

Address by Mr. GRAHAM TOWERS,  
Governor of the Bank of Canada,  
to the Pacific Northwest Conference on Banking,  
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As those who are responsible for organizing this Conference asked a Canadian to address you, I have assumed that you would be interested in hearing about Canadian affairs in recent years. I propose, in the first instance, to give a fairly brief description of our material progress since the end of the war and of the circumstances which made it possible. Then I would like to tell you something about Canadian ideas and policies in the field of international trade and international economic and financial relationships.

Before going further, may I say that I am well aware of the fact that Canada has had a lot of good advertising in the United States in recent times. One reason for our name appearing so frequently in your newspapers and other publications has been the premium on the Canadian dollar. From the point of view of newsworthiness in the United States, that event falls into the category of "Man Bites Dog". Another reason, and perhaps a more important one, is that we have been pushing out our frontiers and embarking on rather spectacular new developments in territories which only a few years ago were the home of the trapper, if indeed they were the home of anyone at all. I suspect that Americans have a certain nostalgia for the exciting days when you were opening up a continent, and the sight of this kind of thing going on to the north of you, even on a very much smaller scale, tends to capture American imagination. In the circumstances, I shall be careful not to describe our situation too optimistically nor to convey the impression that Canada is a land of milk and honey. We have had good fortune in our resources and our people, but like everyone else we have our troubles and handicaps.

I must say, however, that the element of good fortune has been particularly in evidence during the last seven years.

First of all, the transition from war to peace in the business field took place with surprisingly little upset or unemployment even though one and a half million war workers and members of the armed services had to change the form of their activities; and one and a half millions is a formidable percentage of an adult population of less than 9 millions. Subsequently the maintenance of a high level of business has been made possible by a number of factors of which I will cite only the more important. Speaking here today, it seems fitting that the first one I should mention is prosperity in the United States and the substantial growth of your population both of which have helped us to increase our exports to you from about \$900 millions in 1946 to about \$2,350 millions in 1952. Eliminating the price factor, this represents an increase of about two-thirds in volume in only 6 years. In contrast the physical volume of our exports to all other countries taken together was not greatly different last year from what it was in 1946.

The growth of our own population during the post-war period has been a dynamic factor of very considerable importance. The population of Canada has risen from 12½ millions in mid-1945 (including Newfoundland, though of course Newfoundland did not join Canada until 1949) to 14½ millions in mid-1952, an increase of 16 per cent compared with 12 per cent in the United States. The disparity between the two countries in population growth is mainly accounted for by Canadian immigration policy; net immigration added about twice as much proportionately to our population as it did to yours.

Another factor in the continued increase in the level of business, particularly in the early post-war years, has been the backlog of demand built up during the war for housing, durable consumer goods and many other things.

Since the outbreak of fighting in Korea the armaments industry has added its very large demand on our productive resources. For a time this made it necessary to take steps to cool off certain types of civilian demand.

Last, but not by any means least, very considerable success has attended the search for hidden riches in the natural resource field. A high level of demand at very good prices for most primary products provided incentives for this search, and improved scientific methods of exploration have contributed to the success achieved. As you well know, the effect of substantial new developments of this character spreads right through the economy. Roads, railways, power plants and towns have to be built, and processing facilities have to be installed. Oil and natural gas discoveries breed other industries, particularly in the chemical field. And so it goes.

All the factors to which I have referred, combined with a number of other things, have resulted in a great increase in the establishment of new industries and in a great increase in our plant and equipment. During the seven years between the end of 1945 and the end of 1952 new capital investment exclusive of inventories has totalled \$24 billions; this figure includes investment by businesses, by individuals and by all levels of government. Over the whole period it has averaged about 20 per cent of our gross national product and it has recently been running at the high level of 22 per cent. In addition to this, business and farm inventories have risen by some \$5 billions since the end of the war.

I would expect this audience to wonder how this proportionately very large volume of new capital development was financed, and where the savings came from. Actually there were a number of years when we bit off a little more than we could chew - with resultant inflationary pressures. A number of steps of an anti-inflationary character were taken, but I cannot measure their

effectiveness because I do not know what the situation would now be if other policies had been followed. Suffice it to say that, while we did not avoid the inflationary effects of World War II and Korea to any greater extent than you did, we are no worse off than the United States in this respect, and, by the same token, we are a good deal better off than almost any other country. For nearly two years wholesale prices have been declining from the high level which they reached nine months after Korea, and for the moment at least the risks of further inflation do not seem too formidable.

Coming back to the sources of savings which financed the 1946-52 capital investment programme, the most important single contribution came from the retained earnings of corporations; depreciation allowances and undistributed corporate profits together provided almost exactly one-half of the funds required. A further quarter came from personal savings. In the years since the war personal savings have been relatively high; the rate of saving has averaged about  $8\frac{1}{2}$  per cent of personal disposable income over the period, and it has run at about  $10\frac{1}{2}$  per cent over the past two years. These high rates of personal saving have made it possible for us to handle our large investment programme with a good deal less inflation than we would otherwise probably have had. The final quarter of the savings necessary to finance our total investment outlays came from our governments. Over the period the total revenue of all governments - federal, provincial and municipal - substantially exceeded their total outlays for current purposes; the difference was used in part to finance the investment programmes carried on by the various governments themselves and the remainder, which was considerable, became available to finance private investment.

You will perhaps have noticed that I have accounted for all of the saving required to finance our post-war domestic investment programme without

any reference to receipts of capital from abroad. This may seem to you a little puzzling in view of the very large amounts of capital which have moved into Canada from the United States in recent years; for example, in the years 1946 to 1952 inclusive we received from the United States over \$1 billion for direct investment in Canada and about \$1½ billion from sales in your markets of new security issues of Canadian debtors. A good deal of attention has been given by observers to these and other large movements of capital into Canada from the United States and elsewhere. Rather less attention has been given to movements of capital out of Canada, and yet over the seven post-war years flows of capital out of Canada have in total equalled - in fact, they have probably slightly exceeded - the total of capital inflows. The rate and form of the capital outflow has varied greatly from year to year. In the immediate post-war years much the largest element consisted of government loans to the United Kingdom and other overseas countries; these totalled over \$1,700 millions in all. At various times there have been substantial retirements of non-resident holdings of Canadian debtor securities. During the last 18 months or so there have been heavy outflows in connection with the reduction of commercial indebtedness and the increase in private holdings of U.S. dollars. Taking the seven post-war years together, capital outflows of these and other kinds have at least equalled our receipts of capital, and thus we have financed our investment programme without net borrowing abroad.

So much for developments in the Canadian economy over the last several years; perhaps it would not be out of place if I were to say a word here about the performance of our dollar in 1952. It appreciated in value by about 4½ per cent during the year, and ended the year at a premium of 3 per cent over the American dollar, having at one time been as high as a premium of 4 per cent. The situation in the Canadian foreign exchange market during this

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period has been an interesting and rather unusual one. Let me explain that Canadian gold and foreign exchange reserves are held by the Government in a special account called the Exchange Fund Account which was established by Act of Parliament. The Bank of Canada manages this account as agent for and under the direction of the Minister of Finance. Since the rate was freed in the autumn of 1950, the policy of the Government has been to allow the exchange rate to be determined by the normal play of economic forces. Official intervention is limited to smoothing out excessive short-run fluctuations and no attempt is made to resist persistent trends

Now for about the last year and a half Canada has had a small surplus in her international transactions on current account. We have, therefore, as a country been a net exporter of capital. But a good deal of foreign capital, particularly from the United States, has continued to come to Canada to participate in our resource development in oil and metals and a number of other things. As the Government has been unwilling to add materially to its already substantial reserves of gold and foreign exchange - the increase in 1952 was \$82 millions - the demand for Canadian dollars by foreigners who required them for direct investment has had to produce an exchange rate which would induce other non-residents to withdraw capital or induce Canadians to add to their holdings of U.S. dollars or perhaps bring down their foreign commercial indebtedness to less than normal levels. In other words, capital coming in for certain purposes has had to force out an equivalent amount of other types of capital. Another factor in the situation has been the quite substantial borrowing in the United States by Canadian provinces, municipalities and corporations. It may seem strange to you that such issues should take place at a time when the country as a whole does not need to borrow. The principal explanation is found in the fact that interest rates in Canada are higher than

in the United States. Thus certain borrowers go to New York. The transfer to Canada of the proceeds of the borrowings can only be effected by forcing out other forms of capital, and again the exchange rate is the means by which such a movement is induced.

It may be that in my remarks so far I have tended to give the impression that in the post-war years we have had few and only unimportant problems in Canada. This is an impression I would not like to leave for I assure you that we have faced some real difficulties - I think, for example, of the near exhaustion of our gold and dollar reserves in 1947 and much more recently, of the almost overwhelming influx of capital from the United States in the summer of 1950. I assure you that the Canadian diet during this time has not been all beer and skittles. But rather than elaborate on this, I would prefer in the time that remains to say something about Canadian ideas and ideals in the field of international trade and international economic relationships. In doing so, I shall take some liberties in talking about "Canadian views". I need hardly say that no one has authorized me to define or present opinions which can be labelled as Canadian. All I can do is to interpret what I believe to be the views of most Canadians who have given serious thought to these subjects.



Because of Canada's relatively large stake in foreign business, you would expect us to be strongly in favour of convertibility of currencies and removal of restrictions on international trade. We have managed to reach these goals, and we wish others could do the same thing. But our interest in this matter is not simply based on a desire to sell more Canadian products to other countries. We believe that growth of the economic strength of the free world is absolutely essential to military security, and we cannot escape the conviction that a satisfactory degree of strength and security cannot be attained in a world in which the free countries are divided into groups between which trade and travel are restricted or forbidden. We fear the long-term political consequences as well as the economic effects of this division.

I think most people would agree with these views. They have been expressed directly or indirectly at numerous international gatherings, and in essence they underlie the charters of many international organizations. The \$64 question is whether peoples and governments believe in them sufficiently to incur some pain in achieving the desired results. A brief backward glance at some of the high spots in world economic development since 1945 leads to some hopeful and also to some depressing conclusions.

On the hopeful side I put the great increase in production which has taken place in the free world since the end of the war. In your country and mine industrial production is substantially more than double what it was before the war. In the United Kingdom and Western Europe it is, on the

average, some forty per cent higher - this in spite of terrific losses and disruptions caused by six years of fighting, in spite of the closing of age-old channels of trade and of dismemberment of certain countries, and in spite of the continuous efforts of Russia to inspire confusion and fear. This post-war period has been marked by cooperation between friendly countries on a scale never before envisaged. A full description of such activities is quite beyond the scope of my remarks today, but they can be said to have been started with the United Nations Relief and Rehabilitation organization and gone on through post-war reconstruction loans to the Marshall Plan and military assistance. While the vast bulk of the aid has been provided by the United States, Canada has not been an insignificant contributor. Moreover, neither of us should overlook the fact that within the rest of the group help has been extended in many ways from the relatively strong to the relatively weak. .

International organizations such as the Monetary Fund and the World Bank have striven to play their part as best they could in most difficult circumstances; and so has the group of thirty-five countries associated in the General Agreement on Tariffs and Trade commonly known as GATT. Last but not least, there has come into being during this time the North Atlantic Treaty Organization, a group primarily associated with defence but which prudently recognizes in its charter the necessity for economic collaboration. Incomplete though it may be, this is quite an impressive catalogue, and the results achieved are impressive too.

Where we should all be if little or nothing had been attempted in the way of

international assistance and co-operation I hate to think.

I turn now to some of the unhappy aspects of the situation. With very few exceptions the countries of the free world in Western Europe and the sterling area are imposing severe import and exchange restrictions in an effort to balance their international accounts. These restrictions are, as a rule, discriminatory in character - they bear particularly heavily on dollar goods. Now if these import restrictions were limited in their effect to forcing people to forego certain imported luxury or non-essential goods which they could not afford, one might regret that the restrictions were necessary without becoming unduly exercised about them. But I am afraid that most of the restrictions have effects going far beyond this. They encourage uneconomic production in the countries which impose them or in other countries forming part of a regional group from which imports are permitted. Wherever restrictions of this type exist you can be quite certain that labour and capital are being diverted to uneconomic uses, and this at a time when the need has never been greater for the most efficient use of capital and labour so that our economies can respond effectively to the many urgent calls upon them.

Restrictive policies of the type to which I have been referring naturally take time to produce their bad effects. But I believe that a very striking illustration is provided by the way in which the free world's production of foodstuffs and raw materials, which have, as a rule, to be sold on world markets at

world prices, is lagging behind industrial production, which is frequently sheltered by import restrictions. Such developments constitute a most serious weakening of the economic structure of the free world.

The paraphernalia of restrictions and controls which has helped to produce this unsatisfactory situation runs contrary to the declared objectives of the countries imposing them. These objectives are the elimination of import restrictions and the promotion of multilateral trade and the convertibility of currencies. One may reasonably ask why it is that there has been such a gap between declaration and performance in this field. It is clear that in the period immediately after the war a free system of international trade and payments would have been quite impossible. The pressures were too great. What should concern us, however, is the lack of progress in the right direction. The reasons are many. But I think a most important factor has been the constant effort of a great many countries to do more than their resources would permit, even with such assistance as may have been received from outside sources. This has had as a consequence a general situation of strain and recurrent balance of payments crises. Major reliance in dealing with these difficulties has been placed on trade and currency controls, which have, however, merely been able to suppress for a period the symptoms without eliminating the underlying causes of the exchange difficulties

If this situation cannot be changed, if the free world must continue to be divided into dollar and non-dollar blocs,

plagued with import restrictions and exchange crises and seeking an ad hoc solution from time to time by putting a thumb in the dyke, I would have some doubts about our ability to win the cold war. But there can and must be a change of direction, and now is the time to start.

There have been encouraging signs of a change in the approach to some of these problems in certain important countries. On the one hand, there seems to be a greater awareness than has been apparent in the past of the weakening effects of severe import restrictions and discrimination. There seems to be a greater willingness on the part of some of the countries concerned to adopt corrective measures, painful though these may be. On the other hand, in the world's most powerful country - the country which exercises a predominating influence on world trade - there is some indication of a willingness to consider the application of a fundamental remedy, namely freer admission to United States markets of the goods of other countries.

At this point I cannot refrain from mentioning the recent unanimous report of the Public Advisory Board for Mutual Security under the chairmanship of Mr. Daniel Bell. The core of that report is to be found in the recommendation that decisions on trade policy be based on national interest rather than on the interest of particular industries or organized groups. The report contains one of the best descriptions of the complexities of United States tariff law and customs procedure which I have ever read. Judging from my own experience over the years, I doubt whether one

American in a thousand understands the many ways and means by which goods from other countries, particularly manufactured goods, may be kept out of the United States. As the Bell report observes, many goods take longer to pass through the customs than it took Columbus to discover America.

I naturally do not know what influence the Bell Report will have on American policy, nor what will be the influence of some of the other recent contributions from well-informed and thoughtful American groups. Your partners in the free world are waiting anxiously to see whether your policies are going to be of a character which, by increasing their opportunities of earning dollars, enables them to achieve balance and stand on their own feet through their own efforts. If the signs they get are discouraging, then I fear that we face a further weakening of the basic economic structure of the free world

I realize that it is not a good idea to exhort other countries to do certain things. National policies are determined by self-interest, and if the self-interest is enlightened there is no cause for complaint. All that an outsider can do is to express the hope that in this crucial period of world history the close association between trade policies and the defence and security of the United States will be clearly apparent. I was struck by a story told me only a few weeks ago by an American friend. He had been speaking to a large gathering about the desirability of the United States trading more freely with other countries to help the free world build up its strength.

In a subsequent discussion, one man said he heartily agreed with the views of the speaker. A friend turned to him and said, "But, Joe, your business is quite vulnerable. Would you be willing to see an increase in imports?" And Joe said, "If that will help to keep my boy from war, I'll take a chance' "

Mr. Chairman, I hope a great number of people in Canada and the United States come to feel the same way