# Notes for Remarks by David Dodge, Governor of the Bank of Canada On Behalf of the Canadian Minister of Finance, Ralph Goodale To the German-Canadian Business Club of Berlin-Brandenburg-Association of Berlin Merchants and Industrialists

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It is an honour to be with you today. As you may know, this is the second time that I have visited Berlin. In June 2003, I had the honour to speak at this group's founding ceremony in my role as the Governor of the Bank of Canada on the need, based on Canada's experience, for a solid economic policy during uncertain times. I have very fond memories of this visit and I am pleased to see so many familiar faces today.

Since that time you have made great efforts to promote strong German-Canadian trade relations and build a better understanding of the economic and social conditions in both of our countries.

Today I would like to speak to you on behalf of Canada's Minister of Finance, Ralph Goodale, who sincerely regrets not being able to be with you today.

In his Economic and Fiscal Update November 16, Minister Goodale described the remarkable strength and resiliency of the Canadian economy following numerous shocks in 2003, including SARS, a single, isolated case of "mad cow" disease and the strong appreciation of the Canadian dollar.

Canada weathered this period of economic slowdown, and has recovered from relatively weak growth of two per cent in 2003. In fact, Canada saw growth of 3.4 per cent in the first half of the year—much stronger than expected. Private sector forecasters now expect growth of three per cent for all of 2004, and 3.2 per cent growth in 2005. In the Bank of Canada's recent Monetary Policy Report, the Bank projects economic growth of 2.9 per cent in 2005 and 3.2 per cent in 2006.

The origins of this success can be found in policies that began a decade ago. In 1993 Canada had the second-worst government debt-to-GDP ratio among G-7 countries.

It had high unemployment. It had low productivity growth. Federal debt servicing costs were absorbing 38 cents of every dollar of government revenue.

This situation was clearly unsustainable, and many difficult and unpopular decisions had to be taken to clean up public sector balance sheets during the 1990s.

In 1994 the Government launched a series of expenditure reductions which, by 1997, had reduced program spending by almost 20 per cent.

In 1996, action was taken to introduce major reforms to our nation's public pension plan, to put it on a sound financial footing.

Taking these actions was very difficult. So, what was essential during this time was clearly communicating to Canadians the steps that had to be taken to get our fiscal house in order, and the ominous consequences of not doing so.

Fortunately, Canadians understood that you can't forever consume more than you produce. They displayed the innate good sense necessary to make short-term sacrifices for the long-term interests of their families.

As a result, Canadians transformed a vicious circle of rising deficits and debt into a virtuous circle of balanced budgets and surpluses, and falling debt.

Reducing, and ultimately elimating, the deficit in the 1990s helped Canada's international credibility and led to a reduction in the risk premium demanded by investors. This fiscal improvement allowed for lower interest rates, and made easier the implementation of monetary policy.

Not only did lower interest rates reduce debt-servicing costs, they also stimulated economic growth, which brought in more revenues for the government. The extra revenues and lower debt-servicing costs, in turn, led to an even better fiscal position.

The results have been striking. Canada has been among the G-7 leaders in economic growth since 2000. Canada is the only G-7 country expected to post a total government sector surplus this year and next.

As a result of this reduction in the federal debt, public debt charges as a share of revenues have fallen from 38 per cent to just over 19 per cent—the lowest level since the 1970s.

The federal debt-to-GDP ratio has fallen from a peak of 68 per cent to 41 per cent last year. And the Government has set the objective to reduce that to 25 per cent within 10 years.

Business confidence is also high, and investment is increasing.

The main point here is that, in the end, tough choices pay off. While the initial work of fiscal consolidation is certainly difficult, it pays dividends later on.

Now that Canada is in the midst of this virtuous circle, the Government has the means to invest in key priority areas, while at the same continuing to meet its fiscal targets.

One of these priority areas is health care. In September, the federal government and Canadian provinces and territories announced a 10-year, $41 billion heath accord that would focus on streamlining health care delivery, training more health professionals, investing in better equipment, and enhancing research and innovation.

The Government is also focused on the delivery of other key commitments to Canadians, including:

- High-quality early childhood development;
- Predictable and long-term funding to municipalities for critical infrastructure needs;

- Meaningful action on the disparities that impede opportunities for Aboriginal Canadians; and
- Meeting the imperatives of national defence and national security.

As Minister Goodale said in his Economic and Fiscal Update presentation, meeting these priorities will require ongoing fiscal discipline.

It will also require attention to improving productivity. But given the current high ratio of employment to population, and given that Canada's population will soon begin to age rapidly, we will have to rely increasingly on productivity to raise living standards in the future.

To increase productivity, we Canadians need to invest in human capital, physical capital and innovation—the three drivers of productivity growth.The key will be to adapt to change through policies that promote flexibility.

That's why Canada is investing in the skills and knowledge of our people, and is creating a competitive environment through lower taxes that encourage investment in physical capital and reward the efforts of entrepreneurs.

These flexibility-enhancing policies, along with lower barriers to trade, smart regulation and openness to international investment, are the building blocks of Canada's modern and prosperous economy.

Collaboration between Canada and Germany is part of this effort to encourage international investment.

As one example, our two countries have a long-standing relationship in science and technology. The driving force behind this relationship is the Bilateral S&T Cooperation Agreement, signed in 1971.

And there is the very successful partnership between the National Research Council of Canada (NRC) and the Helmholtz Association of German National Research Centres.

The Canadian Embassy in Berlin deserves real credit for encouraging this flourishing collaboration, and promoting technology-oriented partnerships.

Such cooperation is critical in an increasingly connected global economy. So, too, are forward-looking initiatives such as the Trade and Investment Enhancement Agreement between Canada and the EU, which would allow qualified workers to move much more easily between the EU and Canada and would enhance the ability of our financial sectors to seize investment opportunities.

Once concluded, this Agreement would present Germany, Europe and Canada with a unique opportunity to make our economies more global, more efficient and more prosperous.

Now let's turn to a different issue. As you know, G-20 Finance Ministers and Central Bank Governors met in Berlin over the weekend.

Among the themes of our discussions were the importance of promoting flexibility in national economies to help adjustment to changing circumstances, and the need for reductions of global imbalances. The importance of a sound domestic and international financial system to facilitate the trade, savings and investment necessary to bring about a reduction of these imbalances was also discussed.

So let me conclude these remarks this morning with a few thoughts on the importance of international monetary arrangements to facilitate the reduction of imbalances.

Most major industrialized countries and a large number of emerging market countries are operating with flexible exchange rates. The notable exceptions are China and a number of countries in Southeast Asia which, either explicitly or implicitly, tie their currencies to the yuan, which is in turn pegged to the U.S. dollar.

With two systems operating, not everyone is playing by the same "set of rules," and imbalances are building. The concern is two-fold:

- First, the sense that some countries are not playing by the rules could give rise to protectionism, with potentially very serious negative consequences for the global trading system.
- And second, a disproportionate burden of adjustment to changing economic circumstances is being borne by those of us with flexible exchange regimes, including Canada and Europe.

So there is a real need, going forward, to think hard about these international monetary arrangements.

Of course, there is much more to the resolution of global imbalances than just exchange rate regimes. There are issues of savings and investment flows and of promoting strong economic growth worldwide, through strong domestic demand in each country.

But the issue of international monetary arrangements deserves critical attention and debate, as we look out over the medium- and longer-term to the challenges facing the global economy.

To conclude, I hope these remarks give you a good perspective on the fiscal health of the Canadian economy and on some of the bilateral initiatives between our two countries. As well, I hope that I have given you some food for thought on international monetary arrangements.

Thank you for your attention. Let's now turn to hear your views.