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# The Canadian Economy: Charting a Course for the Future

The 1990s was a difficult period for Canada and the Canadian economy. From the beginning of the decade, it was clear that we had to grapple with the problems that had been hampering our economic performance through most of the 1970s and 1980s. Thus, the Bank of Canada set out to lower inflation. Canadian businesses began to restructure their operations to become more productive and internationally competitive. And governments started the process of cutting public deficits and lowering debt burdens.

Dealing with these problems was certainly painful. And, in some cases, it took us a good part of the decade to overcome them. But we have now made some crucial improvements to our economic foundation. And as we step into the new century, we are beginning to see the benefits.

The Canadian economy has been expanding solidly for some time now. In fact, if we look through some temporary monthly declines, we are in our nineteenth quarter of positive growth. This is the longest uninterrupted economic expansion in Canada since the mid-1960s. And throughout, inflation has remained low and stable. The advantages of this expansion are now showing up in gains in employment and incomes.

This is all very heartening. To maximize these benefits, we must build on—not be complacent about—our new-found economic vitality.

We must avoid the boom-bust cycles of the past. This is one issue I would like to discuss today—*how to minimize economic fluctuations*. Not eliminate them altogether, that is just not possible. In today's globalized markets, there will still be times when Canada's very open economy will be hit by external shocks. And sometimes there will be surprises on the domestic side too. In the past, though, some of our economic ups and downs were aggravated by outbreaks of inflation. The question is, what can we do now to keep our economy moving along on a sustainable growth path?

There is also *the question of longer-term economic performance*. For example, how low can our unemployment rate go on a sustainable basis? Will we succeed in narrowing the gap between our standard of living and that of our U.S. neighbours? What choices should we be making today that will improve our economic performance in the decade ahead?

This sounds like a tall order! So before I raise expectations too much, let me say that I do not have answers for all these questions. There are, however, several important steps we can take that would increase our chances of preserving the current economic expansion and help improve our performance over the long run.

Let me start at the beginning—with sound economic policies.

***... keep inflation low and stable***

I see low and stable inflation as an essential building block of a strong economic structure.

Is this just my bias as a central banker? Perhaps, but there are good reasons for it.

Inflation carries with it costs that are more profound and widespread than is commonly recognized. Inflation magnifies uncertainty about the future: when prices are rising, the rate of inflation is rarely stable or predictable. Inflation distorts and confuses the information and incentives that consumers, entrepreneurs, savers, and investors rely on to make their economic decisions. And it causes households and businesses to spend time and money to try to shield themselves, or to benefit, from the effects of rising prices by turning to speculative assets (such as real estate) and away from productive investments. We saw a lot of this during the high-inflation days of the 1970s and 1980s. We also saw our interest rates rise higher and higher to compensate savers for expected higher inflation and for the risks caused by uncertainty about future inflation. And we saw economic booms turn into busts.

So the focus of central banks on price stability these days is neither accidental nor whimsical. It is deliberate. And it has to do with reducing the toll that inflation takes on the economy and minimizing economic ups and downs. Put another way, if the goal of economic policies is a productive, well-functioning economy, capable of creating new jobs and delivering higher standards of living over time, then low and stable inflation is a crucial means to that end.

That is why the Bank of Canada and the Government of Canada have agreed to an explicit target for inflation control, which currently aims to hold inflation inside a range of 1 to 3 per cent.

There are already signs that this commitment is paying off in helping to reduce the fluctuations in our economy. In the nine years that the inflation targets have been in place, not only has the underlying rate of inflation been much lower than in the previous two decades, but the pace of economic activity has been less variable from one quarter to the next.

### *... keep public finances under tight control*

Fiscal prudence is the other crucial part of sound economic policies. Why does tight control over government budgetary positions matter so much?

As I said before, governments have made remarkable progress in recent years in reducing deficits and bringing down the national debt relative to the size of our economy—the debt-to-GDP ratio. But this ratio is still high. Because of this, we remain vulnerable to unexpected developments, such as international financial crises, which can push up the risk premiums in our interest rates.

There is no objective economic analysis that can tell us exactly what is the right debt-to-GDP ratio to aim for. But as long as our national debt ratio is higher than that of most other large industrial countries, we are at risk of being singled out by investors the next time there are international problems.

I hesitate to make any comment on the current debate about tax rates. But it is important for a well-functioning economy to find the level of taxes and government services that would deliver the right balance of incentives and public support programs. Finding this balance is even more important these days. In today's environment of rapidly changing technology, there can be increased uncertainty and insecurity about the future; however, there can also be great rewards.

Let me now turn to this issue of technological change and to some of the other challenges we must deal with if we are to prosper in the future.

### *... keep abreast of, and continue to invest in, new technology*

I do not believe that anyone would disagree with the importance of keeping up with the times. We are in the midst of a global technological and information revolution that is transcending national borders, pushing at new frontiers every day, and transforming our economies. This is the brave new world of microchips, fibre optics, and the Internet—a world more closely connected than ever before, where opportunities abound, competition is intense, and survival is synonymous with innovation.

As a nation, Canada is probably better positioned than most to seize the opportunities presented by this new technological revolution. Canada is a large country that has been a pioneer in telecommunications, and we are well ahead of many countries in the use of personal computers and the Internet. Our colleges and universities turn out graduates that are highly skilled. And, in general, our population is well-educated. But to make the most of potential opportunities, we must ensure that we keep pace with the best in the global race to take full advantage of accelerating technological change.

To appreciate the benefits of moving quickly to exploit the full potential of new technologies, we have only to look at the stellar performance of our next-door neighbour. The "strong growth-high productivity-low inflation" record of the United States over the past nine years has much to do with the systematic efforts of U.S. businesses since the 1980s to restructure their operations and invest heavily in machinery, equipment, and software that embody the latest technologies. Business spending on machinery and equipment as a percentage of that country's gross domestic product (GDP) rose from 6 per cent in 1992 to 11 per cent last year.

Canadian businesses have also substantially increased their purchases of machinery, equipment, and techology—especially since 1996. As a percentage of GDP, such investment has risen from 6 per cent to 9 per cent in 1999—which leaves us where the United States was three or four years ago.

There is no doubt that gains in productivity require more than just investments in technology. The entrepreneurial application of technology in new areas and employees skilled in the use of new practices and equipment are also key elements in this process. But because we are going through a period of major change in applied technology, the spotlight is naturally on investments in technology and on the need to intensify our efforts on this front.

I believe that Canada has what it takes to make the most of this "new economy."

***... the importance of being globally competitive***

More Canadian businesses also need to understand that globalization is irreversible—they must plan to operate on the basis that markets of all sorts *will* become increasingly globalized.

Despite the problems that the World Trade Organization ran into in Seattle, the move towards freer trade is inevitable as more emerging-market economies recognize that opening up to international trade and investment is the best means of raising productivity and improving living standards. And while it may not always seem to be the case, this increased openness in world trade will be good for Canada too, especially if we are adept enough to take full advantage of it.

A freer world trade environment opens up new vistas so that our companies can increase their global reach. Of course, it does the same for our competitors. And they will be out there, going after a bigger slice of the world market. The way to stay ahead of the game is by developing and maintaining a competitive edge.

This means improving productivity and finding more efficient, less costly ways, of delivering the products that foreign customers want. And it goes beyond innovation and investment in new technologies. It also means strengthening our educational system and making sure that the workplace environment in Canada is ready to respond to the technological and market changes as they unfold.

### *... the importance of flexibility, training, and development*

Dealing with rapid change is always difficult. When people are not certain how their lives will be affected by it, they tend to be fearful and resistant.

So what will be needed, to an even greater extent than ever before, is a sense of partnership between employers and employees in developing strategies to deal with the challenges of change. In my view, there are two important elements to such strategies: we need to foster a greater degree of flexibility in adapting to change and we need to increase training so that employees have the necessary tools to operate confidently with advanced technologies and to get the most out of them.

Flexibility is important because job requirements will change more frequently, along with evolving technology. We must be prepared to accept and adjust to these changes as well as to the possible need for greater movement between jobs, employers, and even regions.

When it comes to training, the main point I would like to make is that human skills are essential to innovation. What is the sense of spending heavily on state-of-the-art technology and equipment that ends up idle or inefficiently used because of a lack of trained personnel?

The partnerships that are being formed between industries, on the one hand, and colleges and universities, on the other, are going to be even more important in the future. And I expect that all businesses, especially smaller ones, are going to have to devote more time and resources to training staff.

### *... the importance of an efficient and innovative financial sector*

The final item on my list today is the importance of an efficient and innovative financial sector.

There is considerable evidence that the degree of financial development can have a marked impact on economic growth. A highly developed financial sector helps channel savings into investments and allocates that capital more efficiently.

In these times of rapid technological change, many of the new and innovative applications of technology are going to take place in small, often new start-up, companies. Financing the growth of these companies presents a challenge for the financial sector because it requires an ability to assess the risk involved and then put the right price on that risk. And when concentrations of risk become too high for individual investors and lenders, the financial system must be flexible enough to allow them to shift their risks and rebalance their loan and investment portfolios. One of the factors behind the recent extraordinary performance of the United States has been the flexibility and innovation of its financial system. We will need to ensure that in Canada too, the financial sector responds to the challenges of today's changing financing needs.

## Concluding thoughts

Let me summarize my main points today.

Canada has made remarkable progress over the last decade in strengthening its economic foundation. Starting from that firmer base, we are now in a position to move forward and reap some of the potential gains in employment and incomes from the technological revolution that is now sweeping the world.

Monetary policy can support this process by providing a low and stable inflation environment. This will minimize economic fluctuations and allow our economy to perform at its best. Fiscal policy can help by keeping public finances under control and continuing to reduce Canada's debt burden. The right balance of taxes and government services is also important. A stable, innovative financial sector can also help, by ensuring that financing flows efficiently to where it is needed the most.

All this will go a long way towards providing an environment in which Canadian companies can go about their business confidently in a world of rapid change. It is the business community, however, that must take the innovative, and sometimes risky, decisions that are necessary to improve productivity and competitiveness, in order to meet the challenges and realize the gains of proliferating technologies and increasingly open world markets.

There is no reason why we in Canada cannot meet these challenges and build a better economic future for ourselves.