Notes for remarks by
Mr. J. E. Coyne, Governor of the Bank of Canada,
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I understand the theme of your Annual Meeting is "Canada's Import Dilemma". In making this choice you have focused on one of the most important and urgent problems of the day. No doubt various speakers will put forward their own interpretation of the theme. In my view Canada's import problem can be stated very simply, namely, that we are importing too much in relation to our volume of exports.

In addition to exports and imports of goods, our international balance of payments is affected by a number of other categories of payments and remittances of major importance. These include, for example, tourist expenditures and personal remittances of various kinds, payments for research and technological services and various business services which Canadians buy from abroad instead of buying at home, and payments of interest and dividends on foreign investments in Canada. In this category of so-called invisible exports and imports taken as a whole, our annual payments now exceed our annual receipts by over one billion dollars a year, and the net payment is almost certain to grow for some years to come. The volume of dividend payments could easily double in future merely in respect of the amount of foreign investment that has already been made in Canadian industry, apart from whatever further payments may arise out of whatever further foreign investment in Canadian industry there may be in the future.

Accordingly, a mere comparison of our exports of goods with our imports of goods does not give a meaningful indication of our balance of payments problem. In effect, one must deduct from the value of our exports the large net adverse balance of our current payments on non-merchandise account, many of which are fixed and unavoidable and which in any case are growing, and compare the resulting smaller sum, the net proceeds of our exports, with the value of our imports. When this is done it is clear that as a nation we have been importing goods and services beyond our means on a large scale for nearly a decade. It is obvious that if we are ever to get our international position into balance and stop the growth in our foreign debt we must achieve either a much greater increase in our exports than in our imports, or alternatively a decrease in our imports to the extent that exports cannot be increased sufficiently.

There is another way of looking at the problem which may help to get it into better focus and assist in developing ideas about ways and means of solving it. Stated in this way, the problem is that we have been trying to achieve a level of new investment in physical facilities of all kinds which is much greater than the flow of new saving by Canadian individuals, businesses and governments. The effort to make this excess of investment over domestic saving, to realize it in physical terms, has induced the large excess of imports over exports that I have referred to. In financial terms we have drawn on the savings of non-residents on an enormous scale, a scale which is unprecedented in relation to any country which has got beyond the colonial or seriously under-developed stage. In 1956 and 1957 we used this foreign saving (in the form of the large excess of imports over exports which it made available to us) to achieve a level of new investment in physical facilities of all kinds much greater than the flow of new saving by Canadian individuals, businesses and governments would have provided. In 1958, 1959 and 1960 we continued to use almost as much foreign saving in connection with a somewhat smaller investment programme even while some of our capacity to produce output, income and saving in Canada went unused.

In trying to appraise the level of new physical investment in Canada against the level of our new saving it is interesting to compare our situation with the United States. That country has much the highest per capita income in the world (a great deal larger than ours) which means far more income surplus to ordinary requirements and far more capacity for saving, and it is in fact adding to its capital facilities and improving its technology at what is commonly regarded as a very high rate. It may seem surprising that, despite our substantially smaller per capita income, the Canadian economy as a whole has year by year been saving an appreciably higher proportion of gross national product than the United States economy. On the average over the past five years the percentage has been over 22% in Canada as compared with less than 19% in the United States. To save a larger part of a smaller income involves much greater effort and strain, as any individual can testify.

On the other hand, out of this smaller proportionate saving the United

States has been providing capital on a considerable scale to the rest of the world whereas Canada, in addition to its own larger proportionate saving, has been drawing in capital from the rest of the world. In Canada physical investment in new productive facilities and for such forms of social capital as housing, hospitals, schools, roads and other forms of government capital outlay --- has been equal to approximately 26% of our Gross National Product over the last five years, as compared with 18% in the United States.

This does not mean that we have succeeded in increasing the physical volume of our Gross National Product more than in the case of the United States, except to a very small degree. On a per capita basis, in fact, our increase in national production over the past 5 or 10 years has been less than in the United States. It is evident that the higher rate of capital investment in Canada has not yielded a higher rate of production, upon which the general standard of living depends. It would appear that we have not achieved the best results in the way of over-all, steady, balanced growth. The persistent secular rise of unemployment for some years ---the trend which is apparent after allowance is made for seasonal and for cyclical variations --- also indicates that the development of the Canadian economy for some time has been unbalanced and in part has taken place in the wrong direction. The paradox of a high level of unemployment existing at the same time as a large excess of imports over exports is not a casual or fleeting phenomenon but appears to be the product of structural faults which have been building up for some years.

The very large gap between the high level of Canadian saving and the still higher level of investment (whether fruitful or otherwise) in Canada has involved a huge growth of our foreign liabilities, both those which take the form of fixed money obligations which have to be repaid and those which take the form of increasing foreign ownership of Canadian resources and Canadian enterprises.

Part of the foreign investment in Canadian resources and enterprises has indeed been the cause rather than the consequence of our rapid and uneven expansion of facilities and our balance of payments deficit. The inflow of foreign money both for the exploitation of Canadian resources and the take-over of Canadian enterprises, and as a result of borrowing abroad by Canadian provinces, municipalities and corporations, have had the effect, under our system of a freely fluctuating exchange rate, of keeping the Canadian dollar at such a high level in recent years as to hamper exports and encourage imports, while our foreign debt went on increasing.

It will be recalled that there was some decrease in our foreign debt during World War II, particularly as a result of the repatriation of Canadian Government securities and railway securities and some other securities held in the United Kingdom, but there has been a tremendous increase since the War, and a particularly large increase in the degree of ownership and control of Canadian resources and industries acquired by

United States corporations. Our history has been very different in this respect from that of the United States. Once the United States got out of its colonial stage, and particularly after the early days of railroad building, which to some extent was financed from the United Kingdom, there has been little reliance on foreign capital in the development of the United States economy. The amount of foreign borrowings and of foreign investment never was significant in relation to total capital invested in the United States, or in relation to Gross National Product, or in relation to the United States international balance of payments. Above all, there was never any significant degree of foreign control of American resource development or American industry. Throughout their history the Americans have been very properly and single-mindedly intent on nation building---on asserting their independence and their national sovereignty, developing their economy from the Atlantic to the Pacific on the basis of ownership, management and control of the American people, by the American people, and for the American people.

In Canada our capacity to service our abnormally large foreign debt has not grown commensurately with the increase in our foreign debt. Only a serious and persistent national effort directed to that end will make this possible. Comparisons of the growth in our foreign debt with the growth in our Gross National Product are not relevant for this purpose. A rise in Gross National Product does not of itself increase a nation's capacity to service or repay its foreign obligations. This will only be increased to the extent that the rise in the Gross National Product takes the form of goods and services which succeed in finding an increased market abroad, or takes the form of goods and services which succeed in displacing in the domestic market goods and services previously imported.

What we have had in Canada over the past decade has been a somewhat disorderly attempt to do too much too soon in several important areas. This led to the development or over-capacity in some lines of industry, to a certain amount of waste of resources, and to the stifling of growth and development in other lines of industry which could not keep up with those which had easiest access to large sources of foreign capital or could not afford the rising levels of industrial costs which were consequent on over-rapid expansion in some industries, mainly foreign-owned, and the construction boom to which they gave rise. In addition, the hectic atmosphere of forced growth, the excitement attendant upon huge developments financed from abroad by giant international corporations, and the general appearance of easy profits for ancillary Canadian activities, profits financed in effect by foreign borrowing, have had many undesirable side effects, particularly of a psychological character. I venture the proposition that it is not healthy and will not be fruitful or successful for a country such as Canada to pursue any other course than to stand on its own feet, finance its own development out of its own savings, and refrain from trying to achieve a rate of economic growth greatly in excess of what its own best efforts can support.

Some would justify the very high rate of expenditure on physical facilities in the last decade on the ground that it was necessary for the maintenance of full employment. In point of fact there is no standard relationship between capital investment and employment. It is possible to have full employment with varying levels of capital investment and saving, as the history of many countries will show. Indeed it is possible for an excessive pace of investment or attempted investment to hamper the pursuit of full employment on a stable, balanced, continuing basis, and I believe the level of unemployment that we are now experiencing in Canada is in part evidence of this.

Contrary to what the pessimists say, we do not have to have any given rate of growth in our physical and productive assets in order to achieve and maintain full employment. The importance of sound and sustained economic growth is that it can provide a steadily rising standard of living. It is for this reason that we want as much growth as we can achieve --- not in short spurts followed by recession and unemployment, not in a few industries while others languish, not in some regions while others lag behind --- but steadily, surely, comprehensively, in a wide diversity of industry and in all parts of the country. This we can achieve --- again contrary to what the pessimists say --- without having to lean on other countries for large net imports of capital year after year.

I see no reason why we could not double our output in physical terms within twenty years --- increase average real income of every family in Canada by one-half or more. This would be the result of an average annual increase in real output of $3\frac{1}{2}\%$ which is well within our own physical capabilities without net drawing on foreign resources.

I mentioned earlier that the Canadian economy as a whole has one of the highest rates of saving in the world, and distinctly higher than that of the United States economy as a whole. For reasons which perhaps need some further study, this high rate of saving has manifested itself mainly in the accumulation of savings by corporations, both in the form of high depreciation allowances --- considerably higher than the actual rate of either physical depreciation and depletion or obsolescence --- and partly in the form of retained earnings. On the other hand, personal saving by Canadians, whether considered as a proportion of income remaining after taxes or whether considered as a proportion of total annual production, has been somewhat lower than in the United States. A programme for making ourselves independent of further imports of the savings of foreigners should include measures to increase our own rate of saving, with particular emphasis on whatever increase can be achieved in the rate of personal saving by individual Canadians. A smaller rate of saving on the part of corporations on the other hand, resulting from higher dividend payments, might be of advantage in other respects: investment in Canadian corporate enterprises would be more attractive to Canadians if the dividend scales were higher.

The problem of encouraging saving and growth in Canada, and of creating conditions in which we may have not only a high rate of growth financed out of our own savings, but a condition of stable full employment without inflation, has many aspects. Our difficulties have a variety of causes, and some combination of a number of various lines of attack will no doubt provide the best solution. It is important to realize, however, that there is no single easy solution, no method which does not involve effort and thought and the adaptation of earlier ideas to the actual conditions of the day. Above all, it must be emphasized that economic growth and full employment are not being held back by insufficient total buying power in Canada, but rather by misdirection of that high level of total buying power which already exists. We might well continue to have, as we have had over most of the past decade, a higher level of spending or attempted spending than we are able to satisfy out of Canadian production, unless suitable changes take place in the structure of our economy.

Unless steps are taken by all concerned to improve the structure of production in Canada, the high level of effective demand, of total buying power, will be reflected in a continuing large net import of goods and services which would do little or nothing for employment in Canada, would be financed by further growth of our foreign liabilities, and would further lessen our ownership and control of Canada.

The great problem has been and will be to produce in Canada as economically and efficiently as possible the kinds of goods that are wanted, that Canadians are presently buying from abroad on an excessive scale in the aggregate, and to anticipate and adjust our productive facilities to the changes in competitive products and in the composition of domestic and foreign demand which are bound to occur in a constantly changing world.

The problem is therefore just as much one of the composition of growth as it is of the total quantity of growth. If the growth in our total productive capacity is not well balanced, and in tune with changes in markets for goods and services, we shall be unable to compete as effectively as we should in export markets, or compete with imported goods in the Canadian market, and as a result will have a large continuing balance of payments deficit and further great increases in our foreign liabilities, accompanied by a continuing high level of unemployment.

What kind of public and private policies could be prescribed which would enable us to face up to and solve these problems? I am sure that no one man or small group of men has the complete answer. I believe that solutions to these problems can only be hammered out on the anvil of informed public debate, and the more of this kind of debate there is, the better.

However, there is one generalization which seems to be beyond any doubt; that inflationary conditions or inflationary policies would greatly hamper or prevent the working out of solutions. Inflationary markets do not promote competitive vitality, resourcefulness or adaptability, which are the qualities we will need, but just the reverse. They make life deceptively easy for some in the short run, but only at the expense of putting off adjustments until they have accumulated to the point of constituting major structural problems in the economy.

The danger of further inflation in the future is, of course, a serious concern for monetary policy and the central bank. Although the Bank of Canada's operations cannot be directed towards the affairs of any particular sector or area of the economy, the central bank can set some limits to the expansion of the total stock of bank deposits plus currency from time to time, and in this way it has an influence on the general financial climate. It must certainly see that the stock of money increases sufficiently over time to facilitate the sound growth of the economy. Even the influence which it can exert through changing the stock of money is however subject to the qualification that holders of that money may vary the rate at which they spend it or "turn it over". The "velocity of circulation" is largely outside the influence of the central bank. It may vary considerably, and may easily move in the opposite direction to the change in the stock.

With the best will in the world there is in the day-to-day work of determining the stock of money a natural human bias towards giving expansionist considerations the benefit of the doubt against hold-the-line considerations. In addition, a central bank is the object of repeated pressures from many quarters, often of an abusive nature but sometimes couched in terms of sweet reasonableness, in favour of creating more and more new money as an apparently easy solution for unemployment or for more particularized problems. The growth of the money stock over time in nearly every country, and the rise in prices which it has assisted, bear eloquent testimony to this tendency and to these pressures. The job of the central bank is to weigh the opposing considerations as dispassionately as possible, and in its decisions seek to promote both stability of prices and the maximum degree of sound and sustainable economic growth which it is possible to attain.

There are those who sometimes set out the false alternative of either full employment with inflation, or stable prices with a high level of unemployment. They say the nation must choose between unemployment and inflation. No person in any position of responsibility could possibly subscribe to that doctrine. It is false. Full employment and stable prices are not only compatible, they are in the long run inseparable.

So far as monetary expansion is concerned, we are not today in a position in which there is an over-all deficiency of effective demand in Canada which could be rectified, with desirable effects on employment and production in Canada, by large-scale monetary expansion. The heavy continuing volume of imports and the excess of our spending abroad over our receipts from abroad provide conclusive evidence that our trouble arises not from a scarcity of total spending power, but from the undesirable direction of our spending power towards promoting employment in other countries instead of towards promoting employment in Canada. To the extent that total effective demand may need stimulating from time to time by monetary measures---may need to be facilitated by an appropriate expansion of the money supply---it is of course the duty of the central bank to take the appropriate action, but this does not cause a greater proportion of the actual effective demand at any particular time to be directed towards Canadian products rather than foreign products. To rely on the central bank to take action to achieve something which cannot be achieved by monetary means would be to delude ourselves and to waste valuable time which should bc devoted to study and initiation of other measures directed specifically to the underlying problems.

One easy-going illusion, which seems to be based on unthinking adherence to over-simplified theories without study of the real facts of the situation, is that the central bank can and should bring about large-scale monetary expansion with a view to lowering significantly the general level of interest rates in Canada. On previous occasions I have expressed my view that such action by the central bank is not what is called for by the actual circumstances in which the Canadian economy finds itself today, and moreover would not work in the way in which its advocates seem to think it would. On this occasion I cannot do better than to quote the very succinct statement made by Mr. W.E. McLaughlin, newly elected President of The Royal Bank of Canada, on the occasion of his annual address to the general meeting of shareholders on January 12th last:

"The easy way out of this dilemma, according to some, is simply to increase the money supply and reduce the embarrassing interest differential between Canada and the United States. In fact, the inflationary potential of the increase in the money supply required for even temporary success in such an endeavour would so upset the Canadian bond market that the supply of lendable funds based on savings would be drastically reduced and the appropriate rate of interest even higher than at the beginning of the experiment."

There has been in recent years an increasing amount of discussion of monetary policy in Canada. This is all to the good, although it is disappointing that there has been so little in the way of the development of new ideas, or even of challenges to old ideas. The contrast is very great in this respect between Canada and other countries such as the United States and the United Kingdom, where a great deal of research and re-thinking has been going on in a number of quarters. Some provocative new theories and new aspects of monetary theory have been put forward in England, the United States and many other countries. It is increasingly apparent to those who come to this matter with a fresh mind that there is still much to be learned about the way in which the financial system really works, and especially about the way in which monetary policy interacts with the level of economic activity in the country. The real results of the operations of a central bank may be quite different in important respects from what they are frequently supposed to be. To mention only one avenue worth exploring, the fact that a central bank's operations directly affect only the commercial banks which are members of the central reserve system, and that at times the growth of activities of other financial institutions and financial intermediaries may have more dynamic significance than the activities of the commercial banks, are matters which may well require changes in conventional theory. In any case, I believe it would be valuable to have much more in the way of hard, practical objective study of Canadian monetary policies, techniques and operations in relation to real situations, and particularly the current circumstances and the trends of Canadian economic development.

To facilitate study and analysis, we in the Bank of Canada are trying to make public as much information as possible about our operations throughout the year, indeed from week to week. Students from other countries have told us that more of the essential information needed by analysts is made available and is put out more quickly in Canada than in any other country, and we are constantly striving for improvement in this respect.

In this connection I recall the phrase used by an eminent past president of this Association, the late Kenneth Wilson, so well known and admired by us all. He used to say that "Light is the sovereign antiseptic and the best of all policemen". Of course, there are none so blind as those who will not see, but I believe that the publication of the facts, and the development of new ideas and the testing of old ideas by vigorous public debate in many quarters, are, the best guarantee of wise policy and operations on the part of any public institution.