cereals, towels and dishes in soaps, kitchen utensils in boxes of oatmeal, lapel buttons and cutouts in corn flakes.

The hon. member for Hastings-Frontenac (Mr. Webb) mentioned the order in council which was passed in the province of Alberta. For his information I should like to mention that this was not particularly popular with the buying public for the simple reason that it again was a piecemeal attack on what is after all a larger problem.

When we contemplate this type of legislation, Mr. Speaker, perhaps it might be well to have in mind the feeling and the thinking of the women who do the buying and, I might say, thinking of my own wife, doing it extremely well. They get value for their dollar; otherwise they do not spend it.

In speaking on a similar bill last year the hon. member for York-Humber (Miss Aitken) said, as reported at page 744 of *Hansard* of February 4, 1960:

> I can only assume that nobody likes trading and discount stamps except the women who do the buying in this country.

I suggest that he would be a heroic husband who would endeavour to tell his wife that she must not buy at this store or at that establishment because they give trading stamps. He would probably end up by sleeping on the chesterfield or putting himself out at night and keeping the cat in.

Of course, the hon. member who introduced the bill made no mention of the fact that on television last night a gas installation firm in Ottawa offered a free portable 19-inch television set if you let them put a natural gas installation in your house. I presume the hon. member would approve of this because after all it is a rather substantial gimmick to get business. That is what trading stamps are; they are a gimmick to attract business. As has been said by hon. members who preceded me, give these things time and they die a natural death, as have other similar forms of advertisements over many years.

Will you call it six o'clock, Mr. Speaker?

At six o'clock the house took recess.

AFTER RECESS

The house resumed at 7.30 p.m.

THE BUDGET

ANNUAL FINANCIAL STATEMENT OF THE MINISTER OF FINANCE

Hon. Donald M. Fleming (Minister of Finance) moved:

> That Mr. Speaker do now leave the chair for the house to go into committee of ways and means.

He said: Mr. Speaker, normally 12 months transpire between budgets. Exactly six months ago this evening, I was delivering my last previous budget in this chamber. It was a supplementary to the 1960 budget. Tonight's is the second budget of the present session.

Four years ago tomorrow morning the present government was sworn into office. This is the fifth budget I have had the honour to submit to the house in these four years, not including the financial proposals introduced on December 6, 1957.

The circumstances attending each budget have differed from those associated with the others. Each was aimed to meet the financial and fiscal problems of its time. Tonight's budget is designed to meet Canada's present needs and difficulties. Flexibility has been the keynote of our financial policy in these four years. It will also characterize the approach revealed in tonight's budget.

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(Text):

GOVERNMENT ACCOUNTS 1960-61

In structure my budget speech this evening will depart somewhat from past precedents. I shall begin by placing on the record a brief summary of the government's accounts for the year that ended last March 31. I shall not embark upon any detailed analysis because all the essential facts and figures have been included in the white paper which was tabled and published last Friday.

In my March, 1960 budget statement I recorded my expectation that our revenues for the 1960-61 fiscal year would be $5,892 million, our expenditures $5,880 million, and that the resulting surplus would be $12 million. Last December, in presenting to the house a supplementary budget, I explained that the rate of economic expansion in Europe had shown some hesitation and that the economic outlook in the United States and Canada, which had been most encouraging at the beginning of 1960, had rather unexpectedly reversed itself, resulting in a disappointing slow down during the last three quarters of 1960. This inevitably affected our budgetary position and my revised estimates, after making provision for certain tax changes, were that revenues would be $5,694 million, expenditures $5,980 million and the deficit $286 million.

Our books of accounts for 1960-61 have not yet been closed, but subject to some minor adjustments our revenues for the past year were $5,616 million, our expenditures $5,961 million and our deficit $345 million. In other words our revenues were $78 million and our expenditures $19 million below my December forecast, and the deficit was therefore $59 million greater. As explained in the white paper, the main factor causing the rather large drop in revenues was the timing of the long Easter week end. This year Good Friday fell on March 31 and a considerable proportion of the tax payments due at the month end were in fact not put in the mail until April 3 or 4 and therefore could not be credited to our 1960-61 fiscal year revenues. Our March tax receipts showed an unexpected short-fall of nearly $40 million.

The government's over-all cash position for 1960-61, that is, including non-budgetary as well as budgetary cash receipts and disbursements, resulted in a total cash deficit of $294 million, since our non-budgetary cash receipts exceeded disbursements by $51 million. Thus our budget deficit of $345 million was financed by a net non-budgetary cash surplus of $51 million, a net increase of $223 million in our outstanding unmatured debt, and a reduction of $71 million in our cash balances.

ECONOMIC REVIEW

The white paper also contains a full account of the economic events of 1960. It includes an analysis of the more significant longer term developments in Canada and in the world as a whole as related to the Canadian situation. I commend this analysis to the careful study of hon. members. Tonight I shall not cover the ground in the same detail as in the white paper, but I should like to refer briefly to some of the principal features.

Last year we experienced a number of adjustments in our economy including some related to normal cyclical movements, and others of a temporary, special nature. These took place at a time when other longer term influences were also compelling the Canadian economy to adapt itself to a new world environment. In these circumstances the year 1960 might have been one of serious economic maladjustment and recession. In the event, however, we achieved increases and reached new records in production, incomes, employment and trade, both domestic and foreign. At the same time price levels were more stable than they have been in the last five years.

By now, in mid-1961, we are coming to the end of those adjustments related to special and cyclical factors which, in 1960, were exercising a restraining influence on expansion. Those areas of the Canadian economy where declines took place last year are today showing signs of improvement. Capital investment, which declined in 1960, is expected to rise this year. Activity in housing, which fell off in the early part of 1960, responded well to government measures and other market forces in the latter half of the year and has been moving ahead this year. We may expect not only the housing industry, but other associated activities as well, to benefit from this improvement. The level of economic activity showed little change in the first quarter of this year, but increasing evidence of expansion is now appearing. Latest figures show that total employment has risen materially and the numbers of unemployed have begun to decline even after allowing for the normal seasonal movement. Other sectors where there was continued growth last year are showing further strength this year. In the United States informed observers consider that the recovery is now well under way. Expansion is expected to continue in western Europe and in our other important overseas markets. These welcome developments will make possible further increases in our exports, production, employment and incomes. Thus, an improvement in our situation could be expected to occur even if no further efforts were taken to stimulate our economy.

But this improvement, which could be expected in the ordinary course of events and without further stimulus, would, I believe, be modest, an increase of about 3 per cent in the G.N.P. It would be unlikely to induce the full utilization of our productive resources or to provide substantial improvement in the standard of living of our growing population. It would be unlikely to reduce the scale of unemployment to a more tolerable level.

What are the reasons for this apparent lack of resilience in our economy? Have there been new and abrupt changes in our environment which would explain our situation, or has there been a slow emergence of underlying forces which had their birth in an earlier period? Can we trace these influences to some indigenous development, or must we look beyond our own borders? The answers to each of these questions must, I believe, be a qualified affirmative.

The important longer term developments which are at the root of our present day economic difficulties have been taking place slowly since the end of world war II and to some extent were hidden during the extended period of post-war shortages of goods and capital equipment, a period when inflationary forces were constantly in the ascendant. During this period of shortages and rising prices the economies of western Europe and Japan have been rebuilt with the newest plant and equipment and with a highly skilled labour force, and the underdeveloped countries of the world have tried strenuously to achieve self-sustaining economic growth.

Within the past two or three years direct controls on the movement of goods and capital in the free world have, to a large extent, been dismantled. The pace of scientific and technological development has been rapidly accelerated. The western world has grown more interdependent and the policies of governments and business groups have become more closely linked. In the face of all these changes, the competition in world markets has become much more intense and the need for greater efficiency has been forcefully underlined.

These changes have affected all western countries. But Canada has faced additional special problems. Our largest and most important foreign market, the United States, has experienced an inadequate rate of growth in recent years. This has affected not only our exports but also our general business psychology. Meanwhile, the growth of our own labour force has been unusually rapid and much higher than in other western countries. Our growth in employment has been higher—and I wish to stress this—our growth of employment has actually been higher than in other countries, including the United States; nevertheless we have been unable to absorb into employment all the entrants into our labour force. At the same time, many of those seeking employment have not had the benefit of adequate training to meet the needs of our increasingly specialized and technical industries.

Another special feature of the Canadian situation is that many of our industries have surplus capacity. To some degree this reflects the inadequate rate of growth in the United States market to which I have already referred. In part it also reflects the "lumpy" nature of much of our investment, which for physical and economic reasons must be installed in large units, sufficient to meet prospective as well as current needs. A great deal of the investment in the resource industries was of this type. But surplus capacity in our economy also reflects to some extent the unsustainably high levels of investment which were encouraged by the inflationary atmosphere of the mid-1950's. During this period of excessive pressure on our resources it was inevitable that some speculative investment was undertaken, not only in Canada but all over the world, with expectations of continued rising prices. These expectations proved wrong.

The normal growth of real demand can be expected to overtake capacity in the not too distant future. Meanwhile, the existence of surplus capacity acts as a drag on private investment. It necessitates some transfer of resources out of temporarily overexpanded industries; unfortunately, it also contributes to attitudes and conditions which make such transfers more difficult.

In some quarter the conclusion has been drawn that the disappointing levels of production, unemployment, and our balance of payments deficits, are the reflections of major structural maladjustments and inefficiency pervading our whole economy. We are told that Canada has relied too heavily on the development of her natural resources and that she is lagging in the field of industrial development. It is suggested that efforts be made to force our economy into different channels less dependent on world demand. We are urged to balance our external accounts not by expanding exports but by erecting barriers against imports.

The analysis which supports these proposals is in my judgment basically wrong; consequently the conclusions are also erroneous. Canadian economic development since the second world war has on the whole been sound. Investment has flowed into sectors where an abundance of natural resources gave us a decided natural advantage. It also has flowed into a great variety of manufacturing industries, especially into those related to the fast growing resource industries. It is sometimes suggested that the resource industries have been stimulated in Canada to such an extent that they have expanded at the expense of manufacturing. In this connection, the house should remember that employment in manufacturing industries in Canada, while less than we would like, has been better sustained than in the United States over the past seven years.

This is not to say that we would be complacent about the present state of our economy. Far from it. There is more unemployment and unused capacity in our industries than we can possibly accept. Recent rates of economic growth have been lower than we need to absorb our rapidly growing labour force and the output of our expanding industrial capacity. Some of our industries have been stagnant in the face of strong world competition. Our technological development, the enterprise of our business community, and the skills and training of our people, great as they are, have not kept pace with the needs of a rapidly changing world. The deficit in our balance of payments, while declining, is still too high for our present economic circumstances. These are hard facts which must be faced squarely. This we propose to do.

We do not intend to let events take an unguided course in the hope that these problems will solve themselves. The government has introduced numerous measures during the past four years designed to overcome these and other difficulties. As a consequence our economic situation is very much better than it would otherwise have been. We will pursue this course with energy and determination until these difficulties are fully overcome.

Our objective will be, first and foremost, to provide fuller opportunities for the useful and profitable employment of all Canadians willing and able to work. We shall strive to attain a more rapid rate of stable and balanced growth for all sectors of our economy and all regions of our country. We shall seek to improve the technological efficiency of our industry, to heighten skills and capacities of our workers, and to stimulate the talents and initiative of our entrepreneurs. We shall endeavour to raise the levels of savings and investment by Canadians and reduce the balance of payments deficit. These, sir, are the purposes of this budget.

(Translation):

Our objective will be, first and foremost, to provide fuller opportunities for the useful and profitable employment of all Canadians willing to work. We shall strive to attain a more rapid rate of balanced growth for all sectors of our economy and all regions of our country. We shall seek to improve the technological efficiency of our industry, to heighten skills and capacities of our workers, and to stimulate the talents and initiative of our entrepreneurs. We shall endeavour to raise the levels of savings and investment by Canadians and reduce the balance of payments deficit. These are the purposes of this budget. We shall endeavour, through an appropriate mixture of fiscal, financial and commercial policies, to create more jobs, to stimulate production, and to improve the general state of our economy.

(Text):

I need not remind hon. members that there is no royal road, no magic which a minister of finance may invoke to achieve these goals. If there were easy solutions they would have been adopted long ago. Nor can these objectives be attained by federal government measures alone. In our free enterprise system we shall need self-discipline and the full co-operation of business, labour and all levels of government—indeed of all our people—if we are to succeed. I shall have more to say about this subject later.

The budget which I bring down this evening is not an ordinary budget. In more than usual measure it is an economic budget. We shall endeavour, through an appropriate mixture of fiscal, financial and commercial policies to create more jobs, to stimulate production, and to improve the general state of our economy. I should like now to discuss the policies and measures which I propose that this house should endorse.

FISCAL POLICY

While budget policy can play an important role in attaining the objectives that I have set out, it cannot accomplish the whole task. What we need, and what I shall be putting before the house this evening, is a balanced combination of both broad and specific economic and fiscal proposals. The government has already initiated during this session a number of constructive programs to encourage economic expansion; small business loans, housing development, urban renewal and rural development, greatly increased aids to technical education and training, measures to promote the expansion of exports, and in other ways. These are all parts of an integrated economic policy.

When there is a substantial degree of slackness in the economy, in the form of excess productive capacity and idle manpower, budget deficits can provide an important stimulus. By means of such a deficit the government, through its expenditures, places in the hands of the public substantially more purchasing power than it withdraws through taxation. If appropriately planned and timed, a substantial deficit can encourage higher levels of output, employment income and savings, without incurring risks of inflation. When employment and incomes have reached satisfactorily high levels and the rate of economic growth is strong, a sound budget and tax structure should generate sufficient revenues not only to cover current expenditures but also to provide funds for the orderly retirement of debt.

The present general pattern of our tax structure is, in my judgment, sound. While particular rates and particular applications of tax legislation need to be adjusted from time to time, our present tax structure is such that, provided we do not embark upon large new types of spending, it will provide a balanced budget and some provision for debt repayments as soon as we re-enter the area of high employment and a renewed period of progressive growth.

There is, however, as hon. members know, a time lag of quite a few months between increases in the rate of growth of output and employment and the increased inflow of tax revenues. While I expect to see a significant and accelerating improvement in output, employment and incomes during the balance of this fiscal year, I cannot anticipate an equivalent increase in tax revenues in the same period. Much of the revenue benefits of economic expansion will not reach the treasury until after the end of this fiscal year.

In the circumstances confronting Canada today, it is appropriate, indeed desirable, that the federal government should, by incurring a sizeable deficit, help to stimulate the economy. This we propose to do. Accordingly, I shall not be introducing any increase in our general level of taxation. Indeed, I shall be proposing some significant tax reductions to accomplish certain specific economic objectives. This contribution in the field of fiscal policy taken together with the financial and other policy measures which have already been introduced or which I shall be announcing tonight, will bring about higher levels of production and employment, and a more satisfactory rate of growth.

CAPITAL, SAVINGS, THE BALANCE OF PAYMENTS AND THE EXCHANGE RATE

In addition to this fiscal contribution the government will be implementing other broad financial measures that will encourage general economic growth, as well as specific measures designed to encourage particular sectors or industries. These general measures are in the interrelated fields of capital flows, the deficit on international account, and the external value of the Canadian dollar.

Over the past five years we have experienced net inflows of foreign capital ranging from \$1.1 billion up to \$1.5 billion annually. These capital inflows have been matched by deficits on current international account, that is to say, by an excess of imports of goods and services over exports. When the economy was fully employed and expanding rapidly, and when inflationary pressures were active, such capital inflows, and the matching import surpluses of goods and services, were appropriate and beneficial. Under today's conditions they are not only unnecessary, but in some forms they can be harmful. Our excess imports of goods and services must be substantially reduced; our exports must be expanded. There are large quantities of goods and services that we are buying abroad that we can and should be producing at home at economic prices.

It was for these reasons that in my budget of March, 1960 I issued a serious warning to those Canadians, including provincial and municipal governments and business, who, it seemed to me, were over-ready to raise funds abroad, apparently regardless of the exchange risks they were running. In the December budget, as the house will recall, I took action in the field of taxation to remove certain special incentives to borrow abroad which had been built into our tax system in earlier years when there was an obvious need for foreign funds.

The public reactions to these warnings and measures have clearly been in the right direction. The capital inflow has been reduced, the exchange rate on our dollar has been reduced, the surplus imports of goods and services has been reduced; but they have not been reduced enough. Further measures must now be taken.

Accordingly, the government has reached certain policy conclusions relating to the flows of capital and terms of lending within Canada, the import of capital from abroad, the level of the Canadian dollar, and the deficit in our current international transactions. These conclusions may be set out as follows:

(a) The current deficit in our balance of payments is in large measure inappropriate; with so much unused capacity in Canada, we should be exporting substantially more goods and services and importing much less.

(b) An expansion in exports and a reduction in imports should not be brought about by export subsidies, or by higher tariff rates, or quotas, or other forms of government intervention or protection, but rather by encouraging our exchange rate to fall into a more appropriate relationship with our economic situation.

(c) The appropriate method for relieving the exchange rate of undue and unwanted upward pressures is to take every practicable step to ensure that Canadians who might otherwise be raising funds abroad are, in future, satisfied from Canadian financial sources.

(d) Since it will take time to divert demands for funds from foreign sources to Canadian sources, and since it is urgent to obtain relief from the resulting excess of imports of goods and services, the government has decided to use the exchange fund to neutralize, at least in some degree, the effects of the continuing capital inflows.

The house will no doubt wish me to elaborate on these far-reaching decisions.

First, and of most immediate interest, is the decision relating to the adverse balance on goods and services account which has been running well in excess of $1 billion annually. It is the government's aim to reduce this deficit substantially in the near future and ultimately to achieve a position much closer to balance. The improvement should be brought about partly by increased exports and partly by diminished imports. Our purpose is to put Canadian producers in a position where, as a result of these policies, they will soon be selling, at home and abroad, many hundreds of millions of dollars worth of additional Canadian goods and services. This will yield substantial benefits, direct and indirect, in the form of more jobs, more production and more business opportunities for our industries.

These results will be achieved by encouraging our exchange rate to find a level in keeping with our economic circumstances. They are not to be achieved by subsidies, by government controls or restrictions. It has been urged on me from some quarters that there is a need for direct government intervention to deal with our economic problems. I reject this argument. The policy which I am placing before the house tonight is, in terms of real economic incentives, more significant, more powerful, and more pervasive than anything that could be implemented in the way of subsidies and controls. Moreover, it is free from the arbitrary decisions and the bureaucratic delays that always attend incursions by the government into the affairs of private industry.

The high level of our exchange rate has been impairing the competitive position of Canadian suppliers of goods and services in the home market and in foreign markets alike. An appropriate downward adjustment in the value of our dollar will bring them immediate relief and encouragement. On the export side one thinks of wheat and livestock, of petroleum, metals and minerals, of pulp and paper and lumber, and of the growing range of manufactures for which, since currency convertibility was restored, we are finding increasing markets abroad. On the import side our thoughts run first to industries whose growth rates have been less than satisfactory because of the imports that have, in effect, been carried into Canada as a result of a tide of unduly large capital inflows and a consequently unduly high value for our currency; household appliances, motor cars, a variety of consumer goods, and many types of industrial machinery. The exchange rate also affects service industries such as the tourist industry where we have been incurring heavy deficits because Canadians, at the current exchange rate, spend far more abroad than foreign visitors spend in Canada.

In all these situations a further reduction in the exchange rate will exercise a positive influence. And, as I have said, it is the government's intention so to redress our balance of payments that many more Canadians will be employed producing substantially more goods and services for the domestic market and to serve our markets abroad.

While decisions regarding the balance of payments and the exchange rate are of importance, there is a further decision which is, in a sense, basic to the others. This decision is a positive one; to encourage the supply of capital from Canadian sources, that is from Canadian savings, to meet Canadian requirements for expansion and modernization. The rate of Canadian savings has not been low. In fact it has been reasonably good. But it could be better. The flow of savings varies in response to other changes in the economic and financial system. And by far the most important influence on the flow of savings is the flow of incomes. Normally the more people earn, the more they save. By increasing the level of employment and the flow of incomes and profits, we shall automatically increase the flow of Canadian savings. The measures which I am proposing tonight will help to achieve these goals.

The objective that Canadian capital requirements be met as far as possible from within Canada, rather than from abroad, is based on economic grounds and with particular concern for our international deficit and the level of the exchange rate. At the same time the government welcomes, as the Canadian people will welcome, the fact that, over a period of time, this decision will result in greater Canadian ownership and control over Canadian industry and Canadian assets. For this purpose, Canadian savings must not only be increased, they must be mobilized and put to work in the most productive directions.

I wish to make it quite clear that we do not intend to penalize or discourage foreign capital that seeks constructive employment in this country. I am not proposing, in respect of capital inflows, any substantive further taxation measures. The interim budget of last December removed the unnecessary tax incentives. Nor am I proposing any restrictions on the movement of capital which have been advocated in certain quarters. Canada, even in present circumstances, derives great benefit from certain kinds of capital from abroad. This government remains firmly committed against direct controls on capital.

CAPITAL INFLOW AND INTEREST RATES

Since our aim is to reduce substantially and fairly quickly our excess of imports, visible and invisible, over our exports, it follows that we must aim at replacing, from Canadian sources, an equivalent amount of funds that would otherwise have been raised abroad. We have been giving most careful thought to ways and means of supplying these funds from Canadian sources. This is a field in which there are no quick or easy answers. The degree of success we can achieve will depend in part on the co-operation of our financial institutions.

Capital is not a homogeneous commodity; each borrower has his own peculiar needs and each lender his own preferences. However, despite the infinite variety of capital transactions, we can see our way toward certain broad measures that must be taken.

To begin with, interest rates in Canada are out of line with those in the United States and some of the European capital-exporting countries. We should like to see these spreads narrowed. When Canada was in need of large and increasing supplies of capital from abroad, and when we could welcome the net inflow of goods and services that these capital imports generated, it was natural that our interest rates should be appreciably higher than those in the main capital markets from which we were attracting funds.

But today the situation is very different. We have no reason, in present circumstances, to be offering high interest rates in order to attract capital from abroad. On the contrary, the capital that is thus attracted simply pushes up our exchange rate and pushes up our trade deficit.

High interest rates are a double drag, at times like these, on our economic activity and expansion. Such rates traditionally are recognized as having some effect in restricting or postponing decisions to borrow and expand industrial operations and also the activities of governments and public bodies. And, much more important, with our floating rate of exchange, relatively high interest rates actually cause us to develop an import surplus of goods and services with adverse effects on employment.

Statistics indicating trends of interest rates in recent years in Canada and abroad are to be found in the white paper. These support the view that Canadian interest rates have grown out of harmony with those abroad and with our changing economic circumstances. An important step in the right direction was taken earlier this month; I refer to the reduction by the chartered banks of their prime rate on commercial loans. Further moves of this sort will be welcomed and encouraged by the government.

I am confident that the spreads between interest rates of various types in Canada and abroad can be reduced and brought into proper relationships, but I would not wish hon. members to expect that this can be accomplished by some simple or quick formula. It would be folly, for example, to attempt drastically and artificially to force interest rates down by irresponsible increases in the money supply. Such a device would be not only unsound but before long would prove to be self-defeating. We attach high importance to a climate of confidence and understanding in our financial markets. What is required is a judicious and well coordinated combination of fiscal, monetary and general economic measures, the elements of which vary in accordance with the needs of the times.

While the level and structure of Canadian interest rates is an important influence on our balance of payments and our exchange rate, it is clear that much of the capital that comes in from abroad is not directly responsive to interest rates. For instance, last year more than $600 million of capital flowed in under the broad heading of "direct investment". Part of this inflow can contribute immediately and directly to the Canadian economy; not only does it create new jobs and new industrial opportunities in this country but it often carries with it new industrial technology and assured access to markets abroad. On the other hand, another part of this very large total constitutes the least desirable type of inflow; it involves the purchase by people abroad of established Canadian businesses. Many of these takeovers of Canadian firms do little or nothing for our economy and, at the time of purchase, they involve an upward pressure on the Canadian exchange rate and a consequent drag on Canadian production and employment. I shall have more to say on this subject later in connection with an important expansion in the activities and the role of the industrial development bank.

Some of the capital inflow originates in Canada with borrowers who seek funds abroad, not only in response to lower interest costs but for purely institutional reasons. Access to the New York capital market is almost a matter of habit; it is often simpler to raise money there than to search out equivalent possibilities in Canada. Certain aspects of our capital markets have not been adequately developed in Canada. This does not reflect in any way upon the sound and progressive financial institutions in our country, which have been rendering an excellent service under present arrangements. But it does suggest that we must improve our institutional framework.

I have already held fruitful discussions with certain Canadian financial institutions looking toward a decline in interest rates and a reduction of the inflow of types of capital that can be met from Canadian sources. I intend to have further discussions along these lines in the near future.

DEBT MANAGEMENT

While the government will be calling for the co-operation of Canadian financial institutions in achieving our objectives regarding the supply and application of Canadian savings, we shall at the same time be taking certain positive steps ourselves. In this connection I have three important announcements to make relating to debt management.

I need not remind the house that the federal government and its agencies are by far the largest factor in the financial markets of this country. Their influence is particularly great in times such as these, when the private sector reduces its demand for capital and the federal government incurs substantial deficits as a measure to stimulate production and employment. The proper management of its financial affairs is therefore one of the most constructive contributions the federal government can make to the smooth functioning of Canadian capital markets.

Accordingly I wish to announce that in order to avoid congestion in the "long end" of the capital market, which is the part of the financial market upon which the provinces, municipalities and private business depend for much of their capital needs, I intend to confine new federal market issues for at least the next several months to the "short end" of the market.

The sale of new issues is not the only channel by which the impact of government financing is transmitted to the market. There are sizeable holdings of outstanding securities in government accounts; sales and purchases by these accounts have the same market effect as the issue of new securities or the redemption of old. One of the most important of these accounts, both in terms of size and in terms of volume of purchases and sales, is the unemployment insurance fund. The holdings of this fund have come to be regarded in some quarters as a threat to stability in the long end of the market. The government has therefore decided to remove any such threat.

The entire portfolio of the unemployment insurance fund will in due course be taken over by the treasury at book values, and in exchange the fund will acquire interest bearing but non-marketable bonds which may be redeemed by the government as required on 30 days' notice. The direct government of Canada bonds presently held by the fund will then be cancelled, and the government guaranteed bonds will in due course be traded to the Bank of Canada in exchange for equivalent government bonds which will thereupon be cancelled. This will remove the overhang of about $245 million mid and long term bonds which, as I have said, has had a psychologically disturbing effect on the market.

The third announcement I wish to make in the field of debt management concerns the establishment of a purchase fund for the orderly retirement of government debt. As hon. members know, there is at present a fund known as the securities investment account, which is used from time to time to purchase government of Canada securities, particularly those close to maturity. This fund has served a useful purpose in our management of the public debt. We have not, however, had at our disposal the regular flow of funds which is necessary for any steady retirement of debt. The experience of other governments and of private corporations suggests that the existence of such a fund through which purchases of securities are made can have a steadying effect on the market. Over a period of time it should contribute to a reduction of interest costs.

It has therefore been decided to establish a purchase fund to assist in the management of the public debt. Its initial size will be $100 million, to be used over the next twelve months for the purchase in the market of government of Canada mid and long term securities. Details, concerning the operation of the fund will be announced later.

The combination of the policies I have just outlined combined with others to be described later this evening and the indications I gave earlier concerning budget balance will have, I am confident, a salutary effect on the financial markets of this country. They represent a determined effort on our part to exert strong pressure on the level of interest rates and the exchange rate, in order to bring them more in line with our own requirements and with conditions prevailing in the world about us. The improvement in our capital markets which will flow from these measures will be of direct benefit to the provinces, municipalities, business and other borrowers.

THE INDUSTRIAL DEVELOPMENT BANK

The next link in the financial chain that the government is forging relates to the industrial development bank. The scale of the bank's lending to small and medium sized businesses has been expanding rapidly. In its last fiscal year the bank made 740 loans amounting to $38 million, as compared with 221 totalling $17 million five years earlier. In its current fiscal year which began last October loan approvals have been more than 60 per cent greater than the record rate achieved in the same period a year ago.

The number of branch offices has been increased from four to 13 over the past five years, and further branches will be opened in the near future as suitable staff can be recruited and trained. This expansion has been very desirable and has had the full support of the government.

The predominant business of the bank has been, and will continue to be, the making of term loans to small and medium sized enterprises. However, the bank also has authority to purchase a portion of the equity in an enterprise with a view to resale to the owner or to others at a later date, and to enter into underwriting agreements. These powers will be put to increasingly active use.

In order to encourage continuing growth of the bank's operations, the government has decided to provide it with additional financing capacity, and wider responsibilities. For these purposes I shall be placing a bill before the house in the very near future. Without going into detail at this time, I may say that the bill will make provision for important changes. The types of businesses which the bank may assist will be enlarged. At present it is permitted to provide accommodation to certain specified classes of industry. These include manufacturing and processing, logging and construction, air transport and some service activities. In the future it is intended that all business enterprises in Canada shall be eligible. The bank would, of course, not expect to make loans where funds are available on reasonable terms from other sources and, in particular, where special provision has already been made by parliament, as in the Small Businesses Loans Act and the Farm Improvement Loans Act. It is intended that the financial resources available to the bank should be substantially increased. These resources are now $160 million; it is intended that they should be increased to about $400 million.

In facilitating the growth of the industrial development bank, the government has in mind several important objectives. The expanded operations of the bank will provide for greater employment. They will also assist in the development of a stronger, more productive and more flexible economy in the future. The bank was formed in order to meet a special need in the Canadian financial structure. This gap exists because, while smaller and medium sized businesses have usually had access to short term credit from the chartered banks, and to long term mortgage credit from other institutions, their operations have not been of a size to enable them to sell securities in the market. To fill this gap the bank has supplied term loans for plant and equipment and also provides technical engineering, accounting and managerial advice where needed. Financial and other assistance of this kind will now be available for many businesses not previously included under the bank's operations.

While the primary purpose of the I.D.B. is to help in financing the establishment of new and the expansion of existing small and medium sized businesses, it has become increasingly apparent that it can also play a useful part in assisting with the problems arising from financial consolidation and changes in ownership.

In these days there are often pressures on the smaller firms from both domestic and foreign sources. If our economy is to grow and prosper we must help them to withstand these pressures. I have in mind, for example, the problems that face Canadian family firms. Often such a firm plays a central role in one of our smaller Canadian towns. In the life of such a firm, occasions sometimes arise when infusion of new management together with new capital becomes desirable. In the past this infusion has not infrequently come from abroad; and while foreign capital may be both desirable and helpful, I am sure that we would all be happier if such a firm had the opportunity to obtain the necessary capital and management in Canada. The I.D.B. has already assisted in situations of this sort, and it is the government's desire that activity in this field be expanded.

Similarly, problems sometimes arise where the owner of a firm is facing or anticipating difficulties in connection with estate taxes. In such a situation the owner may feel driven to dispose of a firm, or a controlling interest in it, and often the most ready purchaser may be located outside of Canada. On such occasions the I.D.B. may have a constructive role to play. The I.D.B. has the power, as I have explained, not only to make term loans but also to purchase shares with a view to resale and to enter into underwriting agreements.

The existence of these powers, and of the willingness of the bank to use them, should be made more widely known. It must, of course, always operate with good business judgment. But within this framework I am confident that the industrial development bank will make an increasing contribution to solving problems of the types I have described, to increasing Canadian productivity and improving our competitive position, and to helping retain in Canada the ownership and control of Canadian businesses.

OTHER FINANCIAL MEASURES: A ROYAL COMMISSION

I should like at this point to comment on other important steps in the financial field which the government has announced in the recent past or will take in the near future.

I should like to remind the house of certain recent measures in the financial field that are designedly in harmony with the objectives I have announced tonight and, in particular, the objectives of lowering interest rates and ensuring that, as far as practicable, Canadian demands for capital should be met from Canadian sources.

First, I am glad to say that after a naturally slow beginning, the Small Businesses Loans Act is being put to increasingly good use. The latest figures show that guaranteed bank loans under this legislation are now being made at an annual rate of approximately $100 million to a wide variety of Canadian business enterprises.

Second, I should like to refer briefly to the arrangements which we are making for a secondary market in mortgages. As my colleague the Minister of Public Works has explained, there is no intention of dumping on the market large quantities of mortgages now held by the Central Mortgage and Housing Corporation. If and when the government is in need of funds there are more effective and cheaper means of meeting our requirements. On the contrary, it is our intention to feed out to the market fairly limited quantities, in a manner designed to encourage an active market in insured mortgages. Such a market will give an element of liquidity to these instruments, and as such will harmonize with our general program of broadening and deepening Canadian capital markets and of bringing interest rates in Canada more in line with those abroad.

I now turn to the future. It has become almost trite to say that the economic environment of the sixties will be different from that of the fifties. In no field, as far as Canada is concerned, is this statement more true than in the field of financial relationships, domestic and international. In tonight's budget, as on other occasions, the government has reached decisions on certain reforms and certain improvements that should be introduced. We have, however, become aware of the need for a broader, fuller survey than is possible under the pressures of day to day government decisions.

[Mr. Fleming (Eglinton).]

Major Canadian financial institutions have developed over the years an enviable reputation for soundness, prudence and adaptability. Canada has been well served by them. In recent years there have been important changes in the institutions themselves and in the markets in which they function. Even greater changes may be in store as the Canadian economy matures and becomes more complex. So important are these institutions and markets to the smooth functioning of business and government that a careful review of them is necessary from time to time.

The last major study was made by the MacMillan commission in 1933. The Canada of that day was a much less mature country than the Canada of today, and the world in which she found herself was vastly different. Having in mind the length of time which has elapsed since this last review of our financial framework, and having in mind also the fact that the Bank Act must undergo its regular decennial review in 1964, the government has decided to appoint a royal commission to examine Canada's financial structure and institutions. The terms of reference and membership of the commission will be announced in due course.

Meanwhile, I say that the terms of reference will be broad, covering all aspects of money, banking, credit and finance. The financing of the Canadian economy will be one of the major areas of study. Such broad topics as the pattern and behaviour of interest rates, consumer credit and instalment financing, and the management of the public debt, will be included in the terms of reference. The commission will be asked to study existing financial institutions, such as the chartered banks, the Bank of Canada, and other institutions that perform banking and credit functions, and the various acts of parliament which govern their activities. The commission will also be asked to consider ways and means of encouraging the development of savings institutions. It would be our intention that the report of the commission should be available well in advance of the decennial review of the Bank Act.

EXCHANGE OPERATIONS

I now return to the exchange rate. As I have said it is the government's intention that our import surplus of goods and services, which has been running in recent years well over a billion dollars annually, should be reduced substantially, and that this should be brought about through an appropriate adjustment of the exchange rate rather than by direct government controls or subsidies, quotas or tariffs.

No one can say today what the appropriate level of our exchange rate would be when our balance of payments is in a position better suited to our present economic circumstances. But the rate will certainly be lower than it has been of late, and it may well be appropriate for it to move to a significant discount. It will be government policy to facilitate such a movement.

Accordingly the exchange fund will be prepared, as and when necessary, to add substantial amounts to its holdings of United States dollars through purchases in the exchange market. This would have the effect of increasing the foreign exchange reserves available to Canada to be used in case of need. As many competent observers have pointed out, these reserves have not grown over the past decade in line with Canada's international transactions. Once an exchange rate more closely in line with Canada's economic position is achieved, the government will use the resources of the exchange fund to ensure that the rate is kept within a range appropriate to Canada's changing economic situation. The value of our currency must, of course, ultimately depend upon our pursuit of appropriate economic policies.

It has been suggested in certain quarters in this country that any reduction in our exchange rate is inflationary. I do not think that we are in any serious danger of inflation under present circumstances, with so much unused capacity in our economy. A decline in the exchange rate will mean modest price advances for some of the goods we obtain from abroad as well as some of our export commodities. I am confident, however, that if under present conditions of unused economic capacity there is any effect on consumer prices and the cost of living, these will be minimal.

At this point I should like to issue a word of warning. A downward adjustment in the value of our dollar will open up new opportunities for Canadian industry both in our home market and abroad. The fiscal and financial measures which I have proposed or shall be proposing later in this speech should place Canadian industry in a better position to take advantage of these opportunities. But it would be a sad mistake if Canadians should thereby assume that nothing else needs to be done. Goods and services do not sell themselves. The world has become highly competitive for every type of goods and services which we produce. We must be prepared to intensify our efforts to compete in this new situation. We must work hard; all of us, not only the worker, but the entrepreneur and the business manager as well.

It is well known that adjustments in the exchange rate do not yield advantages that last forever. Recent history is full of examples where such adjustments have proven to be an asset which has been dissipated before the fruits have been harvested. If industry should seek to obtain unwarranted price increases, or labour should seek wage adjustments not justified by improvements in productivity, the opportunity will certainly be lost. It would surely be the height of folly if these new opportunities were to be lost because of lack of self-discipline or failure to achieve effective co-operation between management and labour were to result in higher costs and prices and a deterioration in our competitive position. I have in mind that our competitors abroad, particularly in western Europe, have succeeded in achieving a degree of labour-management co-operation which we in North America have yet to attain. We will need a much fuller measure of such co-operation and self-discipline in respect of profits, prices and wages if we are to take full advantage of the new opportunities which will become available.

International financial policy has been the subject of recent consideration both in the international monetary fund and also in the new balance of payments subcommittee of the organization for economic co-operation and development. I believe I can say that, in both bodies, there is a good degree of understanding of the Canadian situation.

These two groups have been paying close attention to the problems associated with massive short term international capital movements; as the house will recall, both the President of the United States and the Prime Minister of the United Kingdom have recently called public attention to the problems that are involved. Over the years Canada's difficulties in deciding upon and pursuing an effective exchange rate policy have been entirely bound up with the problems of capital movements. If we can achieve a better international understanding of these problems, and devise new international techniques for dealing with them, we shall all benefit.

In summary, therefore, our objective is to achieve an exchange rate for the Canadian dollar which will contribute to a better balance in our current account position and to substantially higher rates of domestic production and employment. We will strive to attain this goal through a combination of financial and general economic policies which will encourage Canadians to meet their capital requirements more fully from domestic sources.

Experience over the past few years suggests that there is sufficient resiliency in Canadian industry, whether producing for export markets or for the domestic market, to bring about the necessary adjustments in our foreign trade balance. This judgment is, I think, supported by the fact that although we are running a very heavy deficit in invisible transactions, we have been able, with variations from year to year, to move from a peak commodity deficit of $728 million in 1956 to less than $150 million in 1960. For the coming year we can foresee a possible surplus on external commodity account which, we believe, should be substantially enlarged through the policies we are pursuing.

We have the material means—the manpower, the resources and the industrial capacity—to obtain these results within a reasonable period of time. But the responsibility for attaining them does not rest with government alone. Indeed, they can only be reached if there is a maximum effort on the part of every segment of the Canadian community, from business and labour. We will have to produce the right goods at the right prices in competition with energetic and competent suppliers from every continent. I urge Canadian producers, encouraged and assisted by the policy measures which I am proposing in this budget, to respond fully to this compelling challenge. In this way we will attain expanded levels of efficient production and create new opportunities for the profitable employment of our growing labour force.

INTERNATIONAL TRADE AND COMMERCIAL POLICY

I now turn to consider the main developments in our external trade relations. In perhaps no other field of our economic life are events moving more quickly or dramatically. With new regional trade groupings either established or in the process of being created, Canada is confronted with fresh challenges and the need to adjust to them. In the face of these developments, and against the background of the recent slow down in our rate of economic growth, the government has been urged from various quarters to alter radically and immediately our traditional commercial policy. In some quarters it has been advocated that we should move toward economic self-sufficiency supported by a highly restrictive trade policy. Others would have us alter our course sharply in the opposite direction by merging Canadian industry and agriculture in some regional economic grouping. In these circumstances it would seem timely to examine afresh the major tenets of our commercial policy objectives.

Let me say at the outset that I reject categorically these extreme positions which are being urged upon us. These are counsels of fear and even despair. Attempts to isolate ourselves from the trading world through the imposition of trade barriers would do irreparable damage to the Canadian economy. It would mean a loss of markets and the stagnation of our most efficient export industries. Standards of living of the Canadian people would decline and our economy would atrophy. It would mean running counter to the whole trend of international economic policy in the major trading countries. It would lead to regional disunity at home and a weakened voice at international council tables.

Nor can I see any gain for Canada in abandoning our present broad trade relationships in favour of joining a regional trade grouping. We shall, of course, have to adapt to changes in the world around us and be alert and flexible in meeting new challenges and opportunities as they arise. For the present at least the situation is much too unsettled to consider seriously a sharp reorientation in our policies along these lines.

Today our foreign trade and other economic ties link us to all parts of the world. With the attainment of convertibility and the removal of quota discrimination against our goods, there are increasing opportunities to extend our markets in many directions. I find it hard to see how, in our particular circumstances, a discriminatory alignment with individual countries or regional groups can help us to diversify and expand our foreign commerce, or fail to do damage to our trade relations with countries against whom we would be turning our backs. Nor have I been convinced that a sweeping elimination of our tariffs in relation to any existing trade grouping can be reconciled with a healthy secondary industry or the balanced growth of the Canadian economy.

I do not believe that the economic problems which confront Canada today require a drastic redirection of our trading relationships; or that these problems cannot be overcome by a vigorous pursuit of our present trading policies judiciously adjusted to meet changing world conditions.

What then are the commercial policies we intend to pursue? Our broad objectives in the trade field have been stated in unequivocal terms on earlier occasions. They are clear.

1. To achieve expansion, diversification, better balance and greater stability in our over-all trade and in our trade with commonwealth and other countries.

2. To support and promote a regime of law and order in international trade; to respect our international commitments; and to stand ready to defend our rights and interest.

3. To recognize the legitimate needs of Canadian producers; to safeguard them against unfair trading practices; and to promote the balanced growth of all sectors of Canadian industry and agriculture.

These have been the guiding principles and objectives in our foreign trade relations since this government took office four years ago. I believe that they are the right policies to pursue today.

Looking back I believe that we can derive considerable encouragement from the success we have had in moving toward these aims. Our exports in 1960 were the highest in our history. The deficit in our external commodity trade for the year 1960 was less than one quarter of the peak level of 1956. Imports are no higher than four years ago and, speaking broadly, our domestic industries are supplying a higher proportion of a growing domestic market. Our trade with individual countries is in better balance and we have enjoyed a gratifying measure of diversification in our export trade both in terms of products and destination.

Looking ahead I am confident that a continued and vigorous pursuit of these objectives will lead to further successes despite the difficulties and uncertainties that exist in several important areas of world trade. As the very high levels of business investment of recent years bear increasing fruit in the form of increased export and import-displacing production, we can look to increasing surpluses in our external commodity trade accounts and reduced deficits in our current account balance of payments.

The movement to a better trade and payments balance will be substantially enhanced as we achieve an external value of the Canadian dollar more appropriate to our present economic situation.

We live in a country rich in many resources, natural and industrial, a country capable of producing many products in great quantity and at competitive prices. Our high standard of living has always depended in large measure upon our ability to sell in world markets the products in which we excel in exchange for those in which other nations have special advantages. It is self-evident that a country which depends on foreign trade for one quarter of its national income must seek to maintain the widest possible system of world trade and payments, a code of international practice to govern that system, and a reasonably diverse balance of interest among external markets.

For very good reasons, therefore, we have consistently supported the general agreement on tariffs and trade and the international monetary fund, and we shall continue to do so. This, of course, is not to say that we shall pursue a blind or inflexible adherence to the specific tariff bindings incorporated in the GATT agreements where the circumstances confronting particular Canadian industries require that they should be modified. The GATT makes provision for the renegotiation and modification of bound rates of duty and we have found it convenient from time to time to make use of this flexibility. In most cases these changes to bring our tariff up to date and adjust it to the changing needs of Canadian industry have followed comprehensive investigations and reports by the tariff board.

In the past several years we have introduced modernized tariffs for basic iron and steel, pipes and tubes, fresh fruit and vegetables, a large part of the textile schedule, as well as for other products. This evening I shall be proposing further changes affecting textile products, nails and several other items. We regard this task of modernizing the tariff as a continuing process and we have recently enlarged the tariff board to permit it to undertake more tasks and to handle its work more expeditiously. In every case where the tariff items in question were bound under the GATT agreements we have entered into negotiations with the interested countries and reached agreements satisfactory to both sides. We have endeavoured through this system of selective tariff adjustments to allocate the available protection to those products and industries which would improve the over-all efficiency of the economy and maximize production and employment in Canada. This, of course, has meant tariff decreases for some items to offset increases for others with no over-all increase in the incidence of protection.

We have pursued Canada's trade interests in the commonwealth through the commonwealth trade and economic conference and other commonwealth meetings, as well as through direct discussions with the United Kingdom and other commonwealth countries. We maintained a close contact with the previous United States administration in economic affairs and have already established an intimate and friendly working relationship with the new administration. We had a particularly valuable meeting of the joint ministerial committee on trade and economic affairs in March in Washington followed by visits to Ottawa of the United States secretaries of agriculture and the interior and then the visit of President Kennedy.

An important part of our success in achieving greater diversity and a better geographical distribution of our export trade has been associated with a substantial increase in our exports to the United Kingdom and continental Europe in recent years. Naturally we are intensely interested in the nature and direction of the regional trading arrangements in which these countries are participating.

The six continental countries comprising the European economic community have