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CANADIAN VIEWPOINT

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Before attempting to forecast what is going to happen to prices, interest rates, and the market for equities in Canada during this decade, we must consider the outlook for the economy as a whole. Fundamentally, the prospects for general economic expansion depend upon investment opportunities and technological change.

The nineteenth century has been dominated by the first industrial revolution, which was based on coal as the main source of energy and on steel as the main industrial raw material. A second industrial revolution appeared at the beginning of the present century and received its full impetus in North America after World War I. Water, oil, and natural gas become substitutes for coal as sources of energy. New uses were discovered for nickel, aluminum, copper, lead, and zinc, often as substitutes for steel. Wood became the basic raw material in the production of paper.

The new technological revolution brought substantial changes in almost every sector of economic activity. In transport, for instance, it produced the motorcar, the airplane, and the Diesel locomotive and, in the field of communications, radio and later television. In many other fields as well, it developed new products, such as electrical appliances and chemical products and new methods of production.

The new technology created a vast potential of new investments, especially in countries which had the resources it required. It greatly favored Canada in particular and North America in general, but it left western Europe in a bad position. Canada and the United States developed rapidly, taking full advantage of the new investment opportunities. Prospective profits were high, private capital was readily available, and private enterprise dominated the scene of economic development in North America.

Our postwar boom was caused mainly by the backlog of domestic demand accumulated during the war, the economic dislocation of Europe, the Korean War, and renewed international tensions. It now appears that the boom which served to strengthen confidence in North America's economic future was the last phase of a long period of growth rather than the beginning of a new one.

Indeed, several signs indicate that the North American economy has been suffering since the late 1950's from basic weaknesses and lack of growth at a time when our labor force was and still is increasing rapidly. For instance, gross national product, in constant dollars per capita, increased by 22 per cent in Canada between 1949 and 1956 but has declined by about 4 per cent since 1956. That is a most revealing sign of stagnation.

What seems to be the origin of that new trend? A rapid survey of the major components of gross national product shows that consumer expenditures, exports, and government expenditures have continued to contribute to growth. Investment is the only component which has declined. Between 1947 and 1957, total investment in constant dollars more than doubled and increased each year except in 1954. Between 1957 and 1961 it has decreased each year, and the decline reached about 13 per cent in 1961. During the same period investment in business capital, as opposed to housing and social capital, showed a reduction of approximately 25 per cent.

Why is investment declining? Mainly because we have lived under the conditions created by the second industrial revolution for more than forty years. We have, during that long period, almost fully exploited the investment and growth potential of the prevailing technology. Some of our older industries are declining; others of more recent origin have reached their maturity, and they expand at a much reduced rate. Declining investment opportunities have been accompanied by the emergence of more and more depressed areas. The same basic trends have been at work in the United States.

If the foregoing assessment of the situation which has developed in North America in recent years is right, it means that the rate of economic expansion provided by the private sector of our economy will be much lower in the 1960's than it has been in any other decade of the present century—except, of course, the depressed thirties, which resulted from severe stagnation in Europe—unless another major and favorable technological breakthrough suddenly develops. When investment opportunities are lacking and prospective profits are not too bright, private initiative cannot be expected to assume the leading role in providing rapid expansion. This means also, since we have not yet reached the stage of another technological revolution, that government action will have at least temporarily to fill the gap if we are to get the additional growth necessary to attain desirable levels of employment.

Three conclusions related to our specific topics can be derived from that general outlook:

1. We are not likely to suffer from inflationary pressures in the 1960's.
2. There will be a relative abundance of capital.
3. Government borrowing requirements will become relatively more important as a factor determining the demand for funds.

Those conclusions deserve further comments. In the situation ahead characterized by unused capacity, demand factors which can be the most powerful inflationary forces will not exercise any material upward pressure on prices. This does not mean, however, that the general price level will remain stable or will go down. Private monopolistic controls will continue to operate and to push prices up gradually. Nothing has been done yet in Canada to check the use of market power by big firms and big unions, and the efforts which have been made in the United States have been spectacular but sporadic. Without permanent tripartite machinery to provide more effective instruments of three-way communication and co-operation, the use of market power will almost inevitably lead to rising prices. And, since we are not likely to create that machinery in the near future, we will continue to suffer from creeping inflation in this decade, although rapidly rising prices will not constitute a real danger.

In our affluent society the volume of private saving will keep rising, and growing economic difficulties will bring easier money conditions. Thus the supply of funds will be relatively abundant. On the other hand, as a result of declining investment opportunities and creeping inflation, private business investment in current dollars will remain fairly stable at the level reached in 1956. Those factors will determine the long-term conditions prevailing on the market for equities. Since 1956, in Canada, the trend of stock-market prices has been almost constant, and, if it changes at all during this decade, it will most probably move slightly downward.

In the postwar period, governments, both in Canada and in the United States, have been assigned the responsibility for maintaining a high level of employment. Thus, as basic weaknesses continue to develop in the private sector of our economy, governments will have to provide additional credit facilities and fiscal incentives in order to stimulate private spending and to increase their share of total investment. They will not be in a position to balance their annual budgets until reasonably full employment has been achieved. Thus government borrowing requirements will represent a growing share of the demand for funds and will have a dominant influence on the bond market and on the structure of interest rates. If market forces are allowed to play freely and if the money supply is kept fairly stable, interest rates will remain high. Foreign-exchange considerations may also work in the same direction. On the other hand, lower interest rates would certainly help to stimulate the economy and to prevent the rapid increase in the burden of the public debt. It is difficult to decide what factors will ultimately determine government policy. I will venture to say, however, that the level of interest rates will be lower in the remainder of this decade than it has been since 1958 in Canada. That view is based on the anticipation of three recessions between

1963 and 1970 and on the fact that tight money and high interest rates not only are undesirable under such conditions but are also highly unpopular.

To sum up, the general economic outlook for the remainder of this decade is not too bright in North America and especially in Canada. Thus we cannot take growth and expansion for granted in the immediate future as we used to in the past; we cannot assume that private initiative will continue to be in this decade a dynamic force as it has been during the first part of the present century. We must therefore be prepared to fight creeping stagnation and to accept greater government participation in economic affairs if we want to avoid social and political instability. More flexible and more imaginative fiscal, monetary, and trade policies are needed. Greater transfers of funds from the private to the public sector of the economy will be required. Planning has become imperative.

I hope that we will be able to avoid ideological controversies on the virtues and defects of capitalism and socialism. We have to face new problems and new challenges. To meet them effectively, we must develop a new partnership between the private and the public sectors of our economy based on co-operation and consistent action, not on controls and compulsion.