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Inside Canada by Pierre Beaudry

A breakaway ally scenario

How many bankruptcies can Canada afford before it rejects U.S. interest rates and imposes controls?

Canadian bankers and financial pundits have started screaming that "a default crisis" similar to 1929 "is almost inevitable," unless interest rates go down now. Two states of affairs can in fact develop. Either Canada soon becomes the first advanced-sector country to go belly-up in a 1929-style depression, or Trudeau and his gnomes will sever the Canadian economy from its ties with the United States and "manage" the crisis.

It was on June 9, during a House of Commons inquiry on banks, that the scenario started to unfold. The background is the potential collapse of big companies such as Dome Petroleum, sending some big banks such as the Canadian Imperial Bank of Commerce (CIBC) over the edge. The number of bad loans reported by Canadian banks are expected to double this year to C$1.5 billion.

At the hearing, the chairman of CIBC, Russell Harrison, warned that his bank was expected to "lose $327 million this year in bad loans, more than its entire 1981 profit," reported the *Toronto Globe and Mail.* Yet, Harrison pleaded in favor of continued high interest rates, alleging that if they were lowered, about $130 billion would leave Canada.

Speaking for the Commerce's big competitors, on the other hand, Gordon Bell, president of the Bank of Nova Scotia, Douglas Peters, chief economist of the Toronto Dominion Bank, and William Mulholland, chairman of the Bank of Montreal, strongly urged Ottawa to lower interest rates.

Mulholland warned of generalized bankruptcy: "The proportion of pre-tax cash flow of industry in Canada going into interest payments in the fourth quarter of 1981 was 66 percent," he said. "The figure for the last quarter of 1980, one year earlier, was only 25 percent."

The Canadian economy is indeed close to plunging over the precipice. Compared with a drop of 7.4 percent in the U.S. economy, the industrial production of Canada has had a year-to-year drop of 10.4 percent, the worst of all advanced industrialized nations. According to the Finance Department, the country's public debt is now at $122 billion, close to $5,100 for every man, woman and child. Figures from the Bank of Montreal show that the current account deficit for 1981 is $6.6 billion and the national debt payments for this year will reach $18 billion. An accelerating rate of bankruptcies, a post-depression record of 10.6 percent unemployment, inflation over 11 percent, and the Canadian dollar at .77 U.S. dollars and still going down, plus interest rates now at 18 percent, are forcing a policy shift.

Trudeau may be forced to resign; but this is unlikely, since he recently fired the last pro-growth officials who could raise opposition within his majority government, and the next general elections are in 1984. The second, and more probable option, would be drastic measures to break the Canadian economy away from the United States. Trudeau watchers say this option is already being seriously considered.

Following a report from the *Los Angeles Times* on May 23 that Trudeau may be "willing to cut Canada's ties to the American economy" by enforcing some kind of "currency exchange controls," the *Montreal Gazette* editorialized on June 21 that, "if exchange controls are the price of lower interest rates, so be it."

Under such an option, Trudeau would also have to impose draconian wage and price controls and reflate the Canadian dollar, that is print more money. As things stand now, the money supply is close to $2 billion below the target range set by the Bank of Canada for this year. Thus, according to Seymour Friedland of the *Gazette,* in order to prevent big corporations from going under, Canada would have to print up to $3 billion, bringing prime rates down by about four points to 14 percent. However, should the Bank of Canada decide to print money, it could collapse the Canadian currency. This might be the pretext to impose exchange controls.

If Trudeau enforces exchange controls, it will have an immense affect on the United States, since Canada is its biggest trade partner. *Gazette* editorialist Joan Fraser said privately that the worst that could happen to the United States, although she found it unlikely, would be if Canadian exchange controls were to entail a "genuine total debt moratorium."

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