

CANADIAN BUSINESS, 1939 - 19??

Address by MR. GRAHAM TOWERS, Governor
of the Bank of Canada, to the 1949
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In choosing the title for my remarks to-day - 'Canadian Business, 1939 - 19???' - I did not have in mind giving a detailed analysis of Canadian economic and financial affairs since the beginning of the war, but I did feel that an appraisal of our present situation could be made most effectively by taking into consideration the major changes and developments which have occurred during the last ten years.

Let me take September, 1939, as the starting point, and remind you what our position was at that time. There were about 4,350,000 people in the labour force, of whom perhaps 500,000 were unemployed. The number of men in the armed services was very small. Gross national output for the calendar year 1939 had an estimated value of \$5,600 millions, a figure some 60 per cent above the depression low, but still far below our potential output as later events were to prove. With the commencement of the war, the picture started to change. First gradually, later on rapidly, the unemployed were drawn into productive activities, and the labour force expanded not only by the growth of our population but also by the recruitment of large numbers of women who would probably not have sought employment in peace-time, and by the continued employment of older men. The armed forces increased rapidly, and by 1944 numbered nearly 800,000. Because of this movement into the armed services, the net increase in the civilian labour force between 1939 and 1944 was only 2 per cent, but the volume of its production, and I underline the word 'volume', was estimated to be over 40 per cent greater than in 1939. Effective organization, continuity of production and, last but not least, a heavy investment in new plant and machinery

all contributed to this remarkable result.

A very substantial proportion of the great increase in production had to be devoted to war purposes - to supplying our own forces at home and overseas, and to aiding our Allies. From the beginning of the war until the end of 1945, we supplied our overseas partners in the war with \$11,000 millions worth of goods and services. Of this amount, some \$3,200 millions represented contributions under the Mutual Aid arrangement which was the equivalent of U. S. Lend-Lease. I think a country which then had a population of less than twelve millions can take some pride in this accomplishment. It was not achieved without difficulty. Taxes had to be raised to very high levels, and the public was constantly urged to save as large a proportion of their income as they could possibly manage to put aside. The policies in these fields reflected the fact that such a large proportion of our production was set aside for war use that there were not enough things on which the civilian population could spend all their income without driving prices through the roof. When it was evident that neither taxation nor voluntary saving would be sufficient to prevent an inflationary move, price and wage ceilings were imposed and a number of things were rationed. With the public support and co-operation which were given to these policies, they operated with a considerable degree of success, owing in no small part, I might add, to the success which attended similar measures in the U. S. The result was that the country came into the early post-war period in good shape from an economic point of view. In the middle of 1946, the index of wholesale prices showed an increase of 51 per cent as compared with pre-war, while the cost of living index was up 23 per cent. This

was a very much better result than had been achieved in the 1914-19 period, in spite of the fact that the second war involved a longer and much more intense effort on the part of Canada than the first one had done. Occasionally, and even in the grim business of war, we profit from experience.

Let me turn now to developments since 1945. At the end of the war, there had been some fear that the reconversion period would be marked by temporary unemployment, not because of lack of work to be done, but because of the difficulties involved in shifting two million men and women from the armed forces and production of war materials to the provision of civilian goods and services. This was a very formidable number in relation to the total labour force of slightly more than five millions. In the event, the change-over took place remarkably smoothly; and at no time since the war's end has there been serious unemployment in the country as a whole. Two major problems which faced Canada in these years were,-

- (1) The maintenance of our all-important export trade at a high level in spite of the bad situation of many of our overseas customers.
- (2) Shortage of U. S. dollars.

In referring first to the question of our export trade, let me remind you that it normally accounts for about 20-25 per cent of our total production. We have never had prosperity in Canada without a high level of exports. It was therefore a matter of great practical concern to Canada that our most important customers had suffered very heavily from the war. In those which had been occupied, production was at a desperately low level and could only recover over

a period of years. In the United Kingdom production for export had been all but discontinued in order that the maximum possible amount of labour and materials could be devoted to winning the war. Moreover, the U. K. had lost a large part of her earnings from foreign investments in the process of paying for food and war supplies in the period before Mutual Aid and Lend-Lease came into operation. All these countries desperately needed food, raw materials and other things from Canada. They could not get back on their feet without aid from countries whose productive capacity had not been injured by war. It was very much in our interest, commercially as well as politically, that these countries should regain their strength. With these facts in mind, the Parliament of Canada authorized large loans to the U. K. and Western European countries in 1946, and the U. S. Congress did the same thing. Canadian loan disbursements and relief grants in the years 1946 to 1948 amounted to \$1,600 millions; those in the U. S. to \$15,700 millions.

Time does not permit me to mention all the other arrangements which were made towards the end of the war, or in the early post-war period, to facilitate the restoration of a high level of international trade. Suffice it to say that the problem was attacked on a broad front, and that the actions taken were on a scale and of a kind which represented a vast improvement over the policies followed subsequent to the 1914-18 conflict, just as Mutual Aid and Lend-Lease were more realistic than the war loans made on the earlier occasion. It comparatively soon became apparent, however, that the programme of assistance was inadequate for the purpose, i.e., the restoration of functioning economies in the United Kingdom

and Western Europe at levels which would give some hope of political as well as economic stability. The problems left as a legacy of the last war made those of 1919 look almost trivial by comparison. The degree of destruction and dislocation around the world was much greater. More important, the anatomy of Europe was sliced up by the lowering of the so-called Iron Curtain, and the dismemberment of Germany. To a considerable extent, the task turned out to be one of remaking a large portion of the continent, rather than restoring its previous characteristics and reopening accustomed channels of trade. This may well be the work of a generation or more, rather than of a decade. And there is the further most important factor that this task must be accomplished in the face of efforts by one country to impede progress in every possible way. Fear is a great deterrent to recovery; and Europe is beset by fear.

The need for further aid on a tremendous scale was recognized early in 1947. The form which this aid might take was outlined by General Marshall in June of that year, and embodied in the European Recovery Programme adopted by the U. S. Congress in April, 1948. The sums allotted to European countries in the first year of operation of the Plan, that is, April 1948 to March 1949, have been \$4,900 millions. It is no exaggeration to say that this assistance has prevented not only a breakdown in the recipient countries, but also, by its indirect effects, a most serious upset in a great many other countries around the world. And I include Canada in this list.

It is perhaps not inappropriate at this point to turn to the second Canadian problem which I mentioned a few minutes ago - our U. S. dollar problem. By

reason of the character of Canadian production - by reason, in other words, of the structure of the Canadian economy built up over generations - it is normal for us to have a surplus in our trade with the United Kingdom and Western Europe, and a deficit in our trade with the United States. We used to be able freely to convert our surplus earnings of pounds sterling and continental currencies into U. S. dollars, and thus pay our bills in the U. S. When our overseas customers are no longer able to settle their accounts with us in that way, because they have run out of foreign exchange reserves and have inadequate U. S. dollar earnings from exports, trouble comes to Canada in the form of a shortage of U. S. dollars or loss of markets, or both. For obvious reasons, we ran into difficulties of this kind early in 1941. At that time, however, we were able to make an arrangement in terms of which the U. S. Government undertook to buy from Canada substantial amounts of war supplies which would not have flowed to the U. S. through the ordinary commercial channels of trade. These were extra purchases by the United States, and they took place to the extent of one billion dollars before this kind of purchasing ceased in 1945. It was only in this way that Canada could earn enough U. S. dollars to purchase war supplies and other necessities from the United States. Here let me emphasize an important point. Canada is not lacking in productive capacity. We did not need nor did we receive Lend-Lease assistance. Provided we were able to import and pay for say twenty cents worth of essential materials or parts from the United States (and I use this figure only as an illustration) we could turn out a dollar's worth of finished goods. But without those materials or parts, much of our machinery would cease to work, and to that

ent our productive capacity would go to waste. It may be added that peace does not change the situation in this respect. The war-time arrangement with the United States was an essential factor in enabling us to supply our Allies with \$11,000 millions of supplies during the war, and thus make an important contribution to victory. It was by means of the Hyde Park Agreement that the threatened U. S. dollar crisis of 1941 was overcome. The problem returned to plague us in 1947. Again it did not arise from any lack of productivity in Canada. Our current account transactions with the rest of the world in 1947 produced a small surplus for Canada in spite of the fact that our imports from the U. S. that year reached the hitherto unprecedented level of nearly \$2,000 millions. In times past, when a very substantial amount of capital development was taking place in this country, we usually had an over-all deficit in our international transactions on current account which was covered by investment from abroad. In 1947, however, we would have been able to pay our way if our overseas customers had been in a position to pay cash for all their imports from Canada. Actually, Canada extended \$600 millions of relief and credit in that year. For that much of our exports we received no immediate payment. But we had to pay cash for all our imports. The result was that our reserves of gold and U. S. dollars were very seriously depleted, and import and other restrictions designed to reduce the demand for U. S. dollars were introduced in November of 1947. From that time on, Canada's exchange position improved. Indeed, from most points of view, 1948 turned out to be a most successful and fortunate year for this country. A whole array of figures could be brought forward to support this statement, but I shall mention only a few. The export figures are amongst the most significant. Our sales to the United

States increased in value by 45 per cent as compared with 1947, and our trade deficit with our neighbours to the south was reduced from about \$900 millions to a little less than \$300 millions. The surplus in our current account transactions with all countries increased from \$85 millions in 1947 to \$472 millions last year; and as our direct extension of relief and credit to other countries was limited - unavoidably limited, in the circumstances - to \$145 millions (net) our reserves of gold and U. S. dollars increased by \$346 millions, plus \$150 millions borrowed in the United States during the year. At the end of the year, holdings of gold and U. S. dollars amounted to nearly one billion dollars.

During 1948, capital development continued on a grand scale. The \$3,000 millions which it was estimated was spent for these purposes, served to increase our productive capacity, helping not only to relieve domestic shortages but also to increase our present or prospective ability to earn U. S. dollars or to lessen our need for that currency. Oil developments in Alberta are a case in point. It is true that not every aspect of the Canadian picture was rosy. The cost of living index went up by 8 per cent during 1948, and cost of construction, already relatively high, experienced a further upward move. By the end of the year, however, there was evidence of a lessening of inflationary pressures as supply and demand came into better balance in a number of lines.

Let me quote a few more figures to remind you of the development which has taken place in Canada since we last experienced peace-time prosperity and full employment. I will compare the years 1928-29, taken together, with the years 1947-48 taken together. Between these two periods, the volume of our

over-all output is estimated to have increased by more than two-thirds, although during that time the population increase was only 28 per cent. I wish that I could cite statistics to show that during these twenty years our dependence on foreign trade has lessened materially. The truth of the matter is that it has not done so. Hence our preoccupation with international trade.

What of the future? I do not propose to enter the decimated ranks of the forecasters. I recall the sad fate of the political prophets in the United States last November, and I have also been reading recently business forecasts which were made by most reliable authorities on various occasions from 1920 onwards. The score is very low. I think it worth while, however, to take a look at some of the salient features of the Canadian situation. One of them is the changed situation of a number of our important and traditional customers. Up to now, this has not prevented the maintenance of a high level of prosperity in Canada. The various means by which difficulties have been avoided or overcome have been indicated earlier in my remarks. How long this course can be maintained is obviously the \$64 question. We cannot hope that Europe's difficulties are going to disappear over-night. I suggested earlier that the recasting of Europe may be the work of a generation unless the political atmosphere changes for the better. Most of these countries have been receiving ERP aid. At the same time, they have been urged to initiate programmes which will eliminate or greatly reduce their dollar deficits by 1952. There are various ways in which this goal can be reached. The countries concerned can reduce imports, or shift their purchases from dollar sources to non-dollar countries. The most constructive line consists

in the attempts which they are making to increase their exports to dollar countries, but a long way remains to be travelled yet.

So far, the countries receiving ERP aid, and the currency areas associated with them (which include the whole of the sterling area) seem to be relying very heavily on the curtailment of imports from dollar countries as the method of reducing and ultimately eliminating the deficit in their dollar accounts. To an increasing extent, imports requiring dollar outlays are permitted only if they meet two conditions - first, that they are essential, and second, that they are not obtainable elsewhere than in the dollar area. At the same time, the countries within the group have taken special steps to develop trade with each other. As part of the ECA arrangements, for example, the participating countries have agreed (in return for equivalent aid from the United States), to extend grants to each other to an amount of \$810 millions this year. In addition to a net contribution of \$280 millions under this arrangement, the United Kingdom has agreed to make unrequited exports of about \$200 millions to other participating countries by authorizing a drawing down of blocked sterling balances to this extent. And apart from these purely financial techniques for developing trade within the sterling area -ERP group of countries, and between these countries and other non-dollar countries, other more direct methods have been extensively used. I refer to bilateral trade deals about which I shall have something to say in a moment.

Developments along the lines I have been talking about have already had an adverse effect on certain Canadian exports, particularly of manufactured goods and non-staple foodstuffs. Foreign import and exchange restrictions

have borne heavily on these lines during the past year. The restrictions have also, of course, been applied to similar exports from the United States. Up to the present, this appears to have occasioned no particular difficulty in the U. S. as the ECA has welcomed the reduction in the dollar deficit apparently achieved by these practices, and United States producers have, broadly speaking, not been confronted with serious marketing problems.

One must, of course, recognize that the ERP-sterling area countries are confronted with very special dollar problems and that until their economies are restored from the effects of the war, and their balance of payments brought into a reasonable equilibrium, the normal trading rules - such as non-discrimination and currency convertibility - may not be fully applicable. What one would like to be convinced of is that the trading methods now being adopted will not unduly prolong the period during which reliance has to be placed on restrictions and discrimination. Some at least of these methods seem to point in the opposite direction. Importers in the countries concerned buy from non-dollar countries, even when they have to pay higher prices, because they are not allowed access to cheaper sources of supply, or that access is strictly limited as to quantity. Conversely, exporters can often get higher prices by exporting to others in the group than by exporting to dollar countries. The effect of trade within the protected area taking place at higher prices means that the normal tests of competitive capacity are suspended. This inevitably tends to distort the normal channels of trade, and may very well impair the true productivity of the countries forming the area, as well as their competitive ability to earn dollars. The division of the western world into two trading blocs has possible political and

economic consequences which are not pleasant to contemplate.

To some extent, this division is already in effect - as Canada has reason to know. If the problems arising from this situation become more serious as time goes on, what courses of action are open to countries such as Canada? In considering the possible answers to that question, we can be certain of one thing, namely that there is no easy financial device by which the difficulties can be overcome. A country whose traditional customers can no longer make purchases in their accustomed volume can try to find alternative markets for its goods. It may also try to employ in domestic activities the labour and materials which the export trade can no longer use. It can, of course, help its traditional customers to obtain their supplies by extending loans or making gifts. While such a policy may be a sensible one in a period of reconstruction, it can hardly be regarded as a permanent solution of the problem. Finally, lacking other alternatives, countries in the position I have been discussing may feel impelled to adopt special measures to facilitate trade. In some cases, these measures may take the form of the so-called bilateral trade deals which have become so common. These deals in their modern pattern are not normally operated on the basis of bartering one commodity for another. It is customary to name a number of things which one country will sell to the other. In some cases, target figures are set, both in respect of quantities of specific articles and the over-all value of trade which it is hoped will be done. The actual results, however, depend in the main on purchases and sales through normal commercial channels, except in the case of the totalitarian states. But the vital feature of

these arrangements is that the parties to them, by restricting or even prohibiting importations from other countries - or at least from countries outside the group - make it more likely that they will achieve the targets set for trade between each other. The element of outside competition is removed or lessened. Price and quality are no longer the final determinants of the course of trade. The policies followed are such as to make classical economists turn in their graves. But the usual answer to any criticism of these methods is that there are no alternatives.

In my remarks to-day I have not intended to be critical of other countries, or pessimistic in regard to our own situation. So far as Canada is concerned, I have painted the picture of a country which has made great strides during the last ten years, with the result that the volume of production and the standard of living of its people are higher than ever before. The quality of our population, and the character of our resources, are sound justification for an optimistic view of Canada's future. We cannot forget, however, that in the short run at least we are highly vulnerable to outside influences; and we are living in the aftermath of an extraordinarily destructive war. It is important, therefore, that we should understand the developments which are taking place around the world. Understanding will lead us to the conclusion that all efforts should be directed towards the maintenance of international transactions at a high level. We on this side of the dollar fence (and I am not talking about Canada only) have responsibilities in this connection as well as the ERP-sterling area countries. One such responsibility is to see that imports from these

countries are encouraged as much as it is possible to do so. The United States alone is in a position of such unassailable international liquidity that it can afford to be undeterred by balance of payments considerations. But all of us, to the full extent of our powers, should guard against the mentality of restriction and contraction, and should seek that greater wealth and greater development which come from enterprise and expansion.