

States investors on the purchase 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 1 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.

TEMPORARY RISE IN CANADIAN RESERVES

I now come to more recent events in respect of which I think this House is particularly interested. In the latter part of 1965, at a season when the Canadian balance of payments is normally relatively strong, our current account and general balance of payments were suddenly strengthened as a result of the second large wheat sale to Russia. During the autumn, Canadian borrowers were also selling a large volume of Canadian securities in the United States. As a result, Canada's exchange reserves, including our net creditor position in the International Monetary Fund, which is proper to count in this connection, increased well above the level at which we were aiming to hold them in accordance with our understanding with the United States in 1963. We regarded this abnormal rise in our reserves as temporary. I said at the time, and I say again, we can reasonably expect to see it reverse in the first half of 1966, but it coincided with a period when the United States was quite concerned over its balance of payments.

The Minister of Finance, in November last, requested all major Canadian issuers of securities in the United States to defer delivery of their issues, wherever possible, until after the turn of the year when our current-account position would be seasonably weaker and the U.S. position could be expected to be stronger. I should like at this time, through the medium of this House, to express the appreciation of the Government for the co-operation shown by these Canadian borrowers in meeting this request, and also for the co-operation of the dealers and buyers of the securities concerned.

While a considerable improvement in the United States payments position had resulted from the measures taken in 1963 and from the subsequent guidelines programmes instituted by President Johnson last February, the United States overall deficit remained large and the United States Government decided last fall that it must adopt further measures. There were two of these of major concern to Canada.

SPECIAL EXEMPTION FOR CANADA

The first of these was a new guideline, a request by the U.S. authorities to financial institutions other than banks, which includes not only investment companies, etc., but also pension funds and other major buyers of securities, to limit the increase in their holdings of long-term foreign investments to a small fraction of their holdings at an earlier date. This was a most important restriction on the sale of long-term securities in the United States. It is one that for some reason or other has been overlooked in some of the comment which has been made in the press of this country. If applied to Canada, it would have had very serious adverse effects. We sought and obtained an exemption from this important restriction, justified on the same grounds as our original exemption from the interest-equalization tax, and in consideration for an undertaking of the same kind on our part regarding the level of our reserves.

We felt - and when I say "we" I mean the