1145

CREDIT AND ECONOMIC PROGRESS

Address by MR. GRAHAM TOWERS
Governor of the Bank of Canada,
to the Second International Credit Congress
Montreal, P.Q., May 20, 1953.

Note: NOT FOR RELEASE until speech has been delivered - approximately 10.00 a.m. E.D.T., Wednesday, May 20th.

Both of these comparisons disclose, on examination, a significant common feature - the scarcity of productive capital. Both in grandfather's time and in many parts of the world to-day, economic life is conditioned by a vicious circle in which there is not enough surplus income to make possible the savings which, in the form of productive capital, can raise standards of living enough to generate savings. Once the vicious circle is broken and standards of living begin to improve, saving is easy enough and the process of growth in wealth and welfare becomes so nearly automatic that we take it for granted, failing to give due credit to the forces and institutions which are an essential part of the process.

Two factors are, I think, indispensable in effectively and permanently raising standards of living. The first is a supply of savings, either generated within the country from the frugality of the population, or brought in from abroad through foreign loans or grants. This supply of saving you will recognize as credit. The second essential factor is a set of institutions - banks, postal savings offices, credit unions and the like - which will gather up what are often tiny driblets of savings, combine them in large enough amounts to be usable for major projects, and then direct them to places they are needed, for without savings and capital there can be no progress. An interesting feature of United Nations studies of the problems of underdeveloped countries in the far east, has been the attention paid to the role of credit institutions and the importance attached to the development of effective organizations in this field.

Canada was once an underdeveloped country in the same sense as those countries I have referred to above. One hundred years ago our meagre population, in a country having very great potential wealth, was clearly unable to provide from its own savings and through its savings institutions the volume of capital necessary to set in motion a cumulative growth towards maturity. The Canadian economy, as a matter of fact, offered unusual obstacles to economic development. In the first place, the country was physically large in relation to its population, and the railroads and canals necessary to economic and political progress represented a cost quite beyond the powers of the local population. Until transportation facilities were provided, the wealth of the interior, particularly the agricultural resources of the prairie provinces, lay practically untouched. The princiapl resources other than agriculture required not only adequate transportation, but, in the case of mining especially, they involved large scale and expensive processing plants. Forestry in the early days was a relatively simple operation, consisting largely of export of logs, waterborne to the principal parts but this gave way in due course to trade in lumber, involving more extensive sawmilling operations and at a later stage came the paper industry with its enormous capital investment.

These potentialities remained only a dream until vitalized by the application of credit, partly in the form of savings mobilized by the growing banking system, but mainly as credit from abroad. Up to the end of the 19th century most of this capital came from Britain. After 1900 the United States, having herself passed through the same developmental stages and become a wealthy economy, was able to provide more and more of our credit needs. The inflow of capital, a mere trickle, vital though it was, up to about 1900, swelled to a flood between then and 1913, subsided during the first war, then revived in the 20's, bringing with it increased population, wealth and income. Internal savings became important enough to finance most of our investment needs and Canadian financial institutions were able to gather together these savings and direct them into productive channels, to the mutual advantage of lender and borrower.

The period of heavy foreign borrowing was about as good an example as one can find of good credit. Availability of credit made it possible for us to import the large quantities of goods required in the course of the period of rapid economic development. These goods consisted not only of capital equipment directly required by the new industries, but also included supplies of consumer goods to sustain the workers engaged in developing our resources and creating and installing capital equipment. When the time came for payment of interest and dividends (and later for some repayment of principal) our creditors had good reason in most cases to be satisfied with their investments, and at the same time the productive nature of the investments meant that these payments were in no way burdensome to this country. In this respect we and our creditors were fortunate because the world as a whole was prepared to help us pay our way by accepting our exports. I must add, however, that in order to obtain enough dollars to make payments of interest and dividends to the U.S. we have had to rely as a rule on earning surpluses in trade with other countries.

You may have noticed that I haven't said anything about the inflow of foreign capital after the period of the 20's and you may think this odd, because surely everyone knows that, in recent years at least, an enormous amount of American capital has gone into Canadian resource development. So it has, but (before taking into account retention of foreign earnings in Canada) on the average we have, especially in the seven post-war years, loaned abroad and repaid debt abroad to an amount somewhat greater than the total of capital inflows. In this, I think I see the maturing of a long period of growth and sound investment. I have no doubt that we shall see a continued influx of American, and perhaps British, capital for many years to come, but our savings are now adequate on balance to meet all but the most exceptional investment needs.

The investment programme of the last seven years, 1946 to 1952, has absorbed, on the average, about 20 per cent of our total national output, a greater proportion than in the U. S. or Britain. The sources from which this investment has been financed may be of some interest to you. The most important single contribution came from the retained earnings of corporations, part of which represents the share of foreign investors. These include depreciation allowances and undistributed corporate profits and 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 8½ per cent of personal disposable income over the period, and it has run at about 10½ 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 took the form of savings by governments, through an excess of revenue over current expenditures. These surplus funds were partly used to finance investment programmes carried on by the governments themselves. The balance, which was considerable was paid out to holders of government securities in the course of a debt retirement programme and the money became available to finance private investment.

Now, gentlemen, as a Canadian looking back at the history of my own country, there is an irresistable comparison and, for the present, a contrast between the course of Canadian development in the last century, and the path along which Western Europe is struggling today. Canada, with the stimulation and help of foreign credit and know-how, has reached the position where she can provide her own capital needs, most of her own technical personnel and can add to the wealth of her industries and the welfare of her people without visible strain or artificial controls. Western Europe, I need hardly say, is not in such a happy state, although I see significant and encouraging similarities between the way we have come and the way they are going. Progress is visible, and with encouragement, progress can continue.

By 1945 the cumulative effect of two wars had put Western Europe in a position which in some respects resembled an area starting from scratch, with hardly more than enough production to maintain minimum standards of living and not enough to devote to developmental projects which alone could lift her out of the vicious circle of low income and low productivity. Such a condition clearly called for a large investment of outside funds to break the vicious circle, and this, fortunately, was clearly in the long run economic and political interest of the United States, the principal source from which the necessary funds could be secured. Americans realized that the world as a whole, and to a significant extent America, could not be prosperous unless there was a recovery in Europe and elsewhere. Moreover it was clear that democracy and freedom and the ability to resist communism depended not only on willingness of these nations, but on their economic strength. All the ingredients were present for what I regard as essentially an investment operation in which the return - dividend if I may use the word - would take the form of a revived and thriving European community, once again able to contribute to the economic and cultural life of the world, and able to resist the insidious pressure of communism. Americans have had a chance to see in their own country the economic miracles that can be wrought with credit and capital, and the pattern of U.S. aid shows, up to a point at least, a determination to apply the lessons of their own experience.

Scarcely were hostilities over when the initial transfusions of credit and other forms of assistance to Europe started, first through the United Nations Relief and Rehabilitation organization, followed by the post-war reconstruction loans, the Marshall plan, military assistance and help through the Monetary Fund and World Bank. The United Nations, Point Four and Colombo Plan programmes for financial and technical assistance to underdeveloped countries reflect the same philosophy. The period of large scale economic assistance may be coming to a close, so far as Western Europe is concerned, and I think that some appraisal of the result is a good idea. There are some encouraging results to show, with a good deal of the physical damage of the war repaired and industrial production some 40 per cent above pre-war. Western Europe has already, by its resistance to communist pressure, gone far to justify the faith of those who helped it in its need. These countries are now entering a new phase, in which they would be expected to stand on their own feet by providing themselves more of the income and savings with which to consolidate their economic future. So far, the contribution of this continent has consisted in providing capital equipment and essential commodities which were unavailable elsewhere, or which these countries chose not to buy from Russia and its satellites. Economic recovery involves little diminution, and, in some cases, an increase in the need for North American goods. The essential difference is that, given a chance, Europe can now pay for a growing proportion of her needs. The objective is "Trade not aid". The underlying purpose of the assistance was to place these countries in a position where they did not require further assistance. This initially involved financial help and, now, to complete the process, we are all called upon to encourage Europe to pay its way by accepting European commodities.

In some respects the background for this transition is favourable. A group of 35 countries led by the United States has entered into the General Agreement on Tariffs and Trade and achieved a considerable reduction in tariffs. The North Atlantic Treaty Organization, created to provide for cooperation in the field of defence, has prudently recognized in its charter the necessity for economic collaboration. It remains the case, however, that the so-called soft currency countries continue to rely heavily on import and exchange restrictions to balance their international accounts, and that the most severe restrictions are applied to those things which have to be paid for in dollars. One of the reasons for this state of affairs has been the efforts of the countries concerned to provide more consumer goods, houses and industrial plant than their economic resources could produce, even with the assistance which has been received from abroad. It would appear that some progress is being made with internal corrective measures to restrain excessive private and public expenditure, thus placing these countries in a better position to balance their trading positions without the crutch of artificial restrictions. It cannot be denied, however, that the task is a very difficult one. Cooperation by financially stronger countries is required. The most important form which cooperation could take would be measures to ensure a readier access to North American markets. This can only occur through willingness of the principal North American country to make it less difficult for other countries to sell goods to the United States in payment for U.S. exports. The United States emerged from obscurity as a nation through the willingness of the world to accept her merchandise. In the same way, the United States can now help the rest of the world to economic recovery and at the same time ensure a growing market for her goods.

There is a popular illusion that the reductions in the U.S. tariff made in recent years have done all that is necessary to open U.S. markets to the traders of the world. Tariffs are still a major obstacle, but many traders feel that tariff concessions can have little effect so long as administrative obstacles, partly unintentional partly otherwise effectively block entrance to foreign goods. We hear from time to time of extreme cases in which, for instance, ping pong balls to be used in toy guns, normally subject to a 10% duty, are classified as ammunition and charged a 95% duty. Quite apart from the injustices of such classifications are the delays involved. At the end of 1952 the U.S. Customs Court charged with classification cases had 83,000 cases pending which, at the 1952 rate of judgments, represented 13 years' work. Determination of the actual duty to be paid is often subject to delay of two to four years, and cases requiring as long as twenty years are not unknown. A major difficulty arises in connection with appraisal of value for duty purposes, and here the backlog of appeals before the Customs Court constitutes, at the average rate of the last two years, 30 years' work. These are the sort of obstructions which have a serious effect in hampering world recovery, and deny to the U.S. the advantages she sought in the grants intended to stimulate recovery.

Not only is harm done to friendly nations abroad, but the United States suffers directly through failing to take advantage of low-cost sources of goods. These considerations have been put before the American public recently in a report to the President by the Public Advisory Board for Mutual Security under the chairmanship of Mr. Daniel Bell. The conclusions reached in that Report are that United States trade policy should be based on the interest of the nation as a whole and not on the special interests of any small group of producers. The security of the United States, it is emphasized, depends heavily on cooperation from strong and unified countries throughout the free world. The economic strength and defence programmes of these countries would be weakened if they were to be compelled, by adverse U.S. trade policies, to reduce their imports of essential U.S. goods. The Report points out that inability to earn more dollars may compel them to restrict such imports and comments at length on the high and unnecessary U.S. tariffs and cumbersome customs procedures which contribute to the dollar problem.

These views represent a dispassionate appraisal of the national interest of the United States by a group of business men and labour and agricultural leaders. To a banker who has had some experience in international economic affairs, their recommendations make good solid economic sense. But I have not reached my present age without realizing that exhortations to behave sensibly are seldom heeded if they are based solely on economic considerations. In the case I have been discussing, however, I believe that the considerations are most clearly and definitely ones of national security. I hope that others will view them in this light, and that the policies our countries follow will contribute to the strength of the free world and to its ability to resist aggression in all its many forms.