pact of the U.S. measures and had more reason to be concerned about their future implications. In particular, they threw into sharp focus the problem of Canada's vulnerability which has been a source of growing preoccupation to Canadians in recent years. It is, therefore, of considerable importance to us to be sure that we understand the problems and perceptions that are likely to shape U.S. policies over the medium term and which, in turn, Canadian policies cannot afford to leave out of account.

U.S. economic policies

Since 1968, the U.S. Administration has faced increasingly difficult internal as well as external economic problems. Inflation, a levelling-off of the economy and substantial unemployment were added to an already existing pattern of significant balance-of-payments deficits. During the spring and summer of 1971, urgent concerns developed over the apparent lack of success of efforts to control domestic inflation and the sharp increase in the deficit of the U.S. basic balance of payments. There was a possibility that the basic deficit, and especially the trade balance, would deteriorate still further, with no clear outlook for recovery.

The United States has experienced deficits in its basic balance of payments for most of the postwar period. However, until the mid-1960s, the U.S. Administration did not view these as reflecting a major disequilibrium in world trading and monetary relations. The level of the U.S. deficit was seen as generally in line with world liquidity needs and both the U.S. trade account and the current-account balance showed substantial surpluses.

From the early 1960s, U.S. long-term capital outflows were, nevertheless, a subject of concern both in the United States and in the major countries of destination. The concern of the U.S. Government centred on the balance-of-payments drain of these capital movements, which reduced the level of U.S. reserves and increased the vulnerability of the U.S. dollar, and on their inflationary effects. For other countries, concern related to the role of the U.S. dollar, which seemingly enabled the United States to avoid needed domestic economic adjustments while continuing to maintain large direct investment outflows.

The United States Government initiated efforts to moderate private capital outflows in 1961, and intensified these efforts in various stages afterward. From 1969, however, U.S. concern shifted from the capital account to the deteriorating U.S. trade position. The final step in these U.S. efforts, confirming this shift in emphasis, was the U.S. measures announced last August. Over this period the U.S. program to moderate private-capital outflows met with only limited success and, while net outflows were no doubt reduced, the growth of U.S. direct investments abroad was not significantly affected, since to a considerable extent these investments were financed from retained earnings and from local borrowing.

Basic determinants

Within the United States, several major recent studies, notably the report of the Williams Commission on International Trade and Investment Policy and the personal report to the President of his then Assistant for International Economic Affairs, Peter G. Peterson, have drawn attention to certain trends as major explanatory factors for the current difficulties of the U.S. economy, and the problems it may be expected to face in the years ahead:

(a) *The problem of controlling inflation*

As the Williams Commission Report indicates, unusually high government expenditures related to the war in Vietnam and inadequately compensated by domestic taxation probably account in large measure for the higher rate of inflation experienced by the United States in recent years, in comparison with other leading industrial countries. At the same time it appears from estimates made by the Federal Reserve Board that the price and income effects of inflation account only in part for the deterioration in the U.S. trade balance. These studies also suggest that in the United States, as indeed in other industrialized countries, important changes in domestic attitudes and social values have taken place, compounding the problems of controlling inflation and of managing the economy. The United States is faced with rising demands for policies, programs and expenditures to deal with domestic social and economic problems. Generally, these pressures seem to add up to a requirement for more effective public management of domestic economic development consistent with social needs and goals. This suggests that there may be substantially *more* rather than *less* government involvement in the economy in the future and that foreign economic policies will be more closely related to and coordinated with domestic economic policies.