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THE NEW ROLE OF NORTH AMERICA

An address by Mr. Donald Gordon, Deputy Governor of the Bank of Canada, to the Thirty-Sixth National Foreign Trade Convention, in New York City, on October 31, 1949.

Since 1939 we have witnessed a series of crises in the field of international trade and foreign exchange. These crises had the common feature that they related to the ability of foreign countries, in Europe and elsewhere, to find sufficient resources of gold and dollars to pay for the goods which they needed to get from North America, and which North America could produce and supply. This created a crisis for North America as well as for the countries which were short of dollars, for it was realized that it was vital to the security of North America that the countries of western Europe, and others closely connected with them, should not be defeated in war, nor collapse into chaos afterwards.

The action taken to meet each such crisis, except the latest, was for the United States and Canada to make loans and gifts to finance the purchase of our goods. During the war the United States did it by way of Lend-Lease, and in Canada we did the same thing, on no less a scale proportionately, under the name of Mutual Aid.

After the war, to assist the transition from war to peace, as we thought, our two countries again tried to meet the dollar shortage by making large sums available to our wartime allies, both in Europe and in Asia. Your Export-Import Bank, and our Department of Finance were given broad authority and large appropriations to make rehabilitation and reconstruction loans in 1945 and 1946 to a number of European countries and to China. The United Kingdom did not come within those general arrangements. In recognition of its special position and of the magnitude of the sums involved, provision was made by special legislation for loans to Britain of five billion dollars, of which three-quarters was undertaken by the United States and one-quarter by Canada.

The crisis of 1945-46 passed, but a new one developed in 1947-48. The United Kingdom found that the attempt to make sterling convertible into U.S. dollars caused a rapid depletion of its reserves, including the funds made available under the U.S. loan, and the attempt at convertibility had to be abandoned. The drain on the reserves of Britain and other western European countries continued into 1948, and led to the adoption by the United States of the Marshall Plan for European recovery, which envisaged the provision of goods over a four-year period amounting to some 17 billion dollars, largely by way of gift.

In 1947 Canada for the first time since the war also faced a dollar crisis. The Hyde Park agreement of 1941, under which the United States had agreed in effect to increase its purchases from Canada to an extent necessary to match Canada's purchases from the United States, did not extend to ordinary civilian goods for peacetime use. With the Hyde Park Agreement no longer effective United States purchases from Canada fell far below Canada's purchases from the United States, and Canada's customers could not provide U.S. dollars in settlement of their accounts with Canada in sufficient quantity to enable Canada to settle its accounts with the United States. For the time being, Canada had to stop the drain on its foreign exchange reserves by slowing down the rate of its assistance to Europe, and restricting certain Canadian expenditures in the United States.

In 1949 we have just seen another crisis, affecting particularly the United Kingdom and sterling area. Once more the sterling area's reserves of gold and dollars were seen to be declining at an alarming rate, despite the receipt of aid under the Marshall Plan. Certain steps were taken by the United Kingdom and other countries concerned to stem the drain, and tripartite conferences were held among representatives of the United Kingdom, the United States, and Canada, first in London and later in Washington, to discuss the sterling-dollar problem and see what each of these countries could do to help solve that problem on a more enduring basis than any hitherto adopted.

On this occasion, unlike all previous occasions, no plans were made for further gifts or loans from the dollar countries to the others. All concerned are beginning to see that such measures, while they temporarily fill the dollar gap, do little or nothing to reduce the gap for the future. They have financed the continuation of the North American export surplus, and perhaps distracted attention from the fact that that export surplus must be eliminated or at least greatly reduced by increased imports into North America.

I have spoken of 'the North American export surplus'. Some distinction must be made, however, between Canada and the United States. Both countries have an export surplus with the non-North American world, but only the United States has an export surplus with the whole world. Canada has no over-all export surplus, or at any rate not a large one, because Canada normally has an import surplus with the United States of approximately the same size as Canada's export surplus with the rest of the world.

Canada imports about as much as it exports, and any reduction in its export surplus with the outside world would have to be counterbalanced by a similar reduction in its import surplus with the United States. Unless the United States by increased imports reduces its export surplus to the point where Canada's customers overseas have enough dollar income to settle for our export surplus with them, Canada will be faced with the loss of necessary export markets when the temporary support of gifts and loans comes to an end. Canada in such circumstances would be driven to a restriction of imports from the United States and would have to find alternative sources of supply, in Europe and elsewhere, among the countries which take our exports. Neither of our countries would wish to see such a departure from normal multilateral trade channels, if it can be avoided. It will be appreciated, therefore, both that Canada has a special interest in United States trade relations with the rest of the world, and that the problem of reducing the North American export surplus to manageable proportions is very largely

a problem of the United States export surplus.

As already mentioned, we in North America have up till now tried to make good the inadequacies of the international income of our friends abroad by capital donations, and for a time, indeed, it was necessary and desirable that we should do so. But that process cannot continue indefinitely. Knowing this, the countries of Europe, and elsewhere, have begun a process of restricting their expenditures in the dollar area to the level of their inadequate income from the dollar area. That is scarcely a process which any of us wish to see go very far, nor, I am sure, would the countries in question wish to pursue such a course if they thought they could instead increase their dollar income to the level of the dollar expenditures which they and we would like to see. It is this aspect of the problem, the increase of dollar receipts by the non-dollar world, which is now, rather belatedly, receiving attention.

Now this presents a great challenge to North America. It requires, I believe, nothing less than a radical and far-reaching change in the whole tenor of North American thinking about international economic policy. I believe it requires that North America now replace Europe as the dynamic centre and chief support of the world trade structure. Experience has shown that a multilateral world has to be underwritten by some country which will provide both an import market and a source of capital for productive developments in less advanced regions. European countries in general, and Great Britain in particular, did that effectively up to 1914, and they have tried to continue the process since without having the necessary strength for the job. North America, it is true, has supplied a lot of capital, thrown in hastily at times of crisis, rather than on a continuous underwriting basis, and without providing an adequate market for imports to assure both our debtors and ourselves that multilateral trade and capital service are indeed possible. Skilful underwriting yields a profit to the underwriter, and is beneficial to all concerned. There is only one region, indeed, only one country, which can do the job today.

Right now is a most appropriate time to consider such matters. At the moment, there is, in respect of international economic policy and action, a period of relative calm after the latest crisis in the efforts to restore a world trading community. No doubt the calm is more apparent than real, and certainly it cannot be more than temporary. Perhaps it might be compared to that deceptive dead spot in the middle of a storm. But some may consider it unduly optimistic to think that the storm has yet reached the half-way point. In any case, it is clear that recent events provide the occasion and indicate the need for some re-appraisal of the objectives being pursued, and of the measures necessary to achieve them.

While the recent tripartite conference in Washington did not itself result in the adoption of any immediate, specific measures, there was one very important development which came to realization just after the conference, namely, the world-wide revaluation of currencies that was set in motion with dramatic suddenness by the revaluation of sterling. The dust has not yet settled from the commotion caused by that action, and its specific effects cannot yet be appraised. It was essentially an overdue recognition of conditions which had been developing for some time and which had created such wide disparities between prices in North America and in Europe as virtually to amount to a two-price system. Devaluation was intended to bring prices in the dollar and non-dollar worlds

much more closely in line, but devaluation cannot by itself correct the conditions which gave rise to price disparities. Currency devaluation is not a cure-all for fundamental ills, and it does not guarantee there will be increased exports by those who ought to increase their exports, nor that there will be increased imports by those who ought to increase their imports. Much more fundamental correctives need to be applied in both debtor and creditor countries before the series of dollar-shortage crises can be terminated. The great value of the communique issued at the conclusion of the Washington talks is the explicit recognition, and indeed emphasis, given to this fact.

No one should overlook the striking degree of post-war recovery which has been achieved by the United Kingdom and other western European countries. Pre-war production has been reached in all countries except Germany, and surpassed in most. The standard of living has not been unduly raised, if at all. On the contrary, a larger than usual proportion of total available resources each year has been devoted to capital investment. The assistance received from North America and some other countries has indeed borne great fruit in helping to make that possible. The export and import trade of European countries with each other and with the rest of the world has continuously increased in all directions save one. The one direction in which substantial progress has not been achieved is in the development of an adequate volume of exports to North America either from European countries or from their dependencies and close associates.

This is the obvious and striking feature of the successive dollar crises, and leads to the conclusion that there has been a failure to recognize the nature of the problem which has confronted us. On both sides of the Atlantic, it would seem that we have not understood, until quite recently at any rate, and certainly not faced up to, what amounts to a fundamental structural alteration in the economies of Europe and North America, and in their relations with each other. We have tried to patch up immediate difficulties in the hope that somehow an older, more comfortable economic pattern would come to life again. We have not accommodated our thinking to the idea that the old pattern is gone forever, and a new one must take its place.

Since this change has affected the United States sooner and to a greater degree than Canada, I hope you will forgive me if, in what follows, I sometimes refer particularly to the United States. It seems clear that Canada is, in the course of time, going to reach much the same state of economic development as the United States, but that time is not yet. For the present, while we are prepared in some respects to take the lead, for the most part we must appear to be advocating policies for the United States which it is not immediately possible for us to adopt in full ourselves.

There have been tremendous changes in the past 35 years. Prior to the first World War, Europe was the dynamic centre of an expanding world economy. The development of North America and other parts of the world was stimulated and nourished by the capital, the technical equipment, the know-how and the energy of the active, enterprising and forward-looking peoples of Great Britain, France, Germany and other nations of western Europe riding the wave of the Industrial Revolution. Just before the outbreak of war in 1914, the development had in fact gone so

far that the United States, at least, was threatening to surpass its progenitors, but this was not widely recognized at the time, at any rate in its implications for economic policy.

The devastation of the 1914-18 war in Europe, and the exhaustion of its peoples, must now be recognized as marking the end of an era. But old habits of thought die hard. The new world made loans and gifts to the old world to put it back on its feet - and then promptly raised tariffs as though it was the new world rather than the old which needed protection. Full recovery was never achieved in Europe after 1918, even in Great Britain, the most mature and formerly the most dynamic economy of all. While some degree of stability was temporarily maintained by American loans, the inevitable ending of such loans left Europe in a desperate situation and was one of the factors contributing to the great agricultural and industrial depression of the thirties.

At the very outset of the depression, the United States once more sought to protect itself by drastic increases in its tariff. By this time, however, as indeed in 1920, the United States was too big, too important, to be able to pass its troubles on to others. A small country may do that, for a time, but not the most powerful and wealthy nation in the world. Other countries could not stand up under the impact. So all of them looked for methods of protecting themselves against the spread of unemployment and falling prices. (You can imagine the effect on Canada, for example, when the United States, which had always exported far more to Canada than it imported from Canada, proceeded to apply prohibitive tariffs and quotas against Canadian products). The net result of all such actions, regardless of how they started, born of misunderstanding rather than of ill-will, was that we were all worse off. Unemployment grew to mass proportions and gave rise to great social conflicts. Hitlerism and other retrograde political movements fed on, and in turn gave rise to, all kinds of distorted economic policies.

In Great Britain, although the fundamental disequilibrium of today was already present, it was obscured by the effects of their unemployment and the abnormal cheapness of their imports arising from depression elsewhere. It is now clear that a full employment policy at that time in the United Kingdom, or in North America, by its effect on the volume of United Kingdom imports or on their prices, would quickly have shown that the balance of payments of the United Kingdom in 1939 was in an even worse condition than in 1949, and the same would be true of a number of other European countries. The fact is, at no time since 1914 has Europe been able to support a condition of full employment without external financial assistance.

In 1938 the current deficit in the United Kingdom's balance of payments was £70 million. Imports exceeded exports by £302 million, and net invisible income was £232 million. But both export prices and import prices were lower in 1938 than they would be under conditions of full employment and buoyant world trade. At 1948 prices, the excess of imports over exports in 1938 would have been about £1 billion. Imports would have been further increased if there had been full employment in Britain. A tremendous increase in exports would have been necessary, therefore, to pay for unrestricted imports under such conditions. Alternatively a large increase both in unemployment and in import restrictions would have been required to balance the United Kingdom's international accounts if today's prices had prevailed.

The United Kingdom and other industrial nations of western Europe have for a long time been dependent on overseas countries for supplies of foodstuffs and raw materials. It was the very essence of the kind of world economy which they built up, based on the international division of labor, that they should concentrate on industrial production, and encourage and rely on a great expansion in agricultural and other primary production in overseas countries. In addition to providing capital for overseas development, they paid for their full import requirements with exports of goods and services. Why can they not do so today, and why have they not in fact been doing so for the past thirty-five years?

The immediate and apparent cause, no doubt, lay in the development of industry in the new countries, which began to produce for themselves some of the goods that they previously had to import, such as textiles and a number of other products throughout the range of light industry. To a large extent such a development was inevitable and right, once these new countries passed out of the early pioneer stage, but it is also true that the process was accelerated and extended into uneconomic fields by excessive use of tariffs. Moreover, Europe found that at least one of the new countries, the United States, was developing more rapid technological progress in many lines and effectively displacing European products in many export markets.

But dynamic free economies ought to be able to adjust themselves to changing conditions, so we must look for more fundamental reasons for the failure of the old-world - new-world trade system to accomplish this. One of these causes may be found in the old world itself, in the rigidities which developed in their industrial structure, the decay of efficiency in certain lines of production, - above all, in the failure to replace obsolete equipment and to adjust production and marketing technique to modern mass market conditions. But even more important, and perhaps a substantial cause of the shortcomings of European industry, was the use made of tariffs and other protective devices in the new world, to thwart and frustrate every attempt by Europe to develop markets for its products. Indeed, the rates of customs duty are often highest on precisely those goods which European and other countries are able to produce best and most efficiently. And that is no accident. It has been the case that, until recent years at least, tariffs, subsidies, import restrictions and other devices have been used not with a view to securing the most efficient use of the world's resources by a free economy, but to encourage the development of industries some of which are uneconomic or should I say inappropriate. When such action comes from North America, the home of free enterprise, that surely is an extraordinary state of affairs and suggests that economic thinking has not kept pace with economic change.

I think it is fair to say that Canada is on the whole less protectionist in its outlook than the United States. It is true, of course, that in many lines our industrial development is a good many years, perhaps a generation, behind yours, and that some Canadian producers require protection against the giant industries of the United States. But as regards our trade with Europe, it is becoming more evident that even little Canada can go a long way in the direction which more and more of your own observers believe the United States must go, - the removal of barriers to imports, the acceptance of foreign competition as an essential factor in a free world economy, and therefore in your own economy. I fully realize that, in the case of the

United States, such a policy goes far beyond the limitations of the Reciprocal Trade Agreements Act. Indeed it challenges the whole assumption that the strongest nation in the world can only encourage imports to the extent that it can secure reciprocal action on the part of other, weaker nations. I say this with full appreciation that there are difficult economic and social problems involved in reducing the degree of protection given to domestic industries. But if substantial progress cannot be made in this direction I believe the consequences for our North American way of life will be far more serious. This issue will provide the acid test of belief in free enterprise and political maturity.

In the meantime, ever since 1945, to say nothing of earlier years, European countries, spurred on by each successive dollar crisis, and being of too faint hope of sufficiently increasing their exports, unable, they feel, to develop freely their production for world markets along the lines best suited to them, have been trying desperately to produce for themselves goods not well suited to their productive resources, goods which North America in fact could produce more cheaply for them. (Certainly Canada could produce lumber, newsprint and most food-stuffs much more efficiently and cheaply than the European and sterling area countries which are trying to expand their production of such items.)

This attempt to reach self-sufficiency, in Europe and indeed throughout the rest of the world, has by no means fully succeeded, and perhaps never will. To the extent that it fails, the maintenance of tolerable standards of living and political institutions in Europe will require that European countries continue to get such supplies from the dollar countries, and get them free - unless the means of payment can be earned. In both Canada and the United States we find ourselves in the fantastic position of having to make loans and gifts to proud and industrious peoples who want to pay us in full with real goods, and would do so if we would let them. And in the meantime they are driven to prop up their own economies with more and more controls, more and more restrictions, more and more bilateral deals. I wonder if it would be going too far to say that free enterprise, the operation of truly free economies throughout the world, is incompatible with the maintenance of obsolete economic policies by the people of North America.

If this analysis is correct, the factor which is necessary to make the Marshall Plan truly successful, that is the development of exports from Europe and the rest of the world to North America, is missing. Unless a more fundamental approach is adopted and the missing ingredient is supplied, there will be further development in the wrong direction - the direction of forcing Europe to seek to become independent of us, of inducing uneconomic production and attempts at self-sufficiency, and of encouraging European nations to trade among themselves behind a barrier of restrictions against North America.

In the plans which were developed for the post-war world, great emphasis was laid on securing agreement by all nations on desirable principles of commercial policy. In particular, we from North America insisted that the nations of Europe should sign the pledge, should join us in declaring that controls, preferences, quotas, discrimination, bilateral deals, barter, and so on, are evil things, and should undertake to refrain from using them. Well, the conditions simply have not existed which would make it possible for them to do as we would like. Indeed, the situation has progressively worsened, in this respect. Is it

possible that here, too, there has been a failure to appreciate the nature of the modern world? Are we safe in assuming that we and other countries are all equal in our ability to take risks and pursue certain policies? Have we not acted rather as though we lived in a peaceful, orderly, stable international environment in which laws can be written and agreements entered into which will automatically be observed and carried out? Experience, both in the 19th Century and in recent years, would seem to indicate that if we want certain policies to be observed throughout the world, - or rather the non-Russian part of the world, - we must ourselves create the necessary environment.

Europeans are not going to follow the kind of policies we want, just because North Americans believe those policies are desirable. They are not going to do that even though they themselves believe such policies are desirable. They cannot. They cannot adopt those policies unless and until the right conditions exist for the success of those policies. It is only the United States which can see to it that those conditions do exist. It is only the United States which can take the lead, which can assume risks, which can take sufficiently sweeping and far-reaching action to do the job and convince others - after an interval - that it is possible for them to do likewise.

To be concrete, I do not believe that European or other countries can return to free economies, can follow the kind of commercial policy to which all of us attach so much importance, so long as the dollar shortage exists, and I do not believe the dollar shortage can be effectively and permanently overcome unless North America, and especially the United States, provides a much larger, more accessible and more reliable market for the goods which other nations have for sale. Only when other nations feel secure in their incomes from exports will they be able to deal freely with their expenditures on imports.

I do not suggest that at any time in the near future it will be necessary or possible for the United States to increase its imports to fully balance its exports. For a long time to come there will be a need also for capital to facilitate the development of other countries in many parts of the world, by way of direct investment and self-liquidating loans for productive purposes. We in North America could never have developed our natural resources, built the necessary transportation systems and developed our industries, without large amounts of foreign capital from countries which, at the time, were in a better position to supply that capital, as well as the technology and know-how that go with it. The wheel of progress has now come round so far that we are in a position to provide those facilities to others.

The methods by which the necessary capital may be provided are various. In the present disturbed conditions private investment may not be forthcoming in volume unless some kind of guarantee is provided. Direct Government loans and expenditures may be necessary at times, but one would hope that, at any rate outside the political and military sphere, adequate means could be found without direct reliance on Government. Perhaps the co-operative method of the International Bank for Reconstruction and Development is the modern answer to the problem. This is a business institution run on sound lines, financed in the first instance by sales of bonds to the public though with an underlying guarantee of the United States, Canada

and other member Governments, which is able to give developmental projects thorough study on the basis of the best commercial and financial advice obtainable. Participation of the International Bank in the development of countries which require outside capital is the best guarantee I know of that the development will be fruitful and will in the end contribute to the ability of such countries to service their obligations.

One factor which has seriously aggravated the present difficulties of a number of European countries is that they are maintaining a high level of overseas expenditures, far beyond their capacity, partly by way of political and military activities to maintain law and order and resist Russia's imperialistic programmes, and partly by way of capital exports for developmental purposes. The United Kingdom, for example, has had a large surplus of exports to many countries outside the dollar area, financed partly by new transfers of capital and partly by a very rapid using up of sterling balances accumulated during the war by India and a number of other countries.

But the economic pattern has changed, and European countries can no longer afford to play the role which they once did so effectively. What is happening today is that they weaken themselves by giving aid to others, and then have to rely on North America for aid for themselves. At the same time, by overstraining themselves they aggravate the austerity of their own condition, which results in new controls and new restrictions.

Surely it is inherent in the altered relations between Europe and North America that the greater part of the financial and physical capital required for world development must now come from a new source, no longer from the old. We have the necessary resources to do the job, and it is vital to our own interests to see that the job is done, and well done. This would be true in a time of peace. It is even more true in the present condition of cold war when in every section of the world one of the most brutal and pernicious forms of imperialism ever known is seeking to attack and destroy everything we believe in. Those underdeveloped areas of the world that are still outside the iron curtain must be assisted to increase their production, raise their standard of living and build up their economic and social defences against the aggression and domination which threaten them.

The question I leave with you for deliberation therefore is very simple. It is that we of North America stand at a cross-roads. If we take one road we accept the new role of North America. It requires that we furnish a ready import market for the goods of other nations and also that we supply development capital for less advanced regions. Following that road we may hope to see an expansion throughout the world of the good life which is our North American heritage based as it is on democratic institutions of a type which have yielded the best way of living that civilized people have ever established. If that be true, as I profoundly believe it to be, then the alternative choice need not be stated.