FINANCING ECONOMIC GROWTH AND BUSINESS EXPANSION

Remarks by
Mr. J.E. Coyne, Governor of the Bank of Canada,
prepared for delivery at a luncheon of the
Quebec Chamber of Commerce, Quebec City,
June 12th, 1961

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On behalf of the Board of Directors of the Bank of Canada and the Industrial Development Bank I thank you for your very kind welcome to this beautiful and historic city. It is a great pleasure to be able to hold our regular June meeting this year in Quebec.

There are twelve Directors from various parts of Canada, one from each of the smaller provinces, two from Quebec, and two from Ontario. Appointments to the Board are made by the Federal Government for a term of three years. I should like to say how pleasant I have always found my relations with the appointed Directors, and to thank them for the support they have given me.

Speaking here in the heart of old Quebec, I wish to pay special tribute to our friends Lieut.-Colonel Herve Baribeau, who has been on the Board since March 1959, and Mr. J. Rene Ouimet, who was appointed in March last year. As eminent Canadians, and as representatives of the Province of Quebec, their business judgment and their sound views on sound money have been of great assistance in the affairs of the two Banks.

The reason for holding our meetings on occasion in different parts of Canada outside of Ottawa is twofold: to enable the Directors to become better acquainted with the people and with economic conditions in different parts of Canada, and also to provide an opportunity for publicizing the work of the two Banks and helping to improve public understanding of what we are seeking to achieve and the methods by which we operate.

The Industrial Development Bank is in the business of making capital loans for a term of years to a wide variety of business enterprises, in the case of the Bank of Canada an essential part of its operations is to provide the chartered banks with a rising volume of cash reserves over the years on the basis of which they may expand their loans and investments of various kinds and so provide the growth in bank deposits and in money supply which is required in a growing country.

I am going to speak first about the work of the Industrial Development Bank in order to emphasize, if I can, the interest of the Directors and management of the two banks in their constructive role of promoting and encouraging and facilitating the expansion of the Canadian economy, the growth and development of Canadian industry, the maintenance of full employment to the extent that this can be influenced by monetary and credit action, and the greatest possible increase from year to year in the real income and standard of living of the Canadian people. The two banks have the same Board of Directors and the same chief executive officer, and they have the same ultimate objectives though they work by entirely different methods.

The Industrial Development Bank was established by Act of Parliament in 1944 in order to help fill what had been generally recognized as a gap in the Canadian financial structure and one which there seemed little likelihood would be filled or could be filled by privately-owned institutions. The job of the Bank was to assist the development of small and medium sized industrial enterprises which needed additional fixed term capital but which because of their relatively small size or lack of an established earnings record, or for other reasons, could not expect to obtain the necessary outside capital by selling a bond issue or stock issue in the market, or from other private sources. (If and to the extent that funds can be obtained from private sources on terms and conditions which are reasonable in the circumstances, the Industrial Development Bank is not permitted to intervene.) The Bank is not intended to operate at a loss if that can be avoided, or to make loans in the nature of subsidies. It can only be helpful to the borrowers to which it makes loans and to the nation as a whole if its borrowers are thereby enabled to operate successfully at a profit and pay off their loans over a reasonable period.

The number of small businesses that obtain Industrial Development Bank financing is growing very rapidly, and we hope will grow even more in the future. The Industrial Development Bank is not expected to provide current operating loans. Indeed, in nearly every case in which the Industrial Development Bank makes a fixed capital loan the borrower also has an ordinary line of credit with a commercial bank for his current operating requirements. However, the commercial banks have not in the past made many term loans to small business and except for business improvement loans guaranteed by the government under the new Small-Businesses Loans Act should not be expected to do so. Our experience indicates that a specialized institution such as the Industrial Development Bank is needed for this purpose.

The business enterprises eligible for loans from the Industrial Development Bank are not confined to manufacturers and processors, but include a very wide range of other business operations and services and the Government has indicated that it will in the near future introduce legislation designed to increase the scope of the Industrial Development Bank.

As the facilities of the Bank have become better known the volume of business has grown at an accelerating pace. The rate at which we are now making loans has been increasing rapidly and quadrupled over the four years ending September 30, 1960. In the first eight months of the current fiscal year the total of loan approvals has been 62% greater by number and 65% greater by amount than in the same period a year earlier. To May 31, 1961 we had authorized 5,400 loans in all, to 3,950 customers for a total amount of $330 million. Allowing for repayments on loans made in earlier years the total amount of our loans outstanding or committed at May 31 last was $139 million to 2,421 borrowers. In the fiscal year which ends September 30 next I expect the Industrial Development Bank will have approved at least 1,200 new loans amounting to at least $60 million.

In a large number of cases old customers who have done well come back for second or third loans in order to continue to expand their operations, and the most successful of them, if they are ambitious for further expansion, reach the point at which they can sell their bonds or stock in the market and no longer require the special facilities of the Industrial Development Bank.

The Bank now has 13 offices throughout the country, of which seven were opened in the past three years, and a staff of 300 credit officers, engineers, lawyers, accountants, insurance specialists and other employees, both men and women. It operates at a small profit and has been fortunate in its loss experience, which has been small. All losses to date plus the special reserve for losses which has been built up on the basis of an estimate of possible future difficulties, together amount to 1.1% of total loans which have been made or which are presently on the books as commitments. After making such provision for possible losses, all the profits of the Bank are required by Act of Parliament to be used to build up a general reserve fund, which is of course invested in the lending operations of the Bank. In addition to the capital provided by the Bank of Canada and the reserve funds provided out of the operating profits, the Bank obtains additional lending resources as required by the issue of its debentures. So far these have been sold only to the Bank of Canada, at rates of interest which are somewhat higher than the corresponding rate on Government of Canada securities, but it is hoped at an appropriate time to finance the additional requirements of the Industrial Development Bank by the public sale of its debentures at whatever may prove to be market rates of interest for such securities.

It may be of interest to a Quebec audience to record that over the past five years loans made in the Province of Quebec have been 24% of the national total by number and 27% of the national total by dollar amount. The average size of loan has been decreasing in recent years, and was about $64,000 in 1960 in Quebec, a little higher than the national average of $52,000.

If I may recapitulate, the main conditions for obtaining a loan from the Industrial Development Bank are that the required funds be not available from other sources on reasonable terms and conditions, that the business should have had an investment in it by the owners of adequate size and character to protect the position of the Bank, and that the business appear to have a reasonable chance to succeed, that is to operate at a profit sufficient to repay the loan over a period of years. In this connection it has been confirmed again and again in the Bank's experience that the main necessity is for good management ability within the business in order that the loan should prove fruitful, that is, in order that it will indeed be of benefit to the borrower and be repaid within a reasonable period. It would confer only an illusory and temporary benefit on any borrower to make a loan if these requirements for success are not present. In our experience, however, they do exist in thousands of cases of small and medium-size businesses throughout Canada and we are ready and anxious to be of every possible assistance to enterprises of this character.

The Industrial Development Bank has been in existence for 16 years. The Bank of Canada antedates it by 10 years. Canada's central bank was established by Act of Parliament in 1934 after study and recommendation by a Royal Commission. The objectives of the Bank and the general directive provided to the management by Parliament are set forth in the preamble to the Bank of Canada Act, which reads as follows:

> "Whereas it is desirable to establish a central bank in Canada to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment; so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion: . . ."

Whatever influence the Bank of Canada is able to exert on economic and financial conditions arises mainly from its ability to increase the cash reserves of the chartered banks so that they may increase the total of their loans and investments, and of their deposit liabilities which are money in the hands of the public.

In the past 26 years, which of course included the Second World War and the Korean War and other periods which involved great changes in money and credit, the level of prices and many other economic factors, the total quantity of currency in circulation plus chartered bank deposits has grown from a little over $2 billion at the end of 1934 to almost $14 billion at the end of 1960. A great part of this money consists of quite inactive deposits, particularly savings deposits. The amount of inactive money varies from time to time and naturally whenever there is a strong demand for money and credit for actual use, there is a marked tendency for inactive money to become activated, either through increased spending by the owners of such deposits, or as a result of those who desire to borrow offering attractive rewards to the owners of idle bank deposits to make them available for loans and investments. The central bank has to keep in mind that at all times, in varying degree, there exists a large volume of temporarily inactive but potentially active money which may become active and thus increase the effective money supply without any further action on the part of the central bank. There are also other kinds of deposits in institutions other than the chartered banks, and other very liquid assets held by various persons and enterprises which are so close to being money that they are often called money substitutes, and these are not subject to any requirement as to cash reserves which might be controllable in total amount by the central bank. In a practical sense, therefore, the volume of money in use is not exactly measurable and only partly controllable. Central banking cannot be an exact science, and the operations of the central bank must have regard to many tendencies and factors, including the expectations of lenders and borrowers, in addition to statistical measures of certain types of financial assets and liabilities.

The other side of the banking picture, corresponding to the volume of bank deposits which represent money in the hands of the public, is of course the assets of the chartered banks, that is, their loans and investments. These can be and usually are expanded by the chartered banks if the transactions of the Bank of Canada result in an increase in the cash reserves of the banking system as a whole. The long-term trend has of course been markedly upward, and over no year has the trend been downward, although at times, when it seemed that no further encouragement to the expansion of credit was desirable, there has been a levelling out of the cash reserves of the banking system and a consequent levelling out in the total loans and investments of the chartered banks.

Within the total of their loans and investments the banks are able to vary the proportions of each category and in particular, since the banks normally hold a large volume of Government bonds, they can if they deem it desirable reduce their holding of such bonds by sales in the market and increase the amount of their loans, even though the combined total of their assets may not have increased.

It has been a typical experience, of the post-war period at any rate, that in times of business recession total loans and investments of the chartered banks have increased, with the increase mainly taking the form at first of greater purchases of Government securities by the banks. As business recovery gathers strength and the demand for loans increases the total volume of bank assets has tended to level off but the banks have for some time gone on increasing their loans, and have been able to do so by their ability to find buyers for a large volume of Government securities.

Perhaps I might conclude by reviewing very briefly recent monetary and banking developments. Much of the discussion by proponents of more and easier money seems to proceed on the assumption that there has been no expansion of the money supply whatever. In actual fact we have had a significant increase over the past year. The total money supply in May averaged more than 5% above the level of May 1960. In the case of the privately-held money supply, that is, excluding deposits held by the Government, the increase has been more than 7%. In each case the increase in Canada has been greater than the corresponding degree of monetary expansion in the United States. The same comparison holds true over the past half-dozen years--monetary expansion in Canada has been appreciably greater than in the United States.

From May 1960 to May 1961 the total Canadian assets of the chartered banks have increased by $676 million or by 5½%. Of this increase $246 million went into additional loans and holdings of securities other than Government of Canada securities.

Almost two-thirds of the growth, or $429 million, has been put by the banks into increased holdings of Government of Canada securities and other very liquid assets. The Minister of Finance, speaking in Brantford on January 12th last, noted that the Canadian banking system had added to its liquidity in 1960 and said that it "is in a position to meet all reasonable borrowing requirements of credit-worthy businesses and institutions". Its liquidity has increased further through 1961 to date. Some further increase, of course, is to be expected, but too much would do no good and much harm.

Adherence to the principles of sound money may sound old-fashioned to some, but it is not a question of orthodoxy or tradition, or of adhering to a fetish; or of putting obstacles in the way of economic progress, or of restricting as by a check rein the level of economic activity. The maintenance of sound monetary conditions, of a sound currency, is itself a constructive force which is vital to the continuation of economic progress. The object of monetary policy in this country is to assist and encourage maximum growth and expansion of which the economy is capable, and rising standards of living, not just for short periods or in hectic spurts, but on a stable basis, over long periods, and without the social strains and injustices and economic distortions that are the offspring of inflationary policies. Let us not be fooled by the suggestion that easy money means easy production or easy sales, either at home or abroad. Sound money is part of the foundation which must exist if business is to expand and be profitable, and if the economy itself is to be progressive and equitable for all members of the community.