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SOME NORTH AMERICAN ECONOMIC PROBLEMS - A CANADIAN VIEW

Text of an Address by the Honourable Mitchell Sharp,
Minister of Finance, to the Canadian Society of
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...I was born and educated in the city of Winnipeg, in Manitoba. The staple intellectual diet of our family was a great newspaper - the Winnipeg Free Press. It was edited by a man who became the mentor and indeed the intellectual hero of many Western Canadians of my generation - John Dafoe. One of his several books was entitled, Canada - An American Nation. From Dafoe I learned one of the facts of Canadian life: that we are a North American nation, shaped by many of the same influences that have shaped the two other nations with which we share this continent. We value greatly our special heritage from the other side of the Atlantic, but we also have to be ready to look at the world from a North American point of view. It is from that vantage that I speak tonight.

I shall talk about three areas of economic policy facing us in North America.

The first is: How are we to continue the attack on barriers to international trade over, let us say, the next decade and how should we deal with other issues of commercial policy? I want to consider, in particular, what ought to be our strategy for trade policy after the "Kennedy round" has been brought to a conclusion next spring.

Second, I shall talk briefly about the problem of financing the growth of world trade.

Finally, I shall say a little about our common problem of managing and prolonging our North American prosperity.

First then, trade policy. I begin by saying that trade policy means a good deal more than tariff policy. For example, tariffs have very little to do with trade in agricultural products. Quotas, production subventions, and economic aid are much more important to the movement of agricultural products between countries than are conventional tariff barriers.

Nor have European countries or our own two countries depended upon tariffs to limit the impact of imports of certain manufactured products from new sources at highly competitive prices. This is the problem of "low-cost" or "disruptive" imports, which is being dealt with either by import quotas imposed by importing countries or export quotas negotiated with the governments of exporting countries.

A third example of commercial policy problems of our time that has little to do with conventional tariffs is how to trade with those economies of Eastern Europe and Asia in which exporters and importers are branches of the state.

Moreover, I am inclined to suspect that in the great modern market entities, such as the United States and the European Economic Community, the tariff plays a relatively small role in the shaping of the economy, or in the solving of real trading problems. In these big mature economies it is much more a taxing device.

But what about the role of protective tariffs in the smaller economies, such as, say, Canada and Australia? These countries have small national markets with industries which have been stimulated over the years by protective tariff systems. In such countries the tariff has a more decisive impact on the industrial structure and the allocation of resources.

In Canada, for example, our population is too small to provide large enough home markets to support the optimum scale of production for quite a wide range of manufactured products. At the same time, many of our potential export markets are fenced off by protective tariffs, so that we are often denied the foreign sales that for us, as distinct from the United States or the Common Market countries, we must have to manufacture competitively.

Canada has been a member and firm supporter of the General Agreement on Tariffs and Trade since its foundation. A nation so dependent on foreign trade must try to ensure that world trade is conducted on as wide and as free a basis as possible. It is easy enough to state this general orientation. The real problem is how to continue to move in this direction in a realistic manner. I believe it is important that in the "Kennedy round", and in future trade negotiations, we ensure that the particular problems of the smaller economies are adequately taken into account. This is an objective we should share in common. Canada is still the United States' largest market. Our mutual interest lies in finding methods of freeing trade in which Canada can participate enthusiastically - methods which fit Canada's circumstances.

In devising our approach to tariff negotiations, we have always shied away from any simple mathematical formula. We adopted a more selective approach to the "Kennedy round" than the United States did, and I expect we shall continue to favour the selective approach to tariff cutting in the future simply because this enables us to participate more effectively in negotiations.

What I mean by this is that we are bound to look for those opportunities where a significant tariff adjustment in the markets of the great economic entities would provide us with the opportunity to move out of the confines of our small national markets and produce and sell on the same continental or intercontinental scale as do the industries of the United States and the European Community.

The Canada-United States Automotive Products Agreement was one essay in such a policy. We realized that to improve the efficiency of our industry we had to make a smaller range of car parts and a smaller range of vehicles. This could only be done if we had free entry to a mass market; for these products and for this industry, this meant the market of the United States. At the same time, we were prepared to provide free entry in our market - albeit with some conditions and limitations for an initial period.

The Automotive Products Agreement is working well from the point of view of both our countries, and I am satisfied that it has done no harm to the trade of any other country. It is a striking example of what can be achieved by a realistic selective approach to trade policy.

It is, I think, most important to understand two points. First, that the form of the automotive agreement - by which I mean the conditions we attached to free entry in Canada, and the understandings reached with each company - was peculiar to this industry. For other products, other arrangements. Second - for this industry it was free entry into the market of the United States which was essential for Canada. For other products, free entry elsewhere may be equally important.

Let me take an example. One broad sector for which there is obvious scope for a greater international division of labour is forest products - lumber, wood products, pulp and paper. But the great expansion of markets for these products will not be confined to North America. Much of it will be in Europe and Japan. A purely bilateral trade arrangement between Canada and the United States in this sector would be second best to a tariff arrangement involving all the industrial countries of the free world. Canada and the United States would both gain much more from a multilateral than from a bilateral arrangement.

Let me give another example. I believe that for all industrialized economies it would make a great deal of sense to provide for the free movement of basic materials - for example, nickel, aluminum, lead and zinc, and a variety of chemicals. I should like to see all the free world move to free trade in these products in a concerted fashion. We should all gain.

What does all this mean for future trade policy? It means, I believe, that legislatures must be bold and must be prepared to back up their governments in negotiations, not just to reduce tariffs by formulae but to eliminate them where that is a part of a sensible pattern.

I should not wish the remarks I have just made about possible trade policies for the future to imply any lack of Canadian support for the "Kennedy round" of trade negotiations. Canada is participating actively in these negotiations and I am still confident that they will be substantially successful. But it is not too early to look ahead to the next stage of the continuing campaign for freer trade.

We must also recognize the potential importance for world trade of the state-trading economies of the Far East and of Eastern Europe. Mainland China, the U.S.S.R. and the Communist countries of Eastern Europe are becoming increasingly significant as traders. Certainly they are important customers for us in Canada. In our experience, the markets of the state-trading countries are difficult to cultivate. Often their willingness to buy is limited by the preoccupation of the governments of these countries with achieving bilateral balances with their individual trading partners in the West, as well as by their shortage of foreign exchange. In Eastern Europe, competition from traditional suppliers in the West - from Britain, France and Germany - is a powerful factor. These countries have been trading with Eastern Europe for many years. They know the markets; they are in a position to give effective after-sales service for their sales of capital equipment, and they are not hesitant about extending fairly generous credit facilities in order to make sales.

In cultivating these markets, much will depend on the initiative and imagination of our businessmen and financial institutions in developing trade with these countries. Recently there have been signs of a greater readiness, on the part of some of these countries, to pursue more independent trading policies and even to restore or create, at least to some degree, some features of the market economy. I believe we should stand ready to help them trade with the free world economies, if they wish to do so.

I turn now to the trade problem of the developing countries. The ending of colonial rule and the emergence of new nations in the less-developed parts of the world has raised acute problems for the continuance of the non-discriminatory multilateral trading system as embodied in the GATT. In the United Nations Conference on Trade and Development, these countries have pressed for special tariff preferences in our markets. They believe these new preferences would help them sell their manufactured products in greater volume and at higher prices. They have also pressed for international agreements to increase and to stabilize their earnings from primary products.

On the basis of our Canadian experience, I am inclined to doubt that new preferential tariff systems would be of much assistance to developing countries. On the other hand, I doubt that, if all of us scrapped our protective tariffs on goods imported from the developing countries, there would be many very serious problems of adjustment for our own industries. The real difficulty facing most of the developing countries is that their industries, by and large, are simply not efficient enough.

I find singularly unattractive the schemes now being elaborated in certain quarters in Europe for a system of tariff preferences for the developing countries limited and confined by import quotas and licensing schemes. If we must give preferences to the developing world (and I remain convinced that they would be helped very little if we did), then I don't see much to be said for attaching all sorts of conditions to such preferences and creating a vast new bureaucratic apparatus to regulate preferential entry to our markets. Such a development would be welcomed only by the protectionists among us.

There is a danger that the failure to find satisfactory solutions to the trading problems of the developing countries on a multilateral basis may result in a series of increasingly anarchic preferential arrangements between the metropolitan powers and their former colonial territories, and the establishment within the world of more clearly defined and antagonistic spheres of economic influence. This would have dangerous implications for international political relationships. I suggest, therefore, that the nations of the Northern Hemisphere are going to have to give more attention to the trading problems of the less-developed countries than we have so far.

Indeed, if all of us put as much effort into that as we devote to restraining their textile exports, we might achieve a good deal! Specifically, I should suggest we begin by making a renewed attempt to work out sensible agreements covering trade in sugar and in cocoa. Then, we ought to scrap all tariffs on "so-called" tropical products. The United States Government has authority to negotiate free entry into the United States for a wide range of these products. We in Canada are certainly prepared to do as much. Together we should press our European friends to be a bit bolder and more imaginative.

Further advance in the trade field must be accompanied by progress in improving the international payments system. There is not much point in pressing ahead with the removal of barriers to trade if the world financial system is not capable of supporting the increased volume of trade we hope to achieve, and of meeting the balance-of-payments problems that many countries face from time to time.

The present payments system came into being in the brave years of the mid-forties. With the chaos and confusion of the depression and war years still fresh in their minds, the governments of that period constructed a new system based on internationally-agreed exchange rates, linked in value to gold, with reserves held in the form of gold and reserve currencies, supplemented by conditional credits. The administration of this new international system was entrusted to a new institution, the International Monetary Fund. This system has served us well in the whole post-war period. The Fund as an institution has won for itself a vital role in the development and management of the international payments system.

But in recent years it has become increasingly apparent that some improvements are required. In particular, it has been recognized that the growth of reserves in the form of gold and reserve currencies will probably be insufficient to satisfy the growing needs. This is not because either gold or reserve currencies are unacceptable as a form of reserves. For Canada, U.S. dollars are quite satisfactory and we have been converting some of our gold into dollars during the past year. The problem is essentially one of the total quantity available for all countries. Most countries would prefer to have these needs met by increases in the reserves they actually own rather than by increased access to lines of credit such as the Fund provides.

For the past two or three years continuous efforts have been made to develop a new form of international reserve asset to supplement gold and reserve currencies. We have sought methods of defining the form and of controlling the quantity and use of this new asset so as to avoid building either an inflationary or a deflationary bias into the system.

Many experts have worked on these problems in recent years and much has been written. They have helped considerably to clarify the issues. They have certainly proved that it would be technically feasible to create a new asset and to control its supply. But governments still have not reached agreement on a mutually-acceptable scheme. We in Canada are becoming increasingly impatient over this failure to reach agreement.

The international payments system has been subjected to severe strains in recent years as a result of pressures on the major reserve currencies. So far, these strains have been successfully met through the close co-operation of the monetary authorities and the IMF. But these have been essentially ad hoc measures. Their success has been due to the ability of the authorities to convince the international financial community that the management of the international system was in firm, competent hands. The longer governments take to settle their differences on basic improvements in the system, the more they leave the burden of short-term financing and adjustment to ad hoc arrangements.

Why have countries been unable to reach agreement on these vital questions? Differences over basic political objectives have quite clearly been a contributing factor. But they do not provide the whole answer. There is a genuine concern in Europe that the collective ability to create new international liquidity would constitute a temptation to many countries to postpone or evade actions that are needed to run their own economies properly.

We in North America tend to criticize Europeans for adhering to policies and arrangements which make it harder for us and for the less-developed countries to correct our balance-of-payments deficits. Many Europeans, on the other hand, believe that the English-speaking countries - and they include Canada in that category - have a basic inflationary bias and would press for the creation of excessive amounts of international liquidity in order to cover continuing balance-of-payments deficits that should be eliminated or financed on a long-term basis.

Despite these differences over the creation of new reserves, we have in recent years made progress in the Organization for Economic Co-operation and Development and in the Monetary Fund towards a better understanding of the means by which deficits or surpluses in international payments can and should be adjusted. The system of surveillance of each other's economic policies and balance-of-payments positions is laying the basis for further advances in this area.

I come now to the third matter I wish to mention - prolonging and managing prosperity.

During the 30 years since the depths of the depression, we have come to understand much better the workings of our North American economy. Economists have produced much better methods of analysis for us. Statisticians have produced more and better statistics, and should produce even more and bring them out more quickly. Informed and serious economic forecasting has become common in business as well as in government. Politicians have learned much more about economics - even if they do not always reveal it or apply it. Public opinion has accepted

the need for a much more sophisticated approach to government budgets, in terms of their effects upon the economy. We all - or nearly all - have come to recognize the need for competent and strong central banks, by which we are now so well served.

It is, I think, largely as a result of the culmination of such developments that we have been able to achieve in North America - and in Europe with some variations - the long period of economic expansion since early 1961. It has brought us to a level of production and prosperity the like of which has never been seen before. Certainly, we have our economic problems still - balance-of-payments problems, problems of unemployment arising from a lack of fit between our labour forces and the demands of our markets, problems of productivity for us in Canada in trying to keep up with the fast pace you set here in the States. But we are fortunate to be able to approach these persistent problems in the context of a high level of demand and production.

We face, however, two major problems which arise from the very success we have had in getting where we are. They are interrelated. The first is to prolong our prosperity - to make a successful transition from very rapid expansion to steady growth without bringing about a recession. This seems to us in Canada to require much more difficult judgements and more careful management of the total of expenditures than did the initiation and continuation of our expansion during the past half dozen years. In recent years, we have all been increasingly apprehensive that our abnormally long period of uninterrupted expansion would come to an abrupt end. Now we find the outlook for 1967, particularly in regard to business capital expenditures, very difficult to assess with confidence. Last spring, in Canada, we tried by budget measures, as well as by credit policy, to exercise a moderating influence on the rapid expansion of business investment without reversing it. Our efforts appear to have succeeded. We also restrained the expansion in consumer expenditure by reversing the income tax cut we had introduced in April 1965.

At present, in Canada, we are having to plan further fiscal action to counteract the effects of a number of decisions made to increase public expenditures, and to maintain an overall budget position appropriate to the economic situation.

Both you and we have federal systems which complicate our public finances and make it more difficult to obtain a correct and timely overall fiscal policy. In Canada, these federal-provincial considerations are highly important and highly controversial. Our provinces and municipalities are responsible for many of the functions of government - education, health, highways, urban development, for example - which require rapidly-increasing expenditures to keep up with our rapidly-growing population and labour force. Naturally, they find the Federal Government, which has its own responsibilities, a serious competitor for revenues. We meet frequently with provincial representatives to discuss these issues in order to co-ordinate our fiscal policies and actions. We are making progress. We have recently, for example, worked out much-improved arrangements for the Federal Government to equalize and stabilize the revenues of the provincial governments, which will further enable them to meet their responsibilities and

harmonize their actions with ours in Ottawa. All of us value highly the opportunities our provinces and municipalities have had to borrow here in New York, and we wish to conduct our affairs in such ways as will merit a continuation of the confidence of your investors.

Our second problem in managing our prosperity - indeed our most serious problem in Canada, as no doubt it is here - is to avoid inflation while we are striving to maintain a steady growth. Our economies, our societies, have not yet learned to live with prosperity. Once we achieve a high level of production and employment, there is a well-nigh universal demand for too much too soon. At such times, many of the groups in our society have strong bargaining powers, which must be used with moderation if we are to avoid serious increases in costs, in prices, in public expenditures and taxes. This presents problems to all of us - business, labour, consumers and government. They are problems both in economics and in politics.

We in Canada are grappling seriously now with this central problem. It requires understanding and action on the part of many. We have been impressed with the degree of success which you in the United States have had in recent years in achieving prosperity without inflation. We aim to do as well, even though our problems and our methods may not be the same.

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