THE ROYAL BANK OF CANADA

HEAD OFFICE, MONTREAL

April, 1944

THE term "National Income" has assumed, of late years, something of the mystic significance that "Coueism" had for a preceding generation. Some people look to it for salvation from all the ills of human life and economic disturbance. They regard "National Income" as a cure-all.

This Letter is not an attempt to discuss such a theory. It is rather a layman's examination into the ascertained facts and principles, a statement of the position in the pre-war years and now, and a prolongation of long-term trends into the post-war period.

It is only within the memory of this generation that the idea of measuring a country's progress by the National Income yardstick has emerged. Most countries are today trying to construct estimates, but unfortunately, not many of them agree on what basic measurement to use. In Canada, figures computing the amount of the National Income in dollars annually, or even monthly, have become common to politicians and to businessmen who are attempting to peer into the future. In almost every brief on post-war conditions, one finds references to the anticipated or ideal National Income. In addition, to support their claims for a larger share of the income, various groups bring forward statistics to show that they are discriminated against, either by the lowness of original income or the impact of taxation.

The National Income of Canada has been boosted to an all-time high since the war started. There is little or no unemployment, and there has been greatly expanded industrial plant activity. Since 1939 the increase in the National Income has been vast — from $4,575 million to $8,800 million.

Economics

As in the case of Coueism, mentioned earlier, it is important to note that success does not rest in knowledge of a principle but in its application. Those who use the National Income measuring rod on the economic machine should have a clear understanding of its possibilities and its limitations. Economics is not a set of solemn laws and principles: it is what happens when one buys a pair of shoes or invests $50 in a Victory Bond. The economic machine is a name for all those things which people do to provide themselves and their families with food, houses, clothes, medical attention, tickets to the movies, and the other goods and services they use. This economic machine is made up of farms, factories, railroads, power lines, retail stores, banks, money, and the work of Canada's 4 million employed people, plus the meals, clothes, schools and beds for all 11½ million of us. As a gauge of the success of this machine, the National Income is the most efficient formula yet devised. But, while a measure of the National Income is fundamental to the study of most national economic problems, care must be taken not to worship the golden calf instead of the reality of which it is a symbol.

Measuring Income

The estimates of National Income can measure the flow of money at three different levels: payments made by productive organizations to individuals for their contribution in the form of personal effort or ownership; the payment made by individuals for goods and services for consumption; and the savings invested in projects which add to the productive equipment.

In Canada, the National Income figure most commonly used is defined as the net value of goods produced and services rendered during a given period.

Other estimates appear to measure fundamentally dissimilar aspects of the national economy, but these are merely different totals, useful for various purposes. For instance, there may be National Income figures measuring income produced, received, paid out, realized and spendable. They all refer to the same stream, but are taken at different points.

The starting point for all National Income calculations is the gross national output, which is, in short, the market value of all the goods and services produced by Canadians. That figure is, in itself, significant as a measure of capacity to produce. From it must be deducted depreciation and taxes, which add to retail prices but do not represent real production. The same thing must not be counted twice. True net income is found by deducting from the gross income the outpayments connected with its production.

Sources of Income

Where does the National Income come from? Well, there are material resources and human resources. Take into consideration our vast forests of merchantable timber, described in last month's letter; our mines of valuable metals, our coalfields and our waterpower, our acres of fertile agricultural land, and our fishery resources of two oceans and inland seas. These give a measure of the places from which we may draw the things needed for the comfort of our people. Then add Canada's human resources: engineering skills, mechanical inventiveness, organizing ability, and labour with a status enhanced by a high degree of education, initiative and technical training. To bring these together, Canada has capital supplies in abundance.

Value is created by organized application of capital to land and resources through workers of various kinds. No one can presume to say that so much of the output is produced by the capital, so much by the resource being developed, and so much by this and that class of worker. The whole effort enters into National Income, and as the total volume of production goes up, so does the income of the worker and the farmer. Moreover, individual average productivity tends to rise, because technological improvements and increasing capital per employee make possible a larger output per man-hour; economies conducive to greater production are constantly being evolved by industrial organization; and improved standards of education and nutrition increase the worker's efficiency.

For purposes of statistical compilation, estimates of the National Income are sub-divided so as to cover primary, secondary and other productive effort. Primary production, including processing activities which are closely associated with forestry, fisheries and mining, accounted for 25.3 per cent of the income originating in Canada during the period 1919 to 1940. Secondary production, which includes construction, general manufactures, and repairs, provided 19.9 per cent. In third position was trade, with 12 per cent, while service, government, transportation and finance followed in that order. It would be well, at this point, to make clear that while the National Income is presented for statistical purposes in money terms, it is not money. The dollar sign is merely a common denominator for all the food, clothing, shelter, travelling, education, and amusement of all the people. The real income is the goods and services produced to satisfy the nation's wants. Most people who receive an income contribute to production either in their own persons by their work, or as owners of property which aids production. It is well known that in this age of specialization everyone cannot produce everything he desires to have or to use. These things are obtained by exchange, and it is only because our exchanges are made through the medium of money that we have any difficulty in perceiving that an increase in supply *is* (not "causes") an increase in demand.

A corollary of this principle is that goods and services which do not pass through the market are not included in the computation of National Income. For instance, the value of services of housewives is excluded, as are income from illegal pursuits, capital gains or losses, gifts to charity, relief payments, and other forms of income which do not result from current production. On the other hand, account is taken of the value of home-produced food consumed by farm families, since this is an undeniable form of income to the farmer, and the estimated net rentals on owner-occupied houses, because the occupants receive a real income in the form of shelter.

Money income is affected by price levels, which have undergone wide changes in the past thirty years. The direct comparison of National Income by years in terms of dollars of those years is bound to mislead, because the purchasing power of the dollar is always changing. In the period between wars, for instance, the real income of Canada showed an upward trend despite the handicap of industrial inactivity during the depression, and the persistence of adverse weather conditions in western Canada. If the influence of price fluctuations is eliminated by expressing the National Income in terms of dollars of 1926, the income of 1937 was able to command more in goods and services than that of any previous year. There was a gain of about 2.5 per cent in the second decade over the first, in average real income. From 1921 to 1929 real income rose 39.3 per cent, compared with an increase of 37.9 per cent in income at current prices; the decline from 1929 to 1933 was only 28.5 per cent in real income as compared with 45.7 per cent in income expressed in terms of current values. There was a fluctuation of $2,343 million in money income, but only $1,971 million in real income between 1919 and 1939. The difference per capita in real income was only $157 between the highest and the lowest in these twenty years. The lowest total real income was not in the early 1930's as many take for granted, but in 1921.

Distribution of Income

These figures are interesting, but the realist will require something further: how was the income distributed? There are some who assert that at least 15 per cent of the people do not work, but live on interest and dividends. Well, if that is so they do not make a very good living. If we take 15 per cent of the population, about 1,725,000 people, and divide that into the total bond interest and dividends paid out to Canadian individuals in 1939 ($216 million) we find that each one would receive only $125.15. As a matter of fact, the proportion of income received by labour in wages and salaries has been increasing, while the proportion received by property in profit, interest and rent has been decreasing. The distribution of the National Income is not so bad as is argued by some factions. There are many artisan households which would lose by an equal distribution of the National Income. In the period 1919-40, in Canada, salaries and wages to workers amounted to nearly 58 per cent of the total, or to 61 per cent if living allowances of so-called "unpaid labour" and other labour income are added. The withdrawals of working proprietors, mainly farmers, retailers and professional workers, constituted nearly one-quarter of the total for the twenty-two years. Investment income, including dividends, interest, rents, etc., reached 14.6 per cent of total income payments. It is worth noting that during the depression years, 1930 to 1939, the workers' share of the National Income averaged 63.6 per cent, with an extreme range of 62.4 per cent and 64.6 per cent. In addition, those of the workers who had jobs received higher real earnings in purchasing power than during the boom. Farmers took a much harder shock in those years, with a share of only 9.2 per cent on the average, ranging from 5 per cent to 12.1 per cent. The years 1926 to 1940 give a good range of ups-and-downs in the National Income, and in that 15 year period workers and farmers received 74.2 per cent. These two groups make up 75 per cent of the people, so that the division of the income, as between them and the rest of the people, is practically exact. Maldistribution seems to lie more between agriculture and labour than between either of these groups and others.

There are several factors which make comparison of farm and city work difficult, if not meaningless. These include the differences between rural and urban modes of living, the variation of standards with which different people are content, the difficulty of fixing money values on the "in kind" yield of farms, and the inadequacies of the statistical data upon which estimates of farm income are based. Many city workers, who yearn for "a place in the country", believe that the work of a farmer has more variety, and more room for personal initiative and self-direction, than that of the ordinary artisan or even of his foreman, and that these yield satisfactions not measurable in money.

Income May Expand

Both farm and city work enter into the solution of the post-war problem of employment. In this connection, Sir William Beveridge's term "avoidance of mass unemployment" seems better than "full employment", as being less likely to lead to anticipations of an economic stability that is practically unattainable. The demand for work comes from the National Income, that is, from work. The less work of one kind there is, the less demand there will be for work of other kinds. But the National Income is not a fixed sum limiting employment. There is always room for an increase in production, whether due to a new machine, the labour of hitherto unoccupied workers, or the more efficient organization of workers already in employment. There is a demand for this additional product, because the addition to society's income enables society to pay the extra workers or machines or organizers. The energy of muscles has been replaced with the energy from coal and electricity. We have accepted electric power, automobiles, automatic steel rolling mills. We have raised the standard of living from the ox-cart age and the spinning wheel. We cannot go back, and if the advance has raised problems we must face them as they are.

What a contrast there is with yesterday! A century ago, nine-tenths of the things consumed in a typical Canadian village were grown or made right in the village; less than a tenth came from other villages or towns; only a tiny fraction came from outside the country. Today we are competing with every nation for every kind of trade. No tale out of Arabian Nights would seem so incredible to a man from Mars as the plain account of the growth of this country in wealth and influence and living standards, and yet there are some who picture this as a decadent and dying age. They overstate the economic evils of today and ignore the conditions of earlier ages. Such pessimistic descriptions of this century, combined with romantic exaggerations of golden ages in the past or future, tend to set aside methods of progress, the work of which may be slow but is solid. Some persons advocate the hasty adoption of other systems of greater promise, but these resemble the patent medicines of a charlatan, which, while quickly effecting a little good, sow the seeds of widespread and lasting decay.

The history of Canada, as seen in its National Income, has been one of steady and not spectacular growth. Briefly, the income rose to a high level in 1920, fell off nearly 24 per cent during the following year; recovered steadily until 1929, when a new maximum was set; slumped to 52 per cent in 1933; rose consistently to 1937; suffered a temporary setback in 1938; and then entered the war years. When a car runs smoothly, the driver does not worry much about its insides, but if it stops on a lonely road at midnight with the gauge showing plenty of gasoline, he begins to worry a lot. That is what happened in Canada in 1933. The world was gripped by a depression which prevailed in almost every country, under every form of government. Policies of self-sufficiency adopted by several European countries aggravated the Canadian condition, particularly that of agriculture. This blow was accentuated by drought, and the yearly average farm income declined from $856 million in the first inter-war decade to $495 million in the second. Forestry and the minor extractive industries also declined. The backlog of residential building accumulated during the war kept construction going in the first twenty years, but this disappeared after 1933. Exports fell from $1,178 million in 1929 to $498 million in 1932; manufacturing declined from $3,883 million to $1,980 million. The National Income sank from $5,149 million to a low of $2,795 million.

All of Canada did not suffer equally. Variety of climate, difference in physical conditions and natural resources, and variation of distribution of population, have caused the provinces to develop along separate economic lines. Unfortunately, the data is not available to show the exact distribution of National Income by provinces or sections. The Dominion Bureau of Statistics has published figures which give an approximate picture. The annual average share of all Canadian individuals in income payments was $447 per capita from 1919 to 1928, and $370 from 1929 to 1938, a decline of 17.2 per cent. The provincial averages were, in the two decades: Prince Edward Island $263-$249; Nova Scotia $306-$284; New Brunswick $294-$266; Quebec $370-$323; Ontario $515-$448; Manitoba $482-$361; Saskatchewan $435-$272; Alberta $511-$349; British Columbia $599-$465. By contrast, the Financial Post tabulation gives these figures for 1942: Canada $618; Prince Edward Island $378; Nova Scotia $484; New Brunswick $428; Quebec $539; Ontario $775; Manitoba $566; Saskatchewan $422; Alberta $548; British Columbia $773.

It will have been seen by these brief outlines of distribution, by classes of workers and by sections of the country, that total National Income is not all-important. Many people who talk glibly about the income needs of Canada fail to take distribution into account. The drift of economic thought for several generations has been toward the idea that there is no real necessity for extreme poverty, although there will always be differentials caused by the relative energy, initiative and skill of individuals. Any diminution of indigence which can be attained without sapping the springs of free initiative and strength of character is eagerly sought by all responsible men as a clear social gain. There is a growing devotion to public well-being on the part of more successful people, and a spreading consciousness of the spirit of social chivalry. The working man of today has comforts and luxuries which were rare or unknown among the richest of a few generations ago. The children of each grade of population are pressing upon the children of higher grades, so that classes are today overlapped and widening in the higher grades. There is probably no country in the world where class consciousness is so tolerant, and class warfare so non-existent, as in Canada.

This country has been built by that very factor—the climbing of its people from one class to another. It has been built by the process of earning, saving, spending, investing. If no one had ever saved, then railroads, factories, and power lines would not have been constructed, the country would never have been opened up, and inventions would not have been put to use. Saved dollars move around when invested, and help buy back production. Many people do not care to accept the responsibility of investing money themselves, so they deposit it in a bank. Then the bank lends it to businesses which wish to expand production; this helps to keep people at work, and the saved dollar gets back into circulation through wages and the channels of commerce.

Just as people cannot be self-centered personally, and hoard their wealth, nations cannot, in this expanding world, live unto themselves. Modern industrial civilization rests upon a raw material base that is unavoidably international.

This inevitably means trading, exporting and importing. Canada, with only 11½ million people, the third largest trading country in the world, had a total foreign trade last year of nearly $5 billion. Every Canadian has a tremendous stake in a large and expanding international trade. This cannot be an isolated economy. If Canada is to maintain large-scale activity providing avoidance of mass unemployment and attain the maximum National Income, the world market must be re-constituted on a solvent basis, and domestic problems of investment, production and distribution must be solved.

Forecasting Income

It is ridiculous to make a forecast of what the National Income will be or should be in the post-war period. Some are fond of declaring Canada "must" have a National Income of from $7 billion to $9 billion, figures which vary from 50 per cent to 90 per cent higher than the highest pre-war National Income. The National Income cannot be increased by thoughts or wishes, however exalted, unless these thoughts and wishes can be transmuted into actions as applied to increased production to be sold in expanding markets. Suppose no miracle happens, and Canada continues growing along the steady lines indicated in the pre-war long-term trend, what may reasonably be expected ? Most of Canada's statistical indices are now based upon the five-year period 1935-1939, so it will be convenient to take dollars of that period in which to calculate what may be anticipated as the real National Income in future. On this basis, the National Income in the ten pre-war years was, in millions of dollars: 1930—$3,750; 1931—$3,700; 1932—$3,500; 1933—$3,300; 1934—$3,400; 1935—$3,600; 1936—$3,750; 1937—$4,000; 1938—$4,000; 1939—$4,300. Using the same basis, the National Income five years hence would be $6,000 million; in 1954 it would be $6,700 million; in 1959, $7,300 million, and in 1964, $7,900 million.

This increase is predicated upon certain factors, variation in any of which will affect the projection. There must be peace; a world shivering on the edge of war cannot address itself efficiently to consideration of standards of living. Canada must avoid economic nationalism; every country that turns its back on world economy sows the germs of war among the economic discontents of other nations. Canada must go forward as a whole; a country's growth is the growth of all its parts; and provinces, industries and individuals must co-operate. Canada must encourage inventiveness and initiative; these are the factors which give dominance in a competitive world. Canadians must invest their savings in productive enterprises; this keeps the National Income flowing through all the nation's activities.

PRINTED IN CANADA
by The Royal Bank of Canada