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SOME POSTWAR FINANCIAL PROBLEMS

Speech, by G. F. Towers, Governor, Bank of Canada, to Association des Licenciés de l'Ecole des Hautes Etudes Commerciales, Montreal, May 11, 1946

MR. PRESIDENT: the United States and

EXEMPLAIRE DE LA BIBLIOTHEQUE

It is indeed a pleasure to come to Montreal, my home town, to attend the annual dinner of the Association des Licenciés de l'Ecole des Hautes Etudes Commerciales. In particular, I am happy to be present when you welcome your new members, the young men who have just completed their studies. I should like to express to them my best wishes for a happy and successful future.

When we think of young people starting out in the world, to-day, it is borne in on us that it is just a year since the end of the war against Germany, and less than nine months since the collapse of a beaten Japan under the final horror of the atom bomb. For six years Canada has been at war; many changes have taken place here during that time, and even greater changes in the countries where the armies fought and the air forces dropped destruction from the skies. It is not going to be easy to build an economy of peace and plenty, a social order of justice and decency, in a world which has suffered so much destruction and human degradation. It is to the young men of to-day that we must look for new ideas, for strength and buoyant spirit; and it is they who, in the end, however much they may be discouraged at certain times, will have the satisfaction of achievement, of determining the future of the world.

My own field, like yours, is that of economics and finance. In Canada, this means that one is concerned as much with international matters as with purely domestic activities. Our country which extends

from ocean to ocean across the northern half of North America depends for its economic existence upon its relations with other countries, particularly the United States and Western Europe. Our geography has determined our history; we are so situated, so constituted and so peculiarly endowed that we could not, even if we wished, live unto ourselves alone. Accordingly, much that I shall have to say to-night will refer to international developments, as they affect Canada.

But first, let us cast our eyes back over the financial and economic aspects of our situation since 1939. For six years the dominating concern of the nation was the prosecution of the war, and what was done then will continue to affect us in the future in many ways, both good and bad.

It has become a platitude that "whatever is physically possible is financially possible". Certainly no financial obstacles were placed in the way of the war effort in this or any other country.

But financial and economic policy in the broad sense is no less important on that account. The particular financial methods adopted from time to time have a profound effect on the degree of success achieved in national policy as a whole, through their encouragement or discouragement of different activities, or through their influence in promoting or failing to promote a feeling of equity and social justice.

Modern war creates an insatiable demand for everything that can be produced, for constant expansion of productive capacity, for the allotment of human and material resources in the greatest possible degree to the supplying of munitions to the armed forces, companies and other institutions which invest the savings of

and of food and other essentials to both the armed forces and the individuals, or from the banking system. Only to the extent that civilian populations in the theatre of actual warfare. As the rents are raised, directly or indirectly, from the current physical problems of production and transport are overcome, and a savings of individuals out of their current incomes, can borrowing condition of full employment is reached - indeed of over-full be said to be an effective method of combatting inflation. Over employment, of strained productive resources of every kind - the 80 per cent of subscriptions to Victory Loans and other government great problem of inflation arises. No matter how high production borrowings during the war came from individuals and savings bodies, may rise, if nearly 50 per cent of it is directed to the war. After allowing for certain sales since the issue of the bonds, these programme and not available for consumption, a most serious inflation groups still hold 70 per cent of the wartime increase in the national is threatened. Indeed, unless a reasonably successful anti-inflation debt. Total savings by individuals in the form of Government bonds, programme is carried out, the nation will not succeed in making a savings deposits, currency and insurance are to a very large extent full war effort, and the attempt to do so will be much more costly in the other side of the picture presented by the increase in the money terms, and will lead to unbearable social conflicts as first public debt.

one group and then another finds its position seriously injured.

These figures tell the story of a magnificent savings

In the first year or two of the war, there was room for effort by all the people of Canada, and of the untiring efforts of expansion of production without undue strain, but from late 1941 - the thousands of persons who helped to organize and carry on the and especially after the United States became a belligerent also - national savings campaign. In this effort, I am happy to be able to the maintenance of a maximum war effort without too great or too record the fact that the Quebec Committees and the individual rapid a rise in prices was the dominant objective of financial and citizens of Quebec established a magnificent record: economic policy.

Taxation and Victory Loans are financial methods; in

The first weapon in the fight against inflation is always addition there are the direct physical controls of production and taxation; the second is the encouragement of people to save whatever distribution. By prohibiting or restricting the production of possible out of their current income instead of spending or attempting certain goods, competition between civilian and military demand for to spend it all. Taxation cannot do the whole job. The target which specific materials or production facilities is reduced. By rationing was achieved was to raise by taxes slightly more than 50 per cent of such commodities as are available in limited quantity, the bidding up total government expenditures. The remainder had to be raised by of prices is likewise discouraged and more equitable distribution borrowing, either directly from individuals, or from insurance applied. Finally, there is price control, which alone could not companies and other institutions which invest the savings of

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possibly succeed, but in conjunction with the other methods individuals, or from the banking system. Only to the extent that the funds are raised, directly or indirectly, from the current savings of individuals out of their current incomes, can borrowing be said to be an effective method of combatting inflation. Over 80 per cent of subscriptions to Victory Loans and other government borrowings during the war came from individuals and savings bodies.

The domestic problem of inflation has continued from the war period into the transitional postwar period, but will eventually disappear. Before pursuing that subject further, I should mention an important matter in our international financial affairs, namely, foreign exchange control, which looks as if it will be a continuing postwar institution in Canada and in all other countries except perhaps the United States. Total savings by individuals in the form of Government bonds, savings deposits, currency and insurance are to a very large extent public debt.

The Foreign Exchange Control Board was one of the many first special wartime bodies to be established having been set up by effort by all the people of Canada, and of the untiring efforts of the thousands of persons who helped to organize and carry on the national savings campaign. Although a considerable amount of work had been done, the introduction of foreign exchange control was a most difficult task. It had to be done overnight for in the circumstances citizens of Quebec established a magnificent record. In this effort, I am happy to be able to record the fact that the Quebec committees and the individual was a most difficult task. It had to be done overnight for in the circumstances of that time any preliminary notice would have encouraged and aggravated that flight of capital and instability of exchange rates which it was the very object of the control to prevent. However, the job was done, with the co-operation of all groups affected, the banks, commercial businesses, exporters and importers and the general public, and effective machinery to safeguard and conserve the supply of such commodities as are available in limited quantity, the bidding up of prices is likewise discouraged and more equitable distribution achieved. Finally, there is price control, which alone could not

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possibly succeed, but in conjunction with the other methods it provides one more very explicit discouragement to inflationary pressures and plays a most important role, like rationing, in protecting the weaker economic groups in the community and maintaining a tolerable social balance.

The domestic problem of inflation has continued from the war period into the transitional postwar period, but will, we hope, eventually disappear. Before pursuing that subject further, I should mention an important matter in our international financial affairs, namely, foreign exchange control, which looks as if it will be a continuing postwar institution in Canada and in all other countries except perhaps the United States.

The Foreign Exchange Control Board was one of the very first special wartime bodies to be established, having been brought into existence on September 16, 1939, or just six days after Canada declared war on Germany. Although a considerable amount of planning had been done, the introduction of foreign exchange control was a most difficult task. It had to be done overnight, for in the circumstances of that time any preliminary notice would have encouraged and aggravated that flight of capital and instability of exchange rates which it was the very object of the control to prevent. However, the job was done, with the co-operation of all groups affected, the banks, commercial businesses, exporters and importers and the general public, and effective machinery to safeguard and conserve our supply of gold and foreign exchange has been in operation ever since.

We are accustomed to think of war as a great... of gold and foreign exchange has been in operation ever since. The years afterwards. I do not speak now of... tremendous personal sacrifices of the fighting men and their...

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The drain on our foreign resources, especially in the first two and a half years of the war, was a matter of very grave concern. We cannot help but buy much more from the United States than they buy from us, because of the nature of our trade and the differences between our two countries. Normally, we are able to do this because we sell more to Great Britain and Europe and other countries than we buy from them. They pay us the difference, and we pay the United States, and the United States in turn pays certain other countries. But the coming of war in Europe meant that our customers could not long continue to provide us with U.S. dollars, or to keep their own currencies convertible into U.S. dollars, and we ourselves, therefore, had to be prepared to limit, by one method or another, our expenditures in the United States, and in particular to prevent the added drain of a possible flight of capital.

I will not go into the details of what was done. At one time we were very near the bottom of the barrel, but with the aid of our own control measures and of the co-operation of the United States in placing war orders in Canada, we were able to get by and more than re-establish our former reserves of gold and U.S. dollars. Our position to-day seems to be good, but I do not feel that the future outlook is so good that we could run the risk of abandoning the machinery of foreign exchange control.

We are accustomed to think of war as a great burden, a tremendous expense, an imposition of hardships which will endure for years afterward. I do not speak now of human misery, of the tremendous personal sacrifices of the fighting men and their

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families, nor of the sufferings of civilian populations in the battle zones or under enemy occupation. I am talking only of the material cost of war, and its effects, the production of vast quantities of goods for destruction rather than consumption, the using up of material resources. The extraordinary feature of the material war effort of both Canada and the United States was that it did not involve a reduction in total civilian consumption, or in total production of goods and services for civilian use, but came entirely out of a tremendous increase in production. Previously undreamed-of levels of economic activity were achieved, under the stimulus of an inexhaustible demand for particular types of goods and services and a dominating national objective. In the course of this war effort, the standard of living of the people as a whole rose. The production and consumption of civilian goods and services increased to and remained at a higher level than ever before in our history. Undoubtedly some groups, particularly those of the upper and upper-middle incomes, suffered a curtailment in their net incomes and in their standard of living, but the great majority, especially agriculturalists and wage-earners, received higher family incomes and bought greater physical quantities of consumption goods than ever before. This raising of total consumption accompanied by greater equalization of incomes and living standards is typical of the early stages of any period of full employment, and should be a social objective at all times, but it would not have been possible in the circumstances of the war if these various anti-inflationary

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measures which I have mentioned had not been reasonably successful. For total money incomes of individuals more than doubled between 1939 and 1945, even after allowing for personal income taxes, while the production of goods and services for civilian use increased by something of the order of one third in physical terms. In such circumstances, continuous inflation of prices, especially of finished goods, would be certain to occur, in the absence of vigorous Government measures of control. The rise in prices would far outstrip wages and salaries and farm incomes.

The end of active hostilities in Europe and the Far East, as and the termination of direct war production, did not mean that the danger of inflation was over. While heavy expenditures for war supplies quickly came to an end, there was and still is in Canada and other countries a great excess of money incomes, of money available for spending, as compared with the volume of goods available for civilian consumption. In our own country we are spending in 1945 and 1946 over a billion dollars to war veterans by way of gratuities, allowances and rehabilitation grants and loans, to assist them in making their own personal reconversion. Although there has been a certain amount of transitional unemployment, the total incomes of primary producers and wage earners are being maintained at a very high level, partly because of the continued high volume of exports which we are making to European countries. These are being made possible by funds to the value of two billion dollars which is being loaned by the Government to Allied countries over a period of two or three years.

It was natural, therefore, that much of North American



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thinking. So the end of the war did not mean an immediate end of the now familiar wartime threat of inflation, but it did bring other changes. New situations have to be dealt with before the difficulties and dangers of the old have passed. Within our own country we have had to reconvert from a war economy to a peace economy. In other countries, similar problems exist, of a much more serious character in the case of those whose cities have been laid waste, factories destroyed, and farm lands ruined by enforced neglect. The problems of these other countries, or most of them, are of very serious concern to Canada. We could not long exist as an independent nation without our foreign trade. There are many things we must import, which we could not produce here, or only at very heavy cost. There are many other things we can and do produce efficiently in Canada beyond our own needs, and so must export if we are to benefit from our national advantages. The same considerations apply to the United States. Their direct economic reliance upon foreign trade is less than ours, it is true, because of their greater endowment of a broader range of natural resources, but it is great enough for them to regard both the volume and the conditions of international trade as matters of the highest importance. And both of our countries have reason to take a profound interest in the maintenance of peace. The establishment of social stability and some degree of orderly economic progress in other countries is essential to the maintenance of peace in the future. It was natural, therefore, that much of North American

thinking and planning for the post-war period should have been concerned with international relations, the reconstruction of Europe and other wartorn countries and the re-establishment of world trade and exchange. It was realized, long before the war was over, that when peace came many countries would be so damaged internally, and have suffered such losses of their external resources, as to be unable to re-establish commercial relations with the rest of the world without assistance. It was realized also that the whole economy of North America would be violently disrupted if our industries and primary producers were suddenly faced with a cessation of wartime markets unaccompanied by restoration of normal and necessary peacetime markets because of inability to pay. Special measures for the transition period had to be planned, or else there would not be a transition, a successful adjustment from war to peace, but an indefinite period of social and economic chaos throughout the world.

For the long-run tasks of ensuring adequate finances for world reconstruction and development, an international bank was agreed upon at Bretton Woods in July 1944, and established at the recent meeting in Savannah, Georgia, with more than forty countries as members. Most of the funds raised or guaranteed by the Bank in the early years may be expected to be spent in Canada and the United States, and ultimate payment is guaranteed by all countries which are members of the Bank. There was likewise established an International Monetary Fund, with a code of rules of international conduct in respect of the regulation of foreign exchange transactions

All these desirable things, however, simply cannot be and rates, and a supply of gold and foreign currencies available to member countries at times when their own supplies of foreign exchange are being exhausted. Both these Institutions have yet to prove themselves. They cannot by themselves bring about economic stability and progress in the world, but they have been established in the hope that they can make some contribution as part of a wider effort - if such materializes - to maintain the highest possible level of international trade and orderly relationships between the various national currencies. In each case, a Canadian has been elected to the 12-man Board of Executive Directors.

Of even greater potential importance are the commercial policy proposals made public last December by the United States, and supported in principle by the United Kingdom. These suggestions for the reduction of tariffs and other trade restrictions, for the adoption of rules of international trade, regulation of international monopolies and supervision of commodity agreements are still only in the proposal stage. They will have to be discussed at international conferences, and a wide measure of agreement will be necessary. The success or failure of these talks will depend very largely on the responsible leadership and practical good sense shown by the United States, but all countries must co-operate if it is desired to create healthy conditions for the widest degree of international trade, convertibility of foreign currencies and protection of our exporters and producers from unfair competition.

But in truth, as a matter of intelligent self-interest, we

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have no All these desirable things, moreover, simply cannot be helped and achieved without the restoration of economic activity in those price countries, particularly in Western Europe, which did not need price emergency help from UNRRA, which can pay their way in the long run, but which do need assistance in the immediate post-war period. It is pre-eminently Canada and the United States which are in a position to provide that assistance by selling goods on credit. Present programmes comprise goods to the value of \$8 billions to be provided on credit by the United States, and goods to the value of \$2 billions to be provided on credit by Canada. These amounts represent, broadly speaking, what each country expects to be able to export on over and above such exports as are balanced by imports; since in imports represent the only form of immediate payment of real value to us, the excess of our exports can only be sold on credit terms, that is, for deferred payment. The United Kingdom is becoming the largest single debtor in this period, both to Canada and to the United States, because it is most dependent on overseas supplies and it is always the largest single importer in the world—and can only gradually restore its export production which was restricted during the war in order to release manpower and materials for war purposes. No doubt many people in North America feel that these loans, which for convenience we express in terms of money but are really shipments of goods which we produce, should be made in recognition of a moral responsibility resting upon two strong, wealthy, Christian nations which have not themselves been harmed economically by the war. But in truth, as a matter of intelligent self-interest, we

have no practical alternative. Some of the goods, such as ships and heavy machinery, which we are sending to Europe and other countries to help their reconstruction are the product of wartime industries which could not make a sudden and complete adjustment to the conditions of a peacetime domestic market, but which by this means are able to continue production and cushion the decline in employment while making a gradual and orderly adjustment over a period of several years. That is an obvious case of our immediate self-interest in specific activities which are of vital importance to European reconstruction. But in other fields the long-run advantage is the important one. No doubt a limited amount of our present exports on credit could be sold to other countries, not indeed for payment in valuable goods but for payment in gold or foreign exchange accumulated especially by several neutral countries which now are eager to buy, wherever they can, the products which were denied to them during the war. But once they have satisfied their accumulated demand there is little likelihood that they would continue to buy from us. We would then find that we had failed to re-establish those other countries which, historically and by the nature of their own economies, are most likely in the long run to provide a continuing market for us, and which are also most likely in the long run to be able to provide us with their products, if and to the extent that we choose to take them. Building of every kind, is in part an abnormal and temporary demand to what I have described represents the continuance during this transitional period of a policy with respect to exports and imports which harmonizes with our traditional economic pattern as

well as with the special features of our wartime development. This does not mean that we are tying our hands for all time to a particular type of economic activity, but until we can see the future more clearly we should be foolish to throw overboard the familiar things that we know about and which served us well in the past. No doubt there will be changes in due course, but it is important that such changes should come gradually and in response to developing conditions over a period of time rather than that they should be suddenly forced upon us in the space of a year or two. Only if we can restore order and strength in the economic world as we know it, will we be in a favourable position to make progress and meet changing conditions in the future.

At present, it is dangerously easy to take an optimistic view of the state of trade and employment. There is danger of forgetting that we are still in a transitional period, not in a normal peacetime. But the present emergency situation with respect to food, for example, will not last forever, perhaps not beyond the next harvest or that of the following year, and our farmers and fishermen will once again be dependent for their surplus income on the state of employment at home and on the desires and policies and prosperity of their customers in other countries. The present demand for clothing and household goods and automobiles, and even for houses and new building of every kind, is in part an abnormal and temporary demand to make up for wartime shortages and to replenish inventories in the hands of manufacturers and distributors - to fill up holes, as someone has said. Those who are not prepared to make adjustments,

to meet new conditions in the future, may suddenly find themselves, when the excessive demand disappears, with stocks of relatively high-priced goods on their hands at a time of falling prices and more limited demand or shifts in demand.

We must realize, too, that much of the better post-war world which we hope to see, is a world, not a single country. We are making one more great effort to establish an international order, for in that way we believe we can achieve greater economic and social progress than if each country endeavoured to produce for itself everything it desired to consume, no matter how inefficient or expensive such production might be. This great objective is well worth attempting. The chief reason for hope in the past few years has been the attitude and energetic activity of the United States, which has beyond doubt assumed the leadership of the international movement among western countries. With their great power, the people of the United States can, if they choose, establish and maintain a form of world organization based largely on American ideas of liberal democracy, devoted to peace and progress, and enabling the United States to preserve the great position they have won. But such a world system cannot function unless the United States continues along the road on which they have started. And even with the best will in the world, the attempt will fail if the United States itself cannot succeed in maintaining reasonably full employment, a high national income and a high level of imports from other countries which are being asked to maintain their own economies in close interdependence with the United States.

The long-run prospects, therefore, are good only if the United States continues to give a lead in practice as well as in talk. If they fail, the rest of us will be forced to make other arrangements.

In conclusion, I think I should say that I have not intended to give the impression of being actually pessimistic about the future. I think the world as a whole has now a great opportunity. But the terrific shock of the war will continue to make very serious difficulties which can only be overcome by a high degree of international co-operation and appropriate domestic policies.

We are not yet, indeed, in the postwar period. We are still in a transitional stage, moving with the dying momentum of the war effort and of what are really wartime expenditures and credits. We must look ahead to the more distant future and hope that we shall all have the wisdom and the will to work together to our mutual advantage. We would never have succeeded so well in our wartime activities except by the most widespread and wholehearted co-operation such as was so marked a feature of the savings campaign in your own Province of Quebec.

Parliament and the Government cannot, after all, do much more than give a lead and assist in organizing activities which depend fundamentally on the whole people, in town and country, and particularly on local leaders of public opinion. Especially in the economic field, both domestic and international, the facts and ideas which underlie and determine public policy are complicated and not easy to understand without study and careful thought. There is a very real responsibility on those with the advantage of



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special education in these matters to assist in the informing of others, to give a lead to the rest of the community. I should like to close my remarks, therefore, as I began, with a salute to the Licenciés de l'Ecole des Hautes Etudes Commerciales, and with an earnest wish that they may prosper in their private affairs and at the same time make a useful contribution to the public good of Canada, our country.

My best wishes for a happy and successful future. When we think of young people starting out in the world to-day, it is bound in on us that it is just a year since the end of the war against Germany, and less than nine months since the collapse of a beaten Japan under the final horror of the atom bomb. For six years Canada has seen at war; many changes have taken place here. During that time, and even greater changes in the countries where the armies fought and the air forces dropped destruction from the skies. It is not going to be easy to build an economy of peace and plenty, a social order of justice and decency, in a world which has suffered so much destruction and human degradation. It is to the young men of to-day that we must look for new ideas, for strength and buoyant spirit; and it is they who, in the end, however much they may be discouraged at certain times, will have the satisfaction of achievement, of determining the future of the world. My own field, like yours, is that of economics and finance. In Canada, this means that one is concerned as much with international matters as with purely domestic activities. Our country which ext