CANADA

STATEMENTS AND SPEECHES

INFORMATION DIVISION
DEPARTMENT OF EXTERNAL AFFAIRS
OTTAWA - CANADA

No. 60/15

POLICY FOR 1960

A Speech of Mr. Donald Fleming, Minister of Finance, to the Canadian Club of Toronto January 11, 1960.

... It is inevitable that at the commencement of a new year our thoughts are divided between retrospect and prospect. Today we stand at the threshold not only of a new year but of a new decade. We are prompted on that account to see both 1959 and 1960 in a larger setting. History is continuous. Neither the years nor the decades are detached from each other. This is not the occasion to attempt a review of the decade that has just closed. Indeed, there is no time today for that purpose. All of us will, however, look back on the fifties as a momentous decade in our lives and in the life of our country.

We have good reason to remember 1959 as an important year in Canada's history. When I addressed you a year ago we were concerned with the aftermath of recession, with the strength and pace of recovery, with something of an economic paradox, namely, the co-existence of an abnormal degree of unemployment and an inflationary potential which was giving rise to an exaggerated anxiety psychosis.

Fears Unfounded

In retrospect, it is now apparent that many of the uncertainties and apprehensions of a year ago were unwarranted. The year just ended was one of vigorous and healthy growth for the Canadian economy. In 1958, recession gave way to recovery. In 1959, recovery yielded to the powerful forward thrust to expansion. The past year was not without its financial strains. High interest rates and credit stringency accompanied and reflected the extraordinary acceleration in business activity. Difficult decisions in the fields of fiscal and monetary policy had to be made in the cause of steady, rather than explosive and inflationary, progress. But 1959, I believe, stands on record as a year in which the dominant theme was one of expanding output and employment, with real gains in productivity and more price stability. In this pattern lies the foundation for achieving sound and sustainable economic growth in the future. In contrast to a year ago, our concern today is not with whether we will continue to grow, but with that kind of growth we wish and will have.

The gratifying progress which took place in the Canadian economy in 1959 cannot be divorced from the perspective of certain significant developments outside our borders. The environment of the free world economy, particularly in the industrialized countries, was one of general improvement and expansion. The United Kingdom and Western Europe achieved significant progress to which hard work, self-discipline and financial statesmanship made an impressive contribution. Recovery abroad was characterized by control of inflation, currency stability and a striking improvement in reserve positions which made possible a greater degree of currency convertibility and the removal of most financial discriminations against imports from dollar countries.

The strengthened international financial structure, developments in European trading arrangements, and the improved outlook in the free world economy hold significant implications for Canada; as a trading nation and as a nation chronically short of capital. The world economy today is not only steadily expanding; it is increasingly competitive.

U.S. Economy

Events in the United States have, of course, an important bearing on our Canadian experience. On the whole, the United States economy has displayed great vigour in 1959. Production, income, spending, capital investment and other indices have all exceeded previous peaks. Expansion has been accompanied by certain financial problems in the United States, just as it has in Canada and is beginning to in Europe. But there is no evidence in the United States, just as there is none in Canada, that these developments are interfering with the process of economic growth. The deterioration in the United States balance of payments position, from a short-term viewpoint, has not been altogether unhealthy or unconstructive. Indeed, the flow of gold and dollars to other countries encouraged and underpinned the welcome moves to currency convertibility and the reduction of discrimination. Nevertheless, any long-continued drain on American gold reserves of the degree witnessed in 1959 would raise some serious implications.

The rate of progress was interrupted in the second half of the year by the steel strike which had adverse effects on production and employment. However, it is reassuring to find the consensus among qualified observers in the United States is that economic expansion there has already resumed and that 1960 will be a year of substantial further growth.

The recovery in Canada, which began in mid-1958, moved forward strongly throughout 1959. Gross National Product, seasonally adjusted, reached an annual level of $34,724 million in the third quarter of 1959, a new and impressive record for the most comprehensive indicator of business activity. Economic growth has been measured largely in the real terms of productivity and a sound dollar. If the economy paused briefly in the third quarter partly in response to the uncertainties engendered by the steel strike, it appears to have resumed its upward momentum in the months since. In my Budget Speech on April 9 last, I forecast that the G.N.P. would increase in 1959 as a whole by 7 per cent over the previous year. I see no reason to doubt that this result will have been achieved. In shaping the quality of this growth, I think it fair to say that fiscal adjustments to the circumstances of an expanding economy and the restraint of federal demands upon the capital market for new money played a vital part. Certainly in the choices we made in the Budget we did not impede or hamper the forces of expansion. As we face 1960 those forces continue strong.

A Prosperous Year

In brief, therefore, 1959 was a good year for Canada. It was a year of growing confidence, rising employment and recovery moving into a broad expansion — moving, indeed, to such an extent that it brought financial strains with it. Internationally, it will be remembered as a year of relaxation of tension when talks replaced threats. It will also be remembered as a year of tremendous economic recovery in Western Europe and Japan and consequent sharpening of competition.

I have been speaking of the fifties as a momentous decade. The 1960 scene opens in Canada on an economy which is much more mature and more developed than that of 1950. We cannot, however, spend long in contemplation of the past. We cannot relive it, we cannot undo it. We contemplate it in order to derive instruction from its successes and failures, to profit from the lessons to be learned from it.

During the decade just ended, Canada has enjoyed substantial growth. Gross National Product has almost doubled from $18 billion in 1950 to nearly $35 billion in 1959. However, to a considerable degree this progress has been associated with unstable elements in the economy, over a quarter of the gain has been consumed by price increases, and the lustre of our prosperity has been somewhat tarnished by two recessionary cycles. Too often we have been tempted to pursue too rapid a rate of growth with too little regard for the inevitable consequences and inequities.

A New Decade

For the Canadian economy, the new decade of the sixties opens in an expansionary phase, one that gives promise of being more securely founded in terms of demand, resources and productivity. 1960 offers the prospect of continued sustainable growth provided we are prepared to pay heed to the lessons of the fifties. New elements bid fair to come forward to lift the economy to new heights, chief among them export demand and capital investment.

The level of Canadian exports is rising. The international economic climate is expansive, many of the war-born impediments to trade are vanishing, and the rising reliance in the United States and other major countries of the free world upon external suppliers of industrial materials holds important potential for Canadian exports so long as they can remain competitive.

Private surveys of capital investment intentions suggest that the plans of the business community for 1960 contemplate an accelerated rate of investment in the commercial and industrial sector of the economy. While there may be some reduction in residential construction, increases in investment in plant and equipment are likely to more than offset them and in the aggregate there seems to be a clear indication that total investment, both private and public, will reach new records in the coming year.

The continued increase in exports and capital outlays suggests that 1960 will be a year of rising output and employment which will see a more efficient and fuller use of the productive resources of the economy than 1959. Correspondingly, it can be expected that the trends of income and consumption will continue to move upward with output and employment.

In summary, it would appear that a production increase of substantial magnitude can occur in 1960 without placing excessive pressure on plant and man-power capacities.

There are the prospects. These are the potential of the Canadian economy. The promise of further enlargement of national production, incomes and employment should not, however, blind us to the fact that continuous progress throughout this year and beyond it is not inevitable. We cannot assume the assurance of a higher national income year after year unless we take steps to ensure that the expansion is orderly and balanced. There have been years, even in the postwar period, when the real rate of growth in Canada was considerably less than the economy was capable of achieving. If we are to have continuous and sustained improvement in production, and thus in our standard of living, we must employ all the collective intelligence and discipline which we possess to prevent unnecessary interruptions in the progress of the economy.

One thing has been made abundantly clear in the past decade. It is that the Canadian people are firmly determined to preserve the system of free enterprise. It is under that system that the prosperity and growth of this country have been achieved. It is that system which provides the maximum of security, combined with freedom and opportunity. It is not the perfect system, it is just the best system. Its corollary is that governments should not attempt to do for people what they can better do for themselves.

<u>Three Dangers</u>

In harmony with the note which I have sounded that uninterrupted progress for the indefinite future is not inevitable, I discern three dangers confronting the Canadian economy, namely, instability, inflation, and high costs. Each of these dangers is related to the other two.

We are so dependent upon foreign trade, and so closely linked in many ways with the fortunes of the United States and our other trading partners that we are bound to be affected, for good or ill, by the swings of economic activity originating outside our own borders. Then, too, in a dynamic economy such as ours, technological changes, variations in demand at home and abroad for particular goods and services, and errors in judgment on the part of those whose business it is to try to anticipate these changing demands, all serve to produce fluctuations in economic activity from year to year, and sometimes to interrupt our progress.

But the kind of instability that we have to fight against is a more serious one. I refer to the instability which arises when a condition of greatly increased demand develops over a wide area of the economy, usually based upon the use of credit, and which threatens to outrun the productive capacity of the economy. This is the kind of situation which causes inflation and recession. It was present to a considerable degree in North America in 1955 and 1956 and in fact is a condition which can easily develop in a dynamic economy, particularly if prices and costs are rising, or if it widely believed that costs and prices are likely to rise. As we know from experience, if these conditions are allowed to develop it is usually impossible to apply the brakes without bringing about economic dislocation and recession, with all that this means in terms of wasted resources and unemployment.

The fact is that a condition of steadily-rising price-levels is not conducive to sustaining the growth of the economy. It is a dangerous temporary stimulant, and no more. We have seen that the very impressive expansion of production and living standards which the countries of Western Europe have begun to achieve in the last few years was not able to gather momentum until they had achieved price and currency stability.

The lesson we should draw from experience is that in a period of economic expansion such as we are now enjoying in Canada we must all avoid doing those things which are likely to encourage a forced or excessive growth in spending. If we fail to act in this way we will be faced with the distortions and instabilities which cause economic recessions. We all know that if an upsurge in the total spending in a country proceeds too rapidly, and in too many directions, in too short a time, prices and costs are bound to be pushed up. In such a situation those who speculate, or who can operate on the basis of increased borrowings, tend to be rewarded, while normal business suffers. All too often, we find that the economy has accumulated swollen inventories and built more plant capacity than we need for the time being. So production is curtailed, or shut down, workers are dropped from the payroll, and almost every other business finds it necessary to go slowly for a year or two. If price inflation becomes very marked, or continues for very long, confidence in the value of fixed interest-bearing securities is likely to be undermined, thereby discouraging saving. When this happens the more productive and dependable forms of enterprise was unable to obtain capital and the whole economy is weakened.

Wide economic fluctuations, whether upward of downward, produce very harmful effects. We must seek to spare Canada the experience of "boom--bust". Excessive fluctuations create fear and disturb confidence in the future.

Inflation has accompanied economic growth in Canada in the postwar period. This has given rise to an erroneous belief in the minds of some that a measure of inflation is necessary to stimulate growth. This is a fallacy of the deepest dye. Growth in this postwar period has been achieved in spite of and not in consequence of the measure of inflation which has accompanied it. I believe that inflation is an evil in any of its forms. I believe also that it cannot be overcome by governments alone. It will be vanquished only by the efforts of all.

Buyers' Market

I have spoken of the first two of the dangers which confront us, namely, instability and inflation. The third is very closely related to them. It is the danger of rising costs. Canada cannot insulate its economy from the rest of the world. We are the fifth trading nation of the world. Twenty per cent of our national production is disposed of in external markets. We must be aware that we have moved into a period of the keenest international trading competition. This is the inevitable consequence of the sweeping economic recovery of Europe and the enlargement of the resources of Asia. The Communist bloc, with the possibility of dumping of goods in international markets without regard to the cost of production, confronts us with a new and disturbing form of competition. The scarcity of goods in the earlier postwar years has disappeared. The sellers' market is a thing of the past. The buyers' market is here and is likely to continue as far as one can see.

Trading associations are taking form in Western Europe, in countries which today absorb $1.25 billion worth of our exports per annum. We must be alert to resist the possibility of new discriminations arising in that quarter.

In the light of all of these circumstances, the warning to Canadian producers is clear: keep your costs down, or you will price yourselves out of world markets. At the same time you may price yourselves out of Canadian markets. All Canadians, whether directly engaged in production or not, have a direct interest in preventing the loss of markets through high costs of production.

Particularly at this juncture it is to be hoped that Canadians will enjoy industrial peace and co-operation. In the face of developments abroad, this is a time to avoid the supreme folly and waste of resources in industrial strife and work stoppages.

Policy During Expansion

This review of the bright prospects for 1960 and the lurking dangers which are inseparable from it leads me to ask what are the appropriate economic policies for the year which lies ahead of us? What useful part can Government fiscal policy play in the development of the economy? How may it be employed to make the fullest use of the enterprise of all Canadians for the good of all, to promote stability in the economy, to resist the perils of inflation and to help the competitive position of Canadian producers in world markets?

Admittedly public policies have their limitations. Governments are not omnipotent. Although they are expected to do much, they cannot do everything. In a free society where the laws of supply and demand are still the most dominant of all economic forces, how may fiscal policy be employed to aid in achieving the accepted economic goals of that society?

The experience of the last two and a half years has taught us that in a period when economic conditions are changing rapidly fiscal policy must be flexible. It must be adapted as far as possible to changing conditions. It is not easy to alter fiscal policy to keep fully abreast of conditions when they are undergoing rapid or frequent change. So much of government fiscal policy must express itself annually in the Budget measures. Adaptations between budgets are not possible on a large scale. This fact adds to the importance and responsibility of the Budget and the accuracy of the economic forecasts on which it is based.

In the last several years we have seen practically every kind of economic trend expressed in the Canadian economy. It has been necessary to adapt fiscal policy from time to time accordingly. The policy which guided the Budget of 1959 was not the same as that which governed the Budget of 1958. The conditions of 1960 are different from those of either 1958 or 1959. What then is the sound fiscal policy to meet the conditions of 1960?

Why Deficits?

I have on other occasions in recent months reviewed the sound reasons why we deliberately budgeted in 1958 for a substantial deficit and in 1959 for a reduced deficit. Each of these programmes was adapted to the circumstances then confronting us. Two years ago we were meeting the problems of a recession then at its low point, and were seeking to use fiscal measures to offset the decline in business activity and to stimulate recovery. We gave strong support to new housing construction; we increased substantially our own direct expenditures on capital projects; we reduced our own resources to increase those of the provinces and municipalities; we sustained and enlarged the general purchasing power of the Canadian public both by tax reductions and increases in pensions and other welfare payments.

One year ago we were budgeting for a period of recovery. Our problem was to strike a balance. It was not yet a time for a severe application of fiscal restraint, but the situation did require a reduction in the stimulus which government fiscal policies had injected into the economic stream. We took a firm course designed to ward off the perils of inflation and to preserve the purchasing power of the Canadian dollar without retarding the forces of recovery.

In 1960 we have neither recession nor incipient recovery. We are in the midst of a period of marked expansion in the Canadian economy. We welcome it, but we do not wish to see it mushroom into a boom which would set loose the forces in inflation. What we must all desire is orderly growth without inflation. That must be the goal of policy in this year of expansion 1960.

To this end our aim, as I have stated in recent utterances, will be to avoid expenditures that are not strictly necessary now and to bring government revenues and expenditures into better balance. In this way we are deliberately seeking to assist the provinces, municipalities and business in meeting their borrowing problems by restricting our own federal borrowing operations.

There is always a high degree of interest on the part of the public and in the press at this season of the year as to the trend and volume of government expenditure in the coming year. That interest seems to be particularly evident this year. Some people speak as though it were a simple and easy matter for the Government to make sweeping slashes in expenditure. Let me assure you that it is not.

It is well to remember that the Government's responsibilities do not remain static from year to year. Increases in population necessitate higher expenditures and providing government services at the same level. The cost of most of our social security programmes is on a *per capita* basis, rising automatically with population increases, which have been averaging 400,000 *per annum*. Much of the annual expenditure is already of a statutory nature, thus vastly reducing the area of expenditure which is subject to the pruning handiwork of the Treasury Board. Moreover, there are elements of government expenditure which are related directly to the growth of the national income. Furthermore, we are spending more government money on research, as we should. Our payments, both conditional and unconditional, to the provinces under existing programmes are bound to rise substantially in the coming year. Hopeful as we are for agreed disarmament, it has not yet arrived, and in the meantime the cost of modern arms and equipment for our defence forces is constantly rising, ...

Let me add that I believe very simply that governments must practise what they preach to their people. They must set their faces against waste and search tirelessly for efficiency.

Borrowing, Debt and Interest

The fiscal measures which were taken in 1958 and 1959 were accompanied by far-reaching measures of debt management. I have pointed out on previous occasions that good debt management is essential to the maintenance of the purchasing power of the Canadian dollar and the achievement of sustained national development. It is at the very heart of national thrift and is vital to the realization of the economic goals of a free and competitive society.

The great conversion loan of 1958 achieved an unprecedented success. It proved to be a major anti-inflationary step. It removed a source of heavy pressure on the bond market and by nearly doubling the average length of our debt it enabled us to develop and carry forward a sound debt management policy. It has greatly contributed to the stable growth of the economy in the year just ended.

As the Governor of the Bank of Canada pointed out in a speech on November 16th: "The value of the conversion loan should not be under-estimated. It was the most important single factor in the changed circumstances which made it possible for the net financing requirements of the Government to be raised entirely from non-bank investors after September 1958, and therefore made it possible for monetary expansion to cease and comparative stability to be maintained for a considerable period thereafter".

In the fiscal year which ended March 31st, 1959, the Federal Government borrowed $1,296 million of new money in the market. As I forecast in my Budget, in the present fiscal year new money requirements should be reduced to some $850 million and if account is taken of the decision of the CNR to repay to the Government the proceeds of its public issue of last month, the Federal Government's requirements for new funds will be reduced by a further $300 million. In short, our new market borrowings for the fiscal year ending March 31st, 1960, will be about one-half of our requirements of 1959. Moveover, our new market borrowings in the current fiscal year have all been raised from the savings of the general public, as the Governor noted, and therefore in a non-inflationary manner.

In the last four months the bond market has been stabilized and strengthened and there has been a notable return of confidence. Interest rates, it is true, have been high, but these rates have served to attract investors. The Government's bond offering in September and the CNR bond offering in December were both heavily over-subscribed. The recent 14th Canada Savings Bond campaign attracted the highest volume of subscriptions ever attained in a savings bond campaign -- over $1.4 billion. I am not suggesting that there are no problems in the market, but I draw attention to the solid and constructive improvement evident since September.

Bond Purchases

The return of public confidence has been striking. The public's willingness to purchase government bonds is in the last analysis the best test of its confidence. In 1955 the general public's holdings of Government of Canada securities were about $9 billion; by mid-1958 they had fallen to less than $8 billion. Today the public's holdings of our bonds exceed $10.75 billion, an increase of $2.75 billion in fifteen months. In other words, in fifteen months the public's holdings in Canada Bonds have risen by 35 per cent. Moreover, the public has in the same period increased its holdings of other Canadian securities, whether provincial, municipal or corporate by another billion dollars. This increase is in part a reflection of the more attractive interest rates prevailing, but it also demonstrates unmistakably the growing public confidence in the Government's determination to resist inflationary pressures and to defend the value of our national currency.

The return of confidence in the bond market enabled the chartered banks to finance the enormous demand for commercial credit by the sale of their holdings of Canada Bonds in exchange for new savings of the public. Accordingly they disposed of over $1 billion of Government of Canada Bonds to meet commercial credit requirements which during the first nine months of last year rose by 25 per cent and have remained at a level about 15 per cent higher during the last three months. The extraordinary demand for bank credit arising out of expansion, the heavy selling of government bonds by the banks and the increase in net new borrowings through the sale of securities combined to exert a strong upward pressure on the structure of interest rates in 1959. This was not just a Canadian phenomenon; the United States experienced a similar pressure on credit and a corresponding rise in interest rates.

As we all know, the demand for capital associated with expansion, together with the reluctance of many borrowers to utilize the capital market, placed a heavy strain on the resources of the banking system and in the spring and summer of last year the banks, acting on their own responsibility, were obliged to impose credit restrictions.

The restraints imposed by the chartered banks on the growth of overall total bank credits and their more selective policy of lending appears to have brought about a more orderly situation within the banking system. In the last three months, for various reasons, the banks have not been fully utilizing the funds available to them as a result of their reduced lending activity, and thus both their cash reserves and their overall liquid position have been maintained at levels well above the required ratio.

One consequence of these policies on the part of the banks has been to enable them to re-enter the market as purchasers of government issues. As a result the pressures on the market for short-term bonds and treasury bills have diminished. Interest rates have tended to level off and both of these circumstances have contributed to stability. There is also some reason to hope that the effects of the lending policies of the chartered banks will be to persuade those companies and other bodies able to finance themselves in the capital market to turn to this source of credit for funds for capital expansion. In this respect I wish to commend those corporations which in recent months have been prepared to face the capital market with realism. To the extent that the trend towards a greater use of the capital market develops, more credit should be made available to smaller borrowers within the banking system.

Credit Restrictions

In speaking of the improvement in the technical position in relation to bank credit I should not wish to leave the implication that every borrower is receiving all the credit he seeks. Credit restrictions continue to impose difficulties for certain sections of the economy although there is no evidence that from the overall viewpoint they are interfering with the process of growth. The banks are continuing to be selective in the allocation of credit even though their capacity for lending has improved. Nor can we expect any sharp reversal in this situation. If the industrial and commercial expansion takes the forward surge in the spring and summer of this year that seems likely, it would be only reasonable to expect a recurrence of intense demand for bank credit.

It is clear that expansion places heavy demands upon our capital resources which are not unlimited. It would be unrealistic to assume that changes in the allocation of bank credit or greater use of the long-term capital market by business corporations would make capital as plentiful and interest rates as modest as they tend to be when the economy is not expanding. Let me add one final observation on the subject of interest rates. There are those who contend that a measure of inflation would today bring about a reduction in interest rates. This is another fallacy of the deepest dye. Inflation would tend to decrease total savings and to divert them away from bonds and other forms of investment. The inevitable result of inflation is to force interest rates still higher.

Today there is keen competition in the market place by federal, provincial and municipal governments and business for the not unlimited supply of capital available there. In this situation, the Federal Government can best contribute to facilitating the necessary financial operations of other borrowers by confining its own borrowings to the essential minimum, and that is what the Federal Government is doing. We are seeking deliberately to bring our revenues and expenditures into closer balance in order that we may not find it necessary to make new borrowings. As a consequence, I think that with the continued rise of the levels of income, employment and production, we may look forward to a further substantial improvement in our overall cash requirements. And thus we may hope that the market will be more and more left to the provincial and municipal governments and business.

In this connection it is our expectation that the increase in the ceiling on the interest on loans under the National Housing Act from 6 to 6.75 per cent will result in a re-entry of the approved lending institutions on a considerable scale into the mortgage field under the National Housing Act. This will both support house-building activity in Canada and relieve pressure on government financing.

Canadian Dollar Premium

The current high premium on the Canadian dollar has given rise to further questions recently. I have dealt with this subject previously, but perhaps a more extended reference to the subject today is warranted. Let me stress at the outset that responsibility for exchange policy rests solely with the Government. The Bank of Canada in this regard acts only as the Government's agent.

In 1950 Canada stopped pegging the rate of exchange of the Canadian dollar and in 1951 abandoned foreign-exchange control. From that time to this the value of the Canadian dollar in relation to the United States dollar and other currencies has been determined not by the Government but by the forces of supply and demand operating in a free market. Since 1952 the Canadian dollar has been ruling at a premium in terms of the United States dollar. At first this was a matter for pride on the part of Canadians. It has for some time been and is a matter for concern. The premium has fluctuated, rising to 6.25 cents in 1957. Currently it is under 5 per cent. It adds to the difficulties of our exporters and our gold-mining industry; it has the effect of reducing tariff protection for Canadian producers and expanding our imports by making them cheaper.

It is regrettable that there is an element of misunderstanding prevalent as to the premium and its causes. This is illustrated in demands made from time to time for what is called "restoration of parity" between the United States dollar and the Canadian dollar.

No Reason for Parity

Permit me to observe in the first place that there is no existing reason why there should be parity between them. Each dollar is a form of managed currency, and the management of the two currencies is in different hands. The fact that they happen to bear the same name constitutes no reason for any precise equality between them.

In the second place, the exchange rate of the Canadian dollar is determined in an absolutely free market. Its value is not arbitrarily fixed by the Government but results from the free play of economic forces, that is to say, the laws of supply and demand.

Why is the Canadian dollar ruling at a premium in terms of the United States dollar? Let us examine this question in simple terms. Whenever anyone, whether in Canada or the United States or any other country seeks to buy United States dollars with Canadian dollars he is helping to create a demand for United States dollars. This demand arises from our merchandise imports, from our tourist expenditures abroad, from transfers of interest and dividends, from purchases of securities and other assets. Similarly anyone seeking to buy Canadian dollars with United States dollars or other foreign exchange is creating a demand for Canadian dollars. This demand for Canadian dollars arises from our merchandise exports, from foreign tourist expenditures in Canada, from foreign purchases of Canadian securities and from a whole host of other transfers of funds from foreign countries to Canada. Basically the exchange rate for the Canadian dollar is determined by the variations in the demand for Canadian dollars on the foreign exchange market and the supply of Canadian dollars on that market resulting from the millions of individual transactions of the type I have described. The effect of Canada's very large deficit in its commodity trade and other current account transactions tends to raise the value of the United States dollar in relation to the Canadian dollar. Indeed, the larger the trade deficit the stronger is the upward pressure on the United States dollar as compared with the Canadian.

But other things are not equal or static. Many persons in the United States and other countries abroad are choosing to invest in Canada. In order to make their investments they must purchase Canadian dollars with United States dollars or other foreign exchange. This creates a demand for Canadian dollars and an upward pressure on the value of the Canadian dollar in relation to the United States dollar. The volume of demand by holders of United States dollars and other foreign exchange for Canadian dollars for investment and other purposes has tended to outrun the volume of demand for foreign exchange for settlement of trade deficits and other purposes. The consequence is the substantial premium on the Canadian dollar.

In the net result the premium is a result of the operation of the forces of supply and demand in a free market. Our dollar has a higher value than the United States dollar because holders of so many United States dollars wish to exchange them for Canadian dollars, particularly for investment in Canada, and they wish to invest in Canada because they have confidence in our country and its financial soundness and are attracted by the returns paid on capital in Canada, for ours is a country chronically short of capital.

The next question that is asked, and properly, is cannot the Canadian Government intervene to eliminate or reduce the present premium? The answer is - "yes, but".

In the first place, the Canadian Government could take steps to shut out or discourage capital from abroad or it could follow policies that would disturb external confidence in Canada and its financial soundness. It could, for example, follow inflationary policies. Would anyone advocate this?

In the second place, it could take steps to increase the deficit in our commodity trade with the United States. I have heard no support for such a proposal.

In the third place, it could ask Parliament to reimpose foreign exchange control as in wartime, and thus prevent purchases and sales by Canadians or United States dollars except under permit. It could, for example, refuse to grant licenses for the import of capital or certain types of capital. This course of action would, however, not be consistent with the desire of Canadians, which is shared by free peoples generally, to move away from controls of this kind as their economic strength grows.

Cost of Enforced Parity

In the fourth place, the Government could employ Canadian dollars belonging to the people of Canada to buy and hold United States dollars in order to create an artificially high value for the United States dollar expressed in terms of the Canadian dollar. No one knows how many Canadian dollars would be required. But it would be a huge sum. It would be necessary to raise the money by increased borrowing or taxation. If the two currencies were brought to a quoted equality at any given moment as the result of such artificial measures they could not be expected of their own accord to continue in that equal relationship. No one knows how many more dollars would be required to maintain equality between them. The Minister of Finance would be placed in the position of taxing the Canadian people or borrowing on the market to provide Canadian dollars which he would then convert into huge holdings in United States dollars. This is not a use of the money of the Canadian taxpayers which I would be prepared to recommend to my colleagues.

In the Exchange Fund today the Minister of Finance holds approximately $1.9 billion -- about half in gold and half in United States notes and treasury bills. This Fund has for years been employed merely to eliminate wide fluctuations in exchange quotations in the two currencies from day to day, not to influence the long-term trend in exchange rates. The sums required for this modest purpose leave no doubt as to the huge sums which would be required to raise the United States dollar today to equality with the Canadian dollar and to hold it there indefinitely artificially.

In the fifth place, it has been suggested that the Canadian Government could reduce or eliminate the premium on the Canadian dollar by increasing the price it pays for gold. The price the Government pays for gold is now determined by taking the world price of gold, namely $35(U.S.) an ounce and converting this into Canadian dollars at the current rate of exchange. Let us consider for a moment the consequences of an artificial increase in the price paid by the Government of Canada for gold. If a higher price were paid only to Canadian gold producers, this would have no immediate consequences on the exchange rate for the Canadian dollar. It would in effect be an increase in the subsidy on gold production over that which Parliament has authorized through the Emergency Gold Mining Assistance Act. To limit the payment of the increased price to Canadian-produced gold it would, of course, be necessary to prohibit the import of gold from outside Canada. However, if it is desired to influence the exchange rate by arbitrarily raising the price we pay for gold, then we must be prepared to pay the higher price to foreign gold. By offering a higher price in Canadian dollar terms than gold was really worth at the current exchange rate, we would certainly attract gold from the four corners of the earth. Anyone holding gold which he wanted to convert into United States dollars would sell it to us at the artificially high price and convert the Canadian dollar proceeds into United States dollars. This process would, of course, soon result in a fall in the value of the Canadian dollar to the level determined by the relationship between the arbitrarily fixed price of gold in Canada and the world price of $35 an ounce. In other words this proposal turns out, on analysis, to be a proposal that the Government of Canada should arbitrarily determine what the exchange rate should be from day to day or week to week by fixing the price it is prepared to pay for gold and standing ready to buy unlimited quantities of gold at that price. The Government does not seek any such arbitrary power. And I point out, moreover, that the procedure suggested would require us to use Canadian dollars raised from the Canadian people by taxation or by new borrowing for the purpose of adding to our reserves of gold.

These are five courses that are open to the Government. Notwithstanding long personal study of the problem I know of no others. I dislike the present high premium and I am well aware of the losses that it causes for some business interests. But I have been forced, reluctantly, to the conclusion that the disadvantages of the alternatives open to us outweigh the disadvantages of the premium.

It follows from the description I have given of the factors operating in the exchange market that borrowings in the United States by provincial and municipal governments and business have the effect of raising the premium. The sums they raise in United States dollars must be converted into Canadian dollars for use in Canada.

I may add that the premier of one province, which depends to a large extent on exports of its raw materials, recently asked the Federal Government to wave a magic wand and eliminate the premium on the Canadian dollar. I informed him that, as Minister of Finance, I am already holding about $1 billion United States dollars. He offered to buy them from me. When I asked at what price he immediately stipulated for a 10 per cent discount on the United States dollar. Consistency, what a gem thou art! I declined to take responsibility for driving up the premium on the Canadian dollar by accepting his terms.

The course of the exchange rate in the future will depend, as in the past, on the behaviour of the inward and outward movement of capital as well as on the course of our commodity service imports and exports. It will be symptomatic of internal and external conditions affecting the Canadian economy. It is not, therefore, something which is susceptible to restriction or control by the Government, short of the complete and direct kind of control which was applied in wartime. The exchange value of the Canadian dollar would certainly be much lower than it is today if external investors lost confidence in the future of the economy, or if Canada were thought to be on the road to inflation, or if our exports were to lose ground in competing for markets abroad, of if our domestic manufacturers became unable to meet the normal competition of imports. I hope the Canadian dollar will never lose any of its exchange value for these reasons.

Foreign Capital Investment

Foreign capital investment in Canada is, as I have indicated, responsible for the existing high premium on the Canadian dollar. It also gives some Canadians concern over the extent of foreign ownership and control of Canadian resources and industry or, alternatively, the extent of Canadian indebtedness to foreign countries.

Capital inflow into Canada in 1959 has undoubtedly again exceeded $1 billion, and 80 per cent of it came from the United States.

Beyond question the rapid development of our resources has been greatly aided by investment of capital from abroad. Until Canada generates far more capital than at present it will continue to need capital from abroad, unless we were prepared to be content with a much slower rate of development of our resources. The Canadian Government will continue to maintain a climate hospitable to investment of capital from abroad.

Most countries of the world today are suffering from a shortage of capital. Canada has always been an importer of capital. It is by far the largest importer of capital in all the world. Our Canadian economy has been absorbing capital on a scale rarely matched in the world's history. Gross public and private investment has been maintained at 26 per cent of Gross National Product, compared with approximately 18 per cent in the United States. Canadian domestic saving, including provision for depreciation, has been running at over 20 per cent of Gross National Product. This saving rate is higher than that in the United States and many other countries. If the Canadian economy is to continue to absorb capital on the same scale we must have either a still higher rate of domestic saving or a continued high rate of importation of capital.

Home-made Capital Needed

It therefore behoves us to endeavour to the utmost of our power to generate capital within Canada. That means that we shall need more saving by Canadians and the marshalling of their savings into capital and the wise investment thereof in Canada. The policies of government will continue to be designed to encourage the creation of more Canadian capital as the key to some of our most pressing national problems.

The suggestion for increased saving on the part of individuals is based not only on the greater security which saving brings to the persons or families concerned, but on the contribution that saving makes to the growth of our country. As such, it will provide the capital that our industry needs and thus help to increase our productivity and our standards of living in the years ahead. As such, increased saving will lessen the need for foreign borrowing and enable Canadian industry to expand with capital funds contributed by Canadians themselves.

It should not be forgotten that an increase in savings is likely to lead to a greater flow of funds, in one way or another, into new capital investment in Canada. We have had a great improvement in the machinery for collecting and distributing loanable funds in this country over the last few decades and our capital markets are becoming more unified, more inter-related. As a result the temporary or more permanent savings of individuals, private businesses and corporations (not to speak of governments and other public bodies) are easily and quickly made available for capital investment and other similar purposes. The millions of Canadians who put aside their savings in the form of bank accounts, insurance policies, pension funds and the like are contributing in this way to the growth of Canada. The further encouragement of this practice should occupy a high position on our list of priorities.

This country owes much in its history and development to the virtues of thrift and hard work. It is the duty of the Government to assist in the cultivation of the habit of saving. Those who practise thrift are entitled to the reward of the protection of their savings against the ravages of inflation. I shall continue to do all that lies within my power as Minister of Finance to encourage and protect the savings of the people, however small.

People must have confidence in their currency. If they lose that confidence, they will in self-defence either consume their savings or turn to unreasoning speculation.

Conclusion

We stand at the threshold not only of a new year but of a new decade as well. In this decade Canada will attain her one hundredth birthday. Those of us who live to celebrate that historic event will, if the world is given peace, look with pride upon a greater Canada, more developed, more mature, more populous by far than the Canada of 1959. We are privileged to participate in the building of the greater Canada of that bright future. We may be thankful that the days of Canada's building are not only of the past.

1960 should be a year of new growth in almost all sectors of the Canadian economy. If Canadians can hold production costs in line and demonstrate renewed efficiency as producers and salesmen, and if they are prepared to take the self-denying measures needed to resist the lurking dangers of inflation, the present period of expansion could carry the Canadian economy far beyond the high watermarks heretofore attained. With wisdom, courage, self-discipline, self-reliance and forbearance, we can, if given peace, look forward to an era of sustained growth outstripping that of any comparable nation of the world. The message which I should like to convey to Canadians at the threshold of this new year and decade, therefore, is a challenge in simple terms: "Work and Save".

S/A