

One of the first important measures the United States took to improve its balance of payments was the interest-equalization tax, a tax payable by United States investors on the purchases of foreign securities. This was intended to make foreign investment less attractive to Americans. When this was first announced by President Kennedy in July 1963, there was consternation in the financial markets of Canada, because it was quickly realized that this measure as originally proposed would either leave Canada seriously short of foreign exchange and investment capital or would necessitate a substantial increase in interest rates in Canada to levels that would induce Canadian borrowers -- provinces, municipalities and corporations -- to borrow in the United States in the required volume despite the tax, and I would suggest the order of magnitude is more than a one percent increase in interest rates, which, under these circumstances, is very substantial.

Fortunately, we were quickly able to convince Mr. Dillon, then Secretary of the Treasury, and through him President Kennedy, that for the reasons I have described it was not possible for the United States to improve its balance-of-payments position by reducing the exports of capital to Canada below what was required to meet Canada's current-account deficit. Consequently, the United States authorities agreed to exempt new issues of Canadian securities from the interest-equalization tax. In return, the Canadian Government undertook that it was not its intention to increase its foreign-exchange reserves through the proceeds of borrowing in the United States.

For some months after the announcement of this special interest-equalization tax in the United States there was uncertainty as to just how it would apply and the need for working out specific aspects of the exemption. During this period there were relatively few issues of Canadian securities in the United States. Once the situation had clarified, however, U.S. lenders and Canadian borrowers anticipated the final enactment of the law and the exemption, both of which were to be retroactive, and a big backlog of Canadian issues held up during the months of uncertainty moved onto the U.S. market in the second, third and fourth quarters of 1964. In keeping with the spirit of our undertaking to the United States, the former Minister of Finance, my predecessor in office, appealed to the provincial authorities in December 1964, to avoid as far as possible adding to the volume of new Canadian issues in the United States at that time.

Early in 1965 President Johnson reinforced the interest-equalization tax with a programme of guidelines -- advice, suggestions -- for voluntary action on the part of U.S. investors and companies to restrain the flow of their investment outside the United States and bring back to the United States such funds as they reasonably could which had been held abroad by them or their subsidiaries. These guidelines made in February contained some specific provisions for Canada in keeping with the special circumstances which had been recognized in the exemption granted Canadian issues from the interest-equalization tax. Notwithstanding these provisions, however, the guidelines of early 1965 did cause some difficulties in the Canadian market for short-term securities which did not benefit from the special provisions applicable to long-term investment.