



STATEMENTS AND SPEECHES

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An address by the Governor of the Bank of Canada, Mr. Graham Towers, to the Investment Dealer's Association of Canada Annual Meeting, at St. Andrews-by-the-Sea, N.B., June 13, 1952.

You may find it rather surprising that I should have chosen to speak today on some aspects of international trade. It is true, of course, that Canada's interest in this field is far from academic because our prosperity is heavily dependent on a high level of foreign business. On the other hand, there has been a tremendous amount of discussion of international trade and related problems during the last seven or eight years, and one might wonder what more could usefully be said. My intention is not to thrash old straw, but rather to assess, so far as I am able, the results of all the discussion and effort to improve international trading conditions in the post-war period. In other words, I propose to ask the score.

As a first step, let me briefly sketch in the background, familiar as it may be to all of you. Long before the war ended, it was obvious that the disruption which it was bound to cause would leave many countries in a very weakened condition. For those which had suffered serious war damage or occupation, the task of restoring pre-war conditions would be a formidable one. And yet this in itself was not enough. Such countries needed resources to look after growing populations and to hold out tangible hopes of improvement in pre-war standards of living. The same could also be said of many countries which had not suffered war damage, but had been indirectly affected by the chaos in Europe and parts of Asia, and would continue to be affected by the weakened position of the European continent. The desire that things should be better, and the recognition that the strong must help the weak, was inspired solely or even mainly by humanitarianism, in spite of occasional jeers to that effect from those who take a dark view of such things. It was based upon the belief that political security is founded on economic strength, and that unless the freedom-loving nations of the world could demonstrate their capacity for material progress, the international political consequences might be most unfortunate. Nothing has happened since the end of the war to indicate that this view was wrong.

Another belief was that economic strength could not be achieved if each country, or even groups of countries, put up barriers to trade and tried to pull themselves up by their own bootstraps. It was felt that the free world's interests could best be served by the maximum possible degree of economic co-operation between countries, so that the waste of resources in uneconomic production would be kept as low as possible.

While, later on, I shall express the view that the world has not made great progress towards this objective, I think the objective itself still makes sense.

Since the end of the war, the views and beliefs which I have mentioned have been given tangible expression in a number of different ways. Fifty-one countries associated themselves with the International Monetary Fund and the International Bank for Reconstruction and Development. The Articles of Agreement of the Fund, in describing its purposes, state amongst other things that it is intended to facilitate the expansion and balanced growth of international trade and the development of the productive resources of all members. It is to assist in the establishment of a multilateral system of payments in respect of current transactions between members, and in the elimination of foreign exchange restrictions which hamper the growth of world trade. Another post-war development was the extension of very large credits by Canada and the United States to the United Kingdom and a number of other countries mainly in Western Europe. One of the purposes of these credits was to assist the countries concerned in assuming the obligations of multilateral trade. Subsequently, as we all know, the United States contributed vast sums under the Marshall Plan to help freedom-loving countries regain their strength and cast off the economic fetters which weakness almost inevitably imposes. I should mention also the formation of a group of about forty countries in the general agreement on tariffs and trade commonly known as GATT. This group of countries has endeavoured to promote the reduction of tariffs, and the simplification and standardization of customs practises, in the hope of eliminating a number of the handicaps to international trade. Last but not least, there has come into being the North Atlantic Treaty Organization, a group primarily associated with defence but which recognizes in its charter the necessity for economic collaboration.

It is not surprising that Canada has played a part in these affairs, or that Canadian post-war policy has been consistently directed towards the support of efforts to maintain a high level of international trade, to reduce or eliminate restrictions on imports, and to achieve convertibility of currencies. The attainment of such objectives would serve our best interests as well as - so I believe - the best interests of the world at large.

Today, seven years after the end of the war, it is, I think, worthwhile to enquire what degree of success has attended all these efforts, unprecedented in their scale. No one can deny that the positive accomplishments have been great. In the United Kingdom and the countries of Western Europe, industrial production is estimated to be some fifty per cent higher than before the war - this in spite of the terrific losses and disruptions caused by six years of fighting and, in many cases, enemy occupation; in spite of the closing of age-old channels of trade and of dismemberment of certain countries; in spite of the continuous efforts of Russia to inspire confusion and fear. The task which faced many of the countries was not just one of reconstruction. It involved the painful building up of something new. We are surely entitled to take a good deal of satisfaction in the progress achieved since 1945, not only in the war devastated countries but in many other places round the world. At the same time, I think we would be well-advised to take a look at existing weaknesses in the world structure, not for the purpose of sterile criticism but as the basis for a sober appraisal of the present position and future prospects as far as anyone can understand them.

Time does not permit a survey on all fronts so to speak, and in any event I am not qualified for such a job. So I am going to confine myself to the subjects which formed such an important part of post-war hopes and planning, namely the elimination of import restrictions, the convertibility of currencies and restoration of multilateral trade. Here the record is an unhappy one. Convertible currencies can be numbered on the fingers of one hand, and trade restrictions, often of a highly discriminatory character, are the rule rather than the exception. Why should this be so? Why should a large part of the world still be in this fix seven years after the war, in spite of the enormous amount of money and effort devoted to the solution of the underlying problems? To this question you can get as many answers as there are men. One answer which seems to be popular in certain places is the bad behaviour of the dollar countries - particularly the United States - in not buying enough from others. "The intractable dollar problem" it is called. Another reason given is that many manufacturing enterprises in the more highly industrialized countries of Europe have not been able to modernize their equipment and improve their processes to the extent achieved by those who were far from the scene of conflict and had ample resources at their disposal. Still another is the pressure of rearmament on countries which have relatively little to spare for this purpose if they are at the same time to maintain a tolerable standard of living. As regards certain countries - in the main, relatively undeveloped ones - which were not engaged in the war and are not burdened with substantial defence expenditures today, it is often pointed out that their growing population and needs for capital development impose strains on their resources which almost inevitably result in import restrictions.

No doubt the various reasons put forward to explain the continuance of trade restrictions and currency inconvertibility all have some degree of validity. The difficulties to which they point have contributed, along with many other things, to a constant state of inflationary pressure in most countries in the world - pressure which has usually been relatively stronger in the non-dollar countries than it has been in the dollar area. There has been a constant attempt to do more than the resources of most countries would permit, even with such assistance as may have been received from outside sources. This situation is not surprising. There are growing populations to support, there is a keen desire for improvement of standards of living and many forms of social security, and in some cases more leisure time. North America has no monopoly on these needs and desires. We are simply more fortunate in our ability to fulfil them up to a point.

The countries which find themselves in this situation, whose desire outruns ability to pay, inevitably tend to use up their foreign exchange reserves. When there is strong pressure on a country's economic resources - which is one way of describing an inflationary situation - some of the pressure tends to spill across its borders, taking the form of an import surplus. If adequate foreign exchange financing to pay for this import surplus is not available from one source or another, the country soon finds itself in balance of payments difficulties. As we have seen time and again since the end of the war, the first reaction of countries in this position is to impose or increase restrictions on imports. If they have cash or credit in some currencies but not in others, the restrictions are likely to be discriminatory in character. In dealing with their payments problem by means of such restrictions, they are

of course attacking the symptoms rather than the cause of the trouble, but it is often felt that getting to the root of the matter by anti-inflationary measures would set up intolerable political strains.

Now I did not come here today to inflict a philosophical discussion on you, so I will get to the main point which I wish to make, namely that import restrictions, for whatever reason they are imposed or retained, are contributing to a most serious weakening of the economic structure of the free world. Wherever they exist, you may be sure that labour and capital are being diverted to uneconomic uses, and this at a time when the need has never been greater for the most efficient use of capital and labour to build up the world's production of foodstuffs and primary materials as well as to improve the efficiency of manufacturing enterprises in countries best suited to their development.

The distorting and weakening effects on basic economic structures of the developments I have been referring to are strikingly illustrated in the way in which the world's production of foodstuffs and raw materials has been lagging behind industrial production. These comparisons are usually made with figures for the immediate pre-war period, and this is as good as any other, provided one remembers the great increase in the world's population that has taken place during the last thirteen years. I am not going to cite global figures because they tend to be misleading, but let me remind you that the population of the United States and Canada has increased by nearly 20 per cent since 1938 and the population of the United Kingdom and Europe, west of the Iron Curtain, has increased nearly ten per cent.

In summarising briefly the situation regarding world production of primary products, I think I can do no better than quote from an address made not long ago by John H. Williams, Professor of Political Economy at Harvard University and a Vice-President of the Federal Reserve Bank of New York:

"A great change appears to be under way in the relation of industrial production and trade to foods and raw materials. For perhaps three-quarters of a century, the problem has been whether the industrial countries could absorb the food and raw materials which they had been instrumental in developing in other countries, on terms of trade tolerable to the latter. Now the imbalance appears to be swinging the other way. Owing partly to the expansion of industrial output in Europe under the Marshall Plan, and even more to our own absorption of raw materials, there is a general world problem of availability of supplies. Again, this problem has been accentuated by the rearmament program; but it was becoming apparent even before Korea. World industrial production since 1948 has grown by some 50 per cent, while the output of food and raw materials has at most increased by 10 per cent. Some experts have estimated that, apart from the United States, the world's food production is now lower than before the war; and if we take out a few items, such as petroleum and aluminum, this may well be true also of the raw materials."

This decline in the relative importance of the world's production of foodstuffs and raw materials threatens to have serious effects both on the countries which have in the past produced surpluses of primary products and are now turning more and more to manufacturing industry, and on the consuming

countries which are dependent on foreign supplies of foodstuffs and raw materials.

So far as the former group of countries are concerned, many of them have shown in recent years an ardent desire to increase their manufacturing facilities. Factory chimneys belching forth smoke have come to be regarded as symbolic of economic progress. No doubt a greater degree of industrial development in under-developed countries is most desirable over a period of time. But when capital resources are relatively scarce, the question of priorities assumes major importance. The first law of economics applicable to a situation of inflationary pressure is that goods are scarce and have alternative uses. What the import restrictions do is set up false priorities; they make the worse appear the better alternative. By their effects on prices and profits, they encourage the development of secondary industries which are dependent on continued import restrictions or prohibitions for their survival. In many cases, these industries produce non-essential goods. Import restrictions produce a situation which draws people away from the country to the cities. They reduce the relative profitability of the production of exportable foodstuffs and raw materials which have to face world competition, and they therefore operate to reduce the production of these essential things. In a word, the effect of the restrictions is to channel resources in the wrong direction to perpetuate inflationary conditions, and to weaken the basic economic structure of the countries applying them.

The economic development of under-developed areas is a task of great importance and urgency. These countries are poor and populous; their domestic savings are low; they need foreign capital for their development. Policies which weaken the basic economic structure do not make for attractive investment opportunities.

Turning now to the industrial countries, it is clear that developments along the lines I have been mentioning carry great risks in the way of reduced supplies of foodstuffs and raw materials, and adverse terms of trade. If one excludes countries such as Canada and the United States, it is difficult to find many examples of substantial increases in the pre-war level of production of foodstuffs and raw materials. Moreover, increases in domestic consumption in the producing countries have in many cases tended to reduce the size of exportable surpluses. These developments are of great significance for highly-industrialized European countries which have traditionally depended on overseas suppliers of foodstuffs and raw materials.

Canada and the United States are exceptions to the tendencies I have been describing: our production of foodstuffs and raw materials has increased quite considerably. But the fact that we are able to supply the goods does not get them into the hands of the United Kingdom and other industrial countries which need them: there is the slight matter of payment which intervenes. And unfortunately the same tendencies which have been operative in some of the primary producing countries have also, for somewhat different reasons, been operating in certain industrial countries, with debilitating effects on their economic structure and on their capacity to make payment for their imports in the only ultimately feasible way - by exporting the right goods to the right places at the right time at the right prices. In these industrialized countries too, inflationary pressures have been strong and have given rise to balance of payments difficulties: here too the difficulties have resulted in import

restrictions. The consequence is the same: resources are misdirected and uneconomic production encouraged. Originally imposed to meet balance of payments difficulties, the import restrictions in effect in these countries, and the special discriminations which others practice in their favour, become props for industry to lean on, and on which industry ultimately becomes dependent. Temporary in their conception, the restrictions have continuing weakening effects. As the French, with their customary realism, point out, "Il n'y a rien qui dure comme le provisoire".

When a person from a country fortunate enough not to have import restrictions points to their evil consequences, it is often thought that his remarks are prompted only by a desire to sell more goods to other countries, and that in the process he develops into a preacher of perfection. I would not like to have it said of me that my capacity for taking a stern view of other people's duties is matched only by my ability to maintain a calm, philosophical attitude towards other people's troubles. I want to assure you that I have not fallen into the habit of preaching, that I am well aware of the difficulties confronting other countries and that I do not think there is any easy solution to the problems which I have been discussing. Perhaps I am just exercising the traditional right of the banker to "view with alarm". But in all seriousness, I do suggest that the present state of affairs constitutes a chink, and indeed more than a chink, in the armour of the free nations and that it represents a weakness in the economic foundation underlying their defence efforts - a weakness which, if allowed to develop could become very great indeed.

If I am right in these anxious thoughts, then we must hope that people will not be merely "against" the paraphernalia of import restrictions, special currency arrangements and so forth in the way that everyone is "against" sin. The world did not get into the present position because of deliberate choice, but because at each moment of time the immediate situation seemed to call for action along certain lines, and the longer-run future consequences seemed remote and unforeseeable. The future - or part of it - is at hand; and the longer-run consequences of past emergency measures are clearly perceptible in many fields. If countries are to get out of these entanglements, they must first of all base their policies on a clear recognition of the direction in which they wish to move, and then make sure that the measures adopted produce incentives which lead in this direction and not - as has so often been the case since the end of the war - in the opposite direction. If international balance at a high level of transactions, without import restrictions, is to be attained and the misdirection of economic resources avoided, we shall have to make an ally and not an enemy of the system of prices and incentives.

What lessons can we in Canada draw from the state of affairs I have been describing? We must, of course, do what lies within our power to influence the course of world events in a favourable direction. But we must also be prepared to keep our heads well above water even if developments elsewhere are unfavourable. To do so we shall continue to need flexibility in our economic system, we shall have to maintain our productive efficiency at a high level, and to keep our costs on a basis where we can face world competition. We shall need, in short

to avoid the rigidities and the misdirection of resources whose weakening effect on the basic economic structure is only too apparent when one sees it in others. If we are successful in avoiding these mistakes, we shall be better able to deal with whatever vicissitudes the future may hold and to derive the maximum benefit from the great economic expansion which is now taking place in our own country.

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