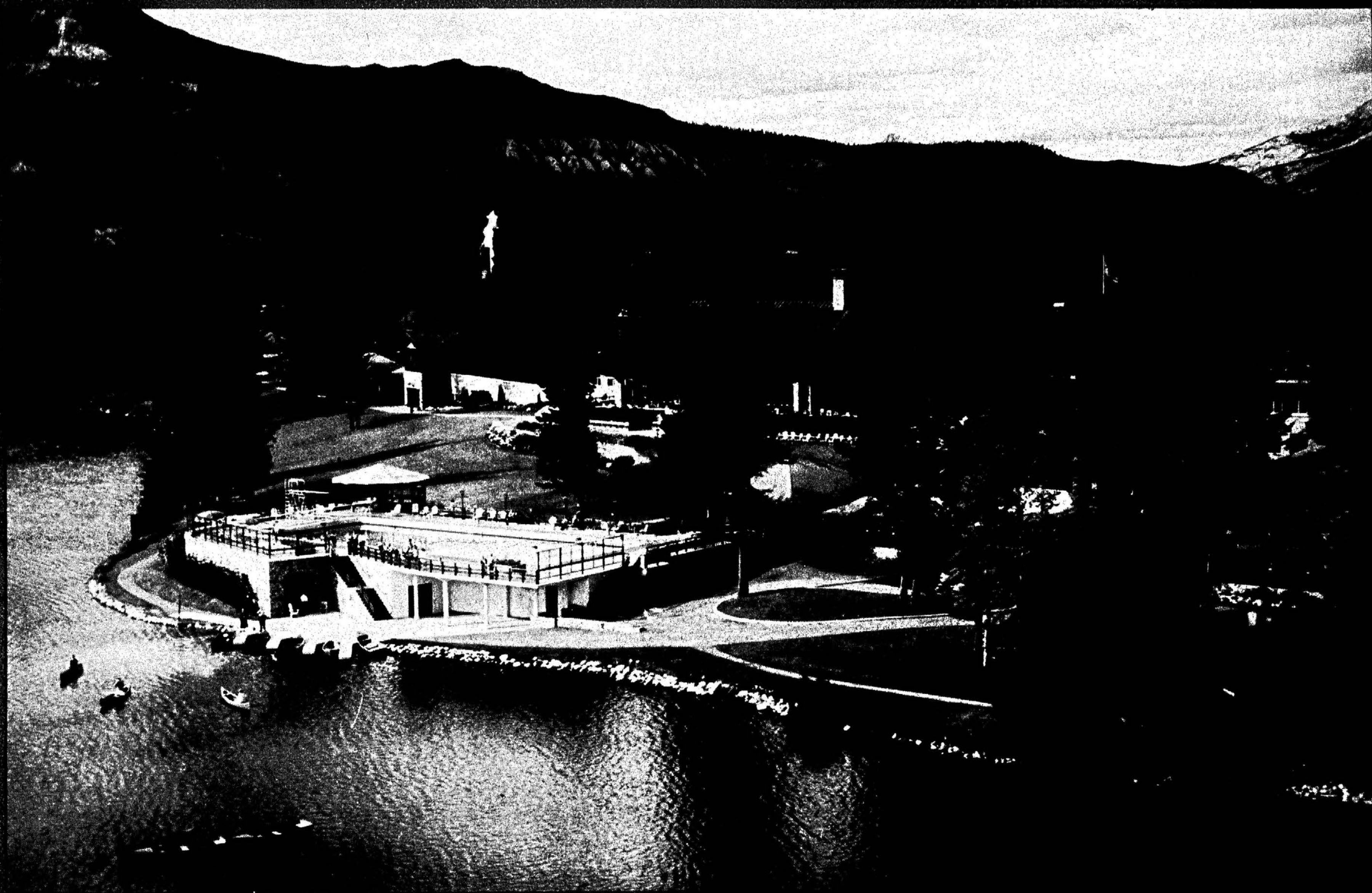

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45TH ANNUAL MEETING

JASPER PARK LODGE • • • JUNE 22-25, 1961

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Canada's Economic Problems Are Readily Solvable

By Eric S. Morse,* *Vice-Chairman, W. C. Pitfield & Co., Limited, Montreal, Canada; Retiring President, Investment Dealers' Association of Canada*

Uncertain as to whether his government has or has not damaged financial relations with foreign investors, Mr. Morse urges nothing further be done to discourage any capital inflow vital to future development. The investment dealers' spokesman calls for an augmented effort to channel more of the increased personal income into investments, and flays the Federal Government's deficit financing for the poor example it sets when it should provide the leadership for greater savings. In placing the facts of Canada's problem in perspective, the investment banker notes: (1) the balance of payments is within manageable bounds and that self-correcting forces are at work; (2) the emergence of a significant decline in the relative importance of business investment as against housing and social capital needs; (3) utmost need to rectify lagging productivity.

I would like to deal with a few problems which have plagued the Canadian economy in recent years. To give the picture, as I see it, I will endeavor first to outline the economic or business setting in which we find ourselves; give an opinion on some of the difficulties arising out of our international balance of payments; and, finally, indicate how Investment Dealers can make a significant contribution to the solution of these difficulties by stimulating saving, and by channeling it into effective forms of investment.

Eric S. Morse

It is indeed unfortunate that the long-awaited Federal Budget has not yet been made known to us—as perhaps these comments might be somewhat more enlightening.

There have been four cyclical interruptions in Canada's fabulous postwar expansion. The first came in 1949, when the pent-up demand for consumer goods arising out of wartime restrictions became pretty well satisfied. That recession (it was more of a pause than a recession) was terminated abruptly by the outbreak of the Korean War in 1950 which caused an inflationary spiral of world demand for virtually all of Canada's basic resources.

The letdown from the war-inspired and artificial boom came in 1954. It was brief and it was mild. Sharp recovery followed in 1955, sparked by the greatest capital spending program in the nation's history. It was also accompanied by a sharp increase in export trade.

The tempo of this greatest of all economic booms accelerated all through 1956 and carried over into 1957. Then its steam began to run out. Late in 1957 it was fully apparent that a third postwar interruption of our economy's growth was in course. Most of the economic indicators in 1958 were moving sideways or showing modest declines. But, like the two earlier recessions, this one was brief and not severe. Recovery made in 1959. Business generally underwent another cycle of significant expansion. Major elements in the 1959 resurgence were a major capital expenditure outlay, a 10% increase in exports and a 5% increase in domestic retail trade. Gross National Product in 1959 showed a strong quarterly growth trend, and the year's total was 7% ahead of 1958.

The fourth postwar economic expansionist wave began to wobble in the second quarter of 1960, when GNP showed its first decline since the fourth quarter of 1957. Capital expenditures declined last year—so did exports. Retail sales flattened out. Corporation profits dropped by some 6%. Unemployment rose sharply to record postwar highs. The seasonally adjusted index of industrial production in July, 1960 was the lowest in 17 months.

Nevertheless this fourth postwar recession has not been as serious as some forecasters had predicted. Despite the slowing down, national production increased by 3.2% in 1960. More Canadians were at work than ever before. Personal income and personal expenditures on goods and services continued to rise.

Rise in Unemployment

In terms of unemployment, however, this most recent readjustment period has been considerably more spectacular than the earlier periods. During last year the annual average of unemployed persons, based on Canada's present yardstick, was 7% of the labor force. In the first quarter of 1961 it averaged more than 11%. This has been the result, largely, of the marked increase in the labor force which was up by more than 7% in the first quarter of 1961 over the first quarter of 1960. Moreover, a large number of the unemployed are young and unskilled persons who have not completed secondary school education. There is still a distinct shortage of skilled personnel in many industries.

We are now confronted with the paradox of high unemployment—relatively the highest since the depressed '30s — at a time when employment, national production, exports, personal income, capital and consumer expenditures are at or near record levels. I venture to predict that unemployment will be a continuing problem because of automation and general change in the character of the Canadian economy.

To place the present state of our economy in proper perspective, I think that we should re-examine the underlying forces that have put us where we are. There have been three successive waves of capital inflow since World War II. Each period of expansion in those years shows capital investment accounting for an ever larger proportion of Gross National Product. During the period 1956-57 total capital investment provided more than 27% of GNP, the largest, relatively, since before World War I and substantially larger than in the United States and in western Europe in the same period.

Developments abroad exerted major influences on our postwar expansion. Much of the capital inflow was the result of resource development in this country by foreign corporations seeking long-term supplies of low-cost raw materials. The impact of this new investment was such that it necessitated immigration and imports of capital goods at levels greater than since the opening decade of the century. Naturally, our international balance of payments position has reflected the heavy capital inflow.

The balance of payments deficit on current account with other countries was $1,270 million last year, most of which was on non-merchandise items. Although concern has been expressed about the magnitude of this current account deficit, **it is not a new situation.** Our net international indebtedness and deficit on non-merchandise account are smaller now relative to GNP than during most of the period between 1900 and the outbreak of Warld War II. It is my view that the present situation is neither new or unmanageable. Of course, a price must be paid for the inflow of capital that has enabled this country to achieve unprecedented prosperity and high standards of living. Part of the price is the foreign control of so much of Canada's productive capacity. Most recent figures show that more than half of the manufacturing, petroleum and natural gas, and mining and smelting industries is foreign-controlled. The economic and political importance of this situation in my view has been overstressed.

Balance of Payments Problem Not Too Bad

Returning to the balance of payments situation, I think that an examination of our commodity trade position is re-assuring. Between mid-1956 and mid-1957 our merchandise trade deficit was just under $900 million. In the calendar year 1959 the deficit had fallen to less than $400 million. In 1960 it was less than $150 million. In the first quarter of this year it was nominal. There are, I think,, good reasons to expect a trade surplus which will help to finance the growing deficit on the non-merchandise balance of payments items. Frankly, I believe that our so-called balance of payments problem is well within

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The Columbia River Project

By Dean Gordon M. Shrum,* *O.B.E., M.M., E.D., M.A., Ph.D., F.R.S.C., Chairman of the British Columbia Energy Board*

As a physicist and not as the Energy Board's Chairman Mr. Shrum presses for the building of the world's largest single hydro-electric power plant in British Columbia at an estimated Canadian cost of $1 to $1.5 billion compared to $478 million share of the St. Lawrence waterway. The Energy Board's financial and engineering report is to be submitted in August and Mr. Shrum sees little doubt that British Columbia will go ahead with either the Columbia or Peace, or both, projects. The energy expert calls for the repeal of the anachronistic, self-defeating Electricity and Fluids Exportation Act of 1907; castigates the burning up of irreplaceable resources when there is this enormous, available water power being wasted; denies term contracts for recapturable power cannot be enforced; and foresees utilization in southern B. C. and expanding California markets. Mr. Shrum compares hydro, thermal and nuclear power, which he expects will be competitive in 10 years, and urges there be no delay in this hydro-electric project.

It is quite understandable that Canadian investment dealers and others, should be interested in large scale hydro-electric developments. They require investments of millions, even billions, of dollars. If the Columbia River Treaty is ratified by Canada it will initiate not only one of the largest single industrial projects ever undertaken by Canadians, but the largest single hydro-electric project ever developed by any nation. The total expenditure for the Canadian section only of the completed Columbia project will be of the order of $1.5 billion. In comparison Canada's share of the St. Lawrence waterway was $300 million for power and $178 million for navigation. The first phase of Canada's share of the Columbia is approximately $450 million. The problems associated with the financing of the project may well rival some of the engineering problems connected with building the highest rock-filled dam ever attempted by engineers. This is an important subject for discussion not only for those of us who live in British Columbia but for Canadians from coast to coast.

Gordon M. Shrum

I should emphasize that this paper is in no sense a preview of the B. C. Energy Board's forthcoming report on the Columbia. The Board's report will be based on the findings of eminent consultants and I hope will be ready for submission to the Government of British Columbia in August. At this time, I shall be identified not as Chairman of the Energy Board but as a physicist. Physical science can be roughly divided into two main divisions, one dealing with matter and the other with energy. During the 19th century and the early years of this century, the chemists pre-empted matter as their own special interest and left energy for the physicists. For a long time the chemists had the better of the bargain, for matter seemed to be the more important subject. However, during and since World War II energy has been the much more important concept and now since matter can be transformed into energy all chemistry may eventually be taken over by the physicists. Physicists are the experts on all forms of energy and to a physicist hydro-electric power is just one form of energy, an inexpensive and convenient form.

Our civilization is based upon energy and no other commodity is so important to our well-being. The standard of living in any country can be measured by its per capita energy consumption. This per capita amount varies from 3,000 kilowatts per day in some of the underveloped countries to 150,000 in the more advanced nations. This factor of 50 is a pretty fair measure of the range in the standard of living throughout the world. It might also be noted that one-quarter of the world's population consumes four-fifths of the world's energy and we are fortunate enough to be included in this one-quarter. One may assume that sooner or later the other three-quarters of the world's people will demand their fair share of the available energy.

Fossil Fuels Diminishing

Up to the present time practically all our energy has come from the sun. Today only by means of agriculture and by harnessing hydro-electric power are we able to capture a minute part of the sun's energy. With the exception of hydro-electric power which represents only about 4% of the world's energy consumption, we depend upon coal, petroleum and gas for our supply of energy. These are really fossil fuels which represent captured sunlight transformed and deposited in the outer crust of the earth since it was formed millions of years ago. Unfortunately, these fuels are not being produced today except on an insignificant scale and consequently so far as energy is concerned we are living almost entirely on our capital reserves.

It is interesting to note that the earth receives in four days from the sun more energy than all our reserves including atomic fuels. Unfortunately, very little of this daily quota of energy can be captured and utilized. Actually this enormous amount of energy which the earth receives is only about one billionth of the total energy radiated from the sun. The latter is really a gigantic reactor using a nuclear fusion process to produce helium from hydrogen. Unfortunately, our sun, which is only a second rate star, is gradually running down and will probably have a useful life of only 10 to 20 billion years!

When we use coal, oil or gas we are using up our reserves and some day these supplies will be exhausted. If no other large scale source of energy can be found our civilization will gradually grind to a halt. Estimates vary regarding our reserves of fossil fuels and the time which may elapse before their exhaustion. The most pessimistic estimate I have seen is 25 years and the most optimistic 250 years. The most important unknown factor in these estimates is the rate at which the underdeveloped countries will raise their standard of living. In the final analysis it is really not a case of whether we shall exhaust our fossil fuels but merely of when.

All this anxiety about our future energy supply has been lessened to some extent by the development of nuclear energy. The use of atomic fuels will extend our reserves by a factor of at least 10. If the fusion process can be controlled and energy produced from heavy hydrogen then physicists have solved man's energy requirements for all the time. This is the main reason that the development of nuclear energy is the most important scientific advance of all times and, so far as potential benefit to mankind is concerned, space exploration by comparison fades almost into insignificance.

B. C.'s Energy Needs

We must not be carried away by future prospects but must make certain that we can meet our immediate needs not only throughout the world but in Canada and particularly in British Columbia. The future energy requirements of B. C. can be fairly easily determined. We know our present consumption, its rate of increase and our rate of population growth and can therefore predict our energy needs at any time during the next 50 years. We have about an 8% annual increase which means a doubling of our requirements about every nine years. This is about the same rate of increase as Great Britain although she has a much older industrial economy.

There are many potential sources of energy for B. C.—coal, oil, gas, hydro and perhaps nuclear energy from the fission of uranium or even perhaps by the fusion process. Cost and convenience will be the chief considerations in making a choice from these various potential sources although reliability is also becoming more and more important. Cost is usually looked upon as a very important factor but this attitude cannot be entirely justified. In the case of an automobile we accept a high cost for energy in order to have more comfort and convenience. In fact, in most industries the cost of electric power is not an important consideration as it is usually only about 3% or 4% of the over-all cost. Only in the case of electro-chemical or electro-metallurgical industries is the power cost a real determining factor in respect to location. This latter type of industry uses prodigious amounts of electrical energy. In B. C. the plants at Trail and Kitimat use as much electrical energy as all the rest of the Province combined.

Relative Power Costs

It might be helpful to have a look at the relative cost of hydro, nuclear and thermal power. In

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Some Built-in Defects in Canada's Financial System

By W. Earle McLaughlin*, *President, The Royal Bank of Canada, Montreal, Quebec*

Singled out as fundamental defects in Canada's financial system are the near-banks' deposit currency rise as a competitive threat to chartered-banks and the danger this poses not only to the chartered-banks but, also, to effective monetary control. Mr. McLaughlin absolves monetary managers from responsibility for this, and recommends legislative changes placing near-banks' deposits in the money supply and subjecting them to some type of— to be explored—reserve requirements under Bank of Canada's control. He also recommends removing the 6% ceiling imposed on chartered-bank loan rates of interest. The banker hopes the recently announced plan to set up a Royal Commission will allow not only an investigation of banking operations but also of near-banks.

My title calls attention to some "built-in defects" in Canada's financial system. They *are* built in because they are *fundamental* defects of structure which are not due to human error in the administration of our system on the part of the monetary authorities, the chartered banks, the investment dealers, or any other entities in the money market. However, my remarks will concentrate not only on the defects — glaring as they are—but on what I consider possible means to correct them.

W. Earle McLaughlin

Much has been said, and much more has been written, concerning Canada's economic independence, or lack of it, in the years that have passed since the end of the second world war. I do not wish to thresh over this old straw. I intend instead to concentrate on one prerequisite to that independence—a prerequisite which I believe has received little recognition in the immense, and often stimulating, literature on this vital subject. I refer to our need for a financial structure which is not only eminently sound and reasonably efficient but one that works smoothly in its short-run adaptation to the economic climate of the day. For reasons beyond the control of any of us, we do not have this degree of flexibility now, but it is easily within our reach; and very moderate legislative reforms would make it a fact.

Monetary policy in Canada, as in most Western democracies, derives its power from the control by the central bank of the supply of money in the economy. In Canada this money supply is defined by the monetary authorities as the total amount of chartered-bank deposits in Canadian currency plus Bank of Canada notes and Canadian coin in the hands of the public. By far the greater part of this sum, or almost 90%, is in the form of chartered-bank deposit liabilities.

Bank of Canada's Role

Against their deposit liabilities averaged over a reserve-base period the chartered banks are required under the Bank Act to hold 8% cash reserves. In addition, under an arrangement with the Bank of Canada, effective May 1956 the chartered banks maintain a further minimum of 7% in secondary reserves consisting of Government of Canada Treasury bills and day-to-day loans to money-market dealers.

The Bank of Canada has complete control over chartered-bank cash reserves, which consist of chartered-bank deposits with the Bank of Canada plus their average holdings of Bank of Canada notes in the reserve-base period. If, for example, the Bank of Canada wishes to contract cash reserves it sells securities in the open market. Should these securities be bought by a bank, there is a direct debit to that bank's account with the Bank of Canada, and hence a reduction of its cash reserves. Should anyone else buy them, he issues a cheque on his account with his bank, and when the check is cleared by the Bank of Canada, his bank's deposit with the Bank of Canada is reduced and hence chartered-bank cash reserves are reduced. Conversely, a purchase of securities by the Bank of Canada reverses the procedure and increases chartered-bank cash reserves.

But, because of the 8% minimum cash-reserve requirement under the Bank Act, to control these cash reserves is to control chartered-bank deposits. The total money supply, as we have seen, consists of notes and coin in circulation plus the chartered banks' Canadian deposit liabilities. Since the Bank of Canada is the sole issuer of notes and the sole distributor of coin, even though these are passive elements in the money supply, and since, through open-market operations the Bank of Canada controls the *active* part of the money supply, i.e. the volume of bank deposits, it clearly follows that the money supply of Canada, as here defined, is completely responsive to Bank of Canada policy.

"Money-Supply Substitutes"

So far the role of monetary policy would seem to be straightforward enough. But, as the cliche has it, we live in a changing world. And one of the most important changes in recent years has been the development of what might be called "money-supply substitutes" almost identical with the real thing but entirely outside the official definition and completely outside direct central-bank control. For the most part these money-supply substitutes take the form of deposits with checking privileges in Trust Companies, Caisses Populaires, Credit Unions and similar institutions which I shall lump together in the simple descriptive term "near-banks." Since 1934 when the Bank of Canada Act established our central bank, these near-bank deposit-receiving institutions have enjoyed a period of rapid growth. This is especially true of the deposit business done by Credit Unions, Caises Populaires, Trust Companies, and in a sense also by finance companies and small loan companies. But perhaps we should also include in the category of near-banks certain other organizations that borrow money on the street and in effect accept temporary deposits.

In spite of this change in the true nature of the money supply, the classic definition is still adhered to and the money supply as officially defined excludes all deposit currency existing outside the chartered banks. As a result, the immediate impact of monetary policy, directed at the money supply so defined, is entirely upon the chartered banks, and other depositories are affected only indirectly, if at all.

The various near-banks to which I have referred have all the advantages, real or imagined, which are supposed in the popular mind to be the exclusive property of the chartered banks. They do not have the disadvantage, unique to the chartered banks, of having the total value of their collective assets completely beyond their own control.

Near-banks can "create" credit by purchasing assets in return for deposit liabilities subject to check. Beyond this their range of banking services is narrower than that provided by a chartered bank, but they are not precluded by law from extending this range. In fact, the only difference between their deposit operation and that of the chartered banks is that unlike the chartered banks, these institutions are not subject to the stringent regulation which the Bank Act and the Bank of Canada Act impose upon Canada's chartered banking system.

Interest Rate Advantage

These near-banks do not have to maintain a fixed percentage of their deposits in the form of cash reserves which in turn are subject to Bank of Canada control; they are not limited by law to a maximum lending rate of 6%, which gives them a significant advantage in the interest rates they can pay on deposits; and moreover, as I pointed out earlier, their deposit liabilities are not considered part of the money supply even though they are "money" in the same sense that chartered bank deposits are money.

I am not suggesting that these various near-banks are in some sense "draining away" deposits from the chartered banks. The loss of a bank customer to this kind of competition reduces chartered bank deposits of one type: deposits owned by the general public, but it increases chartered bank deposits of another type: deposits owned by trust companies, credit unions, or other near-banks. Nevertheless, it is clear that in this process, while chartered bank deposits are unchanged, the deposits of near-banks have risen.

The rapid growth of deposits in near-banks, whatever the source, has, in fact, meant that in spite of the growth of the chartered banking system its share of the total supply of deposit currency has become smaller. Should this trend continue at the present rate, Canada may in time approach the stage which a noted British financial expert foresees for the U. K. where, on some still distant day, credit created by near-banks may displace ordinary bank deposits, just as over the last century bank deposits have displaced banknotes as the principal part of the money supply. Under these conditions chartered bank deposits in Canada would, like their U. K. counterparts (clearing bank deposits) "become the small change of the monetary system!"

Banks Must Meet the Challenge

Under these conditions, too, the implications for chartered-bank lending operations would be at

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Canada's Economic Outlook

By Marvin W. Farrell,* *Manager, Economic Research Department, The Steel Company of Canada, Ltd., Hamilton, Canada*

Canadian economy is viewed as having solid strength despite its present period of slowed economic growth. Mr. Farrell sees recovery in 1961 as directly dependent on recovery here in the U. S. and in Western Europe and, therefore, he describes the short run prospect as moderately strong with greater strength reserved for the longer run future. Canada's underlying problem is depicted as the two-fold need for improved exports and new funds for the expansion-modernization of medium-sized firms. The economist calls attention to the feeling in Canada that it is being closed out of ECM and EFTA without improved entry to our markets, and caution that the deployment of domestic savings to replace corporate borrowing from abroad may merely shift the problem of capital inflow to mortgage and government bonds.

Introduction

In discussing the business and financial prospects for Canada, I suffer from the disadvantage of being so close to the crossflows of Canadian affairs that some of the happenings may not be as clear to me as to the discerning outside observer. I propose to consider the subject under the three headings: the general setting of Canadian development; some particular problems in the short-term outlook; and finally some major issues in the longer run Canadian prospects.

M. W. Farrell

The General Setting of Canada's Economic Development

The main objective of Canadian economic development is to encourage the use of our national resources and to employ a growing labor force at a high and rising standard of living.

This has not been a simple or easy matter. The distribution of national resources has not been as broad or as rich as in the United States, though in forest products, metals and natural gas, and in certain farm products our advantages are substantial in the markets of the world.

To develop as an industrial nation we have to import many industrial materials, much machinery, and technologies. Where our resources are rich, and when we have ready access to world markets, the efficient industries—primarily in the processing of natural resource products—can establish units for very large markets, and gain the full advantage of large scale volumes. Where our industries are oriented to the domestic market, and are relatively lightly exposed to the competition of imports, they must develop their efficiency in smaller units for the small domestic market. Finally where our industries must share the market with a substantial or rising flow of direct import competition, the disadvantage of the small market may be almost overwhelming.

Although Canada covers a great area on the map — greater than continental United States I believe —the population and the present size of markets are small by comparison. There are about 18 million people compared with 182 million in the United States, while the comparison of Gross National Product is 36 billions annually in Canada to around 505 billion in United States.

The government and peoples of Canada have made ambitious efforts to encourage rapid development of resources. At the end of 1945 the Canadian population was barely 12 million people. Through a concerted immigration program which brought two million arrivals in 1946-60, the population and the labor force have increased sharply, particularly in the younger age brackets. As long as employment was expanding the fast growing population was easily absorbed into jobs. The population growth has been so rapid that the nation needs a fast expansion of industry and employment to keep unemployment down to acceptably low levels.

Industrial Output Outraces Savings' Pace

In recent years the pace of industrial expansion has been at a much faster rate than the generation of savings in Canada. Capital investment during the 1950s at annual levels between 22 to 27% of the G.N.P. has been far beyond the combination of personal savings and corporate earnings. To finance the national growth there have been heavy borrowings by the sale of bonds in the United States by all levels of government. There has been relatively little corporate borrowing in the United States, but there has been a great deal of American direct investment in Canadian enterprises, plus many new ventures initiated, owned and financed from the United States. Foreign investment in Canada is now around $18.5 billion—most of it American. This is over half of the value of the G.N.P. in our highest year, 1960.

Canada can be thankful, in many respects, that so many resources came into productive development in recent years. Some of the more obvious cases are an iron-ore industry in Quebec-Labrador, a petroleum and natural gas industry in the four Western provinces, nickel in Manitoba, uranium, new aluminum smelters, railways to serve the mines, new pulp and newsprint mills, and a greatly expanded variety and capacity in manufacturing and construction.

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Published Twice Weekly
The COMMERCIAL and FINANCIAL CHRONICLE
Reg. U. S. Patent Office
WILLIAM B. DANA COMPANY, Publishers
25 Park Place, New York 7, N. Y.
REctor 2-9570 to 9576
CLAUDE D. SEIBERT, President
WILLIAM DANA SEIBERT, Treasurer
GEORGE J. MORRISSEY, Editor
Thursday, July 13, 1961
Every Thursday (general news and advertising issue) and every Monday (complete statistical issue — market quotation records, corporation news, bank clearings, state and city news, etc.)
Other Office: 135 South La Salle St., Chicago 3, Ill. (Telephone STate 2-0613).

Reentered as second-class matter February 25, 1942, at the post office at New York, N. Y., under the Act of March 8, 1879.
Subscription Rates
Subscriptions in United States, U. S. Possessions, Territories and Members of Pan-American Union, $65.00 per year; in Dominion of Canada, $68.00 per year; Other Countries, $72.00 per year.
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Bankers Bond Corp. Ltd.
Toronto

DESROCHERS, PIERRE*
Lagueux & DesRochers Ltee.
Quebec

DLOUHY, DOMINIK*
La Maison Bienvenu Ltee.
Montreal

DORAN, E. J.*
Royal Securities Corp. Ltd.
Calgary

DUGGAN, ERIC M.*
D. M. Duggan Investments Ltd.
Edmonton

DUNCAN, T. A. W.*
Annett & Co. Ltd.
Toronto

DUNLOP, W. S.*
Oldfield, Kirby & Gardner Ltd.
Winnipeg

DUNSTAN, J. R.*
James Richardson & Sons
Prince Albert

EBBELS W. D.*
Houston, Willoughby & Co. Ltd.
Regina

EDWARDS, J. C.*
Matthews & Co. Ltd.
Toronto

ERTL, EDWARD C.
The Financial Times
Montreal

FARRILL, F. B.*
Greenshields Inc.
Toronto

GARRETT, W. LLOYD*
La Maison Bienvenu Ltee.
Montreal

GASSARD, H. L.*
Investment Dealers' Association
Toronto

GOLDRING, WARREN*
Fry & Co. Ltd.
Toronto

GOUINLOCK, R. W. JR.*
Bell, Gouinlock & Co. Ltd.
Toronto

GRAHAM, JOHN JR.*
Bell, Gouinlock & Co. Ltd.
Winnipeg

GRAHAM, R. C.*
Osler, Hammond & Nanton Ltd.
Winnipeg

GRAY, H. A.*
James Richardson & Sons
Winnipeg

GRAY, W. S.*
Doherty Roadhouse & Co.
Calgary

GREEY, J. G.*
Wood, Gundy & Company Limited
Toronto

GREGG, Arthur E.*
McLeod, Young, Weir & Company Limited
Edmonton

GRIFFIN, F. E.*
Greenshields Inc.
Montreal

GRILLS, R. M.*
McLeod, Young, Weir & Co. Ltd.
Montreal

GUNDY, C. L.
Wood, Gundy & Co. Ltd.
Toronto

HADLEY F.*
Nesbitt, Thomson & Co. Ltd.
Vancouver

HANSON, MURRAY
Investment Bankers Association of America
Washington

HANSON, TELFER R.*
Hanson, Richardson & Co. Ltd.
Toronto

HARVEY, D. R. C.*
Daly, Harvey & Cooper
Toronto

HERMAN, H. G.*
A. E. Ames & Co. Ltd.
Calgary

HILBORN, ROSS*
McLeod, Young, Weir & Co. Ltd.
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HILL, J. EDGAR
Royal Securities Corp. Ltd.
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HILL, W. F.*
Annett & Co. Ltd.
Toronto

HINMAN, HON. E. W.
Provincial Treasurer, Alberta
Edmonton

HODGINS, A. F.*
Osler, Hammond & Nanton Ltd.
Calgary

HOLTBY, P. N.*
Doherty Roadhouse & Co.
Toronto

*Denotes Mr. and Mrs.

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Mr. & Mrs. Ian Matheson, *Dominion Securities Corporation, Limited,* Montreal

Harry Gassard, *Investment Dealers Association of Canada, Toronto;* Mr. & Mrs. Eric Morse, *W. C. Pitfield & Company, Limited, Montreal*

Mr. & Mrs. Arthur J. Ackerman, *Bache & Co.,* Toronto; Eric Morse, *W. C. Pitfield & Company, Limited,* Montreal; Mr. & Mrs. Chet Burley, *Bache & Co.,* New York

Canada's Economic Problems Are Readily Solvable

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manageable bounds. Self-correcting forces are already at work. Accompanying the decline in our merchandise trade deficit there was a marked drop in capital inflow last year. The downward trend has continued through the first quarter of 1961 when net inflow on capital from transactions of portfolio securities was less than half of the figure a year earlier.

There has emerged a significant decline in the relative importance of investment. Since 1957, which was the all-time high of capital investment, total business and government capital outlays have accounted for a diminishing share of the national output. The official estimate of capital expenditures for 1961 is $8.3 billion, compared with $8.7 billion in 1957. The heavy investment program in recent years has resulted in substantial surplus productive capacity in many industries. For example, in the past five years capacity in the cement industry has been increased by 90%; capacity for petroleum refining is up by 50%; primary aluminum is up 33%; newsprint is up by 25%. Marked increases have also occurred in iron ore, utilities, steel, chemicals and others.

Productivity Lagging

Unfortunately, the $25 billion investment of business capital over the past five years has not resulted in the economic benefits that might have been expected. Regardless of the great increase in productive capacity, our rate of output has slowed down. Furthermore, per man-hour output has shown a declining rate of increase and is lagging behind that in Europe, even although we have had the greatest relative capital investment program in the Free World.

This cannot continue if we are to maintain our competitive position in world markets—this accentuates the urgency of the need for labor and management together to face up to the seriousness of the problem.

I am not implying that there will be a significant decline in our new capital requirements. Rather, it seems likely that the pattern may be changed. Since we have built more productive capacity than we can use, at least for the present, investment in the business sector may be expected to decline. Profit margins have fallen and the rate of return on both sales and invested capital has been falling for some time. The Canadian Manufacturers' Association reports that profits as a percentage of sales in Canada's manufacturing industry last year were the lowest recorded in the 13 years during which the Association has conducted its annual survey.

Emphasis on "Social Capital"

Relatively greater emphasis is already being placed on "social capital." In short, capital requirements of governments at all levels will continue to expand and to occupy a relatively larger sector of the investment program. The trend is already apparent. In 1957 business investment accounted for 65% of the total leaving housing and social capital at 35%. This year the official estimate is 55% for business and 45% for housing and social capital. Conceivably government investment could outstrip business investment in the foreseeable future, because the spade work of expanding our productive capacity has been done, at least for the present.

Assuming future overall capital requirements in excess of $8 billion a year, I now turn to the problem of the source of funds. It is abundantly clear that we Canadians have been unable (or unwilling) to generate the savings necessary to meet our capital requirements. Last year our total domestic capital formation was about $7 billion, leaving a shortage of over $1 billion that had to be imported.

We are fully aware of the sharp debate over the pros and cons of our international balance of payments position, and the allegation that Canadians have been living beyond their means. During my term of office I have tried to make some contribution to this issue. When I assumed office a year ago, I felt that domestic savings were a key issue. In a number of addresses across the nation I tried to make the point that the savings habits of Canadians are more or less comparable to those of other industrialized countries. Over a period of 35 years Canadians have saved roughly an average of 7% of their net disposable income. An examination of the trend, however, reveals that we are really "living it up." Since 1926 our income has gone up sixfold—our savings on the other hand have only quadrupled. From this you will see a wide gap.

More Foreign Capital Needed

Our industry has a real challenge in the form of promoting personal savings and channeling them into sound investments. There is a substantial personal savings potential that could be tapped. The better the job we do, the less dependent we will be

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on foreign capital. But it will not be easy.

Canadians, unlike their forebearers, seem to be increasingly prone to spend rather than to save. Thrift seems to have become outmoded. Perhaps the welfare state has conditioned our spending habits. At any rate, we are now spending income before it is even earned. The prevailing merchandising philosophy of "no down payment" and "go now — pay later" and live on your credit cards has, in my opinion, dangerous economic implications.

I have indicated earlier that we are not able to generate adequate savings to meet all of our capital requirements. It seems apparent that we shall continue to require further amounts of foreign capital particularly for the development of our larger projects.

In the last three years net new issues of Federal provincial, municipal and corporate securities have averaged $2.4 billion a year. Net personal savings averaged $1.6 billion in the same period. But the gap could be narrowed under favorable conditions. As I see it, our major job is educational. Important strides have been made in our education program—but it should be intensified and expanded by individual member firms. There are hundreds of thousands of potential investors in Canada who are not investing either because of ignorance about securities or pure apathy. Although their resources may be small, in the aggregate their investment could be substantial. If they could be taught to plan a systematic and continuing saving and investment program, it should help materially to boost our domestic savings—thereby lessening our dependance on foreign funds. Broadening our distribution of securities would not, of course, be in conflict with our own self-interest.

More than $7 billion are on deposit in Canadian chartered banks in the form of personal savings accounts. Most of them are small and not a likely source of investment capital. But there are something like 80,000 of these accounts amounting to $10,000 and upwards. It should be possible to channel some of this capital into high-grade portfolio securities.

I feel that that the opportunity for considerable success in this venture is good. There are many signs that we are now experiencing another upturn in our economy. Housing starts in the first four months of this year were 47% ahead of the same period of 1960. The overall construction outlook is good. Labor income has continued to increase and the employment situation has improved considerably. Exports remain strong although domestic retail sales are not yet demonstrating any marked revival. I do not, however, anticipate a major boom. This recovery will probably be gradual and more moderate than the situation in the roaring '50s. Public confidence appears strong, if the stock market is any indication of how people are thinking. My point is that in reviving economy it should be possible to accomplish a considerably broader investment base.

Much has been said in recent months about foreign investment in Canada. December's Baby Budget was apparently designed, at least in part, to discourage borrowing outside Canada. It is to be hoped that the government will do nothing further to discourage the capital inflow that is so vital to our future development. Time alone will tell whether or not we have, to any degree, already damaged our financial relations with foreign investors. If Canada ever gets the reputation of changing the rules after the game has started, the consequences could be very grave indeed.

Deplores Deficit Financing

In respect to savings, I doubt if the Federal Government is providing the financial leadership required. We, as individuals, are being exhorted officially to live within our means, while at the same time the government pursues a continuing program of deficit financing. Instead of the forecast surplus in the fiscal year 1960-61, there appears to be a deficit of some $300 million. It is the considered opinion of discerning financial people that the budgetary deficit this year will be not less than $700 million. Indeed, the cash deficit could well be as much as $1 billion.

Such massive Federal deficits have a most unfortunate impact on our capital market. The huge requirements of the Federal Government for new capital must inevitably force some other Canadian borrowers into foreign capital markets, a situation which the government has been trying to curtail by other means. This is not the only factor involved. Massive deficit financing is inflationary. It tends to cause apprehension and weaken investor confidence in the Canadian economy. Finally, it disrupts the market place as evidenced by sharply fluctuating bond prices during this era of deficit financing.

In conclusion, I can only express the sincere hope that the government will endeavor to put its own house in order so that there will be real leadership to encourage all Canadians to increase and build their savings with confidence—and we Investment Dealers can get on with our job of directing these savings toward efficient and effective use.

*An address by Mr. Morse before the Annual Meeting of the Investment Dealers' Association of Canada, Jasper, Alberta, June 23, 1961.

Mr. & Mrs. J. Ross Oborne, *Nesbitt, Thomson and Company, Limited, Montreal;* G. Reg. Howard, *F. J. Brennan & Company, Limited, St. John;* Mr. & Mrs. John Penny, *Royal Securities Corporation, Toronto*

Mr. & Mrs. J. P. W. Ostiguy, *Morgan, Ostiguy & Hudon, Ltd., Montreal;* Mr. & Mrs. Lionel J. Crevier, *Morgan, Ostiguy & Hudon, Ltd., Montreal;* Mr. & Mrs. Paul H. Brault, *Brault & Chaput, Montreal*

The Columbia River Project

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the case of hydro there are large capital costs for generation and transmission but there are no fuel costs. Nuclear power also has high capital costs although the transmission cost is low as the plants can usually be located close to the load center. There is a fuel cost in the case of nuclear power but it is low—we hope it will not be more than one mill per kwh. Thermal power — generated from coal, oil or gas — has a much lower capital cost for the installations than either hydro or nuclear plants. The transmission cost is low for the same reason as in nuclear plants but there is a fairly large item for fuel cost. Thermal plants have recently been deriving a cost advantage also from the gradual increase in efficiency of the boilers and from the current surplus of various fuels. At the same time hydro and nuclear projects are being handicapped by the increasing interest rates on their large capital expenditures. The net result is that hydro and thermal units are now more or less competitive on a cost basis and within 10 years all three hydro, thermal and nuclear should in many areas—including British Columbia—be competitive sources for electric power. In Vancouver the B. C. Electric Co. is currently building a 900,000 kw steam turbine plant burning gas from the Peace River which will be competitive with many of our potential hydro sources.

It is worthwhile pointing out that only very large units — 200,000-400,000 kw or even more— of hydro, nuclear or thermal installations give low cost power. This underlines the necessity for a grid or network so that the province can absorb large increments of power when they are developed. There are other important economic reasons for developing a provincial grid. These include the variation in time for the run-off of our rivers, the need for standby service to provide for failures of generators or transmission lines, variations in peak loads and in general the possibility of smoothing out seasonal surpluses and deficiences.

Hydro Potential Enormous

The hydro-electric potential of B. C. is enormous. There are many sources — The Columbia, Peace, Fraser, Homathko, Clearwater, and the rivers farther north such as the Liard, Nass and Yukon. It is estimated that the total potential may be of the order of 30 million kw. of which at the present time we have developed about 10%. Improvements in high tension transmission will make all this power available at load centers in Southern B. C. or the U. S. A. At the present time it is proposed to effect economies in the transmission of power from the Peace River by using 500,000 to 600,000 volts on the lines. Even higher voltages may be used in the future and no doubt direct current transmission will eventually be possible.

We have far more hydro-electric power potential than we can use in B. C. for the next 30 years. In the case of other commodities we would immediately think of sharing our surplus with our neighbors or exporting it to a foreign market. There are really no arguments against exporting surplus power, provided one can find a market for it. It is a renewable resource which we cannot store and which is wasted if it is not used. In fact we are exporting it now to the Arctic and Pacific Oceans but we do not get paid for it. One can present far better arguments against the export of oil or gas. These are irreplaceable resources which some day will be the raw materials for valuable petro - chemical products. Water flowing in a river can produce only power and, furthermore, it can do this without using any of the water. There is nothing mysterious or unique about electrical energy produced from water power. It is exactly the same as electrical energy produced from oil, gas or uranium.

Personally I feel that to waste the energy of our rivers by prohibiting the export of hydro-electric power is economic folly. I would go even further and say it is morally wrong to waste the energy from water power and at the same time produce our energy by burning up valuable raw materials which we can never replace. I am a conservationist who feels some obligation to conserve our irreplaceable resources so that future generations of Canadians may have some of the necessities of life.

Cites Norway's Position

B. C. is in something the same position as Norway—we both have small populations and abundant unused resources of hydro-power. Here is what Trygve Lie, the Chairman of Norway's Energy Board, has to say about the export of power:

"I now come to the crux of what I want to say. Norway is developing its waterpower faster than ever before, but even at the present rate we shall not have harnessed all the economically exploitable waterpower until about the year 2000. Waterpower is our asset that should be exploited as quickly as possible, chiefly because of technical progress in the nuclear power field, but also because it is a pity to see water run into the sea unused when it could be made to yield power and help production and employment. Probably Norway's own economic resources do not permit a faster rate of hydro-electric development than the present rate. But it is perfectly conceivable that foreign capital could be secured in return for power from the new hydro-electric stations thus built. No country in Western Europe has such large water power resources as Norway. With only 1% of the OEEC countries' total population, Norway has 20% of these countries' total waterpower resources. These are remarkable figures and show that Norway could have quite a future as an exporter of power."

Most of the countries of continental Europe have large scale

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electrical interconnections for the import and export of electric power. Great Britain and France are just completing a submarine cable at a cost of $15 million for this purpose. For the first five years Great Britain expects to import power and then when she has completed proposed new atomic plants with pumped storage she expects to reverse the flow and export power to the Continent over this cable.

Yugoslavia is developing all her hydro-electric power sources as rapidly as possible and arranging to pay off the cost of the developments by selling power to her neighbors. She now has five international electrical interconnections and is negotiating for three more. The countries include Austria, Italy, Greece, Hungary, Germany and Switzerland. Southern Rhodesia has recently completed large hydro-electric installations and has made long-term contracts to export to the Congo.

Roadblocks in B. C.

In British Columbia we are handicapped in the development of our hydro resources by the Electricity and Fluids Exportation Act of 1907 which limits any exports to a yearly contract and also imposes a 0.3 mill export tax. Anyone familiar with the development of electrical energy knows that energy cannot be exported on a year to year basis. It takes four to five years to design and build a power plant and thus no community could accept a supply of power that might be interrupted on 12 months' notice. The 0.3 mill export tax is also an almost insurmountable handicap and so far as I know, Canada does not put an export tax on any other commodity. Some seem to argue that since this Act has been on the books for 54 years, it should not be changed. However, in 1955 it was repealed for oil and gas so that Westcoast Transmission's application could be considered by the Federal Power Commission.

It is argued that difficulties were encountered during World War I when a power company in Ontario was selling power to a company in N. Y. State and the Canadian Government wished to terminate the contract. The main difficulty at that time was that the export was by the privately owned Ontario Power Co.—owned largely by United States interests —to privately owned U. S. A. companies in N. Y. State. The Ontario Power Co. itself did not wish to terminate its profitable export contract and claimed that other privately owned utilities in Ontario and Quebec should reduce their exports instead. Conditions today are entirely different from 1917. At that time there was no thermal power at competitive prices and atomic power was not even a dream of the physicists. In B. C. we are concerned lest a controversy that took place over 40 years ago, under entirely different conditions from those of today, should restrict our industrial development. We wish to look towards the future rather than the past.

So far as I have been able to determine, there is no parallel any place in the world, where any nation has declined to take advantage of an opportunity to export a surplus of hydro-electric energy. Surely if France and Germany or Yugoslavia and its neighbors, Hungary and Italy can make arrangements to export surplus hydro-electric power, two such friendly nations as Canada and the U. S. A. should be able to make a satisfactory agreement to do it. Unfortunately with the possible exception of thermal power from Alberta and some hydro power from Manitoba there is no other Province in Canada with a large exportable surplus of power close to a good market. Ontario with her hydro-electric sites nearly fully developed must either import coal from the United States for her new thermal plants or develop atomic power. The export of hydro-electric power must come sooner or later and with our current difficult unemployment situation and the problem of increasing our world-trade surely the time is now.

Not a Political Issue

In British Columbia this question of the development of one of our most valuable natural resources is of too vital importance to become a political issue. Neither should it be approached in an emotional nor anti-American attitude. It seems logical to suggest that the export of electric power be permitted without export tax, and that the National Energy Board be asked to use its present powers to determine that the amounts proposed are really surplus for the locations and periods suggested. This might enable B. C. to sell, not waste its tremendous surplus. I say might here because hydro-electric power like any other export commodity must meet the competition in price. The export price would have to be sufficient to warrant the investment. To those who maintain that term contracts for recapturable power cannot be enforced I should like to point out that if this is true then the Columbia River Treaty may be invalid for it not only provides for the export of Canada's share of downstream benefits but it also provides for a gradual reduction of these power benefits to which Canada is entitled. When Mica Creek storage is completed in 1970 these benefits amount to 1,310,000 kw capacity. From 1982 on this amount decreases at a uniform rate to 212,000 kw. in year 2010. The Treaty thus provides for the U. S. to recapture power delivered to Canada after many years.

Unfortunately, due to our ban on the hydro power export we have probably already lost a good part of the market in the Pacific Northwest for Canadian power. As an example, the plutonium plant at Hanford will probably be authorized and will be supplying up to 800,000 kw. to this market during the next 10 years. However, there does appear to be a market for electrical energy in California to replace oil and gas now being

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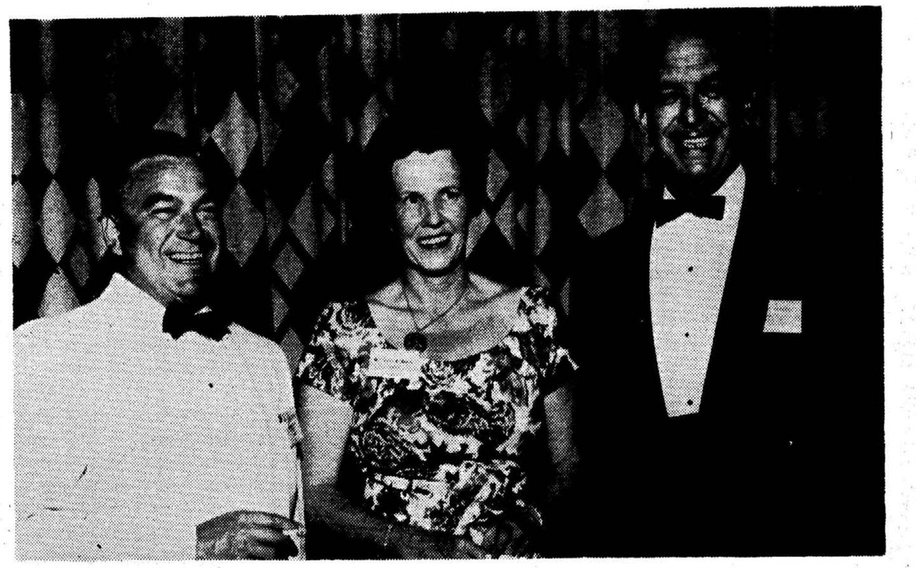
Mr. & Mrs. Allan Turney, *Locke, Gray & Company, Limited, Calgary;* Mr. & Mrs. George E. B. Ormonde, *Thomson & McKinnon, Toronto*



Mr. & Mrs. Telfer Hanson, *Hanson, Richardson & Co., Ltd., Toronto;* Jack Barker, *Thomas B. Read Company, Ltd., Vancouver*

The Columbia River Project

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burned to produce electric power. I should add that some of this gas is from B. C., sold to the Pacific Gas and Electric Co. at a floor price of approximately 22 cents per 1,000 cf. whereas the corresponding wholesale floor price in Vancouver is 32 cents. The California market for electrical energy should be an expanding and a profitable one. The annual load increment in this one state is over one million kw. per year, which is about half of B. C.'s present total installation for domestic and industrial use other than the two large electro-chemical and metallurgical plants.

Economic Benefits

As Trygve Lie has pointed out for Norway, there are sound economic arguments for getting our hydro-electric plants in B. C. installed and amortized before A. E. becomes too competitive. The building of these plants would be the most certain and direct way to ensure the future prosperity of B. C. We would produce an immediate improvement in employment and business activity with the commencement of construction and when the plants were amortized B. C. would have low-cost power to stimulate industrial activity. We might be able to sell to the U. S. at the beginning about $25 million worth of energy per year and by the end of 20 years this annual revenue could reach $200 million. This amount would be comparable with our total forest products exports to the U. S. A. and would greatly improve our balance of payments with the U. S. A. I would suggest that in accordance with the provisions of the Treaty we should make arrangements immediately to sell all or part of our downstream benefits at least until our market can absorb this energy, which will be at least three and probably seven years. I visualize that eventually we might build in B. C. thermal plants, using our abundant supplies of coal, oil or gas, and transmit the power to California over the lines used for hydro power. We might even build nuclear plants for the export of power. It would surely be to the advantage of Canada to process and up-grade these raw materials —coal, gas, oil and uranium— B. C. and export the electricity rather than to export the raw materials.

I do not propose to discuss the pros and cons of the Columbia River Treaty. As Chairman of the B. C. Energy Board I expect to have to live with this treaty. It might be easy to criticize some of its provisions but then one must bear in mind that this is a bilateral agreement and neither side obtained everything it wanted.

One could spend a good deal of time comparing the two projects —the Peace and the Columbia. Whatever happens I think Canada is indebted to the Peace River Power Development Co. and the Government of B. C. for speeding up the negotiations on the Columbia. In fact they were speeded up to such an extent that the treaty finally got ahead of the engineering. Both the Peace and Columbia appear to be feasible and both will give power which will be low-cost compared with power in most parts of the world. One can argue that developing the Peace would help open up the north country and that this would be a good thing for B. C. as its population at present is too concentrated in the southwest corner of the Province. There are also good arguments in favor of proceeding with the Columbia.

The downstream benefits have been greatly over-rated. Most people seem to think that since we appear to be getting something for nothing from the Americans we should grab for them. The idea that these benefits are free has influenced our thinking and affected our judgment. They can hardly be free when we have to spend $450 million to get them. Actually, the amount of energy involved and the cost when delivered in Vancouver will be such as to produce very little effect upon B. C. light bills. It has been estimated that at best it may mean 15 cents per month to the average householder.

Fundamental Differences Between U. S. and Canada

Canada has signed the Columbia River Treaty and the U. S. has both signed and ratified it. The Treaty will become effective when Canada ratifies it. Some quite sincere but uninformed persons wonder why B. C. has not already given its approval for ratification. Aside altogether from the difficult financial arrangements which have to be completed between Victoria and Ottawa there are important fundamental differences between the Canadian and the U. S. position. In the first place there are no penalty clauses applicable to the U. S. whereas Canada must complete the various storage basins within the schedule laid down in the Treaty or incur penalties up to $237,400 per month. Furthermore, the U. S. has a total new expenditure of approximately $90 million whereas Canada and/or B. C. must spend $450 million on the first phase of the Columbia development. Although $90 million may be a mere pittance for the U. S., $450 million in comparison represents a gigantic undertaking for Canada. There is also the marketing problem. When the first unit is completed the U. S. has an assured market for the resultant power, whereas in the early stages we in B. C. cannot absorb our share of the benefits.

The B. C. Energy Board has been asked to evaluate the feasibility of the two projects—Columbia and Peace—and to determine the cost of power from each in the Vancouver area. We have also been asked to see what might be done to phase the two projects. The feasibility of either project could be greatly improved by assurance that surplus power could be exported. We might for a period of years sell all our downstream benefits from the Columbia. This would defer the heavy capital cost of a long transmission line from Oliver to Vancouver and would make unnecessary the payment to the U. S. of nearly $2 million per year for a standby transmission service as required by the Treaty.

The Energy Board's report will be submitted in August, about six months after the signing of the Treaty. This does not seem to be an unreasonable time for an examination of the financial and engineering aspects of one of the largest single undertakings ever contemplated in Canada. It would not be prudent to be committed to an expenditure of this magnitude without first making certain that the project was economically sound. In any case, there is no necessity for a crash program as

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B. C. has no market for any downstream benefits before 1965 at the earliest. Further, a short delay in the ratification date gives time to complete the preliminary engineering studies and thus improves our position in respect to the penalty clauses as they all date from the time of ratification of the Treaty by both countries.

There is little doubt but that B. C. will be going ahead with one if not both of these projects. Either one is the largest single hydro - electric development ever attempted at one time in any part of the world. The total cost of the Columbia project will be close to $1.5 billion dollars whereas the Peace will be about $1 billion. These are massive and unparalleled undertakings for any nation, let alone 1.6 million people of one Province. They will ensure employment and industrial activity in B. C. for the next 20 years and prosperity for many decades to come.

In contemplating these gigantic projects I sometimes think that we British Columbians must be the most optimistic, imaginative and courageous people in the world today.

*An address by Mr. Shrum before the Annual Meeting of the Investment Dealers' Association of Canada, Jasper, Alberta, June 23, 1961.

Some Built-in Defects in Canada's Financial System

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least equally severe. But I would like to say most emphatically at this point that resisting this trend in loans and deposits is primarily a problem for the banks themselves. They must show imagination and initiative if they are to avoid what must be for bankers a fate worse than death: viz., to become mere repositories for savings used as a source of funds for schemes proposed by Ottawa and supported by government guarantees.

I know that the banks are able to meet the long-run challenge; and I shall not therefore dwell at any greater length on the sad state of affairs which, in an admittedly extreme view, might appear from present trends to face them over the next century or so. Instead, I shall concentrate on an immediate danger, not to the chartered banks as such but to the very existence of an effective Canadian monetary policy.

Under the present system, as deposit-currency in near-banks grows relative to chartered-bank deposits, monetary policy, directed at chartered-bank deposits only, has to become progressively more vigorous to bring about a given expansion or contraction of total money expenditure.

When monetary policy is restrictive, to combat an inflationary trend, it results in heavy pressure on the banks which is not shared by deposit-receiving institutions outside the direct control of the central bank. In other words, under these conditions, the chartered banks have to restrict loans and deposits at a time when the near-banks can continue the process of loan and deposit expansion.

Conversely, when monetary policy is expansive, a given increase in total credit can be achieved only through a greater increase in chartered-bank cash than would otherwise be called for. Like the former case, this too has an arbitrary and distorting effect on the market for credit. The effect on the efficiency of central-bank policy is exactly the same. A larger volume of central-bank open-market operations is needed to achieve a given result, and the risk of undesirable side effects in the bond market is correspondingly increased.

Efficiency of Monetary Policy Impaired

The greater the effort the central bank must put forth to achieve a given change in money expenditure, the less efficient monetary policy becomes. Thus the relative distortion, either up or down, of chartered-bank vs. near-bank loans and deposits is reflected directly in reduced efficiency of the central bank's control over total money expenditure.

This wholly unnecessary reduction in the efficiency of monetary policy is further compounded by the built-in rigidity imposed on the chartered banks by Section 91 of the Bank Act. The operative part of this section reads as follows:

". . . no bank shall in respect of any loan or advance payable in Canada stipulate for, charge, take, reserve or exact any rate of interest or any rate of discount exceeding 6% per annum and no higher rate of interest or rate of discount is recoverable by the bank."

The 6% ceiling thus imposed on chartered bank loan rates of interest has two main effects on the banks, both of which reduce the efficiency of monetary policy.

First, it prevents the banks, alone among financial institutions, public or private, from charging rates consonant with market conditions when the general level of

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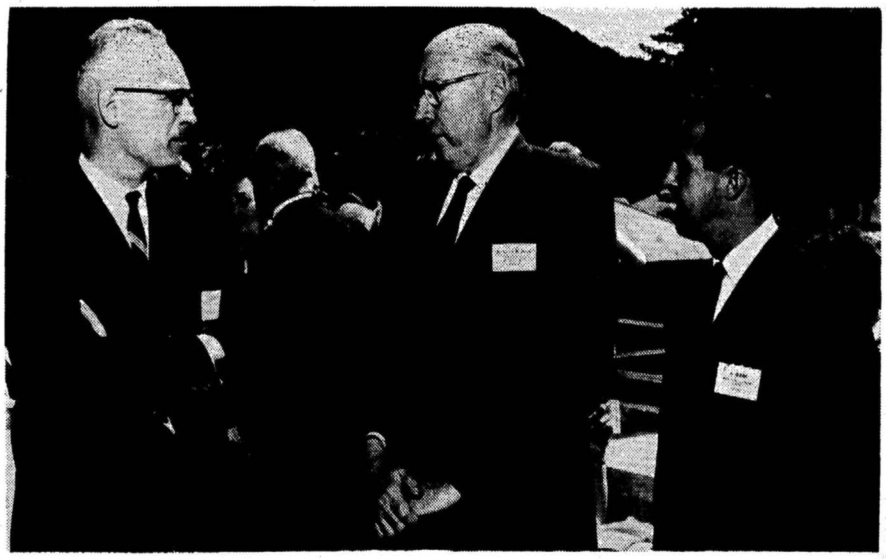

J. G. Greey, *Wood, Gundy & Company, Ltd.*, Toronto; Dr. Gordon M. Shrum, *Chairman of British Columbia Energy Board, University of British Columbia*, Vancouver; G. Clark, *Wood, Gundy & Company, Limited*, Calgary

Eric Morse, *W. C. Pitfield & Company Limited*, Montreal, *President of Investment Dealers Association of Canada*; George A. Newton, *G. H. Walker & Co.*, St. Louis, Mo., *President of Investment Bankers Association of America*

Some Built-in Defects in Canada's Financial System

Continued from page 13

interest rates (and lenders' costs) is high; *second*, and equally if not more important, it prevents the bank from paying higher interest rates on savings deposits when indicated by conditions in the market for credit.

Thus, the ceiling tends still further to reduce the chartered banks' share of total deposits in the economy and serves still further, therefore, to remove our official definition of the money supply from the world of economic reality. In other words, as in the previous case, it tends to reduce the relative importance of that part of the total supply of credit, namely chartered-bank deposits, which the central bank has the legal power to control and thereby correspondingly reduces the efficiency of monetary policy.

All this is bad enough, but the rigid ceiling on chartered-bank interest rates also decreases the efficiency of monetary policy in an even more direct fashion.

First, when maximum lending rates are held below the market rate—this was the case in 1959—it obliges the banks to resort to the necessarily clumsy, and highly unpopular, device of arbitrary credit rationing; *second*, it prevents the banks from implementing, as efficiently as they otherwise could, the stated or implied policy of the Bank of Canada.

With the ceiling, in periods of tight money, banks can restrain borrowers only through arbitrary rationing forced by the overall restriction of the money supply; they are not allowed to raise, consistent with market conditions, the *price* of bank credit and thereby secure an efficient, fair and economic distribution among all classes of borrowers of the scarce supply available; nor are they able to use price, in the form of higher interest paid on savings deposits, to combat one of the real causes of inflationary pressure—lack of savings.

How to Correct the Problem

Now I come to the really important point: what should we do to correct these built-in defects in our financial system?

Let me begin with a statement of broad principle.

I believe that any measures taken to ensure the full and effective functioning of the market for credit and to improve the efficiency of monetary policy should follow the principle that any extension of regulation should be held to a minimum, and, where possible, that regulation should actually be reduced.

I have two proposals to make, both of which have been devised with this principle fully in mind. I advance them with all due deference, in the hope that they may become a basis for further discussion and early action in these important matters.

My first proposal is that we increase the efficiency of monetary policy by broadening the monetary base on which that policy operates, to include as part of the money supply deposits in credit unions, caisses populaires, trust companies, finance companies and any other near-banks. This means that these institutions, like the chartered banks, would have to maintain reserves subject to control by the Bank of Canada.

I can provide no single reserve scheme which I could say with confidence is the best. Further study is required before a wise selection can be made. Quite frankly, I do not know, for example, whether reserves should be held against near-bank deposits or whether, because of the peculiar nature of some of these near-banks, reserves should be held not against deposits but against the total of near-bank loans. Or, it may be that the reserves should be a combination of the two; that is, they should be applied against both deposits and loans under some formula, or even against deposits for one type of near-bank and against loans for another type.

There is, too, the very important question: what form should near-bank reserves take? Here again further study is needed. I do not know whether these reserves should be in the form of government of Canada obligations placed with some depository such as the central bank, or whether they should take the form of minimum deposits with the chartered banks.

Let me hasten to add that this last suggestion is not made for any selfish reason. I explained earlier that the increase in near-bank deposits does not reduce overall chartered bank deposits. Likewise, calling for near-banks to maintain special reserves with the chartered banks only changes the ownership of the deposits but does not increase the overall total of deposits in the chartered banking system.

Flexible Reserves

Whatever form the reserves take, the Bank of Canada will not be able to control them directly by open-market operations as it can the cash reserves of the chartered banks. Control by the Bank of Canada would, therefore, have to operate by raising or lowering the reserve percentage which near-banks would be required to keep against their loans or deposit liabilities. These changes in near-bank reserve requirements could then be co-ordinated with our present system of open-market operations, which is designed to affect the reserve position of the chartered banks.

In this way the impact of any future credit squeeze would be spread over all deposit-receiving and lending institutions and not confined, as it is today, to the chartered banks alone; and the same would be true of any future policy of credit expansion by the monetary authorities. As a result, there would be no distortion, favorable or unfavorable to the chartered banks or to other deposit-receiving institutions, in the market for credit. At the same time, the broader impact of monetary policy would have the effect of greatly increasing its efficiency; smaller operations would be required to effect any given expansion or contraction of the total supply of credit, and undesirable side effects in the bond market would be correspondingly reduced.

My second proposal is, in line with sound principle, simply to reduce the total amount of regulation in the economy by amending, at the next revision of the Bank Act in 1964, Section 91 of that Act which, as I have pointed out, provides that chartered banks may not charge more than 6% on loans.

I would suggest that, if the ceiling is retained at all, it should be made flexible. It could, for example, be set at the present rate of 6% or at a rate of, say, some appropriate number of points above bank rate, whichever is higher. (For this purpose I may remark, parenthetically, our present floating bank rate would be ideal because of the way it reflects the market. However, we would still be without any signal, by bank rate or otherwise, indicating the central bank's intentions in monetary policy).

No ceiling preferably, or a flexible ceiling such as I have described, would greatly increase the efficiency and flexibility of monetary policy by enabling the chartered banks, at long last, to reflect, as the near-banks have always been able to do, both in their loan rates and in the rates of interest they pay on savings and other time deposits, any general tightness or relative ease in the money supply that may at any time be dictated by events and imposed by the Bank of Canada.

Problem Subject of Royal Commission Study

I have already said that the whole matter of near-bank reserves requires further study and the same applies to other aspects of our monetary and banking structure. Because I feel strongly on these matters, I am heartened by the recent announcement in the Budget that the government plans to set up a Royal Commission. One would hope that this commission would be composed of men of the most distinguished stature and independence of view, backed by a strong, experienced secretariat. The brief reference in the Budget indicated that the commission would not be restricted in its investigations to the operations of the chartered banks and the Bank of Canada. While its terms of reference are not yet known, I would urge that the commission's powers should be broad enough to take into its frame of reference the operations not only of the banking system as classically defined but of all those institutions to which I have applied the term "near-bank" because as I have already pointed out, these institutions are playing an increasing but an unrecognized and uncontrolled part in the vital monetary and banking structure of the Canadian economy.

The Fathers of Confederation, in their wisdom, have decreed that in the vital matter of banks and banking, the *national* interest, and not the presumed interest of various occupational and regional groups, must reign supreme. It is then in this national interest, in the broadest and truest sense of that term, that I appeal here for action to restore to our monetary authorities their rightful and necessary power to control the total supply of money in all its forms and not merely that part of the total supply which happens, at any given time, to take the form of the deposit liabilities of Canada's chartered banks.

This is a time of decision for Canada.

Some of the most important decisions that have to be made today are in that broad, and to a surprising degree in Canada *unclaimed*, realm of monetary and fiscal policy. The most important thing, of course, is simply the *will*, on the part of our fiscal and monetary managers to move decisively to correct, so far as fiscal and monetary policy *can* correct, the present slack in output and employment. But given the will, we must also have effective fiscal and monetary machinery to implement policy. I believe that a move along the lines I have suggested herein will ensure that the wisdom of our fiscal and monetary authorities can be made effective in action, and that our economy can enjoy prosperity and growth within our traditional framework of political and economic freedom.

*An address by Mr. McLaughlin before the Annual Meeting of The Investment Dealers' Association of Canada, Jasper, Alberta, June 24, 1961.

Reed Johnston, *G. E. Leslie & Co., Montreal;* Mr. & Mrs. J. C. Edwards, *Matthews & Company Limited, Toronto;* Mr. & Mrs. Donald I. Webb, *Merrill Lynch, Pierce, Fenner & Smith Incorporated, Toronto;* Mr. & Mrs. Ted Percival, *Merrill Lynch, Pierce, Fenner & Smith Incorporated, Toronto*

Mr. & Mrs. A. M. Rutherford, *W. C. Pitfield & Company Limited, Calgary;* Mr. & Mrs. William S. Gray, *Doherty Roadhouse & Co., Calgary;* Mr. & Mrs. D. J. Langill, *W. C. Pitfield & Company Limited, Winnipeg*

Canada's Economic Outlook

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have in turn spent a great deal of public taxes and borrowings toward improving Canada's capacity, e.g. the St. Lawrence Seaway, public power projects, highways, streets, water, sewage, education and other familiar government services.

As long as world markets are buoyant, the Canadian economy has functioned at a high level of industrial activity, employment and living standards. If there is a halt in the expansion of world demand or even American demand, the situation in Canada becomes vulnerable. The situation is complicated by the generally abundant capacity situation now existing across Canadian industry.

With the work force increasing at a slow steady rate, when the export industries turn into stability or recession, the domestically oriented industries are not able to absorb the unemployed labor and the many new additions to the work force. Last year about 15% of Canada's G.N.P. came directly from the proceeds of commodity exports.

On a similar theme Canada has substantial commodity imports, which have exceeded commodity exports every year since 1953. For a country with a foreign debt equal to half of the Gross National Product and with relatively minor foreign investments itself, it might be expected that Canada would have a surplus of exports over imports to pay for the borrowed or invested foreign capital. This has not been the case in recent years as the flow of imported capital has kept rolling in. We have not yet, on balance, had to pay for the large investments made in Canada in the past decade.

Accompanying the inflow of capital have been large imports of industrial machinery, equipment and other specialties necessary for developing the resources into active producing plants.

The importation of capital, techniques and skills has been made easy in that Canada is frequently not regarded as a completely foreign country. In addition, Canada has maintained a fairly respectable reputation for decent treatment of foreign investment.

So, on the surface, Canada might appear to have enjoyed an enviable position in having developed a rising standard of living, a rapid expansion of population, and very impressive expansion in forestry, mining and metallurgical processes, petroleum and natural gas, construction and general manufacturing.

So much for the general setting. Some troubles have appeared in this Garden of Eden. I shall deal now with some of the difficulties of recent months.

Recent Difficulties

The succession of postwar booms, and the abnormally high rate of capital investment have diverted an abnormal proportion of the labor force into construction and similar supporting industries. When Canada settles down to a more restrained rate of growth, such labor will have to shift from industrial and heavy construction to other occupations.

In 1960 Canada experienced a moderate recession from which it is now recovering. In terms of percentage decline from the previous peak in the G.N.P. it was a mild recession. Some sectors of the economy were barely touched. Salaries and wages increased in each quarter.

Rent, interest and miscellaneous investment income quickly recovered from a slight decrease. Farmers' income increased in spite of conditions elsewhere. Personal consumption expenditures in total never weakened, particularly on services. Commodity exports reached a new high level.

The weak spots in the Canadian economy included the following: corporation profits, residential construction, heavy construction, new machinery and equipment, durable goods manufacturing output, freight car loadings and inventory liquidation in manufacturing. Government expenditures increased in 1960, partially because of anti-recession spending. One of the most disturbing features throughout 1960 was the steady growth in unemployment to the highest levels in 20 years. The seasonally adjusted unemployment peak was 7.9% in December. On a seasonally unadjusted basis the peak unemployment was in mid-February 1961 when 11.3% of the labor force was unemployed. The most serious pockets of unemployment were in construction, mining — especially coal — and durable goods manufacturing. Inventory liquidation in manufacturing was at its greatest severity in the steel consuming trades. The primary steel industry was spared the full impact of the decline in domestic consumption by its ability to enter the export trade on a scale without previous parallel. The decline in steel consuming inventories was still continuing through January, 1961, though the economy as a whole had swung back to accumulation of business inventories.

The 1960-61 recession might be described as a mild decline from a rather weak business peak attained in the first quarter of 1960. The G.N.P. declined only for the second quarter, then increased in the third quarter, with a good recovery in the fourth quarter. The incidence of the recession was mainly on construction, heavy industry and on unemployment.

Short-Term Outlook

The next question is the probable nature, strength and incidence of the shorter term business recovery in Canada.

One of the major indicators of the present year is the anticipated capital expenditures by industry, commerce and government. The latest survey taken in October, 1960 forecast a modest increase in total spending. More would be spent on basic construction, less on machinery and equipment. Manufacturing and transportation anticipated lower capital outlays. Governments, fuel and power, and housing expected to spend more. With a recovery in business optimism since October there may be heavier capital spending by private industry as 1961 advances.

There are scattered indications that housing and the companion fields of appliances and home furnishings are moving in rather slow fashion. If the stock market is a proper guide the recent advances in the Canadian exchanges are a very encouraging sign. The Canadian steel industry has had a good recovery from its low production rate of November and December 1960. Perhaps it is a characteristic of recovery from a shallow recession, but there is a good deal of reservation, or lack of firm conviction, about the probable strength of the business recovery.

Perhaps it is the discomforting presence of a high level of unemployment, perhaps the widespread feeling that in every area of domestic production capacity is adequate—even generous, perhaps it is the feeling that Canada is being closed out of the European Common Market, the European Free Trade Area, and without serious prospect of a similar accommodation into United States markets. In any case there is a considerable opinion that there is no strong and certain pressure in sight to develop a strong, sustained recovery which would give us an early resumption of a good rate of economic growth, and the elimination of the serious unemployment that is the most worrisome fact in the short-run setting.

Looking further ahead there are many factors that are encouraging for Canada. Whether we admit it freely or not our major link with the outside trading world is by way of the most efficient export—oriented, raw materials—processing industries. Unless we had these exports we wouldn't have an import problem to deal with, because we would have no means of buying imports. Given free access to American, European and even Asiatic markets, many Canadian forestry, metallic, and petrochemical products and even some machinery items based on servicing the resource industries, could be very competitive on world markets. Canada will have to keep open its access to world markets for its low cost exports as a means of generating new growth and expansion.

Any major resumption of economic growth in Canada will entail heavy capital expenditures. An important policy question in the prevailing sensitive climate of financial nationalism in Canada is whether the full amount of capital could be raised internally. Some observers feel that a considerable amount of funds could be raised internally by bonds or sales of equities. The likely result would be to divert the limited supply of domestically-generated corporate and personal savings away from mortgages and government bonds to equities, and to shift the problem to another area in which foreign bororwing would be needed.

Pressing Problem of New Funds

One of the more pressing and difficult problems in the Canadian economy is the raising of new funds for the expansion and modernization of the medium-sized Canadian owned corporations. Many of these firms in recent years have sold out to American principals or to Canadian holding companies.

Suppose that half or more of the funds for expansion have to be raised abroad. If this were the case, Canada may find that a new situation has arisen in the American financial market now that Western Europe, Japan and other regions have become strong contenders for capital. Canada may have to pay higher prices in its competition for free funds. Possibly more capital may have to be secured by the sale of debt rather than by equity financing. In this circumstance the results of investment may be less inclined to risk-seeking ventures. Foreign

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Mr. & Mrs. K. S. Langfeldt, *W. C. Pitfield & Company, Limited, Edmonton;* Mr. & Mrs. George C. Knowles, *Ross, Knowles & Co., Ltd., Toronto;* Mr. & Mrs. James Coulter, *Ross, Knowles & Co., Ltd., Toronto*

Mr. & Mrs. William Hovey, *Equitable Securities Canada, Limited,* Toronto; Edgar Hill, *Royal Securities Corporation, Limited,* Montreal; Mr. & Mrs. Alan Chippindale, *Calvin Bullock Limited,* Montreal

Canada's Economic Outlook

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debt is likely to be less stimulating to the Canadian economy than foreign equity ownership or direct investment. There is the additional necessity of meeting the interest regularly rather than postponable forwarding of dividends.

Changes in the American tax policies on retained earnings in wholly-owned Canadian subsidiaries, and more particularly tax changes on depletion in crude oil and natural gas, may restrain vigorous investment in Canadian crude oil and natural gas ventures, as well as in some other areas. The decisions of the United States Congress on this matter will be watched in the Canadian West where much American money has been invested with very low short-run returns of profit and dividends.

Another longer run issue is whether Canada should undertake again a vigorous immigration policy to increase the size of the domestic market. I believe that the answer is that immigration for the short run will be limited to the skills that are scarce in Canada. Large scale immigration cannot be considered until unemployment is reduced to low levels. Then immigration will be encouraged.

Can Canada retrain the unemployed, and direct the technical training of the young toward the industries which stand the best chances of competitive strength in the broader trading areas that Canada sooner or later will have to join? This suggestion might seem a slow-working solution to the problem of unemployment being highest among the untrained and the unskilled, but over a time period it would upgrade the productivity of labor. Canadian industry in the meantime has the responsibility of holding wage increases to levels which will not injure the employment prospects.

One of the more obvious needs of an advancing industrial nation in a competitive world is initiative, progress, and efficiency. Canadian industry, and the broader group of the public and governments, will have to maintain efficient plant and equipment, and a favorable climate toward innovation, initiative, and high productivity levels.

On the whole, the Canadian economy has solid strength, but is passing through a period of slowed economic growth. With our labor force, industrial plant and construction industry keyed to high levels of capital investment, unemployment has appeared as a major short-run problem. For the long-run Canada is endowed with many rich and marketable resources and a stable political climate favorable to business initiative. In the situation of 1961 it is unlikely that the internal conditions in Canada will generate by themselves a sustained business recovery. It is to the recoveries in the American and West European economies that Canada will look for the supports of our economic growth. Our assessment is that the short-run prospect is moderately strong, with greater strength for the longer-run future.

*An address by Mr. Farrell before the fourth annual conference of the National Industrial Conference Board, N. Y. C.

Attended the Convention

Continued from page 7

HOVEY, W. N.*
Equitable Securities Canada Ltd.
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HOWARD, G. R.
F. J. Brennan & Co. Ltd.
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HUDSON, W. S.*
Brink, Hudson & Lefever Ltd.
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Ringland, Meredith & Co. Ltd.
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W. C. Pitfield & Co. Ltd.
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LAUBER, R. C.*
A. E. Osler Co. Ltd.
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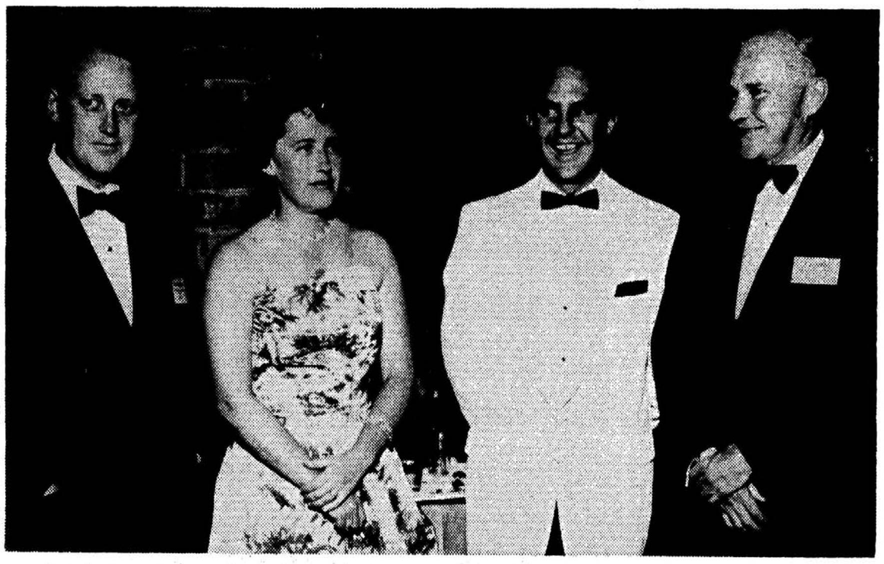
LAWSON, D. G.*
Moss, Lawson & Co. Ltd.
Toronto

Mr. & Mrs. John H. Brown, *Gairdner & Company Limited, Toronto;* Mr. & Mrs. Pat Shaw, *Gairdner & Company Limited, Toronto*



Mr. & Mrs. Ken Johnston, *Wood, Gundy & Company Limited, Calgary;* Gerry Clark, *Wood, Gundy & Company Limited, Calgary;* C. L. Gundy, *Wood, Gundy & Company Limited, Toronto*

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Rene-T. Leclerc, Incorporee
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Nesbitt, Thomson & Co. Ltd.
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McARTHUR, JACK*
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McConnell & Co. Ltd.
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McDermid, Miller & McDermid Ltd.
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MALKIN, H. L.*
Gairdner & Co. Ltd.
Vancouver

MALLON, B. A.*
McLeod, Young, Weir & Co. Ltd.
Toronto

MARCUSSON, P. A.
Investment Dealers' Digest
New York

MATHESON, IAN*
Dominion Securities Corp. Ltd.
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*Denotes Mr. and Mrs.

MAYHEW, L. E.*
Harris & Partners Ltd.
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MEDLAND, C. E.*
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MEREDITH, T. W.*
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Mills, Spence & Co. Ltd.
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MOORE, J. C.*
Burns Bros. & Denton Ltd.
Winnipeg

MORSE, ERIC S.*
W. C. Pitfield & Co. Ltd.
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MURPHY, H. E.
Commercial and Financial Chronicle
New York

NANKIVELL, NEVILLE J.
The Financial Post
Toronto

NEWMAN, M. F.*
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NORRIS, JOHN H.*
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OSTIGUY, J. P. W.*
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PENNY, J. A. S.*
Royal Securities Corp. Ltd.
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J. H. Whittome & Co. Ltd.
Duncan

REAY, W. M.*
Nesbitt, Thomson & Co. Ltd.
Montreal

REID, W. G.*
Fry & Co. Ltd.
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Kingston

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Ringland, Meredith & Co. Ltd.
Lethbridge

RITCHIE, D. M.
Sydie, Meredith & Co. Ltd.
Edmonton

RITCHIE, J. W.*
Eastern Securities Co. Ltd.
Halifax

RODOMAR, DOUGLASS V.
Calvin Bullock Ltd.
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ROSE, FRANCIS M.
Dow Jones & Co. Inc.
New York

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Calgary

SAMIS, J. C.*
Samis & Co. Ltd.
Vancouver

SCHAEFER, D. E. M.*
Nesbitt, Thomson & Co. Ltd.
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SCHULTZ, JOHN D.*
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SCHWEITZER, MRS. D.
Court Reporter
Edmonton

SCOTT, JAMES*
The Globe and Mail
Toronto

SCOTT, W. M.*
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Toronto

SEDGEWICK, K. M.*
W. C. Pitfield & Co. Ltd.
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Harris & Partners Ltd.
Toronto

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A. E. Ames & Co. Ltd.
Toronto

SHAW, H. V.*
Gairdner & Co. Ltd.
Toronto

SHRUM, Dr. GORDON M.
University of British Columbia
Vancouver

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James Richardson & Sons
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SMITH, BRUCE*
Okanagan Investments Ltd.
Kelowna

SMITH, PETER*
G. E. Leslie & Co.
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Carlile & McCarthy Ltd.
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Hall Securities Ltd.
Vancouver

TETRAULT, A.*
Burns Bros. & Denton Ltd.
Montreal

THOMPSON, A. G.*
James Richardson & Sons
Vancouver

Continued on page 18

Gordon Richardson, *G. R. Richardson & Company, Kingston, Ont.;* Mr. & Mrs. John Norris, *Collier, Norris & Quinlan, Ltd., Montreal*

Mr. & Mrs. John M. Lewis, *Equitable Securities Canada, Limited, Toronto;* Mr. & Mrs. Allan Duncan, *Annett & Company, Ltd., Toronto*

Attended the Convention

Continued from page 17

THOMPSON, C. R.
Nesbitt, Thomson & Co. Ltd.
Halifax

THOMSON, W. E.*
Pemberton Securities Ltd.
Vancouver

TINGLEY, H. W.*
Wood, Gundy & Co. Ltd.
Montreal

TORREY, A. S.*
W. C. Pitfield & Co. Ltd.
Montreal

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Greenshields Inc.
Toronto

TURNEY, A. H.*
Locke, Gray & Co. Ltd.
Calgary

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Investment Dealers' Association
Toronto

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Vancouver

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Bongard & Co.
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WILLIAMS, L. B.*
Hagar Investments Ltd.
Victoria

WILLIAMS, V. B.*
C. M. Oliver & Co. Ltd.
Vancouver

WILLIS, B. G.*
Greenshields Inc.
Toronto

WILKINS, D. J.*
Fry & Co. Ltd.
Toronto

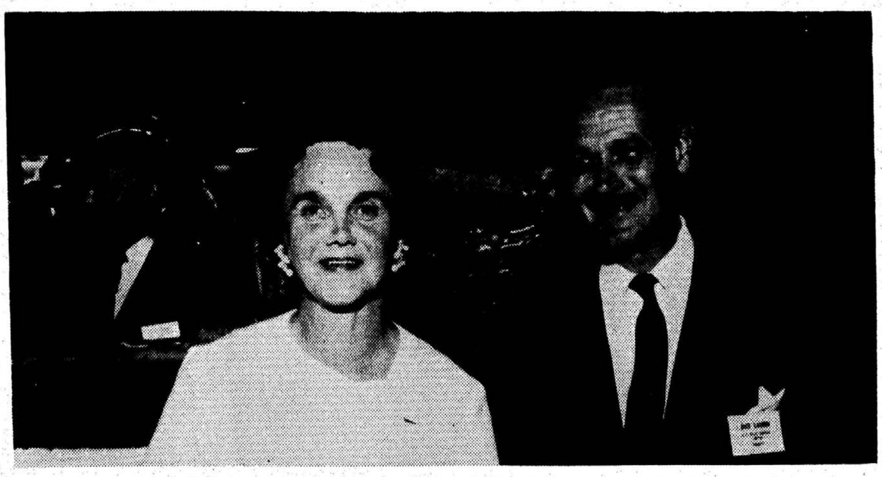
WILSON, ROSS*
A. E. Ames & Co. Ltd.
Vancouver

WINSLOW, MRS. J. D.
Winslow & Winslow Ltd.
Woodstock

WITHERS, MICHAEL*
Wood, Gundy & Co. Ltd.
Toronto

YOUNG, GEORGE W.*
Dominion Securities Corp. Ltd.
Toronto

Evelyn Bradbury; Mr. & Mrs. Thomas Bradbury, *Brawley, Cathers & Company, Toronto*



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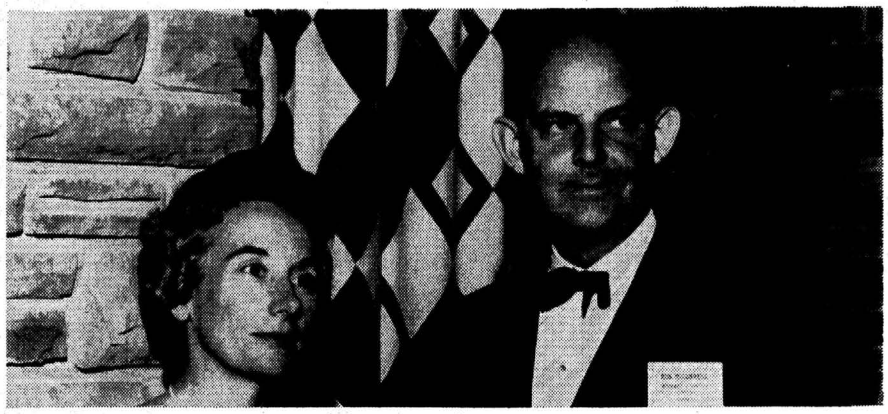

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