

## FISCAL POLICY

In our study of monetary policy, debt management and exchange rate policy we have been unable to avoid paying considerable attention to fiscal policy, i.e. the tax and expenditure policies of the government. This has been the case in both a narrow and a broad sense. In the narrow sense, tax and expenditure policies affect the cash requirements of the government and these in turn influence the actions of the monetary and debt authorities. In a broader sense, the fiscal policy of the government does a great deal to shape the economic environment within which the other policies must operate. In this chapter we shall be concerned with the contribution the tax and expenditure policies of the government can make to the achievement of the objectives of policy.

It is clear from our earlier analysis that a good deal turns upon the ability of the government to make effective use of fiscal policy. If the future is like the past, the domestic and international forces influencing the Canadian economy will at times lead to a satisfactory level of aggregate demand combined with reasonable price stability, and at other times either to excessive inflationary pressures and marked price increases or to an inadequate level of demand and excessive unemployment. If these conditions are anticipated, policy changes are required to reduce as far as possible either an excess or deficiency of demand. We have concluded that if the excess or deficiency of demand is of a major kind, even a judicious use of monetary, debt and exchange rate policies alone will almost certainly not achieve the desired

results in a reasonable time. We must, therefore, accept the fact that a good deal of reliance must be placed from time to time on fiscal and other policies if Canada is not to fall far short of achievement of her policy goals.

Our enquiries have confirmed that changes in credit conditions brought about by monetary and debt policies in recent years have influenced expenditure, but they have also convinced us that the effects to be expected in offsetting short-term fluctuations are strictly limited. Over periods extending beyond the short-term business cycle, the effects can well be larger. Given enough time, it may be possible to vary credit conditions over a wider range, and in particular to bring about significant changes in long-term interest rates. In addition, over a period of several years all of the direct and indirect effects of changes in credit conditions will have time to work through the system. However, in the absence of accompanying exchange rate changes the longer-term effects of monetary and debt policies on the demand for goods and services will be weaker than at some times in our recent history.

We have considered the possibility that the relative weakness of monetary and debt policies used within the conventional range could be overcome by operating these policies over a wider range. But general changes in credit conditions in Canada relative to those in other countries influence capital movements across our borders. This in turn affects the exchange rate or the exchange reserves or both, but under a fixed

exchange rate system the primary effect will be on the exchange reserves. For both domestic and international reasons there will be some limit to the extent to which these reserves are permitted to fluctuate and thus some limit on the range over which credit conditions can be allowed to vary. It may be possible through the use of selective credit controls to widen the range of variation of credit conditions with a dampened effect on international capital movements which affect our exchange reserves, but in our opinion these weapons are too blunt and arbitrary in their effects to use except under emergency conditions. We can see even more objections to the general use of other direct controls. We are thus driven to the position that there will be times when vigorous use of the fiscal instrument will be essential to an effective stabilization policy, although it will not necessarily assure success.

The notion that governments should use their tax and expenditure policies to reduce fluctuations in the private sector of the economy is not a new one. Indeed, these ideas are at least fifty years old, and in some forms much older, but they had not become widely accepted prior to the great depression in the 1930's. Thus when national governments were faced with a catastrophic decline in employment and output at that time, many of them reacted initially by reductions rather than increases in expenditure. The principal reason for this reaction was the deepset public belief in the desirability of a balanced budget, a belief which is perhaps best described as a rule of thumb which men have developed over the years to prevent their representatives from being unduly extravagant. If political leaders are required to undertake the unpleasant task of levying additional taxes in order to carry out the relatively popular act of increasing expenditure, they will tend to exercise restraint in reaching decisions on spending. Moreover, under conditions of full employment, if government expenditure is increased without additional taxes being raised, there will be an excess demand for goods and services and prices will rise. As a safeguard against both extravagance and inflation the public have tended to apply a simple test

to a budget: is it balanced or unbalanced and by how much? This may be a reasonable and sensible test if applied over a series of years, but if interpreted to mean that governments must balance their budgets in each and every year it is inconsistent with the broader obligation of governments to use their tax and expenditure policies to stabilize and balance the economy.

The fundamental idea of using fiscal policy as an instrument for mitigating economic fluctuations is a straightforward one. When the level of demand forthcoming from the private sector of the economy is too low to make for prosperous business conditions and high employment, it makes sense to suggest that governments supplement this demand by carrying out the construction of needed public works. Conversely, in periods when the level of private demand is too high and pressure on available resources leads to rising prices, governments can ease the strain on labour and other physical resources by refraining, as far as possible, from undertaking spending projects of their own. Proposals of this kind were in fact made prior to World War I. But such arrangements have implications for the rule of the balanced budget. Most of the stimulating effect of additional government expenditure on public works during a period of economic slack would be lost if new or increased taxes were imposed to raise the revenue to finance the construction. On the one hand, increased government spending would be adding to the stream of spending and incomes in the economy, but on the other hand higher taxes would produce an offsetting reduction in the incomes of individuals and businesses and tend to reduce their expenditure. Thus increased reliance must be put on borrowing as opposed to taxing, i.e. government deficits must be incurred during periods of economic slack. Conversely, in periods of excessive demand, it would be undesirable to reduce taxes merely because government expenditure is being reduced. Such action would limit the restraining effect of a reduction in government expenditure by adding a compensating amount to the incomes and hence expenditure of those in the private sector of the economy. The conclusion follows

that during periods of excess demand the government should plan to collect revenue in excess of its spending, i.e. run budgetary surpluses.

Thus even if the stabilizing fiscal policy of the government is restricted to an attempt to schedule public works in a way which provides opportunities for employment during periods of slack and reduces pressure on resources during periods of excessive buoyancy, this calls for deficits in some years and surpluses in others. It is only one further step to recognize that similar stabilizing effects can be achieved by changes in the level of taxation in place of, or in addition to, changes in government expenditure on goods and services. If the level of effective demand is too low, a reduction in taxes unaccompanied by a reduction in government expenditures will add to the incomes of individuals and businesses and thus produce a net increase in spending and employment in the private sector. If the government encounters considerable difficulty in increasing its expenditure on public investment during a period of economic slack, or if the change likely to be brought about is too small in relation to the short-fall in demand, a reduction in taxes provides a further source of stimulus. Alternatively, an increase in taxes adds to the effect realized in a period of excess demand by a curtailment of public investment. A combination of changes in taxes and expenditure of this kind can lead to substantial deficits and surpluses in particular years but if the policy changes are appropriately timed and the amounts involved are not excessive in relation to the fluctuations in economic activity, then such policies can make a substantial contribution to the achievement of the objectives of economic policy.

The view that this wider approach to fiscal policy is necessary in Canada was officially recognized almost twenty years ago in the White Paper on Employment and Income in which the government adopted a "high and stable level of employment and income . . ." as a major aim of government policy. It was recognized that such an aim could only be achieved if, among other things, the government were prepared to run surpluses or deficits as the economic situation re-

quired, with a balance only being achieved over a period of more than a year.

"The Government will be prepared, in periods when unemployment threatens, to incur the deficits and increases in the national debt resulting from its employment and income policy, whether that policy in the circumstances is best applied through increased expenditures or reduced taxation. In periods of buoyant employment and income, budget plans will call for surpluses. The Government's policy will be to keep the national debt within manageable proportions and maintain a proper balance in its budget over a period longer than a single year".

While there has been a limited acceptance of this view, succeeding post-war governments have been inclined to apologize for their surpluses or deficits even in years when a failure to bring down an unbalanced budget would have amounted to a dereliction of duty. As a result, public understanding and support for an effective fiscal policy has not been readily forthcoming, and this in turn has come to be regarded as a limitation by governments. This is a vicious circle which has been partially broken once and needs to be broken again. It must be clearly recognized that one of the principal functions of the Government of Canada is to order its tax and expenditure policies so as to contribute to high employment, stable prices, economic efficiency and a sound external position. At times this will call for a surplus of revenue over expenditure, at other times for a balanced position and on still other occasions for an excess of expenditure over revenue. Fiscal policies designed to limit the wastes of unemployment and idle capacity or to prevent the damages and inequities of inflation can be entirely consistent with a strict regard for efficiency and economy in government and entirely consistent with a wide range of views on the appropriate size of government. Nor need they be a serious bar to the development of a well-balanced structure of taxes, even though it would be an advantage if tax and expenditure policies could be decided upon without regard for the needs of economic stabilization. In short, an effective fiscal

policy is quite compatible with a government which is moderate in size, efficient in the use to which it puts the public's resources, and sensible in the way it raises its revenues.

An effective fiscal policy is also quite consistent with a level and rate of growth of the public debt which past experience has clearly demonstrated is manageable. A rough indicator of the national burden of servicing the federal debt is provided by the ratio of interest payments on the debt to national income. In 1962, despite a series of deficits since 1958 and a level of interest rates well above the historical average, the ratio of interest payments to national income was only around 2.6%. This compares with 2.7% in 1929, 3.1% in 1939, 3.6% in 1949 and 2.2% in 1957. As indicated in Chapter 4, debt charges are also a much lower percentage of federal revenues than they were in the late 1920's or the depressed 1930's. While the effect of increases in the federal debt should be carefully assessed, it is clear that large increases can occur over the long run in a growing economy; in this respect the federal debt is not unlike private indebtedness. The relative burden in terms of national production may even fall in such circumstances.

There is in fact a good deal of misunderstanding of the problems posed by the public debt. In particular, exaggerated fears are often expressed over the consequences which will flow from a series of deficits which lead to an increase in the debt. While we do not think that an increase in the federal debt is unimportant, it should be realized that private debt usually rises slowly in periods of economic slack, and that all forms of indebtedness in the economy may not be increasing rapidly. Moreover, unemployed labour and unutilized plant and equipment produce nothing. If these resources can be put to use through a reduction in taxes or an increase in government expenditure, this is a gain to the economy as a whole. As chart 24-1 shows, the ratio of federal debt to national production hardly changed from 1957 to 1962 despite cumulative deficits amounting to about \$3 billion on a public accounts basis. If these deficits had not been incurred,

G.N.P. and federal revenues would undoubtedly have been lower, and the ratio of government debt to output and revenues might not have been much reduced.

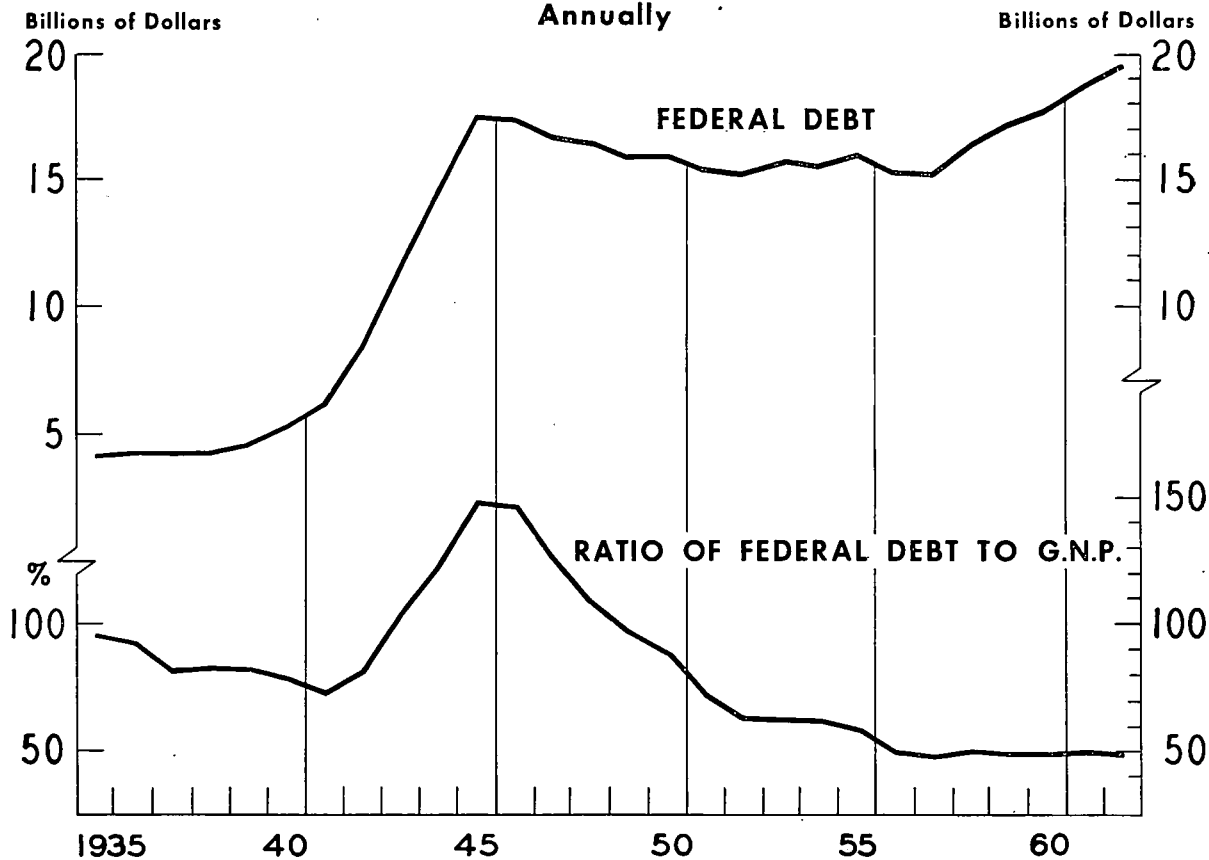
We can specify no rules as to what size of deficits or surpluses are appropriate in varying circumstances. This will depend on the severity of the economic downturn or boom, the method by which deficits or surpluses are incurred, the purposes for which government expenditures are made, and their influence on national production. Nor is there any formula for relating the amount of government debt to G.N.P. to guard against inflationary pressures. As the chart shows, this ratio was about 80% before the war and yet conditions were still depressed and prices weak. On the other hand, we have had inflationary pressures with much lower ratios and sizable government surpluses. Clearly, everything depends on the prevailing economic environment.

Government deficits, in addition to having direct effects on incomes and expenditures, will also have indirect influences. The private sector's holdings of financial assets in the form of government bonds will increase and this may exercise a stimulating effect on expenditures and incomes.<sup>1</sup> On the other hand, a larger deficit—or smaller surplus—will tend to tighten credit conditions and thus have some indirect contractionary effects on economic activity if not accompanied by accommodating monetary and debt management policies. It is argued that increases in the community's wealth and liquidity resulting from such expansionary fiscal and monetary policies may pose problems in a subsequent period of excess demand. This, however, need not be true if a combination of fiscal surpluses and restrictive credit policies is employed in such periods.

This is not to say that the task of adjusting fiscal policy is easy. On the contrary, it is very difficult and the necessary skills will be acquired only with persistent effort. Unless governments can reach reasonably accurate judgments as to

<sup>1</sup> The increased government debt is not usually regarded as a liability by the tax-payers who will have to service it. To the extent that it is so regarded, the stimulating effect of the deficit will be reduced.

Chart 24-1  
**FEDERAL DEBT OUTSTANDING**  
 Annually



what the economic situation will be, there is a danger that action will be taken too late. This likelihood is enhanced if changes in fiscal policy are generally carried out only once a year. Given the time it takes for fiscal changes to be introduced and to have effects on output, this requires governments to agree on the economic conditions and problems that will have to be met for well over a year ahead. This is not the only problem. As we shall argue in greater detail below, the amount of expenditure which is both under the direct control of the federal government and capable of substantial variation over the short-run is fairly limited. This means that a good deal of reliance must be placed on the concerting of policies among the three levels of government

and that tax rates must become more flexible than they have been in the past. Both of these steps raise major political and administrative problems.

Nevertheless, it is important to find ways to overcome these difficulties. This is particularly true under a fixed exchange rate since it further enhances the power of the fiscal instrument to influence expenditure relative to that of the monetary and debt instruments. However, under any exchange system the fiscal instrument can operate powerfully and directly on the flow of income. In addition, changes in fiscal policy which are well within the bounds of the practical can be used to provide incentives to, or impose disincentives on, private spending which are simi-

lar to those brought about through changes in monetary and debt policies. As pointed out later in this chapter, taxes or subsidies on investment—and other fiscal measures—have been introduced by other countries with effects far greater than anything likely to be experienced from changes in interest rates alone. We believe, therefore, that developments in fiscal policy—if effectively co-ordinated with other policies—hold out greater hope for improvement in the economic policy performance of the government than corresponding developments in monetary and debt policies. These are not, however, alternatives: the greatest hope for improvement lies in the co-ordination of all economic policies and their direction towards the desired goal. Yet, despite its powerful effects, fiscal policy has not been vigorously or extensively used in the post-war period, and excessive reliance has at times been placed on monetary policy.

While we have felt that our analysis would be incomplete without consideration being given to fiscal policy, we are not prepared to make precise recommendations in this field. To do so would lead us into some intricate tax problems which we leave with some enthusiasm in the competent hands of the Royal Commission on Taxation. There are, however, four aspects of fiscal policy on which we comment:

1. the budget surplus or deficit—public accounts, national accounts and cash requirements;
2. the built-in stabilizers;
3. discretionary tax and expenditure changes;
4. the possibilities of concerting policies with the provincial and municipal authorities.

#### THE BUDGET SURPLUS OR DEFICIT

There is more than one meaning which can be attributed to the terms surplus and deficit, and in Chapter 4 we have discussed some of these differences. In thinking about fiscal policy, we are particularly interested in those items of government expenditure and revenue which directly influence income levels. Additions to the level of

income include purchases of newly produced goods and services and transfers to persons and business enterprises. The subtractions from the income stream include taxes, payments into Unemployment Insurance, Old Age Security and government pension funds, and miscellaneous government income. Purchases and sales of existing assets do not have a direct effect on economic activity. For example, if the government acquires a piece of land or an existing building, this does not increase employment and income directly in the way in which the hiring of a new employee does. The indirect effects of the purchase of an existing asset may nevertheless be significant as the proceeds of the sale to the government are put to use elsewhere.

One of the deficiencies of the public accounts budget presented by the Minister of Finance to Parliament is that it includes some transactions in existing assets. It also includes some transactions among government accounts which are of a strictly bookkeeping nature and excludes a number of government activities of an income-influencing nature<sup>2</sup>. The public accounts surpluses and deficits in a particular year are therefore an inadequate measure of the contribution the government is making to the income stream. A more accurate indicator of the effect of fiscal policy on the economy is provided by the national accounts. These accounts are designed to measure the flow of income, and the estimates of the government sector which they contain are specifically devoted to this end.<sup>3</sup>

<sup>2</sup> Payments into and out of the Old Age Security Fund and the Unemployment Insurance Fund are not included in the public accounts budget, although costs of administering the Unemployment Insurance Fund and any deficit incurred by the Old Age Security Fund are included.

<sup>3</sup> See the discussion in Chapter 4. It will be noted that the national accounts budget measures corporate tax accruals rather than government receipts from the corporation income tax, a contrast to the public accounts which record transactions at the time cash actually changes hands. It is true that the corporations have the use of the accrued but unpaid corporation income taxes, but if a change occurs in the level of the tax this can be expected to have an effect on decisions at the time the tax liability is incurred rather than at the time the tax is remitted to the government. Measures were taken in the 1963 budget to reduce the time which elapses between the accrual of corporate tax liabilities and payments to the government.

The national accounts budget nevertheless excludes a number of financial transactions which are of interest in any total assessment of the effect of government fiscal actions on the economy. For example, loans to and investments in the Central Mortgage and Housing Corporation, the Farm Credit Corporation, the Canadian National Railways and other government enterprises are excluded from the national accounts, although they are included in the accounts used to estimate the cash requirements of the government. The cash requirements estimate also includes loans to foreign governments and advances to the Exchange Fund. It thus provides a measure of the government's need to run down its cash balances or sell debt to non-government holders.<sup>4</sup>

Changes in these cash requirements have an important effect on credit conditions. For example, in a year of buoyant economic activity the government may decide to increase taxes and reduce expenditure and convert a national accounts deficit into a surplus. Other things equal, this will reduce the government's cash needs or increase its cash surplus or convert a net demand for funds into a net supply of funds, as was the case in the early post-war years. If, as has typically been true in the past, these funds are used to reduce debt, credit conditions will be easier than they would have been in the absence of the government surplus and the resulting retirement of debt. It has been suggested to us that under these circumstances the government should add to its cash balances. As we mentioned earlier, there may be occasions when the monetary and debt authorities decide that this is a useful means of varying the components of credit conditions. However, they may normally find that the retirement of debt and offsetting action through other monetary and debt operations is preferable. The crucial point being made by those who oppose the retirement of debt during a period of prosperity is that if excessive demand pressure exists,

credit conditions should be established which will contribute to the achievement of the domestic and international objectives of economic policy. In some post-war years, this was not the case, and the effect of the fiscal surpluses of those years was diminished by the failure to tighten credit conditions in the face of excessive pressure on the economy.

Thus, when surpluses and deficits are being discussed, there are three numbers to which reference can be made—the figure derived from the public accounts, the estimate made in the national accounts and the cash requirements of the government.<sup>5</sup> There can be significant differences in the results shown by the three measures. For example, in fiscal 1951, the public accounts showed a federal surplus of \$211 million and the national accounts a surplus of \$873 million while there was a cash surplus of \$107 million: in fiscal 1962, the three figures showed deficits of \$791 million, \$551 million and \$478 million respectively. It would be useful if, as in some other countries, estimates were provided of the projected national accounts surplus or deficit at the time that the public accounts budget is presented. However, no system of budgeting can fully reflect the impact of government on the economy. For example, changes in the terms and conditions of lending by government agencies such as CMHC represent changes in important components of credit conditions, although not formally classified either as fiscal or monetary and debt policies. The blurred nature of the distinction between the various instruments of policy serves to emphasize the importance of co-ordinating them all closely.

<sup>5</sup> Suggestions have also been made that a budgetary statement should be developed which draws a distinction between current and capital items to help draw attention to the fact that in some respects governments are like corporations in that at least some of their debt has as a counterpart the real capital assets they have acquired. Although the line between a current and a capital item is frequently a fuzzy one and some new uncertainties can result, the separation of capital and current accounts is a common practice among a number of other national governments and Canadian provinces. The provinces, however, have a different system of accounting than the federal government and most of them include debt retirement as a current expense.

<sup>4</sup> It would be helpful for analysis of the government's position if statistics on the federal government's cash position were available at least quarterly in seasonally adjusted form.

**BUILT-IN STABILIZERS**

If governments design their budgets to secure a long-run balance or to give a balance at a high level of employment, there will be surpluses and deficits as output expands and contracts. These surpluses and deficits occur without any discretionary changes in expenditures or rates of taxation. A fall in output and employment will lead to a fall in revenue automatically. In the case of some taxes, revenue will fall more or less in proportion to the decline in economic activity, for example, when a decline in domestic output and sales affects the yield of the general sales tax, excise taxes and excise duties. A fall in employment will also reduce payments into the Unemployment Insurance Fund. Some items in the tax base are particularly sensitive to changes in economic activity, including corporate profits, imports and manufacturing shipments. This is especially true of corporate profits, and the accrued yield from the corporation income tax thus varies very sharply with economic activity. In addition, the rate of personal income tax is higher on higher incomes, and changes in personal income therefore have a magnified effect on the yield of the personal tax.

In the absence of a discretionary reduction, most expenditure items will not decline in response to a fall in output and employment. For example, most normal departmental expenditures, defence spending and welfare payments such as family allowances and old age pensions will be maintained. On the other hand, some expenditure items, notably payments from the Unemployment Insurance Fund, rise substantially during periods of economic slack and thus contribute in a major way to a national accounts deficit. The term "built-in stabilizer" has been used to refer to all revenue and expenditure items which automatically contribute to surpluses in periods of buoyancy or deficits in periods of slack. These built-in stabilizers, especially on the revenue side, are much more important than they were a generation ago

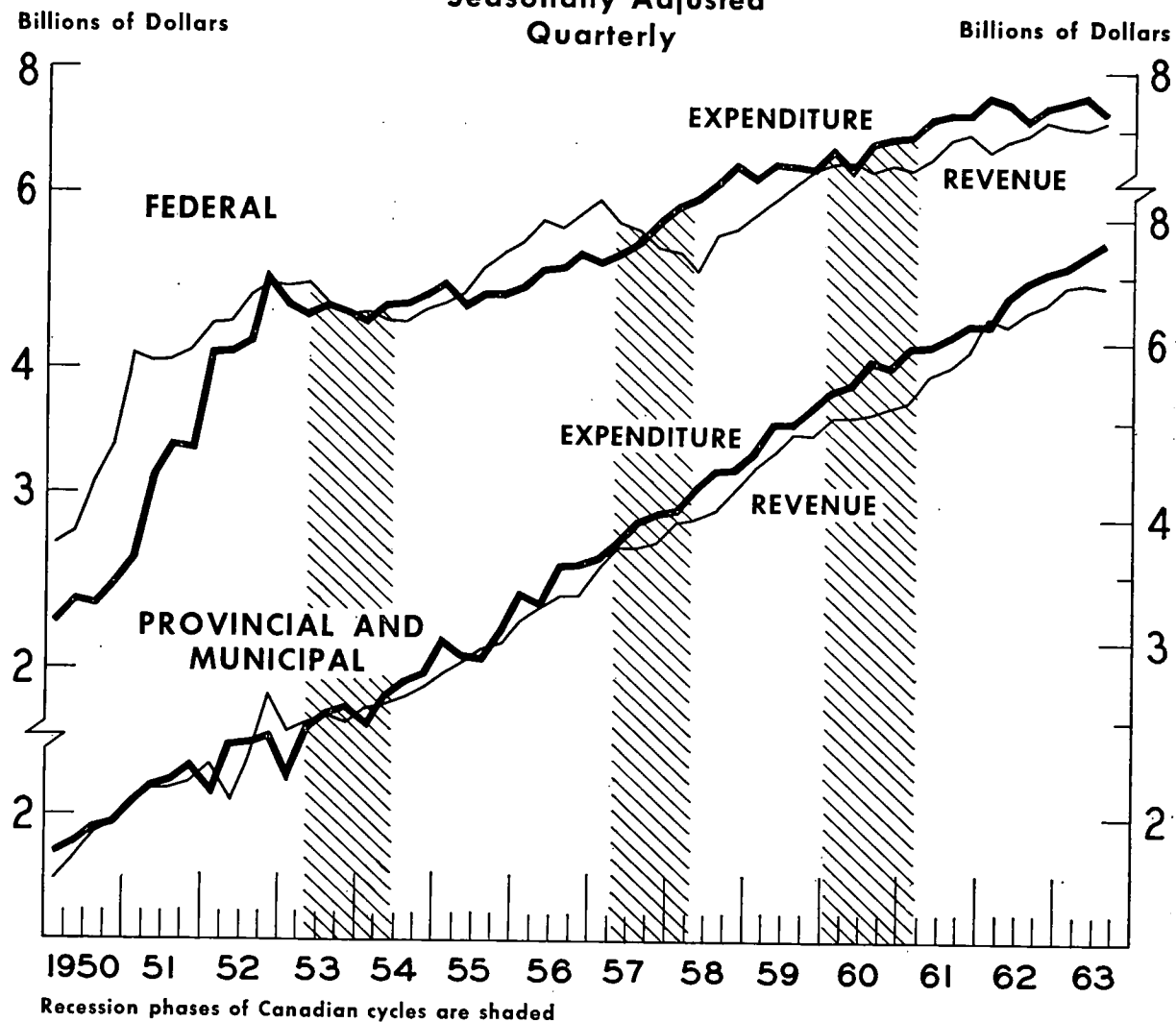
because of the increased government reliance on corporate and personal income taxes noted in Chapter 4.

Chart 24-2 indicates the extent to which the revenues of the federal government have fluctuated over the course of the last three business cycles. To some extent these fluctuations represent discretionary tax changes, in particular the tax cut of 1957, but in large measure they reflect the contribution of the built-in stabilizers. For comparative purposes, trends in provincial and municipal revenues and expenditures have also been shown. It is evident from the chart that little in the way of contra-cyclical changes in revenue and expenditure have occurred at the provincial and municipal level, although the lack of pro-cyclical fluctuations has contributed to the stability of the economy. It will also be noted that there is little or no apparent cyclical change in federal expenditures in aggregate.

The built-in stabilizers have some advantages over discretionary tax and expenditure changes. They are brought into action automatically without delay. As soon as unemployment rises and incomes are reduced, the fiscal system begins to provide some resistance to further movements in the same direction. This is true both for a rise and for a decline in economic activity and thus the economy gains a measure of inherent stability which it would otherwise lack. It needs to be emphasized, however, that the built-in stabilizers are passive rather than active instruments of policy. They resist cumulative movements in one direction but they do not actively promote corrective action in the other direction. They can contribute to preventing a recession becoming a depression or to moderating a runaway boom, but they do not actively promote prosperity or restrain inflation. Indeed, if measures taken to encourage or discourage economic activity are proving successful, the built-in stabilizers come into play on the other side. This diminishes the quantitative impact of a given change in discretionary policy and must be taken into account



Chart 24-2  
**GOVERNMENT REVENUES AND EXPENDITURES**  
 Seasonally Adjusted  
 Quarterly



when such policy changes are being considered. For example, a fairly sizable cut in tax rates may be necessary to stimulate economic activity, although the actual outcome may be a comparatively small deficit if it is successful. This is because higher personal incomes and corporate profits will increase tax revenues and higher employment will increase unemployment insurance contributions and reduce benefits.

#### DISCRETIONARY CHANGES IN TAX AND EXPENDITURE POLICIES

The built-in stabilizers are the result of past decisions, but work automatically without the need for current decisions. Discretionary policy changes, on the other hand, require a positive decision in the light of existing and anticipated economic conditions; on occasion this is a serious

handicap. It has frequently been the case that few or no changes have been made in taxes or expenditure in the face of considerable fluctuations in income, or that the changes have come so late that they have contributed to excessive movements in the other direction.

Economic stabilization considerations are only one of the many influences shaping government decisions on taxes and expenditure. On occasion there is a happy conjuncture of circumstances in which other than economic factors are responsible for fiscal decisions, but these decisions nevertheless turn out to be timely from the point of view of stabilization. On other occasions, economic stabilization considerations are less well served by the decisions which emerge from the many competing influences which help to shape government budgets. This comment could equally well be made of many other government policies, economic and non-economic. It is only mentioned here to indicate that even if a solution could be found to some of the difficult technical problems of fiscal policy, success or failure will still turn upon the willingness and ability of governments to give due weight to the achievement of the objectives of economic policy.

If discretionary changes in taxes or expenditure are to contribute to economic stability, the major impact on output must come before a change in economic conditions dictates discretionary changes in the other direction. This is not difficult if one is dealing with extended periods of economic slack or over-expansion. In such circumstances, delay in recognizing the need for action and delay in taking action will mean that for a period the performance of the economy is inadequate. However, once steps have been taken there is ample time for the effects to work through the system with no danger that the direction is wrong. The danger is much greater in dealing with short-term fluctuations. If there is a significant delay in recognizing the need for policy changes and there is a further delay in taking action, a danger exists that by the time the major share of the influence on output and employment is felt, economic conditions will have altered. Under these circumstances the effect of frequent policy changes

can be perverse, with fluctuations being made larger rather than smaller than they would have been in the absence of discretionary changes.

We have already discussed the problem in some detail when considering discretionary changes in the other instruments of policy. The factors leading to delays in the implementation of fiscal changes and the lags in the subsequent effects on output and employment are somewhat different than in the case of the other instruments of policy and vary depending upon the nature of the fiscal change. However, because of the budgetary process, the time taken to put a given fiscal policy into action is normally longer than for monetary and debt policies. This is particularly true if large changes are contemplated; such changes will, of course, be necessary if the excess or deficiency of demand is pronounced. Moreover, because of the stability of consumption, the dampening effect from the automatic stabilizers in the federal revenue structure, and "leakages" of Canadian expenditure into imports, the "multiplier" effect of fiscal changes may be smaller than once thought. This is a matter which is receiving study from others, but obviously fiscal changes have to be larger the smaller is the multiplier; for example, if the multiplier were five, a fiscal change of only \$30 million would be needed to bring about a \$150 million increase or decrease in national spending, whereas if it were as low as 1.5—which some believe to be the case in certain circumstances—a fiscal change of \$100 million would be needed to get the same effect.

There are many ways in which the government can affect the level of demand through its tax and expenditure policies, but it is convenient to think of them as falling into two categories, direct and indirect. Direct measures include changes in the government's own demand for goods and services arising, for example, from decisions to accelerate or postpone public works. Indirect measures include all the steps which can be taken to influence expenditures in other sectors of the economy. The most important indirect measures open to the government are tax changes, but indirect measures also include changes in

transfer payments such as family allowances and old age pensions. Similarly, transfers from the federal government to the other levels of government can be regarded as indirect measures.

#### (i) *Tax Changes*

Indirect measures such as tax changes take time to have effects on output and employment. The length of this period is of some importance in indicating whether it is worthwhile taking steps to reduce the period it takes for the tax changes themselves to occur. If the "outside lag", that is the lag between the changes in tax rates and the consequent effects on output and employment is very long, there may be little hope of an effective use of fiscal policy for combatting short-run fluctuations. Efforts to shorten the "inside lag", that is the lag between the time when action should be taken and the time when in fact it is taken, would then have a lower priority.

We have had some preliminary econometric studies made on the extent and timing of the response of consumer expenditure to changes in personal income tax. These studies were not extensive, but the general results are of interest. One of these studies indicated that if personal disposable income—that is, after-tax income—were increased by \$100 million in a given quarter and maintained at this new higher level, it would take 3 to 6 months for consumption to increase by around \$50 million and 12 to 15 months for consumption to increase by around \$75 million. The stimulating effect of these estimated increases would be reduced to the extent to which they spilled over into imports, and increased by the further expenditures which they would induce.<sup>6</sup>

This statistical result is derived from the average of recent Canadian experience of the relationship between income and consumption, and no difference was detected in the response of consumption to changes in personal disposable income arising from tax changes as compared with other changes. The change in consumption

expenditure resulting from a particular tax change, however, might well depend upon a number of factors, including the direction of the change, the groups affected and the circumstances of the period. We would not, therefore, be prepared to place too much weight on these estimates in predicting the response to a particular tax change. We do, however, regard these results as providing some positive evidence that the likely lag in the response of consumer expenditure to income tax changes is not by itself long enough to preclude the use of tax changes as a means of mitigating short-term cyclical swings.

Turning to business capital expenditures, similar calculations show a relationship between construction expenditures on the one hand and retained earnings and depreciation allowances on the other. A similar relation between internally generated funds and expenditure on machinery and equipment did not emerge from the statistical analysis. Since it is not easy to explain this difference between expenditures on construction and expenditure on machinery and equipment, we have some doubts about the usefulness of these estimates. They do indicate, however, that if corporate retained earnings and depreciation allowances rise by \$100 million and remain at the new level, 9 to 12 months would elapse before business construction rose by as much as \$35 million.<sup>7</sup>

Our survey of corporations indicates that there are some firms which work fairly closely to the level of their internally generated funds in determining their capital expenditures, while others are influenced to varying degrees; it might have been expected, therefore, that at least some relationship would have appeared in the statistical series. In general, however, the pressure of demand against capacity, and its accompanying strong profit prospects are more important in determining the level of investment than the availability of internal funds. As in the case of the results for consumption, the relationship which emerges from the statistical study is the average

<sup>6</sup> See the excerpt from the paper by R. M. Will—*Post-War Fiscal Policy in Canada: A Study of Policy and Policy Lags*, to be published by the Canadian Tax Foundation.

<sup>7</sup> *Lags in the Effects of Monetary Policy in Canada*, Chapter XI, prepared for us by H. G. Johnson and J. W. L. Winder.

response to any change in internally generated funds, and the response to a particular tax change might well diverge from this average, particularly if it signalled a general tax climate more favourable to business enterprise. Nevertheless, the results indicate that a tax cut to stimulate investment has smaller, slower and more uncertain effects than one designed to stimulate consumption.

Changes in business disposable income may be made by varying corporate or other tax rates, or—for businesses with substantial durable assets—by varying the allowable rate of capital cost allowance. Assuming a given stream of gross earnings, an increase in the allowable rates of depreciation increases the rate of return on new investment as well as cash flows and therefore has effects essentially similar to lowering the rate of interest payable on borrowings to finance the project. We in Canada have had some experience in varying the allowable rate of depreciation, but have by no means exhausted its possibilities. On the other hand, too many variations may create uncertainties or simply cause businessmen to ignore their effects.

Various calculations can be made to show the effect of changes in the allowable rate of capital cost allowances. These all depend on a series of assumptions about tax rates, the absence of much over-capacity, the profitability of the firms concerned and the method of calculating capital cost allowances. The estimated effects are therefore indicative rather than precise. For example, Mr. E. M. Bernstein, who appeared before us, submitted some calculations to the Joint Economic Committee of the United States Congress in 1962 on the effect of a number of tax and interest rate changes on the gross annual investment costs of equipment. He showed that a change which accelerated capital cost allowances from 20 years to 10 years had effects on the gross annual investment costs of a piece of equipment similar to a reduction in the rate paid on borrowed funds from 5% to 4%. An acceleration of depreciation from 20 years to 5 years has effects approaching those resulting from a change in interest rates from 5% to 3%. Similar calculations can be

made showing the effect on the after-tax rate of return on a discounted cash flow basis.

It can be shown, for example, on the basis of a particular set of assumptions,<sup>8</sup> that a change in the capital cost allowance on a Category 8 asset from 20% per annum to 40% per annum can raise the after-tax rate of return by 1½% from 6.4% to 7.9%. If the entire cost of the asset could be written off in the year of its acquisition as a current expense, then assuming there were income available against which to apply the tax credit, the prospective rate of return would rise from 6.4% to 9%. Similarly, if the law permitted a corporation to take this asset with an eight-year life and a 20% per annum capital cost allowance into the pool of depreciable assets at 125% of cost, the prospective after-tax rate of return would rise from 6.4% to 8.3%. It can be shown that the effects of such changes on the prospective rates of return are higher for short-lived assets than for long-lived assets. These changes are large when compared with the after-tax effects of changes in interest rates on borrowed funds. A change from 6% to 4% in the interest rate on borrowed funds on an after-tax basis is roughly equivalent to a fall of 1%. Comparable dampening effects on capital investment can be obtained by decreasing the rates or deferring the application of capital cost allowances as was done in Canada during the Korean War period.

We were particularly interested in the description given to us by Professor E. Lundberg of the methods used by the Swedish government to exercise an influence over the amount, timing and character of private capital investment expenditure in Sweden. Companies in Sweden are encouraged to set aside annually a portion of their profits in an investment fund. Profits transferred to this fund are not taxed, provided the fund is managed in a manner consistent with

<sup>8</sup> Assume an investment of \$200,000 in a machine lasting 8 years with no scrap value and that working capital of \$60,000 is required to operate the machine. Operating profits from the machine over the eight successive years of its life are expected to be (in thousands of dollars), 70, 65, 60, 40, 50, 30, 30, 20. With a tax rate on profits after depreciation of 47%, the prospective rate of return on this investment discounting the future cash flow to the present is 6.4%.

the economic policy of the government as evidenced in the regulations from time to time. Capital expenditures out of these funds are authorized as business conditions warrant. Since no taxes have been paid on the funds, such authorized capital expenditures are in effect fully written-off immediately; on one occasion an additional "investment deduction" of 10% of the funds so used was allowed as an expense for the purpose of calculating taxable income.<sup>9</sup> Many variations upon this particular scheme may of course be devised. According to Professor Lundberg, this method has been applied with success in Sweden since 1957. Its success is attributed in part to the fact that it is based on voluntary participation by firms and in part to the fact that the changes in the advantages of undertaking capital expenditures, though drastic, are recognized as temporary. Accordingly they have induced rapid response. As in the case of other schemes which provide very favourable conditions for investment, there is a possibility that too much capacity will be put in place, although this appears unlikely if profits are basically unsatisfactory.

Another Swedish device illustrates the way in which the fiscal instrument can be used to alter the conditions influencing investment decisions to an extent which would not be possible through the use of conventional monetary and debt policies. In 1955, in response to a situation of excess demand, the Swedish government introduced an investment tax of 12%, brought about a 1% increase in interest rates and established credit rationing. As Professor Lundberg points out:

"An investment tax of 12 percent is, in comparison with the normal interest rate changes of 1 to 2 percent, enormous. These investment charges were, with certain exceptions, to be levied on expenditures for machinery and building investments effected during the year. If—

and this has often seemed to be the case—companies expected these charges to be removed after one or two years, there was good reason for them to postpone their investments if possible and thus avoid an extra capital cost. Over one year it can be said that, with respect to the investment expenditure concerned, the companies had an extra interest cost of 12 percent and that the short-term interest rate may thus have amounted to more than 15 percent".<sup>10</sup>

Fortunately, an investigation was made of the effects of the combination of measures taken by Sweden in 1955. Questionnaire enquiries were carried out in 1955 and 1956 involving 2,200 and 1,100 companies respectively, the companies being asked how much bigger their investment expenditures would have been in the absence of the measures taken. It was concluded that manufacturing industry's investment expenditure on machinery, building and plant had "been cut down below the planned level by close on 15%". As pointed out by Professor Lundberg, this appeared consistent with the totals shown for the whole economy:

"The policy pursued during the 1955-57 boom aimed at checking investments was actually so effective that, despite high profits and rapid expansion, the volume of industrial investments remained practically constant at the 1954 level. Instead—and this is clearly a successful feature of the stabilization policy followed in Sweden during the period in question—these investment outlays (calculated in constant prices) rose very steeply during the recession years of 1958 and 1959 (by 11 and 9 percent, respectively); the investment tax was abolished at the beginning of 1958, this being followed by a reduction in the interest rate at the same time as the restrictive credit policy was brought to an end".

He concludes that the "ordinary interest rate increase of 1 per cent must appear to be of minimal importance in the explanation of the policy effects". Professor Lundberg told us that

<sup>9</sup> Transcript, p. 4339. See also *State of the Economy and Policies for Full Employment*, August 1962, Hearings of the Joint Economic Committee of the U.S. Congress, p. 716, for details.

<sup>10</sup> Skandinaviska Banken, No. 4, 1962. See also Transcript, pages 4335-6.

this view is supported by the results of the answers to the survey questions on the relative importance of the various measures which showed that half of the effect in damping down investment resulted from this tax, with most of the balance coming from credit-rationing policies.<sup>11</sup>

While tax measures of this kind have the great advantage of being effective, their very effectiveness opens the door to considerable inequities. Firms which are fortunate enough to have just completed a substantial investment program or firms which are in a position to postpone future expansion easily are clearly little affected. Other firms which badly need additional capacity might have no choice but to proceed in spite of the additional costs arising from the tax. The purpose of the tax, however, is to discourage investment in a particular period, and in this respect it imposes the same burden on all firms regardless of any differential advantages they might have in other areas. Clearly, such measures should be used only in extreme circumstances if they are to retain their effectiveness—a point to which Professor Lundberg alluded. We have no enthusiasm for frequent and extensive tax changes of this kind with all their potentially disrupting effects.

When use is made of any fiscal measures, particularly those with as powerful an effect as these, it is clearly of great importance that the timing should be correct. This is made difficult if it is common practice to restrict fiscal changes to an annual budget. Parliament has the fundamental right to control the collection and disbursement of funds but there are opportunities for varying the application of revenue laws other than at the time of the annual budget, and for most of them there are precedents. For urgent circumstances, it is possible to call Parliament into a special session, while under more ordinary conditions there can always be an additional or supplementary budget. Moreover, while tax rates and tax liabilities are set by Parliament, the rates of deduction at the

source are administratively controlled. If circumstances justified it, it would be quite possible for a government to announce that it would bring in legislation when Parliament assembled to reduce or increase income tax liabilities by 5 or 10% and adjust the deduction requirements immediately. A similar change could be made with capital cost allowances or excise taxes, although the former do not involve deductions at the source. Such abnormal action, however, we think would be desirable only in exceptional conditions.

#### (ii) *Changes in Expenditure on Goods and Services*

If taxes are reduced or transfer payments increased, consumers and business firms will subsequently be induced to expand their consumption or investment. When added spending on goods and services is undertaken by the government, there is no intermediate step in the spending process. However, a serious limitation on federal contra-cyclical expenditure policy is the small total of the expenditures which as a practical matter can be varied in response to changing business conditions. Out of total budgetary expenditures in 1960-61 of \$6 billion, only about \$415 million—on a national accounts basis—was capable of substantial year to year variation. This was expenditure on capital projects and amounted to 5.1% of the total public and private spending on capital formation. It is apparent that, in order to achieve a swing of \$100 million, defence and non-defence capital spending would have to change by about one-quarter.

There are also practical difficulties in accelerating or decelerating a capital expenditure program. The major difficulties in expanding and speeding up government capital projects are the time consuming processes of determining requirements, site selection, planning, getting Treasury Board approval and, finally, of obtaining parliamentary authorization. There is the added difficulty of determining when measures to promote expansion or contraction are required and what interval is available for the preliminary work. We therefore emphasize again what we have said

<sup>11</sup> Transcript, page 4275. He went on to note that in 1960-61 the credit measures were not so drastic, the time lags were long and the effects hardly visible. However, he noted that no interviews were carried out at that time and that too little is known about the period.

elsewhere about the importance of speeding up the availability of statistical indicators and the co-ordinating and strengthening of economic forecasting throughout the government departments.

We have been gratified to note that a longer-term perspective on capital expenditures is developing within the government service in Ottawa. The Public Works Department for example, likes to keep projects covering a span of about three years under continual review so as to be able to accelerate its program should the need arise. The Department of National Defence makes provision for continuing review and development of projects proposed by the three services. Defence projects are classified according to priority, the Treasury Board's approval for those of highest priority is sought and a general indication of Treasury Board's likely future decision on those of lower priority is also obtained. The objective is to have a pipeline of projects at various stages of preparation and completion so as to ensure an early start on projects included in any year's estimates and to permit acceleration of the program should that be necessary. In 1962, the Department of Finance began the practice of asking departments, at the time of forwarding estimates for the forthcoming year to the Treasury Board, also to submit forecasts of expected expenditure requirements for three years ahead. Departments have been advised that it is hoped to extend this to a five-year projection as soon as practicable.

All these developments we welcome as adding to the flexibility of the capital expenditure program. If the shelf of public works can be made the pipeline of public works, we may expect more support from capital expenditures for the general stabilisation program of the government. Forward planning of capital projects over a period of three to five years does not imply in our minds a five-year budget or spending program to be submitted to Parliament for approval. It is necessary, however, for the government to look far ahead, to include in the estimates for each year provision for development expenditures covering projects in the early stages of the pipe-

line, and to come forward with supplementary estimates if it is desired to accelerate expenditures.

Even if forward planning provides a stream of projects ready for execution, it is not easy to bring about an increased flow of expenditure with a minimum of delay. It takes time to receive bids, award contracts and complete all the formalities. There is a further delay between the time that all the terms of the contract are settled and the beginning of construction. Our staff obtained some evidence on this lag from Defence Construction Ltd. On a typical group of projects involving small buildings, they found the delay between contract awards and the start of construction was a month and a half in the winter and under a month in the summer. There is also a lag between the time that construction begins and the time when on-site employment reaches a substantial level. This lag tends to increase with the size of the project and to be longer for projects which are started in the winter. Considerable efforts should continue to be made to minimize the delay between the time a decision is taken to increase government expenditure and the time that the benefit is felt on the level of economic activity.

#### PROVINCIAL AND MUNICIPAL EXPENDITURE

Such variation in federal government expenditure as can be achieved will have helpful but not adequate effects. To achieve substantial results there must be some co-ordination of federal with provincial and municipal expenditures. We noted in Chapter 4 that spending on goods and services by provincial and municipal governments is now over one and a half times similar federal spending, while their combined capital outlays are three times those of the central government. We do not suggest or imply here any encroachment by the federal government on the responsibilities of other governments. Indeed, we believe that progress in the concerting of policies can only come about through agreements about the objectives and limits of co-ordination.

It is nevertheless clear from the evidence presented in earlier chapters that the existing methods, which depend to a considerable extent on the sensitivity of provincial and municipal expenditure to changes in credit conditions, are relatively ineffective. In recent years, when credit conditions have altered significantly, the capital expenditures of provinces and municipalities have not been influenced enough to give us any confidence that monetary and debt policies provide an effective means of adjusting the capital expenditure programs of the provinces and municipalities to the needs of economic stabilization. What is required is a more direct and more effective method of co-ordination.

We have found in our enquiries sufficient interest in such co-ordination among provincial governments to lead us to believe that significant progress can be made, though persistence and patience will be required. The more the federal government can restrict its interest to the timing and amount of the capital expenditures of other governments and the less it seeks to influence their direction, the more effective the co-ordination will be. As we noted in Chapter 4, there are considerable delays involved in spending on detailed joint-cost programs, and their usefulness is further limited in some instances by the slowness with which the federal government makes payment for work already completed.

We have not explored these matters sufficiently to justify us in suggesting machinery for the exchange of information and views and for reaching an understanding on the methods and limits of co-operation. However, the responsibilities of the continuing Committee of Ministers of Finance and Provincial Treasurers and their officials might be extended to cover the question of co-ordination. While we do not have precise proposals to make, we are satisfied that any successful arrangement will involve making it cheaper and easier to finance provincial and municipal works in periods of slack employment and more expensive to undertake them in periods of economic boom. It will be necessary also that these governments can depend on such arrangements for the future.

## CONCLUSION

Our general position is that the limited effects of monetary and debt policies alone require that more use be made of fiscal policy as part of a co-ordinated economic policy than has been the case in the past. Of course, the fiscal instrument has limitations. As in the case of all other policies, there are difficulties encountered in foreseeing future developments and acting with sufficient speed. If action is taken too late, it can add seriously to future difficulties. Moreover, at any point of time there are limits to the vigour with which fiscal policy can be used. These limits derive in part from the difficulty and undesirability of making massive and frequent changes in expenditures and taxation—particularly in taxes on business—in part from international payments considerations and in part from the effect of fiscal changes on domestic and international confidence.

Many of these limitations, which are by no means rigid or sharply-defined, can be overcome by a wise use of fiscal policy. For example, in times of modest or short-lived economic contractions, temporary cuts in taxes and a moderate speeding-up of useful public works at all levels of government are less likely to have adverse effects on confidence than are deficits created solely by a program involving continuing higher expenditures. Similarly, obvious make-work spending on projects of doubtful utility may easily impair confidence in the government's policies. Moreover, higher continuing expenditures will necessitate higher taxes subsequently, and may lead to the inhibition of enterprise and investment and thus slow our economic growth. If such outlays also lead to continuing deficits even in buoyant periods, they may absorb undesirable amounts of national savings, increase our reliance on foreign capital and lead to the suppression of desirable business investment.

In cases of more prolonged or serious economic difficulties, changes in tax and expenditure policies can and should be more pronounced. However, even though these new revenue and spending levels are expected to be necessary for several



years, the measures taken should be designed in ways which do not impair the ability of the government to deal with a new set of circumstances. In other words, they should be carefully planned, should be capable of reversal, and—on the expenditure side—should play a constructive part in the longer-term development of the economy.

Regardless of the circumstances in which fiscal policy may be needed, it is important that the government plan its measures deliberately. Haphazard measures are always disturbing, especially if they are unco-ordinated with other aspects of policy. Similarly, a series of minor measures or fiscal steps which have more eye-appeal than effects are no substitute for a broad and well-thought-out general policy which is clearly aimed at stabilizing the economy. Appropriate fiscal deficits or surpluses incurred in sensible ways for sensible purposes are, after all, not national disasters—they are acts of prudent economic management.

Indeed, we think that there may be circumstances when deficits or surpluses may need to be considerably larger than they have been in the past. This should not prove unmanageable if the government has a reasonable and acceptable pattern of policy—including a clear and consistent

view of its financing plans. The Minister of Finance must be willing to explain, rather than apologize for, deficits and surpluses. If the government's program is clearly and vigorously explained to the public and if the measures it contains are both constructive and reversible, there is good reason to hope that the contribution of fiscal policy will be greater in the future than it has been in the past.

We have already offered our comments on ways in which the tax system might be made more flexible. While changes in government expenditure on goods and services are difficult to make quickly on a sufficiently large scale, the development of an adequate pipeline of projects will make possible a more rapid reaction of expenditure to changing economic conditions. In addition, greater co-ordination among the three levels of government can add significantly to the size of the changes brought about. Nevertheless, difficulties in developing an effective fiscal policy will remain, and we recognize that costs will be associated with overcoming these difficulties. But we have no doubt that unless the fiscal instrument is made a more effective part of general economic policy, we shall from time to time have to bear the much heavier costs associated with avoidable unemployment or inflation.

## CHOOSING AND CO-ORDINATING ECONOMIC AND FINANCIAL POLICIES

Like any other activity in which man must apply imperfect judgment and limited knowledge to a changeable and unpredictable environment, economic policy-making is an uncertain art. In it, scientific principles must co-exist uneasily with feel and flair, mechanical formulae lead at least as frequently to disastrous error as to reliable results, and ideal solutions lie impenetrable behind realities which often allow choices to be made only in terms of the lesser of two evils. Yet if no reasonable man can expect perfection of policy, the world is not so difficult—nor the instruments available to the authorities so few and ineffective—that an intelligent approach to economic problems must be either doomed to failure or totally dependent for success on the working of the fates. On the contrary, it is one of the main theses of our report that properly conceived and co-ordinated policies can significantly improve the performance of the Canadian economy. While an impeccable record will never be achieved and luck will always play some role in the outcome of events, a not inconsiderable part of Canada's economic destinies will be determined by the wisdom with which financial policy is chosen and executed.

Economic and financial policy will, however, make a useful contribution to the attainment of the objectives of rising productivity, high and stable levels of employment, price stability and a sound international economic position only if a number of conditions are fulfilled. First and most important, the authorities must get the broad "set"

and timing of general policy right; for example, when stimulation of the economy is required, numerous minor steps—some of them aimed primarily at subsidiary goals—are unlikely to meet with measurable success if the general tenor of fiscal and monetary policy is inappropriately restrictive. Secondly, if a suitable policy climate is to be created effectively, monetary, debt, fiscal and international economic policies—as well as other non-financial measures—must be co-ordinated into a coherent whole. These individual strands of policy are not so independent in their effects that they can be considered as separate and isolated responsibilities of different arms of the government. Nor is any of the instruments so powerful when unsupported by the others that they can be regarded as alternatives to each other in the sense that a craven choice in one area of policy can conveniently be left to be offset by a bold step in another.

Thirdly, a successful and unified approach to policy must be based on the application of balanced and informed judgment to widely varying circumstances. It is tempting to seek an ideal prescription of policy which could be easily or automatically applied to a simple set of readily recognizable situations. In practice, however, the correct and feasible combination of policies can only be devised in the light of what is suitable to the unique set of circumstances emerging at the time. Fourthly, and following from all that we have just said, the quality of policies will be dependent upon the quality of our political

leadership and of public opinion generally. Finally, success in this difficult task will be achieved only if the officials who advise on policy are skilled and vigorous, equipped with prompt and relevant economic information, and able to assess events against a longer-run background as well as against the immediacy of today.

We cannot emphasize enough that the essential condition of successful policy is to get the general instruments set in the right direction for the prevailing circumstances. If the broad aggregates of demand for goods and services are not encouraged to move towards the appropriate level in this way, the performance of the economy is likely to be unsatisfactory. Moreover, if suitable steps to stimulate or restrain total output are not taken, there will be a strong temptation to introduce a series of direct measures which attack the symptoms rather than the disease and have little effect on demand levels, prices and employment in the nation as a whole. Indeed, such measures may lead to complications and confusion, to increased government intervention in the economy, to high-cost production in particular areas or industries and to discriminatory barriers to the flow of resources; their net effect may thus be to impede the achievement of national objectives.

The recent discontent in Canada with the general instruments of policy, and the increasing resort to more specific measures, is not a necessary result of the difficulties of using broad monetary and fiscal weapons effectively. As we have seen, the process has stemmed at least as much from an unwillingness to use these instruments in the way necessary to achieve national goals. The examples given in earlier chapters need not all be repeated here, although it is worth illustrating the point from the experience of 1960. It will be recalled that, despite the existence of considerable slack in the economy, monetary policy was quite restrictive, a long-term government bond issue was sold in the fall of the year, and an inappropriate N.H.A. rate and virtual withdrawal of CMHC from direct lending had cur-

tailed housing activity. Taxes had been increased in mid-1959 with the result that the federal budget was virtually balanced in the first half of 1960 (on a national accounts basis), despite the existence of unemployment rates in excess of 6½% of the labour force; in fact, about half of the increase in Gross National Product in the previous two years accrued to the federal revenues, and this exercised a considerable drag on the economy. In the light of this mix of policy, it is not surprising that the economy's performance was sluggish, that our currency was at an inappropriately high level in the foreign exchange market and that capital inflows were unusually large for a recession period. The resulting public discontent led to the adoption of the various specific measures, discussed in earlier chapters, which unleashed a host of difficult consequences; significantly, however, the economy did not really respond until the broad set of general policies was changed subsequently.

One can also recall other periods when the posture of policy resulted in some sacrifice of national economic objectives. One example was the 1955-57 boom when no deliberate fiscal restraints were employed, debt management measures eased credit conditions and monetary policy was insufficiently restrictive. There have similarly been occasions when the federal budget has seemed contradictory—for example, by containing incentives to stimulate output on the one hand but lacking any general reduction in tax burdens, or even containing net increases, on the other hand. In making these points, we are not denying the usefulness of vigour and imagination on the part of the authorities. Nor are we arguing that fiscal policy should not be selective or that specific measures may not sometimes be valuable supplements to broader policies. We are simply stressing that if policy is not set to exert the right influence on total demand—as opposed to its composition—and to create the right general climate, no amount of more direct intervention is likely to lead to the achievement of our employment, price and other national objectives.

In earlier chapters, we pointed out that the effectiveness of the different policy instruments working separately was frequently limited. In particular, monetary and debt policies do not have powerful enough effects—within the range that they can be used without incurring international complications—to be counted upon to stabilize the economy unaccompanied by other policies. Moreover, the way in which individual components of policy are used has important effects in any event on the jobs which the others are called upon to do. Haphazardly co-ordinated measures can thus have unfavourable repercussions on both domestic and international confidence which sooner or later will be reflected in reduced economic activity in Canada. Policy must thus be cohesive and co-ordinated, and the various elements of government cannot be narrowly concerned with just one objective while leaving the others for some other body to look after. The monetary, fiscal and other authorities each have special responsibilities, but only within the context of how they can help to achieve broad national goals. None should be allowed to develop separate or isolated aims of their own since unbalanced attention to one major objective—or, still worse, to subsidiary or minor aims—will almost certainly prevent the attainment of the nation's wider economic objectives.

A planned, complete and consistent program of policy will take account of all the many interrelations between policies. We have shown, for example, how changes in fiscal policy affect credit conditions, debt management decisions and our international financial position; how the effects of government cash surpluses or deficits on national spending are only fully realized if coupled with the appropriate monetary policy; and how changes in the maturity of the federal debt have implications for other monetary measures and credit conditions generally, and—through them—on domestic spending and the balance of payments. In Chapter 23, we also outlined the many relationships between domestic policies and the international financial position and how the relationships worked themselves out under both fixed

and floating exchange rate systems. Similarly, other government policies—measures dealing with matters as varied as trade and tariffs, vocational training and combines legislation—can have important repercussions on both the domestic economy in general and our international competitive position in particular, and thus on the freedom and effectiveness with which the monetary and fiscal authorities can devise measures to maintain full employment. Finally, banking and financial legislation affects the type and amount of capital available in Canada at given rates of interest and thus affects domestic spending and our resort to foreign capital. If action in any one field of policy—financial or non-financial—is taken without regard to the consequences in others, the results are therefore likely to be unsatisfactory, both in themselves and because of the uncertainties they create.

Earlier in the report, we gave some illustrations of occasions when post-war policies appear to have been but imperfectly co-ordinated, for example in the inflationary years right after the war when an easy monetary policy provided no assistance to a restrictive—perhaps insufficiently restrictive—fiscal policy. The situation was reversed in some of the years after 1957 when expansionary fiscal measures were partially offset by tight credit policies. Indeed, at times in the post-war period it has seemed that unnecessary burdens have fallen on one or the other instrument of policy because it has been politically inconvenient to take the necessary steps in other areas. This has not always been the case, and it is only fair to point out that on occasions—like the outbreak of the Korean War or in late 1957—fiscal, monetary and other measures have been used harmoniously, if not always vigorously enough. Such occasions seem to have been altogether too rare, however, even allowing for circumstances like the summer of 1962 when a conflicting combination of policies was consciously used by the authorities, with credit conditions having to be tightened for international reasons despite the slackness of the domestic economy.

## FACTORS INFLUENCING THE CHOICE OF POLICIES

We do not want to suggest that improved co-ordination will provide an answer to all the policy-makers' problems. There have been shortcomings of policy even when there has been the maximum of co-operation and consultation within the federal government, and these deficiencies have sometimes arisen from an unwillingness to deal appropriately with difficult situations. Granted however, that there is no unwillingness to take the necessary steps, the major difficulty confronting the authorities is that of assessing the emerging situation and judging what measures are necessary to handle it. We have tried to stress that this is a matter of discretion, not of formulae. Each set of economic circumstances has its unique qualities, and remedies which work in one situation will fail in another. Clearly, much will depend on developments and policies in the rest of the world, especially the United States, on the structure of the domestic economy and how it is changing and on public attitudes and confidence; these in turn will be shaped by recent experience and policy at home and abroad. It would thus be unreal and dangerous for us to attempt to prescribe policy for an unpredictable future. The costs and benefits of pursuing one objective rather than another are always changing and the effectiveness of individual policy instruments will vary widely with the circumstances.

If it seems unsatisfactory that we can put forward no precise and detailed formula for policy, it will appear even less satisfactory that we are unable to establish an unchanging yardstick by which to judge our success in meeting national objectives. Nevertheless, objectives which are easy to reach in some circumstances may prove impossible to attain in others. For example, seasonally-adjusted unemployment rates as low as 3½% of the labour force may well be reached without inflation in a favourable world environment if structural problems are minor and both labour and management are moderate in their

demands, while even 5% may be almost impossible to achieve in the reverse circumstances, particularly if the labour force is growing rapidly. Much the same applies to productivity gains which—for reasons beyond the control of policy—can vary significantly in the short run from a satisfactory long-term average. The objective of maintaining a sound external financial position naturally cannot be reduced to purely quantitative terms at any time: it involves many separate component aims relating to our competitive position, reserve holdings, dependence on foreign capital and international trade and payments arrangements generally.

Nor is there any rigid order of priority which we can assign to objectives in the event of temporary or more lasting conflicts between them. International considerations may predominate temporarily, and may at times need to receive primary emphasis for more extended periods, especially if the economy has become uncompetitive internationally. In normal circumstances, however, we would be inclined to give priority to the employment objective because of the high costs of unemployment in terms of personal hardship and lost national output, although we have tried to show that this objective is not independent of the others. If the international competitive or financial position is weakening, if productivity gains are low or non-existent, or if prices are continuing to rise significantly, more attention must be paid to solving these problems. Not the least reason for doing so is that failure can inflict lasting damage on the chance of attaining high and stable levels of employment.

Despite the impossibility of laying down a set of unvarying rules of policy to meet differing situations, there are certain broad classes of problem which will continue to be encountered in Canada. It may therefore be helpful to sketch in the sort of policy approach we believe will be necessary in dealing with them. We first discuss the problem of insufficient demand and unemployment, and then discuss the opposite problem of excessive demand and rising prices.

(i) *The Problem of Insufficient Demand*

If a slowing rate of growth in exports and domestic investment, rising unemployment and other indications suggested that mild and short-lived weakness in general demand was imminent, the solution might be comparatively simple. The situation might call for some easing of credit conditions (including the termination of any voluntary or legal restraints on credit terms and lending imposed earlier), a speeding-up of useful and reversible public works and, perhaps, a temporary tax cut to stimulate consumption. The job of the authorities would be made easier if conditions in the rest of the world were buoyant, our international cost position were competitive, and our foreign exchange reserves were large, since domestic expansionary policy would then be freer of external limitations. The same would be true if international payments arrangements allowed us ready access to any necessary reserves on a temporary basis. Expansionary measures would also be facilitated if labour and management were showing restraint, so that price stability were not threatened, and if public confidence in past and prospective government policies were high.

If there were prospects of a prolonged period of weakness—say because an extended investment boom had led to substantial over-capacity in industry—it would be much more difficult to find effective remedies. The degree of monetary ease would have to be greater, government debt issues would need to be confined as far as possible to shorter maturities (a task facilitated if earlier policy had extended the maturity of the debt) and greater reliance would need to be placed on fiscal measures. A program of financial incentives to, and co-operation with, the provincial governments to encourage them to expand their social capital outlays would also play a vital role.

The complexities would be even greater if there were widespread structural problems in the Canadian economy because of changes in domestic and world demand. The essential general measures would need to be supplemented by special steps to improve the mobility of labour,

to up-grade the skills of the population and, perhaps, to provide industrial incentives which did not lead to high-cost production. Despite unemployment in many areas, there are still shortages in many skilled occupations in Canada, and re-training programs can be used both to increase employment and to prevent shortages of certain classes of workers from pulling the whole wage and price structure upwards. Such retraining, however, need not always emphasize particular skills—general adaptability and a command of language and elementary mathematics may well be more useful to some workers in an age of computers.

In devising policies appropriate for the country as a whole, the authorities will also have to take account of regional problems. Seasonally-adjusted unemployment rates in November 1963, for example, were 9.5% in the Atlantic region, 7.2% in Quebec and 6.2% in British Columbia compared to 3.6% in Ontario and 3.1% on the Prairies. The extent to which both regional, and seasonal, pockets of unemployment can be eradicated will clearly play an important role in determining how successful we are in attaining full employment levels on a national basis. In this endeavour, general fiscal and monetary measures have little part to play beyond maintaining an appropriate broad level of demand. Federal taxes and services cannot easily be different in different parts of the country, nor is it possible to conceive of a meaningful regional monetary policy given the essential unity of capital markets and the readiness of capital to flow to the centre offering the best return. However, regional development funds may be useful if it is desired to create enterprises which are either not able to pay going interest rates or which are being established for other than economic reasons. It should be noted, however, that we did not find significant evidence that an inability to obtain capital was the basic difficulty in regions of the country characterized by high unemployment.

Measures designed to keep the economy competitive and adaptable have a particular importance because if our cost structure is high, it becomes still more difficult to pursue policies

designed to stimulate employment and output in Canada. More rapid increases in domestic prices than those elsewhere would quickly impose external limitations on expansionary measures. These external limitations will also be severe if our reserve position is weak or the world environment unfavourable. Our reserves would be under still greater pressure if Canadian credit conditions were eased much more than those in the United States, because of the substantial and prompt reaction of international capital flows to significant changes in interest differentials between the two countries.

Although the interest-rate links between Canada and the United States are not rigid and the external environment will not always frustrate our domestic policy, it is only realistic to recognize that international considerations will frequently limit the range over which Canadian credit conditions can be allowed to move, even when supported by operations in the forward exchange market. This limit will be encountered sooner, and be more severe, if the United States is following inappropriately restrictive credit policies, perhaps out of concern about the size of its gold stock or its international position generally. This possibility serves to stress the importance of developing adequate international liquidity arrangements. Not only would they directly give Canada and other countries more time and freedom to correct fairly deep-seated difficulties, they would also have important indirect benefits: the major industrial countries would not be as likely to impair world prosperity by pursuing inappropriately restrictive policies in a fruitless attempt to attract a limited stock of world reserves from each other.

We therefore hope that the occasions when international considerations require us to set monetary and fiscal measures in a different gear, or even in a different direction, will be infrequent. Our evidence does not suggest that any single instrument of policy is so powerful that we would want to use it in virtual isolation if this can be avoided. On the other hand, the very fact that monetary policy normally has limited effects on real expenditures—as opposed to financial flows

—means that it can be used perversely from a domestic point of view in order to restore a temporarily unbalanced international financial position or to gain time for more fundamental measures to take effect. This was the case in the speculative exchange crisis of 1962: while monetary restraint's impact on the domestic economy on that occasion was substantial, it did not so dominate events that the business recovery then under way was interrupted. The position would have been different if failure to take other action had resulted in this policy being a lasting one.

The existence of international limitations on the easing of credit conditions, and the apparent inability of monetary policy even without these limitations to restore the economy to full employment levels in a period of serious slack, both suggest that fiscal measures must carry a substantial burden at such times. To some extent, an additional easing of credit conditions without major interest rate effects might be achieved through such steps as lowering N.H.A. down-payments and making I.D.B. loans more freely available, but the most direct and immediate effects on domestic incomes and expenditures will probably have to come from the fiscal side and include substantial tax cuts.

We are not willing to contemplate the use of foreign exchange controls on capital or commodities in peacetime: quite apart from their limits on freedom, they invite retaliation, may lead to high-cost production and impose lasting damage on capital flows. The federal government may be able to add just as much to our reserves by borrowing funds in the long-term market in New York. Even if the United States government is concerned about its own reserve position, it might not object if the reserves borrowed in this way by Canada were likely to flow back to the U.S. as a result of our deficit position. Whatever the situation, however, it is important that the two countries agree to co-operate in managing their reserve positions so as not to impose unnecessary difficulties on each other; Canada recently played a constructive part in this process by reducing the share of gold

in its reserves to ease the strain on the U.S. gold stock.

In extreme circumstances—for example, if a serious weakening in world demand for Canadian exports occurred—it might be necessary to change the foreign exchange value of the Canadian dollar. We hope that constructive world and domestic policies will not make this necessary, but there may be times when it is not sensible or possible to defend the value of the exchange rate through restrictive policies which result in excessive unemployment and stagnation at home. This, however, should not be taken as an excuse for mismanaging the domestic economy; if the exchange rate is allowed to depreciate needlessly under any rate system, it can result in increasing domestic costs and prices and an undermining of confidence which become cumulative and dangerous to employment and growth.

#### (ii) *The Problem of Excessive Demand*

The problem of excessive demand, like that of inadequate markets, can be of varying intensity and difficulty. If the period of actual strain on real resources and of rising prices is expected to last for only a year or two, it may be relatively easy to handle by tightening credit conditions fairly early in the upswing, cutting back some government expenditures and, if necessary, by increasing taxes. Our exchange holdings might well increase substantially if capital flows exceeded the current account deficit, but a temporary increase could be handled readily, especially with some international co-operation; such reserve gains might indeed be welcome if the initial position were weak.<sup>1</sup> On the other hand, it is possible that our reserve position might weaken in a domestic boom—thus minimizing the conflict between domestic

and international objectives—although this has not been the usual pattern of our experience.

The task of the authorities would be more difficult if the period of inflationary strain seemed likely to be prolonged or if it followed soon after a similar recent experience. Moreover, if the world environment were also inflationary, Canadians might come to expect further price rises and both labour and management might become less competitive and less restrained in their attitudes. The resulting price and wage increases would be intensified by pressure from abroad—psychological as well as economic—and would call for more lasting and pronounced fiscal measures on both the expenditure and tax side, including perhaps reducing depreciation allowances and imposing special taxes on investment goods. The federal authorities would also need to seek the aid of the provincial and municipal governments in reducing the pressure on real resources. In addition, monetary policy would need to be highly restrictive, although limitations on the use of this instrument might be encountered in the form of embarrassing inflows of capital and exchange reserves. The extent of this limitation will depend in part on policy being followed elsewhere. If U.S. policy, for example, is also restrictive, we will have more freedom to raise domestic interest rates; if, however, American rates are kept unduly low—perhaps because of concern about the reserve position of the rest of the world in the absence of other international arrangements—our freedom to manoeuvre will be correspondingly reduced.

If these international limitations seriously limit our ability to use general monetary measures to restrain critical inflationary pressures, we would not rule out the use of more selective instruments with less interest rate consequences. These might include direct measures to restrict the type and amount of credit granted by financial institutions and changes in the terms of N.H.A. lending. (We do not know whether consumer credit regulations lie within the federal power, and in any event a general increase in sales taxes might be more equitable and just as effective). We

<sup>1</sup> The problem of excess reserves would be less intense in the unusual situation of a period of inflation in Canada coinciding with a period of relative slack in the rest of the world. The resulting relative weakness in export demand and strength in import competition would tend both to check Canadian price increases and our rate of reserve accumulation.



indicated in Chapter 22 that we have reservations about the imposition of asset ratios and the use of moral suasion because of their interference with the development of the capital market, their discriminatory effects and the evasions and grey markets to which they may lead. Nevertheless, if conditions are sufficiently serious and the authorities are prevented by international considerations from tightening up the financial system in the usual way, such measures may be needed. However, they should in our view be subject to governmental concurrence, be temporary in nature and so far as possible be applied equitably to all institutions doing a similar business.

The government's debt management operations, while perhaps playing a minor role on balance, should also be used where possible to bring about the appropriate credit conditions. For example, refunding maturing issues into longer-term securities may help the monetary authorities to put the maximum pressure on long-term interest rates, which appear to have more influence on domestic spending, while at the same time reducing the pressure on shorter rates, which are most relevant for some types of international capital flows. If excess reserves were used to repay the external indebtedness of the federal government in such circumstances,<sup>2</sup> it might alleviate speculative forces and reduce the pressure from the United States for us to ease our policy because of the drain it created on their reserves and thus give us more scope to pursue restrictive credit policies.

We have stated in Chapter 23 that we do not favour directly interfering with capital inflows to meet the problem of excessive additions to reserves. Although such measures can be highly effective in the short run, they also have enduring effects which might prevent us from obtaining needed foreign capital when circumstances subsequently change. In fact, if resisting upward pressure on the Canadian dollar in the exchange markets should seriously weaken our ability to pursue domestic objectives and result in significant

irreversible increases in Canadian prices and costs, the authorities might finally have to revalue the dollar. We do not favour frequent changes under a fixed exchange rate system, with all their accompanying disruption, and it may well be possible to avoid them by a combination of counter-speculative measures, international co-operation and appropriate fiscal policy. Should this prove impossible, however, without inflationary damage to our international competitive position and to the maintenance of full employment in the longer run, some change might be unavoidable.

It is all but certain that prolonged periods of strain on Canada's resources—whether or not they ultimately necessitate revaluation of the currency—can only be combatted effectively by a mix of policy in which fiscal measures are prominent. Monetary policy is just not powerful enough to do the job by itself over any reasonable range of credit conditions, even if there were no international inhibitions about using it fully. This makes it particularly important, as we stressed in Chapter 24, that fiscal policy be used wisely and with foresight. Irresponsible and irreversible spending commitments undertaken in recession periods will limit the ability of governments to run the necessary surpluses at reasonable levels of taxation in times of boom. If the federal government adds to the strain on resources and absorbs domestic savings in buoyant times, or if it raises taxes to intolerable levels, our long-run growth may well be undermined and domestic ownership of the economy reduced. Moreover, failure to plan ahead will have adverse effects on domestic and foreign confidence and financial markets which will limit fiscal policy's possibilities and its effectiveness in times of future weakness in economic activity. While we think deficits desirable when they employ savings and manpower that would otherwise go to waste in recessions, we have no sympathy for the view that this justifies a Minister of Finance in embarking on projects which he is not prepared to tax for or to curtail when circumstances require.

<sup>2</sup> Other borrowers are unlikely to do so, since it is precisely at such times that they find difficulty in meeting even their needs for new funds in the Canadian market.

*(iii) Other Problems of Policy*

It has sometimes been suggested that varying the emphasis given to monetary and fiscal measures can help to foster the goal of rising productivity in the long run. There is some scope to make such alterations in the "mix" of policies, and, as we have indicated, such variations may indeed be necessary to reduce conflicts between domestic employment and price objectives and the international goals. However, there are limits to this freedom and in any case there can be no certainty as to which combination will lead to the highest rate of productivity growth in all circumstances.

Increased efficiency is largely a result of the energy and enterprise of labour and management, of skills, education and research, of technological developments in Canada and elsewhere, and of the adaptability of our citizens to new situations. Government financial policy plays some part in this process through its impact on the incentive to invest in new capital facilities, upon which increased efficiency and employment in large measure depend. Thus fiscal policy—the amount and type of government expenditures and revenues—can influence the amount of savings, investment and consumption in the economy, while international financial policy—particularly that relating to capital flows—can have similar effects. Monetary policy also has some influence on productivity trends insofar as they are dependent on capital investment and capital investment is sensitive to the cost of borrowed funds.<sup>3</sup> However, more direct government influences on productivity are usually exerted by non-financial policies—measures affecting education, labour mobility, and the general flexibility of the economic environment. Trade policy in particular has a special role to play in ensuring that the econ-

omy remains competitive and that high-cost production is not fostered.

Whether a restrictive fiscal policy and easy credit conditions will lead to faster productivity gains than the reverse combination (employment, price levels and other policy assumed equal) will depend, for example, on the nature and impact of the extra taxes involved. They may fall on consumption, investment or savings with varying degrees of intensity or they may more generally affect the willingness of citizens to work and innovate. Similarly, if some part of the fiscal restraint is achieved by curtailing expenditures, the net effect on productivity will depend on the usefulness of the spending eliminated and of the private spending which replaces it. If fiscal restraint does not greatly affect investment incentives or reduce productive public expenditures, and if productive private investment responds to the easing of credit conditions created in part by government surpluses supplementing private savings, the result may well be higher productivity gains than are obtainable with some other combination of policies.

Yet it is equally possible to imagine circumstances in which rising efficiency would best be promoted by easier fiscal policy and more restrictive credit conditions. Quite apart from the possibility that it might have less adverse effects on incentives, it would probably attract more foreign capital and thus enhance capital formation in Canada. Similarly, if the increased fiscal outlays relieved shortages in the government sector, this particular mix might result in more rapidly rising productivity than policies designed to stimulate growth of a stock of private capital already relatively high in relation to demand. In fact, fairly expansionary budgets and high interest rates—much higher than those in Canada—have been the policy in a number of European countries in recent years.

Under either combination of policies, the longer-run set of fiscal policy can be used to discourage consumption and encourage saving at full employment levels. If pushed too far, however, this approach can blunt the desire to work and so weaken consumer demand that business-

<sup>3</sup> See, for example, the Submission of Professor Paul Samuelson—p. 43, para. 3—in which he states that faster growth, if it can be achieved at all, must depend upon monetary policies designed to stimulate a long-term deepening of capital; the corresponding reduction in the proportion of consumption in total output at full employment levels would be achieved by a tighter fiscal policy.

men have no incentive to invest in new and improved capital facilities. In any event, we do not believe that the authorities will normally have great scope for altering the mix of policies without sacrificing one or more of the major national objectives. To the extent that a wide area of choice does exist, the mix which is most appropriate can only be determined in the light of the particular circumstances prevailing at that time.

An important factor in the choice of policy will be the extent to which the goal of price stability can be reconciled with that of high employment. Although there is no inherent or rigid conflict between the two goals, we noted in Chapter 20 that prices do show some tendency to rise when unemployment ratios get much below 4% to 5%. How much prices will in fact rise will depend largely on management and labour attitudes. This in turn will depend in part on the world environment, on the competitiveness of domestic and export markets and on the structure and adaptability of the labour force. Despite "the age of automation", productivity gains recently have been less than those in many other periods of our history, although the pace of increase may accelerate in future. The period ahead will also be one in which the additions to the labour force will be even larger than in recent years.<sup>4</sup>

If rapid technological change, substantial additions to the labour force and competitive business conditions do not in fact significantly reduce the conflict between the price stability and full employment goals, the authorities will be faced with difficult decisions. If they restrict total demand to curb undesirable wage and price increases, additional unemployment and economic slack may result. On the other hand, if they fail to stop the process, our international competitive position and basic willingness to save and invest may be undermined—with consequent repercussions on our ability to maintain full employment at rising standards of living in the future. It is thus important to ensure that money wages and prices do not

rise unjustifiably if the authorities wish to be free to pursue full employment policies effectively.

In an attempt to deal with this problem, a number of countries have introduced "incomes policies", which we discussed with some of our distinguished foreign witnesses. In some cases, these policies amount to nothing more than guide lines as to the appropriate rate of annual wage increases which can be granted without inflationary stress; these are determined by bodies representing the various interests in the community. In others, wages and prices are more directly controlled by the government.

Even the more voluntary arrangements seem to depend in large measure on agreements between highly-centralized trade union movements and confederations of employers. They would thus not be adaptable without change to the Canadian situation in which autonomous unions bargain with individual employers or industries,<sup>5</sup> and in which labour contracts are—with few exceptions—a matter of provincial jurisdiction. The results are not always satisfactory in any event—political pressures frequently leading to large annual wage increases—and most of the countries involved have much more rapid rates of inflation than Canada or the United States. Any attempt to freeze wage differentials also leads to unrest and injustice and to the danger of misallocating resources in changed circumstances. Professor Lundberg told us, however, that Sweden avoids some of these dangers by maintaining a highly competitive atmosphere which squeezes workers out of declining industries and gives them government assistance to relocate. Nevertheless, he admitted there are wage "slides" as employers try to obtain scarce labour by bidding over the going rate.<sup>6</sup> If provision is made for independent arbitration, moreover, the arbitrators are not likely to be guided solely by government policy and the system may well break down under the pressure of exceptions. Finally, as the late Sir Dennis Robertson reminded us, it is virtually

<sup>4</sup> In the six years from July 1957 to July 1963, more than 800,000 people were added to the working population outside agriculture.

<sup>5</sup> The Canadian Labour Congress, for example, has no authority or control over any of its affiliated unions with respect to their collective bargaining policies—Transcript, page 6514.

<sup>6</sup> Transcript, pp. 4285-97, 4361-7.

impossible to have an effective and acceptable wages policy without also having a profits policy, which may well freeze earnings in an inappropriate pattern and remove much of the incentive to expand and improve efficiency.<sup>7</sup>

The whole question of wages and incomes policies and their place, if any, in the armoury of government policy requires more study than we have been able to give it. However, it is clear that formidable difficulties and costs are involved in establishing such sweeping new arrangements, and we have the impression that they are not necessary or desirable at this time. This does not mean that the problem can be ignored, but we think that a combination of general financial policies, non-financial measures and reasonable self-restraint on the part of labour and management can prevent any tendency for excessive wage and price increases to reassert themselves. The recently-established Economic Council of Canada should be able to play a constructive role in this area by studying the problem and making the public and the parties involved aware of the issues. Its periodic studies of Canada's domestic and international economic position should also serve to alert those engaged in wage negotiations and pricing policies to both the short and long-term implications of their decisions.

Such studies will not, however, relieve the authorities of their obligation to use their general policies to maintain effective demand at appropriate levels. Nor will they relieve the government of the obligation to use non-financial measures to keep the economy adaptable and competitive. The task facing the authorities will thus be complex at virtually all times. It may involve the use of many instruments of policy, depending on the structure of the economy, the number of subsidiary goals sought, and the "feedback" effects of individual policies designed particularly to promote one objective on the likelihood of attaining others.

The authorities will also be confronted with choosing from a wide range of techniques to implement these policies. As we have argued in earlier chapters, they must try to choose those

which do not create confusion or lack of confidence and thus put unnecessary limitations on the effectiveness of policy. Nevertheless, the choice of operating techniques used is of secondary importance to the task of establishing the correct climate of policy in a carefully-planned and consistent way. If 4% is the right level for short-term rates, it matters little whether they are achieved under a fixed or floating bank rate system, although it may be easier to obtain public acceptance under the former. Similarly, if long rates must be increased, it will depend on the circumstances whether this is best achieved through new issues of long-dated government bonds, tightening up short-term rates, direct open market operations or some combination of these techniques. The end result may not be very different, and the choice should be made in terms of which technique is the most suitable and least disruptive. Whatever the choice, the authorities should not bind themselves unnecessarily to rigid operating rules or techniques; within the scope of their legal powers, the sole test of methods they use should be whether they will best achieve the ends of policy in an acceptable and effective way.

#### THE ORGANIZATION OF POLICY-MAKING

We stressed earlier that even well-chosen policies will be effective only if our political leadership is wise and far-sighted, willing to consider its actions and their consequences carefully, and—if necessary—prepared to take steps that are temporarily unpopular. If the national interest calls for restrictive policies in the form of higher taxes or tight credit conditions, this will rarely be applauded. If a recession leads to demands for permanent and unwise government expenditures on the grounds that they will help to combat the current weakness in demand, it is not easy to refuse. Yet the long-run consequences of failing to take a firm stand may be serious, and the Minister of Finance must be a man whose suspicions are aroused if his tax and expenditure policies suddenly become too popular. He has also a special responsibility to ensure that rival

<sup>7</sup> Transcript, pages 5146-58.

economic policies do not develop within his own sphere of responsibility, although it is on the Cabinet as a whole that the final responsibility for the unity, coherence and good sense of policy must rest.

The best of political leadership will, however, be ineffective if it does not have the support of an informed and intelligent public opinion. The government itself has an important role to play in this process, by the timely release of statistical and other economic data, by informative discussion of its policies in and out of Parliament and by encouraging its officials to explain its policies and participate in discussions with interested members of the community. Nevertheless, a large measure of responsibility for creating a sensible public interest in policy must rest with the private sector—business, labour, the academic community and the press. Some private organizations do play a useful role in studying and commenting on policy issues, but we have the impression that more useful commentary could be made.

It seems to us also that the Canadian academic community all too rarely takes a leading part in stimulating informed discussion of economic policy matters, especially in monetary affairs. We realize that the number of economists who are not working on government assignments at any point in time is limited, but we hope they will play a more active role in public discussions of policy. Finally, the financial press in Canada could with great advantage to the country devote more resources to informed and intelligent assessment of economic policy issues. Canada is still a small country, but there is no reason why its financial press could not improve the standard of commentary and analysis of financial policies and developments.

A third essential ingredient of good policy is the existence of an adequate and well co-ordinated staff of policy-making advisors, equipped with prompt and relevant information on which to base its recommendations. Canada's statistical services have greatly improved since the days of our predecessors on the Macmillan Commission; data

are now available, for example, on the labour force, national production, the annual investment outlook and a wide range of financial and industrial affairs, much of them seasonally-adjusted. Yet, the increasing complexity of the economy, and the increased policy responsibilities of government, have led to a still greater increase in the need and demand for statistics; this comes not only from the federal government itself but from the private sector, other levels of government and even international bodies.

We therefore find ourselves in sympathy with those recommendations of the Royal Commission on Government Organization designed to increase the funds, personnel and other resources devoted to the collection and publication of statistics by the federal government.<sup>8</sup> From the viewpoint of economic policy, the main concern is not the quantity of data available but its promptness and relevance. In Chapter 22, we cited some of the delays involved in present publication schedules of economic information and indicated how this handicaps the authorities in determining what is actually happening in the economy, and therefore what the posture of policy should be. While agreeing with the general view that the Dominion Bureau of Statistics is on the whole doing an excellent job with the resources at its command, we hope that it will be found possible to accelerate the production of the main statistical series and make more resources available for this important task.

There also appear to be some gaps in the statistical data needed both for short-term policy decisions and for an assessment of the longer-run trends in the economy. We have mentioned a number of examples in earlier chapters, among them the need for quarterly government cash requirement data on a seasonally-adjusted basis, for uniform information on the financial position and capital spending of provincial and municipal governments, and for quarterly data on the financial position of non-financial corporations. The task of the authorities would also be eased if

<sup>8</sup> *Report of the Royal Commission on Government Organization* (Glassco Commission), Vol. 3 pp. 35-51.

the survey of investment intentions were carried out quarterly, if good data on new orders, inventories and shipments were available sooner, and if prompt and more detailed information were available on financial institutions other than the chartered banks. There have been recent striking improvements in this last area, but there are still gaps, especially with respect to the credit unions and caisses populaires. For longer-term purposes, it would be helpful to have more information on the conventional mortgage market and on the financial position and problems of agriculture and small business.

In general, we believe that improved and extended statistical series, particularly in seasonally-adjusted form, can help businessmen to make more intelligent decisions about their investment and inventory policies. They thus may make a contribution to stabilizing the flow of economic activity by reducing the possibility of excessive bunching of private spending as well as by assisting government policy-makers to pursue improved stabilization policy.

Important though good data are to the policy-making process, much depends on the calibre and vigour of the personnel in the public service. The Canadian public service is rightly held in high regard in Canada and abroad, but we have the impression that the policy-making departments are not now attracting and retaining sufficient numbers of able men to handle their increasingly heavy responsibilities.<sup>9</sup> This is only partly the result of the increasing challenges and opportunities open in the private sector. It also stems from the insufficient time and attention paid to recruiting and development by overworked senior officials in the public service and from the inflexibility of civil service recruiting procedures, pay schedules and promotion policies. In any event, as the Glassco Commission observed, many of the most able persons in the public service today were recruited during the depression and immediate post-war periods.<sup>10</sup> They have served the country well, but it is essential that future

needs for qualified senior personnel not be obscured by the very fact of the unquestioned talents of those now in top-level positions. Steps should therefore be taken—along the lines recommended by the Glassco Commission—to develop improved and more flexible personnel policies in the civil service to make it possible to attract and retain the most highly qualified men available and ensure that those in senior positions have the necessary skills and temperament to discharge their burdensome duties well.

We also share the impression of the Glassco Commission that the Department of Finance is understaffed and lacks sufficient personnel to undertake more fundamental research, particularly on longer-run problems. This is partly the result of the constant pressure to carry out *ad hoc* investigations when unforeseen and urgent problems arise. Some of these longer-range functions will undoubtedly be carried out by the new Economic Council. This body is charged with studying, and advising the government on, such matters as the medium and long-term prospects of the economy and the policies which can help to attain the nation's major economic objectives. It also has a series of more specific instructions to deal with such subjects as Canadian ownership of industry, automation and technical change, patterns of change and investment in individual industries, regional development, major investment projects and labour-management relations. In addition, it is charged with fostering improvements in productivity and management techniques, the training and re-training of labour, the extension of research and a number of related matters.<sup>11</sup>

The Council's studies and annual reports, including an annual review of medium and long-term economic prospects, should contribute significantly to increased public awareness about policy issues and lengthen the perspective from which they are viewed. The Council will no doubt perform much the same useful functions for the main policy-makers in Ottawa, although its exact position in the policy-making process will only be

<sup>9</sup> The Bank of Canada's organization will be discussed separately in the next chapter.

<sup>10</sup> *Op. cit.*, Vol. 1, page 246.

<sup>11</sup> See the governing legislation, Bill C-72, 1st Session, 26th Parliament, 1963.

established with experience. The Council, composed of three full-time members and twenty-five representatives of various interests in the community, will have its own staff and presumably will be a source of independent advice to the government, to which it reports through the Secretary of State. However, because it will have no specific operating responsibilities in the policy field, its members will also be free to participate in public discussion of policy in a way that is not possible to departmental staff, whose advice must be given in private and who cannot become embroiled in public controversy. In this respect the Council will not be unlike such semi-independent advisory bodies in a number of European countries, although we hope it will work closely with the policy-making departments and the Bank of Canada.

However, as Professor Samuelson stressed to us,<sup>12</sup> outside committees, no matter how distinguished their membership, should not be allowed to determine policy or to blur the responsibility of government for making decisions and accepting their consequences. As an additional advisor and as a means of focussing attention and initiating discussion on policy issues, the Council will undoubtedly play a constructive role, but the Minister of Finance should always have the central place in the making of economic and financial policy. It is he, after all, who is responsible for monetary and budgetary policy, the two main instruments of economic stabilization.<sup>13</sup> It is thus important that the Minister of Finance have a strongly-staffed department, whose personnel are capable of undertaking more policy studies of a long-range nature, no matter how close their working relationship with the Council. Both the Finance Department and the Council might usefully strengthen their staffs by bringing in outside experts from the academic community, from business and from the labour movement to serve with

them for temporary periods, say up to two years. This practice is followed extensively in the United States, and to a lesser extent in the United Kingdom, and leads to both a freshness of approach and a more practical understanding of policy problems both in and out of government.

## CONCLUSION

Even with effective policy-making arrangements, many obstacles to the formation of good policy will remain. The authorities can never be certain of our exact position in the expanding universe of economic events, and—despite significant improvements in the art of forecasting—predictions of the future inevitably retain a pronounced Delphian quality. However, we do not believe it impossible to get the broad set and timing of policy right—a few months in which the direction or strength of policy later proves to have been wrong are not catastrophic. Moreover, the record shows that the major errors of the post-war period have arisen in large part because of a reluctance to use the general policy instruments appropriately or because hasty and haphazard expedients have been resorted to when well thought-out and carefully co-ordinated programs would have accomplished the task more satisfactorily.

There will be limitations too, on the use of policy because a free and diversified society is unlikely at all times to be unanimous on the objectives to be pursued and the means of accomplishing them. We have argued, however, that these difficulties can be minimized by effective leadership and a conscious attempt to show as far as possible the costs and benefits of pursuing one aim rather than another. An enlightened public opinion and financial community are unlikely to put serious limitations on the use of monetary and fiscal measures over a fairly wide range. It is for this reason that we have stressed the importance of fully explaining policy and its goals so that, for example, the authorities are not forced into balancing the budget at times when to do so would only unbalance the econo-

<sup>12</sup> Transcript, pages 6323-7.

<sup>13</sup> The situation is different in the United States where the President has final responsibility for all policy, subject to legislative approval where required. The Council of Economic Advisors are full-time government appointees charged with advising the President on economic affairs, and are frequently used to defend the Administration's policies in partisan forums.

my and create unemployment. It would be equally undesirable if the authorities were compelled by uninformed public demands to keep interest rates unduly low in the reverse circumstances when to do so would only result in inflation and later difficulties.

A third major limitation on policy and its effectiveness will from time to time be imposed by the international environment. We have, however, indicated that shorter-run problems of this kind can sometimes be met without serious damage to the domestic economy by varying the mix of policy to put more emphasis on fiscal measures and by the development of more extensive international financial arrangements. In more extreme and prolonged circumstances, however, changes in the external value of the currency might prove necessary to relieve some of the strain on the domestic economy. Yet, the fact remains that we are connected to the world economy whatever our currency arrangements, and if the world economic environment is unfavourable, the Canadian economy will perform unsatisfactorily despite the best efforts of the policy-makers.

The use of policy in the circumstances of any country involves substantial difficulties and is likely to achieve something less than the ideal. The Canadian authorities are subject to additional restrictions because of our extreme openness to world conditions, particularly those in the United States. Our economy has outperformed theirs in much of the post-war period, in part because of our ability to draw in and displace imports in periods of rising and falling activity respectively, but it will always be difficult for Canada to do significantly better than the United States. Nevertheless, we should be capable of

doing at least as well, and prolonged failure to do so would raise questions about the effectiveness of our domestic policies.

Despite the lags, uncertainties and limitations of policy, our view is essentially a fairly optimistic one. We believe that discretionary policy, wisely used, can improve our economic performance and that reasonable economic objectives are not beyond our ability to attain by such means. We have no reason to believe that discretionary decisions will so often be wrong or perverse that more would be accomplished by replacing them with automatic rules of action relating to the maintenance of a given level of interest rates, to specified annual increases in the money supply or to some other factor. Indeed, we have argued that automatic or mechanical guides are inadequate to cope with constantly changing economic situations and political preferences. Moreover, only in operating policies in the light of varying conditions will the authorities gain the experience needed to deal with new and difficult situations.

We have found that each individual strand of policy has effects sufficiently powerful that it cannot be a matter of indifference if it is wrongly set or ignored. At the same time, we have stressed that no one element of policy has results so strong that it can be relied upon in isolation. Incoherent or incompatible policies will thus have serious results for the economy. If taken together and carefully co-ordinated, however, the stabilizing potential of all policies can be large in relation to the swings in economic magnitudes that would otherwise occur—larger indeed than the sum of the effects of the individual component policies. Conversely, the results of a program of policy which is wrongly conceived can be serious.



## THE STATUS AND ORGANIZATION OF THE BANK OF CANADA

We have emphasized that policy is composed of many diverse strands which must always be closely interwoven—although in different blends at different times—to produce a total policy fabric with the pattern, qualities, and texture most appropriate to the particular climate in which we find ourselves. We therefore turn to examine the machinery for working the threads of Bank of Canada policy into the broader policy patterns of government and for organizing the central bank to make it an effective and consistent contributor to policy as a whole.

The preamble of the Bank of Canada Act presently gives the Bank a set of general instructions to regulate credit in the best interests of the economic life of the nation and refers more specifically to the goals of external and internal price stability and to the avoidance of fluctuations in employment and production. A number of witnesses suggested that this preamble should refer specifically to the goals of full employment and economic growth. Although this might not have any practical effect on the Bank's current operations because such objectives are already kept firmly in mind, we believe it would be useful to redraft the preamble so that it more accurately reflects the full range of economic policy objectives. It might instruct the Bank to use its powers to promote the general economic and financial welfare of the nation and to contribute to the achievement of such goals as rising productivity, a high and stable level of employment, the protection of the value of the national monetary unit,

the development of an efficient and flexible Canadian financial system, and the maintenance of a sound external financial position.

### GOVERNMENT RESPONSIBILITY FOR MONETARY POLICY

The Bank of Canada Act is silent on the matter of government responsibility for monetary policy, partly no doubt because the Macmillan Commission—while recognizing that the state must retain ultimate sovereignty—felt it desirable that the central bank be free from the fear of interference for political ends.<sup>1</sup> This view of the Bank as an independent body carrying out national policy in the public interest was confirmed by the Finance Minister of the day who stressed that the Bank of Canada should not be subject to government dictation because government financing requirements might conflict with a wise monetary policy.<sup>2</sup> In 1936 a shift in opinion occurred, with the then Minister of Finance indicating that while the Bank should resist temporary gusts of public fancy, it must in the long run show responsiveness to public opinion and be responsible to government. However, the government was not to be concerned with daily management, but would have control through the assurance that the direction of the Bank was in

<sup>1</sup> Paragraphs 207 and 219 of *The Report of the Royal Commission on Banking and Currency*, 1933.

<sup>2</sup> House of Commons Debates, 1934 session, pages 827-8, and 840-1.

the hands of men in whose judgment it had confidence.<sup>3</sup>

The emphasis was further altered by a subsequent statement of the Governor that central bank policy must conform to the policy of government, and by a 1941 statement of a different Finance Minister who, correcting an earlier denial of any ability to control Bank of Canada policy, said that the responsibility of the Governor and Board did not in any way relieve the government of the responsibility for the Bank's policy nor militate against public control of monetary policy. The Bank's monetary policy must be the government's policy although execution of that policy should be left to the management of the Bank; in the event of a dispute there could be no question that the government's view would prevail.<sup>4</sup> In 1951 and 1954 another Minister of Finance indicated that he shared these views and in the latter year the Governor made a further statement confirming the view that the directors and management had no excuse for not taking full responsibility for everything they did in the monetary field, but that equally there was no excuse possible for the government. The administration of the day, supported by a majority in parliament, could always change the legislation even though parliament had placed the immediate responsibility on the Bank of Canada.<sup>5</sup> The second Governor of the Bank confirmed this opinion in 1956, indicating that any government sufficiently displeased with the Bank or its management could bring about a change in management.<sup>6</sup>

The original legislation, however, had not been altered to reflect the change in views which had occurred since 1933, and in 1956 a different Minister of Finance was able to deny any government responsibility for the Bank's policy—that responsibility being placed only on the Bank—although he admitted that the government was kept informed of monetary developments.<sup>7</sup> This

view was severely criticized in some quarters but the next Minister, too, rejected categorically any suggestion that he was responsible for monetary policy in any way,<sup>8</sup> and the official interpretation thus continued to be that only parliament had a direct responsibility for the Bank and that the Minister had no part in the matter. By 1961, however, events had shown that this position was unrealistic and untenable. The new Governor upon assuming office therefore issued a statement indicating that in the ordinary course of events he believed that the Bank of Canada had the responsibility for monetary policy, but that if the government disapproved of that policy it had the right and responsibility to direct the Bank as to the policy which was to be followed. This statement was accepted by the government and the current position seems to be that the Bank accepts full responsibility for its policy while the government—which is kept fully and continuously informed—does not disclaim its responsibility.<sup>9</sup>

The legislation, however, does not provide any means for the government to exercise its responsibility for monetary policy. The 1961 and pre-1956 statements cited above indicated that management or directors who disagreed with the government on a fundamental issue would have to resign, or implied that there were ways and means by which directors and management could be got rid of—especially if a continuing struggle should develop. In fact, however, the government has no power to dismiss directors and the Governor or to make the Bank comply with its wishes, except of course by introducing special legislation, even though it now seems to be generally accepted that ultimate responsibility for monetary policy must lie with the government and that the central bank should not be a state within a state.

There is, however, no universal agreement on what the exact relationship between the two bodies should be. It does not necessarily follow that because the Bank is a policy arm of government it should be made a department of government. Indeed most of the world's 100 central banks—

<sup>3</sup> House of Commons Debates, 1936 session, pages 3262-4.

<sup>4</sup> House of Commons Debates, 1941 session, pages 3936-7.

<sup>5</sup> Proceedings of the House Banking and Commerce Committee, 1954, pages 25-6.

<sup>6</sup> Proceedings of the House Banking and Commerce Committee, pages 348 and 373-5.

<sup>7</sup> House of Commons Debates, 1956 session, pages 7351-2.

<sup>8</sup> *Ibid.*, 1959, pp. 2050, 3098-9.

<sup>9</sup> Transcript, page 7454.

apart from those in totalitarian countries—are separate institutions in fact as well as in form precisely because experience has shown that the objectives of society can best be met by an arrangement which leaves some measure of independence to the monetary authority. Although it can be argued that any measure of independence, however small, is in logical conflict with the aim of bringing unity and coherence into financial policy, we do not accept this view. There is no lack of common sense in preferring some division of responsibilities to a concentration of power in one centre, provided there is a sensible means of reconciling any divergent views into a consistent whole. All policies must work to the same ultimate objectives and must be purposefully directed to those ends, but if the arrangements for designing and executing each of them were rigidly identical and did not take into account the special tasks which each must perform, we believe that the national interest would be but imperfectly served.

One of the more important operating reasons for giving the central bank a measure of freedom within government is that both residents and non-residents, particularly those engaged in financial affairs, look to an independent central bank as a guarantee that market dealings are not being undertaken for day-to-day political considerations unrelated to the broad aims of monetary and financial policy. If market values were subject to capricious influence from government efforts to gain the temporary fancy of the electorate, neither Canadians nor foreigners would be as willing to invest in this country, and the foreign exchange and domestic financial markets might become too concerned with speculating on the government's next move rather than with channelling the flow of savings into investment. The central bank also has an important responsibility to encourage the development of an efficient and flexible financial system to serve the needs of the economy as a whole as well as the special requirements of the policy makers. This function, and the closely related one of advising government on financial developments, makes it

imperative that the central bank be market-oriented as well as policy-oriented if it is to be really useful. Normally some measure of independence will encourage a central bank to develop the vigour and freshness of approach, the technical competence and flexibility, and the basic understanding of market forces and attitudes needed to discharge these functions effectively. Dealing with markets, unlike many other aspects of financial policy, involves continuous decision-making and cannot be done on any sensible basis if all transactions are subject to prior approval by a responsible Minister or the cabinet. To some extent too, external financial responsibilities, especially dealings with international financial organizations and other central banks, are more easily handled if a central bank has some independence of status.

The main reason, however, for conferring some measure of autonomy on the central bank has been the historical tendency of governments of all forms to develop the habit of inflating the currency.<sup>10</sup> Since the process of inflation is understood by relatively few people and since it has few other organized opponents in our society, a special responsibility is imposed on the central bank to see that the objective of price stability is not forgotten by government merely because other goals have more political popularity in the short-run. While we agree with the Governor and other witnesses that protecting the value of the currency should not be an objective superior to others—although at times it deserves special emphasis—it is only realistic to recognize that government might occasionally be tempted to use the monetary system in an inappropriate way to finance its requirements through the hidden and discriminatory tax of inflation rather than through taxes which expose it to close, and possibly embarrassing, parliamentary and public scrutiny. Indeed, it was largely because the Macmillan Commission found that rates on Finance Act advances were varied mainly to meet the exigencies of government finance rather than the credit

<sup>10</sup> Submission of Mr. G. F. Towers, pages 10 and 11.

needs of the country that it recommended setting up an independent central bank.<sup>11</sup> Such independence allows the central bank to take certain steps to protect the public if the total policy climate seems more inflationary to the bank than the national interest demands, although it should be emphasized that the only real and lasting defence against inflation is the determination of government itself to resist it. A status of some freedom also makes more effective the Bank's ultimate safeguard of the public—the warning stemming from resignation of its senior management—since the departure of men of independent standing will usually attract considerable public notice and concern.

We also believe that some measure of independence strengthens the central bank when exercising its right and responsibility to try to bring about the most appropriate "mix" of government policy through private persuasion, leadership, nagging or disagreement. The increasing complexities of government policies and the growing repercussions of fiscal, debt management and international financial policies on monetary affairs make this role vital. We are convinced that the expert advice of a central bank not dominated by fears of short-run political pressure leads to more carefully considered policies than would be the case if the Bank management were only another set of departmental advisors under no obligation to resist policies with which they disagreed. Such independence must of course be reconciled with the responsibility of government to mesh together all aspects of policy, and in fact imposes on government the duty of not abdicating its functions to the Bank, particularly when they prove temporarily unpopular. If a persistent difference developed, government must have the assurance that its policy, and not the central bank's, would prevail—at least until parliament, and ultimately the public, rendered a final verdict.

There is a view that it is impossible and undesirable to tie up this awkward package of government responsibility and central bank independence with a neat legislative knot, and that

it is better to leave it in the looser wrapping of common sense. No law can specify the precise ingredients which make for a working understanding in every conceivable circumstance between Governors and Ministers with different personalities and approaches to their jobs. Clearly two men of intelligence and good will can arrive at a harmony—if not necessarily an identity—of views and can make even the worst designed system function smoothly, while the best system in the world can not be made proof against folly, ill-will, or an unshakable determination to misunderstand. It is argued, therefore, that a crisis between government and central bank has a certain aura of inevitability about it and that there is no satisfactory set of rules that can prevent the development of such a crisis. On the other hand, we believe it is scarcely edifying or helpful to have an unresolved difference of opinion between the Governor and the Minister fought out in public and allowed to create awkwardness and uncertainty about the future direction of policy. Until the government has made a decision, discussions should be behind the scenes. Otherwise the result might be confusing and might distort the public debate which would be sure to take place in any event if no agreement were reached. It might also lead to hasty and ill-considered legislation which could have been avoided by creating suitable legal machinery for resolving such differences or for ensuring that the government's views on policy finally predominate. Memories are too short to leave the situation as it now stands.

We have considered a legislative framework within which the central bank would operate under a continuing directive from government. In our view such a continuing directive—suggested by a number of witnesses—would have to be either so broad as to be virtually meaningless or so narrow as to destroy the Bank's independence. Even though the Bank's views might be considered in each redrafting of this unending series of instructions, we believe this arrangement would merely maintain a misleading façade of independence and might give us the worst of both worlds.

<sup>11</sup> *Op. cit.*, para. 195.

We believe that central bank independence within the context of government responsibility for monetary policy can best be assured by a dual system of responsibility under which the Bank formulates monetary policy and executes it from day to day but under which the government must accept full and continuing responsibility for the policy being followed, although not in the normal course for the details of its execution. The Bank of Canada Act should be amended to make this clear and to provide the Minister of Finance with the right to issue a directive to the Bank if the government disapproves of its policy. We believe that this procedure of government direction of the Bank's policy should be used only as a last resort and after extensive and conscientious attempts to reach agreement have failed. If such a situation ever arose, its seriousness would call for highly formal procedures designed to focus full and intelligent public discussion on the matter under dispute. We therefore recommend that any directive take the form of an order-in-council to ensure that it receives cabinet consideration; that it be as specific as possible in its terms, making it clear that the government feels the Bank has been too restrictive or too expansive in its policy, pointing out in a closely-reasoned way how its actions have conflicted with national economic policies, and indicating what steps—including possibly a change in Bank Rate, market yields, or the cash reserves of the banking system—the government wishes carried out; that it be published with the briefest of delays, say within 15 days of issue; that it be accompanied by a statement from the Governor setting out his opinion of the matter; and that it should automatically lapse after 30 days so that it would not become in effect a continuing directive.

Some witnesses mentioned that these procedures might be an embarrassment to both government and central bank, but we tend to feel that they ought to be sufficiently uncomfortable to discourage their unconsidered or frequent use. Moreover, if the situation were grave enough to force resort to a directive, the public ought to know about it without delay—no matter how inconvenient that might be to the parties involved.

Such provisions exist in a number of other countries, including Australia, and we were informed that their mere existence has helped to avoid difficulties that might otherwise have arisen, although so far as we are aware they have never been used. As we were told by the Governor and other witnesses, it is possible to imagine rare circumstances in which Governor and government agree to disagree in order to focus responsibility for a certain policy directly on the government. In such unusual circumstances both parties would also have to issue statements making clear the reasons for the issue of a directive; otherwise an unjustified atmosphere of crisis might be created and the independence and prestige of the Bank undermined.<sup>12</sup> Although we do not wish to close the door to this possibility, we think it highly unlikely that a directive would ever be used except in a situation of basic disagreement which would lead to the Governor's resignation.

We are conscious of the danger that government might get into the habit of using a directive if that power were open to it and if the sometimes convenient ability to avoid responsibility for monetary policy were denied it. Conceivably, too, the Bank could become similarly addicted to the directive in order to shift its responsibilities onto other shoulders. However, we do not believe either party would find this procedure very palatable or popular in the ordinary course of events, and we take some comfort from the fact that it has in practice never been resorted to elsewhere. In the light of recent developments in Canada and of the generally-accepted view that the ultimate responsibility for monetary policy must rest with government, we thus agree with the Governor that the existence of directive powers would not further reduce the real independence of the Bank (or the real responsibilities of government), but would merely make explicit the position now held by both parties and the vast majority of the public.<sup>13</sup> No legislation can, of course, guarantee the central bank its independence in perpetuity

<sup>12</sup> Transcript, pages 7848-50.

<sup>13</sup> Transcript, page 7842.

since a government with the necessary parliamentary support and determination can always change it. Nor can it guarantee the country against a government which is determined to evade its responsibility for financial policy. Good legislation can, however, serve to focus public attention if the government's role in Bank of Canada affairs tends to be either too little or too large.

No matter what the legal arrangements, it is obvious that they will be workable only if the Governor and Finance Minister keep each other fully and continuously informed on policy and the factors underlying it. Although we understand that the Governor and Minister now hold regular weekly meetings in addition to numerous more informal contacts, we believe that the legislation should explicitly impose the duty to maintain close and continuing contact and assure the Governor access to the Minister as an advisor on government financial policy. The frequency of these discussions would doubtless vary with the circumstances but, as in the United States, we think they should take place regularly and often. The existence of the directive power should not bind the Governor to consult more with the Minister than he would in any event, but it does make it desirable to give statutory effect to the present practice of obtaining the Minister's prior approval of a change in Bank Rate. Ordinary open market operations, however, require only that the Minister continue to be kept closely informed.

In view of the proposals put forward in this chapter and of our earlier recommendations on the co-ordination of government economic policy, we do not see any need to establish yet another committee to co-ordinate the roles of the Bank of Canada and Department of Finance. The Deputy-Minister of Finance is after all an ex-officio member of the Bank's Board and Executive Committee—an arrangement which we believe is satisfactory and which calls for no special comment—and by virtue of his frequent formal and informal contacts with the Governor is in an excellent position to provide the Minister with another closely-informed view of the Bank's policy and activities.

We have argued that the independence of the central bank is meaningful and necessary for its dealings with financial markets and the public, both at home and abroad; for the force and relative detachment with which it can give advice to government; and for its ability to warn the nation if any government were tempted to tamper with the currency. This independence, however, does not give it the right to enjoy sovereign power—it imposes the duty to act in the public interest. It has content only if the Bank's management has enough wisdom and good sense to find workable compromises where disagreements are not over central issues, and enough courage and integrity to stand firm if it truly believes the national interest is being endangered. A good Governor will never do anything to which he is fundamentally opposed but he will not feel it necessary to oppose automatically all ideas originating outside the Bank. In the last analysis, however, if he sincerely believes government policy makes it impossible for him to discharge his job as monetary manager he must be prepared in good conscience to resign.

We have also stressed that the government must share responsibility for monetary policy and must have the means to ensure—in the event of conflict—that its views prevail. While we hope the Minister would normally leave monetary policy in the Bank's hands and would shield it from short-run political pressures, we realize this will not be easy—it was after all an opposition question about raising the Bank rate to the "unprecedented high level of 3½%" which led a former Minister to deny responsibility in 1956.<sup>14</sup> However, we can only hope that, as in other countries, the somewhat awkward and embarrassing procedure which we have favoured will strengthen the resolve of future Ministers to defend the monetary authority against unjustified attack and encourage them to acknowledge their own responsibility for prevailing credit conditions, if only because they have not chosen to object to them.

<sup>14</sup> The question went on to refer to "spectacular increases" from 1½% and to their "very dangerous and unsettling effect". House of Commons Debates, 1956 session, page 7351.

In a well-functioning democracy, responsibility for monetary policy, while dual in nature, must be clear and unmistakable. There should be no possibility of Bank and government hiding behind each other's back by claiming that they were forced to act against their wishes. Our political system obviously requires government to respond to the preferences of the public, but it is equally clear that it must not do so in surreptitious, ill-conceived, or hasty ways which sacrifice the longer-term public interest to short-term political pressures. Accordingly, we have suggested a mechanism which allows the government to take direct responsibility for monetary policy if it believes the national interest requires it—but in a way which should reduce the possibility of concealed domination of the central bank, encourage full consideration of all the implications of its action, and lead to that full and informed public debate which is an essential part of a truly responsible democracy.

#### RESPONSIBILITIES OF THE BANK'S DIRECTORS

The responsibilities of the directors of the Bank of Canada are not very different in form from those of other corporate directors. The Act states that the Bank shall be under the management of the Board but provides that the Governor, as chief executive officer, has the direction and control of its business on the Board's behalf and may act on all matters not specifically reserved to the Board or Executive Committee. However, the substance of their responsibilities is of necessity different from that of most other directorates in view of the technical complexity of many aspects of Bank of Canada policy operations, the government's ownership of the institution, and the need for closely co-ordinating all aspects of government policy.

Nevertheless, we believe outside directors can and should play an important and active part in the affairs of the Bank, not least in ensuring that its business and administrative procedures are sensible and efficient, expenses are well-controlled, real estate is properly managed, and that the Bank

stays within its legal powers. These "house-keeping" functions are particularly important in a central bank since its expenses are small relative to its revenues and it is easy to slip into inefficiency. A more important function of the directors, however, is that of appointing staff, seeing that salaries are reasonable, ensuring that the proper personnel is recruited and adequately trained, and judging management's performance—particularly in the higher ranks. The job of selecting top management puts a special responsibility on the Board to make certain that a number of suitable candidates are always available within the Bank—even though there may be some senior appointments from outside.

We received views that the Board's role should be confined essentially to these functions and to a minor advisory status on broader Bank policy. However, we do not believe that the government is likely to be able to recruit men of the judgment necessary to perform even these limited tasks if they are to be only glorified management consultants who learn of policy always after the event and who—while useful for window-dressing—can be freely ignored for other purposes. As was emphasized to us, the basic responsibility of the directors is a heavy one—and could extend to informing the Minister that management was not equal to its work.<sup>15</sup> It also involves a broad appreciation of monetary policies and their part in national economic policy. For these reasons, the Board must be composed of men of first-rate ability and a strong sense of public service.

The Board's duties also include supplying management with business information and with first-hand impressions of business and public reactions to the developing economic scene and the Bank's policies. Although these duties may be less important than they used to be because of improved public communications and the development of new statistical and other sources of information, we have the impression that the Board could well do more than it now does in this field. Board members—like the Governors of the Federal Reserve System—should also play

<sup>15</sup> Submission of Mr. G. F. Towers, page 2.

an active role in explaining the Bank's policy to the community, although we recognize that the difference in the two systems will not allow them to fulfill this function with quite the vigorous independence of their American counterparts.

In our view, however, the most important of the Board's functions is to accept collectively the final responsibility for the management and policies of the Bank—subject to the Minister's right of directive. This responsibility must take many forms and includes: reviewing the actions and proposals of management to ensure that they are sensible; putting forward suggestions, ensuring that different opinions within the Bank are considered, and preventing the domination of policy by the wrong-headed views of any one man or group of men; and—most important—giving support and encouragement to the Governor, if necessary by being prepared to resign with him to defend policies which the Board believes to be right. As with any good board, the directors must and do rely heavily on the full-time management to take the initiative in putting forward policy recommendations and must give the officers a free hand to implement these measures—subject to subsequent Board review. If, however, the Board were to lose confidence in the senior officers of the Bank, it would clearly have to watch developments more carefully and keep the Minister closely informed. In normal circumstances, the Board would have sufficient control of the Bank's affairs merely through management knowing that it would shortly have to explain and justify its actions to the directors. No doubt occasional lively debates would take place, as happens for example in Australia and the United States, but we hope that the Board would not consider it part of its function to be continually second-guessing the management.

While we recognize that the Governor now takes pains to know the general thinking of the directors, to explain and justify his actions in a broad way, and to indicate the nature of the policies which may be appropriate for the immediate future,<sup>16</sup> we nevertheless have the

impression that the Board might be somewhat more closely consulted on Bank policy. For example, special meetings might be held to discuss unusual problems and, if this were not possible, the Board ought to be at least informed and consulted about major policy or other changes by telephone. We also urge the Governor, whose close and continuing relations with the Minister make him much more familiar than the outside Board members with government policy, to make every effort to take the directors fully into his confidence. We realize that at times—for example when the budget is being prepared—he will have confidential information about government policy, but there is a tendency for secrecy to be overdone in Ottawa. The Minister should whenever possible encourage the Governor to discuss with his Board—if only in the most general way—matters of government policy relevant to their decisions. We have been told of the discouragement which Bank directors feel when asked to put a rubber stamp on accomplished facts.

Canada's geography does not allow the directors to meet as frequently or easily as the Court of the Bank of England, but we believe they ought to meet more often than the present seven or eight times a year, although perhaps not as frequently as the Federal Reserve Open Market Committee which assembles every three weeks. We therefore recommend that the Board be required to meet not less frequently than 10 times a year and more often if circumstances make it necessary. To this end we suggest also that the present \$30,000 annual limit on aggregate directors' fees, which acts to limit the number of meetings, should be raised in order to allow the directors' fees to be made more comparable to those of the chartered banks. We further recommend that the Executive Committee—which meets weekly and has the powers of the Board between meetings—should be enlarged by adding one, or preferably two, outside directors to the present membership of the Governor, senior Deputy Governor, Deputy Minister of Finance and one outside director (a second

<sup>16</sup> Transcript, pages 7801-2.



outside director who is a member of the Executive Committee of the Industrial Development Bank<sup>17</sup> often attends these meetings as well). The role of the Executive Committee is a vital one because of its frequent meetings and close contact with policy, both past and prospective, and we believe more of the outside directors should now participate on it, especially since improved travel facilities make it less difficult than formerly for them to do so.

These proposals, while strengthening the independence of the Bank within the framework of government, are not likely to increase the remote possibility of conflict between the Board and the Governor or between the Board and the Minister of Finance. A good Governor will be the leader of the Board and if he develops sound working relations with the directors he is not likely to run into an unsupported conflict with the political authorities. In any event, it is one of the Board's functions to detect early any tendency for the Governor to fail to discharge his duties effectively and to take steps to bring the situation under control. In this connection we believe that if the Board should ever lose confidence in the Governor the Act should require the directors to inform the Minister of Finance of their view, preferably in writing. If such disagreements arise between Governor and Board, the government, as sole shareholder and ultimate controller of the Bank's affairs, must be the final arbiter. If the Minister and cabinet agreed with the Board's view, any further steps would have to be taken by the government. If, on the other hand, the government disagreed with the directors, the Board would presumably resign. However, an informed and intelligent group of directors is far more likely to be a source of support to a competent Governor than a centre of opposition to him. No government is likely to regard lightly the threat of wholesale resignations from a Board representing a cross-section of national opinion, especially if it arose from unjustified interference with the Bank, and

—as we were told had happened elsewhere—would probably drop any unreasonable demands or seek a sensible compromise.

#### COMPOSITION AND QUALIFICATIONS OF THE BOARD

Our predecessors on the Macmillan Commission recommended that Board members be men of "experience, skill, and integrity",<sup>18</sup> but the legislation states only that directors must be Canadian citizens from outside the federal or provincial public services who are not over 75 and "selected from diversified occupations". Appointments have in practice been regional, with one representative coming from each province except Ontario and Quebec, which have two; the Governor, senior Deputy Governor, and Deputy Minister of Finance complete the Board, which is appointed by the Minister of Finance with cabinet approval. We received many submissions stressing the importance of the quality of the Board, and some proposals for changing the present Act. However, no law can guarantee that governments will make appointments with wisdom and good sense and our first and most important recommendation is thus to urge government in the strongest terms to fill Board vacancies only with men of the very highest qualifications.

In terms of efficiency and the directors' sense of participation in Bank affairs, the Board might well be smaller, and less weighted by geography, than it now is. We believe that a satisfactory regional representation and a useful diversity of occupations could be realized if, say, five outside directors were appointed with such factors in mind and three others were appointed exclusively for their intrinsic qualifications or financial expertise. Even if it is not practical to reduce the Board's size, it should, nevertheless, have a very substantial nucleus of men with particularly relevant qualifications and experience. We do not favour adding to the Board's numbers since this might seriously reduce its usefulness and would not make it any easier to select suitable candi-

<sup>17</sup> This might not be the case in future if our recommendation, about creating a separate board for the I.D.B. is adopted. See Chapter 12.

<sup>18</sup> *Op. cit.*, para. 227.

dates. Our views on the size and regional composition of the Board are related to our later suggestion that regional advisory committees might be established, but whether or not this approach is followed, we wish to recommend that the term of Board appointments be extended to five years; the present three year period seems unnecessarily short in view of the time required to become familiar with the responsibilities. The law should also provide that appointments be on a staggered basis (with provisions for interim appointments to complete unexpired terms) in order to assure maximum continuity and to eliminate the possibility of wholesale changes when new governments took office.

We considered a proposal that the Board itself have the right to appoint one-third of its members, subject to approval by the Minister of Finance. However, this seemed to lead to unjustifiable complexities, particularly since we were told that the Federal Reserve's own appointments to regional Bank boards were not very different in calibre from the nominations of other groups. While it might not be appropriate in our different circumstances to imitate the Bank of England practice under which the Bank itself plays a significant role in choosing members of its Court—although they are formally nominated by the Chancellor—we do feel that the government and Bank could profitably emulate the United Kingdom tradition of doing an extensive "scouting" job for Board prospects. We understand that the Governor, and other independent sources as well, are now sometimes consulted in an informal way on appointments to the Board of the Bank of Canada. It would be useful if this process were extended to give more weight to the opinions of the management and directors of the Bank.

On a more technical point, we wish to recommend the removal of the prohibition on Bank directors holding shares in chartered banks set out in Section 10 (1) of the Act. Relatively minor shareholdings in any financial institution are unlikely to influence the conduct of men of integrity and independence, and the present divestiture

requirements are an unnecessary irritation. We believe the public interest would be adequately safeguarded by an amendment providing that directors should disclose their holdings in all banking or financial institutions to the Minister of Finance. Directors should also be required to advise him promptly of any changes.

However helpful these legislative changes, it is on the calibre of appointments that the quality of the Board ultimately depends. This does not mean that the only qualifications for Board appointments should be expertise in financial markets or economics. We agree with our central banking witnesses from at home and abroad that the collective wisdom and standing of the Board would be weakened if it were composed only of financial and economic experts. There is after all a great deal of expertise within the Bank itself, and the primary qualities of good Board members should be intelligence, wisdom, and good judgment. We believe these can best be found by choosing highly-qualified men from varied backgrounds and experience, although we explicitly reject the view put to us on several occasions that these men should be appointed to represent the interests of particular bodies such as provincial governments, chambers of commerce, associations of professional economists, or trade unions. Board members should serve only the public interest—they should not be instructed delegates of special interests. Although men with backgrounds in economics, government service, or the labour movement could bring valuable understanding and experience to the Board of the Bank, we do not feel that there should be any rigidity—statutory or otherwise—in the composition of the Board; the only prescription is that it be filled with the best talent available. Clearly it is desirable that some of the Board members be men with economic and financial backgrounds who can supplement the expertise and experience of the Bank management in these fields, and bring informed opinions to the vital task of judging management. Although there are now men on the Board with considerable financial experience—including a retired bank president, directors of

life insurance and trust companies, and directors of a provincial savings bank and a municipal finance corporation—it would be constructive to add one or two more members with suitable qualifications in the field of economics and finance.

We are, however, firmly of the opinion that it would be unsuitable to appoint to the Board any officer, director, or employee of security firms and banking institutions. We recommend, therefore, that Section 10 (1) of the Act, which refers only to the chartered banks in this connection, be amended accordingly. This is in fact the position in most central banks although the Bank of England has a director from one of the smaller banks on its Court, and some members of the boards of Federal Reserve Banks—which do not participate in the System's policy-making—are from the field of banking and finance. It was also admitted to us quite freely that in Canada a banker could not serve on the Board without a conflict of interest and the appearance of gaining some advantage over his competitors.<sup>19</sup> Honest men will naturally try not to be influenced by the conflicting interests which are encountered in life everywhere, but developments in other countries have convinced us that no central bank board which is closely involved in policy should even give rise to any suspicions of such conflicts—however unfounded—that might reflect on the good name and standing of the institution itself. To this end, we recommend that appointees to the Board should divorce themselves from those aspects of their firm's activities which could be immediately affected by decisions of the central bank so that their actions, or lack of them, will not encourage speculation that something is afoot in the Bank of Canada. The Board might wish to pass a by-law to formalize this practice. We also think it would be good practice for members leaving the Bank board to allow some time to elapse before assuming private directorships in institutions with which the Bank has direct dealings.

It might be found desirable to supplement the role of the Board by establishing a number of

regional committees—e.g. in the Atlantic Provinces, Quebec, Ontario, the Prairies, and the Pacific region. Such committees might help to increase the Bank's knowledge of general developments and public reactions in different parts of the economy, would encourage senior officers of the Bank to get out of Ottawa more frequently, and could assist in the creation of an informed public opinion on monetary matters. These committees might consist of six to eight men appointed by the Board and drawn from a cross-section of informed people familiar with the region concerned, including bankers and security dealers. They might meet twice a year in different centres within the region under the chairmanship of a Bank director and, after a brief introductory review by a senior officer of the Bank, have an extensive discussion of economic, financial, and monetary developments in Canada.

#### INTERNAL MANAGEMENT OF THE BANK

In view of our earlier proposals, we are not suggesting any change in the present provisions which make the Governor, or in his absence the Deputy Governor, responsible for the daily management of the Bank between Executive Committee and Board meetings. While management by a committee of officers, as in the United States, has the advantage of limiting the power of any one individual to implement ill-conceived decisions, it has the disadvantages of lessened flexibility and sensitivity and it, too, depends on effective leadership from the chief executive officer. Such a system would represent a radical departure from that which has developed in Canada and on balance we do not believe that it would be a desirable innovation. With a strong Board and Executive Committee, the danger of major and sustained errors of judgment should be much reduced. If in addition the senior staff is strengthened from time to time by the appointment of an experienced member of the financial or academic community, we believe that the Canadian central bank can be well adapted to meet the growing and increasingly complex demands upon it. In other words, we would not wish to

<sup>19</sup> Transcript, pages 8308-9.

divide or lessen the responsibility of the Governor, but we believe it of the utmost importance that he should have the best available advice. The responsibility for decisions must remain his, but like any good manager he must make sure that all aspects of these decisions are carefully considered before they are executed: indeed, the Governor stressed that he is careful and anxious to get all the help and advice that he can from his staff, and has continued his predecessor's practice of meeting with the senior personnel of the Bank each morning to review financial happenings, economic information, new government policy positions, and general international developments.<sup>20</sup>

We received a number of representations that the central bank has become ingrown and out of touch with financial markets and that more persons with substantial outside experience should be appointed to its senior staff. In particular, it was proposed that law or custom require one of the Deputy Governors to be brought in from a private financial institution for a specific tour of duty with the Bank.

Lying behind these suggestions is the contrast between the present position and the Bank's formative years. Many of the first top officers of the Bank had come to it with experience in senior positions in banks and investment firms. While central banking experience was lacking, this was borrowed from the Bank of England in the person of the first Deputy Governor. A generation later, the most lively concern is not a shortage of monetary skills, but the need for the Bank to keep in touch with and understand financial markets, banking institutions, and the people who run them. The deficiencies of the Bank in this respect are difficult to determine, but they are quite widely felt and we believe there is a real problem to be met. The Bank itself appears to be aware of it as some of its recent actions and appointments suggest.

We think some suitable senior appointments from outside can be helpful, and we hope the Bank will be alert to such possibilities. Admit-

tedly, there are real difficulties. We were told by our central banking witnesses of the universal difficulty of recruiting outside personnel at senior levels, in part because central banking has become a unique profession requiring special skills and attitudes and in part because of the inability of central banks to match the material rewards offered elsewhere. We would agree that limited tours of duty at the Bank by senior outsiders would encounter formidable obstacles, including conflicts of interest, the difficulty of becoming thoroughly conversant with basic central banking problems in a short span of time, and interruption of a career. While we would not wish to rule out this possibility, it is more feasible to contemplate making the occasional permanent appointment of an experienced outsider at a senior level. We feel that the addition of an able investment dealer, academic economist or banker to the top management of the Bank can contribute to mutual understanding between the Bank and the outside community. As to the problem of offering sufficient inducement, this emphasizes the need for an adequate scale of remuneration at the Bank, although because of its proximity to the civil service, salaries in the central bank will never be competitive with those available to able men in private occupations. The importance of the work, reasonable status, an interest in public service, and other non-financial inducements are, however, important, and in this connection we think the Bank might be better able to attract qualified outside personnel by the appointment of additional Deputy Governors. While the number of senior posts which can be filled in this way is small, we do not see any difficulty about one or two additional appointments (at present there are three Deputy Governors), particularly if they helped at the same time to bring some new experience into the Bank's counsels. A further useful step might be to appoint more than one of the Deputy Governors to the Board of the Bank, although we would not wish to see it dominated by "inside" directors.

We believe that the present method of appointment of the Governor and senior Deputy Governor is sound. Appointment by the directors

<sup>20</sup> Transcript, pages 7818-9.

ensures that an outside non-political view is brought to this important task, while the need for cabinet approval allows government in effect to veto any nomination unsatisfactory to it; presumably the Board would resign if its members believed the government were not anxious to see good men hold either office. Other appointments are made by the Board itself, but as with the top two posts, the presence of the Deputy Minister of Finance on the Board ensures that any suitable suggestions from government are considered. The Governor's present seven-year tenure of office seems adequate to safeguard his independent status; shortening the term would only mean he spent a higher proportion of it learning the job. Nor do we believe the appointment should lapse automatically when a new government takes office since this could relate the job too clearly to the political party in power; a directive procedure would also make such an arrangement unnecessary. We are satisfied with the provision that he hold office during good behaviour, apart from voluntary resignation for personal or policy reasons. This provision means that the Governor (and Deputy Governor) can be removed only by special legislation or a joint address of both houses of parliament. This is admittedly a somewhat cumbersome and embarrassing procedure but there is no reason why it should be easy for a government to get rid of its central bankers without valid cause. We take it that any Governor who found himself in clear and basic disagreement with the views of the Government would resign, whether or not a directive were actually used.

We did not consider in detail the salary and pension arrangements of the Governor and Deputy Governor, but we believe that their compensation should reflect their special and heavy responsibilities and the problem of obtaining senior persons from outside. Considerable private means or willingness to make personal sacrifices should not be a requirement for these posts, the salaries of which, as noted earlier, are below comparable positions in the private sector. We would also like to record our view that pension arrangements be sufficiently generous so that no

Governor has to be unduly concerned about his family's security in deciding to resign on a question of principle, particularly since he is not easily able to take a suitable job in private industry immediately. The present pension arrangement for the Governor appears to meet these tests. The Bank's Board has power to set the Governor's salary subject to cabinet approval and, to avoid future controversy, we recommend that pension entitlements also be put on this basis.

Another aspect of the Governor's status which we considered is his power to veto decisions of the Board, subject to informing the Minister in writing of the circumstances within seven days. Any director or member of the Executive Committee is also entitled to inform the Minister in writing of his view of the matter. This correspondence must be transmitted to the cabinet, which may then confirm or disallow the veto. The provision was originally put in the Act when directors were elected by private shareholders and is now an anachronism. If Governor and Board should ever have a falling out, the Minister of Finance will learn about it through the channels discussed earlier and can take the steps necessary in the circumstances. Since the veto power would be redundant under any directive system and since it may at times inhibit Board discussion, we recommend its abolition.

We believed our terms of reference did not require us to conduct a detailed examination of the internal organization of the Bank of Canada and we did not do so. Our impression is that its affairs are administered efficiently and effectively. Most of the 840 people on the Bank staff are in fact engaged in routine operations—handling currency and the public debt, internal audit, administration, and the processing of regular statistical series; the key central banking functions are performed by a comparatively small group. About ten people attend the daily meeting with the Governor, although they in turn may have sought opinions from as many more.<sup>21</sup>

<sup>21</sup> The personnel of the securities, research and foreign exchange departments combined number about 60—excluding library and clerical staff.

Some of the staff members not engaged in routine operations are by qualification and preference best suited to the performance of one job, but we believe that many of them, including the small minority who will ultimately form the top management, could profit from more interchange between departments of the Bank. While we recognize the extent to which a varied training can be gained within the different sections of a single department, particularly on the research side, we were struck by the extent to which the Federal Reserve Bank of New York moves its people around from one department to another and by the apparently excellent results of this program. We believe the Bank of Canada might find it useful to expand its own program of moving key personnel to other departments so that, for example, research officers get a practical working knowledge of financial and foreign exchange markets, and securities personnel improve their understanding of the basic economic and monetary forces which underlie day-to-day market movements. Thus a research man who reached a top post in the Bank might have had two tours of duty on the securities side—in a junior and in a more responsible position—as well as a period in the foreign exchange department. This program might widen the possible routes of staff advancement and increase the number of potential top managers in addition to improving the Bank's internal communications, co-ordination, and knowledge.

Within the staff, too, continuous efforts should be made to prevent the Bank from becoming inward-looking. Personnel at all except routine levels might be encouraged to acquire more trading and general financial experience and exposure to "outside" attitudes by the arrangement of temporary interchanges with banks and investment houses. Moreover, the management of the Bank ought to be prepared to see a certain amount of turnover of personnel, especially since an outward movement of staff can lead to a more informed financial and academic community. We would not wish to see these movements in and out of the staff pushed to the point where there is no permanent and satisfying career open to

central bank staff with high potential, but it must be recognized that central bankers, no matter how recruited, will quickly become inbred if efforts are not made to foster contacts with the outside world and to bring them into continuous touch with markets, financial institutions, and the community generally.

#### PUBLIC RELATIONS AND CONTACTS

We received a suggestion that the central bank should undertake more exchanges of personnel with the universities: the Bank now brings university faculty members in to work on summer projects and recently arranged for a university professor to work with it for a year. We hope it would be found worthwhile to expand these activities, which we were told have yielded fruitful results in the United States. We would not even wish to rule out the possibility that the Bank might create occasional fellowships to encourage studies of financial markets and policy of value to the Bank. This might be part of a program of more fundamental research which the Bank management may well find it worthwhile to institute, even though most of its research must continue to be of an operational kind. We were told by the Governor, for example, that the Bank may do more econometric and other work on monetary policy's impact on spending decisions, a project which our own experience suggests would prove interesting and helpful. We hope also that the Bank will not hesitate to publish more of its own research and statistical work as part of a continuing program designed to improve Canadian monetary and financial information. In some respects, the amount of information and statistics available from our central bank lags behind the United States, although in others—particularly in the money market area—information is more completely and quickly compiled than anywhere else in the world. As part of this broad education program, the Bank might also consider organizing informal meetings with economists from universities, governments, labour and business to exchange ideas, information, and opinions about monetary and financial developments.

The central bank has sometimes been criticized for being too like an "ivory tower". Indeed, it needs the broad view and atmosphere of detached reflection of an ivory tower, but it also needs to be equipped with a good usable—and well used—door, a welcome mat, and plenty of windows on the world. While the Bank of Canada has always been aware of the need for good contacts with the financial institutions and markets, there have been occasions when these relations have been given a rather low priority. At times intentions may be good but both sides are too busy to arrange a meeting; at other times an air of mutual distrust appears to divide the Bank and the private sector. On occasion, too, the private institutions have gone to these meetings ill-prepared, with the result not only that relatively little was accomplished but that resentment accumulated at the way the Bank was able to dominate the meeting. Our only suggestion is that both the Bank and the private institutions continue to increase their efforts to make franker and more frequent contacts with each other, although the usefulness of such discussions will also depend on the willingness of each side to listen to and try to understand the other, and on a readiness to prepare seriously for them. However, it must be realized that the central bank will never be in a position to be completely open about future policy, although there is no need for it to carry secrecy to excessive lengths.

In some respects the contacts of the Bank with the financial institutions and markets appear to be extensive and improving, for example in the banking field where quarterly meetings are held with the general managers, other meetings occur with the presidents, and more informal contacts are made at other levels. These discussions result in an exchange of information and views on the broader economic outlook and on banking developments and financial trends generally. With the investment community, too, there is a fair amount of what the Governor called "to-ing and fro-ing" as well as the occasional more formal meeting with the money market dealers, but it was suggested by the industry that there is a need for a

formal advisory committee. However, the difficulties of selecting members for such a committee, the conflicts of interest entailed, and the responsibility of the government and Bank for financial policy do not suggest that such a committee would be useful—indeed it might become too ritualistic and unreal. Nevertheless, the Bank might still try to meet regularly with associations representing the investment dealers and stock exchanges. The Bank has recently agreed to maintain regular contact with the association of trust companies and its principal individual members; it might also institute similar meetings with the different bodies representing the credit unions, small loan, instalment finance, and life insurance companies, all of whom expressed a desire for some such regular and informal contacts.

As in England and the United States, these contacts would be essentially for the purpose of encouraging mutual understanding and, to a lesser extent, for the exchange of information and ideas. We do not believe such meetings should lead to the giving of formal advice by either side; the Board of the Bank should be the formal outside advisor to the management, although of course the latter should consider all the worthwhile ideas put forward from any source. Nor should the Bank ordinarily use these contacts to influence the behaviour of the various institutions concerned and to substitute its judgment for that of the market. However, there may be times when the Bank because of its special knowledge can point out the consequences and dangers of certain types of activity and the desirability of others, but this should be done only rarely and in unusual circumstances. We pointed out in Chapter 22 that we do not believe the Bank should be given powers to impose selective controls on financial institutions, although it may wish to reach temporary agreements with them in unusual circumstances. As we stressed there, such agreements should have the express approval of the Minister and should as a general rule be publicized promptly.

Although these proposals are designed to make the Bank's market contacts broader and less olympian and although we are very much aware that the making of monetary policy—while a government function—should not take place in seclusion with only statistics and computers for companions,<sup>22</sup> we are anxious at the same time to avoid seeing the central bank become a captive of the market with its somewhat different, and often narrower and more short-run, viewpoint. We found it difficult, therefore, to judge the wider validity of the representations already noted in Chapter 16 that the Bank's trading procedures, while on the whole good, could be improved. The main claim seems to be that more trading personnel with greater trading authority are needed in Toronto and Montreal in order to reduce occasional delays and eliminate certain operating practices which upset the market and reduce the effectiveness of the Bank's operations. The Bank trading operation, although very busy at peak periods, does not appear seriously understaffed. Nevertheless we have the impression that market contacts could be improved if more trading discretion were at times given to the Bank's Toronto and Montreal representatives and if they were informed more closely about the objectives they were to pursue.

Market relationships might also be improved if the Bank discontinued its present time-consuming practice of only responding to bids and offers from the market. At times it may need to have a precise list of posted prices, and if so it can safely make them known; if on the other hand it is trying to encourage the market to find its own level in a self-reliant way, there is no reason why it couldn't immediately tell an enquirer whether or not it was in the market and at which level, even if, like the Federal Reserve System, it was not active in many issues or was maintaining prices outside the range at which private trading was taking place. We are sure the result would be improved confidence and understanding.

One proposal put to us was that the Bank centralize all open market operations in one of

the main financial centres, a parallel to the New York activities of the Federal Reserve System which result in excellent market contacts and imaginative execution and policy techniques. However, partly as a result of this arrangement, there is only one money market centre in the United States, whereas in Canada about 60% of the transactions take place in Toronto and most of the balance in Montreal. Clearly it would make little sense to have all Bank operations directed by two senior officials in two different centres outside Ottawa, and even less to force them into one. Moreover, conducting operations virtually independently of Ottawa would cause problems of communication to occur within the Bank rather than between the Bank and the market. The Federal Reserve System, despite the broad authority delegated to the account manager, has to devote much effort and extensive resources to maintaining communications between Washington and New York, and even then is not always successful.

While the central bank in Australia has continued to be based in Sydney with a large office in Melbourne even after the capital was moved to Canberra, we do not regard it as practical or desirable to consider the radical step of moving the Bank of Canada's head office to one of the main financial centres. Quite apart from the difficulty of choosing its new location, the problem of bringing about improved relations with the financial community is neither so serious nor so incapable of remedy in other ways as to justify such a drastic upheaval. More important, however, the central bank is an advisor and an arm of government and we believe it would seriously impair its effective working relationships with the federal authorities if it were to be removed from Ottawa.

An opposite proposal is that all market operations be centralized in Ottawa. Although there would be no technical communication problems in doing this, we feel there would be a serious loss of that market understanding which comes not just from frequent personal contacts but from living in the climate of an active market centre.

<sup>22</sup> Submission of Mr. Allan Sproul, page 19.



The Bank must be a market institution as well as a policy-making one, and we believe that moving all the trading to Ottawa would result in some loss of imagination and effectiveness in the execution of policy.

We were thus led to the conclusion, reinforced by the views we expressed earlier about exchanging staff within departments of the Bank, that the directors should consider the possibility of changing the functions and qualifications required of those who in future serve as the Bank's agents in Toronto and Montreal. These men might be in overall charge of the trading operations at these centres and be advisors on market policy, would be responsible with administrative assistance for handling the entire business of the agency, and—as in New York—could be given a small staff to work on more market-oriented research and current financial statistics. Like officials in New York, they might set aside at least half an hour every day during which two or three of the main market dealers in rotation could come in to discuss technical problems or policy matters of mutual interest. While these arrangements should not preclude members of the financial community visiting Ottawa, they might be expected to raise most points with the Toronto or Montreal agents first. As now, the Governor and other senior officers from Ottawa should continue to visit the principal financial and other centres but the agents—who might ultimately be given the rank of Deputy Governor—would relieve them of some of the increasingly numerous more routine contacts which a growing financial system makes necessary. Obviously the agents and Ottawa would have to keep in close touch to ensure that policy was being effectively co-ordinated and executed and that the views of Bank and market were being made known to each other. We believe this arrangement—while admittedly more difficult to administer than the present one—would adapt easily to changes in the structure of Canada's financial markets and would accomplish the dual objectives of improving the training of senior management and of increasing mutual understanding between the central bank and the financial

community; these in turn would help to achieve the broader objective of increasing the effectiveness of monetary policy.

We have already made a number of suggestions designed to improve the general public's understanding of monetary policy and to continue dismantling the barricades of secrecy still surrounding central banking. Mystery leads to misinformation, and monetary policy needs informed public opinion to function effectively and acceptably. As the Governor pointed out, much of this information must be backward-looking, but we believe it need not all be. The Bank's annual report provides an excellent background for public discussion, and we would hope that whenever conditions are appropriate the Governor and his senior staff will not hesitate to make public speeches dealing with Bank policy and its role within the framework of government policy. Although it should by now be well-established that any controversial public discussion by Bank officials of other aspects of government policy can only take place if acceptable to the Minister (unless a directive procedure were invoked), we firmly believe that the central bank must take the lead in providing the public with ideas as well as data if it is to stimulate intelligent and informed analysis and debate about financial policy generally.

We noted earlier the importance of top level contacts between the Bank and the Department of Finance, but would like to emphasize here the need for the Bank staff at all levels to keep in close and frequent touch with their opposite numbers in Finance and other departments. We believe there have been times when working contacts were not frequent or extensive enough, and certainly less than in the United States. There may always be a certain amount of healthy professional rivalry between departmental and Bank officials, but this should not be allowed to impair relations between them. The Bank's greater independence in recruiting staff and its greater flexibility in promoting them may also cause some resentment in Ottawa, even though Bank salaries below the very top level are com-

parable to those paid for equivalent responsibilities in the public service. In any event, as we argued in Chapter 25, the best way to deal with this problem is to give more freedom to the Finance Department to hire and promote talented personnel at salaries in line with the heavy responsibilities that they must bear.

#### OTHER LEGISLATIVE RECOMMENDATIONS

There are a number of points in the Bank of Canada Act which call for amendment besides those noted earlier in this chapter. For example, Sections 22 and 23, which provide for the redemption of Bank of Canada notes in gold and the maintenance of a gold ratio, have both been suspended for many years and should be removed from the Act. The basic integrity of our currency does not depend on gold but on the skill and wisdom with which it is managed: the world no longer depends only on gold for its international reserves—holdings of other currencies may be a more important measure of our international position, but no precise ratio of these reserves to our liabilities or to any other measure can or should be spelled out in legislation. Although we recommended that our exchange reserves continue to be held by the Minister of Finance to eliminate any unnecessary monetary complications from changes in them, the Bank should continue to operate as agent for the Minister in this field and should retain power to deal in foreign exchange on its own account. This is particularly important in view of the gradual expansion and development of the international currency operations of central banks designed to strengthen the world payments system.

While we received no representations that the list of instruments in which the Bank of Canada has power to deal is either inadequate or excessive, we see no reason why this list—already extremely broad—should not be removed entirely from the Act and replaced by a provision which entitles the Bank to deal in any securities, take or pay interest on any deposits,

and make any loans which the directors may deem necessary, provided that it engage in no such transactions for purely commercial reasons. This would ensure flexibility to meet any contingencies which could not be handled under the present provisions and would make it unnecessary to change the Act specifically to give the Bank powers to take deposits from, and make advances to, the various classes of institutions which we recommended in Chapter 19 should hold their cash reserves with the Bank.<sup>23</sup> It would also make it unnecessary to insert a special provision giving the Bank the ability to pay interest on international deposits should this prove necessary.<sup>24</sup>

The Bank clearly should continue to act as the fiscal agent for the federal government in view of its special market expertise and of the need to harmonize debt management and monetary policy. However, the same section of the Act enables the Bank to act as banker or fiscal agent to the government of any province by agreement. While never used in practice, we believe it should be removed since the Bank could not run an effective national monetary policy if it were to be continually under the obligation to put out new issues for the provinces, at least without conflicting with its fiscal responsibilities to its provincial clients. Adequate fiscal and banking advice is available elsewhere, and the embarrassment which would result from the central bank vetoing an unsound provincial financial program rises all too readily to the imagination.

We also believe that the real estate provisions of the Act should be amended to make clear the Bank's right to acquire real estate to the extent necessary to meet its present requirements and

<sup>23</sup> It hardly seems necessary to retain Section 71(3) of the Bank Act which extends a government guarantee to chartered bank deposits at the Bank of Canada if "the property and assets of the Bank of Canada are insufficient to pay its debts and liabilities and if the Bank of Canada suspends payment of its liabilities".

<sup>24</sup> At present, the Bank meets this problem by earmarking the interest on certain securities for the account of the international body concerned.

reasonable future needs. We received representations that the Bank was acting beyond its powers in planning a building in Vancouver, although the Bank's counsel is of the opinion that this was not the case. In any event, the Bank's powers in this field should be clearly stated and should in our view not leave any room for doubt about the Bank's ability to rent to others space not immediately required.

We have no special recommendations to make regarding the present audit requirements, which provide for the appointment of two outside auditors from a suitable panel. However, we suggest that schedules be appended to the Act which would oblige the Bank to show in fair detail the sources of its revenue, the classifications of its expenditures, the numbers and functions of its staff, and other relevant information; a worthwhile start has been made in recent annual reports. This report must be tabled in Parliament within a limited time after the fiscal year-end, a provision which seems suitable and satisfactory. Normally the Minister of Finance might be expected to answer parliamentary queries about monetary policy, whether or not they arise from the annual report, since he has political responsibility for Bank of Canada operations. However, direct questioning of the Bank management by parliamentary committees could be quite appropriate in special circumstances, for example when the Act is under revision or if a directive has been invoked.

## CONCLUSION

In making recommendations, our over-riding aim has been to ensure that the status and organization of the Bank of Canada enhance the effectiveness of monetary measures. We are convinced that this can best be achieved under a system in which the responsibilities of all concerned are sharp and real. Our proposals offer no excuses to government for failing to harmonize monetary policy with other measures or to the Bank management and Board for not taking all the action which the public interest requires. Yet the freedom which the central bank requires to fulfill its duties to the nation is not the freedom to evade the public will. If there is a conflict, the political authorities must have their way, preferably by a process which ensures full and informed debate of their actions. While the central bank must be very much an institution of public policy, it must be no less an institution oriented to financial markets. It must be a confidential advisor to the government yet provide the public with the fullest information about its activities. Above all it must be directed by men of integrity and ability—the best designed arrangements in the world will be useless if its management is weak or arrogant or if its political masters are fearful and short-sighted. More and more may come to be known about the techniques and effects of financial policies, but the success of such policies will still depend essentially on the will and wisdom of those who design and execute them.

## FINAL ASSESSMENT AND SUMMARY

Canada's financial institutions and markets have evolved at a quickening pace in the last generation and have on the whole adapted well to the changing needs of borrowers and lenders. They have become more competitive and more alert to opportunities for useful and profitable new business, and there has been a desirable increase in the overlapping of activity among institutions. In the process, however, some gaps have appeared in the framework of regulation designed to protect the public. In addition, certain provisions of laws drawn up for an earlier and different age no longer serve their original purpose: some of them in fact now serve only to raise the costs and inhibit the provision of necessary financial services. Thus we have in general found a good financial system, but some important modifications in its laws and practices are necessary to ensure that it may adapt itself to the evolving economy along safe and constructive paths.

In examining the needs of final lenders and borrowers which the financial system is designed to serve, we noted that the personal sector appears on the whole to manage its finances soundly. As Chapter 2 indicates, the rate of personal saving is high by most standards and the pattern of personal borrowing and investment is generally rational. Debt has risen eleven-fold from its unusually low levels at the end of the war but is still of manageable proportions. Much of it has been incurred for investment in housing and related durables which yield high returns, and much of it replaces previous unrecorded but

nevertheless real commitments for rent, laundry and other services. We pointed out that much personal saving is now taking place through pension funds; that government plans have important implications both for the rate of saving and the form it takes; and that their repercussions on the capital market generally, and equity investment in particular, should be most carefully considered. Business investment, which reached abnormally high levels in 1957, has since receded in relative importance; as Chapter 3 shows, this investment is now being largely financed from funds generated internally, with debt ratios remaining quite moderate and beginning to decline after having increased through much of the post-war period. Government financial requirements have risen sharply in recent years, but debt ratios remain favourable by most standards.

Foreign resources have at times in the post-war period supplied a relatively large share of our requirements. However, the fall in the rate of domestic capital formation from its abnormally high levels in the middle and late 1950's and more appropriate financial policies have reduced our drawings on funds generated outside the economy to much more moderate proportions. The relative burden of foreign interest and dividend payments is not large—indeed it is lower than in earlier comparable periods in our history—but the big inflows of direct investment capital which have characterized the post-war wave of foreign investment have led to an increased non-resident control of certain sectors of the economy. While the non-financial issues

this raises are not ours to analyse, we have pointed out that the ability of Canadians to devote increased amounts to equity investment depends primarily upon increasing their incomes and their ability to save: tax incentives, better disclosure standards and increased institutional equity purchases can also be important in altering the form of savings, but these by themselves will not lead to any significant net increase in the generation of savings by Canadians. If, however, adequate measures are taken to keep the economy competitive, we see no reason why we should expect to be net users of foreign savings when there is slack in the Canadian economy; indeed, the usual delayed adjustment to a more balanced position is already well under way. Nevertheless, foreign capital will continue to make an important contribution to our economic growth, particularly in times of strain on Canadian resources.

While the basic determinants of Canada's economic performance will continue to be the vigour, imagination and self-discipline of the people themselves—as well as the performance of the world economy of which we are a part—wise financial policies can lead to worthwhile improvements in the economy's performance. There are limits to what even the most appropriate policies can accomplish and perfection is not therefore to be expected. Yet the undoubted difficulties of devising and executing good policies are not so serious that we must accept as inevitable the proposition that policy measures will on balance be harmful rather than helpful or be satisfied with mediocre performance. On the contrary, we believe that policy can and should make a positive contribution to the attainment of such goals as low unemployment, price stability, rising efficiency and a sound international position.

We have emphasized that there is no easy or automatic prescription for achieving these or the other goals sought by the community. This is a matter calling for judgment, skill and courage on the part of the authorities. The particular combination of objectives which the public is willing to support is not unchanging and neither are the problems to be faced; the best means of dealing with one situation may therefore be quite

inappropriate for another even though they appear similar on the surface. We are convinced nevertheless that it will be a rare occasion when a coherent solution and a proper policy set can be achieved by using one of the policy instruments in isolation: effective performance will almost always require a co-ordinated approach and a combination of monetary, fiscal and non-financial measures.

To restate in detail all our recommendations in the full context in which they were made would be to repeat unnecessarily the argument of earlier chapters. On the other hand, to attempt to summarize them apart from this context and without the qualifications attaching to them would be at best of little value and at worst misleading. In the pages which follow, therefore, we have merely sketched in the main lines of our reasoning and the broad groups of recommendations to which it gave rise.

#### PUBLIC PROTECTION

We have argued that the public dealing with the financial institutions and markets can never be guaranteed against loss, but that the best safeguard against this possibility is legislation which provides for adequate disclosure and sets high standards of self-regulation backed up by strong government supervision and powers to enforce proper practices.

The wider coverage of the Bank Act which we have recommended should be an important factor in increasing the protection of the public against avoidable losses. We have suggested that the main features of the present Act be carried forward, and in line with our view that specified asset ratios add little to the soundness of institutions we have not recommended that such ratios be incorporated in the legislation. We pointed out that it is difficult to prescribe specified liquid asset, capital or other ratios that are appropriate for all institutions without at the same time impairing the working of the financial system. We have therefore recommended that the Inspector General of Banks should work out appropriate guide-lines with the institutions concerned and

should be given greater powers to enforce sound practices.

Similarly, in Chapter 9 we recommended strengthening the supervision of local credit unions by the provincial authorities and proposed that the locals be required to belong both to central unions subject to the federal banking regulation and to co-operative mutual aid funds which could assist them in times of difficulty. In Chapter 13 we recommended that pension funds—a growing source of savings—be subject to certain broad rules governing their solvency, eliminating the possibility of conflict of interest, and requiring some diversification of investment.

In Chapters 16 and 17, we recommended that the securities markets and dealers be more closely integrated into the framework of government regulation. Despite the significant improvements which have taken place in the industry's standards of self-regulation—which govern both professional ethics and financial requirements—we believe that government securities regulation should be further strengthened and a federal regulatory agency established to give leadership in this field and to work in co-operation with the provincial authorities. We also believe that corporate disclosure standards in Canada are inadequate and that more stringent requirements should be enacted into law as part of a program designed to encourage the development of a better-informed Canadian investor community willing to purchase Canadian equities. It is our view that the public interest would be better served, and the investor better protected, if securities dealers were to disclose more information about their own financial position. A number of other specific recommendations are designed to serve the same ends, including the recommendation that stock exchanges prohibit use of their facilities for primary distribution of speculative securities, that they adopt more stringent listing and delisting standards, that they increase their permanent staff and give it more power and that they recruit a number of outside governors to represent the public interest.

## PROMOTING FREE FLOWS OF FUNDS

We have emphasized throughout our report the advantages of allowing the financial institutions to compete as freely as possible for business, subject to the regulation necessary for the protection of their customers. Many of the present investment restrictions contribute nothing to public protection, impose inequitable constraints on the institutions and thus serve only to reduce the efficiency with which a more competitive system could serve the country. These blockages in the financial system frequently cause the public to pay higher prices for credit, and sometimes prevent it from getting credit at all. Thus the present 66⅓% loan to value ratio on first mortgages has reduced the amount of first mortgage lending and forced many borrowers to use the higher-cost second mortgage market. Newer and more reputable unregulated lenders have now entered the field—which the caisses populaires have for many years served soundly and economically in Quebec—and the regulated institutions are working under increasing competitive disadvantages. We have seen some merit in retaining a guide-line to sound lending practice in the first mortgage field but have recommended that the maximum loan to value ratio be raised to 75%. Together with our recommendation that the present chartered banks be allowed to enter the conventional mortgage field—in which they can safely invest a portion of their funds—this should significantly improve the facilities for financing existing properties in Canada and make unnecessary any extension of government guarantee facilities. Our recommendation that the N.H.A. rate on new housing be set free should also improve the flow of private mortgage funds into new housing and make this market less subject to sharp variations arising from the rigidity of the rate and from changes in government direct lending. The desirable transition to increased private N.H.A. lending and reduced direct lending by CMHC might be assisted if the government were to compete less with the institutional collectors of savings through its Canada Savings Bond program.

We have also recommended that the valuation and equity rules governing life insurance company investment be relaxed to encourage the institutions to invest in common shares: a 25% maximum for equities should give them enough scope for the present but the matter can be reviewed again in a few years if higher ratios seem appropriate. Finally, we have recommended the removal of the present 6% maximum lending rate applying to the chartered banks: like the mortgage prohibitions, this impedes the flow of credit to some borrowers and—by driving them to higher-cost lenders—frequently harms the very people it is designed to help. Moreover, the chartered banks are unable at times to pay as high returns on their liabilities as they otherwise might. Some savers are accordingly penalized, although others are able to obtain higher returns on their funds from the unrestricted institutions which are direct competitors of the banks.

Government institutions and guarantees can play a part in encouraging private lenders to be more venturesome and in developing new techniques and facilities—the auctioning of mortgages by CMHC is a recent example—but care must be taken to ensure that government programs do not inhibit private lending by making credit available at rates below the market. We have accordingly recommended in Chapter 12 that some government guarantee programs be discontinued, that those which are retained be made more flexible and that government lending agencies should keep their rates in line with market rates. For example, rates on Farm Credit Corporation loans are now below those the government itself pays for comparable funds, having been left unchanged at 5% since the days when government rates were under 3%. Nevertheless, the Corporation has a useful role to play and we have accordingly recommended that the maximum size of its loans be increased at the same time as its lending rates are brought more into line with levels prevailing elsewhere in the market. Similarly, we have recommended that the Industrial Development Bank give less emphasis to competing with private lenders and put more

stress on encouraging the provision of new private facilities and on supplying financial advice and guidance to small business borrowers. We have, however, seen no need to establish new regional or other government lending agencies and programs since we have not found evidence of significant “gaps” in the financial system.

Greater competition will be a valuable spur to improve service and pioneer new developments. If unregulated, however, it can also lead to unsound investment practices and to the possibility of exploitation of the public. The first danger can be guarded against by the regulatory authorities in the ordinary course of their work, but the second requires additional legislative provisions. Accordingly, we have recommended in Chapter 19 that all personal cash lending, not just that covered by the Small Loans Act, be subject to a maximum charge on all amounts up to \$5,000 rather than the present \$1,500. This extension should help to curb the exploitation of ill-informed borrowers by certain fringe institutions and lenders. We also recommend that the formula retain the present 2% per month maximum on the first \$300 borrowed—on which administrative expenses are high—and that a flat rate of 1% per month apply to all higher amounts (the present  $\frac{1}{2}$  of 1% applying to amounts between \$1,000 and \$1,500 merely checks lending in this range).

We would not wish to suggest that legislative changes alone will make for a competitive and adaptable financial system. This will depend also on the attitudes and initiative of the institutions and market participants themselves. They alone can ensure that they do not become excessively bound by tradition or by the conventional rules of thumb necessary for the day-to-day conduct of their business. A competitive framework will, however, make it more difficult for them to escape the consequences of such actions and should ensure that less energy is devoted to excessive branch openings and to competition in terms of size and that more emphasis is given to competing in terms of prices and other financial services.

## A COMPETITIVE BANKING SYSTEM

Against the background of this desire to promote the further development of a freely competitive system under sound and equitable regulation, we have devoted considerable attention to the banking institutions and have emphasized the very close similarities between those institutions which we happen in this country to call banks and those called by other names. In principle they carry out many of the same functions and in practice there is no longer any basis for governing them by different sets of regulations. Banks cannot "create" credit in some mysteriously different way from the others, as we pointed out in Chapter 6, and all institutions play an essentially similar role in the flow of credit from lenders to borrowers. What differentiates the banking institutions is the nature of the liabilities they offer—short-term and demand claims which serve as a means of payment or as close substitutes for it. We have concluded that the present assortment of laws governing such institutions is no longer suited to the needs of the country: it subjects them to illogical and inequitable restrictions which do not serve them, the financial system or the community well while failing in some cases to provide adequate supervision of their activities.

We have accordingly recommended in Chapters 18 and 19 that the Bank Act be extended to cover a wider group of institutions which are now engaged in the business of banking, that those not coming under the legislation be prohibited from undertaking this business and that a broader range of lending powers be granted to all banking institutions. Thus in addition to leading to removal of the 6% ceiling and mortgage prohibition applying to the present chartered banks, our recommendations would permit the savings banks and the trust, loan and other companies coming under the banking legislation to compete for commercial and personal lending business. We have, however, recommended that all banking institutions be required to maintain uniform cash reserve ratios against their short-term

liabilities, the ratio being lower against genuine notice claims than against demand obligations. While this may have some desirable effect in encouraging the institutions to manage their other assets so as to maintain adequate liquidity, our main purpose has been to ensure that all institutions doing similar business are equitably treated within the system of monetary control.

There is a danger that competition can be weakened by collusion or excessive concentration of power. This is particularly the case with the banking institutions and we have therefore recommended in Chapter 18 that there be a prohibition on agreements between them with respect to lending and borrowing rates, and that this prohibition be supported by appropriate powers and penalties. We have also recommended that no banking institution may own more than a 10% interest in the equity or voting shares of any non-financial firm and noted our disapproval of the practice of bank officers or employees serving as directors of commercial concerns. To prevent undue concentration in the banking and financial system we have recommended that no banking institution be allowed to acquire more than a 10% interest in the equity or voting shares of any non-bank financial institution. We have also made recommendations whose effect will be to maintain the present prohibition on one chartered bank investing in the stock of another and to prevent all other equity investments among banking institutions unless permission is first obtained from the Treasury Board (subject to an exception when two small institutions are involved). In addition we have recommended that the Board be empowered to review any such acquisition in subsequent years and that it have power to order such remedy as is necessary to preserve competition in the public interest. We have also suggested that there be statutory limits on interlocking directorates between banking institutions. Finally, we recommend that the anomaly in the present law, which prohibits share ownership of one Canadian bank by another but is silent on foreign bank ownership, be removed (although express provision



should be made for the establishment of foreign bank agencies under the Bank Act). Such provisions, while not ruling out bank mergers or acquisitions which may enhance competition or protect the public interest, will subject all sizable transactions to prior scrutiny by the authorities and enable them to ensure that an excessive concentration of power does not develop.

We have, in summary, favoured a more open and competitive banking system—carefully and equitably regulated under uniform legislation but not bound by restrictions which impede the response of the institutions to new situations, enforce a particular pattern of narrow specialization or shelter some enterprises from competitive pressures. We believe that this framework will encourage creativity and efficiency and offer the public the widest possible range of choice of financial services, while reducing the danger of unregulated institutions springing up to serve real needs which others are prevented from meeting. Some institutions may attempt to offer a full range of services and others may choose to specialize in a variety of ways, but the legislation will allow all of them—and such new institutions as are qualified—to adapt to new opportunities and situations created by changing public preferences and needs.

#### ECONOMIC AND FINANCIAL POLICY

We concluded from our examination of economic policy that monetary measures used within their postwar range of variation are unlikely to have sufficiently powerful effects to combat strong cyclical fluctuations by themselves. In very short cycles, moreover, the inevitable lags in the effects of monetary measures reduce their usefulness still further, although the delayed effects of a policy of restraint are unlikely to be sufficiently serious in the ensuing recession to inhibit their use if reasonably prompt shifts in policy are made. In conditions of prolonged boom, there is of course some point at which high interest rates would by themselves effectively restrict economic activity, but we indicated that there are practical limits to how far rates can be raised.

In conditions of serious weakness, on the other hand, it is not possible by conventional monetary measures to provide a major stimulus to the economy, especially if profit prospects are unfavourable and excess capacity is widespread. Over a long period, however, persistent monetary ease may be more helpful, although we have no real evidence on the point.

In Chapter 22, we noted that debt management can sometimes play a useful supporting role in altering credit conditions and should in any event be co-ordinated with monetary policy. However, the evidence does not suggest that it is a powerful and separate instrument for influencing credit conditions. We also pointed out that it is not technical limitations which prevent the authorities from varying credit conditions more. Operating techniques are of secondary importance compared to the set of policy itself, and while it is important to ensure that they do not disrupt markets and public confidence needlessly, the authorities have no reason to bind themselves to a particular group of operating rules in the securities or other markets.

Our findings also suggest that there may be emergency conditions when international limitations or urgent domestic circumstances justify the use of direct credit measures designed to limit the availability of funds to borrowers with a dampened effect on interest rates or to obtain more pronounced effects than can be expected from general credit policy. However, the frequent use of direct measures will disrupt and weaken financial markets and may induce the authorities to be less careful in the use of more general measures in the knowledge that they can subsequently impose controls. Moreover, the capital markets will develop ways—admittedly inefficient but nevertheless effective—of circumventing the direct measures. Such measures should therefore be sparingly used and removed as soon as possible after the emergency has ended.

The limitations of monetary measures lead us to conclude that they must normally be supplemented by fiscal measures designed to operate more directly on the flow of incomes and expenditures. Discretionary fiscal policy can, we

believe, be used over a wider range than has been the case in the post-war period—provided that measures are carefully planned and that irreversible expenditure commitments are not made. The need for massive tax or expenditure changes should be rare, but there may be infrequent occasions when substantial changes in taxes on investment goods or in capital cost allowances can play a useful role in affecting the timing of investment. We have pointed out that to be fully effective, fiscal measures of a major kind necessarily involve close co-ordination and co-operative consultation with the provincial governments since these governments now account for an important and rising share of government expenditures on goods and services.

We have emphasized also that non-financial policies can make an important contribution to our major national objectives, particularly that of increasing efficiency. Both fiscal and non-financial measures take on increased importance as instruments for achieving our domestic objectives under a fixed exchange rate system, since under this system monetary measures must be geared more closely to external considerations. We have laid stress throughout the report on the increasingly close links between the capital markets of Canada and other countries, and emphasized that international financial flows are highly sensitive to changes in interest rate differentials, which can be readily influenced by the monetary authorities. While Canada is bound to be influenced by external developments under any exchange rate system, our links with the rest of the world have more immediate consequences for monetary policy under a fixed exchange rate.

We have ruled out attempts to isolate ourselves from the international economic community by direct measures because of the high price such efforts would involve in terms of reduced efficiency and growth. Indeed, it is only by keeping the economy adaptable and competitive that we can build a viable international position which minimizes the possibility of conflicts between external considerations and domestic objectives. As a country linked more closely than most to

the world economic community, Canada has a particular interest in ensuring that international financial and payments arrangements are adequate to encourage world growth without inflation. We have therefore urged in Chapter 23 that the country should play a constructive role in the discussions now under way to make modifications in this system by providing access to additional currency reserves for countries which need time to carry out the fundamental adjustments required to improve their competitive positions.

Throughout the latter part of the report, we have emphasized the many inter-relations between monetary, fiscal, exchange rate and other policies and drawn attention to the important impact which a concerted program of such policies can have on the economy. The effects of individual strands of policy may not be as large as some have thought, but in total their effect is impressive: indeed, this total is undoubtedly more than the sum of its component parts. Hence our stress on the importance of the proper co-ordination of policy, our recommendations for strengthening the policy-making staff of the federal government, and our urging that more careful consideration be given to the immediate and long-run costs and benefits of following one policy rather than another. However, since many of the policy failures in the post-war period have come about from a reluctance to take the necessary action, partly out of fear of lack of public support, we have also put considerable emphasis on the importance of far-sighted political leadership and the development of a more informed public opinion.

The principal task facing the authorities is to get the broad set and timing of policies right—to influence aggregate demand in the right direction. These policies may need to be supplemented by more specific measures to influence the allocation of resources within the total, but such measures will be largely ineffective as instruments of attaining our major objectives if the whole policy climate is wrong. The particular mix of policies needed will vary with the circumstances—sometimes one instrument may even have to be

used in a different direction from the others as part of a conscious program to achieve particular aims. There will not normally be a wide choice of policy combinations open to the authorities to achieve our other major goals at full employment levels. In any event, there is no presumption that any one combination of policies is in all circumstances particularly favourable to productivity gains and price stability. Apparently similar circumstances may in fact call for differing policy approaches and the authorities cannot be guided by doctrinaire preferences for emphasizing one policy instrument rather than another.

In the previous chapter, we emphasized that the Bank of Canada must be regarded as a policy arm of the government. There are, however, special reasons why in its role as manager of the currency and as a market and financial advisor to the Minister of Finance it should have some independence of status within government. At the same time, a mechanism must exist for the government to be able to exercise its responsibility for monetary policy in the event of a conflict. We have accordingly recommended the establishment of a directive procedure—which we hope will never need to be used—to accomplish this aim, while at the same time ensuring a maximum of public debate and discussion of the issues raised. As with all relationships, however, that between the Governor of the Bank and the Minister of Finance depends ultimately on the responsibility and good sense of those involved. Having stressed the important role which the directors and senior staff of the Bank can also play in that institution's affairs, we have made a number of specific suggestions designed to ensure that the quality and background of these key people are of the high standard required. Because of the importance for effective monetary policy of close links and understanding between the

Bank on the one hand and the financial community and broader public on the other hand, we have also made a number of recommendations designed to improve the contacts between the Bank and the markets and public.

In summary, the changes we have recommended in the area of policy and policy-making are related to the approaches which should be taken by those concerned rather than with the establishment of new rules or laws. Taken together with the more adaptable and competitive framework of regulation which we have proposed for the financial institutions and markets, and with the modifications to lending practices which we have suggested, we believe a wise approach to financial policy should significantly improve the economy's ability to perform well and adjust to the changing needs of its citizens. We must emphasize again, however, that there is no arrangement of the financial system which can guarantee the attainment of national economic objectives: financial institutions, markets and policies can only influence the climate and create the facilities necessary to reach these goals. If they are constructive and innovating in their approach, they will help to achieve them, while if they are not, attempts to do so will be frustrated. The approach which we have taken is designed to favour such creative evolution of the financial system. We are convinced that the changes which have been occurring since the time of our predecessors on the Macmillan Commission will continue at an accelerated pace and that it would be impossible—even dangerous—to attempt to prescribe for every possible future contingency. While we cannot foresee the precise pattern of financial developments in the next generation, we are confident that our successors will find a financial system which played its full part in responding to the continuing challenge of building a great nation.

ALL OF WHICH WE RESPECTFULLY SUBMIT FOR YOUR EXCELLENCY'S  
CONSIDERATION.

Danatt Harris Postle

Chairman

W. Thomas Brown

James Dingley Gibson

Gordon L. Harold

Carl H. Leman

John C. MacIsaac

W. C. Mackintosh

Harold Anthony Hopson

Secretary

W. H. McCreary

Joint Secretary

February 5, 1964.

## APPENDIX 1

### THE ORDER IN COUNCIL

P.C. 1961-1484

*Certified to be a true copy of a Minute of a Meeting of the Committee of the Privy Council, approved by His Excellency the Governor General on the 18th October, 1961*

The Committee of the Privy Council have had before them a report from the Minister of Finance, representing:

That it is desirable periodically to undertake a broad review of the functioning of the Canadian financial system;

That the last review of this nature took place in 1933;

That, in the meantime, the Canadian economy, its financial resources and its financial requirements have grown and changed greatly;

That orderly economic growth is dependent in no small measure on the adequacy and adaptation of the financial institutions through which funds are made available for expansion and development; and

That the charters of the banks under the Bank Act and the Quebec Savings Banks Act expire in 1964 and that these Acts should be carefully reviewed before that time.

The Committee therefore advise that:

The Honourable Dana Harris Porter,  
Chief Justice of Ontario,  
Toronto, Ontario

Mr. W. Thomas Brown, M.B.E.,  
Investment dealer,  
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.,  
Banker,  
Toronto, Ontario

Mr. Gordon L. Harrold,  
Agriculturist,  
Calgary, Alberta

Mr. Paul H. Leman,  
Corporation executive,  
Montreal, Quebec

Mr. John C. MacKeen,  
Corporation executive,  
Halifax, Nova Scotia,

Dr. W. A. Mackintosh,  
Vice-Chancellor, Queen's University,  
Kingston, Ontario

be appointed Commissioners under Part I of the Inquiries Act

(a) to enquire into and report upon the structure and methods of operation of the Canadian financial system, including the banking and monetary system and the institutions and processes involved in the flow of funds through the capital market; and

(b) to make recommendations

(i) for the improvement of the structure and operations of the financial system and, more particularly,

(ii) concerning the Bank Act, the Bank of Canada Act, the Quebec Savings Banks Act, and other relevant federal legislation.

The Committee further advise:

1. That the Commissioners be authorized to exercise all the powers conferred upon them by section 11 of the Inquiries Act and be assisted to the fullest extent by government departments and agencies;

2. That the Commissioners adopt such procedures and methods as they may from time to time deem expedient for the proper conduct of the inquiry and sit at such times and at such places in Canada as they may decide from time to time;

3. That the Commissioners be authorized to engage the services of such counsel, staff and technical advisers as they may require at rates

of remuneration and reimbursement to be approved by the Treasury Board;

4. That the Commissioners report to the Governor in Council with all reasonable despatch, and file with the Dominion Archivist the papers and records of the Commission as soon as reasonably may be after the conclusion of the inquiry;

5. That the Honourable Mr. Chief Justice Porter be Chairman of the Commission; and

6. That Mr. Harold Anthony Hampson of the City of Toronto be Secretary of the Commission.

R. B. BRYCE,  
*Clerk of the Privy Council.*

## APPENDIX 2

### SCHEDULE OF COMMISSION HEARINGS

The Commission held 69 days of public hearings at the eleven centres listed below at which 95 briefs were presented and discussed:

Victoria, B.C. ....	March 12, 1962
Vancouver, B.C. ....	March 13-16
Edmonton, Alta. ....	March 19 & 20
Regina, Sask. ....	March 22 & 23
Winnipeg, Man. ....	April 9 & 10
Toronto, Ont. ....	April 12-17

Montreal, Que. ....	May 14-17
Fredericton, N.B. ....	June 4 & 5
Charlottetown, P.E.I. ....	June 7
Halifax, N.S. ....	June 11-12
Ottawa, Ont. ....	July 9-20
Ottawa, Ont. ....	Sept. 10-28
Ottawa, Ont. ....	Oct. 16-Nov. 1
Ottawa, Ont. ....	Jan. 7-22, 1963

## APPENDIX 3

### ACKNOWLEDGEMENTS

We have had many occasions in the 2½ years since our appointment to appreciate the generous help which we have received from all quarters. No body such as ours could begin to discharge its task without relying heavily on the willing co-operation of many organizations and individuals. We received this support in full measure—not only from all parts of the financial community, but also from governments, non-financial businesses and others who contributed facts, opinions and suggestions which helped us to reach a better understanding of the workings of the Canadian financial system.

Valuable information and ideas were contained in the many briefs submitted to us by organizations and individuals across Canada and discussed extensively at our public hearings. The complete list of submissions will be found below. We wish to extend special thanks to the distinguished group of foreign central bankers and economists who helped to make our education in financial matters such a stimulating and enjoyable experience. The late Sir Dennis Robertson's wit and clarity on central banking policy have been beyond our powers to emulate, but we hope the discussions he had with us have left some mark in our report. Lord Cobbold, Dr. Holtrop, Mr. Thomas and Mr. Sproul each gave us forceful and perceptive insights into the duties and problems of central bankers and provided us with many interesting ideas on the theory and practice of their profession. Mr. Lundberg's full discussion of the implications of some of Sweden's credit and other economic policies and the wide-ranging exchanges we had with Professors Viner and Samuelson and with Mr. Bernstein all contributed to improving our understanding of both the inter-

national and domestic consequences of financial measures.

We have necessarily relied extensively on both the private financial institutions and government bodies, and we are indebted to them for the prompt and co-operative way in which they met the many requests from us and our staff for statistical and other information about their operations. Among those deserving special mention are the representatives and officers of the credit unions and caisses populaires across the country, of the Canadian Bankers' Association and its individual members, and of the two Quebec Savings Banks. No less valuable were the contributions of the Trust Companies Association of Canada and their members—in particular the Royal, Montreal, and National Trust Companies which undertook an extensive survey of their estate, trust and agency accounts for us. The principal stock exchanges, the Investment Dealers' Association of Canada and many provincial securities commissions assisted us immeasurably, while The Federated Council of Sales Finance Companies provided us with much additional information on their industry. Our thanks are also due to the Canadian Life Insurance Officers Association—and in particular to 12 of its members who compiled new statistical information—as well as to the Dominion Mortgage & Investments Association, the Canadian Consumer Loan Association and the recently-formed Canadian Mutual Funds Association.

Public bodies, too, made valuable contributions to our work. The Industrial Development Bank, Export Credits Insurance Corporation and Central Mortgage and Housing Corporation each assisted us with facts and opinions about the

special financial markets in which they work, while the Dominion Bureau of Statistics lent its usual valuable assistance to many phases of our enquiry. Officers of the Department of Finance were always willing to answer our queries and the Inspector General of Banks was especially helpful to us because of his thorough knowledge of the Canadian banking system. The Bank of Canada eased our task throughout—in its excellent submission, in the administrative and research assistance it gave to us and our staff, and in the personnel it made available for our work.

Organizations representing labour, agriculture and business all prepared able and thoughtful submissions for us. In addition, members of our staff conducted mail and direct-interview surveys with over 1,500 firms and provincial and municipal governments, all of whom co-operated fully in our enquiry and many of whom went to additional time and trouble to assist us and to let us have their considered comments on the operation of the financial system. Finally, some 1,200 households obligingly submitted themselves to a lengthy questionnaire about their financial affairs: to them and to McDonald Research Limited, who conducted the survey for us, we express our sincere thanks.

We were fortunate not only in the outside assistance we received, but in the high quality of our research staff. We extend our thanks to them for their excellent work and express our indebtedness for the contribution which they made to the development of our thinking. A list of the staff is given elsewhere: in addition, valuable papers were prepared for us by A. W. Johnson of the Government of Saskatchewan, E. K. Cork of Noranda Mines Limited, G. D. Sutton of Nesbitt, Thomson and Company Limited, D. H. C. Stanley of Wood, Gundy & Company Limited, J. D. McNeil of the Sun Life Assurance Company of Canada and by M. A. Crowe of the Canadian Imperial Bank of Commerce. To them and to their employers we express our gratitude. We would also like to record our appreciation to Messrs. J. M. Andrews and W. A. McKay of the Bank of Canada who

assisted in parts of our research and to Dr. D. W. Carr and his associates for their study of agricultural finance in Canada.

Professor William C. Hood, in addition to his role as Director of Research, served as our Economic Advisor and in both capacities helped us to an understanding of the complexities of the financial system and the framework of economic policy. We were fortunate to have the guidance of such an outstanding scholar. He was ably supported by our three Assistant Research Directors: Dr. D. J. Daly was responsible for studies of the financial needs of the main sectors of the economy and provided us with fresh and interesting ideas on the long-run implications of financial policy; Mr. R. Johnstone directed the studies of the financial institutions and markets, contributed much to our perspective on the behaviour of the financial system and assisted in the drafting of large parts of the report; Dr. J. H. Young was responsible for the studies of financial policies and played the major role in our survey of corporate and government response to changing credit conditions—in these studies and in the drafting of part of the report he helped us to develop our views on the strengths and weaknesses of the different policy instruments.

The Commission's affairs were managed throughout with unobtrusive efficiency, thanks in no small part to the work of our Administrative Secretary, Mr. Leo Lafrance, who cheerfully relieved us of all worry about the myriad administrative problems inherent in any government body. Mr. Gilles Mercure, the Joint Secretary, carried out major research assignments with outstanding success, contributed much sound judgment to the report itself, and handled important administrative duties with skill and good humour. He also assumed overall responsibility for translation of the report and bore much of the burden himself. Our greatest debt has been to Mr. H. A. Hampson, the Secretary of the Commission. His intellect, organizing ability and energy proved invaluable in the planning of our work, the development of our views and the drafting of our entire report.



## APPENDIX 4

### BRIEFS SUBMITTED TO THE COMMISSION

- \*Mr. F. A. Angers, Montreal, P.Q.  
Atlantic Provinces Economic Council  
Bank of Canada  
Professor C. L. Barber, Winnipeg, Man.  
Mr. E. M. Bernstein, Washington, D.C.
- \*Professor H. H. F. Binhammer, Kingston, Ontario  
British Columbia Bond Dealers' Association  
B.C. Central Credit Union  
B.C. Credit Union League  
British-Israel-World Federation (Canada) Incorporated, Toronto, Ontario  
The Broker-Dealers' Association of Ontario  
The Building Owners and Managers Association, Vancouver, B.C.  
Business Dynamics, Toronto, Ontario  
Mr. A. H. Cameron, Toronto, Ontario  
Mr. John R. Campbell, Q.C., Toronto, Ontario
- \*The Canadian Anti-Communist League, Manitoba Branch  
Canadian Bankers' Association  
The Canadian Chamber of Commerce  
The Canadian Construction Association  
Canadian Consumer Loan Association  
Canadian Co-operative Credit Society Limited
- \*Canadian Exporters' Association  
Canadian Federation of Agriculture  
Canadian Federation of Mayors and Municipalities  
Canadian Importers and Traders Association, Inc.  
The Canadian Labour Congress  
The Canadian Life Insurance Officers Association
- The Canadian Manufacturers' Association  
Canadian Metal Mining Association  
Canadian Retail Federation  
Canadian Small & Independent Business Federation
- \*Canadian Wholesale Council  
The Canborough Corporation, Toronto, Ontario  
Central Mortgage and Housing Corporation  
The Charterhouse Group Canada Limited  
Lord Cobbold, Knebworth, Herts, England  
Communist Party of Canada  
Consumers' Association of Canada  
Messrs. G. R. Conway and M. W. Goodman, Toronto, Ontario  
The Corporation of the District of Burnaby  
Credit Union League of Alberta  
Credit Union League of Manitoba Limited and Co-operative Credit Society of Manitoba Limited  
The Credit Union League of Saskatchewan  
Credit Union National Association Inc.  
The Department of Finance, Ottawa  
The Dominion Mortgage & Investments Association
- \*Mr. S. J. Drache, Q.C., Winnipeg, Man.  
Dr. A. K. Eaton, Ottawa, Ontario  
Export Credits Insurance Corporation  
Farmers' Union of Alberta  
The Federated Council of Sales Finance Companies  
La Fédération de Montréal des Caisses Desjardins

- La Fédération de Québec des Unions Régionales des Caisses Populaires Desjardins  
Gairdner & Company, Limited, Toronto, Ontario  
General Trust of Canada, Montreal, P.Q.  
The Government of Manitoba  
The Government of New Brunswick  
The Government of Nova Scotia  
The Government of Ontario  
The Government of Prince Edward Island  
\*The Government of Quebec  
The Government of Saskatchewan  
Mr. G. A. Hart, Montreal, P.Q.  
\*Mr. W. T. House, Gravenhurst, Ontario  
Dr. Marius W. Holtrop, Amsterdam, The Netherlands  
Mr. J. R. Horne-Payne, Vancouver, B.C.  
Industrial Acceptance Corporation Limited, Montreal, P.Q.  
Industrial Development Bank  
\*Industrial-Talcott Limited, Montreal, P.Q.  
Inspector General of Banks  
The Investment Dealers' Association of Canada  
Mr. M. M. Koerner, Toronto, Ontario  
\*W. C. Krug, Windsor, Ontario  
Laurentide Financial Corporation Ltd., Vancouver, B.C.  
Mr. Erik Lundberg, Stockholm, Sweden  
Mr. D. B. Mansur, Toronto, Ontario  
Mr. N. J. McKinnon, Toronto, Ontario  
Mr. W. E. McLaughlin, Montreal, P.Q.  
Montreal Stock Exchange and the Canadian Stock Exchange  
Mrs. Helen G. Moore, Vancouver, B.C.  
\*Mr. John Narsted, Montreal, P.Q.  
The National House Builders Association  
Professor E. P. Neufeld, Toronto, Ontario  
National Association of Canadian Credit Unions  
The Nova Scotia Credit Union League  
Mr. Frank O'Hearn, Scarborough, Ontario  
Ontario Co-operative Credit Society  
Ontario Credit Union League Limited  
The Ontario Securities Commission  
Quebec Credit Union League  
The Quebec Savings Banks  
The Retail Merchants Association of Canada Inc.  
Sir Dennis Robertson, Cambridge, England  
Mr. M. A. Rowat, Elmvale, Ontario  
St. Francis Xavier University Extension Department  
Professor P. A. Samuelson, Cambridge, Mass.  
The Security Analysts' Association of Toronto  
\*Mr. H. Sharp, Tofino, B.C.  
\*Mr. H. H. Splett, Ottawa, Ontario  
Mr. Allan Sproul, Kentfield, California  
\*Mr. R. K. G. Stursburg, Vancouver, B.C.  
The Superintendent of Insurance, Ottawa  
Mr. Woodlief Thomas, Washington, D.C.  
The Toronto Stock Exchange  
\*Mr. G. F. Towers, Ottawa, Ontario  
The Trust Companies Association of Canada  
Urban Development Institute, Toronto, Ontario  
Vancouver Stock Exchange  
Professor Jacob Viner, Cambridge, Mass.  
The Winkler Credit Union Society Limited, Winkler, Man.

\* Not presented at the public hearings.

#### OTHER COMMUNICATIONS RECEIVED

- Alert Bay Board of Trade, Alert Bay, B.C.  
Professor C. A. Ashley, Toronto, Ontario  
Mr. R. H. Babbage, Chambly, P.Q.  
Mr. J. Balch, London, Ontario  
Mr. S. A. Bensh, Nanaimo, B.C.  
Mr. Gerard Bernier, Laprairie, P.Q.  
Mr. M. Bieman, Foxboro, Ontario  
Mr. M. N. Campbell, London, Ontario  
The Corporation of the Village of Squamish, B.C.  
Miss D. G. Faulkner, Halifax, N.S.  
Mr. G. Glenn, Indian Head, Sask.  
Mr. A. E. Grassby, Winnipeg, Man.  
Mr. H. H. Hallatt, Don Mills, Ontario  
Mr. M. Haltrecht, Montreal, P.Q.

Mr. W. H. Hamilton, Winnipeg, Man.  
 Mrs. L. V. Hodgson, Vancouver, B.C.  
 Mr. W. R. S. Henderson, Calgary, Alta.  
 Mrs. Irene E. Johnson, Ottawa, Ontario  
 Mr. L. O. Kelso, San Francisco, Calif.  
 Mr. Carlo Lamberti, Scarborough, Ontario  
 Mr. E. Litchfield, Vancouver, B.C.  
 Mr. A. J. Livinson, Westmount, P.Q.  
 Mr. B. C. Masterson, Ottawa, Ontario  
 Mr. C. S. Matthews, Toronto, Ontario  
 Mr. R. E. Melvin, Bracebridge, Ontario  
 The Metropolitan Trust Company, Toronto,  
 Ontario  
 Mr. R. Mitchell, Welland, Ontario  
 Mr. E. T. Nesbitt, Vancouver, B.C.

Mr. T. O'Dwyer, Edmonton, Alta.  
 The Ontario Retail Lumber Dealers Association,  
 Inc.  
 Mr. J. Quittner, Ottawa, Ontario  
 Mrs. E. B. Ravenscroft, Vancouver, B.C.  
 Mr. Arthur Rawett, Toronto, Ontario  
 Mr. H. S. Rosenberg, Toronto, Ontario  
 Mr. B. B. Shekter, Hamilton, Ontario  
 Vancouver Safeway Employees Credit Union  
 Mr. Ralph Wagner, Ottawa, Ontario  
 Mr. S. E. Weir, London, Ontario  
 Mr. Howard Weese, Carrying Place, Ontario  
 Mr. G. J. Wesley, Montreal, P.Q.  
 Mr. William Wright, Toronto, Ontario

## APPENDIX 5

## STAFF

H. A. Hampson  
*Secretary*

Gilles Mercure  
*Joint Secretary*

Leo Lafrance  
*Assistant Secretary—Administration*

Wm. C. Hood  
*Research Director and Economic Advisor*

D. J. Daly

R. Johnstone  
*Assistant Directors of Research*

J. H. Young

A. Asimakopulos  
 John F. Helliwell  
 John Kim  
 J. V. Poapst  
 R. A. Shearer

Irving Brecher  
 Harry G. Johnson  
 R. C. McIvor  
 Margaret R. Prentis  
 F. X. Wildgen

J. P. Evans  
 W. A. Kennett  
 Jacques Parizeau  
 G. L. Reuber  
 Robert M. Will

John W. L. Winder

Paul Wonnacott

## APPENDIX 6

### PUBLICATIONS AND DOCUMENTS

The Commission will be publishing at a later date an appendix volume containing supplementary statistical information and research work, including tabulations and commentary based on the main surveys undertaken for us.

Much of the work contained in the many useful working papers prepared for the internal use of the Commission is incorporated in the report itself. However, the Commission felt that a number of these papers should be available to a wider audience. Accordingly, those listed below are shortly to be put on sale in mimeographed form by the Queen's Printer:

A. Asimakopulos	"The Reliability of Selected Price Indexes as Measures of Price Trends"
D. W. Carr & Associates	"Farm Credit in Canada"
E. K. Cork	"Finance in the Mining Industry"
A. W. Johnson	"Provincial and Municipal Governments and the Capital Markets"
Harry G. Johnson and J. W. L. Winder	"Lags in the Effects of Monetary Policy in Canada"
Gilles Mercure	"Credit Unions and Caisses Populaires"

J. V. Poapst	"The Residential Mortgage Market"
G. L. Reuber	"The Objectives of Monetary Policy"
R. A. Shearer	"Monetary Policy and the Current Account of the Balance of International Payments"
G. D. Sutton	"Corporate Finance"
Sidney Turk	"The Foreign Exchange Market in Canada"
Paul Wonnacott	"The Height, Structure and Significance of Interest Rates"

In addition to these papers, the Commission had certain confidential studies prepared, notably that on debt management by Professor Jacques Parizeau. Moreover, other papers, including that on financing small business by F. X. Wildgen and that on fiscal policy by R. M. Will are to be published in modified form elsewhere. Finally, the paper by Harry G. Johnson on "Alternative Guiding Principles for the Use of Monetary Policy" was published in his book *The Canadian Quandary* (McGraw-Hill, 1963) and that by D. H. C. Stanley on "The Financing of Oil and Gas Exploration and Production in Canada" was privately distributed by Wood, Gundy & Co. Ltd. in 1963.

## INDEX

### A

- Agricultural finance, 46-9, 231-4
  - Farm Credit Corporation, 48, 231-3, 562
  - Farm Improvement Loans Act (F.I.L.A.), 47, 115, 125, 231, 233-4
  - financial position and requirements of agriculture, 46-7
  - problems of farm finance, 47-9
  - provincial govt. lending, 48, 233
  - sources of funds, 47-8, 231-2
  - Veterans' Land Administration, 231-2
- Alberta Municipal Financing Corporation, 63-4
- Alberta Provincial Marketing Board, 226
- Alberta Treasury Branches, 107, 226
- Annuities: *see* Life insurance cos.; *see also* Pensions and pension funds
- Annuities Branch, 237, 257
- Asset ratios, 152-4, 338-9, 362-3, 364, 367, 375, 380, 473-6, 560-1: *see also* Capital ratios and Liquidity and liquid asset ratios

### B

- Balance of payments: *see* Non-resident sector and Foreign exchange and international economic policies
- Bank Act, 113-7, 358, 362, 380; *see also* Banking and banking institutions
  - audit requirements: *see* Inspector General of Banks
  - bank shares: *see* separate heading
  - capital requirements, 113-14, 115, 383-6
  - cash reserves: *see* separate heading
  - control of other businesses, 116, 370-3, 563-4
  - directors and loans to directors, 114, 371, 372-3, 385-6
  - and foreign banks and agencies, 373-5, 563-4
  - guarantee of deposits with central bank, 556 fn.
  - Inspector General of Banks: *see* separate heading
  - interest rate ceilings in: *see* separate heading
  - major revisions proposed: *see* Banking and banking institutions
  - powers granted by, 115, 116
  - prohibition of note issue, 115
  - prohibition on mortgage lending: *see* Mortgages and mortgage market—chartered banks
  - section 88, 115-16, 125, 375-6, 380
  - and Treasury Board, 114, 371-4, 379, 380, 381, 563
  - use of bank's name in prospectus, 116, 310, 355
- Bank for International Settlements, 501

### Bank of Canada, Chapter 26, *passim*

- balance sheet of, 460
- and bank rate: *see* separate heading
- and cash reserves: *see* separate heading
- and credit conditions: *see* separate heading
- and debt management, 61, 71, 101, 425, 449-50, 454, 455-6, 457, 459-60, 461, 556
- directors—duties of, 539-40, 545-7, 549, 550-1, 557
- directors—qualifications of, 547-9, 550, 566
- execution of monetary policy: *see* Credit conditions and *also* Monetary policy—techniques of
- Executive Committee of, 546-7, 549, 551
- as financial advisor to govt., 541, 542, 544, 557, 566
- and financing of provincial govts., 71, 461, 556
- foreign exchange dealings, 293-4, 297, 461, 495, 541, 556
- govt. directives to, 540, 542-5, 546, 547, 551, 555, 557, 566
- Governor and Deputy Governors of, 540, 542-7, 548, 549-51, 555, 557, 566
- independence of, 539-45, 566
- and interest rates: *see* Credit conditions
- internal management of, 549-52
- legislation governing: *see* Bank of Canada Act
- and market and public contacts, 222, 318, 322-5, 357, 378, 393, 467, 541, 550, 553-5, 557, 566
- and money market, 318-19, 322, 461
- and new Canada issues, 325-8
- notes of, 3, 92
- parliament and, 540, 541, 542, 557
- power to call for statistics, 141
- power to deal in securities, 556
- regional advisory committees of, 548, 549
- and responsibility for monetary policy, 539-45
- and trading and securities operations, 322-5, 329, 426, 450-2, 454 fn., 455-8, 463-5, 554-5
- and treasury bill operations 460, 464-5
- Bank of Canada Act, Chapter 26 *passim*
  - audit and report provisions, 557
  - background and evolution of, 539-40
  - dealings permitted by, 556
  - directors and executive committee, 545-9, 550, 551
  - gold redemption and ratio, 556
  - govt. directives to, 542-5
  - Governor's status, 545, 547, 550-1
  - preamble to, 539
  - and provincial fiscal agencies, 556
  - real estate provisions, 556-7
  - recommendations, 542-5, 546-9, 550-1, 553, 556-7
  - veto power, 551
- Bank Rate, 4, 410-11, 413, 461, 464-5, 543, 544

Bank shares, par value and issue price, 143-4, 152, 383  
 Bank shares and prohibitions on dealing in or lending on, 115, 116, 370-3, 383, 563-4  
 Bankers' acceptances, 124, 320  
 Banking and banking institutions—general views and recommendations, Chapters 18 and 19 *passim*:  
   *see also* Chartered banks  
   aims of proposals, 10, 357-9, 361-3, 375-6, 377-8, 396, 559, 560-4  
   asset ratios: *see* separate heading  
   background of increasing competition, 360-3, 369, 559, 562-4  
   capital requirements, 383-5  
   cash reserves: *see* separate heading  
   definition of, 114-15, 352, 361-3, 377-80  
   and disclosure, 357, 382-3, 385, 386, 388-9  
   extending federal banking regulation, 361-3, 377-80, 560-1, 563  
   foreign banks in Canada, 373-5, 563-4  
   fostering a competitive system, 362-3, 364-73, 374, 375-6, 379-80, 391, 393, 396, 559, 560-4  
   inner reserves: *see* separate heading  
   Inspector General of Banks: *see* separate heading  
   interest rate ceilings: *see* separate heading  
   loans to directors, 385  
   mortgage lending of, 287-8, 364, 366-7, 369, 375-6, 561  
   ownership and directorate limitations, 369, 370-3, 374-5, 563-4  
   preventing undue concentration of power, 369, 370-3, 374-5, 563-4  
   prohibiting rate agreements, 369-70, 375, 563  
   supervision and inspection: *see* separate heading  
   and trustee powers, 373, 380 *fn.*  
   use of name "bank", 114-15, 379  
 Barber, Professor Clarence, 453 *fn.*  
 Bernstein, Mr. E. M., 453, 516  
 "Bills only" doctrine, 465  
 Bond market, 3, Chapter 16, *passim*, esp. 315-18.  
   Bank of Canada trading: *see* separate heading  
   character and development of, 301-2, 315-18  
   listing bonds on exchanges, 337  
   and new issues: *see* Underwriting  
 Broker-dealers Association of Ontario, 333-4, 341, 346, 347  
 Broker-dealers, role of, 331, 341, 353  
 Business cycles: *see* Economic developments in Canada, 1946-63  
 Business sector, Chapter 3, *passim*  
   cost of debt and equity funds, 39-41, 311-13  
   debt outstanding, 6-7, 42, 184, 243, 559  
   demand for funds, 34-8,  
   interest charges of, 41, 431  
   internal funds, 33, 38-9, 42, 430-1, 435, 446, 559  
   investment of, 33-8, 429-32, 434-5, 436-7, 441-8, 559  
   inventories, 34, 35, 37, 432, 442, 443  
   liquid assets of, 34, 35, 38-9  
   non-resident financing by, 41-2, 43

profits of, 36-7  
 quality of credit, 6, 33-4, 41  
 response to monetary and debt policies: *see* Credit conditions  
 small business: *see* separate heading  
 sources of finance, 38-43, 122-5, 307-8, 319-20  
 trade credit: *see* separate heading

## C

Caisses populaires and credit unions, Chapter 9, *passim*  
 centrals, 157, 164, 165-8, 169-70, 363, 379, 389, 561  
 character and development of, 2, 155-61  
 common bond of association, 155-6  
 deposits and shares of, 159-61, 394  
 leagues of, 157, 164-5, 169  
 legislation governing, 158, 167, 169-71, 362, 363, 364, 379, 561  
 lending of, 158-9, 163-4, 224, 274, 277, 287, 561  
 liquidity of: *see* separate heading  
 and monetary policy: *see* Monetary policy  
 mutual aid funds, 163, 169, 170, 384, 561  
 rates charged by, 159  
 recommendations, 168-71, 363, 379, Chapters 18 and 19, *passim*, 561  
 revenues, expenses and capital, 161-2, 368-9, 384-5, 389  
 supervision, 167-8, 169-71, 362, 363, 379, 561  
 taxation, 162-3, 389  
 Canada Pension Plan: *see* Pensions and pension funds  
 Canada Savings Bonds (C.S.B.'s): *see* Savings bonds  
 Canadian Association of Investment Clubs, 251  
 Canadian Bankers Association, 117, 294  
 Canadian Bankers Association Act, 117, 145, 393  
 Canadian Consumer Loan Association, 203  
 Canadian Co-operative Credit Society, 167, 170  
 Canadian Enterprise Development Corporation Limited, 225-6  
 Canadian Mutual Funds Association, 252, 256, 353  
 Capital cost allowances and investment taxes, 38, 515-18, 529, 565  
 Capital investment, 1, 5, *see also* Business sector and Personal sector and Governments and interest rates: *see* Credit conditions  
 Capital issues controls, 477  
 Capital ratios, 176, 383-5, 560  
 Cash reserves:  
   current requirements and practices, 116, 128, 148, 158, 165-6, 178, 180, 181, 183, 392-3  
   effect of on monetary control, 93-6, 98, 390-2, 393, 460-3  
   effect of on institutional competition, 93-6, 98, 109-12, 199, 390-3  
   not a means of "multiplying" liabilities, 101-2, 109, 563  
   and protection of the public, 390, 391-2, recommendations, 390-4, 462-3, 474-6, 556, 563  
   variable ratios, 474-6

- Central Mortgage and Housing Corporation (CMHC):  
*see* Mortgages and mortgage markets
- Chartered banks, Chapter 7, *passim*: *see also* Banking and banking institutions
- assets of, 122-9
  - branches, 113, 115, 120-1, 562
  - business lending, 38-9, 122-5, 223-4
  - changes in lending policy, 129-36, 468-71, 473, 475
  - competition among, 127-8; *see also* Banking and banking institutions
  - concentration of: *see* Concentration in the financial system
  - deposits and notes of: *see* Deposits
  - foreign currency business, 136-41, 291-8, 300
  - inner reserves: *see* separate heading
  - inspection and supervision: *see* Inspector General of Banks
  - legislation governing: *see* Bank Act
  - lines of credit, 132-6
  - and monetary policy: *see* Monetary policy
  - mortgage lending of: *see* Mortgages and mortgage markets
  - overdraft lending, 128
  - personal lending, 123, 126-7
  - rates charged by, 127, 135-6
  - recommendations: *see* Banking and banking institutions
  - relationships with other institutions: *see* Concentration in the financial system
  - revenues, expenses and capital, 141-5, 368-9, 384-6
  - security holdings, 122-3, 125-6
  - share of financial business, 3, 106-7
  - term lending, 124-5, 223-4
  - underwriting, 310, 355
- Charterhouse Group Limited, 225-6
- Clearing system, 145-6, 165, 178, 182, 393-4
- Closed-end investment cos., 237-8, 251-2, 256
- Cobbold, the Lord, 454
- Commercial paper: *see* Money market
- Commission on Money and Credit (U.S.), 444-5
- Common shares: *see* Equity ownership
- Companies legislation: *see* Securities and shareholder legislation
- Competition in the financial system—general, 3, 8-9, 10, 101-2, 105, 559, 561-4, 566
- and banking legislation, 357, 358, 360-3, 364-73, 375-6, 563-4, 566
  - for cash, 93-6, 98-9, 100, 101-3, 109-12
  - in deposits and long-term liabilities, 118-22, 149-51, 159-61, 173-4, 201, 237-8, 241, 264
  - in lending, 122-4, 127-9, 149, 159, 174, 201, 203-5, 209, 222, 228-30
  - for mortgages: *see* Mortgages and mortgage market
  - rate and other agreements limiting, 127-8, 369-70, 563
  - size and prestige and, 108, 128, 367-8, 370, 372, 562
  - in underwriting, 309-10, 311-13, 329
- Concentration in the financial system:
- banking legislation and, 10, 366-73, 374, 375, 563-4
  - extent of, 2, 113, 174-5, 194, 202-3, 208, 238-40, 250, 264, 303
  - relationships between institutions, 145-6, 165, 194-6, 209, 370-5, 563-4
- Cost and availability of funds, factors affecting, 13, 93-101; *see also* Credit conditions
- Consumer credit outstanding: *see* Personal sector—debt
- Consumer credit controls: *see* Selective credit controls
- Consumer loan companies, Chapter 11, *passim*
- character and development of, 201, 203-5, 209-11
  - legislation governing: *see* Small Loans Act
  - monetary policy and: *see* Monetary policy
  - revenues, expenses, capital and sources of funds, 214-16
- Consumers: *see* Personal sector
- Contingency reserves: *see* Inner reserves
- Conversion Loan, 414, 452, 454-5
- Co-operatives, 43; *see also* Caisses populaires and credit unions
- Co-ordination of policy: *see* Financial policies—co-ordination
- Corporate finance: *see* Business sector
- "Country banks", 122, 304-5
- Credit conditions: *see also* Monetary policy
- and agriculture, 442, 443
  - Bank of Canada and, 93-101, 424-5, 460-78
  - and business sector, 429-32, 434-5, 436-7, 441-2, 443-8
  - and debt management, 101, 425, 449-60, 527, 530, 564
  - defined, 423-4
  - effect of on spending generally, 97, 98, 100, Chapter 21, *passim* esp. 430-1, 434, 443-8, 564
  - effect of on financing plans, 429, 432
  - and govt. and institutional spending, 433, 440-1, 442, 443, 446
  - and housing expenditures, 280-5, 433-4, 437-8, 439-40, 441, 443, 444, 445, 446-7
  - international effects of, 79-83, 435-6, 438, 442-3, 444, 446, 447, 472-3, 528, 529, 565
  - lags in altering, 461-72
  - lags in response to, 430, 436-8, 470-1, 564
  - and liquidity, 96-8, 99-100, 423, 425
  - limits on varying, 426, 429, 434, 448, 471-3, 505-6, 526, 528, 529, 536-7, 564
  - links between credit conditions and spending, 423, 424-5, 428-9, 430, 434-5
  - longer-term effects of, 428-9, 446, 564
  - and personal and consumption expenditure, 433-4, 435, 439-40, 443
  - post-war changes in, 409, 410-13, 468-70
  - special measures affecting, 473-8; *see also* Selective credit controls
  - surveys and measurement of response to, 9-10, 423, 426-30, 435, 437-48

- usefulness and limitations of policies affecting, 398, 421-2, 434, 438, 443-8, 472-8, 505-6, 523, 525, 527-32, 564-6
- Credit, extension of, 93-102, 563
- Criminal Code and securities offences, 345, 347, 348, 354
- Currency, 3, 92
- Cyclical fluctuations in Canada since 1946, 402-16; *see also* Financial policies

## D

- Day loans: *see* Money market
- Debt management, 60-1, 449-60
  - Bank of Canada and: *see* Bank of Canada
  - cost minimization and countercyclical policies, 450-2, 453-7
  - and credit conditions: *see* Credit conditions
  - Govt. of Canada debt outstanding: *see* separate heading
  - organization for, 425, 449, 459-60, 556
  - post-war developments 410-14, 451, 454-6, 457
  - principles of, 413-14, 450-9, 527, 530, 564
  - provincial and municipal govts., 61, 71
  - similarity to monetary policy, 425, 449-50, *see also* Financial policies—co-ordination
  - techniques of timing of new Canada issues, 325-8, 450-8
  - types of issues sold, 457-9
- Dept. of Finance, personnel, 535-6, 555-6
- Deposit insurance, 170, 363-4, 382
- Deposits:
  - banking legislation and, 377, 378-80, 390-6
  - competition for: *see* Competition in the financial system
  - institutions now accepting, 89-90, 92-3, 101-3, 105-8, 117-22, 149-51, 159-61, 174, 176, 178, 180-2, 184-6, 352-3
- Depreciation, depletion, etc.: *see* Capital cost allowances
- Deputy Minister of Finance and Bank of Canada, 544, 546-7, 551
- Desjardins, Alphonse, 155
- Development companies, 2, 43-4, 225-7
- Direct credit measures: *see* Selective credit controls
- Directorate links: *see* Banking and banking institutions
- Disclosure: *see* Interest rate disclosure, *also* Securities and shareholder legislation
- Dominion Housing Act, 269-70

## E

- Econometrics and econometric studies, 426-7, 438, 515-16
- Economic Council of Canada, 533, 535-6
- Economic developments in Canada 1946-63, 402-17, 428, 438-9, 452-6, 480-8, 524-5

- "Eight percenters", 3, 108, 202, 352, 354
- Employment as an objective, 397-8, 399-400, 417-22, 526, 532-3
- Equity ownership:
  - extent of by Canadians, 24-31, 75, 83-6, 126, 183, 188, 191-2, 243-4, 251-5, 259-60, 335-6
  - factors affecting, 18-19, 27-8, 29-31, 39-41, 42-3, 44, 86-7, 126, 191, 242-3, 247-50, 251-5, 256, 263-4, 335, 336
  - measures to encourage, 31, 87, 248-50, 255-6, 260-1, 336-59, 360, 487, 497, 559, 561
  - stock exchanges and, 334-44
  - Supply of equities, 39-41, 42-3, 86-7, 335-6
- Estates, trusts and agencies; *see* Trust companies
- Euro-dollars: *see* Chartered banks—foreign currency business
- Exchange Fund Account, 293-4, 461, 482-3, 486, 492-5, 556
- Exchange rates and reserves: *see* Foreign exchange and international economic policies
- Export Credits Insurance Corporation (E.C.I.C.), 3, 235-6
- Export finance, 234-60
- Export Finance Corporation, 236
- Export-Import Bank (U.S.), 481, 487

## F

- Factoring and commercial financing, 208-9, 223
- Farming and farm finance: *see* agricultural finance
- Federal Reserve System (U.S.), 323-4, 467, 501-2, 545-6, 549, 552, 554
- Federated Council of Sales Finance Companies, 202
- Fédération de Québec des Unions Régionales des Caisses Populaires Desjardins, 165, 168
- Fiduciary business: *see* Trust companies—E. T. & A. business
- Finance cos.: *see* Sales finance cos. *also* Consumer loan cos.
- Financial institutions and markets Chapter 6, *passim* and Chapters 7-19, *passim*
  - broad changes in, 1-4, 6-7, 90, 92, 105-8, 264-5, 301-2, 331, 358-62
  - competition among: *see* Competition
  - concentration of: *see* Concentration
  - distinct from non-financial units, 13, 89-90, 91
  - effect of on economy, 7-9, 10, 13-14, 89-93, 96-8, 100, 105, 358-9, 360-1, 561, 564, 566
  - effect of financial policy on, 93-101; *see also* Monetary policy
  - legislation governing: *see* Caisses populaires, trust cos., etc.
  - liabilities of a means of payment, 3, 92-3, 96-8, 100-2
  - regional activities of, 8, 29-30, 120-1, 156-7, 188, 245, 277, 302, 333, 359, 367, 376, 396



Financial policies, 4, 7, 9, Chapter 25, *passim*; *see also* Debt management, *also* Fiscal policy, *also* Foreign exchange and international economic policies, *also* Monetary policy, and Economic developments 1946-63

co-ordination of, 7, 397, 416-17, 421-2, 448, 449-50, 478, 502, 503, 520, 523-5, 528, 529-30, 533-4, 536, 537, 539-45, 557, 560, 564-6

effectiveness of, 7, 398, 416-17, 421-2, 425, 443-8, 472-8, 489-90, 505-6, 509-10, 520-1, 523-5, 530, 532-3, 536-7, 560, 564-6

factors affecting choice of, 397-8, 419-22, 447-8, 450, 472-8, 479-80, 488-93, 494-7, 503, 505-6, 509-10, 520-1, 523-33, 536-7, 560, 564-6

federal-provincial concerting of, 61 fn, 509, 519-20, 527, 529, 565

formulae unsatisfactory, 397-8, 419-22, 523-4, 526, 536-7, 560, 566

housing policy and, 283-6, 416-17, 433-4, 439-41, 446-7, 476-7, 528, 529

importance of setting in right direction, 421, 523-4, 533, 536-7, 565

inter-relation of, 397, 413-4, 417, 420-2, 449-50, 497, 507-8, 511, 523, 525, 565

need for strong leadership in, 398, 422, 523-4, 533-4, 565

organization of policy-making, 533-6

policy-advisory officials and, 524, 534-6, 565

post-war combinations of policies, 408-17, 524-5 and productivity increases, 531-2, 565-6

public opinion and, 398, 523-4, 534, 535-6, 565

regional policies, 527, 548, 549

specific measures, 419, 421-2, 473-8, 495-7, 503-4, 523-5, 528, 529-30, 565

Financial press, 534

Financial system: *see* Financial institutions and markets, *also* Financial policies

Fiscal agencies: *see* Underwriting

Fiscal policy, 4, 9, Chapter 24, *passim*

automatic stabilizers, 414, 512-13

budget deficits and surpluses, role of, 506-10, 513-15, 520-1, 526, 529, 565

budget deficits and surpluses, measurement of, 52 fn., 57, 510-11

co-operation with provinces in, 61 fn., 509, 519-20, 527, 529, 565

co-ordination with other policies: *see* Financial policies

debt charges and, 508-9

discretionary expenditure changes, 513-15, 518-19, 520-1, 526, 529, 565

discretionary tax changes, 513-18, 520-1, 526, 529, 565

and international financial policy, 489-91, 505-6, 509-10, 520, 564-5

limitations of, 509-10, 513-14, 518-19, 520-1 and monetary policy and credit conditions, 472, 508, 511

need for more vigorous use of, 505-6, 509-10, 520-1, 528, 529, 530, 564-5

post-war record, 414-16

Fisheries Improvement Loans, 234

Flows of funds and the financial system, 4-5, 9; *see also* Primary debt outstanding

Foreign exchange and international economic policies, 4, Chapter 23, *passim*; *see also* Foreign exchange market

and balance of trade and payments, 79, 81, 88, 400-2, 419, 481-8, 489-90, 495-7, 503-4

changing the value of the Canada \$, 400-1, 419-20, 491-2, 498-9, 503-4, 529, 530

fixed exchange rates and policy, 294, 299, 438, 444, 446, 447, 448, 472-3, 486-95, 496-7, 498, 503-4, 527-8, 529-30, 565

flexible exchange rates and policy, 79, 81, 299, 429, 435-6, 438, 442, 443, 444, 446, 472-3, 482-3, 488-90, 491, 492, 496-7, 498, 503-4

and international economic competition, 4, 88, 400-1, 410, 419, 491, 503-4, 527, 532, 565

and international economic co-operation 3-4, 88, 400-2, 419-20, 487, 495, 498-504, 527, 528, 556, 565

and international liquidity, 498-504, 528, 556, 565

links between Canada and other countries, 75-81, 88, 400-2, 479-80, 488-9, 492, 503-4

and non-resident investment 79-88, 400-1, 420-2, 479, 495-7, 503-4

objectives of, 400-2, 419-20, 490-2, 526

and official reserves, 401, 481-3, 486-7, 490-1, 492-5, 496, 498-504, 556

post-war policy and events, 4, 403, 408-10, 412-13, 481-9

Foreign exchange market, Chapter 15, *passim*

Bank of Canada and: *see* Bank of Canada

chartered banks and: *see* Chartered banks—foreign currency business

Exchange Fund Account: *see* separate heading

forward, hedged and swap transactions, 292-3, 295, 296-300, 484-6, 492-5

interbank market, 293-6

short-term capital flows and, 292-3, 296, 297-8, 299-300, 484-6, 492-5

speculation in, 297-9, 484-6, 494-5

Foreign investment and ownership: *see* Non-resident sector

## G

Gaines, Tilford C., 452 fn.

General Arrangements to Borrow, 500, 502

General insurance cos., 250-1

General Investment Corporation, 226

Gold and gold standard, 480, 500, 501, 502-3, 556

Govt. cheques and bank accounts, 394, 456-7, 460-1, 463, 511

Govt. lending and guarantees, 3, 125, 233-4, 359-60, 375, 562

CMHC: *see* Mortgages and mortgage market

Export Credits Insurance Corp: *see* separate heading

- F.I.L.A. and F.C.C.: *see* Agricultural finance  
 Fisheries Improvement Loans: *see* separate heading  
 Home Improvement Loans: *see* Mortgages and mortgage market  
 Industrial Development Bank: *see* separate heading  
 Municipal Loan Fund, 72  
 National Housing Act: *see* Mortgages and mortgage market  
 provincial development funds and business lending, 3, 226  
 provincial farm lending: *see* agricultural finance  
 provincial guarantees of municipal and other debt, 57-8, 63-4, 68, 71  
 Small Businesses Loans Act: *see* Small business  
 Veterans Business and Professional Loans Act: *see* separate heading  
 Veterans Land Administration, 231-2  
 Govt. of Canada: *see also* Financial policies  
   cash balances of, 394, 456-7, 460-1, 463, 511  
   Canada Savings Bonds: *see* Savings bonds  
   debt management; *see* separate heading  
   debt outstanding, 6, 57-8, 184, 243-4, 450-1  
   expenditures, revenues and financial position of, 51-7, 410, 413-16, 508-9, 512-13  
 Govt. policy: *see* Financial policies, *also* Non-financial policy measures  
 Govt. responsibility for monetary policy, 539-45, 557, 566  
 Governments: *see* Govt. of Canada, *also* Municipal govts., *also* Provincial govts.  
 Growth: *see* Productivity and growth  
 Guaranteed investment certificates (G.I.C.'s): *see* Trust companies

## H

- Holtrop, Dr. Marius W., 475 fn.  
 Households and household survey: *see* Personal sector  
 Housing: *see* Mortgages and mortgage market

## I

- Incomes policies, 532-3  
 Index Bonds, 458  
 Industrial Development Bank (I.D.B.), 3, 106-7, 108, 209, 226, 227-31, 360, 528, 562  
 Industrial Estates Limited, 227  
 Inflation and deflation: *see* Price stability and instability  
 Inner reserves, 144-5, 151-2, 198, 386-9  
 Inspector General of Banks, 114, 116-17, 140-1, 153, 370, 372, 374, 379, 380-2, 385-6, 388, 389, 395, 560-1  
 Instalment finance cos.: *see* Sales finance cos.  
 Institutionalization of savings: *see* Financial institutions and markets—broad changes  
 Insurance cos.: *see* Life insurance cos., *also* General insurance cos.  
 Interest Act, 179, 272

- Interest-equalization tax, 67, 88, 473 fn., 487-8, 491 fn.  
 Interest rate ceilings: *see also* Small Loans Act  
   effects of, 116, 122, 124-5, 126-7, 135-6, 143, 146, 151, 199, 223, 275, 283-4, 286, 289, 361-2, 364-7, 369  
   views and recommendations, 361-2, 364-7, 369, 370, 375-6, 562, 563-4  
 Interest rate disclosure, 207, 366, 382-3, 562  
 Interest rates, *see also* Credit conditions  
   charged and paid by institutions: *see* Caisses populaires, Trust cos., etc.  
   and financial developments, 89-100; *see also* Monetary policy  
   and spending and saving, 13-14; *see also* Credit conditions  
 International Bank for Reconstruction and Development, 3-4  
 International policies: *see* Foreign exchange and international economic policies  
 International Monetary Fund, 3, 294, 410, 486-8, 499-502  
 Inventories: *see* Business sector  
 Investment: *see* Capital investment  
 Investment clubs, 251-2  
 Investment cos.: *see* Mutual funds, *also* Closed-end investment cos.  
 Investment dealers, Chapter 16, *passim*; *see also* Bond market, *also* Money market  
   Bank of Canada and, 318, 319, 322-9, 449-50, 451-8, 461, 463-5, 466-8, 471-2, 553-5  
   banking functions of, 379  
   borrowing and inventories of, 304-6, 315-19  
   Govt. of Canada financing and, 325-9, 457-8, 459-60, 553  
   Investment Dealers Association of Canada (I.D.A.), 302, 306-7, 347  
   nature and functions of industry, 301-7, 315, 317-19, 328-9  
   revenues, expenses and capital, 303-7  
   "riding" and "withholding", 328  
   and securities and shareholders legislation: *see* separate heading  
   self-regulation and ethics, 306-7, 328-9, 344-5, 347, 355  
   underwriting: *see* separate heading

## J

- Jenkins Committee (U.K.), 351 fn, 352 fn., 388

## L

- Labour retraining, 416, 421-2, 525, 527  
 Leasing and lease-backs, 39, 208  
 Legislation governing financial system: *see* Quebec Savings Banks, Trust cos., *et al.*

- Life insurance cos., 237-51  
 annuities, fixed and variable, 2, 22-4, 240-1, 258, 260-1  
 character and development of, 103-4, 237-43  
 competition for savings, 3, 105-7, 237, 240-2  
 equity investments, 242-3, 247-50, 360, 562  
 investments and investment policy, 242-50  
 legislation governing, 239-40, 242-3, 247-9  
 monetary policy and: *see* separate heading  
 prohibition on one co. investing in another, 239-40  
 revenues and expenses, 241-2, 244  
 valuation rules 247-9, 360, 562
- Liquidity and liquid asset ratios,  
 banking institutions and, 377, 390, 391, 394-6, 473-6, 527, 529-30, 553, 560, 563  
 caisses populaires and credit unions, 165-9, 170-1  
 chartered banks, 122-3, 129-32, 199, 473-6  
 credit conditions and liquidity: *see* Credit conditions  
 financial system and public liquidity, 89-100, 423-5  
 life, loan, sales finance and trust cos., 176, 180, 183, 199, 213-14, 237, 242  
 monetary policy and liquid asset ratios: *see* Monetary policy
- Loan cos.: *see* Mortgage loan cos., *also* Consumer loan cos.
- Lundberg, Professor Erik, 263, 432, 474 fn., 517-18

# M

- Macmillan Commission, 1, 3, 9, 534, 566  
 and Bank of Canada, 4, 539, 541-2, 547
- Mansur, Mr. D. B., 277, 280 fn.
- Means of payment: *see* Money and money substitutes
- Mining finance, 42-3, 340-2, 351; *see also* Business sector
- Minister of Finance:  
 and banking legislation, 370, 375: *see also* Inspector General of Banks  
 and debt management, 326, 449, 456-7, 459-60  
 and fiscal policy, 507, 521, 533-4, 536  
 and monetary policy, 476, 533-4, 536, 539-40, 541, 542-4, 546-7, 548, 551, 553, 555, 557, 566
- Mishan, E. J., 453 fn.
- "Mix" of policy: *see* Financial policy—factors affecting choice of
- Monetary policy, 93-101 Chapter 22, *passim*; *see also* Credit conditions  
 Bank of Canada and: *see* Credit conditions, *also* sub-heading "techniques of" below  
 banking legislation and, 357, 358, 364-5, 374, 375, 377, 390-4, 396  
 caisses populaires and credit unions and, 163-4  
 chartered banks and, 99, 129-36, 297, 439, 461-3, 468-71, 473-6  
 co-ordination with other policies: *see* Financial policies—co-ordination of  
 farm lending and, 233  
 life insurance cos. and, 99, 245-7  
 liquid asset ratios and, 129-32, 411, 473-6, 527, 529-30, 553, 563

- mortgage market and, 280-6, 433-4, 441, 446-7, 468-71  
 post-war policies, 408-9, 410-14  
 Q.S.B.'s and, 150-1  
 regional policies, 527  
 responsibility for: *see* Bank of Canada  
 sales finance and consumer loan cos. and, 216-22  
 security markets and, 93-101, 301, 317-19, 324-5, 449-52, 454 fn., 455-6, 554  
 selective policies, 449-50, 473-8, 553, 564  
 and spending on goods and services: *see* Credit conditions  
 techniques of, 449-50, 460-8, 473-8, 553, 564  
 trust and mortgage loan cos. and, 184-6
- Money and money substitutes, 3, 92-3, 101-2 *see also* Financial institutions—liabilities  
 effect of on credit conditions and spending, 93-101, 423-5  
 post-war developments in money supply, 410-14
- Money market, 38-47  
 bankers' acceptances, 124, 320  
 Bank of Canada and, 3, 318-19, 322, 461  
 borrowing in, 35, 68-9, 122-4, 211-13, 220, 319-22, 461  
 commercial paper, 3, 122-4, 319-20, 321-2  
 day loans, 3, 129, 318-19, 461  
 investors in, 35, 38-9, 122-4, 183, 320, 321, 322
- Moral suasion, 475-6, 529-30, 553
- Mortgage loan cos., Chapter 10, *passim*; *see also* Banking institutions; *also* Mortgages and mortgage market  
 assets of, 174, 178-80  
 cash reserves: *see* separate heading  
 character and development of, 173-7  
 concentration of and relations with other institutions: *see* Concentration  
 deposits of: *see* Deposits  
 debentures, 178-9  
 inner reserves: *see* separate heading  
 legislation governing and supervision, 175-7, 179-80, 380  
 monetary policy and: *see* separate heading  
 prohibition on personal and commercial lending, 177, 198, 375-6, 377-8, 380  
 rates paid and charged, 179, 184-6  
 revenues, expenditures and capital of, 176, 196-8, 368-9, 384-6
- Mortgages and mortgage market, Chapter 14, *passim*  
 agriculture and: *see* Agricultural finance  
 amount outstanding, 6-7, 16, 17-22, 184, 243, 267-9, 276  
 caisses populaires and credit unions and, 158-9, 231, 274, 277, 287, 561  
 Central Mortgage and Housing Corporation, 3, 269-71, 273, 275, 277-81, 284, 285-7, 289, 433-4, 437-8, 441, 443, 444, 561, 562  
 character and development of, 3, 243-5, 267-73, 277, 283-4  
 chartered banks and, 115, 125, 126-7, 267, 270, 273-5, 277, 286, 287-9, 359, 360-1

- c.b.'s and the prohibition on mortgage lending, 115, 124, 198-9, 223, 275, 278-9, 287-9, 360, 361, 364, 366-7, 375, 379-80, 561-2
- conventional mortgages, 179, 183, 271-3, 275-7, 280-3, 285, 287-9
- extending N.H.A. to existing properties, 278-9, 287-8
- Home Improvement Loans, 125, 233, 269-70, 287
- insurance of (private), 3, 279
- insurance of (govt.): *see* N.H.A. mortgages
- Interest Act and, 179, 272
- life insurance cos. and, 242-6, 271, 273-4, 281-3
- loan to value ratios, 147-8, 153, 270-1, 273, 276, 278-9, 280-2, 283, 286, 287-9
- monetary policy and: *see* separate heading
- mortgage loan cos., and, 2, 178-80, 198-9, 231, 271, 273-4, 281-3
- National Housing Act (N.H.A.) 115, 269-71
- N.H.A. mortgages, 126-7, 149, 179, 183, 232-3, 244, 246, 270-1, 272-3, 275, 277, 279-84
- N.H.A. rate, 126, 149, 245-6, 271, 273, 275, 280-7, 288-9, 433-4, 441, 446-7, 468-71, 561
- personal lenders, 26-7, 269, 273, 275-6, 277
- Q.S.B.'s and, 2, 147-9, 151, 152-3, 267, 270
- recommendations and general analysis, 284-9, 360-1, 364, 366-7, 375, 379-80, 528, 529, 561-2
- regional variations, 275, 277, 285, 288-9, 359
- sales finance cos. and, 208, 276-7, 287-8
- second mortgage market, 273, 275-7, 288-9
- supply of mortgage funds, 273-7
- trading in, 269, 279-80, 282, 286, 289, 562
- trust cos. and, 2, 180-1, 183, 198-9, 271-2, 273-4, 281-3
- Municipal governments, Chapter 4, *passim*
- Bank of Canada financing of, 71
- borrowings and borrowing policy, 51-3, 55-8, 60-1
- cost of borrowing, 61-5, 70-3, 311-12, 359
- debt outstanding and debt charges, 6-7, 57-60, 66, 184, 243
- expenditures, revenues and financial position of, 52-60, 72-3
- foreign borrowing of, 66-8, 79-80, 81
- and monetary policy: *see* Credit conditions—effect on govt.
- problems of, 55, 59-60, 64-5, 70-3, 359
- sources of finance, 65-9, 125-6, 184, 243, 320-1
- underwriting techniques: *see* Underwriting
- Municipal Loan Fund, 72
- Municipal rating services, 71
- Mutual funds—*see also* Closed-end investment cos.
- character and development of, 2, 237-8, 251, 252-4
- influence on markets, 254-5
- legislation and regulation, 254, 255-6, 353, 357, 360
- non-resident owned (N.R.O.) funds, 79, 252, 254
- ownership of, 26-9, 252, 255
- N**
- National Association of Securities Dealers, 328
- National Housing Act mortgages: *see* Mortgages and mortgage market
- Non-financial policy measures, 398, 420-2, 523-5, 527-8, 531-3, 565
- Non-resident sector, Chapter 5, *passim*: *see also* Foreign exchange and international economic policies and banking in Canada, 373-5, 563-4
- Canada's total indebtedness to, 75-7
- dividends and interest paid to, 75, 83-4, 479, 483, 503, 559
- financial policy and: *see* Foreign exchange and international economic policy
- holdings of Canadian debt and factors affecting, 2, 42-3, 66-8, 75-83, 87-8, 139-40, 220, 264, 297-300, 314, 321, 560-1
- holdings of Canadian equities and factors affecting, 43, 75-9, 83-8, 252, 264, 360; *see also* Securities and shareholder legislation
- net drawings on, and impact of, foreign funds, 7, 42-3, 75-83, 85-8, 408-10, 412, 417-18, 420, 480-4, 486-7, 495-7, 503-4, 559-60
- ownership and control of Canadian industry, 2, 83-8, 560-1
- taxation and direct measures affecting, 67-8, 79, 86-7, 88, 409-10, 486-8, 491 fn., 495-7, 503-4
- O**
- Objectives of policy, Chapter 20, *passim*
- characteristics of, 397-8, 401-2, 526, 560, 566
- conflicts among, 417-22, 450, 455-6, 478, 490-2, 497, 498-500, 526, 528-30, 531-3, 539-43
- the employment objective: *see* Employment
- the international objectives: *see* Foreign exchange and international economic policies
- the price objective: *see* Price stability
- the productivity objective: *see* Productivity and growth
- the post-war record, 402-21
- Ontario Development Agency, 226
- Ontario Municipal Improvement Corporation, 63
- Operation "nudge", 454
- Organization for Economic Co-operation and Development, 4, 501
- Out-of-town cheques, 394
- Ownership of one institution by another: *see* Concentration, *also* Banking and banking institutions
- P**
- Pawnbrokers Act, 202 fn.
- Penny savings banks, 2
- Pensions and pension funds, 256-65
- character and development of, 22-4, 237-8, 256-60
- effects of universal govt. plans, 262-4, 559
- equity investments, 259-61, 559
- govt. annuities, 237, 257
- investments of, 259-61
- life insurance and trust cos. and, 2, 174, 188-9, 257-60
- need for regulation of, 260-1, 360, 561
- "vesting" and "portability", 257-8, 261-2

Personal sector, Chapter 2, *passim*  
 assets of, 14, 16-20, 21-30, 559  
 debt of, 6-7, 14, 15-17, 18, 19-22, 123, 126-7, 201, 203-5, 440, 559  
 equity investment of: *see* Equity ownership  
 life insurance, annuities and pensions, 22-4  
 regional investment patterns: *see* Financial institutions—regional activities of  
 response to credit policies: *see* Credit conditions  
 saving of, 14-15, 30, 87-8, 433, 439-40  
 Policy: *see* Financial policies, *also* Non-financial policy measures  
 Post Office Savings Bank, 2, 107  
 President's Committee on the Financial Institutions (U.S.), 391  
 Price indexes, reliability of, 400  
 Price stability—objective of, 398, 399-400, 417-421, 526, 527-8, 529-30, 532-3, 541-2  
 Price and cost trends—post-war, 1, 4, 403-8, 410-11, 418-19  
 Primary borrowers and lenders, 4-7, 13-14; *see also* Business sector, *and* Personal sector, *and* Governments, *and* Non-resident sector  
 financial institutions and, 7-9, 13, 89-93, 96-98, 99-101; *see also* Chartered banks, *etc.*  
 Primary debt outstanding and institutional share of, 2, 5-7, 90-1, 188  
 Prime rate: *see* Chartered banks—rates charged  
 Private placements: *see* Underwriting  
 Productivity and growth, 398-9, 403, 405, 417-18, 419-22, 526, 531-3, 566  
 Prohibited business of institutions: *see* Chartered banks—legislation, *etc.*  
 Protection of the public in financial transactions: *see* Banking and banking institutions, *also* Interest rate disclosure, *also* Security and shareholder legislation *and* Supervision and regulation  
 Province of Ontario Savings Office, 107  
 Provincial governments, Chapter 4, *passim*  
 agricultural lending: *see* agricultural finance  
 Bank of Canada financing of, 71, 461, 556  
 borrowing and borrowing policy, 51-3, 55-8, 60-1  
 cost of borrowing, 61, 64, 70-1, 311-12  
 debt outstanding and debt charges, 6, 57-60, 65-6, 184, 243  
 development funds: *see* Govt. lending and guarantees  
 expenditures, revenues and financial position of, 52-60, 73  
 and financial policy, 61 *fn.*, 509, 519-20, 527, 529, 565  
 foreign borrowing of, 66-8, 79-80, 81  
 ownership of banking institutions, 107, 226, 378  
 response to monetary policy: *see* Credit conditions  
 savings bonds: *see* separate heading  
 sources of finance, 65-9, 125-6, 184, 243, 320-1  
 underwriting techniques: *see* Underwriting  
 Purchase Fund, 455

## Q

Quality of credit, 6, 33-4, 41  
 Quantity of money: *see* Money and money substitutes  
 Quantity theory of money, 423-5  
 Quebec Farm Credit Act, 48, 233  
 Quebec Savings Banks, Chapter 8, *passim*  
 assets of, 148-50, 151, 152-3  
 cash reserves, deposits and inner reserves of: *see* separate headings  
 legislation governing: *see* Quebec Savings Banks Act  
 monetary policy and: *see* separate heading  
 mortgage and personal lending of, 2, 147-9, 151, 152-3  
 rates, revenues, expenses and capital of, 150, 151-2, 368-9, 384-6  
 Quebec Savings Banks Act, 147-9, 362  
 geographic and investment limits, 147-9, 150, 151  
 recommended amendments, 152-4

## R

Radcliffe Committee (on the Working of the Monetary System), 445, 449-50  
 Regional matters: *see* Financial institutions and markets, *also* Financial policies  
 Relationships between institutions: *see* Concentration  
 Robertson, the late Sir Dennis, 426, 453, 465, 471, 532-3  
 Royal Commissions:  
 Banking and Currency in Canada, 1933: *see* Macmillan Commission  
 Canada's Economic Prospects, 374 *fn.*  
 Government Organization, 257, 534, 535  
 Taxation, 9, 57, 87, 162, 235, 311, 336, 510  
 RoyNat Ltd., 225

## S

St. Francis Xavier University, 155  
 Sales Finance cos., Chapter 11, *passim*: *see also* Consumer loan cos., *also* Banking and banking institutions  
 business lending and leasing, 207-9, 224-5  
 character and development of, 2, 201-2, 203-5  
 concentration of and relationships with other institutions: *see* Concentration  
 dealer arrangements, 205-6  
 deposit taking powers, 201, 214, 222  
 legislation and supervision, 201-2, 214  
 liquidity of: *see* Liquidity and liquid asset ratios  
 monetary policy and: *see* separate heading  
 personal lending of, 203-5, 206-7, 219-22  
 rates charged by, 206-7, 219, 221  
 revenues, expenses and capital, 214-6, 368-9, 383-6  
 sources of funds, 201-2, 211-14, 220-1  
 Samuelson, Professor Paul, 531 *fn.*, 536  
 Saving and interest rates, 13-15, 433, 439-40: *See also* Personal sector; Governments; Business sector; Non-resident sector *and* Credit conditions

## Savings Bonds:

Canada Savings Bonds, holdings and amount of, 24-9, 58, 450-1, 458

C.S.B.'s competing with other claims, 3, 119-21, 287, 328-9, 458-9, 561

issues of other govts., 69

Saxon Committee (U.S.), 387, 388

Secondary reserves: *see* Liquidity and liquid asset ratios

Section 88: *see* Bank Act

Securities and Exchange Commission (S.E.C.), 255 fn., 346, 348-9, 351

Securities and shareholder legislation, 1, 344-55, 360, 561

corporate disclosure, 338-9, 342, 349-52, 355, 561

Criminal Code and, 345, 347, 348, 354

dealer disclosure and capital requirements, 306-7, 315, 348-9, 561

deposit-taking or short-term borrowing, 352-3, 377-9; *see also* Banking and banking institutions

federal legislation, 348-9, 350, 354, 355, 561

mutual funds, 255-6, 353, 355, 360

need for uniformity, 345-6, 348-9

philosophy and nature of in Canada, 344-7

prospectus requirements, 313-14, 342-3, 345-6, 348, 349-50

salesmen and selling techniques, 302-3, 307, 345, 346, 347, 353, 354, 355

securities administrations, 342-3, 345-9, 352-5

takeover bids, 351-2

and underwriting, primary distribution and escrowed shares, 340-3, 346, 348, 353-5, 561

Securities Investment Account, 456

Selective controls, 411-12, 448, 450, 473-8, 505-6, 529-30, 553, 564, 565

on consumer and housing credit, 221, 414, 440, 476-7, 528, 529-30

on international dealings, 86, 88, 415, 419, 486-7, 528, 530, 565

on prices and incomes, 414-15, 532-3

6% ceiling: *see* Interest rate ceilings

Small business, 43-6, 223-31

financial position and earnings of, 44-5, 225 fn.

and monetary policy, 45, 134, 441-2, 473-4

problems of financing, 43-4, 45-6, 223-5, 230-1, 359-60; *see also* Interest rate ceilings

Small Businesses Loans Act, 45, 115, 125

Sources of finance, 2, 43, 128-9, 223-31, 308, 313

Small Loans Act, 201, 202-3, 209-11, 363

suggested amendments to, 210, 366, 375, 382-3, 562

Special deposits, 475

Sproul, Mr. Allan, 467, 554

Statistics, delays and deficiencies in,

financial sector, 4-5, 169, 276, 307, 348-9, 467, 534-5, 552

non-financial sector, 4-5, 16, 41, 46, 57, 64-5, 71, 465-7, 534-5

Stock markets and stock brokers, 3, Chapter 17, *passim*; *see also* Broker-Dealers

and business finance, 38, 39, 42-3

Calgary Stock Exchange, 343-4

commission structure, 336-7, 344

and equity ownership in Canada: *see* Equity ownership

listings and listing standards, 334-9, 343-4, 346, 350, 351, 352, 353-4, 561

Montreal and Canadian Stock Exchanges, 333, 335-6, 338, 339, 343

nature, functions and membership of the industry, 331-5, 339-40, 343-4

over-the-counter markets, 331, 335

primary distribution on stock exchanges, 340-3, 353-4, 561

revenues, expenses and capital, 333-4

self-regulation, 333-4, 339-40, 342-3, 344, 347, 350, 351, 353-4, 355, 561

Toronto Stock Exchange, 333, 336, 338, 339, 342-3, 346, 347

trading and trading practices, 334, 338, 340, 343-4

Vancouver Stock Exchange, 333, 334 fn., 343-4

Winnipeg Stock Exchange, 333, 343-4

"Successive approximation", 324, 467, 470

Superintendent of Insurance: *see also* Supervision and regulation of the financial system

and credit unions, 167, 170

and insurance cos., 240, 242-3, 247-9, 382

and pension plans, 258, 382

and Small Loans Act, 202-3, 382

and trust and mortgage loan cos., 177, 380

Supervision and regulation of the financial system: *see also* Inspector General of Banks, Superintendent of Insurance and Banking and banking institutions.

general views and recommendations, 7-8, 10, 105, 153-4, 169-71, 176, 344-5, 357-64, 366, 375-6, Chapter 19, *passim*, 559, 560-1, 562

particular institutions and markets: *see* appropriate heading

Surveys conducted by the Commission, 9-10, 16, 122-4, 189, 298, 426-8, 467

## T

Take-over bids, 351-2

Taxation, 54-5; *see also* Fiscal policy

and caisses populaires and credit unions, 162-3

deductibility of underwriting commissions, 311

and equity ownership, 31, 87, 336, 560

exemption from of municipal bonds, 72

of long-term institutions, 238, 254

of physical investment, 515-18, 529, 565

and response to changed credit conditions, 431, 477

Thomas, Mr. Woodlief, 465 fn.

Till money and cash reserves, 463

Towers, Mr. Graham, 476, 541, 545

Trade credit, 2, 5, 6, 7, 35, 38, 43, 75, 79-81, 87, 299-300, 429, 485, 493; *see also* Primary debt outstanding

Treasury bill auctions, 460

Treasury Board and banking legislation: *see* Bank Act

Trust companies, Chapter 10, *passim*: *see also* Banking and banking institutions

- assets and liabilities of, 180-4
- branches, 175, 181-2, 195-6
- cash reserves and liquidity of: *see* separate headings
- character and development of, 173-7
- concentration and relationships with other institutions: *see* Concentration
- deposits and inner reserves of: *see* separate headings
- estates, trust and agency business, 173-5, 177, 186-94, 196, 197-8, 355
- guaranteed investment certificates (G.I.C.'s), 176, 180-3, 184-6
- legislation governing and supervision, 175-7, 179-80, 183, 186, 380
- monetary policy and: *see* separate heading
- mortgage lending of: *see* separate heading
- pension business of: *see* Pensions and pension funds
- possible conflict between trust and other business, 193, 373 fn.
- prohibition on commercial and personal lending, 177, 182, 198, 375-6, 377-8, 380
- rates, revenues, capital and expenditures of, 176, 184-6, 196-8, 368-9, 384-6

Trust Companies Association of Canada, 176 fn., 182, 193

Trustee investments, 179, 183, 190-1, 193

## U

Underwriting, 307-15

- character of business, 307-9
- chartered banks and, 310, 355
- concentration of, 303
- costs of, 302, 308, 311-13
- Govt. of Canada issues, 325-9
- municipal and provincial issues, 69-70, 308-13
- problems of 306, 309-10, 312-15
- through stock exchanges: *see* Stock exchanges—primary distribution

Unemployment: *see* Employment

Unemployment Insurance Fund, 456

## V

Variable annuities: *see* Life insurance cos.—annuities

Velocity of money, 100

Veterans' Business and Professional Loans Act, 115

Veterans' Land Administration, 231-2

## W

Wages and wages policy, 418-19, 529, 532-3

Withholding and take-over taxes, 67, 79, 86-7, 409-10, 486-8, 491 fn., 497, 503-4