



CANADA

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CANADA-U.S. FINANCIAL RELATIONS

The following statement was made in the House of Commons by Mr. Mitchell Sharp, Minister of Finance, on January 27:

...For more than a decade Canada has been spending more abroad than it has been earning abroad. The deficit has been as high as \$1.5 billion in 1959. In 1963 and 1964 it was down to about half a billion dollars. In 1965 it got up to about \$1 billion and, during the present year, it will probably be a little more.

At times of prosperity like the present, when our own resources are almost fully employed, this current-account deficit and the import of capital which accompanies it enables us to grow and develop more rapidly than would otherwise have been the case. We are, of course, able to have these continuing substantial deficits only because we are able to finance them.

Where is the capital to come from? Only from the United States can we expect to raise private long-term capital in the quantities that are required to finance this substantial and continuing excess of current international payments over current international receipts. Neither the volume of saving disposed toward foreign investment, nor the organization of the capital markets, is great enough in Europe or elsewhere to supply more than a modest fraction of our requirements. We are fortunate that, for a variety of reasons, Canada enjoys the confidence of American investors. It is that confidence which enables us to invest and to grow at the high rates that we desire, and indeed expect, while also maintaining a high standard of consumption.

There are differences of view whether it is desirable that we should incur such substantial

current-account deficits year after year and import capital on the scale that we do. One point, however, is obvious, namely that it makes more sense to incur deficits and import such large sums of capital at a time when we are working close to potential and growing rapidly, as is now the case, than it was, say, in 1959 when the party opposite was in power and there was a high rate of unemployment. I have already mentioned the figure for 1959 when Canada was in a bit of a recession. That year we were importing capital at the rate of \$1.5 billion a year. It is nonetheless true that we are heavily dependent upon being able to import the capital we need and we are, therefore, vulnerable to any change in the United States capital markets or any restrictions placed on the United States capital markets of a nature that would interfere with the flow of capital into Canada....

From what I have said earlier about Canada's position, it is evident that we are particularly vulnerable to restrictions on the outflow of U.S. capital. At first sight, it might look as if we were the country most seriously affected. In fact, however, the United States cannot really improve its own balance-of-payments situation by restricting the flow of capital to Canada. That is the difference between the Canadian position and the position of other countries. In short, we are not a drain on the United States. We provide support to the U.S. balance of payments.

BACKGROUND OF U.S. ACTION

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 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

RHODESIA - FURTHER ECONOMIC MEASURES

Prime Minister Pearson announced recently the decision of the Canadian Government to take further economic measures against Rhodesia. A ban is being placed on all imports into Canada of goods of Rhodesian origin and on all exports from Canada to Rhodesia, with certain exceptions. These measures are a follow-up to the United Nations Security Council resolution of November 20 recommending the severance of economic ties with Rhodesia during the continuance of the present régime. The exceptions are food, medical supplies, other goods for humanitarian purposes and goods for the essential needs of the Rhodesian railways, the Central African Airways and the Central African Power Corporation, which are operated jointly in Zambia and Rhodesia. Export permit applications will continue to be considered for such goods as these.

MEASURES ADOPTED PREVIOUSLY

Other measures taken by the Canadian Government since the unilateral declaration of independence on November 11 include an arms embargo, an embargo on the export of oil and oil products from Canada to Rhodesia, the withdrawal of the preferential tariff on Rhodesian imports, an import ban on commodities constituting over 90 per cent of normal Rhodesian imports into Canada and the withdrawal of export credits and export credit insurance facilities from Canadian exports to Rhodesia. These measures are now consolidated and extended in the total import and export ban.

The crisis in Rhodesia has had adverse effects on relations between members of the Commonwealth and on race relations and stability in Africa. The Canadian Government, therefore, strongly supports economic measures that are designed to bring about an early end to the illegal situation. With this aim in mind, Britain has recently implemented new economic measures. The Canadian Government believes that similar measures by Canada and other countries will mean a further and significant contribution to ending the illegal régime in Rhodesia.

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TRADE FAIR PROGRAMME

Details of Canada's 1966-67 Trade Fair Programme were announced recently by the Minister of Trade and Commerce, Mr. Robert H. Winters. During the next 18 months, Canadian manufacturers and producers will display their products at 73 international trade fairs and exhibitions round the world under the sponsorship of the Trade and Commerce Department. The programme for the January 1966 to June 1967 period includes fairs in the United States, Britain, West Germany, France, Italy, Switzerland, Thailand, Spain and Yugoslavia.

Product exhibits will be entered in 68 fairs and trade-information booths will be placed in five others. Canadian companies will show clothing, electronics, food, office furniture and furnishings, furs, hardware

and household accessories, house-building materials and techniques, leather, machinery and tools, heating equipment, sporting goods, toys and gifts, livestock, aircraft and ancillary equipment.

The Department of Trade and Commerce encourages Canadian manufacturers and producers to enter the export market; and one of the best means of achieving this end is an annual programme of sponsored Canadian exhibits at trade and consumer fairs round the world. Growing numbers of Canadian companies have participated each year, with gratifying results. In 1965, more than 400 firms took part in the Department's programme, an increase of 25 per cent over the figure for the previous year.

NOMINAL COST TO COMPANIES

The cost to companies participating, apart from that of providing the display goods and of manning the exhibit, is nominal - a percentage of the actual space charges and, on occasion, the costs of special facilities or stand services. The Department of Trade and Commerce finances exhibit design, shipment to site, erection and dismantling, return of the goods where applicable, publicity and advertising.

Trade and Commerce also designs and erects a display to provide the best presentation of a firm's products. Many exhibits created by the Canadian Government Exhibition Commission have won design awards and honourable mention at major shows.

PUBLICITY ARRANGED

Attractive promotional booklets, illustrating and describing the products exhibited, are produced for direct-mail distribution before each fair in the market area of the show to attract buyers. Additional copies are available from the exhibit stand itself. Press releases are issued to trade and consumer publications to promote interest. Canadian participation is also usually supported with advertising.

Further services are provided to participants by the Department's trade commissioners abroad. Market and credit information, such as terms of payment preferred by foreign buyers, tariffs, advice about import and exchange controls is provided before the fair.

For their part, participating firms are expected to man their own exhibits. Much of an exhibitor's success at any trade fair depends on having qualified personnel on-the-spot to answer questions on technical aspects and prices.

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CUSO AND THE CYC

Prime Minister Pearson announced on February 7 that, in a recent meeting with Professor J. King Gordon, Chairman of the Canadian University Service Overseas executive committee, he had discussed "present and proposed programmes of CUSO and the Company of Young Canadians".

The Government he said, recognized "the valuable work undertaken by the Canadian University Service Overseas since its inception in 1961". Last year,

he added, the Government had provided a direct grant of \$500,000 to expand the CUSO programme, continuing, besides, to transport CUSO volunteers to their assignments in aircraft of the Royal Canadian Air Force.

NO DUPLICATION

CUSO continues to be the principal Canadian agency providing opportunities for young Canadians to serve as volunteers on long-term contracts in developing countries. The Company of Young Canadians will be concerned at first chiefly with Canadians serving on projects in Canada. In its overseas activities there will be no duplication of the CUSO programme. "I am confident that the partnership and co-operation that marks the relations between the Canadian Government and CUSO will characterize relations between CUSO and the Company of Young Canadians," Mr. Pearson declared.

He concluded with the assurance that the Government "will continue to add its own substantial financial support to the very necessary contributions CUSO receives from the public at large, including business and the professions, in order to encourage this significant Canadian service to developing countries".

GREAT LAKES POLLUTION

Mr. Paul Martin, Secretary of State for External Affairs, recently tabled in the House of Commons the interim report of the International Joint Commission to the Canadian and the United States Governments on pollution of Lake Erie, Lake Ontario and the international section of the St. Lawrence River.

Mr. Martin said that the Commission had been asked by the Canadian and U.S. Governments to undertake a study of this matter in October 1964 because the deteriorating condition of these waters made it essential that remedies be found as soon as possible. He pointed out that the measures recommended in the report were considered by the Commission as being essential first steps in restoring water quality to an acceptable level.

COMMISSION RECOMMENDATIONS

The report recommends that, as soon as possible, the United States and Canada, in co-operation with state and provincial governments, act to ensure: (a) sufficient purification of municipal and industrial wastes before they are discharged into the waters concerned, to reduce their phosphate content as low as possible; (b) prohibition of the building of combined sanitary and storm sewers, and a programme to separate existing combined sewers in communities discharging wastes into these waters and their tributaries; (c) regular sampling of effluents discharged into the waters concerned in accordance with programmes approved by the Commission.

The Commission further recommends that both governments support the programme of investigation and research outlined in its interim report (and as

subsequently developed) by the provision of personnel and facilities required from time to time.

Mr. Martin expressed his appreciation to the Commission for sending the interim recommendations to the Canadian and U.S. Governments within such a short time. The report, he said, was being made available before a decision was taken on the recommendations because the public in both countries was entitled to have the facts without delay on a matter of such vital importance. The recommendations, he added, were receiving immediate attention with a view to reaching agreement quickly with the U.S. authorities on the action to be taken. He emphasized that such action would be the initial step in combating this grave problem and that the Government was determined, in co-operation with Ontario, to bring relief in this area. He said that the Commission was continuing its study and would make a final report to the two Governments as soon as it was in a position to do so.

NEW GOVERNOR OF IMF

The Secretary of State for External Affairs, Mr. Paul Martin, announced in Ottawa recently the appointment of Mr. Mitchell Sharp, Minister of Finance, as Canadian Governor of the International Monetary Fund and of the International Bank for Reconstruction and Development. These positions were held formerly by Mr. Walter L. Gordon. The headquarters of the two international financial institutions are situated in Washington.

CITY POPULATIONS EXPAND

Population estimates, as of June 1, 1965, for 11 major metropolitan areas with populations of over 100,000 in the city proper on June 1, 1961, were released recently by the Dominion Bureau of Statistics. For purposes of comparison, these figures relate to the metropolitan boundaries established for the 1961 census. Though population estimates are shown only for 11 metropolitan areas, similar estimates have been made for the other six metropolitan areas of the 1961 census.

CITY PERCENTAGES

Increases since the 1961 census range from 2.9 per cent for Winnipeg metropolitan area to 15.7 per cent for Calgary. Of the other areas, Edmonton recorded a 14.1 percent increase. Toronto and Ottawa followed with gains of 13.2 per cent and 12.2 per cent, respectively. Montreal increased by 10.0 per cent, Quebec by 9.6 per cent, Hamilton by 9.1 per cent, London by 8.1 per cent, Vancouver by 7.6 per cent and Windsor by 6.5 per cent. The largest numerical increases during the period from 1961 to 1965 were for the metropolitan area of Toronto (242,000) and Montreal (211,000). The other gains ranged from 60,000 for the Vancouver metropolitan area to 13,000 for Windsor.

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CANADA-U.S. FINANCIAL RELATIONS

(Continued from P. 2)

financial authorities in this country (the Bank of Canada and the Department of Finance) — that, in the present state of the economy, it was not desirable to rely too heavily on general monetary and financial measures to control the inflow of capital and a more specific instrument of control might be needed.

REDUCING OF LIABILITIES IN U.S.

I therefore told Mr. Fowler, the Secretary of the Treasury in the United States, when I was Acting Minister of Finance, that the Canadian Government would be prepared, if necessary, to buy outstanding Canadian securities held in the United States, to offset any excess flow of U.S. capital to Canada and thus to maintain the net flow of capital at the level required to finance our balance-of-payments deficit. Instead of adding to U.S. assets in our exchange reserves, we should be reducing Canada's liabilities in the United States. Conversely, if the volume of borrowing by other Canadians were not sufficient to meet the balance-of-payments needs, the Government would itself arrange to borrow in the United States. In this way, our reserves could be maintained at around the desired level without interfering either with trade or with the normal use of the U.S. long-term capital markets by Canadian borrowers. I also agreed that, while our reserves must be expected to fluctuate from month to month, we should regard it as appropriate that such fluctuations take place around a level somewhat lower than the mid-1963 figure, say, approximately \$2,600 million (U.S.).

Should it be necessary to borrow in the U.S., I should foresee no great difficulty in obtaining moderate amounts as and when we require them. On the other hand, I believe that there are sufficient Government of Canada securities held in the U.S. market to enable us to do what might be required in buying Canadian securities in the U.S. by using the authority to purchase our own securities that is already granted in the Financial Administration Act.

I should like to tell the House that, since the beginning of 1966, we have purchased about \$40-million worth of our outstanding U.S. bonds that were held in the United States. Our purchase of these securities was consistent with the plan I have outlined but was also intended in considerable part to improve the market for the sale of other Canadian issues in the United States this month, when there appeared likely to be a large volume of such issues scheduled for delivery.

A GLOBAL RESTRICTION

The second important measure adopted by the U.S. in December was a voluntary ceiling on direct investment by United States corporations, of whom about 900 will be asked to report regularly on the progress of their co-operation with the United States administration. The guideline, and I will not take time now to give details, does not stipulate how any company shall distribute its direct investment among geographic

areas. This is a global restriction. It does not apply to Canada particularly; it applies to the world. Where it is applied is a matter for the business organization itself to decide. Canada is not exempted from this ceiling or guideline as it was from the previous guideline applying to direct investment.

As soon as we learned of the new United States guidelines for direct investment we told them that, while it was very hard for us to assess what its effects on Canada would be because so much depended on the decisions of the businesses, we thought it would cut down some of the flow of such capital to Canada. In so far as it worked in reducing such flow of such capital direct investment it would simply mean a greater need for new issues of Canadian securities in the United States under the arrangements and exemptions provided for long-term issues. We felt that, from a U.S. point of view, there was no reason why the Canadian balance-of-payments deficit with the United States should not be financed by direct investment just as well as by the sale of new issues of securities. Consequently, it seemed to us there was no certainty that the effort to restrict direct investment in Canada would in fact help the U.S. balance of payments at all in the final result.

We also pointed out that the inclusion of retained earnings of subsidiary corporations in the figures used to determine the voluntary quotas for direct investment worked a particular hardship on Canada. U.S.-controlled companies form such a large part of Canadian industry and have been so long established in Canada that they must be regarded as a basic and substantial part of the Canadian economy.

On the basis of these arguments, we suggested that the United States should continue a special exemption for Canada in their guidelines on direct investment or, if they could not see their way clear to do that, they should permit the investment of retained earnings to be outside the quotas.

My understanding is that the American authorities considered the points we put forward, as they said they would, but came to the conclusion that the guideline on direct investment had to be relatively simple and without special exceptions if it was to be effective in meeting the aims of their general programme. They did assure us, however, that these guidelines would not affect in any way the expansion necessary to achieve the purposes of the Canada-United States automotive agreement.

This guideline on direct investment is intended to restrict the outflow of capital from the United States parent companies to branches and subsidiaries in other countries. There is nothing in these guidelines, so far as I can see (and this is an important point), that would prevent Canadian subsidiaries of United States companies from borrowing like other Canadian companies by means of long-term issues in the United States market.

PROJECTS POSSIBLY DELAYED

As I said when these guidelines were announced, they have come into effect at a time when capital investment by business in Canada has been increasing very rapidly and cannot be expected to go on increasing at the same rate. In some measure the restraints

imposed by the direct-investment guidelines will not conflict with the necessities of our own domestic situation. In particular cases they may, however, result in the delay or cancellation of projects that we might have preferred to see proceed. It is our general economic dependence on imported capital which exposes us to dangers of this kind.

In all the circumstances, we have been fortunate in making arrangements that enable us to finance our balance of payments without restriction on current trade or payments and enable us to secure foreign savings to supplement our own.

I cannot agree with those who say that we should have accepted the application of the interest-equalization tax and accepted limitations on our right to raise long-term funds in the United States and should in return have retained our freedom to increase our reserves at will...So far as I can see, the result would have been to increase very substantially the cost of Canadians borrowing money both in Canada and the United States without increasing the supply of funds available to us and without gaining anything of substance by way of increased freedom to control our own affairs.

These American guidelines limiting direct investment have also raised another issue that is to say, whether through them the United States Government is interfering in the internal economic affairs of this country. As I have already said, we pointed out to the United States Government that this kind of measure as it applied to Canada was of very doubtful value as a means of relieving the United States balance-of-payments problem. I believe they would have been better advised to continue the exemption to Canada, both on economic and political grounds. It must be recognized, however, that in attempting to limit the direct investment of its companies abroad, the United States Government is following well-established precedents. Other countries faced with balance-of-payments problems - I have in mind, for example, the United Kingdom and France - have taken and do take measures to limit direct investments abroad of their international companies, and I have never heard of any suggestion that either the United Kingdom or France is thereby interfering in the internal affairs of other countries....

ADVANTAGEOUS RESULTS EXPECTED

But given the overall arrangements between the Canadian and United States Governments which ensure an access to the United States market for long-term funds and the scale and nature of the temporary guidelines on direct investment, I do not think there will be damage to the Canadian economy at this time; indeed, the results could be advantageous

if the emphasis on capital imports is shifted somewhat from direct investment to borrowing as successive Canadian Governments...have been attempting to promote in the past decade. Certainly, it is inconsistent for Canada to protest measures which have the effect of limiting the foreign ownership of our industries and resources.

This is a situation that calls for watchfulness on the part of the Government. We want to see the Americans succeed in their efforts to solve their balance-of-payments problems, we are on their side, so that these kinds of defensive measures on their part, the kind of measures I have been talking about, will become unnecessary. This Government will continue its consultations with the United States with the aim of ensuring that both countries deal with their balance-of-payments problems in ways that take into account the interest of the other.

PENSION FUNDS FOR PROVINCES

Mr. Mitchell Sharp, Minister of Finance, announced recently that an estimated \$380 million would become available to the provinces during 1966 from the operations of the Canada Pension Plan.

Under the Plan, all funds received but not required to meet expenses and the payment of benefits during the following three months are transferred to the Canada Pension Plan Investment Fund for the purchase of securities issued by the provinces or the Federal Government. These will be special non-marketable securities, with terms of up to 20 years, bearing interest based on the yields of Government of Canada marketable bonds of comparable period.

The allocations for purchases of provincial securities by the Canada Pension Plan Investment Fund are proportionate to the amounts of contributions paid in each province. Any balance not taken up by the provinces, together with funds collected in the Yukon and Northwest Territories, must be invested in special non-marketable securities of the Government of Canada.

The first monies from the Investment Fund will become available in March.

PROVINCIAL ALLOCATIONS

The estimated amounts to be offered to each province this year will be as follows: British Columbia \$53.99 million, Alberta \$34.90 million, Saskatchewan \$17.89 million, Manitoba \$23.80 million, Ontario \$214.92 million, New Brunswick \$10.85 million, Nova Scotia \$14.45 million, Prince Edward Island \$1.45 million, Newfoundland \$7.75 million.
