chartered banks created a small amount of credit expansion. Of this amount $92,000,000 was used for repatriation of British-held Canadian securities, $28,000,000 retired Canadian loans maturing in October and November and thus only $80,000,000 was available to meet increased Government expenditures. By January 1940 it seemed propitious to float a long term loan, so that a $200,000,000 cash subscription plus conversion of Dominion 3%'s of March 1, 1940, was announced. The new loan consisted of 3¼% bonds issued at par, to be redeemed by lot 1948-1952, redemption being at par for the first three years and with premiums of ½% and 1% in 1951 and 1952 respectively. The average yield was 3.27%. In order to encourage small investors to put their savings into this loan the bonds were issued in denominations as low as $50.00; further, chartered banks advanced loans to prospective purchasers for three months at the same rate of interest the bonds carried. The result was most encouraging, total cash subscriptions being $321,000,000 plus $53,000,000 for conversion purposes. $200,000,000 was allotted for cash and $50,000,000 for conversion. Up to the present, therefore, the Government has been extremely successful in its financial operations and there is no reason to believe that future transactions will be less so.

As full employment is achieved (and this is likely to be the case by the end of 1940), further emphasis is likely to be placed upon direct curtailment of civilian consumption, and to achieve this end governmental machinery has already been set up. This includes the War Time Prices and Trade Board, which has power to fix prices and to ration supplies. So far it has operated chiefly to assure a sufficiency of supplies, the assumption being that if this is successful prices will not rise appreciably. Wool prices, however, were temporarily fixed and it may be that in future this type of control must be extended. The Foreign Exchange Control Board can aid by refusing licences for import of non-essential goods or for export of essential or scarce goods or materials. Also the War Supply Board can "organize" the country's resources for governmental needs, and likewise the Agricultural Supplies Commission is designed "to ensure that the agricultural resources of the Dominion shall be utilized to best advantage". Between them these agencies should be able to hold down prices and to aid in reducing non-essential consumption in those areas where taxation and borrowing have not operated to the most desirable extent. It is unlikely that they will fail, but if they do some more Draconian measures will be necessary in order to achieve the aims of war finance.

Why Foreign Exchange Control

By R. B. Bryce

EXCHANGE Control is to be found among the major wartime economic measures set up in all of the belligerent countries. In Canada it is the most widespread and important of the economic war measures that have yet been adopted. It directly affects tens of thousands of our citizens, and concerns transactions totalling a hundred million dollars or more each month. It represents in principle a distinct change from the peacetime freedom which has characterized the Canadian foreign exchange market, which has, indeed, been one of the few exchange markets not subject to official control or intervention of any kind. Furthermore, the immediate adoption of exchange control at the beginning of this war contrasts strongly with the lack of any such control in the last war. For

EDITOR'S NOTE: R. B. Bryce is an economist with the Department of Finance, Ottawa.

all these reasons it is natural that the intelligent Canadian citizen should be interested in the purposes which have prompted the Government to set up such a complete system of regulation. This article is intended to tell some of the reasons for establishing exchange control without going into the details of the nature and method of the control itself.

It is important at the outset to emphasize that this is essentially a war measure. It was not adopted for any of the reasons that led to the imposition of exchange control in many countries during the decade before this war. Those peace-time controls were generally intended to bolster up a falling currency, to save desperate financial or economic situations, or to protect domestic industry or agriculture against outside competition. Our Canadian control was not the result of any such peace-time difficulties. Indeed the Canadian dollar has in recent years been one of the strongest of currencies and we did not need to defend it by any sort of restriction on exchange.

It is also worth noting that our exchange control is not, and was not intended to be, a form of protection to domestic industry. It is most decidedly not an attempt to evade any obligations under our Trade Treaties. Nor is it a means of trying to gain an unfair advantage in competing in world markets. It is a defence measure, and not an instrument of economic aggression.

The Canadian exchange control has two related purposes. First, it is to enable Canada to conserve her supplies of foreign exchange under wartime conditions and to see that these are used in the national interest. These supplies consist not only of the current receipts from exports, tourist trade, etc., but also of the holdings by Canadian residents of foreign money and other assets having a market value abroad in excess of any foreign claims upon them. The second purpose is to conserve Canadian savings during the war for use in Canada and to insulate in some degree our capital markets from those in other countries.

To appreciate the importance of these purposes it is necessary to picture the dangers to which we might otherwise be exposed. The principal danger is the risk of heavy movements of capital out of Canada, which would absorb both foreign exchange and current Canadian savings. If, for example, a foreign resident sold his Canadian assets to Canadian residents and used the proceeds to buy investments in other countries, then it would take part of our current Canadian savings out of income to buy the foreign resident's securities, and it would take some of the Canadian supply of foreign exchange to convert the Canadian dollars obtained by the foreign resident into the foreign money he will need to invest abroad. Canada is particularly vulnerable to this danger for two reasons. In the first place there are very large foreign investments in Canada. The latest estimate of the gross value of British and foreign investment in Canada and Canadian securities is 6,765 millions of dollars, of which 2,685 millions are believed to be held in the United Kingdom and 3,932 millions in the United States. While a good deal of these investments are of types that could not be readily sold back to Canadian residents there is an enormous amount which could be sold, at least gradually, if the foreign holders desired to sell. Furthermore, many Canadians themselves are used to investing in foreign securities, particularly, of course, in the United States, and many New York stocks are just as familiar to Canadians as those in Montreal or Toronto. Consequently, many Canadian residents might be strongly tempted to invest or to speculate in New York during the war, perhaps feeling that they can in that way hedge against the economic risks of war. It is possible that the withdrawal of capital from Canada, either by Canadians or others, would be the result of a short-sighted attitude and not in the real interests of investors in Canada, but under the influence of wartime alarms and excitement, a great deal of capital might be exported. There appeared to be some evidence of such export of capital during the week or two following the outbreak of war, and before exchange control was introduced. Once the control was in effect it was possible to check any movement of this kind.

A second aspect of the potential need for control should be noted. Certain types of imports may be and probably will be urgently necessary for war purposes, and others as necessities of life or production such, for example, as sugar or machine tools. Other types of imports are less essential from a defence viewpoint, but very apt to increase as incomes in Canada increase and business and investment expands. Since our supplies of foreign exchange, though large, are limited and a considerable part is needed to meet interest and dividend payments and principal requirements on maturing debts, there may come a time when it will be necessary to give priority in the provision of foreign exchange and restrict the use of it in purchasing less essential imports. To meet such a problem would require a system of exchange control.

Since the Canadian dollar has been a strong currency in recent years, and Canada has been able to reduce substantially each year her net international indebtedness, some people may be inclined to doubt the necessity for exchange control in Canada and to suggest she could easily have run the risk of capital exports. Examination of the international balance of payments, however, reveals that the strength of the Canadian dollar had depended to a considerable extent upon a surplus of current receipts over current payments in her dealings with the United Kingdom and the rest of the Empire, and only a small current surplus, if any, in her dealings with the United States and other foreign countries. Since the Empire countries have imposed exchange control it is not possible for Canada freely to use the surplus pounds obtained in her current transactions with the Empire in order to meet requirements for American dollars and other free foreign exchange. On the other hand, if there had been any movement of capital out of Canada it would have been mainly to the United States and a large proportion of any expansion of imports would also come from the United States. Consequently, the control of sterling exchange indirectly increased very greatly the call on the Canadian dollar and rendered the institution of wartime exchange control almost inevitable in Canada.

It is worth emphasizing that the foreign exchange resources of the Allies, including Canada, are one of their strongest weapons in the war. It is this foreign exchange which enables the Allies to use the neutral world as a source of food, raw materials, arms and other finished products. This in turn contributes enormously to the preponderance of economic strength which the Allies have over Germany. Britain and France are, of course, very keenly aware of this importance of foreign exchange, and they are conserving it very carefully for essential purposes. As an Allied power Canada too must conserve the exchange resources for war purposes. We shall need exchange to purchase aircraft and munitions, to purchase equipment parts and materials for making war supplies at home, and to purchase such vitally essential supplies as coal, oil and gasoline. Our exchange situation is complicated by the fact that a great deal of our normal international transactions take place with the United States, which, of course, is a neutral, and our trade with the country is the main source of foreign exchange, particularly now when sterling is controlled. Consequently, Canadian exchange policies must be long-sighted and designed not to hamper good trade relations with the United States. It might be noted at this point that since the main purpose of control is to ensure that ample exchange is available to purchase essential imports, which come mainly from the United States, and also to ensure that exchange is available to meet contractual obligations to foreigners, most of which again are to Americans, therefore the control is essentially to the advantage of the United States, even though it restricts the sale to Canadians of assets owned by Americans.

The relation of exchange control to the capital market should be noted. Canadian borrowing will all have to be done in Canada during this war. Britain and France have enough of a problem in raising their own loans, and Canada is already supplying Britain with Canadian dollars in exchange for sterling by redeeming and purchasing British holdings of Canadian securities. Borrowing from other European countries would be out of the question now, even if they had the foreign exchange to lend to us. Now that Canada is a belligerent the United States Neutrality Act prevents the Canadian Government (or any of our Provincial or Municipal Governments) from doing any new borrowing in the United States. Consequently, we are forced to depend upon our own market to supply the very substantial loans we shall need for our war program. Furthermore, we must ask it to provide not only the funds we need ourselves, but also the funds necessary to repatriate British holdings of Canadian securities in order to provide the British Government with dollars to make purchases in Canada. It is clear that Canadian savings during the war will be urgently required.

Exchange control enables the Government to prevent Canadian savings being used either for speculation or investment outside of Canada, or for purchasing existing Canadian securities or other assets from Americans or foreigners who wish to sell them and invest their funds elsewhere. Either of these processes would reduce the amount of Canadian savings available for war loans and other essential Canadian requirements, and, therefore, cannot be afforded under present circumstances. In other words, the current supply of savings available for investment just as well as the current supply of foreign exchange, is vitally necessary for essential purposes in wartime and must be safeguarded and controlled.

Another aspect of this capital market side of exchange control is the effect it has in insulating the Canadian securities markets, to some extent, against disturbances and fluctuations occurring in other security markets and against sudden exchange "scares" that might otherwise develop under war conditions. While the effect of control is largely to regulate and slow down the movement of capital back and forth across Canada's boundaries, there is special treatment in the case of funds for investment in new enterprises. Since capital cannot freely move, the main connecting link between Canadian and other security markets is interrupted for the time being, though the psychological inter-relations remain unimpaired. Consequently, there is less danger of a speculative movement, say on the New York Stock Exchange, disturbing the stability of the Canadian market. This is an advantage when we must depend upon the Canadian market to absorb large volumes of new Canadian securities. It also affords the Canadian authorities a better chance to control the Canadian market, in so far as such control is practicable and desirable.

These were among the major factors which had to be taken into account when it was decided to establish exchange control in Canada. Space does not permit a review in this article of the various regulations and policies of the Foreign Exchange Control Board. Perhaps, before concluding, however, it is worth simply noting a few special difficulties facing such a control in this country, and the major lines of policy that have been followed. In regard to the first question there are at least three characteristics of the Canadian exchange situation which pose special problems for control. One is the great extent and informality of our tourist trade. This is one of Canada's most important businesses and probably the greatest single source of foreign exchange. Yet it is carried on by tens of thousands of individuals, under the greatest freedom, and Americans have generally brought their own money up here to Canada and used it freely without exchanging it. A second set of problems arises from the intimacy and complexity of our financial relationships with the United States. Americians have invested and speculated in Canada on a very substantial scale, and Canadians have done the same in the United States. There is a tremendous volume of export and import trade, of tourist trade, and of other commercial transactions between the two countries. Consequently, the financial relations between Canada and the United States must normally be more close and complex than those between any other two separate countries. A third series of difficulties is a special case of the second, arising out of the great number of companies in Canada which are subsidiaries of American companies. Financial and commercial arrangements between "related" companies, or between branches and head offices, often present difficult legal and administrative problems in regulation, and this is particularly true in the case of exchange control. However, it should be noted here that American business men as well as Canadians have cooperated wholeheartedly in the working out of the control on practical and satisfactory lines and in observing the spirit of the control, as well as its letter. This has enabled the purpose of the control to be achieved without disrupting the normal course of business.

The general policy followed by the Canadian Foreign Exchange Control Board has been to interfere as little as possible with imports, exports and the tourist trade, but to reduce to a reasonable minimum any movement of capital out of Canada, either by Canadians or others. There has been no restriction of imports or exports for exchange purposes, though licenses are required in order that a check can be obtained on the corresponding exchange transactions. Exchange is being sold by the Board for the purpose of paying interest and dividends (out of earnings) to non-residents, and for meeting debts in foreign exchange at their maturity, so that the control does not preclude Canadians fulfilling contracts entered into before the control was established. It may be noted, in concluding, that these policies are consistent with the purposes of the control as set forth in the paragraphs above.

Price Control in Canada

By H. R. Kemp

AMONG the economic lessons of the war of 1914-18 few have made a more lasting impression than the evils of excessive price increases, whether arising from shortage of supplies, money and credit inflation, or antisocial conduct on the part of individuals, which increased the cost of carrying on war and the burden of fixed debt resulting therefrom, bore heavily upon wage-earners and consumers in general through the rising cost of living, deprived millions of persons in the warring countries of savings to which they looked for financial security, and prepared the way for postwar deflation and depression. It is not surprising, therefore, that one of the first measures for public security to be announced in Canada on September 3, 1939, the day when Great Britain declared war, was the appointment of the Wartime Prices and Trade Board to provide safeguards under war conditions against any undue enhancement in the prices of the necessaries of life, and to ensure an adequate supply and equitable distribution of such commodities. While food, fuel and clothing are mentioned in the regulations, the Board may at any time extend the category of "necessaries of life" to include other articles of any description.

The powers of the Wartime Prices and Trade Board are more extensive and drastic than has been generally realized. The Board may investigate costs, prices,

EDITOR'S NOTE: Hubert R. Kemp, Professor of Commerce in the University of Toronto, is at present economic adviser to the War-time Prices and Trade Board.