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CANADA'S INTERNATIONAL FINANCIAL RELATIONS

Notes for Lecture by Mr. L. Rasminsky, Executive Assistant to the Governors of the Bank of Canada, at National Defence College, Kingston, Ontario, January 30, 1948.

I have been asked to talk today about Canada's international financial relations. The subject is obviously a complicated one and in the course of an hour's lecture I can do no more than touch on some of the high spots, but I understand that there will be an opportunity afterwards to develop any particular aspect of the subject in which members of the group are especially interested.

Some of the problems involved in the Canadian international financial position have recently been highlighted as a result of the action which the Government has found it necessary to take to protect our international reserves - action in the form of import restrictions, travel restrictions and various other measures intended to bring about a better balance in our U.S. dollar receipts and expenditures. I do not intend to discuss in any detail these particular measures today, but I hope that what I have to say may throw some light on the developments which made measures of this sort necessary.

I think that the most convenient way for me to start this exposition is by mentioning two or three of the salient features in the Canadian economic background as it existed before the war, then to go on to describe in what way the war changed our international economic and financial position, and finally to come to post-war developments leading up to the present situation.

Before proceeding, however, I should like to pause for a moment to say a little about the terminology which it is convenient to use in the discussion of these matters.

International financial payments and receipts are usually classified as on either current account or on capital account. The most common transactions considered to be on current account are payments and receipts in settlement for goods imported and exported, for transportation, business, tourist and other services rendered by foreigners or to foreigners, for income on capital invested in the country and abroad by residents, and for benevolent remittances to foreigners or from foreigners. The balance of receipts over payments of current items is called the current account balance and is often described as favorable or as a surplus if positive, or as unfavorable or as a deficit if negative. Most other transfers, as for example those arising from purchases and sales of securities or from loans and repayments are considered to be on capital account. The most important feature which capital account transactions have in common is that they alter a country's international indebtedness.

In the immediate pre-war years it was normal for Canada to have a favorable balance on current account. In those years our receipts from abroad on current items exceeded our payments abroad on current items by something of the order of $100/150 millions per year. This surplus on current account went towards reducing Canada's indebtedness to foreign countries or to increasing our holdings of foreign assets, such as foreign exchange or foreign securities. At that time we were (and at present we are) on balance substantially indebted to foreign countries. It is estimated that at the end of 1939 total foreign investments in Canada were of the order of $7,000 million, whereas the Canadian investments abroad were only something like $1,400 million. This heavy investment of foreigners in Canada I shall have occasion to refer to later for it was perhaps the most important reason for the introduction of exchange control at the outbreak of World War II.

The first point about Canada's international financial position is, then, that we are heavily indebted to other countries and that in the years just before World War II we had normally a favorable current account balance which provided us with surplus foreign exchange which was being used to reduce our net international indebtedness.

The second general point in connection with our international transactions to which I wish to refer is their geographical distribution. In particular, before the war we ordinarily had a very large surplus in our current account transactions with the U.K. and Western Europe, and a considerable deficit in our current account transactions with the U.S. This lack of balance arose, of course, out of the economic structure of Canada which in turn is the result of our economic history. The main export products of Canada - such as wheat and other foodstuffs, lumber and base metals - were products of which the U.K. and Western Europe had a deficiency. On the other hand, the goods on which we had a deficiency - such as coal and petroleum, steel and steel products - were goods for which the cheapest and most convenient source of supply was the U.S. Custom and habit and advertising also played their part in making us look to the U.S. to supply us with these things as well as with a wide range of consumer goods. Whatever the reason may have been, it was the case that we sold substantially more goods and services to the U.K. and Western Europe than we bought from them, while on the other hand we bought substantially more goods and services from the U.S. than we sold to that country.

The triangular nature of Canadian trade was of no particular concern to us before the war for we were readily able to convert the surplus sterling and continental currencies which we got as a result of our transactions with those parts of the world into American dollars to pay for our surplus of imports from the U.S. What this means in non-financial terms is that we were paying for imports from the U.S. with exports to the U.K. The international financial system under which this sort of thing can go on is known as the multilateral system. Under such a system each country may follow the obviously advantageous practice of buying in the cheapest market and selling in the dearest without worrying about whether its sales and purchases with any one country are equal. Under a multilateral system all that matters for a country is that its current receipts from all countries should be suitably related to its current payments to all countries. Since multilateralism was more or less the order of the day in the pre-war world and since Canada's overall current account with all countries was, as we have seen, satisfactory, the existence of a substantial current account surplus with the U.K. and a substantial current account deficit with the U.S. was of little consequence to us. However, since the beginning, and particularly since the end of the second World War the existence of this bilateral disequilibrium has proven to be a factor of major consequence in Canada's international financial relations. The reason is, of course, that under the stresses and strains of the war international multilateralism broke down and has not yet been re-established. The result is that Canada, which grew up in a multilateral environment, is now obliged to get along as best it can in a cold cruel bilateral world.

The third main element of a general character in our international economic and financial position is the great importance of international transactions in Canada's economic life. I am sure that this aspect of our position is well known to all of you and all I want to do is to underline it heavily. As compared with countries such as the U.S. or the U.K. a much greater proportion of Canadian energy is devoted to the production of goods for which we are obliged to seek a market outside our own territory. In the same way, a very large proportion of each unit of goods used in this country, whether for consumption or investment purposes, is imported from abroad. Unfortunately it is not easy to measure Canada's dependence on international trade. Attempts to measure it statistically indicate that something of the order of 25% of gross goods and services produced in Canada are sold to non-residents; similarly something like 25% of the goods and services bought by Canadians are produced abroad. By way of comparison a very rough approximation of the comparable figure for the United States would probably be something around 5%.

But this arithmetical measure of the importance of trade to Canada does not tell the whole story. A great part of what we import is both vital to our welfare and could not be produced in Canada except at costs which would be generally regarded as exorbitant. In many cases it is not so much that we lack the natural resources as it is that those resources are for one reason or another very difficult to exploit. This is, for example, the situation for both coal and petroleum. Whatever the reason, it is undoubtedly the case that many of our imports are of such a nature that we should find it extremely difficult to get along without them.

On the other side of the coin, much of what we export we could find no use for in Canada. We produce, for example, much more wheat, newsprint and base metals than we could make any reasonable use of at home. The continued existence of many of our industries in anything like their present form depends on adequate export markets.

All this is by way of emphasizing Canada's dependence on international trade. I do not wish to be taken to mean that any reduction in either our imports or our exports would involve us in serious economic difficulties. What I do suggest is that really large reduction in either imports or exports would bear heavily upon us. It would involve much redistribution of population and much scrapping of plant and equipment with, probably, a good deal of unemployment in the process. And any substantial reduction of our dependence on foreign trade could probably not be achieved without bringing with it an appreciable reduction in our standard of living.

These then are the main background elements in the Canadian position. During the War, Canada by dint of her economic development and her removal from the scene of actual hostilities was able to make a very large net contribution in the form of goods. There is no need for me to dwell on the nature of this contribution which is as well known to you as it is to me. The general object of Canada's foreign economic policy during the war was to make Canadian production available for war purposes on terms which would not result in the enrichment of Canada, or create unmanageable postwar problems which might impede world economic recovery. Problems of international financing during the war arose mainly in connection with our transactions with the U.K. and our other Western European allies. The amount of goods which we were in a position to supply to them and which they were anxious to get from us greatly exceeded the amounts which they could pay for currently in cash obtained either from their direct exports of goods and services to Canada or by drawing on their attenuated reserves of gold and U.S. dollars. The general magnitude of this financing problem during the war was in the neighbourhood of $6,000 millions. This was the net deficiency of

Canadian dollars experienced during the war period by the British Empire and Commonwealth after they had used up all their earnings of Canadian dollars, including as much as approximately $2,600 million resulting from Canada's military expenditures overseas.

This net deficiency of $6,000 million was covered in a variety of ways. At the beginning of the war, we undertook to provide the British with Canadian dollars by redeeming in advance of maturity all outstanding sterling issues of the Dominion Government. In this way, approximately $700 million of Canadian Government securities previously held by the U.K. investors were repatriated and the British put in possession of the counter-value in Canadian dollars. A second technique which was used in 1941 was the accumulation by the Foreign Exchange Control Board of sterling balances. These balances were subsequently converted into a $700 million interest free loan to the British Government with the understanding that any Canadian dollars which the British obtained as a result of the sale by their nationals of Canadian securities in Canada would be applied in reduction of the loan. In this way, the loan has been reduced to about $370 million as at the end of 1947. In 1942 a gift of $1,000 million was made available to the U.K. to assist her in making purchases in Canada and when this was exhausted the Mutual Aid Act was adopted, under which goods to a value of $2,200 million were made available to the sterling area (and a further $200 million to certain Western European countries). Of the total Canadian dollar deficiency of $6,000 million experienced during the war by the sterling area, only approximately $500 million, or less than 10%, was met by payment of cash in the form of gold or U.S. dollars to Canada.

The wartime developments intensified the bilateral unbalance in Canada's international accounts which I referred to earlier. As we developed our production for war purposes, we found it necessary to import larger and larger quantities of goods of all sorts from the U.S. The surplus with the U.K. did not result in American dollars and our need for American dollars was intensified. Accordingly, it became necessary to take special steps to protect our U.S. dollar position.

The first step taken was the establishment of Foreign Exchange Control in Canada and the stabilization of the Canadian exchange rate at the level of 10% discount on U.S. funds. The purpose of the institution of exchange control was to enable us to control capital movements and thus to ensure that panicky liquidation of Canadian investment on the part of foreigners or apprehensive acquisition of foreign assets on the part of Canadians did not intensify the demand on our limited U.S. dollar resources. The rival claims in the form of payment for imports and for servicing of the large foreign investment in Canada were regarded as more important and the institution of Foreign Exchange Control enabled us to make effective a system of priorities in this field. During the first 18 months of war, our foreign exchange reserves were subject to very heavy drains, and it was necessary to place severe restrictions on the use of U.S. dollars. Under the War Exchange Conservation Act of 1940, a whole range of luxury and non-essential goods were prohibited import into Canada, and in the summer of 1940 a complete ban was placed on the use of U.S. funds for pleasure travelling. These measures, drastic though they were, did not stop the decline in our exchange reserves, which at the end of January 1941 reached a low level of $174 million, or only enough to pay for approximately ten weeks imports from the U.S. at the then current rate of import. Fortunately, at that time, we negotiated with the U.S., the Hyde Park Agreement which provided for the manufacture by Canada for sale to the U.S. of a wide range of war materials and war supplies. In the course of the next few years over $1,000 million worth of goods were sold to the U.S. by virtue of this arrangement. The cash we received enabled us to pay cash for our imports of war goods from the U. S. which, incidentally, were substantially in excess of the figure I have mentioned for our sale of war goods under the Hyde Park Agreement. In essence, the Hyde Park Agreement was a mutually advantageous swap of one type of war goods for another between two countries which were the largest net suppliers of war goods to the allied belligerents.

In the years after 1942, there were two rather important developments which arrested the decline in Canada's exchange reserves and which subsequently led to a very considerable increase in our holdings of gold and U.S. dollars. The first of these was the extremely large sales of grain crops, particularly coarse grain, to the U.S. in 1943 and 1944 to make good the deficiency in foodstuffs caused by the drought in the American corn belt in those years. The second was a very large investment of American capital in Canada. This investment took the form of the purchase by Americans of Canadian securities. At first, the interest of American investors was centered on Canadian securities which were payable or optionally payable in U.S. funds. Later, when it came to be felt that we had passed the hump of our exchange difficulties and as Canadian fiscal and price control policies came to receive widespread and on the whole favourable attention in the U.S., American investors developed an appetite for Canadian securities payable in Canadian dollars. To some extent, these investments no doubt reflected an anticipation (subsequently, of course, justified by the event) that the Canadian exchange rate would return to parity. Whatever the reasons may have been, it is the case that in the course of the war Americans added to their holdings of Canadian securities by an amount of roughly $500 million, and we had this cash in the till at the end of the war. In addition, American-owned corporations in Canada ploughed back earnings which could have been taken out in U.S. funds to an amount of approximately $250 million in the course of the war.

The result of all these factors was that Canada emerged from the war with very large reserves of gold and U.S. dollars. At the end of 1945, these amounted to approximately $1,500 million compared with holdings of $400 million at the beginning of the war. It should be noted that this increase in our cash holdings did not represent a genuine improvement of this amount in our whole international position because of the extent to which it resulted from the forms of borrowing to which I have already referred, namely the sales of securities by Canadians to Americans and the re-investment of branch plant earnings in Canada. However, the existence of these large international reserves did give the Canadian Government considerable freedom of action in its international and national economic policy during the first couple of years after the end of the war.

In the field of domestic economic policy, the freedom of action was used to do away, at a relatively early stage, with wartime exchange restrictions. The travel restrictions were relaxed as early as May 1944 and after a year were virtually abolished. The import restrictions were removed in 1944. The exchange rate, as you know, was restored to parity in July 1946 in an effort to protect the Canadian economy from the full impact of the inflationary rise in prices which was developing in the U.S. These measures which were in accord with the Government's policy of orderly de-control were facilitated by the adequacy of our foreign exchange reserves at the war's end.

In the field of international financial policy too, our large cash reserves gave us a considerable freedom of action. I mentioned at the beginning of this lecture that two of the characteristic features of the Canadian economic background are the great importance of foreign trade in our economic life and the high degree of unbalance in our trading relationship with the U.K. and Western Europe. These two background factors have made it an imperative necessity for Canada to contribute in every possible way to the economic reconstruction of the despoiled and distorted economies of the U.K. and Western Europe. For the same reasons it is clearly in our interest to work for the attainment of conditions which would encourage the development of a large volume of international trade on a basis which would not require the bilateral balancing of accounts.

These two objectives, the economic restoration of Europe and the development of liberal trade and currency arrangements, have represented the two main lines of our foreign economic policy since the end of the war. To take the second element first, we worked alongside the U.S. and U.K. in the initial elaboration of plans for an International Monetary Fund and in the subsequent development of that institution. I do not want to take time now to describe the purposes or methods of the Fund, but I will be glad to come back to that in the discussion period if anyone wishes me to do so. In general, however, I may say that the purpose of the Fund is to contribute towards the achievement of a high level of international trade on a multilateral basis by providing the machinery for consultation and collaboration on international monetary problems and by affording countries access to important financial resources which they can use to cover short term disequilibria in their balances of international payments. In general, it may be said that under the conditions towards which the Fund is working it will be possible for a country to use the proceeds of its exports to any part of the world to pay for its imports from any part of the world -- a condition which, as I suggested earlier, is obviously of special value to countries such as Canada whose balance of international payments with different geographical areas is far from equilibrium. Apart from the Fund, we have also collaborated in the development and in the work of the International Bank for Reconstruction and Development and have played a prominent part in the various discussions which are leading to the creation of an International Trade Organization. In general, it might be said that the purpose of all these international institutions is to avoid the worst errors of the past in the field of international economic policies and to establish means whereby each country may seek to attain its economic and social objectives without adopting policies which would make it more difficult for its neighbours to do likewise.

Apart from our participation in those international institutions, Canada has made a very important direct contribution to world economic recovery. This has taken the form of full cooperation and assistance in the relief and rehabilitation activities of UNRRA, of other grants for relief, and of the extension of very large credits to the U.K. and certain other countries of Western Europe. The various relief and rehabilitation grants to date total some $260 million, while the credits authorized to date amount to nearly $1,860 million, of which $1,250 million is to the U.K. For comparison, I may mention that the post-war credits extended by the U.S., whose population is twelve times that of Canada and whose national income is eighteen times that of Canada, amounted, as at the end of October, 1947, to approximately $8,000 millions. The extension of credit by Canada, like the extension of credit by the U.S., was, of course, not an act of altruism but an act of pure self interest. Let me repeat that the Canadian economy is geared to that of Western Europe. If that part of the world can be set afloat again, we can be prosperous in this country on the basis of the existing economic structure. If that part of the world cannot be floated we shall have to make internal adjustments here which involve major shifts in the use of our resources and the distribution of our population. These shifts would be painful in the extreme and would carry with them the implication of a lower standard of living. It is therefore very much in our own interest to extend ourselves to help in the recovery of Europe.

The effort that we have made in this direction has, as you know, resulted in exchange difficulties in Canada. You cannot pay cash for all your purchases and sell a large portion of your exports on credit without drawing down your bank balances, and this is what has been happening to us. The arithmetic of our position is fairly simple. As I mentioned before, we had at the end of 1945 approximately $1,500 million in gold and U.S. dollars. In 1946, we had a current account surplus of $460 million. If all transactions had been on a cash basis and there had been no capital movements, our national reserves would have gone up by $460 million. However, we had exports amounting to nearly $860 million for which we did not receive payment in foreign exchange. Of this $860 million, approximately $110 million represented goods that we gave away through UNRRA and Post-UNRRA relief, and the balance represented goods that were paid for out of credits extended by the Canadian Government. When you subtract $860 million of credit from our current account surplus of $460 million, it is obvious that our current account transactions alone would have resulted in a cash deficiency of $400 million in 1946 and one would have expected to see our reserves fall by that amount. However, our reserves fell by only $250 million in 1946 to a level of $1,250 million. The difference was accounted for by an inflow of capital representing in part further purchases of Canadian securities by Americans and in part a lump sum payment we received from the U.K. in settlement of certain outstanding war claims.

The general pattern of the picture in 1947 is as follows: we started the year with liquid reserves of $1,250 million, the favourable balance on current account largely disappeared as a result of a great expansion in our imports from the U.S. Notwithstanding the fact that we did not have a large favourable balance on current account, we permitted foreign countries to draw on their credits to the extent of approximately $570 million and make further relief grants of about $35 million. Since we paid cash for all our imports and failed to receive cash for some $600 million worth of our exports, our international cash reserves had to decline by this amount less our small current account surplus. In addition to the decline caused by our current transactions we also lost exchange in 1947 as a result of capital movements, the most important of these being our gold contribution of $75 million dollars to the International Monetary Fund and net capital payments in U.S. dollars, due largely to the redemption of Canadian securities held by American investors, to the amount of approximately $140 million. In consequence, our total loss of exchange to the end of November 1947 was approximately $770 Million, and our reserves at that time were only $480 million. This was the situation which impelled the Government to impose the import and travel restrictions and take the other measures announced in the latter part of November with which you are familiar.

I should like to pause here to raise the question of what went wrong. Some loss of reserves was, of course, anticipated when the Government extended the large credits in 1945 and 1946, but obviously it was not expected that the loss would be as severe as turned out to be the case. What are the factors responsible?

Certainly one of the main factors responsible was the extraordinary propensity to import that Canadians have demonstrated under conditions of high income. There had been no previous experience on which to base a judgment of this factor. The conditions which prevailed in 1946 and 1947 were unique in our history. Everyone was fully employed, money incomes were at very high levels. There was a large backlog of wartime savings in the hands of individuals and corporations which had, as its counterpart, a backlog of requirements in the form of durable consumers' goods and capital goods which it had not been possible to obtain in the course of the war. On the other side of the picture, the reconversion of industry proceeded very rapidly in the U.S. in 1946 and 1947 and the products of American industry became available in a most impressive (and I may add, from the narrow distorted point of view of an exchange controller, a most depressing) flow. Our imports from the U.S., which before the war had amounted to approximately $500 million a year, piled up to the large total of $1,400 million in 1946 and the extraordinary high figure of $2,000 million in 1947. Part of these imports consisted of luxury and non-essential goods, including various types of consumers' durable goods, such as automobiles and washing machines, but the bulk consisted of the raw materials for our industries and the materials and machinery and equipment needed in connection with the great expansion in real investment which has been taking place in Canada in the last couple of years. We should, therefore, by no means think of these imports as money thrown down the drain. On the contrary, by far the greater part of these imports have served to strengthen the Canadian economy and lay the ground work for greater productivity and greater production in the future.

Another reason for the worsening of our position as compared with our expectations was the disappointing rate of European recovery. A series of setbacks due to a variety of factors, including severe winters, crop failures and political tensions, prevented the economic recovery of our European customers from proceeding at as rapid a rate as otherwise would have been possible. Apart from these setbacks, however, I think it is the case that, in common with others, we underestimated the magnitude of the real destruction caused by the war, including not only physical destruction but also the disorganization of business enterprise, the loss of business connections, the disappearance of trained skilled personnel, and so on. Perhaps in the summer of 1945, when the European war was ended, we had no right to think that by this time European countries would be further advanced on the road to recovery than they are. If this mistake was made, it was, as I have indicated, a very general one and perhaps an excusable one - after all there was no objective yardstick which could be used to measure the time or effort required to get the war-ravaged economies of Europe back on their feet.

One direct financial effect on Canada of the relative slowness of European recovery was that the credits which we had, in our interest, extended to help float these economies were used up much more quickly than either we or the receiving countries anticipated, with the consequence that in 1946 and 1947 we failed to receive cash for a larger proportion of our exports than we had reckoned on. The outstanding case of this is, of course, the British credit. The credit of $1,250 million which we extended to the U.K. in 1946, supplemented by the hard currency payments which it was understood that the British would make to us pari passu with their use of the credit, was expected to look after the British financial requirements in Canada for at least three or four years. In point of fact, as matter has worked out, the British drew $540 million on the credit in 1946 and another $423 million in 1947, leaving only $287 million outstanding at the beginning of this year. Their import requirements from Canada continued to be extraordinarily high, while their exports to Canada were disappointingly low with the result that their deficit of Canadian dollars was higher than anticipated. Instead of lasting for three or four years the credit was nearly 80% used up within a period of approximately eighteen months.

There was a second direct financial effect on Canada of the disappointing rate of European recovery. As a result of the inability of the European countries to supply us with imports which we need and which we would ordinarily have purchased from them, Canadian importers turned to the U.S. for similar or substitute goods. This is true not only for cotton textiles but also for woollen textiles and for many other lines as well. In 1947 we obtained 78% of our total imports from the U.S. compared with 61% in the immediate pre-war years. If in 1947 we had been able to obtain the same percentage of our imports from the U.K. and the rest of the sterling area as we obtained before the war, our imports from these countries would have been increased by nearly $400 million, and the British utilization of the Canadian credit would have been reduced by a corresponding amount. If one makes the further assumption that this short fall of our imports from the sterling area resulted in a diversion of these purchases to the U.S., one reaches the conclusion that perhaps something approaching one half of the total decline in our U.S. dollar reserves in 1947 may have been due to this cause.

A further factor responsible for a considerable part of the increase in our outlay of U.S. dollars for imports in 1947 was the rise in prices in the United States. It is not possible to determine exactly, without elaborate statistical computations, how much foreign exchange we would have saved if we had been able to obtain the 1947 quantities of imports at the prices prevailing, say, in the first half of 1946. The prices of commodities imported from the United States may have been 35-40% higher at the end of 1947 than they were in the first half of 1946. Of the $600 million increase in our imports from the United States in 1947, as compared with the preceding year, it seems likely that at least one-third, and perhaps as much as one-half, was accounted for by higher prices.

In as much as the rise in price of our imports from the U.S. was accompanied by a rise in price of our exports to the U.S., it might seem on first glance that it is improper to attribute any of our loss of dollar reserves to this development. This is, however, not so. The value of our imports from the U.S. is very much greater than is the value of our exports to the U.S., and even if the prices of both imports and exports rose by the same percentage, the gap between the value of imports and the value of exports (which must be met out of our U.S. dollar resources) would rise by the same percentage. To illustrate this, imports from and exports to the U.S. in 1946 were about $1,400 million and $950 million respectively, and the gap was therefore $450 million. If both volumes remained the same but prices on each side rose by say 20% the $1,400 million and $950 million would become $1,680 million and $1,140 million, and the gap would then be $540 million instead of $450 million.

If import prices rose more than export prices, this deterioration in our "terms of trade" would account for additional exchange loss. The statistical evidence is, however, not decisive as to whether there was such a deterioration.

What now about the present position of Canada? I have tried so far to indicate to you some of the main general factors in our international financial and economic position, to tell you something of the wartime background in this field, to sketch roughly what our postwar policies have been and to indicate how we got where we are today so far as exchange difficulties are concerned. You will have noted, and it is worth stressing, that these exchange difficulties are in part a reflection of the high level of prosperity which has prevailed in Canada since the end of the war and in part a reflection of the difficult international financial position of the U.K. and other countries of Western Europe with whom we trade on an extensive scale. We would certainly not wish to improve our international financial position through the elimination of prosperity and it is apparent that our main hope lies in the direction of a restoration of the economic position of our customers, so that they will again be self-supporting and be able to trade with us on a cash basis.

As you know, an important additional effort to float Western Europe, from an economic point of view, is at present being considered by the U.S. Congress which has before it proposals of the American Administration which would involve additional U.S. Treasury financing in the amount of $6,800 million to cover requirements of the period from April 1, 1948 to June 30, 1949. An aspect of this programme which is of particular interest to us is the provision for off-shore purchases, that is, for the use of a large proportion of these funds to finance purchases in the Western hemisphere countries other than the U.S. On the basis of the U.S. Administration proposal, $2,600 million of the amount I have mentioned would be spent outside the U.S. As Canada accounts for about one-third of the total current account surplus of the Western hemisphere countries other than the U.S. with the sixteen Marshall Plan countries, it might be expected that something in the neighbourhood of one-third of this amount would be spent in Canada. Such expenditures would enable us to maintain approximately the same flow of exports to the Marshall Plan countries as they have had from Canada in the past, the difference being that in the past they have been mainly financed out of credits extended by Canada, whereas under the off-shore procurement programme they would be financed out of cash payments received by Canada. These cash payments would enable us to maintain the flow of essential imports from the U.S. necessary for running the Canadian economy and continuing our own productivity. And it is only if the Canadian economy is kept going at a high level and our own productivity is maintained that we shall be able to make a further significant contribution to the restoration of the European economies.

The amounts currently mentioned for possible Marshall Plan expenditure in Canada are very large - so large indeed that some think it unlikely that they will, in fact, be forthcoming. If these expenditures are not made it will, I am sure, be only too obvious to you that we in Canada must continue to battle with an immediate and serious foreign exchange problem. But even if they do take place it should be emphasized that even these large expenditures would by no means result in the elimination of our U.S. dollar difficulties. The reason for this may not be too clear. It arises from the fact that even should the Marshall Plan operate in such a way that we received cash for all of our exports that development would not result in an increase in our depleted U.S. dollar reserves unless at the same time we had a favourable balance on current account with the world as a whole. We did have a favourable balance of $460 million in 1946 but in 1947 our current account balance, although apparently still favourable, was certainly very much smaller. This trend in our overall current account balance must be reversed if our reserve position is to be improved even with the most liberal conceivable version of the Marshall Plan in effect.

There is an additional reason why it is imperative that Canada have a substantial overall current account surplus, and that is that we shall presumably want to continue to extend some credit on our own account to European countries. We shall, I think, want to do this both to co-operate with the United States in any programme which would benefit us so materially and because of our own enormous interest in European recovery. But if we provide further exports on credit our reserves can be augmented only to the extent that our current account surplus exceeds such exports. We, therefore, need a current account surplus large enough to permit us at the same time to make further exports on credit and to increase our U.S. dollar reserves.

To produce an adequate current account surplus in 1948 we must either export more than we did in 1947 or import less, or some of both. This we can do only if we either consume less at home or produce more. From this alternative there is no escape if a large current account surplus is to be achieved. Since our need for a large current account surplus is great, and can, I think, not be seriously disputed, it is only sensible that we prepare ourselves either to produce more or to consume less in order to achieve it.

I have come now to the end of my remarks. The general framework of Canada's international financial position which I have attempted to outline is the background of the restrictive actions taken last November. There is obviously room for a good deal of difference of opinion in the matter of what specific action is appropriate for dealing with the problems that I have outlined. That such differences of opinion exist is clearer with every day that passes. All that I wish to say is that I do not think that an adequate solution to our exchange difficulties will be either simple or easy. There is nothing that would interest me more than a magic formula that would be adequate and painless. For a number of years I have searched for such a formula and have always failed to find it. I doubt that one exists.