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CANADA'S INTERNATIONAL FINANCIAL POSITION

An address by Mr. Louis Rasminsky, Chairman (Alternate), Foreign Exchange Control Board, at the National Defence College, Kingston, December 1, 1948.

In the lecture which I gave here 10 months ago, I summarized some of the background elements in Canada's pre-war economic position, described the way in which the war had changed our international economic and financial position and attempted to analyze the post-war developments leading to the exchange difficulties which had culminated in the various restrictions imposed by the Government in November 1947. I do not propose to cover that ground again today. Instead, I intend to devote the major part of this talk to an analysis of the developments of the past year and to some speculative comments on the present outlook.

I should like to begin, however, by reminding you of some of the facts of life so far as international finance is concerned. International finance is supposed to be complicated and esoteric, and sometimes its analysts (and occasionally even its practitioners) like to use many-syllable words to conceal simple truths. In fact there is nothing mysterious about it - there is a virtually complete analogy between the financial problems of an individual in his own community and the financial problems of a particular country in the community of nations.

An individual's expenditures are limited by the amount of cash he can acquire. By cash, I mean all forms of money that are acceptable in one's community. The amount of money a person can command is made up of what he earns plus what he receives as gifts plus what he can obtain from the sale of assets (that is, by drawing on past savings) plus what he can obtain by borrowing. A person can, of course, spend on his current upkeep, that is, on food, clothing, lodging, etc., either more or less than he currently earns. If he spends less than he earns the difference is available to be saved and the savings may take the form of acquiring assets such as coins in the china piggy bank, banknotes stuffed in a mattress, a bank deposit, an investment in a house or a business, or loans to others, or it may take the form of paying off borrowings made in the past. Conversely, if a person spends more than he earns he must use up assets previously acquired - that is, he must loot the piggy bank - or borrow from others, thus mortgaging his future earnings. These are the facts of life in respect of an individual's finances and they are obvious in some cases painfully, to all of us.

The important thing to recognize is that these same homely, and often unpleasant, facts are the facts of life in international finance. A country's expenditures in the community of nations are limited by the amount of internationally acceptable money which it can acquire. Money which is internationally acceptable is usually referred to as foreign exchange, so one may say that a country's expenditures are limited by the amount of foreign exchange which it can command. The amount of foreign exchange which

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it can command is made up of what it earns, plus what it receives as gifts, plus what it can obtain from the sale of assets - that is, from looting the national piggy bank - plus what it can obtain by borrowing. A country's current earnings are the proceeds of its sales to foreigners of goods and of various kinds of services such as transportation services, business and professional services, services to tourists, service on loans and investments, etc. Its expenditures for current upkeep consist of the payments it makes to foreigners for goods and services provided by them. If a country's foreign earnings exceed its current upkeep expenditures, it is said to have a surplus or a favourable balance on current account. This means that the country is "saving" in so far as its international transactions are concerned. The saving will be reflected either in greater holdings of foreign cash, foreign securities or other foreign assets or in a reduction in old debts to foreigners. If, on the other hand, a country's expenditures on current upkeep exceed its earnings, it is then said to have a deficit or unfavourable balance in its current account. This deficit must be met either by drawing down foreign cash balances or other foreign assets or contracting fresh foreign debts - or, if the country is fortunate enough, by the receipt of sufficient gifts from abroad.

While I am recommending to you the analogy between the financial problems of an individual and the external financial problems of a country, I should like to warn you against another apparently similar analogy which is widely used. This is the analogy between the financial problems of an individual and the internal financial problems of a country. This analogy is false and it is false because a government has one means of financing its internal expenditures which an individual does not have of financing his. A government can if it chooses create the money it lacks. It is of course true that some individuals refuse to recognize that the acquisition of money by creating it is a prerogative of government only. Such individuals resort on occasion to balancing their accounts by printing a few dollar bills in the basement. But the practice is frowned on and is fortunately not widespread. When done by governments, however, the financing of internal expenditures with money created for the purpose is a widespread practice. There is a good deal of disagreement as to the circumstances under which it is commendable, but that is another story. As long as there are any circumstances under which government creation of money is considered appropriate, the analogy between government internal finance and individual finance is not valid. But when one turns to a country's external financing there is no such defect in the analogy. Not even the most enthusiastic proponents of inflationary finance have claimed, hitherto at any rate, that one country should create the money of another country. It seems reasonable to assume that the United States Treasury would fail to regard such a proposal as a constructive solution of the so-called "dollar shortage" problem.

If an individual makes investments or loans to friends in excess of his own current savings, he may sooner or later find himself pinched for cash and even forced to cut down on his own expenditures and to borrow in order to keep his head above water. This is exactly what happened to Canada a year ago. After the war we did a great deal to assist in European reconstruction by making very large export credits available to the United Kingdom and other Western European countries. These loans did not particularly reflect Canadian generosity. They reflected rather a realization that Canada had a great deal at stake in the economic revival of Europe. Europe represents the traditional market for some of our staple export products and in the past has been a source of foreign exchange to pay for our large surplus of imports from the United States. This triangular circuit was broken at the outbreak of the war. Broken, that is to say, so far as finance is concerned but not so far as the movement of goods is concerned. Our pattern of trade has continued to be triangular - a surplus

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of exports to the United Kingdom and Europe and a surplus of imports from the United States. The pattern of payments however has only been maintained through special measures of assistance on the part of Canada and the United States. The revival of the triangular pattern of payments is dependent upon the United Kingdom and Europe so restoring their productive capacity and their competitive efficiency that they can earn a surplus of U.S. dollars in their transactions with countries other than Canada which they will have available to settle their deficit with Canada and which we shall in turn have available to settle our deficit with the United States. The alternative to this is the bilateral balancing of our accounts with the United Kingdom and Western Europe on the one hand, and with the United States on the other hand. Such a bilateral balancing would inevitably involve severe and painful adjustments in our economy and the stresses and strain might have far-reaching consequences.

It was no wonder then that Canada should have desired to make an important contribution to the economic restoration of the United Kingdom and Europe. But as matters turned out, the contribution we made exceeded the amount of our earnings we had left over after meeting our own large upkeep expenditures. Taking the two years 1946 and 1947 together we extended net loans to foreign countries in the amount of $1,120 million* and, in addition made gifts to foreign countries in the amount of $135 million - a total of $1,255 million. But during these years our net surplus on current account amounted to only $539 million - $454 million in 1946 and $85 million in 1947. In other words, our net earnings fell short by $716 million of the amount we loaned and gave away. This difference of $716 million came out of our foreign cash reserves held in the form of gold and U.S. dollars. In addition we had to use $290 million of these cash reserves to make net capital payments - the most important being retirements of debt in the form of Canadian securities held by Americans and our gold subscription of $75 million to the International Monetary Fund. The consequence was that our international cash reserves which had been built up to the high figure of $1,500 million at the end of 1945 fell by $1,000 million in 1946 and 1947 and at the end of last year amounted to only $500 million.

In my lecture last year I referred to some of the main factors responsible for both the unexpectedly heavy utilization of credits by foreign countries in 1946 and 1947 and the sharp falling off in our own balance of payments surplus in 1947. I do not intend to repeat that analysis now - it can be summarized by saying that the unexpectedly slow rate of recovery in Europe led to very rapid drawings on the credits made available by Canada and the United States, while the high level of prosperity in Canada led to an extremely heavy volume of imports from the United States. The point I wish to emphasize now is that Canada's exchange difficulties did not arise, as exchange difficulties normally do, out of a deficit in our current international payments or any lack of international competitive capacity. Even in 1947 we had a surplus. Our cost and price structure were and are among the lowest in the world. Our exchange difficulties arose out of the disparity between our net foreign earnings and our net loans and gifts to foreign countries.

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* Net export credits amounted to $1,313 million offset mainly by repayments received on the 1942 Loan to the United Kingdom.

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The various steps taken by the government a year ago to deal with the exchange situation are well known to you. What essentially had to be done was to increase our net earnings, i.e. to raise our current account surplus from the low level of $85 million to which it had fallen in 1947, and to bring our foreign lending into better relationship with our earnings. The policies for the first part of this programme fell into two parts, one negative and the other positive. The negative part consisted of reducing our outlays for imports, particularly imports from the United States, and reducing our travel expenditures in the United States. The positive part consisted mainly in various attempts to increase our earnings of United States dollars by increasing our exports to U.S. dollar markets.

I think that it is accurate to say that our over-all balance of payments situation has improved much more during the past year than was anticipated when remedial action was taken last autumn. Official figures regarding our over-all balance of payments as a whole are not currently available, but from the merchandise trade figures of the first 10 months of this year and from one's knowledge of the behavior of the more important "invisible" items it now seems likely that we shall have a current account balance of payments surplus in the neighborhood of $450 million in 1948. This compares with a surplus of only $85 million in 1947. The improvement is due mainly to increased exports, which are likely to be about $250 million higher than last year. Our over-all import figures will probably be about the same as last year since a reduction of about $200 million in our imports from the United States will be just about balanced by an increase in our imports from other countries. Our net commodity exports, which amounted to about $175 million in 1947 should exceed $400 million in 1948.

Apart from this improvement in our merchandise balance, the major source of improvement in our current account has been in the travel item. Net tourist receipts are expected to be approximately $60 million higher this year than last: this improvement is due in approximately equal measure to higher receipts from American tourists and reduced expenditures by Canadian tourists. There is some satisfaction in knowing that the travel restrictions on Canadians, irksome though they are, have produced so much in the way of exchange saving.

I propose to comment in more detail now on recent developments in our international trade because international trade is, of course, the backbone of our balance of payments.

Our aggregate exports to all countries in 1948 will amount to very nearly $3 billion, a figure which was exceeded only in 1943, 1944 and 1945 when our exports were greatly swollen by war goods. The increase of approximately $250 million, or about 9 per cent, over 1947 appears to have been almost entirely due to price increases. We have been exporting certain goods, such as beef cattle and beef to the United States, in greater volume than last year, but such increases in volume have apparently been just about balanced by reductions in exports of other goods, so that the over-all volume of our exports this year will be just about what it was in 1947.

Undoubtedly the most important recent development in our trade has been in its geographical distribution. The percentage by value of our exports going to the United States has risen from just under 40 per cent to just under 50 per cent. There has been some decline in the percentage of our exports going to the United Kingdom, but the decline has been concentrated mainly in exports going to the other sterling area and other E.R.P. countries. These will be about $120 million less in 1948 than they were in 1947 - a decline of about 20 per cent.

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This shift in the geographical distribution of our exports in 1948 is not primarily the result of any change in the kind of goods we export. Broadly speaking, we are selling abroad in 1948 more or less the same physical amounts of the same things we sold in 1947. These things continue to be mainly agricultural products, forest products and non-ferrous metals, nearly all in an unprocessed or semi-processed state. The big difference is that we have been selling a substantially larger proportion of these things to the United States than we did in 1947.

However, to note only that there has been no substantial change in the make-up of our export bundle in 1948 is to miss some interesting and very significant details. Perhaps the most significant of these is the decrease which has taken place in our exports of manufactured goods. These have never been really important in our total export picture, but the growing industrialization of the country encouraged the hope that we might become less concentrated on the export of primary products which require little or no processing in Canada. However, during the past year Canadian exporters of a wide variety of manufactured products have found themselves shut out of an increasing number of markets by the import and foreign exchange restrictions of foreign governments. As countries have found themselves increasingly pressed for Canadian and U.S. dollars they have taken more and more rigorous measures to discriminate against non-essential in favour of essential imports and to a large extent this has involved a preference for raw materials over manufactured goods. Canadian exports of certain manufactured goods such as autos, trucks and parts, electrical equipment, drugs, dyes and chemicals, rubber manufactures and artificial silk manufactures which amounted to $210 million in 1947 will probably not amount to much more than half that figure this year. Moreover, the world dollar situation being what it is, there is no reason for supposing that the resistance to our manufactured goods in overseas countries has reached its peak or that it will be of short duration. The hardship it causes to individual exporters and the difficulties it places in the way of reducing our dependence on the export of a rather narrow range of raw materials are unquestionably extremely disturbing.

Turning now to the import side, as I have already mentioned the value of our imports from all countries in 1948 will be just about the same as in 1947 - approximately $2.6 billion. Since import prices are, on the average, nearly 15 per cent higher this year than last, it is clear that there has been an appreciable decline in the physical volume of imports.

This decline has been largely concentrated in the goods covered by the import restrictions imposed last November. These measures banned completely the importation of a number of consumer goods and limited many others, including automobiles, trucks and parts, to a percentage of previous imports. On a value basis imports of these goods are expected to drop from about $660 million in 1947 to about $430 million this year, or by about 35 per cent. On a volume basis the decline would be substantially greater. It would probably be wrong to attribute the whole of this decline to the action taken by the government last November. Probably some of the goods were overbought before restrictions and imports would have fallen anyway. On the other hand, Canadian incomes are higher this year than last and, if unchecked, current consumption of imported goods might well have risen above the 1947 levels.

The items affected by the import restrictions are chiefly consumers' goods. The inflow of producers' goods - fuels, raw materials and capital equipment - has continued at more or less the 1947 rate. No matter how unpleasant it may be for Canadians to get along with fewer imported consumer goods, it is of course much more important that the inflow of raw materials and essential equipment should continue.

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The decline in the volume of imports in 1948 was accompanied by a decline in the relative importance of the United States as a source. In 1947, about 77 per cent of our imports originated in the United States; in 1948 only about 69 per cent is expected to originate there. On the other hand the percentage of our imports coming from the sterling area will rise from 13 to 18. These changes are, of course, in the direction of the pre-war situation: in the years 1935-39 61 per cent of our imports came from the United States and 29 per cent from Commonwealth countries.

The movement towards the pre-war pattern in our imports is the result of two main factors. On the one hand the increased ability and determination to export to dollar countries on the part of a number of war-damaged countries (but mainly the United Kingdom) has made more of their goods available to us. On the other hand, our import controls have on balance been so constructed as to encourage imports from these countries. Thus our imports from the so-called "non-scheduled" countries (in effect all countries except the United States) of goods covered by Schedule II of the Emergency Exchange Conservation Act are expected to rise from $80 million in 1947 to about $130 million in 1948, while the quota limitation will cut the import of these goods from the United States from $212 million to about $90 million.

To summarize this brief statement, the recent developments in our foreign trade include both favourable and unfavourable features. On the credit side is (1) the substantial improvement in our net commodity exports which has been a very important factor in strengthening our external financial position in 1948 and (2) a substantial reduction in our bilateral disequilibrium on commodity account. In 1947 we had a trade deficit of about $900 million with the United States: this year our trade deficit may not greatly exceed $300 million, with about two-thirds of the improvement accounted for by increased exports and the balance by reduced imports. Our surplus with the United Kingdom will be reduced from $754 million to about $560 million and with other countries from $306 million to about $185 million. While it would certainly be over-ambitious for us to attempt to reduce our traditional bilateral disequilibrium to negligible proportions, the experience of the past few decades, and in particular the past few years, makes it very clear that the smaller this disequilibrium is, the fewer and more manageable are our international financial problems likely to be.

On the debit side of this account we must enter, as at least part of the price paid for the favourable development, (1) an appreciable reduction in imports of consumer goods and (2) some increase in our dependence on exports of unprocessed or only partially processed goods. The pinch of the former we are all feeling as we go. The pinch of the latter is still pretty well localized, but to the extent that it impedes the diversification of our economy we shall all pay for it in the years ahead.

I revert now to our over-all balance of payments, which is the best single index of our international financial position. I said a few minutes ago that in the situation which confronted us a year ago, with our surplus or net earnings on current account practically eliminated through the rapid growth in imports, with our lending to foreign countries at levels far in excess of our net earnings, and with our international cash reserves depleted to the danger point it was clearly necessary for us to do two things. One was to increase our current account surplus and the other was to establish a more tenable relationship between our current account surplus and the amount of our foreign lending. The first part of this programme succeeded beyond expectation and, as I have indicated, our over-all current account surplus this year may well be in the neighborhood of $450 million.

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On the foreign lending side, steps were taken in 1947 to reduce the rate of releases on the $1,250 million credit granted to the United Kingdom in 1946. It had, of course, originally been thought that this credit would be used up much more slowly than turned out to be the case in 1946 and 1947. When our own exchange difficulties began to become acute in 1947 it was arranged with the United Kingdom to cover a larger proportion of her purchases in Canada by cash payments in the form of U.S. dollars and a smaller proportion by drawing on the Canadian credit. For the first few months of 1948 releases from the credit were authorized at the rate of $15 million per month and releases were suspended in April 1948. The unutilized balance of the credit is now $235 million.

In addition to the 1948 drawings by the British, substantial drawings were also made by France, Holland and certain other countries. In all it now looks as though we shall extend export credits amounting to about $140 million this year and give away, in the form of official post-UNRRA relief, exports to a value of $20 million. The combined figure of $160 million for foreign credits and grants compares with a figure of $601 million in 1947.

As a result of the foreign grants and credits made available in 1948, the earned additions to our international cash reserves will be substantially less than our current account surplus. On the other hand, we ourselves borrowed $150 million in the private capital market in the United States through the issue of 3 per cent 15 years debentures, and these funds have, of course, augmented our U.S. dollar holdings.

When I last spoke to you, the main problem of policy confronting the Government, as I stressed at the time, was to achieve a large current account surplus. Now the main problem of policy for the Government in this field is to decide what disposition to make of the current account surplus which is being realized.

There are, broadly speaking, three rival claimants on our current account surplus. One is our own international cash reserves in the form of gold and U.S. dollars, another is foreign assistance in the form of the credits or grants we may extend to finance exports from Canada, and the third is the additional expenditures on imports and travel which Canadians themselves would wish to make if our present restrictions were relaxed. The use of any part of our surplus for any one of these purposes makes it unavailable for the others. You cannot eat your cake or give it away and have it too.

It may be useful for me to analyze some of the considerations involved, without however coming to any conclusions on matters which are essentially issues of government policy. I take as my starting point the import and other restrictions as the problems here are in some way the simplest. Two main reasons can be put forward for removing them. In the first place, any restriction is tiresome and better eliminated than maintained unless it serves a really necessary purpose. In the second place, the increased imports which we would obtain if the restrictions were relaxed would enable Canadians to enjoy a higher standard of living than would otherwise be possible; for more goods would be available from the outside world without our sending any more abroad. The effect on the country would be the same as on an individual who decides to save less. One consequence of a decision by Canada to save less internationally would be to ease the pressure on domestic prices. This would result from there being more goods for people to spend their money on. In view of the importance of inflation among our current domestic problems, this advantage is a very important one.

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The extent to which the surplus in our balance of payments would be reduced by relaxations of the present restrictions would, of course, depend upon the nature of the relaxations introduced. The government has already introduced some relaxations, notably as regards imports of fresh fruits and vegetables, and indicated its intention of proceeding further along the same line as the exchange position warrants.

Two major considerations can be put forward on the negative side of this question of removal of import and other exchange restrictions. One is that our import restrictions are now operating in such a way as to encourage imports from the United Kingdom and most Western European countries, while restricting imports of similar goods from the United States. The quotas are set up on the basis of pre-war imports, and still leave ample margin for the United Kingdom and the war-shattered countries of Europe to increase their exports, while at the same time cutting drastically into imports of similar goods from the United States. Abolition of the quotas would of course remove the advantage now enjoyed by the United Kingdom and other European countries, and they would have to market their goods in Canada on a strictly competitive basis with the United States. Over any long period of time it would, of course, be contrary to Canada's interests to obtain its foreign supplies on anything but a competitive basis. However, it could be argued that if the lack of competitive capacity in Europe is due to temporary causes which will disappear as the countries concerned get on their feet, there continues to be a case for our lending a hand in giving special encouragement to imports from the U.K. and Europe.

The second major consideration which could be brought forward on the negative side of this question of relaxing exchange restrictions is the very broad problem whether the present unsettled state of the world makes this the appropriate time for Canada to take action to reduce her balance of payments surplus, bearing in mind that this must inevitably diminish our capacity to extend assistance in European reconstruction or to strengthen our own international reserve position.

On the question of foreign assistance the Canadian record to date will bear comparison with that of any country without exception. Expressed in terms of dollars per head of population, or in terms of percentage of income, the Canadian contribution to world reconstruction from the end of the war to date will be found to be much higher than that of any other country. This is not to say that it has been higher than it should have been. After all, we have an enormous amount at stake in the economic revival of Europe.

During the past six months when, to get our own financial house in order, our financial assistance to Europe has been reduced to amounts much smaller than those we previously made available, the United States has come forward with a new plan of financial assistance on an enormous scale. The E.R.P. is one of those bold imaginative initiatives of which the United States has so frequently shown itself capable at a time of crisis. It has revived the hope that Europe can, with outside assistance, restore herself to international solvency.

Our international cash reserves are, in a sense, the residual item in which is reflected the positive decisions taken in other directions. Except to the extent that credit which we extend is used to buy goods in Canada which we would not be able to sell for cash, every dollar of credit we extend comes out of our reserves. These reserves, moreover, bear all the risks of any misfortune that may befall our export industries and of any unexpected increases in our imports. A country like Canada which exports mainly primary products is subject to sudden vicissitudes in the balance of payments. To stay on a fairly even keel and be able to meet temporary adversity without undue strains, we should have reserves large enough so that we can expend substantial amounts without getting down to the iron ration which we wish to maintain against war or the most serious emergency.

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There is no formula, scientific or magic, which can be used to determine what is an adequate level of reserves for a country in Canada's position. Certainly the level of $500 million to which our reserves fell at the end of 1947 was very far from adequate - it was closer to the iron ration. One's views regarding an appropriate level of reserves will naturally vary in accordance with one's attitude towards the economic situation at home and abroad, and the bearing of this situation on the prospective balance of payments. So far as our domestic situation is concerned, the general outlook seems quite favorable. Our industries are efficient and fully employed; our crop situation - always an uncertain factor - has been reasonably satisfactory. Most important, we have in recent years been devoting a very large proportion of our output to improving and adding to our capital equipment. These additions to plants should soon be yielding their fruit in expanded output. One favourable factor worthy of special note is the recent oil discoveries in Alberta which will reduce our dependence on American supplies of this essential commodity.

Taking it all in all, if one were concerned only with the domestic factors in our situation one might not be too dissatisfied with the level of reserves we are likely to attain at the end of 1948. It is the external factors which give the greatest cause for anxiety and which induce one to adopt a more cautious attitude. The anxiety relates to the continued ability over a long period of time of our European customers to continue the present scale of cash purchases in Canada. At the present time their purchases in Canada are bolstered by E.C.A. funds. E.C.A. authorizations for purchase in Canada up to November 8, 1948 amounted to nearly $400 million, or one sixth of total E.C.A. authorizations. Well over three-quarters of this amount was on behalf of the U.K. It should be carefully noted that these off-shore procurements in Canada have not enabled Canada to sell more to the U.K. and other E.R.P. countries than we had sold in the past. On the contrary the value of our exports to the sterling area and other E.R.P. countries will probably be over $100 million less in 1948 than in 1947. Nor has E.C.A. resulted in our collecting substantially larger amounts of U.S. dollars from the E.R.P. countries than we had been doing. What E.C.A. has done is to enable us to continue much the same outflow of exports of essential goods vitally required for European recovery and to obtain much the same U.S. dollar receipts from these countries as hitherto.

In thinking of the future one wonders, however, whether we shall be able to continue the present level of cash exports to Europe. The United States will naturally wish to make progressive and substantial reductions in the E.C.A. appropriations. Moreover, as surpluses appear in United States production of various agricultural commodities the relative ease of off-shore procurements in Canada may be curtailed. The question then will be whether the E.R.P. countries will have so restored their productive and competitive capacity that they can earn enough dollars to maintain something approaching their present level of purchases in Canada. This, for Canada, is the $64 question. And, as in the case of so many of the prize questions I have raised today, I do not know the answer. As usual there are reasons for encouragement and reasons for hesitation. The encouragement is to be found in the restoration of production of the European countries, in the successful efforts made by some of them, notably the United Kingdom, to increase their exports, and in the far-sighted and open-handed assistance being extended by the United States. Hesitation is induced by the tense international political situation which threatens to divert resources to an increasing extent away from the tasks of economic recovery, and by contemplation of the length of the road still to be travelled before the E.R.P. countries can balance their international accounts, and especially their dollar accounts, at a high level without special outside assistance. Some of the policies currently being followed by some E.R.P. countries, indeed, make one wonder whether they have not themselves reached the conclusion that, after the period of special assistance, they will only be able to balance their dollar accounts at a low level and this by restricting

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dollar imports to the lowest possible amount while developing their trade with each other and with other non-dollar countries. At the present time many of the E.R.P. countries are discriminating against imports from the Western Hemisphere in order to economize in their use of dollars. As the dollar deficits are, in a sense, covered by E.C.A. appropriations, these policies reduce the burden on the U.S. Treasury and are not discouraged. Indeed, in present circumstances, one cannot be too strenuous in one's comments. But the danger in these policies, which we might as well recognize, is that the countries concerned, as part of a programme of economizing dollar outlays, may impair their own capacity to earn dollars. They will do this if they establish special techniques for trading with each other at high prices without having to face the competition of efficient producers in Canada and the United States. Exports by the countries forming this system to each other will be easier than exports to the Western Hemisphere. In the long run, I think such a system would break down. There are no continuing rewards for high cost production. But it could delay world economic recovery by concealing the need to raise levels of productivity in countries where they are below the standards needed to meet world competition at home and abroad. And in the meantime, the restrictions and discriminations involved could impose severe burdens on Canada which continues to rely to a considerable extent on having a surplus of exports to the United Kingdom and Western Europe and using the proceeds of that surplus to pay for a surplus of imports from the United States.

I believe that what this general line of thought adds up to, so far as Canada is concerned, is the need for caution in projecting too far forward the relatively favorable position which we have developed in the past year. And it suggests too that we would be well advised to take advantage of the present breathing spell to try to achieve a better balance in our direct bilateral transactions with the United States.

I have come now to the end of what I have to say. I realize that this lecture has been much less positive in tone and less definite in its conclusions than the one I gave here a year ago. This is no accident. A year ago Canada was up against a concrete problem which to a considerable extent we had in our own hands to deal with - we had to bring the decline in our international reserves to an end and build them up again. To do this we had to have a large current account balance of payments surplus. This mission has been successfully accomplished and this year the problems confronting us do not have the same desperate urgency - our reserve position has been considerably improved. But our present problems are more complex and therefore more difficult. They involve economic and political decisions of great importance. The answers are not to be found in the back of the book and I cannot tell you what they are. Both you and I will have to be satisfied if I have managed, at any rate, to indicate to you what some of the problems are.

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