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Chapter Title: Lessons of Canadian Finance in Two World Wars

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When Canada entered the first World War a century had passed since she had been involved in a major armed conflict. She had no experience to guide her policy, or even to indicate what difficulties would arise. There was no one in government, business, or finance who had ever grappled with war problems, and there were very few professional economists in the country. As Dr. Mackintosh (now Special Assistant to the Deputy Minister of Finance) has said, the War Boards "asked and received but little aid from Canadian economists. Too often the advice offered was in the nature of a sermon on the danger of tampering with economic laws, when what was desired was 'practical advice'."[48]

The aims of war finance were modest. The primary objective of the government and the public alike appears to have been "business as usual" and the need for direct action to expand general production seems to have occurred to few. The prevention of inflation was no part of government policy, and the relationship between war finance and inflation was misunderstood both in government and in financial circles. Business recession was accepted with resignation as the inevitable aftermath of war.[49] In fact, the government undertook little direct responsibility for war production: only limited direct controls were imposed on the allocation of raw materials, labor and final products; modest use was made of the tax instrument as a source of revenue or as a counter-inflationary device; and fiat money was issued. The government failed to stress the need for participation of the middle- and lower-income groups in war savings, and allowed the financial system much freedom in the determination of its own behavior.

Canadian economic policy in War II has obviously benefited from experience gained during and after War I. This time the dangers have been more clearly foreseen and the methods of dealing with

48 *Economics, Prices and the War,* Bulletin No. 31 of the Department of History and Political and Social Science, Queen's University (April 1919) p. 1.

49 The relationship between Canadian financial thought and policy in the first World War is treated at some length in the author's report to the Advisory Committee on Reconstruction, *The War and Postwar Cycle in Canada* (mimeographed, Ottawa, 1943). See also Sir Thomas White, *Budget Speeches,* and *The Story of Canada's War Finance* (1921); V. Ross, *History of the Canadian Bank of Commerce* (Toronto, 1922) pp. 352-73; E. Walker, *Canadian Banking* (Canadian Bank of Commerce, 1923); and the *Canadian Annual Review,* 1913-22.

them better understood. The government has been determined from the first to stimulate a large-scale war effort, and at the same time, to control price inflation and minimize postwar disturbances. In contrast to its predecessor of the first World War, the government has been able to draw upon a sizable personnel – in business, finance, government service and academic life – with special training and experience valuable in the conduct of war finance. Virtually every known weapon in the anti-inflation arsenal has been used to some extent, and the government has kept a firm grip on financial policy. The differing results should be instructive, and this section contains some speculations on the significance of these differences.

The Financial System in World War I

Compared to War II, the war effort in War I was on a small scale. Combined British and Canadian war expenditures in Canada were well below a fifth of gross national product,[50] and per capita costs of war and demobilization for the six fiscal years 1915-20 were less than one-fifth of estimated per capita costs of war for the five fiscal years 1940-44.[51]

The fiscal and direct controls in War I were scaled to match the war effort. Per capita tax collections rose only from $16.50 to $27.41, and total tax receipts never reached 6 percent of national income; they exceeded 35 percent of total expenditures only in fiscal 1916. Even in the last year of the war, special war taxes raised only 18 percent of the total current revenue, scarcely more than was raised in the United States by personal income tax alone.[52] Prohibition of

50 The chief sources for figures cited in this section are the following: F. H. Brown, "The History of Canadian War Finance 1914-20," *Canadian War Finance* (Toronto, 1940); J. J. Deutsch, "War Finance and the Canadian Economy, 1914-20," *Canadian Journal of Economics and Political Science* (November 1940); F. A. Knox, "Canadian War Finance and the Balance of Payments, 1914-18," *ibid.* (May 1940); C. A. Curtis, "The Canadian Banks and War Finance," *Contributions to Canadian Economics,* Vol. III (1931); F. H. Underhill, "Canada and the Last War," Martin (editor), *Canada in Peace and War* (Toronto, 1941); Royal Commission on Dominion-Provincial Relations, *Report* (1940) Chapters III, IV, V; DBS, *Prices and Price Indexes,* 1913-40 and *Economic Statistics of Canada,* 1919-30; *Budget Speeches*; *Canadian Annual Review*; *The Canada Year Book*; and special series prepared by the Advisory Committee on Reconstruction.

51 Wartime Information Board, *Canada at War* (December 1943) pp. 26-27.

52 The war did, however, provide the incentive for a broadening of the Canadian tax system which resulted in lasting reform. Before the war, customs duties plus excises on liquor and tobacco accounted for 90 percent of total tax revenue. During the war,

strikes and lockouts, regulation of rents, an Order-in-Council forbidding accumulation of "unreasonable" stocks and requiring "hoards" to be sold at "just" prices were about the extent of the direct controls. A Board of Grain Supervisors to cooperate with the Allied purchasing agency in allocating the grain supply, a Food Control Office to conduct investigations and undertake limited rationing measures, and a Fuel Controller to "worry" about the new pressure upon the coal supply when the United States entered the war, were established. Price fixing was more extensive immediately after the war, under the Combines and Fair Prices Act, than during the war itself.

In the financial sphere, the main item of direct control was the Order-in-Council of 1917 forbidding the issue of new securities by provincial governments, municipalities, or corporations without the consent of the Ministry of Finance. The object of this measure seems to have been the assurance of an adequate market for government bonds rather than the exercise of discriminatory control over new investments. There was no formal exchange control during the last war, but the government had considerable success in maintaining the Canadian dollar close to par, as long as the pound sterling was pegged in New York. Somewhat similar to present Lend-Lease arrangements was the agreement under which Great Britain was permitted to use part of the proceeds of American loans to pay for Canadian munitions.

For the most part, Canada financed the last war by an admixture of borrowing and monetary expansion in both of which the banks were extremely active. They purchased Treasury bills, subscribed directly to war loans, bought bonds on the open market, and made loans to customers to help them buy war bonds. Perhaps even more important than this direct bank support of government borrowing was the expansion of credit, since it provided a good deal of the increase in incomes with which subscriptions to war loans were financed.

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the range of commodity and service taxation was increased, and in 1918 a personal income tax was introduced for the first time. The exemptions were very high and rates very low as compared even with modern peacetime income taxes, but its introduction during the last war made possible its effective use in this one. Similarly, the Business Profits War Tax of 1916 was very light by contemporary standards, but did serve as the precursor of the Excess Profits Tax of today.

From December 31, 1914 to December 31, 1918, the value of Dominion-Provincial securities in bank portfolios increased from $12 million to $163 million. In the same period, funded debt payable in Canada rose by about $1.2 billion. Thus even if the rise in bank holdings of government securities consisted entirely of Dominion obligations, the banks could have assumed directly no more than one-seventh of the increase in debt.[53] Insurance companies took over 10 percent of the first two loans, somewhat smaller proportions of the later ones, and their total subscriptions to the end of 1918 were $96 million. Loan and savings companies took $26 million, trust companies $15 million. Despite the absence of any payroll deduction campaign and insignificant use of war savings certificates and stamps, over half the increase in debt was placed with individuals and non-financial institutions. The proportion of debt absorbed by the banking system was actually lower than in the present war.

The government was anxious that public borrowing should not interrupt the flow of funds to private enterprise, and adopted strong measures to assure an easy money market. Under the Finance Act of 1914 the banks were not required to pay out specie; instead they could issue their own notes and hold any specie coming into their hands as reserves. Bank notes could be issued in excess of paid-up capital up to 15 percent of capital and reserves, provided a tax of 5 percent was paid on the excess circulation. Beyond that, 100 percent reserves in gold or Dominion notes were required, but since the banks could borrow Dominion notes from the Department of Finance for 5 percent and make loans at higher rates, the one curb

[53] In World War I, bank holdings of Dominion-Provincial securities, total money supply (Canadian deposits plus active note circulation) and funded debt payable in Canada increased as follows:

Increase (in millions). Fiscal: / Calendar:	*1915* / *1914*	*1916* / *1915*	*1917* / *1916*	*1918* / *1917*	*1919* / *1918*	*Total*
Debt (fiscal years)	$0	$99	$240	$541	$595	$1,475
Money (calendar year nearest fiscal year)	10	46	302	138	285	781
Bank holdings of Dominion-Provincial securities (calendar year nearest fiscal year)	2	1	17	101	32	153

Source: *Canada Year Book,* 1914-20.

on note expansion was the credit demand by eligible borrowers. As to deposits, the only limit was the customary reserve ratio, which was easily maintained under the circumstances. "The only real check on the ability of the banks to expand credit," according to Professor Curtis, "was the extent to which the operation was profitable."[54] The printing of $96 million of fiat Dominion notes contributed to monetary expansion by swelling bank reserves. Bank loans in Canada expanded by $461 million over the period, and government deposits increased by $120 million. The net result was that from the end of 1914 to the end of 1918 currency and deposits rose from $1.1 billion to $1.9 billion.

Since the Finance Ministry felt that the proper function of banks was to provide working capital for agriculture, commerce, and industry, rather than to lend to the government, official policy took the line of placing war loans as far as possible outside the banking system. Despite this attitude and the liquidity of the money market, the Finance Ministry embarked upon its program of large-scale domestic borrowing with much trepidation. Before the war the government had never raised so much as $5 million by public loans, and in the early months of war the only domestic borrowing consisted of a direct loan of $5 million from the Bank of Montreal. Not until November 1915 did the Finance Minister summon sufficient courage to float a public loan. Even then, only $50 million were called for, and the banks were allotted half the issue on the assumption that the public could not be counted upon for more than $25 million, despite tax-free yields of 5½ percent. To everyone's surprise, the loan was heavily oversubscribed. Encouraged by this success, government borrowing mounted rapidly, culminating in the two Victory Loans of October 1918 and November 1919, which yielded $690 million and $678 million respectively.[55]

Lessons for War Finance

Financial policy in the two World Wars has had quite different results as to war production, prices, and distribution of the "burden" of war finance. Total physical production apparently did not increase much more than 10 percent in the last war,[56] despite con-

54 Curtis, *op. cit.*, p. 28.
55 Curtis, *op. cit.*, p. 12.
56 See Deutsch, *op. cit.*, and Brown, *op. cit.*

siderable prewar unemployment, excess capacity, and the lure provided by a persistent lag of wage rates behind wholesale prices. Even in the field of munitions, where more attention was centered than in any other branch of manufacturing, production during the first war was less than a sixth of output in the equivalent period of this war.

Although the production effort of War I was relatively small, wholesale prices rose 99 percent and cost of living 49 percent.[57] Nearly all prices were left free to soar at will, but the disparities in price movements as well as the rise in the general price indices were greater than in this war. Vegetable products, for example, rose 120 percent, iron and its products 127 percent, fibers and textile materials 170 percent. Wood and wood products, on the other hand, increased only 39 percent, non-ferrous metals and products only 44 percent, non-metallic minerals and products 45 percent, animals and their products 79 percent, chemicals 87 percent. Prices of producers' goods went up approximately 25 percent more than consumers' goods. Foods, beverages and tobacco rose twice as much as other consumers' goods, and manufacturers' materials rose 113 percent, compared to a rise of about 50 percent for construction materials and producers' equipment.

Still greater diversities of price movement appear when individual cases are cited. Prices of tin and linseed oil quadrupled, and the price of wool went up some three-and-one-half-fold, the price of wheat trebled before being pegged at about two and one-half times its prewar level. Yet steel prices increased only 25 percent, and rubber prices actually fell.

The effects of financing the first war upon income distribution are not altogether clear. Wage rates rose 47 percent, about the same as cost of living but much less than wholesale prices. They also rose less than profits, even net of taxes. On the other hand, there was a big growth in employment of unskilled workers. It would seem that the middle-income group lost to both lower- and upper-income groups, and taken as a whole, workers employed when war broke out may have suffered some slight decline in standard of living. However, wage movements showed wide differences. Wages of common labor in steel and coal companies more than doubled, wages

57 The chief sources of wage and price data for the first war period are DBS, *Prices and Price Indexes,* 1913-40, and *Cost of Living Index Numbers for Canada,* 1913-42; and Deutsch, *op. cit.*

of steel workers and electrical machinists doubled, wages of skilled moulders went up 128 percent, and wages of blacksmiths', millwrights' and electricians' helpers only 62 percent. Apparently, some labor groups gained, and others, especially white-collar and service industry workers, were "squeezed," by war finance.

In World War II the expansion of total physical production has been many times as great as in War I. At peak production, 33 percent of manufacturing capacity was employed on war orders from abroad, as compared to 70 percent this time. Net exports have been more than twice as great as in the first World War.

Control of the cost of living in the present war has also been relatively successful to date. An 18 percent rise in cost of living in four years of war cannot be regarded as serious for the economy as a whole, and even this moderate increase has been partly the result of deliberate monetary expansion and exchange depreciation in the early months of the war. Wholesale prices have risen 40 percent, but nearly three-quarters of the rise took place before the price ceiling was established. Since then wholesale prices have been remarkably stable.

The record of Canadian finance in War II is very impressive as long as attention is directed only to broad categories of prices; it becomes less so as price indices are broken down into their component parts. Wholesale prices have risen 12 percent more than retail prices, retail prices have gone up 8 percent more than the cost of living. Prices outside the ceiling have increased more than those of regulated commodities. Wholesale prices of foods and industrial raw materials, many of which do not come under the ceiling, have risen 34 and 50 percent respectively, while prices of manufactured goods, which are almost entirely subject to ceiling regulations, have risen less than 30 percent. Rents have gone up only 9 percent, clothing only 21 percent.

Similarly, prices of raw and partly manufactured goods have risen more than twice as much as prices of fully and chiefly manufactured goods, which have been more rigorously controlled. These figures are not, of course, indisputable evidence that price-cost relationships have been thrown out of line. Compulsory cost reduction, absorption of excess capacity, and improved techniques have all contributed to suppression of price rises in the field of manufacturing, and prices of raw and semi-finished goods may very well have been disproportionately low before the war.

In four years of war, prices of Canadian farm products rose 67 percent, articles of marine origin went up 112 percent, while forest articles rose only 20 percent and mineral commodities only 9 percent. Prices of non-ferrous metals and non-metallic minerals have gained much less than the general average, while prices of animal and vegetable products have risen much more than the average. Building materials prices have gone up less than prices of manufacturing materials; prices of field products have shot up a good deal further than prices of animal products. The contrasts are even more striking when prices of particular commodities are examined.[58] Such data do not in themselves provide proof of increased price disequilibrium but they do suggest that serious maladjustments may possibly have developed.

The effects of war finance on income distribution are somewhat clearer for War II than for War I. The index of employment has gone up more than 55 percent, and hours have been increased. Wage rates, including bonuses, have risen roughly 20 percent, a trifle more than cost of living and considerably more than profit rates. Per capita earnings, total wages and salaries, and farm labor income have attained the highest levels in Canadian history. Taking these facts in conjunction with the highly progressive tax structure and the greater importance of the higher incomes as sources of subscriptions to war loans, it seems certain that there has been a considerable redistribution of national real income in favor of wage earners. Since wage earners' budgets absorb most of their incomes, this redistribution has tended to increase the demand for consumer goods relative to voluntary savings. Thus, while War II has been financed in closer accord with the "ability-to-pay" principle than the previous one, the consequent redistribution of disposable income has aggravated the price control problem.[59]

58 Percentage changes for August 1939-August 1943, based on data from DBS, *Prices and Price Indexes,* were:

Wheat	*Flour*	*Steers*	*Hides*	*Pulp*	*Cheese*	*Raw Cotton*	*Cotton Yarns*
122	−14	97	46	139	51	100	16

In contrast, prices of certain luxury goods have fallen.

59 To the extent that people in the upper-income groups sell assets to finance con-

As in the last war, discrepancies in price movements have brought with them differences in effects upon wages. From 1939 to 1942, the index of hourly rates shows increases varying from about 14 points for builders and printers to about 28 points for unskilled factory workers and labor employed on steamships and in sawmills.[60] Finer breakdowns show even wider disparities.

This brief outline of effects of war finance on production, prices, and incomes in the two wars indicates that greater success has been attained in War II in stimulating production and in controlling general price levels for civilian goods. There is also some evidence that the burden has been distributed more equitably. In order to compare the relative disruption of the price-income structure, however, the "equilibrium" prices and incomes would have to be known in each case. Moreover, the civilian proportion of the total economy is much smaller this time, and it is possible that spreads between costs and prices and among various prices and incomes – which in the civilian sector would be symptomatic of inflation – have developed in the war sector.

The contrast on the production front can hardly be accounted for by differences in prewar excess capacity. The government did not undertake direct investment in war plant and equipment during the last war 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. While this greater measure of government control and risk assumption in War II is unquestionably a factor in the greater volume of war production, another reason for the difference is simply that in War I Canada was not called upon to make so great an effort in the industrial sphere.

The disparities between the price experiences of the two World Wars are attributable to a difference in the extent to which increases in money supply were recaptured by war loans and taxes, immobilized by direct controls or offset by increased output; they cannot be

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sumption, they can offset to some extent the effects upon their consumption of higher taxes and increased purchases of government bonds. There is no clear-cut evidence that any such process has been taking place in this war. Table 11 above shows that the proportion of net income paid out in dividends has fallen rather than increased. Common stock prices fell, up to the middle of 1942, but it would be hazardous to attribute this development to sales by the wealthy in an effort to maintain their standard of living.

60 See Bank of Canada, *Statistical Summary* (December 1943-January 1944) p. 16.

attributed to a difference in the degree of monetary expansion. From August 31, 1939 to August 31, 1943 the supply of money increased 60 percent. From the end of June 1914 until the end of June 1918, a roughly equivalent period, the supply of money increased 52 percent.[61]

No doubt the existence of a central bank in War II has assisted the Finance Ministry in administering monetary policy. The Central Bank affords a continuous relationship with the banks, and provides leadership in banking thought and policy. It has gathered together a staff of experts, and is thus partly responsible for the marked difference between the two wars in quantity and quality of government personnel skilled in various aspects of finance. Yet the difference between monetary administration with, and without, the Bank of Canada can easily be exaggerated. In the last war, the Bankers' Association performed many of the functions of a central bank, and its president served in much the same capacity as a central bank governor.[62] Many of the traditional central banking operations in the international sphere were undertaken by the chartered banks, some of which had widespread foreign branches.

The existence of the central bank in War II has facilitated monetary expansion, making special legislation to provide for an abnormal increase in the money supply unnecessary. Had a central bank existed in Canada last time, when the problem of war inflation was less clearly understood, the price level might have risen somewhat more than it did. As it was, in the first war less than one-seventh of the increase in government debt was taken by the banks, while in this war the banking system had absorbed over a third of the rise in debt up to the Fifth Victory Loan.

In War II, purchases of bonds by the public seem to have been financed to a larger extent by limitation of its spending and to a lesser extent by credit expansion. The increase in money supply was over half of the rise in national debt in the first war, under one-

61 From June 1914 to December 1918, the supply of money went up 68 percent; from June 1939 to December 1943, the supply of money went up about 70 percent.

62 "I discovered when I was Minister of Finance that the Canadian Banking System is the most perfect instrument that a Minister of Finance could have at his hand in floating a loan. . . .What had I to do? Just call up on the telephone the president of the Canadian Bankers' Association: 'I want all the branch banks of Canada notified to do a certain thing.' It was done." Sir Thomas White, in "Federal Administration and the Banks," *Journal of the Canadian Bankers' Association*, Vol. xxix (April 1922) p. 358.

third in the second. The banks have given somewhat less assistance to clients subscribing to loans in War II, and the loans have been more quickly liquidated. They have done little direct financing of industry, and because of government domination of investment in war plants, bank investment in government obligations is in part an indirect form of bank lending to war industry.

War loans have been bigger in the present war, the per capita yield of the two biggest loans of War I was $170, compared to $235 for the Fourth and Fifth Victory Loans of War II. In addition, more savings have been obtained this time by sales of war certificates and stamps. Only one person in eight subscribed to the most successful issue of the last war, while more than one person in four subscribed to the November 1943 loan. Thus it appears that more bonds have been sold in the lower-income brackets this time. Purchases from the lower-income brackets usually represent new savings, whereas purchases from the upper-income groups often represent mere diversion of saving from one type of asset to another. Such being the case, the greater success in selling bonds to lower-income groups in War II means a greater increase in personal savings than in War I.

Finally, a larger share of the increased money income of World War II has been recaptured by taxes; over 50 percent of total expenditures and 60 percent of war expenditures has been met by current revenues. In the last war, tax collections for the equivalent period were nearly 70 percent of war expenditures, but less than 35 percent of total expenditures of the Canadian government. They were a still smaller percentage of total British and Canadian government outlays in Canada.

The abrupt cessation of the rise in the cost-of-living index that occurred in December 1941 might give the impression that the wage-price ceiling imposed at that time was primarily responsible. However, several additional measures have been necessary to make the ceiling hold. First, rationing began in January 1942 and has been gradually extended since. Second, subsidies for keeping prices down have been paid on an ever-increasing scale. Third, the large loan of February 1942 reduced consumer purchasing power, and so likewise did the still larger loans that followed. Fourth, the higher tax payments on 1941 and subsequent incomes exerted a downward pressure on prices. Finally, except for certain durable goods, few stringent shortages appeared in the period under consideration.

The ability of the Canadian government to clamp an effective top on cost of living and still prevent the appearance of extensive black markets is less the result of any magic in the wage-price ceiling as such than it is of supplementary taxes, loans, and rationing that have prevented total expendable consumer income from rising out of proportion to the supply of consumer goods. Of course, it may be that the announcement and enforcement of these ceilings has helped to allay fears of price rises and so to reduce the incentive to hoard goods.

During and after the last war, it was fashionable to explain the rise in prices in terms of "outside forces," which were considered impossible to control by internal measures. While the unquestioning acceptance of this explanation as complete drew attention from grave internal forces of inflation, there can be no doubt that the rise in foreign prices was a contributing factor, especially since export prices rose more than import prices. Indeed, the increase in value of the export surplus was a bigger percentage of prewar national income in War I than it has been in War II. This huge increase in exports alone could have led to a substantial rise in prices, so long as it was not offset by an increase in total output or by anti-inflationary fiscal policy.[63]

The question arises, therefore, whether Canada's relative success in stabilizing prices in War II cannot be explained by the greater price stability in the United States and Britain this time. No doubt foreign price controls have assisted Canada in her efforts to control inflation, but since Canadian prices have risen less than either British or American, it seems that internal policies have been the dominant factor.

If the level of American prices should rise substantially, the task of holding the Canadian price ceiling would, of course, be more difficult. American inflation would tend to increase the cost of Canadian products using American equipment and materials, and would attract other goods away from Canadian markets. The appreciation

63 It is conceivable that offsetting rises in export and import prices with no change in balance of trade might cause monetary expansion at home in order to finance foreign trade at the higher price levels. In addition, if the physical export surplus rises more than domestic production, as it did during the last war, the domestic price level might rise without monetary expansion through reduced supplies of goods in the home market. It seems likely, however, that the main inflationary "outside force" of War I was simply the secondary effect upon money income of the increased export surplus.

of the Canadian dollar in New York would be only a partial solution to the problem, since it would not counterbalance the effect of American inflation on prices of individual Canadian commodities. Moreover, the Canadian government might consider it advantageous to enter the postwar period with her currency still at a discount in New York, in order to stimulate her export industries at that time. If stabilization of Canadian internal prices is accepted as the dominant objective of postwar financial policy, it might be found that nothing short of a complete government monopoly of foreign trade would suffice to stabilize export and import prices in Canadian dollars. Decisions of so far-reaching a character clearly have political as well as economic aspects and involve international as well as national considerations. It is not inconceivable that efforts to maintain Canadian currency at an artificially low level would invite retaliation.

Lessons for Postwar Reconstruction

After a few months' hesitation, a boom developed in Canada during 1919-20. Heavy borrowing by industry, trade, and agriculture, led to continued monetary expansion and an accelerated price rise. Fiscal policy, too, was expansionary. Payment for war materials already produced, completion of war contracts and high costs of demobilization maintained government outlays and deficits on a high level. Other factors in the boom were continued high exports, replacement demand for housing, and a general aura of optimism. From the Armistice to the peak in mid-1920, prices rose 45 percent, cost of living 41 percent, export prices 49 percent, import prices 22 percent, and farm prices 41 percent, while the gap between wage rates and wholesale prices was substantially closed.

The recession that followed was precipitous in Canada as elsewhere. Recovery set in late in 1921, but was hesitant and incomplete. Even in the late twenties the underlying maladjustments of the Canadian economic structure were not entirely remedied. The great depression of the thirties was aggravated by structural distortions which first developed in War I.

Mismanaged war finance was by no means the only cause of these postwar difficulties. Basic problems inherited from the prewar period, readjustment to peacetime demands, and new problems and policies emerging after the war all had their share of responsibility. In

1913, Canada had reached the end of a long period of expansion generated by capital imports and the opening of the west.[64] Once the war was over, the problems arising under such conditions reappeared. While the war effort did not require substantial reorganization of the economy, it did redistribute resources by doubling wheat acreage, accelerating the development of industry, and absorbing men into the armed forces. This redistribution provided the postwar period with a problem of agricultural overexpansion that has never been entirely solved, excess capacity in certain fields of industry, and a demobilization task of considerable magnitude.

These factors would have brought difficulties regardless of the pattern of financial policy; wartime inflation added to them by inducing more reallocation of resources than was required by the war effort itself. Expansion of the volume of liquid assets laid the foundation for postwar inflation, and the extensive and unbalanced price rise from 1913 to 1920, with its accompanying new cost rigidities, made the subsequent price fall highly disturbing for many fields of enterprise.

In this war, the absorption of men into the armed forces has been no bigger in relation to the population than in the last one, and this time agricultural acreage has increased very little. On the other hand, Canada will end the war with something over half her national product comprising manufactured materials. The demand for strictly war products, such as ordnance, munitions, armored vehicles, fighting aircraft, will shrink abruptly after the war. Moreover, the expansion in peacetime industries has consisted largely in manufactured goods for export to Great Britain. Since Great Britain normally has exported manufactured goods to Canada and since there has been an increase also in the manufacturing capacities of other countries, it is unlikely that Canadian exports can be maintained at their present level without worldwide prosperity.

The financing of War II has brought certain developments which, in the absence of proper safeguards, could lead to serious inflation in the reconversion period. The quantity of money was already up more than $2 billion at the end of 1943; over $1.5 billion worth of

64 See, for example, Royal Commission on Dominion-Provincial Relations, *op. cit.*, Ch. IV; Deutsch, *op. cit.;* A. Shortt, *Early Economic Effects of the European War upon Canada* (Carnegie Endowment for International Peace, New York, 1918); F. H. Brown, *op. cit.*

war bonds was in the hands of non-financial corporations, while \$2.3 billion in war bonds and over \$150 million in savings certificates were in the hands of individuals; in addition, refundable taxes due individuals and corporations were mounting. Thus tremendous reserves have been accumulating which could translate growing individual needs for durable and other consumer goods, and corporate needs for inventory, equipment and plant, into effective demands. Unopposed, these demands can lead to undesirable price rises during the period of reconstruction if goods are not available to meet them.

Offsetting and complicating factors might soon develop. With the enormous manufacturing capacity and large stock piles of many primary materials that have been built up for war purposes, output of many civilian goods may be greatly expanded within a short time after cessation of hostilities, in which case no serious price rise need develop. Moreover, under conditions in which inflation threatens, the government may be able to cut expenditures and maintain tax receipts so that much of the intermediate- and short-term debt held by businesses and banks could be retired. If this process takes place, inflationary pressures will be relaxed. There may, of course, be other forces tending toward credit expansion, such as extension of new bank loans to private enterprise or bank purchases of government securities in the open market.

To the extent that wartime discrepancies in price and income movements prove to be disequilibria in terms of peacetime demands, serious readjustments in prices and wage rates may be required after the war. Such readjustments will lead inevitably to temporary losses and unemployment in certain fields of enterprise. In industries that have converted to war production and abandoned their peacetime products, reconversion may bring to light a problem of deflating costs below present levels or of raising prices above prewar levels to avoid operating losses.

The three million subscribers to the Fifth Victory Loan notwithstanding, the data on distribution of wartime borrowing show that the government has not succeeded altogether in its aim of placing the debt in the hands of those "who will use the repayments to provide needed improvements in their standard of living and maintain themselves against insecurity." However, the fact that so much of the debt is in the hands of financial institutions and individuals in the higher-income brackets diminishes the danger of large-scale liquidation of war bonds in the postwar period.

On the other hand, industrial and commercial firms, which have no need to hold large amounts of government bonds as operating assets, may liquidate their holdings faster than men and materials become available for normal peacetime production. In addition, if the wartime distribution of disposable income survives the peace, the danger of inflation during the transition period will be intensified, because of the high level of consumer spending that it entails. Once reconversion is accomplished, of course, this same redistribution may help to provide a market for increased output of consumer goods. The growing strength of Canadian trade unions gives some basis for expecting that much of labor's wartime gains in wage rates, and even in total earnings will be retained in peace. Tax refunds will strengthen postwar purchasing power of the middle-income group in relation to other groups, and it is improbable that this part of the population would put all of the tax refunds received into savings.