

COUNCIL OF FOREIGN RELATIONS
NEW YORK, MARCH 2ND, 1948

by G.F. Towers

In the invitation which I received from the Council to come here to-day, it was very naturally suggested that the subject of my remarks should be some aspect or aspects of Canada's position in the world to-day. For a gathering of this kind - usually followed by some questions and discussion - the best thing to do, I believe, is to single out for mention a few of the most important features of Canadian economic life and to mention also some of the peculiarities of our position.

To maintain a reasonably high standard of employment and economic activity, Canada depends on selling more to the United Kingdom and Western Europe than we buy from that territory, and using the proceeds of these sales to pay for our excess of imports from the United States. There is nothing new in this. It represents the development of certain channels of trade over a period of generations. Food stuffs and raw materials constitute the great bulk of our exports overseas, whereas we rely on our neighbours not only for many important raw materials which we cannot produce, but also for an infinite variety of component parts and finished goods. In the interval between the two wars, we did not always fare too well, but at least our major overseas customer, the United Kingdom, did not have to impose import restrictions during that period; and when we got sterling in payment for our sales we could always exchange it for U. S. dollars at some rate.

When the war broke out in 1939, both the vulnerability of the Canadian position and the possibilities of Canada as a great source of supply were at once obvious. The question was how the United

LIBRARY FILE COPY
EXEMPLAIRE DE LA BIBLIOTHÈQUE

Kingdom, with its limited resources of gold and U.S. dollars, could pay us enough in that form to enable Canada to keep on getting essential supplies from the United States. This worry did not keep Canada from planning a very substantial war programme, particularly after the galvanizing shocks of the spring of 1940. Some gold was forthcoming from the United Kingdom, and the balance of the aid which they needed was covered by repatriation of Dominion Government debt held by U. K. residents. But pretty soon it became apparent that neither country could continue to function unless each found ways and means of receiving or earning more U.S. dollars. Lend-Lease was the answer for the United Kingdom. The Hyde Park Agreement, concluded in 1941, provided the answer for Canada. During the course of that Agreement, Canada sold to the U. S. Government about \$1,000 millions worth of war supplies. The proceeds of these sales, together with the receipts from our normal exports to the United States, gave us enough American cash to pay for the things which we wanted to get from the United States and couldn't do without.

Looking back to the war years, I think it will be agreed that our armed forces made a distinct contribution to victory, and that our contribution in the form of war supplies, food stuffs and materials for our allies was of major importance. All told, we shipped to our overseas allies \$5,500 millions worth of supplies in excess of the amount for which they could find means of payment in goods or hard cash. Of this deficit, \$3,500 millions was covered by gifts from Canada, the balance by loans or repatriation of Canadian securities. I think that was quite a record for a country of some twelve million people. That remark quite frankly has the elements of a boast, but I shall have some sober qualifications to make later in my remarks.

The particular point which I wish to stress is that this performance by Canada was made possible only by the co-operation of the United

States. But note this fact carefully: it was the \$1 billion worth of war supplies which we sold to the United States Government which enabled us to maintain our own substantial war effort in the field, and to give or lend \$5,500 millions of supplies to our mutual allies. Taking only the latter item, you will see how important the multiplier is. Sales of \$1 billion under the special arrangement enabled us to send \$5½ billions worth of supplies elsewhere, surplus to what we received, and in addition to all our own war programme. This, of course, is not surprising. Our case is like that of a manufacturer who has a good plant and his own source of supply of many raw materials. But to the extent of, say, 20 per cent he relies on other sources. If he is able to get 20 cents' worth of supplies from others, he can turn out a dollar's worth of finished articles. But if his outside sources are cut off, the plant closes down.

The mutual interest which Canada and the United States had in winning the war made the arrangements to which I have referred eminently sensible and most productive and desirable for both our countries. Canada did not need any gifts, but what she urgently needed was the ability to exchange large quantities of goods with the United States. It will be a sad commentary on our system if this type of co-operation can only be achieved in war.

I come now to the situation at V-J Day. The war is over, and war-time arrangements lapse. They lapse in a world much of which is shattered economically and grievously disturbed politically. It was recognized that normal peace-time methods of dealing with world economic problems would hardly suffice. Therefore many efforts were made to provide the necessary organization and resources for relief and reconstruction. You are familiar with the general programme in which the

United States played a leading part. Canada shared in these efforts, and here I wish to mention a situation which has a bearing on that boast I made about our own war-time activities. Our representatives at international gatherings found that Canada was highly respected. We seemed to be regarded as a very rich and, for that reason, powerful country - not in the same class as the United States, of course, but still pretty impressive. It is naturally pleasant to be well-liked, but it can also be decidedly embarrassing if people take too flattering a view. Now I do not think that we emerged from the war with a very inflated view of our own capacities, but it may be that the recollection of what we had been able to accomplish in 1939-1945, joined to the high opinions held by others, made us a shade too confident.

In any event, we participated in the post-war recovery programme in a big way - big that is in relation to our population and resources. We became members of the International Monetary Fund and members of the International Bank. We shared in UNRRA, in military relief, and in various other co-operative efforts. In all these fields our participation bore some reasonable relation to population and national income. When it came to the extension of post-war credits to the United Kingdom and Western Europe, however, our programme was relatively very large. The credits authorized added up to a figure of \$1,850 millions. In terms of the national income of the two countries, this amount would be equivalent to \$32,000 millions in the United States. Now we didn't embark on this programme simply in a spirit of generosity. We had a great stake in the recovery of the countries concerned - a political stake as well as an economic one. Canadian policy was based on that most durable thing in international relations - intelligent self-interest. In framing its

post-war policy on the extension of credits, Canada of course had to keep in mind its perennial problem. How could we manage to sell tremendous amounts on credit, and pay cash for all our imports? If we could develop and maintain a substantial surplus in our current account transactions with all countries, then to that extent we would have something to lend or give away without experiencing a shortage of U. S. dollars. Our hopes did not fly so high as to lead us to expect that our over-all current account surpluses in the transitional period would equal the amount of credit extended, but we did hope that with some export surpluses, some cash payments from customers who were at the same time receiving credit, and quite a substantial use of our reserves of gold and dollars, we could come successfully through the transitional period to the better times which lay ahead. And even if some people had serious doubts as to how long those better times might be deferred, it still seemed wise to take a chance.

It so happened that we were in a position to take a chance because of the fact that we emerged from the war with gold and U. S. dollar holdings at a very high level - about \$1½ billions. We had entered the war with reserves of only \$400 millions, but lest you think that we profited materially from the conflict let me say that the difference between the two figures is entirely represented by additional net U.S. investment in our country during the war years. This addition to the net investment took various forms. In part, it came from sales of U. S. securities held by Canadians, in part by new purchases of Canadian securities by Americans, and in part from the ploughing back in Canada of undistributed profits of American-owned companies. Whatever the source, the fact remains that we had this cash on hand, and it gave us certain liberty of action in deciding on the degree of our participation in the European recovery

programme of that time. If we had not possessed these high reserves, accumulated in substantial measure by adding to our debt to the United States, I am sure that we would not have dared to extend more than a few hundred million dollars in credits and relief instead of \$2 billions. This would certainly have added noticeably to the problems of many countries, including, I should think, the United States.

So much for the policy which was framed in the immediate post-war period. How has it worked out? Here I can be very brief because the story is a familiar one. The credits which were intended to cover our customers' requirements for four years were used much more rapidly than was anticipated. Europe was slow to recover, partly for reasons which were no doubt inevitable from the start, and partly because of bad weather in every sense of the phrase including the political. Sterling convertibility came and passed in the night. The effect on Canada of these things was to cause a tremendous demand for our supplies, which many of our customers wished to obtain so far as possible on credit. Our high exports pushed up our national income, and the consuming power of our population. This in turn led to a great increase in imports, the vast bulk of which had to come from the United States. Last but not least, domestic capital investment in Canada increased to heights never before known, and this in turn added greatly to demands for U. S. dollars for the purchase of machinery and other capital goods. We joined the ranks of those countries whose supply of U. S. dollars was running out.

Various steps were taken to try to deal with this problem. Early in 1947 we had to advise the United Kingdom that a larger proportion of their Canadian dollar deficit had to be settled in U.S. dollars, and a smaller proportion by use of the Canadian credit. It eventually worked

out that over the year as a whole the sterling area deficit with us of \$923 millions on current and capital account was covered to the extent of \$505 millions in U. S. and \$423 millions by use of the Canadian credit. I may add here that in our original negotiations with the countries to which we extended credit, we made it clear that their total deficits with Canada could not be covered by loans. In some cases, specific percentages of hard cash settlement were determined in advance; in other cases - and the United Kingdom was one of them - the policy was left to be decided in the light of experience. The arrangements which I have just mentioned did not, of course, cure Canada's deficit in U. S. dollars. For the calendar year 1947, we had only a small surplus in our current account transactions with all countries. We were really not in a position to give or lend practically anything; and to the extent that we did in fact extend credit - some \$563 millions - this action on our part was reflected in large measure in a decline in our reserves of gold and U. S. dollars. For the year as a whole, our external cash reserves declined \$743 millions, of which some \$250 millions related to the redemption of U. S. dollar securities and our payment to the Monetary Fund and other capital investments, and the balance to current account transactions.

I should like to point out that our exchange difficulties are rather unusual in character. They do not rise from lack of productivity. If we had obtained payment in goods or convertible currencies for all our exports, we would have had more than enough to pay all our current account obligations to other countries without drawing on our reserves. In view of the world-wide shortages which existed during 1947, the policy which was followed of extending a substantial amount of credit represented to a considerable extent a deliberate choice on the part of the Government.

By that I mean that a very large proportion of the goods which were sold on credit could have been sold for cash in the year under discussion. Whatever else it was, the policy was not a timorous one.

Further steps designed to overcome our U.S. dollar deficit were taken in November. At that time, import of a number of items of consumer goods was banned and almost all other categories of consumer goods were placed under quotas. These quotas, based on pre-war trade, had the effect of reducing very substantially our abnormally large importations from the United States while leaving scope for our historical suppliers in Europe to increase their exports to us as their productive capacities were restored. Pleasure travel by Canadians in the United States was placed on an annual ration of \$150. The Government also announced that over a period of time it hoped to be able to promote more constructive measures for overcoming our difficulties. For example, the development of our export industries selling to hard currency countries, notably the United States, would improve our position; and so would greater utilization of domestic resources to replace imports if this could be done on an efficient and economical basis. Government was most emphatic in its statements that encouragement would not be given to the development of uneconomic industries which relied for their success on continuation of import restrictions.

What can be said of our prospects for the future? For 1948 I think they are reasonably good, if we can find cash markets for most of our potential exports. The European Recovery Programme is, of course, a vitally important one from our point of view. Without it, we should have to cut down materially on our overseas shipments of food stuffs and raw materials, and try to find other markets for these things. In such a process, we would deal a blow to European recovery - and to the extent

that there were no alternative markets our own exchange difficulties would increase, and further restrictive action on our part would have to result. This in turn would be likely to affect Canadian productive capacity, and so we would join in that terrible spiral of restriction, disruption and falling production which, for somewhat different reasons, plagued the world in the early thirties. It cannot be too strongly emphasized that the European Recovery Programme is, in fact, a world programme. I am aware of the Russian propoganda which suggests that the European Recovery Programme is based on a desire to maintain U.S. exports and so avoid a debacle in this country. I know that is not true, and that Americans are understandably more than a little annoyed by any such suggestion. The U. S. are in fact going to lend or give away many things which they would prefer to use themselves. But if there were no such thing as E.R.P. or its equivalent, I am certain that every country in the world, with the exception of the United States and Russia, would feel the repercussions - and in almost all cases feel them deeply. Would the United States remain unaffected by this gravely unhappy situation? One would want to consider this question very carefully before giving an answer.

Coming back to Canada, it seems likely that in 1948 we shall be able to participate in the European Recovery Programme by continuing to extend some credit to the countries concerned and by selling very considerable quantities of food stuffs to the United Kingdom at less than world prices. While our contribution will be very much more modest than it was in 1947, it will nevertheless be in proportion to our resources and national income. With the economies resulting from our import and travel restrictions, I hope that we shall be able to make this contribution and still remain on an even keel so far as our external cash reserves are

concerned. Predictions of this kind are, of course, very dangerous. They are subject to change without notice. For example, if we should have the good fortune to harvest bumper grain crops this summer, our prospects would be better than those which I have suggested. If we had a crop failure, the shoe would be on the other foot. But I believe in our ability to tackle our problems as they arise, and to pay our bills as they fall due.

I have referred only to 1948 in connection with our relation to E.R.P., following the example of your Congress. I am inclined to think it is a mistake to form any firm view of the more distant future on any basis which involves careful calculations of dollars and cents, or elaborate estimates of production, consumption, exports and imports, country by country and product by product. The human race owes its survival to its adaptability. Given time, we can and will adjust ourselves to almost any conceivable departure from previous norms.

More particularly, if a country has the stuff, both material and human, it will probably adapt itself to changing political conditions whatever these may be. When I think of Canada's future possibilities I ignore the dark clouds - originating elsewhere - which now seem to fill the nearby field of vision, and inspired by a glimpse of the brightness beyond begin to talk something like a Chamber of Commerce booster. And it is an interesting fact that, at least on this continent, Chamber of Commerce boosters have on the whole been justified by history. In any case, I think it is the part of sanity and health every now and then to look beyond the immediate difficulties, to assume that somehow, with hard work and goodwill, we shall surmount them.

I remind myself that Canada is a nation of twelve million active,

well-fed, reasonably intelligent human beings, inhabiting a vast area, capable of great feats of industrial and social organization, and very keen to develop to the utmost the great riches with which the present generation has been endowed. We have to-day in undiminished volume the great reservoirs of natural resources of which we used to boast. Indeed, we know more of them to-day, and have even greater proved reserves than ever before. In relation to the needs of the rest of the world, even of such a rich giant as the United States, our forests and mines and industries appear more valuable from year to year, and several extraordinary new discoveries of vast iron ore deposits and oil fields fairly challenge the imagination.

We shall not, I hope, grow too big for our britches. We realize that our own development must be greatly influenced, and can be greatly aided, by the actions of others, and we trust that we may continue to give and receive on an increasing scale that co-operation with our associates in the United States particularly, which has been so important in the past. In the extractive industries, in many fields of manufacturing, and to an every increasing extent in heavy industry, opportunities for development in Canada are very great - and I do not believe that either our own businessmen or yours will fail to recognize such opportunities. The present temporary exchange shortage, by forcing us to take another and closer look at our own potentialities, may in the end prove to have been very salutary and fruitful.

July 13th, 1948

M.C.