
Promoting Economic Flexibility: A Shared Responsibility

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I. Introduction

- My remarks today are about:
 - the importance of flexibility to economic adjustment; and
 - the need to adopt economic policies that promote flexibility in markets for goods, services, capital, and labour.

II. What is Economic Flexibility?

- Flexibility refers to the ability of an economy to adjust to changing circumstances.
- Changes in economic conditions typically cause movements in relative prices, which in turn send important signals to markets.
- A flexible economy is one that adjusts to these signals and returns to its production potential as quickly, and with as little cost, as possible.

Why is Flexibility so Important?

- Over the past several years, economic expansion in Canada (and around the world) has been robust despite a series of major global and country-specific shocks.
- In the past, these shocks would have caused great difficulty and threatened to derail economic growth.

Why is Flexibility so Important?

- This was certainly the case before the mid-1990s when the Canadian economy had a hard time dealing with economic and financial shocks.
- The boom-bust cycles of the 1970s, 1980s, and early 1990s stand out as clear evidence that we did not have our domestic house in order.

Why is Flexibility so Important?

- The year 1995 proved to be a watershed. By then:
 - the Bank had succeeded in reducing inflation and anchoring short-term inflation expectations to the 2 per cent target;
 - the federal budget deficit began to shrink significantly in 1995, and by the 1997/98 fiscal year, it had moved into a surplus position;
 - other structural policies, including tax reform and free trade, were beginning to pay dividends.

Why is Flexibility so Important?

- Canada's economic record over the past decade stands in stark contrast to this earlier period:
 - output and employment have continued to grow steadily since the mid-1990s, even as our economy has been buffeted by a series of significant shocks.

Why is Flexibility so Important?

- Let me recall some of those shocks:
 - the 1997–98 Asian financial crisis, which then spread to Russia and Latin America;
 - the worldwide collapse of the high-tech bubble;
 - the 9/11 terrorist attacks in the United States;
 - SARS and BSE;
 - intensified competition from China and India;
 - and, since 2003, a sharp increase in commodity prices and associated sharp appreciation of our currency.
- Note that all these shocks were either international in origin or in dimension.

Why is Flexibility so Important?

- How have these shocks affected the economy?
- The Asian crisis of 1997–98 and the circumstances we have been experiencing since 2003 have involved large movements in relative prices.
- That is, they have involved sharp movements in the prices of energy and non-energy commodities and in the exchange rate for the Canadian dollar.
- These movements, in turn, have triggered important shifts in economic activity and reallocations of production resources across sectors and regions of our economy.

Why is Flexibility so Important?

- Adjusting to these shocks has not been easy—indeed, for many firms and their workers it has been downright painful.
- Still, total output and employment in Canada have continued to grow at a good clip over the past decade—averaging 3 and 2 per cent a year, respectively.

Why is Flexibility so Important?

- Canada is not the only economy that has coped better with shocks in recent years.
- To varying degrees, other countries have as well—which partly explains why world economic growth has held up better this time around.

Why is Flexibility so Important?

- This increased flexibility has been the product of economic policies and structural reforms that many countries, including Canada, have undertaken over the years to strengthen their economies and make them more resilient to shocks.

Why is Flexibility so Important?

- But this does not mean that we have nothing to worry about as we look ahead.
- We live in an era of rapid change, and we operate in a global environment that is constantly shifting.

Why is Flexibility so Important?

- Uncertainty, risks, and shocks are a constant feature of the economic landscape.
- For Canada, this is particularly relevant given how open our economy is to international trade and capital flows.

Why is Flexibility so Important?

- In terms of risks and sudden developments, the best approach is to constantly ask ourselves what steps we can take to make our economy and domestic markets more flexible, and thus better able to adapt to changing circumstances.
- And we need to recognize that this is a shared responsibility among firms, workers, and policy-makers.

Why is Flexibility so Important?

- Firms and their workers need to be able to respond quickly to technological advances and to shocks that require significant changes in the way they conduct business, the type of goods and services they produce, and the markets they choose to develop.
- A well-functioning market-based economy and clear relative price signals are critical in this context.

Why is Flexibility so Important?

- At the same time, policy-makers need to be wary of barriers to adjustment, such as labour regulations that inhibit the movement of workers from one type of job, or from one sector or region, to another.
- Some of these issues are particularly relevant in our Canadian context, and I will return to them shortly.

Why is Flexibility so Important?

- The key point is that economic policies and structural reforms that enhance flexibility make it easier to withstand shocks and to make adjustments.
- And this helps to maintain output at the economy's production potential.
- Put differently, strong, well-functioning domestic markets for goods, services, capital, and labour are essential to the economic well-being of Canadians.

III. Policies That Promote Economic Flexibility

- In Canada—and in many other countries—better macroeconomic management has been instrumental to the good economic performance of recent years.

Policies That Promote Economic Flexibility

- Specifically, a monetary policy focused on low, stable, and predictable inflation has helped Canadian businesses read price signals more clearly, respond to relative price changes more promptly, and allocate production resources more efficiently.

Policies That Promote Economic Flexibility

- A floating exchange rate—which is the other key component of our monetary policy framework—has also provided an important stabilization mechanism for the Canadian economy.
- Movements in the exchange rate provide clear price signals that help speed up adjustment to shocks with lower overall economic costs than if the exchange rate did not move.

Policies That Promote Economic Flexibility

- A sound fiscal policy, focused on reducing public sector debt levels relative to the size of the economy, has also contributed significantly to economic stabilization.
- It gives governments flexibility to respond to evolving circumstances and unexpected developments.

Policies That Promote Economic Flexibility

- Despite considerable progress in maintaining macroeconomic stability, the growing integration of the world economy has made it clear that this is not enough.
- To enhance flexibility, raise the economy's growth potential, and increase resilience to shocks, we also need structural reforms.
- For Canada, structural reform has a broad context, with priorities across a number of jurisdictions.
- What are some of those priorities?

Policies That Promote Economic Flexibility

- The financial system, with its vital role in supporting a healthy modern economy, has been and will continue to be a priority.
- An efficient and sound financial system enhances overall economic flexibility by helping to redirect capital and resources to the most productive uses, in a cost-effective way, following a shock.

Policies That Promote Economic Flexibility

- Removing internal barriers to the free movement of goods, services, and labour is another key priority.
- This is an area that is rightly attracting renewed attention in Canada, as differences in regional economic performance and shortages of skilled labour are becoming more pronounced, and as demographic challenges begin to intensify.

Policies That Promote Economic Flexibility

- A number of initiatives to remove internal barriers have been undertaken over the years—but with mixed and generally modest results.
- The “Red Seal” program was introduced 45 years ago to help standardize and recognize workers’ trade qualifications.
- The Agreement on Internal Trade (AIT), which was signed by First Ministers in 1994, was aimed at reducing barriers to the movement of goods, services, investment, and labour.

Policies That Promote Economic Flexibility

- More recently, there has been some progress in areas such as procurement practices, enforcement and dispute resolution, and licensing and residency requirements for employment.

Policies That Promote Economic Flexibility

- One important example is the accord reached last April between British Columbia and Alberta to strengthen enforcement and dispute resolution, and to harmonize labour credentials and business regulations and standards by early 2009.
- Another example is the agreement, in mid-2006, between Ontario and Quebec to allow some further, albeit limited, movement of construction workers between the two provinces.

Policies That Promote Economic Flexibility

- Last September, two temporary “foreign-worker units” started operating in Vancouver and Calgary to facilitate the entry of skilled foreign workers into Canada.
- That same month, the Committee of Ministers Responsible for Internal Trade agreed on an action plan that embraces efforts across a range of internal trade issues.

Policies That Promote Economic Flexibility

- And last December, Finance Ministers established a joint working group to examine how progress can be made on improving international competitiveness by strengthening internal trade and labour mobility, and on improving regulatory efficiency.

Policies That Promote Economic Flexibility

- All this is encouraging because considerably more needs to be done to enhance the flexibility and functioning of our internal markets from coast to coast.
- Business regulations and standards, including those for the financial sector, need to be harmonized across Canada. Dispute resolution and enforcement under the AIT need to be strengthened.

Policies That Promote Economic Flexibility

- And, to make our labour markets more flexible, trades and professional designations should be recognized and fully transferable across the country.
- Based on a recent survey covering 50 regulated occupations, more than one-third of the workers in those occupations and about half of those foreign-trained applying for recognition in other provinces, still have problems getting their credentials recognized.

IV. Concluding Thoughts

- As a nation, we are clearly learning from experience and adapting to change.
- Over the past decade, we have done much to implement sound macroeconomic policies and structural reforms that have helped our economy become more flexible and thus more adaptable to change.

Concluding Thoughts

- Canada's strong economic performance in the face of major disturbances over this period attests to the importance of flexibility.
- However, our success to date does not mean that we can rest on our oars.
- Continuous improvement is essential; given the openness of the Canadian economy, we cannot be complacent.

Concluding Thoughts

- Uncertainty, risks, and shocks will be as much a part of tomorrow's economic picture as they have been in the past.
- We all have a role to play in improving our flexibility and adaptability.
- We all have a stake in our nation's economic well-being.
- The Bank of Canada is committed to doing its part.