REMARKS OF LOUIS RASMINSKY
GOVERNOR OF THE BANK OF CANADA
BEFORE A MEETING OF THE REGINA CHAMBER OF COMMERCE
OCTOBER 21ST, 1970

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After I had accepted the invitation to speak at this dinner, about six months ago, I found myself searching my mind for something cheerful I could say about the immediate economic outlook of this great grain-growing region. Fortunately, time has made my task easier. As you know better than I, there has in recent months been an encouraging improvement in the grain marketing situation, primarily as a result of poor crops elsewhere -- it's an ill wind that blows nobody good! The level of exports and the near-term outlook for sales of wheat and other grains are now appreciably better than anyone would have dared to hope a short time ago, though I am well aware that this part of the country continues to face important problems. The decline in wheat prices has caused a very substantial loss of income and the sharp cutback in production this year has inevitably affected most sectors of the Prairie economy. On top of this you have had an unfavourable market for potash as well. In spite of the impressive diversification of your economy through the shift into rapeseed, coarse grains and in other ways, the state of the world wheat and potash markets could not fail to have a severe effect on your economy. To give but one illustration, in the first eight months of this year retail sales in this province were more than 7 per cent lower than in the same period two years ago, while for Canada as a whole they were about 10 per cent higher. This has certainly been a worrying situation, but there are already distinct signs of an upturn in retail sales, and in view of the underlying

long-term strength of the world demand for Saskatchewan's principal products I have no doubt in my mind that this province has a bright economic future.

Unfortunately the difficulties in respect of wheat and potash, which are of external origin, developed at a time when the over-riding need to deal firmly with persistent inflationary tendencies led to a general slowing of domestic economic activity and rising unemployment in the country as a whole. This combination of events emphasizes one of the greatest difficulties we have in formulating good economic policy in Canada. Policies which are widely accepted as appropriate for the country as a whole may still seem ill-adapted to the circumstances of particular regions that are subject to special conditions or confronted with problems of foreign markets. On the other hand, I do not think it can be denied that you in Saskatchewan suffer at least as much as the rest of the country from the pernicious effects of inflation. The rising prices of the goods you must buy in other parts of the country become even more burdensome when your incomes are less buoyant than elsewhere. It is, therefore, at least as much in your interests as in those of other Canadians that inflation be brought to an end.

But the disparity in economic circumstances remains, and I greatly wish that it were possible for me, as a central banker, to devise ways in which we could be more directly helpful in mitigating the unpleasant side-effects of anti-inflationary policies on the less prosperous regions of the country. We have encouraged the chartered banks to take a tender view of applications for credit from parts of the country whose economic position

is particularly unsatisfactory. However, it has to be recognized that in a country with one currency and a single capital market you simply cannot have a basic monetary policy for one part of the country which is different from the policy applied in other parts. Even if one could somehow contrive to make credit in general cheaper in one part of the country than another, capital would inevitably flow to the places where it got the highest return, and nothing of value would be accomplished for the less prosperous regions, which would find it even more difficult to raise their capital requirements.

One thing that the central bank can do, however, in framing its over-all monetary policy, is to take into account the circumstances in all parts of the country and not only the highly developed industrial areas. I assure you that we do this and you can be certain that the Saskatchewan director on our Board, who is here tonight, loses no opportunity to bring forcefully to our attention the special conditions that confront you in this part of the country.

One of the major longer-term economic problems facing you is to adapt farm production to the changing needs of the world market. I suppose that none of our provinces is more dependent on the maintenance of a healthy international trading environment than Saskatchewan. For this reason, I thought that it would be appropriate, in speaking in Regina,

to focus my remarks to a considerable extent on the last Annual Meetings in Copenhagen of the International Monetary Fund and the World Bank from which I have recently returned.

I propose to talk chiefly about the Annual Meeting of the International Monetary Fund, not because this institution is more important than the World Bank, but because it is more directly related to world trade. Indeed, if one takes a long view, I suppose there are few matters in the world more important than to reduce the enormous disparities that exist between the standard of living of the rich industrial countries of the world and that of the low-income developing nations. The Bank meeting, under the vigorous leadership of Robert McNamara, concerned itself with the need to increase the flow of aid to the underdeveloped countries, to improve the quality of aid by making it less tied to the trade interests of the donor countries, to beware of saddling the underdeveloped countries with a burden of debt service which was beyond their export capacity, and to take steps to try to prevent the flow of aid from being eaten up by the increase of population and so fail in its objective of raising the average standard of living. These questions, dealt with by the Bank, are of basic importance but they deserve fuller treatment than I am able to give them in my brief remarks tonight.

So far as the Fund is concerned, the object of the exercise is to ensure that the international monetary system functions and develops in a way that is conducive to the balanced growth of international trade.

Last year, in 1969, the main item of business at the Fund meeting was the decision to create a new form of international money called Special Drawing Rights as a permanent continuing addition to world international liquidity to supplement gold and dollar holdings and positions in the International Monetary Fund, and so help ensure that there was continuous lubrication to the wheels of trade, neither too much nor too little. This decision to create SDR's as a permanent form of international liquidity was an event of major importance in the evolution of the international monetary system. No decision of comparable importance was taken this year, but there was serious and purposeful discussion of the very important economic issues. These include the problem of inflation in the major developed countries and the continuing need for study of possible modifications in the exchange rate system.

The distribution of Special Drawing Rights authorized at last year's annual meeting of the Fund has begun, and the arrangements for this important new addition to reserve assets seem to be working well. With the improvement in the British balance of payments and the adjustments in the parities of the German mark and the French franc last year, the international financial system has been rather more tranquil. It is true that the persistence of a substantial deficit of the balance of payments in the United States -- however measured -- remains a cause for concern, and that the additions to international liquidity in the form of increased official holdings of U. S. dollars

in 1970 have been greater than had been foreseen. However, the measures adopted by the United States to restrain demand in its domestic economy have produced a marked recovery in the current account position of the United States in recent months, though this is still not large enough to cover the substantial net outflow of capital which that country normally generates and a large payments deficit persists.

The economic problem of overriding concern at Copenhagen was the continuance of inflation among the industrial countries. As Mr. Schweitzer, the Managing Director of the Fund, noted: "inflationary pressures grew progressively more acute in the industrial countries during the course of 1968 and 1969 and are now rooted in strong cost/push forces that render the control of inflation particularly difficult. The price increases that industrial countries experienced in the first half of 1970 were, generally speaking, the largest since the Korean War period nearly two decades ago". It was recognized that in the United States and Canada excess demand had been eliminated, though wage settlements in both countries continue to run well in excess of normal productivity growth. On the other hand, in most European industrial countries and Japan the pressure on resources remains strong. In seeking solutions to these problems, including the persistence of cost/push inflation after demand pressures have been checked, there was a fairly widespread view that countries should give careful consideration to

such supplementary measures as may influence the movement of prices and incomes more directly through some form of incomes policy. Most spokesmen agreed that the highest priority must be given to dealing with the inflationary problem. This point of view was shared by the representatives of developing countries as well as developed countries. I find it interesting and constructive that there is an increasing awareness in the developing world of the additional problems which inflation in the industrial countries creates for them, both through its adverse effects on their terms of trade and through the upward pressure it exerts on interest rates in the capital markets where they must borrow.

Another important topic of the discussion on Fund matters in Copenhagen was the question of greater flexibility of exchange rates. In a special study prepared by the Executive Directors of the Fund alternative ways of introducing greater flexibility were examined. Their views reflected broad agreement on the fundamental soundness of the basic principles of the Bretton Woods system established a quarter of a century ago and concentrated on proposals which involve relatively moderate adjustments to the present system, specifically, proposals for small and gradual changes in exchange rates, a modest widening of the permitted margins around par, and temporary transitional deviations from par value obligations. In these areas the Directors indicated their wish to continue their study after hearing the views of Governors at the meeting.

I think that one could summarize the majority view of the members of the Fund as being that the present system should not be altered in any major way. The more extreme proposals that one hears, such as the general adoption of floating exchange rates, found no supporters and many forceful opponents. Indeed, I think that it would be fair to say that the only proposal for change that received substantial support was the one involving somewhat wider margins than the present one per cent spread on either side of par.

This account leads me to report to you some personal impressions I received of the way in which Canada's present exchange position was viewed in Copenhagen. It is well known that the decision at the end of May to cease to defend for the time being the par value of the Canadian dollar was received in many circles abroad with some misgiving which was not altogether allayed by the assurances that were given that we would return to a fixed parity as soon as circumstances permitted and would meanwhile remain in close consultation with the Fund. However, I think that it would be correct to say that in Copenhagen, as in the other forums in which we have recently participated, such as the OECD, the Bank for International Settlements and the meeting of the Group of Ten in Brussels which took place just prior to the annual meetings of the Fund and the Bank, most of ourmain trading partners have shown understanding of the particularly difficult circumstances in which we found ourselves last May in trying to live up to our Fund commitments. This understanding reflects the widespread concern, to which I have already referred, with the growth and persistence of inflation in the world, and there has been a growing recognition

abroad that the action of last May was primarily motivated by a desire to continue the defence against inflation here and that this defence would have been seriously jeopardized by the strong monetary expansion inevitably associated with further large accumulations of foreign exchange at the old fixed parity. I think that it would also be true to say that there is widespread recognition abroad that our balance of payments position has recently been unusually strong for a number of temporary reasons, and that this circumstance has made it virtually impossible to choose a new foreign exchange parity which was neither too low to prevent further speculation nor too high to be viable over the longer run.

At the same time, I have to add in all candour that there is a lingering concern on the part of many people outside Canada that arises from the fact that on the last occasion in which the Canadian dollar was permitted to float it was eleven years before we returned to a fixed parity. I think that it is inevitable that as our balance of payments moves to a more normal position our major trading partners will increasingly expect us to move to closer conformity with the Articles of the Fund Agreement.

There are two more observations on this matter that I would like to make before leaving the subject. The exchange rate is a very important price in the economy, and we cannot be sure that the rate established by the market at any moment of time will be that which is best adapted to the long run needs of the Canadian economy. At the present time, for example, our current

account is abnormally strong and at the same time we are still receiving an appreciable inflow of long term capital from abroad both in the form of direct investment and borrowing by Canadians in foreign capital markets. I would like here to echo the view expressed by the Minister of Finance last week and to say that in my opinion it would be helpful in present circumstances if all Canadian borrowers, whether public or private, were to explore very carefully the possibilities of doing their necessary financing on Canadian markets before they have recourse to borrowing abroad. I do not suggest that they should borrow here on terms which are unreasonable in relation to those available elsewhere, but it is my impression that there may be occasions when, almost automatically, some borrowers look to external markets when funds might have been obtained in Canada, without incurring exchange risks, at little or no higher cost.

We should also avoid lapsing into the easy assumption that the greater freedom for domestic policy given by a fluctuating exchange rate makes it appreciably easier to get our domestic policies right. We remain confronted with difficult judgments, including perhaps particularly the judgment of the appropriate mix of fiscal and monetary policy. If we do not get this mix right it is conceivable that we could at some stage find ourselves confronted with a Hobson's Choice: on the one hand a degree of monetary expansion which would risk triggering a fresh round of inflationary expectations, or on the other hand the financing of fiscal requirements by large sales of securities to the general public which might, through the effect on interest rates, attract

excessive capital inflows and help to establish a market rate of exchange that was ill-suited to the economic requirements of the country.

Developments of this sort are by no means inevitable and I do not mean to suggest that they result directly from the exchange system. All systems have their problems. The only point I wish to make is that our basic problems are not solved by a fluctuating exchange rate; they merely present themselves in a different way.

Before concluding my remarks I would like to add a few words about the current economic and financial situation. I can be brief on this subject tonight because the Bank of Canada issued a full statement as recently as August 31st, when we announced a reduction in the Bank Rate from 7 to $6\frac{1}{2}$ per cent. In that statement we said that the Bank was trying to steer a narrow course which, on the one hand, was mindful of the degree of slack that was emerging in the economy and of the time lags involved in the operation of monetary policy, but which was also mindful of the risks of excessive or premature monetary expansion at this critical stage in our efforts to bring the inflation to an end.

The attempt to steer this narrow course has involved renewed monetary expansion since early in the year; it has involved an appreciable increase in bank liquidity, even after allowing for the higher secondary reserve requirements; and it has involved easier credit conditions than those prevailing at the beginning of 1970. Short-term interest rates have come down substantially and this process has been carried somewhat further since the last reduction in Bank Rate. Our structure of short-term rates is now

appreciably below that in either the U. S. or Euro-dollar markets. While long-term rates on bonds and mortgages have eased only slightly since the beginning of the year, the Canadian market has demonstrated its capacity to handle a greatly increased volume of long-term borrowing and there has been a sharp reduction in the amount sought abroad.

In looking at the economic situation with the benefit of another two months hindsight, I do not think that I would wish to modify our assessment of late August in any major way. The slowdown in economic activity which developed at the end of the first quarter of 1970 appears to have continued. Total output did not grow in the second quarter and industrial activity declined slightly. Both these trends appear to have persisted in the third quarter. Important strikes in many parts of the country, including most recently the continuing major strike in the automobile industry, contributed to this easing in activity and to the high level of unemployment in recent months. However, even allowing for these special disturbances, it is clear that the growth of output has now been stalled for the past six months and that the margin of slack in the economy over this period has increased appreciably. On the other hand some elements of strength in the current situation are a little clearer now than they were two months ago. For example, house-building activity has recovered rather impressively in the past quarter and the anticipated revival in U. S. economic activity seems to be getting underway, though this has inevitably been temporarily interrupted by the automobile strike.

Our position with regard to prices and costs still remains much the same as before. In one very important respect the most recent statistical evidence continues to be highly encouraging. I refer to the marked slowing in the rate of price increase, particularly as measured in the Consumer Price Index. On a seasonally adjusted basis this has increased at an annual rate of less than 1½ per cent over the past six months and over the past twelve months by less than 3 per cent. Some of this improvement has been due to an easing in food prices and the increase in non-food items in the index over recent months has still been at an annual rate of 3 per cent. Even so, our recent price performance compares very favourably with that indicated by comparable U.S. figures, which still show an annual rate of increase of nearly 5 per cent in the total consumer price index over the most recent six-month period and an increase over the year of more than 5½ per cent. Similarly, our record looks good when compared with the recent rates of price increase in most of the other major industrial countries, where annual rates of price increase in the range of 4 to 6 per cent are typical.

The major qualification which has to be made to this record of course is the failure of wage and salary increases to show anything like the same degree of moderation. Published data on settlements under collective bargaining arrangements so far this year show wage increases exceeding 8 per cent when averaged out over the life of the contract, and the latest months have been anything but encouraging. Increases in wages in the

construction industry, which are not included in the above figures, have continued to show even larger rates of increase. Equally disturbing is the fact that the broader measures of increases in wages and salaries have moderated only slightly to date this year and remain very high in relation to normal productivity gains. It is self-evident we cannot expect such high rates of wage and salary increase and such low rates of price increase to continue together for long. Either the average rate of wage and salary increases must fall appreciably or the improvement in our price performance will not be sustained. The erosion of such sectors of income as corporation profits and farm income, which has made this disparity temporarily possible, cannot continue indefinitely.

To sum up, we are at a critical juncture in the evolution of the economy. A setting has emerged which should be conducive to bringing about the changes in attitudes and behaviour which are essential for acceptable price performance and sound economic growth on a durable basis, but this setting involves a very high level of unemployment, which on economic grounds is wasteful and on social grounds cannot be accepted for long. We have no modern precedents for an inflation which has become as deeply entrenched as the present one in our own economy or in the world at large. Consequently, one is unfortunately less sure than normally about where the processes at work in the economy are leading and what the responses to our policies will be. Fiscal and monetary policies have already eased substantially in recognition of the degree of slack in the economy and the better performance of prices. If there

were some clear sign that wage and salary increases were beginning to adjust, then the risks for expansionist policy would be greatly reduced, and we could give our undivided attention to the job of making the most of our great economic potential.