

GENERAL AGREEMENT ON TARIFFS AND TRADE

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REPORT BY THE GROUP ON CANADIAN IMPORT SURCHARGES

1. The Group, in accordance with its terms of reference, undertook a factual examination of the temporary import surcharges imposed on 25 June 1962 by the Government of Canada on items included in Parts I and II of Schedule V - Canada.

Introductory statement by the representative of Canada

2. The representative of Canada in his introductory statement recalled what the Canadian delegation had said about the background to the measures taken at the meeting of the Council on 11-12 July 1962 (C/M/11 and Spec(62)218). During the last ten years Canada had had a current account deficit every year, ranging from 1,000 to 1,500 million Canadian dollars a year. On the other hand, there had been a rather steady inflow of capital, mostly of long-term nature, which had largely offset financially the current account deficit. There had consequently been no serious problem in this connexion until the beginning of 1962 that is, neither an undue deterioration of the Canadian dollar rate, when it was floating; nor a depletion of reserves. In the first half of 1962, however, the normal capital inflow was reversed and there had actually been a small net outflow, in addition to a continuing large current account deficit. The foreign exchange reserves of Canada fell from about 2,000 million dollars at the beginning of 1962 to about half that figure by 24 June. The rate of loss became severe in mid-June and accelerated. If no measures had been taken late in June it was clear that the reserves would have been completely exhausted in a matter of weeks.

3. In this connexion the Canadian representative wanted to draw the attention of the Group to the statement by the representative of the International Monetary Fund at the discussion of the import surcharges in the Council in July. The Fund had then stated that the surcharges imposed by the Government of Canada did not go, in its view, beyond the extent necessary to stop the serious decline in Canada's monetary reserves.

4. Canada's reserves had improved substantially since June, the representative of Canada explained, but the reserves were not yet adequate. At the end of October 1962 the gross foreign exchange reserves amounted to 2,614 million dollars. This sum, however, included 475 million dollars which Canada had borrowed from the International Monetary Fund, the Federal Reserve Bank and the Bank of England,

and 125 million dollars which had been recently borrowed from private sources in New York. The net reserves, apart from these borrowings, were thus approximately 2,000 million dollars. Such an amount would have been considered as satisfactory when they had a floating exchange rate, but since a fixed rate had been introduced in May 1962, the reserves clearly had to be kept at a somewhat higher level. The present reserves could not be considered as sufficient in order to carry Canada safely through a period of uncertainty as to the various elements in its balance of payments.

5. The development of the current account situation since the establishment of a fixed exchange rate in May 1962 - which involved a substantial devaluation of the Canadian dollar - had been disappointing. Instead of an expected decrease, the current account deficit showed a continuing increase. In the first half of 1961 the deficit had been 653 million dollars but in the same period in 1962 was 730 million dollars. The July figures indicated a continued deterioration and the figure for the whole of 1962 would probably show a deficit well in excess of 1,000 million dollars.

6. As to capital movements only sketchy information was available. There were signs of a recent inflow of some long-term capital and a good deal of short-term capital. There was, however, no evidence of a rate of long-term capital inflow sufficient to cover the current account deficit. There had recently been some special capital transactions - an inflow of about 100 million dollars in payment for a Canadian oil company which had been taken over by one of the great international oil companies, the prepayment by the Government of the Netherlands of a debt payment of 30 million dollars and the inflow of 125 million dollars resulting from a Canadian Government borrowing from private sources in New York.

7. The Canadian representative turned to the question of what elements had contributed to the improvement in the reserves since June. The emergency measures adopted in June succeeded in restoring confidence and put an end to speculation. Accordingly there followed a reversal of short-term speculative capital movements and the reversal of "leads and lags" in payments. Another important factor was that the third quarter of the year was always a favourable season for Canada's export earnings. Then there were the special items referred to in paragraph 6 to which should be added the earlier prepayment by France of some 70 million dollars of post-war debt. There might also have been some movements of longer term capital, but in this respect there was no reliable or precise information as yet. In this connexion the representative of Canada also drew the attention of the Group to the background material dated 10 October 1962, supplied by the International Monetary Fund. The Canadian representative noted that after making allowance for special non-recurring items the improvement in the reserves during the month of October was about 70 million dollars.

8. The representative of Canada said that there had been a number of important changes in the surcharge system since its introduction in June. These amendments had all been relaxations in the provisions or removals from the list of items on which surcharges were imposed. They had been circulated to contracting parties in documents L/1805/Add.2 and 3 and L/1878. Two of the changes were of major importance. At the Council meeting in July contracting parties had expressed concern over the fact that items which were in transit on 25 June had been affected by the surcharges. Although it was not the traditional practice in Canada to make exceptions for goods in transit when changes in tariffs or taxes were announced, the Government of Canada had been impressed by the representations made at the Council meeting as well as directly to Ottawa and had decided that the surcharges should be removed from goods in transit on 25 June. The other major change was the removal of surcharges from industrial items of an import value of about 250 million dollars per year, which had been brought to the attention of contracting parties in document L/1878. This decision had been described in the Canadian Parliament as the first major step towards the removal of the surcharges as a whole.

9. The Canadian representative recalled that considerable interest had been shown at the Council meeting in July in the long-term measures to be taken by the Government of Canada. The Minister of Finance had made a statement in Parliament on 22 October 1962 which gave some information about the policy of the Government of Canada in this respect. This was prefaced by the following paragraph in the Minister's statement:

"Let me emphasize that the necessary basic improvement in our current account cannot be achieved by restrictive measures. Such measures as our import surcharges were essential in overcoming the immediate exchange emergency and will in large part have to be retained until there is clearly evidence of a basic improvement in our external financial position. But they cannot form part of any programme for the lasting improvement of our current account position. Indeed, if they were retained too long they would defeat our purpose, for they would begin to make Canadian industry less competitive when it is clear that we must become more competitive. These are strictly temporary measures and we have already begun to relax them."

10. Amongst the long-term measures referred to by the Minister of Finance were the following:

- (a) The establishing of a fixed rate of exchange in May, which involved a substantial devaluation.

- (b) Trade policy measures. The Canadian Prime Minister had proposed in a letter to the President of the United States the arranging of a ministerial meeting in the early part of 1963 to set in train a comprehensive programme for the expansion of world trade. In this connexion it was the aim of the Government of Canada not only to increase outlets for Canadian exports but also to create a stronger and more efficient industry in Canada.
- (c) Trade promotion. The Canadian Government was implementing a vigorous programme of trade fairs and exhibitions, export conferences, etc.
- (d) Improvement in export financing. The export credit funds had been doubled at the present parliamentary session.
- (e) A new hydro-electric power export policy. The export of hydro-electric power which had formerly been restricted would now be encouraged on the basis of long-term contracts. There were particularly important prospects in this field. Exports of oil and natural gas would continue to make an important contribution.
- (f) Improvement of efficiency in Canadian industry through the increased application of science, productivity studies, expanded technical and vocational training, etc.
- (g) Rail transportation. A Royal Commission had made important recommendations for the rationalization of the railway system, and of freight rates, which would be implemented.
- (h) Improvements in the taxation system. A Royal Commission had been appointed with broad terms of reference.
- (i) Improvement of the Government Administration. A Commission had been at work for several years. It had already made some important proposals some of which were about to be implemented.
- (j) A proposal to create a National Economic Development Board was to be put forward at the present session of the Parliament. The Board would have three functions: (a) to provide a bridge between the Government on the one hand and private industry, labour, agriculture etc. on the other hand; (b) to supplement and expand present Government machinery for economic analysis; (c) to recommend to the Government particular projects or measures in the interest of national development.

11. The representative of Canada concluded by saying that there was no certainty that the balance-of-payments situation was yet stable enough to remove the surcharges. The behaviour of the current account had been disappointing. Canada was now entering the adverse seasonal period for export earnings. It was not yet evident that an adequate capital inflow was in prospect.

He wanted to emphasize the very serious nature of the balance-of-payments crisis Canada had undergone. He had never heard of any case of a country in GATT going through such a crisis, declaring itself out of difficulty and dismantling its emergency defences in a matter of a few months. His Government was therefore somewhat disappointed at the lack of understanding that it had met in the Council in July. In the light of the criticism expressed on that occasion the Canadian delegation had asked whether contracting parties would prefer to have Canada resort to restrictive measures under Article XIII instead of applying customs surcharges. This question had not been answered then and he now wanted to put it again.

Finally the representative of Canada wanted to stress once more that his Government had constantly reminded the Canadian public that the surcharges were of a purely temporary nature and should not be considered as protective measures. He quoted the undertaking reiterated by the Prime Minister on 22 September that the surcharges would not be maintained one day longer than absolutely necessary.

Statement by the International Monetary Fund

12. Pursuant to the provisions of Article XV of the General Agreement the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with the examination of the Canadian import surcharges. The representative of the Fund was invited to make a statement supplementing the Fund's documentation, dated 10 October 1962, concerning the balance-of-payments position of Canada. The statement made was as follows:

"Since the emergency measures taken on 24 June 1962, the Canadian dollar has been strong and reserves have increased substantially. This increase has, however, been brought about largely by US\$650 million of short-term borrowing and a return flow of short-term capital, apparently including substantial amounts of Canadian funds which were exported shortly before the emergency steps were taken, together with seasonal influences. The extent of the inflow of foreign capital - which traditionally has covered the deficit in the current account - in the coming months is uncertain, especially as concerns long-term capital. The Fund has noted the assurances of the Canadian Government that its temporary financial measures, adopted for an emergency, were directed to the improvement of Canada's exchange reserves and that the customs surcharges will not be kept on any longer than necessary. The Fund notes that Canada has begun removing the surcharges and believes that if the reserve and payments position continue to improve over the coming months, Canada should be able to eliminate the remaining surcharges."

The balance-of-payments position of Canada

13. Members of the Group expressed their understanding for the difficulties which Canada was encountering and stressed their confidence in Canada's ability to overcome them. They noted that since June the reserve situation had considerably improved. The question was asked whether the fact that the current account deficit had been increasing during the first half of 1962 could be mainly attributed to invisible transactions or to the trade balance.

14. The representative of Canada explained that the trade deficit had been 49 million dollars during the first six months of 1962 as against 25 million dollars during the corresponding period of 1961. For the invisible transactions the deficit had been 601 million dollars in the first half of 1962 as against 628 million dollars in the first half of 1961. It was thus evident that both merchandise trade and invisible transactions had resulted in increased deficits in the first half of 1962 but that the latter had increased more. An important factor in this context was interest and dividend payments which had continuously increased during the last decade. In 1953 they amounted to 239 million dollars and in 1961 to 561 million dollars. A breakdown of the invisibles deficit in 1961 showed the following figures:

Freight and shipping	82	million	dollars
Travel	160	"	"
Interests, dividends	561	"	"
Other invisibles, net	514	"	"
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	1,155	"	"

(An addition of the four items would give a total of 1,317 million dollars. The difference between this sum and the total deficit, 162 millions, was due to gold production for export.)

15. The increase in the interest and dividends deficit had evidently continued in 1962, the Canadian representative pointed out, but the travel account, on the other hand, had shown a favourable development. On the whole, however, the effects of the devaluation of May 1962 on current account had been disappointingly small.

16. Canadian trade figures for July 1962 showed that both imports and exports had increased. For the subsequent months no official statistical information was available to the Group. Some members however said they had evidence of a decrease of their exports to Canada since July. Asked about the seasonal influences on Canadian exports, the representative of Canada explained that basically the winter was the worst season from the export point of view, due mainly to the fact that the shipping on the St. Lawrence River and the Hudson Bay was cut off in October/November. The best season was the third quarter when exports of bulk commodities such as wheat reached their peak.

17. One member of the Working Party, referring to the explanation of the Canadian representative concerning gross and net improvements in Canadian gold and foreign exchange reserves and noting the experience of his own Government in dealing with balance-of-payments difficulties, asked whether the Canadian representative could give any information as to whether the Canadian Government had engaged in forward exchange transactions and, if so, what effect these transactions had had on the net reserve positions as of 31 October. The Canadian representative regretted that he was not in a position to provide the Working Party with such information.

The surcharges

18. Some representatives of both industrialized and developing countries expressed sympathy with the difficulties which confronted the Canadian Government. They were obliged however to point out the difficulties which the measures under discussion were causing to their own trading interests.

19. Several members of the Group referred to the high proportion of their export trade towards Canada which was affected by the surcharges. The approximate proportion given by members of the Group ranged from 50 to 80 per cent. While statistical data were not available in most cases, in view of the recent introduction of the Canadian measures, some members indicated that the surcharges had begun to make themselves felt. Some representatives for instance believed there were signs that the surcharges were having a protective effect and that Canadian consumers were turning from the imported to the domestic product.

20. One representative of a developing country pointed out that while it was usual to estimate damage to export trade in terms of volume and percentage of trade involved, it should be borne in mind that because of the fact that developing countries had to maintain their exchange reserves at a precariously low level, damage done to their export trade was marginally severe. In this connexion he pointed to the dangers of serious injury to some of their exports to the Canadian market, such as: rugs and carpets; sport goods; fruits and nuts; canned fish; cotton fabrics; jute bags and sacks. To such a country foreign exchange was of course of the greatest value in itself; but perhaps even more far-reaching were the marginal effects of reduced exports on the meagre incomes of families engaged in cottage industries. Special attention should therefore be paid to removing the surcharge on such sensitive items of interest to developing countries.

21. The hope was expressed by some members that they would find understanding in bilateral discussions with Canada which might be required by them with a view to easing cases of particular hardship.

22. The representative of Canada agreed that, since the surcharges had been originally imposed on about half of Canada's import trade, it was natural that a majority of exports to Canada from industrialized countries would be affected. This followed not only from patterns of trade but also from the natural decision to exempt from surcharges, products which would in any case have to be imported. This did not of course mean that exports of developing countries would not be affected. He appreciated the difficulties caused to them, as well as to industrialized countries, but noted that any measures to restrain imports inevitably had effects on trade of others. His Government was always ready to enter into individual consultations with contracting parties.

23. With respect to the protective effect of the Canadian measures, the representative of Canada said it could not be denied that any measures to restrain imports had inevitable protective effects. This was not however the intention behind the measures and he wished to emphasize that Ministers and other Canadian authorities had continuously warned business people that, as these measures were very temporary, they should not make plans based on the assumption of continued maintenance of the surcharges.

24. In reply to questions relating to the expected duration of the measures the representative of Canada said his Government was not in a position to fix a terminal date, as this would imply a precise forecasting of trends on which no clear data were yet available. He called attention to the statement by the representative of the International Monetary Fund to the effect that "if the reserve and payments positions continue to improve over the coming months, Canada should be able to eliminate the remaining surcharges". He did not think the phrase "the coming months" could be interpreted to mean more than twelve months at the most. The Canadian representative emphasized that the short-term measures would not form any part of the programme that was needed to deal with the longer-term problems of reducing Canada's current account deficit. The surcharges would not be maintained beyond the day when there was clear evidence of a dependable improvement in Canada's reserve and payments position.

Alternative measures

25. A member of the Group recalled that the Canadian discount rate had recently been reduced from 6 to 5 per cent. He asked whether the Government of Canada had contemplated the introduction of credit restrictions or other monetary short-term measures. The representative of Canada agreed that the rate of interest was amongst the short-term weapons available in a balance-of-payments crisis. Its effectiveness was, however, dependent upon the characteristics of the capital market, on the general monetary situation, and upon the extent to which a restrictive monetary policy could be pressed having regard to the general economic situation. The Canadian authorities had increased the discount rate at the height of the crisis to 6 per cent, but had later found it possible to lower it to 5 per cent. In the case of Canada the present

employment situation was such that it would not have been appropriate to apply too restrictive a monetary policy. Another point to take into account was the relationship between the United States and Canadian money markets. The Canadian authorities aimed at maintaining a reasonable interest rate differential in order to attract capital in present circumstances. In the past when the capital inflow had sometimes been excessive, they had aimed at differentials which would restrain the inflow. In the case of short-term capital it was, of course, difficult to judge how long it would stay in the country.

26. A member of the Group expressed fears that the surcharge policy applied by Canada would tend to export Canada's difficulties to other countries. He pointed out that his own country had balance-of-payments difficulties and that its efforts to promote exports could be affected by the action taken by Canada. The Canadian representative recognized this problem. He noted that it was a manifestation of a general problem that was being given increasing attention in international financial discussions in the International Monetary Fund and in the Economic Policy Committee of OECD. As far as the current account balance was concerned he pointed out that Canada had for many years been importing far more goods and services than it had been exporting. In the longer term this would have to be rectified, but not by restrictive measures. It was important that Canada's major markets should not put new difficulties in the way of the expansion of Canada's exports.