Action to reduce pressure on bond markets, improve confidence in financial conditions, and bring about a lower level of interest rates than would prevail in the absence of such action

In his Budget Speech of June 20th and in other speeches, Mr. Fleming and his associates have said that the Government had certain policies and proposals which would restore confidence to bond markets and bring about lower interest rates, but that these policies and proposals were incompatible with the views of the Governor of the Bank of Canada and therefore the Governor should be removed.

In his speech the Minister mentioned three specific actions which the Government was going to take, namely:

(1) To rely on short-term financing for some months so as to leave the long-term market open to provinces and municipalities;

(2) To stop sales of securities on the market by the Unemployment Insurance Fund and to replace the Fund's holdings of marketable securities with a direct non-marketable obligation of the Government;

(3) To set up a Purchase Fund which would have $100 million a year to invest in longer term Government bonds.

All three of these actions were recommended by me to Mr. Fleming (and by other persons as well) months before the Budget, in some cases years before. The action taken by the Government in respect of short-term financing and the Unemployment Insurance Fund coincides with my advice. The action taken by the Government with respect to a Purchase Fund is smaller than the degree of action which I recommended.

The Government also has failed to adopt other recommendations which I made which would have had a further effect in giving confidence to investors and reducing pressure on bond markets and on interest rates generally. Among these may be mentioned the following:

(4) One recommendation was to set up a board of commissioners for the public debt, which would have the benefit of professional advice and work closely with committees of investors and of investment dealers. This would remove decisions on bond issues and on management of the public debt from the vagaries of political expediency to which such decisions have at times been subject, as is well known in the financial community.

(5) I also recommended eight months ago and again in February the establishment of a Local Government Finance Corporation which would be a lender of last resort available to the provinces (and also to provincial agencies which provide funds to municipalities) who felt they were unable to obtain their requirements by selling bond issues in Canada on reasonable terms and conditions. Such an agency would restore confidence to provinces and municipalities in regard to their financing and would enable them to plan their borrowing programmes much more effectively than in the past. It would assure investors and borrowers alike that the bonds of any one borrower would not be thrown on the market in excessive amounts at any one time. It would also help provinces and municipalities to avoid the risks of borrowing abroad.

(6) I also recommended months ago to Mr. Fleming that he should reduce the pressure which his deficit financing was going to put on bond markets, by obtaining some of his requirements through the sale of a special type of bond which would not compete with the usual market forms of bond issues, and thus make ordinary market borrowing easier for the provinces, municipalities and other borrowers. This was recommended some months ago with a view to action in April or early May of this year, but the proposal was rejected by Mr. Fleming.

(7) I also recommended to Mr. Fleming that preliminary planning and arrangements be set in hand to ensure that the sale of Canada Savings Bonds in the autumn of 1961 would produce results of the magnitude which the Minister said he desired, and that the terms of the instrument be of a certain character designed to attract the interest of investors of the kind who do not normally buy marketable Government bonds. These recommendations were also rejected.

(8) My suggestion months ago with regard to putting the Canadian dollar at par , and keeping it there, would also have given more confidence as to bond values and interest rates than the exchange depreciation "to a significant discount" and other inflationary sentiments expressed by Mr. Fleming in his budget speech.

(9) I also recommended (on June 9th, 1961) that the talk sometimes heard that large holdings of long-term bonds by the Bank of Canada were "overhanging the market" should be eliminated by having all but a small portion of the Bank of Canada's holdings converted to short-term securities by an "advance refunding" operation.

(10) Finally, I pointed out to Mr. Fleming on many occasions, both privately and publicly, that the size of the Government deficit --- and of its other borrowing requirements for non-budgetary purposes --- are the most important single factor in the level of interest rates, and particularly the level of interest rates and bond prices for Government of Canada securities. Measures which I proposed would have had the effect of reducing the budget deficit and the total borrowing requirements of the Government substantially below the level which the Minister has announced ($980 million) plus $100 million for the Purchase Fund plus whatever amount may be required for the Exchange Fund under the new policy announced by Mr. Fleming.