"INFLATION AND UNEMPLOYMENT"

Remarks by
Mr. J. E. Coyne, Governor of the Bank of Canada,
prepared for delivery at the 48th Annual Meeting of
The Ontario Chamber of Commerce
in Hamilton, May 12, 1960

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I understand that the theme of this year's Annual Meeting of the Ontario Chamber of Commerce is "The Golden Sixties". I shall probably not make myself popular by remarking that all is not gold that glitters. It is not a pleasant task to talk about economic problems rather than successes, about difficulties and dangers rather than achievements and enjoyments, yet I suppose that at times this must be the function and the duty of a central banker. If we do not see the dangers and pay heed to them, we shall never reach the goal that shines so invitingly.

During the past nine months inflationary psychology has abated considerably in Canada and the United States, although there have been some signs of difficulty in this regard in certain European countries. Monetary sobriety and reduction of government deficits, coupled with the evidence of greater stability in the price level, particularly basic commodity prices and wholesale prices, have given us some reason for confidence that inflation can be contained if the will to contain it is strong. We know that economic growth, the conversion to human benefit of the inexhaustible resources of scientific discovery, can go forward, if we wish, in an environment of stability and orderly development. In Canada, however, we still have a major economic problem to overcome if we are to live within our means and avoid the dislocations and set-backs which grow out of trying to do too much too soon with the aid of large-scale foreign borrowing.

Growth in the Canadian economy on a sound and sustainable basis will never be restricted by inadequate bank credit nor by a restrictive monetary policy. So far as your central bank is concerned, the objective of monetary policy is to encourage economic growth and the expansion of employment opportunities, not for short spurts followed by set-backs, but over the long run. Monetary policy will ensure an adequate total supply of money for carrying on an increasing volume of transactions year after year, and an adequate availability of bank credit, in conjunction with other forms of credit, to finance an increasing volume of Canadian production and distribution of goods and services.

For some eighteen months in Canada we have had no significant increase in the total quantity of currency plus bank deposits. There has nevertheless been a substantial increase in the volume of bank loans, which was made possible in part by the very large increase in the quantity of money during the latter part of 1957 and the first nine months of 1958. Last year the banks financed a rapid expansion in various categories of their loans by selling off Government bonds which they had acquired a year earlier. When it became apparent that the demand for bank credit was growing more rapidly than the amount of credit which could prudently be made available, the banks took steps to bring their loans under control.

It soon became evident that a good deal of the demand for bank credit had been anticipatory or unnecessary or could find alternative sources of finance. This is apparent in the statistics of chartered bank loans. The banks' general business and personal loans rose by $1,000 million between the end of September 1958 and mid-August 1959, and declined by roughly half that amount in the following six months. Part of the decline was of a normal seasonal character and the increase of $170 million since mid-February this year is also no doubt partly seasonal.

A number of earlier bank loans have now been retired, in some cases out of the proceeds of bond issues by governmental or corporate borrowers. The high level of bank lending for consumer credit purposes has slowed down and as repayments of past loans accumulate the total volume of loans of this character may well decline, thus releasing further funds for general business purposes. The banks have also put a limit on the amount of funds they will lend to financial institutions specializing in the business of consumer credit, institutions which have other means of raising funds besides bank loans. Interest rate limitations have caused the banks to withdraw from the field of insured housing loans.

As a result of these developments, the chartered banks now have a certain reserve ability to increase their business loans on a prudent selective basis as opportunity offers. Sound new enterprises are able to obtain banking accommodation, and existing businesses are able in appropriate cases to obtain an increase in their lines of credit, where such is necessary to enable them to expand the scale of their operations. This is particularly true in the field of small business. The banks' larger customers have alternative means of financing and need not rely entirely upon bank credit for working capital funds.

It would be an over-simplified view of economic processes to believe that an adequate supply of money and credit is the answer to all economic difficulties and problems. Correction of a shortage of total money or credit, if it develops or threatens to develop, is, of course, essential, but it does no more than contribute to a climate in which business enterprise may progress. It does not and cannot ensure that all the various spheres of action and decision in business and in government and in private affairs will function in such a way as to produce maximum growth, full employment and a balance in our international payments. In particular, the creation of additional money does not ensure that it will be spent, or spent in a way which increases economic activity and employment in Canada. In some circumstances, such as we have in Canada today, the result of additional overall spending may be mainly to increase imports or to maintain them at an already excessive rate, that is, to contribute to employment and activity in other countries rather than Canada, financed by either a drain on our exchange reserves or an increase in our foreign debt.

Last year Canada's payments for imports of goods and services from abroad, including interest and dividend payments on account of debts to foreigners and foreign investments in Canada, exceeded our receipts from exports of goods and services by $1,460 million. This deficit is in my opinion a symptom of excessive total spending and misdirected spending, particularly since it has gone on more or less at this order of magnitude for a number of years. There must be something wrong with the structure of the Canadian economy to permit a balance of payments deficit of such a size to persist for so long. We are spending too much, and we are not fully utilizing Canadian productive potential to produce the kind of goods that we are importing in such large quantities from abroad on credit. Undoubtedly there is not just one single cause for this situation, but one important cause, I believe, has been that in the aggregate, individuals and businesses and governments combined have attempted to accomplish too much expansion and growth too fast, without sufficient regard for whether the total volume of capital expenditures was appropriate in relation to our situation, or whether the capital expenditure, particularly that financed by foreign borrowing, was of a character which added to our national productive capacity in such manner and degree as to improve our ability to pay our way in the world.

Except insofar as it relies on foreign borrowings, a nation's capacity to finance capital expenditures, that is, to allocate real physical resources to production of fixed capital, both private and business and social, rather than to day-to-day consumption, must obviously be determined by its capacity and willingness to save out of income each year. Canadian saving in total is relatively high in comparison with other countries, and indeed appears to be a little higher than in the United States. Personal saving as a percentage of income after taxes is perhaps 1% lower than in the United States, and the government deficit -- all governments together -- larger than in the United States, that is, governments take a greater quantity of the available supply of new saving. On the other hand, business saving by both corporate and unincorporated enterprises and including funds set aside for depreciation and replacement of equipment, is substantially higher than in the United States.

Certainly anything that can encourage increased saving in Canada, particularly on the part of individuals and families, would be helpful, both in the immediate situation and in the long run, and it would be beneficial to those concerned. Our problem, however, does not arise so much from a shortage in our total saving -- although rising consumer debt and government deficits are a definite handicap in that regard -- as from excessive capital spending, which over the past five years or more has amounted to 26% of our total national production, as compared with 18% in the United States.

When capital spending, not just in money but in real physical terms, exceeds saving, that is, when capital expenditure and consumption combined exceed total production, including whatever becomes temporarily available by using up stocks, the excess can only come from imports. An excess of imports over exports means of necessity either using up reserves of foreign exchange or new foreign borrowing, by which, in one way or other, foreigners provide the additional imports on credit. It is one of our problems that foreigners have been only too ready to provide to Canada more credit and more imports on credit than, as it now seems, we could use with real benefit to ourselves. The higher rate of capital spending in this country than in the United States which has been stimulated or facilitated, directly or indirectly, by foreign borrowing has not produced a commensurately higher rate of new production each year, nor has it eliminated unemployment.

The problems that face us today are very real and very large. There is in the first place the problem of the huge imbalance between our annual receipts from current transactions on international accounts and our annual payments on current international accounts. Associated with this is the very large increase in our foreign debt, including within that term both debt incurred as a result of foreign borrowing by Canadian entities, mainly provincial and municipal governments, and the liability represented by direct foreign investment in business enterprises in this country and foreign holdings of the securities of Canadian corporations. At the end of 1959 the foreign investment in Canada was $24 billion, half in the form of direct investment in Canadian industry, many important sections of which are completely controlled or dominated by foreign parent companies, and half in the form of foreign holdings of securities issued by Canadian governments and corporations and other miscellaneous liabilities. Canada's net foreign liabilities, after allowing for our official exchange reserves, government loans to foreign countries after the War, and foreign investments held by Canadians, amounted to $15.4 billion, at which level they had doubled over the last four years and tripled over the last seven years. Dividend payments by foreign-owned branch plants in Canada and by Canadian corporations to non-resident shareholders have for several years greatly exceeded the amount of such payments by all Canadian corporations to Canadian shareholders, excluding duplication through inter-corporate payments in Canada.

We are sometimes told, by foreigners, that we must not contemplate reducing our reliance on new foreign investment each year, and correspondingly our excess of imports over exports, because it would lead to an increase in unemployment. This is absurd, and indeed it implies that only a further increase in the annual rate of increase in foreign debt -- and imports -- could enable the Canadian economy to achieve full employment.

It is simply not true that Canada has to continue to borrow abroad, and import vastly greater quantities than it exports, in order to maintain economic growth and full employment for a growing labour force.

How serious this problem is, and how it should be solved, is a matter for urgent consideration by all of us in Canada. There are some Canadians who feel that the magnitude of our foreign debt and the prospects of its future growth are alarming. Others are still unaware of the problem, or are willing to go on borrowing as long as foreign funds are available, even though to an increasing extent we are now having to borrow the foreign funds required to pay interest and dividends on past borrowings. We have gone along on such a course for some years without having to face up to all the adjustments which other countries in a similar position have had to make. For this reason, however, it seems to some Canadians that the impact on our economy of the ultimate adjustments when they come, as they must, will be all the greater and all the more difficult to cope with, and that steps should be taken now to make adjustments in a more gradual and orderly fashion. Others suggest that the future be left to take care of itself. Some indeed are quite defeatist.

To my mind, we could not leave this problem to solve itself without giving up the attempt to maintain an independent economy and an independent nation north of the American border. Rapidly growing foreign debt must lead ultimately to loss of any capacity to be masters in our own house. If we do not effectively change the trends of the past we shall drift into an irreversible form of integration with a very much larger and more powerful neighbour. I do not believe this is what Canadians want, for it means surrendering the very idea of Canadianism, the dream of Canada as a separate and self-supporting and self-managing nation, which gripped the imagination and stimulated the energies of the architects of the Canadian Confederation, John A. Macdonald, Georges Etienne Cartier and so many Canadians of their time and since.

It is often remarked as paradoxical and extraordinary that the large deficit in our international balance of payments should be accompanied not by a weakening exchange rate but by a marked degree of strength in the Canadian exchange rate, leading at times last year to a value for the Canadian dollar at a premium of 5% over the United States dollar. It is not so often remarked that the large deficit in the Canadian balance of payments has persisted over a period of years when there have been inadequate employment opportunities to utilize the productive capacity of our growing population. These two paradoxes are of course to some extent connected, as all the aspects of our fundamental economic problem today are interconnected. The fact is that at times the amount of foreign borrowing done by Canadians has exceeded even the large volume of imports then requiring to be financed and has led to a strengthening of the Canadian exchange rate. This in turn has induced a higher rate of imports than would otherwise have occurred, pushed the rate of imports up another notch, over and over again, imports which compete with Canadian production for the domestic market and have an obvious effect on employment conditions in Canadian industries. I have no doubt that the marginal factor, the straw that broke the camel's back, so to speak -- and at times it has been a very large straw indeed -- has been the unnecessary and ill-advised borrowing in foreign currencies on the part of some provincial governments and municipalities and their agencies, whose operations have no connection with foreign exchange or foreign trade on which to base the servicing of foreign currency obligations. What the ultimate cost of such borrowings may be no one can tell. Such borrowings are undertaken apparently because the rate of interest on borrowings of U.S. dollars in New York is lower than the rate of interest on borrowings of Canadian dollars in Canada, but the cost of acquiring the foreign currency with which to pay off these debts and to pay interest on them is not calculated and cannot be calculated, as past experience has indicated. If the Canadian dollar ever starts down the slippery slope of currency depreciation, as has been urged already by some, and as can happen to any nation that looks for apparently easy short-run gains without regard to the future, no one can say what the ultimate price may be at which these foreign debts will have to be redeemed.

The state of our export and import trade and the degree of unemployment are affected by many factors which are more important than the exchange rate of the moment, but I should like to say a further word about the problem of the exchange rate in view of the amount of discussion which it has been receiving lately. The Minister of Finance has in several public speeches discussed in detail various possible actions by the Government to bring the Canadian dollar into parity with the United States dollar -- or, for that matter, into any other desired relationship -- and has outlined the disadvantages as well as the advantages inherent in the various lines of attack which various people have suggested. I should like to mention only that suggestion which directly concerns the central bank, namely, that there should be a large degree of monetary expansion in Canada with a view to bringing about a reduction in interest rates in Canada and making more money available for lending at lower rates of interest, so that Canadian borrowers would not feel under any inducement to borrow in New York. This proposal has many drawbacks, including the obvious dangers of inflation, associated with it. But in addition to all other handicaps it suffers in my opinion from the disability that it simply would not work. It would tend not only to create inflation, which would cause a large rise in the money expenditures and borrowing requirements of governments and other public and private bodies, but also fear of inflation on the part of investors and savers, such as we had some experience of in 1958 and the first half of 1959. Under such circumstances lenders would not willingly make loans available at lower rates of interest, but would put their savings to other uses unless offered increasingly higher rates of interest. The conditions making for foreign borrowing, that is, excessive domestic expenditures and borrowing and higher interest rates than those abroad, would not be removed but would more likely be intensified.

Monetary inflation would not increase the volume of real savings within the country, of real goods and services available for use by governments, business, houseowners, farmers and others concerned. If anything, it would cause a reduction in real savings and a waste of real resources. It would tend to increase imports more than it would encourage greater domestic production in competition with imports, and the rise in prices and costs would certainly be a handicap to exports. No nation has ever solved balance of payments deficits by inflation, and those nations which from time to time have got into balance of payment difficulties through over-spending have found that a return to sound monetary practices and sound fiscal practices is essential.

Our position today is such that general measures designed to increase total spending or total purchasing power indiscriminately would not be helpful. If I felt that monetary expansion would make a significant contribution to an increase in employment I would certainly be in favour of it, but not in circumstances where the result would instead be inflation, more difficulties with our balance of payments, and ultimate unemployment on a larger scale than ever. Similarly, under present conditions general measures involving larger government deficits would not contribute significantly to an increase in employment in Canada, but be more likely to increase imports, that is, to increase employment in other countries rather than in Canada. This is not to say that any particular kind of government expenditure is good or bad in itself, but simply that financing government expenditures in general by further deficits would do more harm than good, in the same way as general monetary inflation. The same reasoning would apply also in connection with proposals to increase consumer purchasing power by a general increase in everybody's money income or by a substantial increase in those money incomes which take the form of wages and salaries. Whether a wage increase in any particular industry at any particular time is good or bad for those directly concerned is a matter for them to consider. But there is no foundation for the argument that a general increase in money incomes can increase total employment in Canada today.

May I emphasize once again that sound financial policies are no drag on economic growth, and particularly are not inimical to full employment.

Inflationary measures would aggravate rather than cure the causes of unemployment. There is no easy way by which real economic difficulties can be overcome without effort and cost, at any rate a cost in the short run. The cost of unemployment and of measures to promote increased employment are real, and must be borne by someone. There are non-inflationary methods to deal with this, if the people of Canada are prepared to share the cost. Such methods must all turn on the same basic principle. In one way or another, those of us who are employed must contribute out of our resources to help share the cost of unemployment and to help create conditions in which greater employment opportunities will be available within Canada. The question of maintaining a viable economic structure in different regions of Canada as well as in different industries within Canada is also one which calls above all for a sharing of burdens and opportunities. The cost that must be shared, the price that must be paid in the short run, in order that we may all be better off in the long run, and in order that we may all remain Canadians in the long run, is not in my opinion a very high price, but obviously it is more likely to be voluntarily accepted and undertaken if we all know and study and face up to the facts, and reach a broad measure of agreement on what we want to achieve and what methods are best calculated to bring about the desired achievement.

We can have economic growth without inflation, full employment without inflation, a rising standard of living without inflation, increased social services and various forms of government services without inflation, and a balance in our international accounts without inflation -- and without unemployment. All this is within our own power to achieve, but measures of an inflationary character are least likely of all to bring about such desired social objectives and ought to be all the more suspect because they are represented as being an easy way out.

A few weeks ago the Secretary of the Treasury of the United States forecast a growth of 50% in the Gross National Product of that country over the next ten years. That is approximately the degree of growth in real terms, not money values, that we had in Canada in the last ten years, accompanied by a very large increase in our foreign debt. There is no reason that I can see why we could not have a similar degree of growth in this country in the next ten years without any further large increase in our foreign debt, but it will not come about automatically and it will certainly not come about if present trends continue without change.

Last year the major element in our total international current deficit of $1,460 million was a deficit in respect of what are called invisible imports and exports, that is, current payments other than for goods exported and imported, amounting to $1,075 million. This has shown a persistent upward trend for some years, and some degree of increase is inevitable for many years ahead, partly because of the foreign debt we have already incurred. By 1970, the non-merchandise deficit may well amount to more than $2 billion a year. If we are ever to stand on our own feet, we can only meet the burden of these payments by keeping our expenditures on imports below the level of our receipts from exports by an equivalent amount. I can see no possibility of our exports increasing to a sufficient degree to achieve balance in our international accounts without a change in our propensity to import. We need to develop our domestic industry in such a way as to reduce our propensity to import, so that even though our merchandise imports may rise somewhat over the years, they will come within and stay within the earning potential of our exports after allowing for that volume of export proceeds which must be used to pay for interest and dividends on our foreign debt, tourist travel abroad and various business and other costs abroad.

From study and discussion of these matters will come many suggestions as to the course we should follow. Many heads are better than one, and controversy sharpens the imagination and the will to action. I am not offering a detailed prescription myself, but it is natural for people to expect something more than purely negative warnings against the insidious dangers of monetary inflation, excessive total spending and reliance on foreign borrowing. In general terms, it must be clear that in addition to whatever expansion of employment-increasing export industries may reasonably be expected, a large expansion of domestic secondary industry in various parts of the country is essential if we are to re-establish economic equilibrium between Canada and the rest of the world, and also in order to provide for equilibrium in employment opportunities inside Canada itself. And Canada can only be strong and meaningful in terms of national identity if each of its main economic regions is likewise enabled to develop and maintain a healthy economic structure as the varying circumstances of time and place may require.

Although we have our difficulties and problems, let us not forget that we are capable of providing Canadians in all parts of Canada with a way of life which even in economic terms need be second only to that of the richest and most powerful nation in the world, and in Canadian eyes and taking account of non-material values as well, second to none. We do not have to choose between poverty-stricken independence and some form of economic colonialism, either for Canada as a whole or for any of the regions of Canada. If we put Canadianism in the forefront of our economic and social thinking, and recognize each other as fellow Canadians, if we co-operate and share, we can be both independent and wealthy, even as the world measures wealth. If we are sufficiently determined to pay our own way and make our own place in the world, all Canadians in every part of Canada can achieve productive employment, with an ever-widening range of modern industrial and scientific occupations available to them, and can maintain a standard of living and way of life which in the sum of all its aspects will be capable of satisfying the highest aspirations of the human spirit.

Last October I attended the annual meetings of the World Bank and International Monetary Fund, two institutions which are dedicated to the promotion of sound economic growth, monetary stability, and the expansion of international trade. I heard the President of the World Bank congratulate a European country for having overcome its postwar inflationary pressures and balance of payments problems which - because of the destruction and dislocation arising from the war - were much worse and much more difficult than anything we in Canada have had to deal with.

He attributed their success not to the possession of rich natural resources, of which indeed they have none, but to qualities of personal character and community morale, hard work, self-discipline and financial statesmanship.

With these qualities, and assisted in the early days of post-war rehabilitation by some foreign loans -- including loans from Canada, it is strange to recall that for a time after the war we were a lender rather than a borrower -- with these, they set their house in order, overcame great hardships and handicaps, and succeeded in living within their means, and paying off gradually their post-war foreign debt. The people of the Netherlands did this, and a number of other European nations pursued much the same course, because they knew it was in their interest as an independent, industrious and self-respecting nation.

Who will say it is beyond the power of Canadians to do the same?