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CANADIAN WARTIME FISCAL

POLICIES

by

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# INTRODUCTION

Modern wars, organized by national governments, are fought with men, machines, and materials. The government has to mobilize the men, provide them with the fighting equipment and supplies, transport them to the battlefield, remunerate them and pay indemnities to the families at home. To do this, the government needs money and the money must be obtained from someone. This, then, is the first task of the government.

The money can be obtained either from individuals or corporations at home or from foreign creditors. What is obviously sought is not cash but rather the purchasing power the money represents. Those who give the money have to sacrifice the goods they could have purchased with it. This is unavoidable unless the nation has considerable unemployed resources on which to draw. The second problem of war finance, thus, is to make sure that this burden is carried by the population and carried in some equitable and justifiable way.

How these sacrifices are made depends on the way war is financed. There are three principal methods of war finance: taxation, borrowing from savings, and credit expansion. These are usually supplemented by other government regulations designed to increase the effectiveness of wartime finance, such as foreign exchange control, price and wage control, commodity rationing and other devices. All together form the general machinery for war finance.

The extent to which war materials and equipment can be obtained depends on the degree to which (a) production can be increased,

(b) personal consumption reduced, (c) new investment curtailed, and (d) the maintenance of capital equipment deferred. In so far as dependence is placed on the first two factors the war effort is drawn from the country's current production and the physical costs are borne by the present generation, i.e. by the generation that lives through the war. On the other hand, when increased production is obtained at the expense of capital, the burden is passed on to the future.

This is true both of taxes and borrowing, though taxation will place more of the burden on the present than the future generation. Generally speaking, all methods of war finance may be considered as forms of taxation. Taxation takes funds from those who can afford to pay in accordance with a definite set of rules. In the case of borrowing the problem of the final incidence of the cost is left until after the war. Inflation is the most undesirable form of taxation in that it offers no exemption to those whose incomes are low and hence throws a heavy share of the burden upon the poorer classes of the nation.

The object of this report is to analyse Canada's war effort and to show how the burden of the war has been borne by our economy. The material is organized in the following way. Chapter 1 describes the manner in which Canada has financed her war expenditure by the use of taxation. Chapter 11 is devoted to an analysis of our wartime borrowing from savings and credit expansion. Chapter 111 records the various measures taken to conserve foreign exchange. This is followed, in Chapter 1V, by a comparison of the financial systems in World War 1 and World War 11, supplemented by a brief outline of the post-war problems facing us and some suggestions as to possible solutions.

Source material on the subject of the present study is plentiful but most of it is in the form of articles in periodicals and pamphlets. It has thus been necessary to rely almost entirely on contemporary literature. The annual Budget Speeches as presented in the Parliament and the numerous debates in the House of Commons have been drawn upon extensively. Professor Pigou's 'Political Economy of War' has been most helpful in supplying the theoretical principles of wartime finance.

In the preparation for this study I found most valuable assistance from Prof. W. B. Hurd whose criticism and suggestions helped greatly to improve both the contents and the presentation of the argument.

# WARTIME TAXATION

## 1. Canadian Taxation System Before the War.

Under the British North America Act of 1867 the Dominion was allowed to impose taxes in any form. It was also given the exclusive right to collect indirect taxes, mainly excise and customs duties. As these had been the chief source of revenue to the provinces prior to this Act the Dominion agreed to provide compensation in the form of grants or subsidies from the Dominion Treasury.

Provincial expenditures increased rapidly after the Great War while the grants from the Dominion remained practically stationary. The provinces, therefore, gradually extended their fields of taxation. They imposed income taxes, succession duties, and taxes on gasoline. At the same time the Dominion government entered the field of both personal and corporation income taxes. The situation at the outbreak of war was roughly as follows: Customs and excise taxes were imposed exclusively by the Federal government; personal income taxes were levied not only by the Federal government, but also by six provinces and many municipalities. Succession duties were provincial. Sales taxes were federal, provincial and municipal; corporation taxes were levied both by the Dominion and Provincial governments. The real estate tax was left to the municipalities.

We can readily see that this system was by no means a perfect one. Conflicts over financial jurisdiction were especially acute in the early thirties when most of the governments found it difficult to meet their financial obligations out of decreasing incomes.

Duplication of taxation, that is the levy of tax on the same base by two and sometimes three taxing authorities all simultaneously, tended to depress the national income. Very often mutual understanding between rival tax authorities was lacking with the result that there was no joint consideration of the issues to be faced. This was the situation with which the Minister of Finance was confronted at the outbreak of war.

2. <u>General Policy of Wartime Taxation.</u>

Canada now has a broad and comprehensive taxation system designed not only to produce funds but to facilitate the control that is necessary to carry out a policy that will finance the heavy wartime expenditures without giving rise to unfortunate maladjustments and post-war demoralizing readjustments such as befell Canada and many other countries during the First Great War.

In discussing the conditions confronting the Dominion at the beginning of the present international conflict the Minister of Finance, Mr. Ralston, laid down the broad principles of the Government's policy of war finance in the first war budget. The general policy as outlined consisted of two parts. The first was appropriate to an initial period of comparative hesitation and quietness, lasting from two to three months, in which the expansion of national income and employment would be facilitated. To ensure that out of the rising incomes increased revenues would begin to flow, certain excise taxes were levied, and moderate increases were imposed in the income taxes. To prevent shifting of national wealth and income to particular groups or sections of the country new and heavy excess profits taxes were imposed.

The policy for the initial period was followed by one for a second period during which national income, production and employment gained momentum. At the same time war costs mounted. To make sure that the resulting larger incomes would become subject to heavier taxation and at the same time to discourage specific activities which were considered undesirable or unnecessary in war time, the tax structure was considerably modified. The second war budget brought down on June 24th, 1940, accordingly provided for substantial increases in taxes. These increases, as judged by any standard in our country's history, were very great. It also introduced several new taxes such as the National Defence Tax and the War Exchange Tax.

War expenditures were relatively low during the first nine months of the war when war activities were in the organization phase. They rose rapidly after the fall of France and by the end of the first year of war were running at a rate of more than seven hundred millions per year.

In planning and devising the financial policy of Canada, the Government set for itself two objectives: first, to bring the country as rapidly as possible to the full use of its resources, and, in the second place, to follow as far as might be practicable a pay-as-you-go policy. This was later supplemented by a pay-as-we-earn policy. And the Government has resolutely stood behind these principles. It has relied heavily on direct Income Taxation and it has practically eliminated war profits through the Excess Profits Tax. A new tax in the form of a Dominion Succession Duty was introduced.

The budget of 1943 provided for revenues and expenditures much increased over those of any of the previous years and the pay-as-we-earn policy of collection was effectively used in support of financing. The total expenditures of the year amounted to approximately \$ 4,387 millions; the tax revenue was approximately \$ 2,250 millions, or about 51.3 per cent of the total expenditure.

3. Present Taxation System.

(a) Increase in Rates of Pre-War Taxes.

i Personal Income Tax.

The Personal Income Tax is a very important source of federal revenue in Canada. In 1939 this tax yielded some 46 million dollars or 9.9% of the total revenue. In 1944 it is estimated it will bring in around 930 million dollars which corresponds to about one-third of the total.

This tax is considered the most equitable of all taxes because it alone can be directly related to the means of the taxpayer. By and large, a person's income is the best single measure of his taxable capacity, particularly when allowances are made for the number of persons dependent on him. However, the Canadian government has attempted to follow the principle of equality of sacrifice when constructing the Income Tax schedules. Immediately upon declaration of war a special War Surtax equivalent to twenty per cent of the total Income Tax was imposed by the Government and another increase was made in 1940, by a revision upwards of all rates throughout the whole range of taxable incomes.

Two facts had to be faced when establishing the new rates.

First, there was not enough money in the higher income group to carry any substantial portion of the cost of war. This meant that heavy taxation had to be imposed on the large lower and middle income groups which had so far escaped relatively lightly. The second fact was that six out of nine provinces already were imposing a personal income tax. Any analysis of income tax rates, therefore, had to take into consideration the provincial and local rates as well.

The exemptions under the Personal Income Tax Act accordingly were reduced from one thousand dollars for single persons and two thousand dollars for married persons to seven hundred and fifty and fifteen-hundred respectively. The effects of this change, coupled with the raising of the rate, are shown in Table 1. It will be noticed that the income taxes payable by residents of the United Kingdom in 1940 were still considerably more burdensome, especially in the lower income brackets, despite the substantial increase in our own tax structure. Since 1940, the exemptions have been still further reduced and the rates have been raised steeply all along the line. Inevitably, the increases are proportionately greatest in the lower and middle incomes.

The difficulty of double Income Taxes was removed by an agreement in 1941 providing for a withdrawal from the Income Tax field by the provinces in favour of the Dominion Government for the duration of the war. In return the Dominion guaranteed to pay each year to the provinces either (a) an amount equal to the revenues actually received by the provinces from these taxes during the fiscal year ending nearest to December 31st, 1940, or (b) the amount actually paid by the provinces for net debt service less the revenue obtained from succession duties.

The effect of this agreement was that it enabled the Dominion Government to levy the necessary taxes without injustice to residents of different sections of the country or to different income groups; it also resulted in a net increase in Dominion revenues of approximately ninety million dollars after the required payments to the provinces have been paid in the next following fiscal period. Of the nine provinces, five chose to receive the amount of tax previously collected and four chose the debt service payment.

As rates were increased to higher levels, other factors than ability to pay had to be taken into account, e.g. equality of sacrifice, incentive for harder and better work, the encouragement of saving a decrease in unessential expenditures. In devising measures to obtain an increased yield and at the same time render equitable the increased rates, the Government made two changes. First the National Defence Tax lost its identity as a separate tax and was incorporated into a single assessment, collected as far as possible by deduction at the source; the graduated rates of the tax were steeply increased. These new rates, together with the changes in exemptions and allowances, increased very substantially the amount obtained from taxpayers. (1) Second, it was also provided that part of the total tax was to be recorded as a form of compulsory saving to be refunded after the war. Deductions from the minimum saving requirement were permitted in the case of certain types of personal savings such as life insurance premiums, mortgage payments and contributions to pension funds. The tax

(1) $ 115,000,000.

## TABLE I

## INCOME TAX COMPARISONS UNDER 1940 INCOME TAX

(Married Persons With No Dependents)

| Income | 1940 Dom. Tax | New Dom. Tax with Nat. Def. Tax | U. K. Tax 1 Sterling = $ 4.45 | New Dom. Tax with Nat.Def. Tax & Ont.Tax as % of U. K. Tax |
|---|---|---|---|---|
| $ 1,500 | $ .... | $ 30.00 | $ 141.00 | % 21.3 |
| 2,000 | .... | 75.00 | 328.50 | 22.8 |
| 3,000 | 36.00 | 195.00 | 703.50 | 29.5 |
| 4,000 | 84.00 | 355.00 | 1,078.50 | 35.7 |
| 5,000 | 144.00 | 555.00 | 1,453.50 | 41.5 |
| 10,000 | 781.20 | 2,170.00 | 3,550.07 | 65.8 |
| 15,000 | 1,789.20 | 4,330.00 | 5,993.83 | 77.5 |
| 20,000 | 3,112.20 | 6,530.00 | 8,715.07 | 80.7 |
| 30,000 | 6,514.20 | 11,200.00 | 14,796.31 | 82.3 |
| 50,000 | 14,351.40 | 21,610.00 | 26,943.19 | 88.0 |
| 75,000 | 25,880.40 | 36,065.00 | 46,216.94 | 85.5 |
| 100,000 | 39,299.40 | 51,520.00 | 66,547.56 | 84.7 |
| 150,000 | 70,043.40 | 84,475.00 | 108,265.69 | 75.0 |
| 200,000 | 103,698.00 | 119,430.00 | 150,765.69 | 86.0 |
| 500,000 | 334,656.00 | 357,235.00 | 405,765.69 | 93.9 |

Source: 1940 Budget Speech, Page 17.

rates and minimum savings required from persons with various incomes are illustrated in Chart I. It will be noticed that the refundable portion of the tax is relatively much heavier in the lower income brackets thus serving the principle of equality of sacrifice.

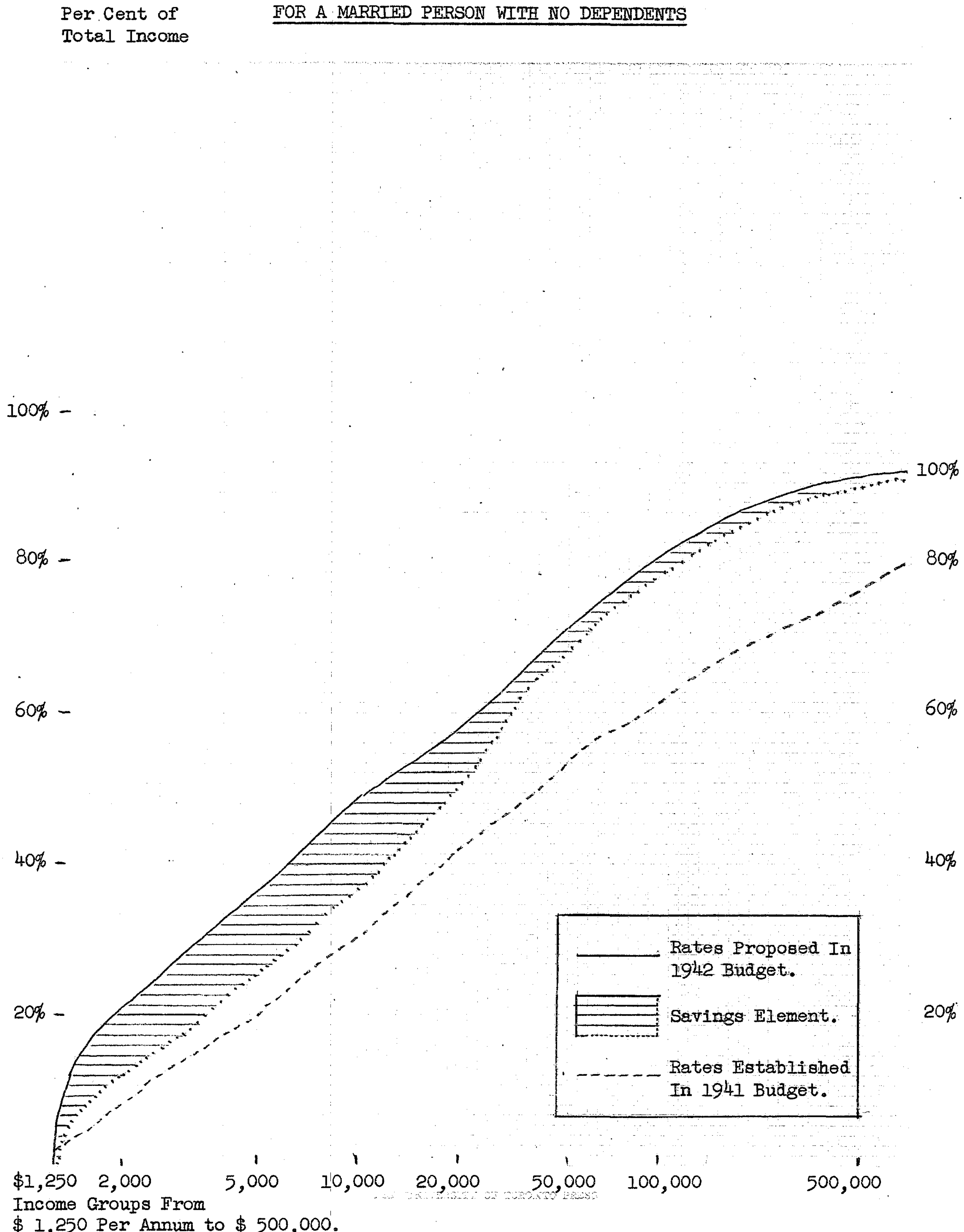
While the method of tax collection at source undoubtedly made the payment much more convenient, the Canadian taxpayer was still, at all times, considerably in arrears to the Government for Income Tax. That is, deductions were made from current earnings but not for current earnings but rather for incomes of an earlier period - eight months prior to the payment, to be exact. If one suffered reduction or loss of income in some future time, he or his estate still owed the Government eight months' taxes. Unless the taxpayer has used exceptional self-restraint and foresight and has set aside some extra money in advance, he was almost certain to run into difficulties when the tax payment date fell due.

In April, 1943, therefore, it was provided that 95 per cent of Income Taxes was to be collected at source, half the tax liability for 1942 was forgiven and payments already made in 1943 were applied to the 1943 tax. The advantage of this system of current payment of tax or the pay-as-we-earn system is that when a man's income falls off, his tax falls off with it; it also enables him to avoid the lag in the payment of tax under the old system, not to speak of other advantages, such as the more effective use of collection at the source and a more prompt adjustment of rates when desirable. Nor was the change altogether disadvantageous to the Government. It secured the immediate right to collect taxes on a greater national income with a resulting increase of

CHART I

PERSONAL INCOME TAX RATES IN CANADA - 1942

FOR A MARRIED PERSON WITH NO DEPENDENTS




Source: Monthly Review, Bank of Nova Scotia, July - August, 1942.

about one hundred and five millions in receipts for the fiscal year 1943/44.

A further revision of the Personal Income Tax was introduced in the 1944 budget. The Minister of Finance, pointing out the hardships caused by the high rates of taxation, announced the discontinuation of the refundable feature of the income tax. Some 110 to 115 million dollars were thereby relinquished and would have to be replaced by voluntary savings.

ii <u>Corporate Income Tax.</u>

The Corporate Income Tax was raised in the first war budget from 15 per cent to 18 per cent - in the case of consolidated returns, from 17 to 20 per cent. This tax was to be paid regardless of whether a corporation made sufficient profits to come under the Excess Profits Tax or not. The reason for this rather lenient increase was that in the interests of equity increased taxation should bear upon excess profits rather than on profits which had not increased substantially over pre-war levels. This increase of one-fifth in the Corporate Income Tax was approximately equivalent to the increase in the Personal Income Tax through the imposition of the War Surtax. (1)

iii <u>Sales Tax.</u>

The Sales Tax, which usually bears disproportionately heavily on the lower income groups, has not been altered since the outbreak of war. The reason is that while comparatively easy of administration and collection and extremely productive, this tax has marked defects as a fiscal instrument. The only changes of importance have been the removal of exemptions for building materials, electricity and

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(1) 20% war surtax over the total personal Income Tax.

gas used for domestic purposes, salted or smoked meats and canned fish. Other changes made were merely for administrative purposes. With the expansion of national income the volume of revenue from this tax increased correspondingly. Nevertheless, its place in the Dominion tax structure has greatly diminished in importance.

iv <u>Customs Import Duties.</u>

Minor changes have been made in import tariffs for revenue purposes and for the conservation of foreign exchange. A customs duty on coffee, tea and preparations used in the manufacture of non-alcoholic beverages was imposed in September, 1939. Other tariff changes were made necessary to correspond with the additional excise duties imposed on similar articles of domestic origin. Other minor adjustments were made in the matter of the wording of several items to facilitate administration.

Generally speaking, the tariff lost its importance for the duration except as a producer of revenue. For under wartime conditions changes in the customs tariff would have little, if any, effect on international trade.

v <u>Excise Taxes.</u>

In the field of indirect taxation the Canadian Government's policy has been to avoid indirect taxes which would unduly raise the cost of the necessaries of life and to follow a selective approach in increasing consumption taxes. In September, 1939, increased levies were recommended on certain luxury articles; domestic and imported liquors (seven and eight dollars per gallon), cigarettes and manufactured tobacco twenty-five per cent, coffee and tea ten cents and five cents per pound respectively. A new tax of two cents per pound was placed on carbonic acid gas used in the manufacture of soft drinks.

In the 1940 budget further increases were imposed to "contribute substantial sums to the treasury and ... as readjustments of unsatisfactory situations". (1) The following were affected: smokers' supplies, including manufactured tobacco (35 cents per pound), raw leaf tobacco (10 cents per pound), cigarettes, weighing less than two and a half pounds per thousand (six dollars per thousand), matches (one cent per hundred). Other taxes were designed to discourage purchase of certain articles made of materials that could be used in the production of war supplies. The peacetime Excise Tax on automobile tires and tubes was increased from two and three cents per pound respectively to five cents and a new excise tax of ten per cent was imposed on radios, cameras and phonographs.

As demand for additional funds increased other items subject to taxation had to be considered. The tax on sugar was increased one hundred per cent to two cents per pound. To hold down consumption of unessential goods and services the basic rate on passenger automobiles was increased from twenty per cent to twenty-five per cent. Similarly the rates on gasoline (three cents a gallon), transportation fares, motion picture admission, wagers at horse-racing meets, long-distance telephone calls and many other minor items were raised.

The fourth war budget announced further large increases in already existing taxes, resulting in an increase in revenue of some thirty-four million dollars in a full year. In addition, new taxes on candy, chewing gum, photographic films, telephone extensions, a twenty

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(1) 1940 Budget, Page 18.

per cent tax collected on amusements and a new excise tax levied on retail purchases of certain luxury articles further extended the long list of items subject to excise duties. When the Dominion's liquor restriction programme was announced in December, 1942, providing for a reduction in the quantity of spirits, wines and beer, the Government felt that the Dominion should make up to provinces any loss in revenue from liquor sales which they might suffer in future as compared with their receipts from these sources in the past. While an additional excise duty of two dollars per proof gallon on spirits was proposed, the Dominion declared itself ready to guarantee to any province the revenue it received from liquor sales during the year ending June 30, 1942, provided it increased the price of spirits by an amount sufficient to cover the extra levy plus an additional amount of two dollars per gallon for the benefit of the province itself. The increase in the retail price of liquors by four dollars per gallon not only eased the difficulties in rationing the smaller available supply on hand but the provinces and the Dominion were assured of an increased revenue as well. Other changes involved an additional tax of one cent per ounce on certain classes of mail.

(b) <u>New Taxes</u>.

i <u>Excess Profits Tax</u>.

The importance of this tax was recognized immediately upon the declaration of war when the Canadian Government introduced the Excess Profits Tax hurriedly in the first war budget in 1939. The basic principles and purposes of the Excess Profits Tax might be said to be twofold: (i) to prevent the accumulation of war profits and (ii) to secure revenue from business profits to finance the war effort. All businesses, whether incorporated or not, are liable under this Act, and whether increased profits are the result of war contracts or not. Two alternatives were permitted in the measure: (i) a tax of fifty per cent on profits in excess of the average income in the base years 1936 to 1939 inclusive, or (ii) a graduated tax on all profits in excess of five per cent of the capital. The following schedule was to be applied in the latter case:

| | | | | |
|---|---|---|---|---|
| on profits of more than | 5% | but less than | 10% | of capital, rate is 10% |
| " " " " " | 10% | " " " | 15% | " " , " " 20% |
| " " " " " | 15% | " " " | 20% | " " , " " 30% |
| " " " " " | 20% | " " " | 25% | " " , " " 40% |
| " " " " " | 25% | " " " | | " " , " " 60% |

The second option was subsequently discarded and the privilege withdrawn, because it was found that many firms would pay little or no tax under this provision and that it was generally inequitable. However, the principle of excess profits taxation as a war measure was established in Canada at the outset of hostilities. Appropriate exceptions and qualifications were made in certain special circumstances.

In June, 1940, the rate was raised to 75 per cent on the excess of profits over those earned in the standard period and in no case was an incorporated company to pay less than 30 per cent of the total profits in Corporation Income Tax and Excess Profits Taxes combined. Thus the income tax feature was incorporated in Excess Profits Tax legislation. A number of other amendments of a rather technical nature were also passed to give adequate protection to new and depressed businesses. The pre-war base or standard profits were not to be applicable to these two types of businesses. The Act provided for a Board of Referees to deal with such cases fairly and realistically subject to certain limitations.

Several practical difficulties were encountered in the working of the Act. The chief criticisms were as follows: (i) The adoption of 1936-1939 as a base period introduced a wholly arbitrary standard for purposes of assessment. It was argued that the 1936-1939 period, according to the long term charts, was below normal and the majority of businessmen were therefore faced with an abnormally low return as the standard over and above which profits were to be specially taxed. Consideration should also be given to the substantial number of concerns which were equipped for special kinds of war work and whose only chance to make money came in abnormal times. These had to earn enough in the good years to provide all maintenance and depreciation plus a return on their capital. Then again, businesses which had been in the developing stage immediately preceding the war had to pay much higher taxes then their competitors because they were comparatively new with a standard not truly indicative of the normal profits. This situation was somewhat relieved in 1941 when the Act provided for a selection of three years out of four as a standard period if the profits of the fourth were less than half the average of the other three. (ii) The other difficulty was that connected with the maximum amount of inventory against which reserves might be set up. Under the original regulation regarding reserves, their amount was limited to the average held at the end of each of the four fiscal or calendar years 1936-1939. Strong representations were made against this decision on the grounds that at least two years of the standard periods were subnormal, that the growth of most healthy companies showed a continued upward trend, and that inventories during the war years could normally be expected to be higher than in the standard period. "Stocks are being built up in greater and greater quantities and at higher prices; profits are shown and taxes paid thereon. After the war inventory values evaporate into thin air and the goods cannot be sold at any price". (1)

The Tax Division's answer to this objection was that such increased reserves would encourage speculation on this type of inventory since the risk would have been eliminated, and furthermore the profits were war profits and should be taxed at the highest rates. With considerable reluctance the Government introduced in 1941 for the first time a provision allowing as a deduction from excess profits taxable income a limited reserve against possible future losses in inventory values. This was subsequently supplemented in 1942 by a revision of the regulation, allowing an increase in the average quantities of stock on hand during the standard period, based on the normal growth that would have been experienced if there had been no war.

Other changes introduced in the 1941 budget were "in the nature of improvements in the structure of the legislation for the purpose of removing inequities and anomalies and to simplify and expedite administration". (2) The minimum rate of the Excess Profits Tax was increased from twelve per cent to twenty-two per cent of net profits.

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(1) Can. Journal of Econ. Ag. 1941.
(2) 1941 Budget, Page 18.

Since the Excess Profits Tax was still applicable in addition to the normal Corporation Tax of eighteen per cent, this provision raised the actual minimum levy to forty per cent. This change was undoubtedly motivated by the realization that war conditions had stimulated general activity to a level where almost all business was benefited.

In 1942 the tax was again considerably increased with the result that the rate on excess profits was raised from seventy-five to one hundred per cent. Provision was made, however, for a twenty per cent refund, over the range where this one hundred per cent rate was effective. "... a company shall pay a flat rate of twelve per cent on its total profits in addition to the eighteen per cent corporation income tax, and then shall pay as well either ten per cent of its total profits or one hundred per cent of its excess profits after deduction of the corporation income tax and the twelve per cent rate thereon, whichever is the greater." (1) The effect of these provisions was to limit profits after taxes had been paid to seventy per cent of pre-war profits before taxes. Monthly instalment payments on account of the tax liability, based upon anticipated earnings or earnings in the preceding period, were also provided for at this time. It was estimated that the above changes would yield an increase in revenue of about fifty-eight million dollars in a full fiscal year with profits at the current 1942 level.

In the following two budgets more revisions were introduced. As the increase in production would undoubtedly result in abnormally heavy wear and tear on capital assets during the war, a provision was made granting accelerated rates of depreciation on machinery and equip-

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(1) 1942 Budget, Page 17.

ment being operated for two or three times the normal number of working hours. Another set forth conditions under which standard profits might be adjusted from year to year with pari passu increases in capital. A corporation was required to show a change in capital stock before any adjustment would be made. Another section of the Act conferred wide powers on the Minister of Finance to prevent avoidance of high taxes through extravagant expenditure which might be unreasonable for that particular type of business.

The gradual modification of the Excess Profits Tax indicates the manner in which the levy has developed from the original purpose of keeping the over-all increase in profits of all corporations within moderate limits to a major source of revenue from industry in general. This was a natural trend as industrial activity expanded to affect companies outside war industries. As time passed, inequalities and injustices have been gradually eliminated but on the whole a much more rigorous general economic policy has been adopted.

ii <u>National Defence Tax</u>.

This is a tax on personal incomes, collected as far as possible at the source and in addition to ordinary income tax. It was introduced in the second war budget. As originally proposed it consisted of an over-riding flat rate of two per cent for married persons if the income exceeded twelve hundred dollars and three per cent for single persons if the income exceeded six hundred dollars and not more than twelve hundred. It thus included lower incomes than those covered by the income tax ($ 750 and $ 1,500 respectively).

These rates were increased in the subsequent budget from two and three per cent to five and seven per cent for married and single taxpayers respectively. However, the minimum income exemption for single persons was increased from six hundred to six hundred and sixty dollars per year because of the rather heavy rate at the bottom in the case of single persons. It was estimated that these adjustments would result or balance in an increase of about eighty million dollars in revenue.

When in 1942 the Personal Income Tax was steeply increased and the refundable portion was introduced for the first time the National Defence Tax was combined with the Income Tax and thus lost its identity (see section on Personal Income Tax). This was done to simplify the tax structure and to facilitate the implementing of the new provisions of the Income Tax introduced at that time.

iii <u>Dominion Inheritance Tax</u>.

In the 1941 budget the Dominion Government entered the Inheritance Tax field. This type of taxation had previously been used only by the nine provinces. It is considered second only to the Income Tax in its essential fairness and the possibilities of adjusting it progressively to ability to pay.

This action by the Dominion introduced complications. Since different rates were levied in the several provinces, the combined provincial and federal taxes involved the imposition of different total levies on different parts of the same estates. Moreover, duties were in some cases charged on the same property by more than one province.

The tax is of a composite type similar to the majority of provincial inheritance taxes; its amount is determined not only by the size of the bequest to the beneficiary but also by the size of the estate itself and the relationship of the individual to the deceased. The general level of the Federal Tax is roughly comparable with that of the Provincial Taxes. When added to the provincial rates, it results in a total tax almost equal to the British succession duties. An exemption of twenty thousand dollars is provided for the widow of the deceased and of five thousand for each dependent child. It is applicable to the properties of those domiciled in Canada at the time of their death and also to property in Canada of persons dying abroad. It is under the jurisdiction of the Income Tax Division of the Department of National Revenue and it was expected to yield some twenty million in a full fiscal year.

iv <u>Taxes Designed to Conserve Essential Products and Foreign Exchange</u>.

Several emergency measures were undertaken by the Government early in the war for the conservation of (a) domestic resources of labour, raw materials and equipment, and (b) non-Empire exchange. Both are at the same time productive of considerable revenue.

To the first group belongs a special steeply graded tax on new passenger automobiles, introduced in June 1940. The purpose of this tax was to divert demand away from automobiles so that resources which the war is rendering scarce, might be utilized for essential purposes. At the same time it aimed at conserving badly needed exchange. Similarly, special taxes on radios, cameras, phonographs and tires were imposed for the same purpose.

The second war budget also introduced a special <u>War Exchange</u>

Tax of 10% applicable to all imports from non-Empire countries for the purpose of conserving exchange urgently needed for payments on purchase of munitions and arms in the United States.

The War Exchange Conservation Act was passed in December, 1940, as another device to reduce the demand for foreign exchange. Two schedules of articles were effected. Importation of articles in Schedule I was prohibited from outside the sterling area, except under a special permit from the Minister of National Revenue. Importation of many articles in Schedule II from non-Empire countries was reduced by twenty-five to fifty per cent and in a great many cases was prohibited altogether. The purpose was to conserve non-sterling exchange on one hand and to encourage imports from the United Kingdom on the other. (1)

In the summer of 1944, when the situation in respect of foreign exchange improved, the Government repealed that section of the Act dealing with Schedule I.

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(1) Imports were to be encouraged because British exports would thus, partially at least, offset the adverse British balance of payments with Canada and help Great Britain to purchase much needed goods from this country and the United States.

4. Yields of the Dominion Taxes in Peace and War.

This section is devoted to comparisons of the yield derived from (a) new taxes and incomes in the rates of old taxes, and (b) from direct and indirect taxation. The fiscal years compared are 1939 and 1943, the latter being the latest for which information is available at the present time.

Table II shows that in 1943 the total tax revenue amounted to about $ 2,066 millions; an increase of some $ 1,630 millions over the year 1939. Of this amount, $ 1,088 millions, or two-thirds was attributable to increases of pre-war taxes and $ 542 millions, or one-third to new war taxes. (1) The general nature of the tax structure is as follows: the most important tax increases have been in the field of Personal and Corporate Income Taxes. Here, alone, the additional yield amounted to something like $ 720 millions over the 1939 figure. It resulted both from increases in National income and from the application of the new high rates, mainly those of the 1941 budget. Increases in Customs and Excise Duties, although quite numerous, accounted for only an $ 120 million increase in revenue over that in 1939 because of a reduction in the volume of products on the market. The Sales Tax, with some minor alterations, yielded $ 250 millions in 1943 as against $ 122 millions in 1939.

The new taxes, imposed since the outbreak of war yielded $ 542 millions in 1943. These taxes included the Excess Profits Tax, ($ 434

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(1) It should be remembered, however, that the Personal Income Tax assessment in 1943 consisted in part of a flat rate tax on the total income, which prior to 1942 was a separate National Defence Tax, and in part of a steeply graduated Income Tax proper. It is therefore not entirely correct to attribute the total increased yield from the Personal Income Tax to the old tax only. (See section on Personal Income Tax and National Defence Tax.)

## TABLE II

### DETAILS OF TAX REVENUE, FISCAL YEARS 1939 AND 1943

NOTE:- Dashes in this table indicate that the corresponding stub item is not applicable for the year 1939.

| Item | 1939 | 1943 |
|---|---|---|
| Customs Import Duties........ | $ 78,751,111 | $ 118,962,839 |
| Excise Duties................ | 51,313,658 | 138,720,723 |
| Income Tax................... | 142,026,138 | 860,188,672 |
| Excess Profits Tax........... | --- | 434,580,677 |
| Sales Tax.................... | 122,139,067 | 250,478,438 |
| War Exchange Tax............. | --- | 94,553,380 |
| Succession Duties............ | --- | 13,273,483 |
| Gasoline..................... | --- | 24,897,924 |
| Other Taxes (1).............. | 42,024,570 | 131,063,825 |
| | $ 436,254,544 | $ 2,066,719,961 |

(1) Includes export tax on electric power and furs previously included in Non-Tax Revenue under Electricity Inspection and Dominion Lands, Parks, etc., respectively.

Source: The Canada Year Book 1943-44, Page 814.

millions), War Exchange Tax, ($ 94 millions), and a Succession Duty, ($ 13 millions).

During this process of steadily increasing taxes, the tax structure has been really revolutionized. It has been converted from a system which relied mainly on indirect taxes, taxes on business costs and on consumption to one in which the main emphasis is placed on taxes levied on the principle of ability to pay and taxes on luxuries and non-essentials. Before the war about two-thirds of the tax revenues were obtained from indirect taxes and only one-third from direct taxes. Today, those proportions are reversed. In 1943 about two-thirds of the tax revenues came from direct progressive taxation. The increases in old taxes and new taxes yielded some $ 1,630 millions more in 1943 than in 1939/40. Towards this total, Income Taxes, Excess Profits Tax, and the Succession Duties contributed $ 1,165 millions or 71.5 per cent, while commodity taxes contributed $ 465 millions, or 28.5 per cent. This shows clearly that a large proportion of the new tax revenues have been derived from direct taxation.

1. General Aspects of Government Borrowing.

The main problem of war finance is to adjust the volume of money incomes in such a way as to effect the most efficient expansion of the productive capacities of a country for war purposes. There are several ways in which a government may influence money incomes: (1) by controlling the extent and direction of government expenditure, (2) by regulating the nature and volume of taxation, and (3) by means of government borrowing and credit expansion.

Government expenditure in wartime gives rise to a tremendous amount of industrial activity. Unemployed labour and unused capital is put to work and machinery is operated at its maximum capacity to supply the tools and implements of war. If a country is to obtain the largest possible output of these goods it will have to minimize the output of the so-called non-essential goods and services, once full employment has been reached. These compete for the use of productive facilities which may be vital for the production of essential goods and services. In the meantime the total consumer purchasing power of the country rises substantially. Greater employment and higher wages increase the supply of money on the market. A country at war, therefore, is faced on one hand with an abnormal expansion in the supply of money and, on the other hand with a decreased supply of commodities and services on the market. The problem thus becomes one of devising methods of disposing of this surplus purchasing power in the hands of the individuals, if inflation or a general rationing of commodities is to be avoided.

Taxation is one method. It may exercise an important restrictive influence on various undesirable uses of resources, but its usefulness is limited. In the first place it is impossible to devise a single comprehensive schedule of taxation that would reduce the incomes of all the people so as to take care of the full cost of the war without serious individual injustices. Moreover, a one hundred per cent tax on incomes over and above the pre-war level by its very severity would run the risk of causing general discontent and adversely affect the output of war materials. Thus in practice there will remain, after taxes have been paid, a certain amount of purchasing power in the hands of individuals which must be drawn off the money market if inflation is to be prevented and the Government is to have adequate funds to finance the war. Here is where wartime borrowing comes in.

There has been a wide belief that in so far as a part of the war costs are financed out of loans, a country can shift this part of the burden to the next generation. Such, however, is not the case. Borrowing from the public through war loans does not involve the borrowing of physical goods and services from future production. 'Resources obtained by extra work and by economies in personal expenditure come, in the main, out of income and hit the present only, whereas resources obtained by refraining from new investment, by letting equipment run down, by selling property to foreigners and so forth come out of capital and hit the future.' (1).

When a government borrows a certain sum of money from an individual for war purposes, it prevents him from investing it in consumption goods or fixed capital. When the bond falls due in the future the government will have to pay him not only the principal but interest as well. Where will the money come from? Probably from taxation. In the last analysis, therefore, taxation and borrowing are in a sense the same, the latter being a form of taxation, the burden of which has not yet been definitely distributed among the population of the country. There are, however, important differences.

Loans, unlike taxes, are generally voluntary and the decision as to how large a subscription can be made is left to the individual. In the case of taxes the transfer of income is final; in the case of loans the ultimate distribution of the financial burden will depend on

(1) Pigou, Political Economy of War.

the future policy of the taxing authority. As we have seen, the repayment of both principal and interest will probably have to be provided for out of future taxation. When that time arrives, the system of taxation will probably be much less steeply graduated than the system which would have been necessary to raise the same amount of money during the war. The net result is a somewhat different distribution of the burden of financing the war than would have occurred had it been financed entirely by taxation. Holders of large numbers of bonds have good reason to expect that the interest on their investments will exceed the contribution in taxes which they will have to make toward the payment of this interest. It appears, therefore, that a loan penalizes them less than does direct taxation. In this respect borrowing is somewhat less fair than direct taxation.

If these loans, whether raised from reserves of corporations and financial institutions, or from savings of individuals, are to prevent inflation, they must be retained by the purchaser. For this reason borrowing through the sale of bonds is not an entirely reliable preventive of inflation. The holder of a bond may sell it without loss whenever he pleases, thereby withdrawing savings that had freed a certain amount of resources of men and material for war uses. As far as the saving induced by bond selling campaigns is concerned, it has been pointed out that loans are effective only in the period immediately prior to and following each loan campaign. Periodic war loans in themselves do not ensure continuous and regular saving which is the thing to be desired. With this in mind, the situation in Canada has been much improved by the introduction of the system of instalment payments on bonds with periods almost as long as those between each subsequent campaign. The compulsory savings plan, which has recently been withdrawn, and the War Savings Certificate campaign serve the same purpose. The latter through the use of a redemption clause tending to discourage the holder from taking an undue advantage of this privilege, is an especially effective device for promoting continuous saving.

The third important method of war finance is the creation of credits and new money. This may be desirable in the early stages of war in order to facilitate the increase of production and employment. More people and more machines are being employed and unless money income per head is to be reduced the supply of funds and bank credits has to be increased to correspond to the expansion of industrial output and activity. An increased supply of funds will give the government more purchasing power and if carefully controlled it will be instrumental in speeding up the mobilization of resources for war. If, however, it becomes excessive, prices will rise and the real value of the purchasing power left in the hands of the public will fall. This would constitute a concealed form of taxation, taxation in a most unfair and inequitable form since it would throw an unfair proportion of the burden upon the person of small or medium income, the salaried man and the holder of fixed income bearing securities of all kinds. Its effect would be a general redistribution of income from one class of people to another and if long continued it would only end in the complete financial and economic collapse of the country.

2. Loans.

(a) Volume and Source.

During the first five years of the war, ending December 31, 1944, no less than nine public war loans were issued for a total amount, including conversion and redemption, of eighty-five hundred million dollars. Details concerning the first six issues are given in Table III. The First and Second War Loans were sold by the government to the Canadian public to provide a part of the funds required for various purposes that were not covered by revenue and to mobilize previously accumulated capital which could be borrowed without touching the current savings of the people. The First War Loan, in June, 1940, was for two hundred and fifty million dollars. It was quickly subscribed. Subscriptions included numerous small and moderate-sized orders, as well as many large ones. The Second War Loan, dated October 1, 1940, amounted to three hundred and twenty-five million. Although over-subscribed, it was not supported as wholeheartedly by the public as the government had hoped. Several explanations were suggested. It was claimed that the yield was too low, that the increase in taxes and cost of living had intervened between the First and the Second Loan and that the drain on the small investor through the purchase of War Savings Certificates prevented him from investing more. The real explanation, however, was that the government had been overconfident about the outcome of the loan and had devoted only a few days to the pre-loan publicity. This was insufficient. Furthermore, no bonds of less than one hundred dollar denominations were available. This circumstance prevented many small potential purchasers from participating. There was also much duplication of effort and machinery in the campaign.

# TABLE III

## DOMINION OF CANADA DOMESTIC LOAN FLOTATIONS FROM THE OUTBREAK OF WAR TO AUGUST 31, 1943

(Thousands of Dollars)

| Title of Issue | Issue Date | Maturity | Interest Rate | Public | Sold to the Chartered Banks | Bank of Canada | Number of Subscriptions |
|---|---|---|---|---|---|---|---|
| Two Year Notes | October 16, 1939 | October 16, 1941 | 2 | - | 200,000 | - | |
| First War Loan | February 1, 1940 | February 1, 1948 | 3¼ | 250,000 | - | - | 178,363 |
| Five Year Bonds | March 1, 1940 | March 1, 1945 | 2 | - | - | 40,000 | |
| One Year Notes | May 1, 1940 | May 1, 1941 | 1 | - | - | 250,000 | |
| Five Year Bonds | March 1, 1940 | March 1, 1945 | 2 | - | 40,960 | - | |
| Second War Loan | October 1, 1940 | October 1, 1952 | 3 | 324,946 | - | - | 150,890 |
| Two ½ Year Notes | July 2, 1941 | July 2, 1943 | 1½ | - | 250,000 | - | |
| One Year Notes | May 1, 1941 | May 1, 1942 | 1 | - | - | 250,000 | |
| 1941 Victory Loan | June 15, 1941 | December 15, 1946 | 2 | 193,286 | - | - | 968,259 |
| 1941 Victory Loan | June 15, 1941 | June 15, 1951 | 3 | 643,534 | - | - | |
| Totals - 1941 Victory Loan | | | | 836,820 | | | 968,259 |
| Three Year Notes | October 16, 1941 | October 16, 1944 | 1½ | - | 99,700 | 100,300 | |
| Second Victory Loan | March 1, 1942 | September 1, 1944 | 1½ | 57,169 | - | - | |
| Second Victory Loan | March 1, 1942 | March 1, 1948 | 2½ | 269,879 | - | - | |
| Second Victory Loan | March 1, 1942 | March 1, 1954 | 3 | 669,658 | - | - | |
| Totals - Second Victory Loan | | | | 996,706 | | | 1,681,267 |
| One Year Notes | April 15, 1942 | April 15, 1943 | 1 | - | - | 250,000 | |
| Two Year Notes | April 15, 1942 | April 15, 1944 | 1½ | - | - | 100,000 | |
| Second Victory Loan | March 1, 1942 | September 1, 1944 | 1½ | - | - | 92,831 | |
| Third Victory Loan | November 1, 1942 | May 1, 1946 | 1 3/4 | 144,253 | - | - | |
| Third Victory Loan | November 1, 1942 | November 1, 1956 | 3 | 847,136 | - | - | |
| Totals - Third Victory Loan | | | | 991,389 | | | 2,041,610 |
| One Year Notes | April 15, 1943 | April 15, 1944 | 1 | - | - | 250,000 | |
| Fourth Victory Loan | May 1, 1943 | November 1, 1946 | 1 3/4 | 197,455 | - | - | |
| Fourth Victory Loan | May 1, 1943 | May 1, 1957 | 3 | 1,111,261 | - | - | |
| Totals - Fourth Victory Loan | | | | 1,308,716 | | | 2,668,420 |
| Two Year Notes | July 2, 1943 | July 2, 1945 | 1½ | - | 194,000 | 56,000 | |
| Deposit Certificates- Various | | | 3/4 | - | 740,000 | - | |
| War Savings Certificates- Various | | | 3 | 192,657 | - | - | |
| Non-Interest Bearing Certificates | | | - | 7,386 | - | - | |
| Grand Totals | | | | 4,908,622 | 1,524,660 | 1,413,171 | |

Source: The Canada Year Book, 1943-1944, Page 835.

Coverage tended to be extensive rather than intensive.

To insure a successful result for the 1941 Victory Loan, the Minister of Finance set the nominal size of the minimum objective at six hundred million dollars which was somewhat less than had been generally expected. The government apparently counted on a substantial over-subscription which, of course, was good psychology. Quotas were set for each community and province and experienced securities salesmen and about four thousand full-time life insurance agents were enlisted in this drive. The appeal was directed with a view to absorbing a large portion of savings deposits in Canadian banks which had in the meantime accumulated to about one and three quarter billions of dollars. In addition to providing funds for war and general purposes, it had become necessary to furnish funds for the repatriation of sterling issues held in Great Britain. These repatriation operations had the ultimate effect of making available Canadian dollars to the United Kingdom for the purchase of Canadian commodities and manufactured products required for the prosecution of the war. The results of this First Victory Loan campaign lead to rather interesting innovations. The loan was over-subscribed by some two hundred and thirty six millions of dollars but only a very moderate response was received from the industrial population of the country. This suggested that the worker by and large was spending the bulk of his increased earnings as fast as they came in. A still more intensive selling campaign and the introduction of an instalment plan for the Second Victory Loan proved to be the answer to this problem. All three maturities of the Second Victory Loan were over-sold and more than one and one-half million subscribers participated.

The Third Victory Loan, dated November first, 1942, had as its minimum objective seven hundred and fifty million dollars. This amount, the Minister of Finance said, would be sufficient to carry the entire cost of our war effort at that time for only about two and a half months. Canada in 1942 was spending about a dollar a day for every man, woman and child in the country with the taxes meeting only about fifty-one cents of the dollar of government expenditure. The balance had to be borrowed. When the campaign was concluded, nine hundred and ninety-one millions were loaned the government by the people of Canada.

The Fourth and Fifth Victory Loan campaigns, dated May the first, 1943, and November the first, 1943, respectively, were equally successful. About three million out of a total of five million Canadian workers decided during the Fifth Victory campaign to buy bonds with their surplus current income instead of bidding against their neighbours for a limited supply of civilian goods. It is interesting that Canadians, as individuals, subscribed nearly half the total amount of fifteen hundred and seventy million. Subscriptions from the "special names" division amounted to seven hundred and seventy-seven million.

The Sixth and Seventh Victory Loans were the greatest in the total amounts of subscriptions sold; the former, in addition to attaining new records in the number of applications received and the dollar amount of bond sales made to individuals, brought in over fourteen hundred million dollars. This represented a great deal of money that was withdrawn from current consumption but apparently still not enough to prevent additional accumulation of funds in banks. As a proof of this it is interesting to note that on August 31, 1944, Canadian savings deposits advanced to a new all-time record of $ 2,369,598,000 dollars -- only four months after the Sixth Loan. At that date savings and current account deposits had an aggregate total of $ 4,263,000,000 dollars -- an all-time high.

The Seventh Victory Loan, with a minimum objective of 1.3 billion dollars which was one hundred million above the objective of the preceding loan but more than one hundred million below the amount actually subscribed in that loan, raised $ 1,517,000,000. No objections were made if holders of previous issues turned in their bonds so they could participate in this latest issue. The maturity date of some of these bonds was sufficiently close that they were in keen demand by the banks and other institutions and were selling at a premium of a point or two.

If we take the figure of 4,908 million, in Table I, for government borrowing from the public from the outbreak of war to August 31, 1943, and compare it with government revenue of 5,674 million from other sources, (1) for the same period, we come to the conclusion that during this time 53.6% of the government's total receipts came from taxes and miscellaneous minor sources of revenue and 46.4% came from the proceeds of loans from the public. War Savings Certificates accounted for only 3.6% of the total loan receipts up to August 31, 1943.

The table below shows the progressive increase which has taken place in the total amount of purchases by individuals of moderate means, (as distinct from individuals of larger means included in the Special Names Canvass). The amount of cash applications by individuals, excluding

(1) The Canada Year Book, 1943-44, Table III, Page 814.

special names, for the first eight loans was as follows:

(In Millions of Dollars)

| Loan | Individual Subscription | Total Subscription |
|---|---|---|
| First War Loan.................. | 132 | 250 |
| Second War Loan................. | 113 | 324 |
| 1941 Victory Loan............... | 280 | 836 |
| Second Victory Loan............. | 336 | 996 |
| Third Victory Loan.............. | 375 | 991 |
| Fourth Victory Loan............. | 530 | 1,308 |
| Fifth Victory Loan.............. | 604 | 1,383 |
| Sixth Victory Loan.............. | 644 | 1,407 |
| | $ 3,014 | $ 7,495 |

Almost 40 per cent of the total value of subscriptions to war loans came from individuals of moderate means for the period ending October, 1943. The number of subscribers has multiplied almost seventeen-fold from 178,363 in the First War Loan to 3,077,123 in the Sixth Victory Loan, indicating that sales have apparently been made well down the income scale. Figures released by the National War Finance Committee for this period show that employees' applications account for less than ten per cent of the total value, but over half the number of total subscriptions. The same source estimates that individuals have probably kept all but one to two hundred million dollars of their subscriptions, leaving them with nearly 2.5 billion more government securities after the Fifth Victory Loan than they held before the war.

(b) Interest Rate.

An indication of the official attitude toward interest rates on government loans was given by the Minister of Finance, Mr. Ilsley, in the First War Budget in 1939. He said: 'We do not expect that any material change in interest rates from peace-time levels will be necessary to attract a sufficient portion of the large increase in savings...' (1) The Department of Finance has felt that interest rates exercise only a negligible influence on war savings; any increase in rate, therefore, would raise only the cost of war finance and would not help to promote lending to any considerable extent. The result has been that maturities have been set as short and yields as low as was expedient.

Most of the government's refunding operations have been carried out with a reduced yield as compared to the pre-war period. This was partly due to some shortening in the term of the outstanding government debt in conformity with a trend that has been continuing since the outbreak of war. Banks have shown an increased preference for the shorter-term issues because of their greater liquidity under wartime conditions.

The First War Loan provided a yield of three and one quarter per cent. Subsequent long-term issues declined to 3.09%, 3.07%, 3.06% and for the last four loans a flat 3.0%. The 1919 post-war offering was for 5.5%. While yields on long-term securities and obligations have tended to fall, yields on intermediate-term securities (two to six years)

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(1) First War Budget, Page 5.

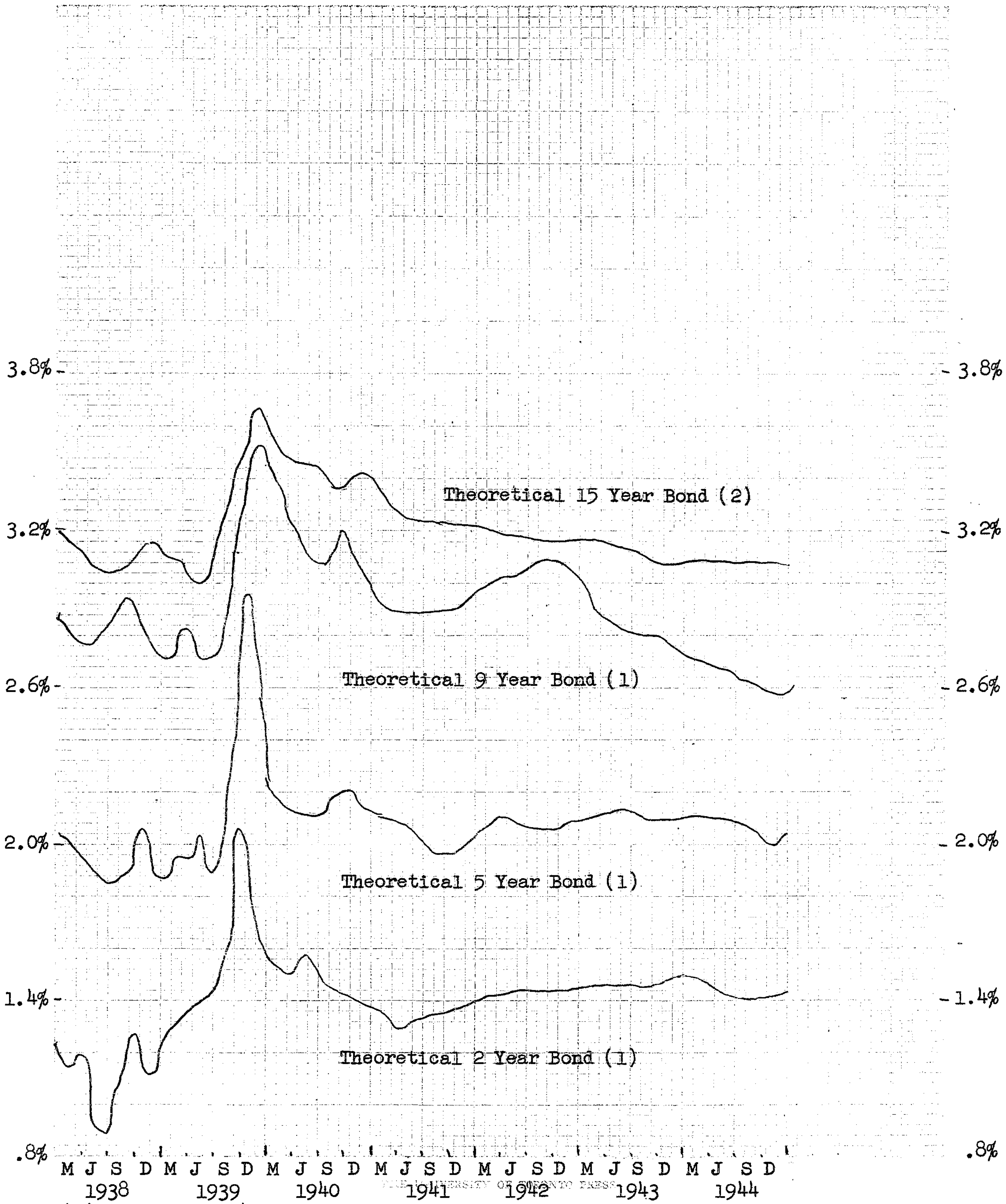
have risen slightly. At 2.6% the average rate on Federal obligations at the close of the fiscal year 1943 was the lowest in the history of Canada. Chart II illustrates the yields of Dominion Government bonds for the last six years.

(c) Forms and Methods of Borrowing.

The Canadian government has raised its funds from the general public through the sale of bonds and War Savings Certificates. Since the outbreak of war no less than nine public War Loans have been launched. The first two loans, opened in January and September of 1940, were intended primarily to raise money from the well-to-do and business in general. The purpose of the succeeding seven Victory Loans has been to absorb an appreciable portion of the growing savings deposits in banks. They were not designed to tap current incomes, the War Savings programme took care of that. Table III reveals in detail the main features of the first six War Loans. The public issues have consisted of intermediate-term bonds, two to six years, yielding from 1.5% to 2.0% and long-term bonds, eight to sixteen years, yielding roughly 3.0%.

The organization of the loan campaigns to the end of 1941 was directed by a War Loan Working Committee, which had been operating continuously since May, 1940, and the Victory Loan Committee which had been set up as a temporary organization to conduct the First Victory Loan campaign in 1941. The War Loan Committee consisted of representatives of the banks, including the Bank of Canada, and investment dealers. Its general expenses, including advertising, printing costs and commission to salesmen were paid by the government. A commission of three quarters

CHART II
YIELD OF DOMINION GOVERNMENT BONDS - 1938-44
PAYABLE IN CANADA ONLY
QUOTATIONS FOR 1ST AND 15TH OF EACH MONTH




(1) Prior to 1940 Figures are for 1st of Month Only.
(2) Prior to 1940 Figures are Average for Month.

Source: Statistical Summary, Bank of Canada, August - September, 1944.

of one per cent was paid to all general agents, excluding banks. These were assigned a certain percentage of the total commissions payable on the loan before each campaign. It was explained that the banks with their country-wide system and numerous personal contacts could, if they desired, monopolize the sales of such a campaign. To insure a sufficient incentive for the general salesman the government realized that he must receive a reasonable proportion of the total commission on sales payable as a remuneration for his services. Some doubt was expressed as to whether the fixed over-all commissions would not tend to reduce the sales by banks rather than act as an incentive for them. Results from the first two loans have shown, however, that sales of bonds made through banks under the new arrangement roughly corresponded to the allotment that had been assigned to them on the basis of a percentage commission on sales.

A further step in the reorganization of the nation-wide machinery set up for selling wartime issues was effected when the National War Finance Committee was established by the government in January, 1942, just before the Second Victory Loan campaign, under the chairmanship of Mr. G. W. Spinney. In effect, the new committee represented a merger between the two original bodies and the functions and many of the personnel were absorbed by it. Its objectives, as announced in the 1943 Budget were as follows: (a) to plan, organize and administer arrangements for the maximum public sales of government securities, and, (b) to promote maximum voluntary savings. At the present time the National War Finance Committee is made up of the National Executive Committee and representatives of major industries, agriculture, commerce, labour and finance. In addition, there are Provincial Committees and some five hundred local units. The administration in the central office together with the chairmen of the Provincial Committees constitute the National Executive Committee. The entire permanent staff, located in Ottawa and throughout Canada, numbers some 350 persons and operates in conjunction with three main bodies of workers. First, there are some 125,000 voluntary workers attached to the local units in each province. Then there are the salesmen on commission and other temporary paid workers, numbering some 17,000. The third group consists of investment dealers and brokers, about 2,000 strong.

The work of the National War Finance Committee is carried out through five divisions. The Special Names Division canvasses corporate and institutional subscribers as well as individuals capable of subscribing twenty-five thousand or more. The investors in this group, about eight or nine hundred, have accounted in the past for some sixty per cent of Victory Loan subscriptions. The Payroll Savings Division covers the armed forces and employees with incomes up to three thousand dollars. No commissions are paid on subscriptions in these two divisions. The General Sales Division deals with the rest of the potential investing public. Commissions are paid to individual canvassers at a rate of 1/8 of one per cent on medium-term and 5/8 of one per cent on long-term issues. Banks, through which the bonds are usually delivered, are paid a handling fee of 1/8 of one per cent on short-term and 1/4 of one per cent on long-term issues. The Public Relations Division handles advertising and the Administrative Division looks after the organization and supervision of the whole process.

The costs of our public borrowing operations are very low considering the magnitude of the loans, and the number of individual transactions. In the year ended March 31, 1944, costs incurred by the National War Finance Committee with respect to sales of Victory Bonds and War Savings Stamps and Certificates, including the cost of engraving the bonds and of all publicity activities, amounted to only 87 cents for each one hundred dollars of securities sold, that is seven eighths of one per cent of total sales.

In addition to Victory Loans proper the Dominion government has been issuing other war loan flotations, such as War Saving and Non-interest bearing certificates. The latter are dated the 15th of the month in which payment is received and mature June 15, 1945, the registered holder having the option of redeeming his certificates at par at any time after six months from the date of issue.

The War Savings Stamp campaign was inaugurated in May, 1940. It was designed to promote more wide-spread and regular saving through a continuous sale of War Savings Certificates and Stamps than would be possible by means of War Loan campaigns alone. The nature of the War Savings Stamp campaign calls for regular and systematic savings from current earnings. Certificates are issued in denominations of 5, 10, 25, 50 and 100 dollars. Each certificate runs for ninety consecutive months ($7\frac{1}{2}$ Years) with compound interest computed half-yearly at three per cent per annum. The return is tax free and slightly higher than on bonds of comparable maturity, but purchases are limited to fifty dollars per month. Six months after purchase, a certificate may be redeemed with the authorities at its purchase price, and after a year at a price which includes some accrued interest. For the convenience of those who find even an amount of four dollars difficult to save at one time War Savings Stamps were issued at twenty-five cents each; when four dollars' worth have been affixed to a form it may be exchanged for a certificate. The campaign for sales of these certificates and stamps has been organized by provincial and local committees in conjunction with various public utilities, financial institutions, commercial organizations and business firms throughout the country. No commission has been paid to these voluntary salesmen and even citizens who are organizing this project both in Ottawa and throughout the Dominion are giving their services without remuneration.

(d) Market for Loans.

High grade bond prices were maintained during the first seven and a half months of 1939, in spite of disturbing events abroad. A considerable inflow of foreign funds during the early part of the year contributed much to the firmness of the market. The outbreak of war brought a severe decline in the market for government obligations, as it did in London and New York, and despite a sharp recovery in the latter part of September and October, government issues were being offered at prices ranging from five to nine points below their pre-war prices. Further recovery during January, 1940, following the issue of the First War Loan, left yields about one quarter of one per cent higher than they had been at the beginning of 1939. Since then the chief characteristic of the Canadian market for government securities has been stability around a gently rising price trend.

In spite of the large increase in the over-all volume of new money raised in the Canadian market, high-grade bond prices rose steadily during the year 1941. The same holds true of the year 1942. In 1943 medium and long-term Dominion government bond prices again rose moderately and at the end of the year were about the same as comparable averages for the first half of 1939.

In the case of each War Loan, the dealers' prices have usually fallen slightly below par for some time after the issue. To prevent speculation, the Bank of Canada has imposed restrictions for periods varying from a few days to a few months on below par offers made to the public by dealers. On the average, however, some months after issue, all long-term loans usually rise slightly above par as a result of their closer approach to maturity.

3. Bank Credit.

Special wartime issues to banks, in the form of one-to-five year notes and bonds carrying one to two per cent interest, have been next in importance to public loans. Table I shows, that these special issues have dwindled in size as the war has progressed, partly because of the introduction of deposit certificates. These are six months' securities issued only to banks, bearing 3/4 of one per cent interest. The Table reveals that these have produced nearly as large a volume of funds as all other special issues to banks combined.

The first war bank loan of a short-term character was arranged in November, 1939, on the security of two-year notes, at a rate of two per cent. Of this amount ninety-two million were used to repatriate Canadian securities held in London. The loan from the banks was facilitated by an appropriate monetary policy. Between August and November the Bank of Canada assets increased by approximately one hundred and seven million as a result of the purchase of securities and the increase in the value of its gold and foreign exchange. This provided cash to meet the enlarged public demand for notes in circulation and to increase the cash reserves of the chartered banks. With this increase in cash reserves the chartered banks were able to expand their loans and to purchase the two hundred millions' worth of securities from the Dominion government. This short-term financing followed the programme outlined in the Budget Speech at the Emergency Session of Parliament in 1939, viz., that in the initial stage, financing by the Dominion government should take a form which would not in any way hamper the process of adjustment necessitated by war. Only after the initial period of expansion was well under way did the government offer a loan for general public subscription in order that increased savings could be put to use.

On July 29, 1942, the Treasury began to borrow money against paper securities called Deposit Certificates, at a rate of 3/4 of one per cent per annum. These operations continued on a weekly basis in varying amounts until the proceeds of the Third Victory Loan began to come in in October and November of that year. At that time some six hundred and forty-five million of Deposit Certificates were outstanding but the government subsequently by arrangement took up two hundred and five million from the banks in November, leaving the amount outstanding at four hundred and forty million. During 1943 the amount outstanding rose by another two hundred and seventy-five million. This new and significant departure in Canadian war finance policy raised suspicion and doubt as to the effect of this expansion of bank credit. Alarming voices were heard pointing out the inflationary damper of this policy. While it was admitted that a loan of this nature could be inflationary, it was pointed out that the situation under existing conditions was not alarming. It is true that banks can, theoretically, expand their credit substantially with the backing of bonds taken from the government and use the increased issue as the foundation for enlarged commercial loans and deposits. It must be remembered also that the possibilities of such an operation are limited under war conditions. Only firms engaged in war production are likely to require substantial loans and credit to farmers is limited both as to size and duration. As a matter of fact, commercial loans increased only twenty million in the first four years of war, and actually dropped one hundred and sixty-six million in the last two years.

Data presented in Table IV reveal that up to August 31, 1943, the chartered banks absorbed only nineteen per cent of the total increase in the domestic loan flotation. When the securities received by the Bank of Canada in return for its gold and foreign exchange are excluded, the Canadian bank holdings as a whole accounted for approximately thirty per cent of the rise in debt; when these are included the figure is thirty-five per cent. Table II compares the growth of the Canadian government debt and holdings of the banking system on a percentage basis as well.

The wartime policy of the Bank of Canada since 1939 has been to provide the chartered banks with sufficient reserves to meet credit requirements and drains on cash, and to facilitate sufficient purchases of government securities to maintain a stable and orderly market. Open market operations have been the main source of these reserves. Their purpose has been to provide funds for seasonal movements in the note issue, to maintain the cash reserve position of the banks at the usual ratio to their deposit liabilities of 10 to 1, and to facilitate rapid expansion of credit has been especially needed before the issue of War Loans or whenever the bond market tended to be weak on account of disturbing events abroad. Open market operations were also intensified on special occasions, such as at the time of the withdrawal of American currency from circulation in this country, and immediately preceding every major purchase of Dominion securities on the part of the commercial banks.

On the whole there has been an expansion of open market operations every year since the war began, as national income and prosperity increased. The total holdings of securities by the Bank of Canada increased by some nine hundred and eighty million between August 31, 1939, and August 31, 1943, which corresponds to 16% of the increase in government debt for the same period, as shown in Table II. Most of this increase was in the category of securities maturing within two years. The following is a comparative statement showing the volume of investments held by the Bank of Canada as at December 31, 1939 and December 31, 1943, respectively:

## TABLE IV

## INCREASE IN CANADIAN GOVERNMENT DEBT AND BANK HOLDINGS OF GOVERNMENT SECURITIES, WAR YEARS 1940-43

(Dollar Figures in Millions)

| Item | 1940 | 1941 | 1942 | 1943 | Total |
|---|---|---|---|---|---|
| | Twelve Months Ending August 31, | | | | |
| Increase In: | | | | | |
| Can. Government Debt..... | 677 | 1,296 | 1,378 | 2,818 | 6,209 |
| Chartered Bank Holdings.. | 118 | 146 | 448 | 471 | 1,183 |
| Bank of Canada Holdings.. | 388 | 110 | 209 | 270 | 977 |
| Total Holdings of Banking System................. | 506 | 256 | 657 | 741 | 2,160 |
| Percent of Increase in Government Debt Represented by: | | | | | |
| Chartered Bank Holdings.. | 18% | 11% | 33% | 17% | 19% |
| Bank of Canada Holdings.. | 57% | 9% | 15% | 9% | 16% |
| Total Holdings of Banking System................. | 75% | 20% | 48% | 26% | 35% |

Source: Bank of Canada, Statistical Summary, August - September, 1943.

| | 1939 | 1943 |
|---|---|---|
| Investments - at values not exceeding market: | | |
| Dominion and Provincial Government Short Term Securities............ | $ 181,896,819.41 | $ 787,578,136.19 |
| Other Dominion and Provincial Government Securities............ | 49,875,738.20 | 472,797,116.42 |
| | $ 231,772,557.62 | $ 1,260,375,252.61 |

Source: Bank of Canada, Annual Reports to Minister of Finance and Statements of Accounts, February 10, 1940, and February 10, 1944.

The only special issues bought by the Bank of Canada were those in connection with financing the Foreign Exchange Control Board and the refunding operations. During the first year of war, under an agreement made under the Foreign Exchange Acquisition Order of April 30, 1940, the Bank sold to the Board 28 millions' worth of foreign exchange and 226 millions' worth of gold. Also to provide the Board with funds to buy gold and exchange, the Bank bought 325 millions' worth of Dominion one per cent one-year notes and Treasury Bills. Again in 1942 the Bank acquired 193 million in two $2\frac{1}{2}$ year notes to finance government purchases of sterling exchange from the Foreign Exchange Control Board.

On the other hand, no great use has been made of the re-discount rate to influence bank reserves. The Bank rate remained unchanged at $2\frac{1}{2}$ per cent until February 8, 1944, when it was decided to reduce it to $1\frac{1}{2}$ per cent. It was felt at that time that the rate had been somewhat out of line with the current market which had in the meantime shown a considerable reduction in interest rates on short-term securities. This action was not a matter of great importance, however, since the chartered banks do not borrow significant amounts from the Bank of Canada. The main purpose of lowering the rate was to signify the Bank's intention to continue its policy of providing 'easy money' at the current level of interest rates during as well as after the war and that no rise in the interest rates should be expected. Such a policy, the government felt, should not only encourage business to formulate plans for the post-war period of expansion but also ease the task of government financing in the future.

4. Currency Expansion.

Canada's note circulation increased from December, 1939, to December, 1943, by almost six hundred million dollars. In 1939 the Bank of Canada issue of notes amounted to 233 million; four years later the note issue was 874 million. During the same period, however, the amount of outstanding notes of the chartered banks dwindled by some fifty million to conform to the Bank of Canada Act of 1934, thereby offsetting to that extent the increase in the volume of Bank of Canada notes. The amount of Bank of Canada and chartered bank notes in public hands at the end of each of the last five years was as follows: (1)

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(1) Bank of Canada, Annual Report to Minister of Finance, February 10, 1944.

(Millions of Dollars)

| December 31st | 1939 | 1940 | 1941 | 1942 | 1943 |
|---|---|---|---|---|---|
| Bank of Canada Notes.... | 162.2 | 261.6 | 379.6 | 572.5 | 751.5 |
| Chartered Bank Notes.... | 84.6 | 79.8 | 70.6 | 60.3 | 42.2 |
| | 246.8 | 341.4 | 450.2 | 632.8 | 793.7 |

In 1940 the note circulation showed a continuous rise throughout the year. The largest part of the increase was due, no doubt, to the general expansion of business activity and rising payrolls. Some of the increase also served to replace United States currency. A marked expansion in note circulation was observed during the months of May, June and July of that year as a reaction to the bad war news.

At the end of 1941 the general public held 379.6 million of the total amount of notes of the Bank of Canada, more than double the amount held in 1939. The continuous increase in publicly held note circulation during the first two years is to be explained as a deliberate policy on the part of the government to mobilize the necessary resources of war in as short a time as possible. Monetary expansion during the succeeding two years was chiefly due to the increase in incomes in war industries, higher farm prices and increased numbers in the armed forces. But the increase was somewhat less than that of the previous two years. As we approached the level of total employment both the absolute and percentage increase in note issue tended to slow down.

This expansion of currency should cause no alarm. In the words of the Governor of the Bank of Canada, Mr. Towers, from a monetary point of view, the volume of notes in active circulation is a matter of secondary importance in a country like Canada. The major portion of payments by means of cheques drawn on banks so that the amount of notes in active circulation is determined by the needs of the people, rather than by the bank authorities.

5. Public Debt.

Canada will enter the post-war world with a national debt much greater than ever before. Our net debt when the war started amounted to about three billion; in March, 1944, the net debt was estimated at 8,850 million. Will the post-war debt be bearable? To answer this question we have to consider the factors that determine the magnitude of this burden. The first, of course, is the size of the debt. The second is the rate of interest and the third is the level of prices, employment and national income after the war.

The increase in our national debt as a result of war should be viewed in perspective. Today, some ninety-seven per cent of this debt is held in Canada by Canadians. In the last analysis this represents a large transfer of incomes through the hands of the government from one group of citizens to another and it is probable that a large number of those who will receive interest on their bonds will pay a large part of it themselves in the form of taxes. The size of the burden, so far as it is held in Canada, is of secondary importance to the wealth of the country. Moreover, the amount of the domestic burden may give us an exaggerated impression of the extent to which the debt has increased. It should be remembered that a country at the end of the war is poorer, not by the size of its public debt, but by the amount of physical goods that have been used up or destroyed and by the amount of expansion in capital equipment which has been foregone as a result of the war. While the national debt has increased, our national income has almost doubled since the start of the war and our ability to carry the heavy burden through taxation has increased even more so because surplus income over and above our basic requirements has increased proportionately more than total income. In relation to taxable capacity therefor, the debt charges have declined substantially during the war period.

While the national debt has increased substantially, the average rate of interest has declined from 3.52 to 2.57 per cent and the annual interest charges have risen only two and a quarter times. If the revenue received by the government is taken into account then the net interest charges have increased only by a much smaller amount. Suppose the national burden rises by the end of the war to, say, ten billion. If we estimate the interest, plus sinking fund, at not more than 6%, we have an annual charge of 600 million dollars, of which about 160 million was a pre-war charge. This amount plus the normal costs of Federal Government would require an annual budget of only about one billion, which is less than one half of the present tax collections. This amount may be compared with that of the year 1939 when the cost of the Federal Government, including interest on debt, amounted to some five hundred million - an amount that was easily collected by a moderate system of taxation.

How heavy the real burden will be depends on the size of the national income and on the post-war level of prices. Our hypothetical calculation suggests that the burden will not be unduly heavy provided the present rate of industrial acticity is not materially diminished after the war. But are we justified in assuming a continuance of today's prosperity after peace has been declared?

Canada today is much better prepared to combat post-war difficulties than it was twenty-five years ago. A sharp rise of prices has been checked by an over-all price ceiling and the danger of a severe decline after the war should therefore be prevented. As far as our second hypothesis, the maintenance of present national income is concerned, we must be less optimistic. Even under the most favourable of circumstances following the war, we have to expect some reduction in the output of goods and services. To what extent this reduction of income will take place will depend on our ability to find employment for the men and women of the armed forces and the munition industries in a peace-time economy.

# FOREIGN EXCHANGE POLICY

## 1. Canada's Foreign Exchange Market.

Up to September 15, 1939, no official restructions had ever been placed on foreign exchange transactions in Canada. Prior to that time all rates of exchange depended upon Canada's international position vis-a-vis the rest of the world, particularly the British Commonwealth of Nations and the United States. Free exchange markets were the characteristic channel of international settlements.

In the years preceding the outbreak of war the Canadian economy had an average of two hundred million dollars a year at its disposal over and above its current requirements. (1) The surplus was in large part due to our trade with the United Kingdom and other members of the British Empire who bought from us a great many commodities which were produced or manufactured in this country in excess of our actual requirements. Our commercial and financial transactions with the United States, on the other hand, resulted in a deficit. The result was that imports from the United States exceeded our exports, whereas exports to Great Britain exceeded imports. Our task, therefore, was to secure United States dollars to pay for the goods and services imported from the States. This was comparatively easy because the surplus sterling balance, which we obtained as a result of our transactions with the British Empire, was freely convertible into U. S. dollars. Moreover, it was not necessarily important, in the long run, whether there was a debit or credit balance of exchange with any particular country since foreign funds could be traded on the market. This

(1) The Canada Year Book, 1942/43, 1943/44, Plumptre: Mobilizing Canada's Resources For War.

triangular settlement served Canada's ever-growing export trade quite well and left the Dominion every year plenty of foreign exchange for her normal needs. These included, among other items, capital export for investments in foreign securities and the retirement of foreign debt. Countries other than the United Kingdom and the United States had surplus credit balances arising mainly from a surplus of exports and to a large investment income.

Canada's intermediate position between the United Kingdom and the United States was naturally reflected in the Canadian dollar on the foreign exchange markets. It usually followed an intermediate course whenever the exchange rate between the pound sterling and the U. S. dollar fluctuated. This was necessarily so because both currencies constituted a pool of foreign exchange out of which our external obligations could be met. Surplus supplies of sterling were used by Canada to meet her deficiency of U. S. funds and vice versa. The determinate of the rate was the impact of the total demand for it upon the total supply.

The war, however, interrupted the system of multilateral settlements. While there was a substantial increase in our favourable balance of trade with the United Kingdom, a very large proportion of the surplus sterling exchange which we obtain could no longer be converted into United States dollars. American dollars suddenly became a hard currency and the size of our trade with individual countries particularly the United States and Great Britain, became of paramount importance.

Let us now briefly examine the most important factors in the balance of Canada's international payments. Table V shows that the commodity trade has for some years been the major source of foreign exchange and one of the largest providers of a surplus to cover shortages elsewhere and permit some repayment of foreign debt. The greatest part of our merchandise trade has been with the United Kingdom and the United States, the former being our chief customer for exports, and the latter our most important source of imports. In the five year period prior to the outbreak of war, three quarters of the total export-import transactions were with these two countries. The volume was much increased as a result of the war. Our exports to the United Kingdom were greatly augmented by shipments of munitions, supplies, raw materials and food while our imports from the United States, too, were tremendously expanded to enable us to produce and assemble the mechanized equipment needed by our own and the British forces. Capital equipment, among other imported items, was important especially in the earlier years of the war. Commodity trade with other countries, which had been producing a substantial surplus, declined due to disruption of trade routes, transportation and markets.

The surplus from our commodity trade declined somewhat during the earlier period of the war. Later, however, our net balances began to rise sharply thanks to our increased shipments of essential products overseas to Great Britain and our Allies within the sterling area. The English pound sterling, in the meantime, ceased to be freely interchangeable with the American dollar. The result was that Canada suddenly found herself in a position where she was accumulating enlarging surpluses of sterling and at the same time experiencing a growing shortage of U. S. dollars.

The second item in Table V is non-monetary gold. Exports of gold, that is, the sales of the Canadian production of the metal, since 1932 have been confined almost solely to non-monetary gold. Gold exports increased considerably after 1932 as a result of the increase in the world price of the metal and the increase in Canadian production following this rise in price. The recent premium on U. S. funds also added to the value of the exported metal.

The receipts from the tourist trade represented in peacetime an appreciable factor in Canada's international balance of payments. The volume was reasonably well maintained even during the early years of depression and although it decreased steeply after 1933 it revived again until in 1939 it amounted to approximately one hundred and fifty million dollars. It may be of interest to mention that one can observe a close relationship between the expenditures in Canada by American travellers and the national income and the state of employment in the United States. As domestic conditions in that country improved, Canadian tourist trade improved too. After the outbreak of hostilities, owing to the war stimulus to industrial production in the United States and the closing of Europe to tourists, our credits from the tourist trade were again somewhat increased. The premium on U. S. funds, no doubt, also increased the number of visitors from the United States. Our own tourist expenditures abroad were also much heavier than would normally be expected. They did not show the tendency to fluctuate as markedly with changes in national income as our credit tourist balances and in the immediate pre-war period amounted to some eighty-five million a year.

TABLE V

BALANCE OF INTERNATIONAL PAYMENTS BETWEEN CANADA AND ALL COUNTRIES

1937-1942

(Millions of Can. Dollars)

| Item | 1937 | 1938 | 1939 | 1940 | 1941 | 1942 |
|---|---|---|---|---|---|---|
| A. CREDITS: | | | | | | |
| Merchandise exports - after adjustment | 1,041 | 844 | 906 | 1,202 | 1,732 | 2,523 |
| Net exports of non-monetary gold | 145 | 161 | 184 | 203 | 204 | 184 |
| Tourist Expenditures | 166 | 149 | 149 | 104 | 111 | 81 |
| Interest and Dividends | 76 | 66 | 57 | 52 | 60 | 67 |
| Freight and Shipping | 112 | 95 | 102 | 138 | 185 | 221 |
| All other current credits | 53 | 46 | 59 | 77 | 166 | 308 |
| TOTAL CURRENT CREDITS | 1,593 | 1,361 | 1,457 | 1,776 | 2,458 | 3,384 |
| Special Gold Transactions (1) | - | - | 2 | 248 | - | 23 |
| Capital Credits | 622 | 458 | 558 | 283 | 566 | 1,235 |
| B. DEBITS: | | | | | | |
| Merchandise imports - after adjustment | 776 | 649 | 713 | 1,006 | 1,264 | 1,406 |
| Tourist Expenditures | 87 | 86 | 81 | 43 | 21 | 26 |
| Interest and Dividends | 302 | 307 | 306 | 313 | 286 | 270 |
| Freight and Shipping | 137 | 105 | 119 | 132 | 167 | 228 |
| All Other Current Debits | 111 | 114 | 112 | 133 | 229 | 345 |
| TOTAL CURRENT DEBITS | 1,413 | 1,261 | 1,331 | 1,627 | 1,967 | 2,275 |
| Special Gold Transactions (1) | - | - | 2 | 248 | - | 23 |
| Capital Debits | 794 | 570 | 694 | 471 | 1,063 | 1,341 |
| Billion Dollar Contribution | - | - | - | - | - | 1,000 |
| C. NET BALANCES: | | | | | | |
| Merchandise trade - after adjustment | 265 | 195 | 193 | 196 | 468 | 1,117 |
| Net exports of non-monetary gold | 145 | 161 | 184 | 203 | 204 | 184 |
| Tourist Expenditures | 79 | 63 | 68 | 61 | 90 | 55 |
| Interest and Dividends | -226 | -241 | -249 | -261 | -226 | -203 |
| Freight and Shipping | -25 | -10 | -17 | 6 | 18 | -7 |
| All Other Current Transactions | -58 | -68 | -53 | -56 | -63 | -37 |
| TOTAL CURRENT ACCOUNT | 180 | 100 | 126 | 149 | 491 | 1,109 |
| Special Gold Transactions (1) | - | - | - | - | - | - |
| Capital Accounts | -172 | -112 | -136 | -188 | -497 | -106 |
| Billion Dollar Contribution | - | - | - | - | - | -1,000 |
| Balancing Item (2) | -8 | 12 | 10 | 39 | 6 | -3 |

(1) This represents gold received from the United Kingdom in part settlement of her deficiency with Canada, and used in turn to settle part of Canada's deficiency with the United States.
(2) This balancing item reflects possible errors and the omission of certain factors that cannot be measured statistically.

Source: The Canada Year Book 1943-44, Page 498.

Payments for interest and dividends were second only in importance among the current debit payments. They reflected the debtor-creditor relationship of Canada with the rest of the world. In 1937 the amount of British and foreign capital invested in Canada was estimated at \$ 6,765 million, and the Canadian capital invested abroad at \$ 1,758 million. (1) The corresponding movements of funds representing the earnings on these investments for the year 1937 were \$ 302 million and \$ 76 million respectively as compared with \$ 270 million and \$ 67 million respectively for the year 1942. It is interesting to notice that the <u>net</u> debit balance of interest and dividend payments for the year 1937,-\$ 226 million, is not much lower than the most important <u>net</u> credit item, merchandise trade, by \$ 265 million for the same year. The gradual decline in interest and dividend payments abroad can be accounted for largely by (a) a tendency of Canadian borrowers to confine themselves to the domestic market rather than foreign, (b) the elimination of interest payments on British-owned Canadian bonds repatriated from Great Britain and refunded since the start of the war, and (c) the increased receipts from Canadian investments abroad, particularly direct investments in the United States. These helped to reduce our net payments to that country and generally improve our financial position. Payments to other countries have been comparatively negligible.

Freight and shipping charges constitute credit balances in so far as they represent the earnings of Canadian carriers in transporting exports to the United States boundary, to ocean ports, or carrying goods

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(1) Dominion Bureau of Statistics.

abroad in Canadian vessels. To these are also added various expenditures in Canada on account of British and foreign vessels and freight charges earned by Canadian railways on the transit traffic. International payments arising from freight services, on the other hand, represent the cost of carrying imports from the point of origin to Canada on non-Canadian vessels or United States railways. Both receipts and payments have varied in the past with the volume and distribution of imports and exports and changing freight rates, but on the average debits have usually exceeded the total of credits by a small margin.

Other current debits and credits include small invisible items such as immigrants' remittances, government expenditures and receipts, charitable contributions, etc. Although not very large individually, their aggregate is substantial; debits usually exceed credits. In recent years various wartime factors, including expenditures by the United States Government on developments in Canada, have been added to the list.

Capital transfers into and out of the Canadian economy play a dominant role in the foreign exchange fluctuations. As a matter of fact, they may be said to have been the most important factor behind the decision to set up foreign exchange control in Canada. On the credit side, the simplest form of raising capital outside Canada is by borrowing from more economically mature countries where lower rates of interest normally prevail. Before 1914 our principal creditor was Great Britain where government, railway and other corporation securities were sold on the London Exchange. After 1914 the United States became the principal external source of loans to Canada. New government and private corporation issues were unusually heavy in the American market during the later 1920's; in addition, American capital flowed into Canada through the purchase of securities and by direct investment through branch plants and subsidiary companies. The average annual borrowings from the United States fluctuated around \$ 200 - \$ 220 Million per year during this time, reaching a peak of almost \$ 400 million in 1930; the British capital averaged only some \$ 20 - \$ 30 million for the same period. During the 1930's the volume of new Canadian securities sold abroad diminished considerably due to the fact that most of the foreign new issues were connected with refinancing rather than the import of new capital. At the same time our external indebtedness was being reduced through our credit surpluses established in our credit account transactions. In other words, the retirement of Canadian securities held abroad exceeded new borrowing. Despite this fact, however, the non-resident interest in Canada at the close of the last decade amounted roughly to almost seven billion dollars; of this amount the United States held some four billion dollars. These included direct investments, government securities, and railway, public utility and corporate bonds and stock.

Other transactions involving international capital movements took the form of trading in listed securities on the stock and bond markets in London, New York and Canada. Sales of securities to other countries have been small but steadily increasing. The movement in both directions has been rather irregular, being determined by various factors, including the prospects for the securities concerned, exchange rates, etc. Sales on this account have, as a rule, exceeded purchases.

Another prominent source of capital transactions has been the movement of industrial capital, mainly British and American, into Canada for the purpose of establishing industrial and commercial enterprises controlled by the parent firm abroad. Until about 1930 the movement of capital, which resulted from a variety of motives, had been an inward one; since then there has been a constant tendency on the part of the external owners to discontinue further investments and utilize the accumulated profits. Capital credits and debits also originate in connection with insurance and real estate transactions, and in connection with changes in the foreign assets and liabilities of Canadian individuals, firms, public institutions and banks, including the Bank of Canada.

The special gold transactions, appearing on the debit as well as the credit side, represent the sale in the United States of gold purchased from the United Kingdom. The $ 1,000 million gift to the government of the United Kingdom in 1942, which shall be dealt with in more detail later on in this chapter, is shown separately. It represents current and capital expenditures incurred in Canada by the United Kingdom for purchases of munition, raw materials, food, and other expenditures necessary for the prosecution of war.

## 2. Constitution, Resources and Purpose of the Foreign Exchange Control Board.

### (a) Constitution of the FECB.

The FECB was established and given the necessary powers, subject to the direction of the Minister of Finance, within a week of our declaration of war. Plans for the establishment and operation of control had been under consideration many months before, in case it should be needed, and, when the Government decided that such control was essential, the Board swung into action very quickly and without any advance notice.

The Board was established by an Order-in-Council P.C.2716 on September 15, 1939, under the Foreign Exchange Control Order, and consisted of six members. It was later extended to seven by an amendment of July 17, 1943, and at present consists of the following members: (1) G. F. Towers, Governor of the Bank of Canada, W. C. Clark, Deputy Minister of Finance, H. D. Scully, Consul General for Canada, New York, Oliver Master, Acting Deputy Minister of Trade and Commerce, N. R. Robertson, Under Secretary of State for External Affairs, Henri Fortier, Chief Inspector, Post Office Department, and David Sim, Deputy Minister of National Revenue, Customs and Excise.

While legally a distinct and separate body, the Board is in close working relationship with the Bank of Canada whose Governor is its Chairman. The Bank is the Board's technical advisor and most of its personnel has been borrowed from the Bank of Canada. The Bank at the same time acts as an Authorized Agent or Banker for the Board, to deal in foreign exchange and otherwise assist or act on behalf of the Board. The Order also appoints all branches in Canada of Canadian chartered banks as Authorized Dealers and Agents of the Board to buy and sell foreign exchange for the Board's account and also appoints postmasters as agents of the Board with a limited authority to sell foreign exchange and to issue export and import licenses. The Authorized Dealers are given 1/8 of one per cent on both purchases and sales of foreign exchange. Since there is a discount of roughly one per cent between the buying and selling rates, the remaining 3/4 of one per cent on all transactions probably yield the Board a substantial income over its expenses.

The sudden transition from a free exchange system to a far-

(1) Foreign Exchange Control Order No. 3 (2), FECB, Ottawa, November 1, 1944, Page 6.

reaching form of control was expected to produce widespread inconvenience and disruption. But the transition proved to be comparatively easy. This is the more remarkable when one considers that Canada is a very difficult country in which to operate successfully a control of foreign exchange. In the first place, international transactions play an extremely important part in our economic life, probably more important than in any other industrialized country of the world. In the second place, our industrial relationship with the United States for the past fifteen years has been so close and our financial relationship so intimate that an exchange control was feared to disrupt these ties entirely. And, finally, an exchange control in Canada is difficult for the simple reason that it is something new for the average Canadian citizen who was always accustomed to a "free exchange" and hardly ever thought in terms of a foreign currency. That the exchange control system achieved a considerable measure of success is due primarily to its careful preparation and the willing co-operation of the Canadian public.

Its operations, discussed in part three of this Chapter, are regulatory rather than prohibitive, and the fact that it has been functioning for more than five years without any major alterations being required indicates that the system has been well designed to suit our wartime economy.

(b) Resources of the FECB.

The original Canadian dollar resources of the Fund consisted of the profit created out of a revaluation of the gold stock of the Bank of Canada in 1935. The price of gold was raised from \$ 20.67 to \$ 35.00

per ounce. The profit was credited originally to an Exchange Fund account by virtue of Exchange Fund Act of 1935. This Fund, however, was allowed to lie inoperative, in fact, to all intents and purposes it disappeared until it was re-established at the outbreak of war. It amounted roughly to \$ 75 million when it was placed at the disposal of the FECB. In May, 1940, under the Exchange Acquisition Order, the Exchange Fund was increased by approximately \$ 325 million out of the proceeds of a sale by the Minister of Finance of \$ 250 million of one-year one per cent notes and \$ 75 million in bills to the Bank of Canada. In June, 1941, a cash advance of \$ 325 million from the Minister of Finance out of the proceeds of the Victory Loan again increased the dollar resources of this Fund. Additional needs for Canadian dollars have been met by temporary borrowings from the Bank of Canada, or by advances from the Department of Finance. In the fiscal year 1942-43 the indebtedness of the FECB to the Dominion reached \$ 400 million. Further advances, totalling \$ 185 million, were made to the Board during 1943-44 bringing its total indebtedness to \$ 585 million. (1) This amount is shown as an active asset on the balance sheet of the Dominion.

With regard to the most important foreign assets acquired by the Board - gold and United States dollars - the information is usually not made public. Under the Foreign Exchange Acquisition Order of April 30, 1940, all residents of Canada were required to sell to the Board, before the first of June, their holdings of foreign exchange, including cash deposits. Certain exemptions in the case of commercial companies operating authorized foreign currency accounts, and insurance companies operating abroad were granted. On the basis of indirect information it

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(1) 1944 Budget, Pages 73 and 81.

has been estimated that some $ 150 million were acquired from the public. (1) In addition, the Board acquired about $ 250 million in gold and foreign exchange from the Bank of Canada at the current market price. The reason for these transactions was the advisability of having all liquid foreign resources centralized with the agency charged with the management of our foreign exchange transactions.

During 1940 about $ 248 million were received in gold from Great Britain on current international account as a part settlement of her debit balance with us; but, owing to our own debit balance with the United States, the gold was in turn sent to that country. In 1942 another $ 23 million were disposed of in the same manner.

It has been emphasized before that Canada's chartered banks were appointed agents for the Board with the authority to buy and sell foreign exchange on its behalf. It is interesting to note the effect of the Board's operations on the cash resources of the chartered banks and the role the Central Bank plays in keeping the latter at the desired level. All transactions between the Board, on one hand, and the banks, on the other, are carried on through the Bank of Canada. If the Board is buying foreign exchange from the banks it requires cash to make its purchases. It therefore sells treasury bills and other securities to the Bank of Canada thereby putting itself in Canadian funds. With this money the Board acquires the foreign exchange from the commercial banks. The cash transferred to the chartered banks' accounts will increase their cash balances considerably, especially if unusually large quantities of foreign exchange were transferred. It now becomes the task of

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(1) Dominion Bureau of Statistics.

the Bank of Canada are reversed - it buys securities to increase the reduced volume of the banks' cash balances.

(c) Purpose of the Foreign Exchange Control.

We said in section one of this chapter that both our imports and exports were expanded substantially as a result of the war. Prior to 1939 we were able to use any excess from our trade with one country to meet any deficits in our trade with another. With the outbreak of war, however, when Great Britain began to feel an acute shortage of Canadian dollars and had to economize in her use of United States dollars to pay cash for purchases of essentials as she was obliged to do under the terms of the United States Neutrality Law, we could not expect her to settle all her trade balance with us in gold or foreign exchange. She has therefore been paying for her purchases in Canada in pounds sterling.

Since the start of the war, despite a marked increase in our favourable balance of trade with the United Kingdom, we have been unable to convert the accumulated sterling into U. S. funds in order to meet our adverse balance of payments with our neighbour. The United States did not require sterling owing to the shrinkage of merchandise imports from the United Kingdom. Furthermore, our exports to non-Empire countries, other than the United States, which before the war had brought in handsome amounts of foreign exchange, soon dwindled into insignificance which further aggravated the situation.

On the import side our purchases in the United States also expanded enormously. These were principally in the form of equipment for our armed forces and of machinery and materials essential for the establishment and operation of our war industries. Payments for these goods could be made only with American currency. In addition, United States dollars had to be found to enable this country to continue buying commodities essential for carrying on the civilian life of Canada and to continue meeting, as they fell due, our contractual obligations payable in U. S. currency. Since, as has just been explained, the sterling could not be converted into dollars in the normal way, other measures became necessary.

During the first year of war England sold $ 250 million worth of gold to Canada, and increased her commodity exports to this country by $ 24 million; but since then, Canada has in effect paid for her own exports to Great Britain, except for another $ 23 million of gold sold to Canada in 1942 and $ 150 million U. S. transferred by Britain early in 1943. The chief method of financing the sterling area's deficiency of Canadian dollars has been the repatriation of English-held Canadian securities from Britain with Canadian dollars. The rest of our sterling balances have been accumulating in London. Canada has thus been making available Canadian dollars to the United Kingdom for the full amount of her deficit with us. To assure Britain of Canada's wholehearted assistance the Minister of Finance in his 1941 Budget Speech declared that "...Canada would meet such proportion of that total deficit as Britain herself would not be able to meet by the transfer of gold or United States dollars to Canada." (1)

During the fiscal year 1941-42 the entire deficiency amounted to approximately $ 1,100 million and was financed by Canada. Of this total, about $ 50 million were financed by a private repatriation of

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(1) 1941 Budget Speech, Page 4.

securities. Of the remaining $ 1,050 million, which required government financing, $ 365 million were financed by repatriation of government and government guaranteed securities and the remaining sum of $ 685 million was deposited in London to our credit. This sum plus some $ 215 million, accumulated prior to March 31, 1941, was then consolidated into a new interest-free loan of $ 700 million worth of the sterling balances; the rest was charged to a newly created $ 1,000 million gift authorized by the War Appropriation (U. K. Financial) Act of March, 1942. This gift of one billion dollars in war supplies to cover the Canadian war expenditures and it can be found in Table I under capital debits. In February, 1943, the Mutual Aid Program was introduced, making another billion dollars of war supplies available under various terms to all the United Nations with provisions for reciprocal assistance wherever possible.

But the fact still remained that the surplus sterling, whether used up by repatriation or not, did not help us, as it would in normal times, to pay for the heavy imports from non-Empire countries, chiefly the United States of America. Some other source of U. S. dollars had to be found.

It was to meet this situation that Foreign Exchange Control was established in Canada. We may, therefore, say that the main object of our exchange control was to balance, as far as possible, our import and export of United States dollars in order to ensure, on one hand, that U. S. funds would be available as required to obtain vital war materials and, on the other, that they should not be dissipated on non-essential purposes. What was feared, of course, was a large-scale export of capital in search of what might have been regarded as greater security abroad. Non-residents might wish to liquidate their Canadian investments and convert the proceeds into U. S. funds. The policy which has been followed by the Board has been to restrict such movements of capital out of Canada to a minimum while at the same time to interfere as little as possible with import and export trade and the flow of normal business transactions. This danger of capital outflow was feared not only in the case of residents but to an even greater extent in the case of non-residents. The latter, if no control were exercised, might at any time convert their holdings of Canadian cash and securities into U. S. exchange and export them. What effect such transactions would have on our international exchanges was sufficiently well demonstrated on the Continent during the latter part of the last decade.

The prevention of export of capital was necessary for still another reason. Canada's financial task had become so vast that no capital export could be permitted. Huge sums of money had to be spent on war expenditures of all kinds and if, in addition to this, funds had to be raised for the purchase of assets from non-residents who wished to export their capital in the form of foreign exchange it was clear that the amount which the Government of Canada could afford to spend in war expenditure would have to be reduced accordingly. An outflow of capital would also have a depressing effect on our dollar and would probably disorganize our domestic securities market.

Other purposes in establishing an exchange control can be briefly listed as follows: (a) to prevent a dissipation of foreign assets held in Canada so that it would be possible to use them for the benefit of the country in case of an emergency, (b) to stabilize the rates of exchange between the Canadian dollar and other currencies, mainly the U. S. dollar and thus to stabilize our trade relations with the U. S. A., (c) to set up a Board that would function as an advisor to the Government in financial matters, in particular to facilitate implementing financial assistance which Canada was providing to the United Kingdom and other Allied countries. (d) Finally, an exchange control had to be imposed for the simple reason that all other belligerents had done so. The existence of exchange control in sterling countries made it impossible to convert sterling freely into American dollars, ending thereby the possibility of a triangular settlement.

3. Regulations of the FECB.

(a) Foreign Exchange Acquisition Order.

As soon as control became effective, residents of Canada who were holding foreign securities and foreign bank accounts in excess of $ 1,000, had to declare them. The Board was then in a position to draw up a rough balance sheet showing, not only a total of the amount of foreign exchange held by Canadians, but by whom it was held. On April 30, 1940, the Foreign Exchange Acquisition Order was passed requiring all residents of Canada to sell to the Board their foreign exchange holdings at the official buying rates. After the end of May no resident was permitted to maintain a balance in a bank account outside Canada or in a foreign currency account in Canada without the authority of the Board. Certain exceptions were made, chiefly for commercial purposes. Banks, companies and individuals who could prove its necessity were allowed to continue to operate their foreign accounts, provided they make a periodical report to the Board. Foreign securities owned by Canadians have not been disturbed.

Furthermore, all foreign exchange coming into the possession, ownership or control of residents of Canada must be sold immediately to an Authorized Dealer or other Agent of the Board. This requirement was to prevent dissipation of American dollars by reason of Canadians hoarding the money indefinitely in the hope that at some future date they would be able to sell it at a more advantageous rate of exchange or export it abroad. Similarly, all foreign exchange required by residents of Canada had to be purchased from an Authorized Dealer or other Agent of the Board.

(b) Export and Import of Commodities, Goods and Services.

All exports from and imports into Canada of commodities, goods, and services might be made only under a special permit issued by the Board. To ensure that our exports do make available the proper kind and amount of foreign exchange and that the Board actually obtains this exchange, it is necessary for the Board to know what exports are being made and when and by whom payment for such exports has been or will be received. Our exports are our largest source of U. S. dollars and it is a fundamental principle of exchange control that all exports from Canada should produce U. S. dollars or foreign currencies which then may be freely converted into U. S. dollars. The Board has therefore adopted the general policy that any exports from Canada must be paid for in U. S. currency or in the currency of the importing country where such currency is freely convertible. Upon payment to the exporter it must immediately be accounted for and made available to the FECB. Exports to countries in the sterling area may be settled by payments either in Canadian dollars or pound sterling because of the operation of similar exchange controls in those countries. The Board is thereby assured that the Canadian dollars which must be purchased in connection with such export sales will be acquired only through authorized channels. We, therefore, accept payments in sterling or in Canadian dollars for all our exports to sterling-area countries, even for those exports which have a high percentage of United States content.

An exporter who receives payment in sterling is not required to sell it to the Board, unless he wishes to do so. He may deposit the sum in a sterling bank account either in Canada or in a country in the sterling area, or he may use it to pay any of his own expenditures in the sterling area. The Board has also made arrangements whereby an exporter who within ninety days is to receive sterling for goods exported or to be exported from Canada may, if he so wishes, protect himself against any fluctuations in the Board rates before payment is actually received by entering into a forward contract for delivery of a specified amount of sterling to the Authorized Dealer on the approximate date of receipt. Forward contracts are not available to non-residents, as a general rule.

On the debit side of our international accounts payments for imports cause the principal drain upon our foreign exchange resources. The Board, before it provides foreign exchange at its official rate for permitted imports, must be assured that the goods have actually entered or will enter Canada within a reasonable time. For this purpose every importation from a non-sterling country requires an import license issued by the Collector of Customs and Excise on behalf of the FECB, at the time of entry through customs. The procedure is similar to that followed when goods are exported but the Board is this time even more concerned with the kind of foreign exchange which is used to pay for the imports. When goods are imported from a sterling-area country, no licence is required. The only foreign currency which may be used to pay for the goods is sterling; however, payments alternatively may be made in Canadian dollars as well. United States dollars are being conserved to pay for goods originating elsewhere than in the sterling-area or Newfoundland and brought into Canada under an approved FECB import licence.

Export and import licences are issued by the Collector of Customs and Excise on behalf of the Board. Copies of these certificates, which have been consolidated with the export entry forms required by the Customs Authorities, are sent to the Board where they are in due course matched against the forms covering the Board's purchases and sales of exchange. By doing this the Board makes sure that they are getting the foreign exchange for the export of goods or getting the goods for which exchange had been given up in imports. In some cases an approval of an Authorized Dealer or of the Board itself is required before the Collector can issue the licence. It should be noted at this point that the export and import licences are mere declarations that goods have been legally exported or imported from or into Canada. They do not authorize any export or import of goods which may be prohibited under any other law, such as the War Exchange Conservation Act of December, 1940, prohibiting the import of certain articles from the United States except under a licence from the Minister of National Revenue. This Act, designed to conserve U. S. exchange, is more fully discussed in section 3 of the chapter on taxation.

Various special export-import permits are issued by the Board under which the permit holders do not have to account for each individual foreign exchange transaction. They must, however, make periodic reports supplying the information required by the Board. The Board is at any time at liverty to examine the company's books to satisfy itself that all purchases and sales of exchange are supported with import and export entries. The most significant in this group are the BD and BE permits. Under the former, companies whether or not incorporated, can apply for a general import and export licence and for authority to maintain a foreign currency account. The proceeds from payments received for exports may be deposited into these accounts and they can be drawn on to pay for imports and other payments of a commercial nature; financial and capital payments may not pass through these accounts. Periodic monthly reports must be mailed to the Board reconciling all individual transactions. A BE permit is issued to a company whose export business is of such a nature that it is difficult to identify payments received for such exports with individual export licences. A BE permit holder is required to obtain the ordinary export licence in the same manner as other exporters but he need not send it to the Board. Monthly reports on a form prescribed by the Board and furnishing the Board with the necessary information have to be submitted. Unlike the former, a BE permit requires from its holder to declare and offer for sale to the Board, as soon as received, all U. S. dollars obtained in settlement for exports.

(c) Sales of Securities.

International dealings in securities are also controlled by a system of licencing. The principle is that no exports of capital from Canada shall result from such transactions. Residents (1) can no longer use foreign exchange for the purpose of purchasing securities from non-residents. In so far as they already own securities, residents may continue to hold them; if they dispose of them to non-residents, payment for their full value must be turned over to the Board or reinvested at once in another readily marketable foreign security. (2) On the other hand, non-residents are not permitted to reduce the total amount of their investment in Canada by selling securities. They may, however, sell and buy again as long as they switch from one Canadian security to another of no shorter maturity. On such transactions ten per cent can be taken in cash, up to a maximum of $ 1,000 and disposed of freely. Transactions in either Canadian or foreign securities between residents or between non-residents are not subject to exchange control since such transactions do not affect either the total resident holdings of foreign securities or the total non-resident holdings of Canadian securities.

Licences for export are required from the Board. (3) (a) for the export and sale of securities by residents or for sale and reinvestment of the proceeds, (b) for the export of securities held in Canada by non-residents. Licences for the import of securities are

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(1) "Resident" means any person whose residence is in Canada (and for most purposes Newfoundland) and it specifically does not include persons who come to Canada as tourists or temporary visitors.

(2) In February, 1945, the Foreign Exchange Control Board issued amended regulations regarding sales and exchange of securities in the U. S. by Canadian residents. Proceeds of sales may now be held temporarily uninvested in the resident's account with a resident stockbroker, investment dealer, bank or trust company. Such funds may be later sold or reinvested according to regulations.

(3) Foreign Exchange Control Order, Pages 11-12.

necessary (a) for the import of securities by residents or non-residents in connection with transactions in Canada which are permitted by the Board, (b) for the import of foreign securities for safekeeping or otherwise by residents or non-residents. Licences are also granted if foreign exchange is to be provided to meet foreign debts at maturity or to maintain sinking fund payments, and all current payments to non-residents from Canadian sources. Thus permits will be granted for the purchase of U. S. funds to pay interest or dividend to a non-resident where such interest or dividend is expressly payable in U. S. funds.

(d) Travel.

Another feature of Canadian exchange control has been a rigorous limitation of unessential travel expenditures abroad. At the outbreak of war, supervision was established over the purchase of American funds for travel to insure that travellers should not take out money for export abroad. Later on, when the demand for U. S. funds was intensified as a result of increased purchases of war materials in the United States, restrictions were introduced to prevent use of American funds for pleasure travel. Permits from the Board are now required for travel in countries other than those of the sterling area. These are granted only if the traveller leaves Canada for business or other special purpose. Permits for pleasure travel are not granted. On the other hand, American tourists visiting Canada are not subject to FECB regulations.

(e) Export of Capital.

The Board, as a rule, does not approve applications for export of foreign exchange which reduces capital (1) invested in Canada by non-residents. On the other hand, current earnings payable in foreign exchange are usually available to non-resident shareholders upon application. In addition to a transfer of capital in exchange for a foreign currency the following transactions are deemed to be an export of capital, as stated by the Foreign Exchange Control Order: (2) (a) export of property for which no payment has been received, (b) export of property for payment of a price less than the fair value thereof, (c) failure of an exporter to take reasonable steps to collect a debt owing by a non-resident, and (d) to import into Canada any property which has been purchased at a price greater than the fair value thereof.

(f) Rate of Exchange.

The Board announced on September 15, 1939, that the official exchange at which all foreign exchange transactions are to be made would be: for the U. S. dollar 10% buying and 11% selling premium and for the pound sterling \$ 4.43 and \$ 4.47, respectively. The rates are roughly those prevailing immediately prior to the introduction of exchange control, i.e. half-way between the two major currencies. They have been pegged at that premium and maintained unchanged since September 15, 1939.

Although the Board deals directly only in U. S. dollars and pounds sterling, transactions in other foreign currencies, too, must be made through the FECB. Mention is frequently made of the exchange rate

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(1) "Capital" as defined by the Board includes: capital stock, surplus, reserves, the funded debt, mortgages, long-term loans and any balances of inter-company accounts with any foreign, parent, subsidiary or associated company.

(2) Foreign Exchange Control Order No. 28, Page 15.

for the Canadian dollar in the New York market. The rate in this so-called 'free' or 'open' market fluctuates from day to day, subject to supply and demand, frequently showing a greater discount than that represented by the 'official' rate. It represents the price which one resident of the United States is willing to pay to another resident for our dollars. There is no direct relation between the 'official' and the 'open' market rate but it is obviously to Canada's advantage to prevent, as far as possible, the flow of our dollars into the 'open' market. For such transactions are illegal and usually deprive us of the use of U. S. dollars as a counter-value for the exporting capital.

4. Hyde-Park Declaration.

A magnificent contribution to the solution of Canada's American dollar exchange problem was made by the Hyde-Park Declaration of April 20, 1941. The declaration was made jointly by the President of the United States and the Prime Minister of Canada. Its implications concerning the solution of Canada's foreign exchange problems are that (a) the government of the United States will make available to Great Britain under the Lease-Lend Act the component parts, including raw materials, which Canada obtains from the United States for manufacture into war materials for Great Britain. This relieves Canada of the necessity of finding American dollars for a substantial percentage of her imports from the United States. (b) the United States also undertakes to purchase in this country various war materials and equipment which Canada can produce and which are required in the United States. These include: munitions, strategic materials, cargo and war ships, among other items. These were originally expected to run to $ 200 or $ 300 million annually but the actual figure seems to have been higher. The agreement provides additional supplies of American dollars at a time when the danger of a shortage of U. S. exchange was becoming a bottle-neck in our war effort. The treaty, although not completely effective, resulted in a great alleviation of our exchange problems and marked the beginning of an "... intelligently planned integration of the industrial capacities of this North American arsenal." (1)

(1) 1941 Budget Speech, Page 6.

4. A Comparison of the Financial Systems of World Wars I and II.

The object of this chapter is to compare the financial systems of World War I and World War II. It is worth while for the purpose of this discussion to take a brief glance at the position of this country at the outbreak of the two wars.

In 1914 Canada had just completed an era of expansion associated with the opening up of the west. The carrying charges on debts incurred for large governmental undertakings were only beginning to affect taxes. In our external trade there was a tendency toward expansion of exports during the decade prior to the outbreak of war but imports had been advancing at a much more rapid rate, so that in 1914 we had an adverse balance of about a hundred and sixty-three million dollars. Our chief foreign market then, as today, was the United Kingdom; about three fifths of our imports originated in the United States.

In 1914, Canada was a nation with one great dominating industry--agriculture. She served as the "Granary of the Empire" and her prosperity depended in large measure on the success or failure of the operations of a single industry and in particular on the success or failure of a single crop, viz., wheat. By and large Canadian manufacturing industry consisted of small concerns. Mechanization was not as extensive as it is today and mass production was practically unknown. There was a certain amount of unemployment but no official statistics were available. Wholesale prices were rising slowly, averaging about 2% per annum, and in 1914 averaged about 20% under those prevailing in August, 1939. The value of our country's physical production in 1914 was about $ 1,650 million or $ 340 per head of a population less than

8,000,000 people. Business was not too prosperous due to a world-wide financial stringency which marked the pre-war years of 1912-1913, and the industrial machinery was not running at its full capacity.

Gold coins circulated freely but were little used, most people preferring Dominion and chartered banks' notes. The total circulating media in the hands of the public at the end of 1914 were some $ 150 million. There was, of course, no central bank. Capital, at this time, was rather scarce and this circumstance was reflected in the interest rate. Our greatest supplier of capital was London although an investment of American capital in Canadian branch plants was beginning to take place on a considerable scale.

Practically no steps had been taken to meet the growing threat of war. Canada was thoroughly unprepared for participation in a world conflict; her armament programme, if it could be called so, required about $ 10 million a year. When the First World War was declared the Government had no experience to guide the nation. There was no one in the country who had ever attempted to tackle the numerous war problems, and the machinery of finance, which lay at the disposal of the Government in 1939, simply did not exist in 1914.

Canada was in a substantially different position in 1939. During the twenty-five years that separate the two wars the Canadian economic structure had been transformed from one based mainly on agriculture to one of greater diversification in which manufacturing played a leading role. This change may be said to have definitely set in during the period of the Great War, 1914-1918. How much better the Dominion was equipped to serve the Allies in 1939 than it was in 1914 is indicated by a comparison of our industrial position of 1939 with that which existed thirty years ago. In mining, for instance, we had developed almost entirely new industries in gold and base metal mining, both of the utmost importance for a war economy. Our lumber output had increased and the industry had become an important factor in our export trade. In manufacturing we had established a substantial automobile and shipbuilding industry which had been closely integrated with American industry and especially dependent on it in periods of expansion when a good deal of machinery and technical equipment and personnel have been required. As in 1914, there was a considerable amount of slack in the Canadian economy at the outbreak of the war, in the Canadian economy at the outbreak of the war, in the form of unemployed men and capital. There were reported to be some 330,000 wage earners unemployed, or about 12% of the whole. Not all of these men, however, possessed the necessary skills to make them immediately available for the armament programme.

In contrast with the position in 1914 we were already building up dangerous agricultural surpluses in 1939. It was clear that this war was unlikely to make the demands on agricultural resources that had been made thirty years ago. Thus wheat was sown in 1914 to some ten million acres and a crop of a hundred and sixty million bushels was harvested. In 1939 the area sown was the second largest on record, more than twenty-six million acres, the total crop falling but little below the half billion mark.

In our external trade we were still well below prosperous levels of the previous years, despite some recovery during the summer of

1939. Our favourable balances were averaging some $ 200 million a year which reflected an entirely different position from that existing in 1914 when quite heavy debit balances of payments were occasioned by substantial imports of capital. Our still relatively small population of slightly more than eleven million had a national income of about four billion, some thirteen hundred and sixty million over that of 1914. Expenditures by all governments, Dominion, Provincial and Municipal, absorbed about 30% of this total; the more severe the depression the higher was the percentage of national income channelled into government expenditures. Less than one per cent of our national income was spent on defence.

About one quarter of the income was deprived from exports, chiefly of primary products or of commodities involving only a slight degree of manufacture. The existence of a central bank had done much to assist the Government in administering the monetary policy. The Bank of Canada had been performing many of the functions which had been performed in the last war by the Department of Finance and the Bankers' Association. In contrast to its predecessor of the First World War, the Government was able to employ methods of taxation and borrowing which did not exist in 1914. By 1939 the machinery of the income tax had been developed, we had a substantial domestic capital market and we were no longer dependent upon capital imports. The Government leading Canada into World War II undoubtedly benefited from the experience gained during and after the First War and this time the methods of dealing with wartime fiscal policies were better understood. Moreover, there was a much wider public understanding of the economic and financial issues involved and a greater willingness on the part of the public to accept the necessary burdens of war than was the case in 1918.

Compared to World War II the war effort in War I would seem to have been on a small scale. (1) Combined British and Canadian war expenditures in Canada were well below a fifth of the national physical production, and..."per capita costs of war and demobilization for the six fiscal years, 1915-20, were less than one-fifth of the estimated per capita cost of war for the five fiscal years, 1940-44. (2) Canada's objectives in war finance during the last war were not as spectacular as those of our time. In the first place, there was no conception of the magnitude of the task upon which we had engaged. It was, for instance, estimated that the war would involve an expenditure of $ 50 million for the first year, but by the time the fiscal year was over the initial $ 50 million had been over-spent by $ 10 million. The Minister of Finance at the end of the first year of war was not only facing increasing expenditures but, due to the influence of poor business conditions, a shrinkage in Government revenue as well. The need for increasing the leval of production and national income became of utmost importance.

As a result of the agricultural expansion in the west, Canada was able to render outstanding service as a supplier of food products for Great Britain and her Allies. With a depleted labour force Canadian farmers extended the area planted to farm crops from 33 Million acres in 1914 to 51 million in 1918, an increase of 41 per cent. Substantial

(1) The chief sources for figures cited in this section are the following: The Canada Year Book, 1943-44; Budget Speeches, 1914-20; G. L. Connor, A Survey of Canada's Federal Income and Expenditure; A. F. W. Plumptre, Mobilizing Canada's Resources for War.

(2) Wartime Information Board, Canada at War, Dec. 1943, Pages 26-27.

progress was also made in the manufacturing industry where the value of the manufactured or finished goods increased from $ 1,166 million in 1910 to $ 3,460 million in 1918. This accomplishment was even more outstanding when we consider that the country was totally unprepared for and inexperienced in wartime activities. Moreover, a substantial part of its manpower was on the fighting fronts. Various new industries established under the direction of the Imperial Munitions Board began to supply shrapnel and other ammunition and in less than a year nearly 400 Canadian establishments were engaged in the manufacture of shells and other war materials. Exports of such products from Canada increased as follows: (1)

| | |
|---|---|
| 1914.......... | $ 28,164 |
| 1915.......... | 57,213,688 |
| 1916.......... | 296,505,257 |
| 1917.......... | 388,213,533 |
| 1918.......... | $ 260,711,751 |

In addition, Canada was also awarded shipbuilding contracts to a total of $ 70 million and built some 2,900 aeroplanes.

The expansion of existing industrial concerns and the establishment of new factories with greater efficiency and a higher degree of administrative ability had a far-reaching influence upon Canadian manufactures. It tended to diversify production not only for war purposes but also for home consumption of many commodities formerly imported. The direct controls imposed on the allocation of raw materials, labour and final products were of a very limited character as compared with those of today, and the industries were allowed much greater freedom in determining their own policies. This fact, coupled with the practical suspension

(1) Royal Bank of Canada Monthly Review, November, 1939.

of the importation of many manufactured goods, meant that the Canadian producer had practical control of the home market. Moreover, it meant that the industries, working now at high pressure, were producing munitions and war supplies side by side with manifold varieties of goods required for the stimulated civilian demand. The net result was that Canada established herself in a new position, as one of the leading manufacturing nations of the world.

Curiously enough, the Government did not undertake direct investment in war plants and equipment on anything like the present scale, nor did it apply the same controls to assure an adequate flow of men and materials into war production. This can, perhaps, be explained by the fact that the volume of our production was not as great then as it is today. Canada was not called upon to make so great an industrial effort. For this reason the Government undertook little direct responsibility for war production.

The outbreak of war, which at first brought in its train unsettlement in business, industrial slack and unemployment, resulted in the Government facing the necessity not only of organizing, equipping and maintaining the first contingent but also of providing work to reduce unemployment. Public works programmes were pushed forward as quickly as possible, including railway, canal and other important port and terminal undertakings. As the war went on, general business conditions improved. Canada in 1915 was favoured with a bountiful harvest--the greatest by far in the history of the Dominion. This, coupled with British and Allied purchases of shells, munitions, food supplies and ships, stimulated domestic trade and industry. Moreover, these developed a heavy home consumption and importation of luxuries from foreign countries which were still accessible. Our foreign balance of payments, unfavourable by $ 36 million in 1914, turned to a favourable balance of over $ 200 million with a total trade of over $ 1,200 million in 1916. Wages were rising, employment was excellent and some working people lived better than ever before, and so did most farmers. Wage movements showed wide differences. Wages of common labour and certain kinds of skilled labour more than doubled. Others, especially white-collar workers, were less fortunate. Wholesale prices and profits rose even more than wages generally. "The cost of living in Canada during the war period rose by 100% from 1914 to 1920, but the preoccupation of the people with the serious problems of the war meant that it was given little public attention." (1)

With regard to the Dominion Government debt, since the financing of the war was the responsibility of that Government, a great increase in its debt was to be expected. The debt rose from $ 406 million in 1914 to $ 2,750 million in 1920. Total war expenditures amounted to roughly $ 1,670 million in this period and other expenditures contributing to the increase in debt were railway aid subsidies, advances and guarantees, canal undertakings, advances to the Imperial and foreign governments, advances to provinces and banks, expenses of the Soldiers' Settlement Board and the undertakings of public works and buildings.

That our World War II effort has been a gigantic one in comparison to 1914-18 is unquestionable. Suffice it so say that in the field of munition manufacturing, where more attention was centered in the last war

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(1) G. L. Connor, A Survey of Canada's Federal Income and Expenditures, Page 24.

than in any other branch of manufacturing, the production during 1914-18 was less than a sixth of our output in the parallel period of this war.

Canada in 1939 was capable of much greater service to the Allies than she was in 1914. Her expanded industrial power, mineral resources and capital, a great percentage of which was idle at the outbreak of this war, could now be fully employed to supply the tools for modern warfare. Starting from this position, the direction of Government policy was quite clear. It was necessary to develop the full use of our resources and man-power and to devote as much as possible of both to the prosecution of the war. First of all, industries had to be reorganized in order to produce the mechanized war equipment. All this required large investments in capital equipment and the period after the fall of France to December, 1940, was marked by a rapid expansion of manufacturing equipment rather than production of actual war supplies. Unlike in 1914, the Government, through the Department of Munitions and Supply, assumed responsibility for initiating and supervising the program of plant additions and expansions. Many new plants of a specifically wartime character were established and equipped by the Government and although their operation in most cases has been left to private companies the Government has retained the ownership. Additional productive capacity was created by installing Government-owned machinery in existing pre-war plants.

The process of increasing industrial capacity was at the same time accompanied by a corresponding policy of expansionist finance. Lest this period of expanding production and rising national income should result in inflationary tendencies and other economic maladjustments, the Government took restrictive measures both in the field of commodity control and in the field of fiscal control. Price regulation was introduced, essential factors of production began to be rationed and a system of priorities was set up. Anticipated shortages of labour occasioned an extensive labour training program.

Production of war materials from these new capital facilities did not commence on a large scale until the middle of 1941. As this second stage developed, certain modifications of financial policies were called for. Business became even more active and still more workers entered employment. The expanding incomes in the hands of wage-earners were bound to become subject to taxation for the purpose of ensuring that the increase in national income would be diverted to war needs instead of being disbursed in increased personal consumption and private investment. The answer was found in the so-called 'pay-as-you-go' policy, that is a policy of taxation with an ultimate objective of paying as much of the current expenditures in the form of taxation as is humanly possible. What was really meant, of course, was a policy which would avoid the gross inequities and effects of inflationary increases in prices and incomes.

As was indicated above, there was a certain amount of slack in our economic system of 1939. Both the volume of manufacture and the amount of employment in manufacturing sank in 1932-33 to rather less than two-thirds of the 1928-29 level. Although they climbed most of the way back by 1937, they fell away again in 1938. At the outbreak of war the volume of our manufacture was about what it had been in 1928 and considerably short of the 1929 level. This in itself would indicate an appreciable amount of idleness.

In 1944 the picture was considerably different: the country's industrial machinery was much expanded, working twenty-four hours a day, and Canada ranked fourth among the United Nations as a producer of war supplies. This was achieved in the face of various difficulties, such as constantly changing requirements and specifications and shortages of materials, tools and skilled labour. In addition, many of the industry's best managers and technicians were loaned to various Government departments. Of the total war production, excluding food supplies and metals which by the spring of 1944 totalled some $ 6,000 million since the war began, less than 30% had been for Canada's own armed forces; the remaining 70% went to other Allied countries.

The upward trend of war expenditures by the Canadian Government has not been an even one. The total expenditures on defence prior to the outbreak of war were less than one per cent of the national income of $ 4,000 Million per year. In the first six months of the war expenditures grew to $ 24 million a month. They stayed at that level for about four months. In June, 1940, they began to soar to $ 40 million a month as a result of the changed conditions in Europe, and in October they reached $ 82 million. This corresponds to a percentage increase of 17% in the first nine months and 25% in the succeeding five months, including the increase to $ 82 million, following the months of June-July, 1940. The comparative war expenditures including payments for the account of the Government of the United Kingdom for the five fiscal years, 1939-44, were as follows: (1)

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(1) 1944 Budget Speech, Page 55.

| | |
|---|---|
| 1939-1940............. | $ 118,291,022 |
| 1940-1941............. | 752,045,326 |
| 1941-1942............. | 1,339,674,152 |
| 1942-1943............. | 3,724,248,890 |
| 1943-1944............. | 4,624,596,613 |
| | $ 10,558,856,003 |

The grand total for the five fiscal years, 1939-44, of $ 10,559 million, compared to last war's total cost of war and demobilization, of $ 1,698 million, reveals that the latter costs were well below a fifth of the cost so far incurred in this war. This would correspond to a little more than one-fifth of the estimated per capita cost for the years 1939-44. In the last war a fighting plane cost $ 8,000. In this war it costs $ 25,000. A full tank brigade now costs $ 60,000,000. Anti-aircraft guns cost $ 15,000 and in one hour's firing spend more than $ 40,000 of the taxpayer's money.

How does this spending correlate with our national income? In 1939 the national income was estimated at $ 4,162 million; in 1943 it was some $ 8,800 million. Of the total national income in 1943, as stated above, Government expenditures for war purposes represented some $ 4,625, or roughly 53%, which in itself is in excess of the total pre-war income of the nation.

Several important factors have contributed to the expansion of the national income. (1) Increased exports of goods, particularly war materials, (2) Increased Government current and capital investments, (3) Increased private investments, (4) Government investments in wheat surpluses, and, (5) British Government capital investments. Amid all this activity of industry and finance, there was a wider distribution of the national income in favour of wage-earners and farmers.

Since both these classes, as a rule, spend most of their incomes, this redistribution, undoubtedly, has indirectly tended to increase the demand for consumer goods. Although the effect of the redistribution of disposable income has been substantially the same as that of 25 years before, the present fiscal policy, unlike that of World War I, has aimed, through the principle of the ability to pay with a progressive tax structure lowered exemptions and an emphasis on war loan subscriptions, to mitigate it.

The Government this time was from the very beginning determined to finance the war as far as may be practicable by a pay-as-you-go policy. Such a policy would not have been expedient twenty-five years before. Canada then had no system of general taxation -- there was no machinery established for directly taxing the net incomes, profits and wealth of the individuals. Direct taxation was resented and the taxation system before 1914, however light in comparison to our own, was regarded at that time as heavy.

At that time the Government was rather reluctant to impose taxation on any heavier scale because it feared opposition both in the public and the parliament. General discontent, it was thought, would have serious repercussions and would possibly interfere with a successful prosecution of the war. Furthermore, the Government felt that Canadian industry which was at that time expanding at an enormous rate, required the accumulated profits for reinvestment in machinery to meet the constant demand for new and different types of munitions and war supplies. This period was characterized by sharply rising prices, enormous profits, a drastic expansion of bank credits and a redistribution of the national income. Industrial profits and property incomes increased greatly while the real incomes of salaried men and individuals receiving interest payments at fixed rates declined or rose less rapidly. The distribution of profits was very uneven and the Government was doubtful whether it could tax the people on a basis that would reach the fortunate classes without inflicting injustice on the classes of community whose purchasing power was lessened by the war.

The Dominion Government of 1939 was more fortunate in this respect. It had at its disposal a tax-machinery, the total revenue of which amounted to approximately $ 436 million at the beginning of the war. It included: the Sales Tax, the Personal Income and the Corporation Income and Profits Tax, and Customs and Excise Duties. In 1914 the Income Tax was completely unknown; Customs Duties plus Excise on liquor and tobacco accounted for 90% of the total tax revenue (1939 = 28%). The first step in war taxation, both in 1914 and 1939, was to increase sharply Customs and Excise Duties on articles commonly regarded as luxuries. While the purpose in 1914 in doing this was to raise revenue the main object of the 1939 revision was to discourage spending on luxuries.

The main feature of the first Second World War budget was the introduction of the Excess Profits Tax, to prevent profits that are excessive or unreasonable. This tax has been amended in subsequent budgets until a company pays an Excess Profits Tax of 12% of total profits, plus 100% on profits in excess of the average for the four fiscal years, 1936-39, or another 10% of total profits, whichever is greater. During the fiscal year 1943 it yielded some $ 434 million. A similar tax, which possibly served as the precursor of the Excess Profits Tax, was introduced in the 1916-17 war budget when expenditures were becoming quite heavy. It was the Business Profits War Tax of 1916. It was fairly light by contemporary standards: 25% tax on business profits in excess of 7% on the capital of the corporation and in excess of 10% on the capital of individuals, partnerships, etc. The 1917-18 budget increased the rate to 50% on earnings over 15% with a 75% levy on profits over 20%. It was also made retroactive to the beginning of the war and ultimately realized a war revenue of more than \$ 200 million.

The greatest increase in revenue during the Second World War has, of course, come from the stiffening of the Income Taxes, both Corporate and Personal. Both existed before the war and represented the single greatest contribution to our Federal tax revenue - \$ 142 million out of a total revenue of \$ 436 million in 1939. They were completely unknown in 1914. Only when increased needs were faced on our war account in the fiscal year 1917-18 and when new taxes were deemed justified did the Minister of Finance, with a considerable amount of reluctance, introduce the Income Tax Bill. Considerable organization and administrative difficulties were anticipated in imposing the tax. Several provinces and some municipalities were already using this tax to raise revenue and it was feared that a Federal Tax would only make the discrepancies between the various tax structures more serious. However, the mounting expenses of war and the absolute necessity of securing additional funds made it imperative that such tax be introduced.

Similar difficulties were encountered by Mr. Ilsley during this war until, by an agreement between the Dominion Government and the provinces, the latter vacated the fields of Personal and Corporate Income Taxes receiving by way of compensation either (a) payments of the amounts actually received by the province from these taxes during the fiscal year ending nearest December 31, 1940, or (b) the amount actually paid by the province for net debt service less Succession Duty collections during the same period. The exemptions in the 1917 Income Tax were very high and the rates very low as compared even with our modern peacetime Income Taxes: a 4% tax was levied on single persons with incomes over \$ 2,000, (as compared with 22% for incomes of \$ 2,000 in 1944), and on married couples with incomes over \$ 3,000. There were also surtaxes up to 25% on incomes over \$ 100,000. Despite the marked differences in rates, the fact remains that the introduction of the tax during the last war made possible its effective use in this war and thus marked a distinct step forward in our Federal public finance.

The greatest single increase in revenue during the First World War occurred in the item, Customs Import Duties. The receipts from this source in the fiscal year, 1916-17, viz. \$ 134 million, exceeded the total tax revenue of the country in 1914-15, viz. \$ 127 million. During 1916-17 the total tax revenue including tax from Customs and Import Duties enabled the Government to pay not only all its current and capital expenditure and interest charges upon the national debt but also to repay some \$ 60 million of the outstanding war debt itself.

As a preliminary step, various Customs Duties and Excise Taxes were increased, viz. the charges on coffee, sugar, tobacco and liquors. To raise additional revenue the budget of 1915 levied special taxes on wines, perfumery and patent medicines and imposed special war taxes on banks, financial and insurance houses, loan companies and certain items, such as transportation and steam-boat tickets, cheques and bills of exchange, cables and telegrams, money orders and bills of lading. The postal rates on letters and postcards were also increased. The main feature of the 1915 budget, however, was the uniform raising of the intermediate and general Tariffs by 7½% and the British Preferential by 5%.

Comparatively little use has been made of commodity taxes during this war. The Government, preferring to tax the people on the basis of ability-to-pay, introduced only very few changes in the Customs Import Duties and the Excise Taxes. Moreover, it was anxious to avoid raising the cost of the necessaries of life through increasing the rates of indirect taxes. However, it did increase taxes on luxury goods to discourage purchases. A 20% tax was levied on the consumption of unessential goods and services, such as gasoline, expenditures in dance halls, night clubs and receipts on motion picture theatres. Other tariffs, e.g. the 10% War Exchange Tax on non-Empire imports, were designed to conserve foreign exchanges. Generally speaking, commodity taxes lost much of their importance as revenue producers for the duration. Whereas prior to 1939 they were responsible for some two-thirds of the Dominion tax revenue, four years later they represented only about 35% of the revenue. The Sales Tax and the Succession Duty Tax, which added together, yielded some 13% in 1943, were unknown in the Federal tax structure of the last war. Table VI compares in section A the per capita tax burdens of the two wars. Section B compares the percentage of war expenditure covered by taxation in the two wars.

As we can see, the last war was financed for the most part by other means than taxation, viz. by public borrowing and the expansion of credit. The Canadian banking system played an especially important role both as an investor and a custodian of the nation's savings in terms of money. Chartered banks subscribed directly to war loans, purchased Treasury Bills and made loans to customers to help them buy war bonds. Still more important was their expansion of credit. Immediately after the outbreak of war, banks were given emergency powers to increase their own circulation to a limited extent and arrangements were made for their securing additional Dominion notes against approved securities. The value of Dominion and Provincial securities in bank portfolios increased from \$ 12 million to \$ 163 million during the four years of the First War. Despite this rise in bank holdings, the banking system as a whole was able to absorb only about one-seventh of the increase in the funded debt (\$ 1.2 billion), as against over a third in the present war, (\$ 6.2 billion), up till August, 1943. (1) Of the total holdings of the banking system until August 31, 1944, (\$ 2,160 million), the chartered banks have been responsible for \$ 1,183 million and the Bank of Canada for \$ 977 million.

It is at once evident that the presence of a central bank in the Second War has been of a great importance to our wartime financial system. The Bank has from the very beginning of the war pursued the so-called easy-money policy. It maintained the rediscount rate at $2\frac{1}{2}$% and reduced it further to $1\frac{1}{2}$%, effective February 8, 1944. The Bank further has assured the public that the banking system would use its resources

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(1) Bank of Canada, Statistical Summary, August, 1943.

# TABLE VI

## INCREASES IN TAXATION - 1914-19 and 1939-43

### A

| | Fiscal Year 1914 | Fiscal Year 1919 | % of Increase |
|---|---|---|---|
| Dominion Taxes per capita.... | $ 16.50 | $ 27.41 | 66.1 |

| | Fiscal Year 1939 | Fiscal Year 1943 | % of Increase |
|---|---|---|---|
| Dominion Taxes per capita.... | $ 38.67 | $ 174.97 | 452.5 |

| | Percentage of War Expenditure | Percentage of Total Expenditure |
|---|---|---|
| 1914-1919 Dominion Taxation.............. | less than 70 | less than 35 |
| 1939-1943 Dominion Taxation.............. | 60 | over 50 |

Source: The Canada Year Book, 1943-44, Pages 813-21.

to maintain a low rate after the war as well. In the 1919 fiscal year the rediscounting rate was 5%.

A large portion of the Bank of Canada purchases of Government securities have been used as backing for the expansion of the note issue. The remaining purchases have been used to increase the reserves of the commercial banks which have expanded their commercial loans. As a result the total volume of Canada's note issue has continued upward and increased by almost $ 600 million from December, 1939, to December, 1943. The Central Bank has also assisted the Government by loaning and placing at their disposal its staff of experts and other skilled personnel. The open market operations of the Bank which have made abnormal increases in the supply of currency unnecessary have done much to avert the danger of war inflation. It is true that many of the functions of a central bank were being performed by the Bankers' Association during the First Great War but in the international field the chartered banks were left without leadership and were called upon to undertake all the operations by themselves. The Bank should thus be given a great deal of credit for the financial administration of this war.

The effectiveness of a wartime financial policy does not necessarily depend upon the <u>degree</u> of the monetary expansion provided for war purposes but rather upon the extent to which these increases in the supply of money are <u>immobilized</u> by taxes, war loans and increased production. We have already seen that the present taxation system is superior to the one of the last war, in several respects. How does our credit expansion compare with that of the First War?

We already know that the major proportion of the last war's total expenditures was financed by borrowing rather than taxation. Altogether six public loans were floated: three War Loans, (1915 = \$ 100 million, 1916 = \$ 200 million, 1917 = \$ 250 million), and three Victory Loans, (1917 = \$ 400 million, 1918 = \$ 670 million and 1919 = \$ 680 million). The first loans floated completely upset the opinions of the leading financial experts in Ottawa who underestimated the amount of funds in the hands of the public. All issues were heavily oversubscribed, the first three by 100%, 100% and 66%, respectively. The extra \$ 50 million subscribed for during the first campaign were used to establish credits in Canada at the disposal of the Imperial Government for financing purchases of munitions and supplies in Canada and the United States. In effect, the sum was to be an offsetting balance for part of the  28 million in loans which had been borrowed from England to finance the overseas units of the Canadian Expeditionary Force.

It is true that the public loans were made attractive with a high rate of interest, 5% for War Loans and 5½% for Victory Loans, a tax-free privilege from Dominion Government taxation, (with the exception of the final Victory Loan, floated after the end of war), and a privilege of conversion at issue price to any succeeding Canadian domestic issue. Nevertheless, not only did the unexpectedly high contributions to the cause of the Allies have an excellent moral effect, but they also marked a new step in our wartime finance, i.e., for Canada to finance British expenditures in this country and for Great Britain to cover the expenses incurred by our forces overseas.

Public borrowing during this war, although smaller in proportion to total expenditure, has been both bigger in amount and per capita yield than in the last war. In the First War total subscriptions made by the public amounted to roughly \$ 2.3 billion. This amount, compared to some \$ 9 billion up to December, 1944, for this war gives us the per capita yield of \$ 288 and \$ 750 respectively (population estimated as eight and twelve million, respectively). In addition, more savings have been obtained this time by the sale of War Savings Certificates which are intended to mobilize small savings of individual purchasers.

Only one person in eight subscribed to the most successful loan of the last war, while more than one person in four purchased a bond in the Sixth Victory Loan of 1944. This indicates that sales this time have been made well down the income scale. This change is particularly significant since purchases from the lower income classes usually represent new savings whereas purchases by high-income groups very often amount to a diversion of money from one saving to another. The conclusion is therefore that more people have been saving their money and to a greater extent than was done in the last war.

The function of bank credit also differs somewhat from the role it played during the last war. The Government at that time felt that the proper function of banks in wartime was to provide sufficient credit to industries, commerce and agriculture, rather than to lend money directly to the Government. That is why there was no considerable purchasing of Dominion War Loans by the chartered banks in the last war. To enable the banks to increase the flow of credits to private enterprises the Government, under the Finance Act of 1914, adopted a policy whereby the banks (a) could issue their notes in excess of their paid-up capital up to 15% of capital plus reserves; beyond that 100% backing in gold or Dominion notes were required, (b) were not required to pay out specie; instead they could issue their own notes and hold the specie as a reserve.

Since the interest rate on Dominion Government notes was 5% and the banks could contract loans at higher rates the incentive was very attractive. The result was that from 1914 to 1918 the amount of currency plus deposits increased from \$ 1.1 billion to \$ 1.9 billion, that is by more than one half of the rise in the national debt. In the Second War the increase in the supply of money has been less than a third of the increase in debt.

In this war the Government's policy has been to provide as much of the funds for investment in capital equipment for war purposes out of taxation and public borrowing as possible. The Government, by installing and owning all equipment of specifically wartime character, has been rather encouraging banks to invest in Government obligations. By doing so, the banks are contributing indirectly to the expansion of our war industries. Direct bank loans to industries, accordingly, have not risen greatly in this war.

It was evident from the beginning that in contrast with the last war scarcity of foreign exchange would constitute an acute problem. Our close relationship to the United States, the lag of the U. S. defence programme behind our own and other factors made it inevitable that our demand for American dollars would exceed our acquisition of them. In the last war, or rather prior to it, England had great credit balances in the United States, some of which she found necessary to call in after the outbreak of hostilities. But the United States could not ship this gold to England because of the presence of enemy warships in the Atlantic. The immediate result was that the American dollar fell to a heavy discount on the London market which in turn affected the Canadian dollar. The sterling continued at a moderate premium for several months. Ultimately, however, when the American gold, which in the meantime had been stored in Ottawa in trust for the Bank of England, began to be sent back again to the United States in exchange for purchases, the exchange rate tended to turn against Great Britain.

The operation worked quite satisfactorily and it is reported that some $ 1,200 million were transferred in this manner. Canada thus acted as a trustee for Allied gold used to finance Great Britain's war expenditures in the United States. Parts of Allied purchases in America were also financed by proceeds of Canadian and American loans and foreign securities held in Canada and placed at the disposal of the Imperial Government. This arrangement was roughly analogous to our present Lend-Lease system of financing the war, since Great Britain was in return financing the expenditures of our armies overseas.

The Canadian dollar remained close to par as long as the English pound was pegged in New York. The alteration in Canada's trade balance from an unfavourable balance in 1914-15 to a favourable balance of over $ 200 million in 1916, no doubt, was an important factor in the improvement of Canada's international position. Then, as today, our exchange shortage vis-a-vis the U. S. was being offset by our favourable trade balance with the U. K. There was no Foreign Exchange Control and the only prohibition regarding export of capital was an order from the Department of Finance in June, 1918, forbidding the export of gold except by a licence. Unessential buying in the U. S. was also restricted.

The movement of prices before the outbreak of the present war was quite different from that which preceded the War of 1914-18. Prior to 1914 the broad movement in wholesale prices had been gradually upward for a number of years, not only in Canada but in most other countries. By July, 1914, the index advanced from 64.0 in 1913 to 64.4 (1926 = 100) and the farm product prices were the highest in more than two decades. In 1939 the wholesale prices, after a gradual rise, were down to about eleven points above the 1913 (75.4) as a consequence of the collapse of the wheat market in 1938 along with the general depression in other markets.

The relatively low level in 1939 probably contributed to the sharper initial advance of prices after the declaration of the present war. Generally speaking, there was no marked increase in the price-level after the outbreak of both wars until the second year. The large grain crop of 1915 and the collapse of France in 1940 reduced somewhat the price of farm products but the recovery was much more rapid in the War of 1914-18 than in the present one. Industry had in the meantime adjusted itself to the initial dislocation of trade and the interruption of shipping. As it became apparent in the last war that the conflict would be protracted and extensive orders for essential materials and army supplies could be expected, there was a sharp upturn in 1916 which continued, apart from occasional interruptions, until 1920. In the present war, an acceleration in the rate of increase could be observed from the beginning of 1941. The underlying feature of the price movement in 1917 and 1941 was the world shortage of food, aggravated by the difficulty of shipping. Prices moved steeply upward during the first part of 1917 and 1941, but less rapidly thereafter.

The upward trend of wholesale prices was much reduced after 1941, although wholesale farm-product prices continued to advance. In the third year of war there was a sharp contrast in price behaviour as between the First and Second World Wars. While the uncertain movement of the two preceding years gave way to a sudden and inflationary upturn in midsummer, 1916, which raised the wholesale prices between June, 1916 and May, 1917, 47% and farm-product wholesale prices 83%, the corresponding period from June, 1941 to May, 1942 showed an increase of only 6% and 13%, respectively. The upward surge of prices assumed renewed intensity in 1918, the trend being particularly steep during the first half of the year.

The effectiveness of price control, introduced in December, 1941, may be judged by the increase in wholesale prices for 1942 and 1943 of only 5.6% and 4.4%, respectively.

Although Canada's war effort in War I was relatively small as compared to the present one, wholesale prices rose by more than 100% (64.4 in July, 1914 to 132.8 in November, 1918), in contrast with an increase of less than 40% for approximately the same period in this war (72.3 in August, 1939 to 102.5 in December, 1943). This is still more impressive when we remember that nearly three quarters of the rise took place before the price ceiling was established. Since then, prices have remained practically stable. Not only were prices in the last war allowed to rise without check; there was also a greater disparity in price movements than in the present war. Variations in the behaviour of prices appear not only among the numerous classes of products but also among individual items. Thus, producers' goods went up 25% more than consumers' goods, textiles rose 170%, tin by 300%, while steel increased only 50%. In this war, too, the movement of prices has not been a uniform one but for another reason. Commodities that came under the regulations of the WTPB, mainly manufactured goods, have risen less in price than those goods that are outside the ceiling,- mainly agricultural products and raw materials.

It is beyond any doubt that prices of many commodities and especially foods and strategic war materials would have been substantially higher had it not been for certain measures which Canada has been using to (a) prevent undue increases in the prices and (b) to administer the allocation of essential raw materials into proper channels. These were not present in 1914-18. At the beginning of the last war there was little machinery for diverting money incomes into the hands of the Government; public borrowing was in the initial stage, Government controls and regulations were practically non-existent and inflation was allowed to develop. True enough, there was an Order-in-Council forbidding the accumulation of 'unreasonable' stocks and ordering dealers to sell at 'just' prices but both prohibitions were ineffective. There also was a Food Control Office to administer a limited rationing, a Board of Grain Supervisors to look after the supply of wheat and a Fuel Controller. A somewhat more extensive price-fixing was undertaken after the war under the Combines and Fair Prices Act. An 'attempt' to influence the people to cut down waste and save money was observed only toward the end of 1918.

In this war we started with a developed financial machine which the Government has not hesitated to use to its fullest extent. (1) Various Government controls and regulations have been applied as thoroughly and rapidly as was expedient. Possibly the best known is the Wartime Prices and Trade Board which controls prices, rents and supplies. There are many other types of control, for example, the Combined Production and Resources Board to coordinate the production of war supplies, the Canadian Division of the U. S. War Production Board to allocate raw materials and finished goods produced in the United States; most bulk purchases are undertaken by Commodity Prices Stabilization Corporation, Ltd., the Food Requirements Committee considers all major questions of policy connected with food production and supply in Canada; labour requirements are controlled by the advisory Interdepartmental Labour Priorities Committee, representing the National Selective Service, the Wartime Prices and Trade Board and the Departments of Munitions and Supply, Labour, Trade and Commerce. Needless to say, there are sources of other boards, each one exercising individually wide powers over resources and industries subjected to special wartime demands.

This vast machinery of controls, based on the experience of the last war and the experience of other war-waging countries and supported by public understanding, has made it possible for the Government to attain a greater measure of success in stimulating production and in controlling the general price levels than was achieved in the last war. In the final analysis the success of combatting an inflation under a democratic government depends on one fundamental factor: the degree to

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(1) The chief source of data for this section was the Canada Year Book, 1942-43, Pages 724-727, and 1943-44, Pages 354-362, 521-526, and Pages 776-83.

which the population is willing to co-operate with the government to carry out the anti-inflationary policy. In this respect, we can say that Canadians in this war have shown a great understanding of the problems that have been facing us and with a spirit of self-denial and self-discipline have followed their Government in carrying out the measures necessary for a successful operation of the war on the home front. A good deal of credit for this, no doubt, goes to the Government publicity which in this war has been handled much more efficiently than was the case in 1914-18.

The cost of living in Canada as measured by the official index of retail prices increased by almost 50% during the Great War, 1914-18, and by less than 20% for the same period of years in this war. The advance in retail prices continued in the immediate post-war period, prices reaching a peak in July, 1920, when the index rose to 190.2 (1913 = 100). In 1939 the advance in retail prices set in immediately from the outbreak of the war, the index rising in 1940 by 4.1 points beyond the 1939 level to 105.6 (1935-39 = 100). In the First World War the upward movement did not really start until the latter part of 1916. For 1916 the index was still comparatively low at 105.4 but in 1917 the upward trend became pronounced and continued to increase in intensity as the war continued. The introduction of the price control, late in 1941, had a definite effect on the cost-of-living index. It advanced only 1.4 points from 1942 to 1943 as compared with 5.3 points from 1941 to 1942.

Summing up the situation, we can say that our control of the cost-of-living in the present war has also been more successful than in

1914-18. An advance of less than 20% is not a serious one and if we consider the changes which have been imposed on our consumption of commodities we have done rather well in this regard.

The slow and less pronounced movement of the retail price level and cost-of-living as compared with the index of wholesale prices during both wars was probably due to: (a) the less sensitive nature of the commodities included as compared with raw materials, (b) the inclusion of rent or cost of shelter, (c) and the fact that commodities affected more directly by the war demand show the most marked increases. These are more important constituents of the wholesale price index.

Three of the major characteristics of the First Great War, from an economic standpoint, were the greatly increased monetary expansion, the violent rise in prices and the development of new productive capacities in industry, trade and agriculture. The rise in prices of commodities during and after the war was no doubt due to both internal as well as external economic forces. Canadian wartime finance was by no means the only responsible factor; the rising prices and the increasing volume of our export trade during the last war, which in 1918 was much higher than our imports, played an important role. While our export surplus was rising even at a greater pace than our domestic production, prices in Canada, too, had to rise because of reduced supplies of goods on the domestic market.

The situation was intensified during 1919-20. Still a greater monetary expansion to finance the completion of war contracts and cost of demobilization, heavy borrowing by industries and commerce, rising prices and wages, which now reached the level of wholesale prices, marked the immediate post-war boom period.

This period was followed by a short recession which was again followed by a recovery, though rather hesitant and incomplete. What to do with the greatly expanded industries, the overexpanded agriculture and how to employ the demobilized and home-coming members of the armed forces become major problems.

These problems, most of which remained unsolved, coupled with war and post-war inflation and the failure of the economy of the nation to cope successfully with the reallocation of resources and the readjustment to peacetime conditions, laid the foundation for later unemployment, a period of falling prices and the great depression of the thirties.

Such, in brief, were the highlights of the post-war period following 1918. Let us now examine the situation that will confront us and the problems that will present themselves to us at the close of the present war. (1)

The last five years have witnessed an enormous expansion of old and new industries in Canada. Not only our productive capacity has increased far in excess of our domestic demand, but also our industrial production has been diffused. For the products of these establishments, new outlets must be found upon cessation of hostilities. Many of the new types of products, materials and processes, no doubt, may be used in peacetime and their production will provide jobs, but for a great many of our products demand will shrink immediately after the war.

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(1) The chief sources of information for this section were the following: H. Michell: Canada After the War; Can. Mfrs. Assoc: Post-War Planning.

We must remember that our wartime expansion has been carried out, not according to any carefully laid plans, but solely on the basis of military requirements. This situation, undoubtedly, will call for a great deal of economic adjustment.

Immediately our thoughts turn to the possibilities of selling our products abroad. Canada, today, is the third largest trading nation in the world but her exports are almost wholly for war purposes. To find peacetime markets at competitive prices that can at the same time assure social security for our people will not be an easy task. Many of the countries, including Great Britain, that are today buying from us almost anything we can sell them, are unlikely to maintain their purchases at the present level, once the war is won.

Then there is the re-employment problem, a task of an unprecedented size. Of the estimated one and one quarter million employed in manufacturing at the present time something more than three hundred thousand are women, many of whom, it is expected, will return to their homes. On the other hand, there are some eight to nine hundred thousand men and women in the armed forces who will want employment after the war. If employment is to be found for this greatly increased labour force, it is clear that our industrial production must be kept running at least at something like its present capacity. This will involve a considerable shift and diversion of labour.

There will also be an enormous demand for consumer, especially durable consumer, goods backed by accumulated savings and investments in bonds and certificates as well as by the refundable income tax credits. With our present industrial capacity, many of the civilian commodities will be produced almost immediately to satisfy the demand, while the production of other goods may have to be delayed because of insufficient raw materials or because of the time it will take to reconvert the plants to a peacetime production. Shortages may arise and under conditions like these a serious price rise may develop if the various fiscal controls to which we are now subject are abolished.

These are only some of the difficulties that we may, or rather, have to face and be prepared for.

Immediately upon cessation of hostilities there will be a period of hesitation and confusion. War workers will suddenly find themselves without work and factories will have to shut down for reconversion to peacetime production. But this period of comparative idleness should last but a few months. The tremendous reserves that have been accumulated will represent, at least temporarily, an enormous purchasing power that will demand durable and consumer goods, on one hand, and inventory, equipment and other capital goods, on the other. If uncontrolled this purchasing power in the hands of the people may lead to undesirable results, provided demand cannot be entirely satisfied. This in turn raises the question as to whether our elaborate system of price control need be retained and in what degree.

This boom period of heavy spending and increased production of consumer goods will be characterized by a tendency for prices to rise and the task of holding the price ceiling will be a most difficult one. The purchasing power, or at least the demand, of the liberated countries of Europe and Asia for food and other necessities, too, will play an important role in our post-war period in that it will compete with our domestic market for the goods available in Canada. Other forces that may increase the amount of money on the market are: (a) industrial and commercial firms selling their holdings of government bonds faster than men and material become available for peacetime production, (b) rediness of individuals to sell and of banks and other financial houses to purchase Government securities in the open market and, (c) the extension of new bank loans to private capital.

Fortunately for us, the Government of Canada will this time have a number of offsetting fiscal measures at its disposal to counteract the evils of post-war economic maladjustments.

Foremost are the wartime controls. Of the need of some measure of control in the period of reconstruction there can be little doubt. All the controls by which the wartime economy has been governed cannot be relaxed completely and instantly. But on the other hand they cannot be maintained permanently. They are wartime measures and based on emergency legislation. Broadly speaking, there are two extreme views held on this point. There is that of the business man and the man in the street who regards controls as an evil to be accepted only as a war measure, and who wishes to have them abolished as soon as the war is over. The other group argues that the state should play a constant role in our economic life. Whatever the merits of these claims one thing is clear: the end in view is the same, namely, stabilization of the business cycle.

It will probably be the duty of the state to lay down the conditions governing the operation of an enterprise, but it is doubtful whether a government should take part in actual management. Our guiding principle should be progressively to remove wartime restrictions in general, as fast as these can be removed without endangering our economic equilibrium. After all, war controls have been imposed for two main reasons: (a) to stimulate our war effort to the maximum, and (b) to prevent the diversion of resources to the satisfaction of many of the civilian wants. It is evident that soom after fighting ends these objectives lose much of their significance. The right of an individual to conduct his own affairs and manage his own enterprise we feel should not be curtailed if it can be supposed that the business man, who has learned from the bitter experience of the great depression, will attempt to work out methods of self-regulation that will prevent many of the abuses of private control and production and distribution.

Another question that arises is, how high are our post-war taxes likely to be? Here again, spending of the money that had been accumulated by means of loan campaigns and refundable taxes will require regulating if reconstruction is to be effectively planned and carried out. If this spending is not to result in inflation it may well be that present taxation must be retained at or near its present levels at least for some time. But there is another aspect to this problem. Our present taxation has been developed for war purposes and therefore once the war is over it is suggested that the tax structure should be amended so as to encourage initiative and stimulate private investment, rather than discourage it, as it tends to do today. Under the present tax structure, for instance, industry and commerce is not permitted to retain profits that would normally be accumulated to provide required working capital. It is argued, therefore, that the general burden of taxation should be reduced and if this is done the profit motive will stimulate business activity and private planning for the reconversion of industry and trade will be encouraged. Furthermore, fiscal policy should also recognize the necessity for corporations to put aside certain funds for losses, replacements, etc., to meet the uncertainties of the period of reconstruction. The possibility of falling prices and obsolescence of inventories and equipment also constitute great hazards to working capital.

Of course, it cannot be expected that war finance will terminate upon the Armistice Day. Payments in liquidation of war orders may well continue for some months and even years; so will compensation payments to owners of requisitioned equipment and for the care of war veterans. Furthermore, the lagging of state revenue behind taxpayers' income receipts may make it necessary to continue wartime levies for some time, despite public resentment. Some taxes, like the Excess Profits Tax, cannot be discontinued entirely upon the signing of the armistice; were this done, excess profits made on war contracts following the cessation of hostilities would largely go untaxed, because they might not yet be realized and hence not yet be taxable.

Finally, during the period of demobilization, when hundreds of thousands of Canadians will be seeking employment the Canadian industry will not be able at once to provide all the jobs that will be sought. Very large responsibilities for the welfare of the Canadian workers will, therefore, inevitably rest upon our Government. In the immediate post-war period employment for all men and women should be secured as speedily as possible and production of adequate supplies of essential goods and services should be commenced with the least possible delay. The role of the Government will be a dual one. In the first place it will be expected to assist, financially and otherwise, private investors who are ready to undertake new ventures, thereby encouraging initiative and private investment. Along with this, the Government must be prepared to undertake certain public works which will provide at least temporary employment for some of our people. In this connection the Government should be prepared to launch various projects for the conservation and improvement of our soil, waterpower, forest management, etc.,--- in short to add to the permanent wealth producing capacity of our country.

In the long run the role of the Government will be an indirect one. Once depression sets in, industries, especially those which produce durable goods, and in particular capital equipment, must in large measure help themselves. Attempts by a government to compensate for unemployment in this group of industries by means of public works are always costly and seldom sufficient for the purpose. The root of the problem is that the savings of corporations and individuals, which normally constitute a demand for durable goods and capital equipment, fail in times of depression to come on the market. The result is unemployment which in turn lessens the demand for consumer goods of all kinds and thus adds to the general distress.

The solution to this problem can be found, not by an intrustion of the Government upon the field of private enterprise, but rather through Government measures which will ensure that the normal demand for durable goods and capital equipment continues without an interruption. In other words, the Government should try to maintain, as far as possible, a constant volume of private investment. That is, in a time of boom it should restrain somewhat the volume, in depression increase the rate of private investment by regulating the interest rate.

The Federal Government in Ottawa, in the meantime, has set up various committees with the purpose of studying the problems which will arise from the demobilization and rehabilitation of our armed forces, demobilization of the war industry and economic post-war reconstruction generally. (1) Parliamentary and other committees set up to explore and advise the Government on matters of reconstruction and reestablishment are: (a) The Senate Committee, (b) The House of Commons Committee, (c) and advisory committees reporting to the special Cabinet Committees: (i) the Advisory Committee on Demobilization and Re-establishment; (ii) the Advisory Committee on Economic Policy, and (iii) the Advisory Committee on Reconstruction.

The special Advisory Committee on Demobilization and Re-establishment was among the earliest to be set up under the reconstruction machinery of the Cabinet Committee. It acts as a co-ordinating agency between various Government Departments in investigating problems of demobilization and rehabilitation and brings before the Cabinet Committee recommendations for legislation in respect of these problems. Sub-committees study individual matters of employment of returned men, discharge pay, administration of special funds, land settlement, etc.

The Advisory Committee on Economic Policy is essentially an over-all committee of co-ordination. Its establishment and operation is itself a recognition of the principle that the development of post-war reconstruction policies and measures must be carried on in many different Departments and through many agencies of the Government with

(1) The Canada Year Book, 1943-44, Pages 737-48.

due provisions for effective co-ordination. The Committee is responsible directly to the Prime Minister in the sense that recommendations, which the Cabinet receives from the other advisory committees, are often referred back to the Advisory Committee on Economic Policy for analysis, comment and final recommendation. The latter Committee also makes recommendations on its own initiative on questions of economic and financial policy.

The Advisory Committee on Reconstruction was established to deal with post-war reconstruction, i.e., the general post-war problems and to make recommendations as to what Government facilities should be established to deal with these problems.

To sum up the contrast between our position of today with that in 1914 we find ourselves with a more firmly established credit reputation at home and abroad, with a sound Dominion Government financial policy, with taxation providing funds for about half of total disbursements, and with required loans raised mainly from the Canadian public at a cost substantially lower than in the last war. The two main Government objectives -- to meet about half the cost of the war by current taxation and to borrow as much as possible of the other half from individual and corporate investors rather than from the chartered banks -- have been achieved.

The task of the Department of Finance to provide funds for the costliest war in history, has not been an easy one. War expenditures since 1939 now total no less than $ 12.5 billion, while the non-war expenditure for the last five and one-half years are $ 3.3 billion, making a combined total of $ 15.8 billion. About 59 per cent of this sum was obtained in the form of tax and other revenue. Finance has not been allowed to limit the war effort; on the contrary, our physical burden of war production and mobilization has determined the financial burden that has had to be met.

The story of Canada's war finance is one of rapidly mounting expenditure necessitated by the swiftly rising level of activities, and of sharp tax increases and great loan campaigns to meet these costs. The Government of Canada with the assistance of financial institutions and the general public have sought to carry the burden of this war in a manner that would call for an equal marginal sacrifice from each citizen of this Dominion. The way in which this policy has been carried out to date justifies the hope that the financing of the war and the reconstruction period, unlike the last war, can be completed with a minimum of disturbance to the nation's monetary structure.

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