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Translation of Remarks of  
Louis Rasminsky, Governor of the Bank of Canada,  
before a meeting of La Chambre de Commerce du  
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I should like to begin, Mr. Chairman, by thanking you for your kind words of welcome. I am very pleased to have this opportunity of addressing La Chambre de Commerce du District de Montreal.

The Bank of Canada was established only a little over thirty years ago. The history of central banking in Canada is consequently a relatively short one. However, certain activities which are now taken for granted to be central bank functions, especially the issue by public authorities of paper currency, have a much longer history in this country and particularly in the province of Quebec. I suppose that it could be claimed that central banking began in Canada back in 1685 with the issue of the famous playing-card money in Quebec City. I said something about this playing-card money when I had the privilege of speaking to your sister organization, La Chambre de Commerce de Québec, 18 months ago.

I am not aware of any similar central banking activities in the early history of Montreal which I can talk about today. But it is the case that an institution called the Bank of Canada was organized here in 1818. It was a commercial bank, not a central bank. Its history seems to have been somewhat checkered, to say the least, and it did not stay in

business very long. In an article which appeared in the Journal of the Canadian Bankers' Association in December 1894, R. M. Breckenridge wrote:

"Beginning with 1825, there is to be noticed a rapid decline in the business of the Bank of Canada. The fall in its deposits from £11,000 in 1824 to £295 in 1825 seems to have decided the proprietors to wind up the bank. It nowhere appears that the bank defaulted on any of its obligations, but the management, undoubtedly, entertained rather faulty notions as to the privileges and duties of a bank. As early as 1820 they had incurred discredit by refusing to pay in dollars, and offering to cash notes and cheques presented for payment by other banks in half crowns, small and much worn silver pieces. . . ."

Such was the first institution called the Bank of Canada. In case you are getting rather nervous, let me hasten to assure you that it was not an ancestor of the present Bank of Canada. We run our affairs on an entirely different basis.

The present Bank of Canada has many connections with the city of Montreal. We have an important Agency here whose activities include the servicing of the currency and the public debt. In addition,

the Bank is active in the securities and foreign exchange markets here. The General Manager's Office of the Industrial Development Bank, a wholly owned subsidiary of the Bank of Canada, is located here together with its Montreal Office.

The Industrial Development Bank, as most of you know, is engaged in medium and long term lending to Canadian industrial, commercial and service enterprises where such financing is not otherwise available on reasonable terms and conditions. Since its establishment in 1944, the Bank has, in the Province of Quebec, approved 3,300 loans for a total of more than \$200,000,000. In its latest fiscal year nearly 500 loans totalling over \$25,000,000 were made in the Province. The average loan was about \$50,000. A substantial portion of these loans were to businesses in the area served by La Chambre de Commerce du District de Montreal. I am confident that the Industrial Development Bank will continue to participate in the dynamic growth of the Province of Quebec.

The city of Montreal provides dramatic visual evidence of the rapid pace of economic development in this Province. Each time I come back here, to my birthplace, I am startled by the presence of a completely new skyscraper. Of late, indeed, it seems to have become necessary even to check on the number of islands in the St. Lawrence. Like everyone else, I am looking forward to the Universal and International

Exhibition in Montreal in 1967, an event which will focus world attention on your city and on Canada in our Centennial year. In this connection you may be interested to know that when I attended the Second Annual Meeting of the Governors of the Central Banks of the American Continents in Punta del Este, Uruguay, earlier this year I extended an invitation to the Governors to hold their Fourth Annual Reunion in Canada. I am pleased to say that this invitation was warmly accepted. When the Governors meet in the Laurentians in May 1967 a highlight of the programme will be their official visit to Expo.

The rapid development of Montreal has perhaps been more spectacular and more exciting than one finds in most parts of the country, but it is indicative of the growth that has been occurring in Canada as a whole. We have indeed experienced a remarkable period of economic progress since 1961. Looking back, one cannot fail to be impressed by the duration of the economic expansion and by its magnitude. This expansion, now nearly five years old, has lasted much longer than any previous post-war expansion. Between the first half of 1961 and the first half of 1965, gross national product has risen at an annual average rate of nearly  $8\frac{1}{2}$  per cent per annum; in real terms, that is after allowing for higher prices, the total increase has been about 20 per cent per head of population. The growth of the economy has been sufficient to absorb the

whole of a very rapid increase in the labour force and at the same time greatly reduce the level of unemployment.

I think it might be useful to examine some of the reasons for the extent and duration of the present economic expansion. In some cases the reasons are ones which do not give us any particular cause for self-congratulation. One reason is that the expansion started from a low level of economic activity, as reflected in an unemployment rate of almost 8 per cent in early 1961. This provided scope for an unusually large increase in output before there was any question of our pressing against the limits of our productive capacity and having to face the problems that only arise in such circumstances.

A second important reason has been the parallel economic expansion in the United States. This has had a powerful influence on the course of the Canadian economy. Generally buoyant economic conditions in overseas countries and a steady rise in world trade have also been factors helpful to us.

But there have been other factors, somewhat more under our own control, which have been important in sustaining the economic expansion and which have helped, I think, to explain our high growth rate. I do not propose to list all the contributions that the policies and actions of public and private bodies have made to economic growth but I would like to single out a few that seem to me to have been particularly significant.

The downward adjustment of the exchange rate of the Canadian dollar, in 1960 to 1962, from the very high level of the preceding years was important, in the circumstances of the time, in improving our competitive position in international trade. Equally important, in my opinion, have been two accompanying developments which enabled us to derive significant benefits from this step. The first has been our success in protecting our competitive position by a relatively good performance in keeping down costs. For example, over the whole of the economic expansion the consumer price index in Canada has risen at an average annual rate of 1.6 per cent, which represents a considerably better performance than that of most other countries. The second has been the strenuous efforts of our producers to take full advantage of the improved competitive position of the Canadian economy, both in seeking out new markets abroad and in competing more effectively with imports in the home market. Though our exports of manufactured goods still constitute only 20 per cent of our total exports, such exports have risen substantially over the last five years, and there has been a considerable diversification in the range of finished goods which we are now selling in foreign markets. The enhanced competitiveness of domestic industry is also evident in the fact that the rise in the volume of our imports, though substantial, has been no greater, over the whole expansion, than the increase in domestic

industrial output. As a consequence we succeeded during the first three years of our expansion in reducing our current account deficit. This was contrary to the normal way in which our trade balance has moved on similar occasions in the past. It is apparent from these facts that improved competitiveness has played a vital role in this expansion.

Another part of the explanation of the duration of the expansion is that the advance appears to have been well balanced, with relatively few excesses either in terms of speculative activity or in terms of unsustainable rates of growth in important sectors of the economy. There have of course been some exceptions to this general statement, and there are some recent trends in this and other respects which bear careful watching. I shall return to this subject later.

Happily, the exchange difficulties of 1962, which were dealt with firmly by fiscal, monetary and other corrective measures, produced no serious interruption to the expansion. Apart from this episode, Canada has managed to avoid serious foreign exchange difficulties over the economic expansion, although we had one other fairly close call. In 1963 the announcement by the United States of the Interest Equalization Tax raised a good deal of uncertainty regarding the access of Canadian borrowers to the United States capital market, even after a partial exemption for Canada was promised. The first



large Russian wheat sale, which came at a most opportune time in 1963, dispelled doubts about our ability to balance our international accounts. Again this present year, the large Russian wheat sale occurred in a period when the underlying deficit in our current account was widening (though this was partly masked by seasonal factors) and when some unfortunate incidents in our financial markets lessened the interest of foreign investors in certain types of Canadian securities. These developments, taken in conjunction with the measures adopted by the United States to correct their own balance of payments by reducing the outflow of capital, have given Canadians plenty of reason to reflect on how much less exposed a position we would be in if we did not run a large current account deficit which requires substantial net inflows of foreign capital.

Though I would not wish to claim too much credit for it, I would like to think that monetary policy has made a useful contribution to the expansion of economic activity and to the maintenance of a reasonably satisfactory external financial position. Perhaps, in view of the post which I occupy, you would not think it inappropriate if I were to dwell on this subject for a little while. So long as there was a good deal of slack in the economy the central bank did not feel that the growing demand for funds associated with the economic expansion should result in credit becoming appreciably more expensive or more difficult to obtain. Except

for a temporary interruption during the exchange crisis of 1962, the money supply (defined as currency outside banks and total chartered bank deposits) expanded steadily. Over the whole of the expansion the average annual increase has been 8 per cent. Again excepting the period of the exchange crisis, interest rates, as measured by the yields on Government of Canada securities, moved within a relatively narrow range during the first three years of expansion.

As the economy moved closer to full-capacity operations, however, the heavy demands for credit associated with the expansion did have some effect on credit conditions. There has, to be sure, continued to be a substantial increase in the money supply. Over the past twelve months, indeed, the money supply has increased at a more rapid rate than the average rate in the preceding three years of the expansion. Nevertheless, market rates of interest (including mortgage rates) have gone up, and credit conditions have also been influenced by the difficulty encountered by some firms in continuing to raise money in the short-term money market. Bank loans have risen very substantially and the banks as a group have found it necessary to become more selective in their credit policies.

In my view it has been appropriate that as the amount of unused capacity in the economy was progressively reduced, a move to less easy credit conditions should have occurred. This development also

helped to enable Canada to attract sufficient capital from the United States to maintain our external financial position, having in mind our present and prospective requirements.

This brings me to the present. The high level of economic activity that we have reached represents the attainment of one of the most important goals of economic policy and is therefore a cause for great satisfaction. But it also, of course, presents certain problems arising from the fact that as the amount of effective slack left in the economy has declined, there has been increasing evidence of pressure on our resources.

On a seasonally-adjusted basis, unemployment has fallen well below 4 per cent of the labour force -- on the average of the last three months, to about 3.5 per cent. On an unadjusted basis the unemployment rate was 2.5 per cent in September and 2.4 per cent in October. These figures apply to the country as a whole. In October the unemployment rate was only 1.4 per cent in Ontario and 1 per cent in the prairies. Unemployment was still high in some areas, particularly in parts of the province of Quebec and in the Atlantic provinces. It is important that selective regional policies continue to be implemented to reduce unemployment in areas where there are significant pockets of unemployment. There can be no doubt, however, that as a practical matter, the economy as a whole has been giving evidence of a relative shortage of many kinds of labour, particularly skilled labour.

Other indications of some pressure on our resources are not hard to find. There is the evidence provided by the renewed tendency for the deficit in our balance of payments to widen, as a result of a more rapid growth in imports than in exports. There is also the evidence provided by the recent behaviour of costs and prices.

Whether one looks at comparisons of wage and productivity increases or at changes in final product prices, there are clear signs that our cost and price performance has begun to deteriorate during the past year. Finally, we have for some time been seeing reports of extended delivery dates and shortages of various materials. While some of these arise from pressures on international markets, others are almost certainly related to the strength of demand in the domestic markets.

In these circumstances, the problems of maintaining satisfactory economic growth have become increasingly complex and challenging. We must, of course, continue to aim at maintaining a level of demand for goods and services sufficient to realize the increases in output of which the economy is capable, but I think we should also be increasingly concerned with the supply side of the equation, with the factors which bear directly on our capacity to produce. Basically, the main sources of continued economic growth on the supply side are the increases in the labour force and the increases in productivity or output per man which we can hope to achieve. Productivity improvement in the

sense in which I am using it, of course, has to do with many more things than how hard all of us work. It reflects the quality of our labour force and improvements in the average levels of education and skills, including managerial skills. It also reflects additions to and modernization of plant and capital equipment, and the extent to which we incorporate in these the rapid advances in technology. And, of course, it also reflects the efficiency with which we employ both our labour and our capital.

These factors, labour force growth and increased productivity, provide scope for continued economic expansion at impressive rates. But the task of achieving this potential growth requires careful handling, for the less slack there is in the economy the greater is the risk of excesses or distortions in one form or another which would threaten the continuance of sound and sustainable expansion.

One risk is that total spending might rise at a rate that substantially exceeds the potential growth of our real output of goods and services. This could lead to the emergence of serious price and cost pressures and to balance of payments difficulties which might check the expansion.

Another risk is that the economic expansion might become unbalanced, that certain important sectors might expand at rates that are unsustainable. In the Mid-Year Survey of Investment Intentions published by the Department of Trade and Commerce it was indicated that public

and private investment was expected to rise by  $18\frac{1}{2}$  per cent in 1965 following an increase of  $15\frac{1}{2}$  per cent in 1964. The intensity of the investment boom, particularly in the construction industry, led to the announcement by the Government on August 3rd that it was postponing some of its own construction plans. There can be no doubt that action by public and private bodies to stretch out their capital expenditures is helpful in the present circumstances, both in relieving present pressures and in providing an underpinning for future growth. In line with this thinking, the Board of Directors of the Bank of Canada at the beginning of November decided to defer for the time being the start of construction of our badly-needed new head office in Ottawa, plans for which had been publicly announced last February.

It is generally accepted that the posture of public economic policy and the mix of the various types of policies -- monetary, fiscal, debt management and other policies which affect the aggregate level of demand or total amount of spending of the community -- should vary as the economic situation and outlook change. I have explained how monetary policy has sought to recognize the changes that have been occurring in our economic circumstances. However, I am inclined to think that despite the view expressed in the recent Report of the Royal Commission on Banking and Finance there may still be some tendency to expect too much of

monetary policy. In urging an appropriate mix of policies to deal with periods of pressure on resources, the Commission stated:

"Monetary policy is just not powerful enough to do the job itself over any reasonable range of credit conditions, even if there were no international inhibitions about using it fully."

I agree with this view, and I made this clear in my own evidence to the Commission. Excessive reliance on monetary policy to control any inflationary pressures that emerge would not only fail to produce the desired results, it would have unfortunate side effects as well. It could well give rise to difficulties because of its uneven impact on different classes of borrowers, and because of its effects on flows of capital across our borders. Monetary policy should of course continue to play its full part as changing circumstances may require. But it is only one of many elements in public policy which, along with private actions, can contribute to the objective of encouraging sound and balanced growth while avoiding the excesses which would threaten the continuance of expansion.

I suggested a few moments ago that once the slack in the economy was taken up, the further real growth in the economy was basically determined by the increase in the labour force and in productivity -- which I characterized as the factors operating on the supply side of the economy. We are assured of a very large increase in the labour force in the years ahead. What, as it seems to me, we should be increasingly

concerned with is the policies that will contribute to increased productivity, for this is what will finally determine the rate at which the economy grows and the standard of living which we can achieve and sustain.

I think there has recently been a greater awareness of the need to be concerned about productivity if we are to realize our full potential. This is in large part due to the great stress properly placed on this matter by the Economic Council in its First Annual Review. It can hardly receive too much attention, particularly in view of what seems to have been a rather disappointing performance over the last year or so.

Our future performance in respect of productivity will depend in large part on what importance we are prepared to attribute to it in the formulation of our economic policies and in the allocation of our resources. If we attach great importance to achieving the full economic growth of which we are capable, it will be necessary to pay great attention to increasing the mobility of resources, to upgrading labour skills, to encouraging education and research. These are directed to increasing the efficiency of the economy and providing the basis for future growth, and may well need priority over other uses of resources which, however desirable they may be in themselves, do not add as much to our real productive capacity.

To conclude, the recent performance of the Canadian economy has demonstrated that it can operate effectively at a high level, that it can



provide employment for our growing labour force. Our success should not, however, blind us to the fact that as the slack in the economy is progressively taken up, problems, in some respects of a different character, emerge in maintaining a satisfactory rate of growth. I have tried in these remarks to draw attention to some of them. Our continued success will inevitably depend to some extent on external economic conditions over which we have no control. But the potential for sustained non-inflationary growth in Canada is there, and we must endeavor to do all that is within our power to see that it is realized.