External Affairs Canada   Affaires extérieures Canada

Statements and Speeches

No. 75/10

THE ECONOMIC SITUATION

Statement by the Minister of Finance, the Honourable John N. Turner, at the opening in Ottawa on April 9, 1975, of the Conference of First Ministers.

In the last few months, several important developments in the world economic situation have taken place.

First and foremost, the recession in the industrial countries has become more widespread and more serious than had been expected. There has been a veritable parade of revised forecasts, each one predicting lower levels of activity than its predecessor. It is still expected that a recovery will set in during the second half of this year. But the earlier optimism that this recovery would develop into a vigorous expansion in 1976 has been replaced by the general expectation that the OECD (Organization for Economic Co-operation and Development) countries are likely to continue to experience a substantial degree of slack through 1976.

Secondly, with the recession of activity some decline in commodity prices has set in, and the prospects for moderation of price increases have improved. These prospects vary from country to country depending upon the course of domestic cost-determining factors. Indeed, in some of the OECD countries the forces of inflation emanating from domestic cost developments have become more virulent in recent months.

Thirdly, the recession, the break in the acceleration of prices and deliberate policy measures have all combined to produce a lower level of interest-rates around the industrial world.

Finally, while the balance-of-payments deficits of the oil-importing countries burgeoned much as had been expected, it would probably be fair to say that concern over the great oil-deficit problem is somewhat less now than it was some months ago, though it properly remains high. The moderating of concern emanates from three facts: the oil-exporting countries have shown a higher propensity to import goods and services than had been expected; oil imports by consuming countries levelled off dramatically and the international price of oil ceased to rise, so that there are some signs of an oversupply in the international markets; and, finally, the recycling of oil funds has proceeded with considerable smoothness as official bodies and the private markets have both operated effectively.

I am planning to visit several of the oil-producing countries in the Middle East later this month to discuss international economic problems with their economic and financial leaders. I do not believe in the economics of confrontation and I believe it is important that the industrial world develop its relations with these countries, which have a major role to play in the smooth functioning of the international monetary system, in the adjustment of payments balances and in the flow of aid to poorer countries. On my way, I expect to call on the Minister of Finance of France and the Chancellor of the Exchequer in Britain for further consultations on the world economic and financial prospects. Of course, I have frequent contact with the Secretary of the Treasury of the United States.

The changes in the world economic situation have affected Canada's performance and prospects and we have developed some trouble of our own.

The slowing-down of the industrial economies has adversely affecte[d] our own economic performance, although the slowdown in Canada has not reached the proportions that it has in the United States. Real gross national product (GNP) fell 2.2 per cent in 1974 in the United States; in Canada it rose 3.7 per cent. Last year the United States had four successive quarters of declining real output; in Canada, growth ceased after the first quarter of last year, was zero for the next two quarters and declined only in the fourth quarter.

The real demand for Canadian exports decreased last year. After the middle of the year, housing starts fell off rapidly. By the fourth quarter, the slowdown had spread in varying degrees to all the main categories of real domestic demand, with the exception of business investment. We were also plagued last year with serio[us] loss of output owing to work stoppages arising from industrial disputes.

The current account of our balance of payments deteriorated by nearly $1.5 billion last year. The surplus on trade account alone declined by some $1.25 billion. The deterioration of the trade account was even larger in constant dollar terms, since the prices of our exports rose much more rapidly than those of our imports.

Employment grew strongly through most of last year. The unemployment rate first fell but then stabilized in mid-year. Towards the end of the year the decreases in output began to affect the growt[h] of employment and the unemployment rate moved up.

Increases in prices in Canada in 1974 were a good deal larger tha[n] in the previous year and prices of final goods and services accelerated through most of the year. Although world commodity prices decreased in the second half, the impact of these decreases on final-goods prices in Canada only began to appear at year-end. World oil prices increased tremendously in 1974 and the increases were large in Canada, even though our policies cushioned the impact of the world changes. Increases in most farm-gate and imported food prices continued in 1974 at very high levels, reflecting particularly the disappointing 1974 harvests in North America and elsewhere. The dominant factor in the change in Canada's price experience in 1974, however, was the rapid increase in domestic costs, reflecting sharp increases in the prices of labour and other "inputs", as well as the poor productivity performance associated with the flattening, and later decline, in output.

Up to the end of the third quarter, both wages and profits per unit of real output continued up strongly. But in the fourth quarter the situation changed. Profits per unit of output tumbled by 6.7 per cent. Wages and salaries per unit of output, on the other hand, continued to advance. To my mind, this continued surge of wages and salaries and the sagging of profits epitomize the problems of the Canadian economy in the period ahead.

Let me be a little more specific on this question. If one considers the data on wage settlements, one is struck by the fact that, whereas in the early 1970s the increases in our settlements were, on the average, below those of the United States, for the last three years the increases in our settlements have been higher. The margin is now very wide. Indeed, the increases in settlements for the first year of new contracts, at about 20 per cent, are roughly twice the size of those in the United States. The increases in average hourly earnings are also now running about twice those of the United States. Our increases in labour costs per unit of output for the economy as a whole are not only high (17.3 per cent in the fourth quarter last year) but in the latter part of last year began to run very much ahead of those in the United States. In the manufacturing industries, our absolute levels of average hourly earnings pulled above those in the United States in the course of last year, and are rising much more rapidly than in the United States. In the non-manufacturing industries, increases in wage settlements tend to run even higher than in the manufacturing industries. Settlements for government employees, for teachers and for other service employees exert an upward pull on settlements in the goods-producing industries. These stark facts should warn us of the danger we face of a very serious loss of competitive position that threatens our export industries and our domestic import-competing industries.

Looking ahead, the prospects for the U.S. economy are, of course, of particular concern to us. The policy position in the United States has been unclear and even yet leaves some important questions unanswered. Monetary policy has been eased -- certainly interest-rates came down quite sharply, though there has recently been some reversal of that decline. A more stimulative fiscal package has now been patched together by the Congress and the Administration. The extent of the expenditure side of that package is not yet evident, however. Most observers expect the rate of growth of output in the United States to pick up in the second half of this year, but, even so, there will be a substantial decline in real output this year. Unemployment will remain high. A characteristic of the U.S. recession has been a substantial working-down of inventories. The rebuilding of inventories will be a feature of their recovery. The more difficult question to assess is the strength of fixed-capital investment in the U.S. recovery. The general view now is that capital investment, including housing, will strengthen and add force to the recovery, especially in 1976, but that, in spite of this fact, output will still be well below potential at the end of 1976. The pick-up of employment and the decline in unemployment will be sluggish, because a renewal of expansion is typically characterized at the beginning by an increase of productivity rather more than of employment. Accordingly, unemployment rates will remain high in 1976. Rates of price increase may well fall appreciably in the United States over the next two years. This will be the more likely if the United States manages to continue to keep its domestic cost increases within reasonable bonds.

For Canada, our problem will be to turn the economy around and to achieve a recovery of real growth. To do this, we shall have to achieve some moderation of the inflation. A good response to our quest for a national consensus on price and incomes, about which I shall speak later, would be of great benefit to the Canadian economy in terms of prices, growth and employment.

Canada was among the first of the industrial countries to adjust its policies in response to the softening of the economy. The stimulus that we provided in the November Budget and that derived from the adjustment of monetary policy last fall is at work in the economy now. The automatic stabilizers, such as higher Unemployment Insurance Commission payments and lower tax receipts brought into play by the decline of activity and of profits, are also having their cushioning effects.

As of this moment, without making any allowance for new policy initiatives, it seems unlikely that, on average, our national production this year will be appreciably higher than last year.

From the evidence at hand, it appears that we have had a decline in production in the first quarter and we may have a further decline in the second. We anticipate some turn-around in the second half, but we think the recovery in the second half and into 1976 may be sporadic and sluggish.

Exports will not pick up until the U.S. economy gets into its recovery phase. We may well find, however, as I have suggested, that the rise in our costs will restrain the recovery of our exports and give trouble to our import-competing industries as well. We are anticipating that the deficit in the current account of our balance of payments will increase substantially in 1975. The terms of trade that have been moving in our favour will move against us as the prices of the goods we export rise less rapidly than the prices of the goods we import.

The financing of the current-account deficit will require the net import of a substantial amount of capital. Last year our net capital imports were just under $2 billion. This year we shall probably require an inflow of significantly more than twice that amount. As you know, I recently withdrew the request to Canadian borrowers to explore fully the availability of funds in the Canadian capital market before floating issues outside of Canada. Parliament has also approved an extension of the exemption from withholding tax of interest on government bonds. The exemption will now apply to government securities issued before 1979. I should like to take this occasion to remove any confusion that may exist as to the policy of the Government of Canada regarding the foreign sources from which Canadian borrowers may seek to obtain capital. It is the policy of the Government not to express any preference among the foreign sources of capital flowing to this country.

The current-account deficit and the associated import of capital means that we shall be making a larger net drawing of real goods and services from the rest of the world. I recognize that a higher Canadian deficit is helpful in the broad picture of the adjustment of world payments balances. I should prefer, of course, if the net increase in our use of foreign goods and services were also a net increase in supply flowing onto Canadian markets and not just a substitution of foreign supply for domestic. Our inflation problem would be relieved by a net increase in supply available on our markets. Our employment problem would be relieved if the foreign-source supply did not replace domestic output.

If we can keep our capital-investment programs rolling ahead, we shall have better success in taking full advantage of the higher net inflow of goods and money. Capital investment will improve our own productivity and help to maintain our competitiveness. At the present time, business fixed investment remains relative strong, and, indeed, is the main support of the economy. But I am not unmindful of the threats to the investment program posed by falling profits and softer demand in other sectors of the economy.

I believe that national production will start growing again lat this year, as I have said. But I have to acknowledge that histo tells us that employment gains are likely to be modest in the first part of the period of renewed growth. The initial phases of expansion are almost always characterized more by a step-up of productivity than of employment.

The outlook for prices is very difficult to gauge, even on the assumption of reasonably good crops. One has to weigh the effe of the higher wage costs against the downward tendency of many commodity prices and the likelihood of a general decline in the rate of increase of prices in the United States, where domestic cost pressures are much less severe.

It is because our own cost situation is now so dangerous, beca inflation is itself so damaging to our own national production and because the fact of inflation limits one in the choice of measures to counter the slowdown of activity that I attach grea importance to the effort we are making to achieve a national consensus on the necessity of exercising restraint on the increases of prices and incomes in the Canadian economy.

If we all persist in trying to gain at the expense of others, cost in terms of human welfare will be great, and greatest for the weakest.

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