

Public Affairs

Canada's Defence Economy

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THE price of peace is high. Once again, in less than a generation, Canadians have learned that freedom cannot be bought cheaply. Its preservation is an individual responsibility which cannot be delegated, which we cannot shirk. We must be vigilant; above all we must not permit freedom to become a meaningless abstraction, unrelated to everything we do or say. We must be ready to sacrifice some of our standard of living so that we do not lose the single, most valuable touchstone to our whole way of life!

For most Canadians, this period of twilight war is a new experience; there is nothing really comparable in our history as a nation. For while we lived in the shadow of a threat in the years 1914 and 1939—the false security of geography reduced our military establishment to the posturing of regimental bands and the traditional inertia of the peacetime soldier. This time, the shadow has substance,

while distance no longer offers the attractive illusion of protection. In a sense we are back to those pioneer days when the harvest was always secondary to defence against the sporadic forays of the savage.

We shall not examine here the political and psychological implications of this new situation, although they are of vital importance. It is rather the economic impact of mobilization for defence with which we shall be concerned. Obviously, past stereotypes have largely lost their validity. We should not cajole ourselves into the belief that the old ways were sufficient for the old problems and therefore, they are good enough today. The plain fact is, we must construct a new working model with which we must live for the indefinite future. This we call "*The Defence Economy.*"

How should it be achieved? There are no really convenient standards to apply.

Mathematical measurements have distinct limitations but they do sharpen our perspective. Looking back to World War I total war expenditures, including those made by Britain in Canada, did not exceed 20 per cent of our Gross National Product. That war was also very far from the "pay-as-you-go" basis which was initiated in the 1939-45 period. Tax receipts in World War I were at all times less than six per cent of national income. It was only in 1916 that they met more than 35 per cent of military expenditures.

In the years between the end of the first holocaust and its revival in 1939, expenditures for our military establishment remained a very fractional percentage of our total national income. In 1933 they reached a low of \$13.1 millions and by 1938, despite the alarums from Munich, they had only risen to 32.8 millions. At no time did they have a significant impact on our civilian economy.

During World War II of course, military spending rose sharply, both in absolute and comparative terms. It reached a peak of approximately 40 per cent in 1944, from which there was a rather rapid decline. In the hopeful days immediately after Hiroshima, our current defence outlays gradually sank to the point where they were less than 3 per cent of our national income. While undoubtedly they still had some effect on the generally inflationary structure which has prevailed since 1945, it was not markedly so.

II

WE are now faced with a new situation. This might be called *the constant threat of imminent war*. It calls for the mobilization of our resources to arm ourselves and our allies up to a point where we will survive the initial onslaught of aggression—and still not wreck our economy in preparing to meet it. It is a difficult point of balance which we shall only achieve by trial and error and because our very existence is at stake, ordinary economic considerations may disappear as the red cloud spreads over larger areas of the world.

Some arbitrary and subjective standard of the Defence Economy should be established to distinguish it from total war on one hand and total peace on the other. Our Defence Economy may be bounded on the down-side by a minimum of 5 per cent of national income devoted to defence preparations while flexibility on the up-side is much greater. It is possible—indeed highly probable—that we could sustain an expenditure of 20 per cent of our national output of goods and services for defence insurance over a prolonged period, without serious deprivation to the health and welfare of our citizens.

Aside from these mathematical considerations, there are other factors which isolate the Defence Economy from both the period 1918 to 1939 and total war itself. Unlike those halcyon years in the twenties and thirties, the Defence Economy will bring with it some reduction in our standard of living—but mainly in what we used to regard as luxuries. It will be a prime directional factor in the level of economic activity. Yet unlike World War II it will not be directed towards the definite objective of victory.

This brings us to some of the differences which exist today between a Defence Economy and total war. In World War II, every economic factor was subordinated to war requirements. The maintenance of a healthy civilian economy through price control and other comparable measures was, first of all, a contribution to that end, i.e. victory. It was only secondly an effort to maintain equity and to prevent the damage which deflation brought on the home front after World War I. Besides, in the Defence Economy there is not the same powerful and productive drive of patriotism. It is more a passive, less active contribution.

Our Defence Economy must essentially be created from existing availabilities of men and materials. We can add or subtract—but not much. What then is the size of the problem with which we must grapple? As this is being written, the pre-Korean estimates of \$1 billion for defence in 1951 are being revised upward. With defence spending in the United States heading towards an annual rate of \$50

billions, or more than 15 per cent of their Gross National Product, it is quite possible our own program will now be expanded substantially. Unless there is a marked deterioration in the international situation to the point where we are involved in many Koreas, it is unlikely that our effort would be scaled higher than 10 per cent—which would still permit a 50 per cent hike in the earlier estimate of \$1 billion. Irrespective of the exact figure—probably somewhere between 7 or 10 per cent—the basic outline of the problem remains. It will only vary in its intensity.

Our economy is already functioning very close to full employment of our resources, both human and material. In 1950 our Gross National Product was close to \$17¼ billions compared with \$16.1 billions in 1949 and \$11.8 billions in 1939. There is every indication that, even with a minimum but reasonable estimate of defence spending, our Gross National Product in 1951 will be in the area of \$19 billions. It may even exceed that figure.

Perhaps the single most important factor in this almost fabulous achievement has been the expanding capital expenditure program by business, individuals, and governments over the past five years. In 1950 Canadians expended \$3.9 billions for capital goods. This represented almost 23 per cent of our Gross National Product: an achievement which apparently is unequalled in the Western World. The prospect for capital expansion in 1951 is almost staggering. Estimates of expenditures in 1951 have been placed in excess of 4¼ billions. Even with some prospective increase in the supply of building materials it is highly unlikely that this program will be achieved. Certainly the full scope of industrial expansion necessary to meet military production targets is not yet known—indicating some civilian investment plans may have to give way to more urgent priorities.

In our export trade, the United States has been taking a rising percentage of the total. Last year two-thirds of our total volume was transacted with the United States, in comparison with one-half in 1949. With the improvement in the

exchange position of our European customers, there may be some shift towards shipments overseas, particularly food stuffs. Therefore, it is apparent that there will be some further increase in our total export trade. Yet while there will be a tremendous pressure from export and capital goods demands on the civilian economy, the most acute shortage will be manpower.

III

THE outline of the defence program will show other differences from the 1939-45 full-war effort. There is no immediate prospect that we will have under arms as large forces as we did in those years, which means there will be less demand for such things as uniforms, footwear and small arms. Undoubtedly, there will be a very considerable emphasis on the production of materials for our Allies in Europe. On the other hand, it is unlikely that the same acute pressures will be exerted on our agricultural areas to produce even greater quantities of food. We should remember too, that we have a resource development program under way which really can be considered a defence project since it is mainly directed towards the bringing into production of strategic defence materials. Perhaps our position, in many ways, will be analogous to that of the United States in the early months of 1941, when President Roosevelt declared that his country was the "arsenal of democracy."

Now, the real important question is whether we will be able to absorb this program. In the first place there is still some industrial capacity available. This is particularly true of the aircraft and ship-building industries. Then too, our ability to produce the basic materials of war—oil, iron ore, base metals, aluminum etc.—has also expanded greatly over 1939, with the prospect of further increases. With a huge capital expenditure program under way since 1945, more and more industrial capacity has been coming into production. (Only a very small proportion of it, of course, can be utilized for military output). In addition, we must

not forget that productivity has been increasing at an annual rate of almost 3 per cent over the past decade. This will be a major contribution to the reduction of the inflationary gap created by the proposed defence program.

The really difficult conundrum to solve is the supply of manpower. Even here there are untapped areas. During the summer months there will be a large addition to the working force by many students from our schools. At the other end of the working age group, as the labor situation tightens, many older employees will be retained beyond normal age of retirement while others may be brought back from retirement into service. There is also a large reservoir of married women who might be persuaded to come into the employment ranks as in the last war, if the situation warranted. Unfortunately, there is not yet the same patriotic drive to do so as existed at that time. To a marked extent, the tightness of the situation will depend on the rate of intake into the armed forces. If our military establishment exceeds 100,000 by the end of 1951 then the manpower situation, instead of merely being quite difficult, could be acute. It could be eased to some extent by a much more active immigration policy that that which has been in effect during the past two or three years.

IV

IT is quite apparent in surveying the situation that the defence program superimposed on an economy which is already tightly drawn in materials and resources, will create two basic developments:

- (1) the military program will have to be met by some physical controls, and
- (2) the civilian economy will have to be buttressed by anti-inflationary monetary and fiscal policy.

How can we do this ?

1. The mobilization of resources to increase our military effective will be more efficiently achieved if some over-all directive agency is established. It should be

more than a mere advisory body—a defence equivalent to the Wartime Industries and Control Board. It should include not only government officials from departments concerned with procurement but representatives of the industries which in the ultimate instances are going to make the goods which the armed services use.

2. The Essential Materials Act already provides the Federal Government with the adequate powers to allocate strategic materials required for defence purposes. The actual operation of the Act could be helpfully expedited by the advice and direction of the overall mobilization agency. Such a body could be of considerable assistance in assuring that adequate stockpiles were maintained of strategic raw materials. In so doing, it would ensure that a great deal of strategic material was not being put away for an indefinite emergency in the indefinite future. We have already seen how semi-hysterical stockpiling in the United States can create priority unemployment. Then there is the whole question of cutbacks in production of civilian and capital goods. With the meshing of Canadian and United States economies, in this mobilization effort, decisions of this character necessarily have to be co-operative to a degree. It would appear though that civilian capital expenditures will compete more with defence requirements than will consumer spending. It is most important that the civilian economy will not be starved unnecessarily by injudicious cutbacks of consumer goods production before military orders are able to take up the slack.

3. While physical controls over manpower are most definitely undesirable in a free country, the grim possibility that there just will not be sufficient men and women to meet the needs of the armed forces, defence industry, and the civilian sector, implies that some allocation of manpower may be necessary. Certainly it is to be hoped that we can avoid this most unpalatable interference with individual liberties. But if we must direct manpower into those places where the greatest

good will be achieved from the standpoint of the country as a whole, then it should be done with a minimum mandatory approach.

V

WE are faced too with a substantial increase in inflationary pressures as our mobilization expands. We should depend on monetary and fiscal policy as still the most effective instrument to meet the size of the inflationary gap in prospect, rather than adopting the straight-jacket of physical controls.

There are several steps which should be taken:

1. All levels of Government should make every economy consistent with the efficient functioning of essential services. When our existence as a nation is endangered, it is no time to contemplate an expansion of costly measures of social security—irrespective of their desirability in normal times. It is just as important that individuals and businesses buy only what they require for normal consumption.

2. The defense programme brings with it the grim prospect of higher taxes. Provided this taxation is equitable and not so heavy an impost that it bonuses

wastefulness, we should regard the tax we have to pay as a small price for peace.

One form of tax does lower productivity. The Excess Profits Tax is a poor fiscal instrument. It is inequitable; it promotes waste; it is difficult to administer. It adds to the inflationary fires.

3. Some brakes on further expansion in credit may be needed. The retail trade is now operating under consumer credit controls. It is not unreasonable to suggest that similar measures of restraint should be applied to the other sections of our credit structure. While a modest increase in interest rates would not of itself act as deterrent to inflation, it would help, particularly in view of the enormous capital expansion program now indicated for 1951.

It will be some time before we learn how to operate a Defence Economy. It took us several years to run effectively a total war machine. In a sense the political and economic problems which we face in semi-mobilization are just as difficult. Yet there is no reason why we should not succeed today as well as we did under actual wartime conditions. We must be prepared to live with a Defence Economy for an indefinite time in the future. If it preserves our very existence the effort we may have to make will have been worthwhile.

The Chinese philosopher Lao-Tze, who was born about 600 B. C., still had a modern edge to his thinking. "Govern a great nation", he said, "as you would cook a small fish. Don't overdo it."