As I have already said, the Automotive Agreement had its origin in efforts by Canada to increase its industrial efficiency and thus improve its current-account balance. A new dimension has been added to the Canadian problems by the recent emergence of the United States balance-of-payments problem. Canadians, at least until recently, had not given much thought to the possibility that the United States might ever have to limit its export of capital.

Let me describe what happened when the United States began taking defensive action.

I think we may fairly say that the first major measure adopted by the United States to deal with its balance-of-payments problem, the Interest Equalization Tax, was announced, in mid-1963, without full appreciation of the interdependence of our two countries. As you know, the tax, in essence, was designed to reduce the return on U.S. loan capital placed abroad or, conversely, to increase the cost to the borrower by roughly one per cent.

The reaction to this announcement in Canadian financial circles was one of shocked surprise, quickly followed by serious weakness in the markets. Canadian official reserves of gold and foreign exchange declined by more on the single day of the announcement than on any one day during the Canadian exchange crisis of 1962. It was fairly obvious that the tax would be counted the more successful the less its yield, in other words, even supposing that Canada could bear the added cost of borrowing in the U.S. market, the volume of such borrowing was also in question. Clearly the situation was critical. A team of senior Canadian officials went immediately to Washington. As a result of their discussions with the U.S. authorities, a joint announcement was made that new issues of long-term Canadian securities in the United States would be exempted from the provisions of the tax. That crisis was ended.

The basis on which Canada successfully gained the exemption of its own long-term borrowings from this tax is twofold; first, these Canadian borrowings do not contribute to the U.S. balance-of-payments deficit, and second, there would be no net gain to the United States from reducing them. Roughly speaking, every dollar of capital invested in Canada by U.S. residents flows back into the States more or less immediately in payment for at least a dollar's worth of goods or services imported by Canada from the States. Without any deliberate action on Canada's part, measures such as the Interest Equalization Tax would reduce the U.S. payments surplus in respect of goods and services approximately in proportion to the reduction in U.S. capital outflows.(1) The undertaking given

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(1) A precise reconciliation of the balance-of-payments statistics published by the United States and Canada is not possible. Generally speaking, Canadian statistics show a larger Canadian current-account deficit vis-à-vis the United States than do United States statistics. On the other hand, United States statistics generally show a larger flow of capital to Canada from the United States than do Canadian statistics. In spite of these discrepancies, the basic fact remains that United States capital rarely finances the whole of Canada's current-account deficit with the United States.