A.F.W. PLUMPTRE

THREE DECADES OF DECISION

CANADA AND THE WORLD MONETARY SYSTEM, 1944-75

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To Beryl
who
"tells it like it is"

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Contents

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Despite all this assistance, it is inevitable that errors will have crept in; for these I apologize. Moreover, while I have accepted many suggestions on matters of emphasis and opinion, I have not accepted others; I take full responsibility for the whole of the text.

Summer, 1976 A. F. W. Plumptre

Introduction

Over a period of some three decades, from the mid-forties to the mid-seventies, a love-hate relationship grew between Canadians on the one hand, and, on the other, the new world monetary system which they worked so hard to build, strove so tenaciously to keep alive, and yet found so difficult to live with. Within five years of the opening of the International Monetary Fund, the massive ebb and flow of funds across the Canada–U.S. border drove the Canadian dollar off its official peg and set it afloat. Twenty-five years later most of the other major currencies were also afloat for reasons that were not entirely dissimilar.

An attempt is made here to set out, from a Canadian point of view yet within the international framework, the complex sequence of major events and decisions involved in this relationship, and to put each in its proper political context and its appropriate historical perspective. (This is the first time that such an attempt has been made.) Accordingly, I believe that this book will be valuable to a number of specialized groups, including economists, bankers, political scientists and historians, as well as less specialized readers who are more broadly interested in international affairs and who may work in the interdisciplinary environment of Schools of International Affairs or of Canadian Studies. But if it is to retain the interest of these readers it must be written in language that is reasonably intelligible to them.

This raises the question whether it is really possible to produce, on a subject that is often considered to be recondite and obscure, a book that will be useful to the various people I have in mind. I believe that it is. Over a period of many years in the Canadian public service I attempted to draft for six successive ministers, most of whom had little or no financial background, speeches and statements that would be found understandable, even interesting, by audiences that could lay no claim to financial expertise. Indeed, members of governments, members of Parliament and members of the well-informed public must of necessity discuss financial matters. Finance, international as well as national, is central to the working of our economic system. Like war, it is too important to be left to the experts.

While I have tried to minimize the use of technical terms I have not excluded them altogether. When they do appear I try to offer brief explanations or to make their meaning reasonably clear from the context. Concepts such as foreign exchange markets and foreign exchange rates and balances of international payments occur frequently and readers who are unfamiliar with them at first will become more familiar as they proceed. In addition, in appendices at the end of some chapters I include comments of a technical character designed for the expert rather than for the more general reader.

So much for the way in which I try to handle the material of this book. Now a few paragraphs to explain the pattern in which the material is presented. A glance at the contents will reveal that the material is presented in chronological order. A second glance will reveal that I seem to cover most of the ground twice. This is because the book had to be written around two distinct yet closely interrelated themes.

The first theme presents Canada as a part of the international financial community and a member of international financial organizations in Washington, London and Paris. This is the theme on which the volume opens in chapters 1 and 2. Chapter 1 recalls the prewar financial chaos of the Great Depression when, indeed, there was no recognizable international financial community and, as in Genesis, "the earth was without form and void." From this point we move into the great community-building period of the late war and early postwar years. We find Canadians, influential as well as active, involved in the founding of various international organizations, including the International Monetary Fund.

In chapter 11 the institution-building theme comes through again, loud and clear. Once again, although for rather different reasons, Canadians are influential as well as active in rebuilding the Fund after the breakdown of the early 1970s.

In two intervening chapters the same theme is developed. Chapter 5, entitled "North Atlantic Resurgence, 1948-60" is concerned with Canada's involvement in international financial issues and organizations during the period dominated by the cold war which, for convenience, is here considered to have begun at the time of the Marshall Plan and to have continued until the countries of Western Europe were able to cease their postwar financial and commercial discrimination against North America and until the inward-looking Organization for European Economic Cooperation (OEEC), in which the United States and Canada were only associate members, became the outward-looking Organization for Economic Cooperation and Development (OECD) in which both were full members. Chapter 8, "New World Problems, 1960-70," deals with the international financial community and Canada's association with it during the long decline of the U.S. dollar. It lays an essential foundation for the discussion of Canada-United States relationships which is the subject of the following chapter.

A different theme is introduced in chapter 3 and developed in chapters 4, 6, 7, 9 and 10. The earlier theme centred on Canada's role in Washington, London and Paris, but now the focus becomes Ottawa. The two themes are, of course, interrelated. Financially speaking, Ottawa behaves as it does partly because of Canada's involvement in the international financial community and partly because of purposes and policies that have their origins in Canada. Thus chapter 3 (1944–48) finds Ottawa pressing forward at the end of the war to rebuild overseas markets, especially in Britain. Chapter 4 then explores the wartime and immediate postwar problems of managing the Canadian dollar – problems which have dogged Ottawa in one form or another ever since.

Chapters 6 and 7 deal with two fascinatingly different periods of Canada's floating exchange rate, the first (1950–56) when everything seemed to go right and the second (1957–62) when everything seemed to go wrong. But the discussion on whether Canada gets on better with a fixed or a floating dollar is postponed to the final section of chapter 9. The earlier part of that chapter is concerned with Ottawa's policies during the period in which the U.S. dollar was in deepening difficulty and when the Canadian dollar, perhaps by accident rather than design, was once again fixed instead of floating.

It has not been possible to bring the two themes to a simultaneous and harmonious conclusion. The theme that centres on the work, breakdown and reform of the International Monetary Fund builds up to a natural finale early in 1976 when major decisions were taken internationally as to the future of that organization. But there seemed no way to bring the Ottawa-centred theme to an orderly end at the same time. In 1974 Canadian economic policy entered a period which, both at the time and in retrospect, seemed confused. At first the mistaken impression prevailed that Canada would escape many of the difficulties which beset other countries as a result of the four-fold increase in world oil prices, and policy initiatives were launched on this basis. In fact Canadian international payments plunged into deep deficit. Nevertheless the Canadian dollar continued to float at a premium above the American. Meanwhile, partly because of the oil price situation, regional tensions within the country mounted and the government's anti-inflation program received a very mixed reception. As the manuscript of this book is being put into final shape for the printer the Parti Québecois, dedicated to the separation of that province from the rest of Canada, has won a resounding victory at the polls, a victory which carries with it important financial implications both domestic and international. Against such a background, unsettled and uncertain, it has been possible to make a number of comments on international financial policies during the year 1974 and 1975 and even into early 1976, but it would be misleading to try to present such policies as terminal rather than temporary.

It remains for me to explain my own associations with the events that are presented and discussed in this volume. It is, I hope, clear that it is not an autobiography. On the other hand, I cannot pretend that I was somewhere else, far off and completely objective, on those occasions when I was, in fact, involved. The reader will find that my personal experiences surface from time to time, but I have tried to describe the international financial policies of successive Canadian governments as they themselves saw them and as they explained them in Parliament and on other platforms at home and abroad. *Hansard* is a basic source of material. The confidential departmental files for the period 1944 to 1975 are not yet, for the most part, open to public inspection.

But, apart from personal experiences, my general attitude to the course of events and my interpretation of them has been moulded both by my academic background and by my experiences and associations in the Canadian public service. I joined the service at the end of 1941 when, after ten years' teaching and writing at the University of Toronto, I went to Washington as Financial Attaché at the Canadian Legation (later the Canadian Embassy) and also as Washington Representative of the Wartime Prices and Trade Board. Apart from a two-year stint (1947–48) as an editorial writer under the wing of the great B. K. Sandwell of *Saturday Night*, I continued in the service until 1965, first in the Wartime Prices and Trade Board (1942–47) in Washington and Ottawa, then in the Department of External Affairs (1949–54) in Ottawa and with the Canadian Delegation to NATO and the OEEC in Paris and, finally, in charge of most of the international work of the Department of Finance (1954–65), nominally in Ottawa but with much of my time spent at international gatherings in Washington, London, Paris and elsewhere. Indeed, it was largely because my life had become so peripatetic that I sought respite by returning to the University of Toronto in 1965. In 1972, having reached retiring age, I returned to Ottawa and, as a Visiting Professor, joined the School of International Affairs of Carleton University.

1

A New World Order

Planning for a More Orderly World

Canada's international economic relationships were vastly changed by the Second World War. Country by country, continent by continent, the world that confronted Canada in the postwar years had altered beyond recognition. Britain, towards which so much of the national economic effort had traditionally been focused, was exhausted by her shattering wartime ordeal; the war-ravaged countries of Western Europe all looked to North America for help in postwar reconstruction; Japan quickly learned to play the game of international capitalist competition and then learned to outplay her less flexible, less disciplined competitors; the United States, shedding her cloak of isolationism, emerged as the dominant power, economically, politically and militarily; the Soviet Union challenged the military primacy of the United States, first in terms of conventional weapons and, in due course, by producing atomic bombs; China's revolution opened the way to economic advancement for the masses of her population; and finally, not least among these changes, the countries of Asia, the Caribbean and Africa successively emerged from the constraints of colonialism to face the opportunities as well as the disappointments and disruptions of a new and insecure independence. All these developments confronted postwar Canada with new problems and new opportunities.

But there was another development, a development of a different and novel dimension, around which Canada's new economic policies clustered. The postwar world would never have taken its actual shape if, during the war and indeed while victory still appeared remote and uncertain, plans had not been developed for replacing the international economic chaos of the prewar decade by at least a measure of internationally acceptable and accepted rules. These plans for a new world order were pressed forward under the auspices of the Atlantic Charter, promulgated by President Roosevelt and Prime Minister Churchill in August 1941 (the text will be found in the appendix to this chapter on p. 32.

Some of the economic planning took place in bomb-torn London but the greater part was developed in Washington. A new central politico-military organization was to be created, which became the United Nations, and associated agencies were to be set up that would be concerned with a variety of issues such as food production (FAO), health (WHO), science and culture (UNESCO), and so forth. But a unique feature of the proposed institutions in the fields of finance and trade was their code of rules to govern international commercial and financial conduct and their provision for financial support to help member countries keep the rules. A new regime of law and order was to be introduced into world economic affairs.

At the end of the first World War, it will be recalled, there was also a plan for a new world organization. Its fate, along with the tragedy of President Woodrow Wilson, its sponsor, was much in the minds of the planners during the Second World War. In negotiating the peace treaty at the end of the Great War Wilson had insisted on attaching to it his project for a League of Nations. In due course the project was rejected, not by his skeptical, often scornful, allies, but by the U.S. Senate – a blow from which he never recovered. Thus the American planners during and after the Second World War kept their eyes closely on the moods and attitudes of Congress.

To understand the nature of the plans for a new international economic order that were taking shape in 1943 – 45 it is necessary to recall the disorders of the Great Depression of the 1930s. The fear uppermost in the minds of the planners was that the world would relapse after the war into the international economic anarchy that had characterized the years from

1929 to 1939. War, with its toll of death and destruction, had been terrible, but from one point of view the Great Depression had been worse. The wartime armies at least had the satisfaction of serving a purpose, however unwelcome. But the peacetime armies of urban unemployed, millions of destitute farmers, and countless ruined business and professional people, had found themselves adrift in a purposeless, rudderless world. It was the doubt and disillusionment of depression that had made a leader like Hitler credible.

National governments, at a loss to know how to deal with such unprecedented economic disaster, grasped at the most familiar yet, from a world viewpoint, the most damaging of economic remedies. They hoped that, by cutting off unwelcome import competition from abroad, they could give respite and encouragement to domestic producers. Tariffs, quotas, import restrictions, exchange-rate manipulation – all these and other protectionist weapons were wielded indiscriminately. But while it might appear possible for each country to add to its production and employment at the expense of all the rest, it was obviously impossible for all to do so. As trade dwindled all suffered.

This dog-eat-dog, beggar-my-neighbour attitude was never to be repeated; such was the overriding objective of the wartime economic planners. Their hope, their belief, was that the Great War and the Great Depression together would have taught the peoples of the world that some sacrifice of sovereignty to newly established international institutions was in their own interest. It seemed reasonable to suggest that new institutions should embody new codes of behaviour for the conduct of international economic affairs.

The Disorders of the Great Depression: Canadian Experiences

Few if any countries suffered more severely in the Great Depression than did Canada. The Canadians who took part – and it was a significant part – in the plans for a more orderly economic world were strongly motivated by the Canadian experience. The same grim recollections were in the minds of the members of Parliament and the public who, in due course, gave strong and almost unanimous support to the plans that emerged.

Today many Canadians have no recollection of the Depression. The following brief survey is intended to give them some idea of the dimensions of the economic disaster which overtook the country in the decade between 1929 and 1939 and of the unpreparedness of Canadian governments to cope with it.[1]

In those days, Canada's economic life was dominated by earnings in world markets from a few staple exports. Between 1929 and 1933 the price of wheat fell by 55 per cent, cattle by 63 per cent, lumber by 32 per cent, newsprint by 38 per cent, copper by 56 per cent, and dried cod by 58 per cent. The average price of all Canadian exports fell by 40 per cent.[2] The collapse of world commodity prices was aggravated for many Canadian exporters by sharp increases in trade barriers abroad. Particularly hurtful were the American tariff increases of 1930 against agricultural imports and of 1932 against lumber and copper.[3]

As incomes from abroad fell, Canadians spent less on Canadian products. Manufacturers responded in part by lowering their prices but chiefly by reducing their output and employment. Manufacturing and processing slowed down and, with the general collapse of confidence in the future, construction projects, public as well as private, were abandoned. Statistics of the labour force were not regularly compiled in those days, but official estimates of unemployment at the depth of the depression were around 20 per cent and other estimates ran over 30 per cent.[4]

The impact of unemployment on those thrown out of work was far more severe than it is today. There were no national or provincial arrangements for unemployment insurance, no family allowances and no medicare; old age pensions, recently introduced, were subject to a strict means test. Because unemployment persisted for years, it usually led to destitution and to an attempt to eke out an existence on charity or on such relief payments as were available. The acceptance of either charity or relief was widely accepted as a stigma of failure.

The federal government, at least at the outset, assumed no responsibility for relief payments. The capacity of the provinces to support their municipalities differed widely and dwindled rapidly. The capacity of municipalities differed even more widely. Even in the wealthy metropolitan region of Toronto, ten of the thirteen municipalities were soon in financial default and these, of course, were the municipalities where most of the unemployed lived and where funds for relief were most urgently needed.[5] On the prairies the farmers, and the people of towns and cities who depended on farm purchasing power, suffered not only from the collapse of world grain prices but also from a debt structure greatly inflated during the preceding boom. The chief grain-growing area of Saskatchewan also experienced a seven-year drought. Much of the top soil dried up and drifted away in dust storms. People drifted away too.

Among the provinces economic conditions differed considerably. Between 1928/29 and 1933 per capita incomes (in terms of dollars) fell in Nova Scotia by 36 per cent, in New Brunswick by 39 per cent, in Quebec by 44 per cent, in Ontario by 44 per cent, in Prince Edward Island by 45 per cent, in British Columbia by 47 per cent, in Manitoba by 49 per cent, in Alberta by 61 per cent and in drought-ridden Saskatchewan by no less than 73 per cent. On the average, Canadian incomes fell by 48 per cent.[6] Per capita incomes did not fall as steeply in the Maritime provinces as elsewhere only because these provinces were already relatively depressed in 1928/29 and because their farming was more nearly on a subsistence basis. Newfoundland, not yet part of Canada, was even worse off than the Maritimes and even more exposed. Threatened with default on her debts, the self-government of Britain's oldest dominion was revoked; she had not even earned the right to go broke.[7]

Canadian banks and other creditors, faced with increasing credit risks, persistently tried to call in their loans and reduce new commitments. Many investors, large and small, who had bought securities on credit during the preceding boom, found themselves hopelessly in debt as stock prices fell even more rapidly than commodity prices and as many bond issues went into default. Bankruptcies and evictions were widespread in all parts of the country.

Confronted by shrinking revenues, both federal and provincial governments cut costs as best they could. As salaries were reduced, civil servants, teachers and professors were severely squeezed. Doctors, lawyers and other professional men were often unable to collect their fees; on the prairies and in other rural areas many of them were glad to accept payment in such farm produce as penniless farmers could provide. By means of stringent cost-cutting the federal government was able to continue to meet its debt obligations; it also assisted the poorer provinces to keep out of bankruptcy. Governments were thus able to remain credit-worthy on financial markets and the Canadian dollar remained relatively firm on the foreign exchange market.

But, one may ask, what action did governments actually take to combat the depression? The federal government initially made extensive use of the only instrument that, according to the accepted tenets of the time, was ready to hand: the tariff. Tariff rates were first raised early in 1930 by the Liberal government under Mackenzie King and then, later in the year and more substantially, by the Conservative government under R. B. Bennett. They were raised again, chiefly in order to enlarge British preferential tariff margins, following the Imperial Conference in Ottawa in 1932. But increased tariffs were only the most obvious form of the added protection provided for Canadian industry. Further protection was afforded by the administrative application of dumping duties based on arbitrary (inflated) valuations of the goods imported; such valuations could be applied to importations which, in the opinion of the responsible minister, were "harmful to Canadian producers." Another device was to fix arbitrarily, at an over-valued level, the rate of exchange on the basis of which the tariff could be levied. In negotiations with the United States in 1935, after Roosevelt and Mackenzie King had replaced Hoover and Bennett as President and Prime Minister, tariffs began to come down again and some of the arbitrary practices were removed; but the average level of the Canadian tariff remained far above that existing prior to 1930.[8]

Why were other policies not pursued to relieve the depression? What about monetary and budgetary expansion and exchange rate depreciation? The answer is that in those days proposals of this sort were unfamiliar and suspect; in some cases, the machinery to make them effective did not as yet exist, at least in Canada. It might be noted in passing that Australia made much more imaginative and vigorous use of financial policies to combat the depression.

Many voices were raised, particularly in western Canada, demanding an expansion of money and credit, and a depreciation of the Canadian dollar along with new governmental machinery to implement such policies. In 1935, after the worst was over, a central bank was indeed set up. It helped in sorting out federal-provincial financial relationships, but the Ottawa government was financially conservative and probably would not have tolerated a substantial expansion of the money supply which it would have considered inflationary.

As for depreciation of the Canadian dollar, which was then floating freely on the foreign exchange market, the general opinion in Ottawa was skeptical. It is now recognized, said the Rowell-Sirois Report in 1940, "that the purchasing power of the dollar not only can be deliberately altered but that it is expedient, and now considered almost respectable, to do so."[9] On the other hand, the report also noted that "over one-half of the total debt of all Canadian governments and over four-fifths of the bonded debt of Canadian corporations were . . . payable in a foreign currency."[10] Accordingly the authorities were not disposed to add to their budgetary burdens by exchange depreciation.

As for fiscal policy, the traditional objective of a balanced budget, although seldom achievable, was generally pursued by all Canadian governments. Keynesian ideas of deficit-financing to alleviate a depression (and of surplus-financing to moderate a boom) were accepted by Canadian governments after the war but not before it.

Professor Neatby, in *The Politics of Chaos: Canada in the Thirties*, summed up the situation "In retrospect the depression appears as an unmitigated disaster, a decade in which people could only wait helplessly for the return of better days."[11]

Canada's Part in the Economic Planning

Against the background of Canada's experiences in the depression it was not surprising that Canadian representatives should seek to play an active part in plans for a new world order. And fortunately their desires were matched by their opportunities. For a number of reasons they found themselves particularly well placed to influence the course of events in Washington, where most of the planning was done.

They could not have exerted the influence that they did had it not been for Canada's substantial contribution to the common war effort. In different ways and at different times the Canadian navy, the Canadian army, and the Canadian air force were deeply involved. In addition, Canada was able to supply food, materials and an increasingly massive flow of arms and ammunition to her allies and friends, including the United States. Any review of the performance is impressive.[12] Seen through American eyes at the time it was perhaps the more impressive, because Canada was able to mobilize her manpower and resources at high speed immediately after Hitler overran most of western Europe in 1940, while the United States was half committed and half neutral until the Japanese attack on Pearl Harbor in December 1941. Thus, during the earlier years of the war, the Canadian effort was less inhibited than the American, and Canada's performance undoubtedly stood high in the eyes of those involved in wartime economic organization and in postwar planning in Washington.

In addition, there were a number of other wartime developments, not always so clearly apparent nowadays, which enhanced the position of influence in which Canadians found themselves. Not the least of these related to shipping. In those days the airplane had not yet emerged as a significant factor. It was only in August 1939 that regular transatlantic flights were inaugurated by Pan American World Airways and British Imperial Airways; they used flying-boats that took some thirty hours to complete the crossing and that settled, duck-like, on the waves. In the same year Trans-Canada Airlines, later to become Air Canada, inaugurated its Montreal-Vancouver service and two years later extended it to Halifax. Its planes, carrying ten passengers at a time, could scarcely be considered as vehicles of mass movement. When a group of Canadians including the present writer flew to England late in 1945 to attend the Preparatory Commission of the United Nations, they were transported in the chilly belly of a Lancaster bomber and were held up for three days in Gander, Newfoundland, by a blizzard. Obviously, it was still the ship that carried people and things across the seas.

And ships in wartime were prey to submarines. For lengthy periods during the war Hitler's submarines sank Allied ships far more quickly than they could be built. There was a continuing danger that, in the crucial battlefront that operated out of Britain, the beleagered island would be cut off from outside support and beaten, starved into submission. So ships had to be used as economically and as efficiently as possible. Canada was beyond the reach of enemy bombers and was, by all odds, Britain's nearest source of supply. The North Atlantic became Britain's lifeline. And it was primarily on North American supplies that Britain had to draw.

Not that all shipping was cut off from other parts of the world. Ships still moved over far-off sea lanes, zigzagging to avoid torpedoes or in tedious convoys that had to move at the speed of the slowest vessel under such protection as navies and air forces could provide. But it was from Canada and the United States, based on the wealth and power of North America, that the great convoys moved, keeping the British bridgehead open, carrying support for the Soviet Union, and in the end providing the massive military and economic strength required to cross the English Channel to open up the Second Front in Europe.

As the economic mobilization of North America progressed it was natural and sensible that the Canadian and American systems of wartime plans and wartime controls should be closely meshed. Occasionally the issue that needed to be resolved was financial. Early in 1941, when Canada's war effort and war expenditures were substantially outrunning those of the United States, Canada found herself very short of U.S. dollars. Accordingly, under the Hyde Park Agreement of 20 April President Roosevelt agreed with Prime Minister Mackenzie King that the United States would accelerate its purchases of Canadian material and supplies needed for U.S. defence and would, under its recent lend-lease legislation, finance U.S. components of tanks and other equipment that were being assembled in Canada for onward shipment to Britain.

More often, however, the problems concerned administration: the danger that wartime regulations and restrictions, conceived and administered on a national basis, would cut across and distort the effective wartime utilization of the economic resources of the continent. It has been suggested that there was some far-reaching integration of the whole North American economy for wartime purposes. This was not the case; but there was a real and effective coordination of wartime economic planning and wartime controls in the two countries.[13] Canadian associations with wartime Washington became intimate and extensive. Canadians in positions of authority could be available for meetings and discussions in Washington at short notice, without facing the delays and hazards of the sea.

Various Canadian offices were set up there, and an office of the U.S. War Production Board was set up in Ottawa.

After the Japanese attack on Pearl Harbor, when the final props had been knocked from under American neutrality and when the United States was completely committed to war, more formal arrangements became possible. There were three, not two, countries to hold membership in two of the "Combined Boards" concerned with Allied economic mobilization: Canadians, along with the Americans and the British, sat as full members of the Combined Food Board and the Combined Production and Resources Board. Canada would also, it was said, have been on the Combined Raw Materials Board had not C. D. Howe, Minister of Munitions and Supply, apparently decided that his hand would be stronger if the other two, the "big boys," had to come and seek his concurrence, rather than demanding it by a two-against-one vote within the framework of a Combined Board. Thus, while Canadians were not included in the top military direction of the war,[14] they were closely associated with or actually members of bodies in Washington that were responsible for wartime economic decision-making.

Another factor contributing to Canada's special position in Washington lay in the fact that most of the great industrial and trading nations of the world had been overrun by Hitler. There were, of course, a number of governments-in-exile set up in London: the Free French, and also representatives of the Netherlands, Belgium, Norway, Denmark, Poland and other captured countries. Their representatives could and did appear at certain postwar planning sessions in Washington, but they were not on hand all the time and, unlike Canada, they were not major partners in the war effort itself.

Canadians and Americans were also drawn together on wartime economic issues by the fact that both were supplying to other countries – particularly to Britain, but also to the Soviet Union, Australia, India, and Latin America – far more goods and services than they could currently pay for. Each of the two supplying countries had to devise politically acceptable systems that kept the goods moving, despite impossibility of payment. And, in doing so, both countries were setting the stage for their postwar international aid programs.

It has been suggested that Canada approached the United

States as a mendicant, begging for favours whether economic or administrative.[15] This is a misapprehension of the actual relationship. The administrative arrangements that were made were designed to benefit the common defence effort. Each country had its surpluses and its shortages; just as Canada had to seek many products from the United States, so the United States had to seek many from Canada: aluminum, copper, lead, zinc, lumber, pulpwood, newsprint and food stuffs, as well as certain manufactures. It is probably true to say that most of the Americans who became responsible for economic mobilization in pre-Pearl Harbor Washington envied Canada's full participation in the war and were anxious to help the Canadian war effort in whatever way they could; this, surely, was the motive that underlay President Roosevelt's readiness to accept Mackenzie King's Hyde Park proposals.

And so, when it came to postwar planning in which the United States was so clearly and so necessarily taking the lead, the comparing of notes, the interchange of confidences with Canada came naturally. Not least important was the fact that Canadians had a reasonably good understanding of the American political and constitutional system. Much of what was or was not practicable in the field of postwar economic arrangements depended on judgments as to what would and what would not be acceptable to Congress. This is a subject that is, of necessity, more than familiar to Canadians.

In London also, Canada played a part in the postwar planning. The British consulted with two groups: with the Commonwealth, and with the governments-in-exile, and Canada, of course, was included in the former. Sessions were held on several occasions under the magnetic and imaginative leadership of Lord Keynes. Senior Canadian officials and occasionally ministers crossed the Atlantic to attend to these and other matters. (A ship carrying C. D. Howe was torpedoed; he and some, but not all, of his colleagues were rescued.)

Canadians did not have quite the same special economic relationship with wartime London as they did with wartime Washington; nevertheless, there appears to have been something special about that relationship. Roy Harrod, himself a participant on the British side, later wrote as follows about the Canadian contribution to postwar planning sessions:

Meanwhile in London, in October, a meeting of Dominions representatives was taking place, at which Keynes' ideas were expounded. It was judged to be a useful meeting. The Canadians were keen that the British and Americans should think alike on post-war topics; in these talks and throughout the subsequent negotiations the Canadians continued to make valuable contributions. They were represented on successive occasions by able men, including Messrs. Rasminsky, Towers, Mackintosh and Pearson. Almost alone, outside the ranks of British and Americans, the Canadians seemed capable of understanding the international monetary problem as a whole. Their suggestions were intelligent and constructive, and the British and Americans were always anxious to have them.[16]

There were, of course, reasons why Canadians thought along lines similar to the British and Americans. At the top of Canadian priorities for the postwar economic world was that there should be harmony and cooperation between the United States and the United Kingdom. Canadians were continually pressing the case for such principles as "multilateralism" and "non-discrimination." In more homely if more limited terms, this meant that the British pound (in terms of which Canadians received so much of their export income) should be fully and freely convertible into U.S. dollars (which Canadians needed to pay import bills and debt service) and that, as part of the price Canadians would pay for gaining freer access to the highly protected U.S. market, they would sacrifice the pleasant but diminishing advantages of the tariff preferences Canadian exports enjoyed in various British markets. (The Australians, by contrast, were much more closely tied into the British trading and financial system; their economic interests in Washington related mainly to particular products such as wool.)

After the fragmentation and constriction of world trade and finance in the Great Depression, and after the distortions of war, it was reasonable to argue (as Canadians certainly did) the advantages of freer trade and payments. But the pattern of Canada's trade and financial relationships was such that Canadians had a very special interest in promoting a world-wide system. Their major contributions to postwar economic plans probably lay in helping to find acceptable compromises between British and American positions which, in some respects, were wide apart. It was most important, moreover, that the compromises should not founder, as had the League of Nations, on the rock of the U.S. Congress. It was this factor, rather than lack of sympathy for the more imaginative and far-reaching plans of Lord Keynes and his colleagues, that led Canadians to advocate positions that, on the whole, seemed more American than British.

This is not the place for a detailed account of the part that Canadians played in the establishment of each of the postwar economic agencies. Nevertheless, it may be useful to give a few examples to indicate its extent and importance.[17] A Canadian, L. B. Pearson, was in May 1943 appointed chairman of the committee responsible for drafting the constitution of the Food and Agriculture Organization (FAO) and in 1945 was chairman of the international conference that considered and adopted the draft. Pearson was also chairman of the Supplies Committee of the United Nations Relief and Rehabilitation Administration and later became a member of its Central Policy Committee. At Bretton Woods in 1944 Canadians were selected to chair the Committee on the Operations of the proposed International Monetary Fund and to chair its Drafting Committee.

At the Chicago conference which led to the formation of the International Civil Aviation Organization (ICAO) Canadians were given much of the credit for drafting the constitution.[18] A Canadian, Dana Wilgress, became the first chairman of the Contracting Parties of the General Agreement on Tariffs and Trade (GATT) and was re-elected annually for seven years. And in the United Nations itself, Canada was among the first countries to be elected to a three-year membership in the Economic and Social Council. A Canadian (Mitchell Sharp) was a leading member of the committee that established the Scale of Assessment for national contributions to the U.N. budget. Another (J. T. Marshall) was a leading member of the commission that laid the basis for the compilation of U.N. statistics. A third (W. A. Mackintosh) became the first chairman of the U.N. Economic and Employment Commission.

In recent years it has been suggested that, in the formation of the postwar international agencies, Canada played the role of a wide-eyed innocent, serving general world interests rather than specific Canadian interests. Such suggestions do not recognize the nature and extent of Canadian interests either then or now.

The general case for Canada's support of international organizations in the postwar world was stated by Louis St. Laurent, then Canada's Minister for External Affairs, in a speech at the University of Toronto early in 1947. After noting Canada's contribution to UNRRA and postwar reconstruction in overseas countries he went on to say:

> We have done this as a matter of policy because we believe that economic reconstruction of the world must go hand in hand with political reconstruction. We are aware, too, that economic revival is a matter of great importance to us. We are dependant on markets abroad for the large quantities of staple products we produce and cannot consume, and we are dependant on supplies from abroad of commodities which are essential to our well-being. It seems to me axiomatic, therefore, that we should give our support to every international organization which contributes to the economic and political stability of the world.[19]

The need for international organizations within which to protect and advance Canadian interests was not just an idea of Lester Pearson, the ex-professor; it was shared fully by Louis St. Laurent, the corporation lawyer, by C. D. Howe, the successful entrepreneur, by other members of cabinet and by senior officials, many of them with business, financial and professional experience. Mr. Howe was particularly active in the creation of ICAO in order to promote the interests of Trans-Canada Airlines ("his" airline, as he used to call it). He was also much concerned to develop Canada's trade interests under the GATT. No country stood to gain more than Canada from the reduction of prewar and wartime trade barriers, from the establishment of codes of rules for international trade, payments and exchange rates, and from the introduction of more stable arrangements for international lending.

For Canada it was of particular importance that Washington, which had emerged from the war as leader in the direction of strengthened international relations and lower trade barriers but which until the election of Franklin Roosevelt in 1932 had been isolationist and protectionist, should be committed to its new goals as firmly as possible. This objective could only be accomplished by a series of binding agreements entered into by the United States, not with Canada alone, but with all the main trading and financial centres of the world. If the United States should, at a later date, seem to back away from its international obligations, it would be well for restraint to come, not from Canada alone, but from countries large and small all over the world. (The importance of this consideration emerged all too clearly at the time of the world financial breakdown of 1971 which is described in chapter 10 below.)

Moreover, only by means of agreements embracing both the United States and the United Kingdom, along with other leading countries, would it be possible for Canada to avoid her historic schizophrenia. In a world of multilateral arrangements Canada would not be forced into agonizing choices, political and economic, between her ties with the United States and her ties with Britain, the Commonwealth and Europe.

Finally, and perhaps of overriding importance in the light Canada's disastrous experience in the 1930s, it was only practicable for this country to pursue effective full-employment policies within an internationally agreed framework of economic law and order. The fundamental objective of a high and stable level of employment pervaded all the postwar plans and all the postwar organizations.

It is true, and it was true at the time, that the new international institutions, largely fashioned in Washington, were designed to serve the international interests of the United States. The charge that they could in many respects be considered as the creatures of American "capitalist imperialism" can in a sense be accepted. It does not follow, however, that their establishment and operation were contrary to Canadian interests as perceived at the time or subsequently by Canadian governments or Canadians generally. The kind of postwar world the Americans, in collaboration with the British, were attempting to build was one that was in large measure well adapted to Canadian requirements, and as a result of Canadian efforts the adaptation was improved.

With the passage of time Canadians have paid decreasing attention to the international organizations of which they are members, with the possible exception of the United Nations itself to which Canadian media and Canadian authors still pay a good deal of attention. It is an interesting comment on the state of opinion in Ottawa (particularly, perhaps, in the Department of External Affairs) that the only two international organizations to be discussed in any detail in Canada's official foreign policy review of 1970 were the United Nations itself and (of all things!) the Organization of American States.[20]

Nevertheless, the international economic institutions are still the cornerstones of Canada's international economic relationships. This volume, directed towards financial policies, will be chiefly concerned with the International Monetary Fund; the next chapter is devoted to Canada's interest and influence in its establishment. Canada's subsequent relationships with the Fund emerge, chapter by chapter, throughout this volume and it is no accident that the final chapters, which are concerned with world financial breakdown in 1971–75, find Canadians once again participating, actively and effectively, in the task of world financial reconstruction.

APPENDIX
THE ATLANTIC CHARTER

Declaration by the Prime Minister of the United Kingdom and the President of the United States, August 12, 1941.

The President of the United States of America and the Prime Minister, Mr. Churchill, representing His Majesty's Government in the United Kingdom, being met together, deem it right to make known certain common principles in the national policies of their respective countries on which they base their hopes for a better future for the world.

First, their countries seek no aggrandizement, territorial or other;

Second, they desire to see no territorial changes that do not accord with the freely expressed wishes of the peoples concerned;

Third, they respect the right of all peoples to choose the form of government under which they will live; and the wish to see sovereign rights and self-government restored to those who have been forcibly deprived of them;

Fourth, they will endeavour, with due respect for their existing obligations, to further the enjoyment by all States, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity;

Fifth, they desire to bring about the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labour standards, economic advancement, and social security;

Sixth, after the final destruction of the Nazi tyranny, they hope to see established a peace which will afford to all nations the means of dwelling in safety within their own boundaries, and which will afford assurance that all the men in all the lands may live out their lives in freedom from fear and want;

Seventh, such a peace should enable all men to traverse the high seas and oceans without hindrance;

Eighth, they believe that all of the nations of the world, for realistic as well as spiritual reasons, must come to the abandonment of the use of force. Since no future peace can be maintained if land, sea or air armaments continue to be employed by nations which threaten, or may threaten, aggression outside of the frontiers, they believe, pending the establishment of a wider and permanent system of general security, that the disarmament of such nations is essential. They will likewise aid and encourage all other practicable measures which will lighten for peace-loving peoples the crushing burden of armaments.

SOURCE: *British and Foreign State Papers 1940–1942*, Vol. CXLIV (London, HMSO, 1952).

NOTES

1 For fuller accounts the reader should look elsewhere. The most authoritative account appeared in 1940 in Book I of the *Report of the Royal Commission on Dominion Provincial Relations* (Rowell-Sirois Report) (Ottawa: King's Printer, 1940), and in its Appendix 3, *The Economic Background* by W. A. Mackintosh, which was subsequently republished as No. 13 in the Carleton Library series (Toronto: McClelland and Stewart, 1964). A comprehensive retrospective account will be found in A. E. Safarian, *The Canadian Economy in the Great Depression* (Toronto: University of Toronto Press, 1959) and republished in the

Carleton Library series (Toronto: McClelland and Stewart, 1970). More recently several books have been published which attempt to convey the impact of the depression in more personal terms. These include: Barry Broadfoot, *Ten Lost Years, 1929-39; Memories of Canadians Who Survived the Depression* (Toronto: Doubleday, 1973); Michiel Horn, ed., *The Dirty Thirties; Canadians in the Great Depression* (Toronto: Copp, Clark, 1972); L. M. Grayson and Michael Bliss, eds., *The Wretched of Canada*, a selection of letters written to Prime Minister Bennett asking his help (Toronto: University of Toronto Press, 1971); and James H. Gray, *The Winter Years, The Depression on the Prairies*, a moving personal memoir by a reliable journalist (Toronto: Macmillan of Canada, 1966).

2 *Rowell-Sirois Report*, Vol. I, p. 146.

3 Safarian, *The Canadian Economy*, p. 92.

4 Horn, *The Dirty Thirties*, pp. 10-11.

5 A. F. W. Plumptre, "Report on the Government of the Metropolitan Area of Toronto," submitted to the Hon. David Croll, Minister of Municipal Affairs in Ontario, June 1935.

6 *Rowell-Sirois Report*, Vol. I, p. 150.

7 A. F. W. Plumptre, A. M. Fraser and H. A. Innis, "Newfoundland, Economic and Political," *Canadian Journal of Economics and Political Science*, Vol. III, no. 1 (February 1937), pp. 58-85.

8 *Rowell-Sirois Report*, Vol. I, p. 160

9 *Ibid.*, p. 186.

10 *Ibid.*, p. 154.

11 H. Blair Neatby, *The Politics of Chaos: Canada in the Thirties* (Toronto: Macmillan of Canada, 1972).

12 See F. H. Soward, *Canada in World Affairs: From Normandy to Paris, 1944-1946* (Toronto: Oxford University Press, 1951), chapters 1 and 3.

13 See. R. Warren James, *Wartime Economic Cooperation, A Study of Relations between Canada and the United States* (Toronto: Ryerson Press, 1949), p. 397 and *passim*; also S. D. Pierce and A. F. W. Plumptre, "Canada's Relations with War-time Agencies in Washington," *Canadian Journal of Economics and Political Science*, Vol. XI, no. 3 (August 1945), pp. 402-19.

14 See C. P. Stacey, *Arms, Men and Governments: The War Policies of Canada, 1939-1945* (Ottawa: Queen's Printer, 1970), especially chapter 3, "Canada and the Allied Direction of the War."

15 For example, see R. D. Cuff and J. L. Granatstein; "Canada and the Perils of Exemptionalism," *Queen's Quarterly*, Vol. LXXIX (1972), pp. 473-81. See also Appendix 2 to chapter 3 below.

16 R. F. Harrod, *Life of John Maynard Keynes* (London: Macmillan, 1951) pp. 541-42.

17 A more extensive review may be found in F. H. Soward, *Canada in World Affairs 1944-1946*, chapters 4 and 5.

18 F. H. Soward, *Canada in World Affairs 1944-1946*, p. 186.

19 L. St. Laurent, "The Foundation of Canadian Policy in World Affairs," Department of External Affairs, *Statements and Speeches*, No. 47/2, January 13, 1947.

20 *Foreign Policy for Canadians*, published in six pamphlets (Ottawa: Queen's Printer, 1970).

2

A New Financial Framework 1944 – 45

Steps toward the Fund Agreement

The term "epoch-making" has been debased by frequent use, but it can reasonably be applied to the establishment of the International Monetary Fund. "Something very important happened at Bretton Woods in 1944, and that was that the world consciously took control of the international monetary system."[1] And again, "The Articles of the Fund are one of the great law-making charters of the post-war world."[2] The achievement of 1944 is not diminished by reason of the fact that thirty years later, by 1974, some basic revisions of the original Articles of Agreement were found to be necessary. At that time proposals were made for an entirely new institution that would replace the Fund but they received very little support and the task of reforming the Agreement was carried forward within the framework of the Fund itself.

There was some prewar experience or precedent for a number of the international arrangements that were developed during the war. For example, the General Agreement on Tariffs and Trade (GATT) drew heavily on international commercial treaties dating back over many years. But there was no such general background of precedent that dealt with international payments and exchange rates.

There were, of course, some isolated prewar experiments which in some measure made a contribution in terms of ideas or experience to the comprehensive edifice that was built at

Bretton Woods. The Economic and Financial Section of the League of Nations had performed useful services, particularly in the effort to restore the European financial structure after its collapse of 1931. The Bank for International Settlements (BIS) had been launched in 1930 to smoothe out problems associated with German reparation payments following the First World War; however, since Germany stopped paying reparations shortly thereafter, the BIS served chiefly as a centre where, for the first time, European central bankers began to foregather on a regular monthly basis. In 1936, in order to bring some order into the erratic movements of sterling, the French franc and the U.S. dollar (the three key currencies to one or other of which most other currencies were in practice attached), a Tripartite Agreement was worked out between Britain, France and the United States.[3] However, none of these early experiments in international financial cooperation exercised much influence on the Articles of Agreement that were hewn, almost out of whole timber, by the Bretton Woodsmen.

Article I sets out the purposes of the new institution:

> The purposes of the International Monetary Fund are:
>
> (1) to promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
>
> (ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
>
> (iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
>
> (iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
>
> (v) To give confidence to members by making the Fund's resources available to them under adequate safeguards, thus providing them with opportunity to correct malad-

justments in their balance of payments without resorting to measures destructive of national or international prosperity.

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

The Fund shall be guided in all its decisions by the purposes set forth in this Article.

Determination to escape from the beggar-my-neighbour experiences of the Great Depression emerges at every point in these purposes: international cooperation, consultation and collaboration; growth of trade; maintenance of employment and income; development of productive resources; exchange stability and avoidance of competitive depreciation; multilateral payments and elimination of restrictions; promotion of equilibrium; and, not least, the provision of new international resources to support and reinforce national efforts to abide by the new international rules.

The interrelationship between financial and commercial matters also emerges clearly. It is useless to establish international rules governing (for example) tariffs or dumping duties or import restrictions if countries remain free to juggle their exchange rates or to impose restrictions on the release of foreign exchange to pay for imports. Thus discussions relating to postwar trading rules were of necessity going forward at the same time as the new rules for international payments were being hammered out. In the General Agreement on Tariffs and Trade (GATT), which came into effect in 1947, there were specific provisions that recognized the complementary character of obligations relating to trade and to payments; they called for consultations between the two bodies and made binding on the GATT certain findings and determinations reached by the Fund regarding national balances of payments and reserves.

The tale of the origins of the Fund is a tale of two cities and more particularly of two formidable figures: John Maynard Keynes in London and Harry Dexter White in Washington. As early as 1941 each of them, apparently independently, was at work on plans for new international financial institutions. The "Keynes Plan" and the "White Plan" emerged for public discussion in 1943. While the two plans shared a number of fundamental objectives they differed widely in both scope and method. Much of the task of bringing them together fell, of necessity, to the Americans and the British. At a fairly early date, however, discussions both in the United States and in Britain were broadened to include representatives of a number of other countries. Canadians were among those to be invited. (The present writer, who was at the time Financial Attaché at the Canadian Legation in Washington, was among those who attended not only the final negotiations at Bretton Woods but also preparatory discussions in Washington and Atlantic City).

In these negotiations and discussions, as in those directed toward the establishment of other postwar bodies, an overriding Canadian objective was to build a durable international institution which the Americans and the British would find acceptable in terms of initial legislation and also workable in terms of continuing operation. In the field of international payments such an institution was particularly important to a country which normally earned so much of its export income in terms of sterling and other overseas currencies, but which had to convert so much of that income into U.S. dollars to pay for imports from that country: the twin goals of convertibility and multilateralism were always kept in view.

The chief Canadian spokesman, Louis Rasminsky, recalls how the Canadians were at first attracted by the intellectual elegance of the Keynes Plan for a so-called Clearing Union, but how they reluctantly concluded it could not be made acceptable to the Americans, partly because it involved the United States, as the world's major creditor, in putting up what was, in effect, a blank cheque, and also because this cheque was to cover not only normal postwar trading deficits but also the cost of postwar emergency relief (food, clothing and health supplies in war-ravaged areas) and the economic reconstruction of war-torn countries.

Turning to the White-Bernstein (Bernstein was White's Treasury associate) proposals, Rasminsky continues:

> ...there was a good deal more emphasis originally on the supranational character of the Fund. The original concept was that the Fund could fix the initial exchange rates and the Fund could require countries to change their exchange rates. In this earlier version the Fund would have much more influence on domestic policy than anything that was provided in the later plan. Probably the consideration of

what Congress would put up with explains why there was a movement away from this emphasis on the Fund as an active directing organization in the later American versions of the plan. Having in mind the *real* distribution of economic power at the time, my overall impression is that the Americans moved a very great distance, that they did not exploit that power in determining the final version at Bretton Woods. They went a very great distance towards meeting the British view. I would naturally like to think that Canadians played some part in that. I do not honestly know whether we did or not. We came to the conclusion in the spring of 1943 that we should have a shot at it and we produced a proposal [the details of which I will not cover here]. . . .

We adopted the American form of a 'mixed bag of currencies' but we provided for a larger fund. The small size of the originally proposed American fund was quite consistent with the concept of an activist fund: not much extra liquidity would be needed. We provided for a larger fund and we introduced for the first time in these discussions the concept of the right of the Fund to borrow from particular members. . . . We provided for a bit more flexibility with regard to changes in exchange rates than in the American proposals and we objected to the extent of the veto power that the Americans were originally asking over major decisions. We left only a veto on a change in the price of gold. We provided for virtually immediate withdrawal from the Fund on the part of a country that wished to leave, a proposal that was designed to deal with the problem of an attack on the basis of loss of sovereignty which we anticipated would come up in national legislatures.[4]

Canada was the only country other than the United States and the United Kingdom to put forward a fully rounded proposal.[5] Many of its features came to be included in the final Agreement but it should be stressed that this was a reflection not so much of independent originality in Ottawa as of sensitivity to those elements that would, when put together, prove to be acceptable both in Washington and London.

Be that as it may, both British and American authors have called attention to the special role of Canadians in the founding of the Fund. The testimony of Keynes' biographer has already been quoted. In a chapter on Canada in his recent volume, *The United States and the Industrial World*, William Diebold refers to the "intimate collaboration between the two governments in working out the Bretton Woods Arrangements."[6] And another American authority, Richard N. Gardner, has described the roles and non-roles of various countries as follows:

> Perhaps the first important thing to note at the outset is that the Bretton Woods Conference and the crucial negotiations that preceded it were very much an Anglo-American affair, with Canada playing a useful mediating role. For historical reasons that were unique, these three countries had an unusually large influence in the negotiations; Germany, Italy, and Japan, countries that today hold a large measure of economic power, were then enemy countries and thus not represented at Bretton Woods. France was still under German occupation; its government-in-exile played only a marginal role. The less-developed countries played nothing like the part they play today in international economic conferences. The Soviet Union came only at the last minute and sat on the sidelines.[7]

E. M. Bernstein, who was White's closest associate in the U.S. Treasury in the negotiations leading up to the establishment of the Fund, has noted the usefulness of various Canadian suggestions, particularly the suggestion that the Fund should be empowered to borrow the currencies of its members. He has also referred to the special role of the Canadians in bridging a communications gap which emerged, particularly in the early discussions, between White and various British representatives.[8]

At length all the preparatory discussions were over. During the last week of June 1944, a preliminary meeting of technical experts was held in Atlantic City. The Conference at Bretton Woods, New Hampshire, which opened immediately afterwards, lasted only three weeks, from 1 July to 22 July. That agreement could be reached so quickly on so much by representatives of forty-four countries reflected not only the careful preparations that had been made but also the fact that there was no time to be lost. Only three weeks previously, on 6 June, the long-awaited D-Day had arrived; the Allied forces under the command of General Eisenhower had established a beachhead in Normandy for the recapture of Europe. The end of the war in Europe was at last in sight. The time had come when talk about postwar institutions had to be translated into commitments.

A detailed description of the events of that three-week conference may be found in the official history of the Fund.[9] Two members of the Canadian delegation occupied positions of special importance. Louis Rasminsky became the chairman of the Committee to draft the Articles of Agreement and also the official rapporteur to the Plenary Conference on matters relating to the Fund; (it must be recalled that the Conference was concerned not only with the Fund but also with the World Bank and some other matters). W. A. Mackintosh, then serving with the Department of Finance, took the chair of what was probably the most contentious of all the committees – that concerned with the operations of the Fund. A Russian, N. A. Maletin, had been elected chairman but because of language difficulties he asked that someone else should sit in the chair on his behalf.

The Articles of Agreement were signed on 22 July 1944. The national representatives who signed undertook to recommend them to their national governments and legislatures for ratification. By 27 December 1945 the majority of the member countries contributing most of the resources had formally ratified the Articles and a signing ceremony, at which twenty-nine countries including Canada were represented and which brought the Agreement into force, took place in Washington.

The New Rules

Apart from Article I, which sets forth the basic purposes of the new institution and which was quoted in full on p. 37 above, the original Articles of Agreement were of three types. There were those that laid down the new rules to be observed in pursuit of the basic purposes; there were those that provided funds to be used in assisting member governments to keep the rules; and there were those dealing with organization and management. In this section of the chapter we examine Articles that established new rules: other articles are considered in the next section.

A fourth group of Articles was added in 1969; there were no amendments of the original Articles before that year. The purpose of the new Articles was to provide for the issuance of Special Drawing Rights, sometimes referred to as "paper gold"; this subject is discussed in chapter 8 below. Subsequently, following the breakdown of the international monetary system in 1971 – 73, an extensive reform of the Articles was launched. Agreement on the main elements of reform was reached in January 1976 and these elements are discussed in chapter 11.

Central to the rules agreed to in 1944 were the setting up and maintenance of a system of stable, although not immovable, exchange rates. It became known as the par value system. Each member country undertook initially to select a par value for its currency, thereafter to maintain the actual exchange rate within 1 per cent on either side of the selected par, and only to propose an alteration of the par value when required to correct a "fundamental disequilibrium" in its international payments.[10]

Different countries complied in different ways with the obligation to keep actual exchange rates within 1 per cent of par value. In many countries, including most if not all developing countries, the central bank simply announced its buying and selling rates in terms of the U.S. dollar or in terms of some other reserve currency such as sterling. In countries with well-developed capital and foreign exchange markets, including Canada, the central bank would usually cushion the market rate of exchange as it moved in one direction or the other, only intervening decisively as the rate approached the upper or lower limit. A common feature of both systems was, however, that market rates were managed either directly in relation to the U.S. dollar or else indirectly through some other reserve currency. The dollar thus occupied a pivotal role in the actual operations of the system and this was recognized by the provision that countries could establish and alter the par values of currencies by reference to the U.S. dollar.

Obviously, however, the par value of the U.S. dollar could not be fixed in terms of itself; nor could its market value be effectively controlled in terms of other currencies whose values were, directly or indirectly, being controlled in terms of it.

Accordingly the Articles also provided for the way in which the value of the dollar would be controlled and defended; that is, by means of purchases and sales of gold.

The Articles of Agreement thus confirmed the U.S. dollar in roles which it had already acquired in practice. It was the currency in which the par value of all other countries were expressed. It was the currency in terms of which, directly or indirectly, all other currencies were stabilized. It provided the formal link between the par value system and the official value of gold. And it provided the medium through which the exchange rates of other countries were linked with the market price of gold. The unique position of the dollar began to cause difficulties in the 1960s when the value of the U.S. dollar came under attack, and it became the crux of the breakdown of the system in 1971 when the U.S. authorities were no longer able to defend that value by means of gold sales. We will return to these matters below.

As for changes in individual par values, the Articles require that the initiative must lie with the member country. At the same time, however, each member undertakes to consult the Fund in regard to any proposed change and only to propose a change if required to correct a fundamental disequilibrium in its international payments.

The insertion in an international agreement of provisions regarding selection and alteration of par values raised a sensitive issue: a country's authority over the value of its own currency. The issuance and control of currency is often considered to be an element, indeed an essential element, of national sovereignty. In the thirty years since Bretton Woods hard-line views on this matter have no doubt softened, but in 1944 it was decided that any proposal for a new par value must come from the member country itself, not from the Fund. It was also decided that in a situation in which the Fund objected to a change proposed by a member, the country should remain free to make it if it were willing to take the consequences: that is, ineligibility to borrow from the Fund and the possibility of compulsory withdrawal. Finally, a country's commitment to the par value system as a whole was limited by the ease with which it could withdraw from the organization; if a country gave notice of withdrawal it came into effect immediately.[11]

Under the gold standard as it had operated in the interwar years, each country had exercised complete sovereignty over the international par value of its currency. It was free to select or indeed to alter the value at which its currency was exchangeable into gold and thus exchangeable into all other currencies whose values were also pegged to gold. Under the Fund system, as outlined in the previous paragraph, this freedom became subject to a self-imposed limitation.

The Fund Articles thus represented a major advance towards recognition of the fact – obvious on reflection – that any country's exchange rate is, in a sense, as much a matter of concern to other countries as it is to that country itself. For every Canadian importer, paying for his imports from abroad, there is an exporter abroad who has an equal interest in the value of the Canadian dollar. Of course, Canadian interests in the value of our dollar are concentrated in Canada while the outside interests are dispersed around the world. Nevertheless, the fact that every exchange rate has an outside as well as an inside remains to confute those few who still maintain that an exchange rate is solely a matter for national sovereignty and no fit subject for international consideration, let alone international determination. Moreover, while a country in joining the Fund gives up a measure of control over movements of its own currency, it acquires at the same time, through the operations of the Fund, a measure of influence if not control over movements of the currencies of other members. There is a real internationalization of decision-making on a matter of clearly international significance.

The requirement that a country should only propose a change in its par value if necessary to correct a "fundamental disequilibrium" was inserted to avoid petty and premature exchange rate adjustments and also to preclude any repetition of the competitive currency devaluations of the 1930s. Subsequently, however, it emerged that countries were generally reluctant to propose changes in par values chiefly because of the unpleasant political and economic implications that appeared to be involved. The stigma of admitting to a fundamental disequilibrium may have acted as a further deterrent. We shall return to this matter in later chapters.

The rules provide for members to borrow from the Fund in order to give them time to take the financial and other measures necessary to arrest and reverse developing disequilibria in their international payments. (The Articles of Agreement and all the technical literature of the Fund use the term "drawing" or "purchasing"; strictly speaking, what is involved is a purchase of foreign currency in exchange for domestic currency with an undertaking to reverse the transaction at a later date. However, for the general reader, the term "borrowing" seems to convey the essential meaning of the transaction more effectively.) The constitutional provisions for such borrowing were complex and they have been substantially adjusted and extended by successive decisions of the Executive Board. Generally speaking, the underlying principle is that a country can obtain, solely on its own statement of need, an amount equal to its contribution to the organization in the form of gold (usually one-quarter of its total contribution); but on larger amounts, up to and even beyond its total contribution, the conditions laid down become increasingly strict. Loans are expected to be repaid within three to five years and the charges have usually been considerably below market interest rates.

In recent years, supplementary borrowing arrangements have been introduced, including one for "compensatory financing" (related to the volatility of prices of commodity exports from many developing countries) and another, called the "Oil Facility" (related to special balance-of-payment difficulties following the world increase in oil prices in 1973). Each country's entitlements to borrow are related to its quota in the organization which, in turn, is related to its subscription; the nature and purposes of quotas are considered below.

A basic aim of the Fund in 1944 related to the elimination of restrictions on international payments; "no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions" (that is, for purchases of goods and services from abroad) and the currency acquired by the foreign sellers of these goods and services must not be "blocked" but must be "convertible." Members are similarly expected to renounce "discriminatory currency practices or multiple currency arrangements," the sort of currency manipulation at which Hitler's Germany became so adept in the prewar years.[12]

At the same time it was necessary to recognize that in the reconstruction period immediately following the war it would not be possible, or indeed desirable, for all countries to abide by these new rules relating to convertibility and non-discrimination. Accordingly, a general exemption was provided for countries in balance-of-payments difficulty during the so-called "transitional period."[13] As things turned out, however, the transitional period stretched out over some fifteen years, despite the increasingly vigorous protests of those countries, including Canada, against which the restrictions and discrimination were directed (see chapter 5 below).

Another constitutional provision covering matters of special interest to Canada is that relating to capital transfers. At the time of Bretton Woods all countries had rigorous foreign exchange controls which applied both to payments made for imports of goods and services (current transactions) and also to the movement of funds between countries for investment and for speculative purposes (capital transactions). The Agreement provided, as indicated above, for the progressive elimination of restrictions on current payments, subject to the transitional period exemption. There was no provision, however, for the elimination of restrictions on capital transfers. On the contrary, it was specifically provided that "members may exercise such controls as are necessary to regulate international capital movements" and the general assumption was that these controls would be continued more or less indefinitely. Furthermore, the Fund was empowered to request a member to exercise such controls in order to prevent misuse of its loans.[14] It should be added, however, that the application and operation of this Article was subject to numerous difficulties.

What was not foreseen at that time was the extent to which, on the one hand, the progressive elimination of controls over payments for current transactions would inevitably erode and weaken controls over payments for capital purposes and, on the other hand, the fact that international capital movements would eventually grow to such a size as to sweep aside stabilized exchange rates and, indeed, the par value system itself as it operated between major financial centres. In 1950, for example, Canada confronted a very heavy inflow of capital and, despite her par value obligations, allowed her dollar to float for a temporary period which, in the event, lasted for more than a decade. A similar situation arose in 1970 and, once again, the Canadian dollar was allowed to float. The more general floating of major currencies followed in 1973.

Resources, Administration and Decision-Making

Each member country of the Fund has a quota, which serves three purposes. It establishes the basic contribution that the country is required to make to the resources of the Fund; it provides a basis for the country's entitlements to borrow; and finally, it is directly related to the votes which the country may cast, or which may be cast on behalf of the country, in the decision-making processes of the organization.

At the time of Bretton Woods the initial quotas agreed upon by the participating countries were broadly related to a statistical formula which took into account each country's national income, international reserve holdings, variability of export earnings, and value of imports. Provision is made in the Articles both for the adjustment of individual country quotas and also for a general review and possible general adjustment of quotas at intervals of not more than five years.[15] A list of the quotas assigned at Bretton Woods and a recent list of membership and quotas are provided in Appendices 2 and 3 of this chapter.

General quota increases have in fact taken place in 1959 (50 per cent), 1966 (25 per cent), 1971 (33⅓ per cent) and (prospectively) 1976 (32½ per cent). Special increases have also been accorded both to countries with small quotas and also to countries, including Canada, which from time to time exhibit exceptional economic growth. The total of the quotas agreed to in 1944 at the Bretton Woods Conference was $8.8 billion, of which $1.3 billion lapsed when the Soviet Union failed to take up its membership. By 1976 the total was approaching $30 billion and was due for a further increase to $39 billion. Forty-four countries attended Bretton Woods, of which thirty-eight were represented at the inaugural meeting in 1945; by 1976 the membership had grown beyond 125.

The resources from which the Fund has been able to make loans to its members have been largely derived from their initial subscriptions and from their supplementary subscriptions at times when their quotas have been increased. Resources have also been augmented when the Fund's earnings exceeded its costs of operations. In addition, as noted above, the Fund is empowered to borrow from its members; the Fund has made use of this authority in different ways at different times.

The Articles of Agreement establish decision-making at two levels; the Governors and the Executive Directors. Decisions reserved to the Governors include the admission (and expulsion) of members, revisions of quotas, changes in the (general) valuation of gold, remuneration of Executive Directors and of the Managing Director, and final liquidation of the organization. Each member country appoints one Governor, usually the Minister of Finance or Governor of the central bank. Voting by Governors takes place either at annual meetings or in between meetings by mail or telegraph. "Each member country shall have two hundred and fifty votes plus one additional vote for each part of its quota equivalent to one hundred thousand U.S. dollars".[16] The basic two hundred and fifty votes has little significance for a country with a comparatively large quota (for example, Canada, whose quota was initially $300 million and became $1,100 million after the 1971 general increase). But it has always been important to the smaller member countries and it has increased in significance in recent years as more and more small countries have joined the Fund. By 1971, 37 out of 117 members had basic votes that were half or more than half of their total votes.[17]

The great majority of decisions are taken by the Executive Directors. They are in "continuous session" (usually meeting about three times a week); all of them now reside at the site of the headquarters in Washington, D.C. Each must appoint an alternate who, under the Articles, is empowered to act in his absence. Five Executive Directors are appointed by the five Governors with the largest quotas; the remaining fifteen (originally seven) are elected for two-year terms by groups of the other Governors.

Each Executive Director may cast a total (indivisible) vote equal to the sum of the votes of the member countries he represents. For the purpose of election, groups of Governors cluster together so that the total votes commanded by each elected Executive Director are roughly equal, and also so that an Executive Director will not have to represent too diverse a constituency on the Executive Board. This clustering of countries for the election of Executive Directors is formally required, under the Articles of Agreement, in the case of the Latin American Republics which were well represented at Bretton Woods; for other groupings it is voluntary and informal.

The Articles of Agreement provide that most questions are to be decided by a simple majority of the votes cast. A number of questions, however, require a qualified majority of votes or of voters. The Article providing for the right of a member to withdraw can only be altered by unanimity, thus protecting the individual right to withdraw of each member. A country's quota may not be altered without its consent. A number of decisions require an 85 per cent majority of the votes cast; these include general quota increases and a general proportionate change in par values (that is, a change in the monetary value of gold). Originally the requirement was for an 80 per cent majority; this in effect gave a veto to the United States, which held well over 20 per cent of the total votes. In the 1969 revision the percentage was raised to 85 to give a collective veto to members of the European Economic Community. Amendments to the Articles of Agreement require a plurality of three-fifths of the members having four-fifths of the voting power.[18]

The system of weighted voting, agreed for the Fund and also for the World Bank at Bretton Woods, was an important innovation. The normal system for international organizations is "one country – one vote," applied to large and small alike. It is based on the concept of national sovereignty, ignoring other considerations, however relevant. Under the weighted voting system of the Fund and the Bank it has been possible, for internationally agreed purposes, to mobilize and dispose of very large sums of money, sums that would never have been forthcoming if the vote of the smallest carried the same weight as that of the largest.

There have been complaints, of course, both inside and outside the Board of Governors about the relative size of individual quotas or groups of quotas. Thus European countries have asserted (not without cause) that their original quotas were unduly small and those of the United States and Britain were unduly large. Underdeveloped countries have asserted (not without cause) that their quotas have been too small by comparison with those of developed countries. But, as we have seen, the Articles of Agreement provide for quota changes, and over the years alterations have been made in response to the complaints. At no time since the Fund was founded has the basic principle of weighted voting, as such, been seriously under attack.

A Canadian has, since the beginning, served as one of the Executive Directors. In the early years the Canadian quota was sufficiently large, in relation to the total, that an Executive Director could be elected on the strength of Canada's vote alone; nevertheless the Canadian Director was able to accommodate Norway by representing that country from 1946 to 1948 and Iceland by representing it from 1948 to 1950. Later, beginning in 1960, the Canadian represented one or more of several other countries that voted for him from time to time: Ireland, Jamaica, Guyana, Barbados and the Bahamas. On one occasion (1958) Canada, as the second-largest creditor of the organization, became entitled to appoint rather than elect its Executive Director. The provisions in the Articles of Agreement that made such an appointment possible was of Canadian origin – a protection against a situation in which all the Executive Directors except one (presumed to be the American) were appointed or elected by prospective debtors of the organization. It seemed important to have at least two creditors on the Executive Board.

At the time of Bretton Woods the British, with strong support from the Canadians and a number of others, thought of the Executive Directors as being senior officials who should foregather for Executive Board meetings only as occasion demanded and who, coming from their national capitals, would be in a position to speak and exchange views with first-hand knowledge and authority. The Americans, on the other hand, considered that the business of the Fund would be too continuous and too sensitive to be dissociated from the continuing input of political considerations which could only come through the Executive Directors; they also had in mind that Congress would find unacceptable an arrangement that did not give the U.S. Executive Director a very active and continuing role in the affairs of the organization.

For better or for worse, the United States insisted that their position be accepted, and thus the Fund's Executive Directors are in continuous session in Washington. It has fallen to other organizations, such as the Bank for International Settlements in Basle (where central bankers still foregather each month) and WP 3 of the OECD (Working Party 3, on balances of payments, of the Economic Policy Committee of the Organization for Economic Cooperation and Development in Paris), to fill, at least in part, the central role in the formation of international financial policies which the British and the Canadians had foreseen for the Fund Board. These developments are reviewed in more detail in subsequent chapters.

The Executive Directors select the Managing Director, who is both chairman of the Executive Board and also head of the staff of the organization.[19] (Actually, it was informally agreed among the leading countries at an early stage that, while the United States would provide presidents for the World Bank, with its continuing need for access to capital markets, the European countries would provide managing directors for the Fund). The Articles also provide that "the Managing Director and the staff of the Fund, in discharge of their functions, shall owe their duty to the Fund and no other authority." Member countries undertake "to respect the international character of this duty."

In various Articles there are references to "consultations" between member countries and the Fund. The Articles do not specify the nature of these consultations, but they have in fact become an essential element in the operations of the organization. We shall return to this matter in chapter 5. Suffice it to say at this point that the consultations could not have been effective if the staff had not been competent.

This outline is primarily directed to those Articles of the Fund that are of importance to this volume. No attempt is made to be comprehensive. Articles regarding which no comment has been offered include those relating to the admission of new members, to scarce currencies, to privileges and immunities, to relations with other international organizations and with non-members, to the inauguration of operations, to offices and depositories and to emergencies involving suspension of operations and final liquidation.

Canada Joins the Fund

The Minister of Finance, J. L. Ilsley, in presenting the Bretton Woods Agreements Act to the House of Commons for approval late in 1945, drew attention to four important features of the International Monetary Fund.[20] First of all, this was to be a permanent international institution for collaboration on monetary matters, with Governors and Executive Directors meeting regularly and representing all the member countries. Second, the member countries "recognize that exchange rates have more than purely domestic implications and are therefore properly matters of international concern"; they subscribe to rules relating to exchange rates both to ensure exchange rate stability and also to ensure that stability does not become rigidity. In this regard Ilsley also noted that "the Fund is specifically enjoined from concerning itself with domestic policies.... The fact that a country has adopted a social security programme or has socialized its major industries can be no concern of the Fund's if that member should subsequently apply for a change in its exchange rate." Third, members undertake, after a transitional period, not to impose restrictions on current account transactions and to remove existing restrictions as soon as circumstances permit. The transitional period provision was unfortunately necessary because of international economic imbalances created by the war and notably by the tremendous war effort exerted by the United Kingdom. Fourth, the funds contributed by all, including the $300 million from Canada, are to be available in case of need to give assistance to each. The Minister went on to stress that the Bretton Woods proposals, while essential, were not in themselves sufficient. In addition, "some means will have to be found of dealing on a constructive and imaginative basis with the transitional balance of payments difficulties facing the United Kingdom and other countries whose foreign position has been weakened as a result of the character and extent of their contribution to victory."

Later the same afternoon Ilsley was able to announce first, a postwar loan to Britain from the United States of $3.75 billion and second, a proposal by the United States and Britain for a world conference on trade and employment. "The proposals on commercial policy... have resulted from discussions among officials that have extended over two or three years, in some of which our officials have participated."[21]

In supporting the bill J. M. Macdonnell, financial spokesman for the Opposition, drew particular attention to the damage to Canada's markets in Britain that would arise from the perpetuation of bilateral trade arrangements. "Let us be clear what the sterling bloc means to us.... Most of our competitors are in it, the Argentine, the Scandinavian countries, Australia, New Zealand.... They have all the advantages."[22] The CCF party largely withheld comment in the House but participated constructively in the discussion in the Banking and Commerce Committee. The Social Credit party castigated the Fund proposal as undermining British independence and the integrity of the British Empire by reimposing the restraints and rigidities of the gold standard and by aiding American imperialism.[23]

The bill was before the Standing Committee of the House on Banking and Currency for a further three days; Louis Rasminsky was the chief witness. General and detailed questions were posed by members of all parties, particularly Social Credit. The only amendment introduced into the bill, was a provision that reports on the operations under the Act should be made annually to Parliament by the Minister of Finance. At the third reading on 14 December 1945 all except the nine Social Credit members of the House voted approval for the Bretton Woods Agreements Act.

APPENDIX 1
A NOTE ON THE ARTICLES OF AGREEMENT OF THE INTERNATIONAL MONETARY FUND

The original twenty Articles were agreed at Bretton Woods in July 1944 and, after ratification by the necessary majority, came into force in December 1945. The Articles were first amended in 1968 and ratified in 1969. The primary purpose of these changes was to add twelve Articles empowering the Fund to issue Special Drawing Rights, but it was necessary and expedient to adopt a number of amendments to the original twenty at the same time.

The text used in this volume is the amended text, originally published by the International Monetary Fund, Washington, D.C., in 1968. The amendments to the original Articles are explained in detail in J. Gold, *Reform of the Fund* (Pamphlet Series No. 12, International Monetary Fund: Washington, D.C. 1969).

As this is written the Articles are again in process of amendment following the breakdown of the par-value system among major currencies.

APPENDIX 2

IMF Quotas
As Agreed at Bretton Woods[1]
(in millions of U.S. dollars)

Australia	200	Iran	25
Belgium	225	Iraq	8
Bolivia	10	Liberia	.5
Brazil	150	Luxembourg	10
Canada	300	Mexico	90
Chile	50	Netherlands	275
China	550	New Zealand	50
Colombia	50	Nicaragua	2
Costa Rica	5	Norway	50
Cuba	50	Panama	.5
Czechoslovakia	125	Paraguay	2
Denmark[2]		Peru	25
Dominican Republic	5	Philippine Commonwealth	15
Ecuador	5	Poland	125
Egypt	45	Union of South Africa	100
El Salvador	2.5	Union of Soviet Socialist Republics	1,200
Ethiopia	6	United Kingdom	1,300
France	450	United States	2,750
Greece	40	Uruguay	15
Guatemala	5	Venezuela	15
Haiti	5	Yugoslavia	60
Honduras	2.5		
Iceland	1		
India	400		

[1] The total of these quotas is $8,800 million.
[2] The quota of Denmark shall be determined by the Fund after the Danish Government has declared its readiness to sign this Agreement but before signature takes place.
SOURCE: *IMF History,* Vol. III, p. 210.

APPENDIX 3

IMF Quotas as of 31
December 1975
(in millions of SDRs[1])

All Countries	29,211.4	**Less Developed**	8,111.4
Industrial	18,365.0	Oil Exporting	1,542.0
United States	6,700.0	Algeria	130.0
Canada	1,100.0	Bahrain	10.0
Japan	1,200.0	Ecuador	33.0
Austria	270.0	Gabon	15.0
Belgium	650.0	Indonesia	260.0
Denmark	260.0	Iran	192.0
France	1,500.0	Iraq	109.0
Germany	1,600.0	Kuwait	65.0
Italy	1,000.0	Libya	24.0
Luxembourg	20.0	Nigeria	135.0
Netherlands	700.0	Oman	7.0
Norway	240.0	Qatar	20.0
Sweden	325.0	Saudi Arabia	134.0
Switzerland	—	Trinidad and Tobago	63.0
United Kingdom	2,800.0	United Arab Emirates	15.0
		Venezuela	330.0
Other Europe	1,548.0		
Finland	190.0	Other W. Hemisphere	2,174.0
Greece	138.0	Argentina	440.0
Iceland	23.0	Bolivia	37.0
Ireland	121.0	Brazil	440.0
Malta	16.0	Chile	158.0
Portugal	117.0	Colombia	157.0
Romania	190.0	Costa Rica	32.0
Spain	395.0	Dominion Republic	43.0
Turkey	151.0	El Salvador	35.0
Yugoslavia	207.0	Guatemala	36.0
		Haiti	19.0
Australia, N.Z.,		Honduras	25.0
S. Africa	1,187.0	Mexico	370.0
Australia	665.0	Nicaragua	27.0
New Zealand	202.0	Panama	36.0
South Africa	320.0	Paraguay	19.0

Peru	123.0	Other Africa	1,146.0
Uruguay	69.0	Botswana	5.0
Bahamas	20.0	Burundi	19.0
Barbados	13.0	Cameroon	35.0
Grenada	2.0	Central African Rep.	13.0
Guyana	20.0	Chad	13.0
Jamaica	53.0	Congo, Peoples Rep.	13.0
		Dahomey	13.0
Other Middle East	465.0	Equatorial Guinea	8.0
Cyprus	26.0	Ethiopia	27.0
Egypt	188.0	Gambia, The	7.0
Israel	130.0	Ghana	87.0
Jordan	23.0	Guinea Republic	24.0
Lebanon	9.0	Ivory Coast	52.0
Syria	50.0	Kenya	48.0
Yemen Arab Rep.	10.0	Lesotho	5.0
Yemen, P.D. Rep.	29.0	Liberia	29.0
Other Asia	2,784.4	Malagasy Republic	26.0
Afghanistan	37.0	Malawi	15.0
Bangladesh	125.0	Mali Republic	22.0
Burma	60.0	Mauritania	13.0
Cambodia	25.0	Mauritius	22.0
China, Republic of	550.0	Morocco	113.0
India	940.0	Niger	13.0
Korea	80.0	Rwanda	19.0
Laos	13.0	Senegal	34.0
Malaysia	186.0	Sierra Leone	25.0
Nepal	12.4	Somalia	19.0
Pakistan	235.0	Sudan	72.0
Philippines	155.0	Swaziland	8.0
Singapore	37.0	Tanzania	42.0
South Viet-Nam	62.0	Togo	15.0
Sri Lanka	98.0	Tunisia	48.0
Thailand	134.0	Uganda	40.0
Fiji	13.0	Upper Volta	13.0
Papua New Guinea	20.0	Zaire	113.0
Western Samoa	2.0	Zambia	76.0

[1] On that date the value of the U.S. dollar in SDRs was 0.85422.

SOURCE: International Monetary Fund, *International Financial Statistics*, February 1976, pp. 7-10.

NOTES

1 For a full account of the origin and development of the Fund (including much material previously considered confidential) readers are referred to its official history (hereafter referred to as *IMF History*): *The International Monetary Fund, 1945-1965*, edited by J. Keith Horsefield; Volume I, *Chronicle*; Volume II, *Analysis*; Volume III, *Documents* (Washington, D.C., 1969). This quotation from a speech at the Guildhall, London, on 3 February 1969 by Louis Rasminsky is taken from Vol. I, p. 513.

2 *J. Gold, "The Institution," IMF History*, Vol. II, chapter 22, p. 513.

3 For details of the Tripartite Agreement, and some bilateral stabilization agreements subsequently worked out by the United States, see *IMF History*, Vol. I, pp. 6-10.

4 See L. Rasminsky, "Canadian Views" in A. L. J. Acheson, J. F. Chant and M. F. J. Prachowny, eds, *Bretton Woods Revisited* (Toronto: University of Toronto Press, 1970), pp. 34-37.

5 The text of the Canadian proposal is to be found in *IMF History*, Vol. III, p. 104.

6 William Diebold Jr., *The United States and the Industrial World* (New York: Praeger, 1972), p. 76.

7 Richard N. Gardner, "Bretton Woods" in Milo Keynes, ed., *Essays on John Maynard Keynes* (London: Cambridge University Press, 1975), p. 202. The same essay was previously published in Acheson *et al.*, eds., *Bretton Woods Revisited*, pp. 20-33.

8 In conversation with the present writer.

9 *IMF History*, Vol. I, chapter 5.

10 International Monetary Fund, Articles of Agreement (Washington, D.C., 1968) Article IV.

11 IMF Article XV.

12 IMF Article VIII.

13 IMF Article XIV.

14 IMF Article VI.

15 IMF Article III.

16 IMF Article XII.

17 Joseph Gold, *Voting and Decisions in the International*

Monetary Fund (Washington, D.C.: International Monetary Fund, 1972), p. 19.

18 For an elaboration of voting majorities, see J. Gold, *Voting and Decisions*, chapters 10 and 11.

19 IMF Article XII.

20 House of Commons, *Debates*, 6 December 1945, pp. 3040-47.

21 *Ibid.*, pp. 3057-67.

22 *Ibid.*, p. 3048.

23 The Social Credit members, although small in number, mounted a major attack on the legislation both in the House and also in the Standing Committee. Their opening speaker, J. H. Blackmore (House of Commons, *Debates*, 6 December 1945, pp. 3053-59), maintained that wars were caused by international indebtedness resulting from trade imbalances and that the Bretton Woods Agreement made no provision for meeting this problem. On the contrary, it was designed to strengthen the position of creditor countries (especially the United States), to reintroduce the rigidities of the gold standard, and to find a use for $23 billion of gold lying idle in U.S. reserves. It was also designed to undermine the position of debtor countries, particularly Britain, by restricting their rights to limit imports from creditors whom they were unable to pay and to discriminate in favour of each other. It would inevitably lead to the breakdown of the sterling area and the breakup of the British Commonwealth and Empire.

"The key to the whole problem." Blackmore claimed, "is debt-free money both internally and internationally." Trade should be placed on a new basis involving the permanent extension of some machinery like that of mutual aid under which no international debt obligations were incurred.

In concluding the debate Solon Low summarized the same points, adding that what was required was a change of heart on the part of creditors and that, if this took place, there was no need for an agreement like Bretton Woods. "We have put forward what is a successful and scientific alternative to Bretton Woods. . . . If we had time we could prove it. . . . The next few years will vindicate our judgement, and one day the Social Credit group in this house will be credited with having done something during the past week that might eventually save the British Commonwealth of Nations."

The discussion in the Standing Committee was considerably more fragmented. See House of Commons, Standing Committee on Banking and Commerce, *Minutes of Proceedings and Evidence*, 11-13 December 1945.

3

Postwar Reconstruction 1944 – 48

Wartime Economic Assistance to Britain and Other Allies

The nature and extent of Canada's contribution to postwar relief and economic reconstruction can best be understood by considering it as an extension and adaptation of Canada's wartime assistance to her overseas allies. Thus, by way of introduction, this section and the following one relate to wartime developments.

During six years of war Canada provided economic assistance, chiefly to Britain but also to other allies, in an amount well in excess of $5 billion. In terms of the magnitudes of those days this was a staggering sum. The last prewar federal budget (1938/39) had shown ordinary revenues and ordinary expenditures of about $500 million. The total national income in the last prewar year (1938) was a little over $4 billion.

By the latter years of the war, 1943 to 1945, Canada had developed a systematic approach to overseas aid. A Mutual Aid Board was set up to receive monies voted by Parliament and to purchase Canadian goods and services on behalf of Canada's allies. Approximately half of the total was handled in this way. The other half, provided in earlier years, was not handled so systematically. The main items included the repurchase (repatriation) from Britain of Canadian securities held there, an interest-free loan of $700 million, an outright gift of $1 billion to Britain, and various interim advances.[1]

While the greater part of the total overseas aid went to

Britain itself, smaller amounts went to other parts of the British Commonwealth and Empire: Australia, India, New Zealand, and the British West Indies.[2] Some assistance, less than 10 per cent of the total, was also provided to non-British countries: the Soviet Union, China and France.

The purchases made by the Mutual Aid Board were not only large, they were pervasive; they penetrated every province of Canada. The purchases of munitions and raw materials might be concentrated in Quebec and Ontario (aircraft, tanks, guns, explosives, et cetera, along with aluminum and base metals) but lumber came from British Columbia and ships and fishery products came from both Atlantic and Pacific coasts. As for farm products, they came from all across the country (wheat, flour, bacon, beef, cheese, eggs, apples, and dozens of other items). Thus the mutual aid program was built not only on a genuine desire to provide Canadian support to allies overseas but also, on a broad political base at home. A similar base served in the postwar years to support the programs for relief, rehabilitation and reconstruction.

Both the Canadian and American governments, at an early stage in the war, reached the decision that assistance to Britain and other allies should be provided as far as possible on a debt-free basis. Memories were still strong of the war debts that had been left behind after the First World War, with their train of international economic disruption and political resentment. Under the Mutual Aid Act[3] the conditions on which Canadian supplies were to be provided "should not be such as to burden postwar commerce or lead to the imposition of trade restrictions or otherwise prejudice a just and lasting peace." Further, "it shall be good and sufficient consideration for making war supplies available to any of the United Nations . . . that the said war supplies are to be used in the joint and effective prosecution of the war." The mutual aid program gave rise to many administrative difficulties[4] but no basic issue ever arose over the ultimate terms and conditions.

President Roosevelt might have wished to be equally unambiguous about the postwar obligations attaching to the wartime assistance provided by the United States. However, when he placed his lend-lease proposal before Congress in January 1941, opinion in the United States was still deeply divided over

U.S. involvement, even economic involvement, in the war. Thus the legislation made it clear that, while actual payment might not be demanded, the United States in due course would expect, would require, some form of "consideration" in exchange. Roosevelt's famous illustration of the loan of a hose to a neighbour whose house was on fire deliberately stressed the emergency nature of the help to be provided, but it also suggested that the hose was to be returned to its owner. Early in the negotiations that followed the passage of the legislation through Congress, American officials explained that repayment was not expected in cash or in kind, but rather in terms of postwar commercial policy, including the renunciation by the British of trade discrimination in general and their system of tariff preferences in particular. In due course, the Office of Lend Lease Administration imposed burdensome requirements to prevent resale, at home or abroad, of any of the supplies that were provided. There were similarly burdensome requirements relating to "reciprocal lend lease." Thus Sayers, a most sympathetic and appreciative author, describes in his chapter 13 "the Lend-Lease Tangle" between Britain and the United States.

In the end, although this could not be confidently forecast at the outset, the U.S. authorities did write off by far the greater part of the lend-lease obligations against intangible considerations, including Britain's commitment to a liberal postwar commercial policy. Nevertheless Britain did not emerge from the war with her financial position unimpaired. In the first place, both Canada and the United States had made loans to her in the early days of the war. Second, the British were required to dispose of part of their Canadian and all their American investments before becoming eligible for debt-free wartime assistance. Further, Britain ended up with short-term external indebtedness in excess of £3,350 million, the so-called sterling balances, chiefly held by British and Middle East countries.[5] The overhanging liability represented by these balances was a continuing economic burden which Britain after the war could ill afford to bear. Moreover, immediately the fighting was over the flow of wartime aid from North America terminated and Britain found herself forced to borrow heavily from both the United States and Canada.

The Hyde Park Agreement

We now turn briefly to Canada – U.S. wartime financial relationships. A comprehensive review is not attempted; but there was one episode of special interest which is of relevance to issues emerging later in this volume, the results of which seem to have been misinterpreted. This was the Hyde Park Agreement of April 1941.

When Hitler's armies circumvented France's allegedly impregnable Maginot Line in the spring of 1940 and, in a matter of weeks, flooded across the whole of western Europe there were many, not least in North America, who doubted Britain's ability to survive. However, thanks to the miraculous evacuation of her army from France at Dunkirk and to the determination with which the Royal Air Force beat back Hitler's Luftwaffe in the subsequent Battle of Britain, survive she did. Thereafter, in the latter part of 1940, war mobilization and war production were pressed forward with the utmost urgency in Britain and in overseas Commonwealth countries, including Canada. In the United States economic mobilization accelerated but was constantly held back, in one way or another, by isolationist influences.

In December 1940 Canada imposed extensive restrictions on trade and travel and on luxury purchasing in order to conserve for war purposes her dwindling reserves of gold and U.S. dollars; nevertheless; they continued to decline sharply. (For movement of Canada's reserves see chapter 4, Table A.) When the U.S. Congress passed the Lend Lease Act in March 1941 there were some in Ottawa who assumed that Canada would have to apply for lend-lease aid.[6] Others, however, particularly in the Department of Finance, viewed with concern the uncertain terms under which lend-lease support could be provided and the possible impact on Canada – U.S. relations when, after the war, the day of reckoning arrived. Moreover, to satisfy Congress, liquidations of all Canadian-owned assets in the United States would undoubtedly have been required before lend-lease aid was made available.

Thus, it came about that a quite different arrangement was proposed by Prime Minister Mackenzie King and readily agreed to by President Roosevelt. Their meeting took place at Hyde Park, the President's country estate north of New York

City, and the results were embodied in the Hyde Park Declaration of 20 April 1941. It reads as follows:

> Among other important matters, the President and the Prime Minister discussed measures by which the most prompt and effective utilization might be made of the productive facilities of North America for the purposes both of local and hemisphere defence and of the assistance which in addition to their own programs both Canada and the United States are rendering to Great Britain and the other democracies.
>
> It was agreed as a general principle that in mobilizing the resources of this continent each country should provide the other with the defence articles which it is best able to produce, and, above all, produce quickly, and that production programs should be co-ordinated to this end.
>
> While Canada has expanded its productive capacity manifold since the beginning of the war, there are still numerous defence articles which it must obtain in the United States, and purchases of this character by Canada will be even greater in the coming year than in the past. On the other hand, there is existing and potential capacity in Canada for the speedy production of certain kinds of munitions, strategic materials, aluminum, and ships, which are urgently required by the United States for its own purposes.
>
> While exact estimates cannot yet be made, it is hoped that during the next twelve months Canada can supply the United States with between $200,000,000 and $600,000,000 worth of such defence articles. This sum is a small fraction of the total defence program of the United States, but many of the articles to be provided are of vital importance. In addition, it is of great importance to the economic and financial relations between the two countries that payment by the United States for these supplies will materially assist Canada in meeting part of the cost of Canadian defence purchases in the United States.
>
> In so far as Canada's defence purchases in the United States consist of component parts to be used in equipment and munitions which Canada is producing for Great Britain, it was also agreed that Great Britain will obtain these parts under the Lease-Lend Act and forward them to Canada for inclusion in the finished articles.

The technical and financial details will be worked out as soon as possible in accordance with the general principles which have been agreed upon between the President and the Prime Minister.[7]

The Declaration speaks for itself, and various authors have described in detail both its initiation and its application.[8] After the Japanese attack on Pearl Harbor American isolationist inhibitions vanished and U.S. expenditures of all types, including expenditures on war materials, war supplies and war installations in Canada, began to soar. Canada's U.S. dollar reserves rose so sharply that U.S. Treasury officials soon began to worry lest the special U.S. purchases in Canada under the Hyde Park arrangements should evoke congressional criticism. Accordingly, late in 1942 they proposed that the rate of U.S. purchases in Canada under Hyde Park should be regulated so as to keep Canadian reserves within a maximum-minimum range of $300 to 350 million – in other words, only slightly in excess of the prewar level.

The Canadian authorities reluctantly accepted the proposal in principle but argued that the range should be from $400 to $430 million. They said that the U.S. Treasury proposal was backward-looking (to meet the preoccupations of Congress) rather than forward-looking (to meet actual postwar needs). Despite this argument the U.S. Treasury "regretfully" insisted that the range they proposed would have to be accepted, although they complied with a Canadian request that any increase in Canadian reserves attributable to borrowings in New York should be left out of the calculation.[9]

In the event, it proved easier to agree to a maximum-minimum arrangement than to abide by it. The difficulties of persuading those in charge of U.S. war purchasing to turn on and off the flow of orders placed in Canada proved almost insurmountable. Through 1943 Canadian reserves stood persistently at levels well above the ceiling. It became clear to the Treasuries of both countries that, under the conditions that had developed since the U.S. declaration of war, Canadian reserves and the Canadian dollar could stand on their own feet without Hyde Park help. Accordingly, on 4 January 1944 the U.S. War Department circulated a directive that no more contracts should be placed in Canada "where the primary purpose ... is to provide U.S. dollar exchange for Canada." All further Canadian contracts should be based on "production considerations alone."

This directive turned off the Hyde Park tap but did so at a time when Canadian reserves stood at a level some $300 million in excess of the agreed maximum. The U.S. Treasury therefore proposed that the excess should be devoted to some special Canadian purchases from the United States, a sort of Hyde Park operation in reverse. On the basis of discussions between the two Treasuries it was agreed that Canada would acquire title to a number of wartime installations that the United States had constructed in Canada. These were for the most part airfields, including those on a "staging route" to Europe; also included was an Edmonton-Alaska telephone line. The total depreciated valuation placed on these installations approximated Canada's excess reserve position of $300 million.

Accordingly, on 21 April 1944, two years and one day after the original Hyde Park Declaration, the Minister of Finance, J. L. Ilsley, was able to announce both the termination of financial operations under it, including the maximum-minimum arrangement, and also the purchase of important U.S. installations in Canada. At the end of his statement he remarked that "the principle of close collaboration" with the United States in matters of war production would still stand.[10]

In this final remark Ilsley was recognizing that, over the intervening two years, the Hyde Park Agreement had come to be interpreted far more broadly than its authors had contemplated. What had originated in a simple understanding that the United States would accelerate defence purchasing in Canada in order to help balance the international accounts had, by liberal extension of interpretation, come to cover the coordination and collaboration which had grown up between the two countries in the management of their economic war effort.

Thus, under the banner of the Hyde Park Declaration, there was extensive coordination of the purchase of war supplies and, perhaps even more important, extensive integration of wartime administrative controls over production and distribution. Canadian defence production requirements were brought within the framework of the American priorities system and American exports to Canada were exempted from the wartime controls that were applied to exports overseas. Conversely, the much less complex system of wartime controls in Canada was adapted to take account of American requirements. The rationing authorities on both sides of the border attempted to minimize the personal and political frictions that arose out of apparent differences as between the two countries in personal rations of meat, butter, sugar, and so on. An office of the U.S. War Production Board was set up in Ottawa and offices of the Canadian Department of Munitions and Supply and of the Wartime Prices and Trade Board were opened in Washington.

It has sometimes been suggested that the Hyde Park Agreement, broadly interpreted to cover such measures as these, either established "economic integration" between the two countries at the time or else, by example, set a pattern for such integration in later years. An American author is quoted as referring to "an unprecedented coordination of the economies" and "the almost complete erasure of national boundaries for certain purposes."[11] Any suggestion that the two economies were in fact integrated under the Hyde Park Agreement involves a misapprehension either of the nature and effects of the agreement or else of the nature of economic integration or both. Economic integration between two countries implies that trade and financial barriers between the two are largely if not entirely abolished and that economic resources are allocated on the basis of economic (market) forces. But during the war, in order to conserve U.S. dollars for wartime necessities, Canadian barriers against many U.S. imports were increased, Canadian pleasure travel in United States was forbidden, and capital movements were strictly controlled. (These measures are described in chapter 4 below.) In any normal, peacetime sense, the two economies were, as a result of war, substantially disintegrated.

The integration that did in fact take place in the name of Hyde Park related not to the normal functioning of the economies but to the wartime operations and the wartime controls that were superimposed on them and that largely disappeared when the war was over. When, after the war, a measure of real economic integration did take place it was the result, not of the Hyde Park Agreement, but of the elimination of trade and financial barriers under the auspices of the GATT and the International Monetary Fund.

The rationalization, simplification and harmonization of war orders and war controls between the two countries which took place in the name of the Hyde Park Declaration would have taken place in some form, whether or not that declaration had been issued. Administrators on both sides of the border, with similar objectives and impelled by a similar urgency, would have found it necessary to work out some such system. By blessing the principles of cooperation and coordination at Hyde Park the President and Prime Minister no doubt facilitated and accelerated the process, but they did not cause or even initiate it. In other words, many things were done and many arrangements were made in the name of the Hyde Park Declaration that had nothing to do with, and in no way originated with, the particular solution that was found for Canada's balance-of-payments problem in April 1941.

Still another interpretation of the Hyde Park Agreement in terms of "exemptionalism" is examined in Appendix 2 to this chapter. Further, in chapter 9 we shall be examining another reserve-ceiling arrangement between Canada and the United States; for it, too, the introduction proves to be much easier than the execution.

Relief Supplies for Europe

So much for two elements of special interest in Canada's international financial arrangements during the war: mutual aid and the Hyde Park Declaration. We now pick up the story of international financial policies as the war was drawing to a close. Before liberated Europe could be rebuilt, before the people of Europe could turn their hands to peacetime tasks and begin to pay their way, they were in urgent need of food, medical supplies and other basic necessities of life. Canada participated in two relief programs which are interesting not so much because of their magnitude but rather because of the differing ways in which they were organized.

The first of these programs, known as Military Relief, was the last of the wartime operations to be set up on a tripartite basis between representatives of the United States, the United Kingdom and Canada in Washington; it was known as the Combined Civil Affairs Committee (Military Relief). The second, following closely on its heels, was the first program to come into action on a multilateral basis under a United Nations agency: the United Nations Relief and Rehabilitation Administration, commonly known as UNRRA.

Military relief supplies were distributed to the civilian population by the allied armies advancing from their bridgeheads in Italy (1943) and in France (1944). The governments of the United Kingdom, the United States and Canada undertook to finance the procurement of supplies. The cost of financing was to be shared initially in proportion to the number of troops engaged, Canada's share being 5 per cent of the total. In due course bills were to be presented to the governments of the recipient countries.[12] Under this program the Canadian government purchased food costing about $50 million, vehicles costing about $33 million, and miscellaneous supplies bringing the total to some $96 million.[13] Two-thirds of the Canadian supplies were distributed in western Europe, a small amount in the Balkans, and the rest in Italy. As a result of various offsets, the Canadian claims were reduced to $67 millions. They were presented by the Parliamentary Assistant to the Minister of Finance, James Sinclair, who visited a number of European capitals and reported to Parliament on 29 June 1950.[14]

In all cases the Canadian claim was further reduced to some extent. Concessions were made partly on the basis of a review of the value of the supplies that had been provided and partly in recognition of the extent of war damage to the country in question. The Belgians paid $7.1 million in U.S. dollars against a claim of $7.8, the Netherlands paid $5.7 in U.S. dollars against a claim of $14.1; Denmark paid $0.5 million against a claim of $0.6, and Luxembourg $0.37 million against a claim of $0.44. France, against a claim of $13.5 million, agreed to pay the equivalent of $7.5 million in francs, to be used for Canadian government expenditures including cultural programs in the country. The claim against Italy was reduced from $28.3 to $1.3 million, which was to be made available in Italian lire for the provision of scholarships and the purchase of property for a Canadian embassy. Small claims against Greece and Albania were cancelled, but Yugoslavia, against an account of $226,000 undertook to pay $150,000 in local currency to be spent in the country.

UNRRA was the first of the international agencies to be launched in the name of the United Nations. Representatives of forty-four countries signed an agreement in Washington on

9 November 1943 and the signing was followed by a conference in Atlantic City where a constitution for the new organization was approved. For Canada, the UNRRA constitution marked an immediate rebuff but the beginning of a long period of advance towards an effective voice in the postwar international organizations.[15] The rebuff took the form of a reassertion by the Great Powers, the United States, Britain, the Soviet Union and China, of their claim to all the seats on the Central Committee of the new body.

The Canadian contention, which had been publicly approved in Parliament and privately pressed through diplomatic channels during the preceding months, was that in any international organization authority should rest with those countries having the greatest stake in its particular operations. It was quite proper that a body responsible for military operations, for example the Security Council of the United Nations, should be dominated by the countries that wielded the greatest military power. But when it came to matters of relief, which involved feeding not fighting, the countries that supplied the food had a right to a special voice. Thus emerged the principle of "functional representation" which Canada, increasingly supported by other middle powers, advocated with considerable success in succeeding years as, one after another, new international organizations were established. Indeed, functional representation emerged automatically at the very next institution-building conference. It will be recalled that at Bretton Woods in 1944 the constitution approved for the International Monetary Fund (and for the World Bank) provided for weighted voting, which, in contrast to one country–one vote, could be considered to provide for such representation.

Even in regard to UNRRA the Canadian initiative was partially successful. The Great Powers agreed that, when the Central Committee discussed "policies affecting the provision of supplies," the chairman of the Committee on Supplies should be present, and the chairman was a Canadian, L. B. Pearson. In 1945, when France was admitted not only to Great Power status but also to the Central Committee of UNRRA, Canada was also admitted to the latter.

Canada, as expected, turned out to be a major source of supply for the new organization. "When the books were finally closed it was found that UNRRA had spent in Canada $254 million for grain, canned meat, fish, food, clothing, automotive equipment, medicines and soap."[16] This amount was considerably in excess of Canada's contributions to the organization which amounted to $154 million (Canadian). Canada was the third-largest contributor; total contributions from all other governments amounted to some $3.6 billion.[17]

UNRRA was brought to an end in 1947. The Great Powers were unable to reach the necessary policy agreements amongst themselves; each preferred to handle remaining relief requirements in its own sphere of influence in Europe and in its own way. Canadians argued vigorously first in UNRRA itself and later in the United Nations for a continuation of multilateral as opposed to uncoordinated relief arrangements, but without much success. However one good thing emerged; The United Nations International Children's Emergency Fund (UNICEF) was created and become a residuary legatee of at least part of UNRRA's assets.

The Export Credits Insurance Act

Some six weeks after the allied armies had established the bridgehead in Normandy the Minister of Finance introduced into Parliament the first of two measures to provide for Canada's main programs of reconstruction assistance: the Export Credits Insurance Act of 1944, and the reconstruction loan to Britain.

Part I of the Exports Credits Insurance Act provided for insurance of ordinary short-term commercial credits. Enlarged and amended it is still in operation today, although the name of the responsible Crown company has been changed from the Export Credits Insurance Corporation to the Export Development Corporation.

Part II of the act, however, provided for postwar reconstruction credits up to a total of $750 million and credit guarantees up to $200 million. These facilities could be used only to finance the export of Canadian goods and services and, in order to provide at least some cash income from these exports, arrangements were made that the recipient countries should, in addition to purchases on credit, make some purchases for cash. Credits could be arranged until the end of 1948. A review of operations up to March 1949 showed that out of export commitments of $730.6 million rather more than one-quarter were to be paid in cash and just under three-quarters were on credit.

Different countries made differing uses of their funds. France, the largest borrower, bought chiefly ships, wheat, other grains and flour, transport equipment and non-ferrous metals; the Netherlands bought chiefly wheat, non-ferrous metals, lumber, and transport equipment; Belgium bought wheat, machinery and meat; and so forth. In brief, the arrangements provided European countries with basic foodstuffs and with machinery, materials and transport equipment for industrial reconstruction. The credits granted to various countries, the terms applied, and the rates of utilization are provided in an Apendix to this chapter.

The subsequent record of repayment has been good. Some payments, under the longer loans, are still coming in. There have been, however, two exceptions to the regular payments scheduled under the individual loan agreements. After the revolution in China in 1949 payments by the Chinese (Nationalist) government were interrupted and never resumed. Payments by Czechoslovakia were interrupted in November 1952. The reason for this was at first obscure but it emerged that Czechoslovakian exports were, it was claimed, unduly hampered by Canadian customs procedures and thus, because the Czechoslovakians attempted to conduct all their trading arrangements on a bilateral basis, they said they were unable to make payments on their loan. A meeting in Ottawa in May 1954 revealed that they had some cause for complaint regarding Canadian import valuation procedures, which were not designed to facilitate trade with countries with completely controlled costs and prices. Modified procedures were immediately instituted, loan repayments were resumed in December 1954, and the loan paid off in full in 1958.[18]

While some payments were delayed, others were accelerated. In 1962, when Canada experienced a foreign exchange crisis and exchange reserves ran low, the French and the Dutch, whose reserves were ample at the time, paid off about half of their commitments amounting in the case of France to $58.6 million and the Netherlands to $32.1 million.[19]

Under the section of the act providing for credit guarantees there were only two transactions. In 1944–45 the Soviet Union arranged for guarantees not to exceed $3.5 million to cover temporary financing of equipment purchases, and by March

1947 all credits under this guarantee had been paid off. The other guarantee transaction was with China; it had a longer history with a surprisingly happy ending.

In 1946 the Ming Sung Industrial Company contracted to purchase nine small ships designed with shallow draft for trade on the Yangtze River. These were to be built in Quebec shipyards (a fortunate circumstance in view of an impending provincial election) and the cost was $12.75 million. The money was put up by three Canadian banks, under Canadian government guarantee, and the rate of interest was 3 per cent. After a rough ocean voyage (the crews deserted at one point) the ships eventually reached China. By that time the Communist revolution had taken place and the Ming Sung Company had moved out. Accordingly the Canadian banks had recourse against the Canadian government. By the time the contract terminated in 1960 the government had paid them interest and principal amounting to $14.5 million.[20] And there, it would seem, the matter might well have ended. However, when Canada officially recognized the People's Republic of China in 1972 the Chinese government reported that the Canadian ships were still in operation; they recognized the validity of the debt and agreed to a settlement covering the outstanding $14.5 million.[21]

The Reconstruction Loan to Britain

When victory in Europe came in sight careful thought was given in Washington and London to the continuance and ultimate conclusion of the war in the Pacific. Planning was postulated on an assumption that it would take a painful eighteen months to recapture Japanese strongholds. Nobody was prepared for the immediate collapse of Japan under the impact of the atom bomb. Hostilities terminated officially on 1 September 1945. Under the terms of the Lend Lease Act, U.S. assistance ceased immediately. The Canadian government, unable to support Britain and other allies single handed, also terminated mutual aid. Thus, although suoplies continued to move from North American under provisional arrangements, the ending of the war created, in effect, an international financial vacuum.

A British delgation led by Lord Keynes left forthwith for Washington. They were met sympathetically by members of the U.S. administration, but there were two basic issues to be confronted, one economic and the other political. In the first place, there were wide differences of opinion as to how much Britain would need in the way of postwar reconstruction support, and over how long a period. Keynes tended towards optimism, but even he hoped to raise $6 billion, if possible as a gift but in any case interest-free.[22] The second issue was the attitude of Congress; the U.S. administration had to consider not only what amount but also what terms could safely be proposed for congressional acceptance. The negotiations dragged out over three months.

The American negotiators took the view that the new U.S.–U.K. financial arrangement could not take into account British losses, let alone British sacrifices and suffering, during the war; it would have to be forward-looking and businesslike. It was eventually agreed that Congress would be asked to provide only $3.75 billion and not as a gift but as a loan. Interest was to be charged at the somewhat concessional rate of 2 per cent, but in order to give the British some breathing space to convert their economy to a peacetime basis, no payments of principal or interest were to be made before 1951. Thereafter payments were to be in equal annual instalments spread over fifty years (to the year 2001) and interest could be waived (postponed) in any year when Britain could claim, under specified conditions, that they were in balance-of-payment difficulties. The British were required to reiterate their undertakings, already made in general terms in connection with their receipt of lend lease, to work toward a postwar regime in which trade would be nondiscriminatory and sterling convertible. In consideration of this, the United States wrote off all but $650 million of accumulated claims on lend lease and other accounts.

Two elements in the agreement turned out to be entirely unrealistic. In the first place, sterling was to be made convertible, not after the five-year transitional period envisaged at Bretton Woods, but almost immediately, in 1947. Britain carried out this undertaking but had neither the international earnings nor the reserves to support it. This effort, obviously premature, collapsed in a matter of weeks.

In the second place, the British were to negotiate with the holders of accumulated sterling balances, looking toward a reduction of the outstanding debt or at least its conversion into longer-term obligations. The amount involved was variously estimated at from $12 to $15 billion. The greater part of these balances were held by Middle East countries and India, as a result of wartime sales of supplies to Britain. Any attempt to reduce their amount or to lengthen their term involved sensitive political as well as economic issues. Discussions stretched out over many years, gradually merging into the general and persistent postwar difficulties of the British balance of payments.

The U.S. Loan Agreement and the Bretton Woods Agreements were placed before the British Parliament at the same time in December 1945. There was a vigorous two-day debate in the House of Commons, and another two days in the House of Lords, where Keynes made his classic defence of the proposals. There were many inside and outside Parliament who, disliking both Bretton Woods and the loan, claimed that Britain had a viable alternative to the proposed U.S.-dominated multilateral trading world: she could build up protective and discriminatory economic arrangements within the sterling area, the Commonwealth (excluding Canada) and the colonial Empire. In protest against the terms of the loan, Winston Churchill and a group of Conservatives, now in opposition in the House of Commons, refrained from voting. The government, however, had the support necessary so that, provisionally upon congressional approval of the loan, Britain accepted before the end of 1945 both Bretton Woods and also the U.S. Loan Agreement.

President Truman submitted the Loan Agreement to Congress in January 1946. There were widespread protests that, with the war over, Britain and other former allies should be left to fend for themselves and that, in any case, the United States negotiators had, as usual, been outmanoeuvred by the wily British. Protests in Britain against the unreasonable toughness of the agreement may have actually helped the U.S. administration to pilot the loan through Congress. The House of Representatives did not give its assent until May, and the Senate until July, 1946; meanwhile Britain moved, month by month, closer to bankruptcy. Nevertheless, in retrospect, and in the light of all the uncertainties existing in 1945, Keynes' biographer, Roy Harrod, regretfully concluded: "That the Loan was inadequate may be granted, but this is not a criticism of those who negotiated it. American generosity was stretched to what at that point was its limit. Doubters may read the protracted hearings of the Congressional committees on the subject."[23]

After the discouraging and sometimes humiliating experience in Washington, British negotiators came to Canada early in 1946. In Ottawa attitudes were different. By any normal standard of comparison the loan that the Canadian authorities were willing to negotiate was much larger: $1.25 billion as compared with $3.75 billion from the United States. A debt of $425 million on the British Commonwealth Air Training Plan was cancelled and the interest-free character of the $700 million loan of 1942 was extended to 1951.[24] Canadian mutual aid had created no outstanding obligations to be negotiated, and there was no reference in the Canadian agreement to sterling balances.

In other respects, however, the terms of the two loans were virtually identical. Payments were to begin in 1951 and run until 2001 with provision for a waivers of interest.[25] There were comparable requirements about non-discrimination and convertibility of sterling (in the Canadian Agreement no date was specified for sterling convertibility but it was implied by a cross reference to the terms of the U.S. Agreement).[26]

The Canadian loan proposal elicited the immediate and warm support of the leaders of all four parties in the House of Commons.[27] The Social Credit members, who had voted against the International Monetary Fund on the ground that it involved an American plot to disrupt the Empire, could readily favour massive Canadian support for Britain.

It is interesting to compare the arguments chiefly employed by proponents of the Loan Agreements in Washington and in Ottawa. In Washington the arguments were, for the most part, of a global nature, stressing the general benefits to accrue to the United States from the new world economic order that the administration was attempting to establish. Emphasis was laid on the fact that Britain and the pound sterling occupied pivotal positions in world trade and world finance; it would be greatly damaging to American interests if the sterling area, for lack of the proposed loan, were allowed to separate from and permanently discriminate against the dollar area. The whole Bretton Woods edifice, already accepted by Congress, would crumble if the British, for lack of transitional financial assistance, were unable to commit themselves to participate in it. There were, of course, references to American interests, in particular exports to Britain such as tobacco and other farm products. However, the thrust was towards the new world system. Incidentally, as Harrod pointed out, the postwar communist threat and the appeal to U.S. defence interests which two years later spurred the Marshall Plan forward had not yet surfaced in Congress.[28]

In Ottawa speakers in the House of Commons referred to Britain's shattering wartime experiences and the need for reconstruction. This was conceived partly in terms of the new world system which Canadians as well as Americans were labouring to build, but also (and with heavy emphasis by the Minister of Finance and by the leaders of other parties who followed him) in terms of Britain's ability and willingness to buy Canadian goods. A discriminatory division between the sterling area and the dollar area would spell difficulty for the United States; for Canada it would spell disaster. The few voices that were raised in protest against the agreement were similar to those that had protested in 1942 against the "billion dollar gift to Britain." Canada, a small country with many problems of her own, could not afford to make grand gestures toward a so-called "mother country" which was, in fact, at the heart of a far-flung and very wealthy empire. In the end, six out of some sixty French-Canadian members voted against the loan while all other members from all parties voted for it.[29]

Officials in the Department of Finance and in the Bank of Canada had been doubly disappointed when they learned of the amount and the terms of the U.S. – U.K. loan. They felt sure that the amount was not nearly sufficient and this judgment was indicated by the size proposed for the Canadian loan. In those days comparisons of economic capacity suggested that the appropriate Canada – U.S. ratio was about 1 to 15 (sometimes 1 to 20). At one-fifteenth of the U.S. loan, Canada's contribution would have been $250 million, not $1,250 million; conversely, at fifteen times the Canadian loan the American would have been, not $3.75 billion, but $18.75 billion – approaching the total sum which the Americans found it necessary to devote a few years later to European reconstruction under the Marshall Plan. Canadian officials also considered that the terms of the U.S. – U.K. loan were undesirably severe, considering the damage and destruction suffered by the British economy during the war, the extent to which her overseas assets had been depleted and impaired, and the problems she would have to overcome in regaining overseas markets. They would have been ready to recommend terms that were considerably more concessional. However, they recognized that, once the terms of the U.S. loan were known, it was not practicable for the Canadian government to place before Parliament a proposal in which Canada was, in effect, underwriting Britain's capacity to meet the more demanding terms exacted by the Americans. Accordingly, it seems reasonable to consider the Canada – U.K. agreement as something of a compromise between the two elements of the U.K. – U.S. agreement. On the amount, the Canadian government was prepared to be far more forthcoming than the Americans, but on the terms it did not feel it could or should be much more lenient. The warm reception given by Parliament to the actual proposal indicates that the government had, broadly speaking, assessed its attitude correctly.

In 1946, only a few months after the Canada – U.K. Loan Agreement had been signed, the two governments signed another which provided for large sales of Canadian wheat to Britain during the four crop years from 1946 – 47 to 1949 – 50. At the time, both governments considered that the Wheat Agreement was good business economically and politically; over a four-year period when the world was full of economic and political uncertainties, it gave them both basic assurance in regard to sales and prices. Specifically, it provided for sales of at least 160 million bushels in each of the first two years (substantially more than Britain's normal consumption of Canadian wheat) and of at least 140 million bushels in each of the next two years. Large quantities of his wheat were to be delivered in the form of flour. As for the price, it was to be $1.55 a bushel in the first and second years (which was appreciably below United States and Argentine prices when the negotiations were taking place), not less than $1.25 in the third year and not less than $1.00 in the fourth. The actual prices for each of the two later years were to be negotiated in advance and (here came the ground for future contention) were to "have regard to any difference between prices paid under this Agreement . . . and world prices" for deliveries in the first two years.[30]

During the four years of this agreement many circumstances altered. Expectations that world wheat prices would probably collapse, as they had after the First World War, did not materialize and the price fixed in advance for each of the two final years was $2. This was well above the minimum prices that had been prescribed in the agreement and also above the ceiling price of $1.80 under a new world wheat agreement, which came into effect in 1948. Finally, by 1949 the U.S. European Recovery Program (Marshall Plan) was in full operation, so that wheat was moving from North America to Europe as a gift; obviously wheat on these terms was preferable to buying it under the terms of the Canadian loan to Britain of 1946. These and other developments contributed to divergences between British and Canadian views. Moreover, there was a sharp divergence within the Canadian cabinet which emerged in the House to the embarrassment of the government and the relish of the opposition.[31]

The British government stoutly maintained that, having paid the $2 price for the two concluding years, their obligation under the "have regard to" clause had been met in full. The Canadian government, under strong pressure from the wheat farmers for whom they were in effect acting as agent, attempted to secure some additional payment relating to the price situation in the first two years, but without success. In a final effort to alter the British decision, Louis St. Laurent, then Secretary of State for External Affairs, called their attention to the "prevailing feeling" in Canada that the British "had not carried out the 'have regard to clause' in the manner in which it had been expected that they would carry it out."[32] The British could not even be persuaded to contribute the sum of $65 millions which remained unspent from the 1946 loan and which, although far less than the amounts that were being talked about in the Canadian Parliament as representing the "loss" to Canadian farmers under the agreement, would at least have saved the face of the Canadian government and been a palliative to the Prairies. In the end, although the figure of $65 million had no rational relationship to the wheat arrangements, the Canadian government made a contribution of that amount on its own account to the four-year Prairie wheat pool that was about to be wound up.[33]

In the light of all these considerations it must remain an open question whether the Canada – U.K. Wheat Agreement of

1946 should be included as an element in Canada's postwar contributions to British reconstruction. There is no doubt, however, that many Canadians believed that it was, including not only the wheat farmers who were persuaded that they got less than their due but also members of the public at large.

During and after the war there was in Canada widespread sympathy for the British and deep admiration for the fortitude and resilience which they had shown in the face of adversity. Up to this time the Canadian and British governments had always been able to negotiate their differences, even deep-seated differences, amicably and without recrimination. The perceptive official historian of British wartime financial policy, R. S. Sayers, ends his chapter on Canada – U.K. relationships by recalling that, at the outbreak of war, the Canadian Prime Minister had personally assured the British government that Canada "was ready and willing to help Great Britain to the utmost of its power and resources"; he then concludes: "it was in this spirit that the conflicts were, in one way or another, resolved throughout the war."[34] The same spirit persisted for some time after the war, and it is sad that the reconstruction period should have ended with a whimper over the price of wheat.

Canada's Contribution in Retrospect

Apart from this unhappy episode, the story of Canada's contribution to recovery overseas appears to have been, from both national and international viewpoints, a creditable one. In the years 1946 and 1947 Canada's external assistance to Britain and other overseas countries ran at the astonishing figure of 6.2 and 4.3 per cent of the gross national product[35] – astonishing particularly in relation to the difficulties confronted by Canada and other countries in later years when attempting to raise their aid to developing countries to 1 per cent of GNP. The financial problem into which Canada ran as a result of this very substantial effort is described in the next chapter.

It must be recognized, of course, that Canada's aid for post-war reconstruction was in the form of loans, not grants. This in no way diminished the economic effort and sacrifice that was required at the time, although it carried the promise of future compensation. Moreover, a loan can properly be considered as a form of international foreign assistance when the financial capacity of the lender is stretched, and also when the borrower's need is urgent, when he is in a position to put the money to constructive use, and when the terms of repayment are not unduly burdensome.

It was unfortunate that the U.S. reconstruction loan to Britain should have been inadequate in size and also, considering the plight of the borrower, so stringent in its terms. The American example served to limit the Canada – U.K. loan, not so much in its size, but in its terms. Action by the United States commensurate with the need had to await the outbreak of the cold war.

Canada's contribution to overseas reconstruction was soon to be overshadowed by the Marshall Plan and the world-wide acclaim that attended it. In this regard John Holmes has recently written:

> It was Canada's bad luck that because of its earlier involvement in the war and in particular in the survival of Britain it provided help when it was most needed and least noticed, that is, during and immediately after the war. While the American administration coped with more refractory public attitudes and the division of powers, the Canadian Government was able to provide financial support to stave off a British collapse in 1946 and 1947 while Congress pondered. By the time the Marshall Plan was approved in 1948, Canada had virtually bankrupted itself. . . . The Marshall Plan is remembered by Europeans with gratitude and properly so, while the Canadian assistance is recalled, if at all, only by elderly ex-officials.[36]

APPENDIX 1
"EXEMPTIONALISM" AND THE HYDE PARK AGREEMENT

The Hyde Park Agreement has recently been interpreted as embodying an "exemption" for Canada from the provisions and requirements of the U.S. lend lease legislation.[37] Prima facie this interpretation makes little sense, considering that Canada was, on balance and for almost the whole of the duration of the war, a provider not a recipient of economic assistance; indeed Canada and the United States were together the great providers of wartime economic assistance to their allies. Nevertheless, this interpretation deserves some scrutiny, along with the suggestion that, in retrospect, Canada would have been better advised to accept lend-lease provisions than to undertake a special bilateral obligation to the United States.

The authors of this interpretation, Professors Cuff and Granatstein, go on to suggest that, following upon the Hyde Park pattern, Canada proceeded to negotiate other special exemptions in later years and that these have involved Canada in an increasing subordination to U.S. policies:

> While the basic pattern of exemptionalism was set during World War I, it was formalized and encased in bureaucratic machinery only during World War II. The key step in this process was the Hyde Park Declaration of 20 April, 1941 which set out guidelines for American purchases of defence articles....
>
> One of the deeper ironies of modern Canadian history is that the triumph of Canada's past strategy of exemptionalism has been so great as to endanger her political future. Though obscured during periods of emergency and war crises, this fact has emerged with alarming clarity in recent years, in part because of the coming end of the Cold War and the beginnings in Canada of a more realistic assessment of the goals of American financial power. While in each case Canadian officials may have believed that the kinds of exemptions they chose – private instead of public loans, or direct purchases instead of lend-lease, for example – helped to guarantee independence, the historical consequences have proven to be just the opposite. Exemptionalism has offered only an illusion of independence while it bound the country ever more firmly into lockstep with American policy.[38]

The authors refer specifically to three periods during which American "exemptions" were allegedly sought and obtained for the purpose of supporting Canada's international payments. The third period, from 1963 onward, when the United States was attempting by various means to restrict an outflow of capital, did indeed involve special exemptions in favour of Canada and we shall review it in chapter 9 below. But neither of the two earlier periods to which they refer involve anything that can reasonably and properly be described as such a special exemption.

Looking first at the events of 1941, there was nothing in the U.S. Lend Lease Act that required Canada to be brought within its terms and it is quite clear that Roosevelt, who had sponsored the act through Congress with great difficulty, did not even suggest at Hyde Park that it should be applied to Canada. In its financial aspects the agreement suited both sides. Within a year it had served its financial purpose; it was effectively terminated in two years, and it had no lasting effects. (Cuff and Granatstein do not even mention the conclusion of what proved to be a temporary financial expedient.)

These authors are right in emphasizing that the close and effective administrative cooperation built up between Canada and the United States during the war influenced attitudes in both countries toward common problems in subsequent years. They are wrong, however, in suggesting that this wartime relationship flowed from the financial provisions of the Hyde Park Agreement. It flowed from far more fundamental causes in geography and in the nature and execution of the common war effort. "Exemptionalism" was irrelevant.

These authors suggest that Canada would have been better off to seek financial support under lend lease than under Hyde Park. They do not elaborate this claim and on examination it seems entirely unconvincing. To begin with, Canada's postwar financial position vis-à-vis the United States would have been impaired and undermined by the necessity of giving up all Canadian private investments in the United States. As for the administrative entanglements, the "jungle of boards and committees" to which the authors refer, these were certainly no greater under the Hyde Park regime, which permitted Canada to deal directly with the U.S. War Production Board (WPB), than they would have been if Canada had dealt indirectly with that body through the Office of Lend Lease Administration (OLLA) and if the U.S. wartime office in Ottawa had been a branch of OLLA, rather than WPB. Further, the wartime policies and practices of those countries that received lend-lease assistance were subjected to continuous and often humiliating scrutiny by U.S. officials. Anyone who labours under the illusion that countries receiving lend-lease aid could retain an aloof, arms-length independence from the United States should read (or reread) the relevant passages in the account of the British experience given by Sayers.

Professors Cuff and Ganatstein are also wrong in suggesting that a second "exemption" for Canada was provided in connection with the Marshall Plan. They are right in stating that Canada in 1947–48 was once again in financial difficulties and that these difficulties were in due course relieved by the provision for "offshore purchases" under the Marshall Plan (that is, by the provision that permitted European recipients of Marshall Plan funds to spend them according to their usual import patterns rather than being tied to purchases directly from the United States). It is also true that Canada pressed strongly for such a provision to be included in the U.S. legislation. But what is not true is that its inclusion constituted a concession to, far less a special exemption for, Canada.

When the proponents of the Marshall Plan in the U.S. administration urged Congress to provide for offshore purchasing they did so (as the record clearly shows) partly in order that the normal channels of world trade should be opened up (explicitly including Latin America as well as Canada) and partly to avoid the inflationary pressures that would have been exerted in the United States if all types of Marshall Plan purchases had necessarily been concentrated in that country rather than diffused through Canada, Latin America and other countries; in due course these countries could be counted on to use the dollars they received to purchase their normal supplies of U.S. goods. It was clearly recognized by those piloting the legislation through Congress that the emergency import restrictions which Canada had had to impose in 1947 on normal purchases from the United States were damaging to U.S. exporters. Offshore purchases in Canada under the Marshall Plan were proposed, not as a handout, concession or exemption for Canada, but as an effective means of alleviating damage to U.S. interests.

APPENDIX 2

Postwar Loans and Advances to Other Countries by the Canadian Government, 1945-48 (in millions of dollars)

	Export Credits Authorized	Interest Rate %	Time of Repayment	Net Amounts Drawn[1]			
				1945	1946	1947	1948
France	242.5	3	1947-76	34.9	108.9	54.6	35.4
Netherlands	125.0	3.05	1950-76	29.8	34.2	40.6	8.4
Belgium	100.0	3	1947-76	22.5	30.1	12.3	1.1
China	60.0	3	1948-77	–	16.5	16.1	18.4
Norway	30.0	2¾	1951-59	6.2	10.2	3.6	3.3
Czechoslovakia	19.0	2½	1950-54	0.7	3.2	8.2	4.3
Netherlands Indies	15.0	2¼	1950-54	0.6	4.8	4.6	5.0
U.S.S.R.	3.0	2	1950	9.9	1.8	–	–
TOTAL	594.5			104.6	209.7	140.0	73.7
Loan to United Kingdom	1,250.0			–	540.0	423.0	52.0

[1] Net amounts drawn include interim advances as well as drawings on Export Credit loans less repayment of interim advances and loans. All advances had been repaid by 31 December 1947 with the exception of $8.8 million to the USSR. Accrued interest settled by funding has been excluded, estimated at $19.5 million by end of 1948.

SOURCES: Government of Canada, *The Canadian Balance of International Payments 1926 to 1948* (Ottawa, 1949), p. 56: also House of Commons, *Debates*, 11 April 1946, p. 746 (for interest rates and time of repayment).

NOTES

1 A brief summary of these measures is to be found in the *Final Report* (Ottawa, 1946) of the Canadian Mutual Aid Board. A fuller account is given in R. W. James, *Wartime Economic Cooperation* (Toronto: Ryerson Press, 1949), pp. 15-19. The best account of Canada's wartime international financial arrangements and the political difficulties they created is to be found in R. S. Sayers, *Financial Policy, 1939–45* (London: H.M. Stationery Office and Longmans, Green, 1956), chapter 11.
2 A consolidated balance of payments between Canada and the sterling area, 1940–45, showing the financial gap of $5.6 billion and how it was bridged, is presented in Government of Canada, *The Canadian Balance of International Payments, 1926-1948* (Ottawa: The Queen's Printer, 1949), p. 38.
3 The War Appropriation (United Nations Mutual Aid) Act, 1943, 7 George VI, Chapter 17.
4 See Sayers, *Financial Policy*, chapter 11.
5 *Ibid.*, p. 439.
6 John Holmes, unpublished manuscript.
7 Declaration by the Prime Minister of Canada and the President of the United States of America Regarding Cooperation for War Production made on 20 April 1941, Canada, Treaty Series, 1941, No. 14.
8 A comprehensive and fully documented account of the factors leading to the Hyde Park Delcaration is to be found in J. L. Granatstein and R. D. Cuff, "The Hyde Park Declaration: 1941, Origins and Significance" in *Canadian-American Relations in Wartime* (Toronto: Hakkert, 1975), chapter 4, pp. 69-92. See also J. W. Pickersgill, *The Mackenzie King Record* (Toronto: University of Toronto Press, 1960), Vol. I, chapter 8. Also Sayers, *Financial Policy*, p. 340 and James, *Wartime Economic Cooperation, passim*.
9 The present writer, as Financial Attaché in Washington from 1942 to 1945, was involved in these discussions and has since been able to refresh his memory from files of the Department of Finance and from conversations with others in Ottawa.
10 Statement by the Minister of Finance, House of Commons

Debates, 21 April 1944, pp. 2226-28. See also F. H. Soward, *Canada in World Affairs 1944-1946* (Toronto: Oxford University Press, 1950), pp. 258-60. The U.S. Treasury attempted to negotiate with the British an arrangement that their reserves should not, as a result of lend lease, run beyond the prewar level. For the acute difficulties and objections that arose, see Sayers, *Financial Policy*, pp. 427-37.

11 James, *Wartime Economic Cooperation*, p. 395.

12 Mutual Aid Board, *Final Report*, p. 43.

13 House of Commons, *Debates*, 4 February 1949, p. 850.

14 *Ibid.*, 29 June 1950, pp. 4378-83.

15 *Mike: Memoirs of the Rt. Hon. Lester B. Pearson, Volume I, 1897-1948* (Toronto: University of Toronto Press, 1972), pp. 250-58.

16 F. H. Soward, *Canada in World Affairs, 1944-46* (Toronto: Oxford University Press, 1950), p. 88.

17 Mutual Aid Board, *Final Report*, p. 44.

18 Minister of Finance, *Report on Operations under Part II of the Export Credits Insurance Act for Fiscal Years 1952-53 and 1954-55.*

19 *Ibid, 1962-63*, p. 1.

20 House of Commons, *Debates*, 17 November 1971, p. 9638.

21 Department of External Affairs, Ottawa, Communiqué, 4 June 1973.

22 The figure quoted by R. F. Harrod is £1,500. (*Life of John Maynard Keynes* [London: Macmillan, 1951] p. 596.) Harrod describes vividly the negotiations in Washington as well as the impact, on various American as well as the British, of the abrupt cessation of lend lease.

23 *Ibid.*, p. 614.

24 This loan of $700 million was gradually reduced and eventually paid off in full in 1958. It was renewed on three occasions (1946, 1951 and 1953), always on an interest-free basis. It was reduced for the most part out of the earnings or liquidation of Canadian securities owned by British residents. (See House of Commons, *Debates*, 8 November 1951, p. 856; 22 November 1951, p. 1269; 10 December 1953, pp. 780-81; 18 December 1953, p. 1010; and 15 June 1970, p. 8093.)

25 In 1957 the provisions for waivers in both the Canadian

and American Loan Agreements were amended as follows. First, an interest waiver for the year 1956 was granted despite a question whether the sterling balances requirement in the U.S. – U.K. Agreement had been met for that year. Second, waivers were thereafter to cover principal as well as interest. Third, the number of such waivers was to be limited to seven. One such waiver was claimed and granted for the year 1957. See *Debates*, 11 January 1957, p. 120; 14 February 1957, p. 1275; 6 March 1957, pp. 1924-25; and 18 December 1957, p. 2512.

26 Financial Agreement between the United Kingdom and United States, Washington, 6 December 1945, in *British and Foreign State Papers, 1943 – 1945* (London: HMSO, 1953), p. 775. Also Financial Agreement between Canada and the United Kingdom, Ottawa, 6 March 1946, in Canada Treaty Series, 1946, No. 9, p. 3.

27 Text of the opening speeches in the debate may be found in House of Commons, *Debates*, 11 April 1946, pp. 762-94.

28 Harrod, *Life of Keynes*, p. 598.

29 House of Commons, *Debates*, 7 May 1946, p. 1291.

30 Agreement between Canada and the United Kingdom for the Purchase of Canadian Wheat, Ottawa, 24 July 1946. Canada Treaty Series, 1946, No. 30, pp. 3-4.

31 J. W. Pickersgill, *My Years with Louis St. Laurent* (Toronto: University of Toronto Press, 1975), p. 151.

32 House of Commons, *Debates*, 13 March 1951, p. 1228.

33 See House of Commons, *Debates*, 2 March, 1951, p. 833; 8 March, pp. 1060-76, 9 March, pp. 1083-84, and 20 March, pp. 1444-56.

34 Sayers, *Financial Policy*, p. 324.

35 Figures for external assistance are given on p. 86. Figures for GNP will be found in the Reference Tables at the end of this volume.

36 John Holmes, unpublished manuscript.

37 R. D. Cuff and J. L. Granatstein, "The Perils of Exemptionalism" in *Canadian-American Relations in Wartime*, pp. 156-63.

38 *Ibid.*, pp. 157 and 161.

4

The Search for a Defensible Dollar, 1945 – 49

The Wartime 90-Cent Dollar and its Defences

Canada's contribution to overseas economic reconstruction, which was the subject of the previous chapter, took place during a period in which wartime economic controls were being rapidly relaxed. As long as all international transactions were under strict control they were not greatly influenced by the level of the international exchange rate. But as controls were removed, as Canadians became increasingly free to buy and sell what they liked where they liked, to decide whether to holiday at home or abroad, and to consider foreign as well as domestic investment, the level of the Canadian dollar became increasingly significant. Thus throughout this chapter the emphasis shifts from policy decisions about controls to policy decisions about the exchange rate.

Throughout the 1930s the Canadian dollar had been allowed to find its own level on the basis of market forces without any intervention or control on the part of the Canadian authorities. In spite of the major international imbalances which bore down on foreign exchange markets from time to time during the Great Depression, the Canadian dollar showed considerable stability; speculation was a stabilizing rather than a destabilizing influence.[1] But speculation could not be relied upon to exercise a stabilizing influence under the vicissitudes of war. Moreover, there were compelling reasons for bringing all dealings in foreign exchange under official control and thus mobilizing under government auspices the international financial resources of the country. Accordingly, on 16 September 1939, in the week following Canada's declaration of war, the government set up a Foreign Exchange Control Board with comprehensive authority over all such dealings.[2]

The Board forthwith announced buying and selling rates in terms of Canadian dollars for U.S. dollars and for sterling. For U.S. dollars the buying and selling rates were respectively, $1.10 and $1.11; for sterling they were $4.43 and $4.47. (The 1-cent spread between buying and selling rates on the U.S. dollar, and the 4-cent spread on sterling were narrowed on 15 October 1945 to ½ cent and 2 cents respectively. The rates thus became $1.10 and $1.105 on the dollar and $4.43 and $4.45 on sterling.) These rates reflected, as far as the Canadian dollar was concerned, the fact that the British exchange authorities had already fixed buying and selling rates for the U.S. dollar which represented an approximate 20 per cent devaluation of sterling. The Canadian decision, representing an approximate 10 per cent devaluation, thus established the Canadian dollar halfway between the two major currencies. Such a relationship had, broadly speaking, emerged on the basis of free market forces during the early 1930s.

To be effective, foreign exchange control involves extensive and troublesome interference with personal and business activities. It affects all who trade, invest or travel across the international boundary. Forms have to be filed declaring the nature of each transaction, the purpose and destination of each trip, the type and amounts of currencies involved and so forth. An attempt to confine control to capital movements involves difficulties that are not apparent at first sight: an export of capital can be accomplished by the under-valuation of a shipment of commodity exports or by the over-valuation of a shipment of imports, by a man carrying a parcel of securities or a woman carrying a box of jewellery. Every Canadian resident crossing the border had to have an individual foreign exchange permit and this had to be scrutinized at the border. The implementation of foreign exchange control is arduous and irksome in any country, but particularly so in one with three thousand miles of undefended frontier. As part of the national war effort people accepted such controls with little grumbling and little attempt at evasion so that the problem of enforcement was manageable. Under other circumstances the results might have been quite different.

In 1939, when the fighting was in far-away Poland and people still wondered whether Hitler planned a full-scale war, the foreign exchange control regulations were not very onerous. They imposed no actual restriction on import or export trade, on travel, on the payment of interest or dividends, or on other current business transactions; the formalities were essentially designed to prevent an exodus of capital to the United States or other countries. Such an exodus, the Minister of Finance explained, would have depleted Canada's reserves of gold and U.S. dollars and these would be needed for wartime purposes. It would, at the same time, he said, have depleted the supply of Canadian savings available for wartime investment.[3]

In the spring of 1940, with Hitler's invasion first of Norway and then of Holland, Belgium and France, followed by the Battle of Britain, there could be no further question about a full-scale war. The controls were rapidly tightened. The first step, taken in April 1940, was to mobilize all Canadian holdings of foreign exchange under the authority of the Foreign Exchange Control Board. In June the Board reinforced its regulations relating to capital transfers. At the same time the government introduced a War Exchange Tax of 10 per cent on all imports, essential and non-essential, from the United States and other hard-currency sources, together with a progressive tax on automobiles (the "foreign content" being higher in the more expensive cars). In July the Board ceased to provide foreign exchange for pleasure travel abroad.

Despite these measures Canada's reserves dwindled during the latter part of 1940. The wartime expansion of the economy, involving the growth of employment, incomes and capital investment, caused not only a normal increase in purchases of consumer and capital goods abroad but also a special increase of purchases of machinery and other equipment for plants to produce war supplies. Since Britain could not maintain its peacetime flow of exports, Canadian import requirements were met increasingly from the United States. Moreover, Britain encountered increasing difficulty in paying cash for her rapidly increasing imports from Canada.

Accordingly, on 2 December 1940 the Minister of Finance introduced into Parliament the War Exchange Conservation Act.[4] It served four purposes. First, it prohibited outright the importation from hard-currency sources of scores of items which, at least in wartime, could be considered inessential (for example, cut flowers, processed and canned fruits and vegetables, cigarettes and cigars, spirits and wines, fiction magazines and comics, perfumes, china, glass and silverware, electrical household appliances, automobiles, sporting goods, cameras, toys and dolls, furniture, clothing and wearing apparel, silk fabrics, ornaments, jewellery and precious stones). Second, it placed restrictions, by means of a licensing system, on several additional categories of imports: tobacco, commercial vehicles, various lumber items and all petroleum products. Third, in order to facilitate the importation into Canada of such exports as Britain could generate under wartime circumstances, duties were reduced or removed on a long list of goods of many types for which, before the war, Britain had been a substantial supplier. (These provisions of the act were greatly extended by an amendment of 14 June 1941.) And finally, in order to encourage the production of goods for export to hard-currency destinations, primarily to the United States, the government was empowered to make financial concessions under the terms of the Income War Tax Act and the Excess Profit Tax Act.

The imposition of a set of national controls often results in certain types of transaction moving abroad. Thus an unofficial market for Canadian dollars grew up in New York. It was a market on which non-residents of Canada, chiefly Americans, bought and sold Canadian dollars. Since both the market and those who operated on it were outside Canada it would have been impossible for the Board to bring it under effective control and it did not try to do so. The greater part of the operations related to security transactions but U.S. visitors to Canada could obtain Canadian dollars there.[5]

Relaxations of Control and the Return to U.S. Dollar Parity

The year 1941 marked the wartime low point of Canada's international reserves; from 1942 through 1945 they revived strongly (see Table A). The turnaround in 1942 can be attributed in part to the effectiveness of Canada's exchange and import restrictions, in part to operations under the aegis of the Hyde Park Declaration, and in part to the rapid increase of

TABLE A Canada's Holdings of Gold and U.S. Dollars (in millions of U.S. dollars)

	Exchange Fund Account and Bank of Canada		Other Government of Canada Accounts	Private[2]	Total
	Gold	U.S. dollars	U.S. dollars	U.S. dollars	Gold and U.S. dollars
September 15, 1939	204.9	33.8	22.4	132	393.1
December 31, 1939	218.0	54.8	33.4	98	404.2
December 31, 1940	136.5	172.8	20.8	2	332.1
December 31, 1941	135.9	28.2	23.5	–	187.6
December 31, 1942	154.9	88.0	75.6	–	318.5
December 31, 1943	224.4	348.8	76.4	–	649.6
December 31, 1944	293.9	506.2	102.1	–	902.2
December 31, 1945	353.9	922.0	232.1	–	1,508.0
December 31, 1946	536.0	686.3	22.6	–	1,244.9
December 31, 1947	286.6	171.8	43.3	–	501.7
December 31, 1948	401.3	574.5	22.0	–	997.8
December 31, 1949	486.4	594.1	36.6[1]	–	1,117.1

[1] Exclusive of $18.2 million in United States dollars borrowed by the Government of Canada in the United States private capital market in August 1949 and set aside for the retirement on February 1, 1950, of a security issue guaranteed by it and payable at the holder's option in United States dollars.

[2] Exclusive of working balances.

SOURCE: *Report to the Minister of Finance of the Foreign Exchange Control Board for 1949.*

U.S. expenditures in Canada on goods, services and installations which followed the U.S. declaration of war in December 1941.

Relaxations of Canadian foreign exchange controls began in a modest way in 1943. They related initially to particular types of capital transactions by non-residents, chiefly Americans. In 1944 Canadian residents were permitted to export capital on condition that it was invested in new commercial ventures that would in one way or another support the Canadian exchange position. In February 1945 further relaxations permitted Canadian residents to participate in trans-border trading of securities. After May 1944 Canadian residents could obtain some U.S. dollars for pleasure travel and the restriction was further relaxed in each of the two following years.

A major relaxation of restrictions came with the repeal, in June 1944, of the section of the War Exchange Conservation Act which provided for the prohibition of imports of inessential goods from hard-currency sources. (Some residual provisions remained in force until the act expired on 30 September 1947, just in time to be replaced by new restrictive measures.) In the budget of 12 October 1945 the War Exchange Tax of 10 per cent on all imports from hard-currency countries was abolished.

In the years 1945 and 1946, the Canadian government was attempting to pursue a policy of orderly decontrol of prices and other elements in the economy. It was, however, confronted by imported inflation on a large scale. Since August 1939 Canadian consumer prices had been held down to a 21 per cent increase while U.S. consumer prices had risen 33 per cent, and continuing U.S. price controls were foundering on the rocks of congressional opposition. Similarly, although far less important, Canadian prices and costs were lower than those in overseas countries so that inflation was being imported from them as well as from the United States.

On the evening of 5 July 1946 in the course of a statement in which he was explaining the continuation and adaptation of wartime price controls, J. L. Ilsley, the Minister of Finance unexpectedly announced an upward adjustment of the Canadian dollar to parity with the U.S. dollar. "Undoubtedly," he said, "the greatest source of inflationary pressure lies in the high and still rising price levels of other countries."[6] An appreciation of the value of the Canadian dollar would, in some measure at least, provide insulation against these pressures. The new buying and selling rates on the U.S. dollar were to be \$1.00 and \$1.005; previously they had been \$1.10 and \$1.105. Similarly, the rates on sterling were revised to \$4.02 and \$4.04 from \$4.43 and \$4.45.

The Minister stated that the International Monetary Fund would be notified of the new rate of exchange as Canada's "initial rate" when it opened for business. Thus Canada would not be "using up" any of the initial freedom of action provided under the Articles of Agreement.

Some months later a charge was levelled against the government that this revaluation of the Canadian dollar had been undertaken in response to pressure from the United States. The Minister warmly denied this allegation.[7] It later transpired that neither the Fund nor the United States had known about it in advance. The legal department of the Fund expressed the opinion that consultation with the IMF should have taken place, but the point was not pressed.[8]

In those days an exchange rate adjustment undertaken to cushion price movements at home from those abroad, while not unheard of, was certainly unusual. The Minister sought to dispel apprehensions: "We do not propose – no Canadian government would ever propose – to move the exchange rate with every passing wind. . . . I should like to reaffirm . . . the great advantages obtainable by maintaining exchange stability for as long a period as economic conditions may justify."[9] Nevertheless the action taken by the government at that time was indicative of two attitudes. In the first place it involved a recognition of the role of the exchange rate as a link, and an adjustable link, between the Canadian economy and those of other countries, particularly the United States. In the second place it disclosed a willingness to consider the Canadian exchange rate as an instrument which could, if necessary, be brought into play in pursuit of Canadian economic objectives. These attitudes, quite novel at the time, will be found reappearing at various points in this volume.

Incidentally, the increase in the value of the Canadian dollar necessitated a writing-down in terms of Canadian dollars of the valuation of Canada's reserves of U.S. dollars and gold.[10] In some countries revaluation of reserves, whether upward or downward, causes considerable excitement. In Canada people pay little or no attention to the paper profits or losses involved; under a floating rate, of course, they occur from day to day.

As of January 1947, on the basis of legislation passed the previous summer,[11] the government rather than the Foreign Exchange Control Board became directly responsible for alterations of exchange regulations and of the value of the Canadian dollar. The legislation did not, however, alter materially the control system as it stood at that time.[12] The change was made in response to growing demands, inside and outside Parliament, that the government should discontinue its reliance on the sweeping emergency authority of the War Measures Act of 1914, should seek specific authority from Parliament for such controls as it considered still to be necessary, and should in such cases vest the authority and responsibility in the government itself rather than delegate it to administrative agencies.

The Setback of 1947

In the years from 1945 to 1949 the world was full of uncertainties in which political and economic issues were intermingled. The war had ended with the collapse of Germany and Japan but the postwar world was still to take shape. The growing tension between West and East erupted in various forms in various places – for example, in the Russian blockade of Berlin and in the crippling of the United Nations Security Council and other U.N. agencies by doctrinal differences and diatribes. Fortunately for the new economic agencies, including the Fund and Bank, the Soviet Union decided not to join them and their development was not seriously impaired by the ideological split. The GATT also got off to a good start; by the latter part of 1947 the new trade rules had been approved and far-reaching tariff reductions, particularly by the United States, had been agreed upon.

Nevertheless, economic recovery in Europe had lagged alarmingly, and communist parties, particularly in France and Italy, had gathered strength. The U.S. loan to Britain had proved quite inadequate; the winters of 1945 and 1946 had been bitter, harvests had fallen far short of expectations, and Britain's premature attempt to make sterling convertible had collapsed. It was against this background that the Marshall

Plan was announced in June 1947, and for Canadian policy-makers, who had put a great many eggs in the basket of British and European recovery, the Plan offered renewed hope. But the Marshall Plan had yet to be piloted through the rocks of lingering, resurgent, isolationism that surfaced frequently in the United States and more particularly in Congress.

Despite difficulties and uncertainties abroad, postwar recovery and reconversion of industry to peacetime activities were making good progress in Canada in 1947. General economic expansion attracted, as always, imports of both consumer and capital goods and, with Britain and Europe still far from recovered, these came largely from the United States. Accordingly, Canada's reserves of gold and U.S. dollars were once more in jeopardy.

Canada's exchange difficulties were in large degree related to the fact that such a large proportion of her exports overseas did not earn cash which could be used to pay for imports from the United States; they were paid for out of Canada's loan to Britain and export credits to other countries. The pace of drawings on these resources far out-ran expectations, reflecting the food shortages caused by bad harvests in Britain and Europe and also the delay in Congress over the approval of the U.S. loan to Britain. Canada's very large loan to Britain, which was supposed to last for five years, was more than half committed within twelve months. (The first instalment of the credit was made available in May 1946; by 23 May 1947 total advances amounted to $680 million.)[13] By the end of two years a billion dollars had been committed, out of the total credit of $1.25 billion, and before that time the Canadian government had had to request a slowdown in its utilization.[14]

The decline in Canada's reserves began in June 1946; (for monthly figures see Reference Table 13 on p. 321). From a level of $1,666.5 million at the end of May there was a decline of $1 billion in twelve months. By mid-November 1947 the figure stood at little more than $500 million.

It was on the evening of 17 November that the Canadian public learned over the radio on the one hand of the success of the trade negotiations under GATT, and on the other hand of the imposition of new restrictions on a wide range of imports which, along with other emergency measures, were designed to redress the imbalance in Canada's international payments. The first announcement was made by Prime Minister Mackenzie King who, speaking from London, extolled the success of the trade negotiations. The Minister of Finance, Douglas Abbott, then disclosed the ugly outlines of the new dollar conservation program.[15] Pending approval by Parliament it would be put into effect immediately by order-in-council.

At the outset Abbott rejected a depreciation of the Canadian dollar. Canadian prices and costs were by no means out of line with those in other countries. To be effective, depreciation would have to be extreme. Thanks to the GATT agreement and the promise of the Marshall Plan, there was good reason to expect that Canada's difficulties would be short-lived. Representations had been made to the U.S. government that Marshall Plan funds could be spent in Canada and elsewhere and not "tied" to U.S. products. As an emergency measure to replenish Canada's reserves, a loan of $300 million from the United States Export-Import Bank had been arranged. (It is not clear why no approach was made to the IMF for a loan. Possible reasons are that the amount required was equal to 100 per cent of Canada's IMF quota and could have involved considerable negotiation and that Canada had not been in very good grace in Washington since its failure to consult prior to the appreciation of the Canadian dollar in July 1946.)

Various measures were to be initiated to earn more U.S. dollars. Capital investment in export industries would be encouraged, particularly where reductions in U.S. tariffs gave new promise of enlarged sales. Branch plants would be encouraged to increase their processing of Canadian raw materials and to reduce their imports of parts from the United States. "It should be possible, for example, for the Canadian automobile industry – which produced large amounts of the cheapest and most efficient army transport during the war – to produce automobile parts or models for sale in U.S. dollars to balance the large purchases of components and materials which they make in the United States."[16] The Canadian gold-mining industry, which had been hard hit by the appreciation of the Canadian dollar in 1946, would receive a subsidy the precise form of which was being devised to conform with the gold provisions of the International Monetary Fund.[17]

The chief component of the emergency program, however, was the reduction of expenditures on imports. The restrictions relating to capital goods would be discretionary; they would be worked out on an industry-by-industry basis under the authority to the Ministry of Reconstruction and Supply, C. D. Howe. Turning to non-essential consumer goods, the import of many was prohibited; a tax of 25 per cent was placed on sales of many durables which involved a large import component, along with a steeply graduated tax on automobiles.

Import quotas were applied to a wide range of goods, including many fruits and vegetables, various prepared and packaged foods, most textiles and wearing apparel, leather footwear, sundry sporting goods and hardware. The pleasure travel allowance was to be cut back to the postwar level of $150 in a single year.

These import restrictions were applied under the emergency provisions of the new GATT trading rules. The rules required that such restrictions should normally be non-discriminatory; yet the government's objective was to restrain imports from the United States while encouraging those from Britain and other overseas countries. The discriminatory objective was to be accomplished in a non-discriminatory form by basing import quotas on a percentage of prewar performance; Britain and Europe were in no position to fill such quotas, but in the case of the United States the quotas involved sharp reductions below current levels.

"I am well aware," said the Minister of Finance, "that the restrictive aspects of this program will come as something of a shock to many Canadians.... We intend to get rid of these restrictions just as soon as circumstances will permit."[18] The restrictions themselves were indeed sufficient to cause grief to many Canadian consumers and businesses but the means by which they were put into effect were, from a constitutional and parliamentary viewpoint, even more grievous. The criticisms were hammered home when, in due course, the matter was debated in Parliament. The House of Commons duly assembled on 5 December 1947, but the Emergency Exchange Conservation Act which confirmed the new restrictions did not gain royal assent until the following March. Meanwhile both the proposals themselves and the fact that they had been put into force provisionally by order-in-council came under prolonged attack in both Houses of Parliament and by all three opposition parties.[19] The government found itself vulnerable on various fronts.

Some attacks related to constitutional issues. The legislation, it was pointed out, would grant wide discretionary powers to the government and more particularly to the Minister of Reconstruction and Supply; such a grant of power in peacetime was unacceptable. The Minister of Finance had imposed taxes on the Canadian people in a "radio budget," not only without the assent of Parliament but at a time when Parliament was not even in session. Further, pending enactment of the new legislation, improper and possibly illegal use had been made of powers granted by Parliament under the authority of the Foreign Exchange Control Act of 1946 which the government had explicitly put forward as a measure designed to control exports of capital and not to control imports of goods.[20]

Other attacks were directed at the government's international economic policies. It was pointed out repeatedly that the government was in fact discriminating against imports from the United States (not to mention other hard-currency countries such as Switzerland and Venezuela) under a formula that, in form but not in fact, maintained a fiction of non-discrimination. The government, however, stood its ground.[21] Both Canada and the United States, in the negotiations formulating the rules of the GATT as well as the rules of the International Monetary Fund, had been aware that, if discrimination were permitted in principle, it would in fact continue to be exercised against them. Both countries were anxious to secure the reduction and ultimate removal of the extensive discrimination already in effect. Thus it would have been most inopportune for Canada to adopt a posture that was formally discriminatory at the very moment that the GATT agreement was announced. Further, with the Marshall Plan in process of crystallization, and with Canadian hopes pinned to permission by Congress that the overseas recipients of Marshall dollars might spend some of them in Canada, overt discrimination by Canada against U.S. exports was to be avoided.

Another criticism related to the government's decision of July 1946 to raise the Canadian dollar to parity with the U.S. dollar. This action had been increasingly questioned inside and outside Parliament and was now bought under sharp challenge.

The Conservatives argued that the move was a mistake from the outset; it had added materially to the imbalance of trade and tourist payments and had deterred the import of capital from the United States.[22] The Conservative financial critic, J. M. Macdonnell, wondered whether the best solution for the Canadian dollar might not be to allow it to float freely, without control; but he went on to recognize that world conditions were not yet sufficiently settled for this to be a solution and that new commitments had been assumed under the Bretton Woods Agreement since the prewar floating rate was in effect.[23]

Speakers for the CCF were not worried about renewed government controls; indeed they wanted more of them. They were in favour of continued dollar parity with the United States as a means of keeping Canadian consumer prices down. As for Social Credit speakers, they seized the opportunity to renew their attacks on the Bretton Woods system.

Eventually the legislation was passed, thanks to the Liberals' slim overall majority in the House. But the debate had been the most arduous and contentious to take place on an economic issue since before the war. The degree to which, in that generally unsettled period, the normal equilibrium and equanimity of the Canadian government was disturbed by the exchange crisis of November 1947 and the subsequent debate in Parliament may perhaps be reflected in the readiness, at least of the Prime Minister and the few ministers and senior officials directly concerned, to consider seriously a proposal for some form of Canada – U.S. free trade arrangement. After a period of some three months, during which two Canadian officials had been under instructions to explore the issue with the utmost secrecy Washington and one of them had visited Havana to ensure that the trade rules of the proposed International Trade Organization (and thus of the GATT) could accommodate such an arrangement, the Prime Minister backed sharply away from the proposal and, in his diary, attributed it all to the excessive zeal of the officials.[24] When the news of the U.S. free trade proposal eventually became public knowledge the general reaction of the Canadian press was sharply critical. By that time, however, the exchange crisis was a thing of the past.

During 1948 Canadian reserves revived strongly; by the end of the year they approached $1 billion and were double the crisis level of November 1947. Moreover, as Abbott was able to report in his budget of March 1949, the revival had come from the most effective source: an improvement in the trade balance with the United States. Some relaxations of controls had already taken place and at that time import quotas were substantially increased and some goods were transferred from the prohibited list to the quota list. The policy of facilitating imports from Britain however, was continued in full force.[25] Relaxations of restrictions continued through 1949 and 1950. The Emergency Exchange Conservation Act of 1948 eventually expired on 15 January 1951 and the remaining Foreign Exchange Control Regulations were revoked in their entirety on 14 December 1951. Thus, for Canada, the system of economic controls built up to meet the needs of the Second World War and its aftermath came to an end.

The New Pattern of Exchange Rates

The next change in the par value of the Canadian dollar came as part of a general postwar realignment of exchange rates over the weekend of 17-18 September 1949. On that occasion the par value of sterling was reduced by just over 30 per cent in terms of the U.S. dollar (from $4.03 to $2.80 U.S.) and the par values of virtually all the currencies of the sterling area and of western Europe were simultaneously devalued approximately to the same extent.[26] The Canadian dollar was devalued by some 10 per cent; but before considering the influences specifically bearing on that action we must provide some account of the broader issues that surrounded the devaluation of sterling.

Dean Acheson, who was at the time the U.S. Secretary of State under President Truman and who was personally involved, has written:

> In July 1949 John Snyder, Secretary of the Treasury, met Douglas Abbott the Canadian Finance Minister, in London. There both were informed by Sir Stafford Cripps, Chancellor of the Exchequer, that the British financial situation was precarious indeed. British monetary reserves of gold and dollars were low and getting lower, although Britain appeared to be enjoying an industrial boom with full employment and high prices. Indeed, this prosperity was, quite paradoxically, a cause of the trouble. Countries of what was

called the sterling area deposited their reserves in London. Since pounds sterling were not freely convertible into hard currencies, principally dollars, these depositors, when they wished to make purchases, which they were eager to do for their own internal development, found it easier to make them in Britain or other countries of the sterling area. This situation, in effect, gave Britain a protected market at higher prices than would be competitive in the United States, so that she was paying her depositors with exports and using up her reserves to buy raw materials and food. This was almost a sure route to bankruptcy.

Sir Stafford wanted to talk about what should be done. John Snyder interpreted this as a euphemism for help and got out of the country as fast as possible, with the suggestion that talks be held in Washington at the time of the International Bank and Fund meeting in September. He flew back like a modern Paul Revere crying "The British are coming!" And come they did to create a situation of great complexity and embarrassment.

Anglo-American-Canadian discussions of great delicacy and secrecy . . . began [in Washington] on September 7. On the day before, John Snyder and I spent an hour and a half in executive session with a nervous Senate Foreign Relations Committee, which feared that we might commit the United States to new obligations. Snyder, at any rate, had no intention of even considering this.[27]

The British were determined that, if sterling was to be devalued, it should be in circumstances that gave promise of a real and lasting improvement in the international position of Britain and the sterling area. At that time such an improvement could only be underwritten by assurance of cooperation and support from the United States and Canada. For example, it would be useless for the British to improve their competitive trade position vis-à-vis North America if the North American response were to be an increase in tariffs or in non-tariff barriers. Thus the tripartite talks were intended to ensure that North American postures and policies would reinforce, not undermine, the economic opportunities flowing from devaluation. The talks were unfortunately inhibited at the outset because sterling devaluation was too secret and sensitive a matter to be mentioned. After a few days the British decided they had to tell the more senior participants (those of ministerial rank) of the planned devaluation; this news was not disclosed, however, to the less senior officials and the information did not leak to the press and financial markets.

No small part of the difficulty which the British confronted arose from the hostile and suspicious attitude of John Snyder and some, but by no means all, of the other Americans involved. Acheson's critical account is fully supported by George Kennan; in some recently concluded negotiations with the British (over atomic matters) he had found his own countrymen "harsh, boorish, shortsighted – for me – deeply discouraging."[28] On more than one occasion in those days the British discussed with various Canadians, and not least with Norman Robertson, the Canadian High Commissioner in London, how best to present and press their needs in the face of the suspicion and distrust that seemed so frequently to be directed against them in Washington. They even asked Canadians to act as go-betweens on some issues.

Despite such difficulties, the British were able to negotiate a resonably successful conclusion to the tripartite talks. The results were embodied in a joint communiqué issued at the same time that the sterling devaluation was announced. Ten matters had been considered, each of which could contribute to the strengthening of sterling: U.S. overseas investment; commodity arrangements and stockpiling; enlargement of the list of items on which Marshall Plan funds could be spent; tariffs; non-tariff barriers (customs procedures); liberalization of inter-European trade (involving a temporary increase in discrimination against North America); sterling balances; petroleum trade arrangements; shipping; and provision for continuing tripartite consultation.[29]

Following this announcement and the general currency realignment that took place at the same time, the balance of payments of the sterling area did indeed improve and these measures no doubt contributed to the improvement. Further support came from an economic revival in the United States, followed some months later by the outbreak of the Korean War, both of which developments resulted in substantially increased expenditures and capital outlays by the United States in countries abroad.

One of the more optimistic statements in the tripartite communiqué was intended to reassure the Europeans that they were not being neglected: "The tripartite arrangements will not in any way encroach upon or detract from the area of competence of the Organization for European Economic Cooperation." But the Europeans were not mollified by such soft words, particularly the French. "The latter," observed Kennan, "lost no time in staging tantrums of anxiety and discontent over their own exclusion from those three-power discussions, despite the obvious fact that the discussions were forced upon us and ones in which the French could not conceivably have played any constructive role."[30] Nevertheless, the tripartite meetings of September 1949 marked the end of the more or less formal economic collaboration between Canada, the United States and the United Kingdom that had grown up and flourished under the very special conditions of the Second World War.

The realignment of sterling and other exchange rates was considered in the multilateral forum of the International Monetary Fund. When, in 1946, most members of the Fund had proposed their initial par values and these had been duly accepted by the Executive Board it was clear that they would for the most part be provisional, pending the time when postwar economic interrelationships would emerge more clearly. By 1948 informal discussions were already taking place in the Fund about the need for new exchange rates, particularly for a new dollar-sterling rate on which others could be based. By 1949 there was a growing sense of impatience. In the end, the British found they could hesitate no longer; during the summer of 1949 they faced heavy reserve losses and the first of the major postwar crises of sterling.

By this time, however, the issues had been extensively discussed and examined in the Fund. Comparative statistics had been compiled and analysed. The actual depreciation of sterling, when it came, was greater than had been generally anticipated, but the fact of a substantial depreciation had been anticipated and national plans laid accordingly.

The British proposal was formally presented to the Executive Board on Saturday 17 September, to take effect on Monday morning. Over a hectic weekend, with almost continuous meetings of the Board and all-night work on the part of the staff, the Fund could and did consider, individually, the actions proposed by all the devaluing countries. Under the Fund rules, it will be recalled, only an individual member can propose an alteration in the par value of its currency and, apart from certain special circumstances, the Fund has a responsibility to respond to the proposal. As things turned out, even under the very special difficulties presented by the short notice and the mass movement on this occasion, the Fund managed to discharge this responsibility.[31]

While the substantive task was accomplished, a technical deficiency in the Articles of Agreement did emerge. The relevant Article stipulates that the Fund should normally be given a reasonable length of time (more than seventy-two hours) to respond to any proposal for a change in a par value. The events of September 1949 showed that, in practice, this stipulation could not always be met. In the case of any important currency that is susceptible to speculative influences, such a period for formal international deliberation is unrealistic; in a crisis situation which feeds on itself there is little leisure for reflection. Fortunately the Managing Director of the Fund is normally aware of impending changes in important par values; the facts can be assembled and some informal consideration can be given to the issues in advance. But when the actual change is formally proposed there is no time to be lost; seventy-two hours can cost hundreds of millions of dollars.

There was, however, an important consideration that facilitated the work of that weekend: there was no question of the necessity for the revaluations that were taking place. Under the Articles of Agreement the Fund is bound to agree to any alteration of a par value that is designed to correct a "fundamental disequilibrium" in the balance of payments and this issue was not in question in September 1949. The informal preparatory discussions that had taken place were important, not so much to enable the organization to take stock of its own formal position on the proposals, but rather in fulfilment of the first of its basic purposes: "To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems." In a sense the devaluation of sterling represented a unilateral decision by the United Kingdom, but it and the devaluations that accompanied it were part of a unprecedented network of decisions that represented a major accomplishment for the new multilateral institution.

The Canadians, having been full participants in the tripartite talks and concerned as always for the restoration and expansion of their overseas markets, welcomed the various moves to strengthen sterling, including its devaluation.[32] But the decision as to how far, if at all, the Canadian dollar should be devalued involved different considerations. According to the official history of the Fund:

> The problem of the appropriate rate for Canada was dominated by two considerations. Had the rate been left unchanged, Canada would have been subject to strains arising from the improved competitive position of the devaluing countries, although still needing to alleviate the imbalance in its trade with the United States. On the other hand, a devaluation equal to that of sterling would not have helped to expand imports from the devaluing countries, which was required if such countries were to correct the serious disequilibrium in their payments position vis-à-vis Canada. In the light of these considerations, the Canadian dollar was devalued by 9.1 per cent.[33]

What this account does not explain is why the Canadian decision was delayed for twenty-four hours after the others had been made, and why Canadian dealings in foreign exchange were suspended for Monday, 19 September. The delay was not caused by lack of technical preparation in Ottawa; some months previously, in anticipation of a sudden move on the part of the British, two sets of market instructions had been prepared, one based on a possible 20 per cent devaluation of sterling and the other on a 30 per cent devaluation.[34]

The fact was that the Minister of Finance, Douglas Abbott, had decided upon the 9.1 per cent devaluation during the Washington discussions, but he ran into unexpected and vigorous opposition from the Minister of Reconstruction, C. D. Howe, apparently on the ground that depreciation of the Canadian dollar would have made more costly the machinery and equipment which at that time Canadian producers were purchasing in large quantities from the United States. Abbott hurried home from Washington for a special cabinet meeting where his position was in due course upheld.[35] The Fund promptly provided the necessary confirmation and accordingly, on Tuesday, 20 September, the official Canadian rates became: for buying and selling U.S. dollars, \$1.10 and \$1.10½; and for buying and selling sterling, \$3.07¼ and \$3.08¾.

Even in the light of hindsight it is hard to fault this choice of a par value. Yet only twelve months later its defences broke down. Once again, the search for a defensible value for the Canadian dollar ended in frustration. Accordingly the Canadian authorities then decided to leave the exchange rate to float on the basis of market forces as it had done in prewar years. The story of Canada's postwar floating dollar will be taken up in chapter 6 below.

NOTES

1 A. F. W. Plumptre, *Central Banking in the British Dominions* (Toronto: University of Toronto Press, 1940), pp. 408-21.

2 Like many other measures of wartime control the Board was set up by Order-in-Council under the War Measures Act: Revised Statutes of Canada, 1927: Chapter 206. For a description of the Board and its operations, see A. O. Gibbons, "Foreign Exchange Control in Canada, 1939-51," *The Canadian Journal of Political Science and Economics*, Vol. XIX (1953), pp. 35-54. Gibbons had been a member of the staff of the Board.

3 House of Commons, *Debates*, 2 December 1940, p. 612. On that occasion the Minister gave a resumé of the origin and activities to date of the Foreign Exchange Control Board.

4 The War Exchange Conservation Act of 1940, 4-5 George VI, Chapter 2. For the Minister's statement and the debate see *Debates*, 2 December 1940, pp. 605 *et seq*. Mr. Diefenbaker asked why the government was seeking Parliament's approval for legislation rather than making use of the sweeping powers granted to the government under the authority of the War Measures Act. The Minister agreed that "if ever there was a war measure, this is the one." However, "it was out of respect for parliament . . . we thought that when parliament was here we ought to lay the matter before parliament" (p. 726). See also Foreign Ex-

change Control Board, *Report for 1946*, p. 25.

5 Gibbons, "*Foreign Exchange Control in Canada*," pp. 51-52. The Board itself published an official account: Foreign Exchange Control Board, *Answers to Some Questions about the Unofficial Market in Canadian Dollars* (Ottawa, April 1947).

6 House of Commons, *Debates*, 5 July 1946, pp. 3180-85.

7 *Ibid.*, 15 May 1947, p. 3090.

8 *IMF History*, Vol. I, pp. 156-57.

9 House of Commons, *Debates*, 5 July 1946, p. 3184.

10 Foreign Exchange Control Board, *Report for 1946*, p. 2.

11 Foreign Exchange Control Act, 1946, 10 George VI.

12 Foreign Exchange Control Board, *Report for 1946*, pp. 6-7.

13 House of Commons, *Debates*, 26 May 1947, p. 3420.

14 Statement by C. D. Howe, *ibid.*, 13 June 1948, p. 5458.

15 Department of External Affairs, *Statements and Speeches*, 17 November 1947, No. 47/20, Address by the Prime Minister over CBC; No. 47/21, Address by the Minister of Finance over CBC.

16 Address by Minister of Finance, p. 6.

17 *IMF History*, Vol. I, pp. 184 and 419-20.

18 Address by Minister of Finance, p. 10.

19 House of Commons, *Debates*, 16-17 December 1947, 26 January 1948, 24 February 1948.

20 *Ibid.*, 2 July 1946, p. 3041.

21 *Ibid.*, 24 February 1948, pp. 1560-61

22 *Ibid.*, 16 December 1947, p. 350.

23 *Ibid.*, 16 December 1947, p. 349.

24 J. W. Pickersgill and D. F. Forster, *The Mackenzie King Record, Vol. IV, 1947-48* (Toronto: University of Toronto Press, 1969), pp. 259-73. Earlier entries in the diary make it perfectly clear that King had, at the outset, warmly espoused the proposal.

25 House of Commons, *Debates*, 22 March 1949, pp. 1786-87 and 1801.

26 See *IMF History*, Vol. II, pp. 98-100. Some European currencies had already been trading below their par values so that the effective devaluation was less; see Foreign Exchange Control Board, *Report for 1949*, pp. 3-7.

27 Dean Acheson, *Present at the Creation, My Years in State Department* (New York: Norton and Co., 1969), p. 322.

28 George F. Kennan, *Memoirs, 1925-1950* (Boston: Little, Brown and Company, 1967), p. 461.

29 See text of joint communiqué issued following British-United States – Canadian monetary talks in Washington, 18 September 1949, published in Canada, House of Commons *Debates*, 19 September 1949, pp. 66-68.

30 Kennan, *Memoirs*, p. 462.

31 *IMF History*, Vol. I, pp. 234-42.

32 See Statement by the Minister of Finance, House of Commons, *Debates*, 19 September 1949, pp. 54-57; also Foreign Exchange Control Board, *Report for 1949*, pp. 3-7.

33 *IMF History*, Vol. II, p. 100.

34 Personal interview with the late Graham F. Towers.

35 Personal interview with Douglas Abbott.

5

North Atlantic Resurgence 1948 – 60

The Marshall Plan

As early as March 1946, in a speech in Fulton, Missouri, Winston Churchill had spoken of the "iron curtain" separating East from West. In April 1947 the U.S. Secretary of State, George C. Marshall, coming from a Moscow meeting, recognized that the United States probably would not be able to secure the cooperation of the Soviet Union in a new and urgently needed effort at economic reconstruction in western Europe. In his speech launching the Marshall Plan in June he left the door open to Russian participation but, as anticipated, the offer was rejected. During the rest of that year and early 1948, while the Marshall Plan was being transformed into specific economic proposals in Paris and into legislation in Washington, work was also on foot to develop new western defence arrangements. In March Britain, France and the Benelux countries concluded a military alliance known as Western European Union (WEU) and in the same month the Soviet Union occupied Czechoslovakia. In April 1949 the North Atlantic Treaty, establishing a much broader alliance, was signed in Washington. And then, in June 1950, actual fighting broke out in Korea.

The Marshall Plan was unveiled by Marshall himself on 5 June 1947 in a brief address to the Harvard Alumni Association.[1] The immediate appeal of the Plan was humanitarian; in the hard European winter of 1947 people were hungry and increasingly hopeless. The probability of communist party victories at the polls was growing rapidly stronger, notably in France and Italy, and the economic situation in Germany was particularly critical. While there was an urgent need for food, the more basic need was for the reconstruction of the economic system of Europe through a cooperative effort in which the European countries would help each other rather than each attempting, in the pattern of the 1930s, to help itself by shutting out imports from its neighbours.

And behind the humanitarian and economic motives lay the military one. Unless the European countries could pull together economically and politically there could be no foundation for western European self-defence against what appeared to be a growing threat from the East. In the years since victory in Europe the military forces of the United States, Britain and other allies had been to a considerable extent demobilized, but the forces of Soviet Union were still largely intact, massive and apparently menancing. In some quarters in the United States the Marshall Plan conjured up visions of a United States of Europe, created in the image of the United States of America, politically cohesive, economically united and vigorous, and militarily self-reliant; when this vision materialized the U.S. troops in Europe could at last come home.

The world-wide implications of the Plan were recognized. "I have been talking about Europe," said Secretary Marshall in one of his early statements, "but the situation is even more serious than that. Europe was at the heart of a great world trading and financial organization. Her failure to recover would have disastrous effects in many other areas. The economies of Latin America and Canada, for example, are organized on the basis of having markets in Europe. . . ."[2]

From a Canadian point of view the Plan represented, first and foremost, a decisive rejection of traditional American isolationism, fears of which had continuously plagued postwar planning in Ottawa. The United States was not going to turn her back on troubles overseas; on the contrary she recognized her own interest in taking those troubles onto her own shoulders. And the funds to be committed to reconstruction by the United States were, at last, to be commensurate with the needs; Secretary Marshall spoke of providing \$16 to \$20 billion in loans and grants. Further, the European countries were to be allowed to spend a portion of the funds in countries other than the United States; ultimately the arrangements for offshore purchases were probably broader than even the most optimistic in Ottawa had dared to hope.

The participating countries of Europe set up the Organization for European Economic Cooperation (OEEC) in Paris to work out, in association with the Economic Cooperation Administration (ECA) in Washington, specific proposals, industry by industry, product by product, year by year. At an early stage a Canadian mission was attached to this new European agency. In the initial phase of the program, covering the period from 3 April to 1 December 1948, no less than 34 per cent of the amounts allocated for food and agricultural commodities, and 42 per cent for industrial goods, were authorized for offshore procurement; the offshore total was $1,408.8 million, of which $593.4 was authorized for Canada, $353.3 for Latin America, $31.6 for Eastern European countries, $185.5 for other non-participating countries, and $245.0 for European countries participating in the Plan.[3] In later years, partly because of congressional objections, a larger percentage was spent in the United States.

In explaining and defending before Congress the principle of offshore purchasing, representatives of the administration stressed the importance of restoring trade to normal prewar patterns. They argued that if all European purchases were directly concentrated on the U.S. market this would produce shortages of particular commodities and inflationary price increases in the United States. At the same time, however, it could confidently be predicted that the dollars thus spent offshore would not lie idle: they would be utilized by the recipient countries, all of them short of U.S. dollars, to expand their normal purchases in the United States. It was specifically noted that, before the end of the first year of the Plan, Canada had been able to begin to dismantle her 1947 emergency restrictions against U.S. imports.[4]

There were some suggestions within the U.S. administration that Canada might be persuaded to become a contributor, along with the United States, under the Marshall Plan arrangements.[5] The possibility that Canada, who had been a leader rather than a follower in regard to overseas reconstruction, would be willing to become a junior contributor to a programme already initiated and completely dominated by the

United States was unlikely in the extreme. Moreover, as we have seen, in 1947–48 Canada was still preoccupied with a balance-of-payments problem that had been created primarily because Canada's contribution to European reconstruction had, on a proportionate basis, so substantially outrun that of the United States. The suggestions were not pressed and a new form of collaboration soon emerged under the North Atlantic Treaty.

Burden-Sharing under NATO

Just as the Marshall Plan embodied a determination to win the cold war on the politico-economic front, so the North Atlantic Treaty embodied a similar determination in terms of military defence. In the light of hindsight there are those who question the wisdom of the cold war policies of the West; indeed, there were some who did so at the time. But there can be no doubt that these anti-communist policies commanded general support in North America and, though less universally, in western Europe. The remarkable readiness even of Quebec, traditionally isolationist, to accept the military obligations involved in the treaty may surely be attributed at least in part to the anti-communist position resolutely maintained by the Roman Catholic hierarchy which still exercised its pervasive influence in that province.

In Washington opinions differed as to whether military support in Europe should be provided by giving North American guarantees to a European military alliance[6] or whether the United States and Canada should be full members of the alliance. The weight of Canadian influence, and it was not unimportant in the negotiations, was thrown in favour of the comprehensive alliance and it eventually won the day. The story is told in the memoirs of L. B. Pearson, who was largely responsible for the formulation and negotiation of the Canadian position. The treaty included not merely mutual defence commitments with Canada's traditional wartime allies, Britain, France and the United States, but also economic and political undertakings which, largely as a result of Canadian persistence, became embodied in Article 2. Indeed Pearson's "Atlantic Vision" (the phrase is his own) foresaw the ultimate formation of a politico-economic commonwealth of those Atlantic countries that shared the cultural heritage of western civilization.

Article 2 of the treaty reads as follows:

> The Parties will contribute toward the further development of peaceful and friendly international relations by strengthening their free institutions, by bringing about a better understanding of the principles upon which these institutions are founded, and by promoting conditions of stability and well-being. They will seek to eliminate conflict in their international economic policies and will encourage economic collaboration between any or all of them.

The vision of a politico-economic commonwealth which lay behind and beyond Article 2 never materialized and Pearson's persistent efforts to have the article implemented within the framework of the new North Atlantic Treaty Organization (NATO) met with much frustration.[7] It remained, in his own words, "a dead letter"; the will to implement it "was never there."[8] Some progress was made in due course in using the North Atlantic Council as a forum for political consultation amongst its members; there was no other international forum which offered similar advantages for such consultation. But on the economic front there were several newly formed agencies which were specifically designed and equipped to "eliminate conflict" in economic policies and to "encourage economic collaboration"; these included the IMF, the World Bank, the GATT, and the OEEC. These bodies were better suited to serve economic objectives than NATO with its more limited membership and its military orientation.

Despite the fact that NATO never became the nucleus of a North Atlantic commonwealth or even an active forum for economic discussion, it nevertheless produced for Canada some financial and economic policy issues of considerable interest. These involved an extension of the concept of international burden-sharing well beyond the voluntary provision of mutual aid and other financial assistance to which Canada had become fully accustomed during and after the war.

Article 3 of the treaty provided for mutual aid to be provided in order that the member countries might "maintain and develop their individual and collective capacity to resist armed attack." Accordingly, Canada initiated a new mutual aid program, substantial at the outset and diminishing as the European countries regained their economic strength. The greater part of the program consisted of transfers to European countries of British-type equipment; this equipment was no longer required by the Canadian forces as progress was made on a recent decision of the government to switch to equipment of U.S. type, but it was welcomed by European allies who were building up their postwar forces from virtually nothing. At a later date there were also some transfers of equipment of types currently produced in Canada for the Canadian forces, including aircraft and aircraft engines, minesweepers, transport and electronic equipment, and ammunition. A third element, which became important and much appreciated, was aircrew training offered at bases in Canada; even in those days Canadian airspace was less cluttered than European. And finally, through a process described below, Canadian contributions to common funds for military headquarters and for infrastructure came to be charged to the mutual aid appropriation.

By 1958 total Canadian mutual aid allocations had reached $1.5 billion. A breakdown by year and by type is provided in Table A.

In distributing mutual aid equipment and allocating vacancies for aircrew training among the European allies, Canada sought and obtained the guidance of NATO military authorities. However, in 1952, a Temporary Committee of the North Atlantic Council (TCC) recommended that the total amount of Canada's mutual aid should be approximately doubled and its content extended to include Canadian raw materials. This body, made up of "three wise men" from the United States, Britain and France, had been established to propose an equitable sharing of the burden of the defence build-up among the member governments. It constituted the first approach to coordinated burden-sharing under NATO and its recommendations caused embarrassment in various quarters, including Canada.

In response to its recommendations the Canadian government did decide to increase its provision for mutual aid, although by substantially less than the amount proposed; on the other hand it rejected firmly the proposal to include raw materials. Opposition members criticised the government for its failure to comply with a NATO recommendation but the government asserted, in Parliament as in NATO, that Canada's external aid performance, including the initial contribution

Table A Canadian Expenditures on Mutual Aid Programs by Fiscal Year (thousands of dollars)

Elements of Program	1950-51	1951-52	1952-53	1953-54	1954-55	1955-56	1956-57	1957-58	Total for Eight Years
Procurement of materiel for mutual aid	–	2,930	32,833	33,181	25,079	15,758	8,081	3,179	121,040
Transfer of equipment from service stocks[1]	195,417	74,934	95,456	182,433	169,984	97,611	63,679	78,399	957,913
NATO air crew training	–	48,552	104,628	71,340	52,890	51,056	47,753	26,418	402,638
Infrastructure and NATO budgets[2]	–	–	2,136	2,753	5,427	10,541	14,040	10,468	45,365
Total mutual aid	195,417	126,416	235,053	289,707	253,380	174,966	133,553	118,464	1,526,956

[1]The expenditures recorded against this item were those made on the U.S.-type equipment which replaced the U.K.-type equipment that was actually transferred to NATO allies.
[2]These amounts represent only the portions of infrastructure costs and NATO budgets which were chargeable to mutual aid. In addition following expenditures were charged to the special infrastructure vote: 1951-52 – $3,519,000; 1952-53 – $11,302,000 (includes $3,307,000 ex-infrastructure); 1953-54 – $10,521,000; 1954-55 – $6,641,967. In subsequent years, all expenditures charged to mutual aid.
SOURCE: White Paper, *Defence 1959*, issued by the Minister of National Defence, April 1959.

under the newly launched Colombo Plan, would bear comparison with that of any other country and, further, that exports of raw materials were the very foundation of the Canadian economy and could not be placed at the disposal of an international body.[9]

The concept of NATO burden-sharing did not die, however, with dissolution of the TCC. On the contrary, the council forthwith established an Annual Review Committee, made up of representatives of all member countries, to perform a similar task on a continuing basis.

The Annual Review Committee provided an interesting experiment in the formulation of international recommendations and in international decision-making. The NATO secretariat started out bravely in the hope that an approach to international equity could be based on a number of objective economic indicators which it produced (for example, the percentage of national income devoted to defence). As time went on, however, it became increasingly apparent that each government was going to make its decisions about its armed forces on the basis of its own assessment of its responsibilities and of its "politico-economic capabilities" and not on the basis of an assessment by an international committee.[10]

Continuing discussions in the Annual Review Committee no doubt exercised, year by year, some influence on government policies. Nevertheless, the actual reports and recommendations which the committee produces have, through a process of discussion and negotiation, generally been tailored to be acceptable to all its members. (The present writer, who was Canadian representative on the Annual Review Committee for its first two years, recalls being warned by two ministers, Pearson and Abbott, against allowing Canada to be embarrassed by receiving any further recommendations such as those of the TCC.)

Far more effective in the early days, as an external force exerted on the defence programs of European NATO members, was the leverage exercised by the United States through its massive program of bilateral mutual aid, under which it provided not only military items but also various forms of economic assistance. Thus, while NATO annually confirmed the results in terms of national defence programs supported by U.S. mutual aid allocations, the bargaining on which those allocations were based was essentially bilateral.[11]

Another burden-sharing exercise in NATO also produced special problems for Canada. This related to the apportionment of the pooled costs of infrastructure. At the outset the infrastructure negotiations lacked even the flimsy guidance of the economic indicators of capacity-to-pay that were placed before the Annual Review Committee; infrastructure cost-sharing was initially a catch-as-catch-can engagement between the NATO Ministers of Defence, each anxious to preserve his national defence budget from undue international erosion. The earliest of these gladiatorial combats was described by the British Minister, Lord Ismay.

> The word infrastructure comes from France, where it has long been used to denote all the work that is necessary before a railway track can be laid, such as embankments, bridges and tunnels; and it was adopted by NATO in its early days as a generic term to define all the fixed installations which are necessary for the operation of modern armed forces – airfields, fuel supply dumps and pipelines, navigational aid stations, radar warning, and so forth. To take the definition a stage further, such installations as were required for the use of international NATO forces were called "Common Infrastructure", and paid for collectively by member countries. The particular problem remitted to Defence Ministers at Lisbon was to find the sum of £150 million for the next stage of the Common Infrastructure programme. The American representative, Mr. Bob Lovett, said that his country was prepared to pay the lion's share provided that the other members were willing to contribute to the best of their ability. Needless to say, there was scarcely a country whose estimate of what it could afford bore any relation to the sum which the other partners thought reasonable; and it was found that to induce a country to increase its contribution was as difficult as getting blood out of a stone. Eventually, however, after a wrangle that extended over sixteen hours in all, the target was reached, and we dispersed as fast as we could lest anyone should have second thoughts. I had felt like a fish out of water, and General Gruenther reminded me in later years that my last words to him at Lisbon were: "This is the first that I have seen of NATO and thank heaven it's the last."[12]

Shortly thereafter Lord Ismay became NATO's first Secretary-General.

In NATO, as in the United Nations and other agencies, annual administrative costs have usually been apportioned among the members on the basis of some composite formula reflecting capacity-to-pay. (The administrative costs of the agencies must be distinguished from the special programs, such as the United Nations Development Program, which are financed on the basis of voluntary contributions.) Such formulae have regularly indicated a share for the "largest contribution" (that of the United States) which was so high as to be unacceptable to all concerned; in the early days of the United Nations it worked out to approximately 50 per cent of the total, which was beyond what the U.S. representatives believed that Congress would have been willing to pay and which, in the eyes of others, would have given the U.S. far too influential a position in the organization. Accordingly, in the United Nations and in most of its specialized agencies an arbitrary ceiling was established on the largest contribution, initially at 40 per cent and later at lower levels. This arbitrary reduction brought the U.S. contribution, on a per capita basis, substantially below the Canadian and this, as the Canadians pointed out, would have caused embarrassment in Ottawa. Accordingly the United Nations and its agencies accepted a "per capita principle" under which no country would pay more, per capita, than the largest contributor with its arbitrarily reduced apportionment.

Despite the U.N. precedent, Canada's NATO partners declined to agree that Canada should be provided wth per capita protection in that organization; they were not willing to revise a formula under which Canadians might be paying, per capita, two or three times as much as Americans. The Canadian government decided that it could not meet such an assessment out of its ordinary National Defence appropriations; to do so would imply acceptance that the assessment represented a reasonable payment for services rendered to the Canadian armed forces. However, rather than precipitate an international confrontation over such an issue, it decided to meet the assessment in part, and later entirely, out of the funds voted by Parliament to be expended on mutual aid to NATO partners.

It is interesting to observe that, some ten years after the NATO Annual Review Committee began its work and in a neighbouring part of Paris, a rather more successful burden-sharing exercise was launched. This was the review, conducted annually in the Development Assistance Committee of OECD, of the support provided to developing countries by each of its members. This exercise was more successful, partly because the proposals to governments became the personal responsibility of a succession of widely respected chairmen rather than the collective responsibility of all the individual members of the committee[13] and also, perhaps, because from the outset there was some general acceptance of the U.N. aid target of 1 per cent of each country's national income. Figures of the proportion of national income devoted to defence have carried no similar authority in NATO. The proportion of Canada's GNP devoted to defence fell steadily from 8.8 per cent in 1953 and 1954 to 2.8 per cent in 1969. In the earlier years only the United States, Britain and France attained a higher percentage than Canada; but by 1969 only Luxembourg had a lower one.[14] Yet, even if Canadians were aware of this slippage, they were not aroused.

The Drive to End Discrimination

Although the Atlantic Alliance might be united in its determination to win the cold war, in its early years it was deeply divided into two economic blocs: the hard-currency bloc consisting of the United States and Canada and the soft-currency bloc consisting of the European countries together with Britain and the sterling area. Under rules of both the IMF and the GATT, the soft-currency countries were permitted to maintain, at least temporarily, discriminatory trade and financial restrictions against the hard-currency countries. It was the task of the 1950s to end this discrimination and to achieve currency convertibility among the major trading countries. Only when this objective had been attained would the Fund and the GATT be in full and effective operation.

Canada and the United States, having rather different commercial interests and financial objectives, were not affected in the same way by the restrictions maintained by different overseas countries. For Canada, it was the British restrictions that were economically the most harmful and politically the most hurtful. Traditionally, Canadian exports of staple commodities, of foodstuffs, feedstuffs and materials had been primarily directed towards the mother country, where such exports from

Commonwealth countries were granted duty-free entry. In addition, certain Canadian manufactures had also enjoyed a preferential market in Britain; American branch plants located in Canada exported to Britain substantial quantities of American-type goods ranging from rubber footwear to automobiles. Some Canadian manufactures also enjoyed preferential access to Australia, New Zealand and South Africa and to various British colonies, notably in the West Indies. Accordingly, after the war Canada had a special interest in persuading Britain and other British countries to abolish discriminatory import restrictions as soon as possible and to adopt economic and financial policies which would lead in this direction.

Successive British governments, at successive Commonwealth conferences, did what they could to persuade their partners in the Commonwealth (other than Canada) to move more or less in step toward the elimination of restrictions against dollar imports. The central gold and dollar reserves and resources of the sterling area were managed in London and if one country outran the others in removing these restrictions it would use up an unduly large share of the scarce dollars.

Within each Commonwealth country there were, of course, conflicting commercial interests. While some were anxious to gain access to cheap, efficient, up-to-date North American goods, others were anxious to keep these goods out and to maintain high-priced, high-cost markets behind the protection of supposedly temporary dollar-import restrictions. Thus, there were political as well as economic obstacles to be overcome in the soft-currency countries.

On the other hand, the operation of the GATT introduced a special incentive for Canada and the United States, the hard-currency countries, to press for the termination of discriminatory import restrictions against them. It will be recalled that a major round of reciprocal tariff reductions had been concluded in 1947. The two dollar countries immediately extended the full benefits of these reductions to all other GATT countries, but the soft-currency countries temporarily withheld the benefits of many of their tariff reductions from dollar countries by resort to import restrictions imposed under the balance-of-payments exemption clauses of the agreement. As time went on this imbalance in the trade benefits of GATT became increasingly irksome to commercial and political interests in the dollar countries.

In addition to concern with Britain's postwar commercial policy, Canada had an interest in Britain's controls over capital exports. Britain permitted her colonies and Commonwealth countries other than Canada free access to her capital market but could not spare the dollars to allow freedom of investment in Canada and the United States. Canadians, however, were anxious to re-establish the inflow of British investment, partly as a basis for industrial expansion and partly as a counterweight to the growing American inflow. Accordingly, Canadian representatives persistently sought the removal of British financial restrictions as well as commercial restrictions.

Once Britain had decided that her postwar future lay in the one-world concept of convertibility and non-discrimination rather than in an attempt to maintain discriminatory economic barriers around herself and her Commonwealth and colonial associates, she moved fairly steadily if slowly in this direction. The first substantial postwar move lay in the devaluation of sterling and the associated tripartite discussions of 1949 which were described in chapter 4 above. The next move came in 1952, when the so-called "collective approach" to freer trade and currency convertibility was launched. By that time the Marshall Plan and the North Atlantic Treaty had laid a foundation for European reconstruction. The British initiative began with a meeting of Commonwealth finance ministers in January and was followed by a meeting of Commonwealth prime ministers in December. The final communiqué of the latter committed Commonwealth countries to a "multilateral trade and payments system . . . extended over the widest possible area. . . . Sterling should resume its full role as a medium of world trade and exchange." But, as emphasized in the tripartite talks, the convertibility of sterling could only be achieved in a favourable world-trading environment. Thus "it is proposed to seek the acceptance of this plan by the Governments of the United States and of European countries whose cooperation is essential."[15]

In successive Commonwealth meetings, and in the more intimate annual meetings of the Canada – U.K. Continuing Committee on Trade and Economic Affairs announced in 1948,[16] Canadian representatives maintained a continual pressure in the desired direction. Fortunately, since both Britain and other members of the Commonwealth were committed, at least in principle, to move in that direction, such pressure, while probably irritating from time to time, was not unacceptable. Moreover, particularly in the Continuing Committee, Canada had special as well as general interests to serve. The progressive relaxation of British restrictions should, as early as possible, accommodate exports from Canada that were either politically sensitive or commercially promising or both. For example, among the subjects raised by Canadians in successive meetings of the Continuing Committee were the British quotas on imports of Canadian apples, cheese, eggs, canned salmon and tobacco. There were also discussions about how many dollars the British could allocate to a "token import scheme" which provided for modest sales of Canadian manufactures in Britain and in the West Indies on the basis of prewar performance.

Just as Canadian representatives made use of their position within the Commonwealth to try to hasten the removal of sterling area restrictions against dollar imports, so Canadian representatives as associate members in the OEEC in Paris attempted to hasten the removal of European restrictions. Like the Commonwealth countries, the European countries tried to move in step. There was no central reserve of gold and dollars upon which the European countries could draw, but its place was taken, at least in some measure, by the operations of the European Payments Union (EPU) which gave these countries a collective financial interest in directing trade toward each other and in conserving dollars. Moreover the British, at the centre of the Commonwealth and, at least in the early days, an accepted leader in OEEC initiatives, had an interest in trying to ensure that both groups moved in the same direction at more or less the same pace.

As time went by, and as British and European exports revived, the dollar shortage, which was the only defensible reason for non-convertibility and discrimination, began to disappear. In the IMF record of 1955-56 discussions we read:

> Mr. Rasminsky (Canada) took strong issue with the position of the staff that some Western European countries felt obliged to maintain a significant degree of restriction because of a sense of European solidarity, or to discriminate against dollar imports in view of the nature of the EPU settlement arrangements. He believed it was becoming in-

creasingly clear that the basic reasons for continued discrimination were commercial policy considerations, including special export advantages gained by European countries through their regional or bilateral arrangements.[17]

Despite such arguments and exhortations the European countries continued to approach the cold world of international competition cautiously, and their various colonies as well as sterling area countries followed suit. Moreover, since the leading countries were agreed that any major move should be taken by all of them together, the pace of all tended to become the pace of the slowest.

The Commonwealth Trade and Economic Conference held in Montreal in September 1958 constituted one of the final milestones on the path to currency convertibility. The theme of the conference was "an expanding Commonwealth in an expanding world.... It remains our objective that sterling should be made fully convertible as soon as the necessary conditions have been achieved and that trade discrimination should continue to be progressively removed.[18]

Later that year, in December 1958, the Fund was able to announce a collective decision on external convertibility for major currencies. This meant "that a majority of the Fund members now permitted non-residents to transfer current earnings of their currencies to any other country."[19] Nevertheless, these countries were hesitant to renounce formally the shelter of the "postwar transitional arrangements." In renouncing this shelter they would be undertaking to comply with the "general obligations" of the Fund – to refrain from discriminatory financial practices and to make their currencies freely convertible in respect of trade and all other current transactions. However, there was still some possibility of shelter in time of need because, under the Articles of Agreement, the Executive Board had authority to grant exceptions to the general obligations. Hence the question arose what exceptions were in fact likely to be granted and under what circumstances?[20] Moreover, the Fund's rulings regarding the justification for discrimination applied not only to financial transactions but also to commercial transactions under GATT. At the 1959 annual meeting of the Fund "the Governors for Canada (Mr. Fleming) and the United States (Mr. Anderson)... believed very strongly that the Fund should take early action to declare ... that there was no longer any balance of payments justification for discrimination."[21]

At long last, in February 1961, after exhaustive discussions regarding the appropriate interpretation of the general obligations, the final major move was taken: nine European countries renounced the protection of the transitional arrangements. By that time "they had eliminated all, or nearly all, restrictions on current payments and transfers."[22] Similarly arduous progress has been made in regard to trade restrictions under the jurisdiction of GATT. Thus, fifteen years after Bretton Woods and thirteen years after the conclusion of GATT, the main trading countries had closely approached the acknowledged goal of complete abolition of discriminatory trade and exchange restrictions on current transactions.

Some Developments in the Fund

With the major countries of western Europe joining those of North America in undertaking to comply with the general obligations of the International Monetary Fund, the organization changed its character in certain important respects. Formerly it had been essentially an American-supported, America-dominated body, but now it became more effectively international. It is not possible to review here all the developments that took place but two are of special relevance to this volume.

When the European countries accepted the general obligations of the IMF they were automatically released from the transitional obligation to hold annual consultations with the Fund. The organization was then faced by a possible loss of continuing contact with the affairs of a number of its important members. In order to prevent this from occurring Canada and the United States proposed, and it was in due course agreed, that all members of the Fund should consult annually even though, for members accepting the general obligations, such consultations were not required. These consultations began in 1961-62 and the first Canadian consultation under this arrangement coincided with Canada's uneasy transition from a floating to a fixed rate regime (see chapter 7 pp. 166-73 below).

Consultations have become such a central element in the operation of the Fund that the procedure deserves some explanation. The normal procedure is for a Fund officer or group of officers to visit the country involved and to engage in discussions with the national financial and economic authorities. These discussions may extend over some days or possibly two or three weeks; the Minister of Finance and the Governor of the central bank may well participate. On the basis of these discussions the Fund staff will prepare for presentation to the Executive Board a report which will provide an analysis of the economic and financial position of the country and its prospects for the coming year or two. It will also, if appropriate, offer comments regarding policies relating to the balance of payments and recommendations regarding borrowings from the Fund, actual or anticipated. After discussion, the Board may support or alter its staff proposals and recommendations.

Since the war international economic consultations have proliferated; the economic policies and prospects of national governments come under review in various international organizations. The consultation system of the Fund is generally considered to be particularly thorough. The familiarity of members of the staff with economic developments and policies in the member countries usually provides a firm foundation for consideration of the issues involved.

Another accompaniment of the move to convertibility by European countries should also be noted. In the early years, when the U.S. dollar was virtually the only convertible and generally acceptable currency, all IMF loans were made in that currency; indeed, apart from the gold contributed by each country (25 per cent of quota), the dollars contributed by the United States (the remaining 75 per cent of its quota) were the only usable resources of the institution. However, as more currencies became convertible they too were used in loans by and repayments to the Fund. In due course the currencies of some developing countries, and particularly the oil producers, came to be used. Thus the Fund acquired the general pool of usable currencies which the founders had expected and intended.

Canada has borrowed twice from the Fund, each time to meet a balance-of-payments emergency: $300 million in 1962 and $391 million in 1968. These transactions are reviewed in detail in chapters 7 and 9. On the other side of the ledger, dollars provided under Canada's quota contributions had by

1973 been borrowed from the Fund on seventy-six occasions.[23] In addition, Canada has occasionally made loans to the Fund under the General Arrangements to Borrow and more recently under the Special Oil Facility. The fact that the Canadian dollar was floating during some of the period, while it complicated Fund accounting, did not preclude its use in Fund operations.

A country whose currency is used by the Fund in making loans earns interest. Canadian dollars have been in active use by the Fund since the early 1960s and the earnings have become appreciable. They reached a temporary peak of $5.8 million in 1971, in addition to $1.1 million earned in that year on loans under the General Arrangements to Borrow.[24]

OEEC Becomes OECD

On 14 December 1960 Canada joined the United States and eighteen European countries in signing a Convention which converted the Organization for European Economic Cooperation (OEEC) into the Organization for Economic Cooperation and Development (OECD).[25] Canada and the United States had been associate members of the former without voting rights but they became full members of the latter.

The OEEC, it will be recalled, had been set up as a European organization, its primary purpose being to present to the United States collective proposals for the allocation among European countries of funds to be provided under the Marshall Plan. It also became a central instrument for promoting European economic integration. An elaborate code and procedure for European trade liberalization (that is, the reduction and removal of regional quota restrictions) was developed. This was supported by credit facilities provided through European Payments Union (EPU). Together, these arrangements had built up an extensive system under which the European countries made special trade and financial provision for each other and, in doing so, discriminated against outsiders, particularly the United States and Canada. This discrimination was accepted in the United States as a means of developing European strength and cohesion; it was accepted rather less willingly in Canada where commercial interests in Europe were proportionately greater.

During the 1950s the OEEC code of intra-European commercial conduct was supplemented by the introduction of other codes of regional economic conduct dealing with capital movements, shipping and other forms of transportation, and other international transactions. The implementation of each of these codes was supervised by a committee, and other committees concerned with the problems and possibilities of each of the main European industries were set up. The headquarters of the OEEC in Paris provided accommodation and staff for their many meetings and became a centre for intra-European consultation and collaboration on economic matters.

This extensive regional activity, which had originally been associated with the Marshall Plan, continued to grow and flourish after the Plan had been successfully terminated. However, as the 1950s wore on and as trade and payments were increasingly liberalized on a world-wide non-discriminatory basis under the GATT and the IMF, questions arose not only in Washington and Ottawa but also within the OEEC itself as to what its future should be. While some Europeans clung tenaciously to the concept of a regional self-centred organization, others, along with Americans and Canadians, became increasingly anxious to reconstitute the organization on some basis designed to meet the needs and conditions of the 1960s rather than those of the early 1950s.

In January 1960 the Minister of Finance, Donald Fleming, made a report to the House of Commons on a series of meetings which he and the Minister of Trade and Commerce, Gordon Churchill, had just attended in Paris.[26] The meetings had not been very effectively coordinated but the practical outcome had been a decision to build a new organization in Paris on the foundations of the old. A group of four "wise men" (an American, a Frenchman, an Englishman and a Greek) were appointed to draw up proposals. Their report became the basis for the new Convention.[27]

The move for reconstitution was based largely on a U.S. initiative led by Douglas Dillon, first as an Undersecretary of State under President Eisenhower and later as Secretary of the Treasury under President Kennedy. From the U.S. viewpoint there were several interrelated objectives. It had finally become necessary to check the in-growing, regional proclivities of the OEEC and to turn them outward in a world-oriented, non-discriminatory direction. There was also a precautionary purpose related to the unpredictable outcome of the recent split of Europe into two potentially competitive commercial camps: "the Six" (original members of the European Economic Community) and "the Seven" (the European Free Trade Area made up of Britain, the Scandinavians and the Neutrals). In this precarious situation the United States was anxious to create an organization where the whole range of economic issues could be kept under continuous review and discussion and in which the United States as well as Canada (and later Japan) were to be full voting members. Finally, the Americans hoped to encourage greater participation by European countries in programs of economic aid to developing countries; the United States appeared to have been carrying the greater part of the load and the U.S. administration was anxious, not only to obtain some relief for U.S. balance of payments, but also to be able to reassure Congress that this particular "white man's burden" was being shared with reasonable equity.[28] Thus D for Development became one of the initials of the new organization.

In December 1960 Fleming reported to Parliament that the Convention had been signed. He spoke at some length on the dangers to Canadian commercial interests arising from the split between the Six and the Seven. He also expressed the hope that, under OECD auspices and with Canadian participation, the flow of economic aid to developing countries would be augmented. He laid particular stress on the need for "the harmonization of the economic policies of member countries." This function "might well emerge as the most important. . . . The economic and financial situation in member countries and policies pursued by member governments will be kept under review. Special attention will be paid to the international effects of national policies."[29]

Brief statements by leaders of other parties in the House of Commons indicated general support for the new organization.

During 1960, when the negotiations leading to reconstitution were being conducted under high pressure, some effort was made to reduce the activities in which the OEEC had become engaged. These efforts were not very successful; indeed, the reconstituted organization showed early signs of acquiring new activities rather than shedding old ones. Almost all of the OEEC committees continued after 1960, although with altered terms of reference, and while the code of (discriminatory) trade liberalization was, of course, discontinued, other codes of economic conduct were adapted and continued.

One of these was the code designed to liberalize international capital movements by the reduction of existing restrictions and the prevention of new ones. It was adopted by the OECD Council in December 1961 and the opening words ran as follows: "Members shall progressively abolish between one another ... restrictions on movements of capital to the extent necessary for effective economic cooperation. ... [30]

Canada decided not to adhere to this code despite strong pressures from her fellow members to do so. Canadian representatives pointed out that Canada's commitment to the basic objective of the code had been clearly demonstrated when, ten years earlier, all restrictions on foreign exchange transactions had been abandoned along with the legislation under which they had been maintained. In these circumstances it made no sense for Canada, at this late date, to undertake to "progressively abolish" such restrictions. At the same time, since the amount of foreign capital invested in Canada was very large, – far larger than in any other OECD country – and since foreign investment was a matter of considerable economic and political sensitivity, Canada would not be able to put her signature to the code without introducing extensive reservations which would have to become operative in hypothetical future circumstances when some sort of control might be required. The formulation and publication of such reservations would be a source of misunderstanding to investors and a blow to confidence in Canadian investments.

Apart from this exception, Canada entered actively into many of the activities of the reconstituted organization. The Minister of Finance, Donald Fleming, became the first chairman of its Council at the ministerial level and presided at a meeting which provided for the initial inclusion of Japanese representatives. He was also active in the selection of the first Secretary General, Thorkil Kristensen of Denmark. In the following years many Canadians, bureaucrats and businessmen alike, attended many of the OECD committees and working parties. In one way or another, most of the federal and some of the provincial departments of government became involved.

For the purposes of this volume the most significant of the continuing OECD activities have been those of the Economic Policy Committee and particularly of its Working Party 3 (WP 3) which is specifically concerned with international balances of payments. It provides a small and intimate forum in which international financial developments are regularly discussed by senior representatives of treasuries and central banks. In chapter 8 we shall be examining in some detail the role of this unique OECD body.

NOTES

1 For the text of Marshall's speech see Department of State, *Bulletin*, Vol. XVI, p. 1159. For elaboration of the nature, purpose and administration of the Plan see statements by Secretary Marshall to a Joint Session of Congressional Committees on 10 November 1947 (Department of State *Bulletin*, 23 November 1947) and to the Senate Foreign Relations Committee, 8 January 1948 (Department of State *Bulletin*, 8 January 1948) and his address to the Pittsburg Chamber of Commerce (Department of State *Bulletin*, 25 January 1948). See also references to the Marshall Plan in R. H. Ferrell, *George C. Marshall as Secretary of State, 1947-1949* (New York; Cooper Square Publishers, 1966), in George F. Kennan, *Memoirs, 1925-1950* (Boston: Little, Brown and Company, 1967), in Harry S. Truman, *Years of Trial and Hope* (New York: Doubleday and Co., 1957), Dean Acheson, *Present at the Creation* (New York: Norton and Co., 1969); and Merle Miller, *Plain Speaking: An Oral Biography of Harry S. Truman* (New York: G. P. Putnam's Sons, 1973).

2 Marshall, Address to the Pittsburg Chamber of Commerce, p. 111.

3 Economic Cooperation Administration (ECA), *Report on Recovery Progress and United States Aid* (Washington D.C.: February 1949), pp. 124-25, and 192-202.

4 ECA, *Report on Recovery*, p. 125.

5 Unpublished manuscript by John Holmes.

6 Kennan, *Memoirs*, pp. 406-7.

7 An unsympathetic U.S. comment on Article 2 may be found in Acheson, *Present at the Creation*, p. 277.

8 *Mike, Volume I, 1897-1948* (Toronto: University of Toronto Press, 1972), p. 66.

9 The following references in Canada, House of Commons, *Debates*, are relevant: 5 September 1950, pp. 269-70 and 299-300; 7 September 1950, p. 438; 1 April 1952, pp. 1015-16; 25 June 1952, p. 3708; 10 December 1952, p. 510; 14 April 1953, 3814; and 17 April 1953, p. 4061-62. Also White Papers on Canada's Defence Programme, 1954, pp. 33-39; 1957, p. 43; and 1964, p. 26. See also Ronald S. Ritchie, *NATO, The Economics of an Alliance* (Toronto: Ryerson and Canadian Institute of International Affairs, 1956), pp. 92-96.

10 Arnold Heeney, *The Things that Are Caesar's* (Toronto; University of Toronto Press, 1972), p. 107, says: "Because of the attitude of most national governments this effort [by the Secretariat] proved quite unrealistic and unacceptable." At the time Heeney was head of the Canadian delegation to NATO.

11 See Heeney, *The Things that Are Caesar's*, pp. 108-9 for an account of some of the manoeuvring that went on between the United States and some other countries, notably France, over the allocation of U.S. mutual aid.

12 Lord Ismay, *Memoirs* (London: Heinemann, 1960), p. 460.

13 For some discussion of the role of the chairmen of DAC, see Goran Ohlin, "The Organization for Economic Cooperation and Development" in *International Organization*, Vol. XXII, No. 1 (Winter 1968), p. 232.

14 See NATO Information Service, *NATO Facts and Figures* (Brussels, 1971), pp. 256, 257.

15 Final Communiqué, Commonwealth Economic Conference, 11 December 1952, Cmd 9717.

16 The formation of this committee was one of the results of a visit to Ottawa by the British Chancellor of the Exchequer, Sir Stafford Cripps. The Prime Minister's Office issued a brief press release on 24 September 1948.

17 *IMF History*, Vol. II, p. 276.

18 Report of the Commonwealth Trade and Economic Conference, Montreal, 15 to 26 September 1958, Cmd. 539. It should be recorded that this conference, which covered many matters of trade, aid and development and was signif-

icant in the postwar development of the Commonwealth, constituted a triumph for it chairman, Donald Fleming. Thanks to his active participation in earlier years in the Commonwealth Parliamentary Association, he was on a basis of personal friendship with many delegates from many parts of the world. He was confronted by various difficulties flowing chiefly from the unexpected announcement by Prime Minister Diefenbaker, returning from an earlier Commonwealth Conference in London, that he intended to shift 15 per cent of Canada's purchases from the United States to the United Kingdom. In an account of these matters Trevor Lloyd, *Canada in World Affairs, 1959-1961* (Toronto; Oxford University Press, 1968), pp. 64-76, casts Fleming in the role of a Tory protectionist; he was in fact a staunch upholder of the GATT as well as the Commonwealth.

19 *IMF History*, Vol. II, p. 27.

20 See Joseph Gold, *The Fund's Concepts of Convertibility* (Washington, D.C.: International Monetary Fund, 1971), Pamphlet Series, No. 14.

21 *IMF History*, Vol. II, p. 282.

22 *Ibid.*, p. 291.

23 Details of these transactions may be found in the annual reports by the Minister of Finance on Operations under the Bretton Woods Agreements Act.

24 Minister of Finance, *Report for 1971 on Operations under the Bretton Woods Agreements Act and the International Development Association Act* (Ottawa, 1972), p. 6.

25 The eighteen European countries to sign the Convention on the Organization for Economic Cooperation and Development were Austria, Belgium, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, and the United Kingdom. The three European communities also became signatories: coal and steel, atomic energy, and the EEC.

26 House of Commons, *Debates*, 18 January 1960, pp. 25-28. For a description of the background to these developments, see Henry G. Aubrey, *Atlantic Economic Cooperation, The Case of the OECD* (New York: Praeger, 1967). Also Ernst

H. Van Der Beugel, *From Marshall Aid to Atlantic Partnership* (Amsterdam: Elsevier Publishing Company, 1966) pp. 344-49.

27 W. R. Burgess, B. Clappier, P. Gore-Booth, and X. Zolotas, *A Remodelled Economic Organization* (Paris, April 1960).

28 When under the auspices of the Development Assistance Committee of the OECD, comparative statistics of the contributions of the various donor countries were compiled, they suggested that the greatest financial burden was being shouldered, not by the United States, but by countries with colonial possessions, specifically Portugal and France.

29 House of Commons, *Debates*, 16 December 1960, p. 865.

30 *OECD*, "Code of Liberalization of Capital Movements" (Paris: OECD, June 1974), p. 104.

6

A Floating Dollar: Buoyant Years, 1950 – 56

The Buoyant Environment

For Canada the years from 1950 to 1956 were vigorous and expansive. In part this reflected a consummation of the hopes on which the new international economic agencies had been built; a major reduction of tariffs, including U.S. tariffs, had been achieved under GATT and a new pattern of stable exchange rates developed through the IMF. But in other respects economic expansion flowed, not so much from the hopes and plans for one world, but from the descent of the iron curtain.

While from a political and military point of view the world of 1950 was widely and sadly different from that which the United Nations and its specialized agencies had been designed to serve, many of the uncertainties of the immediate postwar world no longer impeded Canadian economic planning, private and public. The Marshall Plan of 1947 underpinned European recovery in a manner helpful to countries such as Canada and those of Latin America which traditionally supplied exports to Europe; the North Atlantic Treaty of 1949 offered political cohesion and stability as well as the economic incentives inherent in the defence build-up; the Korean War of 1950 set up additional demands for war material; and the Paley Report of 1952 confirmed that the United States could not rely on its own resources, particularly mineral resources, and for safety's sake should seek to invest in resource development in the territories of the "free and friendly nations of the world," with Canada at the top of the list.[1]

Confidence was the keynote of Canada's economic and political development during these years. The government of Louis St. Laurent, who succeeded Mackenzie King in 1949 and obtained a sweeping mandate at the polls in 1953, included strong, experienced and self-confident men. Its representatives in Washington, London, Paris, New York and Geneva acted with an assurance that reflected purposeful government policies founded on political cohesion and economic strength. Moreover, particularly in the economic and financial sector, it drew support and guidance from a well-equipped public service.

In his well-known and by no means uncritical study of Canada's elite groups, both economic and political, John Porter devotes a special section to the financial elite in the Canadian public service. It runs, in part, as follows:

> *Dr. Clark's Boys*
>
> It is generally accepted by students of Canadian government that the senior public service has had a crucial position in the over-all structure of power, particularly after the appointment by R. B. Bennett, in 1932, of W. C. Clark, an economics professor from Queen's University, as deputy minister of finance. Apparently Clark was recommended to Bennett by O. D. Skelton, also a former Queen's professor who had a distinguished career in the public service. Sometime later, Bennett appointed Mr. Graham Towers as governor of the Bank of Canada. Gradually there was built up around the Department of Finance and the Bank of Canada an outstanding group of expert administrators who were to be the architects of the economic and social policies required by the war and post-war reconstruction. Clark's Department of Finance was described by one former deputy minister [Mitchell Sharp], who had earlier served under Clark, as "the central idea generating department of government." Clark did not see the task of the Department of Finance as simply controlling the purse strings. "His curiosity and his energy found expression in the advocacy of policies touching every aspect of Canada's economic life." Among "Dr. Clark's boys" were R. B. Bryce, K. W. Taylor, Harvey Perry, A. K. Eaton, Ross Tolmie, David Johnston, John Deutsch, and others. Others from the Bank of Canada, and agencies

tangential to the Department of Finance, joined with "Clark's boys" to create the golden age of Canadian public administration. These others included such men as Donald Gordon, Hector McKinnon, W. A. Mackintosh ... Mitchell Sharp, Louis Rasminsky, and J. R. Beattie.... [2]

W. C. Clark died in 1952 and was replaced by Kenneth Taylor; Graham Towers resigned in September 1954 and was replaced by James Coyne; and the St. Laurent government under which Clark, Towers and other senior financial officials had worked so smoothly collapsed of its own weight in 1957 to be replaced by the Diefenbaker government. With these changes the "golden age of Canadian public administration" drew to a close.

In the postwar decade Canada's relations with the U.S. administration were, with occasional exceptions, close, cordial and self-confident. On many issues, bilateral and more broadly international, Canadians made common cause with administration officials to gain continuing acceptance by the U.S. Congress of internationalist as opposed to isolationist or protectionist legislation. Dean Acheson, who was for a time Secretary of State under President Truman, wrote of some developments in 1952:

> Hardest hit by the political revolt in Congress was the whole program to increase international trade by removing national restrictions upon it. In the preceding autumn an amendment had been attached to the Defense Production Act of 1951 restricting agricultural imports by quotas and other devices forbidden by most of our trade agreements. Half of Western Europe as well as Canada, New Zealand, and Australia were up in arms and threatening retaliatory tariffs against our agriculture....
>
> The Administration stood staunchly for a liberal trade policy, but the old protectionist Adam was strong in Congress, which slyly and without comprehension of the responsibility of our new creditor postion went about reducing imports.[3]

Fortunately economic expansion in the United States attracted continuing imports from all parts of the world. These more than offset the protectionist lapses of Congress, lapses which, with industrial employment in United States running at high levels, related chiefly to agriculture. The buoyancy of the U.S. demand for imports overflowed into all regions of Canada and U.S. capital largely underwrote the resulting resource development. During these years Canada approached the "high and stable level of employment" which, since publication of the White Paper on Reconstruction in 1945, had been a top-priority economic objective of the Canadian government.[4]

The prosperity which Canada enjoyed in these years had begun with the reconstruction of Europe under the Marshall Plan in 1948–49. It was broadly based, and, apart from some hesitation in 1954, was continuous. (This is clearly demonstrated in the economic indices presented in the Reference Tables at the end of this volume.) Exports, which had reached a level of $3 billion in 1948 and 1949, exceeded $4 billion by 1952 and $4.8 billion by 1956. The greater part of this increase was directed to the United States which took fish, forest products, minerals, chemicals and some agricultural products in large quantities from many sections of the country. Accordingly, the beneficial effects of the export expansion were widespread. Responding to the prosperity and financed in part by capital imports, commodity imports also rose. Since a rapid expansion of capital facilities was in progress, industrial materials, machinery, equipment and construction supplies of all sorts arrived in increasing quantities.

Resource development forged ahead. Canadian forest products were in strong demand in the United States, as were the minerals, including uranium, which had been located in various parts of the country in preceding years. Oil was discovered in Alberta in 1946 and increasingly replaced imported fuel. Iron ore was developed to replace dwindling U.S. domestic supplies, and by 1956 had become another major mineral export from Canada. Resource development was encouraged by special tax concessions, some of wartime and prewar origin, the most important of which were renewed from year to year and made permanent in 1955.[5] Direct investments from abroad rose from $225 million in 1950 to $650 million in 1956 – a level which was the highest, apart from a peak in 1960, to be reached until 1966. Long-term capital imports of all kinds rose to a total in 1956 of $1,490 million which was not surpassed until ten years later.

If Canadians were highly confident of themselves and their future during this period, foreign investors were at least equally confident. Speaking in New York in 1953, an official of the Bank of Canada remarked: "The editors of some of your leading newspapers and periodicals seem to have entered into a friendly competition with each other to see who could produce the most glowing account of our present prosperity and future greatness, who could pay the deepest tribute to our wisdom and thrift. This warm and enthusiastic discovery of Canada is, of course, highly gratifying. It is also a bit frightening."[6]

In the optimistic and expansive spirit of the period, the inflow of capital was widely welcomed. The croaks of the few Cassandras who dared to question either the economic or the political desirability of such imports were drowned in the Hallelujah Chorus. Ministers of Finance regularly recorded the fiscal surplus of the preceding year and anticipated a further surplus in the year ahead.[7] Responding both to practical possibilities of budget surpluses in these buoyant times and also to Keynesian precepts regarding anti-cyclical budgeting,[8] the outstanding debt of the federal government was reduced from $15.2 billion in March 1950 to $14.4 billion in March 1957. Monetary policy, which had been primarily directed during and after the war to the support of government bond prices, was re-activated on a more normal basis in 1950.[9] In a budget speech in April 1951, and again in March 1956, it was noted that the Bank of Canada was exercising a restraining, anti-inflationary influence on the financial system.[10]

In successive budget speeches ministers explained how the country was moving forward from strength to strength. In the spring of 1951 stress was laid on Canada's national unity: "There are no great issues of principle dividing us. . . . On major questions of policy . . . we are all fundamentally agreed." Year by year, the speeches recorded new economic records at home, enlarging trade opportunities abroad, and the growing power of the North Atlantic alliance. By 1954 it was possible to refer to the recovery of Germany and Japan, along with general progress toward the goals of multilateral trade and payments. In 1956 the budget speech opened with the words: "The world economic situation has, during the past year, shown nothing but solid progress in almost every civilized country."

By the end of the period there were some indications that Canadian attitudes towards international issues were beginning to alter. The balance between nationalism and internationalism had begun to shift. The budget of March 1956 included a proposal for limiting the incursions of "Canadian editions" of such U.S. magazines as *Time* and *Readers' Digest*; the great pipeline debate of May and June, which reached its climax on the constitutional issue of the rights of Parliament, was based on protests against foreign investment and control; and the nationalist accents of Walter Gordon, as embodied in the Interim Report of the Royal Commission on Canada's Economic Prospects, appeared in December. Nevertheless, and in spite of these shadows of coming events, the tone of Canada's buoyant years from 1950 to 1956 continued to be epitomized in L. B. Pearson's Nobel Prize-winning intervention in the Suez crisis, in the radiant optimism with which C. D. Howe approached the exploitation of Canadian resources, and in the courtly confidence of "Uncle Louis" St. Laurent.

The Buoyant Dollar

The strength and independence of Canada's position was reflected in her handling of a new exchange rate problem. On Saturday, 30 September 1950 the Minister of Finance issued a statement on exchange rate policy which in one sense surprised nobody but in another sense surprised almost everybody. It surprised nobody in that the existing exchange situation, with the Canadian dollar pegged at a discount of 9 per cent, had clearly become untenable and had to be abandoned. It surprised almost everybody because, instead of establishing a new par value, the government decided that the Canadian dollar should be allowed to float.[11] This decision carried implications that were broader and longer than were appreciated at the time. However, before examining the results, attention must be directed to the causes.[12]

The immediate cause of the abandonment of the pegged rate was a heavy inflow of short-term funds, reflecting a widespread view in Canada and abroad that, at a 9 per cent discount below the U.S. dollar, the Canadian dollar was substantially undervalued, that its price would have to rise very soon, and that profits could be made or losses avoided by moving funds into Canada or holding them there while the Canadian dollar remained cheap.

In every country that is being forced by circumstances to the brink of a revaluation of its currency the authorities, fearful of adding fuel to the speculative flames, will resolutely deny the inevitable. Thus early in September, in response to a financial spokesman for the opposition in the House of Commons, who on the basis of press reports in London and New York asked whether there was any intention of lowering the value of the Canadian dollar, the Prime Minister replied: "No consideration has been given to the matter."[13] On 5 June in an unguarded moment, C. D. Howe had remarked that "the historic position of the Canadian dollar is at par with United States.... [The present relationship] may not continue very long." But that was before the massive inflow of funds had begun.

In 1949 – 50 several underlying forces in the balance of payments were contributing to the strength to the Canadian dollar. The Marshall Plan was now supplying Canada's overseas customers with U.S. dollars for offshore purchases. Direct investment from the United States had risen strongly in 1949 and then more than doubled in 1950, laying a foundation for a stronger trade-balance in the future. The long-term capital account as a whole improved by some $640 million between 1949 and 1950, partly reflecting the termination of the Canadian program of loans and credits for European reconstruction. And now, on top of this, came a favourable swing, largely speculative, of some $450 million on short-term capital account, so that the total capital account improved by more than $1 billion between the two years.

During the months of July, August and September 1950, in attempting to defend the pegged exchange rate of the Canadian dollar against upward pressures, the authorities had to purchase U.S. $534 million, of which more than $285 million were acquired in September. (In addition, $50 million were accumulated to meet a government bond issue that was maturing in New York on 1 October). On 29 September, the last day before the floating rate, Canadian reserves stood at the all-time record level of $1,790 million in gold and U.S. dollars. The problem posed by the growth of Canadian reserves was two-sided. On the external side there was the problem of keeping down the value of the Canadian dollar by buying U.S. dollars; on the internal side there was the problem of raising the Canadian dollars with which to buy the U.S. dollars.

In different countries an increase in the level of reserves affects the domestic monetary and financial situation in different ways, depending on the financial practices prevailing between the government, the central bank, and the private financial institutions. In Canada, where international reserves are held not by the central bank but in the Exchange Fund (a government account in the form of deposits in the banking system) the government will normally obtain Canadian dollars for the purchase of foreign exchange by enlarging its regular sales of short-term securities. Such securities are sold in part to the commercial banks and in part to the central bank. Thus, when the needs of the Exchange Fund are expanding, the commercial banks will find themselves with enlarged reserves at the central bank and also with enlarged holdings of short-term government securities. In short, the liquid position of the banking system and its ability to expand loans and investments will be increased.

By September 1950 any further expansion of commercial bank credit was contrary to the wishes of the government and the Bank of Canada. The economic situation was developing all the earmarks of a boom and what was required was not expansion but restraint. In his statement of 30 September the Minister of Finance explained: "An influx of funds on this tremendous scale would, if it continued, be likely to exercise an inflationary influence in Canada at a time when government policy in all fields is directed to combatting inflationary developments." Accordingly, unable either to check or to cope with the inflow of speculative funds, the government abandoned its attempt to defend the existing par value.

As a strong supporter of the newly formed International Monetary Fund, Canada might have been expected to establish a new par value either at parity with the U.S. dollar or, conceivably, at some arbitrary and probably indefensible intermediate level such as U.S. 95 cents. A new par value was what the Fund rules required and what the public and the Fund authorities expected. The par value system had been established only six years previously, after much international discussion, and with Canada's full assent.

But there were other considerations. The fixed value of the Canadian dollar which had prevailed throughout the war had already been altered upward in 1946 and then downward in 1949. The sudden strength of the Canadian dollar in mid-1950 was based largely on anticipations regarding trade and investment that related to the Korean War which could terminate at any time and on the Marshall Plan which was to terminate in 1952. Canada's international current account, which had showed a surplus during and ever since the war, was suddenly running into a deficit. The favourable trade balance had disappeared, and Canada's overseas markets, especially in Britain and Europe, had not recovered anything like their prewar strength; indeed, until Britain's economy was stable and prosperous, with trade liberalized and sterling convertible, it seemed to the Ottawa authorities difficult to have confidence in any particular par value for the Canadian dollar. As recently as 1947 the government had been forced into an exceedingly unpopular program of import restrictions in order to defend a pegged rate; was it really wise, in 1950, to risk a repetition?[14]

Alternatively, was there not much to be said for letting the exchange market have its head, at least for the time being? Other countries, with unhappy experiences of exchange instability in the 1930s, might well have hesitated to embark on such a policy; but Canada's experience of the 1930s indicated that, given its freedom, the Canadian rate would behave well. Accordingly the government's decision was, at least provisionally, to let the Canadian dollar find its own level. As a former official of the Department of Finance put it: "Any renewed pressure of capital imports speculative or otherwise, will be met by the elastic resistance of a moving rate which will reduce the prospect of speculative gain. There will no longer be an authority accommodating enough to hold the new rate so that the speculator may withdraw his capital and realize his gains."[15]

And this, indeed, was precisely the scenario that unfolded. Speculators, who had anticipated a quick profit of some 10 per cent resulting from a decision to re-establish the historic parity with the U.S. dollar, were disappointed. During October the premium on the U.S. dollar fluctuated between 7 and 4½ per cent; in November it moved between 4¾ and 3¼; in December it rose a bit, and moved between 6 and 4½ per cent. Faced by such uncertainties, the speculators did not hasten to withdraw substantial funds. In effect they bet with each other, from day to day, on whether the Canadian dollar would rise further or would perversely fall back again.

Taken by itself, the decision to set the Canadian dollar free left two important questions unanswered. First, would the authorities, apart from purchases and sales to meet their normal day-to-day requirements for foreign exchange, refrain from any intervention in the market or would they as a matter of policy play some part, in some way and in some degree, in the determination of the rate? Second, should any time limit be envisaged for the new arrangement?

In regard to official intervention in the market, the public announcement of the Minister of Finance on 30 September was silent. However, it was essential that the Bank of Canada should have some instructions, experimental and confidential as these might be. In the event, they were made up of three elements. First, the exchange rate was to be basically determined by demand and supply on the market. Second, the Exchange Fund should stand ready to buy or sell foreign exchange in such amounts as seemed necessary to maintain an orderly market and avoid extreme day-to-day fluctuations; however, such intervention should not be directed toward the establishment of any particular rate. And third, the actual amounts which could be deployed to limit movements of the rate in the immediate future were specified. These instructions were intended to be provisional. In fact they stood largely unchanged for the next ten years, except that the amounts to be deployed to limit fluctuations in the rate were altered from time to time as the years went by and as circumstances changed. They marked the initiation, indeed the invention, by Canada of what subsequently became known, internationally as well as nationally, as a "clean float."

The first public statement regarding the government's intervention policy seems to have appeared in the annual report of the Foreign Exchange Control Board for 1951: "Transactions of the Exchange Fund Account in the market in United States dollars were directed to helping to maintain orderly conditions without preventing basic supply and demand factors from determining the level of the rate." This statement, and similarly succinct ones to the same effect that emerged from time to time, supported by actual experience in the market, satisfied exchange dealers that they could base their expectations regarding the behaviour of the rate on the economic and financial influences at work.[16] It was on this basis that the movements of short-term funds into and out of Canada exercised a stabilizing rather than a destabilizing effect on the exchange rate. Not until 1961, when the government expressed a view as to the level of the exchange rate, did market operators begin to speculate on the wishes and intentions of the government.

As for expectations regarding the duration of the arrangement, its originally tentative nature was emphasized by the fact that, as explained by the Minister at the time, most of the official regulations covering purchases and sales of foreign exchange, apart from the matter of the exchange rate itself, were to remain unchanged. However, based on the now ample reserve position, he was able to announce the termination of the emergency import restrictions remaining since the emergency program of 1947. By December 1951, with the floating rate still performing satisfactorily, all the remaining foreign exchange regulations were terminated and the Foreign Exchange Control Board itself was wound up. In March 1952 the IMF was notified that the Canadian dollar was fully convertible, and that Canada accepted the general obligations of the organization.

In adopting and then pursuing a floating rate policy the Canadian authorities were embarking on an uncharted sea with little to guide them other than the experience of the Canadian dollar in the 1930s. It was not until some years after 1950 that a floating rate policy came to be regarded in some quarters not only as respectable but as commendable. This line of thought may be traced, at least as far as North America is concerned, to a publication of Professor Friedman in 1953.[17] Many years earlier, in the 1920s, Keynes had argued that exchange rates should be adjusted to international changes in relative price levels rather than vice versa, but this line of argument assumed that the rate would be managed, not floating.[18] In 1950, the IMF system of fixed but adjustable par values had general support in academic as well as official circles. Based on the experiences of the early 1920s and of the 1930s, it was almost universally assumed that a floating rate would be inherently unstable; short-term speculation in either direction would feed on its own successes and in any case any floating rate would soon become a sinking rate, leading to financial confusion and commercial chaos. The Articles of Agreement of the Fund made no provision for floating or fluctuating rates, even as a temporary expedient.[19] Thus, when the Canadian dollar was allowed to float in 1950, it was not because economic precept or organizational arrangements pointed in that direction, but because in practice the alternatives seemed unattractive and because the Canadian authorities felt reasonably confident that it would work.

During the years 1950 to 1956 the performance of the Canadian floating dollar turned out to be satisfactory. The rate gradually strengthened, touching parity with the U.S. dollar in January 1952 and moving through parity to a premium in March. From that time onward it continued at a slight premium for the rest of the decade, apart from a brief visit to parity again late in 1955. As many commentators have pointed out, the rate displayed a high degree of stability. Speculative short-term capital movements, so far from destabilizing, exercised a strong influence toward stability, a tendency that was from time to time reinforced by the Exchange Fund. The propensity of the Canadian economy toward inflation, on the basis of widespread resource development during the period, was tempered by the high value of the Canadian dollar which exercised a moderating influence on Canadian prices and incomes. The exchange market was free from the alarums and excursions that often attach to the defence of a fixed par value, and the operations of the Exchange Fund, which were modest, involved no sharp changes in the level of reserves.

The Floating Rate and the Fund

The response of the International Monetary Fund to Canada's decision of 30 September 1950, and to subsequent developments, as described in its official history,[20] is revealing both in regard to Canadian policies and in regard to changing attitudes in the institution itself. Prior to the publication of that history in 1969 the proceedings of the Executive Board had been kept confidential but we now have a record of the proposals that had been put forward by the staff and of the positions that had been taken by Executive Directors.

In September 1950 the Canadian Executive Director, L. Rasminsky, informed the Board that Canada had decided to suspend the par value of the Canadian dollar and allow its foreign exchange value to fluctuate in response to market forces. The decision had been precipitated by a heavy inflow of capital which was aggravating inflation; it was not possible, at that stage, to select a new par value. In response, the staff urged the intensification of domestic anti-inflation measures and/or the imposition of restrictions on capital imports; they did not share the belief of the Canadian authorities that such imports would be moderated by small movements of a floating exchange rate. Rasminsky replied that these alternatives had already been considered and rejected in Ottawa; in particular the government was opposed to exchange controls of any kind and to actions which might be interpreted as hostile to American investment.

During the discussion it emerged that a majority of the Executive Directors, recognizing "the exigencies of the situation," believed that Canada should, "in the light of its special circumstances," be permitted to try a fluctuating rate for a short period. They took note of the intention of the Canadian government "to remain in consultation with the Fund and to re-establish an effective par value as soon as circumstances warranted."[21] In passing it may be noted that the staff, in carrying out its responsibilities, had stressed the importance of conformity with the rules of the organization while individual Executive Directors were inclined towards a more flexible attitude.

In February 1952, when the next discussion of the Canadian policy is recorded, several Executive Directors suggested that, even for a country in Canada's circumstances, a fluctuating rate had greater disadvantages than a fixed rate. On this occasion, however, Rasminsky was able to claim, on the basis of experience, that the fluctuating rate did in fact moderate oscillations in capital flows. He went on to stress that while Canada was in default on one of the three basic obligations of the Fund, the maintenance of a par value, she was now [unlike most other members] in conformity with the other two: the elimination of exchange restrictions and the establishment of currency convertibility. In supporting his position some Directors expressed the opinion that "the world's exchange situation had been abnormal for some time and in such circumstances fluctuating exchange rates were of great help to countries, particularly in permitting the removal of restrictions."

Four years later the record reveals a further important change of attitude:

> By 1956 the Fund had come to regard Canada's relative success with a fluctuating rate as reflecting the uniqueness of that country's circumstances. Canada had a trade deficit with a large capital inflow. There was confidence in the Canadian dollar because of the fiscal and credit policies being followed; Canada was relatively free of restrictions and had a convertible currency. Moreover, the institutional background led many to regard as natural a parity for the Canadian dollar somewhere near that of the U.S. dollar. Close interdependence between short-term capital movements and movements of the exchange rate had caused capital flows on the whole to be equilibrating rather than disturbing. Finally, the exchange rate fluctuated by only about 3-5 per cent, despite the absence of intervention by the authorities except to maintain an orderly exchange market.
>
> For all these reasons, Canadian trade and normal capital transactions had not lost the important benefits commonly associated with exchange rate stability. The Canadian example was not a precedent, for the circumstances of other countries were quite different.[22]

As far as the Canadian government was concerned the floating rate policy which had been adopted in 1950 as experimental had by 1956 become firmly established. There were some in Washington who continued to remind the Canadian Executive Director from time to time of the obligation to re-establish a par value. In general, however, it was accepted that this particular obligation could not be honoured because of Canada's "special circumstances"; accordingly the Canadian policy did not threaten the maintenance of the Fund's par value system and Canada remained a member of the Fund in good standing.

From the viewpoint of the Fund a floating (or fluctuating) rate did not, as such, raise a serious problem. Immediately prior to dealing with the Canadian decision in 1950 the Executive Directors had dealt with a comparable Belgian decision. A number of countries in various circumstances resorted to a floating rate as a temporary expedient. Major countries, from time to time confronted by special problems of capital movements, allowed a fluctuating market rate to develop for such transactions, while defending the par value for current transactions. (The "outside market" in New York for Canadian dollars during and after the war reflected a somewhat similar attitude.) As newly independent countries joined the organization in large numbers in the 1960s the Fund often proposed a temporary period of float before a definite decision was reached on a par value. What was special about the Canadian position was that it involved a major country and, as time went on, it became increasingly clear that the situation was continuing, not temporary. Accordingly the Fund had to explain it in terms of "special circumstances."

The assertion by the Fund Board in 1956 that "the circumstances of other countries were quite different" may be questioned in retrospect. By 1971–75 the forces leading to the breakdown in the Fund's par value system among major countries had developed a number of features in common with those that led Canada to default on the par value obligation during the years 1950 to 1956. On the other hand, it must also be accepted that the large and uncontrolled international capital movements, which were already a feature of Canada–U.S. relationships in the 1950s, were still embryonic and strictly controlled as between other major countries at that stage. As explained in the preceding chapter, the general move toward convertibility of major currencies did not take place until the years 1958 to 1960.

NOTES

1 A Report by the President's Materials Policy Commission, *Resources for Freedom*, 5 vols. (Washington, D.C.: U.S. Goverment Printing Office, June 1952, The Paley Report).

2 John Porter, *The Vertical Mosaic: An Analysis of Social Class and Power in Canada* (Toronto: University of Toronto Press, 1965), pp. 425-28. The present writer was also among those who owed his early appointments in the public service to W. C. Clark; first in 1933 as Assistant Secre-

tary to the Royal Commission on Banking and Currency in Canada (which recommended the establishment of a central bank) and later in 1942 as Financial Attaché to the Canadian Legation in Washington.

3 Dean Acheson, *Present at the Creation: My Years in the State Department* (New York: Norton and Co., 1969), p. 634.

4 "The Central task of reconstruction, in the interest of the armed services and civilians alike, must be to accomplish a smooth, orderly transition from the economic conditions of war to those of peace and to maintain a high and stable level of employment and income. The government adopts this as a primary object of policy." White Paper on Employment and Income presented to Parliament by the Minister of Reconstruction and Supply, April 1945, p. 1.

5 D. Y. Timbrell and H. Anson-Cartwright, *Taxation of the Mining Industry in Canada*, Royal Commission on Taxation Studies No. 9 (Ottawa, May 1964), Section III. Also House of Commons, *Debates*, 5 April 1955, p. 2738.

6 Address by Louis Rasminsky, Executive Assistant to the Governors of the Bank of Canada, at the Town Hall, New York, 10 March 1953, p. 1.

7 Budgetary surpluses were recorded in every fiscal year from 1946/47 to 1956/57, except for deficits in the years 1954/55 and 1955/56 which were more than counterbalanced by the surplus of 1956/57. It should, of course, be emphasized that the government engages in various financial operations, many of them involving capital transactions, that are not included within the traditional accounting framework of the budget. For example, very large budgetary surpluses were recorded in 1947/48 and 1948/49, but much of the money was needed for other purposes, including the loan to Britain, and the reduction in the government's outstanding debt was substantially less than the budget surpluses.

8 "Canada," wrote John Kenneth Galbraith, "was perhaps the first country to commit itself to a firmly Keynesian economic policy.... At almost the same time that *The General Theory* arrived in Cambridge, Massachusetts, a young Canadian graduate student named Robert Bryce arrived from Cambridge, England. He had been in Keynes' semi-

nar and had, as a result, a special license to explain what Keynes meant in his more obscure passages. With two or three other Canadian graduate students, Bryce went on to Ottawa and to a succession of senior posts culminating in Deputy Minister of Finance in 1963." J. K. Galbraith, "How Keynes Came to America" in Milo Keynes, ed., *Essays on John Maynard Keynes* (London: Cambridge University Press, 1975), p. 137.

9 See E. P. Neufeld, *Bank of Canada Operations and Policy* (Toronto: University of Toronto Press, 1958), chapter 6. See also Annual Reports of the Governor, 1950 to 1957.

10 House of Commons, *Debates*, 10 April 1951, p. 1801 and 20 March 1956, p. 2326.

11 Statement issued by Mr. Douglas Abbott, Minister of Finance, at Ottawa on 30 September 1950 regarding the Canadian exchange rate.

12 For a more extended treatment than is possible here the following sources may be found illuminating: Paul Wonnacott, *The Canadian Dollar, 1948 to 1958* (Toronto: University of Toronto Press, 1960) and also, by the same author, *The Floating Dollar, Exchange Flexibility and Monetary Independence* (Washington, D.C.: American Enterprise Institute for Public Policy Research, 1972). Also Leland B. Yeager, *International Monetary Relations* (New York: Harper and Row, 1966), chapter 24; and Sidney A. Shepherd, *Foreign Exchange in Canada*, 3rd ed. (Toronto: University of Toronto Press, 1961), especially chapters 1, 2, 3 and 27.

13 House of Commons, *Debates*, 2 September 1950, p. 155.

14 These considerations were put forward, in recent conversations with the present writer, by the Minister and senior officials who were directly involved in the decision to float.

15 W. A. Mackintosh, "A Note on the Canadian Dollar," *International Journal* (Winter 1950-51), pp. 50-53. In this note, dated November 1950, Professor Mackintosh examined a number of the considerations underlying the government's decision. He had held senior positions in the Departments of Finance and Reconstruction during the war and afterward.

16 Government statements regarding its intervention policy gave rise, however, to some misunderstandings amongst economists. See A. F. Wynne Plumptre, *Exchange Rate*

Policy: Experience with Canada's Floating Rate, Princeton University, Essays in International Finance No. 81, June 1970. Also the Bibliographical Note on fixed and floating exchange rates at the end of this volume.

17 Milton Friedman, "The Case for Flexible Exchange Rates" in *Essays in Positive Economics* (Chicago: University of Chicago Press, 1953).

18 Formulated in theoretical terms in *A Tract on Monetary Reform* (London: Macmillan and Co., 1924), pp. 154-63, this proposition re-emerged in *The Economic Consequences of Mr. Churchill* (London: The Hogarth Press, 1925), a political pamphlet condemning the exchange rate at which sterling was re-pegged to gold after the First World War.

19 *IMF History,* Vol. I, pp. 272-73. Further, since in Fund usage the term "fluctuating" is used rather than "floating," there seems to be a presumption that a floating rate must be a fluctuating rather than a stable one.

20 *Ibid.,* Vol. II, pp. 159-62. See also Vol. I, pp. 273-75 for a discussion of the principles involved, including a "lengthy argument" by the French Director in favour of fluctuating rates.

21 *Ibid.,* p. 161.

22 *Ibid.,* pp. 161-62.

7

A Floating Dollar: Cross-Purposes, 1957 – 62

Economic Slowdown and Financial Stimulus

For the Canadian economy the years from 1957 to 1962 lacked the buoyancy of those from 1950 to 1956. The world economic environment was not so favourable to North America which experienced increasing competition at home and abroad from both Europe and Japan, and the surge of activity related to NATO and the Korean War had spent its force.

To cope with newly emerging economic problems Canadians elected, in the spring of 1957, a Progressive-Conservative government under the leadership of John Diefenbaker. It replaced Liberal governments that had been in office successively since a Conservative, R. B. Bennett, had lost the election of 1935. At first the Diefenbaker government had only minority support in the House of Commons but in the spring of 1958 it was re-elected to office with the largest majority in Canadian history.

Canada's resource boom reached its peak in 1956. International direct investment, chiefly in resource industries, that year also reached a peak of $650 million, a level which was not reached again until ten years later. With the softening of resource development came a softening of economic activity as a whole. As U.S. expansion became hesitant and intermittent, Canada's exports to that country, having risen strongly to a level of $2,866 million in 1956, flattened out. By 1961 they had only managed to reach $3,217 million, a gain of 12 per cent over five years. Exports to Britain rose, but only from $817 to $923 million (13 per cent). Exports to the newly formed European Common Market were fairly buoyant but they were still only half the size of exports to Britain, while exports to Japan were less than half those to the Common Market. Other overseas exports were more resilient, rising from $689 million to $1,050 million, an increase of 54 per cent, but the greater part of this increase did not materialize until the last two years of the period. Prices of both imports and exports, as well as consumer prices, were reasonably steady throughout the period, so that the figures quoted above in terms of dollars are representative of the physical quantities involved. (For these and other statistics the reader is referred to the Reference Tables at the end of this volume.)

Meanwhile, the Gross National Product gained little in absolute terms after its 1956 peak. In per capita terms it actually fell until 1960. Business investment, which peaked in 1957, fell continuously thereafter both in terms of constant dollars and as a percentage of GNP. In 1957 the unemployment rate in Canada rose above that in United States for almost the first time since the war. The divergence continued up to 1960, based in part on an increase in the Canadian labour force which far outran increases in the United States and European countries.[1] By the end of 1960 the Canadian unemployment rate was exceeding 7.5 per cent, more than double the 1956 level.

Despite the weakening of the Canadian economy, the inflow of long-term capital from abroad actually strengthened. From 1950 to 1956 the net annual inflow averaged $698 million, while from 1957 to 1961 it averaged $1,102 million, a gain of nearly 60 per cent. In the former period the greater part was in the form of direct investment, chiefly in resource industries. But in the latter the growth was in other forms, mostly portfolio investment; new issues of Canadian bonds on the New York market accounted for well over half the total. In addition, while in the earlier period short-term capital ebbed and flowed, during the latter period there was a continuing net inflow averaging $194 million per year. In the light of what follows it should be noted that the inflow in the later period, both long-term and short-term, was increasingly in forms that were responsive to interest rate differentials; Canadians tended to borrow more abroad and less at home when interest rates in Canada were high relative to those in New York and vice versa, and Americans south of the border responded in the same way to the same incentives.

Matching the heavy net inflow of capital was a heavy net inflow of goods, services and other current account items. The deficit on current account first exceeded $1 billion in the boom year of 1956 but it continued above that level for the next four years. A large part of this deficit was made up of interest, dividends and other transfers relating to capital previously imported from abroad; but commodity trade, instead of providing export earnings to meet at least part of these service obligations, actually added substantially to the deficit (see Reference Table 10).

During the whole of the period from 1957 through 1960 the Canadian dollar continued to float at a premium over the U.S. dollar. Early in 1956 the premium had disappeared momentarily but by the beginning of 1957 the monthly average premium exceeded 4 per cent; thereafter, while it seldom rose above 5 per cent, it seldom fell below 2 per cent until late in 1960. Speaking broadly, the upward push of the capital inflow on the floating exchange rate was stronger than the downward pull of the deficit on current account.

Then as now there were wide differences of opinion about capital imports. Some people continued to welcome direct investment in support of industrial expansion and resource development with its invigorating effects on employment and economic activity. They did not distinguish sharply between such investment and other forms of capital import; for them, as for C. D. Howe before them, the main issue was to try to ensure that those in charge of the foreign-controlled enterprises behaved like good Canadians. For others, whose numbers were now increasing, capital imports were increasingly significant because of their implications for Canadian independence, political as well as economic. And for still others capital imports were responsible for keeping the Canadian dollar at an unwanted premium.

As time went by it became increasingly clear that the high level at which the Canadian dollar continued to float, a level which had been appropriate to the buoyant and inflationary period of 1950 to 1956, was inappropriate in the relatively stagnant period from 1957 to 1961. It facilitated imports, it deterred exports, it depressed prices, and it contributed to unemployment. It was not until late in 1960, however, that the government first adopted measures specifically designed to lower the value of the Canadian dollar. Meanwhile, in the face of the slowdown of the economy, various measures were taken in the three traditional areas of national financial management: fiscal policy, debt-management policy and monetary policy.

Throughout the period from 1957 to 1961 the new Conservative government pursued a deliberately expansive fiscal policy; the annual budgets, with the exception of that of 1960, forecast outlays that exceeded revenues from taxes and other sources. Actual outlays, however, frequently outran those that had been planned and the impression grew in the financial community that the government, most of whose members were inexperienced in financial matters, was not in full control of the situation. Nevertheless, the excess of outlays had to be financed by government borrowing. Accordingly government debt which, it will be recalled, had been slightly reduced from 1950 to 1956, rose from $14.2 billion to $18.0 billion between March 1957 and March 1963,[2] an increase of some 25 per cent.

Fiscal expansion in a period of economic hesitancy was in full accord with the Keynesian anti-cylical financial policy that had been initially accepted in the Reconstruction White Paper of 1945.[3] When forecasting a cash deficit of $1.4 billion in his first budget of June 1958 the new Finance Minister, Donald Fleming, observed that "while the prospective increase in our debt will be quite substantial during the next year or two, the net burden of the public debt [as a percentage of GNP] will remain well below what we carried quite easily only a few years ago."[4] However, the fact that good economic authority could be advanced for the shift from government surpluses to government deficits did not mean that, from the point of view of debt management, the change could be made without difficulty.

In this field the situation that confronted the new government in 1958 was one of unprecedented difficulty. It was not merely that federal government deficits, replacing surpluses, brought the government into the security market as a new borrower in competition with such traditional borrowers as provinces, municipalities and corporations. Of more immediate importance were the impending maturities of the great wartime

Victory Loans. The first of these maturities, amounting to $947 million, was due to be paid off in January 1959. A further $1,165 million would come due in June 1960. Three further Victory Loans totalling $4,304 million would mature successively in 1962, 1963 and 1966.

With these heavy maturities overhanging the market the issuance of new government bonds could be expected to run into continual difficulties – difficulties which would be shared by the other borrowers. Indeed in the first half of 1958 new issues of government and Canadian National Railways bonds had already run into resistance. In this situation it was decided to confront the challenge head-on by attempting at one time to persuade holders of all five Victory Loans (which bore interest at 3 per cent) to convert their holdings into four new government issues maturing respectively in 1961 (at 3 per cent), in 1965 (at 3¾ per cent), in 1972 (at 4½ per cent) and 1983 (at 4½ per cent). For this purpose a high-pressure bond-selling campaign modelled on those of wartime was mounted and the Prime Minister launched the campaign on a national broadcast.

As a result of the campaign, Victory Loan bonds amounting to $5,806 million, more than 90 per cent of the total, were turned in for the new Conversion Loan issues. This represented nearly half of the total government marketable debt. In its immediate purpose, that of clearing a place in the market for new federal, provincial, municipal and corporate issues, the Conversion Loan was an unquestionable success.[5]

On the other hand, the loan carried with it side effects and after effects which must be taken into account in explaining the subsequent course of events. In the first place, a substantial number of purchasers who had been carried along on the enthusiasm of the campaign decided soon afterward to sell off part or all of their purchases; and their incentive to do so was increased by the fact that, in the fall of 1958, bond prices were falling and interest rates rising in the United States. For some weeks the Bank of Canada supported the market for the Conversion Loan issues and in order to do so created new money at an exceptionally rapid rate. Subsequently, however, when the support was withdrawn and the prices of Conversion Loan issues fell sharply, enthusiastic investors were disappointed.

Of more lasting importance was the influence that the Conversion Loan operation continued to exert on the level of Canadian interest rates and hence on capital flows into Canada from abroad. By exchanging Victory Bonds (which would have been redeemed by the government at their face value within a very few months or years) for Conversion Loan bonds (with maturities running as far as twenty-five years into the future) the Canadian bond market lost a great deal of liquidity. The longer-term issues, which were subject to the risk of wide price movements on the bond market, necessarily commanded higher interest rates and there was a relative shortage of liquid, readily marketable, short-term securities. Reviewing developments from the vantage point of 1964, the Royal Commission on Banking and Finance concluded:

> In the event, credit conditions tightened markedly despite the considerable monetary expansion that took place and corporations, provinces and municipalities turned to the U.S. market for funds. This led to upward pressure on the Canadian dollar that was to say the least no positive stimulus to domestic expansion.... A smaller operation, more flexibly managed and offered as an option rather than a duty, would not have brought all these difficulties in its train."[6]

Turning to monetary policy, the third element in national financial management (that is, the expansion or restraint of the supply of money and credit by the central bank), the picture was confused and soon became highly contentious. Over the four-year period from mid-1957 to mid-1961 the total Canadian money supply (currency and bank deposits) increased by some 22 per cent – a moderate expansion in long-run terms and one which, while somewhat exceeding the expansion of the relatively stagnant GNP, made little allowance for the "deliquification" of the Canadian security market which had resulted from the Conversion Loan. Moreover, the increase in the money supply was not continuous; there was a very sharp bulge in the summer and fall of 1958 when the Conversion Loan was being strongly supported, but thereafter through 1959 and most of 1960 it held level and even sagged slightly (see Charts of Money Supply in Appendix 1 to this chapter).

During this period the Governor of the Bank of Canada, James Coyne, was increasingly charged with being a tight-money man. He added to the impression by his many public statements stressing the need for financial restraint; he was continually warning against the dangers and injustices of inflation. (These dangers became fully apparent ten or fifteen years later but they were less apparent at the time.) He was equally concerned over Canada's international deficit on trade and current account and the related import of capital. But while economic analysis seemed to suggest that the capital inflow was a basic cause and the trade deficit was an effect, he often seemed to hold them in the opposite relationship which implied a need for direct controls to reduce imports. He opposed relaxations of credit in Canada designed to reduce the interest differentials between Canada and the United States and rejected any policy involving a substantial reduction in the value of the Canadian dollar.

With the courage of deep conviction Coyne carried his views to the public in a number of addresses, beginning late in 1959 and running through to early 1961. These covered a wide range of economic issues well beyond the field of central banking and included many implied criticisms of government policy. They were intended to arouse the Canadian public to an awareness of the issues confronting them; they certainly aroused members of the government to a state of outrage.[7]

It is not possible to trace in detail here the development of monetary policy and its interrelationship with large fiscal deficits and with the aftermath of the Conversion Loan. Fortunately this material has already been covered in breadth and depth by the 1964 Royal Commission on Banking and Finance.[8] However the charts which are reproduced in Appendix 1 to this chapter show the uneven increase of the money supply over the period and also the development throughout the period of exceptionally wide differentials between interest rates in Canada and in the United States. These differentials, which narrowed again after 1961 (except for the crisis period of 1962), are an indication of the incentive that existed to encourage the inflow and discourage the outflow of capital in interest-sensitive forms.

Both in cabinet and elsewhere Donald Fleming, as Minister of Finance, was urged to bring about a relaxation of monetary policy. On this issue, however, he refrained from a confrontation with the Governor of the Bank of Canada. He considered that under the Bank of Canada Act as it then stood the central bank was independent of the government.[9] His initial attempt to persuade the Governor to relax central bank policies had apparently been rejected as involving political interference. Afterward he said, "I had been trying to keep the Cabinet at arms' length from involvement with the Bank of Canada. I was looked upon within the cabinet as having protected Mr. Coyne. A majority of my colleagues . . . were openly advocating action to dispose of [him] . . . I resisted them until the situation became intolerable."[10] Fleming's position in this matter is confirmed by statements from three other ministers, Alvin Hamilton, Gordon Churchill and Howard Green.[11]

In due course, however, in discussions of policy for 1960 in which increasing emphasis was laid on the inappropriate level of the exchange rate, Fleming learned that disapproval of the Governor's policies was shared by some of his senior officials in the Department of Finance. This, he recalls, "was the last straw";[12] he at last agreed with his colleagues that the situation had become intolerable. Cabinet decided that steps should be taken to replace the Governor.[13] In the meanwhile Fleming initiated some debt-management operations designed to reduce the inflow of capital and to moderate the upward pressure on the Canadian dollar. These first emerged in the "baby budget" of December 1960 and then, much more importantly, in the main budget of June 1961.

Getting the Dollar Down

On 20 December 1960 Donald Fleming, whose economic and financial forecasts in the main budget of 31 March had been undermined by the unsatisfactory course of economic events at home and abroad, brought down a supplementary budget. In introducing it in the Commons, he said:

> In the circumstances of today, if capital flows in from abroad in forms and in amounts that put upward pressure on the external value of our dollar, it impairs the competitive position of Canadian producers in both domestic and foreign markets. Imports of goods and services become unduly expanded, exports less than they could be, and our current account deficit becomes unnecessarily enlarged. While in many circumstances, and under many conditions, capital imports enlarge employment, aid productivity and

broaden markets, they can also, in a different environment, aggravate an existing unemployment situation.[14]

The specific measures designed at that time to moderate the capital inflow and thus to lower the value of the dollar were of two types. First, a number of exemptions and concessions relating to the withholding taxes paid by Canadian corporations on income transferred to investors abroad were to be terminated. The general intention was that the standard withholding tax of 15 per cent should in future be paid on all newly imported capital. (The withholding tax on capital already invested in Canada was not altered.) Second, a number of other measures were introduced which would encourage Canadians to invest in Canada and thus lessen the incentive of Canadian borrowers to seek funds from abroad.

Although the government had now openly declared and acted on its intention to lower the value of the dollar, the Governor of the Bank came out even more clearly than before in opposition to the policy. When he appeared before the Senate Committee on Manpower and Employment on 26 April 1961 he said:

> I have not mentioned one specific proposal which is advanced by some people, namely, devaluation of the currency or depreciation of the international exchange value of the Canadian dollar. This to my mind comes definitely within the group of inflationary or "something for nothing" proposals with its appearance of sleight-of-hand and painless benefits. If it were such a sovereign remedy it would be in frequent use, not just in Canada but in every country in the world. In fact, most countries have come to foreswear this dangerous drug, having learned to their cost how much harm it can do. At best it is a confession of failure, a recognition that the whole cost-price structure of the country has got so far out of harmony with the rest of the world that there is no use trying to conceal the fact any longer. We are not in that position in Canada, and in my view we would do great damage to the Canadian economy as a whole and to many persons and enterprises in Canada by engaging in deliberate exchange devaluation or by utilizing the presumed powers of monetary policy with the definite object of putting the Canadian dollar to a discount.[15]

Following the supplementary budget of December 1960, the exchange rate did, in fact, fall slightly and (as later emerged) the Exchange Fund began to be more resistant to its upward than to its downward movements. However, the depreciation was clearly inadequate to promote significant improvement in the international trade balance and in economic conditions.

Early in June Fleming announced that he would bring down his annual budget on the twentieth of the month. And then on 13 June from Quebec City, where the Bank of Canada was holding its monthly board meeting, Coyne announced that his resignation had been requested and that he was refusing to comply. He immediately loosed on the government, and more particularly on Fleming, a torrent of charges of incompetence, mismanagement and misconduct, a torrent which he maintained almost day by day until 13 July when he did eventually resign.[16] If the government had limited their charges against Coyne to the conflict over policy issues, which by now had become clear, it is possible that despite his deep-seated belief that the Conservatives were mismanaging the Canadian economy, he might have been persuaded to retire without public resistance. However, they decided also to charge him with personal impropriety in connection with a substantial increase in his pension which the Board of Governors had decided upon the previous year. In the view of the present writer, it was impossible for Coyne, with his personal integrity at issue, to leave without a fight.

The opposition gladly espoused and elaborated Coyne's charges. The government and its supporters, for their part, levelled counter-charges against Coyne and the media made much of the muck-raking. These events have obscured and distorted impressions and opinions regarding the interesting and important budget of 20 June.

In that budget, pending the day when there could be a new Governor of the Bank, with a new monetary policy and a new attitude toward the value of the dollar, the government pursued its debt-management approach. Among the matters discussed at length in the speech were the unduly wide spread of interest rates between Canada and other countries, the import of capital of differing types, the accompanying deficit on current account and the impact on the level of employment. The financial policy proposals included a decision to relieve the pressure of new government bond issues on the "long end" of the security market, the institution of a "purchase fund" to give temporary support to the market for government bonds in times of weakness, the refinancing of the Unemployment Insurance Fund, the enlargement of the powers and resources of the Industrial Development Bank and, last but not least, the appointment of a royal commission, the first since 1933, to review banking and finance in Canada.[17]

It was recognized that the various policies outlined above could not be expected to ease the inflow of capital and the upward pressure on the exchange rate immediately, but from the viewpoint of the government some action that would affect, and would be seen to affect, the value of the dollar was essential. A general election would have to be called soon and the unemployment situation was urgent. The pressures for increased protection and support for Canadian industries were too intense to be disregarded. If, after this budget, the exchange rate did not move, piecemeal protection would have to be provided. For the first five months of the year unemployment had run over 7.5 per cent – higher, except for one month in 1958, than at any time since the government came into power in 1957.

In the course of his budget speech Fleming explicitly rejected piecemeal protection: "An expansion in exports and a reduction in imports should not be brought about by export subsidies, or by higher tariff rates, or quotas, or other forms of government intervention or protection, but rather by encouraging our exchange rate to fall into a more appropriate relationship with our economic situation." Accordingly, he announced that "the government has decided to use the exchange fund to neutralize, at least in some degree, the effects of the continuing capital inflows." And later, "No one can say to-day what the appropriate level of our exchange rate would be when our balance of payments is in a position better suited to our present circumstances. But the rate will certainly be lower than it has been of late, and it may well be appropriate for it to move to a significant discount. It will be government policy to facilitate such a movement. Accordingly the exchange fund will be prepared, as and when necessary, to add substantially to its holdings of United States dollars through purchases in the exchange market." (Misunderstandings have arisen as to the manner in which the Exchange Fund was in fact used; some explanations are provided in Appendix 2 to this chapter.)

In the days following the budget the exchange rate moved to a discount of some 3 per cent below the U.S. dollar where it stayed until November. It then fell to a discount of 4 per cent, and in February to 5 per cent, where it was informally pegged until April. By this time the Exchange Fund, while never actually used to drive the rate down, had ceased to be deployed with equal force against either increases or decreases. Immediately after the budget it was used to prevent the exchange rate from rebounding toward par with the U.S. dollar. This one-sided deployment of the Exchange Fund to prevent the dollar from rising had in fact been initiated soon after the budget of December 1960. It is reflected in a rising trend of Canada's international reserves from December 1960 to October 1961, resulting in the rather modest total increase over ten months of some $280 million (see Reference Table 13).

In March 1962, however, with the value of the dollar pegged in the vicinity of U.S. 95 cents but now under pressure to fall further, the Exchange Fund came in on the opposite side of the market. Up to this point the situation seemed fairly well in hand and, while pressures upward or downward on the dollar were strong, they were not unmanageable. One reason for this relative stability, in spite of the public controversy that had developed over Coyne's departure, lay in the general approval, both at home and abroad, which attended the appointment of his successor, Louis Rasminsky. Moreover, in accepting the appointment, Rasminsky had drafted, with Fleming's agreement, arrangements which would guide and stabilize future relationships between the government and the Bank.[18] These arrangements were by now in operation.

A new situation arose, however, with the announcement on 18 April of a general election to be held on 18 June. It has become clear from recently published observations that some members of cabinet considered that it was unwise to call an election just then.[19] It would seem that, in reaching the decision, adequate weight was not given to the precarious position of the Canadian dollar. In the weeks preceding the decision to call the election the Canadian dollar, provisionally pegged at U.S. 95 cents, was already under downward pressure. Moreover, this particular election generated several shocks to financial confidence. Promises of new expenditure programs came on top of a succession of large fiscal deficits which the financial community had already found worrisome. A continuation of these deficits had been forecast in the pre-election budget of 10 April. Further, as was inevitable, the financial charges and counter-charges of the Coyne episode were disinterred. It is possible, as some of the members of cabinet subsequently claimed,[20] that political motives underlay some of the speculation that developed against the Canadian dollar, but such an explanation is not necessary to the actual course of events.

Whatever the causes, the run on the Canadian dollar had reached crisis proportions by the end of April and on 2 May the government announced that it had decided formally to peg the exchange rate. The new par value for the Canadian dollar that was established with the International Monetary Fund was set at U.S. 92.5 cents. Fleming subsequently described his meeting with his officials at which he discussed the matter prior to placing it before cabinet:

> As I said, when the election was called we did not foresee that speculative run on the Canadian dollar. It started suddenly. It was very intense for several days. In consultation with Mr. Rasminsky and our officials in the department, I was led to the conclusion that the time had come, regardless of the immediate political consequences, when in the interests of the country the Canadian dollar must be pegged. I called a major conference of the officials of the Finance Department and of the Bank of Canada, and I must tell you that I couldn't get a consensus on what value we should seek for the Canadian dollar. There was a consensus that the time had come when we must devalue and peg the dollar in terms of the articles of the International Monetary Fund, but there was no consensus on how far we should go. I had those officials, including Mr. Rasminsky, sitting around in a circle in my big office in the Department of Finance. After a lengthy discussion, and with full knowledge of the gravity of the decision, I went around the circle and polled every man as to his ideas. Consensus was not possible and it was my personal decision that we should seek a 92.5 cents US value for the Canadian dollar. I thought this was realistic. Under all the circumstances it would be extemely helpful to the

Canadian economy if we could get it. It was in line with what leading Liberals like Walter Gordon and Paul Martin had been urging and advocating publicly. I took that decision.

I authorized Mr. Rasminsky and Mr. Plumptre to make preparations to go to Washington to meet there with the executive board of the International Monetary Fund and I took the matter to cabinet. The decision was accepted by cabinet without difficulty.[21]

The New Par Value and the Fund

The International Monetary Fund had been naturally and properly concerned about the new departures in Canada's exchange rate policy. One of its primary objectives is to protect its members against competitive exchange rate depreciations and, in this light, the actions and intentions of Canada had to be examined.

In July 1961 the matter was placed on the agenda of a meeting of the Executive Directors. They had before them a paper prepared by the staff which began by reviewing the course of Canada's floating rate since 1950. It identified the emergence of a wide differential between Canadian interest rates and those in the United States as the primary cause of the inflow of liquid funds into Canada since 1956 which "kept the exchange rate appreciated during a period when basic long-term capital flows that were normally motivated would have tended to push it downward." It also referred to "mounting uncertainty" regarding the Canadian economy and government policies.[22]

The staff concluded that "Canada should re-establish an effective par value as soon as circumstances permit." This, it will be recalled, was the Fund's conclusion when Canada's dollar was set afloat in 1950. Similar recommendations had been made from time to time thereafter until 1956 when, reassured by six years' experience with Canada's float and in the belief that Canada's circumstances were exceptional, the Fund had ceased its reminders.[23] Now, however, as revealed by the budget of 20 June, Canada's exchange rate policy had altered, and it became necessary to reopen the issue.

Here, ten years after Bretton Woods, is the Canadian Delegation to the 1954 Annual Meeting of the International Monetary Fund in Washington. On the right is Walter Harris, Minister of Finance, and with him is Graham Towers, Governor of the Bank of Canada, since it was set up in 1934. (The Americans had approached Towers to become the first Managing Director of the Fund.) Behind them are Louis Rasminsky, a Senior Officer of the Bank as well as our Executive Director at the Fund; also myself, recently appointed to the Finance Department. Behind us (l. to r.) Alan Hockin (Finance and now Vice President Toronto-Dominion Bank); Jake Warren (then Rasminsky's Alternate stationed in Washington and later Canadian Ambassador there); and George Freeman (Bank of Canada, now a Deputy Governor).

Donald Fleming, who convened this meeting of Commonwealth Finance Ministers at Mont Tremblant, P.Q., in September 1957, had, while a member of the Opposition, made personal contacts with most of his visitors from abroad during his extensive travels with the Commonwealth Parliamentary Association. A year later he was able to announce extensions of the Canadian external aid program to Colombo Plan countries, to the West Indies and to Africa.

On the way home from the Fund Annual Meeting in New Delhi in 1958, and after visiting several Canadian Colombo Plan projects, Fleming and his party visited Japan where the government was, as always, most hospitable. In this picture, seated l. to r., are Beryl Plumptre, Alice Fleming, Donald Fleming, A. F. W. Plumptre and Grey Hamilton, not to mention the geishas. Standing, at the left, are our Ambassador Fred Bull and his wife Marjorie; at the right, Japanese Ambassador Toru Haguiwara, chief negotiator in defence of Japan's rapidly increasing exports of low-cost textiles to Canada.

Here (centre) is the ebullient Per Jacobsson, one of the Managing Directors of the International Monetary Fund, who was fortunate enough to be in office when it became possible to lead the Fund forward to its basic goals: convertibility of currencies and non-discrimination between major countries.

Above is Pierre-Paul Schweitzer, Managing Director of the Fund, who held office during the decline and fall of the U.S. dollar and the consequent breakdown of the Fund's system of par values for major currencies. Here he is speaking at a dinner on the twenty-fifth anniversary of the Bretton Woods Conference. Opposite him, as his co-host, is Robert MacNamara, President of the World Bank, and on MacNamara's right is Dean Acheson, former U. S. Secretary of State.

The scene now shifts to Europe. Here, attending a joint dinner of the two inner groups known as WP 3 and the G 10 Deputies (to say good-bye to a Dutch colleague), are (l. to r.) representatives of Britain (Cairncross), Germany (Gocht), Canada (A.F.W.P.), U.S.A. and Chairman of G 10 Deputies (Roosa), Japan (Suzuki) and France (Pérouse).

Here are two leading figures in European and world economic co-operation. On the right, Robert Marjolin of France, the original Secretary General of the Organization for European Economic Co-operation when it was recommending the division of Marshall Plan aid. He later held other influential posts, both French and international. With him is Emil van Lennep of the Netherlands who is now Secretary General of the Organization for Economic Co-operation and Development and was formerly the exceedingly effective Chairman of its WP 3.

This picture was taken in Paris at the 1971-72 meetings of the OECD "High Level Committee on Trade and Related Matters." I inserted it partly because it was my last appearance as a Canadian representative at an international conference and also as a tribute to my neighbour, the eminent Swedish economist and political leader, Bertil Ohlin. He visited us at the University of Toronto in the mid-thirties but he had become famous as early as 1929 because of his controversy over German reparation payments with Maynard Keynes and Jacques Rueff. In Paris he introduced me to Rueff who by this time had become the arch-protagonist of the use of gold in monetary affairs and a chief adviser to General de Gaulle as to how to oust the Americans and the American dollar from Europe.

The more immediate apprehensions of the Board were allayed by assurances from Rasminsky, Canada's Executive Director, who stated that "Canada did not intend to operate its rate policies so as to cause competitive depreciation. The intention of the Canadian government was not to determine the level of the exchange rate in the market but rather to reduce the inflow of capital and the size of the current account deficit."[24]

The next occasion on which a Fund representative drew Canada's attention to the desirability of returning to the par value system occurred in December 1961. It took place in Paris, where both Fleming and Jacobsson, the Managing Director of the Fund, happened to be present on other business. In the course of a brief discussion Jacobsson was careful not to overstep the proprieties of relationships between an international organization and a member country and Fleming was courteously non-committal.

Another occasion arose in connection with the Fund's regular consultation procedures. The staff's appraisal of Canadian affairs, which they put before the Executive Board in February 1962, was much the same as it had been the previous July and its conclusion proposing Canada's return in due course to the par value system was in identical language. In the ensuing discussion, however, the uneasiness of most of the Executive Directors regarding Canadian developments was readily apparent. Questions were asked about movements of the exchange rate and of the official reserves. How low did the government intend the Canadian dollar to fall? What were the implications for internal financial policy? Was there any continuing case for non-compliance with the Fund Agreement? The Board did not press for immediate re-establishment of a par value but several Directors supported the staff in urging that such a policy should be adopted "as soon as circumstances permitted" and some went further to propose that it should be introduced as soon as government policies could be clarified.[25]

Despite this evidence of disquiet amongst the Executive Directors in Washington, there was no disposition in Ottawa at that stage to abandon the floating rate policy. In the course of his budget speech of 10 April 1962 Fleming reviewed at some length Canada's relations with the International Monetary

Fund since its inception. At the end of this review he said:

> Against such a background of general cooperation, Mr. Speaker, the house will understand why the fund, while naturally and properly retaining the ultimate objective of having Canada declare a fixed exchange rate, has not been disposed to press us into any hasty action which might prove to be premature or impossible to sustain. We on our part would wish the prospects of success to be more assured than they were when the Canadian government made its ill-starred attempts to maintain fixed rates during the years from 1946 to 1950.[26]

Fleming could hardly have used that language if he had any intention at that time of abandoning the floating rate. The fact that the new par value was in fact established some three weeks later is clear evidence that the move was precipitated by the unexpected turn of events, financial and political, during the election and not in response to "insistence" from the Fund.[27]

When the actual move took place on 2 May 1962, the Executive Directors were not disposed to question its motivation; nor was any question raised regarding the level of the par value, U.S. 92 cents, that had been selected. They "welcomed the return of Canada to the par value system."[28]

It was hoped in Ottawa that the formal return of the Canadian dollar to the shelter of the par value system, combined with a reduction of its value from its temporary peg of U.S. 95 cents in April to its new par value of U.S. 92.5 cents in May, would prove sufficient to stem the tide that was running against it. But this hope was not fulfilled. The routine announcement of the level of Canada's exchange reserves at the beginning of June disclosed that, on top of the use of more than $100 million in April, another $100 million had been used up during May. Downward pressure on the dollar continued and was accentuated when, on 8 June, the Minister of Agriculture, Alvin Hamilton, stated publicly that the rate of 92.5 cents was a compromise and that he favoured 90 cents as "the natural peg."[29] From that time onward it was simply a matter of hanging on until 18 June, when the results of the election would be known. It then emerged that the Diefenbaker government would continue in office, but in a greatly weakened minority position. Downward pressures on the exchange rate again took over. The defence of the new par value demanded emergency action.

The support operation which was quickly mobilized in Ottawa and which the Prime Minister announced on 24 June was made up of two parts; each was designed to convince financial and commercial interests operating in the foreign exchange markets that the new par value could and would be maintained.[30] To begin with, the sum of $1,050 million was added to Canada's reserve resources: a drawing of U.S. $300 million from the IMF, a stand-by credit of U.S. $400 million with the U.S. Export-Import Bank, and U.S. $350 million in the form of reciprocal currency swap arrangements with the U.S. Federal Reserve System and the Bank of England. (Shortly after, the Export-Import Bank credit was replaced by a long-term Canadian government bond issue in New York amounting to U.S. $250 million.) In addition, measures of two types were taken to reduce the international current account deficit. The general expansionary pressure flowing from government expeditures was to be reduced by an amount equivalent to $250 million in a full fiscal year. The Bank of Canada also took steps temporarily to restrict credit expansion and raise interest rates. Finally, with direct impact on the international current account, the duty-free exemption for tourists' purchases abroad was sharply reduced and, most important of all, tariff surcharges of 5, 10 and 15 per cent were imposed on various classes of goods comprising, in all, some 50 per cent of Canada's imports.

Walter Gordon, who became Minister of Finance with the change of government in the following year, has suggested that the program was "a package of emergency measures proposed to Canada by the International Monetary Fund."[31] Actually, of course, it was proposed by Canada to the IMF and to the other creditors who contributed to the enlargement of Canada's reserves. The import surcharges could only have been devised by people who knew the Canadian tariff and its legal foundations. And the purpose of the package was not to please the Executive Board of the Fund but rather to allay the apprehensions that existed in financial circles at home and abroad regarding Canadian policies and the value of the Canadian dollar.

The support operation involved Canada in consultations with both the IMF and the GATT. In a situation such as Canada was trying to deal with – a foreign exchange crisis – the basic financial discussions take place with the IMF but, if trade restrictions are invoked, they are discussed in the GATT under agreed arrangements between the two institutions. Since Canada's emergency program included tariff surcharges, GATT consultations were involved.

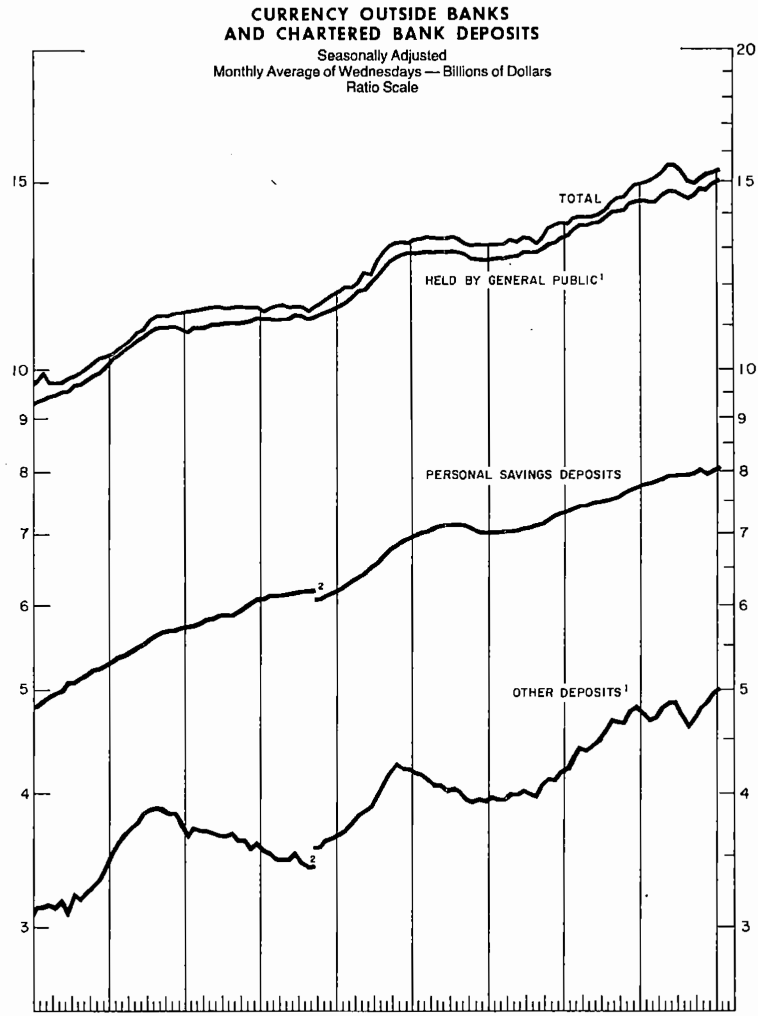
These consultations did not proceed smoothly. Representatives of some countries whose exports were impeded by Canada's import surcharges found it difficult to understand how the whole program had arisen. Indeed, Canadian representatives found themselves somewhat inhibited because a part of the full explanation had involved conflicts of policies and personalities within Canada. Further, Canada was technically in default because, while GATT provided for the use of import quotas in emergencies, since the wartime controls were dismantled Canada had no longer either the legal basis or the administrative machinery for introducing a quota system. Tariff surcharges were imposed instead. (Canada was not the first country to do so and at a later date the use of surcharges gained broad international approval.)[32] Finally, Canadians had often acted as self-appointed prosecutors when restrictions against Canadian exports were under consideration in GATT and on this occasion the representatives of other countries were not unwilling to prosecute the prosecutors. Canada was subjected to a good deal of criticism in the press[33] but since the surcharges were completely withdrawn within nine months of their imposition the storm soon blew over.

This was the second occasion, it will be recalled, on which a Canadian government had found it necessary to protect the balance of payments by imposing emergency restrictions against imports and on both occasions the government found that it had to make use of legislation that was not designed for the purpose. In November 1947 import quotas were introduced under legislation which, so the government had assured Parliament when it was introduced the previous year, would only be used to control capital movements (see chapter 4, pp. 101-2 above). In June 1962 import surcharges were imposed under what can only be considered as an imaginative use of power given to the government under the Customs Tariff. The government had no power to raise the particular rates of duty laid down by Parliament under that legislation, but it did have power to decide that a higher rather than a lower schedule of existing rates should apply to particular countries. Under this power, and certain other powers also provided in the legislation, higher rates of duty were applied instead of the prevailing most-favoured-nation rates. In 1962 as in 1947 the opposition parties in Parliament objected to the government's use of legislation in a manner that had not been intended or even envisaged when the legislation was passed. However the attack in 1962 was neither so strident nor so prolonged as it had been in 1947.

An important element in the support operation was a loan of U.S. $300 million from the International Monetary Fund. The request was presented (in this case by the present writer) on Sunday morning, 24 June. It included a brief review of the emergency measures to be taken, including those to be announced later in the day by the Prime Minister. The Board agreed without difficulty to the request.[34]

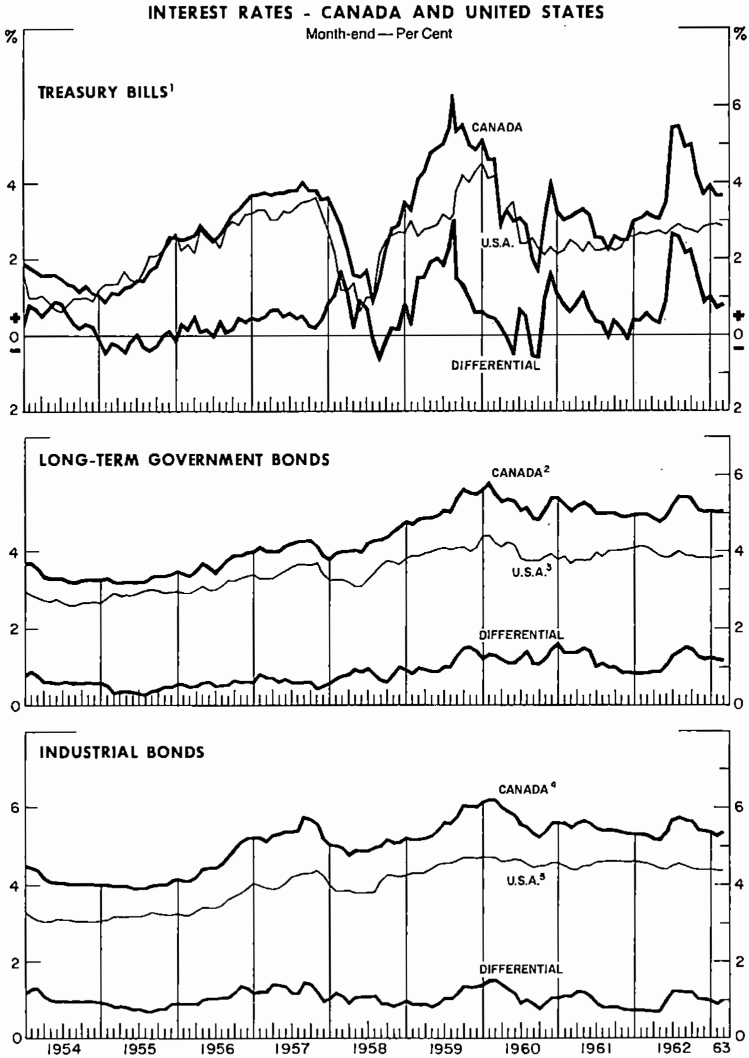
The support operation proved successful. The crisis was essentially a crisis of confidence which had checked the inflow of capital, caused a temporary outflow, and thus left the current account deficit uncovered and the Canadian dollar unsupported on the exchange market. Once financial confidence was restored, market forces soon took over and stability was reestablished. The dismantling of the various emergency measures is described in chapter 9 below. As for the new exchange rate, the Royal Commission on Banking and Finance, which reported in 1964, said: "In our view the existing parity of U.S. 92.5 cents is a good exchange rate for Canada and one which we hope can be maintained for a long time to come."[35] The new rate was in fact maintained from May 1962 to June 1970, a period of strength for the Canadian economy as a whole and, in particular, for Canada's international payments.

APPENDIX 1



1. Excludes Government of Canada deposits.
2. Breaks reflect reclassification at Sept. 30, 1957, of certain deposits from "Personal Savings Deposits" to "Other Deposits".

SOURCE: Bank of Canada Annual Report, 1962, p. 49.



1. 91-day treasury bills. Last tender in month. 2. 3¾% Jan. 15, 1975-78. Last Wednesday in month.
3. 3¼% June 15, 1978-83. Last Wednesday in month. 4. Source: McLeod, Young, Weir and Co. Ltd.
5. Source: Moody's Investors Service.

SOURCE: Bank of Canada Annual Report, 1962, p. 48.

APPENDIX 2
OPERATIONS OF THE EXCHANGE FUND IN 1961

It will be recalled that the Exchange Fund under the floating rate regime which began in 1950 had been used to resist sharp movements in the rate and not to initiate rate movements; further its use had been neutral or unbiassed in the sense that it would be deployed impartially against a sharply rising or against a sharply falling rate. In short, Exchange Fund operations were used to smooth out market movements and not to impose a government view on the direction in which the rate should move.

In the baby budget of December 1960 the government disclosed that it now had an attitude toward the level of the exchange rate, but the action announced in that budget was to reduce incentives for capital imports. No announcement was made at the time regarding the use of the Exchange Fund. It later emerged,[36] however, that early in 1961 new instructions had been issued under which the Fund was to operate more strongly to prevent increases in the rate than decreases. This bias continued throughout that year.

In his budget of June 1961 the Minister added a new element. He announced his readiness, if the rate did not float down in response either to the altered capital-import incentives introduced in the budget or to the firm repetition of the government's intentions regarding the level of the rate, to use the resources of the Exchange Fund aggressively to lower it. Such action would no doubt have been condemned by the IMF at the time.[37]

Subsequent writers have generally assumed that Fleming actually took such action, and some writers who have investigated in detail the interrelated behaviour of day-to-day purchases of U.S. dollars by the Exchange Fund and downward movements of the Canadian dollar seem to have established a strong case that he must have acted in this way.[38] For example, on the day after the June budget the exchange rate fell heavily – by three cents – and the Exchange Fund purchased $30 million U.S.

On the other hand, the Minister subsequently claimed that the Exchange Fund had continued to act responsively (although not, of course, equally on either side of the market) and had not undertaken aggressive action to drive the rate down. In his budget speech, on 10 April 1962, he stated: "In my last budget speech, on June 20, 1961, I expressed the desire of the government to see the Canadian dollar move to a lower level as a means of stimulating Canadian production and employment and of lessening our very heavy international deficit. In some quarters my statement was misinterpreted to mean that we were embarking on an aggressive policy in the market designed to drive our exchange rate down. This, as events made clear, was not the case."[39]

The resolution of this contradiction apparently lies in the behaviour of the exchange market. Like other volatile, speculative markets, when it moves rapidly in one direction, even for a matter of hours, a reaction will set in and a part of the movement will, at least in the absence of intervention, be reversed. What happened from time to time in the exchange market during this period was that, just as soon as the Canadian dollar began to rise after any downward movement, official intervention came into play. Thus the Exchange Fund did indeed purchase U.S. dollars on days when the rate moved sharply downward, but available evidence seems fairly clear that the intervention was usually, and probably invariably, directed toward preventing the upward reaction rather than precipitating the downward movement. In short, the Exchange Fund acted as a ratchet against upward movements and in so doing accumulated U.S. dollars.

NOTES

1 The growth of the labour force in Canada from 1956 to 1966 was about twice as rapid as in the United States and Germany and even more rapid than in other European countries. See *Labour Force Statistics* (Paris: OECD, 1968), Table II.

2 From Budget Papers in Canada, House of Commons, *Debates*, 17 June 1958, p. 1379, and 13 June 1963, p. 1161.

3 Minister of Reconstruction, *Employment and Income, with Special Reference to the Initital Period of Reconstruction* (Ottawa: King's Printer, April 1945), p. 21.

4 House of Commons, *Debates*, 17 June 1958, p. 1242.

5 This account of the Conversion Loan of 1958 is based on the Royal Commission on Banking and Finance, *Report* (Ottawa: Queen's Printer, 1964), p. 454.

6 *Ibid.*, p. 455. An even more critical account has been, *The Canadian Bond Market* offered by Douglas H. Fullerton (Toronto: The Carswell Company, 1962). Both the commissioners and Fullerton discuss the degree of responsiveness of capital flows to differences between interest rates in Canada and the United States. On the extent to which the Conversion Loan, by substituting long-term bonds for short-term, reduced the liquidity available to Canadian investors and hence exerted an upward pressure on Canadian rates the most elegant treatment in terms of "liquidity preference" is to be found in Clarence L. Barber, "Brief on the Conversion Loan presented to the Royal Commission" (mimeographed, undated, available in Bank of Canada Library). He points out that as of June 1961 the average length to maturity of the Canadian government marketable public debt had become nine and a half years, while the average length of U.S. debt to maturity was only four and one-third years. On the other hand the Canadian money supply (on various definitions) was at that time a smaller percentage of GNP than the American.

7 Peter Stursberg, *Diefenbaker: Leadership Gained 1956-62* (Toronto: University of Toronto Press, 1975), pp. 230-40. This volume is largely made up of the taped recordings of statements by cabinet ministers, by others close to Diefenbaker, and by some opposition leaders. Since they were recorded many years after the event some may have been influenced by hindsight. Those to which references are made in this chapter are in general accord with the recollections of the present writer.

8 *Report*, chapter 23.

9 The doctrine of central bank independence from the government which Fleming accepted had been advanced by his Liberal predecessor, Walter Harris, with support from the Prime Minister, Louis St. Laurent. It was, however, a doctrine that had been weighed and found wanting in earlier years. The history is set out in the Report of the Royal Commission on Banking and Finance, pp. 539-44. The Commission accepted the view that a clarification of

the Bank of Canada Act was required and its proposals were in due course embodied in an amendment to the Act. See note 18 below.

10 Stursberg, *Leadership Gained*, p. 239.

11 *Ibid.*, pp. 231-33.

12 *Ibid.*, p. 239.

13 The decision to replace Coyne appears to have been taken in March or April but it was the end of May before agreement was reached in cabinet as to how to implement that decision. See Stursberg, *Leadership Gained*, pp. 243-47.

14 House of Commons, *Debates*, 20 December 1960, p. 1003.

15 Senate of Canada, Proceedings of Committee on Manpower and Employment, 26 April 1961, p. 1407.

16 The sequence of events had been as follows: On 30 May, 1962 Fleming requested Coyne to resign. On 13 June Coyne announced his refusal to do so. On 23 June Fleming introduced a bill into the House of Commons declaring the office of Governor of the Bank of Canada to be vacant. On 7 July the House passed the bill. On 8 July it was introduced into the Senate. On 13 July the Senate rejected the bill and later that day Coyne resigned.

17 House of Commons, *Debates*, 20 June 1960, p. 6639 *et. seq.*

18 The statements issued by Rasminsky and Fleming were reproduced in the Bank of Canada *Report* for 1961, pp. 3-5. It was emphasized that, in order to discharge its statutory duty "to regulate credit and currency in the best interests of the economic life of the nation," the Bank must be sufficiently independent to withstand day-to-day pressures from any source. On the other hand the government must assume the ultimate authority for monetary policy; if necessary it must issue instructions to the Governor of the Bank who, if he cannot carry them out in good conscience, should resign. Both the government and the Bank have a responsibility to promote, by means of close and continuing contacts, the coordination of monetary, fiscal, debt-management and other economic policies. Amendments to the Bank of Canada Act would presumably be required to give effect to these points. See also note 9 above.

19 Stursberg, *Leadership Gained*, pp. 253-56.

20 *Ibid.*, pp. 253, 254 and 258.

21 *Ibid.*, pp. 258-59. According to the recollection of the pre-

sent writer some of the officials in Fleming's meeting, initially favoured an attempt to defend a par value at the level of the provisional peg (U.S. 95 cents) while others favoured 90 cents. The Minister then proposed the figure of 92.5 cents which carried general support. One official had initially proposed that no par value should be established and the floating rate policy should be given full effect; i.e. that the temporary peg at U.S. 95 cents should be removed and the dollar should be allowed to find its own level, however low, on the market. This option was ruled out as being politically unacceptable under election conditions.

22 *IMF History*, Vol. II., p. 163.

23 See chapter 6, pp. 148-51 above.

24 *IMF History*, Vol. II, p. 163.

25 Ministers seek to avoid laying themselves open to the charge, either by their colleagues in government or by the media or the opposition, that their decisions are reached on the basis of pressure from outside sources such as international institutions, and international institutions are equally anxious to avoid such charges. It was thus by mutual consent that Fleming and Jacobsson took advantage of the opportunity to meet on neutral ground in Paris rather than in Ottawa or Washington where the presence of either as a visitor would inevitably have given rise to questions. Further, when the IMF consultation group visited Ottawa they were housed, not as would have been normal, in the Chateau Laurier hotel, but in a less widely frequented establishment.

26 House of Commons, *Debates*, 10 April 1962, pp. 2697-98.

27 Walter Gordon is quoted as follows by his biographer: "I believed it was a serious mistake for Canada to have adopted a fixed exchange rate at the insistence of the IMF." Denis Smith, *The Gentle Patriot* (Edmonton: Hurtig Publishers, 1973), p. 108. No evidence of "insistence" is offered nor is it clear how the Fund would have tried to exert it.

28 *IMF History*, Vol. II, p. 164.

29 Peyton V. Lyon, *Canada in World Affairs, 1959-1961* (Toronto: Oxford University Press, 1965), p. 335.

30 John G. Diefenbaker, broadcast statement on emergency measures, 24 June 1962.

31 Walter Gordon is reported by his biographer to have warned his party leader, Lester Pearson, against approving "a package of emergency measures proposed to Canada by the International Monetary Fund in return for international support of the dollar. The Fund, through the intermediacy of the Bank [of Canada], was asserting the influence it had acquired the previous month when it had persuaded the Government to adopt a fixed exchange rate. Gordon was alarmed at the prospect of future dictation to Canada by the IMF." Denis Smith, *Gentle Patriot*, p. 107.

32 *Policy Perspectives for International Trade and Economic Relations.* Report of the High Level Group on Trade and Related Problems (Paris: OECD, 1972) p. 47.

33 See the account provided by Peyton V. Lyon in *Canada in World Affairs 1959-1961*, p. 375.

34 *IMF History*, Vol. I, p. 502.

35 Royal Commission, *Report*, p. 503.

36 J. Coyne, Evidence before the Senate Standing Committee on Banking and Commerce, 10 July 1961, p. 26. See also comment by Fleming, House of Commons *Debates*, 11 July 1961, pp. 7943-44.

37 It is interesting to note that when, in 1973 – 74, the Fund drew up general guidelines for countries with floating exchange rates (which were not, however, put into effect) these guidelines would almost certainly have rendered acceptable the actions, including aggressive action to move the rate to an acceptable from an unacceptable level, which Fleming proposed in June 1961. See Chapter 11, pp. 276-77 below.

38 For references, see Bibliographical Note of the end of this volume. The writers who examine day-to-day developments are Hartley G. Mellish and Robert G. Hawkins.

39 House of Commons, *Debates*, 10 April 1962, p. 2699.

8

New World Problems 1960 – 70

The U.S. Dollar in Deficit

In the early years of the 1960s, when the Canadian financial scene was still overcast by domestic difficulties and dissentions, the world financial scene was changing rapidly and radically. During the 1950s the U.S. dollar had been unquestionably the strongest currency in the world. In the earlier years, the United States had, in its own interest as well as in the interest of others, attempted to give or to lend enough dollars to needy overseas countries to allow them not only to purchase a continuing supply of U.S. goods and services but also to allow them to rebuild their gold and dollar reserves.

By 1960, however, the international financial balance had shifted. This was partly reflected in a more even distribution of world gold reserves. At the end of the war the United States had owned some three-quarters of the total. By the end of the 1950s U.S. reserves had fallen from \$24.4 billion in 1948 to \$19.5 billion and, equally important, the short-term claims of monetary authorities abroad on the United States and hence on those reserves had risen from \$6.1 billion to \$17.7 billion. In financial circles the narrowing of the excess of U.S. reserves (\$19.5 billion) over claims on those reserves (\$17.7 billion) was regarded with increasing disquiet.[1]

To make matters worse, the current international deficit which the United States had deliberately incurred in order to allow overseas countries to rebuild their reserves was continuing after the rebuilding process could be considered complete. A succession of massive deficits ($3.5 billion in 1958, $3.7 billion in 1959 and $3.9 billion in 1960) in a period when the United States was no longer encouraging them was, in the view of advisers to the President, "reason for alarm." Moreover, it began to appear that U.S. military and economic aid to foreign countries was becoming "continuing, not to say permanent."[2]

By the end of the 1950s, therefore, a new world financial imbalance could be identified in the form of a great, growing, and unintentional deficit in the balance of payments of the United States. Much of the financial history of the ensuing decade can be told in terms of that deficit and of the efforts made to redress it. But for every deficit on the part of one country there must be a surplus on the part of another. Thus the U.S. deficit was in a very real sense the surplus of other countries: Germany most peristently, the Netherlands frequently, France, Italy and other European countries from time to time, later on Japan, and ultimately in some degree Canada.[3]

A number of basic influences were at work to cause the new financial imbalance. Most important was the vitality and economic growth of the European Economic Community, which had been created by the Treaty of Rome in 1957. (One of the difficulties that emerged in attempting to deal with the world economic problems of the 1960s lay in the fact that the Community, while unified for purposes of trade and tariffs, was by no means unified politically or financially and was therefore not capable of replacing the United States in its role of central world creditor.) The rise of the EEC was followed by the rise of Japan. Britain, on the other hand, whose international economic policies had since the days of Bretton Woods most closely resembled and most frequently supported those of the United States, never fully recovered her prewar economic stature and political status. Finally, as the years went by, the United States herself became increasingly mired in the military and financial quagmire of Vietnam which drained her resources and impaired her relations with her friends.

A sharp forewarning of the financial difficulties ahead emerged from the commercial market for gold in London. Ever since March 1954 when the market had been reopened after the war, the price of gold in terms of U.S. dollars had stayed within the limits provided under the IMF Agreement: from \$34.65 to \$35.35 per fine ounce. But on 20 October 1960 the price broke out of bounds and some sales took place as high as \$41 an ounce.[4] This development could be interpreted as indicating doubts about the adequacy of world gold production to support expanding world trade and finance and also about the capacity of the United States to defend the link between the U.S. dollar and the par value system of the IMF.

President Eisenhower promptly issued a statement affirming the determination of the United States to maintain the gold value of the dollar. More significant in the light of subsequent events was the pledge of Senator John F. Kennedy, then campaigning for the presidency: "If elected President I shall not devalue the dollar from the present rate. Rather I shall defend the present value and its soundness."[5]

Another warning of the new international financial imbalance came in March of the next year. After strong speculative pressures in the exchange markets, first the German mark and then the Netherlands guilder were each revalued (upward) by 5 per cent. However, upward pressure continued and the Bank for International Settlements issued a statement that no further revaluation was to be anticipated. A week later the Bank issued a more general statement, which became known as the Basle Agreement, outlining ways in which central banks would give emergency assistance to each other in defending their national currencies against speculative attacks.[6]

Support for the U.S. Dollar

In the years that followed many measures of different types were initiated, mostly by the United States, to cope with the new problems of world imbalance. Some of them were strictly financial; others involved the adaptation of existing international institutions or the creation of new ones. These are briefly reviewed here; the next section will deal with proposals for the creation of a new world reserve currency.

The first of the initiatives taken by the Kennedy administration was to develop a system for keeping financial developments in and between a small number of important countries under close and continuous review.[7] This purpose was to be served within the OECD in Paris by a newly created and limited group, Working Party 3 or WP 3 for short, consisting of representatives of countries most affected by world trade and short-term capital movements. The countries directly represented on WP 3 are Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States. It is attended by senior officials from treasuries and central banks. Under its terms of reference its members "analyse the effect on international payments of monetary, fiscal and other policy measures, and ... consult together on policy measures, both national and international, as they relate to international payments equilibrium."[8] Meetings have usually been held at intervals of from six to eight weeks.

Its work began in May 1961 and most of its meetings were concerned with developments in either or both of the two major deficit countries, the United States and United Kingdom. But it was also concerned with the payments and policies of Germany and later Japan as fairly consistent creditors, and with other member countries whose position swung from surplus to deficit position and back. At an early date WP 3 developed the important practice of attempting, at regular intervals, to collect, collate and appraise the short-term balance-of-payments forecasts of the member countries on a global basis.

The usefulness of a body like WP 3 lies largely in the extent to which its members feel able to talk freely about events and expectations in their own countries, in the contribution which the secretariat (in this case members of the OECD staff) can make in assembling the available statistical and other material promptly and in a meaningful manner, and then in the extent to which the various views, be they divergent or convergent, can be carried by the members of the Working Party to the financial authorities at home for inclusion there in the policy-making process. The influence of any such body is, of course, limited; but WP 3 has had a reputation from the outset of being among the more influential.[9]

Another U.S. initiative came in October 1961, when informal arrangements were made to keep the price of gold within bounds on the London gold market. A Gold Pool was organized through which the U.S. and leading European central banks undertook to sell gold as required to meet growing private demands from industry, the arts, and more particularly from speculators.[10] Canada has never been a major holder or user of gold reserves (as distinguished from reserves in the form of U.S. dollar balances) and it was not included in the Gold Pool. Indeed, as an important producer of gold, Canada might have been embarrassed by an invitation to participate actively in an international operation designed to keep the market price of gold from rising.

A further initiative emerged in December 1961. As the difficulties of the U.S. dollar intensified the IMF authorities began to plan for a situation in which both the United States and the United Kingdom, each with a quota and borrowing entitlement much greater than other countries, might be seeking financial support from the Fund at the same time. To meet such an eventuality the Fund would need to supplement its normal resources. This was the origin of the General Arrangements to Borrow (GAB). Under these arrangements ten leading members of the Fund undertook collective support commitments. The original commitments included $2,000 million from the United States, £357 million from the United Kingdom, $216 million from Canada, and comparable amounts from Germany, France, Italy, Japan, the Netherlands, Belgium and Sweden. Shortly thereafter Switzerland, although not a member of the Fund (or any similar international organization) also made a commitment. The original agreement ran for two years and has subsequently been renewed from time to time.

If the "Canadian Plan" which had been circulated before Bretton Woods had been adopted the IMF would have had the right to borrow additional resources from its members. However, on the basis of arguments by the U.S. delegation which at the time anticipated a strong reaction in Congress against such an additional commitment, it was agreed to provide in the Agreements only for the possibility of loans from a member to the Fund subject to the concurrence of both parties.[11]

As it emerged, the GAB differed widely from the Canadian proposal which would have placed authority in the Fund. The Europeans, led by the French insisted on keeping control in their own hands. They considered that both the United Kingdom and, more particularly, the United States were pursuing inflationary policies with results that were spilling over abroad and they were not confident that the Fund, with its voting power so largely in the hands of deficit countries, could or would keep world inflation in check.

After vigorous negotiations in which the Managing Director of the Fund refused to allow his organization to be stripped of its ultimate authority, a compromise arrangement was worked out. The ten countries agreed that they would lend to the Fund on a collective rather than an individual basis. Hence emerged the Group of Ten or G10 (which, as we shall see below, undertook other tasks as well as the management of the General Arrangements to Borrow). The basic loan arrangements under the GAB were to be made through the IMF but there was a significant provision in which the Fund had no part. This was embodied in an agreed letter from the first chairman of the Group of Ten, the French Minister of Finance, to each of the other participants.[12] Under this provision the GAB could not be activated unless the initiative came from a would-be borrower and unless approval was forthcoming from a two-thirds majority of the lenders providing three-fifths of the total commitment. This arrangement not only took supervisory authority away from the Fund but it also gave a veto to the participating EEC countries.

This was the first but not the last of the EEC vetoes to be included in international financial arrangements. It reflected growing apprehension regarding the international financial effects of successive U.S. deficits. These effects were seen to be in part economic: the inflationary influence in Europe and elsewhere of the inflow of U.S. dollars and the accumulation of U.S. dollar reserves. They were also seen as political: the inflow of American direct investment, most of it through the medium of multinational corporations, bringing a concomitant increase in U.S. ownership and control in Europe.

When setting up G 10 the participants agreed that, for economic analysis and advice, they would use the services of WP 3, an OECD body. The countries represented on G 10 were virtually the same as those on WP 3. While formal meetings of G 10 took place at the Ministerial level, the more routine meetings and active discussions took place at the Deputy (senior official) level, and the persons in attendance were virtually the same as those attending WP 3 meetings. A close working relationship grew up among the senior representatives of treasuries and central banks who attended them. On the other hand this very development in some measure detracted from the influence and authority of the Executive Directors and staff of the IMF. WP 3 provided for just the sort of meetings between senior financial officials from capitals which the British and Canadians, at the time of Bretton Woods, had hoped would take place in the Executive Board of the IMF and would strengthen its international influence.

Moving forward into 1962, two developments deserve to be mentioned. The first was the formalization in February of undertakings of "swaps" between central banks. (A swap between any two central banks consists of an undertaking by each to give credit to the other of a specified amount over a given period.) The new arrangements had been presaged in the Basle Agreement but now Canada was included and the support was specifically directed toward the U.S. dollar. The original central bank undertakings, which were subsequently enlarged from time to time, were: United Kingdom, $500 million; Canada, Germany and Italy, $250 million each; Japan, Switzerland and the Bank for International Settlements, $150 million each; France and the Netherlands, $100 million each; Austria, Belgium and Sweden, $50 million each; for a total of $2,050 million.[13]

The second development of 1962 was the beginning of sales by the United States to the reserve authorities of other countries of the so-called "Roosa bonds," named for the Under Secretary of the Treasury who represented the United States on the WP 3 and on the G 10 Deputies. These short-term obligations of the United States were denominated in the currency of the lender, not in U.S. dollars, and as a result the lender avoided taking a position in terms of U.S. dollars. By means of this device European authorities, whose reserves had hitherto been held almost entirely in the form of gold, were persuaded with greater or less reluctance to absorb additional amounts of the U.S. deficit without drawing on U.S. gold stocks. (Canada has always held a large portion of her reserves in the form of U.S. dollars and thus the question of acquiring Roosa bonds did not arise.)

During 1961 and 1962 the United States was continually urging its partners in WP 3 to take various measures designed to alleviate the imbalance in U.S. international payments and at the same time was taking various measures on its own account. The countries continually or occasionally in surplus were urged to relax or remove their barriers against imports, to remove unnecessary restraints on access by foreign borrowers to their capital markets, to increase their contributions to international aid operations and (in the case of NATO partners) to increase their share in common defence expenditures. Actions taken by the U.S. administration included increased "tying" of U.S. development aid abroad, campaigns to bring European tourists to the United States, a reduction of the duty-free allowance for American tourists returning from abroad and, not least, attempts by monetary action and other means to lessen the relative attractiveness of the U.S. capital market to foreign borrowers. None of the capital markets of the European creditor countries could compete on anything like equal terms with the economy and efficiency of New York in handling foreign borrowings.

There was general agreement in WP 3, as in other international bodies, that in periods of international imbalance, trade and other current account transactions should, if possible, not be restricted and that balance should be sought primarily by control of one sort or another over capital movements. In conformity with this approach the United States launched in 1963 a series of controls designed to limit foreign borrowings in the United States.

The first of these controls was the Interest Equalization Tax announced by President Kennedy in July 1963. In broad terms, this tax was intended to equalize the cost of foreign borrowing from the United States with the cost of borrowing from European markets by adding about one percentage point to the borrowing in the United States. The tax was generally welcomed in WP 3. However, it exerted an impact of unanticipated severity on Canada and to a lesser extent on Japan, countries which, unlike other members of WP 3, were dependent at the time on a large, normal inflow of capital from the New York market.

Unfortunately the Interest Equalization Tax was not much more successful than the various measures that preceded it in righting the U.S. balance of payments. Accordingly, still other measures had to be introduced year after year in the continuing attempt to stem the outflow of capital from the United States. In February 1965 President Johnson announced voluntary guidelines to apply to various types of outward capital movement. In January 1968 the guidelines were extended in coverage and made compulsory. The impact of all these measures on Canada and the Canadian dollar are discussed in detail in chapter 9.

The tightening of the U.S. guidelines in January 1968 came as a result of the very disturbed state of international financial markets in the latter part of 1967. A climax was reached in the ultimate collapse of a long-drawn-out battle to resist a major devaluation of sterling. In this battle various international and national authorities, and particularly the Federal Reserve Bank of New York, had provided massive assistance to the British.[14] When sterling had eventually fallen, speculators turned their attention to the U.S. dollar and the dollar price of gold and also to the Canadian dollar.

As a result of these developments, upward pressures on the price of gold in London became very heavy. Despite sales through the Gold Pool, the price of gold on the London market persistently broke through the ceiling and on 17 March 1968 the Pool was discontinued (France had abandoned it in June 1967). The participating central banks (Belgium, Germany, Italy, the Netherlands, Switzerland, the United Kingdom and the United States) then established what became known as the two-tier gold market.[15] Gold already held by these central banks would continue to be valued at $35 an ounce and could be traded among them at that price, but the price on the London market would be allowed to find its own level on the basis of supply and demand. The gold held by the central banks would be insulated from market influences by the agreement within the group neither to buy from nor to sell to the market nor to sell to any other central bank to replace gold which it had sold to the market. Future increases in world monetary reserves would be supplied, not by an increase in gold holdings, but by Special Drawing Rights for the issue of which arrangements in the International Monetary Fund were by then virtually complete. At the conclusion of their announcement severing the historic link between gold and world reserves in respect of both quantities and price, the participating central banks invited other central banks to collaborate in the arrangements. The following day the Bank of Canada issued a statement that Canada would do so.[16]

By 1968, therefore, traditional links between gold and the world monetary system had in effect, been, broken. Moreover, international transactions involving the U.S. dollar had become hedged about by so many restrictions, formal and informal, relating to payments on both current and capital accounts, that it had become in an important measure inconvertible. Currency inconvertibility had crossed the Atlantic. In the meanwhile, however, a search had begun for a new international reserve asset which might in some way, in some degree, at some time, take the place of gold or the dollar or both.

Toward a New Reserve Asset: the SDR

In 1963 two official studies of world liquidity had been inaugurated. The United States proposed that a study should be conducted by the Group of Ten, and the Executive Directors of the IMF decided to conduct a parallel study.[17]

Such studies seemed timely for several reasons. Additions to world reserves of gold were falling farther and farther short of the rate of growth of world trade and payments. An increasing proportion of newly mined gold was being bought up by private speculators, and withdrawals from existing monetary reserves, particularly through the activities of the Gold Pool to keep the market price from rising, were causing monetary gold reserves to level off; in due course, they actually declined. Of the gold available for reserves, more and more was moving to Europe; but meanwhile U.S. liabilities, in terms of official reserve balances held in New York, were continuing to rise and the position of the U.S. dollar as a reserve currency was increasingly over-extended. Moreover, the question was raised repeatedly on both sides of the Atlantic as to whether it was wise to allow the level of world reserves to become so heavily dependent upon the balance of payments and, more particularly, upon the international deficits of the United States. An overview of the movements and magnitudes involved is provided in statistical terms in Appendices 2 and 3 of chapter 10.

Throughout the period it was persistently asserted both in G 10 and in the Fund that there was no immediate shortage of world liquidity. It was agreed, however, that there was a real danger that such a shortage could emerge in the future. But there official agreement seemed to end. To the authorities in some countries it seemed increasingly obvious that the world needed a new world reserve asset to supplement or replace either gold or the U.S. dollar or both. Others believed that a judicious increase in the price of gold would bring the required result. But against this view it was argued that a gold price increase would give windfall gains to the main gold reserve holders (big, rich countries) and to the main gold producers (less than popular countries like South Africa and the Soviet Union) and that once one began to juggle with the gold price there could be no end to it. Others claimed that the main task had little or nothing to do with gold; what was needed was a plan to support and stabilize the U.S. dollar. Still others, already observing widespread indications of inflation, favoured the provision, not of additional reserves like gold to be owned outright, but of additional credit facilities like those available through the Fund, which could be issued conditionally upon assurance of responsible behaviour by recipient and which would in due course be repaid and extinguished.

Discussions in G 10 were carried forward at two levels. At the higher level the Ministers and central bank Governors met two or three times a year. At the official level their Deputies met more frequently. In 1963-64, at the outset of the discussions, the U.S. representatives were arguing that support for the dollar along with the liquidity provided by IMF was the best and safest approach to the problem. The French, with considerable support from other Europeans, argued for a new reserve asset (the Composite Reserve Unit or CRU). In the view of the French and some other EEC members, such an asset would not merely provide for any necessary increases in world reserves but could progressively displace the U.S. dollar as a reserve currency and thus check the persistent spread of the world banking activities of the United States and dollar-induced world inflation.

This particular confrontation between the United States and France was broken by General de Gaulle who, unexpectedly taking an active interest in the political possibilities of the negotiation, proposed that the best way of providing for additional world reserves while curtailing American financial expansion was to increase the price of gold with the proviso that the United States should use at least part of the profit on its revalued gold reserves to repay U.S. obligations to holders of reserve balances in New York.

By 1966 the Americans, with a new team in charge at the Treasury and in the light of deteriorating elements in the world reserve situation, had come to the conclusion that, after all, a new world reserve asset was required. Since the French proposals for revaluing gold had attracted no support, the Group of Ten, many of whom had favoured a new reserve asset from the beginning, then turned its attention to such questions as which countries should receive a newly issued reserve asset and which countries should control its issuance. Early in the discussions several members of the Group of Ten had held the opinion that they would best serve and protect the world's interests if they themselves, with their collective financial weight and experience, were both to issue and to hold the new asset.

Against any such exclusive arrangement there was an outraged outcry from the many Fund members who did not enjoy membership in the Group of Ten. In due course it was agreed that there should be joint meetings between the Deputies of G 10 and the IMF Executive Directors. Four such meetings were held. They proved to be unexpectedly harmonious and constructive and the IMF staff members gladly undertook to draft specific proposals.

Nevertheless, basic issues still had to be resolved in the more restricted framework of G 10 between the representatives of major countries, particularly the Americans and the French. As the negotiations drew toward a close the Americans were espousing the original French proposal of a new world reserve asset while the French, with characteristic and compelling logic, were upholding the original American recommendation that what was really needed was not a new reserve asset at all but only conditional, repayable credits issued through the IMF.

Despite changing national positions and despite some membership changes, the G 10 Deputies worked together purposefully in their search for the basic attributes that would prove acceptable in a new international reserve asset. The following notes record a conversation with two of the Canadians who had been directly involved over most of the period:

> The official group developed a strong esprit de corps and, while the discussion took place against a background of national guidelines and objectives, it was very wide-ranging and for a good deal of the time personal rather than official. The Canadians along with others were active in trying out ideas and proposing compromises and they did a good deal of homework between meetings.

It is true that the main issues were raised between the United States and France; on the other hand it would be a mistake to suggest that the contribution of the rest was of limited value. As an example the role of Ossola (of Italy) was mentioned; moreover the role of Emminger (of Germany) was far more important than acting as a mere intermediary between the Americans and the French; he made a particularly important contribution in his own right.[18]

In due course, at their annual meeting in Rio de Janeiro in September 1967, the Governors of the International Monetary Fund were able to approve a proposal that the IMF should create and issue a new reserve asset: "Special Drawing Rights" or SDRs for short.[19] Every member of the Fund may participate but is not obliged to do so. SDRs are issued to participants in proportion to their quotas in the Fund; they may be held as reserves or utilized for balance of payments purposes. When a participant wishes to dispose of SDRs and obtain convertible currency (for example, U.S. dollars) to meet a balance-of-payments deficit it will notify the Fund, which will designate some other participant to accept them. However, no participant is obliged to accept additional SDRs if its holdings have already reached a level of three times the total issued to it (minus cancellations). Originally the value of the SDR was fixed in terms of gold at a valuation equal to that of the U.S. dollar, but since 1974 its value has been determined on the basis of the average value of sixteen major currencies. Interest at a rate that is altered from time to time, originally 1½ per cent, is charged on all allocations and is paid on all holdings, thus if a participant, after receipt of an allocation, neither increases nor decreases its holdings, it neither pays nor receives interest on balance. If a participant, on the average over a five-year period, is tending to utilize more than 70 per cent of its allocations, it is required to reconstitute its holdings to an average level of 30 per cent. In order to guard against inflationary issues of SDRs, the decision to initiate an issue is protected by safeguards. Initially there must be a favourable finding by the Managing Director of the IMF. This must then be approved both by the Executive Board and also by Governors having an 85 per cent majority of the total voting power.

The final result of the long negotiations that produced the

SDR was, inevitably something of a compromise. Ultimate power to turn the tap on and off remains with the major powers in G 10; on the other hand, SDRs are held by all participating members of the Fund and the system is conducted by the Fund separately from but in close conjunction with its regular operations.

By 1969 all the necessary procedures, national and international, for launching the SDR had been completed. Moreover, a decision had been taken, basically in the Group of Ten but subsequently confirmed by the IMF Executive Directors and Governors, that the issuance of SDRs would begin in 1970, that it would run for a trial period of three years, and that the amounts to be issued would be \$3.5 billion in 1970, \$3.0 billion in 1971, and \$3.0 billion in 1972 for a total of \$9.5 billion. On 1 January 1970 each of the participating members of the International Monetary Fund duly received an allocation of the new reserve asset. However, by the time the trial period had run its course there had been a great upheaval in the international monetary system. The nature and course of that upheaval, and the place of the SDR in it, are dealt with in chapter 10 below.

Canada's Position

Before leaving the subject of international liquidity and the new reserve asset the official Canadian attitudes should be recorded. Canadian Finance ministers, speaking as Governors for Canada at the Annual Meetings of the International Monetary Fund, made successive statements regarding the Canadian position. As early as 1958 Canada was expressing an expansionist attitude; Donald Fleming stated: "We shall be prepared to give our warm support to a general increase of Fund quotas of at least 50 per cent."[20] In 1963 Walter Gordon welcomed the proposed world liquidity study in the IMF and referred in this connection to the exchange crises that had confronted the Canadian dollar in 1962 and 1963.[21] In 1964, commenting on the general increase of 25 per cent in IMF quotas then in process, he said he "would have preferred a higher figure. . . . A general shortage of liquidity, attended by unduly high interest rates and unnecessary trade barriers, can be a drag on the objectives of high employment and economic growth which we all share."[22]

In 1965 Gordon made a fuller statement on the Canadian position, which may be summarized as follows. Canada has maintained on open mind about the international monetary system, realizing that any real solution must carry the support of all the major holders of reserves. Gold will, no doubt, continue to be the prime international reserve asset, but a return to a standard which linked gold to the volume of money would be a retrograde move, completely out of step with present-day reality. The role of reserve currencies such as the U.S. dollar must be recognized. Nevertheless, world liquidity has depended too heavily on the balances of payments of reserve currency countries. Deliberate management might well be facilitated if a new asset were to be agreed upon. The decision-making process must in some way be associated with the IMF. In this connection coordination of efforts of Executive Directors of the Fund and Deputies of G 10 would be desirable.[23]

In 1966 Mitchell Sharp welcomed the proposal for joint IMF-G 10 meetings and added that, having recently been chairman of a meeting of Commonwealth Finance Ministers in Montreal, "I have the impression that there is a wide measure of agreement... that the new arrangements should be closely associated with the International Monetary Fund."[24] The following year, commenting on the SDR proposals which were now before the IMF Governors, he was able to make a summary statement of the Canadian position, which was on the whole warmly favourable. The Governor of the Bank of Canada also expressed approval in his annual report for the year 1966.

In 1968, after expressing appreciation for IMF financial support in the Canadian dollar emergency earlier that year, Edgar Benson undertook to seek parliamentary approval for legislation to implement the SDR decision.[25] In 1969, referring to the proposal to activate the SDR machinery, Benson added: "I am much heartened by the evidence that the proposal will be overwhelmingly approved: I am even more impressed by the fact that we have committed ourselves for the future to the cooperative management of world reserves."[26]

In detailed discussions at the official level both in G 10 and in the IMF Canada's influence was directed toward a number of special objectives. Canadians were generally of the view that a new world asset was needed which would, over time, displace gold as the primary international reserve and also replace the increasingly unwarranted extension of the U.S. dollar as a reserve currency. The new asset should be issued by the Fund, not by a limited group such as G 10, and all Fund members should be eligible to receive and hold it.[27] Canadians pressed the view that the new asset should be attractive to holders in its own right, particularly in regard to the rate of interest; the initial rate of 1½ per cent seemed, despite the gold guarantee attaching to SDRs, unduly low in relation to short-term money rates in the main financial centres at the time. As far as possible SDRs, like other reserve assets, should move readily from one holder to another; representatives of some other countries, on the other hand, were disposed to introduce rules about receiving it, holding it and disposing of it. Canadians particularly resisted lingering French attempts to produce a system providing for loans subject to reconstitution rather than for assets that were owned outright.[28]

Another contribution of the Canadians lay in helping to promote collaboration between the Group of Ten and the Fund Executive Directors. In 1961 Canada's Executive Director (at that time the present writer) became one of the original members of both WP 3 and G 10. Canadians were also active in attempting to ensure effective participation by the developing countries. The rather special relationship that emerged between Canada and the developing countries is described in chapter 11 below.

NOTES

1 See the analysis and forecast of the U.S. position prepared on behalf of President Kennedy's Council of Economic Advisers by Walter S. Salant and Associates, *The United States Balance of Payments in 1968* (Washington D.C.: The Brookings Institution, 1963).

2 *Ibid.*, p. 11.

3 The special position of Canada is reviewed in chapter 10 below.

4 *IMF History* Vol. I, p. 484.

5 Senator Kennedy's speech is reproduced in Robert V. Roosa, *The Dollar and World Liquidity* (New York: Random House, 1967), pp. 265-70.

6 *IMF History*, Vol. I., pp. 483-84. The Bank of Canada was not a member of the BIS and was not involved in these arrangements at that time. The Bank became a member of the BIS in 1970. See Bank of Canada, *Report for 1969*, p. 16.

7 An account of these initiatives has been provided by the official most directly involved, Robert Roosa, in *The Dollar and World Liquidity*, pp. 26-32.

8 The foregoing description is taken from the only study by WP 3 ever to be published, *The Balance of Payments Adjustment Process* (Paris: OECD, 1966), p. 8. The chairman of the group which produced this study was R. W. Lawson, a Deputy Governor of the Bank of Canada.

9 One of the very few academic attempts to examine and appraise the operations and accomplishments associated with WP 3 and with the bodies with which it has interacted, including the Group of 10, the BIS and the Monetary Committee of the EEC, has been published by Robert W. Russell, "Transgovernmental Interaction in the International Monetary System, 1960-1972," *International Organization*, Vol. XXVII (Autumn 1973), pp. 431-63. Unfortunately this treatment, in its attempt to be strictly mathematical, becomes rather clinical and sterile.

10 *IMF History*, Vol. I, p. 485. See also Roosa, *The Dollar and World Liquidity*, p. 30.

11 IMF Agreement Article VII, 2 (i). For the Canadian proposal see *IMF History*, Vol. III, *Documents*, pp. 109-10.

12 The text of the General Arrangements to Borrow and of the letters sent by the French Minister of Finance to the other Ministers, and the subsequent arrangements with Switzerland, are contained in the *IMF History*, Vol. III, *Documents*, pp. 246-55.

13 *IMF History*, Vol. I, p. 484.

14 A fascinating account of these efforts was provided by John Brooks, "Annals of Finance, In Defence of Sterling," *The New Yorker*, 23 March 1968, pp. 44-96 and 30 March 1968, pp. 43-101.

15 *IMF History*, Vol. I, p. 614.

16 House of Commons, *Debates*, 18 March 1968, pp. 7711-12 and 7781-82.

17 *IMF History*, Vol. I, pp. 543-44. Also Roosa, *The Dollar and World Liquidity*, pp. 35-36.

18 The material in these two paragraphs is based on a discussion with William Lawson of the Bank of Canada and Alan Hockin, formerly of the Department of Finance, who replaced the present writer on WP 3 and G10 Deputies in 1965. See also the account of G 10 negotiations in Stephen D. Cohen, *International Monetary Reform, 1964-69, The Political Dimension* (New York: Praeger Publishers, 1970). As a former member of the staff of the U.S. Treasury, Cohen appears to have had access to material relating not only to the positions taken by the U.S. authorities but also to those taken by others. In regard to the shifts in French policies and personalities, see also Henrik and Michele Schmieglow, "The New Mercantilism in International Relations, the Case of France's External Monetary Policy," *International Organization* Vol. XXIX, No. 2 (Spring 1975), pp. 367-91.

19 The full text, along with associated changes in the existing Articles of Agreement, is provided in the *IMF History*, Vol. III, pp. 497-541. A convenient summary is provided in Vol. I, pp. 605-7.

20 International Monetary Fund, *Summary Proceedings*, Annual Meeting 1958, Washington, D.C., p. 75.

21 *Ibid.*, 1963, pp. 84-86.

22 *Ibid.*, 1964, pp. 74-75.

23 *Ibid.*, 1965, pp. 55-57.

24 *Ibid.*, 1966, pp. 33-34.

25 *Ibid.*, 1968, pp. 43-44.

26 *Ibid.*, 1969, p. 77.

27 Bank of Canada, *Report of the Governor for 1966*, pp. 12-13.

28 It is thus ironic (if true) that, according to Cohen (*International Monetary Reform*, p. 140), the Canadians should have been asked to propose the ultimate "reconstitution" compromise. If they did so it was as part of the general desire to get on with the job.

9

A Fixed Rate Revisited 1962 – 70

Introduction

The preceding chapter reviewed the development of world financial imbalance in the 1960s from the point of view of international organizations in which Canada participated. This chapter reviews the same period but from the more detailed viewpoint of the management of day-to-day affairs in Ottawa. Specifically, it is concerned with the defence of the new 92½-cent par value of the Canadian dollar in the face of disturbances which, while they originated in the world imbalance, reached Canada chiefly as a result of successive efforts of the U.S. authorities to defend the U.S. dollar.

In adopting measures to strengthen the position of the dollar the U.S. authorities were primarily concerned with the new imbalance between the United States and Europe and the measures they took were for the most part directed toward the reduction of capital exports from the United States. But the nature of American capital exports to Canada were different from American capital exports to Europe in three respects. First, Canada was still in a measure a developing country dependent on large and continuing capital imports. Second, since Canada's abandonment of foreign exchange controls in 1951 the Canadian and American capital markets had become so highly integrated as to be virtually a single market. This North American market was separated from European capital markets both by the official controls, formal and informal, which all European countries exercised and also by significant differences in financial practices and financial attitudes. (These differences were considerably less by the end of the 1960s than they were at the beginning.) And third, the extent and complexity of economic interrelationships between Canada and the United States far exceeded those between the United States and Europe.

As a result of these differences measures taken by the U.S. authorities to restore balance with Europe tended to produce imbalance with Canada. For Europeans, anxious that their balance should be rectified, it did not matter if U.S. capital exports became less reliable and more expensive; indeed they were disposed to welcome such developments. But for Canada it mattered a great deal. As a result there were almost constant discussions and negotiations between the financial authorities of the two countries. These led for the most part to compromise arrangements, completely satisfactory to neither side but acceptable to both.

We pick up the story of Canadian financial policy where we left it in chapter 7 – that is to say, in the latter part of 1962 following the establishment of the new 92½-cent par value for the Canadian dollar in May and the support operation in June.

By April 1963, when a minority Liberal government under Pearson succeeded a minority Conservative government under Diefenbaker, the 92½-cent Canadian dollar was well established. Its emergency supports had been almost completely dismantled. Tariff surcharges of 5 to 15 per cent on a wide range of imports had been removed in stages on 31 August and on 17 October 1962, and finally on 1 April 1963. The emergency line of credit of $400 million at the U.S. Export-Import Bank had been terminated; it had been partially replaced before the end of 1962 by a security issue of $250 million placed with five U.S. financial houses. By the end of 1962 the currency arrangements with the Bank of England and the U.S. Federal Reserve System had also been discontinued. The borrowing of $300 million from the International Monetary Fund remained outstanding; it was reduced in 1963 and extinguished early in 1964.

With the return of confidence in the Canadian dollar the Bank of Canada was able to resume the expansionary credit policy which the new governor had pursued when he took office in 1961. This policy had been temporarily reversed during the financial crisis of 1962 when the Bank's official lending rate had been raised sharply to 6 per cent. Subsequently, as the situation eased during 1963, the rate had been reduced, step by step, until it stood at 3½ per cent in May. By this time funds which had left the country during the first half of 1962 had for some months been flowing back and the New York market was once again receptive to Canadian security issues. On 1 May 1963 the government of Quebec was able to announce the successful placement of an issue of $300 million in New York which was not only unusually large but which was also for a purpose – the nationalization of privately owned utility companies – of which New York financiers do not always readily approve.

The first of the major U.S. measures to limit capital exports was introduced in July. But in June there was an episode of Canadian origin which affected Canada – U.S. financial relationships and which should be briefly reviewed.

The Budget of 1963

On 13 June 1963 the new Minister of Finance, Walter Gordon, presented the Canadian Parliament for the first time since early in the 1930s with a budget with strongly nationalist elements; but while the budgets of the 1930s were nationalist in terms of protection against commodity imports, that of 1963 was nationalist in terms of protection against capital imports involving Canada's continuing loss of ownership and control of Canadian industry and Canadian resources.[1]

Three important tax measures were designed to serve these purposes. First and foremost was the takeover tax, a levy of 30 per cent on sales by residents to non-residents of the greater part of the shares or the property of companies listed on Canadian stock exchanges. Next, the withholding tax on dividends paid to non-residents, which had stood at 15 per cent since December 1960, was split: the rate was to be lowered to 10 per cent for companies which were owned to the extent of at least 25 per cent by Canadians but it was to be raised to 20 per cent for companies which, within a period of eighteen months, did not achieve that level of Canadian ownership (including, of course, subsidiaries that were wholly owned abroad). Finally, as one of a number of measures designed to encourage employment, companies having the requisite minimum of 25 per cent of Canadian ownership were permitted, for tax purposes, a more rapid rate of capital write-off on new machinery and equipment than companies failing to achieve that level.

The budget was controversial on many counts, indeed deliberately so. Prior to its presentation there was controversy between the permanent officials of the Department of Finance and three special advisors whom the Minister brought to Ottawa from financial and academic circles. After its presentation there was controversy in Parliament and the press, partly over the nationalist tax measures but chiefly over the irregular use of outside experts in its preparation. In the succeeding weeks a number of the budget proposals were modified and the takeover tax was withdrawn. During this period the Minister offered his resignation, but it was not accepted.[2]

The most publicized of the nationalist elements in the budget was the 30 per cent takeover tax. It ran into heavy opposition in financial circles at home and abroad; would-be Canadian sellers of companies were as much opposed to it as would-be non-resident buyers. Moreover, technical difficulties loomed in connection with the application and administration of the measure: difficulties of distinguishing between the real owners and legal intermediaries, difficulties of dealing with sales that did not pass through Canadian stock exchanges, and so forth. What precipitated its withdrawal was a wave of selling on the Montreal Stock Exchange which had been particularly active in its opposition. The measure was withdrawn six days after it had been presented to Parliament.[3]

It is possible that the opposition of the U.S. authorities might have concentrated on the takeover tax if it had not been withdrawn. It is equally likely, however, that they would in any case have been chiefly concerned with the other two measures, because they both involved discrimination by Canada between one company and another depending on the location of its ownership. The U.S. authorities, alert to protect the interests of American investors, have always been particularly sensitive to such discrimination. While the two discriminatory measures were not withdrawn they were altered by supplementary measures introduced by the Minister into the House of Commons on 9 July.[4] The definition of the specified degree of Canada ownership was modified. This modification, responding to representations received from various quarters including the U.S. government, simplified the operation of the proposed tax; it also reduced the range of Canadian companies to which the rapid capital write-off and the increased rate of withholding tax (20 per cent) would apply.

A further modification was introduced in the next budget in March 1964. The prospective increase in the rate of withholding tax to 20 per cent was abandoned, leaving the tax at 15 per cent in respect of dividends paid by subsidiaries with non-resident ownership that exceeded the specified degree. This modification was influenced by difficulties anticipated in persuading the United States to accept the necessary amendment to the Canada – U.S. Tax Treaty and was facilitated by a reduction in the rates of corporation income tax in the United States which lowered the amount of credit allowed in the United States for Canadian non-resident withholding taxes. However, it was also responsive to representations that had been received from Washington as well as from Canadian sources.

In the end, therefore, some elements of discrimination did remain, but not the most substantial ones. It was not until ten years later that a Canadian government again initiated general legislation relating to foreign ownership and control.[5] In the meanwhile, the matter was widely discussed and debated; it remained a matter of contention, not merely across the country, but also within the Canadian government itself.

The U.S. Interest Equalization Tax of 1963

The U.S. Interest Equalization Tax (IET) was announced on 18 July 1963. The impact on Canada – U.S. financial and political relationships was immediate. In order to see that impact in perspective it is necessary briefly to review the background.

In discussions of the growing problems of the U.S. dollar (which were described in chapter 8) attention focused on losses and impairment of U.S. gold reserves. In 1963 gold was continuing to flow to Europe and the remaining reserves were increasingly impaired by the growth of U.S. liabilities to foreigners.

Until two years previously Canada had not been a significant factor in this situation. During the period of the freely floating Canadian dollar, from 1950 to 1961, Canadian reserves had remained virtually unchanged around a level of $1.9 billion; pressures on the Canadian balance of payments, current or capital, were almost entirely absorbed and adjusted by alterations in the exchange rate. If that rate had altered radically the U.S. authorities would no doubt have been concerned, but actually it remained remarkably stable. Therefore as the early clouds gathered over the U.S. dollar American worries on behalf of their balance-of-payments position with Canada were minimal. To use a phrase that was employed later in a different situation, the U.S. financial authorities could afford to view the Canadian relationship "with benign neglect."

The nature of the relationship altered in May 1962 when the Canadian dollar was once again pegged and Canadian reserves were no longer to be used merely to tend a floating exchange rate but instead to defend a fixed rate against possible depreciation. In the weeks following the new peg Canadian reserves were indeed deployed very heavily to defend the new U.S. 92½-cent rate. On that occasion additional support was readily forthcoming from the U.S. authorities, partly in the interest of general stability and in support of the IMF system, and partly because the new rate at which Canada had in fact pegged the dollar was already low in terms of competitive Canada – U.S. commercial relationships.

But by the beginning of 1963, as explained above, the new Canadian rate was firmly established and generally accepted. Capital which had left the country or hesitated to enter it during the previous year was now flowing in. Unfortunately, this abnormal capital movement into Canada appeared to form an important part of the continuing outflow from the United States against which the U.S. administration was formulating the plans which materialized in the Interest Equalization Tax. Moreover Canadian reserves, which had fluctuated around a level of U.S. $1.9 billion during the float and fallen as a result of the financial crisis in May 1962 to U.S. $1.5 billion, had risen by more than a billion dollars to U.S. $2.7 billion by the early months of 1963 (see Reference Table 13). In Canadian terms, as explained in the annual report of the Bank of Canada for 1962, there was good reason for this increase. The defence of a fixed rate would require more reserves than the tending of a floating rate and Canada's international payments had grown greatly since the reserve level of about $2 billion had been established shortly after the war. However, it seems possible that Washington officials, wrestling with U.S. payments problems, were not fully aware of these peculiarly Canadian considerations.

Early in July 1963, at a regular meeting in Paris of Working Party 3 (WP 3) of the OECD during which the United States was as usual under pressure from Europe to restrict its capital exports and generally to bring its international payments into better shape, the U.S. representatives stated that extensive remedial action including the involvement of Congress could be expected later in the month. Canada had been affected in some degree but not vitally by previous U.S. measures to reduce their international deficit and the Canadian representatives at the meeting saw no reason to expect any special change in this regard. They turned out to be wrong.

When the new U.S. program was announced at noon on Thursday 18 July there was a very important feature of it which affected Canada more immediately and more extensively than any other country. This, of course, was the proposed Interest Equalization Tax. Its purpose was to limit the outflow of longer-term capital from the United States by imposing a tax which would, broadly speaking, equalize the cost of raising long-term funds in the United States with the costs in Europe; it was designed to add approximately one percentage point to the cost to foreigners of raising funds in the United States and to place a comparable deterrent (a 15 per cent ad valorem tax) on U.S. purchases of securities from abroad. The tax was to apply to U.S. purchases not only of new issues of securities but also of outstanding issues. Such a tax measure would, of course, have to be enacted in due course by Congress but the administration would impose it immediately on a provisional basis.[6]

The reaction of Canadian financial markets was immediate; indeed, on the basis of a Washington leak unusual activity began soon after the stock exchanges had opened for business that morning. It affected the markets for bonds, for stocks, and for foreign exchange with a severity which intensified during the following day (Friday).

When, on Saturday morning 20 July, the Canadian authorities reviewed the events of the past two days it was clear that, whatever might have been the purposes of the U.S. action, the results in Canada were disastrous both in their economic impact and in terms of policy statements which the Minister of Finance, Walter Gordon, had made in his budget speech of 13 June.[7] The drop in security prices was sharply reversing the expansionist financial policy that had been pursued by the Bank of Canada and had been endorsed by the Minister; the loss of foreign exchange on Friday had exceeded the loss on any day during the 1962 crisis and clearly threatened Gordon's intention "to maintain the fixed exchange rate at its present level"; and the restoration of confidence in the Canadian financial structure, which he had stressed as a government objective but which had been shaken even at that time by his tax proposals, was now being shattered. Moreover it was difficult, at least from Ottawa, to discern what advantage there could possibly be to Washington in precipitating a new Canadian crisis; the results seemed clearly harmful, not helpful, to the United States. Accordingly, it was decided that a group should immediately go to explain the situation to the U.S. Treasury directly, rather than through diplomatic channels which had already been tried the previous day, and to propose a complete exemption for Canada from the new tax. The Ottawa group (L. Rasminsky, Bank of Canada, A. E. Ritchie, External Affairs, and the present writer, Finance) arrived in Washington soon after midday Saturday and went directly to the Treasury. Time was of the essence; some sort of announcement had to be made before the Canadian security markets and the Canada – U.S. exchange market opened on Monday morning.

During the discussion in Washington the chief Canadian spokesman was Louis Rasminsky.[8] At the outset the U.S. representatives expressed surprise at the extreme reaction of Canadian financial markets to the tax proposal. Rasminsky began by agreeing that it was very severe but not, in his opinion, unduly so considering that an essential source of support had been suddenly removed from the Canadian exchange and security markets. Disruption would continue unless and until there was reassurance regarding renewed capital inflow. Nor was it realistic to think that a renewed capital inflow could be induced by action on the Canadian side (that is, by a contraction of domestic credit conditions and an increase of interest rates); such action was unacceptable in Canada in both economic and political terms. The situation admitted of only two possibilities: either the United States would permit the resumption of capital movement to Canada without the new tax obstruction or else Canada would be unable to pay for imports of goods and services from the United States at the existing level and would be obliged to take steps of one sort or another to reduce them. It was surely in the interests of the United States to maintain the outflow of capital and, at the same time, the outflow of goods and services which it supported.

It was a mistake, he argued, to consider that the normal flow of capital to Canada, large though it might be, constituted a drain on the U.S. balance of payments. On the contrary, it only partially covered Canada's bilateral deficit with the United States. The remaining part was covered out of payments to the United States from Canada's earnings overseas. Because of these payments Canadian international transactions were, on balance, a source of strength, not weakness, to the U.S. position. (Canada's international accounts, set out in a way that illustrates this position, may be seen in Reference Table No. 12.)

Above and beyond this, Canada had tried in various ways to be helpful to the United States in its balance-of-payments difficulties. Canadian reserve policy had been altered at U.S. request so as to acquire some $300 million in the form of non-negotiable U.S. securities of a type which would not impair U.S. reserves as represented in their official statistics. Further, since May 1962 Canada had taken all reserve increases in the form of U.S. dollar assets, or newly mined Canadian gold, allowing the proportion of gold in its reserves to decline from about one-half to scarcely more than one-quarter; Canada had refrained from drawing gold from U.S. reserves. As for interest rate differentials, it had been necessary to maintain spreads wider than usual during and immediately after the Canadian financial crisis of 1962 but in recent months, and particularly since Canadian reserves had reached a satisfactory level early in 1963, it had been possible to bring the relationship back to normal. Canada had no desire to raise capital in the United States beyond what was required to cover the current account deficit. The abnormal inflow had already ceased.[9]

Presentation of the Canadian case was followed by an exploratory discussion. Questions were raised as to how far Canadian borrowings on the U.S. market were really responsive to the spread of interest rates between the two countries and how far they were determined by special features, such as the breadth and depth of the U.S. market which was able to accommodate very large offerings like the Quebec issue (which had, in fact, caught the eye of President Kennedy). The nature of the capital movement to Canada in the first half of 1963 was also examined and further assurances were given, based on up-to-date information, that exceptional factors had ceased to operate. Rasminsky stated that Canadian financial policy was now directed towards an inflow of capital from the United States no more than sufficient to cover Canada's net deficit; further accumulation of reserves had ceased to be an objective.

In response to questions about the possibility that Canada, if granted an exemption, would become a "pass-through" for U.S. funds destined for overseas, Rasminsky said that, if so requested by the Canadian authorities, Canadian underwriters would not offer issues in Canada on behalf of foreigners. If Canada was exempted from the proposed tax the Canadian government would be advised to announce that the arrangement was based on an understanding that Canada would not be used to circumvent the U.S. objectives.

Next morning the U.S. representatives opened the discussion with the news that the President had been consulted by telephone and had agreed to propose to Congress that the legislation should include provision for the President to grant some form of exemption which might be available to Canada and possibly other countries. They went on to say that, although they themselves might accept Canadian intentions regarding further reserve accumulation and the pass-through situation, Congress would insist on the maintenance of some element of control by the U.S. authorities. They suggested a quota for taxfree issues of Canadian securities in the United States of (say) $500 millions per year, Canada to make its own decisions as to what borrowers would have access to the quota. The Canadians, while grateful for this proposal, said that the federal government was not in a position to ration borrowings in New York, particularly among the provinces; moreover, the very existence of a quota limitation would reopen market uncertainties. Rasminsky returned, in the end successfully, to his statements of the preceding day regarding Canada's reserve objectives and Canada's willingness to prevent a pass-through trade from developing.

Almost all the discussion had related to an exemption for new issues of Canadian securities in the United States. When an acceptable agreement had been reached on that matter, Canadians urged that the exemption should also cover dealings in outstanding securities. However, the U.S. representatives were adamant on this point and, since both sides were agreed that the amounts involved were far smaller than those involved in new issues, the Canadians decided to leave well enough alone.[10]

By six o'clock Sunday evening Gordon, who had kept in close touch by telephone with his emissaries in Washington, was able to announce success. (The terms of the agreed press statement are in Appendix 1 on p. 232). On Monday morning the announcement of the promised exemption proved successful in turning the markets around; the immediate crisis was over. However, Congress had still to pass the legislation, including the provision for exemption, and President Johnson, who had by then succeeded President Kennedy, had still to grant the exemption. These uncertainties continued to becloud Canadian financial markets.[11] The legislation including provision for exemption was finally given the force of law in September 1964. Meanwhile, however, the Canadian balance of payments received welcome support in the form of large wheat and flour sales to the Soviet Union. The current account deficit was thus reduced along with dependence on capital inflow from the United States.

As for the pass-through possibility, the necessary explanations were made to the few Canadian security houses that might have undertaken the issuance of foreign securities. On the few occasions when such an opportunity was offered they desisted on the basis of advice from Ottawa. The U.S. authorities never requested an announcement, either at the time or later, and none was made but the existence of the policy was well known in financial circles.[12]

At the next meeting of WP 3 the new U.S. program came up for review, along with the major exemption for Canada and a minor one for Japan; the Europeans were critical of these apparent gaps created in the U.S. defences against capital exports and, in particular, of their discriminatory nature. The Americans, however, were not persuaded to alter their arrangements and European objections subsided.

The final sentence of the joint Canada – U.S. announcement stated "that active consultations would continue." A joint Balance of Payments Committee was set up with senior Treasury representatives constituting the chairmen and other members drawn from departments and agencies of the two governments concerned with Canada – U.S. balance-of-payments issues. A subcommittee was directed to explain a wide divergence in the balance-of-payments statistics of the two countries, a task that was not fully discharged until 1974, by which time the discrepancies emerging in relation to the auto pact arrangements had run beyond acceptability on either side (see Appendix 2 at the end of this chapter). The main committee maintained a continuing surveillance over substantive balance-of-payments movements and over the level of Canadian reserves. The two chairmen used the occasions of the committee meetings to review financial policy developments.[13]

The Reserve Ceiling and the U.S. Guidelines, 1963 – 68

In the joint release "the Canadian authorities stated it would not be the desire or intention of Canada to increase her foreign exchange reserves through the proceeds of borrowings in the United States, and it is the hope and expectation of both governments that by maintaining close consultation it will prove possible in practice to have an unlimited exemption for Canada without adverse effect on the United States." In the course of the subsequent consultations it soon became clear that the U.S. officials considered it necessary to interpret this statement strictly, in terms of a specific ceiling on the level of Canadian reserves. This was not the first time that a U.S. administration had taken such an interest in the level of Canada's reserves (see chapter 3, pp. 66-67 above) and on both occasions the fact that the actual reserve level from time to time bumped against or penetrated the ceiling became a source of difficulty.

At the end of June 1963 just before the IET announcement, Canadian reserves stood at $2.7 billion. Accordingly, for IET purposes, this was considered to be the ceiling – or the target as some Canadians preferred to call it. The reserves remained slightly below that level until the end of 1965 (apart from the month of November 1964 when they touched $2.74 billion). From January 1966 until November 1968, after which the arrangement was terminated, the reserves were frequently just above the ceiling but they never reached $3 billion.[14]

Canada's performance in relation to the ceiling thus did not turn out too badly, but it took a good deal of detailed management on the part of the Canadian financial authorities to produce this result. The management took a variety of forms depending on the circumstances. Initially payments from the United States under certain treaty arrangements were reinvested in that country instead of being transferred to Canada. On at least two occasions provincial governments that had placed security issues in the United States were asked to defer bringing the proceeds into Canada lest they cause a bulge in the reserve level. In 1965 the Canadian government began to use up reserves by repurchasing most of the $250 million bond issue that had been sold in New York in the fall of 1962. When no more of that issue was available a portion of the Canadian reserves was shifted out of short-term obligations of the U.S. government (which appeared as U.S. liabilities in their balance-of-payments statistics) and into securities of the World Bank (which did not).[15] Before each of these expedients was put into effect there were discussions with the U.S. authorities to ensure that, if necessary, it could be satisfactorily explained to Congress.

Despite all such measures, however, the reserves continued at or slightly above the ceiling in the latter part of the period. This resulted on one or two occasions in central bank operations being more permissive or less restrictive than they might otherwise have been. This effect was probably most clearly identifiable during 1965 when economic conditions were buoyant and unemployment fell toward 3 per cent. At that time some extra restraint, fiscal as well as monetary, could have been in order to avoid over-heating in the economy. The Governor of the Bank of Canada offered the following guarded comment in his annual report:

> I believe that the July 1963 agreement worked well. It provided us with the access to the U.S. capital market that we

needed to cover our current account deficit. Though we naturally had to take the agreement regarding reserves into account, we were able to pursue a monetary policy which in its broad lines was appropriate to the requirements of our domestic situation as it developed.[16]

The limitation, actual or apprehended, which the reserve ceiling imposed on Canadian monetary operations could be accepted, along with the advantages associated with the undertaking, as long as the benefits appeared to exceed the costs. The time arrived, however, when it constituted a serious impediment to policy. Reporting on financial developments during 1968 the Governor stated:

> As reserves recovered during the summer and autumn from the low level reached during the crisis of the first quarter, increasing concern was expressed in Canada that the flexibility of Canadian monetary policy was in danger of being severely limited by the existence of a "target" level for Canadian reserves under our agreement with the United States.[17]

Fortunately, circumstances were such at that time as to make it possible to discontinue the ceiling arrangement. To explain how this came about we must examine the U.S. guideline program and its impact on Canada.

The guideline program became necessary because the Interest Equalization Tax of 1963 failed to stem, let alone reverse, the loss and impairment of U.S. gold reserves. Accordingly, guidelines designed to limit capital exports were issued to U.S. banks, to other financial institutions, and to non-financial institutions. The original program was announced in a presidential message to Congress of 10 February 1965. Specific guidelines were issued in the following months, and were considerably strengthened in December of that year and from time to time thereafter; and on 1 January 1968 the guidelines were further strengthened and compliance with them became mandatory.

As a result of the exceptionally close financial interrelationship between Canada and the United States and Canada's continuing dependence on capital imports, the imposition and continual alteration of U.S. guidelines involved frequent discussions and negotiations between ministers and officials on either side of the border. The Canadians were continually pressing either for Canada–U.S. transactions to be exempted, as they had been for the most part under the IET or for other forms of accommodation. The Americans, on the other hand, because of their extreme sensitivity to their own deteriorating balance-of-payments position, were hesitant to place complete confidence in the Canada—U.S. reserve ceiling arrangement; as time went on they became increasingly concerned about U.S. capital using Canada as a pass-through on its way to countries overseas.[18]

Canada obtained exemption almost at the outset (i.e., late in 1965) from guidelines under which U.S. banks and other financial institutions were given instructions regarding the flow of capital out of the country. However, as with the IET, it took a strong mission to Washington, although a less publicized one, to make the case with the authorities of the U.S. Federal Reserve System who were responsible for implementing that part of the program. Thereafter attention shifted to details of the pass-through problem and to the implications for Canada of the U.S. guidelines covering non-financial institutions.

On two occasions the Canadian authorities took steps to prevent pass-through operations in the form of security dealings. The first came immediately after the IET negotiation and is described above (see p. 210). Later, in March 1966, Canadian investors were requested "not to acquire securities . . . which are issued by U.S. corporations or their non-Canadian subsidiaries and which are subject to the U.S. interest equalization tax if purchased by U.S. residents."[19]

It was, however, the U.S. guidelines issued to their non-financial institutions that caused most difficulties in Canada. These applied to the financial position and operations of the numerous U.S. subsidiaries in Canada which dominated many Canadian industries in the fields of both resource development and manufacturing. The U.S. parent companies were directed to limit, under a formula related to past practice, the amount of funds they transferred to their subsidiaries in countries abroad. The guidelines did not specify how much each firm could allocate to each subsidiary and so the subsidiaries in Canada were liable to be cut back to a greater or lesser extent depending on corporate decisions. Such cutbacks could, in turn, lead these subsidiaries to approach Canadian banks and other financial institutions to meet their capital requirements; indeed the guidelines specifically encouraged such a shift. In

Canada's case, considering the size and importance of U.S. subsidiaries, this shift could have meant a large additional burden on Canadian financial institutions. Finally, the later guidelines embodied directions to the U.S. parents not only as to how to finance their subsidiaries (from local rather than U.S. sources) but also as to how their subsidiaries were to dispose of their earnings; they were directed to repatriate substantial amounts to the U.S. rather than invest in the countries where they were located. This measure, as far as Canada was concerned, implied additional burdens both on the Canadian balance of payments and on Canadian financial institutions; it also involved extension of U.S. extraterritorial authority into the affairs of businesses located in Canada. As such it was particularly repugnant.[20]

It is not possible here to recount all the detailed measures that Canadians took to cope with this situation or the mounting Canadian reaction to it. Reporting to Parliament in January 1966, immediately after the first major intensification of the guideline program, the Minister of Finance, Mitchell Sharp remarked: "I do not like the American guidelines and I seriously doubt their wisdom."[21] He had been unable to persuade the authorities to exempt Canada from their non-financial guidelines despite the fact that the Canadian exemption under the IET offered an open alternative to U.S. subsidiaries that were unable to obtain U.S. funds from their parent organizations. He also reported that the Governor of the Bank of Canada had requested Canadian banks not to permit their normal accommodation to Canadian firms to be impaired or displaced by new credit demands from U.S. subsidiaries.

Similar objections raised at the Canada – U.S. Ministerial Committee on Trade and Economic Affairs were equally unproductive. The U.S. members stressed the difficulties they would face in trying to apply guidelines to individual parent firms in respect of some of their foreign subsidiaries and not others and reiterated that these firms were free to apply "market considerations" in deciding which of their subsidiaries should be affected by the required cut backs.[22] The Canadian response, pursued with U.S. acceptance, was to mount a campaign to persuade Canadian subsidiaries of U.S. firms to behave as "good corporate citizens" of Canada.

During the latter part of 1967 and the early part of 1968 the

Canada – U.S. discussions over the U.S. guidelines and over the reserve ceiling arrangement were caught up not only in major international financial crisis but also in a Canadian crisis. This was the period in which sterling, despite intense efforts of national and international authorities, was forced into a major devaluation. International speculation then turned against the U.S. dollar. (In order to assist the U.S. authorities to meet overseas demands for gold the Canadian authorities sold them $100 million from their gold reserves.)[23]

With the U.S. dollar under heavy pressure the U.S. guidelines were once again tightened and on this occasion (1 January 1968) made mandatory. U.S. firms were to cut back their direct investment abroad to 60 per cent of the 1966 level and since the firms were free to choose the subsidiaries into which they would channel this reduced investment it was possible that none at all would flow to Canada. This announcement naturally caused speculation against the Canadian dollar and this speculation was aggravated because, in the view of the financial community, Canadian financial policies at that time seemed to lack restraint and Canadian labour costs seemed to be rising unduly.

It was not only the Canadian authorities that were worried by the pressure on the Canadian dollar; the U.S. authorities were aware that if the Canadian dollar went the way of sterling the defence of the U.S. dollar might well become untenable. As Canadian reserves sank, Canada – U.S. discussions intensified. During the early weeks of 1968 the Canadian authorities took a series of measures to defend the 92½-cent dollar. On 1 January, as a response to the U.S. announcement, Sharp issued a statement that was intended to reassure the market: "The U.S. will be taking effective measures to strengthen its balance of payments in ways that should have little adverse effect on the Canadian economy."[24]

The market was not reassured; the Canadian dollar came under pressure. On 22 January, Sharp spoke in Parliament about "exaggerated fears" regarding the effects on Canada of the new U.S. regulations and about the increase in the Bank of Canada lending rate from 6 per cent to 7 per cent (a very high rate in those days). "Our present exchange parity," he affirmed "is appropriate to our economic situation and should be and will be maintained.... We are fully prepared, if this should be necessary, to use our reserves and the other resources available to us, to defend the Canadian dollar in the exchange markets."[25]

Despite this further reassurance, the attack on the Canadian dollar continued and by the end of January Canada had used up reserves to the extent of some U.S. $350 million. This was only partially offset by means of a drawing by the Bank of Canada on its standby line of credit with the U.S. Federal Reserve System to the extent of U.S. $240 million.[26] In February, with the pressure continuing, it became necessary to mobilize additional resources. A drawing from the International Monetary Fund was arranged in the amount of U.S. $391 million.[27] However, the exchange market still remained unconvinced and the erosion of Canadian reserves continued. A contributing factor was the shakiness of the government's position in Parliament following their defeat on a snap vote in the House of Commons on a budget resolution on 19 February.

Urgent discussions were then launched with the U.S. authorities for the purpose of obtaining exemption from the major U.S. guideline from which Canada had not yet been exempted. This time the discussions ended in success. In announcing the complete exemption Sharp observed that it was "a goal towards which we have been working for some time." In connection with it, so as to prevent Canadian businesses, now having virtually free access to U.S. financial sources, from indulging in pass-through operations, the Canadian government undertook to issue a series of guidelines of its own. In addition, to give some immediate relief to the U.S. reserve position, the government undertook to transfer Canadian reserves of U.S. dollars, over and above a working balance, into U.S. securities that "do not constitute a liquid claim on the United States with, of course, effective safeguards to our position should our reserve level require."[28]

At the same time Sharp announced still further reinforcement of the defences of the Canadian dollar: U.S. $500 million to be made available by the Export-Import Bank of the United States and U.S. $400 million by the Bank for International Settlements and the central banks of Germany and Italy. Nevertheless, despite all these measures, the Canadian dollar remained weak for the next ten days, while the U.S. dollar and the gold market in London were still in a state of siege. The turnaround came on 17 March 1968, when members of the Gold Pool decided to abandon their efforts to hold the market price down to $35. (See chapter 8, p. 190 above).

It still remained for Canada to implement her undertaking to prevent pass-through operations by issuing her own guidelines. Discussions with the Canadian groups affected were initiated forthwith and three sets of guidelines were issued in due course, those to the chartered banks on 3 May, those to other financial institutions on 24 July, and those to other businesses on 17 September. These remained in effect until the U.S. guidelines were removed in January 1974. In the meanwhile there were occasional alterations and consultations with the U.S. authorities, but no fundamental changes were introduced.

By July 1968, with international financial tensions relaxed, the Bank of Canada had completed repayment of the emergency credit from the Federal Reserve System (U.S. $250 million) and terminated its standby credits with the BIS and the central banks of Germany and Italy (U.S. $400 million). In August, with U.S. subsidiaries in Canada no longer pressing the Canadian banks for extra accommodation, the relevant request by the Bank of Canada was withdrawn. In September the government announced that the standby with the U.S. Export-Import Bank had been terminated and that the drawing from the IMF had been discharged in full. By the end of the year Canada's creditor position in the Fund had also been restored.[29]

Finally, in December 1968 the United States agreed if not to abolish at least to disregard the reserve ceiling arrangement. With Canada's U.S. dollar reserves invested in a form that did not impair U.S. reserve statistics and with Canadian anti-pass-through guidelines now in effect it served no continuing purpose. Moreover, to an increasing extent Canadians in search of funds abroad were turning to European markets. The Canadian Budget Papers of 1969 recorded that "the most striking development with regard to Canadian borrowing abroad in 1968 was, of course, the extent to which it was carried out in European markets, especially the Eurobond and Deutsche Mark markets; these accounted for $540 million.... The federal government placed...$176 million in Italy and Germany."[30] This was in sharp contrast with the situation existing when the Interest Equalization Tax was introduced. At that time informal enquiries among European members of WP 3 had indicated that the largest issue of Canadian government bonds that could be absorbed would be about $25 million and even for that amount it would be necessary for Canada to take her place in line with other borrowers. Thus, by the end of 1968 the U.S. guidelines no longer applied to Canada and the Canada – U.S. reserve ceiling arrangement had been terminated. Canada was therefore free from these constraints as new dollar problems emerged in 1969 – 70.

One final comment should be made on the tone and temper of relationships between the Canadians and Americans involved in the complex and often controversial financial issues that began with the introduction of the Interest Equalization Tax in 1963 and ended with the suspension of the reserve ceiling arrangement in 1968. All concerned were aware – perhaps the officials involved in frequent meetings of WP 3 and the G 10 Deputies were particularly aware – that the Canada-U.S. issues were not in their origin bilateral issues between the two countries. They were, rather, one aspect of the broader issues that threatened the stability of the U.S. dollar and the international monetary system. This, in itself, would have emphasized importance of reaching agreement. Moreover, the day had not yet come when many people assumed that conflict and confrontation constituted the normal conduct of international affairs in general and Canada – U.S. affairs in particular. It was still considered both reasonable and possible for those on each side of a negotiation to try to understand the problems faced by the other side and to seek, on the basis of discussion and negotiation, a solution that was durable because it was acceptable to both sides. The belief in the possibility and durability of mutually agreeable solutions persisted throughout the period.[31] It is particularly necessary to make this comment because these relationships have been misinterpreted.[32] Conflict and confrontation arrived on the scene in 1971; but that is a matter for chapter 10.

The New Float of 1970

In the early months of 1970, as in the early months of 1968, the Canadian financial authorities were confronted by a complex situation which arose partly from developments within Canada and partly from international developments. The U.S.

dollar came under heavy attack from many quarters. Short-term capital movements were an unfavourable factor in the U.S. balance of payments but in other countries, including Canada, the movement was strongly favourable. This was one of the final warning gusts that were building up to the hurricane of 1971.

There were several specifically Canadian factors in the situation. In the latter part of 1969 there had been prolonged strikes which temporarily dammed up Canadian West coast exports but when labour settlements were reached at the turn of the year exports flooded out. The current international account was further strengthened as a result of a phenomenal and fortuitous credit balance under the Canada – U.S. auto pact; certain new car models that the manufacturers had decided to produce on the Canadian side of the border became extremely popular in the United States. (Some auto pact statistics are provided in Appendix 2 to this chapter.) As a result of such special influences coming on top of a generally strong position, the Canadian current account deficit of $1 billion in 1969 was transformed into a current account surplus of $1 billion in 1970. As an additional source of upward pressure on the Canadian dollar, there was a continuing import of long-term capital.

During the first five months of 1970 Canadian reserves rose by some $1.2 billion U.S.[33] Accordingly on 31 May the government announced that it was no longer prepared to defend the 92½-cent dollar; once again the Canadian dollar was afloat.

The circumstances of 1970 resembled in several respects those surrounding the decision to float which had been taken twenty years previously. On both occasions the decision to abandon the fixed rate (U.S. 90.9 cents in 1950 and U.S. 92.5 cents in 1970) was precipitated by a heavy inward movement of capital. In both cases the inflationary impact of the acquisition of reserves became an important consideration. In both cases the decision was made to allow the Canadian dollar to float rather than to attempt to peg it at a new rate. In both cases the Canadian dollar immediately floated upward (in contrast to the more usual international situation in which an exchange rate is forced to float in the face of heavy downward pressures.) In both cases the departure from the fixed rate system was announced to be temporary and provisional but there were at least some of those concerned in Ottawa who could not envisage any early return to a fixed rate.

At the same time there were important differences. While in 1950 the current account had recently gone into deficit, in 1970 it had recently produced a very large if insecure surplus. Moreover, while in 1950 to embark on a floating rate policy was to set out on an uncharted sea, by 1970 floating rates had been closely examined and widely acclaimed in the academic world and many member countries of the IMF had resorted to them (although none for so long a period as Canada). Indeed, the IMF had not infrequently encouraged countries which were considering a new par value to test out market opinion by experimenting for a period with a fluctuating rate.

After the Canadian dollar was allowed to float on 31 May 1970 it rose about 3½ per cent during the month of June and a further 3 per cent during the rest of the year, ending the year at approximately U.S. 99 cents. During this period reserves rose by U.S. $595 million. Of this, however, $360 million represented deliveries on forward exchange contracts that had been entered into while the rate was still being held down and before the float was announced. This leaves only $235 million as the accumulation of reserves attributable to resisting sharp movements in an appreciating exchange rate over a seven-month period; such a sum, accumulated over such a period, does not seem incompatible with the concept of a clean, unbiassed float.[34]

The swing of $2 billion in Canada's current account balance between 1969 and 1970, from a deficit of $1 billion to a surplus of the same amount, was not, of course, entirely absorbed by the increase in Canadian reserves. A large compensating shift in the capital account took place and the Canadian authorities attempted to facilitate it. Remarking on this shift the Governor of the Bank of Canada pointed out:

> The magnitude of what was needed, and of what was in fact accomplished, is impressive. In 1971 provinces, municipalities and business corporations raised a total of $3.5 billion by net new issues of bonds in the market. Of this amount, only $0.4 billion was in the form of foreign currency issues. Two years earlier when net new bond issues of these borrowers totalled $2.1 billion, the net issue of foreign currency bonds

was \$1.4 billion. Thus the sales of Canadian dollar issues rose from \$0.7 billion in 1969 to \$3.1 billion in 1971.

The adjustment in our international capital account was assisted by the relatively easy credit conditions encouraged by Bank of Canada policies. These conditions facilitated the placement of long-term securities in the Canadian market and the transfer of financial business from foreign markets. This whole process has involved a substantial increase in financial intermediation in Canada, that is, increased borrowing and lending through financial institutions. Since a large part of financial intermediation occurs in the banking system, the process naturally contributed to the high rate of increase in the monetary aggregates which occurred last year.

The change in our capital account, which was necessary if pressure on the exchange rate was to be mitigated, was also helped by the response of Canadian borrowers to the request by the Minister of Finance that they explore carefully the potentialities of the Canadian market before offering securities for sale abroad. I continue to support that request and appreciate the response to it.[35]

Fixed and Floating Rates in Retrospect

In order to review Canada's experience under fixed and floating rate regimes it seems reasonable to concentrate on the period 1950 – 70. The preceding years, up to the general realignment of world currencies in 1949, were overcast by the aftermath of war. The years since, which included breakdown of the world monetary system and early steps toward reform, were too unsettled and too recent to provide a basis for firm judgments.

During the period under review floating rates gained wide support in academic circles in Canada and elsewhere. (For a classification of the literature see the Bibliographical Note at the end of this volume.) The defence of a fixed rate has traditionally involved periods of tight money, credit restriction and unemployed resources of labour and capital. Moreover, a floating rate often seems preferable to a fixed rate because the exchange rate will move in a direction that supports the policy actions of the national financial authorities while under a fixed rate these policy actions seem likely to be impeded, not assisted, by movements of the international reserves. For example, if the national authorities undertake expansive action, whether in the monetary or fiscal field, incomes will rise and there will be under either regime an initial increase in imports of goods, services and securities. Under a floating rate regime the exchange rate will then fall and this movement will encourage exports, restrain the increase in imports, and generally support the desired economic expansion. If the rate is fixed, however, the initial increase in imports will, in the ordinary course of events, cause a loss of international reserves and a restriction of domestic credit which will run counter to the expansionary intentions of the authorities.

For Canada, which is bound together with the United States by a network of financial and economic relationships, a floating rate has seemed to offer a particularly welcome element of flexibility. It does not, it cannot, provide the Canadian financial authorities with anything approaching complete independence of action, but it does seem to offer some greater scope for self-determination. Canadian prices, incomes and wage rates are not tied so closely to those in the United States. Moreover the international flow of capital, which is facilitated by a fixed rate and which in large measure imposes American financial conditions and policies upon Canada, is not quite so free when account has to be taken of the reactions and uncertainties attaching to a floating rate. Advocates of an independent foreign policy for Canada have been active supporters of a floating rate and opponents of a fixed one.

In Canada, as elsewhere, however, a fixed rate policy as exemplified in the par value system of the IMF has also had its supporters. During the period under review the widespread stability of international exchange rates was unquestionably a major factor in the unprecedented growth of world production and the even more rapid growth of world trade in which Canada shared to the full. This currency stability was in sharp contrast with the instability of the Great Depression.[36] Moreover, it has often been argued, a fixed rate imposes a desirable (although not always welcome) international discipline on national financial policies. Political leaders, particularly in democracies, will always be tempted to enlarge expenditure programs beyond national economic capacities. Under a fixed rate regime this over-expansion of expenditures will result in an over-expansion of imports and in a loss of international reserves which will serve as a warning that it is time for retrenchment. Under a floating rate, on the other hand, there is likely to be a continual downhill slide into inflation and currency depreciation. Indeed, it would seem to be no accident that, in the 1970s, world inflation should accompany the breakdown of the par value system.

Turning from these broad generalizations to the particulars of Canadian experience, the first observation to be made is that Canada's floating dollar worked well in the buoyant environment of the years 1950–56. So far from depreciation precipitating inflation, the dollar floated upward and maintained a premium over the U.S. dollar which served to mitigate the excesses of the resource boom that developed during those years. At the same time it maintained a high degree of short-term stability, thus offering to Canadian trade and Canadian finance the advantages usually attaching to fixed rate. Finally, the strength and stability of the Canadian currency relieved the international community in general and the IMF in particular of any initial worries they may have had regarding the possibly competitive currency depreciation.

It is tempting to proceed by stating that, when times ceased to be buoyant in 1957–61, the floating rate ceased to serve Canada's interests. This, however, would involve a misinterpretation of what happened. In those years, Canadian financial authorities worked at cross purposes. A royal commission which subsequently reviewed the period, wrote as follows:

> A substantial premium on the Canadian dollar and large capital inflows were appropriate during the investment boom of 1955–57 but when economic conditions changed it was desirable that economic policy should be so ordered that there would be a fall in the international value of the Canadian dollar, the current account deficit and the capital inflow. Had credit conditions been easier, some of the capital inflow would not have occurred and the value of the Canadian dollar would have been lower: while the consequences would not have been immediate, the lower exchange rate would have stimulated employment, incomes and domestic savings. The policies in fact pursued were thus very different

> from those which might have been expected to result from the freedom sometimes thought implicit in a flexible exchange rate. Far from beggaring her neighbours Canada followed policies which in time led to such dissatisfaction with the level of the rate that an escape was sought through direct intervention in the exchange market.[37]

In short, domestic financial management was uncoordinated and in part ill-directed. The results were in many respects unfortunate but the basic question whether the floating rate, as such, was advantageous or otherwise was left unanswered.

This question may be approached by raising two others: How far does a flexible exchange rate in fact enlarge the freedom of national financial authorities? How far is it true that if they concentrate on maintaining domestic economic stability and progress they can and should allow international payments and the foreign exchange rate to look after themselves? Views of this sort are attractive, but on examination they seem incomplete. Such views imply that it is possible for national authorites, when working in an international environment, to distinguish those policies that are directed toward national from those directed toward international objectives. In practice, however, there can be no sharp distinction. Whether the authorities like it or not, whether they intend it or not, operations in the fields of credit management, of debt management, and of fiscal management will affect international payments and the foreign exchange rate. In selecting the appropriate mix of such policies to achieve desired domestic objectives the authorities will ignore at their peril the international effects; indeed the international effects may actually thwart the attainment of domestic objectives.

In this connection the generally useful concept of a "clean float" (which was explained on pp. 145-48 above) may be misleading. If one country's floating rate policy is to be acceptable to others, the country should indeed refrain from biassed operations on the exchange market. This is a necessary criterion of acceptable international behaviour but it should not be mistaken for a sufficient criterion. There are, as indicated above, many ways in addition to direct operations on the exchange market in which the national financial authorities influence the exchange rate. None of these can be exempt from international scrutiny. Thus it came about that when in 1973-75 the International Monetary Fund formulated guidelines for countries on floating rates these included, but went well beyond, the criteria of a clean float.

And if it is true that many actions of the financial authorities influence the level of the foreign exchange rate it is equally true that the level of the foreign exchange rate must influence many of their actions. In any country with international relationships, and particularly in a country with as many as Canada, the level of the foreign exchange rate exercises a pervasive influence throughout the economy. In the Canadian price system it is probably the most important price of all. The authorities must develop a view about the exchange rate and its movements and their view must bear on their actions.

Canadian financial policy is not and can never be independent of financial conditions and financial policies abroad, particularly those in the United States. Its independence will always be a matter of degree. The freedom that flows from a floating exchange rate can be and often is exaggerated. Complete freedom would, in fact, only be achieved if the authorities were willing to allow the exchange rate to be carried in either direction to any degree by market forces without attempting to influence those forces. But no government or central bank could possibly adopt such an attitude toward the exchange rate because of the far-reaching and pervasive effect of the rate over the economic and financial life of the country, not to mention the high level of political interest in it. Thus, whether the exchange rate is fixed or flexible, its behaviour will always be one of the factors that the financial authorities will keep in mind in developing their policies. The demands of the exchange rate for attention may be less rigid and less peremptory if it is variable than if it is fixed, but they will be there and cannot be ignored.

This leads us back to consider briefly what might have happened to Canada's floating rate in the period 1957–61 if financial management had been better coordinated. It seems possible that, with a more expansive monetary policy and perhaps less reliance on fiscal deficits, the capital inflow would have diminished and the exchange rate would have moved down to a substantial discount with favourable effects on exports, imports and employment.[38] The Royal Commission on

Banking and Finance took a rather more guarded view:

> The flexible exchange rate was too high after 1957, in part because of domestic credit policies, but there is no certainty that more appropriate measures would have resulted in an exchange rate wholly suited to the structure of our own relative costs and prices. If the view had been that the flexible exchange rate had not declined sufficiently, it might have been desirable to fix a lower rate, at least by 1960 when the disequilibrium in our international competitive position was generally evident.[39]

One of the reasons underlying the commissioners' doubts whether the Canadian dollar would have floated down to a level "wholly suited" to Canada's position apparently lay in their belief that either the United States or the IMF or both would in some way have intervened to check what they might have considered to be competitive depreciation. During the 1957–61 period, when the Canadian dollar was at an unduly high level, it evoked no objection and when the time came to fix a new par value, even at a 7½ per cent discount, it obtained U.S. support. On the other hand when, following 1971, the U.S. authorities themselves ran into difficulties they began to take a very active interest in the behaviour of Canada's floating rate.

So much for Canada's floating rate policy of the 1950s; but what of the fixed rate policy in the 1960s? The period 1961–71 was one of strong growth in the Canadian economy. The real GNP per capita, which had stagnated since 1957, grew steadily from $2,194 to $3,133, a growth of just over 25 per cent in ten years. The unemployment rate, seasonally adjusted, which was about 7.5 per cent in the first half of 1961, fell below 4 per cent in 1966 and only rose above 5 per cent again in the first half of 1970. Much of the strength of the economy was drawn from commodity exports; in the ten years from 1961 to 1971 exports actually tripled from $5.9 billion to $17.8 billion (including a price increase of less than 25 per cent). Increases of roughly similar proportions were recorded in all the main geographical areas (rather more for the United States and Japan and rather less for the EEC and other) except for Britain, where the ten-year increase including the price factor was only 50 per cent. Substantial increases were also recorded in all the main commodity classifications, with automotive products under the auto pact showing the most spectacular gain. (For these and other statistics see the Reference Tables at the end of this volume.)

Of particular significance was the shift in Canada's balance on current account from a deficit of $928 million in 1961 to a surplus of $442 million in 1971. This, of course, was the result of the excellent export performance which moved the commodity trade balance from a surplus of $173 million in 1961 up to $2,427 million in 1971 and counterbalanced the adverse influence of a deficit on services and transfers which grew by approximately $1 billion.

The change from deficit to surplus in the current account seemed durable. Although deficits exceeding $1 billion were recorded in the two years 1965 and 1966, the situation seemed to have changed fundamentally from the situation which had prevailed in 1956 – 60 when the average current account deficit had been $1,335 million. The capital account in the 1960s also seemed to have become more healthy with an inward movement of long-term capital, much of it for direct investment, making possible the maintenance of relatively low interest rates in Canada and an outflow of short-term capital to the United States and Europe. Apart from the brief crisis in 1968, Canada's international reserves persistently tended to increase. Indeed, as explained on p. 212 above, it was necessary to adopt a number of special expedients to keep them from rising appreciably above the ceiling agreed upon with the United States.

While many factors combined to produce this strong balance of international payments it can scarcely be questioned that one of the most important was the level of the Canadian dollar at a discount of 7½ per cent below the U.S. dollar. The fact that exports of virtually all types expanded so strongly into virtually all areas is evidence that the exchange rate was now helping instead of hindering the activities of Canadian exporters and the fact that exports grew far more strongly than imports is an indication that Canadians producers were, with the help of the exchange rate, competing effectively in the home market.

One of the most significant indicators of the usefulness of the 92½-cent dollar in getting Canada out of a deficit situation was the development of a large export surplus under the auto pact. In this case it happened that new institutional arrangements allowed full play to relative costs of production and the exchange rate. When the auto pact was introduced the main American manufacturers closed their separate purchasing offices in Canada and centralized all purchasing, along with all production planning, in Detroit. Thus the development of a very substantial surplus of U.S. purchases from Canada over sales to Canada could be attributed in large measure to the competitive position of Canadian producers, including the contribution to that position made by the 92½-cent dollar. And although a number of factors also altered, it can scarcely have been purely coincidental that Canada's surplus on automotive account began to disappear immediately after the disappearance of the premium on the U.S. dollar. (Some additional information relating to automotive position is provided in Appendix 2 to this chapter.)

It is against this broad background of economic and financial strength that Canadian policies in the face of the U.S. Interest Equalization Tax and the U.S. guidelines should be appraised. It is clear that neither these measures, nor the special measures and expedients that Canada found it necessary to adopt to cope with them, did any serious damage to Canada's fundamentally strong balance of payments or to the growth of the economy. The willingness of the Canadian government to put up with the inconveniences, the irritations, and (as some would say) the indignities involved in its various responses to the U.S. balance-of-payments programs can be attributed in part to the unpalatable nature of the alternatives, insofar as they could be assessed, and in part to the fact that, despite the difficulties that were created, Canada's current international account continued to improve. Canadian interests, both commercial and financial, sustained little damage from the various financial expedients and improvisations of the period; generally speaking it was one of prosperity and expansion.

This is not to assert that the U.S. programs, and Canada's accommodation to them, caused no damage and no distortion; considering the close interrelationships, financial and commercial, between Canada and the United States, some such effects were inevitable. The damage included a new intrusion into Canada of U.S. extraterritorial authority; this, happily, was terminated in just over two years. Some further damage, quite impossible to estimate, lay in the fact that the reserve ceiling apparently resulted from time to time, and more particularly in 1965, in a monetary policy that was more expansionary than would have been considered appropriate by the Governor of the Bank, and possibly even by the Minister, Walter Gordon. However, by 1966 the reserve ceiling situation was brought under control by means of official repurchases of Canadian securities abroad and the arrangement was terminated in December 1968.

On the debit side also one must accept that some Canadian firms, and some Canadian subsidiaries of U.S. firms, may possibly have been prevented by the guideline programs (first the U.S. program and later the Canadian program) from undertaking all the foreign business that they otherwise might. How far this factor restricted the business and the profits of particular firms it would be difficult to estimate. But it seems that the damage, if any, was not extensive.[40] The restrictions imposed by the United States and later by Canada on export of capital from North America resulted in the establishment of new financial markets in Europe – the Eurocurrency and Eurobond markets – in which North Americans, both as lenders, and borrowers, participated extensively. U.S. dollars, and at a later date other currencies, were freely lent and borrowed outside their national boundaries and indeed outside the jurisdiction of any monetary authority. Canadian banks and other Canadian businesses were quick to develop these overseas operations.

Canadians were also active participants in the profitable development of multinational enterprise that constituted an outstanding characteristic of world economic development in the later 1960s and early 1970s. What made the Canadian capital control arrangements acceptable without great protest to the Canadian business and financial interests affected (and thus to the Canadian authorities) lay in the fact that Canadian businesses of all sorts, and particularly international businesses, were prosperous and expansive, abroad as well as at home.

Canada's readiness to seek exemptions from the U.S. Interest Equalization Tax and from the guidelines, and to pay a price for such exemptions by imposing limitations on the freedom of action of Canadians (whether in terms of a reserve ceiling or Canadian anti-pass-through guidelines), has been criticized as "exemptionalism" – a willingness to subordinate Canada's long-term economic interests and Canada's independence of action to the pressures of Canadian borrowers for easy access to the New York market and the demands from Washington to facilitate and support their international financial policies.[41]

Against this position it may be argued, first, that the price Canada paid in terms of economic damage from the guidelines and the reserve ceiling seems minimal. From time to time Washington may be expected to adopt policies that are directed, not against Canada, but against overseas countries, and it will not be in Canada's interest to accept without argument or protest the full impact of such policies. In this particular case, as chapter 8 shows very clearly, the American policies were formulated in relation to a world imbalance and in particular in relation to a United States – Europe imbalance.[42] For Canada, in such circumstances, there is really no sensible and defensible alternative to seeking an exemption.

It was sometimes suggested during the 1960s that the Canadian dollar should have been set afloat, apparently on the assumption that the freedom attaching to a floating rate would have somehow solved the Canada – U.S. pass-through problems. Actually, no Canadian government could have faced up to the cost to the Canadian economy of a sudden stoppage in the inflow of capital at a time when the current account was still in substantial deficit, as it had been in June 1962 and again in July 1963. The result would, predictably, have been another crisis and another deal with the United States regarding capital movements.

The basic threat to Canadian economic independence does not lie in the negotiation of occasional pass-through arrangements or exemptions from other U.S. policies that are essentially directed towards U.S. problems overseas. It lies rather in a continuing balance-of-payments deficit that has to be covered by capital imports which are at any time subject to interruption and which involve increasing impairment of Canadian control over the economy. In this sense the fixed 92½-cent dollar, under which real progress was made toward eliminating the current international deficit, was a potent factor in developing a basis for independent Canadian policies. It was the level of the rate that was significant rather than the question whether that level was reached by fixing or floating.[43] A floating exchange rate admittedly allows more elbow room to Canadian financial authorities than a fixed rate. But enlarged financial elbow room is no substitute for the enlarged economic living room that emerged from the years on the fixed 92½-cent dollar.

APPENDIX 1
STATEMENT MADE BY THE MINISTER OF FINANCE, 21 JULY 1963

Representatives of Canada and the United States met during the weekend to appraise the impact on the Canadian financial markets of the proposed United States "interest equalization tax."

The two governments recognized the need for effective action to improve the balance of payments position of both countries and are both equally determined that such action shall not impair the intimate economic relationships between the two countries, nor impede the growth essential for both economies.

For many years the capital markets of the two countries have been closely interconnected, and United States exports of capital to Canada have financed a substantial portion of the Canadian current account deficit with the U.S. This need continues. A portion of these flows must be supplied through the sale of new issues of Canadian securities in American markets. U.S. officials had considered that ample flows for these needs would continue under the proposed "interest equalization tax." However, Canadian representatives stated that this would require a very substantial rise in the entire Canadian interest rate structure. It was recognized by both governments that such a development would be undesirable in present economic circumstances.

In the light of this situation U.S. officials agreed that the draft legislation to be submitted to the Congress would include a provision authorizing a procedure under which the President could modify the application of the tax by the establishment from time to time of exemptions, which he could make either unlimited or limited in amount. The President would thus have the flexibility to permit tax free purchases of new issues needed to maintain the unimpeded flow of trade and payments between the two countries, and to take care of exceptional situations that might arise in the case of other countries. U.S. officials made clear that this did not modify their proposals regarding the taxation of transactions in outstanding securities; over the past year such transactions between Canada and the U.S. have not been a major factor.

The Canadian authorities stated that it would not be the desire or intention of Canada to increase her foreign exchange reserves through the proceeds of borrowings in the United States, and it is the hope and expectation of both governments that by maintaining close consultation it will prove possible in practice to have an unlimited exemption for Canada without adverse effect on the United States.

It was agreed that active consultations would continue to strengthen the close economic relations between the two countries and at the same time facilitate measures for making the maximum practicable contributions to economic expansion and the strength and stability of both currencies.

SOURCE: Press release, Department of Finance, Ottawa, 21 July 1963.

APPENDIX 2
THE EXCHANGE RATE, THE AUTO-PACT AND THE BALANCE OF PAYMENTS

One of the major elements in the transformation of Canada's current account from deficit to surplus lay in the working of the Canada – U.S. auto pact of 1965 under the 92½ cent exchange rate. The abolition of impediments to movement of automobiles, trucks and parts across the border in both directions allowed the current account balance between Canada and the United States in this sector to improve as follows (in millions of Canadian dollars): 1965, –\$722; 1966, –\$651; 1967, –\$407; 1968, –\$277; 1969, –\$100; 1970, +243; 1971, +\$200. While Canada's automotive exports grew more rapidly than imports, both showed spectacular increases. Canadian exports rose from \$246 millions in 1965 to \$3,330 millions in 1970 and imports from \$968 millions to \$3,087 millions.

The Canadian and American statistics on commodity trade in general and the automotive sector in particular have shown considerable discrepancies. The U.S. figures for the automotive trade balance with Canada ran as follows (in millions of U.S. dollars): 1965, +693; 1966, +$467; 1967, +$286; 1968, −$90; 1969, −$583; 1970, −$930. (U.S. Senate Committee, Annual Reports on the Canadian Automobile Agreement, 1967–72).

Under the pact the large U.S. manufacturers found it expedient to remove their purchasing offices from Canada and to concentrate in Detroit all purchasing of materials, parts and components. As long as the Canadian dollar stood at U.S. 92½ cents the Canadian producers had this substantial competitive advantage in the continental allocation of orders. This they lost as the dollar appreciated. Thereafter, partly on this account but also for other reasons, the newly developed Canadian surpluses with the United States on automotive account disappeared and were once again replaced by large deficits.

It might also be noted that while the improvement of the automotive account between 1965 and 1970 reduced Canada's dependence on imported capital it involved, at the same time, a greater degree of Canada–U.S. interdependence in other directions. The concentration of purchasing decisions in Detroit has already been mentioned. In addition one should mention the increased interdependence of labour negotiations as exemplified by the intensified demand by Canadian labour for pay parity with their fellow unionists across the border.

NOTES

1 Canada, House of Commons, *Debates*, 13 June, 1963, pp. 997-1009. While the budget proposals were considered by some to be dangerously nationalistic they were much less far-reaching from a political viewpoint than measures taken in other countries to achieve comparable objectives.

2 The detailed story of that budget from the point of view of the Minister is told by Denis Smith, *Gentle Patriot: A Political Biography of Walter Gordon* (Edmonton: Hurtig Publishers, 1973), pp. 134-72. It has also been told in a different vein by Peter C. Newman, *The Distemper of Our Times: Canadian Politics in Transition, 1963-1968* (Toronto: McClelland and Stewart, 1968), pp. 15-26. One semi-comic episode which, in the light of the tradition

surrounding budget secrecy, might have involved Gordon in further difficulties, has escaped the attention of both authors. The present writer, who had been charged with preparing a compromise draft, took it home one night for final editing. Unwisely, he left it in his briefcase while he took his much-neglected wife to a movie. On his return he found to his horror that a burglar had ransacked the house including the briefcase. But the explosive budget document had been left lying on the floor.

3 The Prime Minister, L. B. Pearson, apparently remained unaware of the advice that Gordon received from his department on this matter. In his memoirs (*Mike, Volume 3, 1957-1968*, edited by John A. Munro and Alex I. Inglis [Toronto: University of Toronto Press, 1975, p. 106]) the following appears:

> In view of the fury of opposition that the takeover tax aroused and, as I learned later, the unanimous opinion of the financial establishment in the civil service that it was ill-conceived, wrong, and impracticable, I think those views should have been expressed strongly to the Minister by those who were advising him and felt that way....

Pearson's assumption that Gordon as well as himself was unaware of the nature and intensity of the views of departmental officials is, according to their recollection, quite unfounded. In this connection Denis Smith says (*Gentle Patriot*, p. 149): "Gordon was told bluntly that the takeover tax was unworkable." Peter Newman (*Distemper*, p. 17) records that "Gordon called Taylor [the Deputy Minister] into his office quixotically to reject not just the departmental draft of the budget but also its whole philosophy and approach." Gordon's account of the episode, as it emerges in *Gentle Patriot*, differs materially from that of Pearson.

4 House of Commons, *Debates*, 8 July 1963, pp. 1950-53.

5 Foreign Investment Review Act, 1973.

6 Details of the proposed tax were presented that afternoon in the House of Commons without comment by the Minister of Finance. See *Debates*, 18 July, 1963, p. 2329. The budgetary practice of starting to collect a tax as soon as it is announced without waiting for legislative sanction is

familiar in Canada and other British countries but its adoption in Washington was certainly unusual; indeed this occasion may have been unique. It was no doubt necessary in order to forestall a rush of foreign borrowers to the U.S. capital market pending passage of the legislation by Congress.

7 House of Commons *Debates*, 13 June, 1963, especially pp. 1000-4.

8 The following account of the discussion is supported by notes compiled by two of those present. For a restatement of the case put forward by Rasminsky, see Bank of Canada, *Report for 1963*, pp. 4-7. Also L. Rasminsky, "Remarks to the U.S. Banker's Association for Foreign Trade," Quebec City, 25 May 1964 (mimeographed), pp. 5-8.

9 Subsequently the sharp reduction in Canada's receipts from bond issues in the United States was recorded as follows in the 1964 Budget Papers, *Debates*, 16 March, 1964, p. 1055:

New Issues of Canadian Bonds Sold to United States Residents

Period	Contracts	Deliveries
	(millions of dollars)	
1962		
3rd Quarter	371	75
4th Quarter	372	370
1963		
1st Quarter	530	400
2nd Quarter	131	369
3rd Quarter	28	104
4th Quarter	25	37

10 The figures subsequently published showed that in no quarterly period since the beginning of 1961 had the net Canada – U.S. trade in outstanding securities exceeded $70 million; in ten out the twelve quarters it was less than $40 million. It should also be noted, however, that the *gross* movement was substantial, normally exceeding $200 million per quarter in each direction. Thus the withdrawal of the participation of U.S. residents in the Canadian market

reduced its strength and resilience. (House of Commons, *Debates*, 16 March 1964, p. 1056.)

11 See Bank of Canada, *Report of the Governor for 1963*, p. 6.

12 In a statement in Parliament on 16 March 1966 the Minister of Finance, Mitchell Sharp, referred to enquiries regarding the application of the policy to proposals for particular issues (actually on behalf of Australia and New Zealand, which were not approved). An air of secrecy has been attributed to the policy (Gerald Wright, "Persuasive Influence: The Case of the Interest Equalization Tax," in Andrew Axline et al., eds., *Continental Community, Independence and Integration in North America* [Toronto: McClelland and Stewart, 1974], pp. 149-50 and 162), partly on account of the fact that Walter Gordon, in reply to a question in the House, had stated that no undertakings were given in Washington that were not set out in the joint communiqué; this was inaccurate in that the communiqué did not refer to the pass-through problem.

13 A description of the committee and its work may be found in Gerald Wright and Maureen Appel Molot, "Capital Movements and Government Control," *International Organization*, Vol. XXVII, No. 4 (Autumn 1974), pp. 682-83.

14 In connection with the operation of the U.S. guidelines, to which reference is made below, the ceiling was lowered from $2.7 to $2.6 billion in December 1966.

15 Details of these measures may be found in the Bank of Canada annual reports for 1963 to 1968. Also, regarding the Columbia River agreement, in House of Commons, *Debates*, 26 April 1965, p. 102, of Budget Papers, and regarding the repurchase of Canadian securities from the United States, *Debates*, 27 January 1966, p. 324. In regard to the request to provinces to defer transfer to Canada of proceeds of bond issues in the United States, see Minister of Finance, Press release, 9 November 1965.

16 Bank of Canada, *Report for 1975*, p. 9.

17 Bank of Canada *Report for 1968*, p. 14.

18 The more important documents relating to the reserve ceiling and the guidelines were published in conveniently available form as appendices to annual reports of the Bank of Canada:

1. Statement by the Minister of Finance, Mitchell Sharp,

16 March 1966, on implications of U.S. guidelines for Canada (Bank of Canada, *Report for 1966*).

2. Exchange of letters between the Minister of Finance and the Secretary of the U.S. Treasury, 7 March 1968, providing for termination of application of U.S. guidelines to Canada and other matters (Bank of Canada, *Report for 1968*).
3. Statements by the Minister of Finance (3 May and 24 May 1968) and by the Minister of Trade and Commerce. (19 September 1968) establishing Canadian guidelines on capital exports (Bank of Canada, *Report for 1968*).
4. Exchange of letters between the Minister of Finance and the Secretary of the U.S. Treasury, 16 December 1968, terminating the reserve-ceiling arrangement (Bank of Canada, *Report for 1968*).
5. Statements by Canadian ministers, 30 January 1974, withdrawing Canadian guidelines (Bank of Canada, *Report for 1973)*.

19 House of Commons, *Debates*, 16 March 1966, pp. 2755 and 3037. See also Bank of Canada, *Report for 1966*, p. 55.

20 For comments on reactions in Canada, France and England to this use by the U.S. authorities of their multinational firms as instruments of economic policy, see David Leyton-Brown, "Canada, France and Britain as Hosts of Multinationals," *International Perspectives* (September/October 1975), p. 42.

21 House of Commons, *Debates*, 27 January 1966, p. 326.

22 *Ibid.*, 7 March 1966, p. 2259 and 2348-49.

23 Bank of Canada, *Report for 1967*, p. 10.

24 Department of Finance, news release, 1 January 1968.

25 House of Commons, *Debates*, 22 January 1968, pp. 5761-62. A spokesman for the New Democratic Party in the House of Commons proposed that the government should cease to defend the exchange rate and allow it to float. Walter Gordon, the former Minister of Finance, states that he was at the time urging either a reduction in the fixed rate to a level below 92½ U.S. cents or else a renewed float (Denis Smith, *Gentle Patriot*, pp. 339-40 and 344-46).

26 Bank of Canada, *Report for 1967*, p. 10.

27 International Monetary Fund, *Annual Report for 1968*, p. 78. The total of $391 million was made up of three ele-

ments: (1) repayment of a previous loan by Canada under the General Arrangements to Borrow; (2) utilization of Canada's creditor position in the Fund arising from previous borrowings of Canadian dollars by other countries (see chapter 5, p. 128); and (3) new borrowing of an amount equal to the portion of the Canadian quota which had been subscribed in the form of gold. Under IMF rules all of these amounts were available to Canada unconditionally.

28 House of Commons, *Debates*, 7 March 1968, pp. 7379-80. This description of the new Canadian reserve asset involves a kind of double-talk (an illiquid asset that is liquid when necessary) indulged in by the U.S. administration to meet their special definition of liquid liabilities.

29 Bank of Canada, *Report for 1968*, pp. 38 and 39. Also House of Commons, *Debates*, Budget Papers, 3 June 1969, pp. 9503-4.

30 *Ibid.* p. 9500.

31 A methodical and revealing review of major issues arising between Canada and the United States before and after the Second World War has been offered by Joseph S. Nye, Jr., "Transnational Relations and Interstate Conflicts: An Emperical Analysis," *International Organization*, Vol. XXVIII No. 4 (Autumn 1974), pp. 961-96. This review places the issues arising over the IET and the U.S. guidelines in a broad perspective along with other issues. I regret that Professor Nye has not been persuaded to use the term "issue" instead of "conflict"! I am glad, however, to note his references to the fact that the outcome of a "conflict" can be beneficial to both parties (pp. 965-66 and 994). In this regard and in the light of all the circumstances reviewed in this chapter and chapter 8 one wonders whether he is right in classifying the IET and the guidelines as bilateral (dyadic) conflicts rather than "conflicts involving relations with third countries."

32 A different interpretation of Canada – U.S. financial relationships during the period 1963 – 68 has been offered by Gerald Wright. It originally appeared in "Persuasive Influence: The Case of the Interest Equalization Tax," pp. 137-62. It was apparently used in unpublished form as the basis for another account (Denis Smith, *Gentle Patriot*). It subse-

quently appeared in revised form in a U.S. publication, Gerald Wright and Maureen Appel Molot, "Capital Movements and Government Control," *International Organization*, Vol. XXVIII, No. 4 (Autumn 1974), pp. 671-87.

Wright's assumption of the adversary relationship (together with various derogatory but unsubstantiated remarks about the behaviour of Canadian officials) may be a result of the fact that the interviews on which he based his account took place after most of the Americans involved had left Washington and had been replaced by officials in the Nixon administration who did indeed develop an adversary relationship with Canadians and others; see Chapter 10 below. Nye rightly quotes a U.S. State Department official to the effect that "In the 1960's the [Canada – U.S.] relations among financial officials were so close that we were often shut out of policy. Now [in the early 1970's] their relations are so poor that they complicate policy" (Nye, p. 968). The close partnership that developed between officials working together in WP 3 and G 10 is emphasized by Robert W. Russell in "Transgovernmental Interaction in the International Monetary System, 1960 – 1972," *International Organization*, Vol. XXVII (Autumn 1973), pp. 431-63.

33 Bank of Canada, *Report for 1970*, p. 71. The figure of $1.2 billion excludes the sum of $360 million which Canada received in the first distribution of SDRs by the IMF. On the other hand it includes forward commitments as well as spot purchases; the figures in Reference Table 13 are for the spot position only.

34 For statistics see Bank of Canada, *Report for 1970*, p. 71. The phraseology of the Minister's announcement (Minister of Finance, news release, 31 May 1970, p. 2) had suggested a bias, as had his statement in Parliament (*Debates*, 1 June 1970, pp. 7523-24). However, the bias was against an unduly rapid initial rise in the exchange rate. There was extensive discussion in the House of the floating rate decision during the remainder of the month. The first question in the House about the possibility of floating during this period came from an NDP spokesman on 29 April, *Debates*, p. 6411.

35 Bank of Canada, *Report for 1971*, pp. 6-7. The Minister and

the Governor had both urged Canadian borrowers to canvass the domestic market before looking abroad early in 1970; see Bank of Canada, *Report for 1970*, p. 7.

36 "The existence of a multilateral system of trade and payments, the stability of the monetary system and the continuing liberalization of international transactions have been decisive factors in the unprecedented economic expansion and the even faster growth of international trade that have marked the last 25 years." *Policy Perspectives for International Trade and Related Matters*, Report of the High Level Group to the Secretary General (Paris: OECD, 1972), p. 109.

37 *Report of the Royal Commission on Banking and Finance*, 1964, p. 489.

38 See A. F. W. Plumptre, *Exchange Rate Policy: Experience with Canada's Floating Rate*, Essays in International Finance No. 81 (Princeton, N.J.: Princeton University Press, 1970), pp. 9-10.

39 *Report of the Royal Commission on Banking and Finance*, p. 492.

40 This does not imply that the guidelines were lax. The Canadian guidelines were carefully devised and supervised. Their effectiveness has been appraised econometrically: Charles Freedman, *The Foreign Currency Business of the Canadian Banks—an Econometric Study*, Bank of Canada, Staff Research Studies, No. 10, 1974, p. 211.

41 R. D. Cuff and J. L. Granatstein, "The Perils of Exemptionalism" in *Canadian-American Relations in Wartime* (Toronto: Hakkert, 1975) chapter 8, pp. 156-63. See also Appendix 1 to chapter 3 of this volume.

42 A not dissimilar pass-through problem arose during the Second World War when Canada successfully sought exemption from the cumbersome, time-consuming U.S. controls over commodity exports. Because of the close integration of Canadian manufacturing industry with the American, border delays could have seriously impaired Canadian war production as well as upsetting the flow of U.S. suppliers of all sorts to other Canadian producers and consumers. In order to attain the exemption it became necessary for Canada to restructure her controls over overseas exports so as closely to parallel the U.S. controls. In addi-

tion, in order to ensure a flow of U.S. goods to Canada through the network of U.S. domestic allocation and priority systems, it proved expedient for Canada to accept a type of surveillance that would satisfy U.S. congressmen and others that U.S. goods moving to Canada were not being dissipated. See R. Warren James, *Wartime Economic Cooperation: A Study of Relations between Canada and the United States* (Toronto: Ryerson Press, 1949), pp. 100-106, 160-65 and 198-206.

43 This point is well elaborated by a senior officer of the Bank of Canada with experience as a Canadian representative on WP 3 and G 10. See R. W. Lawson, *Bank of Canada Review*, February 1972, p. 10.

10

World Breakdown 1971-75

Breakdown of the Par Value System

The storm of 1971 which swept aside the par value system of the International Monetary Fund and precipitated an unprecedented series of world financial crises had been brewing for some years, but in the end it blew up quite quickly. In 1968 and again in 1969 the United States had run small surpluses on international current account and in addition had attracted substantial inflows of short-term capital. Even the persistent outflow of long-term capital, now subject to mandatory guidelines, moderated substantially. During 1969 U.S. gold reserves actually increased by $1 billion.[1]

During those years the breeze seemed favourable. In 1970, however, a gale blew up in the opposite direction and by 1971 it had developed into a hurricane. In the latter year the U.S. current account dipped into deficit and there were net capital outflows of $8.5 billion on long-term account and of no less than $21.2 billion on short-term account. As a result, in addition to losing nearly $1 billion in gold, the U.S. reserve position was further impaired by an accumulation of dollar-reserve liabilities of $27.4 billion. Such an increase in U.S. liabilities ran far beyond any previous experience. At the end of 1969 the grand total of all world reserves, including U.S. dollar liabilities to the rest of the world, had stood at only $78.7 billion. By the end of 1970 and 1971 it had shot up to $93.2 and $123.2 billion respectively (see Tables of World Reserves in Appendices 1 and 2 to this chapter).

In passing, it may be noted that the Special Drawing Rights (SDRs) of the International Monetary Fund, the new world asset which was created to counteract the influence of sluggish or shrinking world gold reserves, did just that. Total gold reserves actually declined from $39.1 billion at the end of 1969 to $36.1 billion at the end of 1971 and in the meanwhile SDRs had been issued in the amount of $5.9 billion. Such ripples were, however, inconsequential in relation to the tidal wave of U.S. dollars which was then flowing into world reserves.

The chief recipients of increases in reserves during 1971 were (in billions): Japan, $9.3; Britain, $5.3; Germany, $3.3; France, $2.6; Australia, $1.4; Switzerland, $1.3; Spain $1.2; Italy, $0.9; Libya, $0.8; Saudi Arabia, $0.7; and Canada, $0.6. The total for these eleven countries was $27.3; the total for all countries $29.4.[2]

For a number of years previously the international monetary system had shown increasing signs of strain. A new fissure emerged on 9 May 1971. With the flow of funds from the United States to Europe accelerating, both Switzerland and Austria raised the par values of their currencies, Belgium and Luxembourg altered their dual exchange rate system to discourage capital imports and, most ominous, both Germany and the Netherlands temporarily abandoned the attempt to defend their par values and allowed their currencies to float upward.

As the summer wore on it became clear that these European measures had failed to deter the flight of funds across the Atlantic, let alone the Pacific. Something more far-reaching and fundamental was required, and required from the United States.

Action came on Sunday 15 August 1971. The program which President Nixon then announced to the world at large and to the American people in particular was designed to serve two interrelated purposes. His first purpose was domestic: to bring inflation under control while at the same time raising the level of employment and economic activity. Controls were to be imposed on prices and wages beginning with a ninety-day freeze; these measures were to be supported by budget economies, by tax cuts and by a "Job Development" tax incentive.[3]

The President's second purpose was to extricate the U.S. dollar from the international web of "unfair exchange rates." With the U.S. dollar at an uncompetitive level, imports were facilitated, exports discouraged, and U.S. production and employment retarded. Basically, the process of extrication would require "a new international monetary system . . . the American dollar must never again be a hostage in the hands of international speculators." Two immediate steps were to be taken. First, the convertibility of the U.S. dollar into gold, which was the essential link that bound the dollar into the par value system of the IMF, was suspended. Second, a 10 per cent surcharge was levied on about half U.S. imports; "This import tax is a temporary action. It is not directed against any other country. It is an action to make certain that American products will not be at a disadvantage because of unfair exchange rates. When the unfair treatment is ended, the import tax will end as well."[4]

Two other measures in the President's program were also directed toward the improvement of the U.S. balance of payments. He ordered a 10 per cent cut in foreign economic aid and in the explanatory material that was released with his announcement it was disclosed that a Domestic International Sales Corporation (DISC) was to be set up "to afford our exporters tax treatment more comparable to that provided many of their competitors abroad." Hitherto U.S. tax legislation had encouraged the foreign operations of U.S. firms; under the DISC proposal special encouragement was to be given to exports from their U.S. operations.

President Nixon's announcement was notable not only for its content but also for its tone; two further quotations will provide examples. After a reference to the postwar aid which the United States had extended to European countries he went on: "The time has come for them to bear their fair share of defending freedom around the world. The time has come for exchange rates to be set straight and for the major nations to compete as equals. There is no longer any need for the United States to compete with one hand tied behind her back." And again: "This action will not win us any friends among the international money traders, but our primary concern is with American workers, and with fair competition around the world." The tone, however, was not uniformly belligerent: "To our friends abroad, including the many members of the international banking community who are dedicated to stability and the flow of trade, I give this assurance: the United States has always been, and will continue to be, a forward-looking and trustworthy trading partner. In full cooperation with the International Monetary Fund and those who trade with us, we will press for the necessary reforms to set up an urgently needed new international monetary system."

The untying of the U.S. dollar from gold and from the par value system, combined with the threatening overtones of the President's statement and those of John Connally, his Secretary of the Treasury, threw the international financial community into a state of considerable apprehension. The IMF reported that "in the weeks following the U.S. action, exchange rates fluctuated in the markets and various trade and exchange measures were taken to deal with the new situation."[5] And again: "Nearly all countries ceased to ensure that exchange transactions would be related to par values. These moves set in motion a process of appreciation in most major currencies against the dollar.... Generally, however, the extent of the appreciation was limited by official intervention in the exchange market or by measures taken to curb capital inflows."[6] In other words, exchange rates generally moved in the direction of a new equilibrium pattern but only to the extent permitted by national interventions of one type or another.

The annual meeting of the International Monetary Fund took place at the end of September and, virtually without exception, the Governors expressed deep concern over the new situation. The general fear was that, with exchange rates afloat and trading rules in question, there might be a rapid spread of protectionism and a disintegration of the world's postwar trading and financial system. The Fund reported that there was "broad agreement on the early return to an orderly exchange system. Intensive work was therefore carried out both within the Fund and outside it to determine what exchange rate relationships among major currencies would give promise of stability in the foreseeable future, without recourse to restriction and large scale intervention in the markets by national authorities."[7]

A new pattern of major exchange rates was unquestionably needed and there was no little truth in President Nixon's assertion that the previous pattern was unfavourable to the United States. Under the IMF system the U.S. dollar was in effect the fulcrum against which all other currencies reacted with each other on the exchange markets. Other countries selected their exchange parities in terms of the dollar and bought or sold dollars on exchange markets to defend them but the U.S.

dollar was valued solely in terms of gold and was, in effect, virtually defenceless against alterations in the par values of other currencies. The defencelessness of the U.S. dollar had more than one dimension. Since the value of the U.S. dollar was, under the Articles of Agreement, fixed in terms of gold only and not in terms of another currency, the only option open to the United States, if it wished to devalue, was to increase the price of gold. Under U.S. law this could only be accomplished by act of Congress. Further, it was open to other countries to increase the price of gold by the same amount and by doing so they could nullify the U.S. attempt to devalue the dollar in terms of other currencies. Over the preceding years other countries had sometimes depreciated their currencies (against the U.S. dollar and gold) but they had rarely appreciated them, even if they were in a strong creditor position with their currencies substantially undervalued.

During the period of the Vietnam War, the U.S. dollar had thus become considerably over-valued in terms of other major currencies. President Nixon's announcement of 15 August made it clear that this situation was to be brought to an end. In the autumn of 1971 there were important meetings of G 10 with the Canadian Minister, Edgar Benson, in the chair.[8] The new pattern of major currency values emerged on 18 December after a meeting in the Smithsonian Institution in Washington. Immediately following the G 10 meeting the Executive Board of the Fund met to approve a revised system of stabilized rates under which countries could select new "central rates" for their currencies (without the formalities involved in altering par values under the IMF rules) and could also adopt a wider band around the par value or central rate (2¼ per cent on each side) within which they would defend their exchange rates, as opposed to the narrower band (1 per cent on each side) required by the IMF rules.[9]

Together with the new pattern of major exchange rates a new official price for gold was negotiated. (The official price, it will be recalled, had already been detached from the market price in 1968; see p. 190 above.) The U.S. authorities were reluctant to ask Congress to reduce the gold content of the dollar; they proposed that the European countries should, in terms of their own currencies, devalue both the U.S. dollar and gold to the full extent required. This approach was unacceptable to the Europeans. They saw no reason why the United States should not at least bear its share in whatever political and technical difficulties might attach to the general revaluation of gold. Moreover, on their side of the Atlantic gold reserves are held, not by treasuries, but by central banks, and a substantial write-down of a major asset (gold) could involve book-losses equalling or exceeding their capital, in which case government action would be needed to prevent formal bankruptcy.[10] In the end a compromise was reached in which the official value of gold was to be raised in terms of U.S. dollars from $35 to $38 per ounce and reduced in terms of other currencies. On the average, in relation to major currencies, the value of gold, and of the SDR which was still attached to it, was left virtually unchanged. (Table A).[11]

The United States also agreed to drop the discriminatory Job Development Tax Credit and, much more important, to discontinue the 10 per cent surcharge on imports. This, however, was only agreed on condition that the EEC, Japan and Canada would undertake "urgent negotiations" on what the United States considered to be outstanding trade issues.[12]

For six months there seemed some hope that the new system, with its altered par values or central rates and with its widened margins for movements of market rates around them, might work. As of January 1972 the Fund could report twelve new par values and thirty-three central rates with fifty-one countries taking advantage of the wider margins. On 8 May Congress approved $38 an ounce as the new official dollar price of gold.[13]

But on 23 June 1972 sterling was driven off its new central rate and the durability of the Smithsonian Agreement was immediately in question. During this period the U.S. Treasury did not call for further meetings of G 10 but explored the situation informally with the individual countries involved. Early in 1973 speculation ran strongly against the U.S. dollar; in the first ten days of February $10 billion flowed into the reserves of European countries and Japan. On 12 February President Nixon announced that he would seek a further reduction of 10 per cent in the official gold value of the dollar, bringing the official price to $42.22 per ounce. Meanwhile the market price of gold in London had mounted to beyond $90 an ounce. For a fortnight in March most major foreign ex-

Table A Exchange Rate Relationships Resulting from the Smithsonian Agreement

Member	Percentage Change in Terms of Par Value	Percentage Change in Terms of U.S. Dollar	Exchange Rate Action	Effective Date
Belgium	+2.76	+11.57	central rate	Dec. 21, 1971
Canada			floating rate continued	
France	–	+ 8.57	par value maintained	
Germany	+4.61	+13.58[1]	central rate	Dec. 21, 1971
Italy	–1.00	+ 7.48	central rate	Dec. 20, 1971
Japan	+7.66	+16.88	central rate	Dec. 20, 1971
Netherlands	+2.76	+11.57[1]	central rate	Dec. 21, 1971
Sweden	–1.00	+ 7.49	central rate	Dec. 21, 1971
United Kingdom	–	+ 8.57	par value maintained	
United States	–7.89	–	new par value	May 8, 1972

[1] Based on par value in effect prior to 9 May 1971.
SOURCE: *IMF Report*, 1972, p. 38.

change markets were closed, but no generally acceptable solution was found. By the end of July 1973 the currencies of seven of the major industrial countries were individually afloat (Austria, Canada, Italy, Japan, the United Kingdom, the United States and Switzerland), while eight other European countries were maintaining a fixed rate system among themselves but as a group were letting their currencies float against the outside world. This situation persisted with minor modifications through 1975 and beyond. It signalled the end of the par value system for major currencies that had been inaugurated at Bretton Woods.

Canada during the Breakdown

On 19 August 1971, four days after President Nixon's announcement, the Canadian ministers of Finance (E. J. Benson) and of Industry, Trade and Commerce (J.-L. Pépin) were in Washington. They were meeting with the Secretaries of the Treasury and of Commerce and their request was that Canada should be exempted from the new 10 per cent import surcharge. They agreed with the U.S. Secretaries that far-reaching measures were needed to correct the U.S. balance-of-payments deficit and that for this purpose a major realignment of exchange rates was essential. But since May 1970 when the Canadian dollar had been set free to float it had already appreciated by more than 6 per cent; thus President Nixon's charge that other countries were maintaining unfair rates could not be applied to Canada. Nor did Canada maintain the sort of trade barriers against U.S. goods to which the President had referred. Therefore the United States had no grounds for grievance against Canada.

Despite this, the Canadians pointed out, the surcharge was more damaging to Canada than to any other country; Canadian exports amounting annually to some $2.5 billion were affected. Canada was by far the best customer of the United States, buying more than Germany, Britain, France and Japan combined. Damage to Canadian exports and the Canadian economy would necessarily have damaging effects on U.S. exports to Canada. As for the very substantial trade surplus which Canada had developed with the United States in the previous year, this was abnormal and temporary; in any case, it was more than counter-balanced by "invisibles" so that Canada's overall current account with the United States was still in deficit (see Reference Table 12).

The U.S. ministers did not reject the Canadian case out of hand but said they would consider it.[15] However, from their point of view the argument was not compelling. The U.S. balance on current account had, over a short period of time, gone into deep deficit. To this the swing of the Canadian trade balance of some $2 billion in two years had contributed substantially. As they saw it, they had a threefold problem: Europe, Japan and Canada. They sought corrective action in all three directions. The surcharge was intended to give what seemed to them to be a much-needed jolt to their trading partners and, while Canada might be the hardest hit, Canada could not be exempted.

While the U.S. objectives were understandable the U.S. tactics were at the time, and still remain, a subject for comment. A dangerous element in the Nixon announcement was its protectionist overtone; the President was taking advantage of a financial crisis to foster home production and home employment. The attempt to export unemployment had been one of the most disruptive elements in the protectionist battles of the 1930s and it seemed that President Nixon might be embarking on a course for the 1970s which resembled that precipitated by the Smoot-Hawley tariff of the Republicans in 1930.

The economic effects of the surcharge (as distinguished from its shock effects) were actually a hindrance not a help to the main U.S. objective: that is, to get the value of the U.S. dollar down in terms of other major currencies. The GATT permits a country to use protectionist measures in order to support its currency in an emergency; but support for the dollar was the last thing that the U.S. authorities really wanted. The purpose of the surcharge was to precipitate action by others and this it did. Unfortunately the impact of the shock treatment was more severe on Canada than on other countries, but the early Canadian estimates of the damage to be suffered turned out to be exaggerated and, fortunately, it was terminated after only four months.

During those four months the European and Japanese, who were not nearly so exposed to the impact of the surtax, were able to "play it cool"; the Canadian ministers were not in a position to do so. With Canada so vulnerable, the government was under continuous attack in Parliament. Scarcely a day went by when, either in the question period or in the course of debate on one piece of legislation or another, there were not references to the surcharge, to the buy-American feature of the proposed job development credit and to the DISC proposals which were aimed at encouraging production and employment in the United States at the expense of the U.S. subsidiaries abroad. As a further aggravation it emerged that the U.S. Treasury had developed lists of trade grievances against other countries, including Canada, "irritants" as they came to be called. A Canadian list appeared in the Chicago *Tribune*, seemingly on the basis of a deliberate leak; high on it were the renegotiation (but not cancellation) of the auto pact, reversal of the half-billion dollar deficit that the U.S. had recently run up under the Canada – U.S. defence-sharing agreement and the restoration of the duty-free allowance to returning Canadian tourists (which had never been restored since it was cut back as part of the Canadian dollar emergency program of 1962).

Continual visits back and forth by officials and occasional visits by ministers produced no positive results. The Prime Minister was able to report in glowing terms on the cordiality with which he had been received on a visit to President Nixon late in 1971 but, as for the discussions in which the ministers of Finance and of Industry, Trade and Commerce had been engaged at the same time, he commented, not on cordiality, but on the "skillful, tough and professional manner in which they have led the team of Canadian negotiators."[16]

Not merely were Canadians unable to obtain any alteration in the American stand, but they encountered a tone and an attitude that were very different from those which had generally characterized Canada – U.S. relations since 1935 when new trade negotiations put an end to the trade war of earlier years. John Connally, Secretary of the Treasury, was the embodiment of the new attitude and it infected those around him. His approach to international negotiations seemed to be to establish an "adversary relationship" from the outset. Overtones of this attitude had appeared in President Nixon's original announcement. "It is very difficult," the Minister for External Affairs, Mitchell Sharp, told Parliament, "to settle the kind of problems now facing the world, economic and financial, if one is faced with ultimatums."[17] And a little later: "The United States does not have the right to put on a surtax and say 'Now you must bargain your way out of it'."[18]

Connally's adversary relationship was not, of course, reserved for Canada alone; it extended impartially to Europe and Japan and even to his own State Department which might be blamed for getting the United States into a mess with the rest of the world by agreeing to such one-sided bargains as the Canada – U.S. auto pact. Indeed Connally obtained an agreement from the President, which lasted for some months, that Canadians should discuss the outstanding issues with the Treasury only; State Department was excluded.

During the Smithsonian discussions, when the Americans were bargaining the withdrawal of the import surcharge against a new pattern of exchange rates which would result in a substantial reduction in the value of the U.S. dollar, Connally demanded not only that the Canadian dollar should once again be pegged but that it should be pegged above its existing level and above par with the U.S. dollar. Mr. Benson and his Canadian colleagues, however, would not budge from the floating rate based on market forces. In the end, with welcome support from the Managing Director of the IMF, the Canadian position was grudgingly accepted by the Americans, subject to the proviso (properly applicable to any floating currency) that the Canadian dollar should float freely and not be manipulated by the Canadian authorities. It was then endorsed by the Group of Ten along with new par values or central rates for other major currencies.

When the Minister of Finance tabled the Smithsonian Agreement in Parliament in December 1971, he was able to report the termination of the U.S. 10 per cent surcharge and also the termination of the discriminatory, buy-American element in the job development investment credit. As for the Canadian dollar, it would continue to float and Canadian interventions in the exchange market "will be limited to the maintenance of orderly market conditions." The altered official price of gold in terms of U.S. dollars would in no way affect Canadian trading relationships. And the operation of the Canadian Employment Support Act, which had been hurriedly passed in September to give financial support to Canadian firms damaged by the U.S. surtax, would be discontinued.[19]

On exchange rate policy there had been no give in the

Canadian position, but on other matters there probably could have been some give if the United States had not conducted the affair on the basis of its adversary relationship supplemented by disclosure of its list of Canadian irritants. Canadian ministers and officials were not unaware or unappreciative of the role which the United States had played in postwar world reconstruction. It had been in the common interest for the United States to take an open-handed and constructive attitude in many negotiations, both multilateral and bilateral. While this attitude was primarily extended to war-torn countries overseas it was also, on occasion and in time of need, extended to Canada.

Despite this, and because of the barrage of criticism which the American tactics stirred up in the Canadian Parliament, attempts to discuss the irritants with U.S. representatives tended to be unproductive, sometimes counter-productive. It had become essential that any concession granted by the Canadian negotiators should, at least in form, be matched by a counter-concession from the United States. Negotiations dragged on. More than a year after the Smithsonian Agreement questions were still being asked in Parliament about the irritants, and the questions were still getting negative or elusive replies.[20]

There was one occasion during this abrasive period when officials of the two countries were able to reach agreement on an apparently balanced package to be submitted to ministers. This particular package, however, was not acceptable at high levels in Washington and the opportunity passed. Fortunately as time went on some of the more serious irritants dissolved. Before the end of 1973 a member of Parliament representing an auto-producing constituency (Oshawa) called the attention of the House to the fact that the auto pact was now producing a deficit rather than a surplus for Canada.[21] Similarly, as U.S. military operations in Vietnam subsided, the balance on defence purchases also turned in favour of the United States.[22] And finally, without making any reference to the matter of irritants, the Minister of Finance quietly enlarged the duty-free tourist allowance in his 1974 budget.[23]

Despite the disappearance of irritants, the U.S. Treasury apparently continued for some time to view Canadians and Canadian affairs with mistrust – particularly Canadian reassurances that the Canadian dollar was not being manipulated but was floating cleanly. It probably appeared, at least from the viewpoint of the Treasury in Washington, that the Canadians had used their Exchange Fund to keep the Canadian dollar from appreciating ever since it was set free in June 1970 and that they had continued to do so despite their "clean float" undertaking in the Smithsonian Agreement.

The facts of the matter (as reflected in the Reference Tables at the end of this volume) appear to be as follows. There were periods when the international exchange markets were particularly unstable and when the operations of the Exchange Fund went beyond what has been described above as a clean float. In July 1971, for example, Canadian reserves increased while the Canadian dollar was actually falling. Again, from July to December, when world exchange markets were very unsettled and most major currencies were being protected by their authorities from undue appreciation against the U.S. dollar, the Canadian dollar appreciated by approximately 2 cents; during this period the Exchange Fund, resisting the movement, acquired an additional $700 million of reserves, an amount which probably ran beyond the requirements of "resisting sudden movements" under a clean float policy.

Following the Smithsonian Agreement, however, and following the Canadian undertaking that it included, the story appears to be different. Any misunderstanding there may have been in the U.S. Treasury probably attached to the fact that a clean float will as a matter of course involve some accumulation of reserves during a period when the rate is rising and the opposite when it is falling. Thus Canadian reserves did indeed rise from U.S. $5.6 billion in December 1971 to U.S. $6.2 billion in June 1972 while the Canadian dollar rose from approximate parity to a peak level of U.S. $1.021. (Of this increase in the reserves, U.S. $0.13 was attributable, not to operations in the exchange market, but to the increase of the official price of gold in terms of U.S. dollars; see Reference Table 13.) Both the reserves and the exchange rate remained high until October when a decline set in and by September 1973 the reserves had reverted to U.S. $5.6 billion. Apparently it was not until then that the U.S. Treasury felt able to view Canada's clean float with confidence.

With the U.S. dollar afloat, and with the U.S. authorities generally anxious to see it float at a lower rather than a higher relationship to other major currencies, the U.S. controls on capital exports were no longer helpful. Accordingly, on 29 January 1974 the United States announced the termination of the Interest Equalization Tax and of their guideline programs. The following day the Canadian guidelines on overseas capital exports were also terminated.[24] Thus the introduction of a floating rate regime brought to an end a situation that had complicated Canadian-U.S. financial relationships for a decade.

Breakdown in Retrospect

The final chapter of this book deals with the reform of the International Monetary Fund; but by way of introduction, it will be useful to review briefly some of the more fundamental developments that led to breakdown and that made reform necessary.

In recent years, in a number of the industrial and developed countries including Canada, the democratic process has led governments to launch an increasing number of programs of expenditure which, however worthy they may have been individually, collectively outran both the financial and the administrative competence of the authorities involved. In the administrative field the result has been a proliferation of bureaucratic bungling, but in the financial field the result has been inflation. The politicians who were elected on the basis of promises to undertake more and more expenditures were less and less willing to impose the taxes necessary to finance them. Hence a widespread resort to deficit borrowing by governments and to credit creation by central banks.

Inflation, while spreading from country to country, developed in some more strongly than in others. This, by itself, would have been cause enough for international payments to become unbalanced and for pegged exchange rates to come under attack. But, in addition, those responsible for investing the large and increasing mass of liquid funds under the control of commercial and financial concerns began to anticipate relative rates of national inflation and to move funds from one country to another in response to these anticipations. Thus currency instability based on actual inflation rates was compounded by instability related to anticipated inflation rates.

In no field was the declining effectiveness of financial authority and the rising power of private finance more clearly exhibited than in the major foreign exchange markets during the 1960s and early 1970s. The financial history of that period could well be written in terms of successive confrontations between "the authorities" and "the market." One after another, the world's major currencies were driven by market forces from their established par values, sometimes upward but more usually downward, and this in the face of the best endeavours of national and international financial authorities combined.

The par value system of the International Monetary Fund was, in a sense, an authoritarian system. The financial authorities selected the par value or price of foreign currencies and then, in order to bring international payments into harmony with that price, undertook to deploy whatever "adjustment mechanisms" lay within their power. The adoption of such a system at Bretton Woods in 1944 was natural not only in terms of its similarity to the way the gold standard had worked (or was supposed to have worked) in prewar years but also in terms of the fact that, in 1944, wartime financial controls were universal and private finance completely subservient to wartime requirements. Twenty years later, however, there had been a great shift in the balance of financial power. Thus par values were repeatedly attacked and often overthrown by the market operations of private enterprise. (Canada, having highly developed financial market relationships with the United States, found at an early date that it was difficult to operate within the par value system. She opted out in 1950 and again in 1970. Under her floating dollar arrangement she transferred to the market the primary responsibility for the level of the exchange rate, with the authorities having a reserve or standby responsibility in terms of the clean float.)

The international power and effectiveness of private finance was greatly enlarged by the development of what can, in a sense, be called "outlaw" markets: the Eurocurrency market and the Eurobond market. These markets are outlaw in the sense that they use funds that are for the most part outside the direct influence of central banks. To take an example, the Bank of Canada is responsible for the Canadian dollar and it has legal authority over Canadian financial institutions insofar as they operate in Canada in terms of Canadian dollars. But if those institutions accept deposits or make loans whether in Canada or in their branches or agencies in London, the West Indies, or elsewhere, in terms of U.S. dollars (or sterling or Japanese yen) these operations lie outside the Canadian control system. Nor, unless the particular operation is located in the United States (or in Britain or in Japan), will it fall clearly under the jurisdiction of any particular central bank.

These markets emerged in Europe as American commercial and financial concerns during the 1960s increasingly found themselves in possession of funds overseas which they preferred to hold abroad in terms of U.S. dollars rather than to bring home. In some cases they foresaw opportunities for long-term investment in Europe and elsewhere; moreover, interest rates abroad tended to be more attractive than at home; and when the U.S. government introduced its guidelines restricting capital exports any funds repatriated from overseas would be trapped in the United States.

The advantages of holding liquid assets in forms that lay largely outside national monetary controls, together with the somewhat higher interest rates that were to be obtained, led investors from other countries, including Canada, to place funds in these markets. Their operations grew greatly in the wake of the sudden increase in oil prices which in 1974 raised the international surplus of the major oil exporters from about five billion dollars to about $70 billion (see Appendix 1 to this chapter). The Euromarkets offered a ready and convenient outlet for the investment of a large portion of these funds.

Just as these new markets are fed by funds from many sources, likewise they are tapped by many borrowers.[25] The fact that they are not subject to direct central banking controls has been a source of both strength and weakness. They have greatly facilitated the international deployment of supplies of capital and provided accommodation to borrowers of many types. It is now widely accepted that, if these markets and the institutions of which they are composed had not been available to cope with the initial problems of "recycling" the massive flow of oil funds beginning in 1974, the resulting derangement of international finance and the setback to world economic growth would have been far more severe than, in fact, was the case. On the other hand, the oil-poor developing countries became indebted beyond their means and some of the more well-to-do countries may well have overreached themselves.[26]

Toward the end of 1974 both private financiers and public authorities began to show increasing concern over the new financial patterns that were emerging. The failure of several important private institutions had a sobering effect. The Bank for International Settlements, on behalf of the central banks of the Group of Ten, announced that new information was being collected and that attempts were being made to identify where the major operators in these offshore markets would turn for financial support in time of trouble.[27] As time went on the BIS surveillance system was strengthened.[28]

The fact that these markets are, in a sense, outlaw has not deterred national authorities and national agencies from making use of them both as borrowers and as lenders. A substantial proportion (estimates run as high as 25 per cent) of the recent increase in world reserves, which have more than doubled since 1970, is now held in the form of Eurocurrency deposits. Statistical tables which appear in Appendices 2 and 3 at the end of this chapter illustrate some of the changes in the international financial structure that have accompanied these developments. Among the points to note are the increase in world reserves that took place both before and after the increase in oil prices (January 1974) and the fact that afterward almost the whole of the increase went into the hands of the oil producers. Another point of interest is the fact that, despite the best intentions of ministers and officials who during the 1960s worried about the future of the world monetary system, the subsequent increase in dollar reserves far outran and overshadowed the very modest increase that resulted from the three-year experimental issuance of SDRs. Two words of warning regarding these tables should also be added. First, the figures are all expressed in SDRs as a common denominator. This means that an increase in the value of the U.S. dollar in terms of SDR (such as took place between 1974 and 1975) is reflected in the table as an increase in U.S. dollar reserves. Second, gold is valued throughout at the official IMF price; if gold reserves were valued at market prices they would (depending on the current market) show a very substantial increase.

The foregoing remarks on world reserve developments make it clear that much of the thought and effort that went into the launching of the SDR in the late 1960s, while by no means misplaced from a long-run point of view, was untimely in terms of actual course of events. What cracked in 1971 – 73 within the world monetary system was not its ability to generate new reserves in place of gold and/or the U.S. dollar but rather the rigidity with which major exchange rates were linked together. This was the storm centre of those tempestuous years. One of the notable features of the discussions in G 10 during the 1960s on the future of the world monetary system was that its agenda never provided for a consideration of increased flexibility of exchange rates. Despite the very active discussion of this subject at the time in academic circles, it became virtually taboo in G 10. Such discussion could have implied some question regarding the determination of the United States to maintain what was, for it, the only exchange rate subject to its control: the exchange rate between gold and the U.S. dollar.

A similar hesitancy to explore increased exchange rate flexibility was to be found in the IMF. Individual Executive Directors and senior staff members held a variety of views and in 1970 the Executive Directors issued a report on "The Role of Exchange Rates in the Adjustment of International Payments."[29] But the modest thrust of this document was in favour of some widening of the bands within which exchange rates should be allowed to fluctuate around established parities rather than any basic alteration of the parity system such as automatic parity adjustments (crawling pegs, etc.) or floating rates.[30]

In its report on the world monetary breakdown of 1971 and on the forces and events leading up to it, the Bank for International Settlements stressed the insistence by the U.S. authorities that "the official parity of the dollar was inviolable and could not be changed to achieve a general increase in the official value of gold or to obtain a realignment of currencies."[31] It is true that these and other inhibitions circumscribed the work of the Group of Ten and of the Fund. But, in retrospect at least, it seems clear that what was needed was not merely a new value for the U.S. dollar but a new set of rules and arrangements to replace the par value system, at least as it related to relationships between major currencies.[32]

In this regard, it is important to distinguish between the par value system and the whole structure of the Fund of which that system was a part. In describing the Fund in chapter 2 a distinction was drawn between the purposes of the Fund and the new rules (including the par value system) which were intended to promote those purposes. Primary purposes, as set out in Article I, were "to promote international monetary coöperation through a permanent institution which provides the machinery for consultation and collaboration ... and ... to promote exchange stability, to maintain orderly exchange arrangements among members and to avoid competitive exchange depreciation.... The fund shall be guided in all its decisions by the purposes set forth in this Article." The par value system, with its authoritarian overtones, seemed the best system that could be devised in 1944 to serve these purposes.[33] But it is not the only such system and in the circumstances of the mid-1970s it had ceased to be the best system for relationships between major currencies. What was needed was a more flexible system that reflected the rise in market power.

The process of reform of the Fund involved, of course, more than a restructuring of the particular exchange rate system for which it provided. While greater accommodation had to be provided for market forces, it was important not to throw out the baby with the bath water; the role of the Fund as the world's ultimate international financial authority had to be maintained and, if possible, strengthened. For example, while the initial issuance of SDRs had proved to be untimely, the attempt to provide a basic world reserve asset, whose rate of growth would not be affected by the balance-of-payments deficits of the United States or any other reserve currency country nor yet by the vagaries of gold mining or gold speculation, had to be preserved and pursued.

Further, the creation and movement of funds outside the conventional limits of national central banking control had to be recognized as a threat to international financial stability. The view has been authoritatively expressed that the net addition to the world credit system that has resulted from the operation of the Eurocurrency system can be and often has been exaggerated; on the other hand, there is no question about the increased pressures on foreign exchange rates that have resulted from the movement of these funds.[34]

Surveillance by central banks under the auspices of the BIS is to be welcomed, but its limitations must be recognized. From its inception in 1930 the BIS has performed two quite different functions. Its original formal responsibility – to facilitate the transfer of German reparation payments to the several Allied powers – disappeared almost immediately with the cessation of such payments, but subsequently its members, at that time limited to the leading central banks of Europe, found it a useful agency to assist in the financial rehabilitation of European countries after the shocks of 1930 – 32 and after the Second World War to cooperate in Marshall Plan reconstruction and to manage certain collective financial activities such as the European Payments Union.

Of broader significance, however, has been its role as an informal but none the less influential club of the world's major central bankers in which the Americans and more recently the Canadians have participated. Monthly meetings are held at its headquarters in Basle, Switzerland, and the discussions of world-wide issues are supported by a small but expert staff with access to information, statistical and otherwise, from the cooperating central banks. Occasionally the participants reach collective decisions and make use of the BIS as a means for promulgating them – for example, when the Gold Pool was organized in 1961 or when surveillance of the Eurocurrency system was initiated in 1974. But, as an institution, the BIS has limited powers and a limited membership. It also lacks authority to deal with political issues. For example, while it can collect valuable information regarding the growing indebtedness of oil-poor developing countries, it has no means of mobilizing an attack on or participating in a solution of the problems that emerge.

In short, in the longer term, it is only the Fund, comprehensive in its membership and having formal relationships with governments, which can take responsibility for developing a coherent and cohesive world monetary system. Some people envisage it as eventually becoming a "world central bank." That term can raise as many issues as it settles but it is clear that developments in this direction, being both technically complex and politically controversial, will be slow and time-consuming.[35] However, they must not be lost to sight either in ad hoc settlements of financial crisis or in accommodating a changed balance of power between the market and the authorities. It is within this framework that we now turn to consider the measures taken in recent years to reform the Fund.

APPENDIX 1

Global Balance of Payments Summary, 1972-74 (in billions of U.S. dollars)

		Balance on				
		Trade	Services and Private Transfers	Current Account	Capital Account Balance	Overall Balance
Industrial countries	1972	11.2	–0.9	10.3	–11.0[1]	–0.7
	1973	11.0	–0.8	10.2	–10.6[1]	–0.3
	1974	–10.0	–1.6	–11.5	–4.5[1]	–16.1
Major oil exporters	1972	13.0	–10.4	2.6	1.3	3.9
	1973	21.6	–16.0	5.6	–1.3	4.3
	1974	83.4	–13.4	70.0	–33.6	36.8
Other primary producing countries	1972	–9.6	2.2	–7.4	21.7	14.3
	1973	–11.3	3.7	–7.7	18.4	10.7
	1974	–40.8	1.0	–39.8	36.3	–3.5
More developed areas	1972	–2.9	4.6	1.7	6.2	7.9
	1973	–5.0	6.3	1.3	1.1	2.4
	1974	–18.5	6.6	–12.0	7.3	–4.7
Less developed areas	1972	–6.7	–2.4	–9.1	15.5	6.4
	1973	–6.3	–2.6	–8.9	17.3	8.4
	1974	–22.3	–5.5	–27.8	29.0	1.2

APPENDIX 1 continued

		Balance on				
		Trade	Services and Private Transfers	Current Account	Capital Account Balance	Overall Balance
In Africa	1972	0.1	–1.6	–1.5	1.7	0.2
	1973	0.9	–1.9	–1.1	1.5	0.4
	1974	0.5	–2.4	–1.9	2.1	0.1
In Asia	1972	–3.3	0.8	–2.5	4.8	2.3
	1973	–2.5	0.9	–1.6	4.1	2.5
	1974	–9.6	0.9	–8.7	10.0	1.3
In the Middle East	1972	–2.3	1.7	–0.6	1.4	0.7
	1973	–4.1	2.1	–2.0	3.1	1.1
	1974	–5.9	1.5	–4.4	4.6	0.3
In the Western Hemisphere	1972	–1.2	–3.2	–4.4	7.6	3.1
	1973	–0.5	–3.8	–4.3	8.7	4.4
	1974	–7.3	–5.5	–12.8	12.3	–0.5
Total, all countries	1972	14.6	–9.1	5.5	12.0	17.5
	1973	21.3	–13.2	8.2	6.5	14.7
	1974	32.6	–13.9	18.7	–1.4	17.2

Source: *IMF Report*, 1975 p. 13. For the countries included in the several categories, See Appendix 3 below.

Growth of Official International Reserves, 1955-76
(in billions of SDRs at end of period)

	Gold	SDRs	Reserve Positions in Fund	Foreign Exchange[1]	Total[1]
1955	35.0	–	1.9	18.1	55.0
1956	35.7	–	2.3	19.2	57.1
1957	36.9	–	2.3	18.4	57.7
1958	37.6	–	2.6	18.5	58.7
1959	37.6	–	3.3	17.5	58.3
1960	37.7	–	3.6	19.9	61.2
1961	38.6	–	4.2	20.5	63.3
1962	38.9	–	3.8	21.3	64.0
1963	39.8	–	3.9	24.1	67.9
1964	40.5	–	4.2	25.6	70.3
1965	41.5	–	5.4	25.4	72.3
1966	40.7	–	6.4	26.1	73.2
1967	39.4	–	5.7	29.3	74.4
1968	38.7	–	6.5	32.5	77.8
1969	38.9	–	6.7	33.0	78.7
1970	37.0	3.1	7.7	45.4	93.2
1971	35.9	5.9	6.4	75.1	123.2
1972	35.6	8.7	6.3	95.9	146.5
1973	35.6	8.8	6.2	102.0	152.6
1974	35.6	8.9	8.8	127.1	180.3
1975	35.5	8.8	12.6	137.8	194.7
1976 April	35.3	8.9	14.8	143.8	202.8

[1]Official reserves of Fund members, plus the Netherlands Antilles, Surinam, and Switzerland. Foreign exchange holdings for 1973 include official French claims on the European Monetary Cooperation Fund; those for 1955-66 include amounts incorporated in published U.K. reserves in 1966 and 1967 from proceeds of liquidation of the U.K. official portfolio of dollar securities.
SOURCE: *IMF Annual Report*, 1976, p. 34.

APPENDIX 3

Distribution of Official International Reserves, 1950-76
(in billions of SDRs at end of period)

	1950	1960	1970	1971	1972	1973	1974	1975	April 1976
Industrial Countries									
United States	24.3	19.4	14.5	12.1	12.1	11.9	13.1	13.6	14.7
United Kingdom	4.8	5.1	2.8	8.1	5.2	5.4	5.7	4.7	4.2
Subtotal	29.1	24.5	17.3	20.3	17.3	17.3	18.8	18.2	18.9
Belgium	0.8	1.5	2.8	3.2	3.6	4.2	4.4	5.0	4.5
France	0.8	2.3	5.0	7.6	9.2	7.4	7.2	10.8	8.4
Germany, Federal Republic of	0.2	7.0	13.6	17.2	21.9	27.5	26.5	26.5	29.9
Italy	0.7	3.3	5.4	6.3	5.6	5.3	5.7	4.1	4.4
Netherlands	0.5	1.9	3.2	3.5	4.4	5.4	5.7	6.1	6.2
Switzerland	1.6	2.3	5.1	6.4	7.0	7.1	7.4	8.9	8.2
Other industrial Europe[1]	0.5	1.8	3.8	4.9	6.0	6.9	6.6	9.1	9.5
Subtotal, continental industrial Europe	5.2	20.1	39.0	49.1	57.7	63.8	63.4	70.4	71.1
Canada	1.8	2.0	4.7	5.3	5.6	4.8	4.8	4.5	5.0
Japan	0.6	1.9	4.8	14.1	16.9	10.2	11.0	10.9	13.0
Total, industrial countries	36.8	48.5	65.8	88.8	97.5	96.0	97.9	104.1	108.0
Primary Producing Countries									
More developed countries									
Other European countries[2]	1.6	2.3	5.6	8.0	11.7	13.4	12.3	11.2	11.2
Australia, New Zealand, South Africa	2.1	1.3	3.0	4.2	7.6	6.5	5.0	4.2	4.3
Subtotal, more developed primary producing countries	3.7	3.6	8.5	12.1	19.4	19.9	17.2	15.4	15.5

	1950	1960	1970	1971	1972	1973	1974	1975	April 1976
Less Developed Countries									
Major oil-exporting countries[3]	1.3	2.4	5.2	8.0	10.3	12.4	39.2	49.6	50.8
Other Western Hemisphere[4]	2.4	2.2	4.3	4.4	7.3	9.7	9.1	7.7	8.4
Other Middle East[5]	1.1	0.7	1.6	2.0	2.6	3.6	4.0	4.5	4.8
Other Asia[6]	3.7	2.7	5.8	6.3	7.6	8.8	10.5	11.2	13.0
Other Africa[7]	0.6	0.9	1.9	1.6	1.9	2.1	2.4	2.2	2.2
Subtotal, less developed countries[8]	9.8	9.0	18.9	22.3	29.7	36.6	65.2	75.2	79.3
Total	50.3	61.2	93.2	123.2	146.5	152.6	180.3	194.7	202.8

[1] Austria, Denmark, Luxembourg, Norway, and Sweden.

[2] Finland, Greece, Iceland, Ireland, Malta, Portugal, Spain, Turkey, Yugoslavia, and beginning in 1972, Romania's reserve position in the Fund and holdings of SDRs.

[3] Algeria, Ecuador, Indonesia, Iran, Iraq, Kuwait, the Libyan Arab Republic, Nigeria, Saudi Arabia, Trinidad and Tobago, Venezuela, and, beginning in 1960, Gabon, in 1965, Bahrain, in 1966, Qatar, in 1970, Oman, and, in 1973, the United Arab Emirates.

[4] Argentina, Bolivia, Brazil, Central America, Chile, Colombia, the Dominican Republic, Guyana, Haiti, Jamaica, Mexico, Panama, Paraguay, Peru, Surinam, Uruguay, and, beginning in 1966, Barbados, and, in 1968, the Bahamas and the Netherlands Antilles.

[5] Cyprus, Egypt, Israel, Jordan, Lebanon, the Syrian Arab Republic, and, beginning in 1965, the People's Democractic Republic of Yemen, and in 1973, the Yemen Arab Republic.

[6] Afghanistan, Burma, the Republic of China, Fiji, India, Korea, Lao People's Democractic Republic, Malaysia, Nepal, Pakistan, the Philippines, Singapore, South Viet-Nam, Sri Lanka, Thailand, Western Samoa, and, beginning in 1973, Bangladesh.

[7] African Fund members other than Algeria, Gabon, the Libyan Arab Republic, Nigeria, and South Africa.

[8] Includes residual.

SOURCE: *IMF Annual Report, 1976, p.* 35.

1 Unless otherwise indicated, information in this section is based on the IMF annual reports for 1971, 1972 and 1973. A comprehensive account of the breakdown of the system and the events leading up to it is given in the *Forty-Second Annual Report of the Bank for International Settlements* (Basle, June 1972), pp. 1-33.

2 *IMF Report*, 1972, p. 31.

3 While it cannot be denied that the inflationary forces at work in the United States constituted a very real cause of disequilibrium in world balances of payments, it is nevertheless interesting to note that, on the evidence of the most generally applicable price index (the GNP deflator), the performance of the United States was in fact better in 1970 than that of any major European country or of Japan and in 1971 was better than the European countries although not Japan. Incidentally, the Canadian performance in both years was better than any of them; this was partly attributable, no doubt, to the fact that the Canadian dollar was floating upward. (See *IMF Report*, 1972, p. 7.)

It emerged afterwards that the main incentive measure in the U.S. program, the Job Development Credit, was discriminatory since it applied only to purchases of capital equipment that had been manufactured in the United States. This provision, which contravened GATT, was withdrawn in December.

4 U.S. Information Service, Ottawa, Text of President Nixon's Economic Address: 15 August 1971, pp. 3-4.

5 *IMF Report* 1972, p. 38.

6 *Ibid.*, p. 2.

7 *Ibid.*, p. 38.

8 BIS, *Forty-Second Annual Report*, p. 29.

9 For completeness it should be added that the spreads referred to here related to currencies, including the Canadian dollar, which made use of the U.S. dollar for international transactions. Between currencies utilizing another intervention currency such as sterling (which itself operated within the 1 and later the 2¼ per cent spread against the U.S. dollar) the spreads could be as wide as 4½ per cent.

10 Many commercial concepts such as bankruptcy are not in

fact, applicable to central banks. See A. F. W. Plumptre, *Central Banking in the British Dominions* (Toronto: University of Toronto Press, 1940), pp. 29-42.

11 Table A above indicates the new exchange rate pattern for major currencies that resulted from the Smithsonian Agreement of 18 December 1971.

12 For the full text of the Smithsonian Agreement see IMF, *International News Survey*, Vol. XXIII, No. 50 22-30 (December 1971).

13 *IMF Report*, 1972, p. 39.

14 This account of the Canadian position is based on that given by the Minister of Finance at the opening of Parliament: Canada, House of Commons, *Debates*, 7 September 1971, pp. 7579-82. See also his statement at the annual meeting of the International Monetary Fund (International Monetary Fund, *Summary Proceedings*, 1971, pp. 22-27). A fuller account is contained in a speech by the Minister of Trade and Commerce to the Canada-California Symposium, San Francisco, 29 October 1971, issued by that Department in a news release.

15 House of Commons *Debates*, 8 September 1971, p. 7621.

16 *Ibid.*, 7 December 1971, p. 10205.

17 *Ibid.*, 27 October 1971, p. 9084.

18 *Ibid.*, 15 November 1971, p. 9560.

19 *Ibid.*, 20 December 1971, pp. 10599-600. The alteration of the price of gold in terms of U.S. dollars had been a contentious issue between the Europeans and the Americans, as indicated above, but not in Canada. When the price of gold was again increased in terms of U.S. dollars early in 1973, a question was raised in Parliament about its impact on the value of Canada's reserve holdings. (*Ibid.*, 13 February 1973, pp. 1224-25.) The Minister of Finance was able to give reassurance, but the episode is of interest because Canadians, unlike Europeans and others, have generally been disinterested in the so-called "profits" or "losses" arising from occasional changes in the valuation attached to Canada's reserve holdings. Indeed, with a floating exchange rate, the valuation may change upward or downward from day to day.

20 E.g., *ibid.*, 12 February 1973, p. 1171.

21 *Ibid.*, December 1973, p. 8657.

22 Senate of Canada, Standing Committee on Foreign Affairs, *Proceedings*, 6 April 1976, p. 307.

23 House of Commons, *Debates*, 6 May 1974, p. 2086. "I propose to liberalize the provisions in the Customs Tariff under which goods brought back by Canadian residents on their return from trips abroad are exempt from duties and taxes. The quarterly exemption available after an absence of 48 hours will be doubled to $50 from $25. The annual exemption, now available after an absence from Canada of 12 days or more, will be increased to $150 from $100. Moreover, the minimum period of absence required to qualify for the annual exemption will be reduced from 12 days to 7 days. And I should mention that the Minister of National Revenue has recently directed that the administrative requirements at the border for those claiming the quarterly exemption should be materially eased."

24 The announcement terminating the Canadian Guidelines on 30 January 1974 was reprinted in the Bank of Canada *Report* for 1974.

25 The story of the growth and diversification of these markets is told in the annual reports of the Bank for International Settlements.

26 In the first four months of 1976 Canadian private and governmental bodies raised more than $3 billion on markets abroad, of which $1 billion came from Eurobond markets. See Bank for International Settlements, *Fiftieth Annual Report, 1975-76* (Basle, 1976), p. 94.

27 Bank for International Settlements, Communiqé, 10 September 1974.

28 C. W. McMahon, "Controlling the Euromarkets," *Bank of England Quarterly Bulletin* (March 1976), pp. 74-77.

29 International Monetary Fund, Washington, D.C., 1970.

30 Lest the present writer should be charged with being wise after the event he would refer to A. F. W. Plumptre, "Flexible Parities, The Case for Smoother Exchange Rate Adjustment," presented to a seminar of the Executive Directors and staff of the International Monetary Fund, November 1968.

31 Bank for International Settlements, *Forty-Sixth Annual Report, April 1971 – March 1972* (Basle, 1972), p. 11. See also p. 15.

32 Although the par value system broke down as between the developed countries, it was staunchly upheld by the developing countries who traditionally pegged their currencies to one or other of the reserve currencies (the dollar, sterling or the franc) and to whom movements between these currencies was most disturbing both commercially and financially. The par value system, based on control rather than free market forces, generally conforms to their governmental systems and objectives and they have persistently resisted the move by the major developed countries toward a floating rate regime.

33 Nevertheless, as early as the 1950s the Fund was willing to accept Canada's failure to defend a par value in view of the fact that Canada was upholding the purposes of the organization and the "General Obligations" of its members.

34 See McMahon, "Controlling the Euromarkets." Also Helmut W. Mayer "The B.I.S. Concept of the Eurocurrency Market," *Euromoney* (May 1976), pp. 60-66.

35 H. Johannes Witteveen, "The Control of International Liquidity," *IMF Survey* (26 October 1975), pp. 313-16.

11

Reform of the Monetary Fund 1971 – 75

Plans for Reform

Following the Nixon announcement of August 1971 the need to press forward with international monetary reform became more obvious and more urgent, but even before that time, it will be recalled, a number of steps had been taken.[1] The decision to create Special Drawing Rights was taken in 1969. This had been preceded in 1968 by the two-tier gold market arrangement which segregated world gold reserves from commercial gold markets. It was followed in 1970 by the issuance of an IMF report on "The Role of Exchange Rates in the Adjustment of International Payments"; one of its main recommendations (wider bands for exchange rate movements around established par values) became embodied in the Smithsonian Agreement of December 1971.

Thereafter the pace of reform quickened. Moreover, the direction of reform shifted in response to unexpected disturbances of unprecedented dimensions in the world economic balance. As a result of widespread crop failures in 1972-73 coinciding with a period of strong demand in industrialized countries the prices of foodstuffs and agricultural raw materials had risen by the end of 1973 to 250 per cent of their level two years earlier and by mid-1975 they still stood at 175 per cent of that level. Superimposed on these developments came the announcement by the Organization of Petroleum Exporting Countries (OPEC) at the beginning of 1974 that oil prices would forthwith be increased some fourfold and that exports to certain countries would be restricted. The crop failures and the oil measures added fuel to the fires of worldwide inflation and reinforced growing apprehensions regarding the exhaustion of some world resources, the pollution of others, and the possibility that the limits to world growth were looming no great distance ahead. Basic assumptions regarding economic and social policies, national and international, came into question.

The increase in oil prices created at one stroke a new balance of world economic power, at least insofar as power is reflected in ability to generate a current account surplus and thus to export capital and direct its uses. The major oil exporters increased their modest surplus of $2.6 billion in 1972 to the staggering figure of $70.0 billion in 1974 (see Appendix 1 in chapter 10). The reciprocal of this vast surplus accruing to the oil exporters was, of course, a series of unprecedented deficits among oil importers. Industrial countries collectively switched from a current account surplus of $10.3 to a deficit of $11.5 billion. The less developed countries (other than oil exporters) moved from an already serious deficit of $9.1 to a deficit of $27.8 billion. In 1975 the situation of these countries actually worsened and, while various financial expedients, official and commercial, averted international collapse, the whole situation remained precarious.

Inflationary conditions persisted in the industrial countries; double-digit figures for annual price increases were virtually universal. Moreover, inflation was accompanied by industrial stagnation and high levels of unemployment. New considerations entered into the formulation of national financial and economic policies; for example, while exchange depreciation might result in an export of unemployment it might also result in an import of inflation; conversely, exchange appreciation operated as a dyke against rising tides of inflation abroad. As for the poorer developing countries, their economic situation was clearly insupportable; there can be no surprise that by 1975 the demands of the Third World for a new world economic order were increasingly insistent.

This was the sombre backdrop against which plans for reform of the International Monetary Fund were being pressed forward. The urgency was increased by the ever-present and growing danger that the whole fabric of the postwar economic order would unravel, that as in the 1930s countries would feel forced to resort to protective devices in the hope of alleviating both domestic unemployment and international payments problems. In the hope of restraining member countries from hasty resort to internecine protectionist measures, various international organizations, including the IMF, the GATT and OECD, adopted anti-protectionist resolutions or commitments.[2]

Rather than attempt to trace the various reform proposals from their early origins through the rapidly changing world circumstances just outlined, it seems expedient to begin at the end which, for this volume, must be the annual meeting of the Governors of the Fund in September 1975, as supplemented by a meeting of the Interim Committee of Governors in Jamaica in January 1976. By that time agreement had been reached on a package of measures for reform. Some of these measures would require amendments to the Articles of Agreement and the Executive Directors were requested to draft them; others were put into effect as they were agreed upon.

It is not easy, so soon after the event, to appraise the significance of this reform package. One recalls that, at the time of the short-lived Smithsonian Agreement, President Nixon referred to it as "the most significant monetary agreement in world history" and the French Minister of Finance, M. Fourcade, hailed it "as the beginning of a new monetary and political era." Therefore, before going in some detail into what is contained in the package it is important to call attention to some of the things that are left out.[3]

The contents of the package do not deal in any effective way with the overall world liquidity problem. Five years earlier the agreed approach to this problem had been through the issuance or non-issuance of the new SDRs but by 1975 any influence the SDR might have had was swamped by a vast increase in world reserves in the form of holdings of reserve currencies, chiefly U.S. dollars. No means of coping with the reserve currency problem, exacerbated by the development of Eurocurrency practices, is offered in the package. And the future of the traditional world reserve asset, gold, is left uncertain. It can be claimed that the phasing-out of gold, which began with the two-tier gold market of 1968, is still moving forward. But it can also be claimed that the way has now been opened for those central banks that wish to do so to abandon the now fictitious official value of $42.22 per ounce, to revalue their reserves to market prices (thus adding fuel for further inflation) and once again to use gold among themselves in settlement of international balances. Against this background of developments or non-developments relating to reserve currencies and gold it would seem unwise to place reliance on claims that the SDR is on its way to becoming the world's primary reserve asset. Indeed, agreement was reached at Jamaica to give low, not high, priority to the task of developing an IMF "substition account" which would make the SDR more usable and thus more acceptable and more desirable as an asset.[4]

A second area in which the reform package may be found wanting is in its failure to provide for reasonably firm undertakings by IMF member countries to take measures to facilitate the international adjustment process and to provide the IMF itself with real authority in the field. As late as June 1974 a Committee of Fund Governors (the Committee of Twenty which was succeeded by the Interim Committee) had produced *Outline of Reform*, which in general terms proposed "an effective adjustment process.... Countries will take such prompt and adequate adjustment action, domestic or external, as may be needed to avoid protected imbalances.... Countries will aim to keep their official reserves within limits.... For this purpose reserve indicators will be established.... The Fund will have available graduated pressures to be applied to countries in large and persistent imbalance, whether surplus or deficit."[5] But in the year and a half between this *Outline* and the Jamaica meeting these obligations of member countries, along with the authority to be given to the Fund, were softened and the specifics omitted.

The Jamaica agreement also embodied the final compromise that was negotiated in regard to a very basic issue: an elasticized par value system ("stable but adjustable parities") versus floating rates. The compromise consisted of accepting both the French insistence that the Fund must have a par value system as an objective and the American insistence that, for major currencies, only a floating rate system could be expected to work under world conditions as disturbed as they were at the time and as they seemed likely to remain. The compromise was a permissive one: each member country of the Fund could opt for the system of its choice.

A word of explanation is required regarding a shift in the position of the U.S. authorities. In 1971-73 they were still seeking a system (as at the Smithsonian meeting) based on stable but adjustable par values, but by 1975 they were insisting that "the right to float must be clear and unencumbered."[6] The preceding decade had shown that a regime of stabilized exchange rates (rates that were stabilized by the authorities of other countries in terms of the U.S. dollar as the world's main reserve and trading currency) tended to force the dollar into an overvalued position; this, in turn, hampered sales of U.S. products in markets at home and abroad, depressed employment, and forced the U.S. authorities into cumbersome attempts to improve their position on current account and to restrict capital exports. In negotiations during 1974-75 the United States had pressed hard for an "objective indicator" system under which creditor countries would be bound to play their full part in redressing any imbalance, but the system they proposed had been too rigid for other countries to accept. At this point the United States switched its support to floating rates.

Despite the deficiencies of the reform package which was finally tied together at Jamaica it was probably the best that could be expected under changing circumstances. It was designed to deal with actual conditions, including both national arrangements for the use of new reserve currencies, especially the German mark and the Japanese yen, and also regional arrangements such as the European "snake-in-the-tunnel," under which EEC countries had been attempting, with limited success, to confine exchange fluctuations among themselves more narrowly than in relation to other major currencies. It also reflected conditions as they might be in a more stable world in which a new system of adjustable par values became once again practicable. And finally, it provided the Fund itself with the possibility, although not the certainty, of adequate authority over the international exchange rate system.

We may now turn to other important elements in the reform package with particular attention to those of special interest to Canada. To begin with, since a decision of the Executive Directors in 1974,[7] there are supposedly guidelines to be followed by a country electing to allow its currency to float. Actually, however, these guidelines have not been implemented in the face of continuing U.S. insistence that "objective indicators" of good behaviour for creditors as well as debtors should be pursued rather than anything resembling a new regime of stabilized exchange rates. They are, however, of considerable interest and may in due course become influential.

The proposed IMF guidelines are not as strict as those which Canada had imposed upon itself in the 1950s and again in the 1970s and which have been frequently referred to above as constituting a "clean float." Such a float, it will be recalled, requires that (except in a period of special international disturbance in the exchange markets) the authorities should strictly confine themselves to maintaining orderly conditions by resisting market pressures in one direction or the other without bias and without taking aggressive action. The IMF guidelines, on the other hand, envisage not only that national authorities will smooth market fluctuations but also that they will resist movements in market rates that appear to be deviating substantially from "a reasonable estimate of the medium-term norm." While a country should not normally act aggressively it might do so, with the agreement of the Fund, in order to bring its rate toward such a norm. Indeed, the Fund might actually encourage a member country to act aggressively to bring its exchange rate toward a norm.[8]

It is recognized in the guidelines that a floating rate will be influenced, and can be manipulated, by national financial policies of various sorts (see pp. 225-26 above). No set of formal rules could cover all such practices and accordingly "the Guidelines are intended to provide the basis for a meaningful dialogue between the Fund and member countries with a view to promoting international consistency during a period of widespread floating." Actually, to keep abreast of developments, the Fund holds consultations with major floating-rate members with increased frequency – three or four times a year instead of only once which had generally seemed sufficient as long as the par value system was in effect.

Another matter in which Canadians have shown continuing interest is the role of the SDR. The enormous leap of world reserves in the form of reserve currency holdings has, of course, rendered almost insignificant the initial issue of SDRs during 1970 – 72 and deferred the likelihood of further issues. Nevertheless, the SDR has emerged as an international standard of value – a basic denominator or "numeraire." For Fund purposes gold is now valued in terms of SDRs rather than vice versa. A number of countries that normally pegged their currencies to the U.S. dollar, the French franc or to sterling, now peg them to the SDR. And the international statistics of the IMF and of some other financial authorities are now published in terms of SDRs rather than U.S. dollars or gold.[9]

For this development to become possible it had been necessary to agree at least provisionally on a method of valuing the SDR itself in terms other than gold. Such an agreement was announced by the IMF in June 1974 to take effect on 1 July. The SDR was assigned the average value of a "standard basket" of sixteen major currencies, one of which was the Canadian dollar. Current exchange rates between the SDR and each of these currencies have ever since been announced daily by the IMF.

The fact that private institutions cannot, at least as yet, hold SDRs has not prevented some of them from making use of it as numeraire. Various private transactions are already valued or denominated in it. These include some bond issues and other loans on the Eurocurrency markets, the pricing of oil exports by some OPEC countries, and tolls on the Suez Canal. It is, however, too early to know how far such use of the SDR is likely to spread; while the particular basket of currencies in terms of which the SDR is valued offers advantages for some purposes it involves disadvantages for others.[10] And as a matter of convenience the U.S. dollar is still in almost universal use as the most general measure of international values.

Another constituent of the reform package was agreement on the size and distribution of a general increase in members' quotas. The overall increase was to be 32.5 per cent rounded up to SDR 39 billion.[11] The share of major oil exporters, as a group, was to be doubled and the share of other developing countries, as a group, was not to be permitted to fall. The necessary decline in proportion (but not, of course, in aggregate) was to fall on the developed countries. The negotiation of the shares of individual countries within this group was not concluded until the day before the annual meeting. Among the factors contributing to delay was the changed position of the EEC countries since the previous general quota revision. A country's quota has traditionally been related to its external trade and, although the EEC countries increasingly speak or attempt to speak in unison on economic policy matters, the trade to which their individual quotas had related included their internal trade with each other. To aggravate the issue further, Britain had now joined the EEC, bringing with her an altogether outsized quota and voting power: 8.99 per cent of the total as of April 1975, compared with only 5.17 for Germany, 4.85 for France, 3.50 for Japan and 21.40 for the United States.[12] (Britain's outsized voting power related partly to the prewar international economic strength of the metropolitan country together with its colonies, as viewed from Bretton Woods, and partly to the fact that no provision was made for splitting up the quota of a metropolitan power when its colonies became independent and joined the IMF as member countries in their own right.)

The doubling of the share of the quotas allotted to the major oil exporters was important both in giving them an increased voice in the operation of the IMF and in enlarging the Fund's lending power. The national currencies that they contributed under their quotas were to be acceptable for inclusion in IMF loans. Early in 1975 the IMF could announce that it was already using the currencies of seven oil exporters.[13]

Several provisions for the enlargement of IMF lending facilities were included in the reform package or under earlier decisions. These were important to the members at large and of particular importance to the developing countries that were harmed, not helped, by the increase of oil prices.

Prior to 1975 two new facilities had been introduced. Soon after the increase in oil prices an "oil facility" was set up to assist countries in meeting increased bills for oil and oil-based imports: this facility was terminated following a decision at the Jamaica meeting. The same meeting reported a substantial enlargement of the Fund's facilities for "compensatory financing" (to compensate for reductions in earnings from primary products).[14] Another special arrangement established in the fall of 1974 was the Extended Fund Facility, designed to provide countries in special balance-of-payments difficulties with loans of larger amounts and over longer periods than are normally available under the IMF rules.[15]

In addition the package included a provision that one-sixth of the gold held by the organization was to be sold and the profits placed in a Trust Fund for the benefit of the poorer developing countries. At the Jamaica meeting it was agreed that "the resources of the Trust Fund should be used to provide balance of payments assistance on concessionary terms to members with low per capita incomes. Initially eligible members would be those with per capita incomes in 1973 not in excess of SDR 300."[16] And as a final element in the enlargement of the lending powers of the IMF it was agreed that, pending the approval by Governors of the proposed general increase in quotas, normal lending arrangements could be based on 145 per cent of existing quotas instead of the normal 100 per cent.[17]

While these various arrangements, notably the Trust Fund, were intended to assist developing countries, it should be noted that a proposal in which they had for many years shown special interest was not in the package. This was the proposed "link" under which a portion of any new issues of SDRs would be specifically earmarked for development. This proposal, which had never been agreed to among developed countries, was shelved for the obvious reason that, considering the size of recent increases in the total of world reserves, it was not reasonable to anticipate any renewal of SDR issues. However, while the matter might be necessarily dormant, as far as the developing countries were concerned it was by no means dead. At Jamaica, members of the Committee of Twenty-four (eight from Africa, eight from Asia and eight from Latin America) expressed continuing support for the link.[18]

Before leaving the subject of IMF lending it seems appropriate to make a general comment which relates to the reform process, although not specifically to the reform package. Since the breakdown of the par value system and the emergence of floating rates among the major countries, criteria and attitudes within the Fund towards its lending operations have been changing. Under the Articles of Agreement the basic purpose of IMF loans has been to allow countries time in which to redress balance-of-payments deficit so that alterations in the par values could be avoided; only if a fundamental disequilibrium emerged in a country's payments, which could not be remedied otherwise, was the par value to move. More recently, however, the movement of the exchange rate, whether floating or pegged, has come to be regarded as an essential element in redressing payment imbalances. A movement of the rate sets in motion pervasive market correctives and these are expected to diminish reliance on the monetary and fiscal policies which were formerly regarded as providing the essential corrective measures. In a nutshell, whereas formerly domestic financial measures were to be used in order to promote balance-of-payments adjustments and thus to avoid exchange rate movements, nowadays exchange movements are accepted as an important means of promoting adjustment and thus of avoiding undue reliance on domestic financial policies. Thus, while IMF credit is still being extended to avoid movements of par values (or, since the Smithsonian Agreement, of central rates), it is often extended to assist countries to meet balance-of-payments deficits that are too severe for correction by moderate exchange rate movements and that threaten to involve the imposition of various forms of restriction, financial or commercial.

Finally, it remains to consider one other major move toward reform: the establishment of a new decision-making body within the IMF. This body is to stand between the Board of Governors – massive and cumbersome, with more than 125 members who deliver set speeches to audiences of thousands at annual meetings – and the twenty Executive Directors – officials who are permanently resident at the head office in Washington. What seemed to be needed was a body at the ministerial level, restricted in number, that could meet several times a year. It could take over from the Executive Board important decisions that involved political considerations. It could also take over, by delegation from the Governors, a number of decision-making functions that would otherwise have to be settled at the impersonal annual mass meeting or by the even more impersonal method of a vote by mail. In short, the intention was to introduce a more effective political influence into the Fund's decision-making.

The need for a move in this direction had been continuously urged by the developing countries both in successive meetings of the United Nations Conference on Trade and Development (UNCTAD) and latterly in the Group of Twenty-four.[19] Actually, the developing countries had much more effective representation on the Executive Board of the Fund than might have been expected from their share of the votes[20] in the organization but this fact probably was not widely recognized in those countries, especially in political circles.

It was not only among the developing countries that a desire for change in IMF decision-making was expressed. Other countries not privileged to belong to the exclusive Group of Ten have resented the increasingly important decision-making role that G 10 has been assuming outside the framework of the Fund. Nor were all the members of G 10 opposed to the new initiative. Some of them believed that the Executive Board of the Fund had become increasingly remote from current political issues and attitudes. It seemed to embody an expert elite.[21] Even the Americans, who had insisted at the time of Bretton Woods that the IMF should have a full-time Executive Board resident in Washington, had become disenchanted and John Connally, the Secretary of the U.S. Treasury, extended his adversary relationships to include the IMF and its Managing Director, Pierre-Paul Schweitzer.[22]

Despite criticisms of the structure of the Executive Board, that of the proposed Council is to resemble it. The Council, like the Board, is to consist of twenty members, representing the same member countries or groups of them as are represented by the twenty Executive Directors. However, while each Executive Director can have only one alternate, each member of the Council, like each member of the Interim Committee which provisionally fulfils some of its functions, may have as many as seven "associates." In this way ministers or those "of comparable rank" from many countries may personally participate.[23]

Reporting to the annual meeting in 1975 on behalf of the Interim Committee, its chairman, John Turner of Canada, referred as follows to the powers of the proposed Council: "One of the complicated issues connected with the Council has been resolved by agreement that, with the exception of a few powers of a political or structural character that should be reserved to the Board of Governors, it should be possible in principle to delegate all powers of the Board of Governors to the Council, to the Executive Directors, or to both concurrently. . . . "[24]

During the year 1974–75 the Interim Committee was very largely occupied with the negotiation of the package of measures for the reform of the Fund which has been outlined above. Under its mandate, however, it is also endowed with responsibilities for the on-going management and direction of the Fund system, responsibilities that would in due course devolve upon the proposed Council. It remains to be seen what success will attend this attempt to politicize decision-making within the framework of the Fund on a continuing basis. The Chairman of the Committee, referring to its future and hence to the future of the Council, concluded his 1975 report as follows: "Once the structural issues of amendment are out of the way, the Committee can deal with the crucial questions of our age – inflation, unemployment, poverty and the future of the Third World." These are brave words. They also refer to broad and complex issues. Apart from a few issues that arise only occasionally (such as whether to enlarge the quotas, or whether to undertake a new issue of SDRs), the great bulk of the Fund's business has been and will no doubt continue to be to consider the affairs, the policies and the needs of more than 125 individual countries. World unemployment is made up of national unemployment; world trade is made up of national external trade; and world development is made up of development in each of more than a hundred diverse and distinct developing countries. The decisions that are taken in regard to all these issues remain, in the present state of the world, essentially national decisions subject only to such influence as international bodies can exert.

It seems reasonable to ask how much time and attention can be given to such a vast multiplicity of matters by busy ministers of Finance or of Planning who meet together under Fund auspices only three or four times a year and then only for three or four days. But it is also very reasonable to ask whether an organization like the Fund, which depends for its success on the support and compliance of national governments, can afford *not* to involve ministers in its decisions on at least some of the detailed as well as on the general issues within its competence. There is no easy road, and certainly no well-trodden road, to the politicization of decision-making in an international organization with powers and with duties such as those of the IMF. Second thoughts about the Council are reflected in the fact that, while its powers and responsibilities are included in the new Articles of Agreement, it will not begin operations until a further decision of the Board of Governors requiring an 85 per cent voting majority. Meanwhile the Interim Committee, with advisory but not decision-making powers, can continue to operate.

Canada's Role in Reform

This book ends as it began, full circle, with Canadians once again deeply involved in the task of building, or in this case rebuilding, the world's central financial institution. As chairman of the Interim Committee which was responsible for developing many of the reform proposals, the most visible of the Canadians concerned was, of course, the Minister of Finance, John Turner. As a Canadian he had special qualifications. As in 1943–45 Canada, like other middle powers with broad international interests, had a systemic concern for the successful functioning of the world financial system. In 1973–75 Canadians were accepted within the Fund as having effective associations with all the important groups yet as being reasonably independent of all of them – the OPEC countries, the developing countries, the European Community and, last but not least, the United States.

During the 1960s and 1970s a series of actions by the United States had reinforced the concern of many Canadians to diminish their dependence on that country. In the financial field these actions had included the U.S. Interest Equalization Tax, the U.S. guidelines and, most recently, the Nixon statement of 15 August 1971 and the U.S. import charges. Accordingly, Canadians were seeking means of counterbalancing the pull of the U.S. economy and coping with the push of Washington policies. New counterweights were sought in a contractual link with the EEC, in ministerial visits to the OPEC countries, Japan and Latin America, in a closer relationship with the Organization for American States and, by means of a rapidly expanding external aid program, with the developing countries individually and as a group. In addition to all this, however, it was necessary to ensure that a well-established international institution like the Fund, with its dedication to the convertibility of world currencies and to the avoidance of discriminatory regional restrictions, should not only survive but should flourish. It was therefore with special zeal in the national interest that Canadians, ministers and officials alike, approached the reform of the Fund.

It would be difficult to find a more apt example of the advantage to Canada of working with and through an international institution, rather than alone in the cold world of bilateral power, than the support given at the Smithsonian Meeting in December 1971 by the Managing Director of the Fund to Canada's refusal to comply with the demand of the U.S. Secretary of the Treasury, John Connally, that Canada should join all other members of the Group of Ten in fixing a new par value or central rate which should be set at a premium over the U.S. dollar.

The development of the Canadian position on reform can be traced in public statements by the Minister of Finance. A few months after the Smithsonian meeting he insisted that reconstruction should take the form of rebuilding rather than rejecting the IMF.[25] In the light of subsequent developments this may seem to have been a glimpse of the obvious, but it must be recalled that the policy of the U.S. Treasury had recently been unfriendly, indeed hostile, toward the Fund and its future was by no means assured.[26] In the same speech Turner supported an element of reform that was at that time novel – a Committee of Governors which would be "small enough to be effective and large enough to be representative of all types of countries" and which could thus provide a "forum for negotiations" of monetary matters. One of the central purposes of the reform process, it will be recalled, was to introduce a more active political element into the decision-making operations of the Fund, and Turner assumed this as a responsibility of special importance.

Four months later, speaking at the annual meeting of the IMF, Turner questioned the practicability of any "mechanistic" application of the "objective indicators" which the United States was by that time advancing as a basis for exchange rate adjustments. He favoured giving the IMF itself more authority over such adjustments: "The relatively easy approval given by the Fund to changes in par values in the past cannot be taken for granted in the future." In regard to the future composition of world reserves, he stressed the importance of "giving countries the maximum possible freedom of choice between gold, reserve-currencies and SDRs (implying thereby the need for relaxing of the IMF rules surrounding SDR holdings and transactions), and he anticipated that SDRs would increase in importance while gold and reserve currencies decreased. Despite continuance of widespread inflation he favoured a renewal of the issuance of SDRs.[27]

At the annual meeting of the Fund the following year

Turner reiterated that the SDR should become "the principal reserve asset and numeraire of the system." Gold "should be gradually phased out" and monetary authorities should be permitted to sell gold in the market. The Ministerial Committee of Twenty (forerunner of the Interim Committee and hence of the proposed Council) "should become a permanent feature ... but not for routine matters.[28]

Speaking in Toronto in January 1974, just after the major oil price increase, Turner called attention to the fact that new tensions between oil-rich and oil-poor regions were precipitating old problems. He urged that countries should avoid "predatory measures – such as competitive currency devaluations or adoption of trade and exchange controls.... If we want to keep history from repeating itself we must never lose sight of the crucial lesson of the depression days of the early Thirties, when self-serving actions by individual nations to isolate themselves from the rest of the world proved self-defeating for all."[29]

At the annual meeting of the Fund in 1974, Turner discussed the work to be undertaken by the new Interim Committee,[30] and at the next annual meeting in 1975 he was able to report on its achievements. Speaking subsequently as Governor for Canada, he reaffirmed Canada's support for the future development of the Fund, as well as the World Bank, with particular attention to the needs of the developing countries and the challenge of the proposed "New Economic Order."[31]

Much of Turner's work was done outside the Interim Committee itself, preparing the ground for concession and compromise and enlisting the confidence of Committee members by talking to them at home in their capitals rather than awaiting their arrival at the meetings. He had participated personally in the discussions of groups with particular interests; he was invited to meet with the "Big Five" when they gathered to resolve the gold issue, with the OPEC countries on oil matters, with the developing countries in their Group of Twenty-Four, and with others as well. He explored problems and possible solutions with the Managing Director and staff of the Fund. And in the Committee itself he persuaded members to engage in discussion rather than confronting each other with set speeches. At the end of the annual meeting in 1975 the Managing Director of the Fund, Johannes Witteveen, referred with obvious sincerity to Turner's work: "I would like to endorse the tributes that have been paid to the Chairman of the Interim Committee for the patience, skill, and tact with which he has guided the Committee's deliberations."[32]

On the Executive Board of the Fund another Canadian was exerting an influence of special importance. Robert Bryce, who as this is written is the only one of "Dr. Clark's Boys" (see p. 138 above) still to be a member of the Canadian public service, had become an Executive Director in 1971 (in time for the John L. Connally onslaught) and he continued as such through most of the period of reform covered here. His rich experience in political and economic affairs, together with his flair for finding solutions for complex and controversial issues, which for many years had been at the disposal of successive Canadian ministers, prime ministers and cabinets, were now at the disposal of the organization that was to be rebuilt, as well as the countries that he was to represent. And he played an important role in the formulation and the transmission of Canadian views. By the time of his departure he had earned a reputation for being the most persuasive and individually influential member of the Board.

During the negotiations for reform a special relationship was built up between Canada and developing countries. This relationship dated back at least to the year 1963 when the Jamaicans, on joining the Fund, selected the Canadian Executive Director to be their representative on the Executive Board. Barbados and the Bahamas later made the same selection. Thus over the years "Canadian" Executive Directors became accustomed to taking special account of the views and aims of these developing countries. Indeed, in the reform of the Fund Canada shared with these countries many problems and many objectives: exports of foodstuffs and of materials dependent on the vicissitudes of the weather and of world price movements; the creation of an effective and reliable world reserve asset to take the place, at least in part, of both gold and reserve currencies; the provision of adequate short-term credit facilities; the recycling of oil revenues; and so forth.[33] It may be noted that it was Bryce, during his term as Executive Director, who introduced into the Executive Board the formula for the size and distribution of the new general increase in quotas – a formula which, while giving oil producers as a group a 50 per cent increase, nevertheless fully protected other developing countries as a group against any diminution in their proportion. His formula was not welcomed by some in the group of industrialized countries.

When the Fund and other international institutions were established in the postwar years Canadians were primarily concerned with the attainment of generally satisfactory and workable agreements rather than the particular details of the agreements themselves. The Canadian position was the same in 1973-75. Canada supported the reform of the Fund for its own sake, as a contribution to a viable economic world within which Canadian interests could be effectively pursued and defended. The fact that Canadians were seen to be working for the system and for the institution probably strengthened their ability to influence others and to promote agreement.[34]

At the same time it would have been impossible for the Canadians to adopt such a traditionally internationalist attitude had not the general trend of most of the decisions that were being reached conformed closely to identifiable Canadian interests. The Canadian position as expressed by Turner and preceding Ministers of Finance had been to play up the SDR, to play down gold, to provide for greater flexibility of exchange rates within agreed guidelines, to enlarge the lending powers of the Fund, to participate effectively in the recycling of oil funds, to establish a new decision-making body with political content, to strengthen the economic and political position of the developing world and, as a means towards these ends, to strengthen the Fund itself. Measures such as these would serve Canadian and world interests alike.

NOTES

1 A very useful overview of the background and process of reform is provided by the former Managing Director of the IMF, Pierre-Paul Schweitzer in "Political Aspects of Managing the International Monetary System," *International Affairs* (April 1976), pp. 208-18.
2 That of the IMF may be found in the *Annual Report*, 1974, pp. 126-28.
3 A comprehensive and authoritative appraisal is to be found in Edward M. Bernstein et. al., *Reflections on Ja-*

maica, Essays in International Finance No. 115 (Princeton, N.J.: Princeton University Press, 1976); co-authors are Richard N. Cooper, Nurul Islam, Charles P. Kindleberger, Fritz Machlup, Robert V. Roosa, Robert Triffin and John Williamson. The above quotations from Nixon and Fourcade are reproduced from the essay by Triffin. Another valuable appraisal of the package is given by Tom de Vries, "Jamaica, or the Non-Reform of the International Monetary System," *Foreign Affairs*, Vol. LIV, No. 3 (April 1976), pp. 577-605.

4 For texts of the agreements reached at Jamaica, including a revision of the actual text of Article IV ("Obligations Regarding Exchange Arrangements") of the Bretton Woods Agreement and also the text of the new agreement covering gold, see *IMF Survey*, January 19, 1976.

5 International Monetary Fund, *Outline of Reform* (Washington, D.C.: IMF, 1975). This outline also contains the promise that "The SDR will become the principal reserve asset and the role of gold and reserve currencies will be reduced."

6 *IMF Survey*, 15 September 1975, pp. 268-69.

7 For full text of the guidelines, see *IMF Annual Report*, 1974, pp. 112-14.

8 Canada's much criticized exchange rate policy of June 1961 could apparently have been acceptable if this guideline had been operative at the time.

9 The Fund has published the following pamphlets discussing various aspects of the SDR: Joseph Gold, *Special Drawing Rights, Character and Use* (1970); Joseph Gold, *Special Drawing Rights, The Role of Language* (1971); J. J. Polak, *Some Reflections on the Nature of Special Drawing Rights* (1971); Walter Habermeier, *Operations and Transactions in SDRs, The First Basic Period* (1973); and J. J. Polak, *Valuation and the Rate of Interest on the SDR* (1974). For the text of the "Interim Valuation of the SDR," see *IMF Annual Report*, 1974, pp. 116-17.

10 See "The Commercial Use of SDRs" in *World Financial Markets*, Morgan Guaranty Trust, 19 August 1975, pp. 4-11. Also John Hein, "Will SDR Pricing Displace the Dollar?" the Conference Board *Record*, August 1975, pp. 14-17. The SDR is by no means unique as an international

numeraire. See Joseph Aschheim and Y. S. Park, *Artificial Currency Units; the Formation of Functional Currency Areas*, Essays in International Finance No. 114 (Princeton, N.J.: Princeton University Press, 1976).

11 *IMF Survey*, 15 September 1975, p. 263.

12 *IMF Report*, 1975, p. 107.

13 *IMF Survey*, 6 January 1975, p. 1.

14 *Ibid.*, 15 September 1975, p. 266; also *ibid.*, 19 January 1976, p. 18; also, for data on use of the oil facility, *ibid.*, 5 April 1976, p. 97.

15 *Ibid.*, 16 September 1974, pp. 289 and 302.

16 *Ibid.*, 19 January 1976, p. 18.

17 *Ibid.*

18 For the complete text of the communiqué issued at the time by the Committee of Twenty-four, see *ibid.*, pp. 28-30.

19 A useful compilation of statements on this subject is provided by J. Gold, *Voting and Decisions in the International Monetary Fund* (Washington, D.C.: IMF, 1972) pp. 43-49.

20 *Ibid.*, chapters 2, 13 and 15.

21 *Ibid.*, p. 199.

22 See de Vries, "Jamaica," pp. 581-82: Connally "considered representations by the International Monetary Fund . . . as unacceptable meddling in U.S. internal affairs. His reaction was to block the reappointment of the Fund's top officer Pierre-Paul Schweitzer. . . . "

23 IMF *Annual Report*, 1975, pp. 107-8. The predecessor of the Interim Committee, known as the Committee on Reform of the International Monetary System and set up in July 1972, was similarly structured and became known as the Committee of Twenty. Each of its members, however, was allowed only two associates. Moreover, while the usefulness of the relationship of the Executive Directors to the Interim Committee and to the proposed Council is accepted, arrangements for the Committee of Twenty provided for a separate supporting committee of "deputies" at the official level and provided only that Executive Directors "might participate" in meetings.

24 *IMF Survey*, 15 September 1975, p. 266.

25 John Turner, Address to the International Monetary Conference, Montreal. News release, Department of Finance, Ottawa, 9 May 1972.

26 See de Vries, "Jamaica," pp. 581-82.
27 *IMF Summary Proceedings*, 1972, pp. 142-48.
28 *Ibid.*, 1973, pp. 107-113.
29 John Turner, Remarks to the Canadian Club of Toronto. News release, Department of Finance, 28 January 1974.
30 *IMF Summary Proceedings*, 1974, pp. 178-81.
31 Statement by John Turner at the annual meetings of the IMF and World Bank in Washington. New release, Department of Finance, Ottawa, 2 September 1975.
32 *IMF Survey*, 15 September 1975, p. 267. Similar opinions were expressed informally to the present writer by other senior officers of the Fund. See also articles by Wayne Cheveldayoff in the *Globe and Mail*, Toronto, 15 and 18 March 1975.
33 See A. F. W. Plumptre, "The Developing Countries and the International Monetary System" in *Canada and the New International Economic Order* (Halifax: St. Mary's University, 1976).
34 The views in this paragraph were expressed by Mr. Turner in a recent interview.

Bibliographical Note*

During the past twenty-five years various authors in various countries have addressed themselves to differences between fixed and floating rate regimes.

In the select bibliography which follows each item is, for convenience of identification, numbered consecutively from 1 to 45.

Two early writers may be considered to have given special shape and direction to the literature. Friedman (14) and Meade (25) and (26). Two others have directed particular attention to Canadian issues: Caves (4) and Johnson (16) and (17).

Several writers have provided descriptions of the course of events in Canada along with empirical and theoretical comments: Blackwell (3), Dunn (9), Plumptre (33), Wonnacott (44) and Yeager (45).

Several writers have examined the "inherent stability" of the floating Canadian dollar, particularly in the period following 1950. Some of these stress the tendency of the capital and current accounts to move in harmony: Dunn (9), Hawkins (27) and Wonnacott (43). Others stress the tendency of short-term capital movements to provide a counterbalance to other movements: Caves and Reuber (5), Dunn (9), Katz (19) Hawkins

* In the collection and classification of this material the author is particularly grateful for assistance rendered by Eva Gruca.

(27), Plumptre (33), Powrie (35), Rhomberg (38), Wonnacott (44) and Yeager (45). Eastman (10) calls attention to the counterbalancing role of other capital movements.

The question whether Canada's Exchange Fund has played an active or passive role has engaged the attention of a number of writers. While their definitions are not always the same, "passive intervention" may be defined as resistance to exchange rate movements while "active intervention" accentuates or even initiates rate movements. Most writers interpret the Fund's operations as basically passive, although some believe they have identified statistical evidence of active intervention at particular times. These writers include: Mellish and Hawkins (27), Pippinger (32), Plumptre (33), Wonnacott (44) and Yeager (45). Eastman and Stykolt (12) point out that, "whatever the Fund's success in smoothing out day-to-day fluctuations in the rate, the effect of its operations was to interfere somewhat with the long-term upward trend in the value of the Canadian dollar" (p. 227).

A number of writers considered the impact of the exchange rate regime on the behaviour of the Canadian economy as a whole. Some of them have been primarily concerned with the way the economy behaves under one regime or the other; others have been primarily concerned with the implications for the effectiveness of financial controls.

In regard to the behaviour of the economy, some have drawn attention to the fact that the Canadian economy has not been adversely affected by the additional risk factor which is often considered to attach to a floating rate regime: Clark (6), Dunn (9) and Wonnacott (44). Dunn (9) has concluded that the foreign elasticities of demand are rather low; but others do not find such evidence: Rhomberg (38) and Wonnacott (44). Two writers have examined the general relationships between capital flows, employment and national income under a floating rate regime: Melvin (28) and Mundell (31). Wonnacott (44) calls attention to the escape from inflationary pressures provided by the floating rate after 1950 while Dunn (9) and McLeod (23) claim that a floating rate has not insulated Canadian prices from external business cycles.

A substantial number of writers have addressed themselves to the ways in which financial controls do or do not work under a floating rate regime. Their work is too diverse to classify in any detail. It is probably true to say that financial controls over domestic financial and economic developments tend to be more effective under a floating rate than under a fixed rate regime, an important reason being that the exchange rate will tend to move in a direction that supports the objectives of the controls whereas, under a fixed rate, movements of international reserves will tend to move in a direction that counteracts the controls. The literature provides extensive discussion of the degree of financial independence that is believed to attach to a floating rate regime, with particular reference to the close integration of the Canadian capital market with the American and the sensitivity of international capital flows to various incentives, particularly to spreads between interest rates. The writers include: Caves (4), Caves and Reuber (5), Dernburg (8), Dunn (9), Meade (26), Mundell (31), Rhomberg (38) and Takayama (41). Some writers have paid particular attention to the way in which the financial crisis of 1962 was generated by inappropriate monetary and debt management policies in the preceding years: Caves (4), Katz (19) and Wonnacott (44).

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Reference Tables

Reference Tables 1 to 13 indicate, on an annual basis, the movements in Canada's international trade and payments from 1944 to 1974. Continuous statistical series for the whole period are available for most of the items presented. In the case of merchandise exports and imports, however, the compilation presented here and currently published by the Bank of Canada extends back only as far as 1950. For the years 1943 to 1950, material from an earlier Bank of Canada classification has been used; it reflects the differing circumstances of the earlier years. Table 9 has been inserted to provide a rough indication of the influence of price movements on import and export values.

In addition to the material for the period from 1944 onwards, earlier data for the year 1928 (peak of the boom), 1933 (bottom of the Great Depression), 1938 (last of the prewar years) and 1943 (height of hostilities) are provided both by commodity groups and by areas for both exports and imports.

For any reader wishing assistance in understanding the nature and purposes of Canadian balance-of-payments statistics, a recent publication can be recommended: Caroline Pestieau, *A Balance of Payments Handbook* (Canadian-American Committee: Montreal, 1974).

In addition to the tables on international payments on an annual basis, Table 13 provides on a monthly basis the level of Canada's official international reserves (mostly gold and U.S. dollars), and Table 14 provides, also on a monthly basis, the Canadian dollar exchange rate during the two periods when it was unpegged and floating: from 1950 to 1962 and from 1970 to 1974.

Tables 15 and 16 provide annual data relating to the GNP as well as monthly data on the unemployment rate.

The author is particularly grateful to Valerie Rochester for her detailed work and intelligent guidance in the compilation of these tables and to the Bank of Canada for making her services available. For the trade figures (Tables 1-8) the source is the "Trade of Canada" series published over the years by Statistics Canada (formerly Dominion Bureau of Statistics). The Balance of Payments Statistics (Tables 10-13) have been compiled from publications of the Bank of Canada.

Table 1 Merchandise Exports[1] by Destination, 1928-50 (millions of dollars)

Year	United States	United Kingdom	Other Sterling Area	Western Europe and Colonies	Central and South America	All Other	Total
1928	659	291	88	202	38	85	1,364
1933	196	188	39	72	10	30	535
1938	269	335	95	84	18	44	846
1943	1,118	1,063	353	133	25	299	2,991
1944	1,276	1,259	349	261	37	286	3,467
1945	1,125	1,002	499	398	62	193	3,270
1946	905	595	257	297	97	195	2,299
1947	1,052	749	360	320	135	186	2,790
1948	1,520	685	290	309	127	173	3,086
1949	1,525	706	303	249	132	105	3,004
1950	2,050	471	187	200	160	80	3,143

[1] Excluding gold.

Table 2 Merchandise Imports[1] by Country of Origin, 1928-50 (millions of dollars)

Year	United States	United Kingdom[1]	Other Sterling Area	Western Europe and Colonies	Central and South America	All Other	Total
1928	826	191	61	88	31	26	1,222
1933	217	98	34	32	10	10	401
1938	425	119	65	38	16	15	667
1943	1,424	100	91	16	55	9	1,701
1944	1,447	94	100	9	79	13	1,743
1945	1,202	100	115	15	87	26	1,546
1946	1,387	137	130	40	126	24	1,841
1947	1,952	184	157	64	159	30	2,543
1948	1,798	294	195	75	223	38	2,618
1949	1,915	302	187	82	192	41	2,714
1950	2,090	401	241	96	232	68	3,125

[1] Excluding gold.

Table 3 Merchandise Exports by Commodity, 1928-50 ("Trade of Canada" Basis[1])
(millions of dollars)

Year	Wheat and Grain	Other Farm Products	Fish and Fish Products	Newsprint and Woodpulp	Lumber and Other Forest Products	Farm Implements and Motor Vehicles	Iron and Steel[2]	Alum-inium	Copper
1928	558	122	36	200	87	50	12	9	24
1933	156	56	20	97	34	11	8	6	17
1938	129	102	26	147	66	33	17	24	53
1943	380	258	58	264	128	465	189	129	31
1944	591	350	63	279	162	399	301	106	41
1945	683	347	80	309	179	321	163	134	41
1946	441	290	86	409	217	107	71	56	37
1947	529	278	82	555	332	134	84	64	59
1948	480	404	95	639	316	132	91	102	79
1949	611	295	94	636	239	132	106	94	87
1950	492	296	113	730	385	128	92	107	88

Table 3 Continued

Year	Nickel	Lead and Zinc	Other Metals and Minerals	Chemicals and Fertilizers	Ships and Aircraft	All Other[3]	Total
1928	22	19	44	18	–	163	1,364
1933	23	10	22	13	–	62	535
1938	52	19	52	19	3	104	846
1943	68	27	100	86	134	674	2,991
1944	68	22	91	101	130	763	3,467
1945	55	29	92	111	124	611	3,279
1946	55	45	90	67	29	298	2,299
1947	60	61	115	83	32	322	2,790
1948	74	77	142	79	95	308	3,086
1949	92	98	116	70	67	267	3,004
1950	105	97	153	101	27	229	3,143

[1] Excluding gold.
[2] Includes "Guns, Rifles and Firearms" of $144, $240, $82 and $4 in 1943-46 respectively.
[3] Includes "Cartridge Shells and Army, Navy Stores" of $403, $360, $182 in 1943-45 respectively.

Table 4 Merchandise Imports by Commodity, 1928-50 ("Trade of Canada" Basis[1])
(millions of dollars)

Year	Food and Beverages	Inedible Crude Materials	Textiles and Related Products	Chemicals	Mineral Fuels	Machinery and Transportation Equipment	Wood Products
1928	127	132	201	37	123	205	57
1933	53	50	70	24	62	31	18
1938	82	61	89	35	94	103	32
1943	121	89	195	71	203	245	41
1944	161	81	191	81	221	278	43
1945	180	95	197	80	210	247	49
1946	231	130	264	93	256	333	70
1947	253	176	389	113	361	533	90
1948	244	178	350	118	507	539	73
1949	262	169	333	131	431	619	86
1950	335	219	365	158	497	693	99

Table 4 Continued

Year	Iron, Steel, and Products	Other Metals and Minerals[2]	Other Manufactured Goods[3]	Total
1928	117	84	139	1,222
1933	28	29	36	401
1938	61	52	68	677
1943	175	115	446	1,701
1944	150	99	438	1,743
1945	137	111	240	1,546
1946	157	149	158	1,841
1947	229	185	214	2,543
1948	244	193	172	2,618
1949	272	209	202	2,714
1950	288	247	224	3,125

[1] Excluding gold.

[2] Including glass.

[3] Includes military equipment and materials for the munitions industry in the years 1943-45 inclusive amounting to $346, $315, and $119 respectively.

Table 5 Merchandise Exports[1] by Area, 1947-74 (millions of dollars)

Year	United States	United Kingdom	EEC[2]	Japan	All Other Countries	Total
1947	1,053	749	231	.4	757	2,790
1948	1,520	685	213	8	661	3,087
1949	1,525	707	140	6	626	3,004
1950	2,050	471	118	31	473	3,143
1951	2,333	635	253	76	649	3,946
1952	2,345	750	342	103	797	4,337
1953	2,458	667	262	119	647	4,153
1954	2,359	656	242	97	572	3,926
1955	2,604	772	268	91	577	4,312
1956	2,866	817	339	128	689	4,839
1957	2,925	727	406	140	692	4,890
1958	2,900	777	422	105	695	4,899
1959	3,185	794	316	140	709	5,144
1960	3,039	925	443	180	803	5,390
1961	3,217	923	472	232	1,059	5,903
1962	3,749	921	462	216	1,000	6,348
1963	3,917	1,016	487	298	1,262	6,980
1964	4,437	1,207	566	332	1,761	8,303
1965	5,033	1,185	636	317	1,596	8,767
1966	6,235	1,132	645	395	1,918	10,325
1967	7,332	1,178	689	574	1,647	11,420
1968	9,230	1,226	762	607	1,799	13,624
1969	10,551	1,113	855	626	1,726	14,871
1970	10,900	1,501	1,206	813	2,402	16,820
1971	12,025	1,395	1,109	831	2,458	17,818
1972	13,974	1,385	1,144	965	2,682	20,150
1973	17,129	1,604	1,536	1,813	3,338	25,420
1974	21,325	1,903	2,069	2,224	4,656	32,177

[1] Excluding gold.

[2] Includes Belgium, Federal Republic of Germany, France, Italy, Luxembourg, and the Netherlands.

Table 6 Merchandise Exports by Commodity, 1950-74
("Trade of Canada" Basis)
(millions of dollars)

	Farm and Fish Products			Forest Products		
Year	Wheat and Wheat Flour	Other Farm and Fish	Total Farm and Fish	Newsprint	Lumber	Other Forest Products
1950	419	516	935	488	268	346
1951	555	594	1,149	536	291	550
1952	737	592	1,329	592	280	491
1953	670	589	1,259	620	274	389
1954	434	528	984	635	312	418
1955	412	505	917	666	367	471
1956	584	537	1,121	708	310	478
1957	442	570	1,012	716	266	469
1958	515	657	1,172	690	277	443
1959	507	684	1,191	722	301	488
1960	473	645	1,118	758	324	505
1961	725	576	1,301	762	334	526
1962	658	607	1,265	754	372	576
1963	850	614	1,464	760	426	639
1964	1,123	721	1,844	834	450	724
1965	907	829	1,736	870	458	772
1966	1,144	863	2,007	968	440	831
1967	832	842	1,674	955	475	866
1968	742	837	1,579	990	623	982
1969	526	879	1,405	1,126	665	1,123
1970	747	1,117	1,864	1,110	638	1,181
1971	885	1,340	2,225	1,084	799	1,201
1972	963	1,369	2,332	1,158	1,127	1,316
1973	1,265	2,073	3,338	1,286	1,559	1,662
1974	2,094	1,970	4,064	1,721	1,254	2,573

Table 6 Continued

	Metals and Minerals					
Year	Crude Petroleum and Natural Gas	Iron Ore	Primary Iron and Steel	Aluminum and Products	Copper, Nickel, and Products	Other Metals and Minerals
1950	–	13	29	107	88	368
1951	1	19	37	125	224	358
1952	4	22	58	162	271	405
1953	6	31	88	177	286	314
1954	6	39	44	185	317	324
1955	36	99	98	213	390	391
1956	104	145	107	237	428	452
1957	141	152	137	230	403	532
1958	92	107	84	224	355	581
1959	92	158	129	233	393	653
1960	112	156	161	269	473	643
1961	194	143	158	252	535	580
1962	306	221	163	295	522	559
1963	310	271	197	316	530	546
1964	368	356	248	325	603	597
1965	383	361	237	373	651	680
1966	431	369	254	387	766	724
1967	522	383	266	417	886	779
1968	600	443	354	463	1,064	946
1969	702	333	331	494	917	993
1970	855	476	457	478	1,463	1,086
1971	1,038	413	406	467	1,274	1,017
1972	1,315	353	411	404	1,299	1,146
1973	1,834	462	513	396	1,823	1,593
1974	3,902	543	777	539	2,064	2,164

Table 6 Continued

Year	Chemicals and Fertilizers	Other Manufactured Goods: Aircraft	Automotive Products	Other Manufactured Goods	Re-Exports	Total
1950	93	n.a.	n.a.	n.a.	39	3,143
1951	132	8	101	366	49	3,946
1952	125	38	127	378	55	4,337
1953	138	40	83	392	55	4,153
1954	154	29	38	380	66	3,926
1955	183	20	51	334	74	4,312
1956	183	50	52	386	79	4,839
1957	196	40	51	443	101	4,890
1958	198	109	48	417	107	4,899
1959	202	50	52	359	122	5,149
1960	238	50	67	382	134	5,398
1961	250	102	54	563	148	5,903
1962	248	147	66	679	179	6,348
1963	268	108	100	856	191	6,980
1964	308	249	190	1,001	209	8,303
1965	337	207	368	1,094	242	8,769
1966	367	210	1,010	1,306	255	10,325
1967	390	314	1,762	1,463	299	11,420
1968	417	369	2,718	1,722	354	13,624
1969	450	328	3,551	2,021	428	14,871
1970	533	379	3,537	2,344	419	16,820
1971	555	332	4,205	2,380	423	17,818
1972	588	468	4,714	3,042	477	20,150
1973	718	414	5,364	3,894	564	25,420
1974	990	433	5,655	4,739	759	32,117

Table 7 Merchandise Imports[1] by Area, 1947-74 (millions of dollars)

Year	United States	United Kingdom	EEC[2]	Japan	All Other Countries	Total
1947	1,952	184	26	.3	381	2,543
1948	1,799	294	39	3	483	2,618
1949	1,915	302	54	6	438	2,714
1950	2,090	401	65	12	557	3,125
1951	2,752	415	115	13	710	4,005
1952	2,888	352	96	13	567	3,916
1953	3,115	446	113	13	561	4,248
1954	2,871	382	119	19	577	3,968
1955	3,331	393	143	37	664	4,568
1956	4,031	476	215	61	764	5,547
1957	3,887	507	225	62	792	5,473
1958	3,460	518	237	70	765	5,050
1959	3,709	589	289	103	819	5,509
1960	3,693	589	293	110	806	5,491
1961	3,864	619	318	117	851	5,769
1962	4,300	564	335	125	934	6,258
1963	4,458	526	342	130	1,102	6,558
1964	5,164	574	406	174	1,170	7,488
1965	6,045	619	514	230	1,225	8,633
1966	7,204	673	551	253	1,391	10,072
1967	7,951	649	627	395	1,250	10,872
1968	9,048	696	662	360	1,592	12,358
1969	10,243	791	787	496	1,813	14,130
1970	9,917	738	805	582	1,910	13,952
1971	10,951	837	935	803	2,091	15,617
1972	12,878	950	1,149	1,071	2,621	18,669
1973	16,502	1,005	1,393	1,011	3,412	23,323
1974	21,306	1,127	1,813	1,426	5,967	31,639

[1] Excluding gold.

[2] Includes Belgium, Federal Republic of Germany, France, Italy, Luxembourg, and the Netherlands.

Table 8 Merchandise Imports by End-Use, 1950-74 ("Trade of Canada" Basis)
(millions of dollars)

Year	Fuels and Lubricants	Industrial Materials	Construction Materials	Producers' Equipment	Transportation Equipment[2]	Motor Vehicles and Parts	Food	Other Consumer Goods	Special Items	Total
1950[1]	493	1,004	116	587	65	234	379	235	12	3,125
1951[1]	535	1,367	170	858	118	247	420	265	25	4,005
1952[1]	503	1,134	173	1,027	229	227	401	186	36	3,916
1953	484	1,149	190	1,004	216	368	394	397	46	4,248
1954	446	1,018	193	896	205	300	451	390	69	3,968
1955	478	1,249	219	1,042	229	419	452	426	54	4,568
1956	552	1,505	342	1,384	191	530	505	480	94	5,547
1957	578	1,446	342	1,361	204	459	538	483	62	5,473
1958	490	1,318	255	1,200	196	459	543	524	65	5,050
1959	503	1,437	250	1,349	177	581	542	604	66	5,509
1960	470	1,456	220	1,278	217	600	559	602	89	5,491
1961	464	1,559	213	1,314	352	546	597	635	89	5,769
1962	480	1,752	220	1,480	303	656	581	652	134	6,258
1963	528	1,858	203	1,617	177	698	710	628	139	6,558
1964	546	2,078	274	1,896	295	849	713	717	120	7,988
1965	627	2,318	311	2,162	280	1,169	688	809	269	8,633
1966	661	2,509	308	2,568	349	1,664	740	941	332	10,072
1967	685	2,500	301	2,615	432	2,245	750	1,066	278	10,872
1968	783	2,675	311	2,619	525	3,133	819	1,218	275	12,358
1969	735	3,122	358	3,115	492	3,726	936	1,443	203	14,130
1970	767	3,181	326	3,138	469	3,432	978	1,483	178	13,952
1971	912	3,404	365	3,357	390	4,306	1,001	1,698	184	15,618
1972	1,072	3,890	466	3,993	438	5,141	1,223	2,221	225	18,669
1973	1,326	4,879	623	4,905	693	6,278	1,636	2,723	260	23,323
1974	3,315	6,779	982	6,324	907	7,347	2,175	3,446	364	31,639

[1] The years 1950-52 were not revised when Statistics Canada devised a new classification system in 1964. However, general conclusions can be drawn from the data presented here.
[2] Excluding motor vehicles.

Table 9 Import and Export Price Indexes[1], 1944-74
(1961 = 100.0)

Year	Import	Export
1944	57.2	57.3
1945	58.6	59.2
1946	62.4	65.0
1947	69.9	73.0
1948	78.2	78.2
1949	80.8	82.1
1950	86.5	85.8
1951	95.5	95.4
1952	88.8	94.3
1953	88.7	92.1
1954	88.9	91.3
1955	90.4	95.0
1956	93.4	97.6
1957	95.8	97.1
1958	97.1	96.7
1959	96.5	98.2
1960	97.4	98.8
1961	100.0	100.0
1962	104.6	103.9
1963	107.0	104.9
1964	107.9	107.1
1965	108.7	109.1
1966	111.1	110.1
1967	112.9	114.3
1968	115.8	116.0
1969	119.1	118.5
1970	122.3	122.6
1971	124.5	123.0
1972	127.9	126.8
1973	139.3	145.1
1974	165.8	184.1

[1] Gross National Product: implicit price indexes.
NOTE: For an indication of domestic price movements see GNP deflator in Table 15 below.

Table 10 Balance of Payments Non-Merchandise and Current Accounts, 1943-74
(millions of dollars)

Year	Travel (net)	Interest (net)	Dividends (net)	Freight and Shipping (net)	Other Services[1]	Withholding Tax[2]
1943	52	–109	–93	–6	n.a.	
1944	61	–112	–81	70	n.a.	
1945	82	–113	–58	118	n.a.	
1946	86	–112	–130	92	–183	
1947	84	–103	–170	44	–72	
1948	145	–89	–166	57	–73	
1949	92	–78	–229	50	–116	
1950	49	–81	–300	–17	–155	
1951	–6	–60	–277	–3	–125	–56
1952	–66	–54	–207	8	–75	–55
1953	–63	–58	–184	–56	–107	–54
1954	–84	–77	–200	–43	–129	–58
1955	–121	–73	–239	–17	–80	–67
1956	–161	–90	–292	–45	–89	–69
1957	–162	–110	–331	–70	–194	–83
1958	–193	–118	–329	–59	–246	–48
1959	–207	–140	–351	–105	–224	–74
1960	–207	–163	–322	–91	–259	–79
1961	–160	–180	–371	–82	–282	–116
1962	–43	–194	–387	–86	–315	–125
1963	24	–215	–415	–85	–332	–127
1964	–50	–251	–427	–35	–353	–140
1965	–49	–289	–475	–93	–342	–167
1966	–60	–319	–513	–65	–414	–204
1967	423	–369	–547	–31	–507	–218
1968	–29	–444	–462	–40	–601	–209
1969	–214	–489	–426	–61	–600	–234
1970	–216	–503	–519	20	–612	–269
1971	–202	–535	–606	–22	–752	–278
1972	–234	–593	–487	–111	–894	–287
1973	–296	–656	–609	–172	–984	–322
1974	–284	–673	–812	–223	–1,284	–430

[1] Includes miscellaneous income and business services and government transactions.
[2] Tax withheld on service payments and income distributions to non-residents.

Table 10 Continued

Year	Total Services (including gold)	Transfers[3]	Gold Production[4] Available for Export	Total Services and Transfers
1943	n.a.	n.a.	142	–265
1944	n.a.	n.a.	110	–1,174
1945	n.a.	n.a.	96	–486
1946	–151	–57	96	–208
1947	–118	–21	99	–139
1948	–7	26	119	19
1949	–142	26	139	–116
1950	–341	15	163	–326
1951	–377	16	150	–361
1952	–299	1	150	–298
1953	–378	–10	144	–388
1954	–436	–6	155	–442
1955	–442	–34	155	–476
1956	–599	–45	147	–644
1957	–806	–51	144	–857
1958	–836	–125	157	–961
1959	–953	–113	148	–1,066
1960	–959	–126	162	–1,085
1961	–1,029	–72	162	–1,101
1962	–995	–19	155	–1,014
1963	–996	–28	154	–1,024
1964	–1,111	–14	145	–1,125
1965	–1,277	29	138	–1,248
1966	–1,438	52	127	–1,386
1967	–1,137	72	112	–1,065
1968	–1,752	184	33	–1,568
1969	–2,024	143	–	–1,881
1970	–2,099	153	–	–1,946
1971	–2,395	274	–	–2,121
1972	–2,606	278	–	–2,328
1973	–3,039	337	–	–2,702
1974	–3,706	544	–	–3,162

[3] Includes inheritances and migrants' funds, personal and institutional remittances, and official contributions.
[4] After the first quarter 1968, transactions in non-monetary gold have been included with merchandise trade.

Table 10 Continued

Year	Merchandise Trade Balance	Current Account Balance	Estimated Unremitted Earnings on Foreign Direct Investment in Canada
1943	1,471	1,206	
1944	2,192	1,018	
1945	2,032	1,546	
1946	571	363	
1947	188	49	
1948	432	451	
1949	293	177	
1950	7	–319	
1951	–151	–512	
1952	485	187	
1953	–60	–448	305
1954	18	–424	280
1955	–211	–687	335
1956	–728	–1,372	400
1957	–594	–1,451	425
1958	–176	–1,137	235
1959	–421	–1,487	350
1960	–148	–1,233	280
1961	173	–928	240
1962	184	–830	325
1963	503	–521	435
1964	701	–424	480
1965	118	–1,130	735
1966	224	–1,162	640
1967	566	–499	845
1968	1,471	–97	n.a.
1969	964	–917	n.a.
1970	3,052	1,106	n.a.
1971	2,563	442	n.a.
1972	1,859	–471	n.a.
1973	2,720	18	n.a.
1974	1,519	–1,643	n.a.

Table 11 Balance of Payments; Capital Account and Total, 1946-74
(millions of dollars)

	1946	1947	1948	1949	1950
Capital in Long-Term Forms					
Direct Investment					
In Canada	40	61	71	94	225
Abroad	–14	6	15	13	35
Transactions in Canadian stocks[1]	194	–13	3	8	329
Transactions in Canadian bonds					
Gross new issues	218	95	150	105	210
Retirements	–539	–364	–114	–147	–284
Trade in outstanding	:included above with transactions :in Canadian stocks:				
Transactions in foreign securities	34	5	–8	20	76
Government of Canada loans & subscriptions:					
Advances and repayments	–651	–487	–62	–108	24
Export credits: net	:included in other long-term movements				
Other Long-Term Capital Movements	321	–24	–12	–14	–5
Total Long-Term Capital Movements	–715	–721	43	–29	610
Capital in Short-Term Forms					
Resident holdings of foreign currencies					
Chartered bank net foreign currency position with non-residents	–*	–	–	–	–
Non-bank holdings of foreign currencies abroad	–	–	–	–	–
Non-resident holdings of Canadian assets					
Canadian dollar deposits	71	–26	–21	33	235
Government of Canada demand liabilities	25	33	–	–	–4
Treasury bills	–	–	–	9	–3
Commercial paper	:included in other short-term				
Finance company paper	:capital movements a.i.e.				
Other finance company obligations	:				
Other Short-Term Capital Movements, a.i.e.	–10	–3	19	–61	203
Total Short-Term Capital Movements	86	4	–2	–20	431
Total Long- and Short-Term Capital Movements	–629	-717	41	–49	1,041
Current Account Balance	363	49	451	177	–319
Allocation of SDR's	–	–	–	–	–
Change in Official International Reserves	–266	–668	492	128	722

[1] Includes trade in outstanding Canadian bonds to 1951.
*Not available.

Table 11 Continued

1951	1952	1953	1954	1955	1956	1957	1958	1959	1960
320	360	450	425	445	650	545	430	570	670
–30	–85	–70	–90	–85	–105	–80	–40	–85	–50
38	73	21	129	137	187	142	88	110	51
411	323	335	333	166	667	800	688	709	448
–184	–89	–146	–205	–185	–141	–134	–158	–258	–266
	: –168	–52	–66	–165	11	–45	–	92	3
	:								
15	–11	–1	–24	–5	–3	1	1	–34	–19
68	56	87	72	69	65	49	30	33	21
28	–4	25	25	37	159	42	114	42	71
666	455	649	599	414	1,490	1,320	1,153	1,179	929
–	–	–	–	–	–	–	–	–	–
–	–	–	–	–	–	–	–	–	–
–190	–66	–22	27	60	–30	–15	39	10	79
–8	–5	–11	–15	–9	–	–	45	–8	–12
2	1	–2	8	29	3	–18	21	14	56
	: :								
	: :	included in other finance company obligations							
	: 35	–2	10	23	64	4	24	68	59
98	–570	–202	–81	126	–107	55	–36	213	83
–98	–605	–239	–51	229	–70	26	93	297	265
568	–150	410	548	643	1,420	1,346	1,246	1,476	1,194
–512	187	–448	–424	–687	–1,372	–1,451	–1,137	–1,487	–1,233
–	–	–	–	–	–	–	–	–	–
56	37	–38	124	–44	48	–105	109	–11	–39

Table 11 Continued

	1961	1962	1963	1964	1965
Capital in Long-Term Forms					
Direct Investment					
In Canada	560	505	280	270	535
Abroad	–80	–105	–135	–95	–125
Transactions in Canadian stocks[1]	39	–115	–170	–98	–257
Transactions in Canadian bonds					
Gross new issues	548	729	984	1,100	1,216
Retirements	–301	–319	–404	–382	–383
Trade in outstanding	61	64	39	77	55
Transactions in foreign securities	–35	–65	22	–52	–85
Government of Canada loans & subscriptions:					
Advances & repayments	30	107	7	–	–4
Export credits: net	:	–63	72	–164	–187
Other Long-Term Capital Movements	108	–50	86	164	68
Total Long-Term Capital Movements	930	688	637	820	833
Capital in Short-Term Forms					
Resident holdings of foreign currencies					
Chartered bank net foreign currency position with non-residents	–	–	–	–303	426
Non-bank holdings of foreign currencies abroad	–	–	–	–26	–11
Non-resident holdings of Canadian assets					
Canadian dollar deposits	33	–10	43	28	31
Government of Canada demand liabilities	–2	–4	1	–	2
Treasury bills	–58	4	–27	–16	12
Commercial paper		:	–23	–11	10
Finance company paper		:	93	196	–162
Other finance company obligations	95	119	35	52	209
Other Short-Term Capital Movements, a.i.e.	220	181	–92	–282	–62
Total Short-Term Capital Movements	288	297	30	–33	455
Total Long- and Short-Term Capital Movements	1,218	985	111	787	1,288
Current Account Balance	–928	–830	–521	–424	–1,130
Allocation of SDR's	–	–	–	–	–
Change in Official International Reserves	290	155	146	363	158

[1] Includes trade in outstanding Canadian bonds to 1951.

Table 11 Continued

1966	1967	1968	1969	1970	1971	1972	1973	1974
790	691	590	720	835	880	605	725	585
–5	–125	–225	–370	–295	–220	–380	–775	–675
–83	48	176	263	–79	–126	–18	11	–102
1,408	1,270	1,850	1,877	1,157	1,164	1,707	1,342	2,422
–495	–356	–426	–438	–548	–822	–546	–771	–528
–104	–57	–70	2	–39	–94	293	31	40
–401	–432	–467	102	74	204	260	52	28
–11	–4	–73	–67	–108	–156	–211	–207	–311
–41	107	29	–12	–129	–230	–251	–198	–589
170	273	285	260	–116	–118	198	166	166
1,228	1,415	1,669	2,337	752	482	1,657	373	1,036
–467	–384	–488	–506	–122	1,404	–637	–343	–1,354
–53	22	39	–928	–41	–561	–171	–163	1,610
11	24	72	52	26	92	136	145	592
5	–4	21	–34	–8	50	27	77	45
–15	4	48	20	–79	–3	22	–24	78
4	13	–	36	78	128	–135	164	–57
–1	–64	–132	175	210	–39	–50	–24	94
154	35	24	116	–103	–29	–27	17	170
–63	–542	–807	–293	–282	–1,189	–1,406	–707	–547
–425	–896	–1,223	–1,355	–328	–147	–967	–858	631
803	519	446	982	424	335	690	–485	1,667
–1,162	–499	–156	–917	1,106	442	–471	18	–1,643
–	–	–	–	133	119	117	–	–
–359	20	290	65	1,663	896	336	–467	24

Table 12 Balance of Payments by Area, 1946-74 (millions of dollars)

	Balance on Transactions with the United States						
	Current Account			Capital Account			
	Merchandise Trade	Services & Transfers	Balance	Long-term	Short-term	Total	TOTAL
1946	–430	–273	–703	49	40	89	–614
1947	–890	–343	–1,233	–158	–5	–163	–1,396
1948	–289	–223	–512	126	–15	111	–401
1949	–378	–362	–740	116	–52	64	–676
1950	–50	–498	–548	625	321	946	398
1951	–520	–575	–1,095	560	–4	556	–539
1952	–473	–507	–980	387	–493	–106	–1,086
1953	–590	–461	–1,051	440	–241	199	–852
1954	–440	–515	–955	395	–16	379	–576
1955	–685	–499	–1,184	209	157	366	–818
1956	–1,167	–630	–1,797	1,034	–143	891	–906
1957	–947	–776	–1,723	963	–21	942	–781
1958	–532	–792	–1,324	950	95	1,045	–279
1959	–536	–833	–1,369	927	385	1,312	–57
1960	–693	–848	–1,521	746	228	974	–547
1961	–615	–888	–1,503	953	362	1,315	–188
1962	–438	–809	–1,247	680	392	1,072	–175
1963	–488	–814	–1,302	843	–17	826	–476
1964	–808	–972	–1,780	943	693	1,639	–141
1965	–1,041	–1,034	–2,075	1,074	–637	437	–1,638
1966	–993	–1,164	–2,157	1,393	–437	920	–1,237
1967	–569	–885	–1,454	1,317	–766	551	903
1968	389	–1,136	–747	1,151	–1,423	272	–1,019
1969	472	–1,317	–845	1,669	458	1,211	366
1970	1,121	–1,286	–165	824	–23	801	636
1971	1,445	–1,491	–46	771	628	1,399	1,353
1972	1,513	–1,681	–168	1,159	–1,384	–225	–393
1973	1,227	–2,068	–841	811	–1,123	–312	–1,153
1974	1,002	–2,532	–1,530	1,679	811	2,490	960

Table 12 Continued

	Balance on Transactions with Other Countries						
	Current Account			Capital Account			
	Merchandise Trade	Services & Transfers	Balance	Long-term	Short-term	Total	TOTAL
1946	1,001	−31	970	−764	46	−718	252
1947	1,078	105	1,183	−563	9	−554	629
1948	721	123	844	−83	13	−70	774
1949	671	107	778	−145	32	−113	665
1950	57	−1	66	−15	110	95	161
1951	369	64	433	106	−94	12	445
1952	958	59	1,017	68	−112	−44	973
1953	530	−71	459	209	2	211	670
1954	458	−82	376	204	−35	169	545
1955	474	−132	342	205	72	277	619
1956	439	−161	278	456	73	529	807
1957	353	−225	128	357	47	404	532
1958	356	−326	30	203	−2	201	231
1959	115	−381	−266	252	−88	164	−102
1960	525	−399	126	183	37	220	346
1961	788	−375	413	−23	−72	−95	318
1962	622	−360	262	8	−96	−88	174
1963	991	−364	627	−206	46	−160	467
1964	1,509	−298	1,211	−193	−655	−848	363
1965	1,159	−352	807	−241	1,092	851	1,658
1966	1,217	−349	868	−165	48	−117	751
1967	1,135	−292	843	98	130	228	1,071
1968	1,082	−432	−650	518	200	718	1,368
1969	492	−564	−72	668	−897	−229	−301
1970	1,931	−660	−1,271	−72	−305	−377	894
1971	1,118	−630	488	−289	−775	−1,064	−576
1972	344	−647	−303	498	417	915	612
1973	1,493	−634	859	−438	265	−173	686
1974	517	−630	−113	−643	−180	−823	−936

Table 12 continued

	Canadian Gold Production Available for Export	IMF Allocation of Special Drawing Rights	Changes in Official International Reserves	Total Official International Reserves
1946	96		–266	1,244.9[1]
1947	99		–668	501.7
1948	119		492	997.8
1949	139		128	1,117.1
1950	163		722	1,741.5
1951	150		56	1,778.6
1952	150		37	1.860.2
1953	144		–38	1,818.5
1954	155		124	1,942.6
1955	155		–44	1,900.8
1956	147		48	1,936.2
1957	144		–105	1,828.3
1958	157		109	1,939.1
1959	148		–11	1,869.2
1960	162		–39	1,829.2
1961	162		292	2,055.8
1962	155		154	2,539.4
1963	154		145	2,595.0
1964	145		364	2,674.3
1965	138		158	2,664.5
1966	127		–359	2,701.9
1967	112		20	2,716.9
1968	120		349	3,045.8
1969	–		65	3,106.3
1970	–	133	1,663	4,679.0[2]
1971	–	119	896	5,570.4
1972	–	117	336	6,049.9[3]
1973	–	–	–467	5,768.2[4]
1974	–	–	24	5,825.3

[1] Millions of U.S. dollars at end of year.

[2] In January 1970 the IMF began to issue special drawing rights. At that time Canada's definition of official international reserves was enlarged to include holdings of special drawing rights, the entire reserve position in the IMF, deposit balances of foreign currencies, other than U.S. dollars defined as convertible by the IMF and held by the exchange fund account, the Receiver General and the Bank of Canada, and the Bank of Canada's liquid foreign currency assets.

[3] Revaluation of SDRs, gold and Canada's reserves to U.S. $38 per fine ounce in May 1972. Previous valuation at U.S. $35 per fine ounce.

[4] Revaluation of SDRs, gold and Canada's reserves to U.S. $42.2222 per fine ounce in October 1973.

Table 13 Official International Reserves, 1945-74 (end of month in millions of U.S. dollars)

	1945	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955
January	960.2	1,418.2	1,143.5	511.0	1,021.9	1,149.4	1,743.3	1,783.5	1,866.8	1,834.1	1,934.1
February	997.5	1,478.2	957.7	527.5	1,043.9	1,175.9	1,741.7	1,787.0	1,837.1	1,853.5	1,840.0
March	1,041.6	1,638.7	811.3	607.5	1,067.2	1,192.2	1,653.4	1,787.2	1,845.3	1,827.2	1,871.5
April	1,098.2	1,644.7	700.3	658.4	991.2	1,177.2	1,664.3	1,802.7	1,843.7	1,810.5	1,871.2
May	1,118.3	1,666.5	710.4	694.1	977.2	1,182.4	1,681.6	1,806.7	1,761.2	1,822.2	1,884.0
June	1,234.2	1,624.2	665.9	741.9	970.9	1,355.4	1,683.0	1,827.7	1,750.1	1,863.3	1,930.4
July	1,332.4	1,603.1	651.3	768.7	973.1	1,326.5	1,668.7	1,845.0	1,755.7	1,892.8	1,938.3
August	1,408.0	1,563.1	665.0	814.2	987.1	1,564.2	1,561.8	1,847.9	1,764.4	1,905.6	1,934.7
September	1,439.3	1,517.4	615.4	854.9	985.3	1,789.6	1,610.1	1,855.6	1,787.3	1,898.6	1,936.7
October	1,475.5	1,454.2	526.5	892.2	1,007.4	1,826.6	1,678.1	1,856.0	1,784.5	1,900.9	1,896.2
November	1,491.8	1,350.1	480.2	968.2	1,008.4	1,787.2	1,748.9	1,842.0	1,806.7	1,921.5	1,889.9
December	1,508.0	1,244.9	501.7	997.8	1,117.1	1,741.5	1,778.6	1,860.2	1,818.5	1,942.6	1,900.9

Table 13 Continued

	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966
January	1,878.9	1,930.6	1,857.1	1,900.2	1,861.6	1,892.5	1,921.9	2,662.5	2,582.4	2,668.2	2,997.5
February	1,877.7	1,919.7	1,861.7	1,886.1	1,858.9	1,911.9	1,746.7	2,593.9	2,542.3	2,648.7	2,949.6
March	1,871.4	1,923.6	1,867.7	1,888.3	1,856.1	1,934.9	1,709.4	2,600.1	2,465.5	2,554.1	2,912.9
April	1,865.1	1,901.8	1,875.0	1,913.8	1,841.8	1,935.2	1,594.8	2,671.4	2,481.1	2,536.5	2,882.2
May	1,885.4	1,932.6	1,897.5	1,917.9	1,740.3	1,949.2	1,492.8	2,712.0	2,509.4	2,498.7	2,878.6
June	1,899.5	1,941.8	1,921.4	1,934.2	1,773.9	1,985.2	1,808.7	2,691.6	2,533.9	2,480.1	2,793.3
July	1,893.3	1,973.0	1,936.6	1,917.3	1,820.6	1,960.3	2,114.4	2,501.0	2,533.9	2,491.5	2,775.0
August	1,883.7	1,942.9	1,922.7	1,925.3	1,836.6	1,944.4	2,330.6	2,470.5	2,575.9	2,598.0	2,745.6
September	1,903.5	1,889.9	1,888.2	1,938.3	1,813.0	1,924.3	2,444.6	2,568.3	2,624.5	2,614.1	2,717.9
October	1,913.0	1,923.7	1,917.3	1,875.4	1,845.3	2,110.6	2,613.9	2,581.4	2,686.6	2,643.8	2,698.1
November	1,932.6	1,894.5	1,927.0	1,863.0	1,839.3	2,078.8	2,607.5	2,631.0	2,743.4	2,681.1	2,712.0
December	1,936.2	1,828.3	1,939.1	1,869.2	1,829.2	2,055.8	2,539.4	2,595.0	2,674.3	2,664.5	2,701.9

Table 13 Continued

	1967	1968	1969	1970	1971	1972	1973	1974
January	2,723.5	2,617.6	3,089.9	3,311.2[1]	4,799.1	5,657.3	5,964.5	5,853.5
February	2,679.6	2,499.8	3,044.7	3,423.9	4,850.3	5,668.4	6,052.1	6,197.2
March	2,688.5	2,260.8	3,010.7	3,597.6	4,844.7	5,748.4	5,967.6	6,101.7
April	2,669.9	2,456.7	3,030.8	3,822.4	4,853.9	5,779.4	5,907.3	6,235.8
May	2,660.3	2,749.1	3,011.9	4,084.0	4,878.7	5,914.3[2]	5,949.7	6,230.4
June	2,639.2	2,710.9	2,960.9	4,333.4	4,851.8	6,217.7	5,860.4	6,123.1
July	2,648.7	2,649.2	2,934.4	4,444.0	4,923.8	6,191.1	5,785.8	6,014.4[3]
August	2,664.5	2,725.2	2,966.6	4,615.7	4,992.2	6,199.4	5,588.9	5,852.9
September	2,689.2	2,737.5	2,956.1	4,553.0	4,991.6	6,221.1	5,535.3	5,808.4
October	2,770.2	2,727.9	3,050.0	4,606.9	5,071.5	6,228.9	5,588.7[2]	5,809.3
November	2,723.8	2,885.5	3,075.2	4,644.5	5,273.6	6,046.5	5,735.9	5,796.6
December	2,716.9	3,045.8	3,106.3	4,679.0	5,570.4	6,049.9	5,768.2	5,825.3

[1] In January 1970 the IMF began to issue special drawing rights. At that time Canada's definition of official international reserves was enlarged to include holdings of special drawing rights, the entire reserve position in the IMF, deposit balances of foreign currencies, other than U.S. dollars defined as convertible by the IMF and held by the exchange fund account, the Receiver General and the Bank of Canada, and the Bank of Canada's liquid foreign currency assets.

[2] Canada's gold-based reserves were revalued in May 1972 from U.S. $35 to U.S. $38 per ounce, and in October 1973 to U.S. $42.2222. The revalued figure for May 1972 became 6,048.0, and for October 1973 became 5,773.5.

[3] Beginning in July 1974 reserves are valued on the basis on the month-end value of the SDR in terms of U.S. dollars as determined by the IMF.

Table 14 Foreign Exchange Rates, 1950-62 and 1970-74[1]
(Canadian dollars per U.S. dollar)
(monthly averages of noon spot rates)

	1950	1951	1952	1953	1954	1955	1956	1957	1958
January	0.918105	0.950814	0.995192	1.03036	1.02788	1.03515	1.00133	1.04096	1.01551
February	0.918105	0.953126	0.998921	1.02326	1.03466	1.02369	1.00092	1.04347	1.01938
March	0.918205	0.954803	1.00398	1.01696	1.03008	1.016	1.00131	1.04593	1.02319
April	0.918105	0.943486	1.01946	1.01655	1.01784	1.01403	1.00323	1.04201	1.03033
May	0.918105	0.940113	1.01643	1.00594	1.01592	1.01431	1.00829	1.04644	1.03423
June	0.918105	0.935104	1.02139	1.00564	1.01902	1.01586	1.01491	1.04908	1.03972
July	0.918105	0.942918	1.03178	1.00823	1.02627	1.01568	1.01849	1.05161	1.04167
August	0.918105	0.947348	1.0401	1.01188	1.03075	1.01512	1.01919	1.05489	1.03667
September	0.918105	0.947341	1.04191	1.016	1.03129	1.01237	1.02285	1.04257	1.02372
October	0.94933	0.95163	1.03706	1.01777	1.03109	1.00468	1.0275	1.03657	1.03016
November	0.961296	0.958316	1.02393	1.02282	1.03175	1.00057	1.03696	1.03911	1.0327
December	0.949567	0.975087	1.03031	1.02765	1.03304	1.00054	1.04114	1.02314	1.03671

Table 14 Continued

	1959	1960	1961	1962	1970	1971	1972	1973	1974
January	1.03421	1.04923	1.00712	0.956939	0.932155	0.988493	0.994113	1.00085	1.00867
February	1.02576	1.05077	1.01055	0.953516	0.931899	0.992525	0.995276	1.00449	1.02387
March	1.03114	1.05165	1.01285	0.952936	0.932233	0.993776	1.00161	1.00346	1.02881
April	1.03787	1.03853	1.01124	0.95253	0.932179	0.992439	1.00443	0.999391	1.03384
May	1.03854	1.02243	1.01261	0.923969	0.93213	0.991342	1.01147	0.999519	1.03935
June	1.04293	1.01799	0.994561	0.919239	0.962999	0.979234	1.02106	1.00169	1.03477
July	1.04453	1.02212	0.967032	0.926846	0.968976	0.979292	1.01641	1.00057	1.02450
August	1.04772	1.03119	0.969467	0.927981	0.979064	0.986851	1.01809	0.99618	1.02064
September	1.05087	1.02831	0.970138	0.928699	0.984385	0.987292	1.01742	0.991961	1.01394
October	1.05523	1.02192	0.970621	0.929349	0.979078	0.995613	1.01773	0.99911	1.01733
November	1.05232	1.02386	0.965508	0.928699	0.980362	0.996279	1.01296	1.00122	1.01302
December	1.05134	1.01787	0.95906	0.929369	0.982884	1.00075	1.00333	1.00059	1.01205

Table 15 Gross National Product, 1928-74

Year	GNP ($ millions)	GNP 1961 $ ($ millions)	GNP Deflator	Real GNP per Capita ($)
1928	6,050	12,191	49.6	1,240
1933	3,492	8,555	40.8	805
1938	5,272	11,984	44.0	1,075
1943	11,053	20,719	53.3	1,767
1944	11,848	21,539	55.0	1,803
1945	11,863	21,057	56.3	1,744
1946	11,885	20,493	58.0	1,667
1947	13,473	21,366	63.1	1,702
1948	15,509	21,898	70.8	1,708
1949	16,800	22,735	73.9	1,691
1950	18,491	24,451	75.6	1,783
1951	21,640	25,673	84.3	1,833
1952	24,588	27,968	87.9	1,934
1953	25,833	29,408	87.8	1,981
1954	25,918	29,047	89.2	1,900
1955	28,528	31,788	89.7	2,025
1956	32,058	34,474	93.0	2,196
1957	33,513	35,283	95.0	2,124
1958	34,777	36,098	96.3	2,113
1959	36,846	37,470	98.3	2,143
1960	38,359	38,553	99.5	2,053
1961	39,646	39,646	100.0	2,174
1962	42,927	42,349	101.4	2,279
1963	45,978	44,531	103.2	2,352
1964	50,280	47,519	105.8	2,463
1965	55,364	50,685	109.2	2,580
1966	61,828	54,207	114.1	2,708
1967	66,404	56,016	118.6	2,749
1968	72,586	59,292	122.4	2,864
1969	79,815	62,448	127.8	2,974
1970	85,685	64,014	133.9	3,006
1971	93,307	67,585	138.1	3,133
1972	103,493	71,515	144.7	3,277
1973	118,902	76,395	155.7	3,455
1974[1]	139,493	79,199	176.1	3,530

[1]Publication of data on a 1961 base was discontinued after the release of preliminary statistics for 1974 which are shown here. Subsequent revisions to current dollar GNP for 1971 to 1974 produced the following: 1971 94,155; 1972 104,669; 1973 122,582; 1974 144,616. Revisions for the other series are not available.

Table 16 Unemployment Rate, 1953-74
(seasonally adjusted)

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974
January	3.0	3.9	4.8	3.7	3.8	6.5	6.5	6.1	7.6	6.0	5.9	4.9	4.2	3.7	3.8	4.6	4.6	4.8	6.3	6.1	6.1	5.4
February	2.8	4.0	4.7	3.8	3.9	6.6	6.2	6.4	7.7	6.2	5.8	4.9	4.1	3.6	3.9	4.8	4.6	5.1	6.4	5.9	5.9	5.5
March	2.6	4.1	4.9	3.6	4.1	6.9	6.0	6.5	7.6	6.0	5.9	4.8	4.1	3.5	4.0	4.9	4.4	5.4	6.4	6.2	5.6	5.4
April	2.6	4.4	4.5	3.5	4.2	6.9	5.8	6.8	7.6	5.9	5.9	4.9	4.4	3.4	4.1	4.8	4.6	5.8	6.9	6.1	5.6	5.4
May	2.6	4.7	4.5	3.4	3.9	7.0	6.3	7.2	7.6	5.6	5.9	4.6	4.0	3.6	4.1	4.8	4.8	6.2	6.4	6.3	5.4	5.6
June	2.7	5.1	4.3	3.2	4.3	7.9	5.6	6.7	7.4	5.7	5.5	4.8	4.1	3.4	4.0	5.1	4.7	6.3	6.4	6.4	5.5	4.9
July	2.9	5.2	4.3	3.0	4.6	7.5	5.5	7.1	7.2	6.0	5.4	4.6	3.9	3.7	4.0	5.1	4.6	6.6	6.4	6.5	5.3	5.2
August	3.1	5.2	3.8	3.0	4.8	7.5	5.9	7.6	6.8	5.7	5.3	4.6	3.8	3.8	3.9	4.9	4.7	6.4	6.2	6.6	5.4	5.3
September	2.8	5.1	4.1	3.1	5.4	7.1	5.4	7.5	6.9	5.7	5.3	4.5	3.6	3.9	4.1	4.6	4.7	6.3	6.4	6.5	5.6	5.5
October	3.5	5.1	4.0	2.8	5.3	7.5	5.5	7.6	6.5	5.7	5.2	4.9	3.1	3.4	4.3	4.6	4.9	6.2	6.3	6.6	5.7	5.3
November	4.1	5.1	3.8	3.1	6.2	7.2	5.8	7.5	6.1	5.9	5.1	4.3	3.6	3.7	4.3	4.8	4.9	6.2	6.3	6.4	5.4	5.5
December	4.0	4.7	3.7	3.4	6.5	7.0	6.0	7.6	6.0	6.0	5.0	4.1	3.5	3.6	4.6	4.7	4.8	6.5	6.1	6.4	5.3	6.0

Index

This Index was prepared by Tim Plumptre with an assist from Barbara Ann Plumptre, to both of whom I am duly and deeply grateful. – A.F.W.P.

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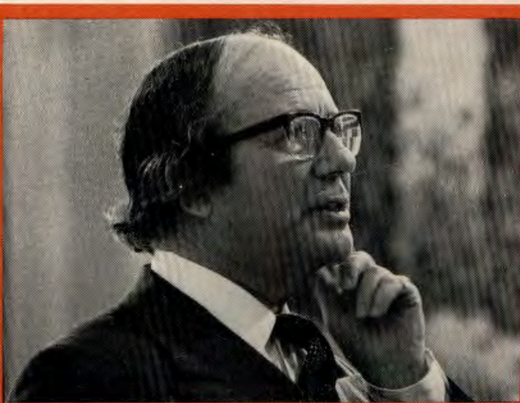

Professor Plumptre was for ten years a senior official in Canada's Department of Finance, served also as Canadian Executive Director at the International Monetary Fund and the World Bank and as head of the Economic Division of the Department of External Affairs, and was until his death in June 1977 Visiting Professor of International Economics at Carleton University.

THREE DECADES OF DECISION
Canada and the World Monetary System, 1944-75

A. F. W. Plumptre

For Canadians and others confused about the worth of their dollar in today's escalating world economy, here is a book that provides a basis for understanding and an historical perspective on the fluctuations of Canada's currency in relation to international monetary developments. Abandoning specialized jargon, finance expert A. F. W. Plumptre explains technical issues in terms comprehensible to the general reader. In a book that fills a long-standing gap in the literature on Canada's international financial relations, he explores Canada's involvement in world monetary issues during the crucial thirty years from 1944 to 1975. He traces Ottawa's financial policies during the same period, examining in detail the merits of the fixed or floating Canadian dollar, describing and evaluating the monetary policies of successive Canadian governments.

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