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No. 52/59 CANADA'S POST-WAR FINANCE

(This address was intended for delivery by Dr. W.C. Clark, Deputy Minister of Finance, on December 29, 1952, to a joint meeting of the American Economic Association, the American Finance Association, and the Chicago Association of Commerce and Industry in Chicago. It was never given. Dr. Clark was stricken by his last illness on his arrival in Chicago on December 27 and died the same day.)

...A forecaster at the close of the war would have had some warrant for taking a gloomy view of Canada's prospects during the succeeding half-dozen years. The war had cost our nation of just over 12 million people not far from $20 billion, and while Canada's war finance policy had been as intelligent and as rigorous as that of any belligerent, nevertheless the net national debt had increased from $3.2 billion pre-war to $13.4 billion on March 31, 1946. Our industry had been vastly expanded for war purposes and we faced a task of suddenly integrating into a peacetime economy a very large volume of war plant capacity as well as nearly 1½ million war workers and men and women demobilized from the Armed Services. Finally, as a country in which export trade normally accounts for 20 to 25 per cent of total production, we were forced to look with concern on the vast destruction and dislocation which war had brought to a large part of the world and particularly on the impaired strength of our traditional major customers in Western Europe and the break-down of the multilateral system of trade and payments.

However, as a result of a happy combination of good luck, good geography and good people ... post-war Canada has confounded the pessimists and has enjoyed a period of unexampled development. It has not all been plain sailing - we have had some squalls to weather, some stormy seas to test our seamanship, but on the whole the log reveals a record of rapid, forward advance in all the major indices of Canadian growth. A panoramic view is to be found in the estimates of our gross national product. At the low point of the depression in 1933, that product had fallen to $3.6 billion; in 1939 it had climbed to $5.7 billion and by 1945 to $11.9 billion. Today it is running at an annual rate in excess of $23 billion. Since 1946, it has increased in <u>real</u> terms by over 24 per cent. This period of rapid expansion could be called a boom, were it not that the growth has been so balanced and the traditional excesses and distortions of a boom so little in evidence.

Causes of Post-War Expansion

If we seek the special causative forces behind this rapid expansion, we find that the first great lurch forward came from the war itself. Under the pressure of war demands, we expanded enormously our industrial plant, modernized our equipment and built up a skilled labour force. We learned to manufacture the most complicated implements of war not only for ourselves but for our allies, and our businessmen found to their own surprise that when they had orders sufficient to warrant production on an optimum scale they could produce a great variety of articles as efficiently and cheaply as any other nation.

The great magnitude of, and pride in, our war effort were to bring new confidence not only to businessmen but to the whole Canadian people. The cautious attitude which had been fostered by experience with the economy's vulnerability in earlier periods began to give way to a more buoyant faith in the solid future of the country. This new faith grew with what it fed on, but without generating the excessive speculative fever that marked some earlier periods in our history.

The post-war period has also been a period of rather rapid population growth. Partly as a result of natural increase, partly as a result of a more vigorous immigration policy (which economic expansion has made practicable), and partly as a result of the voluntary accession of Newfoundland (which has also rounded out our physical boundaries), our population has increased by 17.4 per cent from mid-1946 to 14.4 million in mid-1952. In the same period your population grew by about 11 per cent. The 28 per cent expansion of the Canadian population since 1939, coupled, of course, with the large contemporaneous increase in your population, the market at our doors, has naturally had vital significance for Canadian trade and industry.

Role of Natural Resources

A more spectacular source of the dynamism in the Canadian economy has been the success which has attended the vigorous search for hidden riches in the natural resources field. The Laurentian Shield, the V-shaped area of rock which constitutes the geological backbone and more than half the area of Canada, is not only the world's oldest rock but also probably its greatest treasure-trove of mineral wealth. Promising mineral areas are also to be found in the Cordilleran region of the Pacific Coast and the Appalachian region of the Maritime Provinces. In between the Rocky Mountains and the Pre-Cambrian rocks of the Laurentian Shield and stretching from the international boundary to the Arctic Ocean lie nearly a million square miles of interior plain underlain by sedimentary rocks of Post-Cambrian origin with geological formations similar to those of the most prolific oil and gas producing regions of North America.

Most of Canada's earlier mineral discoveries were either the result of accident or the work of poorly-equipped individual prospectors, and thus in large part limited to cases where outcropping of rocks laid bare the earth's secrets. In the last few years, the aerial survey, the magnetometer, the seismograph and other modern gadgets have revolutionized the art of exploration and in Canada have given rise to a regular rash of new discoveries.

These include major new sources of nickel, copper, zinc, cobalt, uranium and asbestos, a new high-grade deposit of titanium ores and vast new reserves of iron ore both in Northern Ontario and in Northern Quebec and Labrador. The latter project has now proved up reserves of over 400 million tons of high-grade ore and is expected to give rise to an annual shipment of 10 million tons by 1956 and of 20 million tons with the completion of the St. Lawrence Seaway. We have been particularly fortunate in discovering, and finding enterprisers and investors willing to take the risks involved in developing new sources of such basic and strategic metals at a time when the world's need for them is great and when the United States has passed from the stage of net exporter to that of net importer of a number of them.

But most important of all for the stimulation and strengthening of Canada's economy have been the discoveries of oil in Alberta and the other Prairie Provinces and the indications they have given that Western Canada is, potentially, one of the world's major oil and gas producing areas. Some 225 million acres of oil and gas rights are now under lease or reservation and are being actively explored. Proven reserves of oil have increased from 65 million barrels to not far from 2 billion barrels - not counting the much larger reserves in the bituminous tar sands at Fort McMurray, the extraction of oil from which presents difficult but, we hope, not insoluble problems. Already oil production, which has been prorated to less than 60 per cent of the industry's potential, is nearly 40 per cent of Canada's requirements, compared with less than one-tenth of our much smaller needs a few years ago. While our oil consumption has been increasing twice as rapidly as yours, we expect to reach the stage of self-sufficiency by 1956, although a sensible international division of labour might suggest that we should always be exporters in one part of our country and importers in another. Discoveries of natural gas have been equally spectacular. Conservative estimates of our reserves show an increase to at least 10½ trillion cubic feet today, from 7 trillion in June, 1950, and perhaps 2 trillion six years ago.

Increased Capital Investment

The last of the factors fostering the dynamism of the economy, to which I shall refer, is the vast sums that have been spent on resource development and other types of capital investment. New capital investment, exclusive of inventories, has absorbed a steadily increasing percentage of gross national product rising from 14.2 per cent in 1946 to 21.6 per cent in 1951 and probably to something around 23 per cent in 1952. Since 1946 it has aggregated not far from $25 billion and it has been estimated that in 1950 it was directly responsible for the employment of 800,000 people or about 15 per cent of our labour force. Since 1948 it has even exceeded exports as a mainspring of Canadian economic activity.

This investment boom has rested not only on the needs arising from increased population and the discovery of new outlets for investment but to a very considerable extent on the voluntary deferment of capital projects in the 'Thirties and the enforced postponement of expansion during the war. With needs great because of long deferment, with accumulated business and personal savings at a high level, and with the prevailing spirit of optimism, the investment boom got under way very quickly and rapidly offset in large part the decline in government spending. The increase from year to year has been great and this heavy investment demand has combined with rapidly-rising consumer expenditures and a very high level of exports to produce an upward pressure on the price level throughout most of the period.

The significance of this new capital investment goes much further than the direct employment which it has provided and the direct employment opportunities which arise out of it. Its real importance would seem to lie in the underlying change which is being wrought in the structure of the economy - changes in structure which both increase its productive capacity and competitive power and at the same time reduce its vulnerability.

Unlike previous periods of expansion in our history, the development this time has spread over all industries and been felt in all parts of the country. Much of it has served to increase our capacity to produce and distribute the basic materials and the various forms of fuel and energy on which industrial development and economic growth are based. Very large sums have been spent on the mechanisation of agriculture which is now capable of considerably higher production with considerably less manpower. In forestry there has been a steady modernization and expansion of pulp and paper plant and a very large increase in the output of lumber. The oil and gas discoveries have stimulated intense activity in a whole range of projects, including, in addition to exploration and development work, the building of pipelines, the construction of storage facilities, increase in refinery capacity and the development of a petrochemical industry. Over a billion dollars have been spent in these fields since 1946 and over a quarter of a billion this year. Vast capital expenditures are also being made to mine, process and bring to market the newly-discovered minerals, particularly the iron ores, and also to expand the production of aluminum in Northern British Columbia. New investment in the utilities, electric power, transportation, communications, etc., accounts for more than 20 per cent of total investment resulting, to quote only one instance, in an increase of about 50 per cent in power production. Manufacturing has absorbed about 20 per cent of total investment and the fact that income originating in manufacturing has now risen to over 30 per cent of national income is one of several indications of the greater diversification and better balance of the economy.

It is interesting to note in passing that, since the end of the war, if we take into account what we have lent or invested abroad, we have provided enough capital out of our own savings to finance the whole of our development programme. It is true that in 1950 and 1951 Canadian savings equalled only about 90 per cent of the total, but for the period 1946 to 1951 we had a net investment abroad of $78 million and that net result is not likely to have been affected very much either way by developments during 1952.

Finally, it should be added that the near-term outlook suggests no weakening of the driving power behind this capital development programme. If there are certain fields in which slackness may develop, there are also likely to be powerful offsetting factors, including the deferred demand for highways, housing and many civic utilities, the probable intensification of the various developments resulting from the continuing success of the search for oil and gas, and, not least, the construction of the St. Lawrence Seaway and Power Project, which Canadians hope to be able to start in the coming year.

Post-War Fiscal Policy

It was in the light of this developing background that the Government of Canada had to formulate its fiscal, financial and commercial policies during the post-war period. As envisaged at the end of the war, the task of public policy was in general to assist in (1) smoothing the transition from war to peace, (2) restoring and maintaining a free enterprise economy of a dynamic and flexible character, (3) promoting a high and rising level of employment and income, and (4) "containing" the inflationary potential latent in huge war-deferred demand and high consumer liquidity. Later, the task of controlling inflation became even more important, as heavy defence requirements were superimposed on an economy already stretched by the requirements of the heavy capital-investment programme. In keeping with our North American tradition of freedom, these general aims were to be sought not by control and regimentation but rather by fostering the right climate, by offering appropriate incentives, by guiding, steering or coaxing the economy in the desired direction.

To ease the post-war transition as well as to provide improved machinery and greater driving power for a dynamic economy, a series of legislative measures were enacted as the war drew to its close. Authority was taken to set up an Industrial Development Bank to make sure that no sound industrial enterprise should lack the ability to raise sufficient funds to get started or to finance rapid growth merely because it was small or new or unknown to investors. A Farm Improvement Loans Act was passed to provide, through the device of a limited-pool guarantee of intermediate-term loans made by the commercial banks, ample funds to enable farmers to re-equip their farms and to construct or modernise farm homes and buildings. A Central Mortgage and Housing Corporation was established with ample funds to administer a comprehensive housing programme, chiefly by participating in joint loans made by private lending institutions. An Export Credits Insurance Corporation was set up to promote export trade by insuring exporters, on a self-supporting basis, against some of the special risks involved in foreign trading. Further, in order to assist some of our traditional customers to purchase Canadian products and more rapidly re-establish their war-shattered economies, Parliament gave the Minister of Finance authority to grant export credits in very large volume, including a $1¼ billion loan to the United Kingdom on the same terms and conditions as the $3¾ billion loan made by the United States about the same time.

Whatever these measures may have contributed, it is a fact that Canadian industry converted from war to peace with an amazing rapidity and smoothness. It must be remembered, of course, that there was a strong demand abroad for the things we produced and that several of the dynamic forces I have listed were already beginning to influence the Canadian economy.

Principles of the Budget

In the annual budget speeches are to be found the Canadian Finance Minister's diagnosis of the prevailing and prospective economic situation and his prescription of the type of fiscal and financial policy which he believed to be required. The speeches for the first three post-war years show clearly his recognition that public finance is more than the mere arithmetic of balancing the year's accounts and that the national budget is an integral part of the nation's business, influenced by and having its influence on the state of employment, income and prices. They show him attempting to achieve in his fiscal policy a judicious balancing of several competing considerations. First was the recognition that the very high wartime tax-rates tended to weaken initiative, blunt economic incentives and thus impair productivity at a time when maximum, efficient effort was essential to economic health and progress. Against this argument for lowering taxes, the Minister had to balance two opposing considerations: one, the general belief that it was a good thing to pay off debt in years of high prosperity, particularly when the debt had recently been built up to such huge proportions; and, two, the argument that it was desirable to help offset by a budgetary surplus the powerful inflationary pressure being exerted by the large backlog of deferred demand and the enormous volume of liquid resources which the war's financing had placed at the disposal of consumers.

The relative weight assigned to each of these factors varied to some extent from time to time with the changing economic climate. In the first three post-war years taxes were cut drastically but not to such a point as to prevent a substantial surplus, which was a declared aim of the second and third post-war budgets. The excess-profits tax was first reduced and then repealed at the end of 1947. The standard rate of corporate income tax was reduced from 40 to 30 per cent in 1946. Personal income tax rates were cut successively in 1946, 1947 and 1949, with the total reduction amounting to between 60 and 70 per cent for the great majority of taxpayers.

By the beginning of 1949 the Minister was confident that the post-war inflation had subsided at least for the time being, and there were indications in business trends in your country that it was time to shift from the anti-inflationary bias of fiscal policy. In his new budget, therefore, he attempted to complete the process of tax reduction to levels that might be expected to persist in peacetime and aimed at little better than a balance in the accounts - a surplus of only $85 million. There were further cuts in income tax but the main feature was the drastic recasting of commodity taxes. A great variety of commodity taxes were repealed and replaced by what was intended to be a normal peacetime structure, consisting of three parts: first, rather heavy sumptuary taxes on liquor and tobacco; second, the general sales tax levied at 8 per cent at the manufacturer's level on a wide list of goods, but excluding all production goods, all building materials and practically all foods; and third, an additional special excise tax of 10 per cent on a relatively small but highly productive list of articles of mass consumption ranging from cosmetics and furs to radios and motor cars.

Dominion-Provincial Tax Agreements

Two special features of fiscal policy during this period deserve brief mention. First was the initiation of a programme designed to lessen and ultimately to eliminate the double taxation of business profits. The first step to this end was taken by the budget of 1949, when authority was obtained to allow shareholders a credit against their personal income tax equal to 10 per cent of income received in the form of dividends. The other special feature relates to the so-called tax-rental agreements with the provinces. In working out these agreements, the Government had in mind three aims: (a) to avoid some of the difficulties which the financially weaker provinces experienced during the depression of the 'Thirties, (b) to eliminate as far as practicable the evils of multiple and conflicting taxation, and (c) to make it easier for the Federal Government to follow fiscal and economic policies designed to minimise cyclical fluctuations. Under these agreements, provincial governments may rent to the Federal Government for a five-year period their rights to levy income taxes, corporation taxes and succession duties in return for annual rentals which are guaranteed never to fall below certain stipulated amounts and which are increased in proportion to any increase in provincial population and in gross national production per capita. Eight of the ten Canadian provinces participated in such agreements during the last five years and nine of them have recently signed agreements for the next five years. As a result, there is only one personal income tax in Canada (the federal) and two corporation taxes (the federal and that of Quebec), while succession duties are levied only by the Federal Government and the Provinces of Ontario and Quebec.

In each of the fiscal years 1947, 1948 and 1949, despite the substantial magnitude of the tax reductions that had been made, actual revenues exceeded actual expenditures by a substantial amount. In fact, the surpluses amounted to 14 per cent, 31 per cent and 27 per cent respectively of total revenues and, in the aggregate, to $1,645 million or 12.3 per cent of the net debt at its war-end peak. In the last two of these years, when expenditures ran a little under $2,200 million a year, the Minister had budgeted for substantial surpluses but even his optimistic forecasts were exceeded. Even in the fiscal year 1950 the trend of activity in Canada, contrary to some expectations, remained persistently upward and the year ended with a further addition of $131 million to the post-war reduction of net debt.

The contra-inflationary aim of fiscal policy during this period was supplemented by intensive annual savings-bond campaigns designed to encourage individuals to continue the habits of systematic saving developed during the war. Moreover, the various wartime controls, particularly the controls over commodity prices and rents, were relaxed only gradually in Canada. Nevertheless, there was a rapid increase in prices after the war, reflecting partly the translation of wartime subsidies into prices, partly the general inflationary trend to higher prices throughout the world and partly the internal pressure upon resources. The slower pace of decontrol in Canada delayed the full impact of the war and its aftermath on Canadian prices, but toward the end of 1948 a new plateau had been reached with wholesale prices a little more than double, and the cost-of-living index about 60 per cent in excess of, the respective pre-war levels. The next year and a half was to be a period of approximate stability in prices, with the fires of inflation banked, though probably not extinguished.

Korean War

Then this short spell of fairly normal conditions, which had seemed like the beginning of a promising period of sustained peacetime expansion, was rudely interrupted by the Korean war. Suddenly we had to superimpose a defence programme involving expenditures rising to four or five times their previous size on an economy which was already straining its resources to meet the demands of an unprecedented capital investment programme and of a public anxious to increase both its volume of consumption and its leisure. At the same time, in Canada as in other countries, we were too near the end of World War II to have forgotten the nature of a full-fledged war economy, and immediately there began a wave of abnormally heavy buying, by consumers as well as by trade and industry, in order to forestall the expected shortages and higher prices of a war period. Again, because we export more than a fifth of everything we produce and import more than a fifth of everything we consume, a major source of the renewed pressure on our price structure was the inflationary rise in prices throughout the world.

In the new war against Communism and this renewed war against inflation, the major task of public policy was to assess priorities, limit competing demands and assure that adequate resources were available for the tasks with the highest priority ratings. In its approach to this task, the Government had to make a choice between a system of comprehensive, direct controls and the application of general policies designed to bring about the desired results indirectly.

Anti-Inflation Policy

There was great temptation and pressure to use the direct method and apply immediately overall price-controls. The control of inflation during the war had been highly successful and the public tended to attribute this success solely to the spectacular imposition and maintenance of a general price-ceiling and failed to understand how much it depended on the powerful indirect controls that were also at work - the very heavy taxation, the stiff controls over credit and the vigour with which the campaigns to maximise and mobilise public savings were conducted - as well as on a massive application of direct controls on many other aspects of economic life and on general patriotic support which can be sustained only in a full-out war effort. Close analysis of the new situation, however, revealed an entirely new set of conditions. We appeared to be faced not with a short, all-out war but with a hot phase of a cold war of indeterminate duration, perhaps five to ten years, perhaps longer, a war effort that might take 10 to 20 per cent of our national product rather than 40 to 40 per cent, a continuing struggle in which the strength and vitality of our free institutions might be as important as our armed might. Believing, therefore, (1) that overall price controls could not obtain the almost universal support they would need to make them administratively feasible, (2) that if, as seemed probable, they might have to be maintained for a long time, they would tend to impair the productive efficiency of the economy and to undermine the foundations of the very freedom we were seeking to defend, and (3) that in any case they would do nothing to attack the root causes of the threatened inflation, the Government decided to rely upon the indirect methods of fiscal, monetary and credit policies, supplemented where necessary and where capable of easy administration by a few direct controls at particular points of pressure.

Post-Korean budgets reflected this reversal in the immediately preceding trend of fiscal policy. Faced by the prospect of soon reaching more than double the recent level of total expenditures, despite the savings and deferments he was able to effect in the non-defence field, the Finance Minister sought to produce what he called a fully or amply balanced budget by tax increases, and to secure certain supplementary anti-inflationary benefits by the particular distribution of these tax increases. Taxes on personal and corporate incomes were increased by 20 per cent, but an excess profits tax was avoided because of what was believed likely to be, under the prospective conditions, its hampering effect on efficiency and productivity as well as its inequities and its administrative difficulties. Nearly half of the increased revenue yield was designed to come from increased sales and excise taxes, because the Minister believed that while such commodity taxes would, in the first instance, raise prices, it was fundamentally more anti-inflationary to restrain consumption and encourage saving by such taxes on spending than still further to increase taxes on incomes which are, in effect, taxes on producing.

While the Minister aimed in his post-Korea budgets at little better than a balance, his actual revenues reflected a more rapidly rising trend of incomes and spending than he had expected and there has also been the perhaps inevitable lag in getting a large defence programme operating at full speed. As a result there was a budgetary surplus of $211 million in 1950-51 and one of $248 million in 1951-52. These surpluses brought to $2,236 million or 16.7 per cent the decrease in the net debt of Canada since the end of the war. For the current fiscal year, the budget forecast was for a slight surplus and it would now appear that this forecast will prove to be approximately accurate.

An interesting special feature of the budget of April 10, 1951, was the announcement of a novel experiment in fiscal policy to restrain less essential forms of capital investment. This involved the withdrawal for a four-year period of the right to depreciate assets acquired after the date of the budget, except for stipulated classes of undertakings deemed essential for defence purposes or for basic national development. It thus provided a stiff financial deterrent intended to conserve steel and other strategic materials in short supply and to discourage the type of investment which might be attractive not because of its long-run soundness but because it could be written off out of expected high profits in a few years of high corporate-income tax. The device had sufficient teeth in it to compel the review of many expansion programmes and to cause a shift in the pattern and distribution of planned investment toward the more fundamental and essential types of investment. It is being dropped at the end of this year.

It is scarcely necessary for me to add that the type of fiscal policy I have described has been the target of criticism, particularly in the last two or three years, by critics who contend, inter alia, that Canadian tax policy has been unduly and unnecessarily severe, that current high tax rates tend to blunt incentives and impair efficiency, and that reliance for contra-inflationary influence should have been placed on voluntary public saving rather than on savings resulting from a budgetary surplus....

Money and Credit Policies

Anti-inflationary fiscal policy in this recent period has been supplemented by monetary and credit policies with a similar bias. In October, 1950, the Bank of Canada raised its discount rate from 1½ to 2 per cent. As the commercial banks had not been borrowing from the central bank, the effect of this action was essentially psychological - it served as an indication of the central bank's appraisal of the market and a warning that its open market operations would likely be used in the direction of restraint rather than of expansion. The Bank continued to follow a policy of keeping the commercial banks in a fairly tight cash position. It was not long before the pressure of underlying forces brought a general upward adjustment of interest rates. Before Korea, the yield on long-term bonds was 2.7 per cent. By March 1951, it had risen to 3.2 per cent and today it is about 3.7 per cent. In November 1950, the Government moved to restrain the expansion of credit by the introduction of consumer credit regulations, which were sharply stiffened four months later. In February 1951, after a substantial growth in the outstanding volume of bank credit had occurred, a conference of the ten chartered banks called by the Bank of Canada resulted in a voluntary agreement under which the banks agreed to revise their lending policies in such a way as to avoid any further increase in the aggregate volume of bank loans and investments and to restrict certain categories of loans, including loans on securities and for instalment financing.

In addition to these policies designed to attack the root causes of inflation, modest use has been made of certain direct controls, including the controls or priorities relating to the use of a few strategic materials in short supply such as steel, base metals and certain chemicals. Finally, the decision made by the Government in September 1950, to unpeg the Canadian dollar, which I shall have occasion to discuss later, was another contribution made at this time to the fight against inflation. The subsequent rise in the Canadian dollar has had the effect of reducing the cost of imports and the internal price of many of our exports by up to as much as 11 or 12 per cent below what they would otherwise have been.

Logic would suggest that Canada's indirect policies might take longer to produce their effects than the application of direct controls. In any case, the Canadian indices of wholesale prices and the cost of living kept rising after June 1950, for a somewhat longer period and, particularly in the latter case, to a higher level than their U.S. counterparts. On the other hand, they have since fallen farther from the post-Korea peak. During the current year, for instance, our cost-of-living index has fallen by about 3½ per cent, while your consumer price index has risen by about 1 per cent. Last spring, some months after the hectic period of consumer spending and inventory accumulation had ended and when the inflationary threat seemed again under control, the Government lifted its consumer-credit restrictions and the Bank of Canada announced the suspension of all the voluntary restraints on bank credit except the higher margins on loans secured by stock-market collateral. In the last few months consumer spending, consumer credit and bank credit have expanded substantially but their effect has apparently been fully offset by such factors as the abundant harvest, the rising trend of industrial production, the accumulated inventories and an interim budgetary surplus.

Commercial Policy

Turning now to commercial policy, Canada is, as you know, a classic example of an "open economy", heavily dependent on foreign trade. While our gross national product, as I have said, is now running at an annual rate of about $23 billion, our total foreign trade will exceed $8 billion in 1952. Traditionally also, Canada has relied on earning a surplus from its overseas trade to pay for a deficit in our trade with the United States. It all adds up to this: the structure of the Canadian economy, and its balance of payments, are such that Canada is vitally dependent on a trading world organized so as to encourage a high level of multilateral trade and exchange convertibility. The creation of such an environment has been the main driving force behind Canada's trade and exchange policies in the post-war period.

As soon as the war was over, Canada proceeded with an important series of concrete steps to free the channels of commerce, both in the development of domestic policy and in helping to create an international environment which would encourage other countries to liberalize their trade. At home, the buoyant demand for Canadian exports and the satisfactory state of the exchange reserves made it possible to remove almost all the wartime trade restrictions, restore our dollar to parity with the U.S. dollar and relax greatly the exchange controls on current payments. In collaboration with other countries, Canada took an important part in setting up the Bretton Woods institutions and the General Agreement on Tariffs and Trade in order to introduce stability in exchange and commercial relations between countries and to facilitate the development of the economically backward regions. To assist our overseas trading partners we used the authority which Parliament had granted to extend almost $1.8 billion of financial assistance in the form of export credits.

However, the path to convertibility and unrestricted trade in Canada was not without its pitfalls. By mid-1947, we found ourselves in balance of payment difficulties on dollar account, with our exchange reserves falling in less than two years from $1,500 million to the dangerously low figure of under $500 million. Our position was unique in a sense, because we had a significant surplus in our overall current account during 1946 and 1947. The problem was simply this. By extending large credits abroad, we were selling part of our exports on credit at a time when buoyant levels of domestic investment and consumption greatly stimulated imports. The export of capital greatly exceeded the current account surplus, with the difference coming out of our exchange reserves. This experience brought home to Canada in an emphatic way the simple lesson that still needs to be learned in some quarters, that there is a close relationship between the balance of payments and the pressure on available resources.

To deal with this problem the Government adopted a comprehensive programme to correct the imbalance and to restore the reserves to a more adequate level. The programme was based partly on short-term emergency measures, including import restrictions, exchange controls and substantially higher commodity taxes. At the same time more fundamental steps were taken to slow down the rate of foreign lending, to expand output and to increase dollar exports. The purpose of the direct controls was to arrest the drain on reserves and to provide time for the more basic and longer-term measures to take effect. Incidentally, the alternative possibility of lowering the Canadian exchange rate was rejected by the Government at this time, partly because the problem was not one of lack of competitiveness of Canadian exports and partly because of its belief that price elasticities of the goods entering into Canada's foreign trade under the conditions then prevailing in world markets were such that a change in the par value of the Canadian dollar would have little effect.

Even though it was emphasized that the restrictions would be removed as soon as our reserves improved, it soon became obvious that the incidental protection which they afforded was having the effect of stimulating high-cost, uneconomic production of some of the goods subject to import control and introducing distortions and rigidities in the Canadian economy. Vested interests were being created and doubts began to be expressed concerning the merits of trying to follow liberal trading policies in a world of widespread restrictionism, discrimination and inconvertibility. In a sense the very basis of Canada's traditional trade policies was being questioned.

It was clearly realized, however, that if Canada was to continue to market her exports in the United States in large volume, it was essential to keep costs down, encourage productive efficiency, maintain competition and retain sufficient flexibility in the economy to permit adjustments to the inevitable shocks of a dynamic and rapidly changing world. The Government therefore decided to resist the pressures towards increased bilateralism. The emergency restrictions and discriminations were progressively eliminated as soon as our exchange reserves showed any perceptible improvement. The maintenance of a flexible economy was adopted as a positive purpose, and exporters who found themselves excluded from overseas markets were encouraged to find new outlets in dollar markets. The maintenance of a flexible, competitive economy would, it was felt, make the most out of the opportunities provided by the discoveries of new resources to which I have referred and help to maintain conditions in which capital required for basic development could be obtained.

Dollar Exchange Policy

With respect to other aspects of our commercial policy during this period, the record reveals an equally determined effort to remove and reduce obstacles to trade wherever possible. Under the General Agreement on Tariffs and Trade, Canada made substantial tariff reductions in the course of three rounds of extensive multilateral negotiations. Despite some pressure, the Canadian dollar was kept at parity with the U.S. dollar until the 30 per cent devaluation of so many other currencies in September 1949, forced the Canadian Government to revert to the former official rate of a 10 per cent premium on the U.S. dollar. In making this decision, however, the Minister of Finance was again quite aware that under current world conditions the "right rate" for the Canadian dollar at one time was unlikely to be the "right rate" at another, and that he might soon have to face again the problem of altering the official rate, with all the inconveniences and disturbances that these sudden and arbitrary changes create.

We had not long to wait. During the spring and summer of 1950, as our economic situation improved, a large and increasing number of people, both inside and outside Canada, came to the conclusion that the Canadian dollar was undervalued at the chosen official rate and, therefore, on top of a large inflow of investment capital interested in the development of our oil and other natural resources, we had an avalanche of speculative capital lured by the almost "sure bet" of an upward revaluation of our dollar. In ten weeks in the third quarter of 1950, our exchange reserves increased by over $500 million. The flood, which of course increased the already strong pressures toward inflation, seemed to acquire momentum steadily. It was clear beyond peradventure that the existing rate could not be held. It was equally clear that in the unsettled state of world conditions, and having in mind the common pool of highly mobile capital serving our two countries, no-one could pick some new fixed rate "out of the air" or select it by any theoretical equation and say with any assurance that that new rate could be maintained.

Forced off a fixed rate for the second time since the war's end, we had no choice but to leave the rate free to find its own level in the market. We explained our position to the Fund and they expressed understanding of it, although requesting us to keep the situation under review - which, of course, we would do in any case. Since that time, September 30, 1950, Canadian policy has been to allow the rate to be determined by the normal play of economic forces, without official intervention except to ensure orderly conditions in the exchange market. No attempt is made to hold back a trend in either direction but only to smooth out excessive short-run fluctuations. After it was freed, our dollar rose sharply to U.S. $0.95, hovered for a few months around the latter level and then began a persistent and almost uninterrupted rise until it reached par in February 1952, and then a peak in August at a premium of over 4 per cent.

On December 14, 1951, the Finance Minister announced another bold conclusion to which the Government had come, namely, that henceforth "we would be better advised not to rely on exchange restrictions but rather on the general handling of our domestic economic situation to keep it in reasonable balance with the rest of the world and to maintain the Canadian dollar over the years in an appropriate relationship with foreign currencies". The decision to let our dollar go free, and particularly this new decision to abolish foreign exchange control completely, were dramatic moves which apparently caused a great deal of interest on the part of foreign investors. The great influx of capital in 1950, amounting to over a billion dollars, had been to a very considerable extent of a speculative and short-term nature, though much of it stayed in Canada. While the capital inflow was smaller in 1951 - $563 million - it was of quite a different and more permanent character. Almost $300 million went into direct investment in Canadian resources and industries and most of the rest represented borrowings by Canadians, chiefly provincial and municipal governments, in the New York market. These two types of inflow have continued in 1952, particularly the inflow for direct investment purposes.

It would be a mistake, however, to attribute the strength shown by the Canadian dollar during the present year to an inflow of capital. Such partial evidence as we have at this date seems to indicate that it is our balance on current account which has been responsible for the recent strength of our dollar. The change this year in our balance of trade has been quite extraordinary. In the 12 months ended in October 1951, our imports exceeded our exports by $122 million. In the 12 months ended in October of this year, our exports exceeded our imports by $235 million. This net reversal of over $357 million, with its consequent shift in the supply of and demand for Canadian dollars, has been, I am sure, the dominant influence on our exchange rate.

The invisibles in our current account are not likely to have shown any material change during the year and so far as we can now see, capital movements must have been close to a balance. Certainly, if there has been a net movement either way, it must have been a small one. What has probably been happening is that the inflow of capital for direct investment and as the result of public borrowings in New York has driven out a roughly corresponding amount of capital represented by U.S. holdings of Canadian marketable securities. It could not very well be otherwise, given the basic factors in the situation: (1) a favourable balance on current account, as we believe, probably not of large proportions; (2) a flexible exchange rate; and (3) a policy of not building up exchange reserves in order to stop an upward trend in the dollar. (In the first nine months of this year the increase was held to $77 million.) Given a balanced current account, the inflow of capital, say, for direct investment tends to force up the Canadian dollar rate and thus to encourage the taking of profits by foreign investors who hold Canadian marketable securities bought when the dollar was at a substantial discount. This year also Canadians have probably increased their holdings of foreign exchange abroad.

That some measure of success has attended the efforts in Canada to achieve external as well as internal stability in a highly disjointed world is evidenced by the recent strength of our dollar, the present size of the exchange reserves ($1,856 million at September 30 last), the record level of foreign trade, and the unprecedented expansion of the economy. In some respects, of course, Canada has been especially fortunate in comparison with other countries. Our good fortune in being spared the direct ravages of war and in being blessed by Providence with rich and extensive natural resources has contributed in a significant way to the difficult post-war adjustments. The existence of alternative markets for many of our basic exports in the United States, and the buoyancy of that market in recent years, were also fundamental conditions of our relatively successful adaptation to the changing pattern of world trade.

Difficulties With Overseas Markets

However, the persistent imbalance of many of our important overseas customers has required us to make a number of difficult adjustments and confronts us with continuing problems. Markets for some of our minor agricultural products have been closed, with few alternatives in sight. Some manufactured goods have suffered sharp reductions in their sales to overseas markets. As long as our major overseas customers find it necessary to hedge themselves about with discriminatory trade restrictions and keep their currencies inconvertible, we shall have problems to solve and shall retain a measure of vulnerability because of our heavy dependence on one market, great and expanding as it is. We have therefore a great stake, as we believe does also the whole Western world, in the success of some such programme of national action and international co-operation as was envisaged by the recent London Conference of Commonwealth countries, designed to recreate as quickly as practicable an effective system of multilateral trade and payments over the widest possible area.

If, perhaps, this record of developments in Canada since the end of the war has been tinged with some pride in Canada's recent growth and confidence in its future, I would like to warn you that we are worthy neither of the idolatrous esteem with which you sometimes seem to regard us nor yet of the low estate to which you consign us at other times in moments of disillusionment. We are just a young country trying to get along! - with some of the strengths and limitations of youth!

There is nothing more certain in these dynamic and uncertain times than that we shall have fresh problems to face and new adjustments to make. Of these, the continuing disequilibrium in world trade and payments to which I have just referred and the constant threat of inflation arising from the cold war as well as from the impatient striving of a virile people for bigger and better things plus greater security and more leisure are likely to present the most compelling challenge. But there will probably be others as well.

Whatever the problems may be, the Canadian people will, I believe, face up to them with new confidence. We are small in numbers but growing rather rapidly. Our gross national product per capita is 27 per cent lower than yours but rising more rapidly. We are united as never before. That unity and a certain tolerance of mind and steadiness of purpose (call it stolidity, if you prefer!), coupled with inherited traditions and machinery, are enabling us to carry on the processes of democratic government effectively. At least from the economic point of view we are fortunate in our geographic position and in the dowry which nature has bestowed on us. During the last few years the foundations of our economy have been broadened, its productive capacity and diversification greatly increased, its vulnerability greatly lessened. We have been fortunate enough to develop a dynamic and flexible economy, gaining steadily in strength and adapting itself with remarkable speed to changed conditions and requirements.

All I can promise is that when the new problems come Canadians will tackle them with a certain acquired skill in dealing with problems - and make, I believe, a pretty good "fist" of solving them.

S/A