THE FINANCING OF ECONOMIC GROWTH IN CANADA

Remarks by Mr. J. E. Coyne, Governor of the Bank of Canada, at a joint meeting of the Canadian Club and Empire Club, Toronto, February 27th, 1956.

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After ten years of depression and six of war, we have seen on this continent during the past ten years a renewal of the phenomenon of overall growth of the civilian economy. Perhaps it is not too much to say that we now take both the desirability and the fact of continuing growth for granted and when we think of Canada's economic prospects, we think of them in terms of growth, of how much and what kind of growth.

It was to study these questions that the federal government last year appointed a Royal Commission of five distinguished Canadians under the chairmanship of Walter Gordon of Toronto. What conclusions they will come to I do not know, and in any case there will be plenty of room for differences of opinion and further public discussion over the years ahead. I think we must recognize, however, that the Gordon Commission has already done a valuable service in focusing attention on our future economic opportunities and problems, and in stimulating so many studies by outside bodies as well as those undertaken by economists who have come together from all parts of Canada to form the staff of the Commission.

Most of the provincial governments have submitted to the

Commission economic surveys of their particular areas, with the emphasis on probable and possible future developments. To have these prepared, and to bring them together in a national survey, is, I think, a very valuable aid to all our thinking on the problems involved. Members of this audience will, I am sure, find the submission of the Government of Ontario extremely interesting. It is a comprehensive, thoughtful and fully documented study of every aspect of future economic development in the Province of Ontario, dealt with from a constructive and progressive point of view.

For Canada as a whole, economic growth has developed on three bases - population, productivity and investment. Our total population is growing more rapidly than most other western countries, both by natural increase and by immigration, and so is the size of our working force. Output per man-hour is also growing in most industries, and so is the total national product. Conceivably the increase in productivity could be converted into more leisure rather than a greater production of goods and services, but that has not been done to any marked degree, so that production per head of population and the material standard of living have risen substantially over the past ten years.

The third factor in our rate of growth has been the high proportion of total product that is devoted to capital expenditures for new construction and for machinery and equipment. The rate of such new investment is higher in Canada than in most other countries, higher than in the United States, for example, and higher than our own level of annual savings could sustain. It is probable that our rate of saving out of gross national product is also higher than in the United States, but not so much higher as in the case of investment. At all events, investment has for several years exceeded saving in Canada; the deficiency has been made up from the outside world, and particularly from the United States, where saving exceeds domestic investment. Physically the deficiency is covered by an excess of imports of goods and services over exports, and the financial counterpart is an inflow of capital sufficient to pay for the excess of imports. Although the shortfall seems large in amount, over $600 million in 1955, it must be remembered that total new investment in fixed assets in Canada last year was $6,230 million, so that domestic saving provided about 90% of the total.

The fact that the combined total of consumption and investment in Canada in recent years has been greater than our own economic output does not necessarily mean that either consumption or investment is too high, though it might mean that, and opinions may well vary on that point. Some may feel that consumption is too high and that we should be saving more, though in fact our national rate of saving is already high by comparison with most other countries.

Others may feel that investment is too high, that we should not be using so much non-resident capital, that we should not have so large a surplus of imports over exports; it must be recognized, however, that if we do not want to see these things, and do not save more, we must be content with a smaller rate of growth than that of recent years, and probably a different distribution of growth among the various industries.

In a free economy, growth in the form of new investment is not a pre-determined imperative, either in total amount or in the proportions of the different kinds of investment that make up the total. These matters depend on the independent decisions of millions of individual savers and investors. Part of total investment is, of course, a community activity carried on by governments, in the form of schools, hospitals, roads, urban services, and so on, but even in such cases the governments concerned, to the extent that they want to obtain voluntarily the savings of Canadians and others, must have regard to the views of the lenders and conditions in the capital market where other would-be borrowers are also active.

One important feature of a free economy, therefore, is that there is no uniformity or set pattern in the matter of investment; first one kind of investment and then another will go ahead faster than the average or overall rate, and similarly at times one kind and then another may decrease or lag behind. Opportunities for capital development vary from time to time, and the views of persons with savings to lend or invest also vary as to where they want to put their money, as between, for example, natural resource development, heavy industry, secondary industry, housing, social capital, public utilities, the service industries, and so on.

In addition to changes in the relative activity in different fields of investment, there may be changes in the relative importance of the different channels by which savings are invested. An obvious case is the extent to which corporations can accumulate savings in the form of undistributed profits for re-investment in the same business, as against raising money from others by selling stock or bonds or borrowing from banks or other institutions. There may also be variations in the extent to which individual savers make investments themselves by way of mortgage loans or the purchase of securities, as against allowing their savings to accumulate on deposit in banks and other institutions which will then invest the relative funds. Again, a business may change the proportions in which it raises money from security issues relative to its reliance on bank loans even for working capital. As these factors change, both the total volume and the make-up of bank credit will change. There is no fixed relationship between the amount of bank credit, or the volume of money, or the level of interest rates, or any other monetary index, on the one hand, and the size of the gross national product, or the rate of growth, or the amount of investment, on the other.

Under our system the job of channelling savings into capital investment is performed by the capital market. What one wants, presumably, is as many different channels as possible, so that both lenders and borrowers may have freedom of choice and not be dependent on any single outlet or source of funds.

One of the largest pools of savings gathered up in the capital market is that which accumulates in savings bank accounts of individuals, and the savings banks for that reason are important instrumentalities in making funds available for long term investment, that is, for the provision of fixed capital. Commercial banks provide funds primarily for working capital, for the financing of inventories, of work in process, and of sales on credit. In Canada, unlike most other countries, the commercial banks also carry on the greater part of the savings bank business. As such they provide one important source of funds for the capital requirements of governments, business, all sections of the community. Savings deposits increase year by year so that banks have funds available from this source for new investment each year, in addition to the re-investment of funds accruing from previous investments which are repaid out of the current savings of the former borrowers. The principal means by which all these savings are made available by the banks to finance the creation of new fixed capital is through the purchase in the securities market of the securities of governments and businesses and, more recently, through acquiring insured residential mortgages.

I believe all would agree that we need to make the best possible use of whatever amount of saving our people are doing, that we need to find ways and means of making it flow into the kind of capital development which we value most highly. While we have an active and relatively well developed capital market in Canada, and a strong and effective financial system generally, there is no doubt that here as in any other country changes and improvements may appear desirable from time to time, especially if some important sphere of investment seems to be having undue difficulty in gaining access on competitive terms to the various sources of savings.

In 1954, there was evidence that builders and house owners needing to borrow money, and thus to convert the savings of others into useful investment in this particular field, were being confined to too limited an area of the financial market. The amendment to the Bank Act which made insured mortgage loans a permissible outlet for savings in the banks, was a valuable development. It provided an additional outlet for the investment of savings deposits, and an additional source from which funds for house building could be sought. One reason why this development has worked so well in its first two years is that the chartered banks with their widespread network of branches have unrivalled facilities for originating and servicing insured mortgages in all parts of the country. Under the established system for insuring mortgages, other investors who do not have these facilities for originating mortgage loans have the opportunity of buying mortgages from the banks or other authorized lenders, who will usually continue to service such mortgages for a fee. I think we may expect to see develop a broader secondary market in insured mortgages, and a new channel opened up thereby for the flow of private savings into the finance of home building.

In addition to the savings of individuals and corporations re-invested in their own businesses, and the savings deposits in banks, there are a number of other channels through which savings flow to those who make the physical investment. Some individuals themselves participate in the capital market through the purchase of government bonds, corporate stocks and bonds, and mortgage loans. For the most part, however, the process is carried on by intermediaries, such as life insurance companies which accumulate large aggregates of savings arising from the income of their policy holders, and others such as trust and loan companies, credit unions, pension funds, and so on. While circumstances vary from one institution to another, it is generally the case that savings institutions can invest all or the greater part of their funds in long-term investments. For example, a strong case can be made that life insurance companies and pension funds can expect that the aggregate funds in their hands will never decrease significantly, and will probably go on increasing. It follows that such institutions can, if they choose, and if regulatory bodies permit, keep their funds for long periods in investments of a kind that most individuals cannot buy, not because such investments are unsafe over the long run but because an individual wants to be able to get his money out again at short notice in case of personal emergencies. In fact, however, our institutions have not followed such a course to any great extent. In Canada, almost all the investible funds coming into their hands tend to flow into fixed interest obligations, with relatively little going into common stocks and other forms of equity investment. If it is true, as has been stated in a number of quarters, that there is not a sufficient flow of Canadian savings into equity investment, and that too much of the ownership and control, and profits, of the most venturesome and profitable sectors of Canadian industry are going by default into the hands of non-residents, this is an aspect of the capital market which would seem to merit consideration and discussion.

To revert to the overall picture, whatever the particular channels by which domestic or foreign funds reach the capital market, there may be times when the demand for capital funds is greater than the supply. A more rapid expansion of the supply of credit could be stimulated by the central bank, but in some circumstances this would create too much credit and give rise to excessive competition for the available supply of goods and services, with inflationary results. At times, too, even though the total supply of credit might not be excessive, it would be possible for excesses to develop in one or another particular field of credit, such as consumer credit, or credit for stock market trading on margin, or for accumulation of inventories beyond reasonable requirements, or for speculation in real estate,.and so on.

I shall not discuss any particular field of credit today, but I think I should say a word about the kind of situation that arises when the overall demand for credit appears to be excessive. There is clearly a limit to the total amount of new capital development that is physically possible at any particular time, just as there is to the production of consumption goods, for population and the size of the labour force will be limiting factors even if materials and credit were available in unlimited quantities. Under certain conditions, when investment opportunities for the development of new business enterprises and expansion of old seem particularly favourable, the total number of apparently sound and desirable projects may add up to more physical requirements than the economy with all its resources can accommodate. At such a time, unless the monetary authorities are ignorant of the conditions or fail to take account of them, you will have a situation of so-called credit stringency, with not enough credit to satisfy all demands and usually with interest rates showing some rise in one sector or another of the market as would-be borrowers compete with each other for the available supply of funds.

I am not speaking of a condition of actual restriction or contraction of credit, which might arise when the total supply of money and credit had clearly become excessive and must actually be reduced. What I am speaking of, the condition of so-called credit stringency, would arise not because the supply of credit had been excessive and had to be reduced, but simply because demand was expanding too rapidly, more rapidly than the supply of savings available to provide the real basis for growing investment. If more people wanted to do more things by way of investment in new plant and expansion of existing facilities than was in total physically possible or was financeable out of new domestic saving plus borrowing from abroad, it would serve no useful purpose, but on the contrary do much harm, to have the total supply of credit expand so fast as to equal the excessive demand.

It is possible, therefore, that even when the total supply of money and credit goes on increasing - as is happening today, as bank loans are doing month after month - nevertheless the demand for credit, for access to funds giving the right to use the savings of others, may at times increase even faster, and part of that demand may have to go unsatisfied. The fact that there might be some unsatisfied demand in such circumstances should not be allowed to obscure the more important fact that the total amount of investment was continuing to grow at the highest feasible rate, that savings were continually growing, and that larger totals of money and credit were in fact available than ever before.

From all indications, the supply of funds in the capital market in 1956 will be at a higher level than in any previous year. The demand for such funds may be even greater, to judge from the figures of 1956 capital investment intentions which were published last week, but demand for capital, and credit, can change relatively quickly. What kind of economic conditions we shall actually face in the future I do not pretend to know. The margin between under-employment on the one hand and inflation on the other is a relatively narrow one. Economic equilibrium at the desired level is almost bound to be upset from time to time, from one side or the other, by a variety of changing factors, mainly psychological: a swing in public attitudes to consumption versus saving, or a change in the outlook for new business investment or in the demand for new houses; even changes in timing, such as are involved in decisions whether to build up or reduce inventories. And in Canada we are always subject to major dislocations as a result of external events entirely beyond our control, such as a slump in the demand for and physical volume of our exports, or increases or decreases in world prices affecting either our exports or our imports, on both of which the Canadian economy is heavily dependent.

In our circumstances, readiness to adapt policy to changes as they occur, flexibility in action rather than adherence to preconceived plans, will be as important in the field of money and credit, as in all activities affecting the financing of economic growth in Canada.