CANADA: IS PARADISE LOST?

NOTES FOR AN ADDRESS

TO

MEMBERS AND GUESTS

OF

THE CANADA-UNITED KINGDOM CHAMBER OF COMMERCE

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BY

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*Notes on Speaker and the Business Council on National Issues are attached.

Mr. Chairman, Ladies and Gentlemen

It is a very great pleasure for me to visit Britain, to address this gathering of people interested in Canada, and to see among you old friends and long-standing acquaintances.

This evening I would like to talk about Canada: primarily about our economy, the problems we face, and ways that we can pursue economic recovery in the short term, and long term prosperity in the years to come.

To attempt to do this in less than half an hour is, I admit, ambitious. But please consider my thoughts as merely points of departure. Following my remarks I look forward to lively discussion when I would welcome your views about Canada seen from your vantage of distance.

May the spirit of John Milton forgive me for having borrowed from his great epic the title of my remarks this evening, Canada: Is Paradise Lost? Those of you who know Canada appreciate what I mean. Generations of Canadians have come to believe that ours is a land of unending promise, a place where material progress and the betterment of the human condition are as certain as the sunrise.

Suddenly, our sense of certainty has vanished. The most severe world-wide recession since the calamitous early thirties has plunged us into an economic crisis, and a moral crisis as well. In all parts of Canada people are confused and worried. A recent Gallup Poll indicated that four in five Canadians are dissatisfied with the direction in which the country is going.

The most painful source of discontent is the economy. The facts are well known to you so I will not elaborate at length. Our unemployment rate is 10.9%. Corporate profits fell 50% in the first quarter of 1982 after falling over 30% in the previous quarter. Real output fell 2.0 % in the first quarter of this year - the largest quarterly decline in 28 years. Second quarter statistics released on the eve of my departure from Canada indicate that the sharp decline continues. Our rate of inflation remains unacceptably high, and the spread between our rate of inflation and that of the United States is nearly five points.

Business confidence is at an all-time low. Bankruptcies have ravaged the corporate sector, and financial strains are evident in a wide number of firms, including some prominent, well managed companies. High interest rates and reduced cash flows have compelled a growing number of companies to borrow in order to pay interest on their debts. Despite the large reduction in inventories in the first quarter of this year, sagging domestic and foreign sales have kept the inventory-sales ratio extremely high. Thus, in many industries, renewed demand is not likely to be translated into increased production without significant time lags.

Consumer confidence in the economy has also been badly shaken. The Conference Board of Canada's Index of Consumer Attitudes has fallen so low that it is clear that consumers perceive their situation to be very bad indeed.

Canada's economic ills are reflected as well in the rapid decline in the value of the Canadian dollar in 1982 in comparison with the United States dollar, although our currency, as you know, has performed rather well against others, and is showing renewed strength. Influences on the Canadian exchange rate have been almost uniformly negative with the notable exception of the sharp rise in the surplus in Canada's balance of trade. One factor in the dollar's

decline is the federal government's cash requirements this year. The deficit for the fiscal year ending March, 1983 is expected to exceed $19.6 billion. Federal government cash requirements are expected to be in the range of $17.1 billion, nearly three times the estimate in the November, 1981 budget.

If I were to conclude my remarks here, one would have to assume that paradise is indeed lost and unlikely to be regained. But let us consider some mitigating factors. Measured against the indicators I have just outlined, the economies of the industrialized world also have fared poorly. Very simply, the recession has spared no one. And Canada's economic base provides us with certain advantages that our major trading partners do not have. These advantages should be of great assistance on the tortuous road to economic recovery.

But surely the essential question is this - will we take full advantage of our assets, clear away impediments to economic growth, and regain a momentum that will place us among the economic front runners in the late 1980s and 1990s?

Since early this year, this question has preoccupied the Canadian business leaders who make up the membership of the Business Council. Our response is a strategy - a strategy for survival and for recovery.

First, we recognize that Canadians must accept a fundamental reassessment of our role in the economic life of this planet. The fact is that our size and great natural resource base alone can no longer guarantee us a place of pre-eminence among the economic powers. The recent Economic Survey of the OECD is another in a growing list of assessments that point to the erosion of Canada's long term economic potential. Some Canadian commentators are saying openly that the severity of the current recession is far from being entirely a bad thing because it will help to re-shape Canadian society - force

us to work harder, to demand less of others and more of ourselves, to link our personal ambitions more closely to the needs of the country as a whole. Crises they say, will bring out the best in us. And they are probably right. The poet Horace told us long ago, "Adversity reveals genius, prosperity conceals it."

Acceptance by Canadians of the simple but hard facts of economic life must be paralleled by a clear recognition of economic priorities. Foremost among these is the need to combat inflation and to create jobs. This was a predominant theme when Commonwealth Finance Ministers met in London last week. This will be uppermost in the minds of those attending International Monetary Fund and World Bank meetings in Toronto this week. The Business Council has repeatedly warned that the greatest single threat to our jobs, our incomes, and our quality of life is inflation. Our preoccupation with inflation is not a heartless, abstract exercise in economic gamesmanship. On the contrary, we are convinced that unless we check inflation, we will continue to face tragic social consequences, the hopelessness of the unemployed, the fear of those on fixed incomes, the disillusionment of the young.

Our answer to inflation was voluntarism. Early in 1982, we began to advocate among our members and publicly, a policy of self-discipline - we urged employers and employees in the private sector to reduce increases in wage and salaries to levels on average below 7%. In addition, we asked the federal government to provide leadership by implementing restraint guidelines in the public sector. In the June 28 budget, the federal government not only agreed with our advice but went further. It introduced a policy that has come to be known as "6 and 5". The policy sets up national goals of limiting wage, salary, and price increases over the next two years to 6% the first year and 5% the second year. To lead the way, the government has capped average wage and salary increases for all public servants and employees of its crown

corporations and agencies. It has promised to cap similarily prices of the goods and services it sells to the public, and it has directed federal agencies which set the prices to be charged by telephone, pipeline, cable television, and other regulated companies to allow increases beyond 6 and 5 per cent only in very exceptional circumstances.

The Business Council has endorsed the "6 and 5" initiative, and members of the Council including our Chairman, Jack Barrow, are playing a prominent role nationally in encouraging support for the program among our members, among the business community generally, and among provincial governments. We are beginning to see results and we are confident that the voluntarist approach, given sufficient time (in our view a period of at least six months), will contribute significantly to the easing of inflationary pressures.

Our goals are straight-forward. We must close the cost differentials between Canada and our major trading partners. We must break the inflationary psychology that has run rampant in the country for years. And we must prove that the market can deal effectively with inflation, free of mandatory wage and price controls. If self-imposed discipline fails and Canada is saddled once again with mandatory controls, the negative impact on our already seriously weakened economy could be devastating. Such a move would not only signal market failure but would convince the skeptics that Canada had indeed moved from an essentially open economy to one that is closely controlled.

Hand in hand with initiatives to combat inflation and to make ourselves more competitive, we must address urgently what some refer to as the Canadian disease. I refer to the issue of productivity. Many Canadians were stunned by the recent OECD Economic Survey results that ranked Canada, in the period 1960-1980, second lowest among sixteen countries in productivity growth and, during the 1970s, the lowest of all in productivity growth in manufacturing.

As you know, productivity is the enhancement of the quantity and quality of output of goods and services in relation to the input of resources used in producing them. Its great advantage, as the Japanese, the Germans and others have demonstrated during the past twenty years, is that it serves as a means of improving efficiency and international competitiveness, generating real growth in wage levels and standards of living, supporting profitability, containing inflationary pressures, providing a healthy environment in which new job creation can be facilitated, and securing the basics for advances in social programs.

While there is a general consensus on what productivity can achieve, there is less agreement on what its sources are. We know that it depends on some magical combination of more capital, better technology, a proper mix of skilled and professional people, better organization and management of production, growing pride of accomplishment and morale in the work force, an open and flexible system for labour and capital to seek higher levels of returns, and adequate opportunities and rewards for entrepreneurship, initiative and risk-taking.

Obviously Canada's performance in these areas has stalled since those heady two decades following the Second World War. At the Business Council we are addressing the issue of productivity as an urgent priority. We have an open mind. We are not prepared to accept that foreign competitors who have harnessed productivity so successfully cannot be emulated because of mysterious cultural differences. We are convinced that improvements can be achieved by individual firms. We are equally convinced that a revolution in productivity will require a national commitment by companies, by labour and by governments.

If recovery demands that each of us try harder, that we continue in our personal commitment to fight inflation, and that we accept as individuals a

role in reversing our serious decline in productivity growth, then what should we demand of our governments?

This is a critical question. What governments do or do not do will strongly influence the speed and the strength of our recovery, and in the longer term will have a great deal to do with whether we retain a position among economically pre-eminent nations.

In immediate terms much can be done to boost recovery. The Business Council has asked for government action on a number of fronts.

First, we have called for tax measures that will encourage productivity, individual entrepreneurship, and investment in the Canadian economy. Federal proposals for inflation indexing of earnings from certain types of interest income and capital gains are presently under scrutiny by a private sector committee. Some business organizations are urging instead the elimination of capital gains tax on shares of Canadian public corporations. Whatever the outcome of the tax reform debate, we must be more creative in our use of tax instruments to promote growth.

A second area where the federal government could be helpful is in influencing the climate for foreign investment. Those of you here this evening who work in what is one of the most important capital markets in the world, know of the deepening disillusion of foreign investors in Canada. The Canada Survey in the August 7 edition of The Economist is but one in a growing list of foreign editorial indictments of a country seemingly having lost its international perspective and its historical recognition of the advantages of open trade and investment.

I, for one, tell my European, American and Asian friends that the situation is not as negative as the international press and the whispering in foreign boardrooms suggest, and certainly not so one-sided. One has only to point to the myriad of protectionist laws and regulations used so effectively (and so quietly) by our major trading partners to inhibit foreign trade and investment. But the fact remains that Canada is perceived to have become less and less interested in foreign investment, and steadily more willing to use legislation and other policy instruments to discriminate against foreign commerce. The Foreign Investment Review Agency (FIRA), has become a lightning rod of discontent and is now under attack even by a majority of the premiers of Canada's provinces.

While complaints about FIRA both in Canada and abroad are exaggerated, the Canadian government should have moved years ago to correct its most serious deficiencies. Let me mention three that are causing justifiable concern. FIRA has prevented a number of foreign firms from selling their Canadian assets to other foreign companies, or applied extremely onerous conditions to such sales, even though such sales do not increase foreign ownership in Canada. It has sometimes exacted performance conditions that in my opinion are in contravention of the GATT: namely, non-competitive domestic sourcing, and export commitments which can force firms to engage in questionable export practices. And, as well, it does not provide sufficient explanations to companies as to why their applications have been rejected, and frequently takes far too long to make decisions.

A third area where both the federal government and provincial governments could be helpful is the energy sector. No single sector's health is more important to both our short term and long term prospects for recovery. We have repeatedly urged that the National Energy Program, the broad objectives of which the Business Council endorses unequivocally, be reassessed.

Specifically, we have asked for a relaxation of the so-called Canadianization elements of the Program. At the very least this would mean re-examining the system which links the amount of incentive payments a petroleum company can receive to its level of Canadian ownership and control, and eliminating the now notorious "25% back-in privilege" of Petro-Canada. It would also mean curtailing the role of Petro-Canada as an acquirer of foreign-owned oil and gas enterprises.

We have also asked for less direct government ownership of the energy sector as a whole. I should point out that this advice has been ignored not only by the federal government but by provincial governments as well. It has become fashionable for them too to spend enormous sums of taxpayers money and incur deficits in the name of energy self-sufficiency and provincial pride.

Finally, in the area of energy megaprojects - off the East Coast and in Western Canada - we have urged a long overdue resolution of inter-governmental conflicts which have resulted in a loss or a deferral of economic potential of staggering proportions.

Mention of conflict between the federal and provincial governments leads to our fourth prescription for economic recovery. Canadians should demand and accept no less than a revolution in the attitudes of our governments towards one another. We all know that Canada is not an easy country to govern. But the severity of our current recession has convinced Canadians that we can no longer afford the high level of conflict and distrust that has characterized relations between the national government and the provinces. The premiers of Canada's provinces who met in Halifax two weeks ago quite rightly consider that they have a vital role to play on the road to recovery. Ottawa should listen. In turn, the provinces should support sensible federal initiatives, for example, that of "6 and 5". In a time of economic emergency our governments

should be working in the closest possible harmony. And as electors we should make it clear that we are prepared to punish any government that prefers to quarrel rather than co-operate in fighting this recession.

The fifth subject that the Business Council believes must be addressed if we are to achieve recovery and long term prosperity is the role of government in the economy and in our lives. This is a large subject indeed, but before referring to the broader philosophical questions, let me address specific and immediate concerns. We consider spending by all levels of government in Canada to be a central problem, and we Canadians are part of the problem. Demanding more services and security, we have often encouraged government spending to rise as a share of the country's national income. But today, in this new world, can anyone seriously doubt that we must convince governments to cut expenditures in non-productive areas and non-essential programs? And surely there is room for judicious cuts in the size and the operational costs of the public service. Where appropriate , monies saved could be allocated to areas that will assist recovery: for example, support of investment, productivity, innovation, industrial R & D, western rail expansion, and other infrastructure.

The enormousness of the federal deficit is attributable largely to a reduction in government revenues because of reduced taxable incomes - both personal and corporate - and to dramatically increased expenditures for social support programs in the face of crushing unemployment. This deficit, sharply higher than was predicted less than a year ago, has had a disquieting impact on business confidence. It has also increased government's competition with the private sector for sources of funds, adding to upward pressures on interest rates. Although we recognize that the federal government can do little to decrease the deficit dramatically while tax revenues remain unusually low and expenditures caused by unemployment remain unusually high, it should commit

itself to gradually reducing the deficit over time on the basis of credible long term economic policies.

Business Council members consider the regulatory burden placed on business by Canadian governments - federal and provincial alike - to be a further obstacle to economic recovery and an example of how our governments themselves can be found standing in the way of our efforts to become leaner and more efficient. The federal government has committed itself to a program of regulatory reform which, despite energetic efforts on the part of the President of the Treasury Board, seems to have been relegated to a low level of priority. The business community is intensifying the campaign to reduce the economic costs of excessive or duplicative regulation.

Turning to broader philosophical questions, Canadians are at a cross-roads in their economic life. Much of what has been written about Canada in the international press suggests that we are moving under federal leadership towards a society in which governments play an increasingly bigger role. Canadians, some argue, are basically supportive of policies that encourage state partnership - even direct state control of much of the private sector.

Our history does indeed reveal that we have a long tradition of mixed enterprise - public and private - in which the state has played a major role in our economic development. These two strong traditions of enterprise in our country have worked in relative harmony in the past to meet national goals and to promote national prosperity, but are now in disequilibrium. In the last few decades public sector growth has been prodigious. Between 1950 and 1980, government spending increased from an amount that was equivalent to 27% of gross national expenditure to 48%.

As the arm of the state reaches out increasingly into the marketplace, state capitalism is becoming more fashionable. Witness the Petro-Canada takeover of Petrofina, the Ontario government purchase of a minority position of Suncor, the growing power inherent in the Alberta Heritage Fund, and the aggressive activities of the Caisse de Depôt in Quebec. The public sector juggernaut is further encouraged by supposed broad citizen support for economic nationalism, for mandatory wage and price controls, for massive stimulation of the economy, for tougher regulation of big business.

In stark contrast to these developments, we are told that public distrust of government is at an all time high, that Canadians have rarely been more disillusioned by government's inability to deliver value for money, that regional alienation is threatening the integrity of our country, that political institutions such as Parliament are no longer effective as instruments of accountability.

Faced with this extraordinary contradiction, we in business, and all Canadians for that matter, must confront the problem squarely. We must expect less of governments. We must not invite increased regulation of our economic affairs. We must resist the temptation of grants, subsidies, and in particular, special treatment - such as bailouts of badly managed or otherwise doomed companies - that results in blatant discrimination in the marketplace. We must strengthen the system of checks and balances in our political system, in particular Parliament's ability to exact accountability of the executive. We must speak as businesspeople with more skill, and with more conviction about the strengths of the marketplace and of enterprise, and we must behave in a manner that is more consistent with our words.

It might interest you to know that some senior public servants in Ottawa have become fascinated with a recent article in The New York Times Magazine by

the economist, Robert Heilbroner. In the article entitled "Does Capitalism Have a Future?", Heilbroner argues that when we emerge from the world-wide economic crisis we are now in, the capitalism we know will have to undergo wrenching changes if it is to survive, and he predicts that it will. However, he rejects as doomed to almost certain failure the Reagan and Thatcher visions which he describes as "born again capitalism, stripped down to its natural, lean, aggressive fighting weight, once more undertaking its (wealth accumulating) mission with assurance and pride". Equally, he doubts that the model of democratic socialism, championed mainly in Europe "of intensified democratic participation, of widespread workers' management of enterprises and of the gradual elimination of capitalist privileges and waste" can succeed. Heilbroner foresees, instead, an anti-inflationary administrative structure of controls on prices, wages and dividends as pervasive in our economic life as that of the Internal Revenue Service. He predicts that the line between the private and the public sector, already blurred, will all but disappear with the wide-scale advent of state enterprise which he sees as "the only possible means of amassing the finance, exerting the political pressure, and supplying the entrepreneurial zeal to establish our place in the new arena of global competition". Finally, he states that the precondition for erecting a new structure for the wealth accumulation essential to capitalism is the abandonment of the idea of a unified world market. He predicts that concern to protect producers, both capitalists and workers, will triumph, and therefore we will end up with a system of regional blocks, each securing a reasonably protected market for its favoured producers, and regulating its intercourse with other large blocks.

This is not the place to respond to Heilbroner's thesis except to make one fundamental point. His brave, new world would unavoidably be one in which the state would be more powerful, more pervasive than it is now. In it, our lives would become more controlled by what I heard an editor of <u>The</u>

Economist refer to as "public sector imperialism". Certainly startling power would be concentrated in very few hands. This would exacerbate the crisis of accountability that democratic societies are even now facing - people, ordinary people, have simply lost control of their governments. The message that I am hearing in all parts of North America and throughout Europe is let us get government spending, government taxes, and government growth under control. Heilbroner recognizes that blame for the economic crisis we are now facing partly derives from the failures of the mixed economy and the welfare state. Rather than suggesting structural changes aimed at improving the economic base for social policies in western societies, he focuses on a new role for capital within precincts closely guarded by public sector watchdogs.

Heilbroner does recommend, quite rightly in my view, that we must search for ways to revitalize our institutions as we emerge from this period of world-wide hardship. In Canada, that is imperative. It requires labour, business and government to build a new consensus. The Business Council is a rallying point for new ideas, and a few old ones too - the old ones which we abandon at our peril. It is an instrument through which business leaders in the post-recession era can help to reconstruct a stronger, more realistic, yet still free and compassionate society. Our philosophy is clear. We believe in a vibrant marketplace that will both inspire and reward creativity, innovation and hard work. We believe that governments, referred to by Burke as "contrivances of human wisdom", must remain at the service of the people, and so we believe in limited government and dispersal of power. We must indeed form new co-operative structures and forge a new consensus in our pluralistic society, but we foresee grave danger in simply abandoning the notion that the public sector and the private sector have different jobs to do.

The Business Council reflects not merely the aspirations of a few business leaders in Canada. We believe that our philosophy has broad appeal to Canadians and, for that matter, citizens in many parts of the world. In our country we hope that we can help in the common effort to regain a paradise that is slipping away, but not yet lost.