c1

SPECIAL STUDY No. 3

Perspective on Canada's International Payments

A Background Sketch and Survey

by David W. Slater

prepared for the

Economic Council of Canada

Copy 1

Perspective on Canada's International Payments

★

A Background Sketch and Survey

Prepared by David W. Slater
for
The Economic Council of Canada

December, 1965

Available by mail from the Queen's Printer, Ottawa,
and at the following Canadian Government bookshops:

OTTAWA
Daly Building, Corner Mackenzie and Rideau

TORONTO
221 Yonge Street

MONTREAL
Æterna-Vie Building, 1182 St. Catherine St. West

WINNIPEG
Mall Center Bldg., 499 Portage Avenue

VANCOUVER
657 Granville Street

or through your bookseller

A deposit copy of this publication is also available
for reference in public libraries across Canada

Price $1.60 Catalogue No. EC22-2/3

Price subject to change without notice

Roger Duhamel, F.R.S.C.
Queen's Printer and Controller of Stationery
Ottawa, Canada
1966

FOREWORD

Canada's international balance of payments has historically been the subject of recurrent attention and concern. Many complex and interrelated issues are involved in this subject. This study is intended to help to clarify some of these issues, and to promote a broader basis of public information and understanding about payments concepts, problems and policies in the Canadian context.

This study was initiated in the Spring of 1964 under the auspices of the Economic Council of Canada. We were fortunate in obtaining the services of David W. Slater, Professor of Economics at Queen's University and a leading Canadian expert in the field of international economic affairs, to undertake this study. The report and the views expressed in it are the responsibility of the author himself.

This is one of a series of special studies carried out under the sponsorship of the Economic Council of Canada. A list of other special studies and staff studies which have been published to date is shown at the end of this study.

John J. Deutsch,
Chairman,
Economic Council of Canada.

97977-2

CONTENTS

97977-2½

SUMMARY

In the post-war years the balance of international payments has increasingly become a focus of attention and concern in Canada. The purpose of this study is to assess the implications of foreign transactions for a country's international financial position, and the interrelationships between these transactions and the domestic economy. The discussion is intended to put into perspective some of the key issues in this field, as well as some of the misconceptions and myths associated with the subject, with particular reference to recent and historical experience in Canada.

The second chapter of the study describes the basic accounting framework of balance-of-payments accounts. It points out that while all transactions included in the balance of payments are made to balance by means of an accounting identity, the component items may be grouped in many different ways, and a particular group of items may be described as being in balance, in surplus or in deficit. Owing to differences between countries in the ways in which such partial groups of transactions are typically presented in official balance-of-payments statements, confusion may well arise in comparing or contrasting the payments positions of various countries -- for example, in the case of the so-called deficit positions of Canada, the United States and the United Kingdom over recent years. The study emphasizes that partial analyses may not be valid as a basis for inferences about the over-all balance-of-payments situation. Moreover, it suggests that conclusions arising from such analyses can be seriously misleading, and the policy implications drawn from them quite wrong.

This study takes the position that an international payments problem exists when a country has continuing difficulty in "paying its way internationally". This implies the need for an over-all balance in international receipts and payments (taking account of payments and receipts both for goods and services and for capital movements) without undue pressure on the exchange rate, a serious loss of foreign exchange reserves, an unsustainable level of foreign borrowing or recourse to domestic deflation. This is quite a different concept of balance than that which has dominated much of the post-war discussion in Canada; such discussion has tended to focus attention on partial balances -- particularly on the current-account deficit (covering transactions in goods and services) and on net capital inflows (especially long-term inflows with implications for a rising volume of foreign ownership of Canadian assets). A current-account deficit, perhaps even one of substantial size, may thus not constitute an international payments problem -- at least in terms of reflecting the inability of a country to pay its way internationally in the above sense. Similarly, net long-term capital inflows, even if relatively large and persistent, may not necessarily be a reflection of a payments problem as such, although they may be symptomatic of institutional and structural problems, and involve broad social and political as well as economic issues.

National domestic policy is now almost invariably directed towards the primary economic objectives of economic growth, full employment, and increasing productivity. The inability to pay one's way internationally may impose a serious constraint in meeting these goals, and give rise to conflicts between internal and external equilibrium. The conflicts must not be treated as excuses for inactivity in economic policy. Rather they impose requirements for major efforts to integrate diverse strategies of economic policy to promote simultaneously and consistently the attainment of the several primary economic objectives of a society.

It is something of an oversimplification to say that payments difficulties may be classified as short- or long-run, but the difference is both real and important. A short-term deficit in the over-all balance of payments may occur for a variety of temporary reasons, a decline in exports, an upsurge in imports, or reversals of capital flows including speculative movements. In such situations, a country's gold and foreign exchange reserves and the international credit facilities available to it are crucial in providing elbow-room for temporary financing of the over-all deficit. In addition there is a range of special measures which may be deployed – for limiting imports and other payments, stimulating exports, and encouraging capital inflows. However, such measures, which may be both necessary and effective, usually involve economic costs to the economy as a whole, thereby limiting their usefulness beyond the short run.

A prolonged, or fundamental deficit situation is something else again. It arises from structural causes, such as shifts in foreign or domestic demand, the development of persistent excess demand, or major changes in technology, and is almost invariably associated with a loss of competitiveness. Sometimes this loss of competitiveness and the underlying structural maladjustments may be reflected in a clear overvaluation of the currency in relation to other key currencies. In these circumstances, devaluation may be the fastest and most efficient means of adjustment, together with appropriate policies to help assure that the resulting competitive advantages are not subsequently eroded. Alternatively, the deficit may arise from the structural malfunctioning of the domestic economy -- for example, through a general failure of the economy to adjust adequately or sufficiently quickly to changes in the structure of demand or in cost conditions or technology. In these circumstances, the central focus of policy should be put on internal adjustments; to alter the structure of production; to remove redundancies and scarcities of various productive inputs; and to shift the levels and patterns of demand to suit the new supply capabilities. Emphasis should be placed on adjustments aimed at removing distortions and strengthening the competitive capabilities of producers.

The network of relationships between international receipts and payments and the domestic economy is infinitely complex. Chapters 3 and 4 describe some of the important responses of the total economic system and its component sectors to an over-all surplus or deficit situation. There is a continuous interaction of adjustment and response; some of the responses tend to induce adjustment, others may not. In general, the primary impact of the adjustments is on costs, prices, incomes and employment. For a country in deficit, the adjustments will tend to work in the direction of rectifying the imbalance by inducing a reduction in imports and a stimulation of exports and capital inflows. But it is by no means certain that the net effect of these induced shifts will provide anything like a satisfactory total response, especially if institutional rigidities or a strong commitment to a domestic policy of full employment impede adjustment processes.

In situations of conflict between the need for adjusting to a payments deficit and such a domestic objective as full employment, a variety of fiscal and monetary policy measures can be deployed to effect specific external and internal responses with the aim of reconciling both objectives.

The problems of adjusting balances of payments are not as difficult as is perhaps usually indicated. They may require shifts in the use of resources of the dimensions of only 2 or 3 per cent of total national output -- adjustments which are not large in relation to the growth potential of the economy, or to the changes in the structure of production that take place in the ordinary course of medium-term economic development. But what is crucial is that such adjustments must be adeptly, swiftly and strongly encouraged in ways that are directly aimed at improving the international competitive capabilities of the economy.

Chapter 5 outlines the Canadian balance-of-payments experience from the early years of the century. There has been an historical pattern of current-account deficits in times of prosperity, and surpluses in times of slump. In general, a coincidence of dynamic growth with large capital inflows and current-account deficits has posed no over-all payments problem.

Since 1945, there has been a variety of balance-of-payments experience. The immediate post-war years were characterized by the need for aid to Europe in the context of uncertainties about demand, production, and markets at home and overseas. The devaluation in 1947 arose primarily from the temporary pressure of large-scale post-war loans, and was reversed in 1949 and 1950 as undervaluation of the Canadian dollar became clear. At that time, Canada moved to a fluctuating rate, which obtained until 1962.

For the decade from 1948 to 1957 the Canadian balance of payments was essentially strong. While the deficit on current account tended to grow, net capital inflows grew even faster, in circumstances of strong and sturdy growth in total production. Since the latter part of the 1950's the Canadian payments experience has been more complex. The decline in the rate of growth in the late 1950's was not accompanied by any significant narrowing of the current-account deficit; in fact, in 1959 and 1960 the current-account deficit was at record levels. Moreover, net long-term capital inflows fell significantly short of matching the current-account deficits in these two years. In 1960, the domestic economic situation rapidly deteriorated, bringing into sharper focus accumulating evidence of conflict between internal and external balance. These events, along with various other factors; had some bearing on the subsequent 1962 payments crisis; but this was essentially a crisis of confidence which might have been avoided in the absence of political complications and by a different policy orientation. The dollar was devalued and a fixed exchange rate established.

After the 1962 crisis period, the over-all payments situation moved back into surplus, but perspective on more recent developments is complicated by uncertainties and instabilities, especially in the capital markets, arising primarily from U.S. actions to deal with its persistent and substantial over-all payments deficit, but also from official Canadian pronouncements and actions affecting foreign investment in Canada.

In 1964, the Canadian balance of payments was in over-all surplus, and the foreign exchange reserves rose somewhat. In the first quarter of 1965 the reserves fell slightly and the payments account moved into over-all deficit. There are some indications of reversal of this experience in the second quarter. The uncertainties of forecasting balance-of-payments developments are inordinately great, particularly since this implies prescience not only of domestic developments but of those abroad as well. There is, however, no obvious reason to expect a payments problem in Canada over the medium-term future -- in fact there are grounds for at least cautious optimism.

Since the Canadian exemption from the U.S. Interest Equalization Tax in 1963, there has existed an agreement between Canada and the United States that Canadian exchange reserves will not be enlarged on the basis of borrowing in the United States. In the longer run it is, however, in Canada's interest to take every reasonable opportunity to build up its reserves or liquidity position. In the event of future payments problems (which could be more difficult to avert under the fixed exchange rate system), the reserves will constitute a basic factor for defending the Canadian dollar, at least under conditions of temporary over-all imbalance, pending judgment about the need for (and, if necessary, activation of) corrective measures.

Chapter 6 discusses some of the fallacies and truths in the traditional wisdom on the Canadian balance of payments. It covers such controversial points as the balancing of the current account, foreign borrowing and "eating one's capital", payments vulnerabilities, and the costs and advantages of an open economy.

The final chapter is devoted to some thoughtful speculation about the future of the Canadian balance of payments and some implications for policy. In the long run, Canada will maximize its potential for growth and a higher standard of living, not through restrictive measures which insulate the economy and artificially constrict various elements in the balance of payments, but through wider international participation in the exchange of goods, services and capital. This potential can only be reached in co-operation with other countries in joint efforts to maintain high and rising levels of world production and international trade. Joint efforts are needed also to improve the international monetary system -- to underpin confidence in national currencies and to provide effective elbow-room for an efficient reconciliation of diverse national experiences in production, consumption and trade. Within this environment, Canadian domestic policy must be directed towards maintaining and enhancing the competitive capabilities of Canadian producers, so that the economy can take full advantage of external expansionary forces -- forces which have historically played an important stimulating role in all our previous phases of prosperity and rapid economic development.

CHAPTER 1

INTERESTS AND GOALS IN BALANCES OF PAYMENTS

This study is intended as a background paper on Canada's International "Payments". The purpose is a modest one: to sketch conceptual and historical features of the subject, and to help put the current discussions of Canada's payments position in perspective. It is not intended as a thorough analysis of Canada's current and prospective balance of payments.

The nature of this paper dictates many of the relevant questions:

When have Canadians been particularly interested in their balance of payments and why?

What are the "true" interests of nations in their balance of payments? How do balance of payments and other economic experiences fit together?

What balance-of-payments deficits and surpluses are relevant for what purposes? How are these imbalances identified?

When deficits or surpluses appear, what built-in corrective processes operate in the economic system? In what circumstances do these processes produce satisfactory results? When the results are not satisfactory, what principles may guide policies to promote the balance of payments and other interests of the country?

What have been some of Canada's experiences in balances of payments and foreign exchanges? What guidance may be provided from that experience about causes and nature of Canadian problems; about catastrophes and successes of Canadian economic policy; about too slow or rapid adjustments of the country's balance of payments?

What are some of the eternal verities and fallacies in balance-of-payments analysis? And what are some of the common errors of judgment on the subject?

What kinds of problems do Canada and other countries face now and in prospect in adjusting internal and external economic performance? What general policy guidelines may be provided for some of these possibilities?

Some Current Issues

Nowadays, three somewhat separate threads of general economic enquiry draw attention to Canada's balance of payments. The *first* arises from the general uncertainty over the country's external economic environment. The question is whether external developments will permit the relatively easy future attainment of Canadian economic and social goals -- with the current arrangements of Canadian economic policies. Many people think the answer is No, and thus attention is devoted to major rearrangements of the country's domestic and international economic affairs to promote better performance. In its *First Annual Review,* the Economic Council of Canada placed emphasis on the balance of payments in the context of the attainment of such goals. It said:

> Success in achieving our basic economic goals will depend not only on appropriate domestic circumstances and policies, but also on international conditions and developments. Some of these, which are beyond our capacity to shape or control, could impose very severe constraints on the economy's internal achievements. ...any weakness in the world economy makes the *possible conflict between internal and external balance* much more acute for Canada.[1]

and also:

> As the Canadian economy moves towards potential high levels of employment, output and demand, the balance-of-payments position will need careful attention.[2]

As another pressing general issue, many people urge or foresee a substantial reduction in the net rate of importation of foreign capital into Canada. From this notion, inferences are drawn about potential balance-of-payments deficits unless major corrective action is undertaken in Canada's internal finances and external trade. As a third general issue, Canadians are deeply interested in the current problems of the United States Dollar and the Pound Sterling, and in the prospective changes in the international monetary system.

The consciousness of Canadians about their balance of payments is not confined to general considerations that only gradually and indirectly influence policy. Several of the major *specific* post-war economic crises and emergency policies were centred on the country's balance of payments. In the 1947 crisis of foreign exchange deficits, Canada suddenly introduced emergency quantitative trade controls and rather quickly thereafter shifted towards increased economic integration into the North American economy. The run to the Canadian dollar in 1950, in an inflationary setting, led to the adoption of the floating exchange rate system -- one of the great events of modern Canadian economic policy. In the exchange crisis, devaluation and emergency programme of 1962, major changes in the country's internal and external economic position were also introduced. Indeed, the policy changes associated with that crisis have been major factors in Canada's favourable economic experience of recent years.

Danger of Overemphasis

While there is no denying the great significance of the balance of payments for Canada, one must be on guard against overemphasizing such experience or

[1] Economic Council of Canada, *First Annual Review,* "Economic Goals for Canada to 1970", December 1964, p. 203.

[2] *Ibid.,* p. 190.

problems, or of taking these out of context. Looking back over the history of world economic policy, it is clear that one of the greatest enemies of sensible actions has been inflated *national* ideas of balance-of-payments deficits. Deficit positions are frequently overestimated. Despite the world being a closed economy, the "sums" of national balances frequently add up to huge deficit totals, an absurdity in economic arithmetic. Unilateral instead of multilateral points of view are often taken in analyses of balance-of-payments conditions. It is easy for individual nations to see that reductions in their unemployment, increases in their output and greater rapidity in their economic growth will draw in imports, but difficult for them to see the prospect of expanded exports. Yet every import of one nation is an export of another. World economic performance in the 1930's provides the best-know example of such biases, but they exist almost as clearly today. They often tip policy in a cautious, restrictionist, nationalistic direction.

Another of the great enemies of sensible economic policy is the taking of balance-of-payments experience "out of context". This is illustrated by careless piecemeal discussions of countries living within their means, and of general deflation or expansion as *the* means of doing so. As will be seen shortly, a country with a balance-of-payments deficit has a combined use of goods and foreign "lending" which is greater than the nation's production, plus its foreign "borrowing". Correction of the deficit requires some curtailment in the use of resources by the nation *in relation to* its production and borrowing. This is the element of truth in the idea that nations must live within their means to avoid persistent balance-of-payments deficits. But the adjustments necessary to live within one's means are very different for economies which have deficits accompanied by slow growth or high unemployment, than for those with full employment. To counsel *only* deflation for balance-of-payments deficits without regard to the circumstances and other objectives and policies is more often misleading than not. Frequently it is irresponsibility clothed in the name of "sound finance".

A third enemy of sensible economic policy is the presumption that problems are only solved by government policy -- that conjunctures of balance-of-payments disequilibria and unsatisfactory economic situations internally dictate government interventions of a magnitude that approximates the disequilibria, or else the problems will not be solved. People often expect too much of governments. On the one side, administrators often underrate or underestimate the power of adjustment processes that are a part of the economic system. The opposite error arises frequently also. Governments try to have their cake and eat it too, in expecting balance-of-payments adjustments to follow from certain policies, though other policies are powerfully contradictory to the required adjustments. The long, sad world tale of active economic policies to insulate domestic economies from external conditions provides endless lessons in misguided government policy.

These warnings are not meant as a denial that Canada has had, or will have again, difficult balance-of-payments problems, both of deficit and surplus varieties. Nor are they meant as an argument against the use of active policies to deal with Canada's problems of external and internal balance. But in a study which is to make quite a fuss about balances of payments, it is well at the out-

97977-3½

set to recognize that not every "cry of wolf" is accompanied by something at the door; and that when something does appear at the door, it may be the shadow of a wolf of our own creation.

Some New Circumstances and Some International Comparisons

Though Canada's interest in her balance of payments has never been slight, a number of factors have reinforced the concern in recent times. These factors include Canada's return in 1962 to a pegged exchange rate system, the recent problems and policies related to the United States balance of payments, some symptoms of competitive weakness of Canada's position in the world economy, and glimpses of some of the requirements of Canadian economic growth and possible Canadian vulnerabilities during the next few years. These frequently come together as forecasts of balance-of-payments problems arising in circumstances which may make adjustments difficult.

In 1962 Canada gave up one of the mechanisms for adjusting internal and external economic situations when the flexible exchange rate system was formally abandoned. Under that system the country could be regarded as having a standard built-in policy of adjustments to balance-of-payments disturbances, operating partly through changes in exchange rates (particularly at the crucial margins of adjustment). The arrangement was attractive for Canadian economic performance in some respects and circumstances, but not in others. Now other avenues of adjustment have to be used more intensively and some of them may have to be modified if they are to be adequate for the purposes. Different policy mixes for external and internal balance may be required also. Obviously much greater importance now attaches to the country's exchange reserve and international liquidity position. These changes intensify interest in Canada's balance of payments; they alter the appearance, form and some of the real problems of adjustment. These changes must not be taken out of focus. *The main underlying economic tasks of adjusting balances of payments and of promoting the internal economic goals of a country are the same under the pegged and the floating exchange rate mechanisms.*

The persistence of the deficit problems in the United States balance of payments and the somewhat related irresolution of the long-term international monetary problems have also had profound influences on the recent appreciations of Canada's balance of payments. For a number of recent years, United States internal economic performance and policy were less expansive than seemed appropriate because of these balance-of-payments constraints. When economic performance there became more expansive, by fiscal and monetary ease and the favourable turns of the private tide, the balance-of-payments problems persisted, despite fairly vigorous corrective action. With some reluctance the United States has felt it necessary to take many unusual steps to correct its balance-of-payments deficit *directly:* by adjustments in the military and aid programmes (partly to focus purchases more heavily on United States goods and services); by various other export-promoting devices; by some restrictions on imports;[1]

---

[1] However, the United States has shown remarkable restraint in adopting policies to limit imports of goods and services during the recent years of balance-of-payments deficits, a most encouraging sign for prospects in international trade and specialization.

and, more important for Canada, by a series of actions to restrict the outflow of capital from the United States. The room-for-manoeuvre that has existed for a long time in the Canadian balance of payments (because of possibilities of expanded markets in the United States and easy access to massive lines of private and public credit if need be) may thus have been narrowed sharply, even though Canada has received some special treatment in U.S. policies.

A third element that has increasingly attracted attention in appraisals of Canada's balance of payments concerns some indications of competitive weakness of the country in the world economy. From the later 1950's and continuing with only moderate abatement to the present time, a fairly general consensus appeared -- that the competitive position of North America in world markets had deteriorated since the early 1950's. For both Canada and the United States, cost, price, market-share and margin data were adduced in support of such a view. Moreover, the trend seemed to be worse for Canada than the United States, at least prior to the devaluation of the Canadian dollar, for a number of signs seemed to show a deterioration of Canada's competitive position even in comparison with the United States. Such observations tended to shake the confidence of some people about Canada's balance-of-payments position and prospects. Nothing approaching a deep pessimism now abounds, and the most recent Canadian and U.S. economic experience has countered some of the accumulated doubts. Canada's devaluation has greatly improved her competitive position. But one still hears from time to time an urging of the need for frugality, hard work, restraint in increasing the Canadian level of living, and perhaps institutional changes to promote further improvements in Canada's position in the world economy. More basically, however, there is a need for consistent and continuing improvements in industrial efficiency.

The fourth set of elements reinforcing the current concern with the country's international position are some signs of prospective *fundamental* balance-of-payments deficits; some signs of vulnerability of the balance of payments to fairly large unpredictable external shocks; and also some indications of reduced capacity of the country to cope with such problems. The signs are by no means clear, as will be seen from later examinations. The impressions of a medium-term prospect of fundamental balance-of-payments deficits appear from certain possible combinations of Canadian growth *and* the limitations on capital inflows into Canada. The argument about vulnerability has been given specific point by the impact on Canada of the sudden, unusual U.S. balance-of-payments policies in recent years. The allegations of reduced capacity of Canada's policy derive from some of the changes mentioned earlier and from certain judgments about institutional changes in international and domestic finance. The wolves may not be at the door, but some scouts believe that they have seen them over the hills; and others feel the home is less fit for a siege than it used to be.

A number of recent international comparisons also sharpen the interest in Canada's balance of payments, and provide some perspective on the subject. First, in recent years (as frequently happened in the past) the sums of national balances have added up to huge collective deficits. On the basis of consistent concepts of balance-of-payments calculations, however, such a collective deficit position is impossible. The impossibility arises because, in general, one country's balance-of-payments deficit is another country's surplus. Second, there are exceptions to this rule; the relevant concepts of balance-of-payments equilibrium have to be adapted to circumstances and problems. Different measures may be appropriate for key-currency countries than for others; different measures may be relevant to various institutional arrangements and for different time horizons of policy-making. But the collective net deficits which have been commonly suggested in recent years are beyond explanation by such reasonable adaptations of concept. They reflect a tendency to overstate deficits and understate surpluses as part of cautious, often nationalistic exercises in advocacy. Thirdly, the widespread current diagnosis by countries of actual or latent balance-of-payments deficits are accompanied almost as universally by prescriptions to increase exports of manufactured products. Masses of nations appear to be seeking simultaneously the expansion of their exports of manufactures as the solution to their current or prospective balance-of-payments deficits. These plans are not necessarily contradictory with one another, for expanded exports and imports of manufactures may go in step. But comparable changes on the two sides of the trading picture in manufactures do not appear to be the aspirations of most nations.

Policy Constraints and Policy Mixes

Before plunging into the technicalities of balances of payments, economic interrelationships and Canada's economic experience, it seems attractive to explore some general questions about international payments. Why does a nation have to be interested in its balance of international payments? Are there primary and secondary interests? How is the main interest in the balance of payments related to internal objectives and circumstances for a nation? May there sometimes be conflicts and at other times harmonies between the pursuit of objectives of internal balance and external balance? How may some "elbow-room" be provided for a nation in matching up its balance-of-payments circumstances and requirements, and in reconciling its external and internal "balance"? What are some of the general policy problems of balances of international payments, and, more generally of the policy mix for promoting various internal and external objectives of a nation?

The Balance of Payments: A Primary Economic Objective?

A nation's fundamental interest in its balance of international payments is the *constraint* it imposes on the pursuit of its primary economic objectives. *The balance of payments of a nation is not a primary economic objective as such;* rather, certain balance-of-payments requirements have to be met while a nation pursues its primary economic goals. Crudely speaking, *the requirement is that a nation be able to "pay its way internationally" -- continuously and in certain senses efficiently.* The meaning of this is explained below.

A nation's primary economic objectives are: *efficiency* in the use of scarce factors of production; *high and stable levels of employment* of labour and productive capacity; and *equitable arrangements* for the sharing of the fruits, burdens and risks of a complex, interdependent economic system. Price-level stability is sometimes set as a primary economic objective, but it is essentially a means to other ends. A nation's concern with its balance of payments is most fundamentally in paying its way internationally while pursuing the primary economic objectives as well as possible in varying economic circumstances. Using Professor Meade's concepts[1], the primary economic objectives might be called collectively the goals of *internal balance*; and the balance-of-payments constraint as *external balance*. The problem is the *simultaneous pursuit* of *internal balance* and *external balance*.

A nation's first interest in its balance of payments is in the balance as a constraint on economic performance, i.e. in the over-all relationship between its external receipts and payments. But the balance of payments is often also considered as a focal point for examining other features of an economy. The Economic Council of Canada indicated an interest in the *size* of the country's external receipts and payments perhaps as much as in the balance, because of a belief that expanding international receipts and payments may be a positive factor in helping to achieve high internal standards of Canadian economic performance.[2] Canada is by no means the complete prisoner of external winds of economic change, but the external elements are still of decisive importance for the country. It matters whether foreign markets are expanding or contracting, whether foreign costs are rising or falling, whether capital is available on more or less cheap terms from abroad. And it is not just the isolated incidence of these that counts; the combinations within the balance of payments are important. While not wishing to forget about these elements, the immediate concern here will be with the over-all *balance* in payments as an element in the policy requirements of a nation.

The Nature of International Payments and the Provision of "Elbow-Room"

So far, the phrase about the requirement for a nation to "pay its way internationally" has been used without definition. In general terms, what does this mean? How can the constraint of "paying one's way internationally" be made more or less difficult? Does the constraint apply every day, or can some "elbow-room" be provided? If so, how?

The fundamental point is that foreigners who sell us goods and services, or who "borrow" from us, usually want to be paid in their own currency; or if not in their own currency, in some internationally acceptable money. The ability of a nation to pay its way internationally then is essentially a matter of being able to provide foreign monies (particularly internationally acceptable monies) to pay for the country's imports of goods, services and "securities" from foreigners. In turn, the supplies of these foreign monies to a nation arise essentially from the sales by its residents of goods, services, and "securities" to foreigners. For the nation's sales of these things, payment can be demanded from foreigners in an acceptable currency. So far as individual transactions are concerned, foreign purchasers of our goods have their own national money to offer in payment, while our sellers of goods usually want their own (national) money. On the other side, however, our purchasers of goods have their own national money to offer in payment, while the foreigners want their own. The

[1] J. E. Meade *Balance of Payments* (Oxford: University Press, 1951).

[2] *First Annual Review, op. cit.*, p. 204.

exchange market is concerned with marrying and clearing these interests. *A country's ability to pay its way internationally depends ultimately then on acquiring enough "foreign exchange"* (particularly, if need be, as high-powered international money or claims thereon) *to meet its payment requirements for "foreign exchange".*

Paying one's way internationally would be rather badly arranged if barter transactions were required; or if something close to barter ruled under a scheme by which a country's receipts and payments of foreign exchange had to be matched up in each small segment of time. The requirement would be more unsatisfactory under a fixed rate than a flexible rate exchange system, but it would be unsatisfactory under both. And, in fact, *for centuries international banking and monetary arrangements have provided for the temporary filling of gaps between receipts and payments.* "Elbow-room" in "paying a nation's way internationally" is needed for a number of reasons. Various seasonal and other temporary swings in payments and receipts take place; it would be most undesirable if the structure of economic activity had to be shifted around substantially to accommodate these temporary swings. Good systems of economic specialization are promoted by facilitating indirect as well as direct exchanges; and such indirect exchanges depend on the existence of temporary accommodation in a nation's payments.

The case for a nation having elbow-room in its international payments is exactly the same as for individuals and businesses within a country. And the method of accommodation is essentially the same. Within a country the holding (and transfer between individual units) of money balances that are generally acceptable *and* provisions for short-term borrowing and lending (adjustment in the liquidity positions of individuals and institutions) are the means of providing the flexibility. The holding and transfer of ownership of reserves of internationally acceptable monies and the provision for short-term international borrowing and lending provide the elbow-room for bridging gaps between international payments and receipts. Such bridging arrangements are of enormous real advantage to the efficient operation of international trade and finance; they arise under both fixed and flexible exchange rate systems.

Continuous and Efficient "Paying of One's Way"

In setting out a nation's primary interest in its balance of payments, it was said that the concern was with a constraint to "pay the nation's way internationally" -- *continuously* and, in certain senses, *efficiently.* What do these qualifications mean and why are they introduced? The concern with continuity arises because a nation in its international payments has to live through a lot of tomorrows. It will be no good at all for a nation to pay its way internationally today by running up debt burdens that it will not be able to meet tomorrow. Nor will it be satisfactory to cry poor today, when tomorrow one's riches will show. The elbow-room that it is provided by international short-term lending and borrowing arrangements depends on confidence and trust and a reputation for meeting one's obligations continuously. This requirement raises extremely difficult problems. For temporary variations in a nation's international receipts and payments, temporary and reversible accommodation only may be required. But what is temporary, in each regard, in concept and practice? What are the costs and risks and benefits of such accommodation? For more enduring problems in external balance or in achieving both internal and external balance, the use of temporary accommodation in international payments also makes sense, while the longer-term adjustments are taking place or being implemented. But what duration and size of the use of payments "elbow-room" is then appropriate in principle and practice? The constraint of "paying one's way internationally" turns out to be not so precise as one might believe on first inspection. The provision of short-term finance may be abused by a nation, just as by an individual; and it may be used by a nation to put off the longer-term adjustments. But the important questions are not of the possibility, but of the reality of abuse; and of the method and costs of providing the crucially important elbow-room for financing gaps in balances of payments without experiencing serious abuse.

By paying one's way efficiently, a closely related point is raised. The concern is with a nation's paying its way without excessive scrambling around to avoid some creditors, to borrow from some to pay others, and so on. In personal and business life we are all familiar with individuals or firms who may be successful for quite a while in avoiding bankruptcy by a continuous process of juggling their liquid asset and liability positions. For a nation to run its international payments in such a way is not only most inefficient, but would run serious risks of exposing a country to dislocating speculation. Far too much disorganization of the real economic business would arise; and excessive risks would be taken of runs and crises of confidence.

The Policy Mix Problem: Conflict and Harmony

Earlier in the Chapter it was argued that one of the great dangers in analysis and policy is to divorce the balance of payments from the remainder of an economy. The fundamental problem of economic policy in this connection was put as the simultaneous pursuit of "internal balance" and "external balance". For the first, but not the last time in this study, issues of interdependence, blending, conflict and harmony in economic policy are explored, this time very briefly.

Two points are central. The first is that *everything that happens in a country's balance of payments has its counterpart within an economy; and almost everything that happens within an economy has consequences for external payments*. This is equally true for *events* and for *policies*. For example, increases in foreign demand for a country's exports "improve" a nation's external balance *and* increase levels of economic activity within a nation. As another example, policies of fiscal or monetary ease within a country increase internal levels of economic activity *and* "worsen" a nation's external balance. The second point is of enormous importance: it is that *the degree* (often even the direction) *of change in the external balance and in the relevant measures of internal economic change* (employment, productivity, price levels, etc.) *may vary greatly from one event to another and from one policy to another*. For example, a change in the supply of foreign capital may influence the balance of payments substantially but internal employment levels comparatively little. By contrast,

97977-4

certain changes in consumer spending might affect internal employment considerably, but the balance of payments only a little. Or, as another example, the fiscal ease which produces a specified change in internal economic conditions may induce small changes in external balance; whereas monetary ease which produces a comparable degree of change in internal economic conditions may induce quite large changes in external balance.

The tasks of economic policy change with shifts in emphasis among the primary economic goals and requirements, *and* with variations in economic events. Internal depressions may be associated with balance-of-payments deficits or surpluses; but so may internal inflation. Different combinations of internal problems may be associated with a given state of external balance. The problem is then going to be to match up the mixtures of available policy instruments, which yield various combinations of internal and external change, with the specific sets of problems. Sometimes the problem will be relatively simple -- a problem of blending various policies, each one of which produces the right *kind* of change on each front. When a country has inflation internally and balance-of-payments deficits, any general deflationary policy will improve things both internally and externally. The problem then is to combine the right set of deflationary policies to get the right mixture of internal and external change. But sometimes the problem will be much more difficult, for individual policies may be good from one point of view but not another. A policy may improve internal economic conditions but worsen the balance of payments; another may have the opposite combination of effects. The problem remains one of selecting, mixing, combining various policies to achieve the various primary internal objectives of the country, while meeting the balance-of-payments constraint. In Chapter 4, the problems of mixing policies will be examined more fully. Meanwhile, the nature of balances of payments and of adjustment processes are considered in Chapters 2 and 3.

CHAPTER 2

BALANCE-OF-PAYMENTS CONCEPTS

Though it is a somewhat dull business there seems no alternative to presenting a certain minimum discussion of basic concepts and accounting relationships in a country's balance of payments.[1] The concern is with understanding the main elements which enter into a nation's balance of payments, with the nature of the relationships between them, and with some of the concepts of surpluses and deficits.

What the Account Contains; and Total Balance

The most important point about a country's balance of international payments is that, in principle, it records *all* of the economic transactions during a period of time between the residents of a country and the residents of foreign countries. Economic transactions take place both in goods and services *and* in such financial claims as bonds, stocks, mortgages, short-term government and private debts, and bank balances (referred to hereinafter by the rough term, "securities"). The intention is that the statement of a nation's balance of payments should record all of both kinds of transactions which have occurred during a period of time. In this respect a country's balance of international payments has a broader coverage than the current operating statement of a company or a household.

Perhaps the second most important point to be grasped about a nation's balance of payments is that *the total account, in principle, always balances:* if *all* transactions are considered, the sum of the entries on the one side of the account must be equal to the sum on the other side (see Table 1). This point is sometimes made by the assertion that there cannot be a deficit or surplus on the *whole* of a country's balance of international payments. The point is formally correct, but economically trivial; the balance on the total account follows from accounting conventions and definitions and has no more significance than the equality of two sides of a company's balance sheet.

The balance of the total account is derived from the recognition of the two-sided nature of most economic transactions, including those between residents of one nation and of others; and the recording, in principle, of both the sides of each transaction in the balance-of-payments account. Most international transactions are exchanges of goods or services for money or some kind of debt, or vice

[1] No attempt will be made here to give anything like a comprehensive discussion of the notions of national economic accounting and the conceptual apparatus used in balance of payments. A somewhat fuller discussion of concepts is to be found in this author's paper on Balance-of-Payments Deficits, published by the Canadian Trade Committee, and in a number of American publications cited there, including the recent works by Lederer, by Lary and by Salant et al., in the Brookings study. The various official publications of the Dominion Bureau of Statistics on Canada's Balance of International Payments provide excellent discussions of concepts.

TABLE 1

A Simplified Version of Canada's Balance of International Payments

(With some fictional illustrative figures in millions of Canadian dollars)

"Givings-Up" by Canadians to Foreigners		"Acquisitions" by Canadians from Foreigners		Balances ("Givings-Ups" minus "Acquisitions")	
A. Current Account	$		$		$
1. Merchandise Exports	6,100	1. Merchandise Imports	6,000	1. On Trade or "Visibles"	+100
2. "Exports" of Services	1,400	2. "Imports" of Services	2,000	2. On Services or "Invisibles"	-600
3. Contra Item – Unilateral Transfers	50	3. Contra Item – Unilateral Transfers	100	3. On Unilateral Items	- 50
4. SUM (Current "Receipts")	7,550	4. SUM (Current "Payments")	8,100	4. on Current Account	-550
B. Capital and Monetary Account					
1. Long-Term Claims Given Up by Canadians to Foreigners	1,000	1. Long-Term Claims Acquired by Canadians from Foreigners	300	1. Increased Net Foreign Claims on Long-Term Capital Account	+700
				SUB-TOTAL – Balance on Current and Long-Term Capital Accounts	+150
2. Short-Term Claims (other than money) Given Up by Canadians to Foreigners	500	2. Short-Term Claims (other than money) Acquired by Canadians from Foreigners	560	2. On Short-Term Claims, Other Than Money	- 60
3. Private Money Claims Given Up by Canadians to Foreigners (net)	10	3. Private Money Claims Acquired by Canadians from Foreigners	(netted out)	3. On Private Money Claims	+ 10
4. Official Money Claims (including gold) Given Up by Canadians to Foreigners	(net- ted out)	4. Official Money Claims (including gold) Acquired by Canadians from Foreigners (net)	100	4. On Official Money Claims	-100
				SUB-TOTAL, on items B: 2, 3, 4,	-150
				SUB-TOTAL .. on all Capital and Monetary Account: B: 1, 2, 3, 4,	+550
SUM (all Credits)	9,060	SUM (all Debits)	9,060	ON TOTAL ACCOUNT	0

versa; or of one sort of "security" for another; and sometimes barter exchanges of some goods or services for others. The two sides of these transactions will appear in this country's account as Canadians giving up certain things for others, with both sides being entered into the balance-of-payments statement (see Table 1).

Some international transactions, like some domestic transactions, are one-sided, in an economic sense; individuals receive goods or services or money balances from foreigners without making payment; the other side of the account has the nature of a gift. Similarly, foreigners may receive goods or services or "securities" without making payment; the items may be gifts of Canadian residents, including Canadian governments. The convention has been adopted of matching up such one-sided transactions by a "dummy" entry under some such title as "gifts". In this way, the unilateral transactions are recorded in entries of equal magnitude on both sides of the nation's balance of payments, just as if quid pro quos were involved. To sum up, then, since every international transaction has, or is treated as having, two sides of equal value, and since both sides are always recorded in the balance of payments in equal-valued entries, the account as a whole must balance. The actual accounts are built up from fragmentary information, so that gaps arise between the recorded entries on the two sides; but at the level of total balance this merely reflects imperfections in the information available to the balance-of-payments accountants.

Deficits or Surpluses in the Balance of Payments: Accounting Numbers and Measures of Economic Significance

Since the balance of payments as a whole must balance, the term deficit or surplus applied to the account must refer to some selection of items within the account. The entries in the account can be grouped in an almost infinite number of ways, and balances struck for each grouping. The groupings could be, for example, of all exchange reserve transactions, or all long-term lending, or all current trade in goods and services, or the trade in a particular class of commodities with a particular country, or all transactions in immigrants' remittances with a particular group of countries, and so on. Some groupings would balance, but *for most accounts a deficit or surplus would be found.* That is, during the period under consideration it is likely that the residents of a country will be giving up more than they get in dealing with residents of other countries -- a surplus position -- on many *particular* sets of accounts; or vice versa -- a deficit position -- on other *particular* groupings of transactions. Accordingly, almost as many deficits and surpluses could be counted in a balance of payments as ways of dividing up the accounts. Since the account as a whole must balance, every time an element of deficit is encountered on a particular set of transactions, an element of surplus must exist somewhere else in a consistent subdivision of the accounts.

These points are illustrated by Table 1. Some typical classifications of balance-of-payments entries are shown there, in a Current Account (with further subdivisions between current trade in goods and in "services") and a Capital and Monetary Account (with further subdivisions into long-term and short-term lending, and private and official transactions in money claims). The purpose of these and some other classifications will be examined in a moment. For each subdivision, hypothetical entries for each side of the account are put down and balances struck. In this example, every subdivision is either in surplus (trade in merchandise, long-term lending, private money claims) or in deficit (trade in services, unilateral items, short-term lending and official money claims). But the surpluses on some sets of accounts are matched by deficits on others. If the whole account was divided just in two, with the Current Account in one block and the Capital and Money Account in the other, the deficit on the Current Account would be matched by the surplus on the other. Alternatively, if the whole account was divided into any two other blocks, the surplus on the one would be matched by the deficit one the other.

Most of the ways of counting balance-of-payments deficits and surpluses have no economic significance; they are at best handy accounting devices. On the other hand there is no such thing as "the correct" concept of balance-of-payment surpluses or deficits; rather there are a number of different concepts that are appropriate for various purposes. In this regard, two uses must be distinguished, however. First, some measures of balance-of-payments deficits or surpluses are signals of good or bad performance, of difficulties or the opposite, or focal points for the detection of major incipient problems. Secondly, many measures of balance-of-payments deficits or surpluses are at best of minor or subsidiary economic significance as details for the exploration of the nature of a problem and solutions. This is generally the case for the comparison of narrow ranges of transactions between residents of limited groups of nations.

Two distinct concepts of deficits and surpluses in external payments attract, deservedly, an enormous attention in economic analyses. The *first* concerns *the position of a nation as a net acquirer or user-up of exchange reserves and official international liquid asset positions.* "Basic Balances", "Net Balances", "Over-all Balances" [1] (to use some of the common terms of the technical literature) all use variants of this general kind of notion of balance-of-payments deficit or surplus. *A net increase in a nation's exchange reserves and other official international liquidity positions constitutes a surplus position in this sense; and the opposite -- a deficit. Such notions attract great attention in economic analysis because a nation has ultimately to supply an acceptable international means of payment for its international obligations as they emerge. A nation's own currency does not have the requisite general acceptability.* A nation will ordinarily own only a limited stock of exchange reserves and have limited access to the "borrowing" of reserves by various official short-term international credit operations. Thus a deficit in the sense used here refers to a deterioration in an

---

[1] A number of important papers on concepts and measurement of balance-of-payments disequilibria have appeared in the last three years, including: Walther Lederer, *The Balance on Foreign Transactions: Problems of Definition and Measurement* (Princeton, N.J.: Princeton University, International Finance Section, September, 1963); Hal B. Lary, *Problems of the United States as World Trader and Banker* (Princeton, N.J.: Princeton University Press, 1963); Paul Host-Madsen, "Asymmetries between Balance of Payments Surpluses and Deficits", International Monetary Fund *Staff Papers,* Vol. IX, No. 2 (May, 1962); Walter S. Salant et al., *The United States Balance of Payments in 1968* (Washington: The Brookings Institution, 1963); Edward M. Bernstein, *The Balance of Payments Statistics of the United States: A Review and Appraisal* (Washington: special report prepared for the Bureau of the Budget, April, 1965); Charles P. Kindleberger, *Balance-of-Payments Deficits and The International Market for Liquidity* (Princeton, N.J.: Princeton University, International Finance Section, May, 1965).

important aspect of a country's ability to meet international payments; and a surplus to an increase in a country's ability in this regard. Whether or not such changes indicate problems is another matter. This concept is much the most important and fundamental economic measure of balance-of-payments deficits and surpluses. Incidentally, this measure of the state of balance can be viewed from the position of the remainder of the balance-of-payments accounts that must be associated with it. A deficit in the reserve and liquidity position corresponds with an excess of purchases over sales of goods, services and on ordinary security accounts by residents in a country, in their foreign transactions; and a surplus, an excess of sales on these accounts.

The *second concept* of balance-of-payments surplus or deficit which receives *great attention in economic analysis* is the *net balance on the current account* (transactions in goods and services). Sometimes the interest is directly in this balance; sometimes it is in the obverse position of the other elements of the balance of payments, i.e. the net balance on capital and monetary account which is implied by the balance or account. A positive balance on the current account implies a net increase in private or official claims on foreigners; a negative balance on the current account implies a net increase in private or official "indebtedness" to foreigners. *The current account balance is of great significance in economic analysis because the items in that account enter directly into the goods and services of an economy; they are among the direct determinants of the state of prosperity or depression in the country;* they are entries in a country's national income accounts. The items in the capital and monetary accounts do *not* enter directly into the income flows; they have indirect, rather than direct implications for the state of prosperity or depression in a country. This point must not be pressed too hard, for the real and financial aspects of an economy are linked by strong threads. Full equilibrium requires reconciliation of real and financial positions.

The balance of payments was described as, in principle, recording *all* economic transactions between residents of one country and foreigners during a period of time. About foreign investment and the earnings from foreign investment, a gap sometimes appears in the accounts. It shows up in the usual measures applied to Canada's balance of payments, though supplementary material is provided which permits adjustment to close the gap. The gap arises as follows. In the usual measures of the current account, the dividends items record only payments, i.e. dividends paid by Canadians to foreigners and by foreigners to Canadians. The main or standard accounts do not record the incomes earned but not paid as dividends. The undistributed profits due to foreigners who invest in Canada may be as much again as the dividends paid to them; and similarly for Canadians who own foreign equities. Since foreign investment in Canada is so much larger than Canadian investment abroad, the usual accounts thus tend to seriously understate the net economic balance on Canada's current transactions. A parallel gap appears in the usual presentation of the accounts of foreign investment in the Canadian balance of payments. In essence the reinvestment of earnings of foreigners in Canada is a form of lending to Canada; it increases Canada's international "indebtedness" every bit as much as a new sale of Canadian bonds to foreigners. Similarly, the reinvestment abroad of the foreign earnings of Canadians is a form of Canadian lending to foreigners; it increases Canada's international assets. A case can be made therefore, for including such reinvestments in the capital account of the balance of payments. In practice, the measurement is considered to be difficult and arbitrary, so that changes in indebtedness through reinvestment of earnings are not ordinarily included in the capital flows in the Canadian balance of payments. This means, of course, that even though the basic accounts in the Canadian balance of payments might show a zero net balance of capital flows, probably a net increase in Canadian indebtedness would still be taking place. Information has been provided in the published accounts to permit adjustments for these gaps, but such adjustments are much too infrequently made in the figures which enter public discussions.

Incomplete Indicators; and Games of False Division

The balance-of-payments deficits and surpluses that principally interest us are those which pose problems of adjustment. Even for the economically significant deficit (or surplus) concepts, only some of these are associated with problems that require significant adjustments. Moreover, the nature of the problem and the requirements of policy cannot be determined from the balance of payments alone.

A nation which *persistently* runs down its exchange reserves or lines of international credit can be said to have a balance-of-payments problem; its position cannot be allowed to continue indefinitely. A nation which *persistently* accumulates foreign exchange reserves or lines of short-term international lending almost as clearly has a balance-of-payments problem, for its position becomes progressively more difficult to maintain as the accumulations continue. Thus *changes in exchange reserves and related international liquidity positions are the deficit notions with the clearest signals of problems.* But they are by no means unambiguous. They are less clear, though not irrelevant, for a flexible exchange rate system. Exchange reserves may not be changing, though the country really has balance-of-payments problems, for these may be masked by exchange or foreign trade policy or by unsatisfactory internal economic conditions.

Surpluses or deficits on a country's *current* account in its balance of payments are even less clear as indicators of problems. The normal economic position for a nation may be some net rate of import of capital from abroad over extended periods of time; it may even be an ordinary part of economic life that such flows will vary systematically from one time to another. These are not questions of needs but of advantage. Assuming that no problems are attached to the capital flows per se, than a continuous state of debit balance in a country's payments, far from indicating a problem, may merely reflect the real transfer of the resources made available by the capital flows. Problems would only arise, in this context, if the size of the debit balance on current transactions was substantially out of line with the capital flows for extended periods of time. Of course, problems can arise in this way, just as they may from incompatibility of current-account credit balances and rates of capital outflow by countries that are typically international lenders. Also there are the whole range of possibilities of economic, social and political disequilibrium in the capital flows, for which the surpluses and deficits on current account would provide some symptom. The point is, however, the ambiguity of the balance-of-payments measures themselves as an indicator of problems; and the necessity of other information, not contained in the balance of payments, to detect, diagnose, and prescribe for, the problem cases of balance-of-payments deficits.

Among the most common features of balance-of-payments discussions are the connections as cause and effect of particular, arbitrarily selected deficit and surplus positions, i.e. *the playing of games of false division*. The world has recently been treated to a particularly flagrant exercise of this game, as many people have treated the cause of the United States balance-of-payments deficit (measured by losses of gold and increases in U.S. official short-term indebtedness to foreigners) as that country's export of long-term capital to buy up control of foreign companies and resources. One could equally as well treat the deficit as the effect of United States foreign aid, or United States overseas military activities (as many United States observers do) or the fact that the United States is a large net importer of petroleum, coffee, bananas, or not a sufficiently large exporter of cotton or machinery. These alternatives are no more or less fanciful than the more popular foreign or United States expositions of cause and effect.

Games of false division are extremely common in discussions of balances of payments. A deficit of a certain size in the monetary and liquidity position is said to be caused by a deficit in trade with a particular country, or a deficit in trade in a certain class of commodities, such as automobiles or fuels, or a deficit in a particular class of services transactions, such as tourism, or business services, or a deficit in a particular element in the capital flows. Usually these allegations are worthless in analysis and misleading for policy.

This is not to say that all matchings-up of particular elements in balances of payments are false, or that partial balances are always worthless in analysis and prescription. But games of fair and useful division are very difficult to play, if they are to be anything more than propaganda exercises. The essence of the point is that cause and effect relationships in a balance of payments have to be based on the underlying economic factors; and that policy prescriptions should be based on fundamental goals and opportunities, not on symptoms. The game of false division is, at best, measurement and prescription without understanding.

97977-5

CHAPTER 3

MECHANISMS OF EXTERNAL AND INTERNAL ECONOMIC ADJUSTMENT

Disturbances and Adjustment Mechanisms

Both a country's balance of international payments and its internal economic position can be altered by external disturbances, such as changes in the foreign demand for a country's products or in the availability of capital resources from abroad. The disturbances introduce what might be called *first impacts* on internal and external economic conditions. But these impacts will set into operation various *adjustment processes* -- in consumption, production, trade and financial management -- which will make the total results quite different from the first impacts.

The same point applies to disturbances which originate within the country, such as shifts in preferences of consumers between domestic and imported goods, or changes in financial policy. Such changes will have an initial impact, usually on *both* internal and external economic conditions. The initial impacts will induce the operation of certain internal and external adjustment processes; *and the subsequent over-all economic outcome will differ substantially from the initial impact.* The disturbances may arise from changes in some government's policy or in private economic arrangements.

The purpose of this Chapter is to explore these adjustment processes. They are extraordinarily important but somewhat complex. To judge economic problems requires comparison of economic performance and economic goals. *To measure economic performance requires consideration not only of the initial impacts of some disturbance but also the adjustment processes.* Similarly, changes in economic policy may be regarded as disturbances to the internal and external economic position of a country, changes introduced deliberately to make economic performance different in some respects. But such policy disturbances also have initial impacts, which trigger adjustment processes or modify adjustment processes that would otherwise have operated. Accordingly *to judge the outcomes of changes in economic policy requires the knowledge of the relevant adjustment processes.*

In this Chapter, the concern is entirely positive -- that is, with stating the conditions that may arise under certain circumstances, or certain policies, rather than with their desirability. The term "disequilibrium" will sometimes be used, to refer to unstable positions. Movements to or from equilibrium do not necessarily refer, in any simple way, to worsenings or improvements in economic performance as judged by the primary economic goals of society.

The outcomes of adjustment processes depend on the situation into which the initial disturbances were introduced, the nature of the disturbances, and the

97977-5½

mechanisms and policy frameworks which are operative. It is impossible to set out here all of the relevant possibilities for Canada, but the outcomes may be illustrated for a few interesting cases which show the general nature of the adjustment processes and some of the factors that influence adjustment mechanisms. One of the most important sets of questions concerns the extent to which departures from the requirement of balance in a country's external accounts, either in the direction of surplus or deficit, may be "corrected" in various circumstances by adjustment processes *without* specific policy interventions, *and* with what consequences for the internal economic conditions of a country.

A Modern View on Adjustment Processes

The nature and issues of the adjustment processes may be grasped most easily by starting from an example, initially of an external disturbance through a sustained increase in the foreign demand for Canadian export products. The first impact of the disturbance will be: (i) externally, a balance-of-payments surplus; (ii) internally, a degree of expansion in income and employment, and an increase in price levels; (iii) some initial change towards ease in internal financial conditions; and (iv) a disequilibrium in the structure of production, consumption and trade. The form of these initial impacts differ somewhat depending on whether the country is on a fixed or flexible exchange rate system, and it will be assumed initially that the fixed-rate system holds. In this case the external disequilibrium will show up mainly in increases in official exchange reserves and improvements in external liquidity positions; the size of the relative expansion in the aggregate monetary demand for goods and services will be larger than under a flexible exchange rate system; and the increase in the internal supply of monetary instruments will also be larger. The form of these initial impacts within the country will also depend on other considerations, including the nature of the change in external demand, the supply conditions in Canada, the "fullness" of employment of manpower and productive capacity, the monetary and financial system, and the framework of economic policy. These details are important for the adjustment processes, but they are not the main concern at this point.

From these initial impacts upon the economic system will be generated a set of adjustments which will make the external and internal performance of Canada quite different that it initially appeared. In a modern treatment of the subject three main strains in the adjustment process are developed: (1) through direct adjustments in levels of income, employment and prices; (2) through financial re-adjustments; and (3) through changes in the structure of production, consumption and trade. These may be illustrated by following through with the general development of the example.

First, from the initial impact in expanding aggregate demand for goods and services in Canada, a somewhat complicated chain of adjustments will induce a general expansion of income, with increases in levels of output and prices. Imports of goods and services will be enlarged thereby. Consequently this adjustment process through changes in income tends to make the external surplus less than it was on the first impact, but at the same time to increase internal levels of activity more. These adjustments may be either good or bad in terms of the primary economic objectives in Canada, depending on the circumstances. But such issues are put off to later chapters.

The *second* general kind of adjustment process is distinct from the first, but it is interrelated at some points. This kind refers to changes in the supply of money and in credit conditions, and the consequences that flow therefrom. In the present example under a pegged exchange rate system, the initial impact is towards some expansion in the supply of money to Canada and some easing in credit conditions (unless complete neutralization is achieved by the monetary authorities – an extreme assumption). A further easing of credit conditions will usually follow in the adjustment process. Such ease would at least facilitate, and perhaps actively stimulate, the income expansion noted above, and thus bear on the degree of internal expansion in demand (and increases in output and price levels). Also, the ease in credit conditions in Canada would tend to reduce capital inflows to the country and encourage capital outflows, offsetting the the balance-of-payments surplus.

The *third* general element in the adjustment process is through alterations in the structure of production, consumption and trade. The initial impact altered the pattern of prices and profitabilities of the production of various goods and services; and these guides to production and consumption choices would be further altered in the process of adjustment of aggregate income. In consequence the availability of some goods for export would be reduced; a shift towards increased imports would be induced; the profits and earnings due to investors would be increased. The details may be put aside here; but it is important to note that these adjustments make the performance in a country's balance of payments due to the disturbance quite different than appeared on first impact. It should be also noted that these so-called "price aspects of adjustment" are somewhat distinct from the other two elements in the processes, though the pieces of each element cannot be simply added one to the other to yield the whole story.[1]

In this example, emanating from an increase in the external demand for Canada's exports, the position after the "initial impact" included a shift towards a balance-of-payments surplus position for the country. Depending on the circumstances, the response of Canadians and foreigners, and the policies pursued in Canada and abroad, the adjustment processes will usually reduce (perhaps eliminate) this initial external surplus. Various routes of adjustment are involved; and the adjustments take time. So long as the external disequilibrium exists, under a fixed exchange rate system, some means of filling the gaps (positive and negative) in the payments positions of nations must be provided.

---

[1] A.C. Harberger, "Currency Depreciation, Income, and the Balance of Trade", *Journal of Political Economy*, Vol. 58 (Feb., 1950); S. Laursen and L.A. Metzler, "Flexible Exchange Rates and the Theory of Employment", *Review of Economics and Statistics*, Volume 32 (November, 1950); Charles Kennedy, "Devaluation and Terms of Trade", *Review of Economic Studies, Vol. 18* (1949/50); Gerhard Stuvel, *The Exchange Stability Problem* (Leiden: H.E. Stenfurt Kroese, 1950); J.E. Meade,"Theory of International Economic Policy",Volume I, *The Balance of Payments* (Oxford: Oxford University Press, 1951); John Spraos, "Stability in a Closed Economy and in the Foreign Exchange Market, and the Redistributive Effect of Price Changes", *Review of Economic Studies*, Vol. 24, 1957; S.C. Tsiang, "The Role of Money in Trade-Balance Stability", *American Economic Review*, Vol. 51 (December, 1961); J. Vanek, *International Trade: Theory and Economic Policy* (Homewood, Illinois: Irwin, 1963).

Alternatively, some changes in policy may be required to close the gaps. The tendency towards "correction" of the initial balance-of-payments gap in this example illustrates an economic process of very wide applicability. But *the tendency of mechanisms of adjustment to correct balance-of-payments disequilibria should not be regarded as universal nor as always powerful; and certainly no particular adjustment process should be treated as universally desirable and beneficial.* The short- and long-run aspects of adjustment, policies to alter the speed or form of adjustment, and the "financing" of deficits or surpluses, are considered later in this Chapter.

The same ideas apply when the initial "disturbance" arises from within a country. Suppose, for example, that Canada experienced a marked shift in consumer tastes away from imported and towards domestically-produced goods and services. The first impact of the disturbance would have some similar features to the previous case of an external disturbance. Canada would realize a surplus in external accounts and an initial expansion of monetary income and expenditure levels internally; and the international reserve and liquidity position of the country would improve under a system of pegged exchange rates (the external value of the Canadian dollar would take the impact more than the liquidity position under a flexible exchange rate system). First-impact changes would also arise in the structure of prices and profits, but of a somewhat different nature than for the external disturbance. The three broad strains of the adjustment processes would be induced, as in the earlier examples: through readjustments in money incomes, expenditures and price levels; through changes in credit conditions; and in resource allocation. As in the earlier example, the adjustment processes would ordinarily tend to counteract or reverse the initial movement towards a surplus in the balance of payments. The warning that such is not the universal tendency should be repeated.

A number of general propositions about adjustment processes may be developed out of these examples. *First,* the adjustment mechanisms are individualistic, complex, and spread out in time. A complicated set of choices are made by individual economic units (private persons, and decision-makers in business and government) about the uses of labour and property, the organization of production, savings and expenditures, patterns of consumption and investment, and the structure of asset holdings. For most countries, decentralized decisions rather than government programmes are the essence of the adjustment processes, though government policy is of significant influence in shaping the mechanisms and in other ways. Some of the choices are exercised quickly and others more slowly, so that the nature of the adjustments vary with the passage of time.

Secondly, the adjustment processes are bilateral or multilateral rather than unilateral. Those countries which have balance-of-payments deficits must make adjustments which contribute to correcting the disequilibrium. But those countries which have the corresponding surpluses will also feel pressures for adjustments which contribute to correcting the disequilibrium. The adjustment processes may be blunted, distorted or mismatched. But for any major enduring disequilibrium some sharing of the burdens of adjustment between deficit and surplus countries usually takes place. Thus, adjustment of Canada's balance of payments and internal economic position depends very much on mechanisms and policies operating outside, as well as those inside, the country.

Thirdly, governments have important influences in shaping the environment in which adjustment processes operate, and thus in determining the nature of the internal and external performance which follows from any given initial disequilibrium. The on-going arrangements of government influence may be distinguished from the active exercise of specific government policy changes. In adjustment processes, the environmental influence of government is particularly important with respect to the choice of exchange rate systems, and the routine pattern of adjustment of government finances consequent on changes in incomes, production, consumption, profits, and so on. The legislation and administrative practice governing foreign trade, and the routine adjustment of monetary affairs consequent on changes in internal and external economic conditions, are also crucially important. Moreover, if a country has foreign exchange controls or quantitative trade restrictions or both, the built-in processes of adjustment in controlling trade and financial transactions will be affected differently as economic conditions change than would be the case in the absence of such arrangements.

Probably the most important governmental choice for international economic adjustment lies between a pegged and a flexible exchange rate system, for this influences the *form* of disquilibrium which any disturbance introduces in monetary expansion, in levels of monetary demand and internal prices, in the structure of prices, and in the terms of exchange among financial claims. Almost as important an environmental influence on adjustment processes are the choices that a country makes under a pegged exchange rate system about the automatic adjustment of internal credit conditions in response to the changes in the country's external balance, i.e. the internal monetary policy of a country. Convertibility, agricultural policy, planning mechanisms, and relations with the international monetary system, are other important areas of government choice which have powerful effects on the nature of the adjustment processes.

Short-Run Adjustments

Under all practicable, realistic foreign exchange systems and evolutions of economic experience, some countries are bound to have balance-of-payments surpluses and other deficits, at any particular time. By these are meant *gaps* at the ruling exchange rates between the demand for and supply of foreign exchange on ordinary trade in goods, services and securities. This is so even when circumstances or policies promote rapid adjustment to disturbances in the balance of payments; and for both fixed and flexible exchange rate systems. Under present-day pegged exchange rate systems a deficit gap will appear mainly as a weakening in the country's position in exchange reserves and/or net short-term indebtedness; movements in exchange rates can only take place within very narrow limits. Under a flexible rate system, some part of the gap may appear similarly as changes in reserves and short-term indebtedness, depending on speculative capital flows and official exchange operations. But a somewhat larger part of the gap is likely to appear as changes in exchange rates.

What are the more important specific problems and implications of these short-run gaps? What are the principal factors making for greater or lesser ease in dealing with these short-run gaps? How are these related to the adequacy of international liquidity and short-term capital movements? The issues are most easily developed for pegged exchange rate systems and for circumstances which are relatively favourable to the fundamental correction of a deficit gap in the balance of payments.

If there were no system of accommodating short-term capital flows from countries with surpluses to those with deficits in balance of payments, then the exchange reserves of countries would fully reflect the gaps. A unit of deficit would reduce the exchange reserves of the deficit country correspondingly, and increase the exchange reserves equally for the surplus country. Then, unless deficit countries had very large exchange reserves, they would be put under extreme and often quite undesirable pressure to eliminate the balance-of-payments deficit *quickly.* Also, unless the surplus countries had powerful ways of insulating their monetary and credit conditions from the force of enlarged exchange reserves, they too would be brought under extreme pressure towards increased spending. The central issues of the adequacy of the international monetary system would then be related mainly to the size and variation of exchange reserves. The only choices open to a country would be to finance balance-of-payments gaps (both surplus and deficit) by variations in official exchange reserves, or to close the gaps by some means.

The facility for financing short-run gaps, and the issues of adjustment policy are quite profoundly altered by short-term international capital flows. In principle the gaps can be filled by accommodating short-term capital flows, through various possible systems of lending from surplus countries to deficit ones. *Such flows are an alternative to changes in exchange reserves.* The flows cannot, of course, always be one way, and ordinarily they will not be, for countries vary from deficit to surplus positions and back again. Clearly, whether or not short-term international capital flows are adequately accommodating is of enormous importance for the short-run management of balance-of-payments gaps.

Four or five decades ago, there was considerable confidence that private short-term international capital flows could be counted on as sufficiently accommodating for short-term balance-of-payments gaps, at least for the more highly developed parts of the world. (For example, the United Kingdom operated a huge international trading, servicing and lending business with surprisingly small exchange reserves.) The belief was founded on a confidence in the ability of countries to maintain the external value of their currencies within fairly narrow limits, and in stable expectations about the course of balance-of-payments developments. It was also based on a belief that, given the basic enviroment of economic policy, balance-of-payments surpluses and deficits would themselves create credit conditions favourable to private stabilizing short-term international capital flows.

The old confidence in the adequacy of accommodating, private, short-term international capital flows has been greatly lessened during the last four decades. Belief in the willingness and ability of governments to maintain stable exchange rates and (invariant, relatively complete) convertibility has been undermined by experience and by changes in priorities in economic policy. From time to time, private runs to and from currencies have taken place, so that confidence in the stabilizing nature of private speculation is no longer the rule. The actual examination of earlier experience has raised doubts whether the older mechanisms were as effective as they were once thought to be.

As will be discussed later, partially-effective efforts have been made to insulate domestic economic conditions (including monetary and credit conditions) from the external environment as reflected in the balance of payments. Even if there had not developed a new orthodoxy of balance-of-payments policy, there would probably have been some need for improvement in the machinery of accommodating short-term international capital flows. As will be indicated more fully later, the new orthodoxy (involving postponement of balance-of-payments adjustment from time to time; involving, also, substantial changes in exchange rates and in convertibility of currencies as part of the policy mix) has added enormously to the doubts about the adequacy of private accommodating short-term capital flows. The new orthodoxy of balance-of-payments policy has thus intensified the need for reform in machinery for private and governmental short-term international capital flows and for the proper integration of financing and adjusting balance-of-payments gaps.

Attempts have been made to protect against destabilizing private short-term capital flows, i.e. runs to or from currencies. International machinery to take care of this aspect of the liquidity problem has turned out to be almost as urgent as was the earlier development of lender-of-last resort central banking facilities within countries. Beyond this there have been efforts to enlarge the flow and improve the timing of those private short-term capital flows which are stabilizing. Great emphasis has been given to the development of machinery for intergovernmental short-term private capital flows, partly through international institutions and for achieving a desirable rate and timing and set of conditions for these flows. There are extremely difficult issues about the appropriate balance of such systems of financing gaps and adjusting to them issues which are not appropriately tackled here. The issues are essentially of the right balance or fit of financing and adjustment -- they are the principal problems in the adequacy of international liquidity nowadays. It is worth re-emphasizing that while these problems have been altered somewhat by changes in circumstances, policy priorities and economic machinery, they existed also in the hey-day of the gold standard.

The Evolution of Views on Balance-of-Payments Adjustments

Some aspects of the modern positions on adjustment processes are most readily seen by contrast with older views on the subject. In the eighteenth and nineteenth centuries when the central core of classical ideas on international monetary adjustments were consolidated, most economists did not worry much about sustained unemployment of persons and productive capacity, nor about long periods of economic depression. Governments did not have to set full employment as a principal guide to active public policy. Even if they did, there were doubts about the possible effectiveness of such a governmental policy, for the principal determinants of the levels of employment and output were

97977-6

thought to be outside the policy control of governments – at least in the short run and when they used an acceptable range of policy instruments.

In the older view, monetary conditions primarily influenced internal price levels, and the relationships between internal and external economic positions of a country. Monetary policy was not therefore concerned much with full employment, but rather mainly with price levels and the balance of payments. One popular view of monetary policy held that adoption of the gold standard and the following of rules of the gold standard game (by built-in monetary arrangements or active policy) would be the best strategy – protecting against sustained inflation or deflation on the one hand, and providing effective mechanisms for adjusting a country's balance of payments on the other. Thus a priority was given in economic policy to the attainment of "external balance", not only as a requirement which a nation had to fulfil, but also as a means of promoting an appropriate long-run experience in price levels.

Another important thread in the older views on balance-of-payments adjustment was a strong belief in the speed and efficiency of the adjustment processes brought about by a decentralized revision of choices, guided (perhaps accentuated a little) only by the monetary policy referred to as the rules of the gold standard game. The belief was based on notions of a high degree of flexibility in production, consumption, trade and financial management in response to modest-sized changes in the structure of prices and profits. If, for example, some disturbance produced a balance-of-payments deficit, internal depression, and disequilibrium in the internal structure of production, profits, consumption and resources allocation generally, the typical adjustment process was thought to go something like the following. A departure from full employment would reduce wage rates rather quickly; the quantity of labour demanded would increase quickly and in comparatively large proportion in relation to the price change; similar changes would take place for other productive inputs; resources would be transferred from less profitable to more profitable alternatives fairly quickly; the standard of living and the pattern of prices and consumption would also be altered, and in response, imports of goods and services would be contracted and exports expanded. The signals provided by modest-sized changes in prices and profits and large-sized and speedy readjustments in the levels and patterns of production and "consumption" would correct the depression and the balance-of-payments deficit. In the interim the initial disturbance would produce some tightening in credit conditions, which would ordinarily lead to substantial flows of accommodating international finance from countries with balance-of-payments surpluses to those with deficits. The deficit country, according to the rules of the gold standard game, should reinforce the ordinary processes of adjustment by tightening its internal credit policy. This would encourage the appropriate inflows of accommodating international finance and speed up the process of adjustment in the levels of living and the structure of production, consumption and trade.

How different a view of adjustment processes and policies has emerged in our times? *First,* an active national policy to promote full employment internally is a part of nearly every country's operations. This change partly reflects the modern view that full employment is a more important objective in economic policy, partly embodies the modern view that the ordinary economic processes may produce substantial and fairly enduring departures from full employment, and partly is based on a belief that the present-day instruments of economic policy *can* influence substantially the levels of employment of labour and other productive capacity within a nation.

Secondly, price-level stability became for a time an explicit goal of economic policy rather than a handmaiden of external balance under a gold standard. For some people this shift took place because they felt that gold standard arrangements were unworkable and thus could not be relied on as a guide to internal prices. Others felt that, even if a modern gold standard could be made to work continuously without breaking down, it provided an unsatisfactory guide to internal policies for price stability. To a considerable extent, price stability was sought by nations independently of balance-of-payments conditions, as a means towards internal stablization of prosperity and depression.

Thirdly, the older confidence in rapid and efficient adjustments through the price system was badly shaken. Emphasis was given to downward inflexibility of money wages and the prices of other inputs and to immobilities of resources; to rigidity in the pricing of goods, services and financial claims; to sluggish adjustments in the kinds of goods and services produced and in marketing arrangements; to limited responsiveness of saving and investment levels and patterns for changes in interest rates and other credit conditions; to strong elements of monopoly in product and factor markets; to the tendency of governments to shield groups from the winds of market-induced adjustments; to imperfections in the transmission of information in a market economy, and so on.

The picture of the decentralized processes of economic adjustment that emerged was of rigidities, unresponsiveness, sluggishness, instability and perversity rather than of speedy and efficient adjustments in the structure of production, consumption, trade, employment, financial affairs, levels of living and balances of payments. Perhaps most important, the picture was of a tendency towards substantial unemployment and unutilized productive capacity emerging frequently despite comparatively attractive real opportunities for shifts in the employment of labour, productive capacity and natural resources. It was a picture of conflicts between the requirements of external balance and the various objects of internal economic policy. It was a picture of societies which, if they were to rely on the price system for correcting external disequilibria, would frequently find themselves with very "bad" economic performance internally, as regards high employment and full-utilization of capacity, and perhaps even as regards increasingly efficient production. It was a picture from which many people inferred a need for active, if not extreme, programmes of governmental policies, to deal with internal problems and balance-of-payments requirements in a very imperfect and inflexible world. The advocacy was often of such extreme measures as exchange and trade controls; exchange rate changes; export subsidies; state trading; perhaps replacement of the market economy by centralized government allocative systems; or at least an active use of monetary, fiscal and debt management policies.

In the more extreme forms, these pictures of modern-day inflexibility and of requirements of radical government policies are, in my judgment, about as gross a distortion of economic life as were the extremely simplified abstractions of international economic adjustment found in the older treatises. (Economic practice in the eighteenth and nineteenth centuries was much less abstract than the formal discussions, of course; so that it is not entirely a matter of comparing like with like to relate modern-day policy assessments and older treatises.) There is something to the notions of imperfections and inflexibility in the working of the price system; difficult problems of reconciling internal and external interests; and limited effectiveness sometimes of even the best exercise of the general policy instruments for establishing mutually consistant (and, what will concern us later, satisfactory) positions internally and externally. But these qualifications call, I believe, for open-minded modification of analysis and policy based on argument and evidence, rather than the blind acceptance of the substitute picture of extreme rigidity, or of adjustments arising only through extreme changes of government policy.

Policies to Influence the Form or Speed of Adjustment Processes; "Financing Gaps" in the Balance of Payments

In an extremely influential article, Harry Johnson has argued the advantages of the modern approach to balances of payments — emphasizing particularly the treatment of balance-of-payments adjustments as policy issues. He considers this strategy to be more relevant than the older "mechanism of adjustment" and the early post-Keynesian approaches. He says:[1]

> The theory of the balance of payments is concerned with the economic determinants of the balance of payments, *and specifically with the analysis of policies* for preserving balance-of-payments equilibrium. So defined, the theory of the balance of payments is essentially a post-war development. Prior to the Keynesian Revolution, problems of international disequilibrium were discussed within the classical conceptual framework of the mechanism of adjustment ... the actions of the monetary and other policy-making authorities being subsumed in the system under consideration. While the Keynesian Revolution introduced the notion of chronic disequilibrium into the analysis of international adjustment, early Keynesian writing on the subject tended to remain with the classical framework of analysis in terms of international monetary systems ... and to be concerned with the role and adequacy in the adjustment process of automatic variations in income and employment through the foreign trade multiplier ... applicability of the analysis to policy problems was severely restricted by its assumption of general underemployment. ... Since the war, ... the balance of payments has come to be a major PROBLEM FOR ECONOMIC POLICY in many countries. Correspondingly, a new ... approach to balance-of-payments theory has been emerging, an approach better adapted to post-war conditions ... it poses the problem of balance-of-payments adjustment in a way

---

[1] Harry G. Johnson, "Toward a General Theory of the Balance of Payments", reprinted as Ch. VI, in Johnson's *International Trade and Economic Growth*, (London, George Allen and Unwin, Ltd., 1958), pp. 153-4.

which *highlights their policy implications*, and it allows for conditions of full employment and inflation. (Italics and capitals are mine.)

Johnson's argument does not mean, as some people seem to think, that the processes of adjustment described earlier in this Chapter operate no more. Nor does it mean that these processes are irrelevant to policies. The idea is rather that the processes are shaped, influenced, often deflected and postponed and sometimes reversed by policies of governments. Also that balance-of-payments *problems* are created thereby or made worse sometimes, as a by-product of pursuing the general economic objectives of a society. The important implications are of the need for more powerful, manifold, integrated approaches to national and international economic policy; and of the need for somewhat greater ability to finance "gaps" in balances of payments. Johnson goes on in the quoted article and elsewhere to develop systems for blending "expenditure-reducing" (or increasing) and "expenditure-switching" policies in a flexible way, as suits the circumstances and problems, aiming to achieve both internal and external balance. Mundell has developed this type of argument in a much more refined way.[1]

The means and motivations for policies which influence the form or speed of adjustment processes are fairly clear. For temporary, reversible balance-of-payments deficits or surpluses, it is inherently sensible to limit the fundamental rearrangements in the use of resources in an economy. Some such policies will pose larger balance-of-payment problems than would otherwise arise, implying a greater need for financing of such gaps (by varying exchange reserves and by short-term international borrowing and lending) and for ancillary policies. These implications arise equally under fixed or flexible exchange-rate systems.[2]

For somewhat more enduring and fundamental disequilibria in the balance of payments, governments may sometimes dampen down or resist some of the processes which would ordinarily correct the disequilibria. Many perfectly good reasons for such actions can arise; to promote employment objectives or the control of inflation; to balance-up short-run requirements and long-run efficiency; to smooth out the operation of economic policy and economic change, and so on. But again the implications are for larger and more sustained balance-of-payments problems than would otherwise occur, other things being equal. *Such surpluses and deficits are policy problems both in the sense of being partly due to the policies of governments, and in requiring adjustments of policies to make the balance-of-payments position tolerable and to promote simultaneously external and internal balance.*

The issues are sometimes put as if the alternatives were to adjust or not to balance-of-payments disequilibria. This is quite misleading; it is not the way problems arise nowadays. The concerns are rather with the compromises in timing of adjustments, in choice of routes of adjustments, in financing gaps and

---

[1] R.A. Mundell, "The Monetary Dynamics of International Adjustment Under Fixed and Flexible Exchange Rates", *Quarterly Journal of Economics*, Vol. 74 (May 1960); R.A. Mundell, "The Appropriate Use of Monetary and Fiscal Policy for Internal and External Stability", IMF Staff Papers, Vol. 9 (March 1962); R.A. Mundell, "On the Selection of a Program of Economic Policy . . ." *Banca Nazionale Del Lavoro, Quarterly Review*, Vol. 66 (September 1963).

[2] One of the most important ideas argued in Milton Friedman's classic essay on flexible exchange rates, was that flexible rates do not mean unstable rates; and do not mean the abandonment of financing temporary and reversible balance-of-payments deficits or surpluses.

dealing with the other short-run problems. The aims are: to blend balance-of-payments requirements and other objectives as well as possible in the circumstances and with the available resources; to blend the active instruments of policy and the built-in adjustment processes occurring both internally and externally; and to integrate consistently the various national approaches to international problems. Balance-of-payments adjustment there must be, but the how, the when, the circumstances, and the other considerations raise the important real issues of policy. And it is to some general aspects of these issues which we turn in the next chapter.

CHAPTER 4

PROBLEMS AND POLICIES
A PRELIMINARY GENERAL DISCUSSION

Introduction: A Policy Framework

Nations are frequently concerned that the external economic tail may wag the internal economic dog. Some policies that would correct a modest-sized balance-of-payments deficit (surplus) may produce a substantial depression (inflation) in internal economic conditions. It would appear that nations have not yet learned well enough how to achieve *simultaneously* full employment, sustained and reasonably rapid growth in productivity, reasonably stable cost and price levels, external balance, and an acceptable division of economic output among consuming units.

This Chapter is a brief excursion into the general framework of problems and policies in balances of payments, and in the relationships between balances of payments and internal aspects of an economy. The discussion is organized around three questions: *First,* what are some of the factors which bear on the choice by countries between financing and "correcting" balance-of-payments deficits (and surpluses)? *Secondly,* putting aside for the moment the desirability of the internal consequences, what policies might increase the magnitudes and efficiency of correction of balance-of-payments deficits and surpluses per se? *Thirdly,* what principles guide the adaptation of economic policy when the concern is with promoting the primary *internal* economic objectives of a society as well as the requirements of *external* balance? The actual exercise of economic policy depends on the details of particular situations, but a preliminary general discussion of these three questions can provide a useful point of departure for later discussions of Canadian problems and policy alternatives.

Financing Balance-of-Payments "Imbalances"

Because of the temporary and reversible nature of some disturbances, or because it takes time for the appropriate set of adjustment processes and policies to take hold, not all positions of disequilibria in balances of payments will be (or should be) corrected immediately. Under pegged exchange rate systems, surplus countries will often find their exchange reserves and international liquidity position improving for quite some time; and deficit countries the reverse. Even under flexible exchange rate systems, changes in the international liquidity positions of countries with balance-of-payments disequilibria will often be (and should be) a part of the short-run developments. What are some of the more important general considerations for countries in choosing and organizing the short-term financial accommodation of balance-of-payments deficits and surpluses? Fundamentally it is a problem of balancing gains, explicit costs, the availability of opportunities for financing, and risks.

To avoid making real adjustments in an economy for temporary, reversible balance-of-payments disequilibria is an attractive proposition. When real changes are necessary, to avoid the distortions from crash programmes of balance-of-payments adjustment is also attractive. The *gains* from financing rather than adjusting to a disequilibrium arise in this way. But there are possibilities of losses too -- for example, if a balance-of-payments disturbance does not turn out to be reversible in a reasonable period of time. Then, to finance rather than adjust the balance-of-payments deficit or surplus may be a bad piece of economic management, for the burdens of adjustment may be made much heavier by being postponed. *Secondly,* the financing of balance-of-payments disequilibria involves *costs.* The adjustment of nations' inventories of foreign exchange reserves are a principal method of financing balance-of-payments positions. From the point of view of any nation the holding of foreign exchange reserves involves costs (though some of these costs are netted out for a whole set of nations). To increase a nation's short-term borrowing in times of balance-of-payments deficits involves costs; they may become extremely high if a nation makes extremely large use of such external lines of credit, because of risk considerations. On the other hand, a nation which extends additional short-term international credit is usually holding a low-yielding asset, or one which is considered to have a considerable risk attached. There are great difficulties and risks also in forecasting the degree and timing of temporary, reversible disequilibria and fundamental disequilibria; the most notorious modern example is the forecasting of a long-term prospective U.S. dollar shortage in the 1950's.

At any point of time and with any given institutional setting, a nation's exchange reserves, highly liquid international assets, and lines of external credit, are *limited.* A safety margin must always be preserved to guard against speculative runs from the currency. Some "room-for-manoeuvre" must also be provided for random short-run variations in transactions. Limited resources on the one hand and the requirements of safety margins on the other restrict the possibilities of financing balance-of-payments deficits -- frequently to the point which precludes a sensible balancing of the gains and explicit costs. The calculus of gains and costs might recommend the financing of quite sizeable balance-of-payments deficits for two to three years for a country but the means may not permit such a programme.

Changes in international financial institutions and practices can alter the strategy for nations in the financing and adjustment of balance-of-payments disequilibrium. The reversibility of a disturbance may be increased by changes in adjustment processes or other economic relations, thus tipping the balance of choice somewhat towards financing rather than adjusting to the disturbances. The costs of international borrowing and the availability of external resources may be improved by reorganization of the international monetary system and in the relations between national financial markets. This too would tip the balance towards more financing and less adjusting to reversible balance-of-payment disequilibria. Confidence in the economic management of a nation may shift so that the safety margins required in the country's reserve position to protect against speculation are reduced. Whatever may be the state of the international monetary and financial system, an individual nation may improve or worsen its working capital position in various ways, thus permitting that nation a greater possibility in financing balance-of-payments deficits. The balance between financing and adjusting depends to some extent on the methods of adjustment that can be turned to if the judgments about financing a deficit turn out to be wrong; for example, the situation will be different if a comparatively easy, efficient, routine use of exchange rate changes can be resorted to, if and as required, than if such opportunities do not exist.

In providing for the financing of balances of payments, the world arrangements in general and Canada's position in particular could do with considerable improvement. But such problems should not divert us from the main concern of this Chapter. Given the institutional arrangements and given the fact that the country will experience from time to time major enduring changes in its position in the world economy, real balance-of-payments adjustments will be required; and these ought to be blended with the pursuit of the nation's internal economic goals.

Policies Dominated by Concern for External Balance

The ultimate problem of economic policy is for each of a set of nations to be able to promote external balance and their primary internal goals, in ways which are consistent one with the other. But before such matters are considered, a narrower and more partial issue will be examined; this relates to policies for correcting balance-of-payments disequilibria as such. The concern is with the means of enlarging, accelerating, improving the adjustment of external imbalances, without much regard to the desirability of the internal consequences, except to note the characteristics of some internal changes. The theme is that there are many ways in which policy can influence the correction of external imbalances -- ways that differ in locus of adjustment, speed, and economic ramifications. The argument will be developed first for a country with a pegged exchange rate system.

Suppose that it is agreed that a nation has a balance-of-payments deficit that requires correction by adjustments in economic policy. Broadly speaking, what sorts of changes are required, and how may various policies meet the requirements? *Looked at from the point of view of the balance of payments* the requirement is a *relative* increase in the total of the nation's exports of goods, services and financial claims in comparison with the total for comparable imports. Various combinations of absolute increase and decrease will do equally well, if they are equivalent in *relative* adjustment. Considered as a balance-of-payments problem, per se, the problem may appear as that of reducing a deficit (or increasing a surplus) on current trade in goods and services *and* of increasing a surplus (or reducing a deficit) on the nation's capital account position (the alternatives depending on the country's normal position as a capital importer or exporter). But *considered from the point of view of the over-all economy, the problem usually appears to be to reduce a nation's domestic use of goods and services in comparison with its output; and to increase the buildup of* (non-exchange reserve) *debts to foreigners in comparison with the buildup of claims* *on them.*[1] The goods and service aspects of the problem usually appear to be to *both reduce a nation's total domestic use of goods and services* and to *switch uses from imported to domestic sources*[2], in Johnson's terms as *both* expenditure-reducing and expenditure-switching problems.

Deflation and Devaluation

The standard neo-classical policy prescription for countries which required corrective action for balance-of-payments deficits was to *deflate* internally. Some difference would arise from deflation by *monetary* or by *fiscal* policy under fixed exchange rate systems. A tighter *monetary* policy would allegedly reduce expenditures within the nation and in most circumstances result in a reduction in the nation's use of goods and services in comparison with its output, in the balance of payments, imports of goods and services would be reduced in comparison with exports. The effects of the tighter monetary policy in limiting expenditures might be small; but the tendencies would be towards reduction in the over-all use of goods and services within the economy, and probably also towards declines in the levels of output and employment. Tighter monetary policy would also tend to divert borrowing to foreign sources and encourage a foreign interest in the country's securities and this would also contribute to the correction of the country's balance-of-payments deficit.[3]

Deflation by a tighter fiscal policy (increased tax rates, decreased transfers by governments to persons, decreased government expenditures on goods and services) tend to operate directly towards reducing the domestic use of goods and services (absolutely and in relation to the nation's output), and reducing imports of goods and services in comparison with exports. Such tendencies may be partially offset by the internal financial ease that accompanies the fiscal tightness, for such financial ease will tend to discourage net capital inflows. Despite the differences in the nature, locus and timing of adjustment policies from deflation by monetary and by fiscal policies, under most circumstances certain conclusions are held in common. Deflation will usually tend to "correct" a country's balance-of-payments deficit under a fixed exchange rate system, but will usually involve some degree of decrease in the domestic use of

---

[1] It is possible that the adjustments in a nation's financial claims in its balance of payments could be so large as to permit enlargement of deficits (reduction in surpluses) in current trade to accompany "correction" of a balance-of-payments deficit, but this would be quite unusual.

[2] It is also possible that a nation's total use of goods and services may be increased in the process of correcting a nation's balance-of-payments deficit, but this would require strong policies of switching expenditure which would not be undermined by foreign repercussions -- policies which carried output-expanding forces that outweighed those policies directed to reducing expenditures. See Harry G. Johnson, "The Balance of Payments" in *Money, Trade and Economic Growth*, (London: Allen and Unwin, 1962) pp. 15–27.

[3] The mixture of internal deflation and balance-of-payments adjustment depends on the responsiveness of international capital flows to changes in financial conditions among nations and the responsiveness of internal expenditures to changes in credit conditions, as well as other factors. R.A. Mundell has recently shown that when a nation has a high degree of mobility in its international capital position and a low responsiveness of expenditures within the country to changes in internal financial conditions, a change in monetary policy might produce a large correction of a balance-of-payments deficit with little change in the use of resources or levels of output and employment internally. These conjunctures may or may not be desirable, depending on the nature of the country's economic position. See R.A. Mundell, "Capital Mobility and Stabilization Policy...", *Canadian Journal of Economic and Political Science*, November, 1963; and R.A. Mundell, "A Reply: Capital Mobility and Size", *Canadian Journal of Economic and Political Science*, August, 1964.

resources and in the domestic levels of output and employment. Also the deflation in one country tends to be diffused somewhat to the country's neighbours. The deflation may be in general conflict or harmony with the domestic economic requirements, depending on the cirsumstances. Even if a deflation is qualitatively right, it may be wrong in degree or in timing or it may pose very high costs for small gains. As recent British discussion has pointed up very sharply, "stop-go" fiscal and monetary policies are not necessarily the right ones for dealing with balances of payments, even when they can be technically effective regarding external payments, per se. These issues are dealt with below, but it is well to signal them at this point.

The other great neo-classical policy prescription for "correcting" a country's balance-of-payments deficit was *devaluation* in the external value of the country's currency (a policy that might be combined with deflation in certain circumstances).[1] The great attraction of this was that devaluation was a general instrument of policy (as distinct from specific interventions by governments in the allocation of resources) that could alter the gap between a nation's use of resources and its output to a significant degree by *switches* in the use of output. Of course, policies of deflation (or inflation) do carry some changes in the structure of demand, in prices and profitabilities which induce some switching between domestic and foreign sources of supply and markets -- switches that help to correct balance-of-payments deficits. But the incentives provided by deflation for such switches are usually incidental[2] and are frequently of limited magnitude, at least in the short run.

Changes in the external value of a country's currency, however, are directed immediately and specifically to altering the structure of prices among importables, exportables and domestic goods in production and consumption. They have immediate and direct impacts through switches as the means of correcting a balance-of-payments deficit. In contrast with trade or exchange controls (and most alterations of the structure of subsidies and taxes directed towards balance-of-payments problems), the switching induced by devaluation leaves a much greater freedom of choice to the owners of factors of production, and to producers and consumers in the countries engaged in the adjustment. But that very freedom may pose problems, for it opens the possibility of freedom not to react, or not to react quickly enough or in directions which are otherwise considered desirable. Provided that favourable institutional arrangements and appropriate choices or settings of general economic policy are found, devaluation may correct a country's balance-of-payments deficit not only through adjustments in the relationship of output to use of goods and services within a country, but also through the external capital account. While devaluation has implications for the

[1] Devaluation (and appreciation) was never as popular a prescription for dealing with balance-of-payments disequilibria as deflation and inflation, mainly because of beliefs about the likelihood of abuse of such policies, and because of possibilities of weakening the international monetary system. Many economists have also doubted the effectiveness of devaluations, though the current consensus in the profession seems to have rejected such doubts.

[2] The content of general fiscal and monetary policy can be adjusted to some extent to stimulate or discourage certain forms of balance-of-payments adjustment. For example, government expenditures which have rather large import content may be decreased by more than those of smaller import content, in the interests of accentuating the balance-of-payments adjustment from the deflationary policy. Generally speaking, however, there is not much room for manoeuvre in these respects without becoming deeply involved in planning and controls.

97977-7½

level of a nation's output, it is possible to have substantial alterations in the balance-of-payments position per dollar of change in the over-all level of output because of the switching adjustments brought about by the devaluation.[1]

Provided that it is not accompanied by a large degree of stimulus towards internal inflation, devaluation is rather generally regarded nowadays as being capable of correcting a balance-of-payments deficit. But such a policy may be in conflict or harmony with internal economic objectives. Even though capable of correcting a balance-of-payments deficit, it may be poor in timing or degree of change or excessive in costs. The devaluation instrument may carry grave risks of exchange speculation; and the uncertainty of the results may be too large. The disturbance to the general fabric of international trading and financial arrangements may be very great. It is not surprising, therefore, that the IMF charter (the most serious formal governmental commitment ever made in favour of policies of changing exchange rates as a means of dealing with balance-of-payments problems) places limits on changes in exchange rates and requires international agreement for acceptable use of such policies.

Specific Policy Instruments to Correct Balance-of-Payments Problems

To state principles regarding the use of *specific policy instruments* for dealing with balance-of-payments deficits is very difficult at this point. The variety of instruments, circumstances and combinations is very large; the choice of policy does not depend only, or often mainly, on balance-of-payments considerations. But a few general points can be readily made. *First,* in using controls and specific policy instruments, the lessons must constantly be borne in mind of "the part and the whole", and of "direct and indirect relationships". Controls and specific policy measures are inherently piecemeal and fragmented. Yet correction of a problem-deficit in a balance of payments requires certain *general* changes, the most important of which is a reduction in the *over-all use* of resources by a nation in relation to its *over-all output.* A specific policy measure which limits a particular use of resources, such as certain imports, may not be very effective even regarding the balance of payments, if there is merely a diversion of demand to other channels. Specific policy measures operate directly on certain activities, but this over-all effectiveness with respect to a balance-of-payments problem depends also on the indirect responses to the policies. They may undo or reinforce the direct impacts. To be effective, even judged by influence on balances of payments, controls and specific policy measures must be integrated into an over-all economic framework which takes account of both the direct and indirect effects.

Secondly, while the record of the actual use of controls and specific policy measures for balance-of-payments problems is an uneven story of effectiveness, sloppiness, and good and bad timing, there is no doubt about their *potential* effectiveness for dealing with balance-of-payments problems per se. To use Johnson's terminology, the specific instruments have various combinations of expenditure-reducing and expenditure-switching effects at various times, and these are predictable within reasonable limits. It is therefore possible, as a

[1] As will be explained later, the effects of fiscal and monetary policy may be different under a fixed and flexible exchange rate system.

matter of technique, to design systems of controls and specific policy measures to deal effectively with any specified balance-of-payments problem as such.

Thirdly, there are a number of attractions to the use of such measures. They can be made to operate quickly. They provide opportunities for imposition of priorities in the "national interest". They provide opportunities for influence over the distribution of the burdens of adjustment. They sometimes provide opportunities for efforts by nations to improve their terms of international trade. In principle, they are flexible in that they can be varied by small increments through administrative routines, something that is difficult for general fiscal policy and for changes in exchange rates. They often are more flexible than formal changes in the basic tariff and trade policy of nations. They can be hedged with safeguards against beggar-thy-neighbour use. This is an imposing list of pros.

Fourthly, as a general matter, there are strong arguments *against* the use of controls and specific policy measures for dealing with balances of payments. Generally, the use of controls and other specific policy interventions (import surcharges, export subsidies, interest equalization taxes and the like) restricts freedom of choice and emphasizes short-run at the expense of long-run economic attainments. Almost always, some barriers to efficiency and to competitive behaviour are the inevitable by-product from the use of the controls. Administrative flexibility carries the possibility of administrative rigidity too. More often than not, the controls have been used as crutches instead of cures; the fundamental requirements of solving the balance-of-payments problem have not been integrated into the policy. Or, even though effective for dealing with the balance-of-payments problem, per se, they have not promoted the fundamental economic objectives of the country. These experiences are sufficiently frequent to suggest a considerable generality of principle.

Nothing is ideal in this world, certainly not the use of general instruments of economic policy to deal with the problems of internal and external balance. The fact that the use of controls and specific policy measures has not been and probably cannot ever be made ideal even for dealing with balance-of-payments problems, per se, does not constitute a decisive case against their use. The problems are of providing effectiveness for balance-of-payments requirements -- but also of integrating as satisfactorily as possible these requirements and the internal economic performance of a country, an issue which has been somewhat neglected so far. To this, we now turn.

Policy Mix Problems

At an early stage in this essay, it was insisted that a nation's external balance was a requirement or constraint on economic policy rather than a primary policy objective; and that nations have several distinct internal economic goals, including a high and stable level of employment, high and growing productivity, reasonably stable price levels and so on. The policy objectives are to attain some combination of the primary objectives, subject to the constraint of external balance. A nation's position in relation to these objectives and requirements will be shifted around by changes in circumstances and economic behaviour within and outside the country. At any point of time, then, the policy problems are to encourage the achievement of some *mixture* of economic changes; so much of an increase in employment levels; such and such a degree of change in productivity; some other specification of adjustment in balance of payments, and so on. At another point of time, because of differences in goals or circumstances, the *mixture* of required changes will be quite different.

The operation of economic policy is essentially an exercise in the selection and mixing or blending of various kinds of economic policy. This is so not only because several objectives or requirements have to be met, but also because any particular kind of policy instrument can only yield particular combinations of results. Devaluation of a country's currency, considered alone, can yield improvement in a country's external balance and increases in internal levels of activity *in a limited range of proportions. A policy of fiscal tightness yields improvement in a country's external balance, and results in a pattern of internal deflationary pressures which are quite different from those yielded by monetary tightness.* It is rather unlikely that any one *kind* of economic policy will correct the balance-of-payments situation *and* provide movements towards the primary internal economic goals *in the right proportions.* Often there will be even conflict of direction of adjustment, a particular policy improving conditions in one respect by making conditions worse in some other respect. Even when such conflicts do not arise, to achieve the combinations of changes required in economic performance an appropriate blending and weighting of several distinct kinds of economic policy will be necessary.

The importance of an appropriate mixing of several kinds or strategies of policy may be illustrated by the simultaneous pursuit of external and internal balance for a country. The set of easier cases is considered first, comprising situations in which each of several distinct policies can move the economy in the right *direction* for *both* internal *and* external balance. For example, suppose that a country is experiencing internal recession and a balance-of-payments surplus. A particular strategy of an easy money policy would promote both some degree of internal recovery and some correction of the balance-of-payments surplus. Another strategy of monetary ease would also promote both internal recovery and external balance, but with quite different degrees of movement towards the two goals. Different strategies of easy *fiscal* policies may also promote *both* internal recovery and adjustment in the balance of payments, but with other weights of change towards each goal. A fundamental "fact of life" is that, except as a stroke of luck, a particular strategy of monetary or fiscal policy, considered alone, will not promote the desired combinations of correction of the internal and external "imbalances". As a general rule, a mixture of at least two strategies of policy will be required to give the right combinations of adjustments.[1] Moreover, given practical limitations on the effective use of any particular strategy, it will usually be highly desirable to blend the use of more than two strategies of policy together to achieve the desired combinations of external and internal "balance", even in the easy set of cases being here

[1] Nearly two decades ago, Jan Tinbergen pressed economists to accept the simple but profound truth that, the *minimum* requirement for organizing economic policy is the use of at least as many distinct instruments or strategies of policies as there are economic objectives and constraints. For a later statement of Tinbergen's ideas see J. Tinbergen, *On the Theory of Economic Policy* (Amsterdam: North-Holland Publishing Co., 1952).

considered. The desirability of an integrated multi-strategy approach to policy is increased as more specific and additional goals of economic policy are given attention. All of these arguments apply with equal force to the opposite sort of "easy cases", in which the problem is to simultaneously "correct" internal inflation and balance-of-payments deficits.

The more difficult classes of problems arise when most strategies of policy will promote one goal but worsen the economic position with respect to another -- when a strategy introduces basic conflicts between (say) the goals of internal and of external balance. For example, suppose balance-of-payments deficits are to be corrected *and* internal economic expansions is to be promoted. Then, for example, a particular strategy of easy monetary policy would improve internal economic conditions but worsen the balance-of-payments deficits. A particular strategy of fiscal ease (or tightness) would promote internal economic expansion (or contraction) along with increased (reduced) deficits in the balance of payments. In these cases the only conceivable hope to promote the right directions, to say nothing of degrees, of economic adjustment are by adding together in an appropriate type of mix, several distinct strategies of economic policy.

Two implications of these theories of policy must have special emphasis. The first is that particular strategies of policies cannot be determined by isolated, selected objectives. In general, gross errors would arise by guiding monetary policy only by the balance of payments, and fiscal policy only by the internal state of the economy; or vice versa. Sets of policies must be considered in relation to sets of problems. The other implication is the necessity of co-ordination and integration in the design and operation of economic policies.

CHAPTER 5

A SKETCH OF CANADIAN BALANCE-OF-PAYMENTS EXPERIENCE

This Chapter is a very crude impressionistic sketch of Canada's balance-of-payments experience, concentrating on the last decade, but with brief treatment of the earlier experience. The concern is mainly with various ways in which "external imbalance" may appear, and with the detection and explanation of imbalance in Canada's international payments, as such. However, some incidental and summary attention is given to the conjunctures of Canada's external and internal economic experience.

The main concern is to detect and analyse over-all[1] deficits and surpluses in the Canadian balance of payments. Earlier in the study it was argued that the most important interest of a nation in its balance of payments is in "paying its way internationally" continuously and efficiently. It is Canada's experience in this regard that commands attention below. The concern is thus primarily with Canada's exchange reserves, international liquidity position, exchange rates and related matters. Other notions of deficit or surplus, such as those that may arise in the current account or the capital account or some segment of such accounts are not directly at issue here. The central questions are whether Canada did or did not (and in what circumstances did or did not) have ease or difficulties in the business of "paying her way internationally".

Indicators of Disequilibrium

At least three kinds of observations must be examined in order to form judgments about the emergence, duration and size of deficits or surpluses in the over-all Canadian balance of payments.

The *first* and most important concerns exchange reserves, international liquidity and exchange rates of the country. Increasing exchange reserves, strengthening international liquidity positions and increasing prices of Canadian dollars in terms of foreign currencies are collectively the primary indicators of balance-of-payments surpluses; and the opposite of deficits.

The *second* kind of observations concerns the possibility of temporarily favourable or unfavourable events influencing the current and capital accounts.[2] The country might be paying its way internationally, judged by the primary

[1]The term "over-all" is used here not in the sense of the total account, which was shown earlier to always balance because of definitions and conventions. Rather, the term is used in relation to balance on accounts other than exchange reserves and international liquidity *(and thus by implication on the latter)* and the conditions under which the positions on these accounts are arrived at.

[2]It is recognized that introducing this second condition is to open up a Pandora's box, which may permit the balance-of-payments propagandist to argue any way he pleases; but nevertheless some such ideas have to be considered.

monetary criteria, but temporary unusual factors might account for significant portions of either the demand for or supply of foreign exchange. Discounting for such factors is necessary for worthwhile judgments about equilibrium in the international accounts. Evidence from outside the accounts themselves is necessary for such considerations.

The *third* important kind of observations relates to the extent to which a country's international monetary position depends on special or unusual elements of foreign trade and exchange rate *policy* specifically directed to enabling a country to "pay its way internationally". A balance in payments, judged by the primary monetary criterion, which depended on special exchange controls or import surcharges, would not be a state of equilibrium. A proper allowance for the influence of such special policies must be made to measure the balance-of-payments position.

A *fourth* element deserves special mention, although its relevance to detecting balance-of-payments disequilibrium is a little more controversial. A nation's international payments may be quite substantially reduced by serious unemployment and underutilization of capacity within the nation or by unusually slow economic growth. In the circumstances, the nation may even appear to have a balance-of-payments surplus, judged by the three criteria mentioned above. Should allowance be made for the low level of international payments in such circumstances, when judging the condition of balance-of-payments equilibrium or disequilibrium? Should the state of the balance always be adjusted to what it would be under conditions of full employment and full utilization of capacity and "satisfactory" economic growth? Many economists used to answer these questions in the affirmative,[1] but this happens less frequently now. The difficulty is in making precise allowances in the balance of payments for differences between actual and alternative (satisfactory) levels of economic activity. The more usual practice nowadays, and the one followed here, is not to enter the state of employment rigidly into the identification of balance-of-payments deficits or surpluses, as such; but to identify the state of employment and other internal conditions along with the balance-of-payments position for purposes of the over-all formulation of economic policy.

A Summary View and Some Assertions About Detail

Three generalizations about Canada's balance-of-payments experience seem to hold. The *first* is that Canada has seldom had sizeable and persistent balance-of-payments problems, in the sense used here of difficulties in paying her way internationally. Also, periods of substantial surfeit in Canada's international monetary position have generally been short. Judged by evidence on exchange reserves and rates, the country's international liquidity position and the necessity to use special measures for balance-of-payments purposes, Canada has quite a remarkable record of maintaining external balance. If this position is accepted, a healthy scepticism ought to be the first reaction to warnings of future doom about the country's international position.

[1] R. Nurkse, "Conditions of International Monetary Equilibrium", reprinted in American Economic Association, *Readings in The Theory of International Trade* (Philadelphia: Blakiston, 1950).

The *second generalization* provides a significant qualification to the first: while Canadian experience shows little difficulty in the country paying its way internationally per se, it does show very significant disturbance, for both ill and good, to the Canadian economy from external forces, operating at least partly through the balance of payments. If these disturbances have not resulted in substantial over-all deficits and surpluses in the country's balance of payments, it must be because the disturbances were offset by adjustments brought about through changes in income, production, employment, patterns of choice and the structure of industry, changes which were influenced to a degree by the domestic and international economic policies of the country.

The *third generalization* about Canada's external balance follows from the second; this is of the frequent development of conflicts between the attainment of external and internal balance for Canada. Life is not all conflicts between external and internal balance; there probably have been as many examples of harmony between Canada's developments towards internal and external balance, as of conflicts. There is no doubting, either, the long-run advantages for Canada of a deep involvement in international specialization and trade. *But it must be recognized that one of the recurring policy difficulties for Canada has been the fitting together of satisfactory economic results within the country and the balance-of-payments constraint. Something is to be learned from past experience about the incidence and resolution of such problems.*

In turning to the experience itself, there is much to be said for beginning with bald assertions. In this writer's judgment it appears that Canada's balance of payments was in an *over-all surplus* position in the *first half of 1963* and in an over-all deficit position between 1958 and 1961. By implication, 1961 and 1962 were periods of transition from over-all external deficits to surpluses. Throughout most of the period from 1950 to early 1957, Canada was in an over-all external surplus position. The over-all external balance position for Canada in 1964 and 1965 is not entirely clear. The country's surplus position of the first half of 1963 was subsequently strengthened by further surpluses due to the further effects from the earlier devaluation of the Canadian dollar and the institution of the new policy regarding automotive products and other Canadian policies, and temporarily strengthened by the wheat sales to China and the Soviet Union. But the position was undermined, to an indefinite degree and for an indefinite period, by various Canadian and United States policies to limit the capital inflows to Canada. These difficulties, together with some uncertainty about Canada's present competitive position in world markets and economic growth, cloud the interpretation of the current external balance position for the country. My own view is that the situation in 1964 and 1965 is most aptly described as a balance-of-payments surplus as such. The prospect for the next few years is another matter -- one which the Economic Council of Canada is required to consider. Some possibilities are stated and the policy alternatives are examined in the first Chapter of this study.

Going back historically, the most sharply etched examples of over-all balance-of-payments deficits, per se, for Canada were in 1947-48, in the early war years, in the early 1930's and in 1929. And the comparably clear examples of balance-of-payments surpluses for Canada were in the later 1930's, in 1927-28, and most notably during the first decade of the twentieth century. The "fit" of external and internal balances was often notoriously bad – as in the last half of the 1930's, when a surplus on the balance of payments was associated with such massive unemployment and economic stagnation internally as to shake the political and social order of Canada to its roots. These assertions require development and support, to which we now turn, considering each period separately. We work back through the history before considering the current position.

1958 to 1961

By the three kinds of tests considered together, the notion of Canada having an over-all balance-of-payments deficit, per se, can be reasonably well established for this period. The notion would be confirmed strongly if the restriction on the country's payments due to serious unemployment of manpower and productive capacity is taken into account. The discussion below is based on a set of charts, which are reproduced and slightly extended from the author's pamphlet for the Canadian Trade Committee,[1] and on other generally well-known information.

The first set of criteria of a balance-of-payments deficit, per se, concern some combination of reductions in exchange reserves, reduction in those elements of the nation's net liquidity position which are closely related to its exchange reserves, and reductions in the external value of the country's currency. Canada was on a freely floating exchange rate system throughout much of the period from 1958 to 1961 and thus a loss of exchange reserves is not ordinarily to be expected; and no significant loss occurred. The nation's net short-term indebtedness is a measure of some changes in liquidity which are of interest in relation to the exchange reserves and rates. Extraordinarily large increases in this form of indebtedness of Canada took place in 1959 and 1960 (see Chart I) and this is an indicator of external deficits. Beginning in 1959 and continuing through 1960 even before any official change in exchange policy, there was a modest downward drift in the external value of the Canadian dollar (see Chart I). These three items considered together are fairly convincing indicators of deficits in the balance-of-payments deficits.

The second class of factors to be considered in judging the balance-of-payments equilibrium or disequilibrium as such are the presence or absence of unusually favourable or unfavourable events in the payments of receipts situation. From one point of view, the most important unusual factor has already been noted, that is, the extraordinarily large increase in Canada's short-term international indebtedness. As has been pointed out carefully and repeatedly in the Report of the Royal Commission on Banking and Finance[2] and in the *First*

[1] David W. Slater, *Canada's Balance of International Payments — When Is a Deficit a Problem?* (Montreal: The Canadian Trade Committee, Private Planning Association of Canada, November, 1964).

[2] Royal Commission on Banking and Finance (The Porter Commission), *Report*, (Ottawa: Queen's Printer, 1964); see e.g., pp. 412-4.

Annual Review of the Economic Council of Canada[1] Canada pursued a comparatively restrictive financial (monetary, debt management and related elements) policy during much of the period 1958 to 1961. This tended to increase the costs and reduce the availability of funds in Canada relative to those elsewhere (most notably in the United States), and thus tended to encourage a sustained high level of net capital flows into Canada. These events showed up partly in the increased net indebtedness of a short-term variety (noted above); but they also worked to sustain large long-term capital inflows into Canada and to limit outflows from Canada. Accordingly *the actual payments and receipts situation was stronger than warranted on the basis of underlying economic conditions;* and the deficit position of the Canadian balance of payments, per se, would be underestimated by considering the balance-of-payments statistics alone. No other particularly exceptional situations influenced the current or capital payments and receipts in large measure, though a number of factors may have had a limited special influence. The aftermath of the Suez crisis undoubtedly tended to sustain the foreign interest in Canadian petroleum and gas developments for a time. The value of the uranium exports was held at an unusually (and temporarily) high level by the contractual arrangements with the U.S. Atomic Energy authorities. But it is doubtless possible to find temporarily large payments situations on the other side of this balance, for example, with the large shift of North American interest to British and European cars at one stage of the period.

The third set of guides to the existence of balance-of-payments deficits, as such, are the institution of special policies specifically directed to the maintenance of the nation's ability to pay its way internationally. Generally speaking, no significant policies of this sort existed in Canada during the period 1958-61. Towards the end of the period, however, there was one exception -- the development from very late in 1960, but particularly with the budget of June 1961, of exchange policies designed to reduce the external value of the Canadian dollar. These actions provided somewhat ambiguous signs of balance-of-payments deficits -- actions which might have been interpreted as aimed at bolstering a country's ability to pay its way internationally. The policy was related primarily, however, to the promotion of increased employment levels, by "improvement" in the country's external trading position. In part it may have reflected judgments that internal measures to overcome the serious unemployment problem would have produced external deficits unless offset by corrective trade or exchange policies. But such an interpretation of the policy appears to be much too laudatory.

Putting together the evidence from the three sets of criteria, a reasonable case can be made that Canada had an *over-all* balance-of-payments *deficit throughout most of the period 1958 to 1961.* This position was reinforced by some evidence on costs of production of Canadian relative to foreign products; and also by the likelihood of a worsened payments position if vigorous domestic policies had been followed to correct the serious unemployment.

---

[1] *Economic Goals for Canada to 1970, op. cit.,* pp. 24-5.

1951 to 1957

By the same kinds of arguments, in 1951-57 Canada had generally either a balance or a surplus position in her balance of payments. Consider first the position in exchange reserves, liquidity and exchange rates. Since the country was on the flexible exchange rate system throughout these years, one would not expect to find much change in the exchange reserves; and little there was.[1] The exchange value of the Canadian currency showed a general trend of strengthening. No significant increase took place in the country's net short-term international indebtedness, of a sort which would indicate a significant worsening of the country's international liquidity position. Indeed the confidence shown by people in moving short-term funds into and out of Canada under the flexible rate system was itself an indication of the emerging strength of Canada's external trade position.

The second set of criteria concern the dependence of the experience on usually favourable or unfavourable temporary situations in payments and receipts. Beyond all doubt there was a generally very favourable view of Canada's position in the world economy in these years. The country appeared to have good opportunities for exports of primary products, a prospect defined most sharply in the Paley Report but also appreciated elsewhere. The development of the petroleum industry continued to be very favourable. Many people expected improvements in productivity and levels of living to emerge from Canada's newer economic maturity. By historical standards Canada's international terms of trade were quite favourable. There was great interest in some Canadian products due to the military build-up of the United States. These factors may have accounted for the generally favourable conjuncture of Canadian balance of payments and internal economic experience (about which more will be said later), but it is difficult to see that they made the balance-of-payments position, per se, all that favourable or unfavourable.

The final set of criteria, namely the pursuit of special policies directed to influencing specifically the balance-of-payments situation, can be dismissed quite quickly. No significant Canadian exchange and trade policies directed particularly to temporary improvements of international receipts or to special restriction of international payments were operative during the period being here reviewed. Balance-of-payments considerations certainly did not inhibit the pursuit of vigorous expansionary programmes in Canada, either. Indeed, if anything, too little attention was paid to the possible temporary nature of the surplus position, and to the possibilities of longer-run conflicts between Canada's stabilization goals and competitive position on the one hand and the balance-of-

[1]It is frequently suggested that a country on a flexible exchange rate system has no need whatsoever for foreign exchange reserves. This is quite wrong, in this writer's opinion, for the kind of world in which we live. Quite apart from the use of reserves for smoothing operations, they serve an enormously important "confidence-giving" role. Thus even if reserves are not required for transactions purposes, they still have a significant function. Indeed, it may be that, even when a nation is on a flexible exchange rate system, it ought to gradually build up its reserves over time.

There is also a view among some theorists and practitioners of international finance, that a nation should sometimes intervene in the operation of a generally flexible exchange rate system, over and beyond smoothing operations. But if this view is accepted, it may well be that a nation's requirements for exchange reserves are even greater under a flexible exchange rate system (with interventions) than a fixed rate system.

payments experience on the other. In particular a policy of accumulating exchange reserves and a more restrictive financial policy internally would have made a great deal of sense from mid-1955 to early 1957. Canada's post-war economic policy is now generally regarded as having got "off the rails" between 1955 and 1957.

Other Periods of Deficit or Surplus in Canada's Balance of Payments

Judgments about the existence, nature and causes of disequilibria in a nation's balance of payments are based to a substantial degree on comparisons with the nation's earlier experience. Thus, it may be useful to recall a few of the more notable older pieces of Canadian experience with balance-of-payments deficits and surpluses.

(1) Surplus, 1949-50

Canada's surplus in her balance of payments in 1950, around the time when Canada adopted the flexible exchange rate system, is still a highly relevant experience. Canadians and foreigners developed a strong view that the Canadian dollar was undervalued externally, and a massive capital inflow ensued. The situation is recalled today because it illustrates the problems that the Canadian authorities may encounter again in circumstances of strong (actual or potential) over-all balance-of-payments surplus, particularly if such an external imbalance were to arise when internal economic conditions were inflationary. The evidence of the balance-of-payments surplus, as such, in 1949-50, was an extremely large increase in Canada's exchange resources, a strengthening in her international liquidity position, and a tendency for the exchange rate to bump more or less continuously against the ceiling of the then-pegged rate. Evidence of a tendency of rapid growth in long-term capital inflows, and of comparatively favourable cost positions in Canada, supported the monetary indicators. The devaluation of the Canadian dollar in 1949, at the time of the devaluation of sterling, should be recalled. In retrospect it is clear that the devaluation of the Canadian dollar in that year was inappropriate, at least in the sense that it produced a substantially undervalued Canadian currency.

(2) Deficit, 1946-47

The other element of Canada's early post-war balance-of-payments experience that is still frequently cited concerns the deficit that emerged in 1946, but most clearly during the first nine months of 1947. The recollection is strong because, aside from the exchange crisis of 1962, this was the only occasion on which Canada used strong emergency measures designed to cope with a balance-of-payments deficit problem -- including, in 1947-48, a system of quantitative trade restrictions. The 1946-48 crisis showed up unmistakably in a very large and rapid decrease in Canada's holdings of foreign exchange reserves, in a tendency for deterioration in the exchange value of the Canadian dollar, and in a general weakness in Canada's position as regards short-term international indebtedness. The essence of the difficulty, in those days of inconvertibility between the pound and the U.S. dollar, was that Canada was a large long-term lender to the United Kingdom (and to a smaller extent to Western Europe) under the official schemes to aid and promote post-war economic reconstruction. This capital outflow was larger than the small net balance of receipts of foreign exchange by Canada on current trade in goods and services and ordinary long-term capital transactions taken together. Thus, in essence Canada was lending long and borrowing short; she was building up her long-term claims on foreigners (the recipients of the loans) but was drawing down her crucial short-term assets, namely, the exchange reserves. (This conjuncture within the capital and aid accounts is in some respects like the United States balance-of-payments experience in recent years, when United States long-term claims on the world have continued to build up, but that country's short-term asset and debt positions in international payments have been under strain. The problems are not properly indicated by such comparisons, of course.) In any event, a slowdown in the rate of official capital outflows, quantitative trade restrictions with a sharp (but gradually diminishing) bite, and certain readjustments that tended to promote Canada's export earnings of Canadian dollars, rapidly corrected the deficit situation. Before too long, there emerged the surplus situation noted above.

(3) Surpluses and Deficits in the 1930's, 1920's and Prior to World War I

Canadians are frequently reminded that the country had an over-all surplus in the country's balance of payments during the last half of the 1930's. The indications were a marked strengthening in the external value of the Canadian dollar, an increase in Canada's holdings of foreign exchange reserves and a general strengthening in the external liquidity position of the country. On current plus long-term capital accounts, Canada had a credit balance. No special measures directed to the balance-of-payments situation as such were in operation, although, as will be argued below, a number of features of Canadian economic experience and policy showed the very unsatisfactory position of the country internally and externally at the time. The over-all credit position on current and long-term capital account had been aided very substantially by the increased value of gold exports to the United States after 1934, and perhaps by the increased protectionism of the Ottawa tariff agreements. The surplus position was achieved despite a fairly large and rigid burden of foreign debt service due by Canada. The most notable thing about this surplus, however, was its conjuncture with massive unemployment and underemployment of manpower and productive capacity in Canada. Indeed, the principal reason for the surplus was the limited size of Canadian imports of goods and services, reflecting in turn, the extremely low and unsatisfactory level of Canadian income and demand for for goods and services.

The early 1930's provided clear evidence of a balance-of-payments deficit, per se, for Canada. Deteriorating external values of the Canadian currency, dwindling foreign exchange reserves, a weakening international liquidity position, a tendency towards persistent debit balances on the over-all current account and long-term capital transactions, and sharply deteriorating export earnings in the face of more or less rigid requirements for payments on debt service accounts -- all of these indicated deficit.

Canada's experience in the 1930's was not unique, nor mainly explainable in terms of internal experience and policy. A world-wide depression beginning at the end of the 1920's fell particularly severely on the export earnings of some primary producing countries, including Canada. The sharp contraction in long-term international capital flows also was felt by Canada. The depression was deepened and lengthened, and the balance-of-payments problems of many countries were compounded, by the collapse of the international monetary system in 1931. The structure of international commerce was fragmented in ways that were not fully overcome for a quarter of a century.

Only two other incidents are worth mentioning at this point: the first was the deficit position in 1929; and the other was the great period of balance-of-payments adjustment in Canada prior to the First World War. Both still have considerable relevance to modern problems and experience.

The 1929 story has been oft-told in the literature on Canadian monetary affairs. Canada had gone back on the gold standard in 1926, implying the maintenance of the external value of the Canadian dollar within very narrow limits known as the gold points. While the Dominion of Canada held certain gold (and thus foreign exchange) reserves, there was no formal policy of monetary management based on considerations of exchange rates, exchange reserves and the country's external liquidity position. Indeed, much of the nation's exchange reserves were held privately, through a somewhat complex system of secondary reserves of the Canadian chartered banks. The Finance Act provided some limited "lender-of-last-resort" facilities to the Canadian banks, and some system of replenishment of reserves "as needed". The institutional linkages between the internal and external elements of the nation's monetary system were loose and tenuous. The Canadian bankers guided their operations primarily by domestic considerations; there was not as strong an enforcement on domestic views of changes in external circumstances as there once had been. In Canadian experience, *1929 provided one of the prize illustrations of troubles and conflict that may arise between the internal and external position of a country,* at least of troubles that can arise *in the absence of appropriate institutional arrangements and policies.* The appearance of the balance-of-payments deficit was unmistakable; the external value of the Canadian dollar deteriorated beyond the bounds of the gold points; Canadian institutions lost gold and foreign exchange reserves and the external liquidity position of the country deteriorated. There were no major unusual situations in the current or capital accounts. As to special measures the de facto abandonment by Canada of the gold standard position is the clearest indication of the deficit position that had arisen.

Only one point about the experience before the First World War[1] bears recounting here; the whole story is one of the most familiar pieces in Canadian economic literature. From time to time the country developed balance-of-payment surplus positions during the first decade of the twentieth century, based primarily on an enormously large increase in the capital inflow to the country. The surplus position was absorbed (or adjusted to) by a series of steps which somehow pro-

[1] J. Viner, *Canada's Balance of International Indebtedness* (Cambridge, Mass.: Harvard University Press, 1924).

duced enlarged debit balances on current account to offset the enlarged capital inflows. The important point, for the present purposes, is to recall the conjuncture of extremely rapid growth of Canada's population and productive capacity, the huge rates of capital formation in relation to current income, the greatly enlarged debit balance on current trade in goods and services, and the rapid growth in the capital inflows both absolutely and relative to the over-all size of the Canadian economy.

The Exchange Crisis of 1962

Today, the most well-remembered experience of balance-of-payments difficulties for Canada was the exchange crisis in the early part of 1962, the formal abandonment of the flexible exchange rate system that Canada had been on for more than a decade, the additional depreciation of the Canadian dollar, the readoption of the IMF pegged-exchange-rate system, and, after the election of June 1962, the amassing of international resources in support of the Canadian dollar and the adoption of the austerity programme internally and externally, including the imposition of import surcharges. This author's views on this experience have been set forth in a number of places;[1] and they have been rather generally (but by no means universally or openly) supported elsewhere. For a few months, the signs of the existence of a balance-of-payments deficit were clear cut and overwhelming; about this there is no argument. But the nature of the deficit is another matter. *The difficulty was largely a crisis of confidence; it was not a reflection of the underlying economic position of Canada in the world economy, either in a short-run or long-run sense.* In this writer's opinion the worst of the crisis experience could have been avoided by a different set of Canadian policies. But the extreme difficulties of formulating and exercising sensible economic policies in the general political setting of the times and particularly during the election campaign must be acknowledged. By implication, most of the austerity measures were also unnecessary; they were designed to deal with a crisis that should not have appeared in the first place. And many of them were irrelevant to correcting the temporary crisis deficit in any event. Since the crisis experience is generally familiar and the details are so well-documented in the public domain, only a cursory treatment is required here.

After November 1961 the exchange authorities frequently had to defend the (informally) pegged-exchange rate of 97 cents (U.S.) per Canadian dollar, by drawing down the country's exchange reserves. Because of the disruptions to the normal capital inflows, a large over-all debit balance arose on current plus long-term capital account considered together. In a number of respects the country's external liquidity position deteriorated. In February the authorities gave ground, by shifting the informal peg to 95 cents (U.S.) per Canadian dollar. After the announcement of the election, additional pressure developed, and exchange reserves decreased further. In early May the government announced the return to a formally pegged-exchange-rate system under the IMF rules, with a further depreciation of the currency to a rate of 92½ cents (U.S.) per Canadian dollar. During the election campaign, no significant actions were taken to

[1] David W. Slater, *Canada's Balance of International Payments -- When is a Deficit a Problem?*, *op. cit.*; Reports of Interviews, *Kingston Whig-Standard*, at the time of the crisis.

strengthen the base of, and support for, the exchange rate decision. The crisis of confidence mounted; an accelerating run against the Canadian dollar developed and the exchange reserves were reduced to dangerously low levels. After the election a massive set of short-term foreign credits were arranged; monetary policy was vigorously tightened; various restrictive measures on imports were implemented; economies in government expenditures were announced; customs exemption allowances for returning tourists were sharply curtailed; and special programmes to find longer-term measures to limit external payments and expand external receipts were started. Within *weeks* the crisis elements of the deficit position had been reversed, and the underlying strengths of the Canadian balance-of-payments position began to re-emerge. In the event, and given the continued high rates of unemployment, many of the austerity measures can now be seen to have been neither required nor appropriate.

Many lessons can be learned from the 1962 experience; but the principal one of interest here is in the *distinction between crisis deficits and ordinary deficits*. It is rather unlikely that a crisis deficit in a country's external balance will arise when the underlying position is of over-all surplus; though such a conjuncture is not impossible. More important, however, ordinary deficits certainly do not have to be accompanied by crises. Long ago, nations learned that it was possible to have changes in internal monetary conditions without a monetary crisis; indeed, it is now generally agreed that crises in financial markets and in the lives of financial institutions are extremely damaging. They are widely regarded as evidence of institutional imperfections or mismanagement of the financial policy of the nation. The same point of view should be applied to external deficits. Crises of confidence and extreme runs to and from national currencies, in association with balance-of-payments deficits, are essentially evidence of institutional imperfections that are amenable to correction, or of mismanagement of a nation's international financial affairs. The correction of a crisis of confidence in a country's international economic affairs is not to be interpreted as a sign of good management; good management is to be judged by the prevention of crisis rather than their alleviation after the event. This may be regarded as a rather optimistic view of the management of the economic affairs of nations. Many people doubt that governments can be counted on to deal with serious problems until a crisis has in fact developed. In this view, the limited incidence of crisis in international monetary affairs (and the incidence is not all that limited) is due not so much to good management as to the fact that many problems are sufficiently small to be corrected automatically without creating major problems.

Canada's Over-all Balance-of-Payments Situation in 1963, 1964 and 1965

It was asserted earlier that Canada's balance of payments was in an over-all surplus position in the first half of 1963. The country's position in exchange reserves and international liquidity was improving and the exchange rate was well up in the pegged range. Despite the uncertainties of minority government, political turmoil and another election which produced another (but different) minority government, there was no run from the Canadian dollar; no large new special programme was required to defend the Canadian dollar. The comparative cost levels in Canada had improved in relation to those in Western Europe and Japan. While there were some transitory elements of strength in the country's external payments situation (an unusually large net capital inflow, a hangover of the effects of the import duty surcharges which were removed during the election, and the large wheat sales to mainland China) there was at least as strong a prospect of improvements in the external payments from other forces. In particular, the effects of the devaluation in improving Canada's balance-of-payments position had only partially been felt by the first half of 1963. Putting the devaluation effects aside, some further strengthening in the country's external terms of trade also seemed a reasonable prospect.

The over-all balance-of-payments position of Canada in 1964 is a little more difficult to interpret. Since the first half of 1963 the over-all balance has been strengthened by several factors, including the large additional wheat sales to Russia, the further effects of the earlier exchange depreciation, extension of the Canadian export subsidy plan for automotive products, an increase in the protectionist effects of "buy Canada" and "buy province" preferences, and the buoyancy of the United States market. But a number of changes have been adverse to Canada's over-all external balance, the most important of which have been Canadian and United States measures having some effect of restricting capital inflows into Canada, and a particularly rapid increase in the Canadian demand for certain goods which have a relatively large import content. The country apparently did not lose exchange reserves during the year, and the over-all liquidity position of the country has apparently improved. In my judgment Canada's external payments in 1964 are still best described as in an over-all surplus, but the margin of surplus was almost certainly substantially smaller than a year earlier.[1] Moreover, it would have been smaller still if the average performance for the year had been closer to the country's full employment and full capacity output goals.

This became evident as the level of economic activity continued to rise in 1965 and imports of goods and services increased more rapidly than exports. While there was some decline in official reserves early in the year, they became markedly stronger later in the year. This strengthening, which occurred in spite of continued uncertainties associated with the United States balance-of-payments situation, is a symptom of a basic surplus position which reflects a combination of favourable factors -- both underlying and special factors.

Relationships Between Canada's Experience in External Balance and Internal Economic Conditions

While most of this Chapter has been concerned with Canada's balance-of-payments experience as such, some incidental comments have been made about the relationships between internal and external economic positions of the country.

---

[1]The 1964 Annual Report of the International Monetary Fund expressed somewhat ambiguous and equivocal views of Canada's balance in recent times. It emphasizes the improvement due to the (presumably temporary) increase in wheat sales to the U.S.S.R., but the worsening due to the United States interest equalization tax. It mentions the Canadian government policy to reduce certain capital inflows into Canada, but it does not express any judgment about the sense or duration of these trends. It has very little to say about the effects of the devaluation and Canada's policy regarding automotive products.

These interrelationships are now explored a little more systematically. Several questions arise. Are there any reliable simple relationships between the state of "balance" in Canada's external position and various general features of internal economic experience? For example, do *over-all* deficits in the country's balance of payments usually go with high levels of production and income in Canada or with inflationary conditions in the country, and *over-all* surpluses with depression and deflation in Canada? If such relationships are usual, under what conditions do exceptions arise? If the relationships are not quite so simple or general, are there less general regularities? For example, are there any simple relationships between surpluses or deficits and extreme boom or depression conditions in the country; or with booms which are externally rather than internally generated? Regardless of the relationships between the *over-all* position of external balance and the state of internal economic conditions, are there simple systematic relationships between *some important elements* in Canada's balance of payments and some important general features of Canada's internal economic position? For example, do debit balances in the country's current trade in goods and services generally grow rapidly in periods of economic expansion in Canada, of in later stages of such expansions; and do the opposite tendencies towards reduced debit balances or towards surpluses in the current account balance accompany periods of economic contraction?

Many people seem to believe that there are simple stable relationships between Canada's internal economic position and balance-of-payments position. Some allege that increasing Canadian prosperity and various sorts of increases in deficits in the country's balance of payments go together; some allege that such deficit experience is associated with Canadian depressions. Sweeping recommendations about foreign trade policy for Canadian prosperity are often derived from these propositions. Few of the simple propositions seem to hold up, for reasons which are explained below. But some do.

First, major Canadian booms and increasing 'debit' balances on current external trade in goods and services seem to go together; *major* Canadian depressions and sharp decreases in such 'debit' balances are generally associated. At first sight this may seem a strange result, for major Canadian booms tend also to be associated with buoyant export earnings; and major Canadian depressions with unusually low export earnings.[1] The explanation is that *major* economic expansions in Canada are often associated with huge investment booms and a relative enlargement of capital inflows to the country; and the effects of these forces in expanding current payments during the major boom are greater than the expansions in current receipts from the buoyant exports. Similarly, major economic depressions, low levels of domestic investment and relatively reduced net capital inflows generally go together, so that current payments in trade may be small even in comparison with the reduced export earnings. Exchange rate changes may facilitate such conjunctures also.

[1] V. W. Malach, *International Cycles and Canada's Balance of Payments, 1921-33* (Toronto: University of Toronto Press, 1954); G. Rosenbluth, "Changes in Canadian Sensitivity to United States Business Fluctuations", *The Canadian Journal of Economics and Political Science*, Vol. 23 (Nov., 1957); G. Rosenbluth, "Changing Structural Factors in Canada's Cyclical Sensitivity, 1903-54", *The Canadian Journal of Economics and Political Science*, Vol. 24 (Feb., 1958); A. E. Safarian, *The Canadian Economy and the Great Depression* (Toronto: University of Toronto Press, 1960); D. J. Daly, "Long Cycles and Recent Canadian Experience", Royal Commission on Banking and Finance, *Appendix Volume* (Ottawa: Queen's Printer, 1964).

Secondly, however, despite the relation between prosperity and current account trading balances there does not seem to be any simple pattern of relations between internal prosperity and *over-all* deficits in the Canadian balance of payments. Some periods of rapid increase in internal prosperity and in excesses of payments over receipts in current trade in goods and services have been associated with extended periods of *over-all surplus* in the country's balance of payments, as for example, during most of the period of rapid economic development in the decade preceding the First World War and during the major boom in Canadian development from 1949 through 1956. Other periods of major booms and enlarged debit balances in the country's current trade have been associated with *some over-all* deficit positions in the country's international payments, as during the later 1920's, and just after the Second World War. The picture is similarly mixed for periods of *major* depressions, reduced debit balances in current trade, and the *over-all* external balance for the country. In the early 1930's and late 1950's, depressed economic conditions, declining debit balances in current trade and *over-all deficit* positions went together; but in the late 1930's seriously depressed economic conditions and over-all balance-of-payments surpluses were associated.

Thirdly, while the associations of major change towards depression or prosperity and over-all positions in external balance are not correlated in a simple way, there is evidence of some stability in more complex relationships, depending partly on the patterns of Canada's experience in terms of trade and in the attractions of foreign investors to Canada. As yet, however, propositions in this regard are interesting hypotheses, which require more extensive testing.

Fourthly, turning from *major to minor* variations in Canadian prosperity, there is no clear-cut, strong, simple, reliable, direct relationship between Canada's internal economic position and the current account or the over-all position in the country's balance of payments. Relationships there are, but they are not simple, strong and general. A little thought shows the possibilities of diversity. Sometimes a stimulus towards modest-sized improvements in Canadian prosperity will arise from external trading improvements for Canada, in the volume of exports, the terms of trade and so on; but sometimes the stimulus to prosperity will arise almost entirely from forces within Canada. The tendencies will be for reduced or moderately increased current account debit balances in the former case, but enlarged ones in the latter. The internal expansion may sometimes call forth much enlarged Canadian payments to foreigners and sometimes quite small increases. Similar possibilities arise during periods of general slack in the Canadian economy. The mixture of changes in circumstances and policy can be quite different from one time to another. The same points apply to modest variations in Canada's *over-all* position of external balance, particularly when it is recalled that variations in prosperity can be associated also with quite different experiences of financial tightness and ease within the country.

To sum up, the gross correlations of variations in Canadian prosperity and variations in Canada's balance-of-payments position are very low, except for those between major booms and depressions and major changes in the debit balance on the current trading account. Thus one should be wary of the simple propositions on the subject advanced by economists, by journalists, and by many business and political leaders. With luck and hard work, the more enduring stable relationships between internal and external conditions for Canada will be found, but they will not generally lead to simple policy conclusions, and they will seldom be simple, stable empirical laws relating internal and over-all external balance.

CHAPTER 6

SOME IDEAS AND ISSUES ABOUT CANADA'S EXTERNAL PAYMENTS FALLACIES AND OTHERWISE

The main purpose of this Chapter is to examine certain fallacies and misinterpretations that are frequently found in discussions of Canada's balance of payments. In common with other countries, the appraisal of Canada's external economic position is often encumbered by *an old set of mercantilist fallacies,* sometimes in modern dress. Some such ideas are examined first. Attention is then turned to a number of *other ideas* about the country's balance of payments that are not inherently fallacious, but *which are frequently misinterpreted or misapplied.* Ideas about smallness of the Canadian economy, external payments and internal instability, speculation, vulnerabilities of the Canadian economy and certain relations between capital inflows and internal investment are scrutinized in this connection.

The other purpose of the Chapter is to point up two difficult general issues in Canada's balance-of-payments position. One concerns the adequacy of the country's exchange position; the other relates to some of the factors influencing policy regarding capital flows.

Some Common Mercantilist Misinterpretations and Fallacies About Balances of Payments

One of Adam Smith's great contributions to economic thought was to consolidate the intellectual attack nearly two centuries ago on many mercantilist notions. Yet these notions persist, particularly in some governmental and business interpretations, about desirable and undesirable positions in the trade and payments of nations.

Smith and others have shown the fallacy of unqualified propositions about "favourable *over-all* balances" in payments; that is, the fallacy of the idea that an over-all external surplus in a country's balance of payments is both a desirable and a generally attainable position. Roughly speaking, an over-all external surplus in terms of this study refers to the net balance on current trade plus the ordinary regular flows of capital. Or looked at in the other way, it refers to positions in which nations are adding to their exchange reserves, improving other aspects of their international liquidity position and experiencing strong external values for their currency. *The general and continuous attainability of such positions for a nation is impossible,* for a unit of surplus in one country's over-all external payments position is a unit of deficit in some other country's. Through adjustment mechanisms and, perhaps, changes in economic policy, "surpluses" will evaporate in time for any given nation. They must. More important, however, Smith showed that the wealth of nations lies not in accumulating hoards of gold or other international money, but in the efficient use of a growing body of resources and productive abilities, something fully consistent with over-all balance in a country's external payments.

Now, it must be conceded that there may be times when an over-all surplus position in the balance of payments is desirable for some countries, and the quid pro quo, over-all deficit positions, for others. This was the main contention in the earlier discussion about financing some balance-of-payments surpluses and deficits for some periods of time. But the desirability and feasibility of such transitional arrangements differ fundamentally from national attempts to have over-all surpluses continuously. As Adam Smith showed, the wealth of nations lies elsewhere. Even if such "surpluses" were thought desirable, they would be unattainable. Yet the silly notion that it would be desirable and attainable for Canada to have a persistent over-all surplus in her balance of payments remains in some quarters.

A much more important mercantilist notion about balances of payments concerns the desirability of surpluses and undesirability of deficits in a country's current trade in goods and services. The terms "favourable" and "unfavourable" as applied to current account positions in the balance of payments express these notions. Exactly the same idea may be expressed in a different, but corollary way; this is of the undesirability of net capital inflows into a country and the desirability of outflows. Capital outflows and credit balances on current trade go together, and capital inflows and debit balances in current transactions in goods and services likewise. In Canada the most durable hand-me-downs from mercantilist thought are the notions that current account debit balances in trade and net capital inflows indicate undesirable and untenable positions in the country's economic position; that they indicate serious "problems".

As a great generalization of near-universal applicability, these ideas are quite fallacious. But, as will be argued in a moment, to seek the right positions for a nation regarding international capital flows and trade balances raises complex, difficult, often intractable economic and social problems. First, however, the case against the simple, common, extreme views of favourable trade and capital-flow positions should be considered. The central point is that the rationale for the residents of a nation to borrow capital externally or to lend it is the same as for a firm or a family. *If, despite high rates of saving in Canada, capital continues to be relatively scarce and expensive in the country compared with abroad, as it has been in some degree for at least the last century, then it makes economic sense to continue to "borrow" capital.* Costs have to be reckoned in social rather than private terms, of course. Not to borrow, then, is to forgo private and public investment opportunities that contribute to Canadian economic development and rising real income for Canadians. The fundamental economic case for foreign borrowing, as for foreign lending, is *not* need, as so many spokesmen say; it is the expected returns to the borrower and lender. Debit balances on trade account of the capital-importing country are merely the mechanisms of transfer of such capital flows.

The errors of composition arise frequently in the neo-mercantilist dogma. Countries cannot have credit balances on their trading accounts, unless other countries have debit balances. An excess of production over "consumption" in one country can only persist if there are excesses of consumption over production elsewhere. Countries cannot attain positions of being capital exporters unless other countries are international borrowers. It is not possible, then, to promote so-called "favourable" or desirable positions in trade and capital outflows for nations without promoting exactly the opposite position for somebody else.

It cannot be emphasized too strongly, however, that there are difficult real issues both about the long-run and short-run relations appropriate to income and finance in Canada, to the country's balance on current trade and to the use of foreign financing. Sometimes, and for some purposes, reductions in the current debit balance in trade in goods and services (perhaps even surplus balances) will be appropriate, and at other times the opposite. Correspondingly sometimes, and for some purposes, reductions in the use of foreign financing (perhaps even a shift to net capital outflows) will be appropriate; and for some times and purposes, the opposite. The issues have to be settled by careful and explicitly stated analysis of the problems of servicing various positions of indebtedness, the profitability of various borrowing and lending positions, the risks attached to various alternative positions, the real effects of various trends in long-run indebtedness, the feasibility of short-run adjustments within a satisfactory long-run setting of trade and finance, the concerns over dependence and colonialism, and so on. The jingoistic slogans about the desirability of Canada reducing her traditional debit balance on current trade and the associated net use of foreign financing will simply not do as guides to the country's interests and policy. But the formulation of the right policy is very difficult.

Two other quite silly notions about desirable balance-of-payments positions often appear in association with the above ideas. The *first* are suggestions of the desirability of a nation *balancing* its trade or payments *bilaterally* by country, or even bilaterally by country and type of commodity, or perhaps just by type of commodity. As a general guide to policy, these notions make no more sense for a country than they do for an individual in organizing his personal exchanges. To be sure, there will be times of approach towards bilateral balancing; but whether or not such tendencies make sense depends on the efficiency of such exchanges.

The other quite silly notion is that a capital inflow is particularly dangerous if it is accompanied by the development or enlargement of imports of consumer goods; *imports of capital* are not thought to be so bad if they are "matched" by (say) *net imports of capital goods*. Some people refer to an enlargement of a nation's foreign "borrowing", accompanied by increased importation of consumer goods, as *a process of "eating one's capital"*. Now, it is almost inevitable that an efficient arrangement for the use of an increased import of capital will involve an increase in imports of consumer goods. Increased capital imports and increases in real capital accumulation within a country usually go together. But the economics of location and specialization in production make it extremely likely that the cheapest sources of many of the capital *goods* required for the enlargement of the real capital stock of the nation will be within the country. Construction activity has to be carried on at the spot where the structure is required. Many materials required for construction are bulky and heavy; local sources are generally cheaper than those brought from a distance. But the enlarged investment programme and enlarged use of resources for capital accumulation within the nation will often require an expansion in the use of resources in such industries. The resources will be to some extent bid away from the domestic production of consumption goods, the gap being filled by increased importation of such goods. Thus the notion is quite wrong that increased importation of consumer goods and increased importation of capital are necessarily bad arrangements. To be sure, a nation might, just as an individual might, support enlarged consumption for a time by selling assets or increasing debts; for a nation, such a development might be due to government policy. And some such conjunctures would be bad policy for a nation. But to demonstrate and evaluate such a conjuncture requires much more evidence than that contained in a balance-of-payments statement. It appears also that such events have been the exception rather than the rule for Canada. The efficiency of Canada's long-term use of capital is another matter, but one which is too large, on the one hand, and not central to the current purposes, on the other, to be dealt with here.

Some Ideas Which Are Often Abused in Discussions of Canada's Balance of Payments

Quite a number of important ideas about the balance of payments apply at some times but not at others. And frequently such ideas are abused in the analysis of Canada's balance of payments, with consequent misdirections of economic policy. The economics of small countries, the problems from major dependence on external economic conditions, prejudices regarding speculation, and some difficult notions about good and bad capital inflows all open major opportunities for misinterpretations of Canada's balance of payments.

Some people suggest that *Canada is a small country* by standards of the world economy, and that small countries have some advantages, including some *independence in economic action* (though they have disadvantages in other respects). In balance-of-payments matters, for example, it is sometimes alleged that Canada could restrict imports quite sharply without much concern for retaliatory action on the part of other countries because something which is large for Canada is small for others.[1] There is something to this idea, but it is open to extreme abuse. Canada is not all that small economically. The impact of Canadian policy tends to be somewhat concentrated on particular sectors of the world economy. Canada's example is of consequence in the formulation of policies by other countries which have similar relative size, and the collective result of the policy decisions of such countries can be powerful strokes from a double-edged sword in shaping Canada's economic performance.

One of the most persistent notions about Canada's balance of payments is that a reduction in the size of Canada's external economic elements of trade and finance would promote economic stability and economic growth for the country. These notions are apparently predicated on the views that external shocks in Canada's balance of payments make us very vulnerable to extreme fluctuations in income and employment because of the proportionate largeness

[1] The major arguments about such policy concern efficiency and growth, and stand apart from the issue of retaliation. The retaliatory framework is mainly used to illustrate issues of size.

of the country's external sector, and that the country's ability to pursue independent policies is limited for the same reasons. The implication is frequently drawn that reduction in the size of the country's external trade and use of foreign financing would reduce the impact of external shocks on the Canadian economy, improve the internal economic performance with respect to full employment, and increase the degree of independence possible in Canadian economic policy. There is something to these ideas, but unfortunately very little that is realistic and helpful for the kind of world we live in. First, a comparatively large external sector has both good and bad features with respect to economic fluctuations. External shocks are relatively larger for the economy, promoting economic instability. But, a comparatively large part of the adjustments in demand and in output and employment from external *and* internal disturbances in Canada are deflected to foreign rather than Canadian economic units. Indeed, as Professor Rosenbluth has shown most clearly,[1] it appears that Canada has had more stability during the last four decades than has the United States, despite the fact that Canada has been exposed to more destabilizing shocks. The greater stability, according to Rosenbluth, was not due to a more vigorous or more successful stabilization *policy* in Canada, but from the comparatively large spill-over of Canadian economic adjustment to other countries through variations in Canada's imports of goods and services.

The idea persists that Canada nevertheless has a comparatively high degree of vulnerability to external economic conditions and requirements, requiring special considerations in economic policy. Several factors are emphasized, including the fact that the country's exports are concentrated in a relatively small number of commodities marketed mainly in the United States and, to a lesser extent, in the United Kingdom and a few other highly developed countries. Canada's export markets are thought to be more unstable than those of many other countries. The terms and requirements of the country for imports also have a considerable variability, providing sources of potential difficulty. The country is greatly influenced by United States costs and conditions of production, but must sell a significant part of its output in world markets. The availability of foreign supplies of capital is by no means free of risk and uncertainty. A large net international indebtedness and a general expectation of convertibility impose significant restraints on policy, restraints that not all countries feel as sharply as Canada. Even the freedom of movement of peoples across the Canadian border is, from some points of view, a factor in Canada's vulnerability. These sorts of notions can be and often are grossly exaggerated; Canadians often forget how incredibly well-off they have become and have remained with their open somewhat "vulnerable" economy. The lesson is not despair; nor of advantage from a turn towards autarky. Rather it is the need for continued vigilance to provide elbow-room for Canada to cope with the inherent variabilities in her position and to adjust policies accordingly.

Other considerations weigh against the suggestions of an autarkical shift for Canada. Even if the degree of openness of the Canadian economy did add something to Canada's economic instability, this would have to be balanced

---

[1] G. Rosenbluth, "Changing Structural Factors in Canada: Cyclical Sensitivity, 1903-54", *The Canadian Journal of Economic and Political Science*, Vol. 24 (February, 1958).

against the gains in higher average real incomes that the relatively open pattern of trade and finance induces. A relatively small country gains enormously from the broadening of markets and sources of supply provided by a large international commerce. Also, there are serious doubts about the ability of Canada to opt out of an interdependent world economy, one which has increased in interdependence in the last two decades. The connections between economic and social life in Canada and elsewhere are manifold; only some of these are indicated adequately by the entries in the balance of payments. The flows of people, ideas, technology, news media, organizational arrangements and so on link the Canadian economy tightly with the rest of the world. Canada has a degree of independence in economic policy in certain directions, *through her wealth, her liquid assets, and abilities to adjust the mixture of policy in a way that is different from other people.* It seems very unlikely that a significant move towards autarky would really improve Canada's economic performance; other routes towards improvement offer far better prospects, all things considered.

The current notion of vulnerability for Canada from the general structure of use of foreign financing in recent years requires rather careful and balanced examination. There is no doubt that external shocks can hit Canada through the disturbances to our international *borrowing and indebtedness positions.* But international borrowing has another side to it also. It may be varied to accommodate other shocks to a country's economic position. My tentative judgment is that the variations in Canada's use of foreign financing have generally contributed a larger element *towards* than against economic stability, and towards rather than against over-all external balance for the country in the past. This is so at least if one puts aside the occasional incidents of capital flows which were heavily weighted by crises speculative considerations. Indeed, one of the most outstanding elements of flexibility in Canadian policy and development has been provided by the elbow-room of accommodating our international capital flows. The world may be different in the future, but the case and policy implications must be reviewed very carefully and critically.

Two other ideas of some merit, but which are often abused in discussions of Canada's external payments have to be treated in a more summary fashion. The first is the notion that *speculative capital flows are a source of great worry* in the Canadian balance of payments. On some occasions a speculative flow of capital into or out of the country seems to have had almost a life of its own, as was noted in Chapter 5, and flows which embarrassed Canadian economic policy have arisen. But on the whole speculative flows of capital have been more in keeping with Canada's interests and more of an assistance to sensible economic policy than the reverse. In any case, it does not seem likely that a less internationally open economy in trade and finance would contribute to an improvement in Canada's experience with speculative international capital flows.

The other notion of some merit is that some capital inflows at some times seem to be in Canada's economic interest more than other capital flows at other times. This is the idea of distinguishing between "good" and "bad" or "better" and "worse" capital flows. Portfolio flows versus those altering foreign ownership and control; flows related more or less directly or not to new investment projects; flows with better or worse "servicing" provisions – these and many more distinctions arise in these realms. The general issues raised by such notions are extremely difficult and complex; a few of them are pointed up in the next section of this Chapter.

Two Unresolved Issues Concerning Canada's Balance of Payments

Two of the most important unresolved issues concerning Canada's balance of payments relate to principles governing foreign exchange reserves and policies influencing capital flows.

A major unresolved conundrum for Canada is the adequacy of the country's current foreign exchange and international liquidity position, given that the country now conforms to the standard IMF pattern of exchange practices. The required positions depend both on transactions considerations and on domestic and international views about safety margins. What is adequate depends on the nature of these requirements, on what secondary lines of credit are available if the primary reserves and liquidity positions turn out to be inadequate, on what alternatives are open for adjustment if some emergency situation in liquidity matters turns up, and so on.[1] The restructuring of the international monetary system has improved the lines of short-term credit available to Canada and thus made less urgent the task of building up Canada's own exchange reserve and primary holdings of international liquid assets. But there are many unresolved questions yet about the adequacy of the reserves, the other elements in the country's liquidity position, the general effectiveness of the restructured international monetary system and Canada's relationship to it that leave open questions about the current adequacy of Canada's position. If Canada's resources and lines of credit in terms of international money are inadequate, how may they be improved without worsening the already difficult position of the United States? At the present time, the scope for increasing Canada's official foreign exchange reserves is circumscribed by the country's agreement of July 1963 with the United States, in which Canada undertook not to increase her reserves by borrowing in the United States. This arrangement was related to the special treatment of Canadian securities under the U.S. Interest Equalization Tax. But the longer-run aspects of Canada's reserve and liquidity questions are unresolved.

My own view is that Canada should give very high priority to improving, as soon as is feasible and as a part of an international attack on the problem, her combined exchange reserve and liquidity position. More is to be gained in these ways towards providing room-for-manoeuvre for Canadian economic policy

---

[1]H.G. Grubel, ed., *World Monetary Reform, Plans and Issues* (Stanford: Stanford University Press, 1963); this volume contains an excellent selection of post-war documents and discussions of the issues. Of the more recent literature the following items are among the more easily manageable by the nonexpert: Robert Triffin, *The Evolution of the International Monetary System: Historical Reappraisal and Future Perspective* (Princeton: International Finance Section, Princeton University, 1964); Oscar L. Altman, "The Management of International Liquidity", International Monetary Fund *Staff Papers,* Vol. 11, (July, 1964); C.P. Kindleberger, *Balance-of-Payments Deficits and the International Market for Liquidity,* (Princeton: International Finance Section, Princeton University, May, 1965); Robert A. Mundell, *The International Monetary System: Conflict and Reform* (Montreal: Canadian Trade Committee, Private Planning Association of Canada, July, 1965); a series of articles in the *Economist,* June 16, June 19, July 3, July 10, July 17, July 24, July 31, 1965; International Monetary Fund, *Annual Report,* 1964 (Washington). The latest official report, a highly technical document, is the product of the "Ossola group" of the Group of Ten: *Report of the Study Group on the Creation of Reserve Assets,* Report to the Deputies of the Group of Ten, August, 1965.

than by most of the suggestions of shifts towards autarky in trade or finance. If, as many people argue on the basis of recent experience with international capital flows, the Canadian economy is liable to be more vulnerable in the future to forces of external change, the case for the country improving her reserve position is intensified. If, also, it is increasingly difficult for nations to use changes in exchange rates as an instrument of economic adjustment, the case for strengthening reserve and liquidity positions is further reinforced.

The greatest conundrum at present concerns the appropriate long-run position for Canada in the use of foreign capital; and in the appropriate and feasible short-run variation in the use of this capital – to which some reference has already been made. Political and social considerations bear on the long-run trends of use of foreign financing by a country. But there are some explicitly economic considerations and it is these that concern us here. Some people, arguing from what they perceive to be developmental laws for stages of economic growth,[1] suggest that Canada ought now to be a net current exporter of capital rather than an importer – or perhaps, taking a less extreme position, suggest that the country should, on average, make no net current use of foreign financing. Other people, basing their position on more piecemeal considerations of the changes in the structure of the Canadian economy or in some aspects of its wealth, income, saving, investment, and institutional development, advance similar ideas about greatly reduced net imports of capital into Canada or perhaps net exports. The relations between highly developed and less-developed countries also lead people to suggest that Canada should be a net exporter rather than a net importer of capital, but this argument turns somewhat more on political and social than purely economic considerations. It depends substantially on the Canadian people being willing to be net lenders to, or aiders of, the less-developed countries on a major scale.

In economic terms the appropriate long-run position for Canada as an importer or exporter of capital is rather confused. *The most overwhelmingly important evidence is the relative cost of capital in Canada and the United States, the Canadian costs still being distinctly higher, even after reasonable allowances have been made for differences in risks, in tax systems and the like.* The relative expensiveness of capital in Canada has been reduced somewhat during the last half century, but it is still substantial. *This sets up a strong prima facie case, in so far as economic considerations count, for a continued net inflow of capital into Canada. The case may be undermined if it can be shown that imperfections in Canadian institutions and policies account for the relatively higher price of capital in Canada.* But such arguments, if valid, lead towards policies to change these institutional arrangements and policies, not to policies directed explicitly to capital inflows in the balance of payments.

In fairness, however, it must be said that there are some fragments of evidence that lend support to the stage theorists and others who allege that economic conditions for Canada have changed so as to reduce the long-run average use of foreign capital in Canada; and perhaps make capital exports economically sensible now or in the immediate future. But the application of

[1] W.W. Rostow, *The Stages of Economic Growth* (Cambridge: Cambridge University Press, 1960).

stage theories to Canada have been only partially successful; and the partial theories are just that. The feature which gives a particular urgency to efforts to solve these conundrums are the changes in Canadian and United States social and political policies, which appear likely to reduce the capital inflows to Canada drastically, whatever be the economic merit of such inflows. It then becomes extremely important to explore the economic implications of such policies and the institutional and policy changes that are required to facilitate reasonably decent internal economic performance, given the constraint on the external capital position.

Whatever be the position with respect to the long-run *average* net use of capital imports or the net flow of capital exports, it is of course sensible for Canada to vary its external capital position from time to time. In periods of rapid growth and pressure on internal economic capacity, a *relatively* enlarged inflow (decreased outflow) of foreign capital into Canada is sensible. In periods of slow growth and underutilization of manpower and productive capacity in Canada, *relatively* reduced capital inflows (enlarged outflows) appear to be sensible. The trick of policy is to facilitate such obviously sensible adjustments without undue perversion of the country's long-run interests in foreign lending and borrowing.

CHAPTER 7

BALANCE-OF-PAYMENTS PROSPECTS AND POLICIES SOME ALTERNATIVES FOR CANADA

This last Chapter is what journalists and lawyers would call an "iffy" exercise. The scheme is to consider certain prospects that might produce external and internal economic problems for Canada; and then to explore, *if* such problems should arise, what are the more and less attractive (and feasible) possibilities for Canadian economic policy. The Chapter does not constitute a prediction of Canada's economic prospects, nor a comprehensive guide to policy; but it does aim at relevance. The concern is with *real possibilities* and *real policy alternatives*, but possibilities that may evaporate or be swamped by other forces. Those forces which might, on balance, generate over-all balance-of-payments deficits for Canada in the next few years are considered first, followed by a review of *general* instruments of economic policy. Policies which may be directed to specific aspects of production, consumption and trade are then discussed. The possibilities and policy problems of over-all surpluses in Canada's balance of payments are the penultimate topic in the Chapter, and the ultimate one is some general reflection on adjustment in Canada's position in the changing economy.

Possibilities of Over-all Deficits in Canada's Future Balance of Payments

By the primary tests of exchange rates, exchange reserves, international liquidity positions, balance-of-payments policy and so on, Canada's external position appeared to be close to an over-all balance in 1964. If then a significant problem of balance-of-payments deficit appears in the next few years, it will be because the combination of economic developments inside and outside Canada generates a deficit. There is a realistic possibility of such problems emerging, requiring adjustments in Canadian economic policy. Also, at this stage, one cannot rule out combinations of deficit problems in the balance of payments with *either* internal deflationary or expansionary conditions. The combinations depend on the netting -- out of conflicting currents of economic change whose forces are not entirely calculable at this time.

Several of the realistic possibilities of economic change for Canada could tend to produce combinations of external deficits and internal deflation. *First,* internal and external economic conditions in Canada have both benefited in recent years from a number of temporarily favourable influences, including the high value of sales of wheat to the U.S.S.R. and mainland China, the dramatic upsurge in exports of manufactures since 1961, and a very heavy emphasis on using domestic instead of imported supplies of goods and services. These temporarily favourable factors could well be reversed and not replaced by like experience in the immediate future. *Secondly,* the signs are ambiguous, but there are realistic possibilities of deterioration in the foreign demand for Canadian products and in

Canada's underlying comparative cost positions because of improvements in resource positions abroad (e.g., in iron ore, petroleum, wood products) and relative improvements in the technological position of foreigners. Relative inflation in cost and price levels in Canada cannot be completely ruled out either. *Thirdly,* some people have suggested that changes in foreign trade policy in the next few years (the Kennedy Round of GATT negotiations, the continued evolution of the foreign trade policy of the EEC, the possible end of Commonwealth preferences, perhaps some restrictive policies by the United States in such vital trade to Canada as lumber, metals and petroleum) may be seriously adverse to Canada's external payments position and internal levels of economic activity. Canada's new trade policy for automotive products when combined with similar special developments in world trading arrangements may not produce much net stimulation for Canada's external and internal balance. *Fourthly,* there is the possibility of further reductions, due to Canadian and foreign policies, in the rate of capital inflows into Canada from abroad, at least in proportion to Canada's trade and income.

While these forces offer realistic possibilities of external deficits and internal deflation in Canada's economic prospects, the possibilities from these causes should not be overemphasized at this time. Also some other forces of economic growth have to be cast into the balance. Consider first the discounting of the four factors mentioned above. Export forecasters have a notorious record in Canada and elsewhere in underestimating export prospects; just as import forecasters have a notorious record of overestimating import prospects. It is always easy to note certain temporarily favourable circumstances in a country's payments, but hard to foresee what successive temporarily favourable factors may arise in the future. Tariff negotiators find it much more difficult to see the increased markets that may accrue from their bargains, than the increased imports to which their "concessions" will give rise. In trade policy one of the outstanding lessons of the last decade must be the resistance of the United States administration to proposals to apply restrictions on imports from Canada despite very considerable pressure. Canadian policy-makers seem to be well aware of the importance of control over inflation in Canada; indeed many people consider that inflation is given far too much attention in Canadian policy-making.

A most important possibility has thus far been neglected; this is the set of factors which could have the effect, in the absence of changes in economic policy, of generating balance-of-payments deficits with internal economic expansion in Canada. Periods of rapid economic expansion in Canada tend to produce debit balances in Canada's current trade in goods and services. Whether or not these yield over-all balance-of-payments deficits has depended in the past on the behaviour of capital flows into Canada, on the favourableness or not in Canada's export position and terms of trade, and on Canadian economic policy. When rapid growth and enlarged imports have been accompanied by favourable export positions and enlarged capital inflows, balance-of-payments problems have not tended to arise. When rapid growth and enlarged imports have been associated with only moderately favourable export positions and terms of trade, and only moderately sympathetic enlargements in capital inflows to Canada, balance-of-payments problems sometimes have arisen. The possibilities would be accentuated by monetary expansion in the country and inflationary finance, but these would not be absolutely necessary.

Forces which would generate rapid economic growth in Canada along with increased current account balance-of-payments deficits (other things being equal) are a distinct *possibility* for Canada in the next few years. In its *First Annual Review* the Economic Council of Canada pointed to some such possibilities. An extremely rapid growth in Canada's labour force is in prospect, giving us the potential to expand production of all kinds. There are some doubts that exports will expand as rapidly as other production, partly because of the prospects for slow growth of agricultural exports over the balance of the decade from the exceptionally high levels already attained in 1963-64, and partly because of a possible combination of factors which make it difficult to achieve sustained high growth in total exports of industrial materials against a pervasive international background of declining consumption of many of these materials in relation to total industrial output. Canada is fortunate in having a considerable range of export alternatives including some items with good growth potential. Even so, many observers see difficult problems in achieving rapid over-all growth in the country's exports of foods, fuels and industrial materials. Moreover, if full employment and economic growth policies are successfully pursued within Canada, internal demand would expand very rapidly indeed. Investment and consumer spending, particularly on durable goods, would then increase in relation to export earnings. Imports of goods and services would be enlarged perhaps even more rapidly than the increase in total Canadian incomes. Other things being equal, the result would be an enlarged debit balance in the country's current trade in goods and services. This would require, if *over-all* balance-of-payments deficits are to be averted, enlarged net capital inflows.

If rapid potential economic growth in Canada is combined with a weak export performance and some reversion or shift of tastes towards imported goods and services, the balance of problems would be altered a little. The growth potential and the external situation would combine to reinforce the possibility of external deficits. But the prospect of realizing the internal growth potentials would be worsened.

It is not difficult to visualize realistic *possibilities* of future over-all deficits in Canada's external balance. But there is greater uncertainty about the internal economic circumstances that might accompany any such external difficulties. Nevertheless, the possibilities are such as to warrant careful consideration of various policy alternatives to deal with various combinations of external and internal "imbalance". The approach is not of forecasting problems, but of being prepared for difficulties which may emerge.

General Economic Policies

The concern now is with the use of *general* economic policies by Canada to deal with balance-of-payments deficits, if they should emerge in the medium-term future. By general economic policies are meant broad general changes in credit policy, in tax rates, in government expenditures, in debt management, in exchange rates and reserves. These are meant to have widely pervasive effects on the economy rather than concentrated effects on particular activities; they are meant to work to a considerable degree indirectly and by decentralized decisions, by inducing people to change their patterns and levels of spending and so on. The contrast is with specific economic controls and policies that rely on more direct controls affecting economic actions. The dividing line between policies which are general and somewhat indirect, on the one hand, and those which are specific and direct, is admittedly somewhat shadowy; but it nevertheless is a useful framework for our consideration.

For dealing with external deficits the principal general policy alternatives available are: (1) to *do nothing*, relying on changes of economic events and the automatic adjustment mechanisms to eventually correct the deficit, meanwhile financing the deficit from the nation's exchange reserves and external lines of credit; (2) to *deflate* by tighter monetary and fiscal policy within Canada, with little concern for the internal economic consequences (which may be all right if internal economic conditions would otherwise be strongly expansionary); (3) to adjust the *mixtures* of inflationary and deflationary settings of various elements within Canada's monetary, debt management and fiscal policy so as to improve the external balance while, at least, limiting unsatisfactory internal economic developments; (4) to *devalue* (or allow a depreciation in) the external value of the nation's currency, either as a single policy or in some combination with other general internal measures.[1]

Two other possibilities for general economic policies are not included here, different reasons applying to each. The first is a general use of *intervention* by Canada *in forward exchange markets*, a real possibility but of quite limited capacity for dealing with major fundamental balance-of-payments deficits. The other is the use of a *"prices and incomes policy"*, designed to exercise a distinct general control on the general levels of pricing of productive inputs and products. This alternative has not been included because such an arrangement does not now exist in Canada.[2]

One other possibility that may sometimes be encompassed in the class of general economic policies should also be mentioned. This is a comprehensive, integrated, general, medium-term set of policies directed to increasing productivity, increasing competition, improving market access and altering market behaviour -- with, it is hoped, the incidental benefit of solution of balance-of-payments problems in a run of a few years. Such a set of policies may be the companion of short-run arrangements to wait and finance balance-of-payments gaps -- what has here been called a do-nothing (in the short-run) policy. Such medium-term policies cannot be neglected in our survey, but they should be treated on a somewhat different plane than other general policies. They often are piecemeal and unco-ordinated; the connections between policies and effects are often unusually difficult to trace; and the implications for the balance of payments are frequently incidental and uncertain.

---

[1] The organization of my views on these alternatives has been much improved from reading the recent article by Professor Meade, "The International Monetary Mechanism", *Three Banks Review*, September, 1964, pp. 3 - 25.

[2] Many European countries have at least a token of such a general policy instrument, and in a few countries at some times this policy instrument has been of major significance.

(1) A Do-Nothing Policy

To do nothing in the face of a balance-of-payments deficit for Canada is to impose requirements for financing the deficit. Since any nation's capacity to finance deficits is limited, to do nothing requires a judgment that the deficit will be corrected by changes in the country's circumstances or the working of automatic adjustment mechanisms, and that the internal economic conditions will not be made intolerable in the process.

Now to put things into proper perspective it should be conceded right at the start that it will almost always be sensible for a nation to finance some elements of an emerging deficit position. Indeed one of the most important dimensions in the freedom of nations in economic policy is the ability to finance substantial external imbalances. The important questions are of the desirability and feasibility of various degrees and timings of financing such deficits. At times the best policy is to "do nothing" -- but, what are the times?

The desirability of financing ebbs and flows in a nation's balance of payments has been dealt with earlier; essentially the problem is of "tailoring" the adjustment of real activities in economies in ways and at times that are efficient. The feasibility of Canada following a balance-of-payments policy of "waiting and financing" turns on certain technical and political considerations. Given the dimensions of the gap the chief technical questions concern the size and availability of Canada's exchange and external credit facilities, which depends in part on the general adequacy of international liquidity arrangements and in part on the effectiveness of Canada's ability to use such arrangements. Neither of these parts is all that favourable at the present time so that *Canada's technical ability to wait and finance may be much more limited than is desirable.* The political considerations refer to the mixed bag of biases, prejudices and values that attend a policy of waiting and financing external deficits. In some government and private circles, there is always a strong current favouring the putting-off of the adjustment to fundamental changes in a nation's economic position on the ground that the problem may correct itself or disappear. Sometimes these judgments turn out to be right, but sometimes they turn adjustment problems into crises.

There is also a very popular concern nowadays to try to arrange the timing and method of external adjustments so as to not interfere unduly with internal economic goals of employment and productivity. The British arguments about stop-go policies are highly relevant here. On the other hand, there is almost always a well-articulated point of view in government circles (particularly among central bankers and exchange authorities) urging adjustment rather than financing balance-of-payments gaps. Financial businesses and journalists often instinctively support such a strain. Governments are buffeted by opposing prejudices. They must be somewhat conservative in financing balance-of-payments gaps, both because their resources are limited and because they must hold the confidence of the financial communities inside and outside the country. Yet they dislike the turmoil and difficulty of making fundamental changes in economic policy. It should not be surprising that they seek to escape from the dilemmas by using controls to close balance-of-payments gaps -- to limit financing of balance-of-payments gaps but to avoid, it is thought, the more painful adjustment problems.

(2) and (3) The General Setting of Internal Financial and Fiscal Policy

The *most common advice* to a country which must alter policies to correct a balance-of-payments deficit is to deflate by internal monetary management, or fiscal tightness, or by debt management arrangements or some combination of these. Simple dictums of this sort go virtually unchallenged in responsible policy-formulating circles, when the external deficit is associated with over-full employment and inflation internally. Important qualifications have to be introduced of course, to provide mixtures of the various deflationary policies so as to simultaneously promote both external and internal balance with the appropriate force and timing. However, *simple dictums to deflate require much more qualification when balance-of-payments deficits are associated with internal unemployment and deflation.* Then any specific deflationary action may contribute to correcting the balance-of-payments deficit, but at the expense of intensified internal deflation. Such possibilities increase the attention that must be paid to the policy mix problem, even within the use of general internal financial and fiscal policies. They almost inevitably drive policy formulation towards blending exchange, trade and other policies into the mixture. Some of the principles in these regards were set out in Chapter 4, and they are extended briefly here.

Even if exchange rate and foreign trade policies are put to one side, it still may be *technically possible* to deal simultaneously with external deficits and internal depression by the appropriate blending of general financial and fiscal policy. A policy of *monetary tightness, combined with a policy of fiscal ease* could work in this way, if the relative emphasis in the two policies was appropriately set. Monetary tightness would tend to have limited effects in decreasing internal activity in Canada and major effects in improving the country's balance-of-payments position, particularly in view of the likely influence of monetary policy on capital flows. Fiscal ease, on the other hand might produce a quite limited degree of deterioration in the country's external balance per "unit of improvement" in internal economic conditions induced thereby. With the right balance of monetary tightness and fiscal ease it ought then to be possible to produce some *net* improvement in internal economic conditions in Canada *and* some improvement in the country's external balance. Debt management policy offers additional degrees of freedom to these ends.

Further technical possibilities of adjustment in the policy mix arise *within* the monetary, fiscal and debt management frameworks. The internal and external effects of some routes towards credit tightness may be different than for others; and the mix of internal-external effects of some routes of fiscal ease may be different from others. For example, the expansion of imports may be different among various increases in government expenditure; and certain tax cuts may have quite different effects (through spending patterns and financial transactions) on the balance of payments than others. Thus, even within the framework of internal general financial and fiscal policies, there are many technical possibilities for promoting simultaneously the goals of internal balance and external balance for the economy.

Technical possibilities are one thing; feasible policy arrangements are another. To correct an external deficit and internal depression by relying solely on a combination of monetary ease and fiscal tightness will not usually turn out to be practicable, if the degree of disequilibrium is at all large in either respect. Huge changes towards monetary tightness and towards fiscal ease would be required, changes that may well be outside the bounds of realization in economic policy for a country. Extraordinarily difficult problems of timing would be encountered, for the lag structures of the two sets of policy instruments are quite different. The same arguments apply to mixing other changes within the general framework of financial and fiscal policies. These various possibilities ought not be neglected; but solution of the problems will ordinarily require additional policy instruments, particularly foreign exchange and international trade policies to be entered into the policy-blending matrix.

(4) Devaluation or Depreciation; Alone or as Element in Policy Mix

Assuming that Canada continues to follow the pegged exchange rate system of the IMF code, then the principal question of exchange rate policy is of shifting the pegged rate from time to time. If the country turns out to have a substantial balance-of-payments deficit in the future, what are the merits and limitations of a policy of devaluing the external value of the Canadian dollar? What are the relationships of such a policy to other general elements in Canadian economic policy?

Most economists nowadays would agree to the technical point that a devaluation of the foreign exchanges by a country like Canada can improve the country's balance of payments and encourage internal economic expansion, given a reasonable time for the realization of the effects of the policy. The blending of other general economic policies may be required to produce the right matching-up of the effects and requirements from policy. Thus, the main issues about devaluation policy are not about the technical possibilities of such policies but the necessity and desirability of such practices; and about the appropriate articulation of changes of exchange rates in the general fabric of economic policies. Necessity turns on whether, in the circumstances, the required effects from policy are of the sort to which devaluation can be a powerful contributor; and whether alternatives that are preferable on some other grounds are available.

The desirability of Canada adjusting the external value of the Canadian dollar as an important element in the mixture of general economic policies turns on judgments about the general nature of economic trends and on biases of governments and holders of wealth. Countries can have balance-of-payments deficit problems either because of internal inflation or because of changes in real economic circumstances in or out of the country. Technically speaking, devaluation could be used as a "corrective" for Canadian balance-of-payments deficits of either origin. The view of some people is that governments have a strong tendency towards debasing the currency -- towards promoting or acquiescing in internal inflation. According to this view the propensity to inflate would be encouraged by the ready availability of external devaluations as means of dealing with the attendant balance-of-payments deficits. If this view of the Canadian economy is accepted, a strong prejudice against devaluations will exist. On the other hand, if the view is adopted that Canadian tendencies towards or away from inflation are not strongly dependent on the availability of the external weapon of devaluation, and if it is recognized that the conjuncture of real economic circumstances will from time to time introduce difficult balance-of-payments deficit problems for Canada (sometimes in conjunction with depressed internal economic conditions), then a much more favourable view will be taken of the use by Canada of the instrument of devaluation.

The attractiveness to Canada of a policy of periodic changes in the external value of her currency may be limited by some other considerations. First, when countries are known to actively contemplate changes in exchange rates as instruments of economic policy, speculation will take account of these possibilities. Unless the other elements of a country's international economic policy are articulated to the exchange rate policy and the exchange rate policy itself is managed with sense and adequate power, the speculation can be a source of difficulty. Secondly, the real burdens and benefits of many contracts are altered by changes in the external values of a country's currency. It is in the long-run interests of countries to avoid undue and unnecessary changes in these respects. Thirdly, Canada is part of an interdependent international monetary system. Canada's exchange rate policies influence others. Any one country's policies must be constrained to some degree by requirements of the international monetary systems as a whole.

It was a fundamental conception of the post-war international monetary system that countries would treat adjustment in the external values of their currencies as a feasible normal element in the general set of economic policy instruments -- not to be used indiscriminately or unconditionally or for every deficit or surplus -- but available as part of the armoury of instruments for difficult conjunctures of external and internal imbalance. For more than a decade after 1949 the prejudices of national and international monetary authorities outside Canada shifted strongly against such an approach to exchange rates. Now the balance of ideas seems to be swinging back towards a more favourable view of the use of devaluations and appreciations of exchange rates in economic policy. The underpinning of the international monetary system for dealing with speculative difficulties in capital flows has improved. The machinery for co-ordination of international monetary policy has improved considerably. Perhaps a better understanding has arisen of the possibilities and limitations of other approaches to balance-of-payments policy. It is therefore not inconceivable that changes in Canada's pegged exchange rates might under appropriate circumstances, be a significant element in the general set of economic policy for dealing with balance-of-payments deficits and surpluses.

In general the policy alternative is *not* changes in exchange rates alone, but of changes in exchange rates *and* in internal financial and fiscal policy. Large fundamental external deficits coupled with internal deflation may call for both fiscal ease and devaluation. More realistically, there will be various dimensions to both internal and external problems which call for the blending of the several principal general kinds of instruments of economic policy.[1]

---

[1] For a very useful discussion of the principles of mixing policies, see R. A. Mundell, "On the Selection of a Program of Economic Policy" ... reprinted from the *Quarterly Review* of the Banca Nazionale Del Lavoro, in J. P. Cairns and H. H. Binhammer, editors, *Canadian Banking and Monetary Policy* (Toronto: McGraw Hill, 1965).

Selective Policies, Controls, Economic Planning

For many reasons countries like Canada may contemplate the use of selective policies, controls and certain arrangements of economic planning in connection with external and internal economic problems. In some circumstances, the general policy instruments may be considered incapable of dealing with the main problems adequately or with sufficient speed. Even if they are capable, a more efficient policy may call for certain specific approaches to economic change as an element of the policy mixture. Also, in addition to the main objectives of national economic policy, a country may have important secondary requirements of investment, or regional development, or the structure of industry, or of utilization of the national influence over prices and terms of trade and so on. These additional requirements of economic policy may encourage or require the use of specific approaches to economic policy.

Suppose that Canada should, in the future, encounter an over-all balance-of-payments deficit, and that the problem is to correct the balance-of-payments deficit, while avoiding deflationary pressures internally *and* perhaps while actively promoting expansion in certain activities internally. What are some of the possibilities of selective policies to complement or supplement or perhaps even replace in some degree the adjustment of general economic policy? In particular, what are some of the possibilities of specific policies which may be carried out without the use of detailed direct control and planning apparatuses? There are many alternatives. *First*, special incentives (taxes, subsidies, credit) to promote exports of goods and services and financial claims may be developed. Special incentives (import duty surcharges, other taxes, subsidies and credit arrangements) can be directed to reducing imports of goods, services and financial claims. These arrangements can be tailored to the speed, degree and duration of adjustment which is required, and somewhat towards the various specific goals of regional and industrial development, and the shaping of the allocation of resources and the distribution of income. They may be coupled with adjustments in general economic policy so as to promote the right balance between correction of external imbalance and the attainment of internal economic goals. It is a general principle of international trade agreements that such policies will not discriminate among nations. *Secondly*, by government purchasing policies, and by adjustments in the structure of government expenditure, taxation and transfers, specific economic policies can be directed to altering the structure of external-internal economic relations for economies in some degree and for some period of time. Governments may encourage or discourage imports and exports of goods and services and thus an alteration of the external balance, while neutralizing or limiting adverse changes in internal economic conditions by adjustment in the setting of general economic policy. The "buy Canada" and "buy province" campaigns to influence private purchasing and the increased preference for Canadian and provincial sources of supply in government purchasing are but one set of examples of such specific policies. *Thirdly*, the use of such instruments is governed by explicit and implicit codes of international behaviour, and is disciplined nowadays by various arrangements for "multilateral surveillance".

The dividing line between selective policies which do and do not involve controls is not precise; by the use of controls we usually mean that a significant element of government administrative direction is involved -- permitting some things and withholding permission for others, regardless of the private calculus of advantage. Quantitative import controls, allocative directions of production to export markets, administrative controls over the disposition of foreign exchange which permit some uses but not others, administrative controls over a country's external capital transactions -- all of these open up possibilities for altering a country's external and internal economic relationships. Selective policies can be pursued to "correct" balance-of-payments disequilibria while also promoting certain specific internal economic objectives.

As Canada does not now have much of a control apparatus, if she wishes to use controls to deal with external and internal economic problems, she will first have to erect such systems. The war-time patterns of exchange, import and production controls, the post-war use of quantitative import restrictions for dealing with a balance-of-payments deficit (1947-48) and the post-war Canadian control over capital movements (until 1951) all provide political, legal and administrative precedents for the operation of a control apparatus, if that is required.

If Canada does encounter serious balance-of-payments deficits in the future, it may be rather tempting to pass new legislation to erect and permit the use of a set of controls for the exercise of specific elements of policy, as a supplement or substitute for general economic policy. The setting of the controls would be to limit imports of goods, services and financial claims and promote exports of these, while also promoting various general and specific goals of full employment, and regional and industrial development in Canada, and so on. The temptations to use controls are several. First, the general instruments of policy, even when coupled with selective policies of changes in tax structures, subsidies, credit structures, purchasing policies and so on, may be judged to be inadequate to achieve the size and timing of the improvements required in external and internal economic conditions. The temptation is to use controls as a supplementary policy rather than trim back the aspirations of economic policy. Second, even if other methods of economic policy could achieve the desired economic results, to rely (at least partially) on a control apparatus may be viewed as a more efficient scheme of policy. Controls offer attractions of certainty as regards the locus and timing of some of their effects. The co-ordination of the amassing of a nation's market "influence" may be better achieved by the use of a control apparatus than by less direct means; and accordingly a nation may attempt to improve its terms of trade by the use of controls. Controls appear to offer attractions of flexibility, in that they can be adjusted quickly by administrative discretion. Controls offer attractions of precision, in that some features of the effects can be directed quite narrowly to certain objectives (or at least some people seem to think so).

While the temptation to erect and use control schemes for dealing with balance of payments and related economic problems are considerable, they have generally been more than offset by the unattractiveness of control apparatus in other respects. Nearly every industrialized nation had such apparatuses after the last war; the apparatus has nearly everywhere been dismantled or fallen into disuse since that time, despite the fact that many of these nations have continued to experience some difficult problems of external and internal economic adjustment since that time. The continuous use of a control apparatus of detailed administrative direction of the economy turned out to be horribly inefficient. It was not possible for the administrators to do a very good job of detecting the economic possibilities offered by complex changes in tastes, technologies, resource availabilities, and the economic efficiency of individual economic units. Even when the judgments turned out to be not too bad about what was desirable, it turned out to be extremely difficult to readjust the controls appropriately. All sorts of vested interests in particular settings of controls developed, creating inertia in adjustment. It also turned out that the prediction of the long-run and indirect reactions to control policies was very poor. The general sentiment of students and practitioners of economic policy nowadays appears to be against the use of control schemes for dealing with balance of payments and associated problems, except as temporary measures, and except as their use may be improved by very considerable advances in the effectiveness of systems of economic planning. The motto seems to be: "not necessarily controls; but controls if and only when clearly necessary".

There is some relationship between these specific approaches to policy and the recommendations for the development of planning in an economy like Canada's. Planning activities are mooted to facilitate the attainment of a more desirable structure and level of economic acitvity, and to help bring about desirable adjustments more quickly. This may or may not be so. A variety of approaches to planning are still being considered in Canada and the nature and possible effects of the changes from our present arrangements are complex subjects in themselves. For our present purpose, only one point is important however; it is, that any planning mechanism is designed to have some influence over the allocation of expenditures and the structure of production and allocation of resources within Canada. Accordingly there is at least a potential power for influencing the relationships between internal and external aspects of an economy. Methods of production may be encouraged which will require larger or smaller use of foreign exchange. Activities can be encouraged or discouraged with at least one eye on earning more or less foreign exchange. It is much too soon to appraise the potential, though indirect influence of the new (as yet limited) Canadian planning apparatuses (Federal and Provincial) upon adjustments, from time to time, in the external-internal economic relationships of Canada, as various favourable and unfavourable circumstances emerge in the future. The experience of other countries seems to suggest that some possibilities are offered by such routes. In the experience of other countries, the planning apparatus has often turned out to have a considerable bias towards autarky in international economic relations, both in the short run and long run. This need not be so, but the history in these respects should be kept in mind in considering Canadian developments.

Possibility of Balance-of-Payments Surpluses for Canada

Most of the discussions of Canada's balance-of-payments prospects have been about the possibility of deficits. But there are also realistic possibilities that the country's position might turn out to be an over-all surplus in external balance, even without significant policy efforts to improve the balance. The position taken here is not of prognostication, but of indicating some of the possibilities; and then of noting briefly some of the implications.

What are some of the forces that might, on balance, produce for Canada a balance-of-payments surplus in the future? First, there is the possibility of a considerable improvement in the country's terms of trade, as world prices of metals, wood products and some agricultural products increase relatively. The country's terms are distinctly less favourable than they were in their best post-war position, but they have improved a little in recent years. More improvement is a possibility. Secondly, the efforts in North America to keep money costs of production under relatively tight rein and to promote export sales may yield substantial results which endure for some time. Thirdly, there is always the possibility that the winds of change may produce substantial improvements in the external demand for Canadian products, beyond even the reasonably optimistic expectation set out in the *First Annual Review* of the Economic Council of Canada. In this context, the recent increases in investment in Canadian wood and paper products have been astonishingly large and not entirely expected. Things are "looking up" in Canadian mineral production too. Finally, restrictive effects on capital inflows into Canada due to the United States Interest Equalization Tax, to other foreign regulations on capital flows, and to Canadian policies may be relaxed or turn out to be not all that large in the intermediate run.

These and other factors might then produce a somewhat more favourable turn in Canada's external balance than was earlier considered. In this event, the principal implications are: of assistance to Canada in coping with her huge prospective task of absorbing an enormous increase in the Canadian labour force into highly productive employment; of improved opportunities for the country to strengthen her international liquidity position; of increased opportunities for generous policies in aid, in international lending and in carrying the burdens of peace-keeping; and of favourable conditions for reducing trade restrictions.

The Last Word

We have tried to show why and in what way Canada is interested in her balance of international payments; and what are the meanings and importance of various balance-of-payments positions. We have shown that when Canada experiences an external or internal shock to its economic position, both the internal and external economic performance of the Canadian economy will be altered. Adjustment mechanisms will make these performances different than on first impact, and the dimensions and nature of Canada's economic problems will be badly misinterpreted if these adjustment processes are neglected. We have set out the bare bones of some of the policy alternatives that may face countries as external and internal economic conditions change. We have reviewed Canada's balance-of-payments experience to point up periods of balance-of-payments surplus and deficit; and the conjunctures of such experiences and internal economic experience have been considered briefly -- to see whether there are strong, simple, general relations between deficits and surpluses in Canada's international payments and variations in Canada's prosperity. Some of the fallacies and possibilities for misinterpreting a country's balance-of-payments experience have been outlined, and a few of the conundrums of Canada's recent experience in the world economy stated. Finally we have considered some of the possible future developments in Canada's external economic position, and the policy alternatives that may be relevant under various conditions.

The fundamental questions of Canadian economic life are not balance-of-payments questions, but they do have balance-of-payments aspects. First it does not appear feasible or in Canada's interest for the country to opt out of a highly interdependent world economy. The dependence on a world-wide network of technological advance is both great and profitable. The continuing improvement in communications knits Canadians more intensively into a world market fabric of economic aspirations and consumer preferences. It may be sensible for Canada to actively promote her own industrial development and to promote exports and sometimes the substitution of domestic products for imports. But the important point is that these activities be viable and efficient in a world-competitive setting -- that the general long-run cast of the country's economic policy be outward-looking. Secondly, if Canada is to remain essentially as interdependent in the economy in the future as she is at present (perhaps more so), then it follows that problems of external imbalance for Canada and of conflicts between the internal and external balance of the country will certainly arise from time to time. For as far into the future as one can now see, and even if Canada did turn towards a substantially autarkical policy, Canada will have some degree of economic vulnerability from its economic openness. The trick is to arrange Canadian affairs and policies and institutions so that the country can cope satisfactorily with the problems, and gain the lasting advantages of integration with the world economy. Strong positions in foreign exchange reserves and international liquidity; effective intelligence and recognition of Canada's changing economic position; consistent and strong emphasis on developing and maintaining *competitive* production; and a powerful and flexible policy of adjustments in monetary, fiscal and exchange rate positions -- these are the crucial lessons of this reading of Canada's position and experience.

Another central theme of this study has concerned perspective and dimension. Over-all deficits in balances of payments, even when they are unusually large, do not amount to more than a tiny fraction of a nation's annual output. Even under relatively unfavourable conditions, the potential output of a nation grows. It should not be viewed as an overwhelmingly difficult task in the economic management of nations to squeeze out of such growing national products the resources required to put even large balance-of-payments deficits aright in a couple of years. Finally, a crucial lesson of this study, one which Canada has apparently learned well, is of the vital importance to countries such as ours of international co-operation in world monetary affairs and in trade and payments.

TABLE 2
The Canadian Balance of International Payments Selected Data, 1953–1963
(all figures in millions of Canadian dollars)

Year and Quarter	Merchandise Transactions (adjusted)		Total Current-Account* Transactions: items giving rise to		Net Source (+) or Use (−) of Funds on		Capital Transactions[a] Net Source(+) or Use(−) of Funds (excl. OEH)			Changes in Official Exchange Holdings[c] (OEH)	(7) + (8) "Balances" on Current Plus Long-Term Capital Account	(12) Plus Short Forms (excl. OEH)
	Exports	Imports	Receipts	Payments	Merchandise Account	Current Account	Long-Term Forms	Short-Term[b] Forms	Total of (8) & (9)			
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
1953	4152	4210	5491	5934	− 58	− 443	+ 618	−213	+ 405	− 38	+175	− 38
1954	3929	3916	5236	5668	+ 13	− 432	+ 579	− 23	+ 556	+124	+147	+124
1955	4332	4543	5850	6548	−211	− 698	+ 410	+244	+ 654	− 44	−288	− 44
1956	4837	5565	6464	7830	−728	−1366	+1424	− 10	+1414	+ 48	+ 58	+ 48
1957	4894	5488	6515	7970	−594	−1455	+1301	+ 49	+1350	−105	−154	−105
1958	4887	5066	6437	7568	−179	−1131	+1112	+128	+1240	+109	− 19	+109
1959 I	1060	1218	1364	1792	−158	− 428	+ 280	+ 99	+ 379	− 49	−148	− 49
II	1355	1551	1765	2216	−196	− 451	+ 253	+241	+ 494	+ 43	−198	+ 43
III	1286	1380	1816	2138	− 94	− 322	+ 273	+ 52	+ 325	+ 3	− 49	+ 3
IV	1449	1423	1847	2150	+ 26	− 303	+ 342	− 47	+ 295	− 8	+ 39	− 8
1959 Year	5150	5572	6792	8296	−422	−1504	+1148	+345	+1493[d]	− 11	−356	− 11
1960 I	1281	1324	1615	1941	− 43	− 326	+ 397	− 82	+ 315	− 11	+ 71	− 11
II	1321	1508	1737	2214	−187	− 477	+ 285	+110	+ 395	− 82	−192	− 82
III	1398	1316	1956	2083	+ 82	− 127	+ 149	+ 18	+ 167	+ 40	+ 22	+ 40
IV	1392	1392	1802	2115		− 313	+ 69	+258	+ 327	+ 14	−244	+ 14
1960 Year	5392	5540	7110	8353	−148	−1243	+ 900	+304	+1204	− 39	−343	− 39
1961 I	1266	1260	1606	1943	+ 6	− 337	+ 223	+219	+ 442	+105	−114	+105
II	1447	1478	1902	2213	− 31	− 311	+ 302	+ 70	+ 372	+ 61	− 9	+ 61
III	1557	1419	2158	2220	+138	− 62	+ 222	−171	+ 51	− 11	+160	− 11
IV	1619	1559	2068	2340	+ 60	− 272	+ 163	+244	+ 407	+135	−109	+135
1961 Year	5889	5716	7734	8716	+173	− 982	+ 910	+362	+1272	+290	− 72	+290
1962 I	1400	1398	1755	2088	+ 2	− 333	+ 14	− 56	− 42	−375	−319	−375
II	1624	1664	2114	2484	− 40	− 370	− 20	−244	− 264	−634	−390	−634
III	1632	1559	2299	2343	+ 73	− 44	+ 214	+516	+ 730	+686	+170	+686
IV	1724	1582	2215	2342	+142	− 127	+ 460	+145	+ 605	+478	+333	+478
1962 Year	6380	6203	8383	9257	+177	− 874	+ 668	+361	+1029	+155	−206	+155
1963 I	1486	1412	1884	2122	+ 74	− 238	+ 381	− 77	+ 304	+ 66	+143	+ 66
II	1776	1702	2296	2505	+ 74	− 209	+ 204	+116	+ 320	+111	− 5	+111
III	1806	1655	2526	2502	+151	+ 24	+ 27	−110	− 83	− 59	+ 51	− 59
IV	2014	1810	2556	2675	+204	− 119	+ 25	+122	+ 147	+ 28	− 94	+ 28
1963 Year	7082	6579	9262	9804	+503	− 542	+ 637	+ 51	+ 688	+146	+ 95	+146
1964 I	1730	1695	2176	2514	+ 35	− 338	− 15	+311	+ 296	− 42	−353	− 42
II	2198	2048	2767	2915	+150	− 148	+ 152	+ 64	+ 216	+ 68	+ 4	+ 68
III	2182	1828	2972	2758	+354	+ 214	+ 223	−281	− 58	+156	+437	+156
IV	2130	1969	2761	2922	+161	− 161	+ 493	−151	+ 342	+181	+332	+181
1964 Year	8240	7540	10676	11109	+700	− 433	+ 853	− 57	+ 796	+363	+420	+363
1965 I	1825	1866	2300	2697	− 41	− 397	+ 155	+170	+ 325	− 72	−242	− 72
II	2190	2222	2807	3167	− 32	− 360	+ 93	+268	+ 361	+ 1	−267	+ 1

Notes:
(a) "Long-term" and "short-term" forms are concepts used in the DBS publication cited below.
(b) Excluding monetary gold and government foreign exchange reserve transactions.
(c) + = net addition; − = net decrease in official exchange holdings. There figures incorporate changes in Canada's net position at the IMF.
(d) For 1959, the quarterly details re long-term capital movements included in "Other Capital Movements" were not available. The annual total of a $28 million inflow was allocated equally among the quarters.

* Mutual aid to NATO countries is not included in either current receipts or current payments.

Source: DBS. The Canadian Balance of International Payments, various annual and quarterly reports. The latest data were from the publication 67–001, for Second Quarter 1965, published in September 1965. The Bureau provided supplementary information on the capital account so that the quarterly figures could be run back to 1959 on the basis of the new concepts and latest published estimates. Figures for 1964 and 1965 are preliminary.

Revised Oct. 5, 1965.

CHART 1

CANADA: VARIOUS EXTERNAL "BALANCES"

The solid line shows yearly balances on current and long-term capital transactions together. Except for 1959 and 1960, no large sustained net payments balance occurred on these accounts.

The dashed line shows combined yearly balances on current, long-term capital and short-term capital transactions excluding Official Exchange Holdings (OEH). Through 1960, under a floating rate system, the yearly net balances were small, some plus and some minus. Since 1960 Canada developed a SURPLUS on this account, judged by yearly data.

The private short-term capital inflow in 1959 and 1960 was exceptionally large, mainly due to tight money conditions in Canada.

The combination of stability in exchange rates and reserves between 1953 and 1960 suggests monetary equilibrium in Canada's balance. The build up of exchange reserves after the devaluations of 1961–62, shows a monetary SURPLUS position in Canada's external balance.

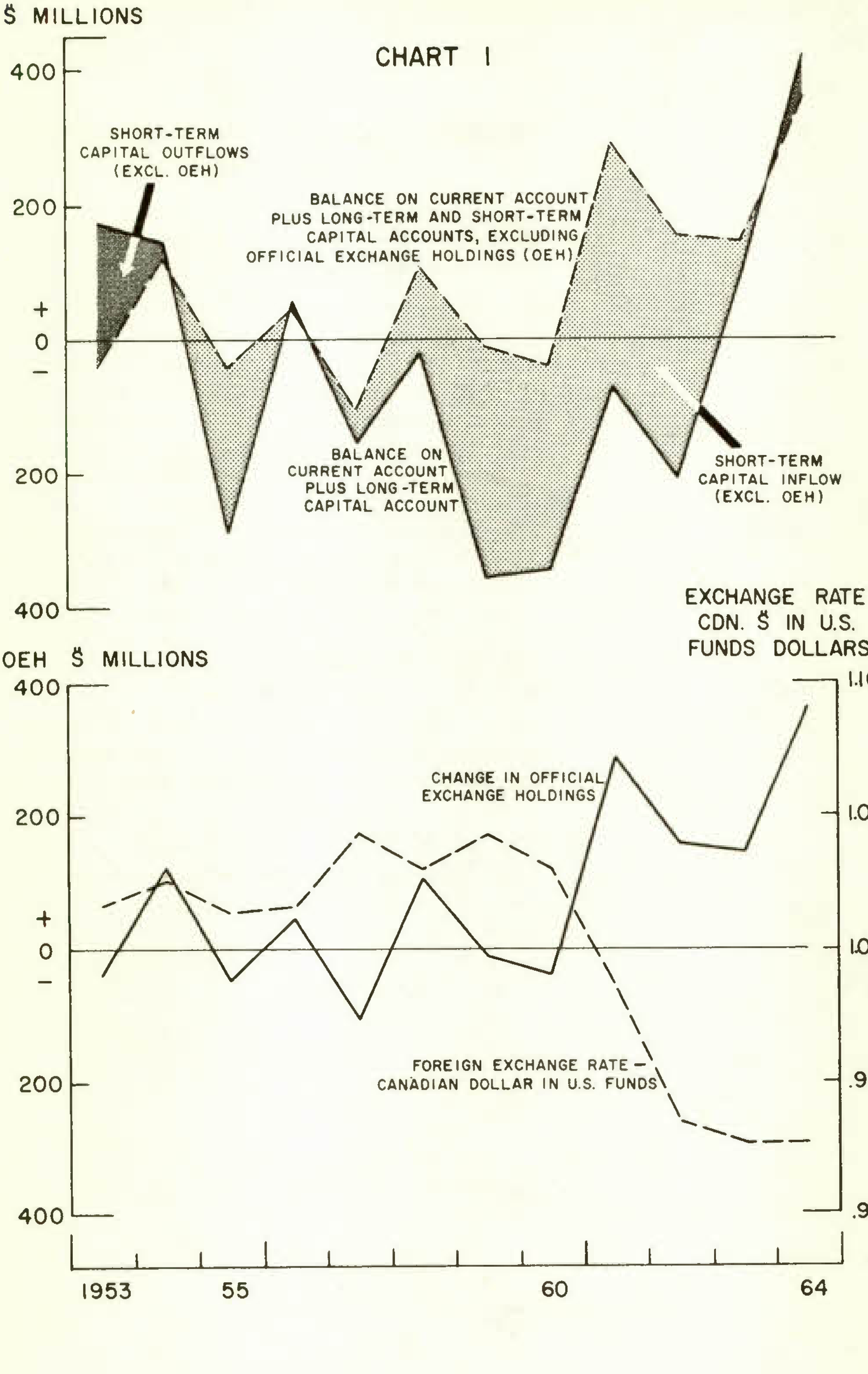

$ MILLIONS
CHART I
400
SHORT-TERM
CAPITAL OUTFLOWS
(EXCL. OEH)
200
BALANCE ON CURRENT ACCOUNT
PLUS LONG-TERM AND SHORT-TERM
CAPITAL ACCOUNTS, EXCLUDING
OFFICIAL EXCHANGE HOLDINGS (OEH)
+
0
−
BALANCE ON
CURRENT ACCOUNT
PLUS LONG-TERM
CAPITAL ACCOUNT
SHORT-TERM
CAPITAL INFLOW
(EXCL. OEH)
200
400
EXCHANGE RATE
CDN. $ IN U.S.
FUNDS DOLLARS
OEH $ MILLIONS
400
1.10
CHANGE IN OFFICIAL
EXCHANGE HOLDINGS
200
1.05
+
0
1.00
−
FOREIGN EXCHANGE RATE —
CANADIAN DOLLAR IN U.S. FUNDS
200
.95
400
.90
1953
55
60
64

CHART 2

CANADA: "BALANCES" ON CAPITAL FLOWS AND CURRENT ACCOUNT

In absolute size the yearly net *long-term* capital inflow reached a peak in 1956, decreasing substantially thereafter. The overall net capital inflow was maintained at a high level until 1961 because of the enlarged and sustained net private *short-term* capital inflow. The latter flow was an important factor in keeping the external value of the Canadian dollar high in 1959 and 1960.

The net payments balance on goods and service account increased in step with the long-term capital inflows through 1957; both were associated with the investment boom in Canada.

The payments balance was exceptionally large in 1959, 1960 and 1961, in relation to long-term capital inflows and internal economic conditions in Canada; but not in relation to the net long-term *and* short-term capital inflows, taken together.

The reduction in the current payments balance since 1961 has been significantly *larger* than the reduction in the net capital inflows, as indicated above.

CHART 2

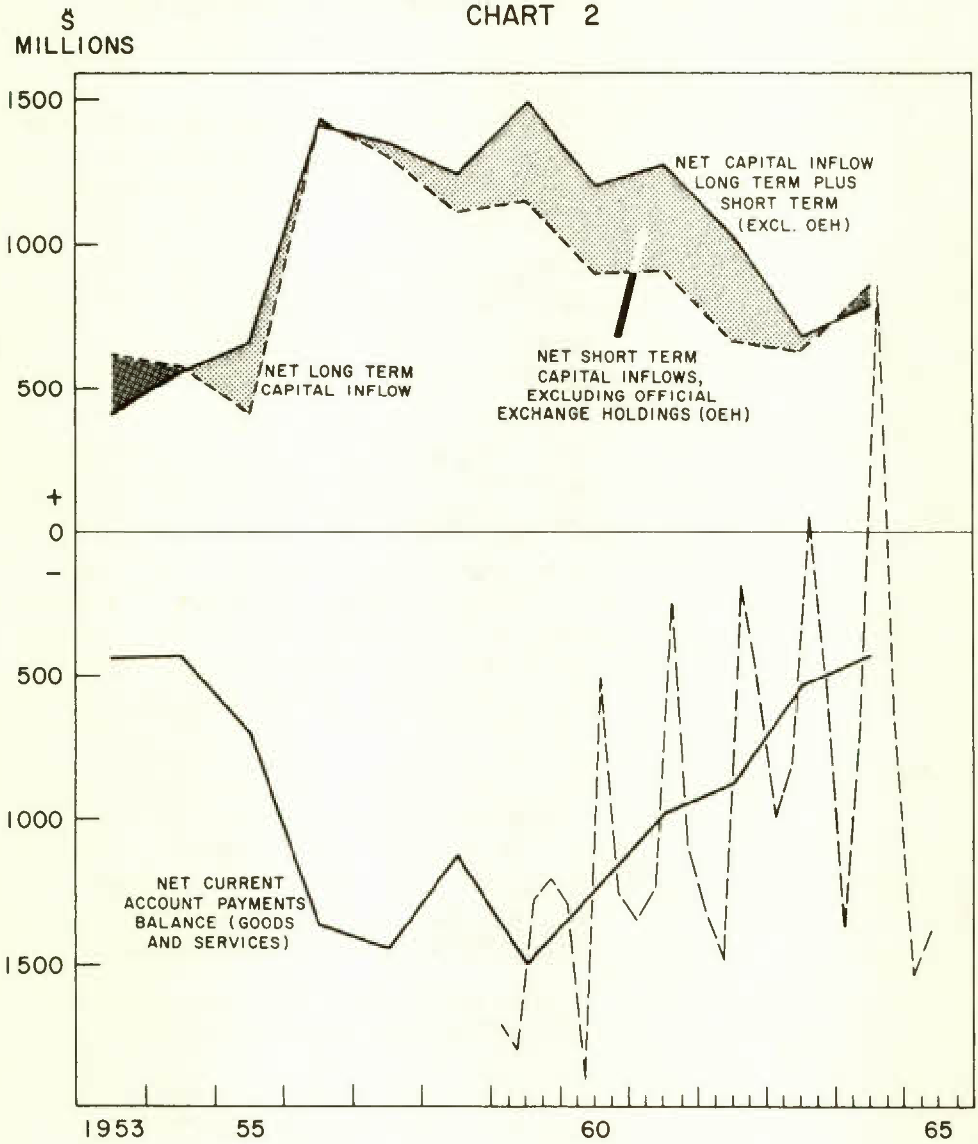

$
MILLIONS
1500
1000
500
+
0
−
500
1000
1500
NET CAPITAL INFLOW LONG TERM PLUS SHORT TERM (EXCL. OEH)
NET LONG TERM CAPITAL INFLOW
NET SHORT TERM CAPITAL INFLOWS, EXCLUDING OFFICIAL EXCHANGE HOLDINGS (OEH)
NET CURRENT ACCOUNT PAYMENTS BALANCE (GOODS AND SERVICES)
1953
55
60
65

CHART 3

CANADA'S CURRENT RECEIPTS AND PAYMENTS

To 1957, imports of goods and services increased more rapidly than national output, and national output more rapidly than exports of goods and services.

In 1958 and 1959, the current payments gap was reduced a little *in comparison with GNE;* mainly by a relative decrease in imports of goods and services. In 1959 exports began to recover a little.

Since 1959 exports have increased much more rapidly than national output and national output more rapidly than imports.

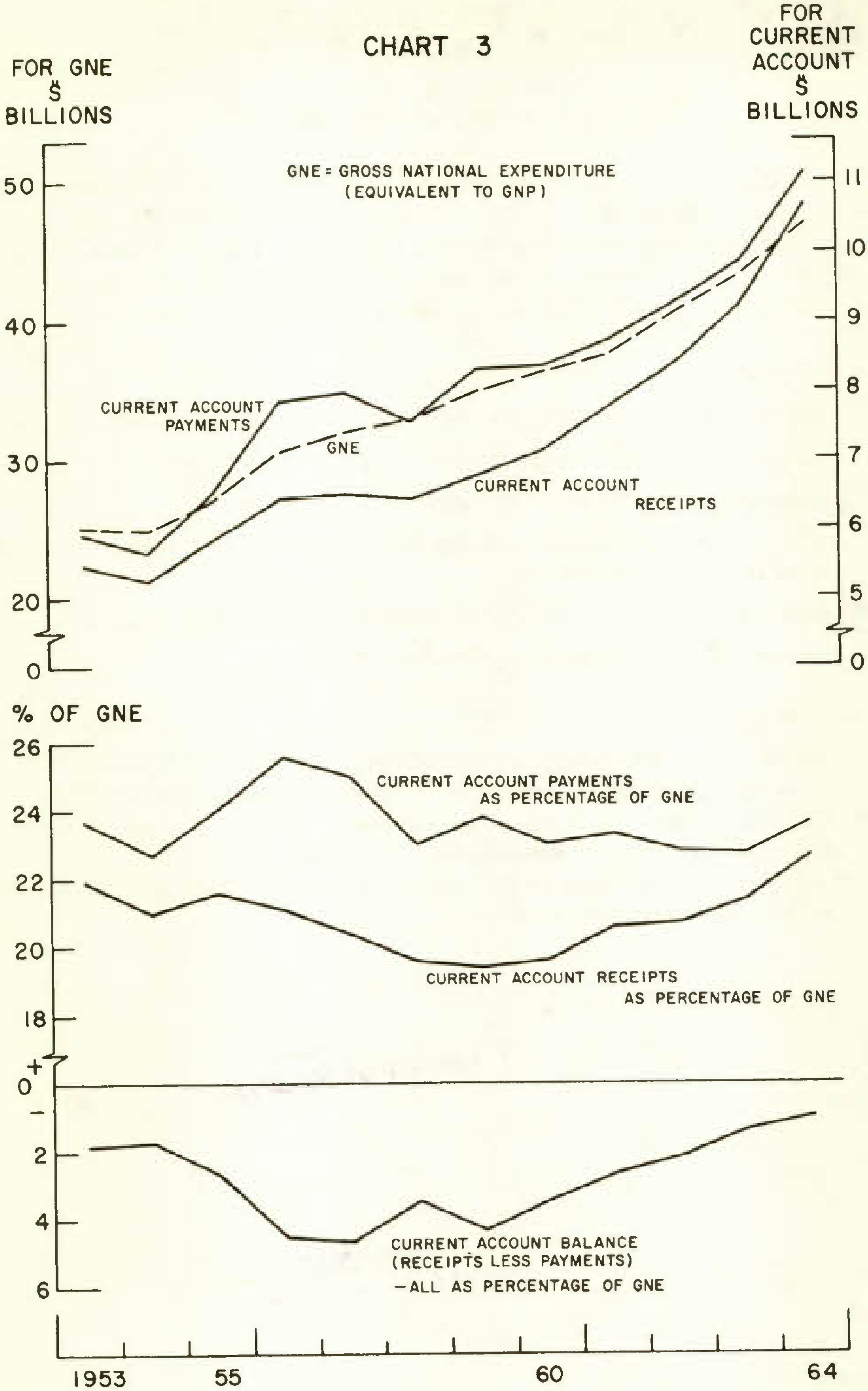
In the big investment boom, 1955–57, Canada's imports were unusually large and her exports unusually small, compared with GNE. In 1958–60 imports were not exceptionally large, but exports continued to decline *compared with GNE.*

Since 1960 a sharp increase has occured in Canada's exports of goods and services, more than in proportion to the increase in national output. To 1963 the increase in imports was unusually small in comparison with past experience in Canadian economic expansions.

In 1964, imports and exports were exceptionally large and increased more rapidly than output.

The exceptionally large ratio of the net balance on current payments to GNE in 1958 to 1960 is shown in this chart, along with the buildup in the ratio before 1958 and decrease since 1960.

CHART 3


FOR GNE
$
BILLIONS
FOR
CURRENT
ACCOUNT
$
BILLIONS
GNE = GROSS NATIONAL EXPENDITURE
(EQUIVALENT TO GNP)
CURRENT ACCOUNT
PAYMENTS
GNE
CURRENT ACCOUNT
RECEIPTS
50
40
30
20
0
11
10
9
8
7
6
5
0
% OF GNE
26
24
22
20
18
0
2
4
6
CURRENT ACCOUNT PAYMENTS
AS PERCENTAGE OF GNE
CURRENT ACCOUNT RECEIPTS
AS PERCENTAGE OF GNE
CURRENT ACCOUNT BALANCE
(RECEIPTS LESS PAYMENTS)
—ALL AS PERCENTAGE OF GNE
1953
55
60
64

BACKGROUND PAPERS FOR THE SECOND ANNUAL REVIEW

The following studies and reports have been prepared as background papers for the *Second Annual Review* of the Economic Council of Canada. They will be published separately and available from the Queen's Printer, Ottawa. Although they are being published under the auspices of the Economic Council, the views expressed in them are those of the authors themselves.

Staff Studies

12. *The Contribution of Education to Economic Growth,* by Gordon W. Bertram
13. *Internal Migration in Canada, 1921-61,* by Isabel B. Anderson
14. *Interregional Disparities in Income,* by S. E. Chernick
15. *An Analysis of Interregional Differences in Manpower Utilization and Earnings,* by Frank T. Denton
16. *Interregional Disparities in Public Services,* by T. K. Shoyama
17. *Business Cycles in Canada,* by Derek A. White

Other Studies and Reports

Perspective on Canada's International Payments, by David W. Slater

A General Incentive Programme to Encourage Research and Development in Canadian Industry, A Report to the Economic Council of Canada by Advisory Committee on Industrial Research and Technology.

Conference on Stabilization Policies, Report of the Conference at University of Western Ontario, August, 1965.

OTHER PUBLICATIONS OF THE ECONOMIC COUNCIL OF CANADA

Catalogue Number	Title	Price
EC1–1964	Annual Report (1964)	$ .50
Fo 1/1965	Annual Report (1965)	.50
EC21–1/1964	First Annual Review: Economic Goals for Canada to 1970	3.50
	Staff Studies	
EC22–1/1	1. Population and Labour Force Projections to 1970, by F.T. Denton, Y. Kasahara and S. Ostry	.75
EC22–1/2	2. Potential Output, 1946 to 1970, by B.J. Drabble	1.00
EC22–1/3	3. An Analysis of Post-War Unemployment, by F.T. Denton and S. Ostry	.75
EC22–1/4	4. Housing Demand to 1970, by W.M. Illing	.75
EC22–1/6	5. Business Investment to 1970, by D.A. White	1.00
EC22–1/6	6. Special Survey of Longer Range Investment Outlook and Planning in Business, by B.A. Keys	.25
EC22–1/7	7. Canada and World Trade, by M.G. Clark	.50
EC22–1/8	8. Export Projections to 1970, by J.R. Downs	.75
EC22–1/9	9. Federal Tax Revenues at Potential Output, 1960 and 1970, by D.J. Daly	.50
EC22–1/10	10. National Saving at Potention Output to 1970, by F. Wildgen	.50
EC22–1/11	11. Changes in Agriculture to 1970, by J. Dawson	.50
	Special Studies	
EC22–2/1	1. Immigration and Emigration of Professional and Skilled Manpower During the Post-War Period, by L. Parai	1.50
EC22–2/2	2. A Survey of Labour Market Conditions, Windsor, Ontario, 1964: A Case Study, by G. R. Horne, W. J. Gillen and R. A. Helling	.50
	Conference Papers and Reports	
EC22–364	National Conference on Labour-Management Relations (1964)	2.00
	Papers presented at "Conference on Productivity through New Technology", Toronto, May 1965:	
EC22–4/1	Modern Management, by G.W. Fisch	.50
EC22–4/2	Practical Application of Data Processing in Small and Medium Manufacturing Companies, by H. S. Gellman and R. C. Carroll	.75

EC22–4/3	A Practical Approach to Automatic Production, by R. W. P. Anderson.	.50
EC22–4/4	Advances in Metal Working, by J. Vande Vegte	.75
EC22–4/5	Improving Material Movement Through the Manufacturing Cycle, by J. A. Brown and B. D. Beamish	.50
EC22–4/6	The Economic Justification of New Equipment, by C. G. Edge	.75

Copies of the above publications may be obtained in English and French from the Queen's Printer, Ottawa. Payment should accompany orders to avoid possible delay in shipment.

ue

Date Due

Perspective on Canada's International Payments

A Background Sketch and Survey, by David W. Slater

Economic Council of Canada