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Balance of Payment Problems in North America

J. E. Coyne
Governor of the Bank of Canada

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The Honorable J. E. Coyne
Governor of the Bank of Canada

The problem of the balance of payments has been a matter of increasing concern in Canada for some years. More recently the United States balance of payments has been the subject of serious discussion and special reports by eminent authorities. We should have a common interest in the bilateral balance of payments–it really should be called the imbalance of payments–between Canada and the United States, which over the past 11 years showed on current account transactions a cumulative surplus for the United States, a deficit for Canada of $12 billion, and over the past 5 years averaged $1,400 million per annum.

The Sproul Report says, “with the exception of the year 1957 the United States has had a deficit in its balance of international; payments in every year since 1949. For the whole eleven year period 1950-60 the cumulative net deficit was $21 billion.” This conception of a deficit combines the current account with part but not all of the capital account. We are more accustomed in Canada to thinking of the current account of the balance of payments as balancing the capital account, a deficit in the current account being balanced by a net import of capital and a surplus by a net export of capital. The current account of the United States balance of payments with the world as a whole for the eleven year period showed a surplus amounting to $48 billion before taking account of United States Government military expenditures abroad ($27 billion), and grants to foreign countries ($22 billion), but a deficit of $1 billion when those items are included.

Without your surplus with Canada, however, your deficit on current account during this period would have been $13 billion instead of $1 billion. The distinctive feature of the United States balance of payments on current account has been not an overall deficit with the whole world, but a deficit with the world ex Canada, offset almost entirely by a surplus with Canada. On the other hand, Canada has had an overall deficit, as our large deficit with the United States has not been except to a minor degree offset by a surplus with the rest of the world.

On the capital account of the United States balance of payments there was during this period an outflow of mainly long-term investment capital of $20 billion representing not a loss to the united States but a very large increase in foreign assets of the United States, chiefly private foreign investments by united States corporations and other investors–and chiefly in United States investments in Canada. This outflow of investment capital (and increase in relatively high-earning assets) was financed or balanced by other items on the capital account as to $6 billion by sales of gold to foreign central banks, and as to $15 billion by a rise in holdings by foreigners (mainly Europeans) of United States dollars in the form of bank deposits, other short term assets and United States Government securities.

Most discussion of the United States balance of payments position in the past year has focused on the outflow of gold. It is scarcely to be believed, however, that any other currency in the world is safer or sounder, or more likely to withstand future inflationary pressures, than the United States dollar, the most important reserve currency in the world.

In Canada, with the exception of one year (in this case 1952) we have had a deficit in the current account of our balance of international payments in every year since 1949. In the whole eleven year period 1950-60 Canada's cumulative net deficit on current account was $9 billion with all countries, the deficit of $12 billion with the United States being offset in part by a surplus with other countries amounting to $3 billion, largely in the earlier years of the period. If the United States had had the same overall deficit in proportion to gross national product you would have had a net deficit on current account of $125 billion. For the five years 1956 through 1960 the deficit on current account for Canada has averaged $1,337 million, the equivalent in United States Terms of $19 billion every year, or as much each year as the total size of your gold reserves.

In our case the capital flow has been inward – our "net international indebtedness," in the official phrase, has greatly increased. The deficit in our current account has been balanced by the capital inflow, consisting in part of direct investment in Canadian resource industries and secondary industries, in part of United States purchases of new issues of Canadian securities payable in United States dollars and placed on the market here by Canadian provinces, municipalities and corporations, and in part of a variety of flows of portfolio investment in the course of which foreign investors have acquired considerable quantities of Canadian bonds payable in Canadian dollars, the risk of exchange rate fluctuations in such cases resting on the foreign investors. In total, the capital inflow has amounted to over $9 billion, and after allowing for the accumulation of unremitted profits, total foreign investment in Canada (less Canadian investments abroad and Canadian holdings of gold and foreign exchange) rose by $13 billion. The outstanding amount of net foreign investment in Canada has, therefore more than quadrupled in these 11 years, from $4 billion at the end of 1949 to $17 billion in 1960.

It has been brought home to us in connection with the Canadian trade and payments problem that it is not enough to achieve balance in merchandise trade alone. We have to develop a large surplus of exports over imports in order to meet the deficit in our non-merchandise transactions, including travel, freight, and various business services, and interest and dividends payable to foreign investors. The total of these items has increased every year since 1949, is now ell over $1 billion a year, and is almost sure to go on increasing. Certainly the net amount of interest and dividends will continue to increase.

The Canadian economy is much more deeply involved with foreign trade and other international payments on current account than is the United States economy. Our international receipts on current account in 1960 amounted to 20% of gross national product, compared with a little over

5% in the case of the United States. Our international payments on current account were 23% of gross national expenditure, compared with something under 5% in the case of the United States.

The structure of our trade, according to the nature of the commodities involved, shows very heavy specialization on exports of raw materials and primary products, including some processed raw materials such as lumber, newsprint, pulp, and certain metals, but not a great deal in the way of finished products, and on the other hand a very heavy preponderance of imports of manufactured goods including large quantities of machinery and equipment as well as a wide range of manufactured consumer goods, both durable and non durable. In per capita terms, our imports of manufactured goods in 1959 were $230 in Canada in comparison with 440 in the case of the United States and $55 in the case of the United Kingdom. In absolute terms with the exception of the United States, Canada is in fact the largest market in the world for other countries' exports of manufactured goods. This condition is clearly reflected in the nature and structure of our domestic industry.

The structure of our trade in terms of the direction of our exports and the sources of our imports also shows a very high degree of specialization in that 60% of our exports go to the United States and 70% of our imports come from the United States. Many of the largest Canadian resource industries are tied to particular outlets in the United States, or depend as to 80% or 90% of their production on sales in the United States market as a whole. Efforts are constantly being made to obtain much more diversified outlets for our exports so that we should not be so greatly dependent upon economic conditions in one market and the attitudes of buyers and the state of public policy in that one market. On the import side, also, it has always been felt in Canada that we must favor a much broader diversification of sources of supply, so that our imports should come to a greater extend from overseas countries which buy more from us than they sell to us.

The structure of Canadian economic development, the direction of our trade and the adverse imbalance in our trade with the United States, are to an important extent the product of United States tariff policy over the past hundred years. The United States tariff has been more important than the Canadian tariff in determining the nature of the development of different branches of Canadian industry. By maintaining free entry or low rates of duty on raw materials and on semi-processed materials of a kind which can be advantageously produced in Canada for use by United States industry, the United States has caused Canada to specialize to an extreme degree in the development of resource industries. Even if Canadians had not themselves been inclined to take that course, it was made inevitable by the part played by United States capital, which has come into Canada in great volume for the express purpose of developing our natural resources in order to maintain an increasing flow of supplies of this character to the United States. On the other hand, the maintenance of relatively high United States tariffs and practices which have been a strong deterrent to imports of manufactured goods from Canada, have been important factors in preventing Canadian secondary industry from developing to the same degree as primary industry. Whatever has been done as a matter of Canadian policy by way of protection of the domestic market for a secondary industry has not been adequate to overcome the influences exerted by the two sides of United States tariff policy.

Our position in this respect has been different from most European countries, which have close at hand a variety of export markets on the basis of which each country has been able to develop secondary industry for export as well as for domestic use. Canadian secondary industry, however, has by reason of geography only one potential export market of the kind that domestic businesses would normally be expected to expand into, and this has been very largely shut off for reasons of high policy on the part of the people and government of the United States.

Generally speaking, we have rising employment when you have rising employment in the United States, and rising unemployment when you have rising unemployment in the United States. For some years, however, trends in the growth of gross national product, employment and unemployment seem to have been rather less satisfactory in Canada than in the United States. Since 1949 our gross national product has risen slightly more than yours, but less in proportion to the growth in the population. Even disregarding the population factor, for the last four or five years gross national product has improved less in Canada than in the United States. Like you, we have had three recessions in the past seven years, and each time the volume of unemployment as a percentage of the labor force has been greater than the time before and the degree of recovery between recessions does not reduce unemployment to the level that obtained in earlier periods of upswing. In our case the trend of the unemployment ratio since 1949 shows a distinctly steeper upward slope than the similar trend in the United States. This has not been for lack of expansive monetary policy or expansive fiscal policy in the sense of the size of government deficits. Since 1954 particularly, there has been much more expansion of the money supply in Canada (35% increase) than in the United States (21% increase using the Canadian definition of money supply) and the combined deficits of all levels of governments have also been larger in Canada than in the United States.

It is evident that reliance on monetary expansion and on deficit finance has not worked for us, at least not in such a way as to enable us to show better results than in the United States, where monetary expansion and deficit finance have been less. Many Canadians are coming to the conclusion that monetary expansion and deficit finance as such are not the answer, and that in the field of public policy greater reliance must be placed on measures which are more specifically directed towards increasing production and employment in Canada rather than across the board measures of what might be called the blunderbuss approach. A second feature in the thinking of many Canadians is that measures to improve the economic situation and overcome the now long standing trend towards higher unemployment ratios must give very high place to the problem of the balance of payments and the nature of our import trade.

I was interest to note that the Sproul Report also laid emphasis on the importance of the balance of payments in relation to domestic policy. “Domestic economic policy must contribute to a vigorous, sustainable domestic recovery and expansion, but it must be carried out at a time when actions will also be needed to strengthen our balance of payments position–actions designed to force domestic expansion without regard to our external transaction would create inflationary pressures and inflationary fears even though the process would start with unemployed resources."

The Sproul Report also emphasizes that "The current disequilibrium in our balance of payments highlights the need for more reliance on fiscal or budget policy and less on monetary policy." The same is true of measures to improve employment and encourage more consistent economic growth. This is an increasingly widespread view which central bankers have been emphasizing for years.

The words which I have quoted from the Sproul Report apply even more strongly to Canada than to the United States, although the conditions which have given rise to trouble in the balance of payments and to a growing level of unemployment are somewhat different in the two countries and the specific measures which may seem appropriate will in some respects be different.

The balance of payments of the United States, has been mainly determined by your own economic situation, and though obviously also influenced by economic situations in other countries has not until quite recently seemed to be itself a major factor in domestic economic conditions and economic policy. In Canada we are more used to the idea that we have to live with our balance of payments and make adjustments to it from time to time in public policy, as well as having the main lines of economic development determined or strongly influenced by the balance of payments, instead of vice-versa.

The economic situation in Canada has a special characteristic which is somewhat delicate to talk about in a foreign country, especially in the United States, for fear of being misunderstood. This feature is the great growth in our foreign debt and in foreign investment in Canada–not just in debt obligations which Canadian debtors must someday find the foreign exchange to meet but, even more markedly, in the degree of foreign ownership and control in the whole field of resource development (other than agriculture) and in the field of secondary industry where more and more existing Canadian owned enterprises are being bought up by foreign corporations in the same line of business.

The Canada of the mid-twentieth century bears no resemblance, of course, to the early colonial days either of Canada or the United States. In some respects the position of our economy in relation to the rest of the world may resemble that of the United States before the First World War, or even that of the United States between, say, the reconstruction period following the Civil War and the end of the nineteenth century. An important difference, however, is that during this period the United States depended almost entirely on its own saving to create its own capital with which to develop a widespread national territory, and upon its own scientific and managerial talent to modernize and expand its industry. Even the great amount of capita required to cope with a large flow of immigration were generated internally, and such foreign companies as did establish subsidiaries in the United States never grew to such numbers or size as to dominate any important sector of the United States economy. The foremost student of United States economic development in that period, Simon Kuznets, has stated that, like Japan, “The United States engaged capital imports that were only minor fractions of domestic capital formation and minute percentages of national product,” and: “gross foreign investments must never have exceeded a few per cent of the country’s wealth.” During the twenty years from 1869 to 1888 according to this study, net new foreign investment in the United States, that is to say, the net import of capital averaged less than 1% of gross national product. From 1890 onwards, except perhaps for occasional years early in the period, the United States developed a growing export of capital rather than an import of capital.

By the end of 1957, foreign companies and other foreign investors had a controlling interest in 56% of all manufacturing industry in Canada, and in some sectors of manufacturing the degree of control was 70%, 80% and even 98%. In petroleum and natural gas, also, some 76% of the industry was foreign controlled, and in mining and smelting 61%. Over 60% of the dividends paid by all Canadian corporations go to nonresident shareholders. Residents of the United States own 76% of all foreign investment in Canada, and control from 80% to 90% by value of all foreign controlled companies in Canada.

I will not elaborate here the disadvantages inherent in such a situation. The question which is being raised in Canada is not whether foreign investment is a good thing–everybody would agree that some foreign investment in and by all countries Is highly desirable, both because if provides an outlet for the surplus capital and superior industrial techniques of some countries, and because the influx of foreign capital and the associated modern equipment technology and know-how can have a very stimulating effect in the recipient country. Rather, the question which presents itself in Canada is whether foreign investment can be carried too far, and in such case have serious undesirable effects. The degree of foreign ownership and control of Canadian resources and secondary industry has been growing rapidly since the war, and particularly ownership and control by large American corporations. Despite its friendly nature, ownership and control of Canadian industry by United States industries is in some ways less desirable than would be similar ownership and control by European interests. For one thing absentee management is much easier and apt to be much more detailed and comprehensive if the absentee owner is only 100 or 300 miles away and can carry on the day to day management of its subsidiary by telephone and frequent trips between the head office and the branch plant, whereas absentee owners 3,000 or 5,000 miles away must rely to a larger extent upon the initiative and managerial capacity and responsibility of resident Canadian operators. Then again, European and especially English parent companies show a greater willingness to allow and even encourage Canadian participation in share ownership of businesses in Canada, either by public sale of stock or by going into partnership with native Canadian companies. For another thing there is always the danger when any person becomes heavily indebted to another that their relationship will sour. No one in Canada today seriously wants to see deterioration in any aspect of the relations between our two countries. Many Canadian, however–and some Americans–fear that such a deterioration may well occur, if the degree of United States ownership and control of Canadian industry continues to grow in the future as it has in the past. A very thoughtful comment on this point is made by Mr. John Fischer, the Editor of Harper's Magazine, in the current issue.

The necessity or usefulness of increased foreign investment in Canada since the war is sometimes greatly over estimated. Some people both in Canada and abroad have said that we would have had very much less economic growth and a much lower standard of living in the absence of the post-war inflow of foreign capital. This is a very pessimistic and indeed defeatist view.

It can hardly be said that Canadian economic development and the standard of living was seriously dependent upon the incurring of foreign debt by our provinces and municipalities which could have done all their borrowing at home, as local governments in all other countries do, perhaps at higher interest rates but without the hazard of exchange risks which attach to foreign borrowing.

The development of the Canadian economy also has scarcely been dependent on the growing extension of foreign control over secondary industry through the purchase of existing Canadian businesses and their conversion to branch plants of foreign parent companies.

Of more importance has been the amount of direct investment, with its associated intake of technology in the particular industries affected and with the tied export markets for certain of our raw materials which otherwise would have had to be developed by the negotiation of contracts for the supply of such raw materials from independent Canadian producers to the consuming industries in the United States.

The inflow of capital, even of the most desirable and fruitful kind, always has an impact on the Canadian exchange rate. In recent years the result has been a tendency towards a premium on the Canadian dollar which has encouraged greater imports of manufactured goods, to the detriment of Canadian development in the field of secondary industry.

The use of foreign resources has been estimated at 17% of gross capital formation in Canada in the years 1950 to 1955, and 27% in the years 1956 to 1959, but these figures include, in addition to new imports of capital, resources provided within Canada by way of re-investment profits, capital consumption allowances and depletion on foreign-owned enterprises in Canada. Taking a narrower definition of foreign resources, consisting only of that part which represented an actual import of capital from abroad, and considering only new direct investment of foreign capital (as being the portion most directly influencing capital formation in Canada) the proportion was a little over 5% for the eleven year period 1950-60, and about 5.5% in the last five years.

The Canadian economy as a whole has actually a very high rate of capital formation–higher than the United States economy–financed very largely by the savings of all kinds of Canadian individuals and Canadian industries, including of course those owned and controlled abroad. In total, our rate of saving is a higher proportion of gross national product than the corresponding rate of saving in the United States, and even without the capital imported each year can support a higher level of capital investment in physical plant and equipment than has been the case in the United States.

The influence of the $9 billion of new foreign capital of one kind and another over the past decade, and of the great volume of physical investment has not been so much on the total quantity of our economic growth, but rather on its direction and structure, and if anything has had rather adverse effects on stability of employment and costs of production.

The nature of our development since the war, as a result of all these factors, has put strong emphasis on the capital intensive industries, especially the resource industries, which require a great deal of construction and imported equipment, both directly and in ancillary activities such as roads and hydro-electric power, but which do not provide large continuing employment after the plant has been built.

Whatever the reason, the fact s that gross national product in Canada has increased very little more than in the United States during the past eleven years, and the physical volume of gross national product–its value in constant dollars–is no higher now per head of population that it was 8 years ago. A somewhat different kind of economic development, with somewhat smaller but better balanced capital investment, and with more continuing effect on employment, could have been carried on without large imports of capital every year, and could have provided at least as high an average standard of living, if not higher, with less fluctuation in employment and a higher average level of employment. It would also have produced much more expansion in the capital goods industries and other secondary industries, with increased production in Canada of machinery and equipment and the acquisition of more advanced technology in our domestic secondary industries.

When the large deficit in the current account of our balance of payments–the excess of imports over exports after allowing for those payments of a non-merchandise character which have to be made–continues for many years in good time and bad, and especially in a period of high and rising unemployment, it is natural that many people should come to the view that Canadian production should be increased in those lines of goods which presently are being imported in such quantity, not with a view to restricting trade as such but in order to bring our trade into balance so that further increases in foreign debt shall not be necessary. Strong efforts are also being made to increase our exports, but there is little prospect that a sufficiently large increase in exports can be achieved to overcome the deficit in our balance of payments, including the continually increasing excess of payments over receipts on non-merchandise account. It is important that Canadian production should expand in those newer lines of industry and in those with the most advanced types of technology, in order that the Canadian industrial structure can relate itself to the expanding economy of the modern world and I order that there may be ample diversification of employment opportunities and in particular an expansion of hitherto inadequate opportunities for employment in the most modern types of industrial production, in scientific research, in engineering, and in technological development.

Canada must always be greatly affected by developments in the United States and the climate of opinion in the United States. On both side of the boundary line we often forget that the relationship between us is that of a large man and another less than one-tenth his size, and with only one-fourteenth his income. You could very easily injure us through sheer inadvertence; you could just as easily smother us in an embrace of excessive benevolence.

Canada's balance of payments problem is largely a problem of our trade and payments with the United States, and of capital movements and foreign investment emanating from the United States. We must in Canada always be seeking to maintain our own equilibrium and to protect ourselves against a development which might seem only a ripple in the United States but may have the force of a tidal wave in proportion to our dimensions when it overflows into Canada. There has rarely been much support in Canada for sweeping over all solutions of our economic relations with the United States of a kind which would involve dismantling all our defenses. We would like to get reasonable access to the United States market on a negotiated basis for the products of our secondary industries, so that they should not be discriminated against by comparison with the treatment accorded the products of some of our primary industries. This has been a perennial fact of Canadian history. In relation to one form of trade or another, we have been trying and hoping for a hundred years or more to get better access to the United States market, equal to the access we give you to our market. While still hoping for such progress as can be made in a practical way from time to time, not many Canadians now expect to see miracles in this direction in their lifetime. We cannot refrain from considering our own interest in the light of the actual situation, merely because of the hope–so long deferred–that someday a different kind of policy will be found acceptable to the United States.

In any case, no matter how favorable or balanced the trading relationship may become between our two countries, most Canadians are firm believers in the adage of Abraham Lincoln that self government is better than good government. Translated into economic and social terms, this principle is no less important than in the purely political sphere. Leaving aside the seriously under developed countries, self development is better for the rounded life and continued vigor of a nation like Canada and will do more to satisfy national aspirations of every kind, than the most ideal kind of purely economic development, if the latter involves perpetuation of large deficits in our balance of payments, continued reliance on endlessly growing foreign debt, and continuously shrinking area of industry under domestic ownership and control. To achieve our goals we must solve our balance of payments problem with the outside world, and especially with the United States, and rely on our own resources, not only material factors, but resources of the human mind and spirit, in order to build our own economic future and our owner expression of national independence.