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"FOREIGN DEBT AND UNEMPLOYMENT"

Remarks by
Mr. J. E. Coyne, Governor of the Bank of Canada,
prepared for delivery at a Meeting of
The Canadian Club of Toronto,
November 14th, 1960

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Mr. President and fellow members of the Canadian Club:

It is said that Mark Twain at one period in his career as a public speaker used to try to establish an immediate bond of sympathy between himself and his audience by opening his remarks with the salutation "Fellow taxpayers". I hope you will not be startled or antagonised if I address you, as I think is appropriate today, as "Fellow debtors". We are all debtors whether we know it or not, and Canadians are more heavily in debt than any other people in the world.

It is true that our public debt (of the national government) at the level of $17 billion, which is almost entirely held within Canada, is not quite as large per capita or in proportion to national income as the public debt in some other countries, but we also have a foreign debt, net financial and economic liabilities to foreigners, which is as large as our domestic public debt, and no other country of any substance has gone nearly that far.

The domestic public debt is, of course, similar in many respects to domestic private debt in that it represents a claim of citizens of the country to receive certain payments out of the capital or the annual production of the same country, to be paid by citizens of the same country in their own currency. Arrangements for paying interest and principal on such debts can be made in an orderly fashion in whatever way the people of the nation concerned may decide among themselves. In actual practice, taxes to pay the interest are to a large extent levied on the very people to whom the interest is paid.

Foreign debt, on the other hand, is something owed to people of other countries, and finding the means to pay it off, or even providing the foreign exchange to meet annual payments of interest and dividends on investments owned by foreigners, may be a very difficult problem indeed. The bigger the debt, obviously, the more serious the problem.

On a number of occasions during the past six years, and particularly during the last twelve months, I have remarked on the dangers inherent in large, persistent annual deficits in our balance of payments and the growth of our foreign debt. Many informed persons whose opinions I respect have shown the same concern, and have indicated agreement in broad outline with the views I have expressed. Some, however, have suggested that these matters are outside the field of central banking and that a central banker should not express views on them, at any rate publicly. Others have taken quite an opposite line of criticism and demanded specific recommendations for remedial action. I have tried to take a middle course between these two contrasting views.

Actually, there is a direct connection between the problems of central banking in Canada and developments in the field of our balance of payments, the exchange rate, and our international debtor position. But from a broader point of view, I believe that central bankers have a responsibility to point out and, if you like, to point up, the major economic problems of the day. In most countries that I know of, the central bankers accept this as a principle. In considering economic problems and possible fields of action to cope with them, it is not good enough for central bankers just to re-iterate that excessive monetary expansion and inflationary finance are undesirable and dangerous. That would be purely negative, and I believe it is incumbent on anyone who takes a negative attitude to one proposed solution of a very serious problem to put forward alternative constructive ideas for consideration. I have, therefore, tried to point out certain areas in which it seems possible that solutions can be found to the major economic problem facing Canada today, and to emphasize the relevant facts and the basic principles involved, in order to encourage the widest possible discussion of these matters by others. From many different quarters there will come forward a wide variety of specific proposals for action. Out of discussion, out of controversy, out of the development of a will to action, the best solutions will be found, the particular steps that should be taken, outside the field of monetary policy as well as in that field.

Foreign Debt

To return to the subject of foreign debt: Our net international indebtedness at the end of this year will be about $17 billion. At the end of 1949 it was less than $4 billion. The amount quadrupled during the fifties, and has increased again by $1.5 billion or more in 1960. It is clear that the proportion of Canada's total real capital assets owned or controlled by non-residents or subject to a mortgage held by non-residents has greatly increased during the past 10 years, and it is still increasing.

Already, 60 per cent of the dividends paid by all Canadian corporations go to non-resident shareholders.

According to figures recently published by the Dominion Bureau of Statistics, 35 per cent of Canada's net capital formation over the years 1956 to 1959 was financed by the use of foreign resources, including the re-investment of unremitted earnings of subsidiaries of foreign companies in Canada. In 1959 and 1960 the percentage was probably more than 35 per cent.

By the end of 1957, foreign companies and other foreign investors had a controlling interest in 56% of all manufacturing industry in Canada, and in some sectors of manufacturing the degree of control was 70%, 80% and even 98%. In petroleum and natural gas, also, some 76% of the industry was foreign controlled, and in mining and smelting 61%.

Residents of the United States own 76% of all foreign investment in Canada, and control from 80% to 90% by value of all foreign-controlled companies in Canada.

It is tempting to speculate how Americans would regard a similar situation in relation to their own country, that is to say, what their feelings would be if the United States had a foreign debt of the order of $250 billion, with the bulk of their most valuable natural resources owned or controlled by foreigners and more than half of their manufacturing industry likewise owned or controlled from outside their own country.

The idea of a United States foreign debt of the order of $250 billion staggers the imagination. We should be equally impressed with the idea of a Canadian foreign debt of $17 billion. Is it not enough to make those who take heed for the future begin to do some very hard thinking?

The Canada of the mid-twentieth century bears no resemblance, of course, to the early colonial days either of Canada or the United States. In some respects the position of our economy in relation to the rest of the world may resemble that of the United States before the First World War, or even to that of the United States between, say, the reconstruction period following the Civil War and the end of the nineteenth century. An important difference, however, is that during this period the United States depended almost entirely on its own saving to create its own capital with which to develop a widespread national territory, and upon its own scientific and managerial talent to modernize and expand its industry. Even the great amounts of capital required to cope with a large flow of immigration were generated internally, and such foreign companies as did establish subsidiaries in the United States never grew to such numbers or size as to dominate any important sector of the United States economy. The foremost student of United States economic development in that period, Simon Kuznets, has stated that, like Japan, "The United States...engaged capital imports that were only minor fractions of domestic capital formation and minute percentages of national product", and again: "Gross foreign investments must never have exceeded a few percent of the country's wealth". During the twenty years from 1869 to 1888 according to this study, net new foreign investment in the United States, that is to say the net import of capital averaged less than 1% of Gross National Product. From 1890 onwards, except perhaps for occasional years early in the period, the United States developed a growing export of capital rather than an import of capital.

In Canada we may also remind ourselves that from 1940 to 1946 we financed the whole of our war effort out of our own economic resources, undertook a tremendous development in many advanced sectors of industry, and in addition became a net exporter of capital on a large scale in the form of gifts and loans to our allies during that period.

We may also contrast with our present position the situation in Western Germany, a country which was devastated during the war and separated from much of its former territory at the end of the war. Germany's tremendous economic growth and industrial development since the war have been financed out of its own new saving without net foreign borrowing. Germany has for years had a surplus in its trade with the rest of the world, has extended credit to a number of other countries and paid off its own debts, and has increased its gold and foreign exchange reserves from zero to a figure of over $7 billion today.

For the past year or two the United States has been concerned, and the outside world has been concerned, about a so-called deficit in the United States balance of payments which has caused an outflow of gold from the United States to Europe. Actually the United States does not have a balance-of-payments deficit in the usual sense, not an excess of imports as in the case of Canada, but there has been a capital outflow on the part of both foreigners and Americans, part of which takes the form of a withdrawal of gold. The gold outflow has been at the rate of $2.3 billion in 1958, $1.1 billion in 1959, and over $1 billion so far in 1960. We may ask ourselves, what would Americans think of their situation? ---what would we think of their situation? ---if they had a balance-of-payments deficit on current account alone which was equal in one year to the whole of the United States gold reserve, and if, beyond that, they had a continuing annual deficit of this size year after year? Yet in proportion to gross national product, the Canadian balance-of-payments deficit at an annual rate of from $1,131 million to $1,455 million in each of the past 5 years, 1956 to 1960, is equivalent to a United States deficit, averaged over those years, of more than $18 billion per year.

The Annual Deficit in Canada's Balance of Payments

The annual deficit in the current account of our international balance of payments is simply the amount of goods and services which we buy from abroad on credit, the amount by which our total purchases exceed our total earnings abroad during the year. The difference has to be met by borrowing, or by selling off capital assets owned by Canadians, or by other forms of transfer of capital.

The amount of our net foreign liabilities is the excess of our total foreign liabilities less such investments abroad as are owned by Canadians. This net amount has increased each year for the past ten years, both by the amount of goods and services which we have bought from other countries on credit, and by the accrual of unremitted profits in Canada in the hands of subsidiaries of foreign parent companies. Retained earnings on foreign portfolio investment in Canada add further large amounts. These profits, if remitted abroad and then brought back as capital for investment in the Canadian business would show up in the balance of payments and make the recorded current-account deficit even larger, in some years as much as $480 million greater, and similarly increase the recorded net capital inflow for new investment by the same amount.

The year 1952 was the only year in the past decade in which we had a surplus in our balance of payments. For the 'fifties as a whole we had aggregate net deficits of $7,640 million---$1,560 million in the first half of the decade and $6,080 million in the second half---plus at least another $3 billion in the form of unremitted profits of foreign investors in Canada. The total increase in our net debt, involving certain other factors as well, was $11.5 billion.

For the last five years of the fifties our trade and payments with the United States alone produced an aggregate recorded deficit of $6,640 million (exclusive of unremitted profits) which was offset to the extent of $560 million by a surplus with other countries.

Our ability to earn a substantial surplus in our trade and payments with overseas countries has disappeared. In 1959 we had, not a surplus, but a deficit of $215 million with overseas countries---in addition to a deficit of $1,215 million with the United States. In 1960 we have increased our exports of goods by rather more than the increase in our imports of goods, but other payments have continued to grow. If there is a surplus with overseas countries it will be a small one. Our over-all deficit is running at a rate of over $1,200 million.

The balance of payments, our expenditures and earnings, include more than just physical exports and imports of goods. There are also payments for many varieties of services rendered by foreigners to Canadian businesses and Canadian individuals, and we have some offsetting receipts of the same nature. There are also such matters as expenditures on tourist travel, remittances home by emigrants, payment of legacies and inheritances, and the annual production of newly mined gold, which is not treated as an export of goods but whether actually exported or not is regarded as an element in our so-called invisible earnings.

There remains one more item which is becoming increasingly important, namely, payments of interest on foreign debt and payment of dividends on foreign investments in Canada. Our net payments on this account amounted to almost $500 million in 1959. This was at the rate of approximately 3% on our net foreign debt, most of which in fact bears a higher rate of interest or is earning in Canada a much higher rate of return than 3%. One factor explanatory of these figures is the large amount of unremitted earnings of foreign investors in Canada. In addition, as the Dominion Bureau of Statistics point out in their latest balance of payments publication, "of even greater significance is the fact that many extensive enterprises owned in Canada by non-residents have not yet reached the stage of significant earnings". It is clear that even if there were no further increase in our net foreign liabilities, the amount required to be paid year after year by way of interest and dividends will go on increasing for some years yet, and could easily rise to a level of more than $1 billion a year. Any further increase in our foreign debt will cause the annual debt burden to rise to still greater sums.

In 1959 the net total of all these invisible items, that is, the excess of our payments over our receipts after allowing for our gold production, was $1,049 million. Much of this will go on growing for some years. If we are to live within our means in terms of our international balance of payments and avoid further increases in our foreign debt, therefore, our merchandise trade must develop a surplus of well over $1 billion a year. Last year, our merchandise trade showed a deficit of $380 million. This deficit will be smaller in 1960 as a result of a somewhat greater increase in exports than in imports, but there is still a tremendous gap which will have to be closed if we are going to pay our own way in the world and match our expenditures with our income, to say nothing of the more desirable goal of developing an over-all surplus in our balance of payments.

We have now got into a position where it is quite clear that equilibrium in our balance of payments cannot be restored simply by letting nature take its course. Our balance of payments will not cure itself. I believe the difficulty is chronic and structural. We have reached a critical juncture in our affairs, when we can see more clearly than before the danger to the Canadian economy, and the urgent need to prevent further damage to the Canadian economy in the future, arising from the persistence of large deficits in our balance of payments, the great size and continuing rapid increase of foreign debt, the spread of foreign economic domination over much of our industrial life, and the distortions in our economic pattern and in our price and cost structure resulting from attempts in the past decade to do too much too fast, which caused over-expansion in some fields of development and retarded the growth of others.

The attempted excessive expansion and resulting distortions were largely induced by an overwhelming flow of foreign capital to this country to exploit Canadian exhaustible resources and secondary industry and take over existing Canadian enterprises, augmented by large-scale borrowing abroad on the part of Canadian provinces and municipalities.

There were many contributory causes to the growing imbalance of the Canadian trade and payments, and the development of chronic or structural unemployment. My own view is that excessive reliance on foreign capital was probably the most important active cause. The excessive flow of foreign capital and the activity of foreign-dominated companies pre-empted various fields of Canadian development---inhibited the growth of various competitive Canadian industries---bought out many Canadian companies, some of long standing in the community---pushed up the Canadian exchange rate---induced a massive inflow of imports---and prevented or discouraged Canadians from investing in many of the most fruitful and most expandable types of economic activity.

It may be noted that the inflow of capital takes three main forms. One is that which results when provinces and municipalities (and occasionally corporations) borrow funds by new issues of securities in the United States or Switzerland or somewhere outside Canada, obtaining foreign currency (and undertaking an obligation to make payments of interest and principal in foreign currency). The foreign currency which they obtain has to be converted through the exchange market into Canadian dollars, and the Canadian buyer of the U. S. dollars uses them to pay for imports of goods and services from abroad. The amount of capital coming in in this form in 1959 was close to $500 million.

A second large source of foreign capital is that which is called "direct investment", that is, additions to the investment in subsidiaries by foreign parent companies or new investments by foreign companies in the form of developing new projects in Canada, or buying up existing Canadian companies---the latter process, incidentally, is becoming depressingly frequent. Funds coming in in this way for direct investment also amounted to $500 million in 1959.

A third major channel of foreign capital inflow consists in the purchase of Canadian-dollar securities by foreign investors at large. These may be Canadian stocks or Canadian-pay bonds of the Government of Canada, or of provincial governments, municipalities and corporations of all kinds. This item fluctuates considerably from year to year, and can at times be very considerable. In 1959 purchases of such securities by foreigners from Canadian issuers or investors exceeded purchases of such securities by Canadians from foreigners by a net amount of $200 million.

There is an obvious connection between the net inflow of capital, the excess of imports, and the failure of Canadian production to expand sufficiently to provide an increase in employment equal to the increase in the labour force.

Buying more than we sell involves going further into debt; in some shape or form an equivalent net inflow of capital must take place. But it is also the case that <u>a net inflow of capital forces us to buy from abroad more than we sell.</u>

For example, when a provincial government borrows U. S. dollars in New York, it cannot make use of the U. S. funds except by selling them for Canadian dollars, and the rate of exchange will move until someone else is found who is induced, by the discount on the U. S. dollars (or the corresponding premium on Canadian dollars) to exchange his Canadian dollars for U. S. dollars and use the U. S. dollars to buy and pay for imports---imports which would not take place otherwise, and which cause unemployment in Canada, or prevent employment from rising. Similarly, every time a foreign company buys out a Canadian company, or sends funds here for direct investment, it must find a Canadian to buy the foreign exchange brought here by the foreign company, a Canadian who can be induced to spend more abroad.

A further effect of both kinds of import of capital is to reduce the value (in Canadian dollars) of Canadian exports and hold them to a level lower than might otherwise be achieved.

It is true, of course, that Canadians sometimes buy U. S. dollars in order to make a capital investment abroad, or pay off a foreign debt. It is also true that the Government may use its available resources of Canadian dollars to buy some of the incoming foreign exchange in order to increase the official gold and foreign exchange reserves, but there are obviously limits to what can be done in this way, as was shown in 1950 when we adopted the system of a free market in foreign exchange because the Government could not go on financing the sums necessary to cope with very heavy inflows of foreign capital.

When full allowance has been made for such outward flow of capital and tolerable movements in official reserves, the net inward flow of capital must induce an equivalent excess of imports of goods and services into Canada over exports from Canada.

It might have been thought that the pressure of the net inflow of capital upon the exchange rate would make Canadian dollars and therefore Canadian investments too expensive for foreigners, but evidently the main effect has been to encourage an increase in Canadian imports on a massive scale and stunt the growth of exports, long before the rate movement reached the point of seriously discouraging the net inflow of capital.

This effect of a continuing net inflow of capital, the effect on Canadian trade and consequently on the whole Canadian economy, with its accompanying effect on unemployment, is serious enough. There is another side to it which has not perhaps been fully appreciated, namely, that unless the inflow of capital is reduced, all attempts to rectify the deficits in our balance of payments must be self-defeating.

Suppose, for example, special efforts are made to increase the sales of certain of our exports by $500 million a year. This would seem to reduce the deficit in our balance of payments from the previous level of (say) $1.5 billion to a new level of only $1 billion. But if capital continues to flow in at the former net rate of $1.5 billion there will obviously be strong upward pressure on the Canadian exchange rate. This tendency towards an increase in the value of the Canadian dollar (i.e., a decrease in the value of the U.S. dollar in Canada) will operate to curtail various exports (at least exports other than those in which special success is being achieved), and increase imports, by such amounts that the deficit in the balance of payments would not in fact be reduced by the anticipated $500 million, and perhaps not at all.

A further consequence which will be quite apparent is that unless the inflow of capital is reduced, all attempts to increase employment in Canada, at any rate employment in export industries and employment in industries competing with imports, must also be self-defeating, that is, they will cause as much loss of employment in some of our export or domestic industries as they cause gain in employment in others.

In other words, efforts to increase employment in the most obvious and essential places, in lines of production which would serve to overcome the deficit in our balance of payments, would in the face of a continuing unabated inflow of capital lead either to a decrease of other exports or an increase of other imports, and a consequent loss of employment in other industries equal in magnitude to any increase in employment which was being attempted.

A reduction in the inflow of capital must, therefore, at the very least, go hand in hand with action designed to improve the current account of the balance of payments and improve employment in useful production in Canada, and to be on the safe side the reduction in the inflow of capital should be such as to anticipate the desired improvement in the trade balance and thus itself help to bring about that desired improvement.

This is not a theoretical proposition, but a very practical consideration in the approach to an urgent problem.

One further facet of the whole problem may be mentioned, namely, that the more action is taken to make economic conditions prosperous in Canada and to encourage increased production and employment in Canada, the more rather than the less eager will American corporations and other foreign companies be to expand their interests in Canada, so that we will be faced with the prospect of an increase rather than a decrease in the inflow of capital, unless by some means Canadians can be discouraged from borrowing in the United States, other Canadians can be encouraged to invest in Canada, and the rate of foreign investment in Canada can be reduced.

In 1957-58, and again in 1960, there has been great concern about the growing volume of unemployment, which to a considerable degree is of a structural character and as such is the direct result of the distortions created by the tendencies already mentioned. A situation of large and rising unemployment always tends to give rise to demands in various quarters for large-scale monetary expansion and massive Government deficits, deliberately induced. These are not the best ways of going about remedying our situation. Indeed, they would not provide a cure at all, but would do great further damage to the Canadian economy, inflate prices and costs, reduce the real value of the fixed incomes of millions of Canadians, and in effect expropriate part of the savings of all Canadians.

On the other hand, it is clear from the history of the past decade that the operation of natural forces alone---the "policy" of laissez-faire---will likewise not cure our troubles. The experience of all other countries in the western world, and particularly of those that have made the most progress in the post-war period, is that to rectify a persistent deficit in the balance of payments, to overcome unemployment and maintain continuously the highest possible level of employment without inflation, requires a strong and active policy in the economic sphere on the part of all levels of government. The lead in such matters will naturally always come from the national government, although particularly in a regionally diverse country like Canada, the co-operation of provincial and municipal governments, of business enterprises and of individual persons in all walks of life is also important.

As a nation, we must learn to live within our means, and increase our means by our own efforts.

To "live within one's means" is perhaps an old-fashioned expression. I was interested, and impressed, to find this phrase used a few weeks ago in an exhortation addressed to his countrymen, and his Government, with special reference to the volume of imports, by the Governor of the Bank of England, the

Right Honourable C. F. Cobbold. The cause for his concern was not that the United Kingdom already had a large foreign debt---because on balance the United Kingdom, unlike Canada, has no net foreign debt. Nor was it that the United Kingdom was running a deficit in the over-all current account of its balance of payments---because the United Kingdom, unlike Canada, is currently earning a surplus in its international transactions, and increasing its net capital position, and has done so in ten of the past twelve years. Nor was he concerned by the fear that imports were causing a large amount of unemployment---because the United Kingdom, unlike Canada, has on the whole a labour shortage rather than widespread unemployment. What the Governor of the Bank of England regarded as a cause for anxiety was that the favourable balance in their trade and other international transactions was decreasing, and he raised the question whether the nation would permit this to go on, or whether they would hold their imports and other payments within the limits of their earnings. The relevant passage from his speech reads as follows:

"I have been speaking of monetary technicalities, because that is my trade. But the fundamental issues for the next decade are different. What really matters is whether the British people and British Governments will choose to live within their means, or to live right up to them and sometimes beyond them. Shall we be content to limit demands on our resources to what we can manage without causing shortages, price rises and too large a bill for imports? Shall we be content to limit our overseas spending and lending to what we earn? If the decisions on these fundamental issues are right, then the monetary technicians can help to keep an even balance. If the decisions on these issues are wrong, there are no monetary gimmicks or international credit schemes which can put them right."

For Canada, to rectify the deficit in our balance of payments requires that we should live within our means as a nation. To some this apparently carries a suggestion of austerity. Under some conditions, if we were really up against it, that might be our unavoidable lot. If we do not take action soon to re-adjust our production and imports, we may indeed be faced in the end with a rather drastic necessity to tighten our belts, as happens when creditors take alarm and shut off the supply of credit to one who seems to be in a hopeless debtor position. But prompt action now to make the necessary adjustments can preserve us from that outcome. To me, the objective of living within our means today carries with it the idea not of austerity but of increased productivity, increased production, increased employment--- and the elimination of unemployment. Austerity is not the only alternative to going deeper and deeper into debt. More energetic development of our own industry, more production to help fill our own requirements, are the constructive alternatives to asking other people to provide for us. To go on borrowing while our own people are unemployed, to go on borrowing in order to import more than we export, to import more goods which could have been produced in Canada and thereby provided jobs for unemployed Canadians---in short, to go on borrowing in order to create unemployment---such a course surely cannot be defended on any basis of rationality.

The Quantity of Money and the Availability of Credit

"Monetary gimmicks" are no substitute for enlightened economic policy and no antidote for excessive reliance on foreign borrowing. Yet there have always been people who advocate an increased amount of monetary expansion as a cure for unemployment, as a means of preventing foreign borrowing as the remedy for our balance-of-payments deficit, as the cure for the premium on the Canadian dollar, and indeed as the cure for anything that ails the body economic.

No one will deny that over a period of time as economic activity increases and the total economy grows there must be an expansion of the money supply. It is another thing, however, to advocate large deliberate doses of monetary expansion with a view to bringing about or causing favourable economic developments.

An increase in the volume of bank deposits and in the resources of the banking system may at times be necessary in order to provide adequately for the normal credit requirements of business. When these are adequately provided for, a further increase in monetary resources---created out of nothing by the central bank and the banking system, not based on or reflecting an increase in the rate of real saving in the economy---may simply lie idle in relatively inactive bank deposits while foreign capital continues to pre-empt the field of direct investment in industrial activity and resource development. A more probable and more dangerous alternative is the possibility that the increased monetary resources may be used for non-productive activities or speculative activities, which will not add to the strength of the Canadian economy.

One possibility which should be very much to the forefront of our thinking these days is that additional monetary resources may be used not to encourage savings and investment but to encourage dis-saving in the form of consumer credit, encouraging more and more people to go deeper and deeper into debt today, at the expense of a reduction in their purchasing power over the next year or two and therefore in employment.

And finally, there is the very great danger that excessive monetary expansion, and the fears and psychological attitudes engendered by excessive monetary expansion, will lead to rising prices, a flight from money into goods and other real assets, and all the injury, destruction and sheer wickedness of progressive inflation.

In connection with the monetary situation, let us first look at the facts, at actual developments in connection with the volume of money and the supply of credit. One fact that may be of interest is that during the last ten years we have had a greater percentage increase in the money supply in Canada than the corresponding increase in the United States. During the last twelve months we have had a greater percentage increase in the money supply in Canada than the corresponding increase in the United States.

In the most recent twelve-months period for which figures are available---actually the 52-week period ending November 2nd, 1960---the total of chartered bank deposits plus currency in circulation increased $504 million, made up as follows: currency $63 million, personal savings deposits $194 million, Government deposits $116 million, and all other deposits ("current accounts") $131 million. The resources of the banks available for lending or investing in Canada increased by $495 million, of which $164 million was used to purchase foreign exchange and increase the net foreign position of the banks. Of the remainder, $381 million went into Government securities (Treasury Bills up $115 million, bonds up $266 million) and $20 million into additional cash and money at short call (including day-to-day loans). Total non-Government loans and investments declined by $70 million on balance, but, within the total, general loans to business, farmers and individuals rose $79 million and housing mortgages $30 million; special categories of loans were down $85 million and holdings of provincial, municipal and corporate securities declined $94 million.

Take another period of some interest, from approximately the seasonal low point of bank loans in late winter to the end of September. Certain details of loan categories are available only on a quarterly or monthly basis, with the latest being those for September 30th. During the six months from March 31 to September 30, the volume of money (as defined) rose by $317 million and the lendable resources of the chartered banks rose $239 million.

It is of interest to note what use the banks made of their increased resources during this period. One of the larger items was an increase of $107 million in the banks' holdings of Treasury bills. Their total liquid assets at the end of September amounted to 18.4% of their deposits, and the average daily ratio for the month was 17.7%, as compared with 17.0% in March and as compared with the agreed minimum average rate of 15%. (During October the average daily liquid asset ratio rose again to 18.3%.) The banks also during this period added $55 million to their holdings of Government bonds and $23 million to their net foreign assets. Provincial, municipal and corporate securities declined by $44 million, and insured housing mortgages declined by $2 million. In the loan field there were mixed movements, partly seasonal in character. General loans rose by $308 million, and other loans, mainly those to provinces and municipalities, loans to grain dealers, and loans for the instalment financing of Canada Savings Bonds, declined by $227 million.

Within the category of general loans there was a rise of $85 million in loans to farmers and of $11 million in loans to institutions. There was no increase in miscellaneous personal loans, including home improvement loans, but there was a rise of $116 million in personal loans in the nature of consumer credit. In the field of business loans there was a pronounced rise in loans in the smaller categories. Those with authorized lines of credit of less than $100,000 showed a rise of $48 million in the amount of credit used. Those with authorized lines of credit of from $100,000 to $1 million showed a rise of $58 million in the amount of credit used. Businesses with authorized lines of credit in excess of $1 million showed a decline of $10 million in the amount of credit used.

It is quite apparent that the banks have had plenty of funds available for their normal commercial lending. In addition to taking care of all normal requirements, and particularly those of small business, they had several hundred million dollars left over which they invested in Government securities and in the field of consumer credit. The latter item is one that some of us would not regard with any high degree of approval, but it is indicative of the fact that the banks had ample funds available for lending. If any business enterprise, or any productive activity, is not now getting essential bank credit, it is not because of any shortgage in the aggregate quantity of money in the country, or any shortage of loanable resources within the banking system. The banks' figures indicate that they were in a position to satisfy all such requirements (within the limits of sound banking practice) and have a considerable amount left over for other purposes.

I should like to draw particular attention to the scale of bank lending in the field of consumer credit, by which I do not mean loans by the banks to instalment finance companies, but loans by the banks direct to individuals who desire the funds mainly for the purpose of purchasing motor cars and other consumer goods on credit repayable over a period of time. Over $800 million is now outstanding on these loans, as a result of the great increase in bank activity in this field in the past two years. These loans are for the most part repayable by instalments over two or three years, so that from 30% to 50% of the total outstanding is repaid each year. Any time the banks want to release funds for lending in other categories, such as business loans or housing loans, they can raise substantial sums simply by slowing down their rate of new lending in the field of consumer credit, and utilizing for the desired purposes the funds received by way of repayments on outstanding consumer loans.

Interest Rates and the Exchange Rate

The suggestion is also made from time to time that the Bank of Canada should take action to reduce the level of interest rates in Canada, and particularly the margin by which interest rates in Canada exceed similar interest rates in the United States. It is usually part of this suggestion that interest rates in Canada should be reduced sufficiently to induce all Canadian borrowers to do their borrowing in Canada, so that a reduction in the amount of capital inflow from the United States would cause the rate of exchange to weaken, with the Canadian dollar going back to parity with the U.S. dollar. Some people urge that it would be desirable for the Canadian dollar to go to a discount. It is implied that all this could and would be achieved simply by central bank action without other measures to discourage foreign borrowing.

One of the difficulties from a practical point of view in carrying out any such programme is that there can be no assurance that the central bank could in fact effectively hold down interest rates under such conditions for more than a short period of time. The attempt to do so would require a considerable amount of purchasing of securities in the market by the central bank, which would increase the cash reserves of the chartered banks and give rise to a large further amount of purchases of securities or credit expansion by the chartered banks. The total increase in the money supply would be about twelve times as great as the amount of purchasing done by the central bank. Persons holding Government bonds or other fixed debt securities might take alarm--- as has happened on occasion in the past--- if they thought that such activities of the central bank were likely to have inflationary results in due course. They would then become very willing sellers of securities, and buyers would be hard to find. In the end, interest rates could very well be higher than when the programme started, rather than lower. This in fact happened both in Canada and in the United States in 1958-59.

It is not the cost of money which counts in the long run but its availability and its value. Both these depend on the generation of real savings and maintaining the confidence of savers, or of intermediaries who invest their funds for them, that the investments in which they are asked to put their savings will be sound, successful, profitable, and in varying degree liquid, that is, realizable if necessary before any fixed maturity date. The rate of interest must be high enough to encourage saving and to encourage savers to lend. This is just as important as the other statement more usually heard, that the rate must be low enough to encourage borrowers to borrow and spend. And above all, it is desirable that savers should feel encouraged to put a good part of their savings into productive investments, not just into bank deposits or even Government bonds.

Another problem raised by any programme deliberately to depress the value of the Canadian dollar to a substantial discount in terms of the United States dollar is the effect on internal prices and costs, an effect which, of course, would be inflationary. While exporters might make larger profits for a time and imports might be discouraged for a time, the effect would gradually wear off as all costs and prices within the country rose progressively in reflection of the lower purchasing power of the Canadian dollar. In the process many people not in a position to adjust their own particular incomes would find their standard of living adversely affected. In effect they would be taxed in order to confer a benefit on others.

It may also be noted that a downward movement in the value of the Canadian dollar would, in itself, if nothing else were done, tend to increase the inflow of foreign direct investment. The buying up of Canadian companies and the bidding for Canadian natural resources would be stimulated as the word got around that Canada was selling out cheap.

What it all comes down to, in this instance as in so many others, is that monetary policy cannot be relied on to overcome difficulties of non-monetary origin, or to substitute for policies in other fields. Monetary policy cannot work miracles, and if we are not determined to live within our means, and to finance and control our own development, and to wipe out our balance of payments deficits by increased exports and by increased production of goods hitherto imported, tinkering with the money and credit machinery will not do it for us.

Conclusion

My major point is that there is a great deal that needs to be done to encourage a more useful application of whatever monetary expansion we ought to have, so that Canadians may be encouraged to save more and to put their savings into valuable fields of national development, so that Canadians may be discouraged from going into debt unnecessarily either at home or by way of further foreign borrowing, and with both these ends in view, to make it much less attractive for foreign funds to push into Canada and do the things that we ought to be doing for ourselves.

A few days ago the general manager of a large iron ore company in a public speech described how his company had decided it was necessary to go to the United States to raise large amount of capital because no one in Canada would provide the necessary funds. He said that if they had waited for Canadians to provide the capital the iron ore development would never have taken place. "Never" is a very long time. The lesson to be drawn from this is not, in my view, that it is right or necessary to call upon foreign capital to develop our resources or our industry, but that we should make the necessary arrangements to ensure that Canadian capital will be forthcoming for those kinds of development and employment which offer the best net advantage to the Canadian economy.

More is needed for this purpose than large-scale monetary expansion. Suggestions for large-scale monetary expansion, and for central bank action designed deliberately to reduce interest rates or to reduce the value of the Canadian dollar, seem to me to be acts of defeatism, a despairing effort to find an indirect way, a magic way, an effortless and costless way, to do something which can only be done by methods which involve real effort and a recognition of real costs, the burden of which can be shifted or shared but which cannot be eliminated except by more employment and more production.

We do not have to limit our perspective to the presumed magical powers of monetary policy.

The key to the whole matter is that we must carry on the future economic development of Canada on the basis of Canadian savings---Canadian capital, not foreign capital---along the lines that make for a strong, diversified and independent Canadian economy, not an appendage to a foreign economy. Monetary tinkering and repeated doses of exchange depreciation will do more harm than good. To achieve our goal, it is desirable to encourage more saving in Canada, but we already have a high over-all rate of saving and what is of even greater importance is to encourage more investment of Canadian savings in more Canadian enterprises. This in turn requires that we widen the horizons of opportunity for Canadian enterprises, opportunities for the expansion of fruitful production. We <u>can</u> live within our means---by increasing our means to live better, to produce more, and to manage our own affairs.

In Canada today, a great surge of national effort is waiting only to be roused and to be given an opportunity to make itself felt. We can undertake and bring to a successful conclusion a concerted national effort to restore growth, flexibility and progress to the Canadian economy---to achieve greater diversification of Canadian industrial and technological output---to bring about an increase in employment of sufficient degree to absorb the present number of unemployed and the continuing additions to our labour force year by year in the future---to maintain the soundness and real value of our currency---and to renew and increase a progressive upward trend in the standard of living of the Canadian people.