Canadian Dollar Commentary

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February 7, 2007

For the last several months, conventional wisdom has been that the Canadian dollar is falling because of energy prices. On Friday, the loon gapped down and made a new low. At the same time, oil prices have been in an uptrend for at least three weeks and are testing an area that would at least suggest the possibility of another rally back toward last summer's highs. If oil can penetrate this area while the loon continues to fall, the energy excuse for the collapsing loon will no longer be credible, at least for a while.

Now likely affecting the minds of those who trade currencies are the strength of the US economy, which surprises everyone, and some signs of economic weakness in Canada.

Of course, all those Canadian exporters who complained about how badly off they were when the Canadian dollar was rising have likely still done very little to increase their labour productivity. The danger is that the drop of the loon below $.845 will now help them forget about their productivity problems. As a result, very little new investment will occur, so they will have something to complain about when the loon starts to rise again, which it will if oil prices continue to rise and/or the Bank of Canada decides it's time to raise interest rates.

Moreover, a country whose prosperity relies mainly on its ability to trade will continue to see its business community adopt a lackadaisical attitude toward World Trade Organization negotiations and will do nothing to get to a rapid and positive solution. Therefore, we will continue to have less than optimum market access. This will give us continued reason not to invest in plant and equipment that give us economies of scale and allow us to respond efficiently to customer needs. To complete the circle, this will give the Canadian business community the ability to be the victims of oil and interest rates.

I remain convinced, as I have been for several years, that Canada's prosperity and, ultimately, the value of its currency will be determined by its relative productivity. Certainly oil and other resource prices, as well as well as relative interest rates, affect the currency in the short run. But in the long run it has to be reflective of our productivity. Ours is lagging. Every general economic think tank in the country, as well as the OECD have been warning of this for some time. We need to change our attitude toward productivity and we need to change policy directions in at least four areas:

- We need to maximize our access to international markets so that we can take advantage of our strong endowment of resources relative to our population. We need to make every effort to get to a favorable outcome at the WTO, one which has the advantage of providing market access to a new range of countries, reduced competition from countries with large treasuries, and rules, within a dispute settlement system, that give smaller countries some semblance of a fair process.
- We need to change our confiscatory tax policy on capital, capital investment and ownership to encourage investment in plant and equipment, which is required to improve our labour productivity.
- We need to change tax policy in ways that encourage investment in capital that replaces labour. There is no doubt that our current labour shortage is not just an oil patch problem: rather it is a long-term structural problem. The best way to resolve it is to encourage investment, training and incorporation of immigrants in the most optimal way.
- Finally, the quagmire that is the Canadian regulatory system needs to be streamlined so that it is rigorous, fast and encourages innovation.

It would be nice to proclaim that the problem of underinvestment is just a problem of the Canadian business community. However, the truth is that it reflects extremely poor economic policy that has been followed over the last 25 years. Until the policy environment gets changed, nothing will change. And nothing will change unless the business community rallies with a focus on those four policy areas.