremely variable and cause dthese problems; secondly, that the lags are not clearly understood; thirdly, that the psychological lag is too long to be functional in terms of doing anything; and, lastly, that there is no coordination of policy tools. Do I read this too darkly?

Mr. Knowles: I would not consider it "dark". There is an early passage in this paper, as I remember, in which I said, "Do not take my words to mean that I have become a despairing cynic", or some such phrase. I think that experience like mine does make some people cynical. I hope it has not made me as much of a cynic as people accuse me of being. To me, all that it has done is give me the humility to recognize the limits of human knowledge and expertise, to recognize that there are characteristics

in the world that make policy making a tough business that requires a lot of patience, a lot of skill and a lot of making of mistakes in order to learn how to do it. It teaches me not to expect miracles. All that these points are saying is that we have had a lot of trouble because we have tried to do what we should not have tried, in the first place, because of the limitations of our skill and knowledge. We should not try to make quick, short-term shifts to little variations in economic activity—too fine tuning, to use the phrase of recent years—because of the lags and because of psychological reactions that people have and the speed with which they can follow suit, so to speak, and adjust themselves to policy, because of the problems of political and economic forecasting. Incidentally, the political forecasting may be more important than the economic. The economist may be bad. You will pardon me, but politicians are often worse forecasters of politics than we are of economics. I lost one major policy battle for that reason, so I am a little senstive these days.

What I am trying to say is that the job is not impossible, if we only work at it the same way as we would work at it if, let us say, we were down here running a textile mill, steel plant, or something else, and used a little common sense in organizing it, dividing it into departments and adopting an administrative apparatus that would manage the process we were trying to handle. We try the push-button, snap routine because somebody is always breathing down our back for results. It just will not work that way. We are really going to get beat up a lot over this, but there it is. You might as well live with it. You are going to have to, anyway. I do not like it, by the way.

Senator Nichol: You have just called for a more efficient structure of economic policy making such as, as you said, if we were running a textile mill.

Senator Grosart: Some of those fail too.

Senator Nichol: Not with the tariffs that Eastern Canada has!

In answer to Senator Benidickson, you said that you did not feel that some sort of supra-organization of economic policy makers would be an effective solution. It would seem to me that there is a conflict between what you said earlier and what you are saying now. These four conclusions paint a picture of some confusion, do they not?

Mr. Knowles: The confusion arises out of the political process and representative government. What I am saying is that if you wish government to work, you have to work at it as a government and not as a business of finding five, nine, fifteen, or however many, saints you want to put up in a room to ordain from on high the way the human race is going to live. I do not think they exist. I do not trust my fellow economists that much. I would not put them in charge of this. There is not any amount of money you could name that would buy my recommendation of that. For the same reason, I would not entrust this to nine lawyers, doctors, accountants or anything else. I just do not think this is the wayhyou run the world. We are all in this, and we must reach agreement. In this case what "coordination" means is the very simplest of things: you simply have to build up machinery so that the people who are working on the monetary side realize that the fiscal side is around in the next hallway, down here, and that, incidentally, the two of them are running the same policy, not two separate policies. There are not two separate policies, there is one, and they had better get together once in a while and, if they do nothing better, go downstairs and have a cup of coffee together in the cafeteria and find out what is going on. They did not do this in some cases that I could cite. I am not asking for super agencies or supermen, just a little less compartmentalizing of life, a little less faith in very quick "between now and breakfast" results, and a little more of the steady hand and inclination to recognize that there are limits to how much we know and can do. If we did this, I think you would be amazed at how much better the results would be.

Senator Laird: Is it lack of communication?

Mr. Knowles: Partly lack of communication—impatience, jealousy; a number of other rather human characteristics.

Senator Molson: Is there a lack of response in time and a delay?

Mr. Knowles: The lack of response in time is a very critical one, and I have been looking into it a little. I am a little disturbed by something that is going on in the United States. As you will well recognize, politically the most sensitive two numbers that any statistical agency can issue are the number about unemployment, on the one hand, and price level, on the other. Either one of those two numbers can upset politics faster than anything you ever dreamed about—anything short of a declaration of war. Those are the two most sensitive numbers to have somebody throwing around some morning. I think we have to . . .

Senator Grosart: There could be an awful lot of people at this coffee party that you are talking about. On page 9 . . .

The Chairman: I think Mr. Knowles is in the middle of an answer. I will come to you.

Mr. Knowles: I think we have to recognize that these figures are late. They tell us what our decisions of six months, a year, two years, or three years ago are doing to us now. They tell us a little, if we are careful, about what will happen a year or two from now, when we make a different kind of decision now. They do not tell us anything about what we ought to be do ng about the here-and-now because that is over with. The result of the political sensitivity is that we have been reacting to cure what was pulling us down into a state of high unemployment after we got the unemployment which is, generally speaking, six months or a year late. We wait for that number on unemployment to tell us to do something, and that is the wrong number. We are looking at the wrong signals. I think a detailed examination of the economic history of the last 25 years might well prove that this was a major factor in what you are talking about, namely, that the people were looking at the wrong sig-

nalling device for information and, hence, they reacted late. There is no doubt that this did cause a lot of trouble.

Senator Grosart: I would speak to what seems to be simplistic. You talk about getting the fiscal and monetary people together for coffee, whereas on page 9 you say, "Fiscal and monetary policies cannot carry the whole burden of achieving regional, national or international economic goals separately or in combination." At these hearings I would think that we have had something like 20 to 30 other policies mentioned. It would be a large coffee party every morning.

Mr. Knowles: I would suspect it would require...

Senator Grosart: It would be an institution. You would have an inter-disciplinary committee, or whatever you would like to call it.

Mr. Knowles: Certainly, there are some institutional arrangements needed to make any system of coordination work.

Dr. Gillies: Mr. Knowles, I was wondering if you favoured the creation of the Council of Economic Advisors?

Mr. Knowles: I would have, if I had been involved in it. It is a valuable institution. I might say that it merely institutionalizes the fact that already existed: Presidents always have advisors, and always have had.

Senator Nichol: Dr. Knowles, you were talking about the unemployment figures being the wrong signal. We had —I think I am right, Mr. Chairman—Dr. Tony Scott from British Columbia who made the specific suggestion that the Government should look at a 4 per cent unemployment figure.

The Chairman: I think it was Dr. Reuber who suggested the use of the unemployment figure as a norm.

Senator Nichol: Yes, and I think Dr. Scott did too. I think he suggested that when it reached 4 per cent this would be the point for policy adjustment. Then we heard from Dr. Giersch from Germany who was very specific. I asked Dr. Giersch what the indicators were which set the system working in his country, and he said that they were Incoming orders, specifically in the investments goods industries or the capital goods industries. I asked him if it was sufficiently close so that it really worked, and he said it was difficult to judge but that is what he watches. My question is: If you do not use the unemployment figure, would you agree with Dr. Giersch that that is a good indicator; or what indicator would you suggest?

Dr. Knowles: You have asked the oldest question in the history of the discipline that is asked of quantitative economists. It has had many answers. I think I would have to render the verdict, as an economic historian, which I was at one time in my younger days, as a failure. To wit, we have never really developed something that is the best thing and that always works. To a very considerable extent, economists are in pretty much the position of any other science, and particularly the medical sciences. We are dealing with a phenomenon so complex and changeable, for reasons we do not yet fully understand and which involve so many disciplines and aspects, that no economist really ought to tell you that he has *the* indicator which is the one that always works.

It is obvious that if you are going to pick something to watch you at least ought to pick something that tends, as a general rule a least, to give you a betting chance of moving before what you are worried about moves. So, if your problem here is to stabilize employment at a high level, you had better find something that moves before employment does, because by the time employment moves it is going to be too late. In that sense incoming orders, or new orders, as we call them in the United States, are a good indicator. Construction contracts, new orders for capital equipment, new orders for consumer products—all of these are important; but in the United States one of the most important of that series we had the foresight to create is right inside the government itself. The federal government in the United States is the largest single creator of new orders. We issue more new orders in a year than anybody else, so we have to keep track of ourselves, at the very least. Incidentally, until recent years we could not do that, and the system is still not very good. But when you get right down to it, you have to look at a whole battery of things.

It is also possible for the so-called econometricians to develop indexes of pressures developing in the economy between different things. A simple form of this is the rate of use of capacity, and if you see the rate of use of capacity falling then, obviously you are investing at a greater rate than you are increasing the consumption and you realize that trouble is ahead somewhere. You do not know exactly when, where, or how, but you know that something is happening, because you are getting idle capacity around, and that is the first signal of trouble of a certain kind or a battery of troubles. It can be any of several, but at least you know it is in the offing, out there. That is the sort of situation in which you have to develop a battery of devices rather than one. It is really the reason for institutionalizing such bodies as our Joint Economic Committee, or the Council of Economic Advisers, or your own Economic Council here in Canada, or other such devices; it is to find somebody to put together a battery of these things.

Senator Grosart: To come back to the problem of the political decision-maker—and I suppose that is what our hearings are all about—I suggest to you that the essential contradiction between, say, short- and long-term economic policies is indicated by two statements which are quite far apart. On page 11 you say, "This means that as long as attempts are made to achieve quick, short-run cures of unemployment and/or inflation, failures in economic policymaking are inevitable." And at the bottom of page 3 you say, "When policymakers ignore the psychological and moral aspects of policymaking, they automatically invite failure."

So here are two ways of inviting inevitable failure; one is to have short-run policies; and the other is to ignore the very things that are going to force you into

a short-run policy, that is, from the psychological and moral aspects. How do you reconcile these?

Dr. Knowles: I suppose that the greatest and most severe criterion that you can apply to leadership in this world, whether in politics, business or university, or anywhere else, is whether or not the leader is able to bridge the gap between the impatience of humanity for immediate results and the necessity for taking enough time to get there.

Let me give you a simple reason why it really does pay to try to make that leadership effort—and it is a big and complex effort. Suppose the United States had advanced at a steady pace from 1909, let us say, to 1969, which is a period of 60 years, instead of fluctuating its way there, as it did, as a result of this very human quality of impatience, our per capita Gross National Product would today be between 50 and 100 per cent higher than it is right now. That is what we have paid. We paid between one-third and one-half of our possible growth for the privilege of having short-range tiddlywinks policies. The truth is that it takes a lot of leadership, personality, courage, determination, wisdom and foresight to do better, as witness the fact that more business firms fail than succeed.

In a lecture I once gave I said that the capitalist system, contrary to Marxism, is a system of exploitation of the capitalists. It is the only system that causes the businessman to fail instead of the worker. Perhaps what it takes is enough patience to exploit the long-run and be the one who succeeds and survives.

That is the test of leadership, and somebody has got to bridge this psychological gap regarding the impatience I have—and I am sure that everybody in your country and mine has—for results. The fact is that real results take a whale of a long time to occur. It has been done: they really did build those pyramids; they are still sitting there; and that was a rather long-term project. It indicates that we succeeded in taking a long-term view. If we can build a tomb and take 20 or 30 years to do it, what is wrong with building prosperity over a longer period?

Senator Grosart: Perhaps your analogy is the answer, because they worked a lot of people to death to build those pyramids. It is probably the crux of this whole question. Are you not saying that we have to have high unemployment, that people have to be out of work, that suffering has to go on, that we have to have inflation, and that we have to ignore the pensioners and people on fixed incomes, in order to carry out a long-term plan? What do we do? These are the moral and psychological factors that you seem to stress so much on page 3 of your brief.

Dr. Knowles: A long-term policy based on mass suffering would not work in the long run. That is precisely what the economy will not tolerate. Your problem really is to have full employment without inflation, and to stay there.

Senator Grosart: We all agree with that.

Dr. Knowles: And if you do not get there and stay there, there will not be any long-term; and there will not be any long-term if you do not get both.

This is one case that is almost a parallel to a popular song of two or three years ago. What was it—"Love and Marriage"? They go together. Well, in this case inflation and unemployment go together. If you want to get rid of one of them, you have to get rid of both of them. I have no idea what it is going to take to get people to realize this.

Senator Grosart: The song goes on to say, "You can't have one without the other."

Senator McNamara: That is the mythology.

Senator Grosart: No, that is the next line of the song.

Dr. Knowles: I must admit that there is no simple way to get the co-ordination that is required to have a consistent policy. It is true, however, that by one means or the other we have to be inventive enough and imaginative enough to create procedures, processes, and habits of thought, if you will, that get the end result, and what I am telling you is that there is a lot we do not know. I am being quite humble in telling you that there is a lot we do not know—not yet. However, if we can break an atom, in a couple of years, I imagine, we could crack this one.

Dr. Gillies: I understand that at your hearings, Dr. Knowles, you usually invite two, three or four economists to appear at the same t me. Do you find this to be a more effective way of eliciting good advice than to have them come one at a time? How does that work out?

Dr. Knowles: In some circumstances it works very well. There are two reasons for this. The first is that it enables the members of the committee to ensure a clash of ideas. They have three or four people with different opinions and who would approach something from different viewpoints. If you want to know what the argument is about in a hurry, the easiest way is to get one representing each of these points of view before you and throw a question at them aimed in such a way as to get them fighting about it. This will produce the answers, and will also be a considerable saving of time. Secondly, and this is the part which really attracted us, because we have to get in a surprising amount of work in 12 months and our members serve on other committees, this being an added assignment to their normal work load. So, as an economic measure, we have the testimony prepared in advance, as you did here, so that we can review it. We often publish it in bound volumes and circulate it, and then we have three or four witnesses at a time in front of the panel so that members may question them all at once and let them disagree with each other, much less the members disagree with the witnesses. You have more targets to fire at, and if you do not get the right response out of one maybe you can get it out of another. It is just enough to stir up some light out there, because very few professionals in any profession have all the light that is to be shed. If you get three or four up there, they will get it down to some point, or at least to where you will find out whether or not there is any area of agreement at all.

And if you get four economists to agree, I assure you there must be something to the opinion.

Senator Isnor: How do you arrive at any decision along those lines, Dr. Knowles?

Dr. Knowles: You mean as to how many to invite, or who to invite?

Senator Isnor: No. If you invite four or more and just try to create an atmosphere of discontent, how do you arrive at any worth while decision?

Dr. Knowles: Well, after you have handled this once or twice you become a little expert—most of our members do—at feeding and question to the panel in such a way as to find out what you are really fishing for. Where you have several witnesses before you, you first want to find out how much of an area of agreement there is. If the question, for example, is whether or not to stimulate the economy, and you find that each of the witnesses, from conservative to liberal to middle-of-the-road, says, "Yes, you should stimulate the economy," and, moreover, everyone of them says that you cannot do it with any more stimulus of monetary policy than you already have, and certainly all of them agree you cannot use a fiscal measure, then you had better start worrying about fiscal policy, because it is unlikely that four good economists are going to be in that much of agreement unless there is a very strong case; that is, if you were careful to have the staff select four people who normally would not agree. If they then agree, you know you have a good strong case, and you are safe in assuming that that is as good economic advice as you are going to get. It may still be wrong, but at least it is as good as you can get.

Senator Molson: Mr. Chairman, I would like to ask Dr. Knowles, in reviewing the problem of unemployment and inflation which we have, whether he thinks there is anything in the relationship of the major power centres—big business, big labour, big government—that is out of kilter sufficiently to be a strong factor in creating this type of problem in the present day?

Dr. Knowles: I am not sure about other countries. This requires a knowledge of what economists call "micro" or little bits-and-pieces of the economy, and an economist in that kind of field should be very careful with respect to what he says about an economy other than his own. The United States, in general...

Senator Molson: I think the United States and Canada are pretty much alike.

Dr. Knowles: I would assume, from my knowledge of the two countries—and my knowledge of the Canadian economy is modest but I know something about it—that my judgment about the American economy might be typical here too. The structural characteristics of these power centres, in general, in such an inflation and unemployment situation as we have now, have only one consequence, and that is that they change the timing of the way in which the economy behaves. When you have a sudden first burst, let us say, of excessive demand—for example, the Government puts in a great new military program, or does some other things that start inflation—these large power centres are generally so organized that they cannot make, and do not customarily make, quick responses to much of anything. They are very slow moving. It will be industries and occupations marked by a great deal of very small units, such as a raw material producers, and so on, who will move first, and they will create a disequilibrium, and gradually the others will pick and go with it and they will start chasing each other in a sort of rolling adjustment process. This means that the process takes longer. If you are going to get a 20 per cent rise in the price level because of a policy that was adopted, you will still get the 20 per cent in either case, within whatever limitations of accuracy economists can estimate such things. In the case of the purely classical economy, where all the units and firms are small, you get very fast results. You could almost literally get the classical case and the extreme case of instantaneous response.

What all these things do is slow the whole process up and you would take five years to do it. I do not think it has any other real consequence except one, and we are in this position in the United States right now. If the big units get out of step with each other—not with the others, but with each other—then you get another policy going, because then, in order to stop the cycle, one of the big ones has to suffer a disadvantage relative to the other large organized units. In other words, the steelworkers have to get less than the automobile workers, or the automobile workers have to get less than the steelworkers, on the next round of increases, or some other such thing has to happen. I do not think there will be any volunteers as to who is going to be the one to get his head chopped off politically or economically. I think volunteers for being this victim are singularly lacking.

Senator Molson: In effect, somebody really has to back down.

Dr. Knowles: Or you have to give him a reason why he should be the victim. In fact, the most interesting case that can be made for the use of compulsory wage and price controls, under any circumstances you can imagine, is not an economic one at all. The economic case for it is a very poor one. It is a political case. It is just to face up to the fact that each of these leaders in industry, labour and agriculture cannot be the man first to be hit. You have to reach out there and put something that is arbitrary and impersonal over everybody, and everybody recognizes that it is arbitrary and impersonal, and you have to so time it so that no one can say you aimed at a particular one. They can then say, "Well, I cannot do anything about it; it is the law." He knew he would have to stop anyway at some point, so this gives him an excuse to do it at a time other than he would otherwise have chosen.

The Chairman: Honourable seanators, we have another witness coming before us, so I am afraid we will have to bring this hearing to a close. I do have a question from Senator Nichol and a question from Senator Beaubien. Senator Nichol?

Senator Nichol: We have been dealing with the apparently contradictory situation where we have a combination of inflation and unemployment, and we have been discussing this at length. Dr. Okun dealt with this this

morning, and he talked about the biases, and so on, within the system. In discussing this with Dr. Gillies last night, he brought up another fascinating paradox which I would like you to ocmment on. It is the situation where you have monetary expansion and a rise in the interest rates at the same time. This is what we have right now. There are various arguments as to why this happens. What do you think? Theoretically, it should not happen.

Dr. Knowles: Oh yes, it should. The theory I learned, when I was a youngster just starting in this business, predicated that this is exactly what would happen. There are two reasons for this. First of all, if you raise the money supply at a liberal rate and—by this I take it you mean that you are increasing it much faster than the rate of increase in real output and employment, so that you have an access of money, so to speak—interest rates should rise. The essential reason for this is that it is inflationary. It is going to raise the price level, and for the lender to get back in real terms what he is lending and stay even with the board, according to classical economic theory that goes back at least to the Middle Ages, if not to Aristotle—I think I traced it last year back as far as some monk back in middle Europe, some place in the Middle Ages—in these circumstances the interest rate is going to rise by most, if not all, of the rate of increase in prices that they expect.

If you have had a period of inflation and you slow down the rate of increase in the money supply and then suddenly raise it again in a short interval, then, the people will remember the inflation that they are already in and the consequences of the last burst of monetary expansion. They have not been away from it long enough to forget, and the result is that you are going to get an instantaneous rise in the interest rate. If there had been a long interval in there it might have taken six months or a year to get the rise in interest rates, but it would have come. In this case, since the interval is short, you have an immediate rise in the interest rates. As Friedman would put it, "You got what you deserved."

Senator McNamara: In other words, the theory which we have heard so much about in this country over the last few years, that we must increase the money supply in order to reduce interest rates and expand the economy, is rubbish?

Dr. Knowles: No. You see, economics, like a lot of other things, is an exercise in what Aristotle called the golden mean. My professor used to say I would make a good economist because I was an Aristotelian in philosophy. You see, what causes interest rates ultimately to fall to as low as they are going to fall, in view of the supply and demand of capital, is that you get the supply of monetary medium in line with the long-term full employment demand for it. At that point the natural interest-making forces can function and as a result, you get inflation. If by any chance you allow the market to be flooded with monetary medium, you get a rise in interest rates. If you have a shortage of money, you get a rise in interest rates. When teaching a class I once called this the "economist's bathtub". You go up the side in either direction. The optimum point is down at the bottom. That is where the lowest interest rate is, it is with the money supply correctly balanced to the requirements of the economy. It is hard to find what this is, because it is a broad flat trough, but as you go away from this you get higher interest rates on either side.

Senator McNamara: That is a very good point.

Senator Beaubien: Dr. Knowles, you have kept your finger on the pulse pretty carefully. Would you say the recovery in your country is rolling or not?

Dr. Knowles: Yes. There is a difficult technical point here, because this has been a very shallow operation and measurements of economic variables are none too perfect. I think a case could be made that the turn occurred somewhere between December, 1969 and anywhere up to November, 1970, according to what your preference is as to where to place the low—the low was in there some place—and it has been going up ever since, with the only interruption being a strike last fall. I see no reason to assume the recovery is not underway, and I see no reason to assume it is going to be a slow one.

The Chairman: Honourable senators, I am sure that we all regret the shortness of this meeting, but we are under a certain amount of time pressure. I hope you will understand, Dr. Knowles. On behalf of honourable senators, I would like to thank you very much for your brief, which will be useful to us, and for your verbal testimony. You have introduced, perhaps more so than most of our witnesses, the political quality that we always face in trying to solve the problem that we have set ourselves, and you have brought to mind that, no matter what we do, we cannot ignore that very real political quality. I also want to thank you for the emphasis you placed on the fact that whatever we do, we must do it in the sense that we are trying to preserve a free economy and a high degree of individual freedom in society. Thank you very much, Dr. Knowles.

Honourable senators, we will adjourn until 4 o'clock when Dr. Deutsch will be our witness.

The committee adjourned until 4.00 p.m.

Upon resuming at 4.00 p.m.

The Chairman: Honourable senators, our witness is Dr. John Deutsch, Principal and Vice-Chancellor of Queen's University. He has probably had one of the most outstanding and wide-ranging careers in Canada. He has been with the Bank of Canada, the Rowell-Sirois Commission, the Under-Secretary of State for External Affairs, the *Winnipeg Free Press*, and the Department of Finance. He has been Secretary of the Treasury Board, head of the Department of the Treasury Board, head of the Department of Economics and Political Science, U.B.C., and Professor of Economics at Queen's University. He has been a member of numerous royal commissions. He was the original Chairman of the Economic Council of Canada. He holds honorary Doctorates of law from virtually every university in Canada. In short, he is a man singularly equipped to give advice to this committee, just as he has to the nation over many years.

It is a great honour to welcome Dr. Deutsch and to ask him if he has a verbal statement to make.

Dr. John Deutsch, Principal and Vice-Chancellor, Queen's University: Mr. Chairhan and honourable senators, it is indeed a pleasure for me once again to be before you in this role, one which is not unfamiliar to me because of my previous responsibilities, and I look forward to our discussion.

I am not going to take much time in my introduction. Any general comments I have to make I think I have included in my brief notes which have been distributed. I do not want to go over ground that you have covered many times already, so I am not going to discuss the many issues that have been constantly raised before you.

In my notes I did attempt to address myself to how we might be able to approach the task of obtaining a better performance in achieving our economic and social goals than we have in fact been able to—or, at least, to some of the basic issues that are involved in an improved performance.

I should say at the outset, as I think has been emphasized many times before you, that we now have accepted for ourselves some rather difficult goals and objectives, and these have become the responsibilities of government in many ways. These have always been objectives of society, but since the second world war governments have undertaken explicitly to achieve these goals and objectives at all times.

In Canada, you will recall that in 1945 our Government issued a famous White Paper on employment and stability, and in that White Paper the Government more or less committed itself to achieving high levels of employment at all times and other social results such as improved welfare.

Similar things were done in other countries. In the United States there has been the Employment Act of 1946. In Britain there have been similar commitments by the government.

It has turned out that the achievement of these goals and objectives has proved to be much more difficult than was thought at the time. We have found that while we are able at times to achieve one or two of these goals, we rarely can achieve all those that we think important. The one you are particularly concerned with is employment and inflation. How do we achieve both high levels of employment, or full employment, and reasonable stability of prices and, at the same time, look after our external requirements, keep the balance of payments viable, and achieve equitable distribution of rising incomes? All these are things which we now accept as objectives which the Government is asked to accomplish.

The demands of Government policy arising out of these are extremely great, as are the demands on the machinery of Government in the carrying out of these policies. These demands are so great that, in fact, in no country have they succeeded in realizing these fully and consistently.

I touch upon three or four basic questions which are involved in the achievement of these goals, why they are so difficult to achieve, and what kind of considerations arise in setting better results.

The first, which I want to emphasize, has to do with information. If we are going to have any chance at all of carrying out policies necessary to achieve these goals, our information system is woefully inadequate and is not sufficiently up-to-date. Most of our information is out of date when it is needed for this kind of purpose. Secondly, the degree of analysis of this information is also inadequate. This, in itself, is a major problem, as to how to organize the gathering of this information and its analysis. It requires, particularly on the analysis side, a high degree of independence and objectivity, which is difficult to guarantee. Nevertheless we must try to do these things if we are going to be, or at least have a chance of being, more successful.

The other point is our general approach to the policies needed to reach these objectives. As many people have already told you, there is no way in which we can approach this except on a long-range basis. Short-run adjustments and short-run interventions in policy in the economy to get long-run, good achievement are impossibile, partly because of the lack of information and partly because of the leads and lags involved in the operation of policy of any kind.

This was not appreciated in the early stages of the post-war period. I think it came in the wake of the Keynesian economics, when there had developed a belief that government could manipulate several things, like monetary policy, fiscal policy and tax policy. It was felt that it could manipulate these fairly quickly and that they would get certain kinds of results. I think, this heritage of Keynesian economics has proven to be a fallacy, and it has played far too great a part in our operations in these post-war years.

The importance of longer-range analysis, longer-range projections and longer-range use of policy, with longer-range objectives, is, to my mind, absolutely fundamental if we are going to get a better performance. However, this runs into very serious political problems, as some of you have often pointed out. The decisions are finally made by political representatives, which they must be, and political representatives are, in the very nature of their task, highly influenced by short-run considerations. This is a fundamental problem which bedevils us in getting better performance of the kind we are looking for.

What the answer to that is, I do not know. One can make some suggestions to reduce this gap, but I do not know whether it can ever be bridged completely in our kind of society. That depends on the intelligence of the public in general and the general understanding of the public that affects politicians. I am afraid that ultimately it depends a great deal on that kind of consideration, but there is a basic clash between the requirement of longer-range policy and longer-range programs and the forces that affect those who have to make the decisions which tend to be of a short-run nature, if for no other reason than that elections and other political events have a fairly short-term effect. Time and again long-run considerations have to take second place to the immediate demands of political necessity. This is the fundamental difficulty.

Another area that is very important is what I call the general role of expectations. If the public, because of events, believe that certain things are inevitable or will

be very powerful in their effect, that belief does not change quickly. Such beliefs take a long time to become established and when they are established they do not change easily.

The task of overcoming the effects of those expectations is something that requires time. I refer to what Mr. Knowles calls patience. I agreed very much with what he said earlier, that once expectations run strongly in a certain direction—for example, we are living in a period of persistent inflation—and become firmly established, they affect virtually all your decision-making processes, including the decision-making processes of other elements of society, whether labour union leaders, farmers, investors, or others. They gauge their own programs and their own policies on the basis of that expectation, and it becomes very difficult to turn around very quickly. Therefore, the idea that we can manipulate certain levers of policy to get quick changes is again a fallacy.

Finally and most importantly, if we are going to have better performance in reaching our goal of full employment, reasonable stability of prices, reasonable and equitable distribution of rising incomes, and all those things that we consider important, it will require very careful co-ordination of your main policies, such as monetary policy, fiscal policy, tax policy, economic development policy, and welfare policy. All these are main elements in influencing society in its operation. These have to add up, in a sense, both in terms of their relationship to each other and the general demands that they make on the total available resources.

In practice we have rarely been able to achieve that kind of consistency. We have a tax policy, an industrial relations policy, an agricultural policy, a welfare policy. We have all these different policies, but they almost never fit together consistently, and apparently there is very little effective machinery which will fit them together consistently.

In Government and in our society, we are organized, largely on the basis of interest groups who are concerned with particular parts of the economy—obviously, their own parts. Governments are organized in much the same way. We have interest-type organizations. One part of the Government is concerned with monetary policy, another with tax policy, another with agriculture, another with industry and trade, and other parts with other aspects.

To a large extent all these pursue what are really their own goals, or are concerned with their own particular occupations. It is most difficult to get these things related to each other in a consistent manner, and they make a tolerable demand on the available resources of the economy and in their distribution according to the objectives which they have set for themselves.

How to get this balancing and consistency in our way of governing ourselves is one of the really great questions.

Formally, we have the cabinet, the Government, which stands at the head of the whole process of policy administration; but this process by itself does not appear to be able to carry out the kind of co-ordination or achieve the consistency which seems to be necessary.

The reasons why that is so are not too difficult to see. Generally what happens is that a whole series of compromises and influences of the most important concerns of the day tend to have a particular influence in any particular situation.

How to get consistency here and proper balancing of all these concerns in relation to the objectives that we have in mind is the fundamental problem, if we are to have better performance.

I suspect that we have to institute some reforms in our machinery. We have to introduce into the machinery some devices which will maintain an over-view of the whole situation. Technically, the cabinet is in that position, but, firstly, it must address itself more explicitly to this task than it has done in the past, particularly on economic and social questions, and, secondly, it has to be assisted by advisory and information services adequate for this purpose.

What these advisory services should be is something that one can debate. I feel that in our cabinet, we should be equipped with more effective devices of a general nature, concerned with the precise task of obtaining consistency and balancing of all considerations in the making of policy, and with less dependence on advice coming from different sectors inside the Government, which seems to be the case at present.

This may require the type of machinery that exists in the United States, the Council of Economic Advisers, or something along those lines. However, it may not be organized in quite the same way. It would have to consist of very competent persons who would not be based in any particular sector of the Government, but who would be concerned with the totality of policy and its consistency. They would have to be people of great competence and with a high degree of independence from any particular interest.

Many different models are appropriate in this regard. However, this kind of service is badly needed if we are to achieve better co-ordination than we have at the present time.

Finally, we are in a federal country and in recent years—and it seems probably that the tendency will continue,—the task of policymaking has become increasingly decentralized. The role of the provinces and regions is increasing. The development of the enormous metropolitan cities which now dominate our society, the very rapid urbanization, will be another factor in decentralizing the places where decisions should be made. This very greatly complicates the task of co-ordinating and balancing. Again, we must develop machinery and processes by which at least we can improve the possibilities of proper co-ordination.

I see no way of avoiding increasing decentralization in this country. This is due to both reasons I have given: firstly, the pressure from the various regions for more determination of their own affairs; and secondly, the one that arises inevitably from the growing importance of the great metropolitan cities, which will inevitably bring about decentralization in the decision-making processes. This means that we have to pay very close attention to consultation mechanisms between the central government and the provinces and, ultimately, in some form with the great metropolitan aggregations.

So far we have had a great deal of discussion and consultation. However, in the field of economics and in social matters it has been rather hit and miss. We must develop much more regular and orderly means of consultation between these various levels of government.

Mr. Chairman, I have perhaps said enough to at least start the discussion. I realize that I have only touched on some of the basic issues. There are a great many details and other factors involved in this, which I hope will come out in the questioning.

The Chairman: There is one point on page 10 of your brief that flows out of the logic of the consultation.

Dr. Deutsch: Yes, these processes must, of course, involve the elected representatives and the instruments of government such as Parliament. We need much more regular discussions in our Parliament and its various committees with regard to our overall economic and social goals and how we are performing. This should be a regular process, the sort of work that you are carrying on in your committee.

There has been in Canada, less so than in the United States, a relative lack of discussion of these matters. We often see reference to the fact that not much dialogue goes on between governments and private groups in our society and between the academics, experts and professionals. This is very important and we need much more. There will be much disagreement, but out of this multiplicity of advice and views will come a much better basis for making decisions, despite the multitude of voices.

We have had far too little of this in Canada. I would like to see the kind of thing that this committee is attempting to do made a regular feature of the whole process of decision making in this country. This kind of discussion should involve not only the federal authorities, but the others which I mentioned, provincial and municipal. Such an interchange, in a public forum, is vitally necessary if we are to arrive at an adequate basis in public opinion. Ultimately these decisions will be made by political processes, and no decisions can be made that are not viable from a political point of view, no matter what the experts say. The impact of the expert on policy making can only be effective if it convinces those who have to make decisions. They will only act if they feel they have adequate public support. The more complex these issues become, the more necessary it is to achieve at least a modicum of understanding among the public, which ultimately affects the decisions of the politicians. Therefore, we must put a very high priority on this aspect if we are to achieve any iiprovement.

Senator Isnor: We have been very fortunate in selecting witnesses from all over the country and, indeed, from all over the world. We have had witnesses from England, Germany, Japan and the United States. However, I think today we have one who is familiar with our own problems from coast to coast and we are very fortunate to have him appear.

He referred to a greater source or distribution of information. I wonder if he had in mind greater use of Information Canada? It is a new organization and does not go back to our early days. Would you care to make a comment?

Mr. Deutsch: Senator, I am not very familiar with Information Canada. I realize that it is a relatively new organization. If it is concerned with distributing information to the public in an objective way, I am all for it.

It seems to me that in the past the public has not had readily available to it the kind of information which it really needs to understand the issues. However, how to do this is a difficult question, and I do not know whether Information Canada has the necessary skills.

Senator Isnor: Mr. Chairman, I asked that for your benefit as well, you might wish to inquire further into the possibilities of making use of Information Canada to a greater extent than at present.

The Chairman: As a matter of fact, we have a representative of Information Canada attending these meetings, and I will introduce you to her after the session.

Senator Isnor: That will be very nice.

The Chairman: It will be a pleasure.

Senator Isnor: Dr. Deutsch, knowing how familiar you are with the various sections of the country, perhaps more than any other witness we have had before us, I wish to deal with balanced regional development, as mentioned on page 1 of your brief. You know which sections of the country I am particularly interested in. Have you a solution for us as to how we can further develop those sections? As the committee will no doubt know by now, I particularly had in mind, the Maritimes.

Dr. Deutsch: Yes, I suspected that, senator. In our country it is essential that we have as one of our national objectives a reasonably balanced development in all our major regions. This is inherent in maintaining the country. In whatever main policies we pursue, whether they be policies for development, taxes, tariffs or trade, one of the considerations that should play an important part in deciding those policies is their role in bringing about balanced regional development. This is something that should pervade all our policies.

There is no single formula or some magic that, if applied, will make sure that the Maritimes will have an equal standard of living to Ontario, just by some single little device of some kind. When policies that affect the development of this country are applied, which are concerned with promoting this development, they must take into account this need for balanced regional development. Account must be taken of how they affect the Maritimes, the Prairies, the central region. Whatever goes into those policies should be the kind of thing that will bring about the best kind of overall development for all these regions. This is the way this has to be approached.

There must also be taken into account some of the basic forces that are operating here. One of the great things operating today is the tendency towards tremendous urbanization in our society. This urbanization is resulting in the very rapid growth of the main population centres. This is a very powerful force that is operating.

In the outlying regions of the country this kind of development creates many new problems, and when deciding on tax policies and regional development policies we must have in mind that these forces are operating. To get balanced regional development there must be incentives in the policies to make it possible for the outlying regions to participate in the economic growth. That is saying a whole lot in a very general way.

Senator Isnor: Those last few words are very encouraging, the reference to incentives.

Dr. Deutsch: That is right. In trying to keep this as a viable natiin, where there are separate political entities that are sovereign in their own right in their own areas, a policy that results simply in the transfer of all the resources to some central places in the country is not a viable one. Therefore, if this is taking place there must be developed processes and incentives to enable those regions to take part in the economic development process in the country, and not simply allow a system to work that brings all the resources to a few relatively small parts of the area. This is just not a viable policy when trying to run a federal nation such as ours.

Senator Isnor: The committee will be making a report later. Would you suggest that they would be justified in saying in their report that greater incentives should be given to the Atlantic provinces and other areas that are less fortunate than the central provinces?

Dr. Deutsch: I do not think I could be specific here. I am not writing the report.

Senator Nichol: You might be!

Dr. Deutsch: I make this general statement. One hears a lot of d scussion about how there might be an equitable and efficient kind of system of, let us say, taxation, and it is said that everything is neutral in this kind of thing. I just take this as an example. These kinds of policies that are so pervasive in their effect cannot be neutral in their effects on what is required in the various parts of the country.

Senator Isnor: Taking the country as a whole?

Dr. Deutsch: Yes, taking the country as a whole. They never have been and never will be.

Senator Isnor: Thank you, Mr. Chairman, I have made my point. I merely ask you to bear it in mind when you are making your report.

The Chairman: We will certainly be reading the proceedings and I am sure we will come across that point again.

Senator Nichol: Dr. Deutsch, I am interested in developing a little further what you were saying about several things. One is our knowledge, which leads directly to the amount of money we spend on economic research compared with scientific research, and its bearing on the question of lags, perhaps, and their identification in different fields.

Making what I admit is a very broad assumption, that it was possible to define goals, we are then always faced with three problems, as I see it: What do we do? When do we do it? What machinery do we have to do it with? Those three questions are interlocked.

What would be your idea of a practical structure, with all your knowledge of our Government and the interoperation of the Department of Finance, the Bank of Canada, the Economic Council of Canada, the Prices and Incomes Commission and, all the rest of it? Putting aside for the moment all the federal-provincial problems—which I guess is pretty daring—what would be your idea, in reasonably hard terms, of the sort of structure we should have to get at this thing?

Dr. Deutsch: First of all, our gathering of both economic and social information is important today. We are still lacking in very important areas in the information available to us and the speed with which we get it. That in itself is not necessarily very difficult. It is just a question of organizing ourselves to gather it. We have a fairly good basic structure in the Dominion Bureau of Statistics, and so on. We need to spend more on it. We need to do a lot more research on just how to collect the information most effectively. That brings me to the next point.

Generally, we have not devoted anything like adequate resources to research in economic and social matters. We have had a tendency to do it in large chunks. Much of the work has been done by royal commissions and such like. We mount a sudden program on a particular problem, spend a lot of money on it, and then drop it and move on to the next item. Then we have another royal commission, with more reports prepared, on one subject. We bring the people together; they disperse; someone puts the documents away, and no one knows where they are.

Senator Nichol: This solves the unemployment problem to some extent.

Dr. Deutsch: Among the scarce experts. You drive up the price and I have to pay higher salaries to the economists in the university. We have very much of a ad hoc system; it is not well co-ordinated or organized. I am making a plea that the collection and analysis of our economic information should be on a much more systematic and regular basis. This can be done by machinery. We have some good basic machinery in the Dominion Bureau of Statistics, and the provincial governments are developing some of their own. This can be built upon.

Secondly, we should be prepared to devote more funds to economic and social research, and generally to such issues, on a regular basis, not on the ad hoc splurge kind of basis on which we have been doing it. Whether the Canada Council, the present body that is used for this purpose, is adequate or not, I am open to other suggestions.

The Chairman: You mean the Economic Council.

Dr. Deutsch: No, the Economic Council is another matter. The Canada Council is the body which, at the moment, is the source of funds for research in the social sciences. It may be that this ought to be part of our science policy. When we come to evolve our science policy, I hope there will be a section of it that will have to do with the social sciences and the support of the

social sciences in a regular way, consistently and systematically. We have not had that in this country. The regular sources have been very limited. They are minor, in most cases. The major sources have been very much on an ad hoc basis, and in a very unorganized way. This could be greatly improved. Without this you are using more resources overall, which could be better used in a systematic way. I hope that this will be part of our science policy, whenever it is formulated.

Senator Cameron: It will.

Dr. Deutsch: I would make a plea in this connection.

Thirdly, we need some more independent analysis of ongoing developments in our economy. We do not have any kind of private analysis and forecasting institution in this country, which most other countries have. We do not have any that I know of, except perhaps a few small ones beginning in some of the universities.

There is room for an institution which is truly independent, not tied to government or to any particular interest, staffed with high quality people, to carry on a continuous analysis of the operation of the economy and attempt to forecast what is likely to happen, as a basis of essential information for governments, private industries and everyone who has to make decisions. This is lacking here. We have bits and pieces of it in some government departments and in some private industries, but there is nothing of an overall nature which has creditability and is completely organized and staffed to do this kind of thing.

I realize that one of the difficulties is to get support for this, but I would hope there could be some way in which, by a combination of some government funds and some private funds, one could get established a body that is independent and competent and that does this on a regular basis. This is a body which I would like very much to see established, in this area of information.

Senator Carter: Are you thinking about an institution that will gather those statistics, or one that would depend on DBS statistics?

Dr. Deutsch: It will use existing information. Some of it will have to be improved, and as this body gets to work it will make many suggestions as to how it could be improved. It will work mainly from information available to it. Basically, it would be an analytical organization, to take the information, analyze it, put it into a form which is useful for decision-makers of the country, on a running basis. It would issue periodic reports, quarterly reports or something like that, on the operations of the economy and its trend, its direction of operation—reports which would be considered to be creditable, objective and reliable. We need this very much. It will take some effort to get it organized, because it needs support. I would not like to see it as a government bureau. I think this would not get the creditability or objectivity which would be required.

Senator Molson: Is there such an institution in other countries?

Dr. Deutsch: Yes, in Europe you find it quite frequently. You find several of this kind—for instance, in Germany, Sweden, and the United Kingdom. These bodies play an important part in the information system of those countries.

Senator Grosart: Was that not the role intended for the Economic Council of Canada?

Dr. Deutsch: Not precisely this. That is a body which is a representative body, not a body of experts. I am thinking here of an expert body. This is not a question of politics; it is a straight analytical problem. This should be staffed by competent experts in the compilation and analysis of information. It would not be concerned with policy recommendations or anything of this kind. This is quite different from the Council, which is very much a policy body, although it does analysis for its own purposes.

You asked me what kind of machinery we need. This would equip us better with the information required, in addition to what government does for itself.

As far as the problem of getting co-ordination inside of government itself, I have come to the conclusion, after observing this for a long time, than in our present organization we have continued to be weak and ineffective at that level. The cabinet does not operate at the present time, and has not in my experience operated, very effectively in this task of co-ordination of policy to achieve consistently our economic and social goals. It just has not. Whether this can be overcome at all, I do not know. I wonder whether it would be worth trying equipping the cabinet with advisory machinery of some kind which would report directly to it, the people in this council of advisers, or some advisory machinery, being charged with the task of an overview of policy as a whole, across the whole spectrum of government. It would constantly monitor this development policy and advise the cabinet regarding the main elements of a properly co-ordinated system of policy in relation to achievement of our goals. It should not consist of people who have line responsibilities of any kind. They should not be people who are delegated from, for example, the Department of Finance, the Department of Agriculture, the Department of Labour and so on. They should be people charged specifically with the over-view task and the co-ordinating task. They should be people who have no line responsibilities or responsibilities to carry out particular functions of any kind.

The Chairman: Would there be any public aspect to their work?

Dr. Deutsch: There are two possibilities here. One is that they should make regular reports which are made public. That is, of course, the situation with the Council of Economic Advisers in the United States. That is one part of their function. Another possibility would simply be that they would be advisers to the cabinet with no public reports. Those are two possibilities.

I myself have a bias here in that I think there should be some public aspect to their work. That is my own view. It would not necessarily be exclusive. There would also be an advisory part to their work as is the case with the Council of Economic Advisers in the United States, who are advisers to the President.

In my view it would be useful to have a public aspect to their work in the form of a public report of some kind, or in the sense of reporting to, for example, dominion-provincial conferences and the like. In that sense it would be public.

I have in mind here the wider debate that would have to take place in Parliament and in society as a whole. Of course, that has attendant difficulties, because in a democratic government the role of the expert as against the political respresentative always leads to difficulties. Whether we are sufficiently mature to live with this remains to be seen, but it is being tried in a number of countries now. Ultimately, we will have to make this kind of thing work if we are seriously interested in getting better performance. Naturally, if we are satisfied to carry on the way we are, that is easy to do, but if we do want better performance, we must be able to adapt our ways of doing things to make this kind of thing possible.

The Chairman: Would these two bodies correlate all the research?

Dr. Deutsch: You mean the private one I mentioned earlier?

The Chairman: Yes.

Dr. Deutsch: No, that is quite a separate thing. I should like to see that as a private organization entirely. It is simply an institute for the analysis of economic developments and the issuance of periodic reports and forecasts of what is happening. It would be for the general use of all decision-makers in society. This other body to which I referred would be part of the governmental machinery.

The Chairman: And that would have available to it all the research that is in government from all departments. It would have the broad ability to go and get the research from, say, the Bank of Canada or the Department of Finance.

Dr. Deutsch: Exactly.

Dr. D. L. McQueen, Study Consultant: Dr. Deutsch, as you know, we have seen a great expansion of the Privy Council office and the Prime Minister's office in the Government in recent years. There are many more competent and skilled people in those offices than there were before, and yet one has not seen the emergence of this kind of distinct advisory body with overview responsibilities on all of our economic policy. We have not seen that emerge, which seems to suggest that there are very strong pressures causing people to get caught up in the run of day-to-day business so that they cannot take this broader view.

Dr. Deutsch: One of the essential conditions I laid down, you will remember, was that they would have no line responsibilities whatever.

Dr. McQueen: Yes. I just wanted to ask you if you say any other way of ensuring that these people were distinct to some degree, independent, and yet in touch with the action. I also wanted to ask you how their functions would relate to those of the Treasury Board, an organization on which you served. They, too, are supposed to have some general over-view of the government operations to see policies as a whole. How do we fit these two groups together?

Dr. Deutsch: Well, the Treasury Board has an overview of the whole program of government expenditures, but its role is primarily to see to it that the resources used are consistent with the decisions the Government has taken to carry out certain policies and to see that the resource used to do that is as efficient as possible. It does not make the decisions about what the total purpose ought to be of all these policies. It does not do that. It never did in my time and so far as I can make out it does not do that now.

The Chairman: As a matter of fact, we had the Treasury Board here a few days ago and asked them just that question—would they be capable, in their judgment, of exercising any function of over-view.

Dr. Deutsch: Over-view function in this sense.

The Chairman: And they said that they would have to refer to the Department of Finance. That was the only agency that they knew of that was capable of exercising this function. Of course there you have a line responsibility.

Dr. Deutsch: There you have many line responsibilities. Their input again would be one of particular kind. That is the trouble with all our organizations here.

Again, the Department of Finance, where I served for many years, in many ways, because of its responsibilities, has more of an overall function than most departments have. But there, too, the primary preoccupation has to do with the raising of the resources needed by the Government. That is a very large preoccupation of that department, quite naturally. That, again, is only one aspect of this problem. The proper co-ordination of our policy does not consist simply in dealing with the problems of the resource raising business. That is only one aspect. It often gets substituted for the overall co-ordination, but it is not true at all, actually.

The problem with our total organization is of this nature, and the trouble, therefore, is that what seems to dominate at any one time is whatever particular problem seems at any particular time to be in the most critical condition, or condition of crisis. The problem in the most critical condition is the one that takes precedence. If at a given time a problem of raising funds or resources seems to be the most worrisome matter, then it gets all the attention. When something else becomes more critical, then the first problem is forgotten as we go on to the next problem. Perhaps the next time it is a problem involving trade, and the time after that it is a problem involving agriculture. There is a tendency, therefore, to focus on the things that have the greatest immediate trouble-making possibilities. But that is quite natural in the political process. By the time you get through dealing with all these issues there is no time left for anything else, usually, and there is no process in the present set-up by which there is an over-view of the total operations of all these processes. Are they consistent? Are they consis-

tent with what our goals are? Furthermore, are they, particularly, consistent with the total resources that are available in the economy to do the various things we are trying to do?

One of the thing that preceded the present difficulties, our present inflationary problems, was the extraordinary increase in government programs which took place after 1965. We had suddenly a tremendous growth in government expenditures. In the five-year period between 1965 and 1970 we doubled expenditures of this kind in Canada.

Senator Grosart: You are speaking now of all governments?

Dr. Deutsch: All governments, yes.

Senator Grosart: Not just the federal Government by itself?

Dr. Deutsch: I am not talking about the federal Government, although it played a good part in this.

Senator Grosart: But much less than the others?

Dr. Deutsch: Much less than the others. Quite clearly the rate at which those programs were growing was going to cause trouble. There was no way in which that rate of growth of expenditures could be carried without causing great difficulty and without producing great pressure on the economy and, in fact, overloading the economy. Yet, program after program was adopted and piled on top of others while this process was going on during that period. There was no overview.

Senator Carter: Should we limit our elections to just two a year?

Dr. Deutsch: You are quite rightly reminding me that political events, and I said this at the beginning, would have required this to be done, perhaps, even if people had understood that this process was going on. But even if this were so, public opinion might learn if we had a process for presenting this properly, and presenting it properly to those who make decisions at all levels. If you have an economy which you are overloading at various periods like this, you are bound to get the kind of results which we have had. And if you do it often enough, you create expectations and developments which become very deep-seated, like these persistent expectations of persistent inflation we are into at the moment. This makes it all the more difficult to deal with the things you want to do when you are being dominated public expectations which are counter to that which you are trying to accomplish. And that is the situation we are in at the moment. I do not know whether the machinery which is responsible for providing a continuing overview of this kind, as a basis of advice for policymaking, particularly inside the government machinery, will be sufficiently effective to make it worthwhile. This is a question which is ultimately political. If political forces are going to dominate regardless of these things, then they take that much longer than we thought to get any results. I would be inclined to think this is a scheme worth trying anyway.

Senator Isnor: You are speaking now only of federal action?

Dr. Deutsch : Yes.

The Chairman: Would this council be organized along Treasury Board lines?

Dr. Deutsch: I would look upon this as an advisory body based on highly competent experts, not political people or even necessarily officials. Preferably they would be people who were independent and who would not necessarily stay in the government indefinitely but would move in and out between government and society. I think we could benefit in this country from a greater degree of movement in and out between government and the academic world and the business world outside. This would be one place and this would be one level where I should like to see that kind of movement take place. This body would consist of a very small group of people, perhaps two, three, four or five, who would be highly competent independent experts, and who would have a reputation in their own right, either because of their work in business, government or the academic world, who would come in for a period of years to take part in this advisory work to the government. As I say, such persons would be asked to come because of their obvious competence to do so. Further, as I have said, they should be people who would move in and out and not stay in the government service necessarily.

This is quite different from the development of the Privy Council set-up which is now taking place. This is quite a different idea.

Senator Grosart: I wonder if it is.

Dr. Deutsch: I want it to be.

Senator Nichol: I suspect a good deal of time is taken up in Cabinet and in the resolution of what you might call "fiscal combat" between ministers and between senior public servants for an ever-increasing share of the money available, because they feel a natural concern about their own responsibilities, and this sort of constant combat between the various organizations of government for money means that any organization such as you describe would have to be very powerful or very close to the centre of power, which is the Prime Minister. This would be necessary in order to fend off the attacks which would be made on it by the existing organization. So for this reason it would have to be almost in the Privy Council office or directly responsible to the Prime Minister.

Dr. Deutsch: It could be made responsible directly to the Prime Minister or to Cabinet as a whole.

Senator Nichol: That is a different thing, and that is why I am asking the question.

Dr. Deutsch: I would prefer to make it responsible to the cabinet as a whole. Of course, it would have to report to some one minister, and that should be the Prime Minister. But, as I say, it would be a body reporting to the cabinet as a whole. It would not simply report to one

man in the cabinet, not even the Prime Minister himself. The Prime Mnister would only be a channel.

The Chairman: It would also have a public role?

Dr. Deutsch: It would also have a public role.

Senator Nichol: Since it had no mechanical authority then, it would not be too suspect by the existing departments.

Dr. Deutsch: No, but it could possibly cause difficulty because the various advisers which the government now has have come from the various particular interest areas in the government and have direct access. This is a problem. While they might have direct access, their advice should not be the only advice. This is a point I would make.

Senator Nichol: It would have to be strong enough that there would not be too many subterranean channels developing around the side of it and underneath it.

Dr. Deutsch: Well, there is no harm in some of this advice getting in, but that should not be the only advice that goes up to cabinet. There was something like this in operation during the war years when the government had, of course, a huge task of policymaking to carry out.

Senator Isnor: Dollar-a-year men.

Dr. Deutsch: Well, I think that was part of the element, but there did develop during that period a very effective co-ordinating machinery which had this kind of relationship to the cabinet. In that case it was manned by people who to a considerable extent had been brought into the Government for the war period from outside, although it was chaired at the time by the Deputy Minister of Finance.

The membership consisted to a considerable extent of people who had recently been brought into the Government for war service from outside, businessmen, academics and experts. It was a very effective body and did a magnificent job of co-ordination during the war.

This is a model which I have seen operate. I was very young. In fact, for a period I was one of the secretaries of it. It had an overview of the whole of economic and fiscal policy during the war period. It made constant reports to the cabinet on the whole posture of economic and social policy at the time. Any major issues that came forward from various departments went through a sieve from the point of view of its overall impact on the total program. Cabinet did not act on any of these matters without reports from this body. It did not always accept those reports, but that was its privilege. This body was dropped after the war.

Senator Nichol: What was the name of that body?

Dr. Deutsch: I forget. The name did not seem to matter very much.

Senator Nichol: We might want to look it up to see how it worked.

Dr. Deutsch: There was not much publicity about it. It had a name such as the Economic Committee, or something like that. It was dropped after the war. I am not too clear as to why it was dropped, but it was dropped because there was a feeling that it represented too great a power on the part of the technocrats.

This is the problem here. That is one reason why I would not like to see this manned by permanent public servants. Also, this kind of apparatus should have fed into it from time to time new experience and competence and it should not become a permanent long-run thing. There should be a flow back and forth, in both the outside world and the Government, of highly competent people who would be willing to play this role for a time.

I am primarily concerned with this very important problem of getting adequate consistency and co-ordination in what governments try to do. Of course, if political events, such as elections, still dominated, then that would be another matter; but it would be hoped that at least the worst features of this kind of short-run decision-making, based on political considerations, could be modified, and perhaps a higher level of understanding, both in the decision-making and public areas, could begin to develop it we are to get better performance.

Senator Cameron: May I preface my question by saying that I am glad to have Dr. Deutsch confirm the pitch that I was making in the Science Policy Committee when I was speaking about the need for an updated and more adequate system of information. How do you see this Council of Economic Advisers relate to a beefed-up research council in the humanities and social sciences? I am thinking of an independent council in this field which would include all the things we have been talking about. What would be the relationship?

Dr. Deutsch: The relationship would simply be that one might be a source of information and analysis for the other. The social science research council would be a research body and it would not necessarily be policy-oriented. This other body would be highly policy-oriented and it would use whatever information it could get from any source, either inside or outside the Government, for the basis of its own decision-making or recommendations.

Senator Cameron: Would you not think that the necessity for this very powerful social sciences research council would be the continuing—

Dr. Deutsch: There could be expressions of concern for areas that need investigation, analysis or research. No doubt there would be an influence from people who have to be given advice as to the kind of information they need, where areas are lacking information, where there is lack of analysis and lack of research. That could be fed back.

Senator Cameron: Could not this council of economic advisers ask an effective social sciences research council to do specific jobs for it?

Dr. Deutsch: That could be done, although, I think there would again have to be independence. The Council of Economic Advisers in the United States has a very small staff, and I would envisage the same thing here. It is directed essentially to the function of policy-making and it is not in itself a research organization, although it

would have some staff. The information gathering, the analysis of basic research, and so on, would be done outside by other bodies which would be financed by the council of economic advisers. It would not be a research council or body in itself. It would have a relatively small staff. It would use the work and information of others. It is modelled very closely on the Council of Economic Advisers in the United States.

Senator Carter: My first question follows along the lines of Senator Cameron's question. Would your body envisage the need of a Prices and Incomes Commission functioning as well, or could these duties be taken over by the new body?

Dr. Deutsch: It depends on what the Prices and Incomes Commission was supposed to do.

Senator Carter: Research.

Dr. Deutsch: If it will merely do research, I would hope that we would have a more generalized research system than that, that we would develop and include social sciences in our science policy and we would have provision for promoting research in all aspects of economic questions. At some time you might want to have a special thing done on prices and incomes. This comes back to the ad hoc thrusts that we go into. Presumably they are going to do a lot of research into prices and incomes. When that is over, they will all go home again and that is an episode gone. I want to get away from this kind of episodic situation. These are problems which are with us all the time, and we should have a much more continuous way of getting the work done that is necessary for policy-making purposes.

Senator Carter: You have laid great stress on the scarcity of information and the slowness in getting that information. When you were Chairman of the Economic Council, did you suffer from that handicap?

Dr. Deutsch: Yes, very much so.

Senator Carter: Has there been any improvement since then?

Dr. Deutsch: We were keenly aware in the Economic Council of this inadequacy of our information. In many of our reports you will find that we drew attention to this and suggested areas where improvement was badly needed. There has been some improvement in recent years, but we are still a long way from doing what is needed.

Senator Carter: I notice in neither your brief nor your opening remarks this afternoon any reference to productivity. Is that an oversight, or do you think it does not have a place here?

Dr. Deutsch: No, I was not addressing myself to that. Of course, we are interested in improving our productivity in Canada. We are now interested in many more matters. The whole question of the use we make of our product, the effect on the quality of life and the environment are all matters that are becoming increasingly important and have an increasing social aspect.

I include the social aspects of our co-ordination of policy, which has to relate itself as much to social as economic goals. I am no longer exclusively concerned with productivity.

Senator Carter: But is productivity not the end product? If we do not increase productivity, what is the use of the rest?

Dr. Deutsch: Increasing productivity is one of our continuing goals, naturally. We should do whatever is necessary as efficiently as possible. However, in doing this we are no longer solely concerned with productivity but with its by-products and effects. This is becoming increasingly part of our concern. In other words, we do not just increase productivity at the expense of destroying our environment or creating social problems in our cities. These must now be inter-related. This brings us back to the problem of co-ordination between our various goals and objectives.

Senator Carter: Are you then in another trade-off relationship?

Dr. Deutsch: Quite right, and they are becoming increasingly of a social nature. This is another task of government. With regard to the whole question of co-ordination, we must reconcile economic and social goals to an increasing extent, not only purely economic goals and trade-offs.

Senator Casgrain: You mentioned the apparatus that is necessary and that it is operating in Sweden, Great Britain and the United States. Does that mean that they communicate with the public and give the information?

Dr. Deutsch: I was thinking of the institutes they have for reviewing the economy on a regular basis and making forecasts and analyses of its operation. That type of institute is quite common in some of the European countries and the United States. The Bureau of Economic Research in New York is one; the Brookings Institute another. Through such organizations the information is usually publicly available.

Senator Lang: I rather took it from your remarks earlier, Dr. Deutsch, that you largely attribute the rather severe inflation we have experienced during the last few years to the rapid increase in Government expenditures post-1965.

Would you also attribute the high degree of unemployment we are now experiencing to the same cause, as an after effect?

Dr. Deutsch: I do not attribute the whole of the present inflationary problem to that. Some of it is due to the influence of the world around us, which we could not wholly escape. This type of inflationary development of the late 'sixties is worldwide, certainly in the Western world. Its presence in the United States in itself has a considerable influence on what happens here.

However, in so far as our domestic developments are concerned, I would say that the very rapid growth of Government expenditures in the late sixties had a great effect on this inflationary development. A combination

of external influences and domestic developments was the major factor. The present unemployment is the result of an attempt to cope with the results of that inflation. By attempting to slow down the economy it was hoped to reduce the degree of inflationary pressure. Indeed, it has been successful to a considerable degree, but it has resulted in quite a heavy volume of unemployment. The best thing, of course, is to avoid in the first place the need to take such steps.

Senator Lang: One would appear to flow from the other though, would it not?

Dr. Deutsch: It is extremely difficult to cope with a rate of inflation with which we are not prepared to live without creating unnecessary and undesirable levels of unemployment, yes. That is why we should always avoid getting into that difficulty. It is necessary to keep an overview of events at all times in order to ensure that we pursue our objectives consistently. This cannot be done if the economy is overloaded in a manner with which it is unable to cope without inflationary results. This is certainly the manner in which Government expenditures developed in the late sixties, which was a major factor in subsequent events.

Senator Burchill: I believe you stated that you would not wish the councils we have been discussing to be bureaux of the Government.

Dr. Deutsch: No, I said the body which I mentioned for collection and analysis of the on-going portions of the economy should be completely independent and not a bureau of the Government.

Senator Burchill: But they would have to be established by the Government, would they not?

Dr. Deutsch: Not necessarily; it could be done by private initiative. It has been done elsewhere.

The Chairman: Would it make much difference if they were established by private initiative?

Dr. Deutsch: I think in this country we would have to have a combination of support from the private sector and the Government. However, if there were sufficient private support, I would prefer it to be operated under private auspices rather than those of the Government.

Senator Burchill: How are such organizations supported in the United States?

Dr. Deutsch: The Bureau of Economic Research is a completely private body, supported by foundations and private industry. It receives some government support through research contracts. The Brookings Institute is a similar body, supported to some extent by regular subscriptions from private customers and governments. Sometimes they get foundation support and things of that kind. This is the type of thing I have in mind. I do not think a thing like this can operate properly as a bureau of the government.

Senator Molson: Dr. Deutsch has in part answered my question. I would like to ask him now if he could enlarge on what he believes are our prospects or our ability to arrange our affairs as we would like to see them, in isolation, considering our international position vis-à-vis both the United States and further afield. What do you think our prospects are of arranging these matters?

Dr. Deutsch: We cannot arrange our affairs in isolation from the world around us, and certainly not in isolation from the United States, with which we have such enormous relationships. I think the volume of goods flowing back and forth across the border is something like $20 billion a year, and the financial and other inter-relationships are equally massive. We are therefore bound to be heavily influenced by what goes on in that country and in what goes on in the world around us, although more so by what goes on in the United States.

It is very hard for us to do a great deal better than they do in the United States. We can perhaps do a little better, but we can also do a great deal worse. The latter is easy to do. Indeed there are many periods when we have done worse. Sometimes we have done better. We can, I think, do a little better with good policy. We must certainly always try to avoid doing a great deal worse. I am talking now particularly about price developments and things like that. This does not necessarily apply to other things.

Many aspects of social policy are matters in which we can do a great deal ourselves. We can have different kinds of policy and different kinds of approach. When you are talking about general effects such as levels of prices and whether export markets are strong or weak, they are bound to be strongly influenced by what happens in the United States and we cannot isolate ourselves from those.

There are possibilities of achieving a somewhat better performance in our economy if we have good policies. We must certainly always be on guard about doing a whole lot worse, which we can easily do. There are many areas of public policy in which we can do our own thing, so to speak, particularly in regard to social policies and things of that kind, and the priorities we have, having our own priorities, where there is scope for doing things the way we want to do them here. There is much room for specific Canadian action. When you talk about general things like price levels and conditions of the export market and so on, these are things where we are heavily dependent on them.

Senator Molson: In employment we are surely very dependent on them.

Dr. Deutsch: As far as employment is affected by exports and price developments abroad.

Senator Molson: Automobile agreements or non-agreements, and a few other things.

Dr. Deutsch: That is right. We cannot isolate ourselves from those effects, but if we are confronted with effects over which we have no control we still have to deal with the problem of how they affect us here. There are various alternatives available and we have to adjust to developments abroad. We still have to make decisions about these things, how to moderate and make these effects as

favourable as possible for our own purposes. That is another question. That does not mean we can isolate ourselves, but we can still do things which will make these effects as favourable to us as possible in all circumstances. This still requires policy and decisions. If there is one decision that is required it is exchange rate policy.

Senator Burchill: Right.

Dr. Deutsch: I have long had the view that in Canada a flexible exchange rate policy is a sensible policy, for reasons such as these.

Senator Laird: Dr. Deutsch, you pointed out the difficulty of arriving at a satisfactory long-term policy under the democratic process. Can you point to any totalitarian state that has really done any better than we have?

Dr. Deutsch: No, I would not suggest for one minute that because of the difficulties that exist in a democratic system, the problem of political decision-making, these decisions are made better in a totalitarian system. My own experience—and I have travelled in these countries—is that we have a far better performance here, in spite of the fact that they presumably have always full employment and all this kind of thing. When they make mistakes they make really big ones—and they make plenty of mistakes, even in economic matters.

Senator Laird: Would this also perhaps be related to the matter raised by Senator Molson of the inevitable influence of international matters?

Dr. Deutsch: They shield themselves more completely than we do. These totalitarian countries generally tend to shield themselves a little more strongly. At least, the big ones do. The smaller ones perhaps not. But they make enormous mistakes, you know, and and when they do occur the upheavals are very great. Take, for example, what happened in Poland last winter. You saw what happened. A whole series of economic mistakes were made in their planning process. There is no way to guarantee completely wise decisions, even under the most highly centralized methods. Surely, experience does not show that you necessarily get it. We have a different way of covering up. Nothing I have ever seen in these countries gives me any confidence that by sheer totalitarian methods, and by complete centralization of decision-making, you can avoid making bad mistakes. There is no way that I have seen.

What you can say about democracy is that it is much more flexible. If it does make mistakes they tend to be much shorter run. We hear about them much sooner, and there is much more reaction. There is more constant assessment of what is being done. The whole system is much more flexible. Even though it may be pursuing short run aims and so on, and be influenced by short run considerations, it is nevertheless a flexible system and a responsive system in a way, even though we may be badgered by the problem of how to get long range approaches.

Ultimately what we have got to do is to get a better understanding on the part of those who influence the decision-makers. The decision-makers themselves, if they happen to be political people, must provide leadership. You will only succeed to the extent that these leaders are given good advice, have good information, and are then prepared to try to convince those on whom they depend for support. I see no other process. All I am saying is that perhaps we can improve this process a bit—and there is certainly room for some improvement. That is the only point I am making.

Senator Bourque: I am very much in favour of your suggestion for an independent committee. I was just wondering if the recommendations of this committee would have any effect on the provinces and the federal government in, say, a conference such as they are now having.

Dr. Deutsch: There may be some aspects of this that would be relevant here, namely the question of carrying out economic and social policy in this country if certain things are done. Of course, this committee would not be a body dealing with constitutional matters; that is another question.

Senator Bourque: You said a while ago that many of these commissions and similar bodies, after their recommendations are made, are put in a pigeon-hole and finished with. Would the committee you have in mind sit regularly?

Dr. Deutsch: Yes, this would be a constant part of the machinery of the cabinet.

Senator Bourque: When they made a recommendation, it would be a non-political recommendation?

Dr. Deutsch: I would hope so, yes.

Senator Bourque: And it would be studies as to the effect of the provinces, on their economic policy?

Dr. Deutsch: This would have to be one of the considerations involved.

Senator Bourque: Thank you.

The Chairman: Dr. Deutsch, in looking at your suggestion of a system for improvements in management of our economy, I wonder if you feel that there should be any change in the operation or objectives of the Economic Council.

Dr. Deutsch: The council has played a different sort of role. It is not part of the direct decision-making process of the government. It is an advisory body which is outside the Government, a completely independent body, concerned with long range economic and social policy.

The Chairman: But it might tie in, in some way.

Dr. Deutsch: It would hope that its work would be a very important input into the decision-making process. If this council of advisers, which I have suggested, is set up inside the cabinet machinery, I would hope the council's work would be a direct input into their considerations. The council was charged particularly with long-range analysis. One of the regrets I have had is that the results of that work have not got into the decision-making processes.

I think of what they should do. The reasons are many. There is quite a number of them here, on the kind of long-range analysis which the council is dealing with, quite basic, social and economic trends and development in other countries and what basic goals would be entailled in this work. It should have a very important influence on the decision making process if it is well done. Unfortunately, this has had much less influence than it should have. It has had influence, obviously in a number of areas, in a number of fields, but not to the extent that it should have. That is partly due to the fact that the machinery we now have is not capable of using it very well.

When you have a series of people concerned with particular functions and particular concerns, they tend to take up those pieces that fit their particular concerns and they will of course accomplish a good deal of success in that. Where there is focus on a particular concern, they can often pick ip up and run with it. When it comes to an overall overview co-ordination aspect, very little has resulted. The machinery does not seem to be capable of utilizing it.

This illustrates the incapacity of the system to look at this from a long-range point of view and from a co-ordinating point of view. That is where the weakness has been. On a particular recommendation about particular things, they have generally picked up; but not in the overall overview and co-ordinated aspects; in the long-range planning aspects, they have been little used.

The Chairman: You feel your council might be an agency by which this could be improved?

Dr. Deutsch: That is right. The council itself could not do this work; it would be a relatively small body with a small staff. It would take as input everything relative to its work, including, of course, if the Economic Council continues its work of analysis and long-range analysis. This would be a very important input into this body, as well as inputs from everywhere else.

The Chairman: Dr. Giersch, when he was here, explained that the German Economic Council tables its report in the German Parliament, and within so many days the government must indicate its reaction to the report and what it proposes to do about the recommendations therein. Do you think that would be a useful departure in Canadian policy?

Dr. Deutsch: In the case of the council itself, we did have a recommendation about earlier reports. We recommended a process by which there would be regular parliamentary hearings once a year, say in the fall, on the state of the economy, prior to the time governments start making their budgets. We also recommended committees of parliament, I think a joint committee of the Senate and the House of Commons, and that one of the things to come before that committee every year would be the Economic Council report. It would go through it and make recommendations. This has never been done. The report would be highlighted and brought to the attention of legislators, the government and the public. Other things could come before these committees, from other sources. This would be one of the committees. To an extent we copied this from Dr. Knowles' practice in Washington. This sort of thing would be very desirable.

I am coming back to my last point in my own little brief, that we need more of this kind of activity.

The Chairman: He goes even further, that the government has to react.

Dr. Deutsch: That is an interesting idea. I notice Dr. Knowles says their government does not have to react.

Dr. Knowles: The committee does not have to. The government must file a report by a certain date, and our committee must react to that.

Dr. Deutsch: He was arguing that the government has to react. I have not thought of this before, but if you set up this internal advisory body attached to the cabinet, it might be that if it makes public reports, the government should react to those. This might be a good device.

Senator Isnor: Would it not have the same effect as the White Paper?

The Chairman: I think we will leave that question just for the moment, senator.

Dr. Deutsch: I am putting this out on what I consider to be a grave deficiency in the present Senate. If we are serious about getting better results in employment and prices, and so on, I do not have any faith in formulas and gimmicks. These things are not going to be solved by some device like compulsory price and wage controls, guideline policy or formula. These are just gimmicks and they do not deal with the basic problems. They are often presented as a solution to the problems. There are not such solutions through gimmicks of this kind. They do not deal with the fundamental issues or processes involved. Price and wage control is a rigid device and, in the first place, it is highly improbable that it can be operated administratively. Secondly, it would produce a rigidity upon the whole society which no democratic society would tolerate. Im this sense, it is a gimmick which evades the issues.

Having said that, however, there are many policies that could make the economy work better. There is no question about that. There are policies that could be used to reduce its rigidities, to make the market system work more smoothly, to avoid the various kinds of imperfections in the system. There are many things that could improve that. I assume we should be working on these all the time. I was merely addressing myself to these basic policies that affect the operation of the system as a whole. Whether we can achieve full employment, have reasonable price stability and a sound balance of payments and so on are the large, basic policies about which we still have to make decisions. We have to operate them in relation to society and an economy which can remain flexible and can react to the wishes of our society and can support a free system.

If you want to do that, then stay away from gimmicks like price and wage controls, which will create an entirely different kind of society, if we really impose it as the chief method by which we solve our problems.

Senator Nichol: Dr. Deutsch, the question of wage and price controls has been given much publicity on television and radio and in the press as the solution to all our problems. Apparently we can have full employment, low interest rates, price and wage controls and no inflation, all at once.

Dr. Deutsch: You would live in a prison, if you did that.

Senator Nichol: Another wide-ranging debate we have had here is whether or not you can have a tolerable level of inflation. If by policy you opt for a certain level of inflation, pre-announced as acceptable by the Government, will this automatically escalate and become a run-away inflation? John Young was most emphatic in his words about that danger, but we have had other equally eminent economists say that we should not fuss too much about it. Can you comment on that?

Dr. Deutsch: A moderate rate of inflation does not necessarily result in run-away inflation. This has been shown by the experience of the last twenty years. There have been long periods in countries like Sweden and Japan where the rates of price increases have been running at 4 and 5 per cent a year, year after year on the average. This has not resulted in the kind of run-away inflation you are referring to.

If you ask me whether it is desirable to have this 4 or 5 per cent increase, then that is another matter. The reasonable stability of prices is the most desirable goal, because if you have continuously rising prices at a rate of 4, 5 or 6 per cent per year, you create many inequities in our society. These are undesirable. Whether those inequities are worse than you would have if the alternative were 10 per cent unemployment, for example, is something I would have some views about. I might say that I would sooner have the inequities that flow from a 4 or 5 per cent increase than the inequities that flow from 10 per cent unemployment, but I would have to make the choice. It is not a completely black-and-white proposition. It depends on the price you have to pay to get the rate of inflation you are going to live with.

Personally, I would hope that we could do better than a rate of inflation which creates those kinds of inequities and also at the same time could have reasonably full employment. That at least ought to be our goal. We should try to get as close to that goal as we can. In the process we might have to accept various trade-offs because we have no alternatives. In the first place, if the rest of the world outside is inflating at 4 or 5 per cent a year, particularly in the United States, then we are going to have a very hard time doing much better than that. We might be able to do a little better, by keeping a flexible exchange rate and letting our exchange rate appreciate. But that creates other problems.

Surely, if the United States has a 4 or 5 per cent inflation, and the world around us has the same, we are going to have a very hard time avoiding the effects of that. We may have to live with it, and, presumably, we would then try to off-set some of the inequitable effects by other things, such as adjusting our welfare payments and that sort of thing. If by that method we were able to achieve a better level of employment, then we might find that as the best trade-off we could get.

On the other hand, if the rate of inflation is very high, then we might decide that we have to try to modify it by reducing our rate of growth somewhat, and we would have to accept that as a good trade-off.

It seems to me that there is not any absolute number of relationships. It depends upon the circumstances you find yourself in—what trade-off you find most reasonable in the circumstances. There is no hard-and-fast formula.

I do not think the 3, 4 or 5 per cent increase in prices, if that is the kind of world we live in, will necessarily result in a run-away situation. It would bring certain inequities where other social policies would have to be followed in order to correct. If it enables you to get reasonably full employment and that is the only way that you are so enabled, then you might well pick that as being a tolerable set of objectives.

The Chairman: But you would introduce your expectation problem then, would you not?

Dr. Deutsch: Yes, you have your expectation problem. You just have to live with it.

The Chairman: You just live with it?

Dr. Deutsch: As best you can. You would have to. This is not the ideal situation. I would prefer to get a more moderate rate of increased inflation and have full employment too. I say that if the world around me is engaged in a price development of that other nature which influences me very strongly, then if I try to offset that I might have to do so at a rate of unemployment that I am not too willing to buy.

Senator Nichol: Dr. Deutsch, when Dr. Young was here we had quite a discussion about the broad field of incomes policy, ranging all the way from job owning down to a firm price-wage control system. He spoke with some interest about a policy that lies partway through that spectrum, by which the Government applies muscle to various groups within society that are out of line in performance, in terms of inflation. He suggested, for instance, that the Government might go to a corporation that was going to raise its prices and say, "Look, if you raise your prices we are going to lift the tariff on your product." This type of muscle is what he was referring to. How do you feel about that kind of thing?

Dr. Deutsch: Tariff is a matter of government policy. That was not set down by the Medes and the Persians. This is a government policy. If the policy is wrong, it can be changed. There is nothing sacred about it. The Government may have to do a number of things to make the economy or the price system work better. There may be rigidities in the system. There may be a tax or there may be a tariff or there may be some other policy of Government that contributes to price raising. Sure, the Government can change that. I think if it was sensible it would do this wherever it was necessary to make the price system work better. I see nothing wrong with that. The tariff in the first place is a government policy. It is not a sacred thing, you know.

Senator Nichol: It is not sacred to me as a British Columbian.

Dr. Deutsch: If it produces the wrong effect or if it is inconsistent with some other policy, then it should be adjusted. That is not a strong-arm method at all. That is simply seeing that government policy is producing the effects you are seeking to produce. That is all. If the policy is not achieving those objectives, you should change it, including tariffs, as they are simply another aspect of government policy.

Senator Carter: Dealing with the very important aspect of psychological factors and the importance of attitudes, I think in reply to Senator Lang you said that we could not isolate ourselves from what is happening in the outside world. But you get this psychological attitude when you start to decide which is the lesser of two evils; whether unemployment is the lesser or whether inflation is the lesser. Which one you choose depends upon circumstances. But out of this comes the sort of psychological thinking where people will say that inflation is not bad because everybody has inflation, so our marketing position is not going to deteriorate by virtue of inflation so let us have more and more inflation. I would like to get your opinion on that kind of thinking.

Dr. Deutsch: The last part of your question bothers me where you say, "Let us have more and more inflation." I have not said that.

Senator Carter: No, I am not saying you said it, but in working out wages and in working out your trade-off, you get this type of thinking. The brake on inflation is the ultimate argument. It is said that if we have too much inflation we price ourselves out of the market but at the same time people are prepared to neutralize that by saying that other countries have inflation as well. So because of that we can ignore it to some extent. Now, to what extent should we ignore that?

Dr. Deutsch: I do not think we should proceed on a policy which counts on a high rate of inflation in the rest of the world and float ourselves off. I think that would be a foolish attitude. The most I have said is that we will be influenced by what goes on around us, and we may not be able to offset completely what goes on around us. If the United States and other countries are having 3 per cent or 4 per cent or 5 per cent inflation, we may not be able to offset the effects of that on us without a very large degree of unemployment, a higher rate than we are willing to accept, and then we have to decide which is the lesser of the evils here. We live with what we cannot offset, and get a better level of employment than by trying to offset it and then having to accept a higher level of unemployment.

That is the kind of choice we have to make very often. That is why we may have to accept the influences of outside inflation rather than accept the very high rates of unemployment we would have to have to offset them. This is the kind of choice you have to make sometimes. That is quite different from saying, "Let us deliberately inflate because the other fellows are going to inflate as well."

Senator Carter: But you would deliberately choose inflation rather than unemployment, because you figure the inflation in other countries will offset the bad effect?

Dr. Deutsch: No, I started the other way around. I say that the other countries are inflating and we did not start the process. But we are influenced by what is going on around us and we have to decide whether we want to accept the degree of unemployment involved in trying to offset those effects. We may decide that certain levels of unemployment are not acceptable, in considering the relative evils as between 3 per cent, or 4 per cent or 5 per cent increase in prices and the higher level of unemployment. We have to see if the lesser evil is in favour of unemployment. This is the kind of decision we may have to make. Insofar as it is possible for us to moderate these influences with a flexible exchange rate and things of that kind, of course I would make those effects as slight as possible. But I do not think it would be wise to say come hell or high water if there is 3 per cent or 4 per cent or 5 per cent inflation in the United States, we in Canada are going to have zero, and if it takes 10 per cent unemployment to do that, then we will accept 10 per cent unemployment. I do not think that is a good policy.

Senator Carter: I agree with you. But I was just wondering whether you would say, "Well, take that 10 per cent inflation in our market because by the time we take it here, they will have another point inflation somewhere else."

Dr. Deutsch: You mean you are guessing that they will have?

Senator Carter: No, but this is one of the psychological factors. It enters into the choice where you want to choose to come down on the side of inflation as the lesser of two evils.

Dr. Deutsch: You have to be sensible here. You do not go on a basis that will make your problem worse. You are reacting to a situation over which you do not have enough control, and so you yourself contribute to it. This does not make too much sense to me.

Senator Carter: It does not to me either.

Senator Isnor: I notice the hour is rather late and Dr. Deutsch has answered every question put to him. The one I want to ask him, I do not think he can answer.

Dr. Deutsch: There are many questions I cannot answer.

Senator Isnor: How long have we to wait for the economy to adjust itself?

Dr. Deutsch: This present situation, you mean?

Senator Isnor: Yes.

Dr. Deutsch: I think the single most important development would be the course of the economy in the United States. Also I think the combination of fiscal and monetary policy which will now be put into effect and pursued is important. An important event will happen in a day or two from now. Of course, it will take anywhere from a

year to 18 months to get the economy back to levels which we consider reasonably satisfactory, at least, and that will be good going. Whether we will have the level of unemployment at the end of that time that will be acceptable is a problem, and even then we will have difficulty because our labour force is growing very rapidly. I think it will be longer than that before we can get the level of unemployment down to what we would consider to be satisfactory.

Senator Burchill: Dr. Deutsch, do you think that we would have to live for a long time as exporters with a high dollar value in our foreign exchange? As you know, that is one factor which contributes greatly to unemployment in our part of the country and, indeed, all over the country.

Dr. Deutsch: Yes. The high value of the dollar has a very big effect on certain important export industries. Again, if the dollar were to decline in value, the condition of those industries would improve and this would help the employment problem that we are talking about. I have no idea what the dollar will do. It is influenced by many things happening around the world, which I do not think anybody can foresee.

The Chairman: You talk about the fallacy of the short-run and fine tuning approach. You say that the levers of Government policy must be used with a much longer range perspective than has been the case in the past. Are there areas where we should be using short-range stabilization policies, or do you believe that it should all be left to the long-range approach?

Dr. Deutsch: There will be fluctuations in the whole field of stabilization and long-range approach.

The Chairman: There may be some that you will not tolerate.

Dr. Deutsch: Yes. There may be certain things that may affect our financial arrangements with the United States, the flow of funds with which you have to deal from day to day. With the long-range approach, you do not worry about some of the short-run fluctuations.

The Chairman: Suppose the trade-off gets bad on the short-range basis?

Dr. Deutsch: There may be emergency situations with what we have to deal as special situations; but generally speaking you do not worry too much about short-run movements if you have a long-range approach and a long-range policy. You have to let the short-range fluctuations go on. You start to get into trouble when you start interfering with those, because most of the time you do not know where you are, anyway.

The Chairman: Would you classify yourself as a monetarist?

Dr. Deutsch: Not in the extreme sense. However, I do believe that money is important in inflation, because, after all, in the end result inflation is a monetary phenomenon. It cannot be anything else. What else can it be? It has to do with money in relation to goods. Therefore, the quantity of money and the rate at which it grows has obviously an important bearing on the subject. But I am not one who says that all policies can be solved by fixing a rate of expansion of money supply. It is much more complex than that. There has to be proper relationship to the fiscal policy.

The Chairman: Would you vary the rate of expansion of the money supply?

Dr. Deutsch: No. If you look at our money supply you see very wide fluctuations. This kind of thing is not what I mean by long-range policy. The money supply should be related to the supply of money appropriate to the growth rate of the economy over a longer period. That should be the basic decision. That does not mean to say that you fix a formula and every morning you crank out this thing according to that formula. There are market movements from day to day which have to be taken into consideration; but as you move along you keep your eye on your longer range needs for money supply.

The Chairman: If your longer range planning got out of whack and started involving you in short-range difficulties, what would you do?

Dr. Deutsch: I would tend to live with them to a much greater extent than has been done. It is precisely because you try to counter them that you get into difficulties. I would live with them to a much greater extent than seems to be the case. I would stick to my longer range perspective much more fully. We have been expending money supplies 10, 15 per cent. Keep that up a little longer and I can tell you what will happen in 1973 or 1974. There is no great secret about what will happen if we keep this up. This is what I mean, the idea that the money supply can be expanded to keep the interest down. I am very interested in Dr. Knowles' remarks. He gave a perfect answer and a splendid analysis of what happens.

Senator Nichol: The bathtub analysis.

Dr. Deutsch: That is right.

Senator Molson: The big bathtub.

Dr. Deutsch: We have been caught in this short-run business by attempting to control the interest rates on the short term. We have flooded the system with credit and finally discovered we have really raised the interest rates every time. This is what I mean by these short-run thrusts that take place in an attempt to achieve short-run goals, which either are irrelevant or cannot be achieved. We will have to live with larger short-run fluctuations and keep our eyes on the longer range goals.

Senator Nichol: Over the past few years we have seen, Dr. Deutsch, recurring international financial crises of various sizes. During that period the American gold supply has been dropping and is down now I believe to $8 billion. There is now a very expansionary monetary policy in the United States. They still have the Vietnam war and other countries around the world are backing off the Bretton Woods Agreement. How do you think this will resolve itself? Some consider it to be a very ominous cloud on the horizon. Do you see it that way?

Dr. Deutsch: Yes, I think it is a serious concern. We have now vast sums of Eurodollars which can move in a massive way from one market to another, depending upon differences in interest rates, attitudes of people, expectations and so on. This will be an unsettling influence in the kind of world we will be living in.

How we can ultimately deal with this, I do not know. One step we have taken is to move to the flexible exchange rate, which helps a little. The Germans and Dutch are now using it. It may be that we will have to move to a more flexible system of exchange, maybe not a completely floating rate, but a more flexible system.

Another step that would help would be for the United States to achieve a better position for its balance of payments. This constantly adds to the supply of Eurodollars, which is now very large and moves easily from one place to the next on the basis of interest rate differences. You can see what would happen in the event of serious differences in the state of the economy between, for instance, Western Europe and the United States, with one trying to follow high interest rates and the other low. This stuff moves around in great quantity. This adds a source of instability to the international world in which we live.

Senator Nichol: This affects us as a trading nation.

Dr. Deutsch: Yes. Some of the things we have to watch very carefully are our own exchange policy and our interest-rate policy in relation to the rest of the world. We can easily get flooded one way or the other with this great supply of liquid funds that are now in the system. This is a source of instability, and we must keep very flexible in this regard. How we are going to solve that problem is not a happy prospect.

The Chairman: Honourable senators, we are very close to the end of these hearings. Dr. Deutsch, who was purposely put in this slot, winds up the input. Tomorrow we hear from Dr. Rasminsky, and then on June 29 we hear Mr. Benson and Mr. Reisman on their reaction to some of the things we have heard.

Dr. Deutsch, we thank you very much for taking the time from what we know to be an extremely busy schedule to give us the benefit of your very valued advise. We are especially thankful to you for dealing with the queston of the machinery needed to accomplish what we want to accomplish.

As honourable senators know, Dr. Deutsch was the economic adviser to the Special Senate Committee on Manpower and Employment. That was, I believe, one of the better reports that the Senate put out. In fact, I understand that it was an outstanding report, which Dr. Deutsch was largely instrumental in writing. I only hope that in writing out report we can in some way live up to the standard you have set, Dr. Deutsch. Thank you very much.

Dr. Deutsch: Thank you, sir.

The committee adjourned.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 21

THURSDAY JUNE 17, 1971

Eighteenth Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses and Appendix—See Minutes of Proceedings)

23920—1

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Kinley
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
Gélinas	O'Leary
Grosart	Paterson
Hays	Phillips
Isnor	Sparrow
	Walker—(27).

(Quorum 7)

**Ex officio Member*

Orders of Reference

Extract from the Minutes of Proceedings of Wednesday, March 17th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—
The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Wednesday, April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates laid before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of Proceedings of Tuesday, May 4, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relation thereto.

The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

23920—1½

Minutes of Proceedings

Thursday, June 17, 1971.
(21)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 9.30 a.m. to consider the Question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Benidickson, Desruisseaux, Flynn, Gelinas, Grosart, Isnor, Laird, Methot, Molson, Nichol and Paterson—(13).

Also present but not of the Committee: The Honourable Senators Burchill, Carter, Casgrain, Lafond, McGrand, McNamara, Rattenbury, Smith and Sullivan —(9).

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics; Dr. David McQueen, Economic Consultant; Mr. William H. Neville, Editorial Writer.

Witnesses heard:

Bank of Canada:

Mr. Louis Rasminsky, Governor;
Mr. J. R. Beattie, Deputy Governor;
Mr. G. V. Bouey, Deputy Governor;
Mr. B. J. Drabble, Adviser.

It was *agreed* to print as an appendix to these proceedings the Brief received from the Bank of Canada.

At 12.55 p.m. the Committee adjourned to Tuesday, June 29, 1971.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Thursday, June 17, 1971

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 9.30 a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, we will resume our hearings on the subject of growth, employment and price stability. We are delighted today to have with us the Governor of the Bank of Canada, Mr. Louis Rasminsky. On his right are Mr. J. R. Beattie, the Senior Deputy Governor; Mr. G. K. Bouey, Deputy Governor; and Mr. B. J. Drabble, Adviser to the Governor.

You have before you the submission filed by the Bank of Canada. I will just comment on it briefly. As I just told the Governor, I think it is an excellent submission. In a way it surprised me because it deals with many of the issues that have been raised by the witnesses who have appeared before us in the course of these hearings.

As honourable senators will know from reading the brief, it opens with a general statement of policy and then goes on later, under headings of the issues that have been raised, to give the reaction of the Bank of Canada to those issues.

I believe Governor Rasminsky has an opening statement, and since there will be many questions on the brief I will ask him to proceed with his opening statement now.

Mr. Louis Rasminsky, Governor, Bank of Canada: Thank you very much, Mr. Chairman and honourable senators. I should like to express my gratitude for what you have said about our brief. We have tried to make it responsive to the preoccupations of the committee, and of course we have followed very carefully the evidence that you have heard over these last weeks, not only because of the inherent interest of the evidence itself but also in an effort to see what we ourselves could learn from it in regard to our own responsibilities.

We certainly feel in the bank that we need all the help that we can get from every source. We do not feel that we know the answers. We are pretty convinced that there are no easy solutions to the extremely difficult problems which this committee is trying to grapple with.

If I may do so without being presumptuous, I should like to say how useful a task I think has been undertaken by this committee. I do not suppose that there is any issue in western industrial societies that is more challenging or more important than the issue you have undertaken to study and report upon—the issue of how we can improve our techniques, our procedures and our policies in an effort to reach the two objectives of full potential growth and employment without inflation. No country in the world has yet succeeded in doing that just as no country in the world, unfortunately, has found a method of bringing a sustained period of inflation to an end without pain.

It is true that we have come a long way over the past 25 years since the end of the war in our knowledge of how to use economic instruments to try to regulate the economy and achieve maximum growth and to avoid serious recession. For we have in fact avoided major setbacks, although it is obvious that the present performance of the economy is not satisfactory, and it involves a degree of unemployment which everyone would regard as unacceptable. And this notwithstanding the fact that even during this last year or two the economy has continued to grow. It has grown at an inadequate rate, but nevertheless it has grown a little over 3 per cent per year last year and perhaps currently it is somewhat higher. It is a performance which compares very favourably with the performance in the United States. But this is below our potential for growth and therefore it is unsatisfactory.

There is one thing I would like to stress since I have the opportunity of appearing before honourable senators, and that is that we in the Bank attach the greatest importance to the objective of attaining full potential growth, or attaining full employment, if you want to call it that. It may seem odd that I should feel it desirable or necessary to make that statement, but I am well aware that the Bank is sometimes thought of as having a single-minded dedication to the goal of price stability and little concern with the great human misfortune of unemployment. This is simply not true. We are greatly concerned. If there is, in fact, any difference in this respect between us and some others, it is a difference of time perspective. We take the view that this country is going to be here for some time, and that our chances of achieving sustained growth and a sustained increase in employment will be considerably greater if we can manage to achieve a reasonable degree of stability in the value of money at the same time.

I do not intend to ring the changes on the dangers of inflation or the ways in which inflation militates against sustained economic growth, and we have not

tried to do that in the brief. I have done it in my annual reports and in my public speeches, and it is part of your own thinking which is incorporated in your terms of reference. Besides, it may seem odd to appear to be belabouring the point about the importance of reasonable price stability at a time when the unemployment rate is in excess of 6 per cent, and in the forefront of everyone's preoccupation.

I know there is some feeling too that our concern to moderate the rate of inflation that was worrying not only ourselves but everybody else a couple of years ago when it reached levels of 5 per cent or so—led us to choose the wrong trade-off in that if we had been less concerned about inflation at that time we would have had less unemployment at the present time. Now, you have heard a fair amount in these hearings about the Phillips curve which suggests there is a direct relationship between the unemployment rate and the rate of inflation, and this Phillips curve theory almost invites the viewer to reach the conclusion that you can deliberately choose to have a higher rate of inflation over time in order to have a lower rate of unemployment. I believe this is a completely unrealistic view because it is completely static and takes no account of the reaction of people to inflation once they are convinced that it is here to stay. I shall have something more to say about this later when I refer to one of the leading ideas put before your committee by several distinguished witnesses who advised that the way out of our dilemma is to concentrate on the employment goal, and if that leads to inflation, then to learn to live with inflation.

I would like to say right now that if I thought that by being willing to accept a higher rate of inflation we could in fact obtain lower levels of unemployment and high growth rates on a sustained basis, I would be prepared to accept this and recommend that we do what we can to see that people were equitably protected against the evils of inflation. I would not allow any preference for price stability to stand in the way of my making this recommendation. But I do not think this is or ever has been a realistic choice, one that we are ever confronted with except for relatively short periods of time. The problem is that once an inflation rate gets established, as ours was getting established in the late 1960s, people naturally count on its continuing and allow for it in all their transactions. This expectation of continued inflation gets incorporated into business pricing decisions, into interest rates, into age and salary negotiations and this inevitably has the effect of pushing prices up. Now unless you are prepared to see this go on year after year, with all the inequities, the distortions, the speculations and the risk of ultimate breakdown that this involves, you have to draw the line somewhere. You gain nothing in terms of increased employment over any appreciable period of time by not trying to bring inflation under control while it is still moderate.

Now, if I can go back to our brief, the first half or so tries to set out the role of monetary policy and fiscal policy as the broad levers of the economy that have an influence on aggregate demand, on spending in the economy and, through its influence on spending, on the level of activity. I do not think it is necessary for me to try to summarize this part of the brief, but I will remind you that monetary policy exerts its influence on the total level of spending by the way it can affect credit conditions, that is the cost and availability of money. Fiscal policy, which of course can be more selective and more purposefully directed towards particular objectives, that is to sectoral objectives or other particular objectives, can be more pinpointed than monetary policy, but it exercises its broad influence on spending through changes in tax revenues and government expenditures including, of course, the important lending activities of the government such as CMHC.

The two policies, that is to say fiscal policy and monetary policy, are closely interrelated, particularly through the fact that the government's fiscal position determines how much borrowing it has to do and how much new public debt it has to issue from time to time. And this taken in conjunction with the way the public debt is managed, that is to say the characteristics of issues offered whether for short-term or long-term, has an important influence on the liquidity of the banking system which would be more inclined to take up short-term issues, on the money supply and on credit conditions. So, honourable senators, it is obvious from what I have said that it is necessary for fiscal policy and monetary policy, which are so closely related, to be closely co-ordinated with each other.

If I may turn now to monetary policy, there are two general remarks that I should like to make about monetary policy. After I have done so, I propose to say something about the problems, the constraints involved in using demand policies generally in the effort to exercise some degree of regulation over the economy.

On the face of it, one would think that monetary policy is an extremely powerful instrument, since there is no technical limit to the extent to which the central bank is able to go in tightening credit conditions or in making credit conditions easier. But in actual practice, monetary policy is subject to a number of very important constraints, and we refer to them in our submission.

One of these constraints—an extremely important one in an economy like Canada, which is so open and whose economic activity is to such a substantial extent affected by its trade relationships, as well as financial and investment relationships with the rest of the world—is the level of interest rates outside Canada. If interest rates outside Canada, particularly in the United States, are low in relation to Canadian rates, it will tend to make Canadian securities attractive for foreign investors, and will tend to bring capital into Canada.

This can have one or both of two consequences. If capital is attracted by a relatively high level of interest rates in Canada, by comparison with rates outside Canada, it would have the effect of adding to our exchange reserves, if we are on a fixed exchange rate. This in turn has certain consequences so far as Government finance is concerned, since Government has to use cash resources, either what it has in the till or what it

has to borrow, to pay for additions to our reserves. If Government does not do that, or if we are on a floating rate, the attraction of foreign capital has the effect of bringing upward pressure to bear on the value of the Canadian dollar.

This is a constraint on monetary policy. Obviously if our interest rates are too low in relation to external rates, the opposite consequences then take place. There is loss of reserves or downward pressure on the Canadian dollar, and depending on the circumstances this too can be a constraint on our policy.

If the central bank is, for this reason or for other reasons, limited in the extent to which it can permit interest rates to rise or fall, it means that the central bank cannot exert complete control over the size of the banking system, or, in other words, over the money supply.

If the credit demands of the community, including governments, are very large, this tends to push up interest rates; and if for reasons relating to the exchange position or to the domestic economy this seems undesirable, the only alternative that the central bank has in carrying out its functions is to permit the banking system or the money supply to expand more rapidly.

I should like to refer now to one or two problems connected with the use of monetary and fiscal policies as regulators of the economy. Unfortunately—and you have heard this from other witnesses, with whom I agree—these policies cannot be used to fine tune the economy in an effort to obtain precise targets, certainly in an effort to obtain precise targets with regard to those things which we are most anxious to influence, namely the level of output and unemployment.

This is an obvious source of difficulty in view of the increasingly ambitious and precise targets that the community has set itself for economic performance.

There are two major sources of difficulty in using these instruments for fine tuning. One is that they operate with lags, and the other is that policy is essentially forward looking.

We are learning more and more about the lags with which they operate. However, they are not precisely known. It appears that they are not even constant, that the lags vary from time to time.

While they operate with varying lags, these policies always have to take into account the immediate situation—in some cases the lags are relatively short, and normally monetary policy would have some influence on interest rates, particularly short-term interest rates without a very long lag. However, since some of the lags are long, in trying to operate your policies you not only have to take into account the immediate situation, but you have also to form a judgment on what the situation is going to be during the period of the lag while these policies that you initiate are taking effect.

In other words, it is an essential part of the operation of these policies that you have to make some sort of forecast. You have to form some judgment on what the economic situation is going to be a year or a couple of years ahead.

We have made considerable progress in the business of economic forecasting, but we still have a long way to go. Even our information with respect to the current economic situation is somewhat out of date. Considerable improvement has been made by the Dominion Bureau of Statistics in the timeliness of their figures. I believe the bureau should be given all the support possible to improve that timeliness and continue as they have been doing to improve the quality of their information. It is the case, nonetheless, that a period of six weeks elapses before we have the first tentative fix issued by the bureau as to what the big measure of economic performance, as embodied in the gross national product, has been. Then we know that these figures may later be subject to very considerable revision.

This means in a sense that when we come to forecasting the first thing to do is backcast. A judgment must be formed as to the actual starting point of the forecast. Then we must go through the difficult exercise of predicting the course of economic activity, not only in Canada, but also—a standard and necessary part of our forecasting here—the course of economic activity in the United States. A view must be formed as to what the reaction of consumers, producers and governments will be to economic developments as they unfold. This sounds rather discouraging, I know. However, I am not discouraged; I think that we have made considerable improvement in our methods of forecasting, including the use of econometric techniques. I am confident that we will see a steady improvement, both in our knowledge of lags and our ability to make tolerably accurate forecasts. In the bank we are devoting a good deal of effort to this and, of course, a great deal of work, which we follow closely, is also being done outside.

Another problem, or constraint if you like on the use of demand management policies as regulators of the economy, is that basically these policies are designed or oriented towards use in a competitive market economy. In fact, it is one of the advantages of these policies that their regulation effect is general and they leave the maximum possible scope for private decision-making as to what is produced and consumed. In the determination of prices they exercise their influence more generally on the level of activity and on the general trend of prices in a way that is consistent with a high degree of economic freedom.

However, it is the case that our economic system is not as fully competitive as all that. In some respects situations do arise from time to time in which particular groups in the economy are able to use market power in ways that seem to produce some inflation. This is so even when the economy is not operating under a full head of steam. They also help inflation to persist when steps have been taken to moderate the increase in demand. The conclusion reached from this is that it is clearly necessary to enforce competition policies and other anti-monopoly policies vigorously.

Apart from this, there may be room for some innovations in the field of preventing the misuse of market power. I should say right away, however, that this is a field in which I am far from being an expert. I am very

much aware of the difficulties in making specific recommendations.

I know also that there has been much discussion before your committee with regard to voluntary agreements and guidelines. I know that most people think that the experience of other countries has not been encouraging and that our own experience with the Prices and Incomes Commission has not been particularly successful.

At the same time, it seems to me and I make this simply as a general statement without being prepared to elaborate on what the technique could be, that in the effort to achieve full employment without inflation we badly need some mechanism for bringing the public interest to bear in the process of price and wage determination.

Looking over the proceedings of your committee and, of course, on account of the lapse in time I have not had an opportunity to see all the evidence, we have picked out in the brief four particular matters on which to comment. One is the proposal made by several of your witnesses who were impressed, as we have been impressed, by the rather wide swings that have taken place in the money supply in Canada and, indeed, in other countries, from time to time under a discretionary monetary policy. One strand of thought that has been put before you is the suggestion that this country should follow a simple money supply rule. This would mean managing our affairs with the money supply increasing year by year at a constant rate which would be more or less commensurate with our potential for real growth. There would perhaps be a modest allowance for an upcreep in prices of perhaps 2 per cent per year.

When I have commented on this I would like, if you will permit me, to summarize the main alternative views of how demand management itself should be considered. The first comment I would like to make with regard to the proposal for a money supply rule is that if I could convince myself that it was a good thing for Canada and would produce the results sought, I would be at the head of the queue in advocating it. It would greatly simplify the life of the central bank. The money machine would be put on automatic pilot, we would go ahead and do the other things that had to be done. We might even have more time to do things that we really wished to do than we now have under a discretionary system. You could be sure that when things went wrong the fault was not to be found in monetary policy; you would have to look somewhere else for the trouble, because you were operating according to the rule.

There are a number of problems connected with this rule. The first one is that the rule is not very precise, and it has not been made very precise by those who have advocated it. They have not really defined what they mean by the money supply, which should be stabilized, and to my way of thinking a great deal would hinge on this; at least, it would make quite a difference what money supply figure you chose to stabilize the growth of. We keep track of various monetary aggregates in the Bank of Canada. Let me mention two or three of them. Money supply as normally defined by the Americans means currency and demands deposits; that is transaction balances, or, to demonstrate that I am familiar with the technical verbiage, M1.

Senator Grosart: Is that what they call the money supply in a narrow sense?

Mr. Rasminsky: That is right, senator, that is money supply in the narrow sense. That is one figure. Another figure is a broader definition of money supply, which would include not only demand deposits, but other claims on banks in the form of savings deposits or certificates of deposits.

Let me just take these two figures, because I do not want to burden you with too many. If you look at these figures over a period of time—and here I have chosen two separate periods to make this point—narrowly defined money supply in Canada between the end of 1960 and the end of 1965 increased at an average annual rate of 5.3 per cent. Currency and total privately held deposits—that is M2 or broadly defined money supply—increased at an annual rate of 7.6 per cent. In later years the differences were even greater. Between December, 1965, and December, 1970, M1 increased at 6.3 per cent, M2 at 9.9 per cent. Surely it would make a very considerable difference which of these magnitudes you chose to stabilize.

Not only this, but the monetary aggregate analysis seems to me to suffer from the defect that money is not a very precise thing. Money is a whole spectrum of things; various liquid assets have degrees of moneyness that make them very similar to each other. You have bank deposits, for example; there are various kinds of bank deposits, which I have just been talking about in the distinction between M1 and M2. There are deposits with trust companies, which from the point of view of the holder are just as liquid as deposits with a bank. There are treasury bills. What is the difference, from the point of view of the inducement, the likelihood of spending of the individual, between a treasury bill that is about to mature tomorrow and a deposit in the bank today? Similarly with short term paper of other sorts.

This is the first problem I have with this concept, the problem of definition. The proponents change their definition from time to time. There is also the problem of the spectrum of liquidity that in modern society we have to hold in various forms.

But more basically the problem that I have in this is that we have not been able to discover through research and experimentation any ascertainable constant relationship between the money supply, however defined, and economic activity for Canada. I know no central bank, that operates strictly on the basis of trying to stabilize the rate of growth of money supply. I think it is the case that the revival of monetarism in recent years—which as you know is quite an old theory, the quantity theory of money—has caused central banks around the world to pay more attention, and in some cases even to give some lip service, to a money supply rule. But, as I say, I know no central bank that operates on the basis of the straight money supply doctrine.

The money supply theory, of course, reflects discontent with the wide swings in monetary aggregates that have taken place under a discretionary policy, and I have sympathy with that. I do not like the wide swings in the monetary aggregates either. The alternative to wide swings in monetary aggregates would be wide swings in interest rates and, for the reasons I gave at the beginning of this exposition, wide swings in exchange reserves, with financing problems, or in the actual level of the exchange rate, that would occur if the central bank did not permit some of the impulses producing these increases in interest rate or interest rate differentials to be moderated by permitting some expansion in the banking system to take place, and consequently some deviation in the money supply.

Of course, many witnesses have pointed out, and I think they are right, that if we were to follow a money supply rule in Canada it would necessarily involve a fluctuating exchange rate. In other words, the price of the money supply rule here would be wider variations in interest rates, wider variations in the exchange rate.

Apart from this there are some occasions on which there is really not much choice with regard to permitting the money supply to expand quite rapidly if a worse evil is to be avoided. Let me remind you of the situation that arose with regard to Atlantic Acceptance in 1965, when the failure of that company created a very serious threat to the whole credit system in Canada. Other issuers of short term claims on themselves came under a cloud, and there was a real possibility that they would not be able to renew their maturing obligations when they fell due.

In other words, there was the possibility of a credit crisis in the country. We dealt with that by encouraging the banking system to come to the aid of credit-worthy issuers of short-term claims and not to be unduly concerned about the adequacy of their resources in order to do so. You will recall that this was a period when the banking system was quite tight, and the result of this was that the banking system did expand quite rapidly and we avoided a credit crisis.

Another example was the revision of the Bank Act in 1967. The removal of some of the competitive inhibitions that there had been on the commercial banks in competing with other financial institutions resulted in a change in the growth relationship between commercial banks and other financial institutions such as trust companies. Trust companies, for example, had previously been growing much more rapidly than had the banks. After the revision of the Bank Act the opposite was true; for a while the banks grew more rapidly. This consequent more rapid growth of the banks was one of the factors contributing to the unusual degree of expansion in the banking system. It was only one of the factors, admittedly, but it was an important factor giving rise to that unusual degree of expansion.

Another example that I might give is the exchange crisis that occurred in 1968 when we were running out of reserves very rapidly. It was necessary to jack up the interest rates very high in Canada in order to make this an attractive country in which to leave your money or in which to put your money. This resulted in a period of very tight monetary policy with very nominal rates of growth in the money supply.

In short, it seems to me that the risks involved in Canada's having a flexible monetary policy which can respond quickly to changes in our external position as well as to changes in our domestic position are much less than those involved in leaving the economy to adjust on occasion to sharp changes in financial conditions or to sharp changes in foreign exchange rates.

Mr. Chairman, am I taking too much time?

The Chairman: No, Governor, that is fine. You are taking more time than we thought you would, but we are pleased that you are since it is such a marvelous exposition. However, honourable senators, we might recess for five minutes at 11.30 and then come back, because I think our questioning will take a little longer than we thought it would.

Mr. Rasminsky: Mr. Chairman, what I should like to do now is refer to what, in our opinion, are three of the main strands of thought that have come before your committee on how we should look at demand management. There have been other strands of thought, but I am not going to refer to them.

One approach that has been put before the committee, and I might say that it is the approach we follow in the Bank of Canada, is that demand management should be responsive to the trend of activity and the trend of inflation in the country and that fiscal and monetary policy should normally try to steer the economy towards sustained high levels of production and employment, but that, if at some stage the economy shows or threatens to show signs of appreciable inflation, financial policy should try to moderate the rate of growth of demand for a time to cool off the economy in order to give the prices and costs a chance to stabilize. The cooling out should be gradual. We should certainly avoid anything like a major recession. After the demand pressure on the economy had eased moderately, it would bcome appropriate to encourage a gradual strengthening in demand with the expectation that the economy would return to its full rate of growth and then gradually become more fully employed and at the same time give a better performance of costs and prices.

This, in fact, is the core of the strategy that we have been following in the last few years in Canada. Of course, it is the same in the United States. Obviously, the success of this strategy depends on how the economy reacts and, whether prices and costs do in fact moderate at only modestly lower levels of activity, and how long that takes. Various things have been done to encourage a better reaction, including public discussion.

Well, I think one would have to say that the issue is still in doubt, although there are some encouraging signs. I said before that I thought there was need to give careful consideration to the means available to improve these reactions and to consider the possibility of limiting the use of special market power by particular groups.

The great advantage of the demand management technique is that it is flexible and that it operates through

market forces to get a better performance of the economy. This technique, of course, is difficult. It raises particular questions. When one is confronted with a situation where the economy has cooled out in the sense that there is a higher level of unemployment and more slack than one would like to see, and prices and costs continue to rise in that situation, then that is a really difficult question in connection with the use of demand management policy.

There are some who think that the so-called cost-push has come to be in modern society a phenomenon that exists regardless of the state of demand in the economy, and that it is, therefore, a mistake to try to have any influence on this by demand management. The consequences of reaching this conclusion would be very far-reaching. If it were a completely independent phenomenon, then to deal with it would involve a degree of direct interference with the processes by which prices and incomes are determined which goes beyond anything that we have seen in this country in peacetime.

For my part, I think that at a minimum it is too soon to reach such a pessimistic view. At the present time, for example, one would not be justified, in my opinion, in reaching the conclusion that significant reductions in the level of unemployment will turn out to be inconsistent with fairly good cost and price performance. This is the general strategy on which demand policies are now based in this country, and while it is true that there has been some disappointment in the performance of the economy, the test is by no means over. I think that we can explain what has happened up to now without having to have resort to this more pessimistic interpretation. I think that we can explain it in these terms, namely that the lags in the response to demand management policy have been unusually long because of the strength of the inflationary expectations that had been built up.

I think that another part of the explanation is that a policy of gradualism has been used. I do not think there is much doubt that, if the central bank had no concern and Government had no concern with levels of unemployment, with the degree of slack in the economy, if the policies had been tough enough, even the cost inflation could have been brought to an end. But of course we do have that concern, we all have, and this led to a stretched out policy of gradualism, which has probably militated against quick adaptation on the cost side.

Of course, the third factor that has worked against us has been the inflationary atmosphere abroad. Costs do, however, show some signs of responding; and I think that it is reasonable to expect that, as the economy moves forward more rapidly, we will get more rapid increases in productivity and that unit costs will go down, so that significant reductions in unemployment will go hand in hand with some improvement in the cost position.

This strategy is not certain to work. A great deal depends upon price developments in the United States. If it turns out that they do not get complete control of their price situation, then an attempt on our part to insulate ourselves completely from the increases in prices and the increases in costs in the United States through demand management policies, would certainly be too high in terms of lost production and unemployment.

It used to be said that we in this country should try to do as well as the United States and perhaps a little bit better. On the price side, we have done a little bit better, in part through special factors such as the rise in the exchange rate and factors relating to food prices; but the underlying trend of costs in Canada has not, I think, behaved any more moderately than it has in the United States.

If the United States does not succeed in reaching its objectives regarding the control of prices, then obviously it is going to be more difficult for us to reach ours.

One of the other main strands of thought put before your committee was the recommendation that we should relax and enjoy it, that we should learn to live with inflation. Our demand management policy should be directed towards full employment at all times and, if it turned out that this produced inflation, we should accept that and adjust to it, by tying what incomes we could to the rise in prices through some process of indexing. The argument is that it is easier for society to adapt itself to inflation than to any significant short fall from full employment output.

This line of reasoning is really a development of the Phillips curve theory on which I commented at the beginning. It assumes that we can trade off our unemployment against inflation over an appreciable period of time. In other words, it assumes that people are fools, that people will not know what is happening to them. I would not be prepared to make that assumption, that people are fools; as inflation proceeds it will become embodied in everyone's expectations, and Government and the central bank will not be able to claim price stability as a goal.

When people saw what was happening they would adjust their behaviour to it and make whatever arrangements they could to protect themselves against what was now an officially sponsored expectation of inflation.

This would lead—I do not see how it could fail to lead—to an acceleration of prices, and this without any benefit in terms of increased employment. Any impulse from inside or outside the economy that tended to raise prices would go ricocheting through the economic system and would affect all other prices.

At some stage in this game, governments would certainly feel that they have to bring the process to an end and they would have to follow restrictive policies to do so.

There is one further aspect of this living with inflation to which we have not referred in our brief and that is the effect on capital markets. Of course, capital markets do not exist as ends in themselves, but as means of mobilizing savings and putting them to productive use. If we embrace the living with inflation theory, it would be very difficult for borrowers to put out long term obligations. It certainly is noticeable that, in countries that have suffered serious inflation, there is virtually no long term capital market and borrowing is done at short term. This inability to fix the cost of borrowing, long term,

would be a very great inhibition on both private capital expenditures, that are so important a factor in economic growth, and on the financing of housing and other social capital.

The third general line that has been taken by some witnesses before your committee is the line of price and incomes control, and I am just going to say a word about that. The view has been taken by some that the world has changed so much and the basic inflationary pressures are so great that you can no longer expect aggregate demand policies to control inflation, and the only thing is to do is to put on price and wage controls. You have heard from other witnesses a great deal about the problems and difficulties in this, their effect on economic efficiency, their administrative problems and the problems that arise when then controls are removed. This proposal relies very heavily on the ability of government to establish an acceptable system of price control that would substitute itself for market forces in determining prices and incomes. And even if we could devise an acceptable system, this would not eliminate this problem of demand management because if you did not regulate demand in a way which did not bring too much pressure against the controls, you would have the whole procedure of black markets, rationing, loss of confidence in the control mechanism and an ultimate breakdown of the control.

Mr. Chairman, I did not realize I was going to talk this long. I had intended to wind up by saying something about current monetary policy.

The Chairman: I think that would be very acceptable, Governor. Is that agreed, honourable senators?

Hon. Senators: Agreed.

Mr. Rasminsky: I shall be very brief on this. Since the first quarter of 1970 monetary policy has been directed to increasing the rate of growth in the economy. We had in the previous period of restraint and earlier periods some experience with the long time-lags involved. This was a reminder that there would also be lags when the time came to encourage a resumption of growth, so policy shifted to an easier stance before there was any really convincing evidence of improved price performance, and certainly no evidence of improved cost performance. Since then, as you know, price performance has improved materially. It is worth drawing your attention to the fact that this shift in our stance took place when the unemployment rate was about 5 per cent, although we realized that, with the lags involved, the rate was going to go higher before the easier monetary policy and the easier fiscal policy which was adopted about the same time would take hold. This change in this policy was based on the view that while the more expansionary policies would encourage an increase in output and an increase in employment, the change in market conditions brought about by the lessening of demand pressure would continue to exert a moderating influence on price and costs. Over the last 15 months or so, there has been a very substantial increase in the money supply, a sharp rise in bank liquidity, funds have been readily available from the banking system and other financial institutions, and from the domestic bond market. There has been a reduction in interest rates, and a particularly marked reduction at the short end of the market, although long-term bonds rates and mortgage rates are also below the peak levels. One of the factors that has influenced us in pursuing as easy a policy as we have done has been not only the domestic situation itself, but the related change in Canada's international position, the swing from current account deficit to current account surplus which, taken in conjunction with some continued inflow of long-term capital, has tended to put upward pressure on the exchange rate. We have been very conscious of the need to conduct our operations in a way which would help to accommodate this change in our international position and relieve the upward pressures on the exchange rate.

I think I can bring it to an end there, Mr. Chairman.

The Chairman: Thank you, Governor, for taking the trouble to give us such a comprehensive statement. It will be very helpful in relation to the questions which you will be asked.

I would suggest to honourable senators that as there will be many questions for Governor Rasminsky and for the officials who have accompanied him perhaps it would help matters if honourable senators would restrict supplementary questions to those questions that relate extremely directly to the main question. We will examine the questions as we go along. But perhaps it would move things a little faster if we could restrict supplementary questions very narrowly to the main question.

Senator Nichol: Mr. Rasminsky, all of our witnesses and visitors here including yourself have dealt in many different ways with the difficulties of monetary and fiscal management, with the problems of lags, the problems of the information system and with statistical difficulties, and there has also been a general rejection of "gimmickry" as a solution—I think that was Dr. Deutsch's word—to the problems with which we are struggling. There has also been a considerable amount of discussion about the need to try to improve the accuracy and efficiency of existing mechanisms rather than to search for magic answers. In this country we have the Bank of Canada, the Department of Finance, the Prices and Incomes Commission, the Economic Council of Canada, and we have economic advisors in the Privy Council office and in the Treasury Board, and I am sure you can think of many other institutions operating in this whole field of economic management.

Dr. Deutsch suggested yesterday—it is not printed, but perhaps you saw what he said—that some sort of council of economic advisers to the cabinet would perhaps be a useful thing. It is obscure to me how decisions of timing are made within our present governmental institution. For instance, you said that a decision was made in early 1970 to encourage economic growth, and so on, and that this change was made when the unemployment level was at 5.5 per cent, and so on.

Mr. Rasminsky: Five per cent.

Senator Nichol: I realize that your position here is different from that of other witnesses, because you have specific, definite and heavy responsibilities for the Canadian economic scene which most of the others have not had. What can you tell us about how such a decision as that is reached within the present overall structure of economic management in the federal Government?

Mr. Rasminsky: In a way, senator, Mr. Benson would be a better witness on this question than I, because the problem of co-ordination within Government is one that I am not able to answer.

As you know, a great deal has been done in the last couple of years in the way of interdepartmental and interministerial committees dealing with economic problems. However, I am not able to tell you precisely how they work.

So far as the Bank of Canada is concerned, our main co-ordination is with the Department of Finance, which is the department responsible for the other broad lever, fiscal policy.

Senator Nichol: Their deputy minister is on your board.

Mr. Rasminsky: The deputy minister is *ex officio* on our board. The deputy minister is also *ex officio* a member of the executive committee of the board which meets much more frequently than does our board. It meets weekly.

This provides the formal occasions for the discussion of the state of the economy, of monetary policy, and of the state of Government finances, in which we are involved not as a principal but as fiscal agent of the Government. We have some responsibility for the management of the public debt, which is very closely related to monetary policy.

Apart from that, there are, of course, many informal contacts between myself and the Deputy Minister of Finance and between myself and the Minister of Finance. I see the Minister of Finance regularly. We discuss the economic and financial situation each week. In fact, the Bank of Canada Act prescribes that we shall do so.

In the course of these discussions we would exchange views and reach a consensus—or we would normally reach a consensus. There might be occasions when we did not, but we would normally reach a consensus on which way the levers should be pushed. This presumably would then be discussed with the Prime Minister. So far as I am concerned, this is the technique of co-ordination and decision-making.

Senator Nichol: Thank you. In effect, without putting a name to it, this is close to what Dr. Deutsch was talking about yesterday.

Mr. Rasminsky: I am not sure of that, senator. I read the account of Dr. Deutsch's evidence in the newspaper this morning. I had the impression that Dr. Deutsch was suggesting that some new body, without any departmental or administrative responsibility, should be set up; that it should be something akin to the American Council of Economic Advisers, and would be another source of advice to the Government on what it should think about the state of the economy.

Senator Nichol: In examining the question of improving the depth of our knowledge on how to use these existing techniques—about which you pointed out that we have made great progress in the past 25 years, but that you would like to see improvements.

Mr. Rasminsky: We have a long way to go.

Senator Nichol: Do you see this structural or mechanical system which I have described as a place where there could be some improvement? That is an awfully broad question.

Mr. Rasminsky: I am sure there is always room for improvement. The forecasts that we make of the economic situation do not invariably turn out to be right. However, they also invariably do not turn out to be wrong. There is certainly room for improvement.

The amount of co-ordination that is now taking place, at both the official and ministerial level, is a good deal greater than it used to be. If I may make your question more pointed than you yourself did, if you are asking me whether I have any specific recommendation to make that would improve the degree of co-ordination, the answer is that I do not have any specific recommendation to make.

Senator Molson: Mr. Chairman, I would like to ask a question regarding the structure of Mr. Rasminsky's area of responsibility. He is, I think, the first witness who has appeared here whose opinion is not only valuable and respected by us but, through his responsibility, he is held accountable for the views follow on through his executive or administrative action.

In those responsibilities in the monetary field, owing to the structure of the banking and non-banking system in Canada, is he not perhaps endeavouring to discharge a very key responsibility in a vehicle that perhaps is operating on seven instead of eight cylinders? Is his work not rendered extremely difficult by the fact that part of the banking system is in the non-banking system?

Mr. Rasminsky: I regard your suggestion that we are operating on as many as seven cylinders as a great compliment.

Senator Molson: I thought of five, but I chose seven.

Mr. Rasminsky: Do not reduce it, please. We have devoted much thought to the question of whether there is in Canada an important group of financial institutions which, in their absence, I will refer to as the near banks. They do not like to be termed near banks; they prefer the expression non-bank financial institutions.

The question is whether the fact that our writ, so to speak, extends only over those institutions which are incorporated under the Bank Act and which have to hold cash reserves with us and, taken as a group, whose size

therefore we are able to control, renders monetary policy seriously ineffective.

My answer for deposits is that there is enough competitition between the banks and these other institutions. Therefore the impulse that we wish to give to the economic system through, for example, tightening credit, can in fact work. If we have a tight monetary policy, then interest rates generally will go up all through the economic system. Trust companies, Caisses Populaires and the other institutions will be affected, and their customers will be affected in much the same way as the customers of banks.

So that while it might in some respects simplify life if all financial institutions were banks and subject to our control, I do not regard the existence of deposit-taking institutions which are not subject to the Bank Act as a very serious limiting factor in the execution of my responsibilities.

Senator Molson: Supplementary to that, could I ask if it has any effect on the time lag?

The Chairman: That is, does it lengthen the time lag?

Senator Molson: Yes, lengthen it is really what I meant.

Mr. Rasminsky: I do not see why it should lengthen the time lag. First of all, the time lag on interest rates is pretty short. The competition is sufficient that there is not a very significant difference in the time lag there. The time lag in the case of banks arises because they have a buffer of liquid assets on which they can draw to make loan commitments, even after we have started to tighten policy. In the same way, when we loosen policy their first reaction is to try to build up their liquid assets, rather than to increase their loans.

However, I think that the competition between the institutions is close enough that it does not materially add to our problem of time lags.

Senator Grosart: My first two questions have in effect been asked.

The Chairman: That is a happy event, senator, but you have more.

Senator Grosart: I have some supplementaries. First of all, following Senator Nichol's question regarding the mechanism for co-ordination and policy decision-making, the brief at page 9, at the top, notes the importance of co-ordination but also states:

> —co-ordination does not mean that at all times the two policies need be moving in the same direction.

I wonder if you would expand a little on that? It is frightening to think of monetary and fiscal policies moving in different directions and yet attempting to achieve co-ordination.

Mr. Rasminsky: This is a very complicated problem of the mix of policies. Both policies are designed to influence aggregate demand in the economy. Monetary policy does so by having an influence on credit conditions, that is on the cost and availability of credit. A situation in which it is desired to have a certain level of interest rates for international reasons, for instance a relatively low level for reasons relating to the international position, may not gibe completely with what is desired with regard to the level of domestic demand in the economy.

Let me give you an example, which I would like to take about as far away from home as I can in order to avoid any misunderstanding. Germany is now faced with a problem of inflation and an overheated economy; costs have been rising extremely rapidly. They want to bring that under control. Until recently the chosen instrument of the Germans in attempting to bring the situation under control has been monetary policy. They have had a rather tight monetary policy, which has meant rather high interest rates. The result was the attraction of a great deal of funds. Their interest rates were higher than those externally in the Eurodollar market and in the United States. The Bundesbank had to buy these funds and create D-marks against them, which increased the liquidity of the economy and went counter to their objectives.

It was this fact that finally led the Germans, as you know, to decide to stop buying the funds and to allow the exchange rate to float.

What the Germans seem to be in process of doing is changing the mix of their policies. They seem to be in process of relying more on a restrictive fiscal policy, accomplished through higher taxation and perhaps reduced expenditures, to control the domestic situation, while they may take a somewhat more relaxed attitude on the interest rate side in order to stop attracting funds from abroad. This is a situation where the overall arm of policy is directed towards cooling off the economy, towards controlling inflation, but the main emphasis on the domestic side is being placed on fiscal policy, whereas monetary policy is not moving as vigourously in that direction.

Senator Grosart: Would this be a partial explanation of why at times we are told, by the financial press at least, that at budget time the Minister of Finance is under diverse pressures, one from, say, the industry trade and commerce side and one from the finance side? That is, the decision, say in broad terms, whether a budget will be restrictive or expansionary.

Mr. Rasminsky: No, I do not think so. I think if there is a difference of opinion originating there between the Department of Industry, Trade and Commerce and the Minister of Finance on whether the budget should be expansionary or not expansionary, that would be more likely based on a different reading of the economic situation, of what was called for. This mix of policy problem is more a question that could arise between the Bank of Canada and the Minister of Finance, because those are the policies that we are talking about mixing. Situations could arise in which it seemed desirable that one policy should be directed towards the international situation and the other would be directed more towards the domestic situation.

Senator Grosart: This would really then be a secondary decision level. Having decided the job, this problem arises when you decide what tools to use to do the job.

Mr. Rasminsky: I think that is right.

Senator Grosart: I should like to put a supplementary to Senator Molson's question. Assuming a decision to adopt a monetary rule policy, to what extent could the central bank make it effective in terms of numbers, let us say a 6 per cent rise per year? Could the central bank actually achieve that?

Mr. Rasminsky: We could not achieve it day by day, or perhaps even month by month, because the linkages in the system are not as tight as people normally believe. I am sometimes quite surprised when I read the paper on a Friday morning, after we have published our weekly financial statistics, and read, "The Bank of Canada last week decided to add $250 million to the money supply." We took no such decision. The money supply figures in any relatively short period would be affected by factors that are not within the control of the central bank. For example, the basic instrument that we have, as you know, is the cash reserves we provide and the requirement that the chartered banks should maintain a certain ratio of central bank cash—that is deposits with us on our notes—to their own deposit liabilities. The chartered banks change their minds, they do not work to a constant ratio day by day or even week by week. They may be affected by expectations or by surprises. If we decide on a cash setting that we regard as being neutral—that is to say, a cash setting that we do not intend, on the basis of past experience, to cause the banks to add to their liquid assets, because they abhor not making any money out of their deposits with us—if the banks have changed their view as to what they regard as neutral, maybe in anticipation of what we are aiming at or for some other reason, then we may be surprised one week to find that the banks have added to their liquid assets, which would produce an increase in the money supply, even though we intended the setting to be neutral.

Another thing that would cause a change in the money supply over a short period of time is the behaviour of bank loans. Banks have very large outstanding commitments for loans; those commitments may fall in a particular week and the bank simply has to meet it. So our control over the money supply in any short period of time is not nearly as precise as most people think. On the other hand, we certainly have the control over a long period of time, provided we are prepared to accept the consequences of exerting control.

If we set out to allow the money supply on some definition to increase at 6 per cent a year, to take the figure that you used, there is no very important technical reason why we should not achieve that result. The consequences would be much wider fluctuations than we would otherwise have had under a more discretionary policy in interest rates, and, under a fluctuating exchange rate system, much wider fluctuations in the exchange rate

Senator Grosart: I was going to ask you that question, Mr. Rasminsky. Why is it that a constant rate of increase in the money supply would automatically bring about a wider swing in interest rates? You would think it would be the other way round, that if the money supply was constant the interest rates would tend to be constant.

Mr. Rasminsky: I suppose the basic reason is that the demand for credit is not constant; that changes from time to time, including the demands of governments for credit. As you know, government cash requirements are quite large. As these credit demands came on the market, if there was no expansibility, if there was no give in the banking system at all, they would, I think, necessarily produce wide fluctuations in interest rates.

Senator Grosart: You do not think that in the long run, over a period of, say, five years, this constant rate of increase in the money supply would tend to give a much higher level of constancy to expectations, business spending intentions and so on?

Mr. Rasminsky: If everything else remained constant; if you had no external shocks, for example, or if you had no inpulses on the domestic economy originating from abroad; if you did not have, say, a foreign-based resource boom such as we had in the 1950s which creates large demands for credit; if government increased its credit demands at a constant rate, and if private credit demands other than those originating abroad increased at a constant rate, this would be nice. It certainly would be nice if things happened this way, and it may well be that in that sort of situation you would have or could have a more stable rate of growth in the money supply without the wide fluctuations in interest rates that I have been referring to. But unfortunately I do not think that is the sort of world we are living in. We do have important relationships with the rest of the world that affect the level of activity here and affect the level of demand for credit.

Senator Grosart: Does this all mean that, dislike it as we may, we might as well learn to live with stop-go financial, fiscal and monetary policies?

Mr. Rasminsky: I hope not. I think we can do better than we have done in the past. I think we have made mistakes but we can learn something from them. I think we know more about lags than we did. I would hope that some of the demands for credit or some of the levels of expenditure would increase at a more constant rate in the future than they have done in the past. I think it would be helpful in avoiding stop-go situations if that were to happen, and here I include government expenditures. I think we can do better now than we have done in the past, but I think that while we should aim and are aiming at trying to get the economy onto a track which is even and which is moving forward at the same pace all the time, I do not think there is any certainty that we are going to achieve it. One of the problems, of course, is that once you get off track—and this is one of the problems with the money supply—the question is as to how you get back to a tolerable position from there.

Senator Grosart: How do you find the track?

Mr. Rasminsky: That is a problem too. There are indeed differences of opinion as to what the track is. But in our present position we are certainly off track and the present position requires a degree of expansion to reduce unemployment rates and to get the economy moving forward which involves stimulative policies both on the fiscal and monetary side. There is a real danger in the situation that at some stage, and I do not say now, these policies will shoot beyond the mark, and there will be a real problem if stop-go is to be avoided. There will be a real problem of timing and trying to choose the point at which to change the inflection of expansion to get it on track so as not to overshoot the mark and get back into a stop-go situation. This certainly is the objective of policy, but whether it can be achieved or not remains to be seen.

Senator Grosart: There is a statement here which I don't understand, and that is not surprising. You seem to have a sort of equation on page 11 which, if I may paraphrase it, amounts to this; that in a market economy, competition plus plant capacity plus manpower capacity equals a steady rate of growth without a rise in prices. You state that almost as an equation. Is it axiomatic that this should be so?

Mr. Rasminsky: What that statement means is that if you had a perfectly competitive society, and your economy had proceeded to a point where inflation was threatened or present, and you decided through your monetary and fiscal policies to reduce aggregate demand in the economy, then the reduction in demand in the economy under conditions of perfect competition would result in the moderation in prices rather than a moderation in output. It is because there are elements where competition is not perfect that prices are sticky and do not respond to the weakening of demand; producers feel that they may do better and that their return may be increased if they maintain their prices and reduce their output.

Senator Grosart: You are referring then to perfect goods competition, not money competition?

Mr. Rasminsky: Yes, competition in the productive process.

The Chairman: Honourable senators, I propose now that we should adjourn for five minutes. We will meet again at 11.30.

Before we adjourn, I would like to suggest that we print the submission of the Bank of Canada as an appendix to today's proceedings. Is that agreed?

Hon. Senators: Agreed.

Senator Grosart: Are we going to print it all eventually?

The Chairman: We are trying to keep the cost down as much as possible. If I had my life to live over again, we would have printed the briefs as an appendix to each day's proceedings. It was on a cost consideration that we did not. Perhaps we should give consideration to a separate *Hansard*-type volume for the papers.

Senator Grosart: The Steering Committee might take that up, because the interest shown in these papers would seem to indicate that there will be a demand for them, and we will not be able to supply sufficient Xerox copies.

The Chairman: What you say may be true. Thank you, senator. We will give it consideration.

(A short recess)

The Chairman: Dr. Gillies?

Dr. James Gillies, Study Director: Mr. Rasminsky, do I understand properly that it is your view that the way in which monetary policy affects aggregate levels of the economic activity is through its effect on interest rates?

Mr. Rasminsky: Through its effect on interest rates and the availability of credit, yes.

Dr. Gillies: Do I also understand correctly that the way to change interest rates is to change the supply of money, somehow?

Mr. Rasminsky: There are two sides to it. The supply of money, or expansion of the banking system, can affect the interest rates in relation to the demand for credit at the time. Other factors which affect the level of interest rates include people's expectations regarding the future of interest rates.

Dr. Gillies: In your view does enhancing the supply of money inevitably mean that an increase in interest rates will follow?

Mr. Rasminsky: No, it does not. We must know what is happening on the demand side and in people's expectations. An increase in the supply of money would normally be expected to bring about, other things being equal, a reduction in short term interest rates. As portfolios are shifted and moved from short term to long term assets, one would normally expect some impact on longer term rates, other things being equal.

Dr. Gillies: Yesterday Dr. Okun said that studies made at the Brookings Institute suggest that once unemployment in the United States reaches a 6 per cent level any further increase will have no effect on price levels, the rate of inflation.

I wonder if similar studies have been undertaken in the bank with regard to this question?

Mr. Rasminsky: No, we have not made such a study.

Dr. Gillies: Do you have a view on that?

Mr. Rasminsky: The first consideration is that unemployment must be kept within a tolerable range, a socially acceptable range. Outside this range, there may be some point beyond which, from the point of view of influencing prices and costs, an increase in the unemployment rate would make very little difference.

Dr. Gillies: I was not quite sure from your discussion with Senator Nichol whether the bank plays an active role in determining fiscal policy?

Mr. Rasminsky: There is discussion with the Minister of Finance regarding the state of the economy, trends in output and the trend in employment and unemployment. We are, of course, directly involved in one aspect of it as an agency in the management of the public debt.

In connection with the latter, we would play quite an active role in suggesting terms of new issues. However, ultimately the decision is that of the minister. In connection with the broader aspects of fiscal policy, I would say that the bank is one of the sources of advice to the Minister of Finance and the Government. Of course, it is only one of the sources.

Senator Grosart: Supplementary to that, would it be fair, Mr. Rasminsky, to ask you if there have been occasions and, if so, would you care to give an example, when there was an agreement that fiscal and monetary policy should go in different directions in Canada?

Mr. Rasminsky: No, I know of no such case, senator.

Dr. D. L. McQueen, Study Consultant: Mr. Rasminsky, you make reference in your brief and your verbal remarks to the imperfections and problems of economic forecasting. As you know, this is something of which I have particular reason to be aware. However, I should like to direct your attention rather to the process of backcasting and performance appraisal.

The basic question that I would like to ask you is how do you tell and how do your ordinary shareholders tell how well the central bank is doing its job? I would suppose that at certain junctures you would wish to sit down, look over a past period and ask yourself what the Bank of Canada was attempting to do, to what extent it succeeded and what amount and kind of impact it had on the Canadian economic situation?

You have rejected the simple monetary supply rule as the criterion of success or failure. What other objective criteria do you set yourself? I appreciate that this is a much more complex question for a central bank than for many ordinary business enterprises. There may not be clear-cut answers at this time, but would you agree that this is an appropriate exercise for the central bank to set itself? Is some of your research directed to going through this exercise rather more satisfactorily in the future? Would you agree that these are appropriate questions for the rest of us to ask with regard to the central bank?

Mr. Rasminsky: Yes, I do, Dr. McQueen. A good deal of self-appraisal takes place in the bank in an endeavour to form a judgment of our past performance.

One of the problems involved in forming a judgment is one that I have spoken of before and is mentioned in our brief. That is the limitations and constraints to which monetary policy is subject.

Monetary policy really cannot be isolated from fiscal policy; it cannot be isolated from our international position. But we do, both in discussion in the bank and in a more systematic review appraisal, look back over past periods and try to form a judgment of how we did and what mistakes have been made. This is a difficult task, because account must be taken of the fact that a policy which, with the benefit of hindsight, may look mistaken, was at the time subject to certain other limitations.

I think the question you raise of appraisal and self-appraisal is very relevant. The best answer I can make is that we are doing some of that in the bank. It may be that we should be devoting more of our research resources to this type of historical introspective analysis.

Dr. McQueen: At the time the bank made its submission to the Porter Commission there was a fairly full discussion in the bank's own submission of how central bank operations were believed to affect the economy. In the light of your research since that time, do you feel that substantial progress has been made in further understanding how what the Bank of Canada does affects the economy? Have you had any sense of any change of views about how the process occurs, in the light of your research since that time?

Mr. Rasminsky: I do not think we have had any basic change of views. It may be that we are now more conscious than we were at the time of the great importance of lags in the implementation or in the effectiveness of monetary policy. I believe we are gradually improving our information of economic relationships; we are devoting a good deal of research resources to the construction of a very large model of the economy, which you probably know about. They are now working on RDX2, which is nearly complete, and it may be we will have reason to make some more basic changes.

Another thing that perhaps I should mention, of which we are now more conscious than we were at the time of the Porter Commission submission, is the importance of expectations in the economy—particularly after the period of three or four years of rising prices that resulted from what I suppose was the greatest peacetime economic expansion we have ever had in this country. Inflationary expectations, I think, assumed a role in the operation of the economy, in the decision-making process of the economy, which was greater than anything we had in mind in the submission to the Porter Commission.

Senator Beaubien: Mr. Chairman, the Governor pointed out that over the last 12 months or so Canada's experience as far as prices are concerned was excellent, but that in that same period our costs had gone up a lot. It seems to me that if costs go up, either you put prices up or you pretty well go out of business. Therefore, I want to ask the Governor: is not the only thing that really matters in the long run control of costs?

Mr. Rasminsky: Costs are certainly a very important element in the determination of prices, and in various public statements I have drawn attention to the difficulty of getting acceptable price behaviour if there is not a better relationship between increases in costs and increases in productivity. I do not think you should forget

about the productivity factor. If productivity is increasing at 3 or 4 per cent a year, then money costs can go up by that much without producing any increase in prices. I think the hope—not a certainty, but a hope—that we have in the present situation is that we do see some sign of a slowing down in the rate of increase in costs. I think it is reasonable to expect that productivity will increase as the economy moves forward more rapidly.

Senator Beaubien: But, Governor, the biggest single thing, of course, in costs is salaries, and I do not think there has been any levelling off in the increase in salaries. I have not seen any. Therefore your costs will keep on rising.

Mr. Rasminsky: There certainly has been a levelling off recently in the rate of increase of negotiated wage settlements. For example, the average annual increase in negotiated wage settlements over the past few quarters have been these: in the third quarter of 1970, 9.3 per cent; in the fourth quarter of 1970, 8.4 per cent; in the first quarter of 1971, 8.1 per cent. These figures exclude construction, where the settlements, of course, have been higher.

Senator Beaubien: Well, where the increase in productivity is around 3 per cent, these increases although they may be down from 9.3 per cent to 8.1 per cent are still important.

The Chairman: The Governor is suggesting they are moving in the right direction.

Mr. Rasminsky: That is right, they are moving in the right direction and hopefully productivity is moving in the right direction.

Senator Isnor: In wage agreements for three-year periods, the first year is always the higher rate.

Mr. Rasminsky: That is a rather hopeful aspect of the present situation. As you move into the second and third years you will be encountering lower rates of increase than in the first year.

Senator Isnor: It is all part of a three-year wage agreement.

Senator Grosart: I have a supplementary question to ask there. When you speak of productivity increases, Mr. Rasminsky, are you measuring this in terms of man-hours or dollars?

Mr. Rasminsky: Productivity is a very elusive concept, but basically it is supposed to be a measure of physical output per man-hour.

Senator Grosart: Has it been related to per-dollar investment?

Mr. Rasminsky: Well, various studies have been made of the relationship between input of capital and output of goods.

Senator Grosart: Is there a consequential relationship between the two?

Mr. Rasminsky: Yes, there is.

Senator Grosart: What is the nature of that?

Mr. Rasminsky: I suppose the nature of it is that as more capital investment takes place, the average output per worker will be higher as a result of more efficient means of production.

Senator Grosart: There is a real equation there, is there?

Mr. Rasminsky: Well, there certainly is a relationship. I do not know that there is a constant, static equation.

Senator Carter: Mr. Rasminsky, you spoke this morning about the automatic pilot, and you rejected the constant increase in money supply as a satisfactory guide. What would you say about selecting an exchange control and using that and gearing our economy to that?

Mr. Rasminsky: Well, I am not in a good position to answer that question because I have something to do with administering the exchange control during and after the war. I do not see what advantage one would get in the overall direction of the economy from an exchange control. You might get a certain degree of insulation from foreign capital movements if you did not want them to come in or to go out, but an exchange control to be effective would have to be comprehensive.

Senator Carter: I was not thinking about exchange control as such, but making a certain exchange rate a goal.

Senator Molson: A fixed rate?

The Chairman: I think what the senator is referring to is that you would choose a goal, and it might either be a floating rate or a fixed rate, and your whole policy would revolve around achieving that goal. Would that be an effective measurement and means of exercising policy? I think that is Senator Carter's question.

Senator Grosart: A float, but you would control the water level.

The Chairman: You might float or you might fix. But what Senator Carter is saying that you would, say, take a target of 98 cents and then you would let policy revolve around that. Is that feasible, Governor?

Mr. Rasminsky: I suppose it is a feasible thing to give top priority to a fixed exchange rate in your policy, but I do not think this would eliminate the need for other policies that are designed to affect the total level of demand in the economy. The goal of not having very broad movements in the exchange rate is one which I think takes into account the great importance to Canada of international transactions where wide changes in exchange rates can be very upsetting. This is something which is not always taken sufficiently into account, I think, by those who feel that we would have a much greater degree of freedom of monetary policy if we were on a flexible exchange rate system. No doubt there is some greater freedom of monetary policy, but even in

such a system I think one would have to be concerned, in a country where international transactions are as important as they are in Canada, with the actual level of the exchange rate. So, you do not have complete freedom in such a system. The exchange rate matters; it is an important price; and as I indicated earlier, our recent monetary policy has taken this into consideration.

Senator Carter: My second question is this; why cannot the Industrial Development Bank be used to develop some kind of regional monetary policy? I do not mean exactly on a par with the Bank of Canada, but something approaching that on a regional basis.

Mr. Rasminsky: The task of the Industrial Development Bank is quite different from the task of the Bank of Canada. The task of the Bank of Canada is to try to exercise an appropriate influence over the general direction of the economy through variations in credit conditions.

Senator Carter: Perhaps I can rephrase my question a little better. Is it possible to use the Industrial Development Bank to offset the effects of monetary policy in the regions which are really geared to central Canada?

Mr. Rasminsky: I do not think it is possible to use it to offset the effects very directly or to a major extent. We have been very conscious of the fact that a restrictive monetary policy or restrictive general economic policy is particularly hard on certain regions of the country which already have high unemployment rates and relatively lower standards of living. I do not think they are more affected by a restrictive policy, but they are less able to tolerate the effects of such a policy. We have been conscious of that both in the operations of the Bank of Canada and in the operations of the Industrial Development Bank.

The Industrial Development Bank is organized regionally. We have five regions of the country, including one in the Atlantic provinces. Over 95 per cent of the flow of credits from the IDB, which amount to about 4,000 a year, are made through these regional offices or through branches, without any need for reference to head office, to the general manager's office.

We are most anxious in the IDB to increase our lending in the slow growth areas of the country, and we have done what we could to do that.

Apart from the large number of branches—and we have proportionately more branches per head of population in the Atlantic provinces than, for example, in Ontario—we have a large number of advertised visits soliciting loans. Also, in terms of personnel, we have tried in the IDB to put particularly aggressive managers into the slow growth areas to try to drum up business there.

It is difficult to gauge the success of all this, but in the last 12 months, if you measure the amount of IDB lending per person employed, the figure is as high in the Atlantic provinces as it is in Ontario. We would like to see it higher still. That is so far as the IDB is concerned.

So far as the Bank of Canada is concerned, I think that all the witnesses who have appeared before this committe have really agreed that it is not possible in a country with a single credit system to have a different monetary policy for different regions. However, when credit conditions have been tight, we have tried to shield to what extent we could the impact of this on the slow growth regions by asking the banks to take a particularly tender view of applications for credit from the slow growth regions, and the banks assure me that they do so.

Senator Carter: Thank you. Is there any fundamental difference between the functions of central banks in the Western world and their counterparts in totalitarian countries? For example, between the Bank of Canada and the Bank of Russia, or whatever they call it?

The Chairman: Here they retire the governor, but they do it differently there. That is the essential difference. No doubt there are other differences. (Laughter)

Mr. Rasminsky: I do not really know enough about the way "central banks"—I put it in inverted commas—operate in totalitarian countries. I suppose that by definition a totalitarian country is one whose economic life is dominated by planning, where decisions are taken by central authorities as to the allocation of resources, as to what shall be produced, and even, perhaps, by whom.

I do not think that they would try to regulate the economy through the use of demand management policies in the way that we do here. Therefore, without speaking from personal knowledge, I would think that there would be very considerable differences. In fact, it may be the case that the central bank in totalitarian countries tends to be a bookkeeping agent for the plan.

The Chairman: The following is an article from the *Christian Science Monitor* in which Dr. Milton Friedman is quoted as saying:

> Federal Reserve officials maintain that it is difficult for the open-market-account managers to hit the money-supply targets set by the committee.
>
> Dr. Friedman regards this as excuse-making. "The natural alibi of everybody is to say, 'There is something funny around here. We tried our best. But we couldn't do it."
>
> He concludes: "That is a bunch of nonsense. They can do it (hit the targets) if they want to."
>
> Those implementing monetary policy miss the targets, he says, because they try to influence interest rates . . .
>
> Dr. Friedman was asked whether a rise in interest rates would dampen the economic recovery, a current concern on Wall Street.
>
> "No," he replied. "This is a great confusion between a cause and a consequence. If the recovery is weak, interest rates will not rise very much. If the recovery is strong, interest rates will rise substantially."

I suppose that what he is saying essentially is that you should only try to influence aggregate money supply, that

reductions or increases in the money supply, while they might have a very short-term effect on interest rates, will have a long-term effect on raising interest rates. Therefore he would really be on the opposite side of the fence from you as far as your submission here today is concerned.

Mr. Rasminsky: Yes, I think he would. I would agree to this extent, that if there is a low level of interest rates, if the economy has a lot of slack in it, and you want to pursue expansive policies, one possibility—and it is one that is followed in the United States—is to try to keep interest rates down, to encourage people to invest and to spend, and make credit easy.

If the policy is successful, and if the economy does pick up, the demand for credit will pick up with it. As you approach a point of full employment, you will presumably ease off on your increases in the money supply, and interest rates may rise. However, the increase in interest rates would, in the circumstances that I have just described, be an indication of the success of the policy, because you are getting closer to your goals.

There is another circumstance in which increases in the money supply might affect interest rates without indicating that you are getting closer to your goals.

That is a circumstance where excessive rates of increase in the money supply led to a triggering or a rekindling of the inflationary expectations, and led investors to demand compensation for the expected erosion in the value of money in the form of high interest rates, and that led borrowers to be willing to pay that compensation because their expectation was the same.

That is not what Dr. Friedman seems to be referring to in the passage that you read, but that is a possibility.

The Chairman: If aggregates were the only things that you had to worry about, how would you use them? You are saying that the constraints on the bank, especially as they concern interest rates, make it difficult for you to talk just in terms of aggregate amount of the money supply?

Mr. Rasminsky: That is right.

The Chairman: If we could assume for a moment that there were no constraints on the bank, that you were not worried about the internal or external interest rate, or any problems when you act as agent for federal financing, how would you use aggregate money supplies?

Mr. Rasminsky: How would you affect aggregate money supplies?

The Chairman: Yes.

Mr. Rasminsky: You would affect it through...

The Chairman: What would your policy be in those circumstances? How would you make use of it?

Mr. Rasminsky: In those circumstances I think we would continue to have to operate a monetary policy which seemed responsive to the economic circumstances of the time. If you were on track, if you were operating at a quite high level, a satisfactorily high level of employment, if you did not have any external shocks or any unusual constraints on the side of government of the type that you speak of, then I would expect that, in those circumstances, the money supply would increase much more evenly and at a rate which was more closely related.

The Chairman: Would you use it in the way the monetarists use it, that is sort of gauge it to the increase in production, productive demands, or would you use it as a tool to slow down or speed up the economy?

Mr. Rasminsky: If the economy were not performing satisfactorily, either because it was overheated and there was inflation, or because it was underheated and there was too much slack in the economy, I would use it as a tool. I would try to use it to get the economy on to the path of satisfactory performance.

The Chairman: As the fiscal agent for the Government, would it be possible to say that you accommodate the Government, in terms of its cash demands and its interest rate level, too much; and is there a case for the bank, in its independent policy, disagreeing openly with the Government?

Mr. Rasminsky: You are not referring to any particular circumstances?

The Chairman: No. I am talking purely theoretically.

Senator Grosart: We will know tomorrow.

Mr. Rasminsky: I think that if the bank reached the conclusion, to take your illustration, that Government demands on the economy were so heavy, so large, that we were confronted with a Hobson's Choice, between levels of interest rates that were excessively high in relation to the needs of the domestic economy or in relation to the external position on the one hand, or an excessive degree of monetary expansion in order to accommodate the Government, on the other; and if we reached the conclusion that this was going to be a continuing affair, that there would not be time to make adjustments before this situation exploded into something that was really disruptive; then I think it would be the duty of the bank to disagree with the Government. I stress that this is a hypothetical situation.

The Chairman: I stressed that, too.

Senator Benidickson: One of the questions I was going to ask the Governor is the one you have just posed to him, the relationship between the bank and the Government. In answer to Dr. Gillies he said that, yes, you, the bank, are just one of the advisers. The Governor knows that some time ago I spent seven or eight years with two finance ministers, as parliamentary assistant, and was able to observe the close relationship between the bank and the minister of finance. I was going to ask that question. Of course, in those days we did not have an Economic Council, we did not have the Prices and Incomes Commission, and so on. I was going to ask, fairly

pointedly, whether a point might possibly be reached where your counsel was not taken to the extent. What would one do? Resign?

Mr. Rasminsky: Would one resign every time?

Senator Benidickson: Not on minor differences, but on...

Mr. Rasminsky: On a matter of fiscal policy?

Senator Benidickson: You indicated to Dr. Gillies that one of the restraints on your monetary policy was fiscal policy. Supposing fiscal policy became so embarrassing for you, in doing what you thought was right in monetary policy, what would happen? Would the senior officers of the bank resign? Is that the signal of disagreement?

Mr. Rasminsky: The Bank of Canada, Senator Benidickson, does not control fiscal policy. It is one of the Government's general advisers. The Bank of Canada cannot assume responsibility for fiscal policy.

Senator Benidickson: No.

Mr. Rasminsky: It is not the desire and the intention of the minister of finance or the Government that it should. The Bank of Canada does have responsibility for monetary policy. If you have a situation where the Government's fiscal policy was one that to accomplish the results that the Government had in mind required an accommodative monetary policy from the bank, and if the bank itself felt that such an accommodative policy was against the interests of the country...

Senator Benidickson: That is my point.

Mr. Rasminsky: If the bank itself felt that such an accommodative policy was against the interests of the country, then the bank should not be prepared to carry out that policy. That, then, is a situation of conflict between the Government and the bank regarding what monetary policy should be pursued.

That situation was foreseen and is provided for in the Bank of Canada Act by a change made actually on my own proposal, dating from the time that I became the Governor of the bank. It is that in the event of a conflict the Government should have the right to direct the Bank of Canada as to what monetary policy should be followed. If the Governor in that situation remains convinced that the monetary policy indicated should not be followed, then the Governor has a clear and obvious duty to resign and make way for someone who is prepared to go along.

Senator Benidickson: You said very modestly that you were just one of the advisers to the Minister of Finance. My experience goes back some years, and I would have considered you to be the principal adviser to the minister in financial matters.

Mr. Rasminsky: In monetary policy.

Senator Benidickson: You even had considerable influence on fiscal decisions. In those days, in the three or four-month period when periodic meetings took place in order to plan for the budget, you invariably sent very senior officers of the bank to all our meetings. I remember that Mr. Beattie, for instance, was practically always at budget meetings. Are you still sending representatives to the minister's meetings when he is considering policies for the budget? In fact, in days gone by they used to consider suggestions that came to the department from the citizens at large as to what should be in the budget. Do you still participate in these budget meetings?

Mr. Rasminsky: Senator Benidickson, I do not really recall that our degree of participation was ever as close as you have indicated. The main concern of the bank with regard to fiscal matters is the balance of revenues and expenditures; it is with the net result of the budget as it expresses itself in the Government's borrowing requirements or in the achievement of a cash surplus available for the retirement of debt.

So far the details of tax changes or of specific expenditure decisions are concerned, the bank does not have nearly the same degree of closeness. We would not sit in on budgetary discussions relating to individual tax changes.

Senator Benidickson: Perhaps Mr. Beattie could explain to what extent I am right or wrong, because I recall particularly that for a period of two to three months prior to the actual presentation of the budget we would have meetings at least once a week, and those meetings would be attended by senior officials from the Department of Finance. They would be presided over by the Minister of Finance. By courtesy he invited the parliamentary assistant and he invited his colleague, the Minister of National Revenue, largely because of customs changes and so on that might be involved in the budget.

Mr. Beattie might say that I am wrong, but my recollection is that at those weekly meetings, or semi-monthly meetings, Mr. Beattie was almost invariably invited to attend as Deputy Governor.

Mr. J. R. Beattie, Senior Deputy Governor, Bank of Canada: Mr. Chairman, I should say the Governor's description of the situation with respect to consultations about fiscal policy is absolutely and literally correct. There are, of course, and always have been many informal consultations between bank people and finance people, and I presume between finance people and people in many other departments, but what the Governor has said does describe the situation accurately.

Senator Benidickson: To your knowledge, Mr. Beattie, with respect to budget preparation has the situation changed any from the years that I was referring to, which are largely the years of the 1950s?

Mr. Beattie: In respect of informal consultations the situation, I presume, will always ebb and flow depending on the personalities involved.

The Chairman: Governor, on page 17 of your brief you make the following statement:

> If the increase in the money supply in the last twelve months had been limited to a significantly lower figure, for example, a rate roughly in line with the underlying growth rate of potential output, one might well ask how much higher interest rates and the exchange rate would be than they are now.

Now, the monetarist would say, I think, that they would not be significantly higher. I suppose it is fair to ask you, therefore, where you think they would be.

Mr. Rasminsky: When you provide a generous amount of cash to the commercial banking system, they wish to employ it in liquid assets of one sort or another, pending the time when they can employ it more profitably in loans. The commercial banking system has been able to increase its holdings of liquid assets, of Treasury bills, of commercial paper, and I think the main impact of the expansive policy we have been following on interest rates has been in the short end of the market. Gradually, it does tend to fan out, but then other things may intervene. And it is in order to prevent capital inflows from occurring, because interest rates make that attractive, or, if possible, to encourage short-term capital outflows, that this policy is followed.

The Chairman: Yet I believe both long-term and short-term rates during this period decreased initially and have now started to come back up. Your average long-term rate a year ago was 7.38. I do not know what it has got down to, but it was lower than that. I have 7.14 for the week ending June 9. It is now back up to 7.23 in a period in which there was no significant tightening, as I understand it.

Mr. Rasminsky: That is right, senator; we have a limited influence on long-term rates. This is a very good example of the extent to which our financial markets are influenced by those outside Canada, particularly in the United States. Over the same period in the United States long-term interest rates have risen, if anything, more than they have in Canada. Therefore I think you are perfectly right, sir, in saying that there is no unique relationship between changes in the money supply and changes in the long-term interest rates.

The Chairman: But the same seems to follow for short-term rates, which also are strengthening. They decreased markedly, but over a period of time have started to strengthen again without an apparent restrictive policy.

Mr. Rasminsky: That is right. There again the main influence has been external. The American Treasury bill rate for example, at the last tender was 4.99; our Treasury bill rate is approximately 3.07. Similarly, some of our short term commercial paper rates are lower than those in the United States.

The fact of the matter, however, is that for one reason or another interest rates have moved up in the United States. One of the reasons may be that there is some thought that the recent rapid rates of monetary expansion in the United States which have, broadly speaking, been about the same as ours, have gone pretty far. There are some who feel that it is embarking on a policy of moderating the increase in the monetary aggregates and accepting the higher level of interest rates. This is so although the economy is not performing very satisfactorily from the point of view of the high level of unemployment.

Another reason may be that there is a good deal of discussion in the United States with respect to the appropriateness or inappropriateness of their mix of policies in the light of the balance of payments situation. They have been leaning quite heavily on monetary policy to start the domestic economy going. The relatively low level of interest rates has led to capital outflows, which have aggravated the deficit of the United States.

There are some who think that their mix of policies should be changed in the direction of putting more emphasis on fiscal policies. That is, having larger fiscal deficits in order to get the domestic economy going. This would be compensated for by having a somewhat less easy monetary policy to permit interest rates, especially at the short end of the market, to rise for balance of payments reasons.

This is an example of the possibility of a mix of policies which does not have both fiscal and monetary policy operating in the same direction, but is nonetheless co-ordinated. I think that the main factor in the trends in our own interest rates to which you draw attention has been the movement of interest rates in the United States.

The Chairman: Thank you.

Senator Nichol: I have one question supplementary to Senator Benidickson's and I have another one after that. I go back to the question of the mechanics of overall economic management, integration of fiscal policy and monetary policy, the process of consultation between the bank, the Department of Finance and so on. I think we have identified, and you explained very well, the degree of control that the government has over monetary policy, and you described the changes in the Bank of Canada Act which were made at your suggestion. The degree of consultation the other way, though, is still not quite clear to me. To put it in its most specific terms: does the Bank of Canada know what is in the budget? Not specifically this budget, but any other budget.

Mr. Rasminsky: Do we know before the budget is produced?

Senator Nichol: Before it is announced in the house.

Mr. Rasminsky: Yes, I think normally I would know what is in the budget before it is announced.

Senator Nichol: Good. If monetary and fiscal policies are to be integrated and the Bank of Canada did not know what was in the budget before it came out, it would be a very poor management situation I would think.

We have discussed the decision-making organization, and one of the things that has come up throughout the

hearings has been some criticism—and you have expressed some yourself—of large changes in the money supply, perhaps larger or deeper and higher than you would like to see. Dr. Giersch from Germany was very specific in saying that the indicator they watched was what he called the investment goods or capital goods industry expenditure indicator. When the time comes to make a decision, as was made in the spring of 1970, to increase the money supply, how is this decision taken within the organization, and what are the indicators that would signal to you and to the Department of Finance that the time has come within this complex of cycles to make such a move?

Mr. Rasminsky: An important factor in the timing of that decision was the external factor. Our balance of payments was very strong; we were buying a lot of exchange; it seemed appropriate in the circumstances to have this lead to easier credit conditions and an expansion in the money supply. In addition, of course, we were watching a whole variety of economic indices. We were watching the employment situation, the unemployment situation, the behaviour of prices, the behaviour of costs, trying to form some judgment as to what the economy would look like six months or twelve months ahead. One of the advantages of monetary policy is that your decisions of this sort are not necessarily big decisions; you can move tentatively week by week and reappraise the factors as they come along.

Senator Nichol: Dr. Giersch and others suggested that some research should be done, and I am sure it is being done, to find other indices because the obvious ones to the public such as unemployment figures or inflation figures or cost-of-living figures had such lags in them and were so affected by so many other lagging indices and lagging systems. They had attempted to search deeply to find some other indices which did not have such lags in them, and came to this capital machinery index. How do you feel about that? I do not mean the specific index, but what are the things in your opinion that call the signals ahead of time? Obviously in the case of unemployment figures, by the time the monetary policy has an effect, the lags may be six months, nine months, 18 months—nobody knows. So, where do you look?

Mr. Rasminsky: I do not think you can look for any single index. I think that you use the research tools that you have to try to form judgments regarding what is likely to happen to consumption, to investment or to government expenditures, including provincial and municipal government expenditures. You get what information you can or what judgments you can as to whether there is likely to be any significant changes in inventories. In other words, you look at as many economic variables as you can, and it is possible now through the computerized technique of forecasting to include quite a few. You come up with a view, subject to correction without notice, as to the broad direction in which the economy is moving and as to the magnitude of the movements you are likely to take.

The Chairman: Do you think you should publish those forecasts?

Mr. Rasminsky: No, I do not, because I think they would be regarded as official prophecies as to what the economy was likely to do and this might lead people to make some investment decisions. Frankly I do not have enough confidence in the forecasts to be willing to publish them although I think they are getting better.

Senator Nichol: I do not want to pursue that any further, Mr. Chairman, but I have some further questions.

The Chairman: Then I shall come back to you later.

Senator Isnor: Mr. Rasminsky suggested that the standard of living in the Atlantic provinces was lower than in the rest of Canada. I think he used the term twice today.

Mr. Rasminsky: I will have to look at the record. I thought I referred to them as slow growth areas.

Senator Isnor: "Slow growth" is different from "Standard of living."

Mr. Rasminsky: I do not think that I referred to their standard of living as being low.

Senator Isnor: I did not want to let that go by. I wanted to put it on the record. I have lived there for over 80 years—a good many years over 80. I have been in public life for 43 years and I have covered the rest of Canada pretty well. I think the standard of living in the Atlantic provinces is on a par with the rest of Canada.

The Chairman: I am glad we have that on the record, senator. It is a powerful statement.

Senator Carter: On page 4 of your brief you give some interesting figures dating from 1953. You say that output per capita increased by 52 per cent and that the standard of living, based on real consumption per capita, increased 53 per cent. That is a very close relationship. Is that merely a coincidence, or is there a formula at work there?

Mr. Rasminsky: I think one would expect to find a close relationship between output per head and consumption.

Senator Carter: It is point for point, 52 per cent against 53 per cent in a period of 17 years.

Mr. Rasminsky: Perhaps, Mr. Bouey, you would like to explain the difference between those two figures?

Senator Carter: Not the difference.

The Chairman: Is there any correlation?

Mr. G. K. Bouey, Deputy Governor, Bank of Canada: There is bound to be a close correlation, because consumption accounts for such a high proportion of output; but there can be variations owing to changes in other forms of expenditure, for example, government spending or capital investment.

Senator Carter: But what I am getting at is whether it denotes a general law that for every point increase in per capita output your standard of living goes up one point?

Mr. Bouey: Not exactly one for one.

Senator Carter: Is it close enough to call it a law? Are there very wide fluctuations in that?

Mr. Bouey: It is close enough.

The Chairman: Mr. Rasminsky, about two years ago, or maybe longer, I think you made a speech in which you said that many of the people who held the levers of power in Canadian society had never known what it was to suffer a serious down-turn. It was on the whole question of inflationary expectations. You said that these people were used to nothing else but going up. You said that something had to be done to change this attitude.

Mr. Rasminsky: Change the attitude towards inflationary expectations, yes.

The Chairman: Do you think you have been successful in this?

Mr. Rasminsky: I think we have had a limited success.

The Chairman: Did I quote you correctly?

Mr. Rasminsky: I do not remember the exact words, but I am sure that I did say something very much along the lines of what you said.

I think we have had some success in this, senator. The behaviour of the consumer price index, which, as you know, has been extremely good, and which compares very favourably with that of any other country, has changed some people's attitudes towards the inevitability of inflation. Perhaps the moderation that we see coming in to wage settlements is also an indication that the inflationary expectations are at any rate less intense than we have had before. So I think I would say that we have had some but not complete success.

Senator Nichol: My question was on the same subject, or close to it, on this question of the much publicized paradox between inflation and economy. I put this proposal to Dr. Deutsch yesterday and I would like to put it to you, sir, and ask you what you think about it. For 40 years, since the depression, we have constructed on this continent—the United States and Canada—and in certain western European countries, too—a social system designed specifically to protect people from the evils of demand slack which was so disastrous in the 1930s. This is what we have done. We have built a whole structure to protect them and it is a structure which most of us enthusiastically endorse.

We are now shifted, certainly in the United States and possibly in the United Kingdom, to policies of protection of corporations which might go broke. We had the cases of Penn Central, Lockheed, Rolls Royce, and the crisis in the Clydeside shipbuilding industry which is now occurring in the United Kingdom. People are demanding that if corporations, because their product is no longer available, or because they are badly managed, or because they have let their current issues get out of hand, or whatever the reason is, are about to go broke, the government has a responsibility to step in.

We built this structure, first of all in terms of people. Secondly now, it is beginning to show up that people are demanding that it apply also to corporations. How can there be a downside effect to monetary policy with this structure so deeply built into our system? How can constriction do anything else but produce unemployment without really bringing prices down?

Mr. Rasminsky: My impression, senator, is that you may be exaggerating the extent to which there is in fact a policy of protecting corporations against bankruptcy. After all, Penn Central did go broke, Rolls Royce did go into bankruptcy.

Senator Nichol: If I might correct myself, the governments are trying to avoid getting into the position of having to do this, but the pressure is on them to do it.

Mr. Rasminsky: There has been a very considerable squeeze on profits, Senator Nichol, and shareholders have had to face reduced dividends without governments coming to their rescue.

Senator Nichol: Yes, of course they have, but I think you would agree that there is a mood. I know that in Seattle, where they have had disastrous effects, they have cut back the space industry, and they have been very conscious of it, and there has been tremendous reaction on the United States Government to get in there and save Boeing.

Mr. Rasminsky: On account of the very great localization of unemployment in the Seattle area.

Senator Nichol: What I am asking is, with this structure, and I did not mean that particular structure, with this whole structure that we have built, are not tight monetary policy effects on the cost of living very limited because of this, because of the destruction of competitive markets—I do not know the economic term.

Mr. Rasminsky: These things that you talk about certainly impair the effectiveness of monetary policy, but the real question that we have to ask ourselves is, what alteratives do we have? If we are concerned about inflation and about the loss of employment which letting inflation go too far will ultimately produce, do we have any better choice than to use the instruments of fiscal and monetary policy to try to keep it in check?

Senator Nichol: There have not been any suggested at these hearings that I have heard in the last several weeks.

The Chairman: Are there any further questions, honourable senators? Does anyone from your side, Governor, wish to make a statement at this stage?

Mr. Rasminsky: I think not.

The Chairman: Governor Rasminsky, on behalf of honourable senators I should like to thank you very much for a most worthwhile submission and for being so good as to answer all our questions, good, bad and indifferent, over three and a half hours. It was very good of you. Thank you very much.

Hon. Senators: Hear, hear.

Mr. Rasminsky: Thank you, Mr. Chairman, and honourable senators.

The committee adjourned.

APPENDIX

Submission of Louis Rasminsky, Governor of the Bank of Canada, to the Standing Senate Committee on National Finance. June 17, 1971

1. *Introduction*

The Bank of Canada welcomes the initiative taken by the Senate Committee in organizing these hearings in order, in the words of your terms of reference, "to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation". We are also very much in sympathy with the purposes of the Committee set out by the Chairman in his opening statement at the first meeting. The objective of improving public understanding of the problems and choices involved in bringing influences to bear to move the economy along the right path is indeed a most important one. As one who carries responsibility for the operation of one element of economic policy, monetary policy, I welcome your endeavour to examine new concepts for achieving the objectives of economic policy. You have been presented with some recommendations for approaches quite different from those now being followed and I am glad to respond to your invitation to comment briefly on some of them.

While I have not had an opportunity of seeing all the evidence, I must say that I have been impressed, as I am sure you have been, by the diversity and often contradictory nature of the arguments you have heard. This reflects the complexity and perhaps intractability of some of our problems, but I think it is also illustrative of the fact that economics is not yet, and probably never will completely be, an exact science. Despite the rapid growth of the profession of economics and the more rigorous testing of theories in recent years, many propositions are not readily demonstrable and much territory remains in which opinion rather than proof holds sway. There is no doubt that we face difficult problems in improving our economic performance and in particular in achieving full growth over any sustained period of time without inflation. It is also clear that there are no easy answers: many other countries are confronted with the same basic problem and they have not been more successful than we in finding solutions.

2. *Economic Goals*

I need hardly say that the Bank of Canada does not set goals for monetary policy that are different from those of over-all public economic policy of which monetary policy forms a part. In its submission to the Royal Commission on Banking and Finance a few years ago the Bank interpreted the objectives of national economic policy to include "sustained economic growth at high levels of employment and efficiency, internal price stability and the maintenance of a sound external financial position, an equitable sharing of economic benefits and burdens, and the maintenance of a high degree of economic freedom". Others have used somewhat different words to describe the economic goals of our society or have reservations about the appropriateness of the statistical measures we now use to determine our progress. To the extent that there is difficulty in attaining all of these goals at the same time, there is some difference of opinion as to the respective weights that should be attached to them. But there is no question that our formulation is consistent with the objectives which you have set out, namely, full potential growth and employment without inflation.

In this connection it is obvious that our economy has at times fallen short of achieving these goals and that we are currently in that position. The present high rate of unemployment, the recent period of slow growth and price and cost inflation are evidence of unsatisfactory performance. At the same time I believe that it is worth remembering that our experience with modern fiscal and monetary instruments is relatively short—it is certainly not more than twenty-five years—and the average performance of the economy in that period has been very much better than in earlier periods of our history.

No doubt demands on public economic policy have risen even more rapidly tnan performance has improved; there is a natural desire to compare actual performance with some ideal standard rather than with the past. But I think that it is worth looking back once in a while to remind ourselves how far we have come. In the years since 1953, a starting point which is useful because it marked the end of both the Korean War and the immediate adjustment period after the Second World War, output per capita has increased by 52 per cent. The standard of living, as measured by real consumption per capita, that is, after allowing for price increases, has increased by 53 per cent since 1953, and in addition our people have had the benefit of very substantial increases in the volume of services provided through governments. Moreover, a very large volume of housing, plant and equipment has been put in place over these years. On the other hand, over the period since 1953 unemployment has averaged 5 per cent of the labour force and prices of goods and services as a whole have risen at an average rate of 2½ per cent.

There is a widely shared interest in improving economic performance further and in the search for better techniques and policies. What is being debated is the question of what are the best ways of making progress toward the achievement of our goals. Here there are some rather wide differences of view as to what approaches or combinations of approaches offer the best chances of success.

3. *Role of Monetary Policy*

Since my responsibility is in the field of monetary policy, I expect the Committee will wish me to say something about the nature and effectiveness of the monetary instrument, and of aggregate demand policies generally, since monetary policy and fiscal policy together constitute the principal means of influencing the development of aggregate demand, i.e., the total level of spending, in the economy.

Monetary policy operates on the total level of spending by influencing credit conditions, that is, the availability

and cost of money, which in turn affect incentives to spend. Changes in the availability and cost of money also have an important influence on flows of interest-sensitive funds in and out of Canada. The chief technical means by which the Bank of Canada exerts its influence is through its control over the rate of expansion of the banking system. Other things being equal, a more rapid growth in bank assets and bank liabilities (bank liabilities constitute most of what is commonly referred to as the money supply) leads to easier credit conditions; a slower growth leads to tighter credit conditions. Competition between the banks and other financial intermediaries and other borrowers and lenders causes the influence of the Bank of Canada on the banking system to spread through financial markets quickly. The Bank of Canada is able to control the rate of growth of the banking system by using the powers available to it under the Bank of Canada Act to regulate the level of cash reserves of the banking system. It has also used its statutory power to set minimum secondary reserve requirements for the banks within certain specified limits.

Although the Bank prefers to discharge its responsibilities through the use of the techniques which I have described, it has felt that there have been occasions when ordinary procedures were not completely adequate and when exceptional requests for co-operation from banks and other financial organizations were justified. This activity is sometimes described as "moral suasion". For the most part, requests for co-operation have been made in an effort to soften the impact of tight credit conditions on less prosperous regions of the country or on certain activities, for example, small business and housing, where such action was believed to be in the national interest. While this use of moral suasion has not played a major role in relation to the over-all operation of monetary policy, it has had useful supplementary effects in particular situations. The Bank has not, of course, usurped governmental powers in making request for co-operation that fall under the heading of moral suasion. I have always been careful to ensure that initiatives of this kind have been taken with the knowledge and approval of the Minister of Finance. Finally, for many years all instances of resort to moral suasion have been made public in press releases, speeches or in my annual reports to the Minister of Finance.

You will note that with the minor exception of these requests for co-operation the influence of the central bank on spending decisions in the economy is general and indirect. The Bank of Canada operates only at the centre of the financial system—on the cash reserves of the chartered banks and in the market for Government securities—and its influence is transmitted to final borrowers and lenders and investors indirectly through financial institutions and financial markets. Except for the operation of certain governmental lending institutions and programmes, the allocation of credit is a matter that is settled in the private sector of the economy.

At first sight monetary policy appears to be an extremely powerful instrument because theoretically there is no limit to the extent to which it can be used to tighten or ease credit conditions. In fact it is subject to a number of important constraints insofar as its use to affect domestic economic conditions is concerned. One of the most important of these is the level of interest rates outside the country. A level of interest rates in Canada which is high in relation to those outside may give rise to large unwanted inflows of interest-sensitive capital which add excessively to the exchange reserves and the amount of funds required to finance accumulations of exchange or, if we are on a floating rate, to what may be an undesired appreciation of the exchange rate. Alternatively, a level of interest rates in Canada that is low relative to external rates may produce effects in the opposite direction that may be inappropriate to the state of the economy.

Limitations on the extent to which domestic interest rates can be allowed to rise places limitations on the capacity of the central bank to restrain the expansion of the banking system and the money supply. If, for example, the borrowing requirements of the Government, taken together with those of the private sector, are rising rapidly, the central bank may find itself in the position of having to choose between allowing the banking system to expand more than it would like to see or having interest rates rise higher than might be appropriate in relation to the domestic economic circumstances or in relation to the level of external rates.

There are a number of other important limitations on the use of monetary policy to achieve precise economic targets which apply to the use of aggregate demand policies generally and they are discussed in the following section.

4. *Role of Aggregate Demand Policies*

The other major demand policy is fiscal policy which affects the total level of spending in the economy through changes in the amount of tax revenue taken from the private sector, through government expenditures and using a broad definition, through the important lending activities of government. Monetary and fiscal policies are often discussed as though they were completely separate. They are by no means the same thing but fiscal policy exerts a strong influence on monetary conditions because it is fiscal policy which determines the amount of borrowing which the Government must do and this, together with the way in which the Government debt is managed, can have an important effect on the liquidity of the banking system, the money supply, and on credit conditions generally. Different combinations or "mixes" of fiscal and monetary policy which are designed to have the same effect on total spending can have quite different effects on many factors in the economy, including the level of interest rates, international flows of interest-sensitive capital, and the exchange rate. Co-ordination of monetary and fiscal policies is therefore most important, though it should be noted that co-ordination does not mean that at all times the two policies need be moving in the same direction.

Unlike monetary policy, fiscal policy can to some extent be directed at specific situations, industries and regions through selected changes in taxes or in particular

kinds of government expenditures or loans. Nonetheless, the major influence of fiscal policy is the broad one of affecting the total level of spending in the economy, in effect by putting more or less into the economy than it is withdrawing.

A major advantage that is claimed for the broad aggregate demand policies—fiscal and monetary policy—is that they leave the maximum scope for private decision-making in regard to what is produced and consumed in the economy and the determination of prices and incomes. In other words, they are regarded as a means of exerting a general influence over the level of activity in the economy and the trend of prices in a way that is consistent with a high degree of economic freedom. One of the major problems in economic policy has come to be that of reconciling the desire for a high degree of economic freedom with the increasingly ambitious and precise targets for economic performance that we are setting for ourselves.

Experience with the broad, general policies affecting aggregate demand has shown that they are not capable of being very finely tuned. Both monetary and fiscal policies have impacts on the economy that are distributed over relatively long periods. While some effects may be felt quite soon, the lag before the maximum impact is felt may be considerable. In the case of changes in monetary policy, interest rates react quickly but significant changes in the availability of credit take longer and there is a further lag between the time that financial conditions are affected and the time that the resulting spending decisions have their effects on economic activity. In the case of fiscal policy, there are lags in the reaction to changing tax rates or levels of government expenditures; the effect of a change in taxes, for example, may for a time be offset by either an increase or decrease in private saving. The time lags associated with changes in either monetary or fiscal policies, or it may be added with changes in the exchange rate, will also differ according to the economic circumstances.

Among other things, this problem of lags means that economic policies must be based on reasonably good economic forecasts. The tools of economic forecasting have improved a great deal over a rather short time-span but accurate forecasting is still very difficult to achieve. It is subject to all the problems of obtaining adequate information on a reasonably current basis and to the difficulties of forecasting the evolution of the domestic economy, to say nothing of developments outside the country, particularly those in the United States economy, which are so important to us. To take a rather extreme example, it would have been no mean feat for economic forecasting in the mid-'sixties to have foreseen the magnitude and timing of developments in the war in South-East Asia. However, I am confident that we can expect to see a continued, steady improvement in the capacity to forecast economic developments over time and to measure the magnitude and timing of the impact of changes in policy. The Bank of Canada devotes considerable resources to research in this area and a good deal of work is being done elsewhere.

Another important feature of the aggregate demand approach to achieving our economic objectives is that it is designed to operate in a competitive, market-oriented economy. In a system of this kind competition between suppliers of goods and services should ensure that an increase in the rate of growth of demand would call forth increased production, so long as manpower and plant capacity were available, without an acceleration in the average rate of prices and money incomes. Similarly, a slackening in the increase of money demand during an inflationary period should result in a levelling off in the rise in average prices and money incomes, rather than resulting in a slower growth of production and employment. In point of fact, of course, competition in any modern economy is far from being perfect. Individual prices and incomes in our society tend to be much less flexible on the down-side than on the up-side for a variety of reasons. At the same time, physical and human resources are not sufficiently mobile to prevent bottlenecks from developing in some sectors of the economy, even at times when a good deal of slack exists in others. In this situation of imperfect competition, a great many people—business corporations, unions, professional groups, and others—are in a position at certain times to exercise their market power in ways which make inflation more likely to develop while there is still more than a minimum of slack in the economy and which, once generalized inflation has developed, make it persist after demand pressures have eased.

There is thus a great deal to be said for doing whatever we can to improve the structure and operation of our economy by improving the quality and mobility of our resources—for example by increasing skills through manpower retraining and by facilitating labour mobility—and by making it more competitive. Apart from the vigorous application of conventional competition policies to protect consumers, there may be a need for further innovations of policy in order to deal with the abuse of market power. Beyond this kind of approach there are, of course, other approaches such as guidelines and voluntary agreements among the main social partners. Such approaches have been explored with vigour by the Prices and Incomes Commission. I was fully in accord with the view that the effort should be made but it would be unrealistic not to admit that the results were less than had been hoped. I do not intend to go into these matters further here because other witnesses who are more expert than I have dealt with them thoroughly. I shall merely add that I completely agree with the view that this is an area of very great importance and that in spite of the disappointing experience in Canada and a good many other countries, the search for ways to bring the common interest to bear more effectively on price and income determination must go on.

Given the characteristics of modern economies and the present state of knowledge, it is not realistic to expect to formulate policies that will achieve precise targets at a precise time. Failure to appreciate this can lead to considerable misunderstanding. For example, in the most recent attempt to follow policies to check inflation no one

in the central bank, or elsewhere for that matter, decided that the situation required an unemployment rate of 6 per cent or more. The objective was to slow down the rise in prices and costs, and the strong inflationary expectations that had developed, by slowing the rate of growth of aggregate demand with as little rise in unemployment as possible. In point of fact, monetary policy, and fiscal policy too, began to ease in 1970 when the most recent seasonally adjusted figure available for the unemployment rate was 5.0 per cent. There was of course concern at that time that unemployment would go somewhat higher, arising from the lagged effects which I have mentioned, but the level that was reached was the result of many factors, which were difficult to predict, including the extent of work stoppages in Canada, and the fact that virtually all of the moderate slow-down in the growth of money demand was reflected in slower increase in output and very little in a slower increase in the GNP price deflator.

5. *Approaches to Policy*

I should like now to turn to the more controversial issues of policy which arise in relation to the use of fiscal and monetary policies in Canada in pursuit of the country's economic objectives. I have of course been very interested in what others have said before this Committee on the big policy questions, and I am going to try to put my own comments within a simple but broad classification of approaches to policy which seems to me to arise from the variety of proposals on public financial policy that have already been made to the Committee.

I shall deal first with what might be called a simple money supply rule for the conduct of monetary policy in Canada. I shall then turn to the use of fiscal and monetary policies together in what is frequently called demand management to influence the level of activity and trend of prices in the economy. I wish to comment on the approach of "learning to live with inflation" and very briefly on the approach of relying on price and income controls.

A Simple Money Supply Rule for Monetary Policy

The Bank of Canada does not follow a money supply rule, that is, it does not set a target figure for the increase in the money supply, however defined, and then seek to achieve that target either over short periods or on the average over long periods of time regardless of developments in Canada or in the world economy. Our approach was explained in our submissions to the Royal Commission on Banking and Finance in the following terms:

> Although it would be possible for the Bank of Canada, with its power to control the cash reserves of the chartered banks within narrow limits, to operate on the basis of a precise view about the appropriate trend, over some period, of total chartered bank assets (or of the "money supply", in the sense of currency outside banks plus chartered bank deposits), it does not in practice do so. The central bank is, of course, inevitably influenced in its judgments by developments in the "money supply", but it must also take a view of the kind of credit conditions that would seem to be appropriate in the light of the current and prospective state of the economy including the external financial position and it must be prepared within limits to use its control of cash reserves as the situation develops in whatever direction is necessary to try to bring about and maintain those conditions. This may mean that on occasion the Bank of Canada allows changes in its own and in total chartered bank assets to absorb pressures developing in financial markets rather than see credit conditions tighten or ease to an undesirable extent.

Some economists, including some who have appeared before this Committee, advocate that the central bank should follow a money supply policy, that is, a policy which would produce over time a stable rate of growth in the money supply. The first thing that I would like to say about this proposition is that my life as Governor of the Bank of Canada would be a good deal easier if I could persuade myself that there was some such rule which was in fact valid for the conduct of monetary policy in Canada. It would be pleasant to be able to say that the money supply was being increased at exactly the right rate and that if the economy was not performing as well as it should then the trouble necessarily lay elsewhere than in monetary policy.

To operate strictly according to a money supply rule, the central bank would have to be convinced that there is some specific and measurable definition of the money supply which was subject to its control and which exerted a reasonably predictable degree of control over the trend of economic activity. Although there has been a good deal of research on this matter, the evidence is far from being firm enough to justify an attempt to operate along these lines in Canada.

The idea of a money supply rule is not as precise as it seems at first sight to be. What, for example, is the definition of the money supply that should grow at some stable rate? Advocates of this approach very often do not say. We use several definitions of the money supply in the Bank of Canada and we can imagine several others, and they usually grow at different rates. It is a real problem with all quantitative monetary analysis that the theoretical idea of the money supply runs into the difficulty in practice that it is impossible in a developed financial system to classify financial assets into those that are clearly money and those that are clearly not. The spectrum of money-like assets is a continuous one. The money supply, with all its various definitions, needs to be watched carefully and we do watch it carefully, but I do not believe it can be the sole guide for monetary policy and I know of no central bank that operates that way.

Most of those witnesses before your Committee who supported a policy of stable growth in the money supply added that this would not be possible unless the exchange rate were allowed to float freely. I believe that is true. Since such a monetary policy would mean that it would be necessary to accept whatever changes in interest rates turned up, monetary policy could not be directed except perhaps very temporarily toward defending a

particular exchange rate. Very large fluctuations in interest rates and probably in exchange rates would have to be accepted as a price for obtaining relative smoothness in the growth of the money supply.

It may be argued that the money supply rule need be met only over the longer-term, but if the longer-term is so long that major departures can be made from the target rate, it ceases to be very helpful as a guide to operations.

The recent problem in Canada has been that we have needed stimulus to help move the economy on to a path of sustained growth and the encouragement of easier credit conditions has required rates of increase in the money supply, however defined, which were considerably higher than the average of recent years. If the increase in the money supply in the last twelve months had been limited to a significantly lower figure, for example, a rate roughly in line with the underlying growth rate of potential output, one might well ask how much higher interest rates and the exchange rate would be than they are now.

Demand Management

I would like to move on now from monetary policy to a discussion of how the power to influence the growth of aggregate demand through fiscal and monetary policies can be used to attempt to achieve the objectives which your Committee have set out. Assuming that the economy is not on a path of stable growth without inflation, it is possible to visualize three different sets of conditions. The first two are relatively easy to prescribe for, while the third is more complex.

The first case is one where there is too much unemployment and unused capacity but no evidence of inflation. This is a clear-cut case of inadequate demand and demand policies can be used to produce with some time lag an increase in total spending and a rise in the level of economic activity in both money and real terms.

The second case is one where it is clear that demand is pressing too hard on our available resources, where shortages have become evident, and prices and costs are beginning to rise. This is a clear-cut case of excess demand. This kind of inflation has come to be characterized as demand-pull inflation. It clearly requires action to bring the growth of aggregate demand into line with what is physically possible.

The third set of conditions, the most difficult one for economic policy to cope with, is often referred to as cost-push inflation. The use of terminology such as demand-pull inflation and cost-push inflation gets us rather deeply into questions of semantics. In a sense, inflation is always due to demand-pull because prices of goods and services could not continue to rise unless there was sufficient demand for them at the higher prices. However, when the rate of growth in the economy has declined to a level that is clearly less than that which would have started a round of inflation, it has become fashionable to say that the inflation is no longer demand-pull but that it is of the cost-push variety. In the cost-push stage the pressure may come from those who strive to compensate themselves for the increase in their costs that originated in a period when demand was excessive or from cost increases coming from outside the country, or to protect themselves against future price increases that they have come to expect as a result of the inflation that has been taking place. Cost-push inflation could undoubtedly be dealt with by very strong policies to restrain demand, if the consequences in terms of unused capacity and unemployment were ignored. In Canada, however, the attempt has been made to direct demand policies toward limiting the growth of total spending only as far and as long as necessary to create market conditions in which it would be difficult for suppliers of goods and services to maintain the rate of increase in their prices and costs. Indeed, it has been because of a desire to limit the slowing of economic growth to a minimum while dealing with inflation that I have been advocating since 1966 that as much as possible be done to improve ways in which the public interest can be brought to bear on the determination of prices and incomes.

It is obvious from the above that the state of expectations greatly affects the resistance of inflation to demand policies. Inflation is much easier to deal with if action is taken at an early stage rather than after inflationary expectations have become entrenched.

In the cost-push phase there is always the possibility that because of the concern to avoid the losses of slow growth and the hardships of unemployment, steps may be taken to accelerate the growth of aggregate demand too much or too soon, before inflationary pressures have been brought under adequate control. When this has occurred, as it did in the United States and perhaps to some extent in Canada in 1967 and 1968, the result has been a ratcheting up of the underlying rate of inflation and a marked strengthening of expectations of continued inflation. It is clearly a difficult matter of judgment to decide where the balance between these opposite dangers lies.

It is believed by some that in modern societies there are social forces operating on income determining arrangements which are so strong that the price of bringing cost-push under control by conventional means is unacceptably high. If this concern were valid it would imply a very basic change in the structure of the economic system and in the degree of continuous direct intervention required of the state. For my part I believe that this is too pessimistic a view. In the present situation it is still too soon to conclude that steady progress toward significantly lower levels of unemployment will not be consistent with a gradual improvement in our cost and price situation. This is of course the view on which the strategy of current demand policies is based and, while there have been some disappointments in the performance of the economy, the test is by no means over.

Under present conditions demand policies are being pursued which are designed to achieve a significant improvement in economic activity and the unemployment picture. As economic activity picks up productivity should increase and reinforce the trends towards a moderation of cost increases. At some stage, it will be important to make timely modifications in the expansive stance

of demand management policies in order to avoid a recurrence of the problem of excessive demand, in other words, to avoid overshooting our targets after the inevitable time lags. And it is of course the case that our fate is not entirely in our own hands because of external influences; if other countries, particularly the United States, do not achieve a reasonable degree of success in bringing their inflation under control, it will be more difficult for us to reach our objectives.

Learning to Live with Inflation

One of the recurrent themes before the Committee has been that public financial policy should aim at the maintenance at all times of full employment output in the economy, and if this leads to the inflation of costs and prices the society had better learn to live with it. According to the advocates of this view, full employment output can be reached and maintained by the use of fiscal and monetary instruments if this use is not inhibited by concern about the degree of inflation that may be generated. It is easier, runs the argument, for society to adjust to even a rapid rate of inflation than to any significant short-fall from full employment output. If, the argument continues, the degree of inflation encountered is sufficient to cause serious hardship to those groups in the community that are most hurt by inflation, the way to shelter them is to expand their money incomes automatically by tying them to some measure of the movement of prices.

The proposition that we do not need to worry about inflation because everyone can adjust to it is one that I and others have dealt with on other occasions but it may be worth covering some of the ground again. It is based on the view that we can choose, if we wish, a higher rate of inflation in order to have a lower rate of unemployment, i.e., that it is possible to trade off more inflation for less unemployment. The origin of the trade-off theory was the evidence that, in the past, high rates of inflation had been associated with low rates of unemployment and that lower rates of inflation had been associated with higher rates of unemployment. But the assumption that a certain high rate of inflation could be deliberately chosen in order to keep unemployment below a certain very low level was based on the fallacious view that the public would not adjust behaviour when it saw what was happening and that the trade-off relationships would remain constant. I stated my own views on this matter a number of years ago, in my Annual Report for 1966, where I said:

> I believe that most Canadians reject the thesis that we can or should accept inflation as a means of achieving high rates of output, and this has been made clear in various ways during the past year. For my own part I do not believe that this option is really open to us. I know that in recent years high rates of price increase have tended in general to be associated with low levels of unemployment. But I think it would be a serious mistake to infer from this that if only we were willing to accept high rates of price increase as a norm it would be easier to maintain low unemployment levels over an extended period. If this approach were adopted, the public would soon realize what was happening and would take whatever economic or political actions were available to it to protect itself against the officially-sponsored expectation of a cont.nuous and rapid decline in the value of money. It would soon become just as difficult to prevent price rises from exceeding a high target rate as it now is to prevent them from exceeding a low target rate. The same policies of restraint would come to be required. Nothing would be gained in employment or output; the difficult efforts to adjust to inflation would thus have been to no avail...

The task of avoiding inflation is of course more complicated if prices are rising at a rapid rate outside Canada and many of your witnesses have pointed this out. There may be occasions when upward pressure on our price levels will be dampened, as it was last year, by an appreciation of our exchange rate. If the exchange rate is relatively stable our price level will be affected by external price increases and it may well be that aggregate demand policies that attempted not only to prevent domestically induced inflation but also to offset the whole of the external price effects would be too difficult and too costly for us in terms of employment and output. There has been a fairly general view that we in Canada should try to do at least as well as the United States in controlling inflation and if possible a little better. In point of fact we have had in recent years a somewhat better record than the United States so far as prices are concerned but in terms of the underlying trend of costs it is not clear that we have done better. It seems to me that the general view that we should try to do at least as well as the United States is a reasonable one when their inflation appears to be relatively moderate and likely to be brought under control. Admittedly the United States has been having its problems but I believe it is much too soon to conclude that the United States or other major countries will in fact be willing to "live with inflation".

I think it has been suggested in your hearings that the danger of inflation accelerating has been overstated, that there is a tendency to look at Latin America for support for the view that inflation could get out of hand whereas the European experience is much more relevant. European countries have not sat idly by and accepted inflation—recently they have resisted it quite vigorously; and some have tried various controls. Nevertheless, their inflation rates have tended to become progressively higher. The average rate of price rise* in the European OECD countries which was 3½ per cent between 1964 and 1968 rose to 4½ per cent in 1969 and 6½ in 1970, and is still moving up.

Price and Income Controls

Not everybody who has said to the Committee that he thinks that fiscal and monetary policies should attempt to maintain full employment output at all times argues that the community should learn to live with inflation. Another view is that the world has changed so much that we can no longer expect inflation to be controlled by

*As measured by GNP deflator.

aggregate demand policies and the only thing to do is to put controls on prices and incomes. The role left for the aggregate demand policies would be to ensure that there is always an adequate level of demand to keep the economy operating at high levels of activity. The Committee has already heard from many witnesses about the great difficulties and problems involved in this course and I do not propose to elaborate on them. This view places an extraordinary degree of reliance on the ability of governments to put in place and maintain an efficient and publicly-acceptable control system. Moreover, it is clear that even with a comprehensive system of price and income controls it would be necessary to pursue appropriate demand policies which did not put such great pressure against the controls as to make them inoperable.

Approaches to Policy—Conclusions

I very much wish that I could conclude my brief on a firmly reassuring note. I would like to be able to promise that demand management together with longer-run policies to improve the efficiency and competitiveness of our economy can be counted on to achieve our goals in the foreseeable future without the danger of disappointing short-falls occurring from time to time. Alternatively, I would like to be able to tell you that I think there actually is some new and relatively painless approach that will bring us closer to achieving our goals. I assure you that if I believed that we could in fact achieve low levels of unemployment and high growth rates on a sustained basis simply be accepting a high rate of price rise, and ensuring that people were equitably protected, I would not allow any preference for price stability to stand in the way of recommending that we get on with the job. If I believed that some form of controls would produce better results in our present situation—and I do not deny the possibility that we may one day be driven to try something along this line—I would not hesitate to say so. But I cannot in all honesty tell you any of these things. I sympathize greatly with those who look at our present difficulties and say "there must be a better way" but wishing does not make it so. The fact of the matter is that managing a modern economy in such a way as to achieve our goals, goals that have rightly been set high, is an extremely difficult business, as all countries have found, and there are some characteristics of the Canadian economy that make it especially difficult here. What I have to offer the Committee cannot be expected to be a popular prescription: it will probably be regarded as unimaginative at best but I would claim for it that it is realistic. As we get on with the job of moving the economy forward at a more rapid rate and reducing unemployment we must seek to learn from our past experience: try harder to make our market economy operate a good deal better than it has recently operated if that is the kind of economy we really want; try to obtain a better public understanding of the limits to the benefits that the economy can reasonably be expected to provide; and strive for monetary and fiscal policies that are as well-conceived and well-timed as we can make them. And as we go along, we must continue to be concerned that the burdens caused by any periodic short-falls in the performance of the economy are distributed equitably.

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS

OF THE

STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 22

TUESDAY, JUNE 29, 1971

Nineteenth Proceedings on the Question of

Growth, Employment and Price Stability

(Witnesses and appendix:—See Minutes of Proceedings)

23922—1

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Isnor
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Croll	McDonald
Desruisseaux	McLean
Everett	Méthot
*Flynn	Molson
Fournier (*Madawaska-Restigouche*)	Nichol
	O'Leary
Gélinas	Paterson
Grosart	Phillips
Hays	Sparrow
	Walker—27.

**Ex officio Member*

(Quorum 7)

Orders of Reference

Extract from the Minutes of Proceedings of Wednesday, March 19th, 1971:

"With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on National Finance be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of Proceedings of Wednesday, April 28th, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Bourget, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the question of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation; and

Notwithstanding Rule 83A, that the budget approved by the Standing Committee on Internal Economy, Budgets and Administration and printed in the Minutes of the Proceedings of the Senate of 18th March, 1971, for the proposed expenditures of the said Committee on National Finance with regard to its examination of the Estimates last before Parliament for the fiscal year ending 31st March, 1972, be applicable as well in respect of its examination of the said question of fiscal and monetary policy in Canada.

The question being put on the motion, it was—

Resolved in the affirmative."

Extract from the Minutes of Proceedings of Tuesday, May 4, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance have power to sit while the Senate is sitting on Wednesday afternoons at four o'clock for the balance of the present session and that Rule 76(4) be suspended in relation thereto.

The question being put on the motion, it was—

Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

Minutes of Proceedings

Tuesday, June 29, 1971.
(22)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 9.30 a.m. to consider the Question of Growth, Employment and Price Stability.

Present: The Honourable Senators Everett (*Chairman*), Aird, Beaubien, Benidickson, Bourque, Croll, Flynn, Grosart, Hays, Laird, McDonald and Nichol. (12)

Also present but not of the Committee: The Honourable Senators Burchill, Giguère, Haig, Inman, Kinnear, Lafond, Lang, Macnaughton, McGrand and Smith. (10)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics; Dr. David McQueen, Economic Consultant.

Witnesses heard:
Department of Finance:
The Honourable E. J. Benson, Minister;
Mr. S. S. Reisman, Deputy Minister;
Dr. William Hood, Assistant Deputy Minister.

At 11.45 a.m. the Committee adjourned to 2.30 p.m.

At 2.30 p.m. the Committee resumed.

Present: The Honourable Senators Everett (*Chairman*), Aird, Beaubien, Benidickson, Bourque, Croll, Gelinas, Hays, Laird and Nichol. (10)

Also present but not of the Committee: The Honourable Senators Macnaughton, McGrand and Smith. (3)

In attendance: Dr. James Gillies, Director; Mr. A. B. German, Administrator; Mr. E. J. Brower of the Parliamentary Library, Division of Economics; Dr. David McQueen, Economic Consultant.

It was *agreed* to print as an Appendix a document entitled "Federal measures to stimulate economy taken since March 1970".

Witnesses heard:
Department of Finance:
Mr. S. S. Reisman, Deputy Minister;
Dr. William Hood, Assistant Deputy Minister;
Mr. Cyril Hodgins, Assistant Director of the Economic Analysis Division.

At 5.40 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Gérard Lemire,
Clerk of the Committee.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Tuesday, June 29, 1971

The Standing Senate Committee on National Finance, to which was referred a study of methods by which fiscal and monetary policy in Canada may be exercised to achieve full potential growth and employment without inflation, met this day at 9.30 a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have with us today a man who is well known to us and who has probably enjoyed the greatest increase in popularity since the beginning of this Parliament. I refer, of course, to the Minister of Finance, the Honourable E. J. Benson. We also have with us the Deputy Minister of Finance, Mr. Simon Reisman. You have before you the brief submitted by the Minister of Finance. I am sure that he has comments to make on that brief, and I will ask him to proceed.

The Honourable E. J. Benson, Minister of Finance: I do not propose to read the brief. You have it in your possession. It is a general outline—

Senator Benidickson: We now have it, but I received it only last night. However, I did manage to read it this morning.

Hon. Mr. Benson: The brief is very general in pointing out the problems faced by the Department of Finance and by the Government in determining economic policy. In the brief we did not go into current economic policy, as to how we have been proceeding. I think I explained this fairly well in my budget address the other night, and I have also explained this several times in the House of Commons.

Unless you would like me to, I do not think that I would like to comment any more than that on the brief. The general outline of the brief is such that it points out the problems in various areas and talks generally about them. It does not come down with any firm conclusions. We are, of course, looking to the Senate Committee to give us their ideas. I will be glad to answer any questions.

The Chairman: Thank you, Mr. Minister. I am sure that in time we will be giving you our ideas. In the meantime, we would like to suck all the knowledge and information we can out of you.

Senator Nichol: Over the last eight or nine weeks, the questions have broadly broken down into three categories: the first is the problem of identifying where you are in economic cycles; the second concerns what weapons you use to change or influence the direction in which you are going; and the third is what mechanical structure within the Government or the state do you use to implement those things. In other words, assuming that you are able to identify the correct fiscal and monetary policies for a given time and in a given direction, what mechanical structure, what system do you use?

The relationship between the Bank of Canada, which is autonomous to some degree, and the Minister of Finance, who is the elected representative of the people responsible for the economics of the country, to me at least, remains obscure. Of those three categories of questions, could you deal with the last first? Could you talk about that relationship?

Hon. Mr. Benson: Generally, the relationship is a close one between the Governor of the Bank of Canada and the Minister of Finance. I think that some people tend to look upon fiscal and monetary policies as being quite separate. They really are not, in my view, quite separate, because the extent to which the bank can act in monetary policy is, at least to some degree, determined by the fiscal policy followed by the Government.

There is the closest consultation with the governor of the bank, and under the Bank Act, as you know, the Minister of Finance presently has the right to direct the governor of the bank with regard to monetary policy. That has not been done by this Government. There has been close consultation with the governor of the bank. He indicates what his current ideas are with respect to monetary policy, and we talk about fiscal policy and what the Government intends to do in this area. So far as it is possible, the two are working in the same direction.

To deal with your first question, as to where we are in the present...

The Chairman: Senator Nichol, do you have a supplementary question?

Senator Nichol: I do not wish to ask the question as to where are we, but what are the techniques for knowing the current economic policy, or asking questions such as where are we, but what are the techniques for knowing where we are.

How do you feel about the degree of consultation between the various organizations within the federal structure? Putting aside the federal-provincial question, then the Prices and Incomes Commission, the Economic Council, the Department of Finance, the Bank of Canada, and the Treasury Board all have input into the decision that

we should go in a certain direction. Is this as closely co-ordinated as it could be? How do you feel about the American system by comparison?

Hon. Mr. Benson: I think that people—and it is partially the Government's fault—think there is much less co-ordination than there really is. Co-ordination must take place at the Cabinet level in the Government, and indeed it does through a very wide system of Cabinet committees which have been set up. We have in the Cabinet a Committee on Economic Policy. This committee includes people who are responsible for the agencies that you spoke of, as well as trade and other facets of Government.

We also have a Committee on Priorities and Planning. I cannot name the ministers, but the senior ministers of Government meet in that committee and decide to review the fiscal and monetary policy of the Government, and the economic overlook not only in the short run but for a period of time into the future. Indeed major economic decisions, whether they be made in regional economic development or in various other areas of Government, must first be approved by this committee.

So there is a tying together of these at the ministerial level. From my experience as a member of Parliament, which is not that long—it will soon be nine years—I think the system of co-ordination through Cabinet committees is far superior to anything that has existed, at least in my time in Parliament.

Senator Nichol: How do you feel about an advisory group, such as John Deutsch suggested, to the Cabinet on economic policy, consisting of people who did not have line responsibility?

Hon. Mr. Benson: Really, here you are talking of something like the Committee of Economic Advisers to the President of the United States.

Senator Benidickson: That is what he was talking about too.

Hon. Mr. Benson: Personally I would not be in favour of this. I do not think you gain very much by it. I think that our economic experience in Canada compares very favourably with what has happened in the United States, particularly in the present cycle. We have gone down less deeply and we have paid a lesser price than has been the case in the United States in combatting inflation, and we have been more successful in doing it. The Governor of the Bank of Canada is not really a line adviser. The Department of Finance is not really a line department; it is a policy department. The Treasury Board, which has many line functions, was deliberately moved from the Department of Finance, as was the Comptroller of the Treasury. The result of this has been the elimination of mechanical functions in the Department of Finance. Therefore, the department can devote its time to policy. Although the policy advice is generally good, now and again we should change a deputy minister, which we have done once, as well as the minister. If the advice is wrong and we do not like it, the thing to do is to fire the minister and deputy minister, rather than appoint an official to second guess the economic decisions. Those decisions can be co-ordinated, with any kind of throughput desired, with the cabinet committee.

Senator Benidickson: This question relates to the testimony of Dr. Deutsch, who has had recent and wide experience with government and with the Department of Finance. He suggested the establishment of a long-term, independent setup, because he felt that cabinet committees are likely to act more on an ad hoc basis and for the short term. However, he also suggested that if there were an authoritative, independent body of advisers their term of office should be very short and they should not consider it to be a permanent career.

I have been here for 27 years, and it seems to me that the principal advisers on economic matters have remained the same. I have been associated with some budgets and we have made some mistakes, but I would say that, by and large, the people who are closest to the Minister of Finance have been the same for approximately 20 years.

Hon. Mr. Benson: Senator, that just is not the case in the Department of Finance. The Deputy Minister of Finance has changed three times since I have been here.

Senator Benidickson: The title has lasted for 20 years. However, the group which is most likely to influence the Minister of Finance has been largely the same for 20 years. I refer to your former Deputy Minister, who was Clerk of the Privy Council, which is a very influential position, and the interchange between the Secretary of the Treasury Board and the deputy minister of your department.

Hon. Mr. Benson: We now have Dr. Hood on the economic side in my department. He came from the university, through the Bank of Canada. He has not been in the Department of Finance for 20 years. It is true that Simon Reisman, the Deputy Minister, was in the Department of Finance and, moved to Industry, then to the Treasury Board, but in quite a different capacity from that of economic adviser to the Government. Therefore, I just do not think there is that sort of morbid atmosphere of which one occasionally hears. There is a tremendous change in personnel in the Department of Finance. The governorship of the Bank of Canada has changed once in recent years. It is a matter of opinion.

Senator Nichol: In order to ascertain the relationship, I asked Mr. Rasminsky whether his officials were deeply involved in the budget discussions. He replied, of course, that they were. I am still not clear; perhaps I have not expressed my question well. Where does the political responsibility, which is the important and over-riding responsibility for economic policies, stop? Where does the independence of the Governor of the Bank of Canada begin? This becomes particularly important now when, obviously, we are in a very delicate position between unemployment and inflation, with a highly expansionary monetary policy.

Wood Gundy's money market paper states that in the period from January through May, 1971 the Canadian

money supply increased at an annual rate of 19 per cent, seasonally adjusted. For May alone the annual rate of expansion approached 27 per cent. That policy may or may not be right. How much influence does the Department of Finance have on that decision, or is it Mr. Rasminsky's business?

Hon. Mr. Benson: No, the day-to-day operating policy of the Bank of Canada is the responsibility of the governor of the bank. Therefore variations in money supply over the short run are basically his decisions. However, its overall trend is discussed by the Governor of the Bank of Canada, the Minister of Finance and, indeed, through the elected representatives in the cabinet, at the highest level. The general, overall trend and the fiscal and monetary outlook are determined really at the highest level possible within our governmental system. This is not determined by the Prime Minister per se, but he is part of it, together with the cabinet. The political influence is there if one wishes to use it and change the direction materially. There is no question of that, and I do not think it is questioned by the governor.

Senator Nichol: If the governor disagrees strongly, presumably his alternative is to resign, if he cannot change the policy through his influence.

Hon. Mr. Benson: The Bank Act, as we revised it...

Senator Nichol: At his request, I understand.

Hon. Mr. Benson: We revised it because of a difficulty which arose with a former governor. No one claimed responsibility for monetary policy and the Government indicated, I believe, at that time—I was not here—that it had no responsibility. That is no longer the case. I agree with your figures: they include Government deposits.

The Chairman: I would doubt, Mr. Minister, if the figure includes Government deposits. It would be all but Government deposits.

Mr. S. S. Reisman, Deputy Minister of Finance: The figure of 19 per cent quoted by Senator Nichol must include the Government deposits.

Senator Nichol: I think it must, because it is so very high.

Mr. Reisman: There are a number of definitions; the time deposits and demand deposits can be excluded. However, your figure is all-embracing.

Senator Nichol: The paper does not indicate what it is.

Senator Grosart: This is M-2.

The Chairman: But M-2 would not include Government deposits. I have not heard a definition yet that would do that.

Senator Nichol: My question does not revolve around whether this is M-1 or M-2, but whether it is an independent process of the Bank of Canada and to what degree the Department of Finance has control?

Hon. Mr. Benson: We have the ultimate control, and under the Bank Act the minister has the right to issue a directive to the governor of the bank. If he decides not to accept it, of course, his alternative is to resign. It has not been necessary to differ in view from the Governor of the Bank of Canada since I have been Minister of Finance. We have operated in the same direction in monetary and fiscal policy. One may question the weight that has been placed on each, but I think one also has to consider the interdependence.

Senator Nichol: I have nothing more on that subject, Mr. Chairman, if there is someone else who wants to proceed with it.

Senator Grosart: Mr. Minister, at the start of your brief you make a great deal of what you call the high level of partnership between business and government. Looking at the relationships in some other countries, such as Japan, Sweden, Switzerland, and even the United States, one gets the impression that we do not have a very high level of partnership between government and business in Canada. Perhaps it would be more accurate to describe it as an on-going confrontation. Would you say that is correct? Do you feel we have a high level of partnership?

Hon. Mr. Benson: It is a partnership in a sense, in that if one is to operate the economy they have to operate as partners, whether they are partners who get along with each other or not, in going towards the aims of economic policy in the country. I think the relationship with business is relatively close in Canada. It certainly is not as close as in Japan, where, as you know, they have a very centralized economy, and that kind of relationship just would not be tolerated in Canada, mainly by business. I think the doors of government are open to business in Canada, and there is relatively close consultation, probably as close as there is in the United States, or even closer.

Senator Grosart: Perhaps one of the objections of the private sector would be the very high level of transfer of GNP components from the private to the public sector in Canada. The indications are that this will increase. The projection shows the all-government "take", if I may use that word, from national productivity running to about 40 per cent by 1980. It is somewhere between 37 and 38 per cent now. Has the question ever been raised in your discussions as to whether this on-going transfer from the private to the public sector may be too high in Canada?

Hon. Mr. Benson: In Canada, I am informed, there are different figures, because people use different measurements. It is around 34 or 35 per cent. One of the things that has been happening, in recent years at least, is that the federal government's share of the transfer from the private sector has been declining. This is not to blame other governments, but there has been additional responsibility placed upon the lower levels of government. They have been requiring a higher overall share of the GNP, and in order to keep it at a reasonable level the federal government's share has been declining.

Senator Grosart: I wonder if it has been declining, Mr. Minister. I know the conventional figures, but whereas the conventional figures take in some loans, investments and advances, they leave out other loans, investments and advances—CMHC, for example—and they do not include the "take" from unemployment insurance or Old Age Security. I know it could be argued that these are loans and that the take is on a different basis, but it is still money taken out of productivity and under the control of the federal government. Actually I think in this kind of definition the federal take is increasing. I do not understand why you come up with a figure of $14.8 billion and say, "This is budgetary expenditure, and if we add another not quite a billion of loans it is $15.8 billion, but we will not talk about the OAS and unemployment insurance take." Why don't we? Why don't we say, "This is what the federal government is taking"?

Hon. Mr. Benson: I have no objection. You would, of course, have to include the Canada Pension Plan and the Quebec Pension Plan in there.

Senator Grosart: Of course.

Hon. Mr. Benson: Those figures are available, and I have no objection to their being put together. The basic question you raise is that of government taking funds out of the economy for various purposes.

Senator Grosart: Yes.

Hon. Mr. Benson: Government, of course, does not take funds out of the economy and keep them.

Senator Grosart: No, no.

Hon. Mr. Benson: Government takes the funds out of the economy for specific economic and social purposes. Whether these are aimed in the right direction is a matter of judgment for Parliament, government and ultimately the electorate in Canada. It is true that over the past 20 years there has been a movement towards more services being provided by government. In that period of time we have seen hospitalization, old age pensions, the Canada Pension Plan, changes in family allowances, medicare, a great many areas where the government has, I think as requested by the electorate, taken over these services. Certainly, the electorate has supported governments that have indicated they wanted to take these things over.

The question is how much further we go. I personally do not see major new areas of government expenditure opening up, although I have some worry about this pollution one. When one starts talking about pollution, I can see vast sums of money being involved. In areas of social change in Canada, unless and until a government moves to something like a guaranteed annual income, I think there will be no major changes in the near future in that area. We have given the undertaking to the provinces that any change in the future involving a joint cost program would involve consultation with governments at all levels.

In percentage of GNP that is taken out by all levels of government, we are somewhat higher than the United States, a point or two, or perhaps three, and we lie below some European countries. I do not know where you end up in this; it is very hard to forecast. It all depends on what sort of services are demanded from governments by the public in the future, and that is hard to forecast. I do not see any major changes on the federal side in the immediate future.

Senator Grosart: Do you think the present level of somewhere between 34 and 37 per cent is viable in, say, GNP terms? What I am getting at is that a very good case can be made out that control of the sources of productivity by the private sector will expand the GNP faster than control by the government sector. What I am really asking is: Do you have an overview policy on this? Do you sit down and say, "Well, that is enough. 34 is too high" or "too low"?

Hon. Mr. Benson: No, I do not think you do that.

Senator Grosart: It is easy to say you respond to what you can offer the electorate.

Hon. Mr. Benson: I do not really think you do this. I think governments make both the short-run and the long-run decisions based on the demands of the electorate. I do not know whether 34 per cent is too low or too high in the longer view. I do know that we must have a viable private sector in order to support a 34 per cent take by governments out of the productivity of the country for governmental purposes, but whether it is too high or too low I do not know. It is lower than many countries in the world; it is a little higher than the United States.

Senator Grosart: Did you put your budget predictions into, say, the Bank of Canada econometric model this time?

Hon. Mr. Benson: We have both the Bank of Canada predictions and our own, in the Department of Finance, and each time they are compared.

Senator Grosart: Do they agree?

Hon. Mr. Benson: Yes, I do not think they are very far out, but sometimes they do disagree and then we start checking them out to find the reasons for the disagreement. We also use outside models.

The Chairman: One of the things that has been troubling us, Mr. Minister, is what agency is there in the Government structure for long-range planning, for the determination of what resources will be available to the country over a longer period of time, and how these resources might well or will likely be used, as opposed to should be used.

It seems to us that the Government, having to face the electorate from time to time, being very sensitive to the will of the electorate, is perhaps more short range in its views, and for very good reason. We wonder just what agency there is in Government that gives them this long-range overview, that makes sure we are not in a position of over-using our resources or committing too many resources to one particular subject.

I am thinking particularly of the one which is worrying you, pollution. What agency in Government is going to determine what resources may well have to battle pollution? I am not talking of Government resources, but community resources as such, to give the public the knowledge it requires really to make a decision on pollution.

Hon. Mr. Benson: The Government has moved, even on expenditure programs of departments, into longer range planning, in the period of time I have been here. It used to be that estimates were decided in December, when they had to be tabled in January or February. This period has been moved back substantially. Here I am talking of the planning of Government per se.

The departments are required now to put in five-year budgets, for example, and these are then brought up to date as they move along. One would expect the second year to be fairly close, but when you start budgeting five years ahead, you tend to get a bit out at the end. However, it is a very useful function to move from just putting in the estimates for the current year, to having to put in the estimated expenditures over a five-year period.

Senator Benidickson: When was the five-year-period requirement put into force?

Hon. Mr. Benson: We started this when I was in the Treasury Board, about two or three years ago.

Mr. Reisman: I think it was in 1968 that we had our first analysis of the five-year period.

Senator Grosart: The same time as the PPB.

Mr. Reisman: Yes, the Planning, Programming and Budgeting system came in at the same time.

Hon. Mr. Benson: Here we have been talking about five years ahead, but regarding the long-range problem, at the cabinet level the Government has been looking at it to see what the country will look like over a ten- or fifteen-year period. A good deal of time has been put into trying to build up what kind of country this is going to be ten years from now and what we could do to influence it to be that kind of country. This is the other sort of thing you are talking about.

The Chairman: This is at the cabinet level?

Hon. Mr. Benson: Yes, at the cabinet level.

The Chairman: What sort of data are you putting into that?

Perhaps we can ask Mr. Reisman that this afternoon.

Hon. Mr. Benson: Yes.

The Chairman: If I may pursue that for a moment, how do you see the Economic Council of Canada fitting into this sort of study?

Hon. Mr. Benson: My relationship with the Economic Council of Canada is simply that they produce reports, and I and my department study them. I have no closer relationship than that with the Economic Council of Canada. Perhaps one should have.

Mr. Reisman: They are supposed to be that way.

Hon. Mr. Benson: It was set up as an independent body, to come out with independent opinions. Of course, we pay attention to their forecasts and opinions—and, on occasion, we disagree with them.

The Chairman: In Germany, Mr. Minister, according to Dr. Giersch—who was at one time, I believe, associated with their long-term planning council—the council submits its report to parliament. I believe it is tabled in parliament. The government there, within a stated period, must react to that report, by a submission also to parliament. The government must state at that time what it intends to do in reference to the issues raised in that report. Would this be an approach that you might welcome in Canada?

Hon. Mr. Benson: One of the things I have tried to avoid since I became Minister of Finance—and one cannot always avoid it—is getting into fights with the Economic Council of Canada. I do not think that much useful to the public is derived from such activity, except in the case of people who like to see a debate between the Economic Council, the Minister of Finance and the Government.

What we do presently is pay very close attention to their recommendations and decide what we should do about various things they recommend. Whether one should have to report this to Parliament or not, I do not know. This is a matter of opinion. The legislation does not provide that; and I think it does not provide it in order to avoid the kind of public debate that might result.

The Chairman: What is your opinion?

Hon. Mr. Benson: On reporting to Parliament?

The Chairman: Yes, and on the Government being required to react to the report as such.

Hon. Mr. Benson: I would not worry terribly about it.

Senator Grosart: You react, anyway.

Hon. Mr. Benson: One reacts anyway, but if it means the kind of building up to public confrontation...

The Chairman: I do not think Dr. Giersch was thinking of public confrontation. The German concept was to bring into focus the long term approach of an agency that was not going to have to face the electorate which could, I suppose, force government, which has by its nature a shorter term approach, to react to the long term approach. Do you not think that may be worthwhile?

Hon. Mr. Benson: Personally, without thinking further about it at the present time, I see no objection to this procedure.

Senator Grosart: It just happens that the Germans formalize it. When you say you have to make a statement on these things, you do it in every budget statement. That is a response to what the Economic Council, the business community, and everybody else says.

On that point, the Economic Council tends to place a great deal of reliance in economic forecasting in respect to potential productivity. I gathered from your brief, Mr. Minister, that you were a little skeptical about that. On page 7 you use the phrase "the hypothetical figures that might be expected to display"—speaking of the Government accounts—"at a standard level of full employment." Have you some doubts about the validity of this potential productivity approach? I have, but I wonder about you.

Hon. Mr. Benson: Everybody says that if everyone was employed in the country and there was no unemployment, we would have X dollars more in productivity. This is a sort of pie in the sky, because it is not going to happen; it will never happen. What you try to do, in an economy, is to get unemployment down to the lowest possible level and to get your productivity as high as you can get it, without having too much inflationary pressure. That is the aim of every government, and must be. To say that one is losing $5 billion in productivity because you have X number of unemployed is not very realistic. It leaves out the other factors.

Senator Grosart: You refer to the rates of growth being measured by aggregates. Is there not some danger in this reliance on measurement by aggregates, when the trend among economists today seems to be one of disaggregating these figures, and really finding out what they mean? I refer you to the last paragraph on page 3 where you speak of the powers to tax, to spend, and to lend.

Hon. Mr. Benson: You really do it both ways. You do it by aggregates, and you break it apart and do it by its parts as well, senator.

Senator Grosart: Do you, really?

Hon. Mr. Benson: Yes. It may be that I overemphasized the use of these aggregates.

Senator Grosart: Finally on that same point, your brief places great emphasis on the aspect of bank deposits—$1.5 billion cash, and so on. Throughout there seems to be a suggestion that the best way to do this is for the Government to get as much money as it can and then decide what to spend and what to lend.

For example, the business sector and other parts of the private sector obviously tend to think that your corporation tax is too high. Other countries feel that if you keep the corporation tax down you are making money available for capital spending. Do you think that our level of corporate taxation is too high? Do you think it could be reduced, in view of the fact that it amounts to only about 17 per cent of the total budgetary revenue?

Hon. Mr. Benson: You have several questions here. The use of bank balances was expository. If there is any implication in the paper that I think it is important that Government get money in and decide how it is to be spent, I would like to clear that up right now. That is not the case. I think that governments must have enough money to do the kind of things people want them to do, and the more we can keep in the private sector the better.

Senator Grosart: Would you repeat that?

Hon. Mr. Benson: It will be on the record, and it was in my budget speech. Dealing with the corporate income tax, here we have to be fair and look at the overall corporate tax in Canada. We have a dividend tax credit, which other countries have not. If you take the two together, corporate shareholders in Canada are better off than those in other countries. You have to take both the corporation and the shareholder together.

Besides that, I thought that corporate tax rates were too high, and that is one of the reasons why, when I started building in the position whereby we would use up additional revenue coming in under the new income tax system, part of it went to the reduction of corporate tax rates over a five-year period.

The Chairman: I have a supplementary to one of your questions, Senator Grosart. You were talking about the aggregation and disaggregation of figures. One of the things that has bothered the committee, and I am sure it has bothered the Department of Finance, has been the use of the figure we call unemployment, how it disaggregates, how much of that is frictional and how much is seasonal, and how much represents people moving in and moving out. It becomes a tremendous—I suppose you would have to use the term "political football", because it is reduced in the end to one figure which is either the actual or seasonal figure; it is not broken down into its components. You must have thought about this a lot. I suppose you have had some sleepless nights over it. I wonder if you have any views that would help the committee on the you you think that figure should be presented?

Hon. Mr. Benson: When unemployment is at unacceptable levels—and I think it presently is, and has been for some time, at unacceptable levels in Canada—one starts thinking about the structure of unemployment, if one is Minister of Finance. But one does not at that time tackle the structure of unemployment and say, "Well, it is measured wrongly or it is measured correctly."

However, I do believe that in the long run we should have a look at the structure of unemployment in Canada, how it is made up, what can normally be expected because of seasonality, what normally would be the upturn in the winter, whether our unemployment, including those over 14 years of age, is appropriate, whether the age level should be changed—this sort of thing should be done at some time in the long range—and how much of the unemployment consists of people moving in and out of jobs. I believe this needs to be done. I think it would be an unfair diversionary tactic for any Minister of Finance...

Mr. Reisman: It is a question of definition.

Hon. Mr. Benson: In the long run we should look at it.

The Chairman: Has the department looked at it?

Hon. Mr. Benson: We do look at it.

Mr. Reisman: We do a tremendous amount of analysis on the structure. There are all kinds of breakdowns insofar as you can get that from a labour force survey. You must realize that, as you disaggregate and break down into components, the information that is obtained from a labour force survey, the examination of 30,000 family units, households, the validity of the information that you get is subject to a margin of error.

We do a great deal of analysis of this, and so does the Department of Manpower and Immigration, and other agencies of Government. The question was really directed to the definition. Have we got the right definition? Does it really measure what you set out to measure?

The Chairman: That is correct.

Mr. Reisman: The minister said that you do not play with definitions at a time when unemployment is high...

The Chairman: Nor was the question directed to asking him to play with definitions, but whether as a committee we might have a look at a better type of definition, or some way of expressing the term that gets closer to the problem.

Hon. Mr. Benson: It would be useful to do this. I think somebody should look at the definition of unemployment.

Senator Hays: In that context, are our methods of measuring unemployment similar to those of other countries, where they are claiming full employment, and that sort of thing?

Hon. Mr. Benson: I think that ours is quite similar to the United States system. But when you start comparing it to the British, the German, and the French, I think there are great differences.

Senator Hays: They use different measuring sticks?

Hon. Mr. Benson: Yes.

Senator Grosart: Are there not international statistical definitions?

Hon. Mr. Benson: I do not think there are.

Senator Grosart: There are everywhere else. In the whole statistical series, everything is clearly defined, it seems to me.

Hon. Mr. Benson: I am informed that there is not.

Senator Grosart: Which of these breakdown figures that Mr. Reisman mentioned are available? Are there figures available to show unemployment by households, by family units? "Household" is a census definition.

Mr. Reisman: I do not think so.

Senator Grosart: It seems that this is tremendously important where there is no family income other than welfare.

Mr. Reisman: There is a figure relating to heads of households, but there is not a breakdown of the kind that you are referring to, to show in great detail just who the unemployed are. There are some breakdowns. I think that we will be getting a good deal of that kind of detailed information from the census that is now being run. Whenever there is a census, one can get a good deal of finer and more complete information than you can get from the monthly labour force survey data. But even the labour force survey data does give some breakdowns. We will know, for example, the breakdown between men and women. We will know the breakdown by age within the men and women. We will know the married women and single women. We will know the heads of households and others. We will know a little by region and also by occupation.

The Chairman: I think I will interrupt there, because we can come to that this afternoon, if we are talking about the evidence that Dr. Reisman will present.

Senator Grosart: We might ask the minister to have the department provide us with the breakdown information presently available from departmental or other sources.

Hon. Mr. Benson: We will do that.

Senator Benidickson: Mr. Chairman, reference is made in the brief to effects from international sources upon employment and prices in Canada. The first thing that comes to mind is our proximity to the United States and the immensity of our trade with that country. To what extent are we independent of either benefits or disadvantages due to that proximity? What independent steps can we take to counter what might be done in the United States with political objectives in mind? For instance, there might be an expansionist policy related in some way to the approaching presidential election. To what extent can we, through fiscal and monetary policies, avoid being inevitably hurt or benefited by conditions in the United States?

Hon. Mr. Benson: There is no doubt that, with our tremendous interchange of trade with the United States, developments there will have an effect upon the Canadian economy. However, we can take steps of our own. Mr. Reisman can show you this afternoon some graphs of what has happened in current economic situations in Canada. Since we are considering not just current situations, this will extend over the past 15 or 20 years, during which time there have been downturns in the United States and Canadian economies. Each time there has been a downturn in the United States economy, with a tightening up after an inflationary period, there has been a downturn in Canada. However, it has not been identical. In the latest one, for example, our downturn was much less, our recovery faster and our policies much more effective than the American experience.

The Chairman: We would appreciate it if Mr. Reisman would do that this afternoon.

Senator Benidickson: At page 11 reference is made to a flexible fiscal policy, the budget not necessarily being effective for 12 months, as has been the case. If it were felt that circumstances dictated a change in fiscal policy, immediate action should be taken. It is stated there that there have been six significant adjustments in the last 15 months. Would you tell us what those six significant adjustments were and their timing?

Hon. Mr. Benson: They were set out in my budget speech in December. Another change, of course, was made in March. There was a tremendous budgetary change a year ago last March.

Senator Benidickson: And the monetary policy?

Hon. Mr. Benson: Again it was in June, August and September, the infusion of money through CMHC, for instance, the budget in December, and again in March. However, these were set out in my budget speech of last December.

Senator Grosart: Mr. Chairman, Senator Benidickson's point is very important. Could we ask the minister to give us a memorandum in this respect, with a brief description of those six significant adjustments?

Mr. Reisman: We will submit that.

Senator Grosart: That is a bit of fine tuning, of which we have had considerable discussion.

Hon. Mr. Benson: It is also rather coarse tuning.

The Chairman: I should make the point that the minister in his paper disclaims any responsibility for fine tuning.

Senator Grosart: At page 11 it is stated:

> This approach should not be damned by tagging it with the "fine tuning" epithet.

We may or may not damn it with that epithet.

Hon. Mr. Benson: I will make a flexible response.

Senator Benidickson: You refer to consultations respecting fiscal policies between provincial and municipal governments and the federal Government. I remember a pattern was set for periodic meetings between Deputy Ministers and Ministers of Finance. I question the effectiveness of those meetings and raise the point that the White Paper was very strongly criticized by the two largest provinces. Of course, most of their criticisms were met by your recent budget and, in large measure, you have been praised by the treasurers of the two provinces. In view of that, I do not know to what extent they were consulted prior to publication of the White Paper, because they certainly were loud in their condemnation of it. That is an illustration.

Your brief indicates that, when the federal Government followed a policy of restraint and endeavoured to reduce capital expenditures, there was a very rapid increase in capital expenditures by the junior governments. In other words, this consultation and these meetings just did not seem to produce the harmonious action necessary to face a national trend of either inflation or high unemployment.

Hon. Mr. Benson: I do not believe such a statement is contained in the brief. The junior governments continued high capital expenditures when we were fighting inflation. However, we now have more consultations with the provincial governments between Ministers of Finance and Treasurers than has ever taken place. There used to be an annual meeting at which the federal Government's outlook with respect to the economy for the ensuing year was outlined to the provincial treasurers. We now meet on a quarterly basis to discuss the condition of the economy. Problems in different parts of the country are quite different and preclude overall agreement with regard to economic policy. However, I believe that in our consultations we do achieve a general understanding of the problems faced by the federal Government and the various provincial governments. Indeed, when we were worrying about inflation we arrived at a general agreement that, although some of the provinces were not expanding as fast as they wished, we had to take action in all governments to combat inflation. This was done to varying degrees. There is no doubt in the world that the actions of provinces and municipalities have a great effect on fiscal policy in the country.

Senator Benidickson: Because, as you point out, they spend more than the federal Government.

Hon. Mr. Benson: We cannot go further than the general consultations we have had. However, they have been quite useful. We do not always agree, but that does not matter. We do understand the individual problems.

Senator Benidickson: I did mention the White Paper and the violent criticisms that seemed to follow from the two senior provincial governments to the philosophies and proposals of that White Paper, so it would appear they probably were not very well informed on what was in the minds of the federal philosophers regarding fiscal matters.

Hon. Mr. Benson: Initially, the federal Government had to put forward a position, which it did in the White Paper on Taxation. It was a position paper which was open for discussion by the provinces and other persons, and I think the evidence is that we listened to them.

Senator Benidickson: The evidence is, of course, that the budget has in large measure followed the recommendations of the two committees that were set up, the Senate committee and that of the other place, a fact we appreciate. I think we are quite pleased that you were so receptive to the suggestions of the committees and, indeed, added in your budget..as I have told you privately, in offering my congratulations—some features that even we in the two committees, who had many, many meetings, did not think up in the interval.

The Chairman: Senator Aird has a supplementary to your question.

Senator Aird: I am not sure that it is a supplementary, but I would like to direct it to the minister.

I would like to come back, if I might, to measurements. It seems to me that when we are talking about measurements, the most important one that we ultimately always get down to is productivity per man hour and output per man hour. To me this has always been shrouded in mystery. The figures that have been forthcoming have always been of doubtful value. I do not know whether Dr. Reisman will speak to this this afternoon, but, to me, it is the nuts and bolts of the performance of any economy, and I would very much like to have this put forward this afternoon, because, to me, it is the essence of the problem.

Hon. Mr. Benson: I have asked Dr. Reisman to bring this problem up this afternoon.

Senator Aird: Thank you.

The Chairman: Had you finished, Senator Benidickson?

Senator Flynn: I think the question put by Senator Benidickson was whether consultation with the provinces took place before the White Paper on Taxation was released?

Hon. Mr. Benson: My first consultation in this case has to be with Parliament, and I can assure you that on the tax legislation I recently brought out I could not consult with the provinces. I can hear their opinions, but in taxation matters the first disclosure has to be to the Parliament of Canada. I maintain that position.

Senator Grosart: On all matters.

Dr. James Gillies, Study Director: When Dr. Okun was here a week or two ago he put forward the point that once there is unemployment of, say, about 6 per cent in the American economy and expansion of monetary supply after that, it will probably only be inflationary. What do you think about that?

Hon. Mr. Benson: When it is down to 6 per cent, is that it?

Dr. Gillies: Once you have unemployment at the rate of 6 per cent in the economy, if you attempt to expand the economy further, through expansion of the monetary supply, the only result will be higher prices and not less unemployment.

Hon. Mr. Benson: I think that is wrong. It is a point of view, but I do not agree with it. I think you can get a decrease in unemployment. I think the history in Canada will indicate that unemployment can be brought materially below the 6 per cent level. The average over the last 20 years does not indicate this; it indicates a 5 per cent average.

Dr. Gillies: I am sure it can be brought down.

Hon. Mr. Benson: But without undue inflation, although it will undoubtedly bring pressure upon the inflationary aspects of the economy.

Dr. Gillies: It seems to me the question is as to what policy you use to do this. The question is whether the expansion of monetary supply is an effective policy to bring unemployment down, if there is that much slack in the economy.

Hon. Mr. Benson: What would you do as an alternative? Expand on the fiscal side further, I suppose. This means you will expand on the monetary side too in order to finance it, because the two are tied together. To spend an extra $3 billion, it has to come from somewhere, and it will have to come from an expansion of the monetary supply. In my opinion, at least, they cannot be treated as independent aspects of economic policy, which people tend to do but which I think is wrong.

Dr. Gillies: Where would that decision be made in the policy making? Where would this question be analyzed in Government today?

Hon. Mr. Benson: It would basically start with the Bank of Canada and with the Department of Finance, but the overall economic policy of the Government for the ensuing year, and indeed the year after, is presently discussed, and seriously discussed, by elected officials at the cabinet level, with a view to forecasting expenditures and the whole economic outlook.

Dr. Gillies: I gathered from your earlier discussion that the fundamental policy decisions are made by the cabinet committees.

Hon. Mr. Benson: Yes, to be approved by cabinet.

Dr. Gillies: And that, therefore, you did not feel there was any need for a council of economic advisers?

Hon. Mr. Benson: I am not ruling out any kind of advisers. What I am saying is that I think our system can work well, not because the decisions are made by a political body, the cabinet, *per se*, but because our system—with the advice of the Bank of Canada and the Department of Finance, going through a Minister of Finance, and other departments involved in things that affect the economy, all working through a cabinet committee—is effective. In the United States there are problems with their committee, because they and the Treasury can be going in opposite directions, and I certainly would not like to see this happen. Here in Canada we have a system whereby the ultimate responsibility lies with elected officials, not appointed officials, as are the Secretaries in the United States. Therefore, the decisions can flow through this way better.

Dr. Gillies: It is policy, of course, not to publish the minutes of any cabinet committee. How do you think it would be possible to put into the public domain more information on how, and the facts on which, policy is formulated?

Hon. Mr. Benson: It is done presently through the white paper and the facts brought forward in the budget. The white paper is a very interesting document, as you well know, and there is a lot of information in there that people just do not look at. Maybe this sort of information

should be put out more often, but it is a question of how much time you have your people spend on producing literature instead of thinking about the problems.

Dr. Gillies: The point is sometimes raised that by the time the budget comes down and goes to Parliament, it is too late for public debate on policy issues. Can you think of any way in which you could get more input from outside the public sector on policy making?

Hon. Mr. Benson: There is continuous debate. Since I have been Minister of Finance, it has never stopped. I do not know whether that was the case before. Every week somebody from the outside is making comments. Whether we reply or not, it is going on continuously. It may be that people would like to get the information we have faster, but we accumulate the information for our purposes and other people are accumulating it from relatively the same sources for theirs and are interpreting it.

Dr. D. L. McQueen (Study Consultant): I would like to invite the minister to elaborate yet a little more on the co-ordination of the formation of economic policy in the federal government. His description gives us the impression that the Department of Finance plays a very central co-ordinating role in economic policy formation in this country. You say, Mr. Minister, that you are well fitted to perform this function because you are not a line but a policy department. With respect, I wonder whether that is wholly true. It seems to me that the Department of Finance has very heavy responsibilities for raising large sums of money through taxation and borrowing. It seems to me, too, that people with heavy and continuing preoccupations of that kind are bound to be influenced and formed by those preoccupations, as in that fine old French phrase "professional deformation". In Great Britain people speak of the "Treasury view". In the United States, too, I think there is a view that the Treasury, to some degree, has its own axe to grind, its own particular view of what economic policy should be. Yet we know, of course, that in Canada there are other important departments and agencies with major economic responsibilities, not just the Bank of Canada, but Regional Economic Expansion, Manpower to some degree, Treasury Board, et cetera. How are these people brought into the act? Are they brought in with lots of homework behind them, with enough facts and data, early enough to be effective? When there is an interdepartmental disagreement, who resolves it, and how?

To the extent that these things get up to cabinet, to the cabinet committee on economic policy, how much back-up is there, in the way of facts and figures and analysis? In short, Mr. Minister, what I am getting at is basically this question: How do we get it all together, in economic policy, and how can we do a better job?

Hon. Mr. Benson: This is a valid question, and I would ask Mr. Reisman to go in some detail this afternoon into the very question you are raising. Believe me, there is a tremendous amount of back-up and co-ordination through the cabinet committee—just a tremendous amount.

Senator Benidickson: This is fairly new, is it?

Hon. Mr. Benson: No, it has been going on ever since this Government was formed, in 1968.

The Chairman: One of the problems we face, Mr. Minister, is this. We certainly will go through the present system with Mr. Reisman, but, of course, you speak for the policy of the department, so I wonder if it would be possible for you to address yourself to the question, as the man who forms the policy, or has a hand in forming the policy of the Government in this direction?

Hon. Mr. Benson: Yes. It was a very long question, almost a speech. Actually, the Department of Finance is not aligning policy. Merely because we are involved in taxation policy, that does not mean that we spend all our time on it. Our economics section, which operates quite independently of the taxation section, cannot spend all its time on this kind of policy. So I would take the point of view that we can act quite independently of the view of merely raising money and paying out money, taking an overall economic view.

The kind of co-ordination you are talking about does take place through the cabinet committee. On the amount of back-up, which you questioned, and how much back-up there is, there is a tremendous volume of back-up that goes actually to the elected officials, backed up by the officials of the various departments of government. The priorities of the Government are decided, based on a tremendous amount of material that is brought forward.

Senator Flynn: Not too much?

Hon. Mr. Benson: Perhaps you always have too much material, but I do think it works reasonably effectively. Nothing is perfect, but I think it is fairly effective. There is the input of the other departments in any decisions that are made with regard to economic policy of the Government. The economic policy of the Government is not determined by the Department of Finance and the Minister of Finance, solely—in this Government. It is the responsibility of the whole Government, and before actions are taken they are approved by the whole Government. This has not always been the case in the Canadian system, but it is presently.

Dr. McQueen: Mr. Minister, as a supplementary, could you elaborate slightly on when those inputs from other departments take place? And are the inputs from those departments to the Finance Department, or are they inputs into cabinet?

Hon. Mr. Benson: They are inputs into cabinet, in committee form.

Dr. McQueen: I see.

Hon. Mr. Benson: When a new economic policy is being determined in a department that affects the economy, such as DREE, they do not just on their own go out and put in $10 million here or $20 million there. This comes through the committee of cabinet and is considered. Before that, the overall policy of DREE—for example,

what it is going to do, how it is going to operate—that is not just dreamed up by someone and passed by cabinet some Saturday morning and put to Parliament the next week. It goes through a tremendous analysis, with inputs from other departments, such as Industry, Finance, and other people who are interested, before it gets to the cabinet committee. Then the cabinet committee makes a decision, and when the cabinet committee has made a decision, it goes to cabinet, and it may be question in cabinet.

Dr. McQueen: I take it then, Mr. Minister, that in the end you would still reach the conclusion that the Finance Department is less aligned than a policy department, and that it tends to take a more overall view of economic policy than any other department?

Hon. Mr. Benson: I would maintain this, but it is a policy that has to be backed up by the Government as a whole—in this Government.

Senator Grosart: How often does the cabinet committee meet and how long? I ask that because we have had some evidence in another committee that the cabinet committee on science activities had met seven times in 50 years.

Hon. Mr. Benson: This is quite a different point. I really did not want to get into the whole committee system of the cabinet.

Senator Grosart: Well, about how often? It is very important.

Hon. Mr. Benson: There are two committees that are basically involved in economic policy, that is, the Economic Policy Committee and the Committee on Priorities and Planning. Both those committees meet every week.

Senator Grosart: How long do they sit?

Hon. Mr. Benson: The whole afternoon.

Senator Flynn: Could we draw the conclusion that the Department of Finance has less influence on the economic policies of the Government than it had under previous administrations?

Hon. Mr. Benson: It is a different system. I do not know whether there is less or more influence, but when you do come out with something everybody is stuck with it.

Senator Flynn: If you have the same influence, the change in system does not mean a thing.

Hon. Mr. Benson: But you have inputs into economic policy from other departments, which perhaps you did not have in the past, which is very useful, I think.

Mr. Reisman: If the questions are: Does the Department of Finance make the decision? The answer is: no. Is the Department of Finance the exclusive department that gives advice to the elected ministers? The answer is: they are one agency out of many agencies, but because other agencies have direct line responsibilities which are their main function, the Department of Finance can often take an overview, a view that is not excessively influenced by a particular approach that an operational department will have, but the inputs come from all the departments that have an interest in it, in discussions at the official level, and then there are major discussions at the ministerial level, in committee, and then in cabinet.

Senator Flynn: I suggest that has always been the case. It may be more systematic now, but that has always been the case.

Hon. Mr. Benson: There have been some very important changes in the form of organization, in the manner in which advice is given, the way policy is formed—major changes in the past three or four years.

Senator Flynn: In the methods.

Mr. Reisman: In the whole operations and machinery of Government.

Senator Aird: I have a supplementary relating to the most recent reply. I do not know whether the minister can answer this question. Is there an overlap in personnel between the committee on priorities and the committee on economic policy?

Hon. Mr. Benson: Yes.

Senator Aird: Is it considerable?

Hon. Mr. Benson: Yes. I really cannot tell you who the members of the various committees are, but there is a considerable overlap.

The Chairman: Mr. Minister, I have a supplementary. I think I am going to phrase it badly, but one of the matters that the Governor of the Bank of Canada brought before us was the fact that the Bank of Canada, in trying to control the money supply, is constantly reacting to constraints that surround it—the exchange rate, liquidity problems, the problem of the Government's ability to finance its cash requirements, the general interest rate level, the problem of CMHC, and the general mortgage area—and one got the impression after a while that the growth or restriction of the money supply was not really that much under control and that it was a reactive thing from time to time. You take part in those discussions, and under the Bank of Canada Act you have the final say. How much cognizance do you put into the growth or restriction of the money supply, as opposed to the problem of the Government of Canada being able to finance its cash requirements, and especially the general interest rate level and the viablity of our export business?

Hon. Mr. Benson: As I stated earlier, I think there is a very close relationship between fiscal and monetary policy. I do not think either one can operate independently of the other. So there are constraints on both sides, and they have to move forward together. The external influence is also important in the monetary supply and, I suppose, has to be important on the fiscal side as well. There is no doubt that our operations with respect to other countries, as regards foreign exchange,

have a great influence upon the monetary supply. Not so much now, but if you go back a year, we suddenly found ourselves in the position, when our reserves were building up, of having to raise tremendous amounts of money in order to finance those reserves, and, of course, that had an effect on the money supply.

I would say, however, that barring unusual changes in foreign exchange, the general trend of the money supply can be determined. People say, "Well, it will whip up and down," and, of course, it does. I think the Governor pointed out to you the reasons why it may change at various points, but the general trend, whether upward or downward, I think, can be determined by the Governor, and is.

The Chairman: As a minister, which do you tend to emphasize more, the level of interest rates and the level of the exchange rate, or the level of the money supply?

Hon. Mr. Benson: I think they are interdependent.

The Chairman: We know that, but faced with the problem of...

Hon. Mr. Benson: I think which one you are going to emphasize varies from time to time. I do not think it is a very fair question, senator.

The Chairman: No, it is not really very fair.

Senator Nichol: We have been talking this morning mostly about the mechanics of the decision-making process, the structure of economic management within the federal Government, and the relationship between provincial and municipal governments and the federal Government. Before we leave this subject of how the process works, Mr. Chairman, I would like to ask a question relating to what Senator Benidickson was talking about.

You have the public and political responsibility for economic stability in the country, for the internal value of the dollar, for the foreign exchange levels and various other things of this type, and yet, as we have seen and as your brief says, the provincial and municipal governments spend something like two-thirds of the tax dollar. The federal Government's responsibility in these areas is specific, but its power is really diluted by the spending power and fiscal policies of the provinces and the big cities. Up to now this relationship has depended on consultation. My question is: Is consultation enough? In order for the federal Government to have the power it needs to manage properly all of these various segments of the economy which I have mentioned, is it not going to need more muscle, and, if so, what kind could it have?

Hon. Mr. Benson: The current split of expenditures is roughly 44:56. The federal Government has 44 per cent, and the provincial and municipal governments 56 per cent. I think that our 44 per cent plus our control of monetary policy gives us enough power to have an influence upon the economy. I would not like to lessen or play down the influence that municipal and provincial revenue collecting and spending does have on the economy. It is also a major factor.

Senator Nichol: The reason I bring it up is because municipal and provincial governments have tremendous, intimate, political influence with the voter, because they are spending their money on things which are easily identifiable—such as schools, sewers, roads, and things of that nature.

Senator Benidickson: A lot of which comes from transfer money.

Senator Nichol: Of course, but this presents a serious political problem for the federal Government because it is constantly being cast in the role of tax collector and policeman, whereas the other fellows are cast in the role of spenders, if you wish.

Hon. Mr. Benson: It would be great to be a benefactor; I would like to try it some day. What you say is true, but I think it is the responsibility of the federal government to accept responsibility in major areas for such things as equalizing revenue in the provinces, equalizing the tax base, and this sort of thing. This involves transfer payments, but I think it is the federal Government's responsibility to do this.

Senator Nichol: It is a problem that is not going to get easier.

Hon. Mr. Benson: No, I agree.

Senator Nichol: Mr. Chairman, may I turn to a completely different side of the problem? One of the questions which keeps coming up is that in the business cycle, which is an old-fashioned term, or in the combination of interlocking business cycles in which we live, how do you tell where you are? This involves the examination of inside and outside lags, statistical competence, and so on. The most specific answer that we had to that question came from Dr. Geirsch who said that in Germany they used the index of capital goods orders—that is, purchases of capital goods—as an indicator. He pointed out that that came at the peak of the profit cycle. Frankly, I am surprised at how specific he was.

Which are the indicators that mean most to you?

Hon. Mr. Benson: Actually, in trying to determine where we stand we use over a hundred indicators in the department. Every day we get reports on what is happening in retail sales, what is happening in capital investments, in building permits issued and in industrial production. They are coming in every day. It is the job of people in my department to get these indices, to watch them and to try to decide where the trend is going, and do so well ahead of time.

You can be wrong sometimes, of course, but I have found that forecasts are reasonably accurate within levels of error that can take place. I mean normal levels of error.

Senator Nichol: With respect to our technical knowledge about lags, would there be any merit in more money being spent in Canada on the examination of these lags and how they work?

Mr. Reisman: The lag is one of the most vital elements in the analysis of the process of economic change. One of the important points here is that there is no constant lag that would apply in all economic circumstances. This turns to a great degree on economic expectations of all the elements in your economy. There is a great deal of effort and energy put into this.

I recall at the time of the Porter Commission that that commission engaged in some very extensive studies in trying to determine what the lags were when, for example, changes were made in the monetary aggregates. It was done not only by examining the history and examining the statistics but by doing field work. A very extensive study was done by Dr. John Young on that subject, if I remember well.

Of course, we worry a great deal about lags and lag effects, because it is quite clear that whenever a change is made on either the monetary or the fiscal side, or when other changes are made, it takes a while for the change to percolate through the economy. But the thing that has impressed me more than anything else since I have been in this field is that these leads and lags change, and change very considerably over time, depending on the general environment, the general atmosphere, the influence from abroad and the expectations of all the people who make up the economy.

Senator Nichol: I forget who they were, Mr. Chairman, but some of the witnesses suggested that a great deal of money is spent on all kinds of research in fields other than the economic field, and that we might do well to invest more money in deeper and more continuing economic research to try to really get to the question of these lags.

Hon. Mr. Benson: I do not disagree with that at all.

Senator Nichol: What do you think of that?

Hon. Mr. Benson: I do not disagree with it at all. We believe that there is a field for wide short-term and long-term economic research in Canada.

Senator Nichol: And for more co-ordinated research, I suppose.

Hon. Mr. Benson: We are willing to support it, but I do not think the Government should support it to the point of control. If we want independent research, we should not be supplying all the money. Moreover, such research has value to other people as well. Any long-term or short-term economic body doing research should try to remain independent of the Government.

Mr. Reisman: In the past year or two there has been a good deal of research done in the the private sector, particularly in the universities. It is research that we have never had in this country before, and I want to say that we welcome it very much. Some of it is most helpful; much of it leads to strange predictions and surprises.

Senator Nichol: We have had some of those surprises here.

Mr. Reisman: Dr. Gillies' institution, York University, has developed a very interesting model, based largely on an approach similar to that used in the United States at the monetarist school. You may have seen in the newspapers just in the last few days that the York University group has come out with some very interesting predictions. I have not reported this to you, Mr. Minister, but Dr. Gillies' group—not his group but his university's...

Dr. Gillies: My group.

Mr. Reisman: Your group, then, has, on the basis of its model, come out with a prediction that the real GNP in 1971 is going to grow at better than 9 per cent, according to the way they read it now. I believe what you said in your budget, Mr. Minister, is that the nominal GNP would grow by something in the order of 9 per cent, but that the real growth would be 5 to 5½ per cent, and that there would be a price component there. There are really some differences. When they say 9 per cent and we say 5½ per cent, that difference of 3½ per cent is more than enough to absorb virtually all the unemployed in the country, plus more.

It is really very interesting that the professionals in this business should be differing to that degree. I know that the University of Toronto has a model which is much closer to ours than that. Perhaps Dr. Gillies would like to comment on that, because it relates to the question of research done outside, and these are completely independent outfit. We watch what they do; we exchange information with them, and they with us.

Hon. Mr. Benson: From a political point of view, I should bring them down here and send you up there.

Mr. Reisman: But what would happen after six months? Dr. Gillies, do you believe that model?

Hon. Mr. Benson: It is too optimistic.

The Chairman: That comes under the heading of unfair questions. I will lump that with my questions of the minister.

Dr. Gillies: The only comment I will make is that it needs financing.

Mr. Reisman: If it comes out the way they say, we will get it financed.

Senator Grosart: If you give them more money they will get it down to 5.5 per cent.

Senator Beaubien: Mr. Minister, you said, as I take it, that as of January 1, 1972, the federal Government will vacate the gift and estate tax fields. Suppose I had a little cash on the January 2, 1972, and I gave it to my son, how would my estate stand so far as the federal Government is concerned, if I died one year later?

Hon. Mr. Benson: You would not have any.

Senator Beaubien: Estate?

Hon. Mr. Benson: That is right, so far as the federal Government is concerned, because we would not be taxing you. But under the system as proposed, of course, if you make a gift in kind, any gain accrued would be taxed at the time the gift was made.

Senator Beaubien: But if it was just cash, Mr. Minister.

Hon. Mr. Benson: You can give as much as you like to whomever you wish to give it to. There will still be provisions under the act whereby there is imputed income in a gift from the husband to the wife, so that you cannot split the gift in that way.

Senator Beaubien: Let us say it is my son.

The Chairman: Who is over the age of 18?

Senator Beaubien: Yes.

Hon. Mr. Benson: There is no problem so far as we are concerned. The federal Government is not going to tax your estate any more. I do not think you are going to get away scot-free, however.

Senator Beaubien: I have in mind the final capital gains tax, Mr. Minister. In other words, my estate is worth so much on valuation day. On the January 2 I give away a percentage of it. A year later I die. So far as the final capital gains tax is concerned, which you talk about, how does it work out? If I give away a good percentage of my estate, my estate is worth less than it was on valuation day. Therefore, we could claim that we have taken a capital loss through the gift and we could offset other capital gains in that way.

Hon. Mr. Benson: The gain or loss is determined on each asset. You can give away any part you like, and if there is a gain at the time of the gift then you pay a tax on it. With respect to what is left in your estate when you die, if a tax is payable it is payable on each asset according to the value of it as compared to the value at the start of the system.

Senator Flynn: At the time of the donation there is a deemed realization.

Hon. Mr. Benson: Yes.

Senator Beaubien: But if you give cash?

Senator Grosart: You could send Senator Beaubien a bill for the advice, Mr. Minister.

Senator Nichol: Mr. Minister, do you charge for advice of this nature?

Hon. Mr. Benson: Not until I am no longer Minister of Finance.

Senator Inman: Mr. Minister, is there any limitation to the amount that you can give as a gift?

Hon. Mr. Benson: No.

Senator Inman: And can it go to anyone other than family such as sons or daughters? For example, can it go to nephews or nieces?

Hon. Mr. Benson: That is fine as far as the federal Government is concerned. We are going to get out of the estate and gift tax fields. You can give your assets to whomsoever you like, but if there is a gain involved, that is of course a capital gain, in the asset you give away, and you pay tax on the capital gain.

Senator Inman: You mean a capital gain would have to come from an investment or something?

Hon. Mr. Benson: Yes, or it might be a painting which went from one-half million dollars at the start of the system to three-quarters of a million dollars. There is a gain there. The best way to beat all taxes under the new system is when you get old marry a young wife, because there is no tax on transfers to a wife, and then when she gets old, she should marry a young husband, and go on from generation to generation like that.

Senator Nichol: And there are supplementary benefits of a social nature.

Senator Inman: What about a widow? If a husband dies and leaves his widow an estate, what is the limitation there?

Hon. Mr. Benson: There is no estate tax and no gains tax at that point.

The Chairman: Mr. Minister, I have a supplementary on this subject. In reading your summary it seems to me that your legislation holds together extremely well. There is even a form of integration for private companies, which is very well done, I think. So, as I say, it holds together if the provinces do not legislate in the income field, corporation tax field, the estate tax field and the gift tax field. If they do, obviously it continues to hold together to a degree, but it seems to me to start to break down. For example, if the provinces legislate in the income tax field so that the maximum rate moves beyond 60 per cent, you are then going to be in a position where private company surpluses are not going to be unlocked and you are going to be faced with all the problems that have grown over the years with reference to dividend stripping, and so on. Now, this may be another unfair question, and of course you are not going to answer it if it is, but do you have any comment on the provinces moving into this field in reference to this latest tax act?

Hon. Mr. Benson: Well, the best tax would be one that was the same across the whole country. If you are looking at the corporate side, which you are doing, then it is best if we have one corporate tax in Canada.

The Chairman: I can also go on and say that I can look at the capital gains, gift and estate taxes. If you vacate that and they move in, then you have the imposition of a capital gains tax and an estate tax at the same time.

Hon. Mr. Benson: Well, as I have mentioned, we felt that in our moving out of the estate tax, the 25 per cent we had been collecting was a fair offset to the fact that a gains tax was going to be levied on death. There is no doubt that if provinces want to they can thwart federal

legislation, but then they have to accept the responsibility for what they are doing. Therefore, if they want to have an entirely different system of corporate tax or personal tax, they can go ahead and do it, but they are doing it on their own responsibility, and I think we would have to continue with this system which we have devised, which I think is fair and reasonable in all the circumstances. But you cannot stop them from doing it, of course, and in fact they have been doing it. In Ontario and Quebec succession duties vary greatly from the Federal Estate Tax Act. This applies to the British Columbia succession duties as well. You can have varied interests and live with them. But there is no doubt that if they wanted to have a different system, they could, but it would be upsetting to the taxpayers, I think.

Senator Grosart: Mr. Minister, some of us were led to believe, I think by you, that you might make a statement on the predicted level of unemployment for the current year. Are you prepared to do that?

Hon. Mr. Benson: No, I am not. I never said I would. I said that I thought the trend would be downward on a seasonally adjusted basis, and I am not prepared to go further than that. People are just looking for something to knock at, and why should I provide another target by saying it is going to be X.2 per cent next month when it might be X.4 per cent, or so? The reaction would be, "He is wrong again!" You can not really predict this within that narrow margin.

Senator Grosart: I was not really intending to embarrass you.

Hon. Mr. Benson: Everybody else is predicting it for me anyway.

Senator Grosart: You said, I believe . . .

> When I make my budget presentation I will indicate what the expected unemployment should be throughout the year, just as I did last year.

I am quoting from *Hansard* of May 3.

Hon. Mr. Benson: Well, last year I just talked about the trend, just as I did this year.

Senator Grosart: So when you said you would indicate the expected unemployment, you were speaking of the trend?

Hon. Mr. Benson: Yes.

Senator Grosart: That was very wise.

Dr. Reisman mentioned expectations, and you have a paragraph in the brief on the subject—it is the only really purple passage in the brief—"which, like the northern sky at night, is sometimes sombre, sometimes glowing and sometimes shimmering but rarely predictable."

Hon. Mr. Benson: Actually I find this a very good document.

Senator Grosart: "The all-pervasive influence and importance of expectations," to quote the brief, is this a new thing or is it something just discovered?

Hon. Mr. Benson: I am told it is neither new nor something just discovered.

Dr. W. C. Hood, Assistant Deputy Minister of Finance: I think it is the all-pervasive impact of expectations on the performance of the economy. It is neither something new nor something that has just been discovered, but that makes it nonetheless real. There is a third alternative. That is that expectations have always been important; we have known about them, and we have had to worry about them down through the generations, and they continue to be the factor that, above all, makes the forecasting of economic events in the future a difficult challenge.

Senator Grosart: Then, Mr. Chairman, is this not something on which economists and planners are placing much greater emphasis, or at least talking much more about, than they did a few years ago?

Dr. Hood: I do not know about that, Senator Grosart. I can say this, that what has been happening in the field of economics in the last number of years is an increasing mathematization, if I can use that awful word, of the subject.

Senator Benidickson: What is the word?

The Chairman: "Mathematization."

Dr. Hood: Expressing the relation between economics and mathematics.

Senator Grosart: It is another word for discovery; it was found in the model.

Dr. Hood: In that process, of doing more formal or mathematical economics, the thing above all that escapes the net of the mathematician, that is difficult to explain, account for and render in mathematical terms, is expectation. It is very difficult indeed.

Senator Nichol: On this question of expectation, there are quite accurate techniques for measuring public opinion, of sensing what people think, which is non-mathematical. Do we use those?

Dr. Hood: Yes.

Mr. Reisman: Let me give you a very specific example. The *Financial Post,* through some of its agencies, carry out periodically, I think annually, an attitude survey on the part of consumers. Another example is that there are investigations and surveys made of capital investment intentions. We look for those and we examine them in considerable detail. We do not put them into the model, but when we get the results out of the model we will look at what these other sources of information tell us, as a means of testing what comes out of the model, and before judgments are made on how we think things will go. We will get our information from wherever we can, and we place a very high value on that kind of survey.

Senator Nichol: Regarding this phenomenon which is happening now, where you have a very expansionary monetary policy with at the same time, rising interest rates, is this an old phenomenon or is this connected with this new expectation ingredient which we have been talking about? It is obviously connected with it, but is this an old phenomenon?

Dr. Hood: Firstly, I would like to repeat that I do not think that the phenomenon of expectation is a new phenomenon.

Senator Nichol: I did not mean that. I mean the phenomenon of loose monetary policy with rising interest rates.

Dr. Hood: I understand that. I will address myself to that aspect now. I suppose that the normal expectation from an expanding monetary supply produces falling interest rates. But there are conditions under which that is not true. Those are conditions in which the expectation of inflation is strong, and the expectation of inflation is strong, I suppose, when there is a recent history of inflation. There is nothing new about that. That has happened before in history.

Senator Grosart: The other matter in which I expected rather more comment by the minister than was made in his budget speech, was the floating or pegging of the dollar. Is there any broad policy statement that you care to make about that?

Hon. Mr. Benson: Not really. When I indicated that the Canadian dollar would be allowed to float, I said at that time that at an appropriate time we would consider repegging the dollar. That was the statement I made to the IMF, and I made it publicly in Canada. That time has not arrived at this point. I really cannot say anything beyond that.

Senator Grosart: A very strong case seemed to be made by some of the monetarists who appeared before us that we should maintain forever, in spite of the IMF, a floating dollar.

Hon. Mr. Benson: That is the point of view that has been put forward by academic economists for a long period of time, that a floating exchange rate was good for the economy. Many others have taken exactly the opposite point of view.

Senator Grosart: Harry Johnson told us that that was the only possible protection we could have against the impact of external influences, particularly from the United States.

Hon. Mr. Benson: A floating dollar certainly allows more freedom for internal economic policy, there is no doubt about that. However, anyone who gets the idea that even with a floating exchange rate you are entirely free in your internal economic policy, they are incorrect, because always in your mind is the value at which the dollar is sitting, and I am sure it influences such things, as it does in Canada, as the money supply in Canada in order to keep interest rates at a level which do not attract short-term capital so that it bounces the dollar up. Nevertheless it does allow for more freedom.

Senator Grosart: Would you say that the basic terms of the IMF agreement by participating countries will be maintained?

Hon. Mr. Benson: There has been wide discussion about a widening of the bands with fixed exchange rates. No conclusions have been reached at this time. Indeed, several of the major countries have a differing point of view, that it should be maintained as it is.

Senator Hays: Do you have any figures on our per capita dollar exports as they relate to other exporting countries?

Hon. Mr. Benson: We can get that information for you this afternoon. It is quite high.

Senator Hays: Ours may well be one of the highest countries in the world.

Hon. Mr. Benson: I think it is.

Senator Hays: In your determining of fiscal policy, do you study product by product so that the exporter can be kept in a competitive position with other exporting countries?

Hon. Mr. Benson: We try to. I do not study personally product by product, but within my department we certainly look at what is happening to various products under existing circumstances. This is a continuing process. Indeed, when people become non-competitive for various reasons, and we can do anything about it, we call them in to tell us about it. They do from time to time come in, and we try to do things to assist them.

Senator Hays: In your budget speech and proposed legislation, are exporters in a competitive position with exporters in other countries?

Hon. Mr. Benson: I think that overall we are, because we are running a very sizable surplus on trade. It ran at about $3 billion last year, which was the highest in Canadian history, even higher than the wartime peak. It was twice as high as it had ever been in Canada's history.

Senator Benidickson: Despite the higher value of the Canadian dollar, were exports pretty high in the first quarter of this year?

Hon. Mr. Benson: It is still running very high.

Dr. Hood: It was higher in the first quarter this year than it was in the first quarter last year, which was a record.

Senator Hays: In connection with this surplus of money, how do you handle that? You say that we have a surplus this year of $3 billion.

Hon. Mr. Benson: Actually, our balance-of-payments surplus last year, net, was $1½ billion to $1¾ billion,

according to current account. After deducting travel, financing of debt and security, we, of course, have a deficit. However, we had an overall current account surplus last year.

Indeed, in addition we had a net capital inflow which eased off considerably, partially due to the fact that we urged borrowing in Canada rather than abroad. Of course, this has the effect of forcing our dollar up, if we do not have a tight currency.

Senator Hays: The unemployed in Canada, through social benefits, are probably taken care of better than the people of any other country. In countries with full employment, such as communist states, New Zealand, Japan and others, the standard of living is far below ours. In endeavouring to reach full employment with such high social benefits, would it be desirable to have selective unemployment to a limit of 3 per cent through fiscal policy, so that the servicing of the debt could go as high as 14 or 18 per cent? How far should we go? Where do we stop, in view of the seasonal problems?

Hon. Mr. Benson: An appropriate level of unemployment is a very difficult figure to pick out of the air. In my opinion, governments must work towards providing productive work. I do not mean just any kind of job. Quite often in areas of high unemployment people do things which could be better done automatically. For example, eight employees work on a railway crossing in Europe doing the job done by an automatic switch in Canada. In some communist countries women sweep the sidewalks. It is always possible to keep people employed, but I think we must aim towards productive employment at the maximum possible level.

Senator Hays: How much impact did the restraints applied by governments at all levels in the fight against inflation have on the increasing unemployment rate when those governments left the labour market?

Hon. Mr. Benson: I doubt if it had a material effect. The overall level of the public service in Canada did not decline very much. Its growth was halted.

Senator Hays: You also slowed the growth in the gross national product.

Hon. Mr. Benson: No, we slowed the growth in the Government service. I could not tell you offhand the effect of the total fiscal policies of all governments at all levels on the public service at all levels.

Senator Hays: Many express the opinion that the Government went too far in controlling inflation. Were it to be done again would you take the same steps?

Hon. Mr. Benson: I think it is an unfair question, but we would do just about the same. At the time we changed materially both fiscal and monetary policy, a great many people said we were changing too soon. Eight months later it is easy for them to say we changed too late.

Senator Benidickson: The minister has commented on Senator Hays' question relating to the general charge that the fight against inflation was over-fought and in large part caused the present unemployment. Would the minister care to indicate whether there were other factors, such as a particular undue input into the labour force?

Hon. Mr. Benson: No government sets out to create unemployment. At the same time, however, inflation cannot be allowed to continue at high rates if we are to operate under our free enterprise system. Therefore when a government takes steps to tighten the money supply and to restrain itself fiscally it has an effect on the economy.

This afternoon Mr. Reisman will illustrate our experience compared with that of the United States, not at this time only but over a period of years. I think you will find it very close on all counts.

Senator Benidickson: The same complaint is made in the United States.

Hon. Mr. Benson: Yes; the only way to absolute control is a controlled economy, which we do not desire. One of my colleagues was in Russia and asked what they do about inflation. They replied that they just do not allow it and prevent it by steps related to the standard of living.

The Chairman: A phenomenal number of witnesses have said that we should accept a rate of inflation in the economy and compensate those who cannot protect themselves. Do you have any views with respect to that assertion?

Hon. Mr. Benson: We seem to have to accept a rate of inflation. I do not think that the Government per se accepts it. However, the trend over the past 30 years or so reveals a rate of inflation. We endeavour to keep the economy in line by avoiding too much inflation because it will eventually hurt. We also strive for relatively full employment and to keep the economy at top productivity.

The method of achieving these goals is a matter of judgment. However, I do not agree with those who say we can accept inflation at any level over a period of time.

Senator Nichol: With regard to prices and wages control many people suggest that all will be well if we have no interest rates, full employment and control the situation with prices and wages control. I do not believe we have had one single witness who supported that view.

The Chairman: That is correct, with the exception of Sir Roy Harrod.

Senator Nichol: He had some suggestions related to selective control.

The Chairman: Dr. John Young also had suggestions.

Senator Nichol: Mr. J. Douglas Gibson was a witness and was asked his opinion with regard to prices and wages

controls. He worked, as you probably know, during the war on the price and wage control structure. He said:

> We had awful trouble with some of those controls even with all the hate and patriotism of war, and to think that people would now behave in the way they did then is too ridiculous. They would not. They do not. It is now a different story altogether.

Could you comment on price and wage controls? I know you have done so publicly, but could you do so for us?

Hon. Mr. Benson: Maybe I could just point out some of the difficulties. I think it would be possible to have controls that were not of the same nature that we had during the war. I do not think one can use the argument that we could not have a system of price and wage controls that was not less complicated than the one we had during the war. To my mind, the great problem with controls is that if you get into them, do you get into them as a crutch? You will have to use fiscal and monetary policy anyway, and all I think controls can provide beyond that is a crutch for a period of time, so you do not have quite the effect on fiscal and monetary policy that you would not have without the controls. If you get into them for a period of time, even on a selective basis, how long a time should it be? What happens with respect to wage settlements, for example? Are they loaded to the end? What happens when you get out? Is there a catch-up if you get out in a period of time? Will it automatically be a catch-up so that you really have not accomplished anything? You have slowed down inflation for a period of time and, all of a sudden, it whips on again and everything is caught up from behind. That sort of thing frightens me with controls.

I would not rule out controls in the future, or say that governments will not or might not use them, but we should not simply say that it is easy to have price and wage controls. If you are to have controls on a continuing basis, as somebody has advocated, you are moving very much away from the free enterprise system that we seem to cherish in this country; and if you have permanent price and wage controls, I think you are moving down the road to permanent control of the whole economy, whether you like it or not.

Senator Flynn: I was counsel for the Wartime Prices and Trade Board and I can subscribe to the quotation by Senator Nichol and the comments of the minister as far as implementing a system of price and wage controls is concerned. It is easy to start, but it is not so easy to finish, and it is not easy to enforce.

Senator Burchill: I return to the question of a floating dollar and its effect on exports. It was indicated that our export balances are up in the first quarter, if I heard correctly. I hope you have not forgotten the pulp and paper industry, and particularly its effect down in our eastern provinces where we have a lot of unemployment.

Hon. Mr. Benson: I am very worried about the pulp and paper industry, but it is not basically the dollar that is causing its problems. The real problem in the pulp and paper industry is that newspaper advertising in the United States has gone down 65 per cent. Well, it is not 65 per cent, but I know that 65 per cent of the pulp and paper produced goes into the United States newspaper industry, and there has been a tremendous reduction in advertising, in the size of the papers, and therefore our pulp and paper industry has been hurt. I admit that the exchange rate had an effect on that. I just could not help that. But they have basic problems beyond that. I tried to help them in some way in the budget, as you know, through heavy fuel oil, equipment and so on, to the tune of several million dollars.

Senator Burchill: I agree with what you say, but the exchange rate is one very serious factor.

Hon. Mr. Benson: Of course it is. I admit that.

The Chairman: Are there any further questions, honourable senators? If not, on your behalf I would like to thank the honourable minister for his attendance today. I would also like to say that he comes at a time when he must have spent an extremely busy period, which I suppose has extended over two solid years. I suppose there are those who will disagree and those who will agree with his accomplishments, but I think we should have on record here that we, as representatives in some way of the people of Canada, appreciate very much the contribution the minister has made to our country.

Hon. Senators: Hear, hear.

The committee adjourned until 2.30 p.m.

Upon resuming at 2.35 p.m.

The Chairman: Honourable senators, I see a quorum, so we shall proceed.

I apologize to our witnesses for the small number of senators in attendance at this stage. It is no reflection on the importance of the evidence but rather of the fact that there is a debate taking place in the Senate chamber which might lead to a division. However, I am sure that other members will be along soon.

We have with us Mr. Simon Reisman, the Deputy Minister of Finance, who will continue the evidence that was started this morning. I understand you have a presentation to make, Mr. Reisman?

Mr. Reisman: No, senator. The brief submitted this morning was the only written submisson that we had proposed to make.

The Chairman: I was referring more to your chart presentation.

Mr. Reisman: I was going to say, if you will allow me, that arising out of the hearing this morning we undertook to provide material on a number of subjects.

There was one request for material referred to in our brief, the half-dozen or so occasions during 1970 and into 1971 when the fiscal stance was altered in an expansionary direction, and this document provides that.

The Chairman: These are the six initiatives, mentioned in the submission by the Minister of Finance, that have been taken by the Department of Finance over the last 15 months. I will have copies of this distributed to honourable senators.

Mr. Reisman: Secondly, Mr. Chairman, there was a request, I think from Senator Hays, for data on the per capita export performance of Canada as compared to other principal countries; and here is a report on that. It does indeed show that the per capita export trade of Canada is higher than that of any other country shown on that list.

The Chairman: Do senators desire this material for themselves?

Some Hon. Senators: Yes.

The Chairman: Then I will have copies made of it.

Mr. Reisman: Thirdly, there was a request for the measures of Canadan productivity. These are contained in our budget White Papers at pages 102 to 107, inclusive. We did not have an opportunity to reproduce those pages between this morning and now, but if senators wish to see this material, it will not be that difficult to reproduce.

The Chairman: If you would do that, Mr. Reisman, then perhaps we could get them out to all members of the committee during the recess.

Mr. Reisman: Very good. We shall have them reproduced.

There was also a request—and I have forgotten which of the members of the committee requested it—for information about the unemployed in this country. I misinformed the committee this morning, and I would like to apologize for that. I indicated that we did not have a breakdown of the unemployed by heads of family units, single sons and daughters, and other relationships in the family. In fact, the Dominion Bureau of Statistics publishes this, I believe twice a year, and it will show on a quarterly basis the detailed breakdowns of that data. I mentioned this morning that the finer the breakdown the less reliable the data, having in mind that it is based on a sample survey of 30,000 households in Canada, but the information is really quite interesting and complete. For your information, I am told that the decision to do this kind of analysis and to publish this material followed on Senate hearings on unemployment. It was an action that the Senate committee recommended, and it resulted in this survey.

The Chairman: Touché.

Mr. Reisman: There is a regular publication with a breakdown by length of unemployment and also a temporary layoff breakdown, and although the temporary layoffs are included in the unemployment figures they are shown separately in the statistics.

There was an interest shown this morning in a comparison of the Canadian economic performance with that of the United States. I think the minister, Mr. Benson, undertook that we would produce a chart or two and give a brief description of how that performance shows up both over the long term, the last 15 or 20 years, and the more recent performance as well. We are in your hands, Mr. Chairman, but if you would like to start with that we have the charts and we can take a few minutes, if that is your wish.

The Chairman: Would you like to start with it or end with it?

Senator Nichol: I suggest we start with it.

The Chairman: Is it agreed?

Hon. Senators: Agreed.

Mr. Reisman: Mr. Chairman, if you will allow me to introduce Dr. Cyril Hodgins who is the Director of our Economic Analysis Division in the Department of Finance under Dr. Hood, who is the Assistant Deputy Minister, Economic Analysis, Fiscal Policy and International Finance.

Dr. C. D. Hodgins, Director, Economic Analysis Division, Department of Finance: We have three charts that we would like briefly to go over with you. Two of them focus on the business cycle experience in Canada and compare it to that in the United States. In the top panel of Chart I, we have examined constant dollar gross national product which is the measure of total output after correction for prise change. We have looked at it by taking the trend out of the growth of the series in the two countries. What we are left with when we take out the trend is basically he business cycle and the irregular movements. What strikes one most clearly, looking at the top panel, is the cyclical movement over the period from 1947 on up to 1970. These are percentage differences from the long period trend, so that in the early fifties—the time of the Korean conflict, for example —output was running about 5 or 6 per cent above its long period trend, and then in the recession of 1954 it fell down below trend. You can see how it has fluctuated around its trend from time to time over the 20-odd year period.

Going back to about the mid-sixties you will note that the United States, which is indicated by the dash line, was, for about three or four years, about 4 per cent above its trend rate of growth, and their economy was performing better on that score than the Canadian economy.

As we get on towards 1970, however, you will note there was a very marked turn-around in the performance of the United States economy so that by 1970 it had turned to about 3 per cent below trend as compared to 4 per cent above trend in about 1968. In Canada the slow-down of 1969 and 1970 was considerably less pronounced in a relative sense, but I think that the main message here is that the two economies do move relatively closely together. From time to time the Canadian economy

does a little worse, as in the case of the 1954 recession. More recently it would appear that the Canadian economy has performed a little better. You will note that the approximate coincidence of this cycle is reflected also in the movements of the unemployment rate in the two countries.

We have a second chart. This middle panel focuses on the price picture which can be interpreted in a similar way. We have another chart which focuses just on the end part of this history, the period from 1968 on. This chart was updated and presented as chart 1 of the recent budget White Paper.

Mr. Reisman: This chart has not been brought up-to-date. We were not able to bring it up-to-date between this morning and now.

Dr. Hodgins: This chart shows by quarters from 1968 through 1970 the percentage change in real output from the same quarter a year ago, so it is an approximate measure of the rate of growth. You can see clearly the slow-down in the Canadian economy starting in 1969 and carrying on until finally hitting a through here in the third quarter of 1970 after which time it has come up again. In the United States the fall-off has been relatively more marked and by the third and fourth quarters of 1970 there was actually a decline in real output. For the year as a whole in the United States there was an actual reduction in the amount of goods and services produced.

In respect of price performance, the percentage change from the same quarter a year ago in the consumer price index for all items—food and other items—is shown, and we note that the trend towards more rapid rise of prices in Canada was pretty strong until we come to the first quarter of 1970 at which time here was a sharp improvement. The improvement in the United States only started to show up there, and in moving into the new year there was some further improvement. The figure for the first quarter in the United States is in this general area and in Canada it is in this general area.

An up-to-date version of this chart is available in the budget White Paper.

We have plotted also the unemployment profile for the two countries. In response to the question in respect of the Canada-United States comparison I hope that gets at the main issues. Perhaps it would be suitable to pause to see if there are any questions.

Senator Gelinas: You say that the consumer price index is not up to date. How far up would the red line go if it were up to date?

Senator Nichol: The end of 1970.

Mr. Reisman: It does not go up. It continues down. The slope of the curve is not as steep, but it continues down.

Senator Gelinas: So it is leveling off there?

Mr. Reisman: Yes.

Dr. Hodgins: One of the reasons why this rate of price increase does get down to such a low level here is, of course, the precipitous decline in food prices which took place during the latter part of this year. Also these are percentage changes from the same quarter a year ago. We are getting pretty low year-ago per cent changes in the early part of this year because we are operating off a pretty high base back here.

Mr. Reisman: There has been some re-establishment of food prices. I think food prices are still below what they were a year ago, but there has been some recovery over the past several months, and I think that one can expect that they will continue to rise. This means if you look at the consumer price index for the year as a whole it will probably reflect some offsetting activity to what was an inordinate decline in food prices last year, but if you look at the index excluding food you will find that the moderating trend has continued.

Senator Gelinas: We all know what happened to food prices in the last year. That is why it shows that trend.

Mr. Reisman: It is only partly that. I should make clear, Mr. Chairman, that the decline in food prices was precipitous and sharp and certainly affected that trend line, but all other prices excluding food showed considerable moderation.

Senator Aird: Are there any material exclusions from these graphs relating to specific areas of activities, or are they all-inclusive?

Mr. Reisman: The GNP is all-inclusive. It is the biggest single aggregate figure that you can get to measure the performance of the economy. That is a measurement in real terms, and there are no exclusions.

Senator Nichol: Would it be possible to identify on those charts—I am talking now of Canada and not the United States—where the go-ahead shifts of monetary policy took place? Was there one in March of 1970 or thereabouts?

Dr. Hood: I do not think I can recall all the way back, but the major change in the setting of monetary policy took place in March of 1970 as you said.

Senator Nichol: And the one prior to that? I am trying to remember, but I do not remember.

Dr. Hood: I would have to go back to the records. I cannot keep these things in my head.

Senator Nichol: The shift in 1970 coincides quite nicely with that. What about the shift before that?

Dr. Hodgins: If we look at the times at which the rate of advance of the money supply turned.

Senator Nichol: Right.

Dr. Hodgins: March of 1969 was when the rate of advance of the money supply was sharply curtailed and monetary policy began to be eased roughly twelve months later. I think the turning point to which you

are referring—the one in 1969—was just at the end of the first quarter.

In 1968 the performance of the money supply varied quite a bit. There were some exchange difficulties at the beginning of the year which had quite an impact on the money supply. It is a little harder to be specific about turn arounds there.

Senator Nichol: Would you give me that once more? There was one in the spring of 1969 and another one twelve months later in the spring of 1970. Is that correct?

Dr. Hodgins: That is right. If we take just the period that is covered by the chart here we note that in the early part of 1968 the money supply was increasing at a slight rate. The impact of the foreign exchange rate on the balance of payments had quite an effect on what was happening to monetary policy at that time. Later in 1968 monetary policy became more expansive, at least as measured by the stock of money, and the stock of money grew through this period.

It slowed down a little bit through the fall and grew until about March of 1969. The rate of monetary expansion was curtailed for about a twelve month period from there until March of 1970.

Senator Nichol: Would it be possible to go back to the next graph which you have behind there, and talk for a moment about where the major shifts occurred?

The Chairman: We will have to adjourn, Senator Nichol. There is a division, and we will lose our quorum over the division. Perhaps we can adjourn now and come back as soon as the division is over. Is it agreed?

Hon. Senators: Agreed.

Mr. Reisman: We are not really prepared in terms of our own analysis to try to match changes in the monetary supply and economic changes. Before I or my people go on to give evidence on that, we would want to examine all of the data. It is a line of questioning which is very interesting. I do not think you will find that the fit will be all that pronounced. It is something we can do a little bit of work on and see what we can come up with, but we have not prepared that kind of analysis.

Dr. Hood: We have not got it here. That is the problem.

The Chairman: Perhaps we can superimpose that, then, on the chart.

Senator Nichol: I think we should ask for some information. I am not asking for it here and now, but I think it is pretty basic to what we are talking about. In fact, it is the core of the question.

Mr. Reisman: That is right. If questions are asked on that we would certainly like to respond, or see that whoever there is in government who has the detail will respond. I do not think we can do it here right now.

The Chairman: We will adjourn on that.

(A short recess).

The Chairman: Honourable senators, we resume our hearing. I believe Senator Nichol was asking a question when we adjourned a few moments ago.

Senator Nichol: When we adjourned a few minutes ago, Mr. Chairman, I was asking questions about the correlation over the long-term between changes in the rate of growth in the monetary supply and the types of curves on unemployment, gross national product and cost of living as shown on those graphs. As I understand it, Mr. Reisman said that they could probably find that material for the committee but that he did not have it available to him right then. If he could find it he would supply it to us. Is that correct?

Mr. Reisman: That is correct, sir.

The Chairman: I assume it would be possible to superimpose on top of the graph the rate of changes in the money supply.

Senator Nichol: That would be fine. It does not matter how the figures come so long as we can take a look at them.

Mr. Reisman: We can do it that way, Mr. Chairman, but if we find a way that is more revealing I take it that you would provide us with the flexibility to present it that way.

The Chairman: Yes, we are all for having these things better revealed.

Senator Nichol: Thank you, Mr. Reisman.

Dr. Gillies: Mr. Reisman, we are very close to the end of our hearings and there is one point which is still not very clear in my mind, and I should really like to get it cleared up. It is the whole question of the role of monetary policy in the Canadian economic policy-making. How would you describe our philosophy about monetary policy in policy-making in Canada?

Mr. Reisman: That is quite a question, Mr. Chairman.

Dr. Gillies: Would you like me to elucidate it a little?

Mr. Reisman: It would be helpful to me if you would.

Dr. Gillies: From reviewing the various statements made to this committee I have received the impression that monetary policy is basically reactionary. I do not mean that it is reactionary in terms of being opposed to "liberal", but that it is taken to solve a particular problem of the moment—for example, to support the exchange rate or to finance deficits or something of that particular sort. I cannot find out what the philosophy about the role of monetary policy is other than that it should be used to correct certain situations which we happen to be in that are unpalatable or cannot be supported. Monetary policy then comes into effect to support the exchange rate or finance the deficit or something like that. But does monetary policy have a different role from that in our economic policy-making?

Mr. Reisman: Mr. Chairman, that does clarify the question sufficiently for me to attempt to reply. You had

as a witness before this committee the Governor of the Bank of Canada and I gather he submitted a fairly lengthy brief and replied to a large number of questions. He could probably comment with greater authority on this subject than I can, but within those limitations I can make a few observations in so far as I understand the position.

There are several large and important instruments available to government to help manage the economy. I use the term "manage the economy" in the sense of dealing with problems of economic stability. You help manage the economy with an instrument to attain certain objectives. The objectives as they have been postulated on numerous occasions by this Government are: to attain a good growth performance; high employment; improved standards of living on a sustainable basis; good balance in international accounts; and good price and cost performance. These are the broad objectives, and monetary policy and fiscal policy are two of the major instruments available to help governments manage the economy with a view to achieving those objectives.

It is my understanding that the monetary setting from time to time is established with a view to reaching those objectives. In that sense they are not reactive in their essence but, as instruments, are used in a positive way to achieve those objectives. This is not to say that there is some fixed setting agreed upon or established and not altered in the light of events and circumstances as they arise. You know and I know that this country has experienced from time to time in the past several decades, disturbances in the balance of payments and disturbances in the impact on the exchange rate.

When developments of that kind occur, the various instruments that are available will be used to help cope with those problems while at the same time reaching for the objectives to which I referred.

I would not myself have characterized the monetary policy in the period that I have been familiar with as reactive in its essence. I would have described it in much more positive terms, while at the same time recognizing that there will be adjustments made in the monetary policy and in other policies from time to time to meet problems that come up. In that sense I think the Governor has said in public statements, as has the minister, that in the most recent period the monetary policy has been used for two important purposes, one being to help stimulate the economy and get us on to a good growth pattern and the other being to deal with the inordinate pressures that have developed on the exchange markets.

I think that is all I would say on that for the moment. If there are further questions I will try to respond.

The Chairman: I have a supplementary question on that point, Mr. Reisman. While you say that the policy has not been reactive, nevertheless the evidence of the Governor before the committee indicated that it was not only exchange rate policy that he was concerned about. He was concerned about financing the Government's cash requirements and the general level of interest rates and he also mentioned in general the problems in respect of liquidity. It just seemed to us that perhaps we were relying on monetary policy to do these jobs that are an essential part of monetary policy, but that in the heavy reliance on those undertakings we were tending to lose the effect of monetary policy in the overall demand policy of a government. As a result perhaps we had made a step backward in the Bank of Canada Act in requiring the Governor to be a little too responsive to the Minister of Finance, and the Governor had lost some of this independence that might result in a better mix of demand policies. If I press you a bit on that it is because we really are concerned about it and I suppose we will continue to be concerned about it until we really get our teeth into the answer.

Mr. Reisman: I can see the direction this line of questioning is taking. There are economists in the United States, in Canada and elsewhere who take a particular view of how a monetary policy should be operated. The Friedman school would argue, I think, that monetary policy should be set at some particular stance or configuration and then left there, that the monetary authorities might just as well pack their bags and go home, and let that automatic setting remain come hell or high water.

I am not aware that that particular approach has ever been tried anywhere for any length of time. I was going to refer to it as a fad. I do not suppose it is a fad, but it is a particular approach which gathers adherents and loses adherents from time to time depending on particular economic circumstances. It was pretty fashionable for a short while in the United States when President Nixon took office, but I gather that of late it has fallen into disrepute.

I for one do not feel that it is a particularly happy approach to the handling of this important instrument of public policy. As I see it, the monetary policy, together with other instruments of economic policy, have to be operated in a real world, with a whole set of constraints and with a particular set of relationships to other policies.

The minister stressed this morning that he sees monetary and fiscal policy—and other policies such as exchange policies—working together to achieve the Government's economic objectives; and it is hard for me to really visualize the operations of this particular instrument in a world which is not subject to some constraints.

Among these constraints are the Government's need to finance itself, the impact on international development on our economy, and the movements of interest rates in the United States and elsewhere. I mentioned the United States because of the impact that that economy has upon us.

Let me cite a couple of practical examples to indicate what I mean when I say that a policy such as a monetary policy has to act within a particular set of constraints. Not so long ago we had in this country a serious problem which developed in the financial community in the case of the bankruptcy of the Atlantic Acceptance Company. That created a whole range of problems throughout the financial community and required certain

responses from the authorities, particularly from the monetary authority in this case.

Senator Macnaughton: Was it provincially incorporated?

Mr. Reisman: Yes, I think it was a provincially incorporated company; but nonetheless that event had certain repercussions and sent a series of ripples throughout the economy of a kind that needed treatment. If the monetary policy had been settled automatically and the governor had packed his bags and gone on holiday, we might have been in a good deal of trouble.

You are aware of the situation in the United States with the Penn Central bankruptcy. There is no question that the monetary authorities in that country had to operate within that constraint and take action in respect of liquidity and money supply, to deal with that crisis.

If I may I will use just one other example in another area, Mr. Chairman, in connection with the exchange crisis which we had in Canada in 1968. That was an exchange crisis where the rate was being pushed down, where the pressure on the rate was in a downward direction.

Again the monetary policy in Canada, and other policies—fiscal policies very decidedly so—had to take into account these particular pressures and constraints, and be to a degree responsive to them. Therefore those elements had to be taken in with all of the other elements in establishing a setting.

I take it, Mr. Chairman, that your question really raises the following point: is the Government's fiscal policy, and in particular its expenditures policy, both on the budgetary and non-budgetary side, of such an order that it is putting the monetary policy in a straight jacket; or that it is compelling certain action on that front of a kind which cannot be consistent with a stance of monetary policy directed to good economic performance or stable growth?

The Chairman: That is right. I think we can ignore, in answering that question, the automatic pilot approach. From looking at the history you have been involved with, has the money supply been performing in order to create the demand or restriction that the Government wants to create, or is the Government putting it in a straight jacket through the constraints that it is forcing? In other words, is it making in correct terms proper use of the money supply?

Mr. Reisman: I will try to answer that directly. I think that historically there have been occasions where the Government's requirements for cash have put sharp constraints on the monetary instrument and have, in that way, limited the usefulness of that instrument for its other purposes.

I came into the picture a year ago April, and I can speak with a little more knowledge of the situation since that time. I do not believe that the fiscal policy of the Government or its requirements for cash to finance both budgetary and non-budgetary requirements were of an order that put that kind of contraint on the monetary policy.

I did refer earlier to the fact that monetary policy in recent months has had to take into account the international financial position, the balance of payments, and the exchange rate impact on those developments. So far as the Government's financing is concerned, whether seen in terms of the budget or in terms of its debt management operations, I do not believe that the monetary policy has been excessively contrained in that way.

The Chairman: What do you say as to the very natural concern of the Government for the level of interest rates?

Mr. Reisman: I have never in my mind, sir, disassociated the price of money, interest rates, from monetary policy. There are some who see monetary policy in terms of the supply of money, the monetary aggregate. I have always seen it in a rather broader sense; the availability and cost of credit is no less a feature of monetary policy than the money supply itself.

The Chairman: Except that it might be possible to put the case that the Government could be more concerned with the price of money than its availability at any particular time.

If I were in government and worried about the cost of mortgage moneys, I might very well be terribly concerned with the price of money but at that particular time I might not be concerned with its supply.

Mr. Reisman: I would agree with that observation, Mr. Chairman, that the question of where the emphasis is placed at any point in time will vary and will depend on circumstances.

The Chairman: I will not labour the point with you; I just wonder if in your history the interest rate, using that definition, ever became a constraint on the aggregate money supply?

Mr. Reisman: I would not really regard that in the sense of being a constraint. I would really prefer to look at it in terms of the monetary policy and the impact that it can have on the cost of credit or the whole series of interest rates, rather than the other way around. The monetary instrument is operated with a view to achieving certain impacts on the economic performance. That can be achieved by a variety of means and interest rates, or the cost of money, is one of the very important prices in the economy, having an important influence on economic performance. Monetary policy, through the influence that it can have on interest rates in addition to availability of credit, the price and quantity, can exert influences on economic performance. Therefore, I do not feel that monetary policy is reactive; it is a much more positive force in that regard.

The Chairman: The question was purely to ascertain where the Government lays its emphasis in determining the monetary policy, but I think we have pursued that far enough.

Senator Nichol: Mr. Reisman, you were discussing a moment ago the monetary theory, the extreme case being that the Government and the Bank of Canada should

pack their bags and leave, and set an automatic pilot. You quite wisely rejected that. However, putting that aside, I think you are aware from reading our testimony that in all countries, and not just here, there have been criticisms, not of the personnel, but perhaps of the techniques which produced strong changes in the money supply. The question that continually arises in this respect is whether there is not a middle ground. I am sure that you are continually searching for the middle ground between what some might consider to be extremes of economic policy moving from one side of the road to the other, and the monetarist theory which says we just set the timer and let it tick.

In all our conversations in the committee we have been searching to discover if there is anything that we can do as a people to attempt to even this process out to some extent. As I mentioned to you this morning, we are now increasing our money supply at a very high rate. Sooner or later a change must be made and a more restrictive monetary policy adopted. If we continue at this rate we know what will happen.

I would like to ask you, not when the change is going to be made because I do not believe that would be a fair question, but how will that decision be reached? Who will be involved? What inputs will there be and how is that decision actually made in our system? What aspects will be considered, and by whom?

Mr. Reisman: With respect to the source of authority or where the decision-making is carried on in respect of the monetary policy, the Bank of Canada Act is really very clear. There is no question that the Bank of Canada is the authority in respect of the day-to-day monetary policy of this country.

Senator Nichol: Oh, yes, day-to-day; I agree.

Mr. Reisman: The Bank of Canada Act also makes it very clear that if the Government is not happy with the way the monetary policy is being handled it can direct the Governor of the Bank of Canada to change direction or make a modification. This would be done through the Minister of Finance.

From the point of view of the statute, the authority and the way it works in practice, according to my reading of it, does not indicate that the Governor of the Bank of Canada and his staff operate in a vacuum. They live in a world they are cognizant of and, indeed, very sensitive to everything that is going on around them in the economy, both public and private. They will carry out their role in that environment.

I think you are aware that the Deputy Minister of Finance is by statute an *ex officio* member of the Board of Directors of the Bank of Canada and the executive committee. Through that mechanism there is a great deal of continuing interchange between the Bank of Canada and the Department of Finance in respect of the instruments that the bank operates and the responsibilities of the Minister of Finance's advisers in the department with respect to fiscal policy, debt management and other related fields.

The board of the bank meets fairly regularly, about eight or nine times a year. The executive committee meets every week. Apart from the regular meetings, when events require more frequent consultations, they do in fact take place. I believe questions were put to the Governor of the Bank when he was giving evidence on the matter of the budget and the fiscal policy. He gave a very direct answer, that he was involved in the process and he certainly knew what was in the budget. I can assure you that he did and that we value very greatly these consultations and advice with a view to getting a mix of policy which, according to the best judgments of the people involved, is suitable to the occasion. I think this is true in respect to the monetary policy also, but there is no question that under the Bank of Canada Act the Governor of the Bank of Canada has certain definite responsibility and ultimately in the day-to-day operations he makes the decision.

Senator Benidickson: I have a supplementary question, Mr. Chairman.

The Chairman: I think, Senator Benidickson, Senator Nichol has a supplementary, then I will call on you for your supplementary, and later for your main question.

Senator Nichol: This is a broad question.

The Chairman: It is a supplementary, though?

Senator Nichol: Yes, it is. With regard to this co-ordination between the Department of Finance and the Bank of Canada with other inputs—presumably in an informal way from the Economic Council and all the other institutions—when you get right down to the crunch and a decision has to be made, let us say to change this policy or—to go back so that we are not dealing with such immediate matters—to make the change that occurred in March, 1970...

Mr. Reisman: In the monetary policy?

Senator Nichol: In the monetary shift of 1970 and the fiscal shift at the same time. Let us say the monetary shifs of 1970. I know this is a long question, and it may be a long answer. What are the indicators that you would really look at, taking into account all the conversation we have had about lags and all the rest of it? What are the indicators you would look at to tell you that now is the time to make such a shift.

Mr. Reisman: I do not think my answer will be very long, and I am not trying to evade the question.

Senator Nichol: Because it is the nut of the economic question, is it not?

Mr. Reisman: Perhaps in the light of my comment you may want to rephrase your question. I was not the Deputy Minister of Finance at the time the March budget was brought down in 1970.

Senator Nichol: You misunderstand me. I did not mean to make my question specific. I was thinking in terms

of examples when I mentioned those dates. Put any specific reference out of your mind. I did not mean that. What do you look at, say we are not in Canada, but somewhere else?

The Chairman: You were attempting to avoid being specific in the contemporaneous sense, but you did not want to embarrass Mr. Reisman.

Senator Nichol: I did not want to embarrass the deputy minister by asking him when he is going to change the fiscal policy. If he told me, he would not be sitting here.

Mr. Reisman: I can perhaps do a better job in answering that question if it were directed to fiscal policy. But let us take monetary policy and fiscal policy together.

Senator Nichol: Let us take them both together.

Mr. Reisman: Basically they have to be looked at as twin instruments that have to be operated in a good mix and seen in their relationship one to the other. To begin with, economic policy is based on knowledge and information, economic intelligence. There is in the Bank of Canada a pretty effective economic analysis unit; there is in the Department of Finance what I regard to be a pretty effective economic analysis unit; they spend a fair bit of their time talking to one another. Basically, however, they operate their systems quite independently. We have a capability, they have a capability. The heart of the operation is to know what is going on in the economy. Where have we been? Where are we? Where do we appear to be going?

Senator: Nichol: Right.

Mr. Reisman: This involves looking at a very large amount of economic information, statistics, data and reports. On the basis of all these facts and statistics an analysis is made of where we are and where we appear to be going, and in the light of that analysis advice will be offered as to what the situation would appear to require in order to achieve certain objectives.

The forecast, the projection, based on this kind of analysis may tell us that the economy over the next 12, 18, 24 or 30 months would seem to be headed in this way, and you reach the conclusion by looking, as I said, at a wide variety of things—exports, imports, production, investments, prices, consumer expenditures, retail sales, et cetera; a wide variety of inputs. On the basis of that you make a prediction and say that here is what seems to be happening. You look at it and ask whether that is really where you want to go, whether that would take you too steeply up a curve with consequences on this or that, on costs or prices, or whether it is a path that is too slow, a path that will not absorb the growth in our labour force, our capacity to produce, and in present circumstances whatever slack there may be that needs to be picked up as well. In the light of that, advice will be rendered to the Minister of Finance. He will get advice from us and from the Bank of Canada; he will get advice from whatever sources he finds advice to be useful.

The Minister of Finance is the principal economic adviser to the government, certainly in terms of the management of the economy, where he is not only the principal adviser but other ministers do not have the kinds of capabilities that he has access to in order to give this advice. But even in respect of other matters, such as regional economic policy or manpower policy, where the responsibility is in the hands of another economic minister, the Minister of Finance will have a view about that as well as part of his overall responsibilities in relation to the economy. Looking at the management of the economy in the sense that we have been talking about it, he will be advising the government.

I might tell you that I do not know what it was like ten years ago, or even seven or eight years ago when Dr. McQueen was here, or 20 years ago when Dr. Deutsch was here, because I did not work in this particular area. As a matter of fact, I do not think Dr. Deutsch did either. In those days things may have been quite a bit different from what they are today, but today the Cabinet and the committees of Cabinet have a great interest in, a familiarity with and an expertise in respect of, the economy.

I can tell you that in the course of 1970, from the time I came into the department to date, the material that was prepared in my department for consideration by ministers with respect to the economy and its performance and the forecasts is enough to fill two or three volumes. I suppose there have been no fewer than perhaps 15 occasions during this period when I was called upon to appear before a Cabinet committee, either the Economic Policy Committee, or the Committee on Priorities and Planning, and other committees as well, but mainly those two committees, to give evidence and provide information of a very wide variety, and in depth, so that ministers could be as familiar as their officials with the facts and the outlook, and so that they could take decisions in terms of their objectives.

I can assure you that that is what happens. I can give some of the particular processes, such as the process in connection with the establishment of expenditure guidelines or expenditure budget, or, for that matter, the process that cabinet would go through in connection with the preparation of a budget, or the process of dealing with a particular set of circumstances, such as occurred last year when there was strong pressure on the Canadian exchange rate and the cabinet had to focus on that problem as an emergent problem and take decisions.

On all those occasions, the role of the Department of Finance and, on some of them, of the bank, was as an adviser to provide inputs of information and data on the basis on which ministers could take decisions. This does not apply to the setting of monetary policy from day to day. These decisions are not taken by the cabinet: these decisions are taken by the Governor of the Bank of Canada in accordance with statute.

Senator Nichol: There is a multitude of statistical inputs into any of those decisions, but there are certain ones that you know to be too late, or where the lags are too long. What I am really getting at is, which are the

indices which this organization that you describe watches the closest in coming to a decision to make changes in fiscal and monetary policy?

I do not wish to belabour the point, but I am trying to obtain a little more expertise on the question of which indices are used. Obviously, if you watch unemployment, you are going to be too late; if you watch inflation, you are going to be too late. What do you really watch, to do this tricky navigation you are engaged in?

Mr. Reisman: It is a bit like navigation. You have to watch a lot of things. You get as much knowledge as you can about the economy and its direction, and there are all sorts of things one must look at.

Senator Nichol: Dr. Giersch, for instance, was very specific about the kinds of things they watched in the German economy.

Mr. Reisman: He put a lot of emphasis on private investment, I take it.

Senator Nichol: He was very specific, much to my surprise. I will find it in a minute. He said they watched capital investment, almost to the exclusion of everything else.

Mr. Reisman: I think he is some kind of a nut if that is all he looks at.

Senator Nichol: I do not want to say that is all he said.

Mr. Reisman: If he is trying to run an economy on the basis of looking at that one indicator, I think he is going to go astray.

Senator Nichol: I do not want to quote him inaccurately.

Mr. Reisman: I do not believe you can run the thing that way.

The Chairman: Perhaps we can come back to Dr. Giersch, when Senator Nichol finds the passage.

Senator Croll: As I understood you, you said there were economic predictives, both in your department and in the Bank of Canada, and they were pretty good. You indicated that you were able to predict up to 24 months—I think that was the term you used.

Mr. Reisman: I went as far as 30 months, but I did not say I was able to predict.

Senator Croll: What were you able to do?

Mr. Reisman: I said that what we do is we try, to the best of our ability and on the basis of the best information available, to get a reading on where we see the economy going, for as long ahead as our data will allow us. That is all we do, and I do not pretend to be able to predict.

Senator Croll: That is fine. So you indicated what you thought the data disclosed. Then the unemployment that came to us rather suddenly and heavily—was that as a result of your failure to predict, or the Government's failure to take your advice?

The Chairman: I think I should interject that the deputy minister, being a civil servant, might find it very difficult—and I know Senator Croll would not wish him to criticize the Government.

Senator Croll: He knows how to get away from that question, if he wants to.

The Chairman: I am sure he does. I am sure he will not take the easy way out, but it is good to offer him the opportunity.

Mr. Reisman: Mr. Chairman, I deeply appreciate your intervention, which was designed to be helpful, and I am going to seek some refuge in it, when I get pressed far enough.

Senator Croll: All right, let us forget it.

Mr. Reisman: Let me try to give an answer to that. I was not there.

Senator Croll: Forget it, then. There is another question.

Mr. Reisman: It is quite an easy game to say that your predecessors were not nearly as good as you are. I would like to select my own crucifix to be crucified on. Senator, I can tell you this, with some confidence, that the people who were engaged in this exercise of looking forward and trying to determine where the economy was going in respect of production, employment, prices and so on, were looking ahead, two years or 30 months, to the period when this high unemployment problem developed in the country, but they did not anticipate unemployment of the order of magnitude that actually developed. This is one of the difficulties with projections and forecasting.

I do not know what my record is going to be—I hope it is going to be pretty good—but I am pretty sure mistakes will be made there, too, in terms of getting the right fix as to how the thing is going to evolve.

I do not know, Dr. Hood, if you were there at the time. You were not in the Department of Finance, but I think you were over in the Bank of Canada. Perhaps you are familiar with the projections of that period, but I do not think they projected unemployment of that magnitude.

Dr. Hood: I would not have changed a word of your answer at all.

Senator Croll: You guys stick pretty close together.

The Chairman: Senator Croll, do you not wish you had had a staff like that?

Senator Croll: My next question is this. When you speak of this up to date information that you are able to obtain, I have no doubt you are indicating that you get it from DBS. Have you a special pipeline in there, because I do not seem to be able to get it?

Mr. Reisman: Would you like to answer that, Dr. Hood?

Dr. Hood: There has been a suggestion in the course of this conversation by Senator Nichol when he was speaking, and you also, senator, have alluded to the same point, that you cannot look at unemployment because that comes too late, but you look at the latest that you have got and beyond that you have to forecast. If the unemployment figure for the month of June reaches us only on the 18th of July and we are concerned with decisions on the first of July, we have to utilize the latest we have got and project from there. It is not a question of a special pipeline, it is a question of using the latest that exists.

Senator Croll: Yes, but when you speak of the latest figures, what do you mean? How late? That is our trouble.

Mr. Reisman: Mr. Chairman, let me try to answer this. You will recall that the unemployment data for the month of April, which came out in the month of May, was rather disturbing. It showed an unemployment figure in this country, seasonally adjusted, of 6.7 per cent. There was a great deal of concern and a great deal of puzzlement over that sudden rise in the unemployment rate from 6 to 6.7 per cent, seasonally adjusted.

Now we had some explanations for this in the Department, and I think the Minister of Finance gave some of the explanations in the House, but they were belittled. It was said that this was the Minister rationalizing, and it was bad forecasting, and that kind of thing. It was a rather troubled position to be in to have to try to explain what took place in that one month's series in terms of its having been a long winter or whatever reasons were given. But I can tell you this, that my staff who do projections on a wide variety of indicators, do projections on employment and unemployment as well. They provided me with a projection of a fairly detailed kind in respect to that series—employment and unemployment—and I was simply amazed on the day that the figures came out. We had to help to prepare a budget during the month of June, to be delivered on June 18 in respect of figures which were not going to be released until June 17. So we had no basis other than our knowledge of the economy and our projections.

I should like to tell you, Senator Croll, that in respect to the increase in employment, my forecasters told me that we should get 350,000 additional jobs in the month of May as released in that labour force survey in June, and the figure turned out to be 347,000. They also told me that unemployment would go down by 120,000, and it in fact went down by 116,000. They told me that the seasonally adjusted figure would be either 6.3 per cent or 6.4 per cent, and it turned out to be 6.3 per cent.

Now I do not want to pretend that we are magicians and that we can get down to that kind of accuracy in looking ahead, particularly on an index of that kind. It just happened that in that month they were right on. Perhaps next month they will be off again. But this is not witchcraft; this is a profession that takes a great deal of skill and training, and very often we are working with data which is pretty thin. This is not a slur on the Dominion Bureau of Statistics because they are a pretty good outfit compared with others in other countries, but very often we are working on projections when we do not know where we are. It is hard in this business to know where you are precisely at any particular time. Yet, that and the history immediately behind you is what you have to go on in doing projections, and projections have to be done.

I think, as I said before, I have a team that is second to none. This is not accidental. One of the first things that I did when I joined the Department, even before I joined the Department of Finance when I was designated as deputy minister in that department, was to look over the operation to see what strength we had in the economic analysis, the forecasting and the fiscal policy side, and we made some very extensive changes. I think that earlier today when the Minister was giving evidence, Senator Benidickson made reference to the fact that there are all the same old horses around, they simply change stables. I think I was referred to as one of the old horses.

Senator Benidickson: I was referring to your previous connection with Treasury Board.

Mr. Reisman: More than that, sir. I joined the Department of Finance almost 26 years ago, and I have also served in the Department of Industry, and I think I also worked for you, sir, when you were parliamentary assistant in that department.

Senator Benidickson: I was aware of that. That is many years ago.

Mr. Reisman: It is many years ago. But in those years I did not have the responsibility for this side of the economy. You made reference to John Deutsch earlier, and I might say that he did not have those responsibilities either, because I worked for him for many years. He left the department as such in 1954, I think, to go to Treasury Board and was there until 1957, and then he went back to the universities, and from there to the Economic Council. But I think his contact with the department ended that many years ago, and to my knowledge he never worked in the economic analysis or fiscal policy fields. I was working for him in those years and we were mainly on international economics, tariffs, international finance, and trade.

The point I want to make is this, and I think it is an important point, that we have in the Department of Finance today several teams of people working in the economic analysis and fiscal policy fields under Dr. Hood, most of whom are new. I think Dr. Hood has been with the department about a year and a half. He has been with the Bank of Canada for a number of years and prior to that he was a well-known professor in the University of Toronto in the field of econometrics and related matters. He has working for him two divisions composed of what I think are outstanding people in this field who have earned their reputation through very hard work at the universities and in other work since that time. But they are new as far as the department is concerned. I do not think we have a senior man in this area who has been with us more than two years.

Senator Croll: Do you not think you should?

Mr. Reisman: That is what I am supposed to be.

The Chairman: I think we have spent a long time on this particular subject of where we are in the particular cycle, so perhaps we should move on. I want to go back to Senator Nichol who has found Dr. Giersch's statement now.

Senator Nichol: Yes. I would not want your reaction to my comment about Dr. Giersch, which was fairly strong, to stand on the record because of my misinterpreting what he said. Now that I have found it, I shall not read it all but I shall read part of it to you if I may. He said:

> My experience in Germany is that the unemployment rate is a laggard variable and if you use it as an indicator, you are bound to come too late with your measures. I mean by that that the rate of employment is lagging behind other variables which therefore are a better indication of where the economy is moving to. For example, the rate of increase in incoming orders, particularly in investment goods industries, is a sufficiently early variable or early indicator, and you have to use an early indicator for your measures of monetary or fiscal policy . . .

Then he talks about time-lag and so on and ends up by saying:

> I would guess from German experience, if there is an effectiveness at all of monetary policy in an open economy—there may be some instances where we can say it had some effect—then the effect came about six months later. That means we cannot use a very early indicator, as I explained to you.

Then he was asked:

> Could I ask you, Dr. Giersch, what are the indicators, other than the one you have mentioned, which set the system working in your country?

And he said:

> These are the incoming orders.

Then he went on to say:

> —in the investment goods industries—the capital goods industries.

Then, after another exchange, I asked him if they specifically keep an eye on this particular indicator, and he said yes. I then asked if it was sufficiently close that it really worked, and I had hoped he was going to say yes, but he said:

> This, of course, is very difficult to judge. It is difficult to judge the figures. Usually one wants to wait for 2, 3 or 4 months in order to be sure that one has the right tendency.

Mr. Reisman: I would not disagree very much with the evidence which that witness gave, and in the light of that I would like to withdraw my comment, if I may be permitted. That makes good sense.

Senator Nichol: He is being very specific compared to . . .

Mr. Reisman: In the context in which that comment was made I would not disagree with what was said.

Senator Nichol: Are there any particular indicators, then, to which you feel some reaction of that kind?

Mr. Reisman: As I say, we look at a lot of things. You are asking me if we look at any particular one?

Senator Nichol: Yes.

Mr. Reisman: Perhaps I can illustrate it this way: in the projections that we made for the Minister of Finance, and against which he and his colleagues took decisions in connection with the budget, we said to him that we expected private capital investment—that is what you are referring to—to be weak this year and to remain weak for a while. We were looking to other forces in the economy to take us forward on the projected growth path that was indicated in the budget. Among these forces we expected a continued good performance on the trade side and we expected a continued stimulus to the economy through the provincial, municipal and federal governments, and we were also looking to a good performance on the part of consumers. This is where we saw some real action in terms of giving us the kind of growth path that we were projecting, and we went on to say that something would have to happen of quite a dramatic nature on the consumer side before it would translate itself into an engine of impulse on the private investment side. We could see the economy moving through 1971 pulled along by the kind of forces that I speak of, and they in turn would bring about a better performance in the private investment side as we moved through 1971 and into 1972.

In that comment you can see that we have already looked at a number of things; exports, Government expenditures, consumer behaviour, and private investment, too, but we looked to other forces than private investment to give us the impetus through this next period.

The Chairman: I think we can leave that subject. Dr. McQueen?

Dr. McQueen: Mr. Chairman, I have a couple of questions and I would like to be guided by you as to whether they are appropriate. One concerns expectations and it refers back to this morning, and the other one concerns how the Finance Department assesses the impact of its policies on the economy. Could you indicate to me whether either or both of those would be appropriate?

The Chairman: They are both acceptable.

Dr. McQueen: This morning, Mr. Chairman, Dr. Hood was talking about expectations. This is a very important matter in our economy. It affects the way policy works on our economy, and I think that having policies that seem to act on these expectations is a very tempting thing for a government to undertake, because manipulating your jaw bone in this way influencing expectations is a very low cost kind of governmental intervention in the

economy. What I wanted to ask, Dr. Hood, is what do we really know at this stage about peoples' expectations? What is it that they are anticipating? He took up the case where you sometimes get what seems to be a perverse reaction where you are expanding the money supply rapidly and yet you find interest rates rising at the same time, and he suggested the reason for that might be that people anticipated inflation, a fall in the value of money and, therefore, they were demanding a higher reward for lending.

What I would like to put to Dr. Hood is: Is it not also a possibility that what people are expecting is not so much what is happening to the economy but what the public authorities are going to do about it? For example, if the people see the Bank of Canada expanding the money supply very rapidly should not this sort of tought run through their heads: well, we know they worry about the money supply so much. It is pretty clear to me they cannot go on expanding at this rate for very long. That means, according to my reasoning, that we are in for a period of pretty tight money and tough credit before very long so that perhaps the thing to do is to get in now and borrow money while you can.

Is it not possible that people's expectational reactions that worry us all so much here are expectations of government policy or about what government is going to do about this inflation, rather than the inflation itself?

Dr. Hood: Well, if the question is directed at me...

The Chairman: Could you answer it in four or five words, Doctor?

Dr. Hood: Four or five?

Senator Nichol: Simple words.

The Chairman: Succinctly.

Dr. Hood: I am known as an economizer in the use of words and I will not let you down.

The Chairman: I jest with you.

Dr. Hood: The formation of expectations is indeed complicated and I would be rash, indeed, if I were to say that members of the public did not have expectations as to what government policies would be.

If their expectations—"if"—are that government policy is going to be such as to induce inflation, you will find it very hard to determine in the data available whether it was their expectation about prices themselves or their expectation about government actions that was producing that? That in the Canadian case they figured the

Dr. McQueen: How about government action to contain the inflation? Could it not be that they were anticipating that? That in the Canadian case they figured the authorities generally move sooner or later to contain inflation? And that this has produced tight credit, and, therefore, what they are primarily anticipating might be tight credit?

Dr. Hood: Might be. How is that for a short answer?

Dr. McQueen: With your very kind indulgence, Mr. Chairman, I should like to ask the witnesses how they go about assessing the impact of fiscal policy on the Canadian economy. I know there are no easy answers to this question, and I am sure they are in the process of working gradually towards answers. However, on page 7 of Mr. Benson's brief the concept of the full employment budget—about which we have had some testimony in this committee—is accepted as an expository device for explaining things to the public but it is rejected as a prescriptive or forecasting device, you might say. There is a statement on page 7 which reads as follows:

> From the standpoint of assessing the way in which the effects of a given fiscal stance will unfold, we incline to the view that it is better to keep the reciprocal effects—

Those are the feed-back effects of the economy on the Government's fiscal position.

> —to keep the reciprocal effects in evidence in the analysis rather than to hide them in some standardized concept.

I should like the witnesses to tell us a little more about just what that means and also how they themselves go about assessing what impact they have had on the economy. For example, some tax rates have been changed recently. How are you going to set about the job of determining how much that change in tax rates affected our economy?

Dr. Hood: In the context of the passage quoted by Professor McQueen, the reciprocal effects on the Government's position that were alluded to were the effects on our revenues and the effects on specific categories of expenditure. It is not very difficult to watch the tax moneys flow in and see whether you are having an effect or whether you are getting a feed-back effect in your revenues. It is also not very hard to watch your unemployment insurance payments and see whether you are getting a feed-back effect there. In respect of those specific items there really is not any great difficulty.

What I think is important to do is not to claim for fiscal policy what is the consequence of the economy's reciprocal action on the Government's own account. I think it is best to keep that clearly in view, both in planning of policy and in thinking it through as you go on day by day.

In terms of the broader aspects of your question, tracing the impact of government policies on the economy itself, it is simply—"simply" is an unfortunate choice of words there, because it is not simple at all and I would not want to convey that impression; but what one does is to continue to watch the indicators—you used the number 100 this morning, and that is a good, round number—to continue to watch the indicators of economic performance and continue to reassess where the economy is. That is the essence of the process.

Techniques are available or are being developed whereby one can try to study the matter more precisely in respect of a specific measure and its impact on specific indicators. Those techniques we are using or are using or are preparing to use to the best of our ability.

Mr. Reisman: Mr. Chairman, certain references were made earlier today. Senator Nichol kept looking for some indicators that have a particular worth and value in helping us make these judgments and learning about where the economy is and what needs to be done about it. Professor McQueen, in quoting that particular passage, also made reference to the full employment surplus, which is one particular tool or one particular device that has had a certain popularity in some places. I wonder if you will permit me, sir, to read into the record a very short quotation from an article written by Dr. Arthur M. Okun and Nancy H. Teeters on the subject of the full employment surplus. I believe Dr. Okun gave evidence before this committee. When he was chairman of the Council of Economic Advisers this particular device reached a certain level of popularity and usage.

The Chairman: Perhaps you could give us the title and page number of your quotation.

Mr. Reisman: The article is entitled "The Full Employment Surplus Revisited". It was written by Arthur M. Okun and Nancy H. Teeters for the Brookings Institution.

Senator Croll: When was it written?

Dr. Hood: It was written last year, Mr. Chairman, and was published in a publication called *Brookings Papers, Volume I,* No. 1.

Mr. Reisman: Arthur M. Okun says this:

> —the full employment surplus has been a useful tool for the presentation and public discussion of some key issues in stabilization policy. It offers a simple, one-parameter description of the macroeconomic effects of fiscal policy for presidents, legislators, journalists, and concerned citizens...
>
> It is not, and was never meant to be, a precise measure of fiscal impact for use by the expert. Indeed, the expert has no dire need for a single, publicly available summary number. The internal development of a budget program by government fiscal experts can and should be based on more sophisticated concepts and computations. The research economist specializing in fiscal policy is free to exercise his own options. He will not summarize fiscal policy if he chooses to develop a structural econometric model; instead, he will apply many fiscal variables and many income-expenditure relationships to spell out the impact of the budget on the economy...he can and will concoct his own tools, his own measurements using whatever sophisticated refinements, weights, and transformations he considers useful.

I think this does throw a little light on what this expert—and may I say he is a damn good one—feels about the use of single numbers or single indicators of this kind.

Dr. McQueen: I myself have never been a believer in single magic numbers, except in playing roulette. But I do think there is a most important need for objective criteria of whether policy is succeeding and to what extent it is succeeding. We recognize as realistic people that too many times there is a great political temptation to say that everything is coming up roses in the economy, and it is all the result of the beneficent Government fiscal policy.

Dr. Hood said some very informative things on how this process of rational, realistic, hard-nosed assessment, of how much effect fiscal policy has on the economy, should be carried out. I want to ask him whether more information could not be made available to the public about the results of this kind of investigation, so that we too can know whether everything is coming up roses, or something else not quite so sweet smelling, and we can form some appreciation of how much of that effect has been due to Government policy and how much to other factors.

Dr. Hood: The objectives of the Government are, I think, well known, and the performance of policy ought to be judged by the performance of the economy in relation to those objectives.

Now, whether more specific information can be made available— I have sugested a pretty strong test. That is the test that I would live by myself. That is public. Those indicators are available.

Dr. McQueen: How much influence did the Department of Finance have on that, be it favourable or unfavourable?

Dr. Hood: How much influence did the Government policy have?

Dr. McQueen: Yes, along with a lot of other factors which may have been at work. Is that not important to know?

Dr. Hood: Of course it is important to know. It is important to know, and it is important not to mislead in any information that you provide to the public. My feeling is that the Government should make available whatever it has, in which it has a high measure of confidence.

Mr. Reisman: The practice has developed recently for a Minister of Finance to make frequent reports to Parliament and to the nation, not only in formalized budgets—and even there, the Minister of Finance had one in March, one in December, and one in June, three budgets in 15 months, but also in a series of statements which, if not formal budgets, were almost tantamount to budgets in the course of 1970. He really said quite a great deal. I am sure that you have read them all assiduously and digested what there is in them. There really is a great deal of stuff there. You are now asking for more. You might say...

The Chairman: Perhaps Dr. McQueen is asking for it on a more formalized basis.

Mr. Reisman: Budgets are pretty formal.

The Chairman: I am taking the position of Dr. McQueen, although he is quite capable of taking his own position. It occurred to me that that was what he was seeking.

Mr. Reisman: The question could have been put to us in terms of why do we not release publicly the projections that we do in the department.

Dr. McQueen: Nobody expects you to release projections inopportunely.

Mr. Reisman: Perhaps under some different kind of system one might be able to do that, and perhaps we will reach the stage where one lets it all hang out. But if the Minister of Finance were to release his projections for the path of employment and unemployment in the next six months, they would hang him before many months were up.

Dr. McQueen: Some of this concerns looking backward, not forward. Let us be frank and realistic about this. There is a lot that we do not know. We are in process of trial and error. We are supposed to learn from our mistakes. I am suggesting that there has been a most useful increase in the output of information from the Department of Finance, and very fine grist for academic mills and all that sort of thing. However, in the public policy context, we want to know where we went wrong in the past, and we would like to see more numbers on it. This would help us to better the future. That is the important aspect.

Mr. Reisman: We do a great deal of that kind of work. When measures are introduced and changes are made we try within our organization to research them out. What was their impact? What were the lags? Were they as effective as one thought they would be when they were introduced? We do a great deal of that. This is of the essence of the whole political process. It is not, I think, to be expected that a Minister of Finance should get up and say "Twelve months ago I did the following and the damn thing did not work.", or "It did just the opposite to what I hoped it would de because some expectations got in the way."

We have good people like you at the universities who are doing all kinds of things. There is a lot of information around for them to work with. We would hope that they and others would engage in this exercise. Indeed, what are we engaged in right here today? This is in a sense, perhaps a novel initiative that Senator Everett has organized and is carrying through, but it is an exciting kind of an approach to bring people in and question them in a pretty tough way.

I think that is good. I think this will add to a good and informed debate and will permit you and others to make judgments about whether the people who are in a position of responsibility have done well, done badly, or ought to be kicked out.

Dr. Gillies: I can agree with you that the Minister of Finance cannot do that. But would that not be an argument for having some other agents in Government that could do that, to make forecasts, to make them public, to react and analyse what was wrong?

Mr. Reisman: If it is going to be a Government agency that does it, it would be subject to all the problems and worries of a Government agency. I am all in favour of and support very strongly the notion that there should be development of institutions at arm's length from the Government, capable of doing this kind of work and constantly informing the public, the press and others about it.

Indeed, a number of proposals were made. When Dr. John Deutsch was Chairman of the Economic Council, in the last report over which he presided a specific recommendation was made to this effect. There were a few initiatives taken on the outside to start up such an outfit. The trouble was, they wanted to finance it essentially with Government money. There is nothing wrong in the Government's wanting to put money in this, but you do not want so much of the Government's money put into it that it ceases to be an arm's length operation. We know that the Canada Council supports some of these activities and the universities at York and Toronto are now engaging in this type of sophisticated work. We like this, want it to happen and will support it in every way we can. Indeed, I would be in favour of providing resources as long as it does not become a government institution, subject to all the constraints of such an institution.

Senator Benidickson: Since I indicated the desire to ask questions some of them have been taken care of.

The Chairman: I must apologize to you, senator. We had met before the division and I had a lengthy list. I should have informed you of that list.

Senator Benidickson: I am not complaining, Mr. Chairman. Some of the notes I made this morning after reading the brief we will not have time to take up this afternoon. However, some points have been cleared up through Senator Nichol's supplementary questions. He came to the point of what were the factors and who was involved in a very important change in policy, not this day-to-day business, which we all know is the responsibility of the Bank of Canada, but a major change in thinking, style or sense of feel which is often referred to as March 1970. As you indicated, monetary and fiscal policy are operated as twins and there is often an admission that there was a real turnaround, the date given being March 1970. Senator Nichol obtained a little more information as to who participated in a major decision of that kind.

Then you cleared up another question by indicating that your appointment was in April 1970. I was interested in the date of your appointment and its relationship to such events as the presentation of the White Paper, the March and December budgets of 1970, et cetera. We have the dates and we know that you were appointed after the March budget and after the presentation of the White Paper.

You indicated that there was a great change in recent times in cabinet participation and decision making. In

fact, you used the word "budget" as an exanple of cabinet participation. Certainly it is only within recent times, if it is now happening, that cabinet hears very much of the contents of the budget.

Mr. Reisman: I want to be very clear about that. The cabinet on the occasions of the budget since I have become Deputy Minister of Finance knew, considered and decided upon every single detail and measure contained in those budgets.

Senator Croll: Eric Kierans stated in an article in *Maclean's* magazine that he saw the budget for the first time the morning after it was delivered.

Mr. Reisman: Mr. Kierans may have been on a holiday.

Senator Croll: No; they do not take holidays at that time.

Mr. Reisman: I do not know where he was, but what I am telling you is a fact and I am prepared to stand by that.

Senator Benidickson: Five years ago it was the practice that no one heard about the budget except the Prime Minister, the Minister of Finance and the Governor of the Bank of Canada, until perhaps 24 hours before delivery.

The Chairman: Of course, senator, I assume you accept the deputy minister's statement.

Senator Benidickson: Yes, and I have read what Kierans said. We have to balance their statements, Mr. Chairman. They are both friends of mine.

Mr. Reisman: I would say that what is being said here with respect to the practice 10, 15 or 20 years ago is in accord with my recollection of the procedures and methods of that day. There have been major changes in the procedures, techniques and decision-making process in the last few years. As a result the Cabinet and Cabinet committees become very deeply involved in this process.

If you will permit me just a further moment, quite apart from budgets and emergent problems, there is now established a regular procedure in connection with what I can term the expenditures budget, or the decisions of the Government as to how they will use their moneys over a particular fiscal period.

There is a standard procedure in the hands of the Priorities and Planning Committee of the Cabinet, which is chaired by the Prime Minister. There is a role in that process for the agencies which have responsibilities for giving advice and providing information and data. I know that the Minister of Finance is called upon. To be precise, let us assume that we are now discussing the expenditures plan of the Government for the period from April 1972 to March 31, 1973. The process for making decisions with respect to that expenditure plan commenced at the beginning of 1971 and a number of meetings were scheduled in that Priorities and Planning Committee.

Senator Benidickson: Is this at the Cabinet level?

Mr. Reisman: I am now speaking of the Priorities and Planning Committee of the Cabinet, which is chaired by the Prime Minister and made up of a number of senior ministers.

Senator Benidickson: A few years ago that process would have commenced in September.

Mr. Reisman: It might have commenced that late then, but it now begins as early as January.

One of the first papers required in the process is by the Minister of Finance on the general economic outlook, medium and long term. The paper he submitted on this occasion was entitled "Some Emerging Economic Issues," in which he attempted to take an overview of the shape and direction of the economy, looking ahead a decade and more.

The committee has a detailed discussion of the paper, with officials invited to attend and respond to questions. The second paper, which is presented during the following week or two, focuses in a little more. This is again by the Minister of Finance to the Priorities and Planning Committee of the Cabinet. In the paper he delivers a picture of the economy as it is today and seems to be developing over a two-year period, in considerable detail. The minister usually chooses to be accompanied by some of his officials, who respond to enquiries, questions and requests for further information.

On the basis of that consideration the Minister of Finance recommends to his colleagues the fiscal settlement for the period in question. If we are talking about February, 1971, now, and about a period that begins April 1, 1972, then we are talking about a period that commences 14 months and runs through to 26 months from the time he offers that fiscal recommendation. This is forward planning, and forward planning of a kind that must inevitably become subject to adjustments and corrections as the process goes on, as time goes by, and as you learn more about the economy and its direction.

Senator Benidickson: That is obvious, because it is referred to.

Mr. Reisman: You have a definitive plan, what we call the fiscal framework, which is the technical term we use. It then becomes the basis on which the government decides how much money it has got to work with during that period. It then proceeds to decide how it wants to allocate that money between the whole range and variety of demands upon it, both budgetary and non-budgetary, which is important.

Senator Benidickson: The lending part.

Mr. Reisman: The lending part. I want to make this point. I was treated to an article in the Ottawa *Journal* written by Dr. Gillies. It was a good article, dealing with the question of the fiscal setting and whether it was right. There was one important gap in it, which I have mentioned to Dr. Gillies. It referred almost exclusively to the so-called administrative budget; it talked about the budget proper. It did not talk about the net cash requirements. In other words, it left out con-

sideration of all the lending activities of government—CMHC, Export Development Corporation, AECL, and a host of other activities by the government. To show you how significant this is the budget deficit, as projected in the minister's June 18 budget, was $750 million on the budgetary side, but on the total net cash requirements it was $2,425 million. There is really quite a big difference there. If one thinks in terms of the total impact of the federal government activity on the economy, it is that net cash requirement which is a much more significant figure than the $750 million.

Senator Benidickson: And that figure, of course, is significantly higher than it was predicted to be as recently as last December.

Mr. Reisman: Very much higher. So was the budgetary side. To begin with, there were the chanves in the budget itself, but in this particular year again, because of the nature of our winter, there was a carryover from 1970 into 1971 of a fair bit of money out of CMHC and two or three other agencies; the money just did not pour out as fast in that long winter. That is what did that. It came off of 1970 and into 1971. I am sure Dr. Gillies would not want to ignore in his analysis the net cash requirement side as distinct from the administrative side.

The Chairman: Do you want to answer that assertion, Dr. Gillies?

Dr. Gillies: I was surprised to hear it was in the Ottawa *Journal*. I did not know they carried my column.

Mr. Reisman: I always read your column.

Senator Croll: I hope you learned something.

Mr. Reisman: This is the way the process goes, and it is on that basis that the expenditure budget is established. On the basis of the expenditure budget and the priorities set by Cabinet, the Treasury Board takes over and does the specific allocation between different departments and different activities.

Senator Benidickson: That setting of a base may be made much earlier in recent years than it was a few fears ago. However, as the deputy minister indicates, certainly there have to be adjustments, and this morning the minister, in answer to a question of mine, said that you would indicate to the committee what the six significant adjustments in the last 15 months have been. What are they, and when were these adjustments taken?

Mr. Reisman: We brought it in, senator.

Senator Benidickson: That has been brought in?

Mr. Reisman: Yes.

Senator Benidickson: That will be an appendix to the record, then.

The Chairman: I did not intend to print it as an appendix to the record. I will, if it is the desire of honourable senators. It is material that has been fairly widely circulated, but if it is your desire to print it, we will do so.

Senator Croll: It is excellent.

Senator Benidickson: We have been talking about long-term planning and then we find we have six significant adjustments in 15 months. I think it would be useful, if anybody reads the report of this committee, to find out what those significant adjustments were.

The Chairman: Is that your wish, honourable senators?

Hon. Senators: Agreed.

The Chairman: Then I order that it be printed as an appendix to today's proceedings.
(*See appendix to today's proceedings*)

Senator Benidickson: I have a number of other questions, but when I look at the clock I realize there are some other people who want to ask questions.

Senator Croll: I have one bread and butter question. Taking a look at this record of puffery, I notice on page 3 certain items. Let me put it in context. In May and June of this year the great problem in this country was unemployment. The people were bothered by that more than they were by inflation.

Mr. Reisman: I think that is true, sir.

Senator Croll: I notice that you took the tax off margerine at a cost of $7 million. Part of it went back to the consumer, five cents or six cents; no great shocks. There was the removal of 12 per cent sales tax on all anti-pollution equipment, at a cost of $8 million. There is no great deal there. That is $15 million. Then you dealt with the excise tax on radio, television and so on, which came to $40 million. Altogether we have $55 million. The first two items, of course, are consumer items. The next one is perhaps 50-50, but they are consumer and other items.

Mr. Reisman: You left out some pretty big ones there, senator.

Senator Croll: Wait till you get the question. I have got some more coming. If you were thinking of unemployment, and of employment, as you should have been at that time because that was the hot question, and you were getting ready for June 18, what was the thinking that led you to believe the expenditure of this $55 million was a better expenditure than dropping, say, the tax building materials, which would probably bring on building, which is, of course, the great employer of labour? Is that embarrassing?

Mr. Reisman: I suggested earlier, Mr. Chairman, on your very kind intervention, that there would come a point in this questioning where I would take refuge in my position. I cannot tell you, senator, why the Government chose one measure rather than the other. What I can tell you is how it struck me.

Senator Croll: Well, go ahead.

Mr. Reisman: It was a Government decision and they chose to do these things. Housing is one of the strongest

features of the economy today. Starts are running at a very high level. They were not quite as high in May as they were in April, but they are still well over 200,000. They were running at a 254,000 annually adjusted rate in May. There is a lot going on on that side. I suppose the Government, looking at that, felt that they were getting good performance out of that sector. Let us look at one of the big excise tax measures in respect of home entertainment equipment. Here is a difficult area.

Senator Laird: Foreign competition.

Mr. Reisman: There was a foreign competition problem, and a tax base problem too. As you know, the excise tax bears more heavily on the domestic producer than on imported goods because of the base that is used. Here was a way of stimulating consumer activity, which in turn could be reflected in factory activity in a rather important industry. This, I suppose, is the logic that must have gone through the minds of ministers when they took this decision. I know you will not leave out the other important changes in the income tax that were made, which ran to many, many scores of millions of dollars of direct impetus to the economy.

The other point, sir, is what you must realize, and I know you do, that the June budget, in respect to adjustment in the fiscal setting, is one of a series of steps that were taken in the period between March 1970 and June 1971. The total, after all, is the figure I gave a moment ago, $2,425,000,000 of injection of net Government cash into the system, both through budgetary and non-budgetary outlets. That is not small.

Senator Croll: I am not a critic of what the Government did in the budget, and I have been very anxious to support it. Before they did it, I supported it. You came back and talked about the need in the electronics field, where you are dealing with skilled people. The great impact in this country came with the unskilled, in the building trades which are the greatest employers of unskilled people, in the main. I suppose you are quite right, and it was not your decision. Let me ask you another question. When it came to depreciation, the law had provided for depreciation—the charge of land depreciation against other income. That was changed. Surely, consideration must have been given to the fact that what these people will do is pass it on in rent? Was that not a matter that was considered at that time?

Mr. Reisman: I think you are referring to a feature of the tax reform, whereby in respect of passive investment in rental, real estate, that losses arising out of capital cost allowances cannot be charged against other income. I think the Government view, when they examined that, was that it was a loophole in the law at the time, which permitted people with substantial income to avoid paying taxes for a very long period of time, through this technique. They took into account the variety of effects such a change would have; and on balance they decided that, in the interest of equitable sharing of the tax load, that particular way of avoiding taxes should be eliminated.

Senator Croll: Did that involve a great deal of money, do you know?

The Chairman: Senator Croll, I have permitted Mr. Reisman to answer the question. I think it is fine that he does. However, it really is a question that probably would be dealt with on the hearings on the tax reform bill. It is just a little bit out of the ambit of this hearing.

Senator Croll: Yes, it was not in here.

The Chairman: I do not want to get too involved, if possible, in a consideration of the tax reform bill at the present juncture.

Senator Croll: I will pass, for the moment.

Senator Nichol: Mr. Reisman, I want to ask you a question which is more general than some of the others we have been talking about. The argument has been made here that, in defence against the disasters of the 1930s, we constructed a system which goes under the rather heavy name of the welfare state. We constructed a system to protect each other from the rigours of economics. The argument goes that because of this structure—which includes tariffs, strong trade unions, welfare programs, unemployment insurance and so on and so forth; all things which nobody would turn their back on—because of these things we have created rigidity in the structure which makes monetary policy less effective as a control than it was in the days when markets were freer.

That argument has been put here, and it is probably right. The other side of the coin, and the question I want to ask you, is this. Going for a moment to a sort of psychic world, or expectations, that we have talked about, it seems to me that I cannot draw the parallel in Canada. In the United States, the economy is becoming in some ways far more sensitive to monetary policy than it ever was before. For instance, the stock market, the Dow Jones, used to look at earnings or profits or projections of markets and so on. It seems to me that nowadays the moment a bank in the hills of West Virginia changes its rate, the Dow reacts in a very violent way and this has a psychological impact throughout the whole economy.

Taking those two separate effect of monetary policy, do you think the system is less sensitive now than it was, say, in the years after we settled down from the war, say in the early 50s? Do you think we have to put more muscle on or less muscle on, to get the same result?

Mr. Reisman: That is really a philosophical question. My answer on that, senator, would be that it looks as if the lags that are experienced, before the economy responds to changes in either the monetary or the fiscal setting, appear to be longer. It looks as if a little more muscle is required to bring about the kinds of results one is looking for.

Whether we have gone through some secular set of changes, or whether what we are experiencing now

is more a reflection of this particular set of circumstances, it is too early to say.

My own feeling is that we are such a long way from the depression of the 1930s, and we are such a long way from a time when prices went down as well as up, that more and more people have come to a view about the likely direction of price changes in the future.

Senator Benidickson: This is back to expectations, is it?

Mr. Reisman: This is back to expectations. I think they have dug in. This inflationary game only be played if there are some winners and some losers.

Senator Nichol: That is right.

Mr. Reisman: That is the way that game is played. As soon as most of the people, not even all of the people but most of the people, get wise to the game, then it becomes a mug's game, it is a game where there are not the winners that one needs to give that economy the stimulus that is so often associated with inflation. This is what I think is wrong with the concept of the Phillips Curve. It may have been reasonably correct in describing the situation that prevailed at one time, but I do not think it is terribly helpful or reflective of the kind of situation we are in today.

This is what I think is wrong with those people who think we should learn to live with inflation. I do not think it does anything for you. It only does something for you when there are enough people around who are getting fooled by it, where somebody is winning and somebody is losing. But when enough people believe, as so many do today, that they are on a trend here, then the game does not work.

Senator Benidickson: On that question of expectations, I think it does exist and so it must be accepted, to an extent, by government. Where we have social benefits such as old age pensions, why do we put in a limitation on escalation of the pensions, such as we had with the 2 per cent practice under the former legislation, and now we have frozen the old age pension, at $80, subject of course to the supplement for those who present themselves for some financial examination as to need and so on? There is no recognition on the part of the Government, of this inevitable increase; this annual inflation.

Mr. Reisman: The government does not accept it. What the government is trying to do and has been trying to do for as long as I can remember is to persuade people that inflation is not inevitable and that it does not need to go on. In fact they would like to change those expectations.

Senator Benidickson: It has not proven to be a very good persuader.

Mr. Reisman: No. When people are critical of the economic performance, this is one of the things they have in mind. I think it was the Economic Council in its last report when referring to the performance of the Canadian economy through the 1960s made it very clear with a statement to the effect that they thought the performance of the economy by and large was very good in relative terms and in absolute terms, except that they thought that the performance was rather weak in respect to constant prices. This I think is the corner of it that they latch on to. Now I know the Economic Council report is a bit like the Bible in that you can find in it what you are looking for, and you can support almost any thesis. But there was a clear statement of this kind. The difficulty with this indexing, which I think is what you are talking about, where you want to tie everything to the cost of living and let it roll up, is that it would persuade everybody that the government has thrown in the towel on price and cost increases. This is not to say that the old and poor and the unemployed should suffer as a consequence.

Senator Benidickson: But they did, because there has been a 2 per cent limitation for years.

Mr. Reisman: It is a question of whether there should be periodic adjustments. If you index, then you have an automatic escalation and you are making the inflationary process more efficient in the sense that it just goes on very quickly and automatically. But there are problems of how to safeguard the position of the weaker members of society, and this has to be done.

The Chairman: But in those elements of society, which, I suppose, is the bulk of society, who can protect themselves that escalation goes on very quickly as it is. The only place where it seems to me that the escalation does not go on quickly is in that element that cannot protect itself. Even a buyer of long-term bonds tends, if the inflationary expectations get very high, to find that he can buy at interest rates that are upwards of 9 or 9½ per cent, as that interest rate tries to offset the expectation of inflation. I find it difficult to accept your argument. If, for example, four-fifths of society can and do protect themselves, what is it about the other one-fifth that cannot protect itself that suddenly makes this an acceptance by the government of continuing inflation?

Mr. Reisman: I think the point I was trying to make is that governments, and here I am simply describing what has taken place, do periodically make adjustments in the size of benefits and introduce some provisions for escalation to deal with precisely that problem. I suppose the most effective technique used so far to help offset some of these consequences has been in raising the level of the benefits.

Senator Nichol: May I ask a supplementary on that, Mr. Chairman? I am sorry, I know you want to go but since we do not often get Mr. Reisman, I would be happy to sit here until midnight.

Mr. Reisman: There are still a few points I hope we will get on to, sir.

Senator Nichol: In the 1960s the debate raged between selective welfare programs and universal welfare programs, and those people in favour of universal welfare programs put forward many arguments, including social arguments and psychological arguments. So what I want

to ask you is this; in your opinion, if we want to help the people in this country who really need help, the sick and the poor and the people who cannot work, can we really do this within the limits of our economy if we continue to have universal programs where, to some extent at least, payments are made to people who do not need them at the expense of people who do need them? Maybe you can answer that.

Mr. Reisman: I think the White Paper that Mr. Munro introduced some time ago on social security does show a rather decided trend or a strong attitude in respect to that choice of which you speak, universality versus selectivity in terms of welfare programs; and I think that the decisions that have been made in the last little while and the decisions now in the making are all leading in the direction of more selective welfare programs. Reference was made to old-age security and supplementary benefits associated with it. You will recall that the $80 was kept flat and there was no escalation on it but the supplementary payment for the very poor with no other income was increased by a very substantial figure and became subject to some escalation.

Senator Benidickson: Full escalation.

Mr. Reisman: Was it full escalation? It may have been made subject to that. I think that shows a very selective bias to the whole OAS-GIS system. I do not know if announcements are going to be made today or if they have already been made regarding family income security plans in the family allowances area. They may have already been announced. There you will find a very strong shift in the direction towards selectivity. I favour it.

Senator Benidickson: I think it should be explained on this matter of selectivity and universality that conditions now are altogether different from when the universal old-age pension was introduced. I was vice-chairman of the committee which recommended that we have a universal old-age security payment by the federal Government. But at that time that was based on advice from all the experts that that was the most efficient way of making payments. But nowadays we have computers and it is an altogether different situation. It is largely a matter of accounting. We were told it was more economic to pay it out to everybody and then collect it back in income tax from those who did not need it. But now that we have new machines that do the bookkeeping, there is a different argument against universality.

Dr. Gillies: I have just one question to put to you, Mr. Reisman. Is it your feeling that the performance of the Canadian economy during the past year has been good?

Mr. Reisman: During 1970-71?

Dr. Gillies: In the past 12 months.

Mr. Reisman: I would think that there are some very definite deficiencies in the performance of the economy during this period. Unemployment is much too high and it must come down. There are ways of getting it down and it is coming down. The growth in gross national product is not high enough. It is improving and I think it will continue to improve and gather momentum, but the performance over the last 12 months was not adequate.

Senator Gélinas: Not adequate or not good?

Mr. Reisman: It was not good enough.

The Chairman: Mr. Reisman, you stated there were some points you would have hoped would have been brought up. Were there any points you wanted to speak on?

Mr. Reisman: There was one area, sir, that I thought I would like to see a little discussion on and that is on the business of organization of the Government's activities in this field. I think some of your earlier witnesses made reference to the technique of using a council of economic advisers as in the United States. I believe that Dr. Barber made a reference to it in his submissions.

The Chairman: Dr. Deutsch, I think, did.

Mr. Reisman: Dr. John Deutsch referred to two kinds of outfits. One, he thought there should be a research organization at arm's length from the Government.

The Chairman: You seem to be in agreement with him.

Mr. Reisman: I think it is a useful thing to have. We have some of it now and there should be more.

He also talked about some of the longer term problems referring to economic policy generally and not merely stability policy and he thought there ought to be some group somewhere not concerned with the day to day operations, but to provide advice to the Government. He was really not specific and not explicit on it and I will not comment on that. With respect to the point on a Council of Economic Advisers I think a few observations might be in order.

I do not suppose, Mr. Chairman, that there has ever been a Senate committee, whether on economic policy, on science, on poverty or on media, that has not sooner or later given some advice as to how the Government should organize itself and should equip itself in respect to the fields which they are investigating. Certainly there has been some interest shown in this regard by this committee.

With respect to this reference to the Council of Economic Advisors, an institution that I am familiar with, I have known a number of the incumbents who ran that council over the last 15 or 20 years, several of whom came and gave evidence before this committee. What kind of institution is it and what kind of sense would it make in our kind of setting? I feel myself that the Council of Economic Advsors is a product that was bred in the United States and is suitable for their particular environment and their particular system, but one which, at least in the form it takes down in the United States, would not be readily acceptable to the Canadian scene.

To begin with, we have in Canada a system of responsible government composed of responsible ministers. These are elected representatives and they are the people

who make up the Government; they are the people who make the decisions and that is what they are elected for. The United States has quite a different system. They do not have a cabinet like our cabinet. What they have is a President and he chooses some secretaries and they call it a cabinet, and because they call it a cabinet it is sometimes confused with our kind of cabinet. The Chairman of the Council of Economic Advisors is actually, for all intents and purposes, a secretary. He attends the meetings of the cabinet or cabinet committees, but if you went to the Canadian scene and looked for the counterpart of that sort of position you only find it in a minister. Our cabinet is made up of ministers.

The Chairman: Except that there is no comparable minister.

Mr. Reisman: I just want to follow that up.

The Chairman: Before you follow it up, let us follow it up in the context that they have a secretary of the Treasury, a budget director, and a secretary of commerce.

Mr. Reisman: That is the point that I wanted to get to. If we wanted to use that kind of device in this country, then, basically what you would have is another minister who would be charged with the responsibility of advising the cabinet in respect to stability policy. At the present time in Canada that responsibility, together with many other responsibilities, is given to the Minister of Finance. There is no magic in that. That is the practice in this country. It is the practice in most the British countries. I think in Britain for a short while they set up a separate department on economic affairs under a separate minister and after a short while they abandoned it. There is no magic in allocating responsibility in a particular way. I think the point I was trying to make is that the Canadian counterpart of something like the Council of Economic Advisors would, I think, have to take the form of a department or an agency responsible to a minister and that minister then becomes the minister charged with advising the cabinet in that particular area.

The Chairman: That minister could be the Prime Minister. Dr. Deutsch referred to a committee which he could not name, but I am sure that you, in your experience, may have heard of it. It was used in the wartime period and its purpose was to oversee economic actions and to tie together the economic actions of the cabinet.

Mr. Reisman: I think that both the minister and I made reference to the Cabinet Committee on Economic Policy and to the Priorities and Planning Committee of the Cabinet. Both of those committees concerned themselves very actively and very extensively in coordinating and tying together the work of the Government with respect to economic problems including the problem of stability.

The Chairman: That is true, although Dr. Deutsch was very strong in his recommendation that these gentlemen not have line responsibilities and, or course, every member of those two committees that you referred to are men who have line responsibilities.

Mr. Reisman: Well, what sort of men is he talking about? Is he talking about ministers or officials?

The Chairman: I got the impression he was not talking about ministers.

Senator Benidickson: May I quote from your release, Mr. Chairman? I was not present at that particular meeting of this committee, but you did put out a release in summary of what Dr. Deutsch said. He said:

> It is impossible to expect cabinet ministers with the responsibility of operating departments to assess effectively economic policy as a whole, and yet there is no way in which proper economic policy can be made unless there is some independent assessment of the various proposals.

That is the end of the press release that you provided, Mr. Chairman.

Mr. Reisman: I find it hard to understand what that quotation means, but if your interpretation is correct, Mr. Chairman, would he be thinking of having wise men who have not been elected but who sit in the cabinet and offer advice in competition with members of the cabinet on matters for which the cabinet has responsibility? If so, I think it is one of the most foolish ideas I have heard.

Senator Nichol: I do not think that is what he meant, if I may interrupt, Mr. Chairman?

The Chairman: I cannot say from the item that Senator Benidickson read because I did not write it, but I will let Senator Nichol explain what was meant by Dr. Deutsch.

Senator Nichol: I think "wise men" is perhaps a slightly derogatory phrase for what he meant. I think what he meant was a group of men who would serve as advisers to the cabinet, not as members of the cabinet. In the same sense, the Prime Minister has staff within the Privy Council office and within his office who have responsibilities for various areas of policy. These men would serve merely to provide opinion to the cabinet or to the Council on Economic Policy, or whatever it is called, of the cabinet, and that there would be a constant changeover of new people coming in and people going out—I do not mean weekly, but every few years. This body would serve with no mechanical capacity and certainly no power in the mechanical sense that the Minister of Finance or yourself has power, or the Bank of Canada Governor has power, but merely in an advisory capacity and as the producer of alternative policies and extra input into the system at the top level. I think that is what he meant.

The Chairman: I think that sounds very good, and is an accurate report of what he said.

Mr. Reisman: It is entirely possible within our kind of system of responsible government for the Prime Minister to have in his office the kind of organization that the Minister of Finance has in his department to do economic analysis and to give advice. But in essence I

think what we would have there is perhaps what we had when Mr. R. B. Bennett was Prime Minister. He was his own finance minister and he chose to operate that way.

Senator Nichol: Mr. W. A. C. Bennett does it too.

Mr. Reisman: There is nothing against that particular form of government organization except that if the Prime Minister, in addition to all his other responsibilities, takes on the responsibility of being his own finance minister he might find that a little wearing.

Senator Nichol: He might end up having arguments with himself.

Mr. Reisman: But this is a perfectly rational and possible way of doing it. I suspect, however, that after a while he would want somebody to take on those responsibilities and he would end up having somebody like a minister of finance doing it for him.

One point I should like to make in this connection is that the notion of bringing over, holus-bolus, some kind of an apparatus that was designed and developed to meet a particular need in the United States system is impractical. To say, "Why don't we have one like that?" would be completely superficial. The U.S. apparatus would be full of all kinds of limitations and weaknesses for us.

One think I want to make clear is that there is nothing magical or God-given or set in concrete about having the responsibilities for advising the Government on economic policy placed in the hands of the Minister of Finance. There is nothing magical about that. It is quite possible for a particular government to have two ministers with competing organizations. There is nothing to prevent a government from saying it wants to create a new organization that will deal with economic analysis and stability policy, but I think that, if that were looked at, there are some difficulties of co-ordination that might arise. If you have taxation policy, debt management policy and monetary policy in one hand and you have a stability policy somewhere else, how do you measure them? How do you co-ordinate them? So you have this further problem.

This morning the minister expressed himself, I think, on the point that if the Government has a Minister of Finance and that Minister of Finance has a staff who together are not giving the Government the quality of advice or level of advice that will get results or that will get the right answers, then they ought to get rid of them and get some people in there who perform better. I think that is the way to improve an unsatisfactory situation; it is not by setting up a competing organization and then running the risk of falling between stools or getting a great deal of conflict between them.

Mr. Chairman, I have made no comment nor have any questions been put to me with respect to the problem of longer-term analysis and longer-term overview. If there are any questions, I would be prepared to comment on that point as well.

The Chairman: I suppose the question there is one that we put to the Minister of Finance today. It is that, as succinctly as I can put it now, politics being what they are, a government is concerned essentially with medium-term or short-term considerations. The very long-term objectives of society do not concern governments quite as much as perhaps they should. Therefore the Government often does not have a framework in which it can operate. It seems to me that perhaps there is an area in which an organization like the Economic Council could play a more decisive role.

Mr. Reisman: I was involved in the work at the time the Economic Council was established and the legislation was drawn. It was my understanding at the time that legislation was drawn up that that was why they set up an Economic Council of Canada. I think there was the view that in the departments of Government and other agencies of Government, the day-to-day problems, crises, and emergent problems consumed all the time there was, and not enough attention was paid to the medium and longer term problems on the economic side. They set up the Economic Council to try to fill that gap.

The Council exists. It had quite an impact for a number of years. It was on the advice of the Economic Council of Canada that the Department of Manpower was established in this country. There were other areas in which they had quite an impact on Government policy.

I can tell you that in a variety of departments of Government they do try to engage in longer term thinking. I was a deputy with the Department of Industry for awhile. It is now the Department of Industry, Trade and Commerce. They have been working away at developing a long-term industrial strategy.

Each of the departments of Government has some personnel who are charged with the task of looking further ahead, trying to anticipate some of the longer term problems. This is true in my department. My predecessor said he found that his efforts in this regard were always frustrated by the emergence of a whole series of problems from day to day. I also find that is happening, but we are making a real effort to have people who do look long.

More important than what happens in individual departments is, I think, the apparatus of the Government decision-making process. The introduction into the Cabinet system of the Planning Committee of Cabinet over which the Prime Minister presides, is the body at the decision-making level which tries to pull in a good deal of the longer term thinking and analysis, and tries to mesh that into some kind of coherent total policy.

I realize that all of this is so new. So much of this has evolved in the last few years and not much of it is known. When more gets to be known about how much that process works, I think you will find that the people who have drawn their experience about how the Government works from World War II, and the years immediately after World War II, are really out of date. I had occasion to make that comment to Senator Benidickson. I would say that also about John Deutsch's evidence. I think that he has been away from the scene too long

and does not really know what is going on in Government. His observations, from my reading of them, do not reflect a proper appreciation of how the process works.

The Chairman: We shall have to give Dr. Deutsch equal time.

Senator Nichol: What do you think of the focal length of the Economic Council? Are they focusing too short, too far out or at the right place? What do you think the Economic Council could do to be more helpful?

Mr. Reisman: There are direct questions and I will give a direct answer. In my opinion the Economic Council needs some revitalizing. They have existed for seven or eight years and are beginning to repeat themselves. We are not quite obtaining out of it what we expected. We need such an institution; it is important. However, it is time to have a look at it. It is not a bad idea to do that every now and then and see if these organizations are doing what they were intended to do.

Senator Nichol: What is wrong with the information they deliver? That is why I asked the question with respect to focal length. I do not mean inaccuracy, but the type of information. Are they shooting too close or too far ahead?

Mr. Reisman: I do not know how many books can be written on one theme. They placed a great deal of emphasis on this thing known as economic potential. Economic potential is basically made up, as they read it, of a couple of factors, the growth in the labour force and the improvement in productivity, which combined gives the potential. They have written quite a few books on that pair of data. I think they have exhausted the subject and should go on to other fields.

That is a rather harsh comment; however, I would like to see them look medium and long.

Senator Nichol: You think they are shooting too close then?

Mr. Reisman: They were not established for that purpose. They will tell you that they have to look close because they cannot forecast longer term performance, which is always made up of a lot of short terms. When they are pressed they will say they are not equipped to do short term and were not established for that purpose?

Senator Nichol: And you do not think they should do it?

Mr. Reisman: I commented earlier on the suggestion that there ought to be, at arm's length from the Government, an operation to produce good, strong, competent economic analyses and forecasting. I continue to hold that view.

Indeed, there are a number now and there should be more. Presumably they will improve as they mature and become seasoned. However, the Economic Council is not set up that way. It has a sort of representative body guiding it who are drawn from different sectors. That is not the type of organization one usually establishes to provide research, analysis and forecasting.

Senator Nichol: Do you think they are the people who do the work in the Economic Council? I do not believe they are.

Mr. Reisman: I am sure they must determine the general content of the reports the Council issues. In any case, my feeling with regard to the reports they issue reflects that kind of a body rather than one established to carry out professional research.

Senator Nichol: So maybe it should be changed in some way?

Mr. Reisman: When I used the term that perhaps it ought to be looked at and revitalized I was not excluding that, but that is one man's opinion.

Senator Nichol: A very important man's opinion in this business we are discussing.

The Chairman: Do you care to comment as to how you think they should be changed?

Mr. Reisman: I would not want to do that off the top of my head. I am going to wait until somebody invites me to do a little more solid work on it before I would offer an opinion.

Senator Nichol: Senator Everett might call this committee together again next year, and then perhaps we can ask.

The Chairman: When I talked to Mr. Reisman about appearing before the committee he asked me why he would not appear as a deputy minister to his own minister; why he would be asked to appear as a separate witness on his own. I said I thought he was not the average type of deputy minister, that he was indeed in a class by himself. I think, honourable senators, he has proven today that he is in a class by himself.

It has been a great pleasure, sir, to hear you. Thank you.

Hon. Senators: Hear, hear.

Mr. Reisman: You are very kind, sir.

The committee adjourned.

"APPENDIX"

FEDERAL MEASURES TO STIMULATE ECONOMY TAKEN SINCE MARCH 1970

Timing	Measures	Amount
March 1970	Budget provides shift to more expansionary fiscal position to finance increased Federal outlays such as:	Swing in Government requirements for 70–71 from previous fiscal year of more than $700 million excluding foreign exchange needs.
	L.I.F.T. program to encourage grain farmers to diversify crops	$100 Million
	Loans to C.M.H.C. with emphasis on low-cost housing and financing of municipal sewage plans	$150 Million
	Extra mortgage funds for farm credit	$ 25 Million
	Extra loans for Department of Regional Economic Expansion	$ 50 Million
June 1970	Accelerated transfer of tax revenue to provinces, accelerated cash payments for technical and vocational schools and higher equalization payments	$350 Million
	Summer employment program for students and extra money for provincially-run social assistance programs	$ 73 Million
Aug. 1970	Extra money to finance construction of 15,000 housing units: $100 Million in calendar 1970, $140 Million in calendar 1971	$240 Million
Oct. 1970	New capital and operations program, plus increased manpower training allocations, to help alleviate unemployment in areas where most severe	$ 60 Million
Dec. 1970	Budget announces new programs to assist individuals, regions and industries adversely affected by slow growth and provide further general stimulus to the economy in current and next fiscal year	Further fiscal expansion increases swing in Federal cash requirements for 1970–71 from 1969–70 to about $1.7 Billion excluding exchange. Finance Minister estimates total Federal cash requirements for 1971–72 of about $1.9 Billion, also excluding exchange needs
	Budget announced:	
	10 per cent increase in unemployment insurance benefits pending start of new scheme on July 1, 1971	$ 54 Million
	Program of capital improvement projects in areas of highest unemployment	$ 23 Million
	Program to develop roads and services for Montreal International Airport	$ 20 Million
	Additional funds for C.M.H.C., on top of earlier provision for 15,000 units	$ 40 Million
	Loan fund for quick, job-creating capital projects	$160 Million
	Industrial incentives program for Eastern Ontario and Southwestern Quebec	No estimate possible at this time
	Direct loans and loan insurance to footwear industry	$ 1 Million
	Substantial assistance to shipbuilding industry	$ 5 Million
	Capital cost allowance supplement to encourage early expansion of capital investment in manufacturing and processing industry	$ 25 Million
June 18, 1971	Budget proposes a number of tax and tariff changes to reinforce expansion of the economy	Budget provides for deficit of $750 million and net cash requirement of $2,430 million
	*Removal of the 3-per cent surtax on personal and corporate income taxes effective July 1, 1971, at a cost of $130 million for the balance of the calendar year.	
	*Changes effective July 1 in lowest tax brackets to exempt taxpayers with less than $500 of taxable income.	
	*Exemption of Guaranteed Income Supplement from taxation retroactive to January 1, 1971.	
	*Low-bracket changes and GIS exemption end income taxes for more than 750,000 effective July 1.	
	*Removal of 12-per cent sales tax on margarine, effective immediately, at a cost of $7 million in a full year.	
	*Removal of 12-per cent sales tax on all anti-pollution equipment used in production, effective immediately, at a cost of around $8 million in a full year.	
	*Abolition immediately of 15-per cent excise tax on television, radio and hi-fi sets, their components and other electronic equipment, at a full-year cost of about $40 million.	

Timing	Measures	Amount
	*Duty on petroleum feedstocks of ¾ cent per gallon under British Preferential Tariff and 1 cent per gallon under Most-Favoured-Nation Tariff reduced to ⅛ cent per gallon to aid Canadian petrochemical industry.	
	*Increase in tariff on polyethylene resins from 7½ to 10 per cent, with corresponding increases for further processed forms of these resins, to assist Canadian plastics industry.	
	*Duty-free entry of production machinery not available in Canada and considered to be in the public interest extended to cover sawmill and logging machinery for the benefit of the Canadian forest industry.	
	*Suspension for two-year period of ⅛ cent per gallon duty on heavy fuel oils to help offset recent substantial price increases incurred by pulp and paper producers and power utilities, the saving for the pulp and paper industry alone amounting to over $3.5 million.	

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THIRD SESSION—TWENTY-EIGHTH PARLIAMENT

1970-71

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

No. 23

THURSDAY, DECEMBER 2, 1971

Complete Proceedings on the Supplementary Estimates (A) laid before Parliament for the fiscal year ending March 31, 1972

REPORT OF THE COMMITTEE

(Witnesses:—See Minutes of Proceedings)

APPENDIX "A"

STANDING SENATE COMMITTEE
ON NATIONAL FINANCE

The Honourable Douglas D. Everett, *Chairman*

The Honourable Senators:

Aird	Isnor
Beaubien	Laird
Benidickson	Langlois
Bourget	Manning
Bourque	*Martin
Buckwold	McDonald
Croll	McLean
Desruisseaux	Méthot
Everett	Molson
*Flynn	Nichol
Fournier (*Madawaska-Restigouche*)	O'Leary
	Paterson
	Phillips
Gélinas	Sparrow
Grosart	Walker—27.
Hays	

(Quorum 7)

**Ex officio Member*

Order of Reference

Extract from the Minutes of Proceedings of the Senate of Wednesday, November 24, 1971:

"With leave of the Senate,

The Honourable Senator Langlois moved, seconded by the Honourable Senator Martin, P.C.:

That the Standing Senate Committee on National Finance be authorized to examine and report upon the expenditures set out in the Supplementary Estimates (A) laid before Parliament for the fiscal year ending the 31st March, 1972.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative."

Robert Fortier,

Clerk of the Senate.

23924—1½

Minutes of Proceedings

Thursday, December 2, 1971.
(23)

Pursuant to adjournment and notice the Standing Senate Committee on National Finance met this day at 10.00 a.m. to consider the Supplementary Estimates (A) for the fiscal year ending March 31, 1972.

Present: The Honourable Senators Everett (*Chairman*), Beaubien, Buckwold, Croll, Flynn, Gélinas, Grosart, Hays, Langlois, Molson, Phillips and Sparrow. (12)

In attendance: Mr. A.B. German, Administrator, and Mr. E.J. Brower, of the Parliamentary Library, Division of Economics.

Witnesses from the Treasury Board:

Mr. M. G. Osbaldeston, Deputy Secretary (Program Branch).

Mr. B. A. MacDonald, Director General, Budget Co-ordination.

On Motion of the Honourable Senator Beaubien, it was *Agreed* to print as Appendix "A" to these proceedings a letter addressed to the Chairman of this Committee, dated July 16, 1971, from Mr. B. A. MacDonald, together with documents attached thereto, relating to two questions unanswered when the Main Estimates, 1971-72, were examined on June 29, 1971.

The officials of Treasury Board undertook to supply to the Chairman of the Committee the interest rates and terms of the loans under the Automotive Adjustments Assistance Program and several other unanswered questions relating to the said Supplementary Estimates (A).

It was unanimously *Agreed* that the drafting of the Report be left in the hands of the Chairman and presented at the earliest possible opportunity.

At 12.20 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Gérard Lemire,

Clerk of the Committee.

Report of the Committee

Thursday, December 2, 1971.

The Standing Senate Committee on National Finance, to which were referred the Supplementary Estimates (A) for the fiscal year ending March 31, 1972, has in obedience to the order of reference of November 24, 1971, examined the said Supplementary Estimates and reports as follows:

1. The Committee has examined the said Supplementary Estimates (A) and has heard evidence thereon from Mr. G. Osbaldeston, Deputy Secretary, Programs Branch, Treasury Board, and Mr. B. A. MacDonald, Director General, Budget Coordination, Treasury Board.

2. The said Supplementary Estimates (A) provide for total expenditures for which Parliament will be asked to provide funds in the amount of $361,925,284; budgetary estimates of a statutory nature of $198,111,500 and loans, investments and advances in the amount of $311,985,001. This brings the total of the Main and Supplementary Estimates for the current fiscal year to $16,212,940,921. The Main Estimates called for an expenditure of $15,340,919,136. Supplementary Estimates (A) increase this by $872,021,785.

3. Included in the said Supplementary Estimates (A) are eighteen $1 items, an explanation of which was provided by the officials of the Treasury Board and is attached to this report.

4. The budgetary expenditures to be voted upon amount to $361,925,284 and include the following major items:

$21 million to implement the first two steps to achieve pay parity in the Armed Forces;
$10 million to cover losses in coal mining incurred by the Cape Breton Coal Mining Corporation;
$22 million for relief of Pakistani refugees;
$25 million to cover the opportunities for youth program of last summer;
$7 million for other items related to the employment of students last summer;
$100 million for the local initiatives program of the Department of Manpower and Immigration;
$20 million for the on-the-job training program of the Department of Manpower and Immigration;
$15 million for additions to the regular manpower training program; and
$80 million for federal labour intensive projects.

$198,111,500 is provided for budgetary expenditures of a statutory nature, of which the main items are:

$80 million for the statutory provision for grants under the Employment Support Act; and
$62 million for costs relating to the Medical Care Act and the Hospital Insurance and Diagnostic Services Act.

Loans, investments and advances total $311,985,001 of which the main items are:

$95 million in loans to Atomic Energy of Canada Limited to finance the rehabilitation of the Glace Bay Heavy Water Plant;
$32 million in loans under the automotive adjustment assistance program in connection with the Agreement on Automotive Products (Auto Trade Pact).

It is noted that approximately 60% of all the budgetary items, statutory and non-statutory, concern unemployment measures.

5. The Committee requested the Treasury Board to provide it with the terms, conditions and present status of loans under the adjustment assistance program in connection with the Agreement On Automotive Products (Auto Trade Pact).

6. The Committee complimented the Treasury Board on the excellent publication entitled "How Your Tax Dollar is Spent" and suggested that it would be improved by including more information on the subject of loans, investments and advances.

7. The Committee requested information concerning the present status of the $80 million provision for the statutory provision for grants under the Employment Support Act. More specifically, it requested information on the total amount of present commitments, the present outlook for commitments up to the end of 1972, a list of commitments by industry and by province and the total employment affected by such commitments.

8. The Committee requested the Treasury Board to examine its method of preparing Estimates to see whether more information can be provided on the terms, conditions and status of all loans, investments and advances in Main and Supplementary Estimates. Officials of the Treasury Board undertook to examine this matter and to report back on the feasibility of providing such information.

9. The Committee requested the Treasury Board to provide along with the Main Estimates and the Supplementary Estimates the total spending program of the Federal Government, including all loans, investments and advances of a previously approved nature, comparing them from year to year in dollar amounts and in terms of a percentage of the Gross National Product. Officials of the Treasury Board undertook to examine this matter and to report on the feasibility of providing such information.

Respectfully submitted.

D. D. EVERETT
Chairman

APPENDIX TO THE REPORT OF THE COMMITTEE

EXPLANATION OF ONE DOLLAR ITEMS SUPPLEMENTARY ESTIMATES (A), 1971-72

Summary

The one dollar items included in these Estimates have been grouped in the attached according to purpose.

A One dollar items authorizing transfers from one vote to another within a Ministry to meet certain increased costs, additional expenditures to be incurred or to reallocate certain funds (3 items).

B One dollar items which require listing in the Estimates in order to secure approval of certain grants and contributions (10 items—includes item 10a for Industry, Trade and Commerce and item 15a for National Health and Welfare which also appear in Section A).

C One dollar items which are legislative in nature (7 items including two to authorize deletion of debts due the Crown).

SECTION A

ONE DOLLAR ITEMS AUTHORIZING TRANSFERS FROM ONE VOTE TO ANOTHER WITHIN A MINISTRY TO MEET CERTAIN INCREASED COSTS, ADDITIONAL EXPENDITURES TO BE INCURRED OR TO REALLOCATE CERTAIN FUNDS (3 ITEMS).

Industry, Trade and Commerce

Vote 10a (also listed in Section B)—Amount of transfer to this vote $2,299,999.

Purpose—This additional amount will be used to provide for the payment of:

(*a*) contributions to develop and sustain an increment in exports of Canadian goods and services	$ 250,000
(*b*) a further contribution to assist Canadian manufacturing industry in financing the cost of industrial design projects	$ 250,000
(*c*) additional contributions to assist in the advancement of technological capability of Canadian manufacturing industry by supporting selected civil (non-defence) development projects	$1,800,000

Source of Funds—Vote 35 ($2,299,999)—Funds are available due to forecast requirements being less for the operation of program during 1971-72 than was expected.

National Health and Welfare

Vote 15a (also listed in Section B)—Amount of transfer to this vote $899,999.

Purpose—To provide for contributions in support of health oriented innovative services projects (such as street clinics) related to the non-medical use of drugs.

Source of Funds—Vote 35 ($899,999)—Funds were provided under Vote 35 of the Main Estimates for all innovative services related to non-medical use of drugs. Funds are therefore being transferred to Vote 15 to cover the cost of the health oriented projects related to innovative services which were carried out within the Health Insurance and Resources Program.

Veterans Affairs

Vote 24a—Amount of transfer to this vote $1,076,999.

Purpose—To provide for the transfer of the required operating funds following the establishment by legislation of the new Bureau of Pension Advocates.

Source of Funds—Vote 1 ($1,076,999)—The funds for the operation of this program were originally provided under the Administration Vote in the Main Estimates for 1971-72.

SECTION B

ONE DOLLAR ITEMS WHICH REQUIRE LISTING IN THE ESTIMATES IN ORDER TO SECURE APPROVAL OF CERTAIN GRANTS AND CONTRIBUTIONS (10 ITEMS—INCLUDES ITEM 10a FOR INDUSTRY, TRADE AND COMMERCE AND ITEM 15a FOR NATIONAL HEALTH AND WELFARE WHICH ALSO APPEAR IN SECTION A).

Indian Affairs and Northern Development

Vote 5a—to authorize a grant of $40,000.

Explanation—The grant to the Manitoba Indian Brotherhood is to assist with the cost of centennial commemoration of the signing of peace treaties.

Source of Funds—Vote 5—Funds originally provided for operating expenditures will be used to pay this grant.

Industry, Trade and Commerce

Vote 10a—(also listed in Section A)—To authorize contributions totalling $3,050,000.

Explanation—This additional amount will be used to provide for the payment of:

(*a*) contributions to develop and sustain an increment in exports of Canadian goods and services	$ 250,000
(*b*) contributions to increase Canadian industrial participation in capital projects abroad	$ 750,000
(*c*) A further contribution to assist Canadian manufacturing industry in financing the cost of industrial design projects	$ 250,000
(*d*) Additional contributions to assist in the advancement of technological capability of Canadian manufacturing industries by supporting selected civil (non-defence) development projects	$1,800,000

Source of Funds—Vote 35—Funds are available due to forecast requirements being less for the operation of program during 1971-72 than was expected.

Justice

Vote 1a—To authorize a payment of three grants totalling $21,500.

Explanation—The three grants consist of:

(1) A grant of $10,000 to the Association of Canadian Law Teachers (Poverty Law Section) to assist with the expenses of a National Conference on Law and Poverty. This grant has already been paid through the use of funds from Treasury Board Contingencies Vote.

(2) A grant of $10,000 to the International Commission of Jurists.

(3) A grant of $1,500 to the L'Institut International de Droit d'Expression Française (I.D.E.F.)

Source of Funds—Vote 1—It is planned to use funds originally provided for operating expenditure.

Labour

Vote 1a—To authorize a grant of $500,000.

Explanation—This additional amount is required to provide for claims against Transitional Assistance Benefits by unemployed workers from automotive manufacturing and part industries. These payments have already been made through the use of Treasury Board Contingencies Vote funds.

Source of Funds—Funds are available from the Adjustment Assistance Benefits Activity based on the forecast requirements of the Textile and Clothing Board.

Manpower and Immigration

Vote 15a—To authorize grants of $110,000.

Explanation—It is proposed to provide additional grants to Immigrant Welfare Organizations to assist with immigrant counselling and settlements.

Source of Funds—Vote 15—Funds are available due to certain reductions made in operating expenditures.

Vote 20a—To authorize grants of $50,000.

Explanation—It is proposed to provide an additional $50,000 to private and public groups in support of manpower research and development.

Source of Funds—Vote 20—Funds are available due to certain reductions made in operating expenditures.

National Defence

Vote 1a—To authorize the payment of a new grant and other increased grants totalling $122,876.

Explanation—It is proposed to provide a new grant and to increase certain grants to various organizations as follows:

(*a*) A new grant is proposed for the Army Cadet League of Canada (This grant has already been paid through the use of funds from Treasury Board Contingencies Vote	$60,000
(*b*) Grants to assist in the establishment and maintenance of military studies at Canadian Universities, including the payment of associated fellowships, are to be increased	$35,000
(*c*) Increases totalling $20,000 are proposed to grants paid to the Navy League of Canada and the Air Cadet League of Canada	$20,000
(*d*) The grant to the Conference of Defence Associations is to be increased	$ 6,100
(*e*) Minor adjustments are to be made to grants to several military and United Service Institutes	$ 1,776

Source of Funds—Vote 1—Funds are available for the payment of these grants mainly due to civilian staff vacancies in the program.

National Health and Welfare

Vote 15a (Also listed in Section A)—To authorize the payment of contributions of $900,000.

Explanation—To provide for contributions in support of health oriented innovative services projects (such as street clinics) related to the non-medical use of drugs.

Source of Funds—Vote 35—Funds were provided under Vote 35 of the Main Estimates for all innovative services related to non-medical use of drugs. Funds are therefore being transferred to Vote 15 to cover the cost of the health oriented projects related to innovative services which were carried out within the Health Insurance and Resources Program.

Vote 35a—To authorize grants and contributions totalling $565,000.

Explanation—The following grants and contributions are proposed:

(1) It is planned to provide grants to provincial and voluntary family planning agencies as well as to assist with certain special projects in this area	$300,000
(2) To provide an additional sustaining grant to the Canadian Council on Social Development (formerly Canadian Welfare Council)	$115,000
(3) To provide for an increase in the contributions to be paid under the National Welfare Grants Program	$150,000

Source of Funds—Vote 35—Funds are available under the family assistance program due to a lower immigration rate during 1971 than was expected.

Solicitor General—Royal Canadian Mounted Police

Vote 20a—To authorize a grant of $24,000.

Explanation—An additional grant of $24,000 has been paid to the Canadian Association of Chiefs of Police. This grant has been paid through the use of funds from the Treasury Board Contingencies Vote.

Source of Funds—Vote 20—It is planned to use funds originally provided for operating expenditures to pay this grant.

SECTION C

ONE DOLLAR ITEMS WHICH ARE LEGISLATIVE IN NATURE (7 ITEMS including two to authorize deletion of debts due the Crown).

Indian Affairs and Northern Development

Vote L16a—To authorize an extension to the Vote-wording so as to permit the making of certain loans and advances to Indians and Eskimos.

Explanation—This extension in authorization is proposed in order, that loans and advances may be made available to Indians and Eskimos for the carrying out of repairs or improvements which are required when they purchase houses off reserves. Under the present authority the cost of these improvements or repairs cannot be included in determining the amount of the loan.

Industry, Trade and Commerce

Vote 11a—To authorize an extension to the vote wording so as to not only increase the amount of Loan insurance available under the General Adjustment Assistance Program but also to extend the date of eligibility and to provide, at a level determined by Treasury Board, loan insurance on those assets secured to protect the Crown's interest.

Explanation—This explanation is proposed to enable the Government of Canada to provide loan insurance to a manufacturer who has been adversely affected by the imposition of a temporary import surtax or similar action by a foreign government. Authority is also included to increase not only the aggregate a mount of the loan insurance to be provided to $250 million but also to extend the date of eligibility for such insurance to January 1, 1976. In addition authority has been included to enable the General Adjustment Assistance Board to insure loans in order to protect the Crown's interest in the assets securing loans previously made under this program. The amount of the loan insurance which may be made to protect the Crown's interest will be limited to a level determined by the Treasury Board.

National Health and Welfare

Vote 40a—To authorize an increase of $1,000,000 in the statutory aggregate amount of payments that may be made under the Fitness and Amateur Sport Act.

Explanation—The increase in the statutory provision under the Fitness and Amateur Sport Program is required to permit payment of athletic scholarships of up to $1 million to eligible students. These athletic scholarships are granted to full-time students attending Canadian high schools, colleges or universities.

Secretary of State—Canadian Film Development Corporation

Vote 63a—To authorize an increase in the statutory appropriation of the Canadian Film Development Corporation Advance Account.

Explanation—This increase in the statutory limit will permit the Corporation to make new commitments for the purpose of encouraging the development of the Canadian feature film industry through loans, grants, awards and investments.

Treasury Board

Vote 10a—To authorize an extension to the Vote-wording so as to permit payment of employer contributions in respect of all public servants beginning January 2, 1972.

Explanation—The present vote-wording restricts the payment of employer contributions to those made on behalf of employees paid through the Central Pay Office. The revised vote wording will enable such contributions to be made on behalf of all employees whether paid through the Central Pay office or through departmental field offices. This revision is required as a result of the amending of the Unemployment Insurance Act on June 7, 1971.

Veterans Affairs

Vote 5a—Authority is requested to delete certain accounts due amounting to $43,460.46.

Explanation—It is proposed to delete debts due to overpayments of War Veterans Allowances. These debts involve debtors who have died without estates or have died leaving estates to which, in the opinion of the Department of Justice, the Department has no recourse to recover the debt.

Vote 25a—To authorize the deletion of certain accounts due, amounting to $18,653.52.

Explanation—It is proposed to write off a debt due from an elderly widowed mother who is presently living in the United States on public welfare and is without assets. This debt originated through the payment over a number of years of a pension to which she was not entitled.

The Standing Senate Committee on National Finance

Evidence

Ottawa, Thursday, December 2, 1971.

The Standing Senate Committee on National Finance, to which was referred the Supplementary Estimates (A) laid before Parliament for the fiscal year ending the 31st March, 1972, met this day at 10 a.m.

Senator Douglas D. Everett (*Chairman*) in the Chair.

The Chairman: Honourable senators, may I have the usual motion for the printing of proceedings?

Upon motion, it was *resolved* that a verbatim report be made of the proceedings and to recommend that 800 copies in English and 300 copies in French be printed.

Honourable senators, I would like to table a letter from Mr. Bruce A. MacDonald, Director General, Budget Coordination, Treasury Board, in reference to questions asked at our meetings on the main Estimates. It reads as follows:

> When Treasury Board officials appeared before the Senate Committee on National Finance relative to Main Estimates 1971-72, two questions went unanswered. One concerned the distribution of expenditures by province under the bilingualism development program and the other deposits on certain air travel credit cards. Both were raised by Senator Hays and accordingly I am sending him a copy of this letter and its enclosures.

Do I have your permission to table this letter?

Hon. Senators: Agreed.

The Chairman: I understand that Senator Hays has a copy of this letter. May we print this letter as an appendix to today's proceedings?

Hon. Senators: Agreed.

(*See Appendix "A"*)

The Chairman: Honourable senators, in considering Supplementary Estimates (A) for the fiscal year ending March 31, 1972, we are honoured to have with us Mr. G. F. Osbaldeston, Deputy Secretary, Program Branch, Treasury Board, and Mr. B. A. MacDonald, Director General, Budget Coordination, Program Branch, Treasury Board. I think we should commence by asking Mr. Osbaldeston if he has a statement to make.

Mr. G. F. Osbaldeston, Deputy Secretary, Program Branch, Treasury Board: Yes, thank you very much.

Mr. Chairman and honourable senators, Supplementary Estimates (A), which you have before you, are made up of $560 million in budgetary expenditures. It may be helpful if you refer to some of the figures on pages 4 and 5. The supplementary Estimates are made up of $560 million in budgetary expenditures and $312 million in non-budgetary expenditures, which are loans, investments, and advances.

Senator Grosart: Excuse me, where do these figures appear?

The Chairman: On pages 4 and 5.

Senator Molson: I read $362 million.

Mr. Osbaldeston: If you take that nearly $362 million figure plus the $198 million figure in the second column, that totals $560 million.

Senator Grosart: Where does this appear?

The Chairman: At the bottom of page 5 there is a figure of nearly $362 million, and to that is added $198 million, the total being close to $560 million.

Mr. Osbaldeston: Then in the next column there is a figure of $312 million which is non-budgetary expenditures. Some $362 million of the budgetary expenditures concern items which will require approval under the Appropriations Act. The remaining $198 million reflects increases in the forecast for statutory items. Honourable senators will recall that last year the Treasury Board introduced a practice of showing an update of the statutory forecasts that appear in the Main Estimates. These are the updated forecasts. With these supplementary Estimates the total budgetary expenditures and estimates amount to $14,912 million and the total non-budgetary amount to $1,300 million.

By far the greatest part of these Estimates concerns the provision of funds for measures concerned with unemployment. Firstly, there is $25 million in the Estimates for the Department of the Secretary of State to cover the opportunities for youth program of last summer and $7 million for other items related to the employment of students last summer.

Secondly, with relation to winter unemployment these Estimates include, first in the Estmates for the Department of Manpower and Immigration, $100 million for the local initiatives program, $20 million for the on-job training program and $15 million for additions to the regular manpower training program. The total, therefore, under the Department of Manpower and Immigration, is $135 million.

The Estimates for the Department of Industry, Trade and Commerce contain an $80 million item for statutory provision for grants under the Employment Support Act. The Estimates of many other departments contain a fur-

ther $80 million for federal labour-intensive projects. Therefore, approximately 60 per cent of all the budgetary items, statutory and non-statutory, concern unemployment measures.

The Chairman: That is about $300 million-odd?

Mr. Osbaldeston: That would be correct; $330 million.

Taken on the non-budgetary side, there is the $160.5 million provision in the Estimates for the Department of Finance for loans to the provinces. The Estimates of the Department of Agriculture include $10 million to institute a program of loans for multipurpose exhibitions. Both of these loan items, of course, are directly related to the creation of employment. The total of these two non-budgetary items is $170.5 million. It accounts for approximately 55 per cent of the non-budgetary portion of the Estimates, that is, of the $312 million.

The only large non-statutory items in these Estimates, other than those I have already mentioned, are $21 million to implement the first of two steps to achieve pay parity in the armed forces.

Senator Grosart: Would you repeat that? These are non-statutory other than loans, investments and advances. Is that correct?

Mr. Osbaldeston: These are non-statutory items, that is correct. They are both budgetary and non-budgetary. The first item is $21 million to implement the first of two steps to achieve pay parity in the armed forces. $10 million is provided to cover losses in coal mining incurred by the Cape Breton Development Corporation, $22 million for relief for Pakistani refugees, a loan to Atomic Energy of Canada Limited in connection with the rehabilitation of Deuterium Canada Limited, for $95 million.

The Chairman: Why is that not under Loans, Investments and Advances?

Mr. Osbaldeston: It is, but it is a non-statutory item.

The Chairman: Oh, you are referring to both budgetary expenditures and Loans, Investments and Advances?

Mr. Osbaldeston: That is right.

Senator Beaubien: And it is not much of an investment.

Mr. Osbaldeston: $32 million in loans under the Automotive Adjustment Assistance Program.

Those are the main items, other than those I mentioned earlier.

Senator Grosart: Mr. Osbaldeston, these are not detailed in the blue supplementaries, are they?

Mr. Osbaldeston: Yes, they are all set out in the blue supplementaries.

Senator Grosart: The non-budgetaries?

Mr. Osbaldeston: Yes, all the items I mentioned are contained in the Blue Book, senator.

The Chairman: Let us return for a moment, if we may, to your earlier remarks. You have $327 million of non-statutory budgetary expenditures; is that correct? Is that the 60 per cent you referred to?

Mr. Osbaldeston: $362 million is the non-statutory budgetary expenditures.

The Chairman: No, I am referring to the list you gave, the $25 million for Opportunities for Youth, et cetera, which aggregates 60 per cent of all budgetary items.

Mr. Osbaldeston: That is correct.

The Chairman: Are they all of a non-statutory nature?

Mr. Osbaldeston: No, some are statutory and some non-statutory.

Senator Grosart: Would you repeat the heading for that?

Mr. Osbaldeston: Which list are you referring to, senator? Is it the one beginning with the $21 million?

Senator Grosart: The last, in which you were grouping budgetary and non-budgetary loans, investments and advances. What was the heading you gave?

Mr. Osbaldeston: Non-statutory items.

Senator Grosart: Why did you use the term "non-statutory"? Do you mean budgetary?

Mr. Osbaldeston: They are budgetary. Again, senator, if I may refer to page 5 and the columns at the top, the first horizontal bar indicates that all the following are included in "This Supplementary Estimate." The first group is "Budgetary Expenditures." Within "Budgetary Expenditures" there are two classifications, one requiring vote by Parliament. The second classification of budgetary expenditures includes items which are statutory. The approval of Parliament for these expenditures has already been obtained and they therefore need not be voted upon.

The second group are the Loans, Investments and Advances under the supplementary Estimates, and these are the non-budgetary.

Senator Grosart: Then you seemed in your list to include both non-statutory, budgetary and non-budgetary; is that right?

Mr. Osbaldeston: That is correct.

Senator Grosart: Thank you.

Senator Croll: When you make a reference, would you refer us to a page?

Mr. Osbaldeston: I was referring to page 5.

Senator Croll: Yes, I am studying page 5 but I cannot follow it.

Mr. Osbaldeston: If you wish, I can give you the page number for each of the items to which I referred.

Senator Croll: Yes, please do.

The Chairman: I wonder, honourable senators, if it would make matters clearer to do this? We are really dealing at the present time with three figures which appear at the foot of page 5: the budgetary expenditures of a non-statutory nature, of $361 million; those of a statutory nature of $198 million; and Loans, Investments and Advances of $311 million. As you broke a number of these items out, I

wonder if you could go over them again and tell us which refer to each one of those total figures?

In other words, under which column is the item $25 million for Opportunities for Youth to be found? It would be clearer if you would take the columns one by one and explain the main items included in them. Let us start with the $361 million; that is the budgetary expenditures of a non-statutory nature?

Mr. Osbaldeston: That is correct.

Senator Grosart: I think it might be easier for Mr. Osbaldeston just to call it off as columns 1, 2 and 3.

Mr. Osbaldeston: I will refer then to each of the items and enumerate the columns. $25 million to implement the first of two steps to achieve pay parity in the armed forces is found under the Department of National Defence on page 3, in column 1, to be voted, as part of the $47 million. The listing of departments is on page 2, senator.

The second item I mentioned was $10 million to cover losses in coal mining incurred by the Cape Breton Development Corporation. That is to be found just a little farther down the page under column 1, to be voted. The figure there is $9,735,000. The next item was $22 million for relief for Pakistani refugees, to be found under the Canadian International Development Agency. The figure of $22 million is in column 1, to be voted.

The next item was a loan to Atomic Energy of Canada Limited in connection with the rehabilitation of the Deuterium Canada limited, for $95 million. It appears under the third column, Loans, Investments and Advances, under the heading of Atomic Energy of Canada Limited, the main heading being Energy, Mines and Resources.

Then there is the item of $32 million in loans under the Automotive Adjustment Assistance Program, which appears under the Department of Industry, Trade and Commerce under column 3, being part of the $40 million.

Those are the main items, Mr. Chairman, to which I referred.

The Chairman: No, we have more. The ones to which you originally referred, which aggregated a total of $327 million, the first item being $25 million for Opportunities for Youth.

Mr. Osbaldeston: That is found under the heading "Secretary of State". Under column 1 ther is an item of $28 million. I mentioned another item of $7 million, which appeared in a variety of departmental estimates. That $7 million is under column 1, but it is broken up between many departments.

The Chairman: That is opportunities for youlh.

Mr. Osbaldeston: That is right. I then went on to refer to the items under Manpower and Immigration, one item being $100 million for the Local Initiatives Programs. That is part of the $140 million appearing in column 1. The second item under Manpower and Immigration was . . .

The Chairman: That was Local Initiatives Program?

Mr. Osbaldeston: That is right. The second part of that $140 million is made up of $20 million for on-the-job training, and a further $15 million for an additional resource related to their on-going Canada Manpower training program. Therefore I have given you $100 million, $20 million and $15 million of that $140 million appearing in column 1.

The Chairman: Again, that is in column 1?

Mr. Osbaldeston: That is correct. In the case of the Department of Industry, Trade and Commerce, I have mentioned an item of $80 million under the Employment Support Act. That is to be found in column 2. I think I mentioned an item of $80 million for federal labour intensive projects. These activities are spread among a number of departments, but the total of $80 million will be found under column 1.

Senator Molson: What is your description of that?

Mr. Osbaldeston: Federal labour intensive programs, or projects. These are activities undertaken by a variety of departments for maintenance, repairs, minor construction, and that kind of activity, whereby they have employed a relatively large number of people.

Senator Molson: Are they new programs because of the unemployment situation?

Mr. Osbaldeston: That is correct; new activities.

The Chairman: That $32 million is under the Auto Trade Pact?

Mr. Osbaldeston: The $32 million is under the Automotive Adjustment Assistance Program.

Senator Phillips: Could we have some explanation of the Automotive Adjustment Assistance Program? I am afraid that I am not well versed in this program.

Mr. Osbaldeston: The item appears on page 58, and will be seen at the bottom of the page under Vote L20a. This program was initiated by the Government at the time of the Canada-United States agreement on automotive products. It was intended to assist, and has assisted, automotive manufacturers and parts producers to adjust to the terms of the agreement. It provides for modernization of plant, the construction of new plant, the purchase of new equipment, and that sort of thing.

Senator Beaubien: Are they loans?

Mr. Osbaldeston: Yes, they are loans.

Senator Beaubien: Do they bear interest?

Mr. Osbaldeston: Yes, they do.

Senator Phillips: What are the terms and conditions of the loans? What is the rate of interest, and for how many years are they usually made?

Mr. Osbaldeston: I do not have that information with me. May I supply that, if it is agreeable to the chairman?

The Chairman: Yes. That is, you will supply interest rates and terms of the loans under the Automotive Adjustment Assistance Program.

Senator Sparrow: Is there any forgiveness provision in these loans?

Mr. Osbaldeston: My recollection is that there is not. But, if I may supply the senator with a brief description of the loans—

The Chairman: And perhaps a list of the loans that have been granted so far.

Senator Buckwold: Perhaps we could also have a statement of how the loans are being repaid, giving any defaults and the condition of the accounts.

The Chairman: The heading would then be the Auto Adjustment Assistance Program: details of the method by which the loans are made; a list of those individuals or companies that have received loans; whether there is any forgiveness in the loans, and the details of repayment.

Senator Sparrow: Is this for the six-year period that we are talking about?

The Chairman: Yes. It is a limited period from the time the automotive trade pact commenced.

Senator Grosart: We are asking for terms, conditions and status. Would it be too much to have this information for all outstanding loans, investments and advances in a table? We discuss these column 3 items from time to time, and we never seem to have much information on how they stand, particularly in view of the fact that these are not voted items.

Mr. Osbaldeston: The ones to which we are referring today are, senator.

Senator Grosart: But there are loans, investments and advances that are not voted.

Mr. Osbaldeston: That is correct.

Senator Grosart: It would seem important to have an accounting of these, because they are not before Parliament for approval in advance.

The Chairman: While we examine that, let us look at pages 40 and 41. I have not looked specifically at this, but I notice that under the Department of Finance there is a considerable amount of money involved, $160,500,000. It is on page 46.

Senator Grosart: This is a specific set of loans?

Mr. Osbaldeston: That is correct.

Senator Grosart: That is not the whole picture?

The Chairman: I recognize that. I am wondering what is involved in your question. For example, that is the loans to provinces, provincial agencies and municipalities defined in the Municipal Development and Loan Act.

Senator Grosart: I would like to see a statement of the terms, conditions and status of every outstanding loan. I use that in the generic sense, because I have never been able to find out why we use the term, "Loans, Investments and Advances." Let us take an obvious case. The CBC subsidy is still carried as a loan, which obviously it is not. I would like to see, as we would in any corporation, how much money we have paid out and how it looks, who is not paying, who is paying, and comparative interest rates.

The Chairman: I see your point, senator. I just want to bring out how much work would be involved. It may be simple or complicated.

Senator Grosart: I hope that it would be very simple, because I would not like to think that the Government did not have that information immediately to hand. If you lend money, you want to know where it is and what is happening. I would like to know the whole picture. I would like to see what interest rates are required, for example, under different types of loans.

Senator Molson: They will have varied monthly over the last few years.

Senator Grosart: I should like to see them.

Mr. B.A. MacDonald, Director General, Budget Coordination, Program Branch, Treasury Board: A great deal of this information is available in the Public Accounts. The balance sheet of Canada shows the loans outstanding, the balances on particular loans, and when they were made. The Public Accounts would not show the terms and conditions of loans. The Public Accounts would show how the loans were authorized. In order to bring forward this data, a substantial part of the Public Accounts would have to be reproduced, and additional work into the background of every loan would be involved.

Senator Grosart: We would not be in any great hurry. It would not seem unreasonable to ask for those figures.

The Chairman: Mr. Osbaldeston has indicated that they would like time to look at it and perhaps report back to us as to the magnitude of the job and how they could best put it into the terms in which you want it.

Senator Grosart: I would agree with that.

Senator Buckwold: Mr. Chairman, my interest in this is with respect to those loans which are in default. I would like to know who have not met their commitments.

Mr. MacDonald: There is a schedule of inactive loans going back to loans to Greece and Hungary, and I think there is even one for the Ming Dynasty in China.

Senator Buckwold: Does it also list municipalities which have not met their obligations, or such corporations as the Central Mortgage and Housing Corporation, or an automotive company which has taken a loan and not met its commitment?

I believe this is what you were referring to, Senator Hays.

Mr. MacDonald: Mr. Chairman, to obtain the information with respect to Central Mortgage and Housing Corporation we would have to go into the records of Central Mortgage and Housing Corporation, so it would necessitate going beyond the Public Accounts. I wonder if we could take the time to look into this in order to determine how large a problem it would be to obtain that information.

The Chairman: If it is agreeable to Senator Grosart, perhaps you could make an examination and report back to the committee. The committee is interested in having this data, so perhaps you could achieve more knowledge on this subject without completely causing an enormous burgeoning in the staff of the Treasury Board.

Senator Molson: We do not want information that is made public in the Public Accounts.

The Chairman: I believe what Senator Grosart wants is to bring it all together in some way that we can get a handle on it. Is that right, Senator Grosart?

Senator Grosart: Yes, Mr. Chairman. I am going to quote our recent report later on with respect to the question of openness, disclosure, communication with the public, and so forth, which this committee has found to be one of the essentials in the management of the economy. My question really speaks to that whole problem. I would like to have the information in a form I can easily digest. This has never really been one of the great considerations of those responsible for the Estimates. They have other considerations, of course, but certainly they have not been noted in the past for a maximum of disclosure in spite of the PPBS, which we should keep reminding ourselves is supposed to be a project that will greatly increase the understandability of the Estimates by ordinary laymen, but it has achieved it by cutting down the total number of votes. In my opinion, that is a bit of remarkable legerdemain.

Mr. Osbaldeston: It is true that the number of votes was reduced, senator, but there was this innovation by which we tried to make clear the purposes for which the money would be used, as opposed to simply stating the standard objectives that so much was going being spent on stamps and so much on travel, and so forth. We did attempt, I hope with some modest success, to describe precisely the purpose of the expenditure by the activities that are carried out under the expenditure, and I would hope that the descriptive material, plus the way the accounts are presented to Parliament, is indeed more informative.

Senator Grosart: I would agree with you entirely; it is an excellent advance in the area of analysis, but not necessarily in the area of disclosure. It is disclosure of purpose, perhaps, but disclosure of purpose is not always disclosure of numbers.

Mr. Osbaldeston: I saw the Estimates that went before my time, honourable senators, and you had a number under a vote which was quite a large number and you were then given information on standard objectives, and that is about all that appeared in the main Estimates. At the present time it is true you have a smaller number of votes, and, therefore, each vote is indeed perhaps larger on the average, but the descriptive material breaks that number down to smaller numbers than was previously the case. The descriptive material I do think, senator, treats with a lower order of things and is more forthcoming relative to smaller amounts of money than was previously the case.

Senator Grosart: Yes. I am not being critical of the PPB system in an overall way. Everyone who has looked at it here and elsewhere, that I know of, agrees that it is a step in the right direction; we are on the road to having a type of poor man's system as to the analysis of the Estimates. This is definitely an advance along that road, but I go along with our own committee's recommendation; that is, that we should keep going in that direction, because understanding this large influencer in the economy is certainly going to be one of the answers to some of the problems that we failed to solve in the past.

The Chairman: What the committee is asking you to do, Mr. Osbladeston, is to examine this problem and the question of investments and advances in order to determine if you can suggest a way in which the committee can get a much better handle than it presently has with respect to those items, and in the spirit of the final chapter of the report of the Committee on Growth, Employment and Price Stability, entitled "Openness and Evaluation".

Senator Grosart: It does not start at that chapter, Mr. Chairman; it starts at page 3.

The Chairman: It starts at page 3, but I believe the description work on it is the last part of the report.

Mr. Osbaldeston: Mr. Chairman, may I just make one further comment?

The Chairman: Yes.

Mr. Osbaldeston: I would like to indicate our concern for displaying the expenditures of the Government, if you like in our main Estimates in our particular area of responsibility. I would point out too, honourable senators, the fact that last year we tried to bring forward more information by including an updating of the statutory items. As the honourable senators are aware, Mr. Chairman, these are large expenditures which previously had not been updated and now are being updated, so that the public and Parliament can see the direction in which the statutory expenditures are going during the course of a year. I hope that is in the direction of your report, senator.

Senator Grosart: Yes, I agree entirely with you that it is an excellent innovation.

The Chairman: Nevertheless we do like to encourage that as much as possible. I recall the mini-budget in which there were grants and loans based on the relative levels of employment in the various provinces. As it turned out, there were two aspects of that program that were quite interesting: firstly, it very much favoured the Province of Quebec over the other provinces due to the relative unemployment figures; and, secondly, it tended to favour the intensively developed provinces due to the workings of those figures. As I recall, we did have a great deal of difficulty getting that fact categorized with the Treasury Board in order to demonstrate that that was in fact the case. We had to go back to it a number of times before we could really see how much was going to the Province of Quebec, how much was going to the Province of Ontario, how much was going to the Province of British Columbia, and how relatively little was going to the other provinces. I suppose the reason for our existence is to keep plugging away at these things.

Mr. Osbaldeston: At page 44, under the heading "Department—Federal-Provincial Employment Loans Program

1971", there is a listing of the total amount and the amount proposed by province. Again, I hope we have improved our presentation of the Estimates in that regard.

The Chairman: That is promising.

Senator Grosart: This is the amount available, but is that not the "up to"?

Mr. Osbaldeston: Yes.

Senator Grosart: Yes, it states, "not to exceed the following amounts".

Mr. Osbaldeston: That is right.

Senator Croll: Is there such a thing as an automotive agreement between the Government and the automobile manufacturers?

Mr. Osbaldeston: There is an automotive pact between the Government of Canada and the Government of the United States.

Senator Croll: Is that public?

Mr. Osbaldeston: Yes, it is—Excuse me, I hesitate for a moment; I am not sure if it is public.

Senator Flynn: It was passed by Parliament.

Mr. Osbaldeston: It was passed by Parliament, yes.

Senator Croll: Is there anything contained in these items in so far as that agreement is concerned with respect to unemployment assistance?

Mr. Osbaldeston: There is nothing contained in the items dealing with the automotive adjustments program that directly affects the employment situation. When I say that, I should add that there are provisions to provide additional assistance to the automotive industry in Canada, and providing that assistance undoubtedly would have a favourable effect on employment, in that they would be modernizing their plant or buying new machinery. However, the additional provisions found in these Supplementary Estimates are to continue the present program under the automotive adjustments assistance pact, which was begun some years ago. These provisions will have a positive effect on employment, but they are not intended solely for that purpose. That is the point I am trying to make.

Senator Croll: I particularly have in mind the moneys paid out to unemployed automotive industry workers, in addition to what is regularly paid out by way of unemployment assistance.

Mr. Osbaldeston: There is provision in these Estimates, and it is found on page 66 under "Grants and Contributions", under the heading "Transitional Assistance Benefits". Earlier in my remarks I was referring to the loan program relative to the automotive industry. This program is a companion program, whereby payments are made to automotive industry workers who are laid off, and it does provide for assistance over that normally available to any other Canadian.

Senator Croll: Is that unique?

Mr. Osbaldeston: No, it is not unique. I believe the Government textile program provides similar transitional benefits.

Senator Croll: Those are the only two?

Mr. Osbaldeston: I believe it is also applicable to the shoe manufacturing program.

Senator Croll: The last two have been recent, in the last year?

Mr. Osbaldeston: They were in the last year.

Senator Croll: And this one dates back to when?

Mr. Osbaldeston: 1968, I believe.

Senator Croll: Those are the three. Where do the other items appear? Or has no allocation yet been made for them?

Mr. Osbaldeston: Yes, an allocation was made in Supplementary Estimates (C), if I recall, of last year. Those benefits are still available, but no supplementary funds are required, so no mention is made of them in this supplementary estimate.

Senator Croll: So that for all purposes those are the three industries in Canada whose employees are receiving supplementary assistance from the Government?

Mr. Osbaldeston: To the best of our knowledge, that is true.

Senator Grosart: Would you add the provisions of the General Adjustments Assistance Program under the Kennedy Round? It is the same kind of legislation. I do not know whether it specifically provides for unemployment benefits.

Mr. Osbaldeston: I believe it is a very similar type of legislation related to manufacturers, the companies in the particular industries we have been discussing. It does not provide for assistance to workers directly; it is a general adjustment assistance program.

Senator Grosart: It is employment rather than unemployment assistance.

Mr. Osbaldeston: That is correct.

The Chairman: Perhaps we can let Mr. Osbaldeston complete his original statement.

Senator Croll Mr. Chairman, could I ask just one question arising out of my further comment about the matter of disclosure, which relates directly to the figures we have before us? I am looking at page 5, the extreme left-hand column, headed "Previous Estimates". We have always assumed that the supplementary is related directly to the main Estimates. We have here the figure of $15.3 billion. If we relate this to the main Estimates, should the figure not be $14.3 billion rather than $15.3 billion?

Mr. Osbaldeston: The main Estimates as tabled for 1971-72 contain two parts, as indeed do these, namely the budgetary expenditures and non-budgetary expenditures.

When the budgetary and non-budgetary items put before the house are added together they come to $15,340,919,000. That is the total of the main Estimates.

Senator Grossart: This is why I raised the question. I hope you do not mind, Mr. Chairman, because it is very important. The Government has put out this excellent document entitled "How Your Tax Dollar Is Spent", with wide distribution to the public.

The Chairman: That is put out by the Department of Finance, is it?

Senator Grosart: The Treasury Board puts it out. It is perhaps the best thing in this disclosure field I have ever seen. However, throughout it gives the definite impression that we are talking about $14.3 billion. It even says that half of this is statutory, which would not be the situation today. I would suggest that the figures we have here do not jibe with the impression given here. I am not saying it is a wrong impression. Here, in the Government's explanation of its money problems, it uses this $14.3 billion figure throughout.

Mr. Osbaldeston: I am grateful to you, Senator, for your kind remarks about our little booklet.

Senator Grosart: I think it is terrific, particularly the centre spread.

Mr. Osbaldeston: Thank you very much.

Senator Molson: It is called "an exploded dollar," is it not?

Mr. Osbaldeston: It is true that in that document we concentrate on the budgetary expenditures of the Government, and there is a reference to the budgetary total. However, it is also true that throughout the document we refer to the loans, investments and advances that are made by the Government. My memory does not serve me well enough to remember whether we have a table in there. I gather we do not. Perhaps you have brought to our attention an improvement that we could incorporate in the next publication.

Senator Grosart: The document keeps using phrases like "the spending program". As you know, I have spent a little time on these Estimates, and I still find it difficult to discover how much the Government is spending. Perhaps I could read what the Economic Council says. It is from the Eighth Annual Review "Design for Decision-Making", chapter 2, page 5:

> . . . when economists speak of the "government sector" of the economy, they are usually referring to that sector as it is defined in the national accounts. This is not the only possible definition. For some purposes, it would be useful to have information on expenditures on the basis of a wider definition—perhaps labelled "the public sector"—that would also include the revenues and expenditures of a wide variety of government-owned enterprises, like the Canadian National Railways, the Canadian Broadcasting Company, Quebec Hydro, and British Columbia Ferries. In total, such enterprises have a large influence on economic, social cultural, and other aspects of Canadian life. Unfortunately, the data that would permit their inclusion in the following measures of government expenditures are not readily available.

Mr. Osbaldeston: Mr. Chairman, the problem which the senator points out is a very real one in terms of bringing together all the expenditures on loans, investments and advances of the Government, into one place where the actions of the Government are clearly visible.

Certainly, the Public Accounts and national accounts endeavour to do this. I am sure the senator knows we share his anxiety in this regard. I might mention that we, in the Treasury Board Secretariat, are presently engaged in a co-operative effort with the Department of Supply and Services, which is responsible for the publication of the Public Accounts, with the Department of Finance and, indeed, with the Auditor General, under the direction of the Public Accounts Committee of the House of Commons, in an effort, firstly, to improve the timing of the publication of this sort of information on the national accounts and public accounts of Canada. Indeed, the Government has improved the timing for publication; they are getting it out much earlier.

Secondly, and the far larger task facing us, is an improvement in the form of the accounts. I believe this is directed to your question, senator, and indeed to the comment of the Economic Council of Canada.

Therefore, Mr. Chairman, my remark is simply to the effect that work is under way quite actively, in an effort to improve the collection, early dissemination, and the manner of presentation of public accounts.

Senator Grosart: What I am also trying to say is that I would like to see some of the information that appears in the public accounts moved up to the point of presentation of the Estimates, so that we know exactly what we are dealing with. This is important in this committee, because the Public Accounts are not before us. They are not referred to this committee: I hope they will be, in due course, because it would make sense to me that, after examining the Estimates, we should back and examine the Public Accounts and see if they "jel" or how they "jel".

It is understandable that public servants say, "This is in the Estimates, and you can find that in the Public Accounts"; but it seems to me that the time it should be before a parliamentary committee is at the time we approve these Estimates, or these supplementary Estimates.

The Chairman: Perhaps you would now continue with your statement, Mr. Osbaldeston.

Mr. Osbaldeston: Mr. Chairman and honourable senators, the only other point I wish to comment on is the $1 items. We have here in these supplementary Estimates a number of $1 items and I would like, if I may, to indicate by type the number that we do have.

The Chairman: You have your usual list of the $1 items?

Mr. Osbaldeston: Yes, we do.

The Chairman: Perhaps those could be distributed now?

Mr. Osbaldeston: Yes, Mr. Chairman. There are ten $1 items which cover grants for which funds are available within the main Estimates, but for which the parliamentary authority has to be sought relative to that specific grant.

There are two $1 items which authorize deletion of debts and claims. I might mention, in regard to the earlier question of the senator, that indeed on occasion the Government does write off bad debts.

There are three $1 items to effect the transfer of funds between votes.

There are five $1 items which amend the provisions of some previous legislation, including previous appropriation acts.

I should mention also, when I mention ten, two, three and five, that there are two items which are common and therefore they appear under two classifications.

Mr. Chairman, that concludes the remarks which I wanted to make.

Senator Molson: Before we leave pages 2, 3, 4 and 5, there is one substantial amount which I do not think has been mentioned. It is National Health and Welfare, a statutory amount of $62 million. I gather that that appears on page 82.

Mr. Osbaldeston: That is correct, senator. The amount of $62 million is made up of two main items. One is an updating of the hospital care costs incurred by the Government. Another is an updating of the medicare costs to be incurred by the Government. Those are the two main amounts. That is an updating of information on statutory expenditures.

Senator Molson: In other words, the Estimates previously were a little on the low side.

Mr. Osbaldeston: That is correct, senator.

Senator Molson: And will continue to be.

Mr. Osbaldeston: Mr. Chairman, I would like to amplify this point, if I may. The senator mentioned that they were a little on the low side. That is correct. We published in the main Estimates $811 million as the forecast of costs to be incurred by the federal Governement under the Hospital Insurance Diagnostic Services Act. Now we are updating that figure by $29 million, so it is about a 3 per cent error. In the case of the statutory medicare, we printed in the main Estimates $550 million. Now we are updating that with an additional $31 million over the $550 million, an error there in the order of 5 or 5½ per cent.

Senator Molson: Thank you.

Senator Grosart: I was about to ask about the $1 items, the group C, that are legislative in nature. I notice there is a very great improvement, or a great deal of moderation in the approach to the use of these $1 items. For the first time, it appears that we have no $1 item that actually amends a statute. As far as I can see, they all are, in substance, increases in amounts or forgiveness of debts or writing off of debts. There is an exception, perhaps, in the authorization under L16a. This would seem to extend the purposes of the vote. Other than an Appropriation Act, does it amend an existing statute?

Mr. Osbaldeston: The original authority resides in an appropriation act.

Senator Grosart: It is not in a separate statute?

Mr. Osbaldeston: It is not in a separate stature. It is in an Appropriation Act.

Senator Buckwold: Mr. Chairman, as this is my first committee meeting, I am not quite sure of the procedure.

The Chairman: We are very pleased to have you here, senator.

Senator Buckwold: Are we allowed to ask questions regarding, for example, the Estimates for agriculture, or do you have a procedure of going through these items, item by item?

The Chairman: We have no specific procedure. Senators are free to ask questions in any area they wish.

Senator Buckwold: I was going to ask about the Agriculture estimate. It shows a substantial credit balance on statutory votes. It is on page 3, where you will see a credit of $4.5 million. It is made up of a much lower amount. It is dealt with in the supplementary Estimates (A), at page 8, under "Statutory—Contributions to the Provinces under the Crop Insurance Act." How are these estimated? Can you relate the history of this for the last ten years, for example? Also, I would be interested to see how that crop insurance has ended up, and whether we have in fact paid out more or less than we estimated. Obviously, this year it has been considerably less. I am interested in this from the point of view of agriculture, since I come from the west. I gather, too, that we do not put this money into a fund, that is just done on an annual basis. Is that correct?

Mr. Osbaldeston: The Crop Insurance Act provides authority for the Government to make payment in the case of natural disasters. It applies to nine of the ten provinces. The Province of Quebec does not participate in this program at the moment. Therefore, when we were preparing the main Estimates for presentation to Parliament, as indicated on page 8, to which you referred, in the column headed "Previous Estimates", we provided for an amount of the likely expenditure under a statutory requirement. It was not required to be voted by Parliament since it had already been provided for in the statute, but the likely expenditure we felt would occur was in the order of $8.8 million, based on historical information and on the expectation that the Province of Quebec would, indeed, join this program in the year 1971-72.

In the event, the Province of Quebec has not joined the program this year; it is hoped that it will be joining it next year. Therefore, to update the information we presented to Parliament, we have reduced the $8.8 million by the amount of $4,587,500, which really has two parts to it. One part is that it reduces the amount that we expected to pay out, because the enrolment under the act changed with the introduction of the LIFT program. That accounts for approximately a $3 million reduction. In other words, there was another unforeseen event which occurred: the

LIFT program was introduced. Secondly, we reduced this amount of $8.8 million, originally included, by $1.5 million, which removes from our expected expenditures that amount we thought would be applied to Quebec. So that makes up the $4.5 million difference. Elsewhere in the Estimates you will see that we have provided an additional amount of money for the Quebec crop insurance program, which is a separate program but is parallel to the regular crop insurance program. We provided in that item for $950,000. I hope that explains the procedures, Senator..

Senator Buckwold: I would appreciate it if I could get an explanation of how that crop insurance payment has gone out. Perhaps it could be noted that I would like the information by province.

Senator Sparrow: Mr. Chairman, perhaps I should point out that there is an annual report put out under the Crop Insurance Act. That report covers all this information.

The Chairman: If there is such a report out, then there is no need for Mr. Osbaldeston to provide you with that information, Senator Buckwold.

Senator Buckwold: Yes, that would suffice. If you deducted $3 million from the LIFT program, was that money then added to the supplementaries somewhere in your Estimates here? If so, where?

Mr. Osbaldeston: There was a reduction in the enrolment of the farmers under the act because of the LIFT program, and that gave rise to a lower expenditure under this particular program.

Senator Buckwold: Where would the LIFT estimates be?

Mr. Osbaldeston: That was contained in Supplementary Estimates (C) for 1969-70.

Mr. MacDonald: Mr. Chairman, the LIFT program is a non-lapsing reserve fund in that particular case.

Senator Phillips: Mr. Chairman, on page 70 of the Supplementary Estimates (A), under "Manpower and Immigration" there is reference to a contribution of $100 million in connection with the Local Initiatives Program. I am interested in who grants the approval of the program. Is it approved by both federal and provincial governments or by a provincial government alone?

Mr. Osbaldeston: Mr. Chairman, this will be found under Vote 10a on page 68. On page 70, as Senator Phillips points out, there is a detailed explanation of the contributions. It is explanatory. The Local Initiatives Program is comprised of two parts: the first is contributions to municipalities and local governments relative to programs they have put forward; the second is contributions to local organizations and groups relative to projects that they have put forward.

Mr. Chairman, I have an application form here and perhaps Senator Phillips would like to have a copy of it after the meeting. I have only the one copy with me at the moment and I will need to refer to it.

The Chairman: I am sure Senator Phillips would appreciate receiving a copy of it.

Mr. Osbaldeston: In terms of the applications made under the program, this sheet that I have before me sets out the projects, the timing, et cetera. If I may, Mr. Chairman, I will give that to Senator Phillips later. It also sets out briefly the types of projects that one would expect to be funded under this program, that the Government intends to fund under this program, relative to municipal and local organizations. Applications are made to the regional offices of Canada Manpower. They have established at the regional level an advisory board comprised of the regional director and some of the local people in order to examine the proposals put forward. In the case of the municipalities, if I may read from section 8 of this project approval form "applications from municipalities must have the concurrence of the appropriate provincial or territorial government and should be submitted to its office as soon as possible." That is, the Manpower office. So they must have the concurrence.

In the case of the local organizations and groups, as I understand it, if the applicants wish to undertake work which relates very directly to municipal services or provincial services in that area—and when I say "relates to", it may be supplementing some activity which might presently be carried on by provincial or municipal governments, or what one would expect to be carried on—they may not duplicate such services. Indeed, if they bear on the municipal or the provincial area of authority, the screening group will seek the concurrence of the municipality or province involved. So, I think the short answer to your question, senator, is that where there is a municipal grant, yes, there must be formal concurrence, and relevant to the local organization we will indeed seek assurance that they do have concurrence.

Senator Phillips: Mr. Chairman, this is probably a question that the witness cannot answer. I am rather curious to know the reasons for leaving hospitals and educational institutions out of this program. I have seen where churches have received grants, and to me it seems logical that hospitals and educational facilities should receive the same consideration as the church.

Mr. Osbaldeston: I was not aware, senator, that hospitals were excluded.

Senator Buckwold: Perhaps I, as an ex city mayor presently involved with much of this, can throw some light on this. Apparently earlier there was some confusion and the educational people thought they would get some grants. But now it has been clarified and the situation is otherwise in view of the fact that already they participate either directly or indirectly in federal money. So, apparently, hospitals and educational institutions are covered in this way and receive a part of this money whereas churches presumably do not.

The Chairman: I am concerned about this $80 million program, "Payment of grants pursuant to section 4 of the Employment Support Act," which is referred to on page 60 of the supplementary Estimates. Can you tell us how much has been expended or committed on that?

Mr. Osbaldeston: I believe there was a statement in the house by the parliamentary secretary to the Minister of Industry, Trade and Commerce indicating that the impact on employment in Canada expected to arise as a result of

the United States surcharge had to this point in time been less than anticipated, and, if my memory serves me, I believe the number of jobs expected to be affected has been reduced by one-half. So far as the payments already made are concerned, I am sorry I cannot comment on that. I expect, from what I have said, that it is clearly less than was originally anticipated, but if you like I could try to determine that and let you have it.

The Chairman: I think we would like to know at the present time the state of the negotiations, the firms that are involved, and the contributions or the commitments that have been made. It may be that they have not yet been paid, but we approved an $80 million figure and I think we should have some indication—since we can have knowledge of what is happening to that figure—at the time we are asked to make the approval of exactly how it is going at this stage and what commitments have been made, and what commitments the Government estimates will be made down the road in the light of the fact that the impact apparently is half of what it was expected to be.

Senator Flynn: Mr. Chairman, there is a technical question relating to this. We have voted this $80 million in the special act, and therefore this amount appears here only because it has to be included in the expenses of the Government for the present fiscal year. I remember that when we discussed the act it was made clear that the $80 million was provided for the present fiscal year. It could not be continued next year, apparently, unless we were to amend the act itself or to amend it by way of the Estimates. So I just wonder if the situation is such that it would require an amendment to the act.

The Chairman: I think it could be done by a supplementary Estimate.

Mr. Osbaldeston: That is correct, it could, because the issue would be simply the dollar limit and the timing of the act.

The Chairman: Since we are at this stage of Supplementary Estimates (A) and since the program has been approved and put into operation, I think it is an area where we want as much information as we can possibly get—Who is getting these loans? What effect are they having? What commitments is the Government undertaking? What does the Government estimate it will use in relation to the total of $80 million? This is an area in which public understanding of what the Government is doing is extremely important.

Senator Flynn: The fact is that if the Government has had to revise its original estimate of $80 million, it would have been proper to provide for a credit for the decrease in the amount. That is if it is foreseen that they will not need this $80 million until the end of the fiscal year.

The Chairman: That may be true, but of course we cannot tell that until we have the information.

Senator Molson: I thought there was an indication that if this amount was not sufficient it would be increased.

The Chairman: It seems to me that they were talking about going to $190 million, and then the next thing I heard was that the effect of the surcharge was half what they thought it would be.

Senator Langlois: Mr. Chairman, since we have been making reference to the surcharge, I think it should be pointed out that this legislation is not limited to the surcharge. It is a corrective piece of legislation to provide corrective measures for any other similar imposition or surcharge imposed by any other country in the future.

Senator Grosart: I think the expression used was, "surcharge or like action."

The Chairman: "Surcharge or action of a like nature."

Senator Molson: Was there discussion about raising the amount if necessary?

Mr. Osbaldeston: I think that discussion did occur, but I believe it was also mentioned in the debates in the house that of course this applied to a six-month period, and if the surcharge were to continue during the 1972-73 fiscal year, the amount would have to be increased to $150 million. That may be the figure that the senator recalls hearing mentioned.

The Chairman: Then, senators, is it agreed that we should get that information?

Hon. Senators: Yes.

The Chairman: What should we ask for specifically?

Senator Flynn: We should ask for what has already been spent and what is expected to be distributed until the end of the fiscal year.

Senator Grosart: We can ask John Connally for that information.

The Chairman: We should ask for what is the amount committed, what is the outlook, the list of firms and the amounts, the provincial breakdown—

Senator Molson: —the employment affected. That is the purpose of the act.

The Chairman: —the employment affected.

Senator Grosart: I think it was suggested that there might be a degree of confidentiality required in the interest of firms receiving assistance.

Mr. Osbaldeston: Mr. Chairman, I do recall that the minister stated in the house he was concerned that a release of such information not adversely affect the competitive position of the firms receiving a grant. We can put these questions to the department concerned and endeavour to obtain an answer.

Senator Molson: They can certainly give us the industry involved.

The Chairman: I think they can go further than that. It seems to me it is very unlikely that the knowledge of a firm receiving a grant to maintain a level of employment is adversely going to affect its competitive position.

Senator Grosart: There were very strong representations made to that effect, and the minister responded sympa-

thetically to them. I think there is something to be said for it. Perhaps a year later it would not matter, but at the moment it could very well adversely affect the position. It would disclose whether a firm was absorbing the surcharge in its export policy matters, and they might not want their competitors to be aware of this.

The Chairman: This is the sort of thing that happened with the Manitoba Development Loan Fund, when the Government said they could not disclose the figures. It turned out later that if they had disclosed the figures it would have been more helpful to everybody involved, and no one's particular advantage would have been affected in any way.

Senator Grosart: I think what was probably in the minister's mind was that if you started publishing the names of beneficiaries you would have a rush on by firms seeking assistance. One firm would feel that, if his competitor was getting assistance in his export market, he would want it too.

The Chairman: That is a different problem. I can understand that. If we were asking for sales information, or for information having to do with the financial statement, that is a different matter. All we are suggesting is information regarding the amount that has been committed to what firms, and what employment is affected.

Senator Grosart: Then, of course, you have to ask why, which means going through the whole procedure which the firm has been subjected to in making its representations under the act. It will be a pretty tough process. A firm will have to disclose information it would not disclose even to the income tax office.

The Chairman: But, in fact, we are not asking why.

Senator Langlois: Mr. Chairman, we are not interested in obtaining the names of the recipients are we? What purpose would that serve in the study we are now making?

Senator Grosart: Perhaps only the fact that it is complete disclosure. Perhaps that is the only thing you can say in its favour.

Senator Flynn: If you do not have the industry—

Senator Langlois: But you will know the industry involved.

Senator Flynn: —sometimes by having the name of the firm we can better appreciate the problem.

The Chairman: I do not see why a grant under a public act should not be made in the most open of ways.

Senator Grosart: Welfare recipients do not want their names published.

Senator Flynn: This is not a welfare matter.

Senator Grosart: It is welfare, in a sense.

Senator Molson: In reverse procedure, when you help the federal Government by paying income tax you do not have to disclose the name of your firm and the amount.

Senator Grosart: I might say that I am not against corporate welfare.

Senator Beaubien: Mr. Chairman, it would affect the competitive position if the Government gave me a grant and I absorbed the 10 per cent figure. If you had two people in the same business and one could absorb the 10 per cent and the other one could not, this would make a pretty big difference to the competitive position.

The Chairman: I do not feel that this is a case of whether or not they can absorb the 10 per cent. It is a case of whether or not the grant will protect a certain level of employment.

Senator Beaubien: If we are both in the aluminum business and I obtain a grant from the Government and absorb the raised tariff, which went from 1.3 cents to 4 cents—of course, if I do not obtain that grant I cannot absorb it—

The Chairman: The point I am making is that, under the terms of the act, it is not a matter of whether you can absorb the effect of the surcharge or not. So long as you are protecting a certain level of employment you are entitled to the grant.

Senator Molson: Mr. Chairman, with great respect, I do not think I would begin by asking for the names of the firms. I would rather feel our way through this matter for a while, and if you feel that this does not tell us anything, then you might come back and say this. I am a little leery about this matter in the task which is before us.

Senator Grosart: So am I, Mr. Chairman. But you can argue it the other way as well. A competitor would be entitled to know if a portion of his competitor's export policy was determined by an employment subsidy, and that is what this would be. He would have to qualify under the terms of the act, and these terms are set out.

Mr. Osbaldeston: Mr. Chairman, the only comment I would make is that in dealing with the disclosure of names the criteria are fairly explicit as to which companies may apply and which companies will qualify. A certain percentage of your production must be exported to the United States. I would suggest that this is information the competitors would like to secure. There may be other criteria such as this which, by the very fact that you received a grant, would indicate that you have met the criteria. This may indeed be helpful to your competitors.

Senator Flynn: Let us leave it to the minister to decide whether or not the information should be supplied.

The Chairman: I am inclined to disagree with you, senator. I am inclined to agree with Senators Molson and Grosart that we ask for a list by industry.

Senator Molson: That is, to begin with, at least.

Senator Grosart: Let us ask for whatever details are available because it does not matter what we ask for, the minister will decide what to give us, in any event.

The Chairman: I would like to know what he does not decide.

Senator Phillips: Mr. Chairman, I would be interested in obtaining information regarding how many jobs were protected.

Senator Grosart: The Government will boast about this, so you do not need to worry about that. We will have a full report on that. We have no disclosure problem there.

The Chairman: The list should include the amount which has been committed, the outlook, a list by industry, a provincial breakdown, and the employment affected.

Senator Grosart: Mr. Chairman, this committee has been interested in the past in the relationship between increase in the Gross National Product, national productivity, and the increase in all federal Government spending. In fact, at one time we recommend that the increase in all Government spending should never, as an annual percentage, be greater than the increase in national productivity.

I would like to let Mr. Osbaldeston know that I have great difficulty every time I attempt to discover the amount of the percentage increase in Government spending. That brings me back to this $15.3 billion and $14.3 billion, because referring again to the brochure, "Your Tax Dollar", page 17, I find a table headed "The Spending Program." I commend the authors of the report for using the word "spending," instead of the circumlocution of "expenditures," and so on. It is the spending program—"past, present and future." This particular tabulation starts at 1964, the total figure being $7.2 billion. The proposed, which is the figure we are discussing for 1971-72, is again $14.3 billion. Referring to the figures before us, I find the new figure of $16.2 billion. I merely point out that these are not the same kinds of figures.

However, how would I relate, for example, the $16.2 billion to last year's comparable figure in an attempt to discover the percentage of increase?

Mr. Osbaldeston: The figures you referred to in the Blue Book, I believe, are the budgetary figures. The figure of $15.34 billion includes budgetary and non-budgetary.

Senator Grosart: Yes, I agree. As I say, they are not the same thing.

Mr. Osbaldeston: So they are not comparable.

Senator Grosart: But where do I go at this moment, in the book that is before the committee, to find out the comparable increase when there is no comparable figure before us for last year?

Mr. Osbaldeston: I am sorry it is not before you. If you refer to the official main Estimates, there is a table which sets out the amounts of the main Estimates year by year.

Senator Grosart: The point I am making at the moment is that the comparable figure is not before us in the Supplementary Estimates (A).

Mr. Osbaldeston: Included in the main Estimates is a table setting out year by year the main Estimates tabled in the house by the Government, plus supplementary Estimates tabled in the house by the Government relative to budgetary expenditures. It gives total budgetary by year. Below that table is another, indicating non-budgetary, which sets out the non-budgetary items tabled in the main, plus the non-budgetary items sought in supplementary Estimates.

Therefore, a comparable figure, as the senator points out, is a composite of the two. In order to arrive at a comparable figure for 1971, to the figure of $15,340 million, one would add the figures for 1970-71.

Senator Grosart: Yes; the point is it is not totalled here.

Mr. Osbaldeston: In that case I suppose we need a third table, senator.

Senator Grosart: Yes, it is not totalled here, yet it is carried over as a total figure. In my opinion, to some extent, to a layman at least this is misleading. I return to the question of which numbers I use to arrive at the percentage. Is it the difference between $16,212 million and $15,340 million?

Mr. Osbaldeston: The phrasing of the question indicates that you are interested in Government expenditures, rather than the growth in GNP.

Senator Grosart: The first question is: What is the percentage increase projected now with main Estimates plus Supplementary Estimates (A)?

Mr. MacDonald: Again, senator, are you referring to the difference between 1970-71 and 1971-72?

Senator Grosart: Yes, the percentage increase in federal Government—now, what word do I use? I cannot use "spending", because that is given a different meaning here.

Senator Beaubien: Total expenditures.

Senator Grosart: It is not total expenditures.

Mr. Osbaldeston: You would have to compare budgetary and non-budgetary expenditures with main Estimates, budgetary and non-budgetary.

Senator Grosart: I agree, but what wording do I use to describe this? "Government spending and commitments"?

Mr. Osbaldeston: We refer to it as the expenditure budget.

Senator Grosart: Of course, you do not include Loans, Investments and Advances in that.

Mr. Osbaldeston: Yes, we do, sir.

Senator Grosart: Oh, yes, you do. Yes, because they are expenditures, the money has gone.

Mr. Osbaldeston: Our term "expenditure budget," senator, covers budgetary expenditures, statutory and non-statutory, and Loans, Investments and Advances.

Senator Grosart: So could I use the term "spending budget"?

Mr. Osbaldeston: Well, sir, we endeavoured to popularize it. I appreciate your kind comment with respect to our Blue Book. We did try to popularize it in order to make it readable to the general public. When we ourselves work on these problems on an official basis we attempt to retain, I suppose, a little history or tradition in addition to using more precise wording. "Expenditure budget" is a fairly precise wording for us.

Senator Grosart: So we would have to make a distinction in the two publications between the phrases "spending program" and "expenditure budget"?

Mr. Osbaldeston: There is a difference, because the spending program in what we refer to as the "baby Blue Book" refers to the budgetary expenditures of the Government. The expenditure budget, as I have just referred to it, includes non-budgetary as well as budgetary.

Senator Grosart: Then I think you would appreciate why a layman might become a little confused.

Mr. Osbaldeston: I do not wish in any way to indicate that many of the public are not interested in the larger Blue Book. We do, however, expect that the "baby Blue Book" has a greater readership than the larger one. Therefore we endeavoured to put to the public in as simple words as possible, without being misleading, the manner in which the Government indeed spends their tax dollar.

There is reference in the "baby Blue Book" to the non-budgetary items. The Loans, Investments and Advances are indeed mentioned, but not in the same detail as the budgetary.

Senator Grosart: Would you then say that if I were to subtract the $15.3 billion, in the left-hand column on page 5, from the $16.2 billion, which appears in the right-hand column, the difference would be the increase to date of this year's expenditure budget?

Mr. Osbaldeston: That is correct; that appears under column 4 under "Total," $872 million. The difference between $16,212 million, in the right-hand column, and $15,340 million, in the left-hand column, appears under the column entitled "Total Supplementary Estimates," the amount being $872 million.

Senator Grosart: I did the arithmetic quickly and it did not produce that figure. However, that is neither here nor there.

Mr. Osbaldeston: Senator, you frighten me if it does not come out that way.

Senator Grosart: I never was good at arithmetic. So we take $872 million as a percentage of $15,340 million. I would like to work that out.

Mr. Osbaldeston: I believe it is approximately 5½ per cent, senator.

Senator Grosart: Approximately 5½ per cent is the increase in the federal Government expenditure budget.

Mr. Osbaldeston: I should like to mention that nearly 50 to 60 per cent of that increase is related to the creation of employment opportunities.

Senator Grosart: I am not questioning that. There are other good uses of money in here besides that.

Senator Buckwold: I gathered earlier that Senator Grosart was looking at the over-all percentage increase of federal expenditures in one year compared to those of previous years. What we are getting now is really just a supplementary. The supplementary estimates are quite clear, but they become meaningless in the over-all picture when comparing them on a yearly basis with the total expenditure.

Senator Grosart: I was coming to that. We already have an increase of 5 ½per cent. What percentage do we add to this to find out the total increase in federal Government budgetary expenditure this year, as an annual percentage, compared to last year?

The Chairman: That is, at the same time?

Senator Grosart: I am thinking in terms of an increase in the GNP, which may be 8 or 9 per cent in current dollars. We are dealing with current dollars here, so that is comparable.

Mr. Osbaldeston: I would have to go back to the main Estimates book, add the budgetary to the non-budgetary to get the total and get the percentage increase to arrive at the $16,212 million.

Senator Grosart: You would have to go back to the Public Accounts.

Mr. Osbaldeston: You are speaking of total Government expenditure? I was restricting my remarks to the expenditure budget increase. We would have to go back to the Public Accounts for the total.

Senator Beaubien: $16 billion is the total.

Senator Grosart: But there is nothing to compare it with here.

Mr. Osbaldeston: The $16 billion refers to the Estimates—

Senator Beaubien: Are there any other expenditures?

Mr. Osbaldeston: Yes, there are.

Senator Beaubien: How much, roughly?

Senator Grosart: I think they are here somewhere.

Mr. MacDonald: In a typical year there are loans, investments and advances provided for under a continuing statute which do not have to be reflected in the supplementary Estimates.

Senator Beaubien: But is could be argued that they would not really be expenditures.

Mr. MacDonald: But they represent several hundred million dollars in loans to the Central Mortgage and Housing Corporation, the Farm Credit Corporation, and so on.

Senator Beaubien: I think we should have that figure.

Senator Grosart: That is what I am getting at. I refer the committee to page 15 of the publication "How your Tax Dollars are spent", it says: "The main Estimates do not represent the whole of the spending program." We have the phrase "the spending plan". It says: "The spending plan also includes such financial operations as the Canada Pension Plan, the Unemployment Insurance Fund, and Government loans and investments," and so on. It goes on to the Quebec situation and so on. Why cannot we obtain at this time the whole of the spending program? We always assume that this is it, but it is not.

Senator Beaubien: I think that is very important. Last year, for the first time, the other two levels of government

spent just as much as the federal level. If we contemplate that the other two levels will spend in excess of $16 billion, and that is not the complete figure, it looks like an expenditure by the government this year of at least $33 billion. If our GNP is projected to be $84 billion, it comes to about 40 per cent, which is just shocking. That is the figure that we should look at.

The Chairman: We are asking for the total spending program, including the budgetary items, the loans, investments and advances, and the loans, investments and advances under the continuing budgetary program for this year compared to last year, showing the percentage increase, and comparing it as a matter of percentage to the GNP of each of the years.

Senator Grosart: That is right.

Senator Beaubien: Can we be given also a rough idea of what the provinces and municipalities are going to spend?

Mr. Osbaldeston: We will secure the best information we can. I am sure that honourable senators are fully aware of the difficulty we may encounter in putting together all of the information requested. We will certainly put together all the information that is available, and if some is not readily available we will indicate why.

Senator Grosart: Surely, we should be able to obtain at least one number which would fit the description here of the whole of the federal Government spending program.

The Chairman: That would involve no problem.

Senator Grosart: But it will. As the Economic Council points out, this data is not available to economists. The Economic Council, in its current report, says, "Unfortunately the data is not readily available." I have been at conferences when economist after economist has got up and said, "I have come down here, but it is hopeless to try to get the necessary information out of federal Government departments." I might say that I told them that I did not believe that was true, that if you work hard enough, you can get it.

Mr. Osbaldeston: As I indicated earlier, in view of requests from the Public Accounts Committee of the House of Commons, work is under way to try to improve the data that appears in the Public Accounts. This problem has been recognized, and work is now under way to try to improve the data. Undoubtedly it will take a great deal of work. My concern is how quickly can I respond in advance of this work to the request of Senator Grosart.

Senator Grosart: I know that it will be a slow process. I am suggesting that we move some of the Public Account numbers up to this point. When we are asked to approve a projected total of $16.2 billion, we should know to what part of the whole spending program that refers. We should know what else there is.

Mr. MacDonald: There are large problems of definition. The Committee is interested in a re-rendering of the national accounts. If we were to take expenditures authorized under other statutes and add them to the expenditures that are in here, we would be adding numbers that are not in a true sense additive. For instance, there are contributions here into the Public Service Superannuation Account and other pension accounts, but they do not necessarily represent actual out-flows of money. They are accounting transfers, and the pension payments in a year may be less than contributions to the pension fund.

Senator Grosart: Yes; but you include all sorts of other transfers. You include all the transfers to the provinces. This is another thing that I would very much like to see broken out, a subtraction of the bookkeeping entries, where what you are doing is really collecting money for the provinces.

Mr. MacDonald: That is done in the national accounts. The difficulty is that the Estimates are a proposal to Parliament for authority to spend money or to take certain actions in the accounts, and are not exactly equivalent to an out-flow of cash. To break this out-flow of cash is enormously more difficult than adding figures from here and figures from other sources.

Senator Grosart: But cash flow represents another problem. You do provide statistics on cash flow, but I come back to this phrase "the whole spending program." I say we are entitled to have this at the time we are asked to approve supplementary Estimates or main Estimates. If your phrase is "whole spending program," then we can only assume we have before us a partial spending program.

Mr. Osbaldeston: It is proper to say, though, that Parliament has indeed approved these other expenditure plans. In other words, they were brought to Parliament, and statutory authority to make these expenditures does indeed exist. Therefore, Parliament has dealt with them on at least one occasion. We then come forward with main Estimates which propose new spending programs. These are the additives. The only point I make, senator, is that these other programs have been brought to Parliament. As to the outflows that are going to occur in any particular years—

Senator Grosart: That previous approval argument would apply to all the statutory items, so it is not a valid argument for not including the others. In the information you give us, you do include the statutory items.

Mr. Osbaldeston: We include here the statutory items which come under budgetary headings, that is correct.

Senator Grosart: Perhaps the difficulty is that your responsibility is to provide the numbers that have to be approved by Parliament, but what I am saying is that when you provide those numbers it would seem to me to be a disclosure obligation to provide further information as to the relationship of those numbers to, and I come back to the phrase, "the whole of the spending program" at the time you ask for this approval.

The Chairman: You are talking about bulk figures.

Senator Grosart: I would like the same type of details here as well.

Senator Phillips: In the phrase you used this morning, "budgetary expenditures," are the expenditures of Crown corporations included?

Mr. Osbaldeston: Some of the expenditures of Crown corporations are included in budgetary to be voted; other expenditures of Crown corporations come under the Loans, Investments and Advances column. As an example, the CBC operating deficit is covered by a budgetary to be voted. The capital expenditures of the CBC are provided through the technique of Loans, Investments and Advances. With respect to other cases it may simply be by loans, or in other cases it may simply be by budgetary.

Senator Phillips: If I was interested in obtaining information on, say, Panarctic, where would I obtain it? Would it be in the Estimates?

Mr. Osbaldeston: The legislative authority to make payments to Panarctic is sought through an appropriate bill, so if you ask the question as to where the Government receives the authority, or what limits are on the authority, I would refer you to an appropriation act and a particular vote which contains that authority.

Senator Phillips: To be more specific, Mr. Osbaldeston, if you wanted to follow the actual expenditure of the money voted, where would you obtain that information?

Senator Grosart: That would be contained in the Annual Report of Panarctic.

Mr. Osbaldeston: That is correct.

Senator Grosart: But this creates another difficulty. There was mention of the CNR coming under a separate act. Parliament is asked to approve some of the expenditures in the CNR annual bill 18 months after they have been made. I have objected to this before a Senate committee.

The Chairman: Perhaps we can leave that point now, senator; it is well made.

Senator Grosart: I hope you will excuse my being persistent, Mr. Chairman, but persistence on the part of this committee in the past resulted in this excellent practice of giving us a breakdown of the $1 items. It was this committee which persuaded our friends to give us this breakdown.

The Chairman: Perhaps we can handle this in the way in which we handled the other item. We know what it is you are suggesting, senator. When we examine the main Estimates and the supplementary Estimates, we would like to have before us the total of the Government spending program, with as much of a breakdown as is possible, as compared to the previous year and as compared to the Gross National Product. Perhaps you could give us some information on the problems in that regard and how you are proceeding towards that; and we will come back to it at a later time.

Senator Grosart: We shall be most thankful for small mercies.

The Chairman: Could we move on now to page 56 under the heading "Industry, Trade and Commerce"? This is a $1 item which you have described. Under Vote 11a, you have increased the insurance from $100 million to $250 million. I wonder if you could give us some more detail on that, especially as it affects Bill C-262, the $80 million Unemployment Support Act, and also as it affects the Kennedy Round?

Mr. Osbaldeston: The purpose of increasing the amount of insurance available was to provide for an expected requirement on the part of Canadian industry for loans in order to adjust to external actions. Honourable senators will recall that under the original vote provision was made to assist Canadian manufacturers in meeting the conditions brought about by the successful conclusion of the Kennedy Round. The conditions brought about were really of two orders. Firstly, it might bring about greater competition for the Canadian company in Canada, and provision was made to assist Canadian companies in adjusting by providing loans, and loan insurance. The second condition that might prevail as a result of the Kennedy Round was that an opportunity might arise abroad, and the Canadian Government wished to provide loans and loan insurance to assist a Canadian company to take advantage of such opportunities. With the introduction of the import surcharge by the United States, a condition in the international market developed which indeed might require Canadian companies to adjust in terms of plant capacity, machinery, and so forth, in order to make them more competitive. Therefore, this is the new part of the Government program, as set out in Vote 11a and, in particular, Section (a)(i) which I will read, if I may, Mr. Chairman:

> (i) requires such loan in order to adjust to changes in conditions affecting his access to foreign markets which are attributable to the imposition by a country other than Canada of a temporary import surtax or to the taking by such country of other actions having a like effect, . . .

The second part of that is that the Government is looked upon as a leader of last resort. Section (b) sets the amount of loan insurance available and section (c) provides authority to protect the Crown interest in the assets which previously have been secured by loan; in other words, it permits the Government to move in and support a company that has been the recipient of a loan or a loan guarantee if it is deemed by the Government to be the correct action to take in order to protect the original investment.

Senator Grosart: Mr. Chairman, I have to go to another committee, the steering committee of which I am chairman. I should like to ask a question and perhaps not wait for the answer. In view of the fact that the interest on the carrying charges on the public debt now absorbs 14 cents of every tax dollar, would Mr. Osbaldeston give us the estimate of the deficit as it will now be with Supplementary Estimates (A)?

The Chairman: You do not want that off the top of his head, do you?

Senator Grosart: I am sure he has it.

Mr. Osbaldeston: I think that with a drop in interest rates things are improving, but if you like, senator, I will get that figure for you.

Senator Grosart: Thank you.

The Chairman: That last part interests me. You say that if the Government feels it is in jeopardy on a loan it can do what?

Mr. Osbaldeston: If under the program the Government has made a loan or insured a loan to a company to assist it to adjust to the imposition of the import surtax by the United States.

The Chairman: Or to the general Kennedy Round?

Mr. Osbaldeston: Or to the general Kennedy Round. If after having received the loan or loan guarantee that company still finds itself in difficulty, and in fact is in danger of, let us say, bankruptcy, the Government may make a further loan or extend its loan guarantee to the company if it is felt that such further loan or guarantee would protect its original investment, its first loan or loan guarantee. It is a supplementary loan fund.

The Chairman: Would that mean the terms of that further loan are not in accordance with the act as originally contemplated?

Mr. Osbaldeston: No. First of all, the General Adjustments Assistance Program was brought in as part of an appropriation act. Certainly, the second loan is to protect the first loan, the purpose of which was to assist the company to adjust to the Kennedy Round. In effect, it is a further loan, a second loan, for the same purpose.

The Chairman: Are you now dealing with the item on page 58?

Mr. Osbaldeston: Page 56.

The Chairman: Going over to page 58, Vote 17a seems to deal with the point you are now raising. Is that correct?

Mr. Osbaldeston: That is correct, Vote 17a deals with loans. You are quite right, Mr. Chairman, I had directed my remarks to Vote 17a when speaking of direct loans. Vote 11a on Page 56 refers to loan guarantees.

The Chairman: It is interesting that in item (b) of Vote 17a it says:

> to a person or to a trustee or receiver authorized to carry on the business.

I gather this is new legislation.

Mr. Osbaldeston: It is a new provision, that is correct.

The Chairman: So you are contemplating loans to somebody who has had a loan, has made an assignment to its creditors, and a receiver has been appointed. Is that correct?

Mr. Osbaldeston: If that is deemed to be the best way to protect the Government's original investment.

The Chairman: But it is clear there must be cases of this nature, otherwise one wonders what the purpose of the amendment is. It is specific, is it not?

Mr. Osbaldeston: There could not have been cases where the Government has actually done this, because this is the first time they seek authority to do it. There may well have been cases in the past where the Government felt it would have been wise to do this, and undoubtedly they anticipate this may arise in the future and want authority to make such a loan.

The Chairman: Have you any information indicating that this condition obtains at the present time?

Mr. Osbaldeston: I do not.

The Chairman: Could you give us some more detail on why this amendment is being made?

Mr. Osbaldeston: Yes. I do recall the discussion on this item, and I recall the statement by the departmental officials that the situation had arisen in the past where they felt it would have been advantageous to protect their position by a further loan, but they had been unable to do so.

The Chairman: Could you enlarge on that information on investigation with the Department of Industry, Trade and Commerce?

Mr. Osbaldeston: I will endeavour to do so.

The Chairman: Let us move back to Vote 16a, the one above. Is that the same item? This guarantees loans made by private lenders. What happens there?

Mr. Osbaldeston: I believe the situation is as follows. Vote 17a seeks to extend the section of the GAAP authority to permit the Government to make direct loans because of the surtax. Also, in Vote 17a, having made the initial loan because of the surtax, they seek authority to make a supplemental loan.

The Chairman: If the loan has gone back.

Mr. Osbaldeston: If it is going or has gone back. Vote 16a seeks the same authority to make a loan relative to the automotive adjustment assistance program.

The Chairman: But it says:

> to guarantee, in the current and subsequent fiscal years . . . loans made by private lenders approved by the Board to the said persons described above for the aforementioned purposes up to an aggregate amount not exceeding $5,000,000.

Were they guaranteed in the past?

Mr. Osbaldeston: Under the terms of the automotive adjustment assistance program we made direct loans.

The Chairman: So this is not a change; this is merely to increase that amount.

Mr. Osbaldeston: It authorizes the further guarantee.

Senator Sparrow: What was the amount in the main Estimates for that? Did the original Estimates show $5 million?

The Chairman: In other words, you want to know whether it was $3 million or $5 million?

Senator Sparrow: Yes.

Mr. Osbaldeston: If I may go back to what the chairman was saying, this one refers to the automotive adjustment assistance program. Vote 16a is:

> for the purpose of protecting the Crown's interest in the assets securing such loan.

That is relative to the position under the automotive adjustment assistance program. This provides for the Government to protect the Crown's interest in those loans. Vote 17a refers to the new authority requested in the supplementary Estimates to provide loan authority to the Government to assist Canadian manufacturers to adjust to the import surtax. Vote 16a seeks the same authority, namely to make a supplementary loan relative to the automotive adjustment assistance program. They do the same thing, only they do it relative to different parts of the Government's general adjustment assistance program.

The Chairman: Who has been handling the Kennedy Round loans?

Mr. Osbaldeston: The General Adjustments Assistance Board.

The Chairman: There is no difference in who is handling it now?

Mr. Osbaldeston: No, it is as in the past.

The Chairman: The increase from $100 million to $250 million is required for that?

Mr. Osbaldeston: The surcharge aspect; the anticipated loans arising out of the imposition of the surcharge.

The Chairman: So that would indicate that the estimated cost at this moment for the surcharge is $150 million plus $80 million.

Senator Hays: In loans?

The Chairman: In actual cash outlays, there is $80 million under the Employment Support Act, and an increase of $150 million under the Industry Vote 30c.

Mr. Osbaldeston: Yes, Mr. Chairman.

The Chairman: That is a total of $230 million that appears to be committed by the Government, in reflection of the American surtax.

Senator Hays: It is a straight grant.

Mr. Osbaldeston: Mr. Chairman, if I may, I should point out that vote 17a, which increases the loan authority to that level—

The Chairman: No, I think it is vote 11a that does so, increasing it from $100 million to $250 million.

Mr. Osbaldeston: That is right.

The Chairman: And you say that that does not transfer that authority from one board to the other; it is still the same board. So the same board is now handling both the Kennedy Round and the surtax imposition?

Mr. Osbaldeston: That is right.

The Chairman: And over on Vote 16a there is another $2 million appropriated to guarantee loans which were approved by the board but made by private lenders.

Mr. Osbaldeston: That is correct.

The Chairman: And there is another $6 million to make additional loans to those recipients of loans where the loans are in jeopardy or where the recipients have gone into receivership in one form or another.

Mr. Osbaldeston: That is correct.

The Chairman: So, in effect, it would appear that the results of the American import surcharge have caused the Government to increase its commitments by $230 million?

Mr. Osbaldeston: Yes. The only point I would like to make there, Mr. Chairman, is that the $250 million limit on the guarantee applies, as you pointed out, both to the Kennedy Round and to the import tax, since they are both administered by the same board and both come under the same guarantee provisions. But it is true to say that the Government seeks an increase at this time in that order, and it is specifically because of the surtax. I just point out that the $250 million can be used either for the Kennedy Round or for the import surtax.

The Chairman: But the $6 million and $2 million, or certainly the $6 million, can only be used for the surtax—is that right?

Mr. Osbaldeston: That is correct, Mr. Chairman. I apologize for not having this quite clear for you. The Vote L80 of 1968, which Vote 17a extends, is—and I am now referring to Vote L80—the vote which established the Kennedy Round assistance program. This Vote 17a extends that provision, to include the surtax. It then provides for $6 million on account of the surtax.

The Chairman: And the same thing happens with Vote 16a?

Mr. Osbaldeston: That is correct.

The Chairman: So now we are up to $238 million.

Mr. Osbaldeston: But the $6 million would apply to both.

The Chairman: Except that it would not have happened if there had not been the surtax, if you were still just dealing with the Kennedy Round. I think what you are saying, in effect, there is clear, that it extends the loans which are attributable to the imposition by a country other than Canada of a temporary import surtax.

Mr. Osbaldeston: Yes, but I mentioned to you, Mr. Chairman, that the departmental officials have pointed out that under the GAAP Kennedy Round there indeed had been cases where companies were in danger of, or indeed in, bankruptcy where such a provision would have been of assistance. Those cases arose prior to the imposition of the surtax.

The Chairman: There would have been a previous provision for that?

Mr. Osbaldeston: No, there was not. This is the first time that the Government is seeking authority to make these supplementary loans.

The Chairman: I see. Do you know of any instances at this stage where they will have to protect the loan or where there has been a case of going into receivership?

Mr. Osbaldeston: I do not, Mr. Chairman.

Senator Phillips: Mr. Chairman, on the section dealing with Energy, Mines and Resources, it is my understanding that this department has been largely absorbed into the new Department of the Environment, yet I notice there is an increase of something like $1.6 million in salaries. It seems rather strange, when a department is being absorbed, to find an increase of that size in salaries.

Mr. Osbaldeston: Mr. Chairman, if I may, the department was not absorbed by the Department of the Environment. One very major portion of it was, and the senator is quite correct in that. It was the water purity branch of the Department of Energy, Mines and Resources. However, that leaves the Department of Energy, Mines and Resources responsible for energy, except water purity. It still retains energy, inclusive of water for power purposes. So they are left with the energy factor—oil, gas, water; all the mineral items and other resource developments, as such. It was only one section that was transferred, just the water branch, relevant to water purity, screening and that sort of thing.

Senator Phillips: You mentioned the water branch. I believe it is being located in Hull at the present time. This has created some problems in regard to the pension funds. I have received a number of inquiries, and probably you could clarify this for me. I understand the employee transferred to Hull now contributes to the Quebec Pension Plan rather than the Canada Pension Plan. How are his benefits transferred back?

Mr. MacDonald: Mr. Chairman, there is an agreement between the Canada Pension Plan and the Quebec Pension Plan for complete transferability of benefits. There is an interchange of records between their computer systems. Where a person has at any time been a contributor to the two plans, both keep concurrent records. When he retires, it depends on his residence as to where he does receive his benefit, and it is a consolidated benefit.

Senator Phillips: The employee still has all his benefits?

Mr. MacDonald: Yes, senator.

Senator Phillips: Thank you.

Senator Buckwold: On page 62, referring to the Grains Program, there is an item of $2,660,000 for interest payments on items provided for in the Estimates. Does that, in fact, represent interest paid on money withheld, that is, late payments, while the Grain Income Stabilization Bill was on the floor of the House of Commons?

Mr. Osbaldeston: Yes, senator.

Senator Buckwold: So that, in fact, every farmer has been paid, or will be paid interest on the money that would have been paid to him under the original act.

Mr. Osbaldeston: Actually, the money due under the Temporary Wheat Reserces Act is paid to the Canadian Wheat Board. The Canadian Wheat Board does not immediately pay these funds to the farmer, but rather waits until the pool is closed, which may be some time in the future. Therefore, it is true to say that the total amount flowing into the pool for eventual payment to farmers is increased by this amount of interest, and it does compensate the wheat pool, the Canadian Wheat Board and, thereby, the farmer for the fact that these moneys were not paid on the anticipated date.

Mr. Buckwold: What date was anticipated?

Mr. Osbaldeston: Well, the procedure is that the wheat in storage is estimated as of August 1, I believe. On the basis of the wheat in storage—at that time over 178 million bushels—the Government calculates the storage charges. That is, as I understand it, usually not fully determined until about September or October. Once it has been determined, the act states that the payments shall be made in equal monthly instalments. So, as I indicated to you, it is administratively not possible to begin payments on August 1 because you do not have all the detail on the wheat in storage; but as soon as it is determined in September or October, the payments begin to go out in equal monthly instalments.

Senator Sparrow: Under what authority can they pay that interest? There is nothing in the Temporary Wheat Reserves Act to permit the payment of interest for overdue accounts.

Mr. Osbaldeston: The payment is paid out of the Vote 5 contingency fund of the Treasury Board, which provides for payment of unforeseen expenditures. Here we seek to recoup Vote 5 of the Treasury Board for the funds expended for this purpose. In other words, with the exception of paylist items, salaries, when we use money out of Vote 5 for unforeseen contingencies, we come back to Parliament and through this device the Department of Industry, Trade and Commerce seeks the $2.6 million already paid out of Vote 5. They seek the authority for that payment here to reimburse us, the Treasury Board Vote 5. We have the original authority because we have the authority to pay for unforeseen emergencies which arise and must be funded in between the submissions of estimates to Parliament.

Senator Sparrow: I am not critical of the amount being paid, because I do believe it is going to a good cause, but on what basis would the Treasury Board determine that in fact this was an amount owing? After all, there is no statutory provision to pay that.

Mr. Osbaldeston: Given that the amounts were to have been paid in equal monthly instalments, and given the interest that would have been available to the Canadian Wheat Board had these payments been made on the date contemplated, one can develop, therefore, if I can describe it this way, the amount of money owing to the farmers for the fact that the payments were not made in equal monthly instalments on the date intended.

Senator Sparrow: That is very loose.

Senator Hays: With respect to the farmers receiving their amounts, when did the delinquency start?

Mr. Osbaldeston: The payments that were made related in large measure, as I recall it, Senator, to the crop year 1969-70 and partially to the crop year 1970-71. The reason for the delay is that the accounts do not close on the pools,

as you well know, so that the payments are related to those two periods.

Senator Hays: At what date would the delinquency in payment have been made? Because it was a year previous, would it not have been in June?

Mr. Osbaldeston: The delinquency began on August 1, 1970, relative to the payments.

Senator Hays: This $2.6 million picks up this slack. Were the delinquent payments not somewhere in June, at which time the farmers would ordinarily have received their payments, whereas they did not receive them until some time in October? Will the farmer be receiving interest on this? That, I think, is the question that was being raised.

Mr. Osbaldeston: The distinction I was trying to make is whether the Government pays to the farmer or pays to the Canadian Wheat Board. Indeed, it pays to the Canadian Wheat Board, and, as senators well realize, the Canadian Wheat Board then deducts all of its operating expenses and it pays for its storage, et cetera. An amount is left over. First, the initial payment is made; and then the final payment is made. Now, when does the amount that the Government pays to the Wheat Board really get to the farmer? I think it depends on how you look at it. It could comprise part of the first payment, if one wanted to look at it that way, or it could make up part of the final payment. It depends on how you look at it. I would suggest to you that it affects the amount of the final payment. If the Government's payment is high, the final payment is higher and if the Government's payment is low, the final payment is lower.

Senator Buckwold: You have determined that interest is paid on the amounts that were not paid when they should have been paid. The bill did not pass the house; it was withdrawn. On the supposition that the bill had passed the house, would the farmers have collected that interest as well?

Mr. Osbaldeston: No. The bill called for the termination of the Temporary Wheat Reserves Act as of July 31, 1970. Therefore, no obligation would have been incurred by the Government if that bill had been passed.

Senator Buckwold: It would have been made up by higher payments?

Mr. Osbaldeston: It would have been made up by a new program which also contemplated an expenditure of $100 million in transitional payments.

Senator Hays: In respect of Senator Grosart's last question in which he was asking for the total amount of interest that is necessary to service the debt, am I correct that it would not be very difficult to give us the total amount of the interest for each year during the 1960s that it took to service the debt? Can we receive this information?

Mr. MacDonald: We can draw that information from the Public Accounts.

The Chairman: Honourable senators, if there are not further questions, shall I report the Supplementary Estimates (A)?

Senator Hays: I so move.

The Chairman: Do you wish to leave the formation of the report in your Chairman's hands?

Hon. Senators: Agreed.

The Chairman: On your behalf, honourable senators, I should like to thank both Mr. Osbaldeston and Mr. MacDonald for their assistance. I would comment on the incredible range of knowledge that these gentlemen have displayed in the examination of a subject that covers almost every aspect of Government activity. It is very rare, if ever, that they are stuck for an answer. Thank you very much.

Mr. Osbaldeston: Thank you very much, Mr. Chairman.

The committee adjourned.

APPENDIX "A"

TREASURY BOARD—CANADA

Ottawa, Ontario
K1A 0R5

July 16, 1971.

Senator D. D. Everett,
The Senate,
Room 572-S,
K1A 0A4,
Ottawa, Ontario.

Dear Senator Everett:

When Treasury Board officials appeared before the Senate Committee on National Finance relative to Main Estimates 1971-72, two questions went unanswered. One concerned the distribution of expenditures by province under the bilingualism development program and the other deposits on certain air travel credit cards. Both were raised by Senator Hays and accordingly I am sending him a copy of this letter and its enclosures.

Yours sincerely,

Bruce A. MacDonald,
Director General,
Budget Coordination.

Encl.

c.c. Senator Hays

RESPONSE TO REQUEST FOR INFORMATION

SENATE NATIONAL FINANCE COMMITTEE

(Raised when 1971-72 Main Estimates were under review)

SUBJECT: (Page 18A15 of the proceedings for June 9, 1971)

Distribution by provinces of expenditures under the bilingualism development program.

Answer

According to information received from the Department of the Secretary of State, the final determination of the distribution by provinces of the 1971-72 funds has yet to be made. However, the distribution for the fifteen month period, January 1970 to March 1971 is known and is shown below.

BILINGUALISM DEVELOPMENT

CONTRIBUTIONS IN RESPECT OF PROGRAMS RELATING TO BILINGUALISM IN AREAS OF PROVINCIAL COMPETENCE

	1970-71 (15 month period)
	Actual
Newfoundland	123,000
Prince Edward Island	101,000
Nova Scotia	734,000
New Brunswick	3,695,000
Quebec	29,987,000
Ontario	14,262,000
Manitoba	800,000
Saskatchewan	597,000
Alberta	865,000
British Columbia	884,000
Autres couts	
	52,048,000

SUBJECT:

Deposits on Air Canada Travel Cards (Page 18A15 of the proceedings for June 9, 1971)

Answer

It is necessary to differentiate between the normal Air Canada/CN credit cards used by individuals and the Universal Air credit cards used by corporations.

There are approximately 142,000 Air Canada/CN credit cards in use. No deposit is required on these cards.

Air Canada has in addition approximately 5500 accounts for the Universal Air credit card. These are almost exclusively with corporations and each corporation may demand as many credit cards as it wishes against its account. For example, Bell Canada has one account and approximately 500 cards are issued against it. For each Universal Air credit card account a deposit of $425 US is required, which is the same figure that is used by other air lines throughout the world. Some of the accounts are dormant but Air Canada has on deposit from Universal Air credit card customers approximately $2 million. Each contract calls for the account to be settled within ten days after the invoice. In practice, it requires 44 days for accounts to be paid. At any one time, Air Canada has outstanding accounts of approximately $10 million with its Universal Air credit card customers. Air Canada allows no interest on the deposit since, in general, the corporations owe Air Canada far more than the amount of the deposit.

CP Air does not use the Universal Air credit card system. Several American air lines, such as AA, EAL, UAL, etc., which operate in Canada, use the system which is good on 115 air lines throughout the world.

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Third Session—Twenty-eighth Parliament

1970-1971

THE SENATE OF CANADA

STANDING SENATE COMMITTEE

ON

NATIONAL FINANCE

The Honourable DOUGLAS D. EVERETT, *Chairman*

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OF PROCEEDINGS

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