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GENERAL CONCLUSIONS

At least four general conclusions emerge from the study of Canada's financial system in war. The first is that diverting money income from one channel to another through fiscal and monetary policy is startlingly difficult. Even with such heavy taxation and public borrowing as that in Canada, a more substantial rise in total consumption has developed than was expected or desired by the government. In each year since war began, personal outlays on goods and services have risen by 30 to 55 percent of the increase in personal incomes net of taxes. Effects of disproportionate increases in demand for particular commodities and particular kinds of labor have been only partly suppressed by direct controls of wages and prices. Money, it seems, clings persistently to peacetime pursuits long after the armed forces and war industry are in action.

In the immediate postwar period, one objective of financial policy will be to assist the speedy reconversion of plant and equipment, to assist replenishment of inventory, and at the same time to continue control of inflation. Investment may have to be stimulated while consumer spending is kept within the limits imposed by available stocks.[65] On the other hand, once the war is won, the motive for prompt reconversion and inventory accumulation will be strong, and competition for men and resources may be keen. Some people may then insist that those industries most "essential" to society should reconvert first, even though the criteria of "essentiality" will be still less clear-cut than in wartime. In view of the wartime difficulties of reallocating resources, the possibility of an allocation problem in the transition period suggests a need for careful advance study to determine the proper timing and technique for abandoning wartime controls.

The second conclusion is that money, which has been immobilized or diverted to war uses by loan campaigns and direct controls, will still need checks and guides to assure its orderly return to civilian channels. The stimulation of a large-scale war effort seems to involve an inevitable expansion of liquid assets. Much of these assets is in the hands of individuals and corporations who normally do not hold

[65] Some of the difficulties inherent in such a fiscal policy are discussed by the author in an article on "Postwar Tax Policy," *Canadian Journal of Economics and Political Science* (August and November 1943).

large liquid balances. Accordingly, the government may continue urging them to hold their war bonds for some time after the war, to dissuade them from spending too much during the transition when supplies of goods and services are inadequate and too little later when these supplies become relatively abundant. Timing the use of these liquid assets will be a matter of concern to government, industry, and individuals alike.

The third conclusion is that the resources of all financial institutions of an economy at war must be mobilized if the objectives of war finance are even to be approximated. In order to attain the relative success of Canada's financial effort in War II, the investment and spending of banks, insurance companies, business concerns, finance companies, provincial and local governments, and individuals have had to be meshed with the fiscal policy of the Federal government.

As we have seen, the banks have necessarily coordinated their activities with the operations of the Bank of Canada and the Ministry of Finance. Except for agricultural loans, which are closely tied up with government buying and price maintenance of wheat, wartime bank expansion has resulted almost entirely from government financing and has been made possible through provision of the necessary reserves by the Bank of Canada. The life insurance companies have bought government bonds to an extent exceeding their net receipts from Canadian business, liquidating other assets to procure them, and have become for the time being intermediaries between individual savers and the Treasury. Provincial and municipal governments have altered their fiscal policies to synchronize more effectively with Federal fiscal policy. Retail finance companies have of necessity turned to the financing of concerns working on government contracts. Individuals and non-financial corporations have made unprecedentedly large investments in government securities.

The outbreak of peace will present problems comparable in magnitude and complexity with problems arising from the outbreak of war. A good deal of labor and capital will have to be shifted, both occupationally and geographically. Until the peace emergency is clearly over, the government will require the assistance of financial institutions in dealing with the financial problems of transition from war to peace. So long as the government finds it advisable to go on mopping up excess purchasing power by taxes, loan campaigns and direct price controls, the tasks of the private financial system will remain much the same as in wartime. If the government deems it necessary to embark on a program of public work and relief to counteract recession, the private financial system may be relieved of some of its wartime duties, but may still be called upon to buy government bonds in large quantities.

The fourth conclusion is that financial institutions have an increased concern with postwar financial policy because war finance brings about a concentration of their earning assets in government obligations. While most financial firms are in a strong position to ride out mild flurries in the bond market they have an understandable interest in relatively stable values for their assets. Mass liquidation would be highly disturbing for the financial system, whether motivated by a desire to offset falling incomes by dipping into savings, to hedge against inflation, or to finance replacement of durable goods. The best guarantee of a stable bond market would be a high level of economic activity, with enough savings to provide a firm market for securities and to keep demands for goods from outrunning supplies.

The Annual Report of the Bank of Canada for 1943 gave virtual assurance that the banking system would use its resources to maintain a low interest-rate structure after the war. Referring to the reduction in the rediscount rate from 2½ to 1½ percent, effective February 8, 1944, the Governor of the Bank stated:

> "It therefore seems appropriate that the bank, by reducing its rate, signify its intention to continue the kind of monetary policy which has brought about the current level of interest rates. A policy aimed at higher interest rates would only become intelligible if, after war shortages are over, consumers' expediture and capital development were to proceed at a rate which would overstrain our productive capacity. I see no prospect of such a situation arising in a form which would call for a policy of raising interest rates."

However, such complete optimism about the possibility of pursuing an easy money policy without danger of inflation has not been shared in all quarters. The Advisory Committee on Reconstruction, in its report to the Prime Minister, has taken the position that inflation is the gravest of immediate postwar dangers.

In closing, it might be suggested that as long as Canada remains at war and continues to pursue her stated aims of war finance — to stimulate war production, avoid inflation, and minimize postwar complications – she will undoubtedly find it advisable to maintain her anti-inflationary forces as close to full strength as possible. There are indications that war expenditures have already passed their peak; budget estimates for fiscal 1945 show a slight decline from the previous year. Nevertheless, large loan campaigns, high taxes, extensive rationing, and substantial subsidies will probably still be necessary for the duration of the war emergency. If so, the tendencies in the financial field already noted will continue. Financial institutions will hold still more money and still more bonds, and their stake in postwar financial stability will be greater than ever.

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