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SUBMISSION OF LOUIS RASMINSKY,
GOVERNOR OF THE BANK OF CANADA,
TO THE STANDING SENATE COMMITTEE ON NATIONAL FINANCE
JUNE 17, 1971

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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 than 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 2 1/2 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 requests 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 early 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 its 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 expection of a continuous 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 3 1/2 per cent between 1964 and 1968 rose to 4 1/2 per cent in 1969 and 6 1/2 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 aggregate demand policies and the only thing to do is to put controls on prices and incomes. The role left for

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* As measured by GNP deflator

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 by 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.