In the first war budget of last September, my colleague, the Minister of National Revenue, who delivered the budget speech, laid down the broad principle of the government's policy of war finance. "We believe it is the part of wisdom," he said, "to follow as far as may be practicable a pay-as-you-go policy." Events which have happened since, and particularly those of the last few weeks, have not detracted from the wisdom of that policy, but rather have reinforced the need for a vigorous effort to apply it in every possible way.

The general policy was elaborated further as consisting of two parts: that appropriate to an initial period of quietness and hesitation, and that suitable for a second period in which rising business activity and expanding income had acquired momentum.

In the initial period of the war in which business was expected to be hesitant, if not actually depressed, the appropriate financial policy was declared to be one which would facilitate the expansion of national income and the drawing into employment of our full man-power. In order to ensure that out of rising incomes increased revenues would begin to flow to the government for the financing of the war, certain excise taxes, chiefly on luxuries, were levied, and moderate increases were imposed in the personal and the corporation income taxes. The increases in income tax were payable only after the close of the fiscal year and therefore would have a relatively slight effect in curtailing purchases by consumers. Furthermore, in order that uncertainty might be removed and that business firms might begin to adjust themselves to the war conditions, the outlines of a new and heavy excess profits tax were announced.

These new or increased taxes were not designed to provide immediately for any large part of our heavily increased expenditures. It was also specifically indicated that our initial borrowing operations to provide part of the funds to cover the inevitable deficit in this early period would probably be of a very short-term character, so as to promote the immediate expansion of productive activity. In harmony with this same point of view, it was emphasized that while the magnitude of the new burdens thrust upon us would make it imperative to do everything possible to conserve our resources and to economize on any expenditures not urgently needed in the national interest, nevertheless it would be "penny wise, pound foolish" to curtail expenditures so suddenly and so drastically as to aggravate seriously the unemployment problem before the stimulating effects of our war expenditures and of foreign purchases in our markets had acquired real momentum.

The initial period of quietness and hesitation, it was felt, would be of relatively short duration and would be followed by the second period during which increasing business activity, expanding production and rising national income had acquired momentum. While perhaps starting slowly, this advance would accelerate under the pressure of war orders from ourselves and our allies until gradually our economy would approach a state of full employment of its labour, capital equipment and material resources. As this second stage developed, certain modifications of financial policy would be called for. Thus it was stated that as business activities increased and idle workers were reemployed, the resulting larger incomes would necessarily become subject to heavier taxation for the purpose of ensuring that the increase in our national income was largely diverted to war needs instead of being disbursed in increased personal consumption and private investment. For the same reason, borrowings from the savings of our citizens and genuine economies in normal governmental services not urgently needed in war time, were indicated as appropriate for this second period.

In accordance with the declared policies, the government made its first financing in the form of a short-term banking operation which was definitely expansionist in character. This was a loan of $200 million arranged with the banks in November, 1939, on the security of two-year notes at a rate of two per cent. It will be recalled that of this amount $92 million was used to repatriate Canadian securities held in London. This gave the United Kingdom a substantial supply of Canadian dollars which was used to purchase Canadian foodstuffs, raw materials and war supplies.

This borrowing from the chartered banks was facilitated by appropriate monetary policy. Between August and November, the Bank of Canada's assets increased by approximately $107 million as a result of the purchase of securities and the increase in the value of its gold and foreign exchange reserves. This provided cash to meet the enlarged public demand for notes in circulation and to increase the cash reserves of the chartered banks by $33 million.

With this increase in cash reserves, the chartered banks were enabled to increase their total Canadian deposits by approximately $306 million. In the same period, they increased their current loans by approximately $147 million, mainly to finance the large wheat crop, and added to their net holdings of securities by $158 million.