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THE BANK OF CANADA:
THE FIRST TWENTY YEARS

Address by MR. GRAHAM TOWERS,
Governor of the Bank of Canada, to
the Canadian Club, Montreal, P.O.,
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THE BANK OF CANADA: THE FIRST TWENTY YEARS

It seems to me that some people have come to the conclusion over the years that we in the Bank of Canada are a pretty uncommunicative lot; in fact, if I recall correctly, I saw a newspaper story not many months ago which described our performance in this respect as "clam-like". Well we don't particularly want to be "clam-like" and it may be that we could have been more forthcoming than we have been, but I am sure that our sins in this matter do not arise from any simple reluctance to talk. I for one am pleased to talk whenever I can find anyone to listen - as you are so kindly doing today. But there is the difficulty, of which I am acutely aware, that description of Bank of Canada activities can become very technical and therefore rather dull for those who have not a professional interest in the subject. This may be the main reason for that predilection for silence which is often said to be the occupational disease of central banking. On this occasion, however, I am going to set aside my fears and talk to you about some of the things that have occupied the Bank of Canada over the years.

The Bank is now within a few months of its twentieth birthday for it first opened its doors for business on March 11, 1935. Organization of the Bank had been commenced in very humble surroundings about four months before that date. Early in November 1934 the Government kindly lent us a room in one of its buildings, also a desk and two chairs. At that point the number on the staff was one. I still don't know just how we managed to start business some four months later. Looking back on that time my main feeling is one of

gratefulness for the calibre of the men whom we were able to attract to our service - men who took interesting and worthwhile jobs to take their chances with a new and untried institution.

Many of you will remember very well indeed the scene that lay before us in the spring of 1935. It was not a pleasant one. For years the level of economic activity in the country had been unhappily low and the level of unemployment unhappily high. Looked at from the financial side perhaps the outstanding feature of the situation was the burden of debt which rested upon all the groups in the community - farm and urban, business and government. In most cases the debt was inherited from the 1920's and a very large part of it was in the form of bonded and mortgage debt and as such carried fixed interest charges. The very sharp fall in prices and incomes which occurred after 1929 had increased proportionately the real burden of carrying that debt - in many cases the burden became unbearable and default and bankruptcy resulted. In these circumstances it seemed to us in the central bank that we should do what we could to relax the general credit stringency by a monetary policy of easy money, and our operations were designed both to increase the liquidity of the banking system and to improve the tone of the capital markets. Our purpose was to improve the reception that would be borrowers would receive whether they were looking for new financing or for re-financing and whether they chose to approach their bankers or to sell a public issue of securities in the market. In this way we did, I think, make a helpful contribution towards easing the debt

burden and towards the creation of economic conditions more favourable to expansion. I would wish to add that an easy-money policy could not and did not solve all the economic problems of the pre-war years and the country continued to suffer far too much unemployment until after the war broke out.

Even while we were struggling with the problems of the depression we felt ourselves increasingly impelled to cast an eye forward to see what would happen if war should in fact break out. The sort of war that we envisaged was of course one in which Canada was engaged and the United States was not, and it was clear that one consequence of such a war would be a drastic weakening of Canada's external financial position unless vigorous measures were taken to protect it. The risk was that we would not be able to pay for even our peace-time imports from the United States, let alone the vast increase in imports that economic mobilization would require. In such circumstances effective economic mobilization would be impossible. Obviously something had to be done. What we did was to work out a system of foreign exchange control. We even had the various forms printed - printed in triplicate or quadruplicate or whatever it was - and we hoped devoutly that nobody would ever have to suffer the vexations of filling them all in. Well it didn't turn out that way; when war came the Government acted quickly and one Monday morning the country woke up to find itself operating under a comprehensive system of exchange control. Whatever the defects of the control, and I know of some, this much can, I think, be said, that the magnitude of the Canadian war effort

was not restricted to any significant extent, not even at the beginning, by an inability to carry the external financial consequences. Looking back now to those pre-war days of planning, the point I would like to make is that, whether by good luck or good management, the creation of the Bank of Canada came at a fortunate time - not too late to get its organization in order and to make various preparations for war emergencies but certainly with no great amount of time to spare.

Earlier in my remarks I referred to the monetary policy of the Bank from 1935 until the outbreak of the war. In this period the problem of what policy to pursue was not a difficult one because the relatively high level of unemployment and the deflationary tendencies of the time clearly called for any reasonable degree of encouragement to the expansion of credit that a central bank could give. Nor in a sense was the war period a difficult one for the framers of monetary policy. The overriding necessities were such that the most a central bank could hope for was that the costs of the war should be covered by taxation to the maximum extent the public would bear and that everything possible would be done to encourage savings. Financing directly or indirectly through the banks had to be looked on as a last resort, but to the extent that it was inevitable central bank policy had to adapt itself to this situation.

So much for the pre-war and the war years; let me turn now to certain developments of the years since the war ended. In respect of monetary policy the post-war period has been a much more difficult one.

I do not propose, however, to take up your time today by a description of our policies in recent years for this was ground which I covered at considerable length in giving evidence before the Banking and Commerce Committee of the House of Commons on March 18th of this year.

Perhaps it will suffice to say that the struggle to minimize inflationary pressures came to an end a little over a year ago. Since then a very much easier credit situation has developed and this has had a distinct effect on interest rates in the market.

One matter which has been of particular interest to us in the Bank of Canada in recent years is the experience of the Industrial Development Bank. The Industrial Development Bank is a wholly-owned subsidiary of the Bank of Canada incorporated by Act of Parliament and it commenced operations towards the end of 1944. The Government held the view that it was too difficult, if not in fact impossible, for smaller industrial firms to obtain money to finance plant and equipment that they needed either to commence or to expand their operations. The loans required tended to be too long in term to make it appropriate for the chartered banks to provide them, and too small in amount to make it feasible for the borrower to go to the market with a public security issue. This was the problem and the Industrial Development Bank was offered as a solution. The IDB has now been in operation for almost exactly ten years. What are we to say of the results?

You will get no uncertain answer from me to that question for I am unashamedly enthusiastic. I think that the Industrial Development Bank experiment has been a great success. In the ten years, the Bank has authorized loans of something like one hundred million dollars to over thirteen hundred different borrowers. The vast majority of these borrowers were relatively small industrial concerns and they are spread widely over the whole range of industry. I think perhaps that I should add that the Bank has earned a moderate return on the investment made in it and I add this because I sense a tendency for some people to suppose that because the Industrial Development Bank is publicly-owned it is safe to assume that it operates at the expense of the tax-payers.

It is not, however, through the accounting records of the Industrial Development Bank, satisfactory as they may be, that what I take to be the important contribution of the IDB is best shown. That contribution is most clearly revealed in the stories of the Bank's clients; I find them fascinating reading and I wish the circumstances permitted me to tell you a number of them. There are literally hundreds of cases where somebody who has been working in some field or other and has acquired great skill, often skill in planning and supervising a production process, has had the enterprise to work out a new or expanded project which he was sure he could make a success of. He has had the courage to commit to the venture all the money he had or could raise elsewhere but it was not enough and he has applied for additional financing to the

Industrial Development Bank. After investigation the Bank has concluded that the project was sound, that the management was capable and that the additional financing required was not excessive, and so it has made a loan, a loan which in many cases was no more than twenty or thirty thousand dollars. Often the Bank has been able to give the borrower some non-financial assistance, as for example some useful engineering advice, or some help in setting up a proper system of costing, or some leads on where he ought to look for his market. Sometimes years have gone by before, out of the uncertainty, there has emerged a successful operation, small but well-managed, prosperous and with a bright future. We have, I repeat, seen something like this happen many many times, and if you believe, as I do, that the successful evolution of new enterprises is the very stuff of sound economic growth, you will understand my satisfaction over the experience of the Industrial Development Bank.

If I may turn now to more general considerations I should like to say that one of the things that has impressed me in my years of central banking has been the extraordinary number and variety of things that the central bank must know as much as possible about if it is to do its job capably. We must of course be fully informed about the state of affairs in financial markets, not only in Canada but also in the countries with which we have close relations. But this is really only the beginning, for what happens in the financial world both here and abroad is closely inter-connected with what is going on in the non-financial world, the world that people who I suspect

do not think too highly of bankers often call 'the real world'. If this were not the case there would be little point in central banking for no matter how you choose to put it the real job of a central bank is to do what it can to ensure that the banking system, and for that matter the entire financial community, operates in a manner best calculated to produce an efficient and healthy economy and sound economic growth. We therefore find ourselves interested in the whole state of the Canadian economy and, especially where things are not going too well, that interest is often quite detailed. But even more than this, because of the exposed nature of the Canadian economy, and because of our heavy dependence on exports, we have to follow quite closely the trend of economic events in those countries which are our principal markets and in the general trade and payments situation.

Trying to keep informed on all these matters is of course quite a job and this is why we have, right from the beginning, kept quite a few people busy on this part of our work. In respect of developments abroad we receive enormous assistance from the contacts which we have developed over the years with other central banks, whose interests in this respect are very similar to our own. But we have also developed very useful connections with a wide range of organizations, national and international, government and private, financial and non-financial, at home and abroad, through which we are continually informed and to whom we turn for more detailed information when the occasion requires.

At the very heart of this whole business of keeping in touch with economic developments is the ability to get hold of and make proper use of good economic statistics. In this connection I want to say that I am very much impressed indeed with the enormous advance that has been made in the last twenty years, both in Canada and abroad, in the production of good economic statistics. This is a matter in which we take some special satisfaction for it is one to which we, in company with many others, have devoted considerable attention. Of course it does not necessarily follow that even with much better information those in positions of authority will in fact deal more effectively with problems that arise in the future than they did, say, two decades ago. Effective action depends also on a proper understanding of how the economic system does in fact operate and this will always be to some extent a matter of opinion. But to know the true facts about a problem is bound, I think, to be quite a help in deciding what to do about it. I therefore place great importance on getting good economic statistics of all kinds, and I am greatly encouraged by what has been and is still being achieved in Canada.

I would like to turn for a moment to a field in which the Bank of Canada does not have direct and primary responsibility but in which we are deeply concerned - the field of international trade. Canada normally exports over 20 per cent of its national product and, as every Canadian knows, we cannot have a high level of economic activity if our export trade is in poor shape. It is for this obvious reason that so much attention has

been devoted to our international trade and financial affairs in the post-war years. When the war was over there were two main tasks to be accomplished in this field. One was to get the war-shattered countries of Europe back on their feet. The other was to reconstruct a functioning international economic system. To help in the first task Canada extended substantial credits and the United States extended very large credits and grants. The financial assistance provided by Canada and the United States, including that granted by our neighbour with such beneficial results under the Marshall Plan, had as one of its objectives the encouragement of a high level of international trade, free from hampering restrictions and discriminations. These were also the objectives sought in the permanent institutions of international collaboration planned during the war and set up soon after - the International Monetary Fund, the International Bank for Reconstruction and Development and the General Agreement on Tariffs and Trade. The institutions embody the conviction, which is not based on some fine-spun theory but rather on the realities of practical experience, that all countries will derive benefit from the elimination of obstacles to international trade. At times it has seemed that in spite of all the efforts put forward very little progress was being made towards reaching the goals of freer trade and convertibility of currencies. The vicissitudes of the post-war period compelled many countries to impose trade and exchange restrictions of all kinds, to foster bilateral deals and, in particular, to discriminate against the dollar area. I think we in Canada recognized that much of this was

inevitable as a temporary means of dealing with the problem. But what we have always fought against in season and out is the argument that trade restrictions and discrimination were props and safeguards which could usefully be employed for a long period of time.

I dwell on these matters for two reasons. First, to remind you, if any reminder is necessary, of the major changes in attitude and policy which have taken place in Europe in the last couple of years. Great progress has been made in the United Kingdom and many countries of Western Europe in freeing trade and reducing restrictions and discrimination. The countries concerned have benefitted greatly from these changes, and so indeed has the whole free world. My second reason for referring to the subject is to record my belief that the change in attitude and policy is no mere flash in the pan. Common sense dictates that further progress must be made in freeing trade of quantitative restrictions and in establishing convertibility of currencies, because policies leading in the opposite direction make nonsense of the political and economic philosophy of the free world and render difficult the close association of free countries on which so much depends. Everyone has to play his part in this affair, not least the North American continent. It is well to recall that currency inconvertibility and trade restrictions, like tariffs, usually afford protection against international competition. North America is not unaware of the opposition which sometimes exists to greater international competition. If at times we run into set-backs or disappointments, we must remember that patience

is a virtue if it is not carried to the point of passivity. What is essential is that we keep our eye steadily fixed on the ultimate goal and that we keep moving towards it as rapidly as at the time is possible.

I referred a moment ago to the fact that at the core of a central bank's responsibility was the duty to do what it could to ensure that the banking system operated in a manner conducive to sound economic growth. I would like to conclude my remarks with a word on this matter of growth and the banking system.

If twenty years ago you had been gifted with sufficient insight to foresee that by 1954 the total physical output of the Canadian economy would grow to nearly three times the level of 1934, you might reasonably have wondered how the chartered banks would be able to find the money necessary to play their part in financing the greater output. If you had also foreseen the very large increase in prices which has taken place - an unfortunate legacy of the war - you would of course have wondered even more how the chartered banks would be able to handle the demands that business would make on them.

In fact the outstanding loans in Canada of the chartered banks grew over this period from about \$1 billion to about \$4 billion. The funds required were found through an expansion of the whole banking structure; the total assets of the chartered banks increased from about \$3 billion to nearly \$11 billion. This growth would not have been possible without a corresponding increase in the cash reserves of the chartered banks, which

ose from about \$200 million to their present level of around \$800 million.

Now the total of the cash reserves of the chartered banks is the responsibility of the central bank and it is principally through altering these cash reserves that central bank influence on the banking system is exerted. The point that I want to make in all this is that we are able to provide whatever increase in cash reserves is necessary to permit the banking system to grow in step with the demands of the economy. You will notice that I refer to the demands of the economy, for it is obvious that the banking system cannot expand unless there is a demand for its facilities. A bank cannot make a loan unless it can find some responsible person who is prepared to borrow from it. But if there is a demand for credit, and if the central bank allows adequate cash reserves, the potential for expansion in the banking system is very great indeed.

The Canadian economy has experienced an enormous growth in the last two decades, and I am sure that, although there may be variations in the rate, we can count on great progress in the years to come. This will require financing on a large scale in various forms - notably through the investment market and the banks. I am sure that in the field of finance we in Canada are well equipped and that our economic growth will not be restricted by a lack of credit. It will be the duty of the Bank of Canada to ensure that this is in fact the case. You will not be surprised if I express the belief that the Bank of Canada will do its duty.