

**Hegemonic Hug:
Canada and the Reordering of
North American Relations, 1963-68**

by

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Abstract

This thesis explores Canada's official relations with the United States between 1963 and 1968. During this crucial period, when the postwar international order crumbled, Canada and the United States faced fundamental choices about their future relationship. The most important developments were economic. The negotiation of the Auto Pact, extensive tariff reductions, and increasingly close financial ties created a more structured and formal economic relationship, reinforcing Canada's continental orientation. At the same time, shifting strategic priorities led the two governments to reassess their close postwar alliance. Carefully, and with due regard for American interests, Ottawa adopted new military and diplomatic postures that were designed to reflect a unique Canadian perspective on world affairs. Acknowledging this development as legitimate and inevitable, American policy-makers realistically adjusted their policies toward Canada. Consequently, despite profound differences over the conflict in Vietnam and growing Canadian nationalism, Canada and the United States found ways to accommodate each other's interests in ways that minimized bilateral disruptions.

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Introduction

This study of Canada's official relations with the United States between 1963 and 1968 draws extensively on Canadian and American primary sources to explore the most important political, economic and defence aspects of the association in their bilateral and multilateral contexts. It challenges the prevailing view that the relationship during this period was characterized primarily by mutual hostility, the product of growing Canadian nationalism and fundamental differences over the conflict in Vietnam. Canada and the United States developed the framework for a new economic partnership during this period that tied the two countries more tightly together than ever before. Closer economic integration was offset to some extent by diverging views on western political and military strategy. However, as Pearson's government pursued distinct foreign and defence policies, American policy-makers acknowledged that Canadian objectives differed from their own and adjusted their policies accordingly. For its part, Ottawa rarely moved without weighing the impact Canadian initiatives might have on Washington's role as the leading Western power. As a result, Canada and the United States found ways to accommodate each other's interests without seriously impairing bilateral cooperation. It was not only the Vietnam War, therefore, that defined Canadian-American relations during the mid-1960s, but bilateral economic cooperation and mutual political accommodation.

Canada emerged as an important United States ally in its own

right in the period immediately following the Second World War. Canadians, anxious to avoid the mistakes of the inter-war years, looked to, and encouraged Washington to play a leading role in the search for an effective means of collective security. While Western Europe struggled to recover from the war, Washington came to count on Canada as a close and reliable North Atlantic partner. When the nascent United Nations proved ineffectual in the face of Soviet aggression, Canada helped the United States create the North Atlantic Treaty Organization (NATO). At the peak of the Canadian effort in 1953-54, Canada spent 8.8 percent of its Gross National Product (GNP) on defence, the fourth largest military budget in NATO.¹ Canada was there when it mattered. In 1950, Canadian troops challenged communist aggression in Korea; in 1954, Canadian diplomats took on the Western burden to help France escape from Indochina; and in 1956, it was a Canadian, the secretary of state for external affairs, Lester B. Pearson, who helped prevent the Western alliance from tearing itself apart during the Suez Crisis. Certainly, Ottawa and Washington sometimes differed - over NATO, over Asia, and over continental defence - but these differences were mostly tactical and easily reconciled.

During the immediate postwar period, the wartime changes in the economic relationship between the United States and Canada were cemented into place. Britain was exhausted, and the prewar "North

¹ Figures cited in David Bercuson, "Canada, NATO, and rearmament, 1950-1954: why Canada made a difference (but not for very long)," in John English and Norman Hillmer (eds.), *Making a Difference? Canada's Foreign Policy in a Changing World Order* (Toronto, 1992), pp. 104-05.

Atlantic triangle", within which Canada balanced its imports from the United States with its exports to Britain, was gone forever.² In the future, American imports would have to be paid for with dollars earned by exports to the United States and imports of American capital. Investors in the United States, which emerged from the war with the world's strongest economy, were happy to oblige, delighted at the prospect of investing in their safe, familiar and profitable neighbour.

Unimpeded, American capital flowed northward, and the economy boomed. Canadians cheered C.D. Howe, the ubiquitous "minister of everything" who trumpeted the benefits of North American economic cooperation, and re-elected majority Liberal governments in 1945, 1949 and 1953. The GNP grew steadily from just over \$15.4 billion in 1945 to \$21.5 billion in 1955.³ By the mid-1950s, American investment in Canada totalled \$10.2 billion, up from approximately \$5 billion in 1945.⁴ In 1955, American-owned companies accounted for 73 percent of Canada's oil and gas production, 55 percent of its mining and smelting operations, and 42 percent of its manufacturing.⁵

² Hector Mackenzie, "The ABC's of Canada's International Economic Relations, 1945-51," in Greg Donaghy (ed.), *Canada and the Early Cold War, 1945-57* (Ottawa, forthcoming 1998).

³ Irving Brecher and Simon S. Reisman, *Canada-United States Economic Relations* (Ottawa, 1957), p. 333.

⁴ *Ibid.*, p. 88

⁵ Cited in J.L. Granatstein, "When Push Came to Shove: Canada and the United States," in Thomas Patterson (ed.), *Kennedy's Quest for Victory: American Foreign Policy, 1961-1963* (Toronto, 1989), p. 87.

Cross-border trade grew as well. In 1945, Canada sent 38.7 percent of its exports, worth \$878 million, to the United States. By the mid-1950s, this trade had increased to \$2536 million, and represented almost 60 percent of Canada's exports.⁶ The buoyant economy fed the sense of national self-confidence that had developed during the war. United under the tranquil if uninspired leadership of Prime Minister Louis St. Laurent, Canadians lapped up American magazines and movies and books, without questioning who or what they were. As one of the country's leading syndicated columnists pointed out, the answer was evident: "Tomorrow's Giant."⁷

Still, in many quarters there was an imprecise but disturbing sense that too cosy a relationship with the United States was somehow not good for Canada. In 1951, Vincent Massey's Royal Commission on National Development in the Arts, Letters and Sciences dismissed American movies, advertising and television as "alien."⁸ The anti-communist witch-hunts of Senator Joseph McCarthy disturbed Canadians, who were outraged when one of their diplomats, Herbert Norman, leaped to his death in 1957 in the wake of allegations that he was a communist.⁹ Many Canadians, especially

⁶ F.H. Lacey (ed.), *Historical Statistics of Canada, Second Edition* (Ottawa, 1983), p. G415-428.

⁷ Bruce Hutchison, *Canada: Tomorrow's Giant* (Toronto, 1957).

⁸ Cited in Joseph Levitt, *A Vision Beyond Reach* (Deneau: Ottawa, [1982]), p. 152.

⁹ J.L. Granatstein, *Yankee Go Home: Canadians and Anti-Americanism* (Toronto, 1996), pp. 116-20.

the roughly 45 percent who were British in origin, waxed nostalgic for the receding imperial connection, and they recoiled at St. Laurent's refusal to support Britain blindly during the Suez Crisis.¹⁰ John G. Diefenbaker, the Progressive Conservative leader, touched this anti-American nerve in the June 1957 federal election and drove the Liberals from power after 22 years in office.¹¹

During his first three years as prime minister, Diefenbaker pursued a policy towards the United States that hardly differed from the one followed by his Liberal predecessors. His anti-Americanism remained more apparent than real, a question of style rather than substance. The deep admiration he felt for President Dwight Eisenhower, who had served as supreme allied commander in Europe during the Second World War (and who carefully cultivated the prime minister's friendship), tempered his hostility.¹² The Conservative leaders's only attempt to reverse the postwar pattern of economic relations was a whimsical promise to divert 15 per cent of Canada's trade from the United States to Britain. Uttered spontaneously in the emotional aftermath of Diefenbaker's first Commonwealth prime ministers' meeting, it was a pledge that he disavowed when he learned how disastrous it would be for the

¹⁰ Figures derived from F.H. Lacey (ed.), *Historical Statistics of Canada*, p. A110-153. According to the 1951 census, 48 percent of the population was British (English, Irish or Scottish) in origin. This figure declined to 43 percent by the 1961 census.

¹¹ J. Murray Beck, *Pendulum of Power: Canada's Federal Elections* (Scarborough, 1968), pp. 297, 308-09.

¹² H. Basil Robinson, *Diefenbaker's World: A Populist in World Affairs* (Toronto, 1989), p. 17.

Canadian economy.¹³

Under Diefenbaker, several pieces of important, unfinished defence business with the United States were quickly settled. In 1957, he signed the agreement establishing the joint North American Air Defence Command (NORAD), which replaced the ad hoc bilateral measures for continental defence then in effect with a formal, fully integrated system for defending the continent. Later that year, he agreed that NATO forces would accept tactical nuclear weapons. The Conservative government accepted the implications of this arrangement in deciding to equip the Canadian Air Division in Europe with nuclear-armed CF-104s and to arm Canadian ground troops with a battery of Honest John missiles, a weapon which also relied on nuclear warheads. Similarly, in replacing the ill-fated Avro Arrow (CF 105), a Canadian fighter that was cancelled in 1959 after huge cost over-runs, the prime minister adopted the Bomarc B missile, which was only effective when armed with nuclear warheads.¹⁴ The negotiations to determine the conditions under which Canada's NATO and NORAD contingents would receive American nuclear weapons initially went well.

Relations between Ottawa and Washington began to deteriorate in 1961. Howard Green, Diefenbaker's secretary of state for external affairs, was an ardent champion of nuclear disarmament.

¹³ J.L. Granatstein, *Canada, 1957-1967: The Years of Uncertainty and Innovation* (Toronto, 1986), pp. 44-45.

¹⁴ John Hilliker and Donald Barry, *Canada's Department of External Affairs, Volume II: Coming of Age, 1946-1968* (Montreal and Kingston, 1995), pp. 237-39.

Convinced that Ottawa's capacity to advance this cause would be reduced by accepting American nuclear weapons, Green pressed the prime minister to repudiate his commitment to equip Canadian forces in Europe and North America with atomic weapons. Caught between his secretary of state and his minister of defence, who urged him to cooperate fully with Washington, Diefenbaker played for time.¹⁵

John F. Kennedy, Eisenhower's successor, had little time to spare. He and his advisors were determined to increase the West's capacity to confront the Soviet Union, and they did not understand or sympathize with Diefenbaker's predicament.¹⁶ Personal animosity soon exacerbated the differences over Canada's commitment to adopt nuclear weapons. Diefenbaker resented the American's popularity and felt slighted when Kennedy gossiped at length with L.B. Pearson, the opposition leader, during a 1961 presidential visit to Ottawa. Kennedy found the prime minister boring; later, when Diefenbaker refused to return a note from the president's briefing book, he dismissed him as contemptible. Relations reached their nadir during the Cuban Missile Crisis in October 1962. Diefenbaker's hesitant response to Washington's request for help in stopping the Soviet Union from basing nuclear weapons in Cuba was, from the American point of view, wholly inadequate.

Canadians thought so too. After the Cuban crisis, defence minister Douglas Harkness tried once more to convince Green and

¹⁵ Robert Bothwell, *Canada and the United States: The Politics of Partnership* (Toronto, 1992), pp. 77-78.

¹⁶ See Thomas Patterson, "Kennedy Quest for Victory and Global Crisis," in his collection *Kennedy's Quest for Victory*.

Diefenbaker to accept nuclear weapons, but without success. When Diefenbaker insisted in Parliament that a Canadian nuclear role in NATO and NORAD was not in fact necessary, he provoked a public dispute with Harkness. The State Department issued a statement repudiating the prime minister's claim. On 3 February 1963, Harkness resigned, and the Diefenbaker government began to collapse in disarray.

At its deepest level, the confrontation between Kennedy and Diefenbaker reflected growing differences between Canada and the United States in their strategic outlook. As Europe settled into an uneasy but stable peace, Canadian policy-makers were anxious to pursue detente with the Soviet Union and normalize relations with Communist China. Western Europe's economic and political recovery sparked a restiveness in NATO. France and West Germany sought new and larger roles for themselves, raising questions about Canada's place in the alliance. As the likelihood of war in Europe declined, Canadians diverted resources from defence to domestic social programs and development assistance. By contrast, the United States was sceptical about detente. For Kennedy, in particular, the threat remained unchanged, though the front had shifted from Europe to the developing world. Communism mixed easily with nationalist movements throughout Africa, Asia and the Caribbean as Britain and Europe abandoned their colonial empires. By the early 1960s, it was no longer clear exactly how Canada would fit into this new international order.

Even more important for future relations between Canada and

the United States, between 1957 and 1963 the postwar economic order started to crumble. Canada's resource boom, fuelled by the Korean War, NATO rearmament and European reconstruction, ended in 1956 and revealed disturbing structural weaknesses in the Canadian economy. The dollar and its floating exchange rate were vulnerable to movements in American capital. These pushed the Canadian dollar to artificially high levels, encouraging imports, deterring exports, and driving unemployment to over 7.5 percent by 1960. In the spring of 1962, the investors and their American dollars finally fled, sparking a Canadian financial crisis.¹⁷

The Conservative government responded (though belatedly) to Canada's economic difficulties, introducing several measures to reduce the current account deficit. In May 1962, the government pegged the dollar at U.S. 92.5 cents, a level that guaranteed an expansion in exports and a contraction in imports. More important, it tackled the largest single contributor to the current account deficit, the lacklustre Canadian automobile industry. Vincent Bladen, dean of arts and science at the University of Toronto, was appointed a one-man royal commission, which proposed a series of measures to improve the industry's capacity to export its products.¹⁸ In October 1962, the first of these proposals, a program providing for the remission of duties on imported transmissions incorporated by Canadian automotive manufacturers

¹⁷ A.F.W. Plumptre, *Three Decades of Decision: Canada and the World Monetary System, 1944-75* (Toronto, 1977), pp. 155-58.

¹⁸ Royal Commission on the Automotive Industry, *Report* (Ottawa, 1961), pp. 58-60.

into their exports, went into effect despite American protests. The implication was clear: any move to address Canada's current account deficit would necessarily involve some adjustment in the terms of its economic relationship with the United States.

The international economy was changing as well, confronting the Kennedy administration with problems of its own. An overvalued dollar, large external financial obligations related to Washington's global security interests, and the expanding economy in Western Europe placed enormous demands on the United States balance of payments. By 1960, the current account, which enjoyed a \$6 billion surplus in 1945, was running a \$3.1 billion deficit. The trend showed no sign of abating.¹⁹ Moreover, the creation of the European Economic Community (EEC) in 1958 signalled a movement toward greater economic regionalism and threatened the multilateral liberal trading system to which the United States remained committed. Kennedy's response to both these problems would involve considerations that went to the heart of Canada's relations with the United States.

The Liberal Party that was returned to power in 1963 was not the party that had been defeated in 1957 and 1958. Diefenbaker's triumph in the 1958 general election reduced the Liberal Party to 49 seats, ravaged the party's leadership and forced it to rebuild both its organization and its platform. "Mike" Pearson, who had succeeded St. Laurent as leader in January 1957, turned to Tom Kent

¹⁹ United States, Department of Commerce, Bureau of the Census, *Historical Statistics of the United States: Colonial Times to 1970, Part II* (Washington, 1976), p. 864.

and Walter Gordon for advice. Kent, an Englishman who edited the liberal-minded *Winnipeg Free Press* from 1954 to 1956, warned Pearson that "[l]iberalism must 'mean' something if was to survive."²⁰ The new opposition leader, who had often supported progressive, social causes in St. Laurent's cabinet, was easily convinced. He delighted in Kent's enthusiasm for government, and welcomed his proposals for new federal initiatives in health, education and welfare. By 1960-61, the Liberal Party was armed with an expensive program for social spending, with obvious implications for Canada's defence budget.²¹

Gordon, who had helped ease Pearson's transition from the Department of External Affairs into politics in 1948-49, and who had organized his leadership bid, also exerted a profound influence on the Liberal Party and its leader in opposition. His principal preoccupation, which arose during the early 1950s and was confirmed by his work as chairman of the 1957 Royal Commission on Canada's Economic Prospects, was American investment in Canada. In his view this scale of investment produced a host of ills. Gordon argued that American subsidiaries concentrated their research and decision-making in the United States, favoured American suppliers and refused to compete with their parent companies for exports to third countries. Most worrying of all, he contended, this close

²⁰ John English, *The Worldly Years: The Life of Lester B. Pearson, Volume II: 1949-1972* (Toronto, 1992), p. 208.

²¹ P.E. Bryden, "The Liberal Party of Canada: Organizing for Social Reform, 1957-1966" in Gustav Schmidt and J.L. Granatstein (eds.) *Canada at the Crossroads? The Critical 1960s* (Bochum, 1994), pp. 35-40.

economic relationship must inevitably give away to political union.

In March 1960, he made it clear that his continued support depended on Pearson's willingness to address this issue: "I am unhappy about the gradual economic and financial take-over by the United States, or rather by the owners of United States capital that is taking place, and if I were in public life I would wish to urge some modest steps to counteract what is presently going on in this direction."²² Gordon was also vaguely concerned with defence policy, and the more general question of Canada's approach to the world:

I am becoming more of the opinion that Canada should begin to take an independent line ... I do not profess to know too much about this subject or all its implications, but I assume that this line of thinking might lead to the cancellation of the Norad deal and thus to a full dress argument, or showdown, with the Americans.²³

Pearson badly needed Gordon's help. The Toronto businessman was a talented fund-raiser and organizer. The successful 1960 Study Conference on National Problems, an important meeting of liberal thinkers which he attended, made Gordon the acknowledged leader of the party's progressive wing. Pearson, according to Gordon, promised his support. "Mike called," he wrote. "He said he agreed completely with my ideas."²⁴

²² Cited in Steven Azzi, "The Limits of Affluence: Walter Gordon, Foreign Ownership, and the Politics of the Independence Issue," (Unpublished Ph.D. thesis, University of Waterloo, 1996), p. 143.

²³ *Ibid.*, pp. 143-44.

²⁴ Walter G. Gordon, *A Political Memoir* (Toronto, 1977), p. 81. Emphasis in the original.

While Pearson shared Kent's interest in social policy, he did not fully accept Gordon's views on American investment or Canadian foreign policy. The Liberal leader was never an economic nationalist. Pearson was concerned with too great a dependence on American markets and capital, but was inclined to seek a solution in a broader, "North Atlantic" context.²⁵ As secretary of state for external affairs from 1948 to 1957 (and under-secretary of state from 1946 to 1948), he was one of the main architects of Canada's postwar economic and political relationship with the United States. This partnership might need adjusting from time to time, but the structure was sound. He recognized that Canada's central foreign policy objective was to secure sound and friendly relations with the United States. To achieve this goal, Pearson overcame his own opposition to equipping Canadian forces with nuclear weapons, and declared in January 1963 that a Liberal government would honour Diefenbaker's unfulfilled pledge.

Pearson's decision angered many Liberals, including Gordon, who was not consulted. But it was supported by many in the party who had served under St. Laurent. This group also wielded influence and power in Pearson's Liberal Party. For six years, they had confronted and baited Diefenbaker in Parliament, pointing up the contradictions in his policies and driving him to distraction. While Kent and Gordon drafted policy papers, they stumped the country, riding by riding. Like Gordon, Paul Martin and the "old

²⁵ John English, *The Worldly Years*, p. 231. Pearson's attention was first focused on this problem in 1950.

guard" were a valuable source of advice, and one which reinforced Pearson's views on the importance of good relations with Washington. Martin, who had often filled in for Pearson at the United Nations and at the cabinet table under St. Laurent, shared almost completely his leader's views on Canadian foreign policy.

A certain ambiguity, then, characterized the Liberal Party's approach to its relations with Washington in the spring of 1963. Uneasily, Pearson held together the two wings of the party. During the federal election that year, one of the few Canadian contests in which foreign policy played a major role, the party repeated its promise to accept Canada's nuclear commitments, and assured voters that it would improve the country's relations with the United States. At the same time, Liberal candidates promised to take steps to reduce the level of American investment in Canada. Gordon grumbled that the Liberal leader was paying too much attention to foreign policy questions, and perhaps he was right. By election night, Diefenbaker's formidable campaigning abilities had sharply reduced Pearson's popular support. On 8 April, the Liberals drew just 41 percent of the popular vote and won 129 seats. The Tories retained 95 seats. The two smaller parties, Social Credit and the New Democratic Party, held the balance of power with 24 and 17 seats respectively. Though four seats short of a majority, Pearson's slim victory was enough. On 22 April 1963, he became prime minister.²⁶

There is an extensive historical literature on Canada-United

²⁶ J. Murray Beck, *Pendulum of Power*, pp. 370-71.

States relations during the Pearson era. Although few of the major American figures in the Kennedy and Johnson administrations address Canadian issues in their memoirs²⁷, Canada's relationship with the United States intrudes, one way or another, into the recollections of many of the most important Canadian figures of the mid-1960s.²⁸

²⁷ See, for example, Lyndon Johnson, *The Vantage Point: Perspectives of the Presidency, 1963-1969* (New York, 1971); Dean Rusk (as told to Richard Rusk), *As I Saw It* (New York, 1990); Robert McNamara (with Brian VanDeMark), *In Retrospect: The Tragedy and Lessons of Vietnam* (New York, 1995); U. Alexis Johnson (with Jef Olivarius McAllister), *The Right Hand of Power: The Memoirs of an American Diplomat* (Englewood Cliffs, 1984); and John Kenneth Galbraith, *A Life in Our Times: Memoirs* (Boston, 1981).

As American records become more readily available, there has been an explosion of writing on Johnson's foreign policy. See, for example, Diane Kunz (ed.) *The Diplomacy of the Crucial Decade: American Foreign Relations during the 1960s* (New York, 1994); Warren I. Cohen and Nancy Bernkopf Tucker (eds.) *Lyndon Johnson Confronts the World: American Foreign Policy, 1963-1968* (New York, 1994); and H.W. Brands, *The Wages of Globalism: Lyndon Johnson and the Limits of American Power* (New York, 1995). None of these works contain more than a passing reference to Canada. Not surprisingly, this kind of ignorance has provoked one American historian, Gordon Stewart, to urge American diplomatic historians to overcome their parochialism about their northern neighbour. See his monograph, *The American Response to Canada since 1776* (East Lansing, MI, 1992), pp. 3-5. This theme, and the growing concern among American scholars with the need to broaden the treatment accorded American foreign policy, is also pursued in Richard Wiggers, "The Value of Another Perspective: The Documents on Canadian External Relations (DCER) Series, 1947-54," *The Society for Historians of American Foreign Relations, Newsletter*, Vol 28 (December 1997), pp. 1-20.

²⁸ Several ministers in the Pearson government have written memoirs, including Walter Gordon, *A Political Memoir*; Jack Pickersgill, *Seeing Canada Whole: A Memoir* (Markham, 1994); Mitchell Sharp, *Which Reminds Me...A Memoir* (Toronto, 1994); Paul Hellyer, *Damn the Torpedoes: My Fight to Unify Canada's Armed Forces* (Toronto, 1990) Judy Lamarsh, *Memoirs of a Bird in a Gilded Cage* (Toronto, 1968). Two of the government's important political advisors have penned accounts of the period. See Tom Kent, *A Public Purpose: An Experience of Liberal Opposition and Canadian Government* (Kingston and Montreal, 1988) and Keith Davey, *The Rainmaker: A Passion for Politics* (Toronto, 1986). Senior members of the foreign policy bureaucracy have also added to the relevant memoir literature. See Charles Ritchie, *Storm Signals: More*

Few offer an assessment of the overall state of relations, focusing instead on single events or issues that involved them deeply. Those evaluating the whole relationship under Pearson tend to emphasize their success in managing the partnership during a difficult period. In the final volume of his memoirs, for instance, Pearson writes that "there was no breach in our relations with the United States during my period as Prime Minister ... There were, of course, difficult issues, but our governments remained on good terms."²⁹ Pearson's secretary of state for external affairs, Paul Martin, shares this view: "Despite fundamental differences ... [the] Pearson and Johnson administrations maintained a good working relationship - sometimes strained, but never beyond the bounds that our natural trust and comradeship could not redress."³⁰

Historians are more ambivalent about bilateral relations in the 1960s, and stress the differences dividing Canada and the United States. Robert Bothwell, a "frank continentalist"³¹ whose study of Canada's postwar relations with the United States generally emphasizes "the convergence of Canadian and American

Undiplomatic Diaries, 1962-1971 (Toronto, 1983); Dana Wilgress, *Memoirs* (Toronto, 1967); A.D.P. Heeney, *The things that are Caesar's: Memoirs of a Canadian public servant* (Toronto, 1972); and A.F.W. Plumptre, *Three Decades of Decision*.

²⁹ Lester B. Pearson, *Mike: The Memoirs of the Rt. Hon. Lester B. Pearson, Volume III: 1957-1968* (Toronto, 1975), p. 113.

³⁰ Paul Martin, *A Very Public Life, Volume II: So Many Worlds* (Toronto, 1985), p. 404.

³¹ The description is from Norman Hillmer and J.L. Granatstein, draft preface to the second edition of *For Better or For Worse: Canada and the United States to the Twenty-First Century* (Toronto, forthcoming 1998).

attitudes and habits," agrees that the Johnson and Pearson governments "got on moderately well."³² However, the University of Toronto historian argues that the growing divergence over foreign and defence policies, especially the Vietnam War, was much more significant. "[W]hat was national security south of the border," he writes, "became social security to the north. In the long run, that was what would count most."³³

John Herd Thompson and Stephen Randall share Bothwell's assumptions about the basic similarity of Canadian and American society. Their study of bilateral relations, *Canada and the United States: Ambivalent Allies*, is inspired by the view that American economic and cultural vitality drew a willing Canada into the United States orbit. They also hold the view that Pearson's government restored "the equilibrium" to official relations, but stress the long term importance of the differences over cold war priorities, particularly the Vietnam conflict, that emerged during the 1960s.³⁴ They echo Bothwell: "America battled the Communist threat around the globe, and in the process, built a warfare state instead of a welfare state."³⁵

Norman Hillmer and J.L. Granatstein begin their study of

³² Robert Bothwell, *Canada and the United States: The Politics of Partnership* (Toronto, 1992), p. 70.

³³ *Ibid*, p. 71.

³⁴ John Herd Thompson and Stephen Randall, *Canada and the United States: Ambivalent Allies* (Montreal and Kingston, 1994), p. 238.

³⁵ *Ibid*, p. 243.

Canada's relations with the United States with very different premises, but their conclusions are much the same. These two historians argue that bilateral relations are defined by the "continued tension between conflict and cooperation."³⁶ Yet their treatment of relations under Johnson and Pearson, in a chapter succinctly and revealingly entitled "You Screwed Us," is long on conflict and short on cooperation. The differences over Vietnam epitomized the division between the two countries. "The Temple speech was symptomatic. A long list of clashes between U.S. and Canadian interests and values had replaced the relative calm and consensus of the ten years after the end of the Second World War."³⁷

There are good reasons for this constrained view of the bilateral relationship under Pearson and Johnson. In narrative terms, the emphasis on conflict is dramatically satisfying. Early success gives way in 1965, the middle of the period and an election year in Canada, to a string of bilateral controversies and a sharp deterioration in relations, paving the way for Pierre Trudeau and a new generation. In addition, there are few detailed case studies of relations during this period, encouraging historians working on broad interpretations to focus on the most readily accessible, and often the most controversial, events. This is compounded, as Michael Hart observes, by the reluctance of Canadian historians to

³⁶ J.L. Granatstein and Norman Hillmer, *For Better or For Worse: Canada and the United States to the 1990s* (Toronto, 1991), p. vii.

³⁷ *Ibid*, p. 234.

wrestle seriously with economic and trade policy, subjects where one might expect common values and interests to persist most strongly.³⁸ Most important, this limited historiography reflects inadequate access to the records for the period, especially in the United States.

This study employs a broad range of recently declassified primary sources to provide a more complex and detailed treatment of Canada-United States relations during the mid-1960s. Records from the Department of External Affairs, the Department of Finance, and the Privy Council Office constitute the most important Canadian collections used in this thesis. It relies, for the American perspective, primarily on White House and National Security Council records held by the Kennedy and Johnson libraries. Additional United States material is found in State Department records, many of which were made available under the provisions of the *Freedom of Information Act*. These official records are supplemented by several manuscript collections in both countries, including the papers of Lester B. Pearson, Walter Gordon, Mitchell Sharp, Paul Martin, Louis Rasminsky, Tom Kent, John Holmes, and Averell Harriman. The written record is enhanced by oral interviews with Canadian and American officials and politicians.

Good relations between Ottawa and Washington, as the opening chapter of this thesis demonstrates, were not automatic under the new Liberal government. Though Pearson and Kennedy, who met at the

³⁸ Michael Hart, *From Colonialism to Globalism*, unpublished manuscript, pp. 327.

president's retreat in Hyannisport in May 1963, respected and liked each other, this was not enough to ensure bilateral harmony, even in the short period before Kennedy's assassination. Walter Gordon's first budget, which included provisions to reduce foreign (American) ownership of the Canadian economy, angered the American administration. At the same time, Washington's efforts to reduce its own balance of payments problems threatened the Canada dollar and worried Ottawa. Chapter one thus explores the different lessons each country drew from these experiences. While Washington redoubled its efforts to seek a renewed basis for continental partnership, Ottawa was determined to seek greater economic independence. It expanded Diefenbaker's duty remission scheme and unilaterally tried to alter the balance of trade with the United States. As the chapter concludes, on the eve of Kennedy's death, two competing visions for the future of North American economic cooperation seemed destined to collide.

Lyndon Johnson's accession to the presidency delayed this confrontation. The president and the prime minister initially got on well together, and Washington tried hard to persuade Ottawa to resolve their differences over automotive products in a cooperative manner that stressed their common economic interests. At the same time, Canada was offered the chance to improve its access to the United States market by negotiating extensive bilateral tariff reductions under the General Agreement on Tariffs and Trade (GATT). As chapter two points out, finding a solution to the automotive dispute, and developing a position on tariff negotiations posed the

fundamental question for the Pearson government: should Canada agree to the further integration of the two North American economies in exchange for the improved standard of living that greater access to the United States market would make possible?

This question, which pitted economic nationalists against "continentalists," also lies at the centre of chapter three, a study in Canadian-American financial relations during the Pearson era. American efforts to stem the flow of United States dollars abroad accelerated between 1963 and 1968. Ever more elaborate measures were erected to limit the circulation of American dollars overseas. While Pearson's government protected Canada's access to American capital, Washington exacted its price. Canada was exempted from the American balance of payments measures on condition that it too regulated the flow of American dollars to Europe, a situation that effectively created a common North American capital market by 1968 and reinforced the view of many policy-makers that Canada's economic security lay with still closer relations with the United States.

As the fourth chapter makes clear, nationalist fears that closer economic integration would eliminate Canada's capacity to pursue its own foreign and defence policy were ungrounded. Under Pearson, Canada adopted a defence policy that emphasized new international roles in keeping with the altered foreign policy environment. This chapter challenges the view that this change inevitably led to resentment in Washington. Instead, it draws on American sources to demonstrate that both the State Department and

the Pentagon possessed an acute understanding of the influences on Canadian policy. Washington adjusted its expectations to meet Canadian realities. Consequently, by the time Pearson left office in the spring of 1968, the two countries had started to refashion the close political and military alliance that had developed during the height of the cold war.

Not every difference could be reconciled. Johnson's decision in 1965 to take the United States to war in Southeast Asia reflected the perspective of a world power, a perspective that was alien to the Canadian experience. Squeezed between American demands for support and growing popular opposition to the conflict, Ottawa had little room to manoeuvre. Still, as chapter five demonstrates, Paul Martin, the secretary of state for external affairs, exploited every available opportunity to advance the prospects for a negotiated settlement in Indochina. This was a risky strategy, one which seemed likely to provoke a direct confrontation with the United States. As the war intensified and the scope for Canadian diplomatic initiative narrowed, Pearson assumed responsibility for Canada's Asian policy, overcoming his minister's temptation to pursue a course too independently of Washington.

The sixth and final chapter of the thesis explores how policy-makers in Ottawa and Washington worked to preserve cooperative relations in the face of rising nationalist sentiment in Canada. The two countries successfully contained and resolved their differences over legislation to protect Canadian magazines from American competition. This experience is implicitly contrasted with

the crisis that resulted when Ottawa tried to stop a large American bank from taking over a smaller Canadian one. The virulent strain of Canadian nationalism that this confrontation released forced Pearson to adopt a more critical attitude to American policy in Southeast Asia. Nevertheless, Pearson made sure that the change in Canada's attitude was gradual and carefully managed. When Canada finally openly questioned United States policy in Vietnam - a muted and ambiguous call for a bombing halt in September 1967 - it hardly registered in Washington, where the administration was almost immune to criticism by then.

Over five years, Pearson's government virtually redefined the parameters of postwar Canadian-American relations. The economic relationship was increasingly grounded in a shared recognition of the value of formalized structures for continental cooperation. These in turn were slowly uncoupled from political considerations. Rather than compromising Canada's independence, Pearson's pursuit of closer economic relations with the United States rescued Canada from the parochial influence of Walter Gordon and his nationalist allies.

Chapter One

An Unsteady Start

Although discouraged by Pearson's failure to secure a parliamentary majority in 1963, many observers on both sides of the border were buoyed by the hope that the new prime minister would quickly recreate a basis for cooperation with Washington. For the moment at least, they were not disappointed. Within weeks of the new ministry assuming office, Pearson and Kennedy retreated to the president's family compound in New England for two days of talks. As the two men chuckled at Diefenbaker's eccentricities, they sliced their way through the backlog of business that had been allowed to accumulate. For the first time in years, Canadian-American relations appeared on the verge of settling into the easy familiarity that characterized the partnership before 1957.

Yet many of the most important questions that the two men addressed - Canada's acquisition of nuclear weapons, for example, and the ratification of the Columbia River Treaty - were firmly rooted in the preoccupations of an earlier era. The two men paid almost no attention to the new set of important issues that had already begun to clamour for serious attention. Indeed, to ensure the success of his meeting with Kennedy, the Canadian prime minister glossed over the importance his government attached to curbing the American stake in the Canadian economy. But within a month of the New England summit, Pearson's cabinet had endorsed a budget which questioned the benefits of unfettered American

investment in Canada and struck at the very basis of the postwar alliance.

Washington's hostile reaction to finance minister Walter Gordon's first budget gave his colleagues plenty of reason to question his nationalist policies and his standing in Pearson's cabinet. The minister's difficulties were compounded in early July when the Kennedy administration sought to solve its balance of payments problems by reducing the amount of American capital flowing to Canada and other foreign markets. While the financial crisis that subsequently rocked the Canadian dollar further eroded Gordon's reputation, it also demonstrated how much the Canadian economy depended on Washington's generosity and forbearance. As a result, by early September, a new sense of urgency characterized the government's determination to create a stronger and more independent Canadian economy.

The summer's economic difficulties resonated just as loudly in Washington. Disturbed by Gordon's nationalist budget, the under secretary of state, George Ball, ordered his department to examine the nature of North American relations. Its conclusion - that the solution to the current bilateral difficulties lay in redoubling efforts to integrate the two economies - contrasted sharply with Ottawa's views. When the minister of industry, Bud Drury, announced his proposals for developing Canada's domestic automotive industry in the fall of 1963, these two irreconcilable visions for the future of the North American partnership seemed certain to collide.

For a small number of prescient observers in the Department of

External Affairs, Pearson's poor election results meant only trouble. Worried that Washington expected more from the new prime minister than he could possibly deliver and wary of the nationalist lobby on the government's left, one official wondered whether the two countries would "be able to get through the immediate future without too much antagonism being stirred up."¹ Most members of the department, however, were much more confident of Pearson's ability to restore the relationship to its former robust condition. After all, as Canada's ambassador to the United States, Charles Ritchie, noted in his diary on election day, "the Liberals seem a sort of normalacy [sic] which is called stable government and seem to mean a return to the old middle-class, middle-of-the-way, reasonable, responsible, familiar Canada."² While he waited for the new ministry to take final shape, Ed Ritchie, an assistant under-secretary of state for external affairs, began to develop a broad and co-ordinated strategy for normalizing relations with the United States.

Ritchie contended that Canadian-American relations were shaped in part by the atmosphere produced by the "nature and timing" of key decisions and suggested that Pearson meet Kennedy to orchestrate a sequence of decisions that would "get the new

¹ H.H. Carter, Memorandum to A.E. Ritchie, 17 April 1963, Department of External Affairs (DEA) File 1415-40, National Archives of Canada (NAC). Canada's ambassador to Washington, Charles Ritchie, expressed similar fears. See, Charles Ritchie, *Storm Signals: More Undiplomatic Diaries, 1962-1971* (Toronto, 1983), p. 47.

² Charles Ritchie, *Storm Signals*, p. 46.

period...off to the right kind of start." This might begin with a series of decisions favourable to the United States on matters where the Americans believed that Canada had been unreasonable in the past. These decisions would be balanced by unprovocative statements which reiterated the Canadian position on issues where Canada had legitimately differed with the United States. The bilateral relationship would subsequently be driven forward by announcing conspicuously and dramatically the intensification of joint efforts to address any outstanding problems which were of mutual interest.³

Ritchie's strategic approach to bilateral relations, a departure from the traditional ad hoc diplomacy that typified exchanges between Ottawa and Washington, failed to impress the new prime minister. With one eye fixed on the country's rising nationalist movement, which already wielded substantial influence within his own party, and another locked on the Liberal party's precarious standing in the House of Commons, Pearson was reluctant to move too quickly. In requesting an interview with Kennedy, he made it clear to White House officials that he was not ready to use a heads of government meeting to announce any bilateral agreements. Instead, he insisted on limiting the agenda to an informal *tour d'horizon*, during which he and the president would simply identify problems in the relationship and set in motion the means for

³ A.E Ritchie, Memorandum, 16 April 1963, DEA File 1415-40, NAC.

solving them.⁴

Aware of the nationalist pressures which faced the new prime minister, officials in the State Department and the White House were ready to give Pearson ample time to settle in and room to set the bilateral agenda. They cautioned the president against assuming that relations with Canada under Pearson would be relaxed and assured. "[E]ven though Diefenbaker was not there any more," the State Department warned, "the Canadians were still going to be difficult to deal with on a lot of subjects."⁵ Pearson's minority government, added the president's national security advisor, McGeorge Bundy, heralded "a period of considerable uncertainty" and complicated the problem of manoeuvring around tender Canadian nationalist sensibilities.⁶ The Central Intelligence Agency (CIA) echoed these concerns and warned the president that Pearson was "a moderately strong nationalist" who was inclined to question "the

⁴ William H. Brubeck, Memorandum for Mr. McGeorge Bundy, 18 April 1963; William H. Brubeck, Memorandum for Mr. McGeorge Bundy, 28 April 1963, National Security Files (NSF), Country Files: Canada, Box 19, Kennedy Library. Prompted by his senior policy advisor, Tom Kent, Pearson also insisted that the meeting not be held in Washington in an effort to protect his government's nationalist credentials. Kent suggested Ogdensburg but Pearson opted instead for the Kennedy retreat at Hyannisport. See, Tom Kent, Memorandum for the Prime Minister, 15 April 1963, Kent Papers, Box 2, Queen's University Archives (QUA).

⁵ Willis Armstrong, Foreign Affairs Oral History Collection, Georgetown University Library, 24 February 1988.

⁶ McGeorge Bundy, Weekend Reading, April 6-7, 1963, Index of Weekend Papers 04/63-06/63, NSF, Box 317A, Kennedy Library.

whole course of US-Canadian defense relationships [sic]."⁷

In response to these concerns, the president quickly reined in agencies which might have been tempted to press Ottawa to resume immediately negotiations broken off during Diefenbaker's tenure. Instead, Kennedy himself seized control of American policy, clearly resolved to regulate the timing and the direction of any new departures:

The advent of a new government in Canada has naturally stirred nearly all branches of the government to new hope that progress can be made in effective negotiations with this most important neighbor on all sorts of problems. It is the President's wish that these negotiations should be most carefully coordinated under his personal direction through the Department of State.⁸

Kennedy and his advisors maintained this restrained and cautious posture during the preparations for the president's meeting with Pearson. Rather than trying to advance particular bilateral objectives, Kennedy was encouraged simply to use the meeting to "gauge Pearson's attitudes on world problems and provide him with a clear picture of [American] views." While the president might reasonably raise those bilateral issues like nuclear weapons or the Columbia River Treaty that were of considerable and pressing concern to Washington, he was reminded that Pearson would not wish to appear as an American pawn and would probably wish to avoid

⁷ Central Intelligence Agency (CIA), Office of Central Registry, Bio Register, "PEARSON, Lester Bowles (Mike), [April 1963], NSF, Country Files:Canada, Box 19, Kennedy Library.

⁸ McGeorge Bundy, National Security Council Action Memorandum No 234, 18 April 1963, United States, Department of State, *Foreign Relations of the United States (FRUS)*, Volume XIII: *West Europe and Canada* (Washington, 1994), p. 1201.

reaching any decisions.⁹

In an off-the-record press briefing designed to counter growing public expectations of a breakthrough in bilateral relations, McGeorge Bundy acknowledged that the United States expected the meeting to resolve none of the contentious issues facing Canada and the United States. Indeed, he hoped that the two leaders would avoid being drawn into any detailed discussions on bilateral issues, focusing instead on larger international questions where agreement might provide the basis for a close relationship between the two men. The president, Bundy noted in regard to continental defense, "would desire only to follow the prime minister's timetable.... [M]uch would depend on what the prime minister judged politically feasible in Canada."¹⁰

Kennedy's restrained approach to his meeting with Pearson and his decision to host the talks at his family's New England retreat rather than in a formal Washington setting removed some but not all of the pressure associated with the occasion. On the eve of his departure for Hyannisport, Pearson nervously confessed to his cabinet colleagues that "he had never approached an international discussion with deeper concern."¹¹ Pearson's anxieties were

⁹ Visit of Prime Minister Pearson: Briefing Memorandum for the President, 6 May 1963, NSF, Country Files: Canada, Box 19, Kennedy Library.

¹⁰ Washington to Ottawa, Tel No 1403, 9 May 1963, DEA File 1415-40, NAC. For the more detailed report on which this telegram is based, see H.B. Robinson, Memorandum: George Bain's report on briefing by McGeorge Bundy, May 9, 1963, H.B. Robinson Papers, Vol 12, File 1, NAC.

¹¹ Cabinet Conclusions, 9 May 1963, RG 2, Vol 6253, NAC.

unwarranted. The easy laughter and casual banter that slid back and forth as Kennedy's press secretary tested Pearson's knowledge of baseball was striking evidence of the warm and cosy environment that was immediately established when the two leaders met. Pearson reflected the patrician, East Coast establishment to which the president and his family had long aspired. Kennedy looked with admiration at Pearson's Nobel Prize and envied his friendships with influential journalists like James Reston, Walter Lippmann and Marquis Childs. The American also respected Pearson's profound grasp of international affairs, which helped the Canadian prime minister appreciate the pressures under which the American president laboured.¹² Struck by the president's "quick mind...great capacity and...forward-looking attitude", Pearson was favourably impressed by Kennedy's determination "to bring [about] a reduction in world tensions and to promote disarmament."¹³

The two men made their way quickly through a lengthy agenda. Pearson retained the initiative during the two days of talks and determined most of the agenda. He astutely began by informing Kennedy of his government's determination to honour Diefenbaker's promise to arm Canada's NATO and NORAD forces with nuclear weapons. Kennedy was clearly relieved. He assured Pearson that he understood the political difficulties which his minority government faced in

¹² John English, *The Worldly Years: The Life of Lester Pearson, Volume II: 1949-1972* (Toronto, 1992), pp. 268-70. The Washington circle in which both Pearson and Kennedy moved was recently described in Sidney Blumenthal, "The Ruins of Georgetown," *The New Yorker*, 21 and 28 October 1996, pp. 221-37.

¹³ Cabinet Conclusions, 13 May 1963, RG 2, Vol 6253, NAC.

reaching this decision. Indeed, he informed the delighted prime minister that outstanding American requests for nuclear storage facilities for anti-submarine weapons and the Strategic Air Command were "well down" the list of American priorities. Until the two countries had concluded a general agreement which established the conditions under which Canada would accept nuclear weapons, these requests could be safely postponed.

After their lengthy discussion of nuclear questions, Kennedy and Pearson tackled the long list of irksome issues whose resolution had been hampered by Diefenbaker's shaky relationship with the American president. Few of these problems were immediately solved. Instead, the two men described to each other the issue as defined in his respective capital and together they decided on the mechanism to be used in seeking a solution. Pearson, for instance, complained of the Pentagon's plans to stem the flow of American defence dollars to Canadian contractors as part of Washington's efforts to resolve its balance of payments problems. Kennedy promptly responded by explaining the logic behind the American position before eventually agreeing to ask the two responsible cabinet members to discuss Canadian concerns in greater detail.

The same fate awaited other troublesome problems. Pearson reiterated his desire to see the Columbia River Treaty ratified and work started on the massive hydro-electric project. When he proposed adding a brief protocol to the treaty in order to defuse nationalist critics in Canada by specifying the benefits accruing to Canada under the treaty, Kennedy responded constructively with

a promise of "immediate consultations." The two men also agreed "to get a high level meeting going as soon as possible" to deal with the intractable problems plaguing Canadian shipping on the Great Lakes, where the American Seafarer's International Union (SIU) continued to boycott Canadian ships in retaliation for Ottawa's effort to clean up its corrupt Canadian affiliate. Pearson and Kennedy similarly agreed that senior officials would begin discussing Canada's plans to extend unilaterally its sovereignty over Canadian territorial waters to a distance of twelve miles. Finally, Ottawa's efforts to renegotiate the outdated Canada-United States civil aviation treaty and to increase American oil quotas were rewarded when the president and the prime minister agreed to hold "early talks" on these questions.

The pleasant atmosphere and a natural reluctance among both delegations to jeopardize the meeting's success inhibited a completely forthright exchange of views on one key question. In outlining his government's intention to address American control over the Canadian economy, Pearson inaccurately assured Kennedy that he would not "penalize United States interests."¹⁴ But for the time being, this hardly mattered. In the weeks that followed the

¹⁴ Record of a Meeting between the Prime Minister of Canada and the President of the United States, Hyannisport, Mass., 10-11 May 1963, DEA File 1415-40, NAC. Pearson claimed that he planned to address this problem by informally urging American industry to promote Canadian managers. He would also create a Canadian development corporation "to buy into industrial companies in such a way as not to invite legitimate U.S. criticism." Kennedy was sceptical. For the American record of the first day's conversations, see *FRUS, Volume XIII: West Europe and Canada*, 1201-06.

Hyannisport summit, the pace of activity seemed proof positive that "the honeymoon was on and [that] everything which had been sour was sweet."¹⁵ On 20 May 1963, Canada presented the American ambassador, Walt Butterworth, with the promised draft treaty on nuclear weapons. Although final agreement on the precise terms of the treaty remained a long way off, the president and his senior advisors were pleased with this indication of Canada's renewed reliability.¹⁶ Reminded that American proposals for dispersing NORAD air defence squadrons were likely to create an untenable situation for Pearson in Ottawa, Kennedy made it clear that he "did not wish to convey any idea that we are pressing the Canadian Government with this new proposal" and ordered his administration to "immediately desist from initiating any further discussions of the dispersal proposal with the Canadians."¹⁷

It was soon evident that American defence authorities were prepared to go to considerable lengths to meet Ottawa's requirement for measurable progress in the defence relationship. In early June, the American secretary of defence, Robert McNamara, met with Drury to review the well-established Defence Production Sharing

¹⁵. Author interview with Charles Ritchie, 29 November 1992.

¹⁶ McGeorge Bundy, Weekend Reading 25 May - 26 May 1963, Index of Weekend Papers April - June 1963, NSC: Meetings and Memoranda, Boxes 317A-318, Kennedy Library.

¹⁷ McGeorge Bundy, National Security Action Memorandum No 248, 3 June 1963, *Freedom of Information Act (FOIA) Request* 9202777.

Program.¹⁸ Drury easily persuaded the American to abandon the unyielding position he had adopted during the NATO ministerial meetings a few weeks earlier and to agree to separate the question of the overall level of U.S. defence expenditure in Canada from the specific problem of defence production. While Drury admitted that the program accorded Canadian producers preferential treatment, he argued that its underlying rationale - a shared interest in ensuring the survival of a viable Canadian defence industry in a cold war context - remained essentially valid. Rather than merely reducing defence purchases in Canada, Drury argued that the solution to Washington's balance of payments problems lay in seeking a "balance or reciprocity" in expenditures which would effectively remove defence programs from the balance of payments context.

As Drury and his two assistant deputy ministers, H.W. Huck and D.B. Mundy, explained how Pentagon directives designed to conserve American dollars had a negative and, at times even unfair, impact on Canada's small defence industry, McNamara moved slowly towards the Canadian position. In the end, the two men agreed that the Defence Production Sharing Program would be administered in the future "so as to assure the maintenance of a long-term balance [in expenditures], at the highest practical level." In computing this

¹⁸ On the origins of the Defence Production Sharing Agreement, see Dan Middlemiss, "The Road from Hyde Park: Canada-U.S. Defence Economic Cooperation," in Joel T. Sokolsky and J.T. Jockel (eds.) *Fifty Years of Canada-United States Defence Cooperation: The Road from Ogdensburg* (Queenston, New York, 1992), pp. 184-93.

balance, the United States agreed to exclude expenditures in Canada on local facilities, uranium and oil. In return, Canada would "examine [the] means of reducing the foreign exchange costs to the United States [of these] items." Most important, in evaluating future Canadian bids for defence work, the Pentagon would disregard normal import duties and schemes designed to favour domestic contractors.¹⁹

The Kennedy administration's willingness to accommodate Canadian sensibilities on defence questions set the tone for the American military establishment and led to a joyous reunion of service representatives at the Permanent Joint Board on Defence's (PJBD) June 1963 meeting. The two delegations moved quickly through a short agenda that culminated in a discussion of possible new mechanisms for improved communication and consultation. On Canada's initiative, the two sides agreed to explore the problem of inter-governmental consultations affecting joint military planning and to prepare a paper for consideration by a ministerial committee sometime that fall. The Canadian representative, Dana Wilgress, characterized the meeting as "the most productive we have had in some time." He assured the secretary of state for external affairs, Paul Martin, "that on the United States side there is a genuine disposition to improve consultative arrangements where this may be necessary."²⁰

¹⁹ Confidential Source.

²⁰ Dana Wilgress to Paul Martin, 24 June 1963, DEA File 50218-A-40, NAC. On Wilgress' general attitude toward the PJBD, see his *Memoirs* (Toronto, 1967), p. 183-85.

Elsewhere, the impact of the Hyannisport meeting was equally immediate and substantial. As Pearson had promised the president, Marcel Cadieux, the deputy under-secretary of state for external affairs, led a delegation of senior officials to Washington on 16 May 1963 to brief American officials on Canadian plans to declare a twelve-mile fishing zone.²¹ The following day, the United States secretary of labor, Willard Wirtz, flew to Ottawa to meet his Canadian counterpart, Allan MacEachen, in an effort to begin unravelling the Great Lakes labour dispute.²² At about the same time, Kennedy asked the Harvard economist, John Kenneth Galbraith, welcomed by his Canadian interlocutors as a "sympathetic and searching listener", to investigate the poor civil aviation relationship between the two countries.²³ Meanwhile, the government in Ottawa moved quickly to convene a meeting with the British Columbia premier, W.A.C. Bennett, in order to secure his complete support for the terms of the Columbia River Treaty before initiating formal talks with Washington on the proposed protocol. The White House was impressed with Martin's speed in handling this

²¹ W.D. Hubbard, Memorandum of Conversation: Presentation of Canadian Position on 12-Mile Fishing Zone, 16 May 1963, NSF, Country Files: Canada, Box 19, Kennedy Library.

²² The lengthy negotiations which followed are treated in detail by William Kaplan, *Everything that Floats: Pat Sullivan, Hal Banks, and the Seamen's Unions of Canada* (Toronto, 1987).

²³ Paul Martin, Memorandum for the Prime Minister, [May 1963], DEA File 9330-40, NAC; see also John Kenneth Galbraith, *A Life in Our Times: Memoirs* (Boston, 1981), pp. 5-6. On the negotiations leading to a civil aviation agreement, see J.W. Pickersgill, *Seeing Canada Whole: A Memoir* (Markham, 1994), pp. 731-32.

matter.²⁴

However, not everyone who witnessed the camaraderie of Hyannisport and the impressive flow of business which followed were convinced that bilateral bliss had arrived. Butterworth, for example, was profoundly sceptical that the problems could be quickly papered over:

I heartily agree that the Hyannis Port meeting augurs well and seems to have got us back into a framework of rational cooperation toward shared goals....I am concerned, however, that our recent difficulties in Canada be not viewed as a superficial lapse of customary cordiality now restored by a smile and a handshake. You note that 'on fundamentals they have always been with us.' They were - ten years ago. The important thing to grasp is that our recent differences were over fundamentals.²⁵

He was right. While Pearson and Martin had been preoccupied mending relations with Washington, Walter Gordon, the minister of finance, pressed ahead with his plans to produce a budget within the "sixty days of decision" that the Liberals had promised during the election campaign. Disturbed by their new minister's haste and his unorthodox program to combat American domination of the Canadian economy, senior officials in the Department of Finance unhappily set about drafting the government's first budget. Gordon, who placed little confidence in these old-fashioned mandarins, rejected their initial efforts and brought in three outside consultants.

²⁴ William H. Brubeck, Memorandum for Mr. McGeorge Bundy, 31 May 1963, NSF, Country Files: Canada, Box 19, Kennedy Library.

²⁵ Walt Butterworth to Walter Lippmann, 20 May 1963, White House Central Files (WHCF), Country File: Canada, 16 May 1963 to 30 June 1963, Kennedy Library. For a different view of Butterworth's letter see J.L. Granatstein, "When Push Came to Shove: Canada and the United States," in Thomas Patterson, *Kennedy's Quest for Victory* (Toronto, 1989), p. 100.

Tension within the Department of Finance, especially over the measures proposed by Gordon's consultants to restrain foreign investment, grew as the budget assumed its final shape.²⁶ Alarmed officials in the department enlisted the help of Louis Rasminsky, the governor of the Bank of Canada, in an effort to restrain their impetuous minister. Rasminsky met Pearson in late May and warned the prime minister that the budget's provisions to stop the growth of foreign ownership were discriminatory and likely to provoke a sharp American reaction.²⁷ Pearson declined to act.²⁸ The cabinet, for whom Gordon carefully reviewed the budget's provisions on foreign ownership in early June, also decided not to interfere.²⁹ On 13 June 1963, Gordon duly presented his first budget to an

²⁶ A.F.W. Plumptre, *Three Decades of Decision: Canada and the World Monetary System, 1944-75* (Toronto: 1977) p. 203. The 1963 budget is treated in considerable detail by Stephen Azzi, "The Limits of Affluence: Walter Gordon, Foreign Ownership, and the Politics of the independence Issue (Unpublished Ph.D. thesis, University of Waterloo, 1996), Chapter 4.

²⁷ Louis Rasminsky, Notes on the Budget, 31 May 1963, Rasminsky Papers, Bank of Canada Archives (BCA).

²⁸ Pearson was almost certainly convinced that he told Kennedy exactly what his government intended. In his report to cabinet on his return from Hyannisport, Pearson assured his ministers that he emphasized his government's determination to act forcefully on this matter. See Cabinet Conclusions, 13 May 1963, RG 2, Vol 6253, NAC. The Canadian record of the Hyannisport discussions, which was reconciled with the American record, does not bear this out. See Record of a Meeting between the Prime Minister of Canada and the President of the United States, 10-11 May 1963, DEA File 1415-40, NAC. On the reconciliation, see H.B. Robinson to A.E. Ritchie, 5 June 1963, Robinson Papers, Vol 12, File 3, NAC.

²⁹ Cabinet Conclusions, 13 June 1963, RG 2, Vol 6253, NAC. See also Mitchell Sharp, *Which Reminds Me...A Memoir* (Toronto, 1993), p. 115.

expectant House of Commons.

Gordon's budget was not intended solely to confront the problem of foreign ownership. It sought to meet a number of equally important economic objectives. Only two of these - the attempt to alleviate chronic unemployment, which Gordon defined as "the most serious domestic problem facing Canada today," and the effort to restore a greater degree of Canadian control over the economy - had implications for Canadian-American relations. The government, Gordon asserted early in his presentation, had already begun to combat Canada's unacceptably high unemployment rate. The new department of industry, he informed the House of Commons, had recently initiated discussions with the automobile industry aimed at extending the previous government's efforts to increase the size of the Canadian industry and the number of employment opportunities available to Canadians. Ominously, Gordon promised to explore similar schemes in other industries. "In the search for new employment and increased economic strength we shall not be satisfied with half measures. Wherever major changes in our industrial structure are found to be necessary, we shall energetically promote them."³⁰ As a further step in this direction, the budget included a provision for an increased capital depreciation allowance for companies with 25 percent Canadian ownership.

Gordon's assault on the unemployment problem necessarily

³⁰ Canada, House of Commons, *Debates*, 13 June 1963, p. 997.

included an attack on the related question of Canada's current account deficit. This was not, however, to be tackled directly since Gordon well knew that Canada would "continue to need substantial net inflows of foreign capital for quite a few years to come if [the country was] to avoid further exchange rate difficulties and if a reasonable increase in [its] standard of living was to be achieved."³¹ Instead, Gordon attacked the general problem of non-resident ownership and control which he clearly felt interfered with the country's natural development as an independent state. It was vital "that industry in Canada...should operate with due regard to the over-all interest of Canadians and the Canadian economy." Gordon suggested that a 25 percent Canadian equity interest would ensure that a Canadian point of view would be brought to bear on corporate policy decisions affecting purchasing, employment, production, research and sales. The budget included two important measures to increase the proportion of Canadian equity investment. First, it levied a takeover tax of 30 percent on sales by residents to non-residents of shares of companies listed on Canadian stock exchanges. Second, the withholding tax paid on dividends was increased from 15 to 20 percent effective 1 January 1965 on companies which were not at least 25 percent Canadian owned.

In Canada, the initial reaction to these provisions in Gordon's budget was moderately cheering. "I think this would be a very strong influence in keeping Canadian ownership here and

³¹ *Ibid*, p. 1001.

reducing the possibility of the sale of Canadian businesses to foreign companies," remarked Howard Graham, the president of the Toronto Stock Exchange.³² *The Globe and Mail* reported that the changes in the withholding tax "were generally welcomed by investment men...as a means of encouraging Canadian ownership of industry."³³ Within a few days, however, the reaction turned hostile. The government's problems began innocently enough when the inexperienced minister of finance mishandled a question about the propriety of employing outside consultants to prepare the budget.³⁴ In the intense scrutiny that followed the first few cries for Gordon's resignation, the enormous administrative difficulties involved in implementing the takeover tax and the withholding tax became apparent. It was increasingly unclear how Ottawa would identify the real owners of shares or prevent sales on foreign exchanges or encourage Canadians to buy the shares offered by foreign companies. Any lingering support for these proposals evaporated completely when Eric Kierans, president of the Montreal and Canadian stock exchanges, attacked the budget. "Today, our friends in the western world," he announced on June 19, "will fully realize that we don't want them or their money and that Canadians who deal with them in even modest amounts will suffer a thirty

³² John Saywell (ed.), *Canadian Annual Review for 1963* (Toronto, 1964), p. 200.

³³ *Ibid.*

³⁴ J.W. Pickersgill, *The Road Back: by a Liberal in Opposition* (Toronto, 1986), p. 201-02.

percent expropriation of the assets involved."³⁵ When Kierans declared that he would tell his friends to sell short, the markets panicked. Pearson and his cabinet colleagues urged Gordon to retreat. The finance minister reluctantly agreed and on June 19, he temporarily withdrew the proposed withholding and takeover taxes until solutions could be found to the administrative difficulties associated with them. On June 24, the battered finance minister announced that the takeover tax would be withdrawn permanently.

At Pearson's request, the White House maintained a discreet silence throughout this tumultuous debate.³⁶ Nevertheless, the American administration was deeply disturbed at the Canadian action and as soon as the immediate crisis had passed, it lost no time in making its views known. In late June, Griffith Johnson, assistant secretary of state for economic affairs, summoned embassy officials to the State Department.³⁷ Some of the American anger sprang simply from their surprise at the Canadian action. Neither at Hyannisport nor during a subsequent encounter with Dean Rusk, the secretary of state, had Pearson indicated that the budget would have so drastic

³⁵ Eric Kierans to Walter Gordon, 18 June 1963, printed as an appendix in Canada, House of Commons, *Debates*, 19 June 1963, pp. 1366-69.

³⁶ Author interview with Basil Robinson, 5 October 1993. See also H.B. Robinson, Memorandum for File: Canadian Budget, 21 June 1963, Robinson Papers, Vol 12, File 2, NAC.

³⁷ R.R. Carlson, Memorandum of Conversation: Discriminatory Tax Measures, 28 June 1963, NSF, Country File: Canada: General, Box 19, Kennedy Library; Washington to Ottawa, Tel No 2125, 29 June 1963, Bank of Canada Records, File 5C-100, BCA.

and so direct an impact on American interests.³⁸

There were other, more substantive reasons for American concern. The proposed Canadian measures undermined Washington's international efforts to maintain the principle that offshore investment should be accorded the same treatment as domestic investment. Should Canada succeed in violating this principle, it would encourage other states - where American interests enjoyed a more tenuous tenure - to imitate the Canadian example. Moreover, the United States was concerned with the practical effects of the Canadian action. These placed an onerous burden on United States companies which would be forced to offer shares for sale in a depressed market. While Johnson hoped that Canada would take up these points when the budget was considered in greater detail, he concluded his message on a disturbing note. Gordon's budget favoured investment by debt rather than equity capital and so imposed a new burden on the weak American balance of payments position. "Much of the net drain on our balance of payments goes to Canada," Johnson remarked, adding that "[w]e would be reluctant to interfere with the capital markets in New York but it is one of the areas which must be watched. If Canada worsens this situation, then the issue will come to the fore."³⁹

Ottawa ignored Johnson's hint that the United States

³⁸ Record of a Meeting between the Prime Minister of Canada and the President of the United States, 10-11 May 1963, DEA File 1415-40, NAC. See also *FRUS, Volume XIII: West Europe and Canada*, pp. 1205-07.

³⁹ R.R. Carlson, Memorandum of Conversation, 28 June 1963, NSF, Country File: Canada, General, Box 19, Kennedy Library.

considered the flow of American dollars to Canada a contributing factor to its balance of payments problems. Canadian officials and politicians remained confident that the country's need for American capital was well understood and accepted as legitimate in Washington. Pearson had described for Kennedy himself how Canada's trade deficit with the United States actually contributed to a positive American balance of payments position.⁴⁰ In early July, Rasminsky had also discussed the bilateral balance of payments situation with the American secretary of the treasury, Douglas Dillon, and with Alfred Hayes, the president of the Federal Reserve Bank of New York. Both men appeared to understand that Canada's need for American capital was more than offset by its current account deficit with the United States.⁴¹

As a consequence, while the United States administration began to draft plans to constrain the movement of United States capital to Canada, the cabinet remained preoccupied with altering the budget to meet American concerns. Faced with stubborn opposition from Gordon and conscious that every retreat further weakened his government, Pearson was reluctant to insist that the budget's

⁴⁰ Record of a meeting between the Prime Minister of Canada and the President of the United States, 10-11 May 1963, DEA File 1415-40, NAC.

⁴¹ Louis Rasminsky to Walter Gordon, 12 June 1963, Rasminsky Papers, File 76-552-47, BCA. This point had also been made to American officials at an Organization for Economic Cooperation and Development (OECD) meeting in July. See A.F.W. Plumptre, *Three Decades of Decision*, p. 206.

discriminatory provisions be removed entirely.⁴² Instead, in an acrimonious discussion that stretched out over four meetings in early July, the cabinet tried to address Washington's concerns by tinkering with the budget's provisions on foreign ownership.⁴³ Gordon, abandoned by such staunch allies as Tom Kent, was forced to retreat.⁴⁴ The minister was provided with some political cover when Rasminsky suggested a formula for broadening the definition of Canadian ownership under which qualified companies could avoid the 5 percent increase in the withholding tax and benefit from the special capital depreciation allowances.⁴⁵ The definition's criteria would be met if at least 25 percent of the voting stock was held by one or more Canadians or Canadian-controlled corporations, or if no single group of foreign shareholders owned more than 75 percent of the stock. In both cases, at least 25

⁴² Tom Kent, For the Prime Minister and the Minister of Finance: Budget Modifications, [20 June 1963]; Tom Kent, For the Prime Minister: Revised Memorandum on Budget Modifications, 24 June 1963; Tom Kent, For the Prime Minister Only: Budget Changes, 3 July 1963, Kent Papers, Box 2, QUA.

⁴³ Cabinet Conclusions, 2, 4 and 5 July 1963, RG 2 Vol 6253. The conclusions for 8 July 1963, when the actual modifications were decided upon, remain closed. The emotional nature of the discussions is captured best by Judy Lamarsh, *Memoirs of a Bird in a Gilded Cage* (Toronto, 1968), pp. 175-76. "We gathered on straight chairs, around the dining room table," she writes, "and there we destroyed Walter Gordon."

⁴⁴ See Tom Kent's intriguing series of memoranda: Tom Kent, Memorandum for the Prime Minister and the Minister of Finance, 20 June 1963; Memorandum for the Prime Minister, 24 June, 1963; and Memorandum for the Prime Minister only, 3 July 1963, Kent Papers, Box 2, QUA.

⁴⁵ A.F.W. Plumptre to Claude Isbister, 4 July 1963, RG 19, Vol 3930, File 5085-04-2, NAC.

percent of the directors had to live in Canada.⁴⁶

The government's efforts, however, failed to meet American objections. Butterworth and the White House both agreed that the United States should maintain its opposition to those provisions in the budget which interfered with American investment in Canada.⁴⁷ But for the moment, the United States had more pressing problems to consider. At noon on 18 July 1963, Kennedy announced that he would ask Congress to impose an Interest Equalization Tax (IET) of one percent on capital raised in the United States for offshore investments in order to reduce the outflow of American capital from the United States and ease Washington's balance of payments problems.

In Ottawa, where the only prior indication of the American action had been that morning's unusual level of market activity, the government was astounded to discover that the president's measures included Canada. Observers were quick to realize that the new tax threatened the country's capacity to cover its current account deficit and to maintain the dollar's value. The market for Canadian securities evaporated and the value of the dollar dropped sharply during the afternoon of 18 July 1963.⁴⁸ Gordon's effort that afternoon to reassure investors in a speech to the House of

⁴⁶ Walter Gordon, Canada, House of Commons, *Debates*, 8 July 1963, p. 1951.

⁴⁷ Ottawa to Secretary of State, Tel No 7170, 9 July 1963; David Klein to McGeorge Bundy, 12 July 1963, NSF, Canada: General, Box 19, Kennedy Library.

⁴⁸ Norman Robertson, Memorandum for the Minister, 18 July 1963, DEA File 171-B-40.

Commons had almost no impact and forced the government to intervene more energetically.

Late on the evening of 18 July, the secretary of state for external affairs called in the American ambassador for a talk. In addition to the substantive currency problems created by the American balance of payments program, the pundits had already begun to characterize the IET as a retaliatory response to the Gordon budget, creating an awkward political problem for a government which prided itself on its capacity to manage the country's foreign policy. The minister, who suspected that the pundits were at least partially right, was in a belligerent mood and complained bitterly of the lack of consultation. He insisted that Washington do something to ease the unfair burden which the measures placed on Canada. Butterworth tried to reassure the minister that Canadian interests had been kept to the fore throughout the decision-making process in Washington and that "there was no element of retaliation in the U.S. programme."⁴⁹ Before including Canada in the program, the Treasury Department had made sure that Canada had no large borrowings scheduled for the next three months and that there was "time available for testing and probing to determine the effects of the new measures."⁵⁰

Martin was not easily appeased. The foreign minister responded rashly with his own threat of Canadian retaliation:

⁴⁹ Paul Martin, Memorandum for the Prime Minister, 19 July 1963, DEA File 171-B-40.

⁵⁰ *Ibid.*

I mentioned the regard which I thought we had shown for U.S. views in re-examining certain of our budget measures...I noted that at the present time other important matters were under discussion between our two countries. While the Canadian Government might not connect these matters with the present issue, I thought the public generally might be inclined to relate them...It seemed to me that we were entering what could be a new and better period in our relations and I hoped that the feeling over this U.S. tax measure would not interfere.⁵¹

Perhaps, he concluded, the government's two problems might be solved if Rusk would issue a statement making it clear that the IET was not a retaliatory measure. At the same time, the United States should grant Canada an exemption from the tax.

Martin's entreaties produced one small but gratifying result. At noon the following day a State Department spokesman issued a statement "absolutely" denying that the application of the IET to Canada was in retaliation for the Canadian budget.⁵² Robert Roosa, the under secretary of the treasury, delivered a similar message to the Canadian wire services a few hours later.⁵³ The two statements provided Pearson's government with some welcome protection from its domestic critics, but carried little weight with investors and speculators. Pressure on the dollar intensified steadily throughout the second day of the crisis. By the time the markets closed, the Bank of Canada had spent U.S. \$104 million supporting the dollar and had been forced to ask the Bank of England to help defend the

⁵¹ *Ibid.*

⁵² Washington to Ottawa, Tel No 2308, 19 July 1963, DEA File 171-B-40, NAC.

⁵³ Washington to Ottawa, Tel No 2307, 19 July 1963, DEA File 171-B-40.

currency in European markets the next day.⁵⁴

The Kennedy administration seemed uncertain exactly how to react to Canada's sudden plight. The State Department seemed inclined to exploit Canada's discomfort as a useful lesson in North American inter-dependence. When Charles Ritchie met with Rusk and Ball, in the afternoon of 19 July to plead for a Canadian exemption, the Americans underlined the situation's ironic aspects. Ball recalled Washington's restrained response to the Gordon budget which threatened to harm the United States' balance of payments position by encouraging debt equity and pointed out to the Canadian ambassador that "the effect of the IET on equity holdings...was consistent with Canadian budgetary measures directed at increasing the degree of Canadian ownership."⁵⁵

The response from the Treasury Department was much more sympathetic. Distressed by the State Department's indifferent efforts to reassure Ottawa, Roosa made a series of telephone calls on the afternoon of July 19 in a futile effort to contact senior Canadian officials. Late in the day, he finally reached Alan Hockin, an assistant deputy minister of finance. The American balance of payments program, Roosa quickly explained, had been designed to slow rather than stop Canadian borrowing in the United States. Under questioning from Hockin, he admitted that Washington

⁵⁴ R.B. Bryce, Memorandum for the Minister, 19 July 1963, RG 19, Vol 4452, File 8070/U58-4-1, NAC.

⁵⁵ Delmar R. Carlson, Memorandum of Conversation: Canadian Reaction to US BOP Measures", 19 July 1963, NSF, Canada: General, Box 19, Kennedy Library; and Washington to Ottawa, Tel No 2307, 19 July 1963, DEA File 171-B-40, NAC.

had anticipated neither the violent market reaction nor the pressure Ottawa might face for an increase in Canadian interest rates. The Federal Reserve Bank, the under secretary stated helpfully, had already offered the Bank of Canada \$10 million to defend the Canadian dollar. In addition, the United States would have no objection if Canada wished to seek some immediate relief in the short-end of the market since securities maturing in less than three years were exempt from the tax. Hockin, who was handed a report of Martin's encounter with Butterworth in the middle of his talk with Roosa, pressed for an exemption. Without exactly rejecting the Canadian request, Roosa replied ambiguously "that a specific exemption for [Canada] would be very difficult for the U.S. to accept."⁵⁶

The generally cooperative tenor of Roosa's remarks comforted officials in Ottawa. At least in the Treasury Department, there was some interest in addressing the problems that the IET caused for Canada. Consequently, early on Saturday morning, Gordon instructed his officials to by-pass the State Department and appeal directly to the Treasury Department for a formal exemption from the IET before the financial markets opened again on Monday.⁵⁷ On arriving in Washington, the Canadian delegation was met by the secretary of the treasury, who expressed his considerable surprise at the market's sharp reaction to the tax. Rasminsky, leading the Canadian

⁵⁶ [Alan Hockin] Memo[ran]dum to File, [19 July 1963], RG 19, Vol 4452, File 8070/U58-4-1, NAC.

⁵⁷ A.F.W. Plumptre, *Three Decades of Decision*, p. 207.

delegation, admitted that this reaction was exaggerated, but "based on a profound truth and basically...right." Canada's large current account deficit demanded a steady flow of capital imports from the United States. The IET blocked that flow and rendered it impossible for Canada to balance its international accounts.⁵⁸

Canada recognized the balance of payments problems which faced the United States and tried where possible to be helpful. During the past year, Ottawa had agreed to Washington's request that it maintain a low level of American reserves and had successfully reduced the gap between American and Canadian interest rates. Canada assisted the United States balance of payments position in one other important respect. As the American dollars borrowed to finance Canada's current account deficit with the United States were insufficient to cover the full deficit, Canada was compelled to finance its deficit through gold production and by importing capital from third countries. Understood in its proper context, the application of the IET to Canada made no sense and would ultimately be counter-productive. Canada should be given a complete exemption.

Dillon acknowledged Canada's past help in dealing with the United States' balance of payments problem. However, he remained reluctant to admit that the American action was ill-judged. He questioned Rasminsky's assumption that Canadian borrowing in the United States was influenced largely by differences in each country's interest rate structure. The most important consideration

⁵⁸ L. Rasminsky, Meeting of Canadian and U.S. Officials on the Proposed Interest Equalization Tax, Washington, D.C., 24 July 1963, DEA File 171-B-40, NAC.

behind Canadian borrowing was the ready availability of large pools of capital in the United States, and Canada would therefore continue to use the American market. Rasminsky countered: If as little as one-third to one-half of Canadian borrowings in the United States were interest-rate sensitive, then an exchange crisis was inevitable and very soon. Dillon slowly gave way and admitted that perhaps "interest rate differentials between Canada and the U.S. were much more relevant and important than between the U.S. and others." Rasminsky was making headway.

After consulting Kennedy and Ball, who agreed that the United States might go part way towards meeting the Canadian request for an exemption, Dillon reconvened the conference early Sunday morning. He suggested that the two countries issue a joint public statement in which they acknowledged as genuine Canada's need to finance its current account deficit with the United States through the sale of securities in that country. The statement would indicate the president's intention to ask Congress for the power to grant limited and unlimited exemptions to the IET. It would also acknowledge that as the United States could not be sure of Canada's ability to eliminate an "entrepot trade" with third parties and to maintain an interest rate structure that would limit capital inflow, the exemption might reasonably be limited to \$500 million annually. Further, the exemption would apply only to new securities.

Rasminsky immediately objected. The \$500 million limit would spark a stampede to issue new securities and would do little to

alleviate the market's fear that Canada might eventually find itself cut off from the American capital it desperately required. Moreover, the proposed statement, which left it to Ottawa to decide who received a share of the annual exemption, would place the federal government in the impossible position of being forced to limit large provincial security issues. Dillon and Roosa insisted that a complete exemption was simply not possible in view of mounting congressional concern about the extent of Canadian borrowing in the United States. Again, the United States offered to compromise. Roosa suggested that the statement refer to an "unlimited quota" and to the possibility of reimposing the IET if new borrowings became too large. Rasminsky pressed harder and secured support for an "unlimited exemption" for new Canadian securities in exchange for an undertaking not to increase Canadian reserves. Supported during the discussions on the Sunday afternoon by Ball, who maintained "that there could not be double legislation which singled Canada as an exception...[for other] countries would demand similar treatment," Dillon and Roosa refused to concede any more ground. Although pressing strongly for the exemption to apply to outstanding securities, Rasminsky was forced to settle for the partial exemption.

The joint statement strengthened the Canadian dollar and stopped the precipitous slide towards an exchange crisis. The government, however, readily acknowledged that the incomplete exemption could not meet the country's continuing need for American capital. Pearson assured investors that his government would

continue to press Washington for a complete exemption.⁵⁹ Continued pressure on the dollar and mounting concern among Canadian security traders convinced the Department of Finance to move quickly.⁶⁰ Wynne Plumptre, an assistant deputy minister of finance, raised the issue during a visit to Washington in late July. The Canadian official tried again to convince Roosa that the trade in outstanding securities which would have to be refloated in any given year amounted to several billion dollars. The IET would disrupt this flow and could nullify the effect of the partial exemption. Already confronted with angry demands from its European allies for the same treatment given to Canada and anticipating further pressure from the Japanese, the Americans refused to give way in case further concessions to Canada jeopardized the entire program. It would be unfortunate, Roosa warned, if Gordon's visit to Dillon, scheduled for later that week, was related to this question, for the only possible result would be another humiliating public failure for the Canadian minister.⁶¹

Senior officials in the Department of Finance echoed Roosa's

⁵⁹ L.B. Pearson, Canada, House of Commons, *Debates*, 22 July 1963, p. 2438.

⁶⁰ Eric Kierans to Walter Gordon, 24 July 1963; Howard Graham to Walter Gordon, 24 July 1963; and A.F.W. Plumptre to Louis Rasminsky, 26 July 1963, RG 19, Vol 4452, File 8070/U58-4-1, NAC.

⁶¹ Washington to Ottawa, Tel No 2430, 31 July 1963, Bank of Canada Records, File 4B-324, BCA; R.B. Bryce to the Minister, 30 July 1963, RG 19, Vol 4452, File 8070/U58-4-1, NAC. On the question of European pressure, which the Department of Finance was helpfully trying to deflect for the Americans, see Robert Roosa to A.F.W. Plumptre, 24 July 1963, RG 19, Vol 4452, File 8070/U58-4-1, NAC.

warning. Gordon ignored them and left for Washington determined to seek a full exemption. His meeting with Dillon was disappointing. He failed to wrestle any additional concessions from the secretary of the treasury, although he did manage to stop him from excluding mortgages and private placements from the Canadian exemption.⁶² The only other tangible result of his talk, an agreement that senior Canadian and American officials would meet regularly in the future to study the whole balance of payments question, offered no immediate prospect of a solution to the Canadian problem.⁶³

Gordon's original objectives, however, were overshadowed by two discussions he had with Ball the same day. No sooner had the two men met than the American under secretary launched into "a tirade" against Gordon's nationalist budget and Ottawa's apparent determination to abandon the principle of the "optimum use of economic resources" in developing the North American economy. Ball's attack culminated in a blunt warning that Washington would "seriously" object to any attempt to stop the American banking giant, First National City, from completing its recent purchase of

⁶² Meeting between Mr. Dillon and Mr. Gordon, 5 August 1963; Message for Mr. Dillon from Mr. Gordon (Telephoned to the Canadian Embassy, Washington for immediate transmittal), 7 August 1963; Department of Finance Press Release, 7 August 1963, RG 19, Vol 4452, File 8070/U58-4-1; and Cabinet Conclusions, 7 August 1963, RG 2, Vol 6253, NAC.

⁶³ Meeting of Canadian and U.S. Officials, Hay Adams Hotel, Washington, 18 August 1963, Rasminsky Papers, Box 46, File LR-76-360, BCA.

the small Canadian-chartered Mercantile Bank from its Dutch owners.⁶⁴

Gordon responded firmly to Ball's assault. He dismissed the question of the Mercantile Bank's ownership as unimportant and assured Ball that the Canadian government "would keep it in perspective."⁶⁵ The minister pointed out that Canada's international deficit and its high unemployment rate were much more important issues. The budget had sought primarily to address these two problems by promoting the growth of secondary industry in Canada. Until changes in this sector of the economy had taken root, Canada would require regular and uninhibited access to American capital. Gordon suggested that the two countries might fully review this entire question at the meeting of the Canada-United States Ministerial Committee on Trade and Economic Affairs scheduled for September 1963. Ball seemed pleasantly surprised by the finance minister's modest description of Canadian objectives (in which the question of reducing foreign ownership did not figure explicitly) and his apparently earnest desire to explore the problem constructively with the United States. The discussion ended with Ball "in a different frame of mind, look[ing] forward with satisfaction to a common review of common problems." To the Canadian officials in attendance, the change in Ball's attitude was

⁶⁴ Cabinet Conclusions, 7 August 1963, RG 2, Vol 6253, NAC; A.W.F. Plumptre, "Discussions between Mr. Walter Gordon and Mr. George Ball on Canada-U.S. Economic Relationships", RG 19, Vol 4452, File 8070/U58-4-1.

⁶⁵ Cabinet Conclusions, 7 August 1963, RG 2, Vol 6253, NAC.

extraordinary and "lent added importance to the forthcoming Canada-U.S. Ministerial meetings and our preparations for them."⁶⁶

Indeed, Ottawa's attention had already come to focus firmly on the proposed ministerial meetings. The prime minister, in particular, was interested in using this forum to explore the summer's bilateral economic difficulties and to demonstrate that his government's relations with the U.S. administration remained close. In the immediate wake of Kennedy's announcement of the planned IET, Pearson urged Martin to advance the date of the joint meeting "in view of current developments."⁶⁷ For a moment in early August, he even contemplated the idea of calling a special meeting of the joint committee if Gordon failed to obtain an exemption on outstanding securities.⁶⁸ Later that month, he virtually ordered Martin to pay close attention to Canadian preparations for the meeting.⁶⁹

The budget and the IET with its disastrous aftermath seemed to shake Pearson's commitment - never deep to begin with - to Gordon's nationalist economic agenda. Increasingly uncertain what course to

⁶⁶ A.F.W. Plumptre, Discussion between Mr. Walter Gordon and Mr. George Ball, RG 19, Vol 4452, File 8070/U58-4-1. Compare Plumptre's account of these encounters, where there is no mention of foreign ownership with Gordon's, where American control of the Canadian economy is the central theme. See Walter Gordon, *A Political Memoir* (Toronto, 1977), pp. 160-61.

⁶⁷ Orme Dier to Under-Secretary of State for External Affairs, 19 July 1963 and 23 July 1963, DEA File 50316-8-40, NAC.

⁶⁸ Cabinet Conclusions, 1 August 1963, RG 2, Vol 6253, NAC.

⁶⁹ Orme Dier to Under-Secretary of State for External Affairs, 23 July 1963, DEA File 50,316-40, NAC.

pursue, the prime minister turned to Rasminsky, who advised him that the IET left Canada with few options. "The main lesson is clear enough, Canada cannot count on being able to import capital from the United States in the amounts needed to cover our current account deficit." The solution was equally obvious. Canada must reduce its dependence on imported capital, which in turn meant that government policies must be judged first and foremost on the contribution they made to that objective. For instance, the government might have to delay its promised pension plan lest it reduce Canada's capacity to compete internationally and earn a greater proportion of its required capital. More important, Rasminsky contended, Canada had to develop a larger secondary industry through government intervention along the lines of the small automobile incentive program introduced by the former government and currently under study by the departments of finance and industry.⁷⁰ Gordon, to whom Pearson sent a copy of Rasminsky's letter, agreed with its thesis and recommended "that as a government we should state our firm intention of bringing our current account deficit into balance and...making this the No. 1 priority in formulating our economic policies."⁷¹

Gordon's influence had declined steadily since the budget fiasco, but the cabinet readily endorsed his recommendation that the government "assign a high priority to the improvement of

⁷⁰ Louis Rasminsky to L.B. Pearson, 27 August 1963, Rasminsky Papers, File LR76-365, Box 47, BCA.

⁷¹ Walter Gordon to L.B. Pearson, 4 September 1964, Gordon Papers, Vol 16, NAC.

Canada's balance of payments."⁷² In handing the minister of finance this vote of confidence, the cabinet knew full well what it had supported. Meeting this objective, Gordon contended in a memorandum for his colleagues, meant that the government must continue to press forward with its efforts to develop a strong secondary industry and to promote a greater degree of domestic control over the economy. During the period of adjustment that would accompany these measures - a period which the minister optimistically thought might be as short as four years - Canada would remain dependent on imports of American capital. As the country sought to establish its economy on a more equal footing with its southern neighbour, Gordon concluded, it was necessary that Washington be made to understand and accept both the rationale behind Ottawa's objectives and the country's critical need for unimpeded access to American capital.⁷³ The forthcoming ministerial meeting would provide Gordon with the opportunity to convince Washington of the legitimacy of the Canadian program.

Washington attached no less importance to this meeting. The nationalist impetus that lay behind Gordon's budget had prompted American officials to begin exploring how the United States should treat its long-standing but increasingly difficult ally. Determined to build on the lesson that Ottawa must surely have drawn from its experience with the IET, Ball was anxious to contain Canadian

⁷² Memorandum to Cabinet, Document 238-63, and Cabinet Conclusions, 9 September 1963, RG 2, Vol 6253, NAC.

⁷³ The Canadian Balance of Payments and Related Problems, 10 September 1963, DEA File 8483-40, NAC.

nationalism by discovering a more dynamic basis on which to re-establish the North American partnership. His extensive experience in reconstructing postwar Europe had convinced him that international economic integration represented the most rational, efficient and practical use of national resources. Frustrated by his recent failure to garner support for his vision of a genuine North Atlantic common market, Ball was determined to use Kennedy's interest in Canadian affairs to integrate further North American continental relations.⁷⁴ In June, he asked the Harvard economist and foreign investment specialist, Raymond Vernon, to lead a series of State Department working groups in a substantial review of bilateral economic relations.⁷⁵

Throughout the summer, while their own ideas on the future shape of North American relations slowly took shape, American

⁷⁴ Ball, a disciple of Jean Monnet, the French architect of the European Economic Community, was an ardent advocate of supranational economic organization. In a controversial passage written in 1968, he concluded that closer North American economic were inevitable:

Canada, I have long believed, is fighting a rearguard action against the inevitable.... Sooner or later, commercial imperatives will bring about free movement of all goods back and forth across our long border; and when that occurs, or even before it does, it will become unmistakably clear that countries with economies so inextricably intertwined must also have free movement of the other vital factors of production - capital, services and labor. The result will inevitably be substantial economic integration, which will require for its full realization a progressively expanding area of common political decision.

See *The Discipline of Power: Essentials of a Modern World Structure* (New York, 1968), p. 113. Gordon, who sees this excerpt as an expression of latent American imperialism, comments critically on it in *A Political Memoir*, p. 165.

⁷⁵ Ben Read to McGeorge Bundy, 10 September 1963, NSF, Country Files: Canada, General, Box 19, Kennedy Library.

officials gently sounded out their Canadian interlocutors for any evidence that Ottawa might be interested in their deliberations. In late June, for example, following the meeting to deliver their complaints about the Canadian budget, Griffith Johnson casually suggested that "it might be helpful to institute a broad review of overall commercial relations with a view to working out some kind of framework which would give recognition to what he [Johnson] called the unique aspects of the situation in Canadian-American commercial relations."⁷⁶ Puzzled Canadian officials initially refrained from reporting this apparently off-hand suggestion to Ottawa. But the minister was quickly informed when, a few weeks later, the Americans admitted that they were thinking of "something along the lines of a Treaty of Friendship, Commerce and Navigation."⁷⁷

Johnson returned to the subject at the beginning of August. Denying that his ideas had any official status, he revealed that the under secretary had set up a working group to examine those areas of Canadian-American relations which did not fit any established pattern of international intercourse. Specifically, the group was interested in Canada's measures to promote its domestic automotive industry through a system of customs rebates calculated on the basis of a company's exports. Such arrangements violated

⁷⁶ Canadian Embassy Washington to Under-Secretary of State for External Affairs, Letter No 905, 12 July 1963, Bank of Canada Records, File 5C-200, BCA.

⁷⁷ Washington to Ottawa, Tel No 2570, 12 August 1963, DEA File 50,316-8-40, NAC.

"all accepted commercial principles," he contended, but were nevertheless evidence that some special arrangements were needed to meet Canadian requirements. Rather than the haphazard approach implicit in the automotive program, such arrangements should be part of a general reordering of the bilateral relationship, perhaps codified in a special treaty in which each nation would define its respective objectives and the reciprocal benefits that would accrue to the other.⁷⁸

Despite their best efforts, Canadian officials were unable to secure a detailed idea of what the State Department was thinking. Canadian curiosity was stretched to its limits in early September when Ball added an item to the agenda for the forthcoming ministerial meeting designed to "provide an opportunity to devise a philosophical framework which might make it possible to deal with specific issues in Canada-United States relations in a somewhat different manner from that which applies to relations with other countries."⁷⁹ The United States, Johnson assured representatives from the Canadian embassy, had no specific proposals in mind.

This, of course, was far from accurate. American ideas on the future course of the North American partnership had crystallized by

⁷⁸ Washington to Ottawa, Tel No 2570, 12 August 1963, DEA File 50312-8-40, NAC.

⁷⁹ Washington to Ottawa, Tel No 2916, 12 September 1963; and Washington to Ottawa, Tel No 2895, 12 September 1963, DEA File 50312-8-40, NAC.

now in a paper drafted by Vernon.⁸⁰ Vernon's paper dismissed the State Department's initial proposals for free trade or customs union as likely to revive the spectre of American imperialism and endanger Washington's efforts to secure Canadian support for the Kennedy Round. Still, it approached the problem of bilateral economic relations in an almost equally ambitious fashion. In Vernon's view, both the United States and Canada were responsible for the growing number of intractable problems encountered in the relationship. Ottawa was preoccupied with the "alleged U.S. domination of [its] industry" and with its current account deficit with the United States. Washington was increasingly caught up in managing global trade and in addressing its own balance of payments problems. Thus, there was a danger in both countries that positions on bilateral issues might be shaped by these larger considerations. What was absent in both capitals, concluded the Harvard economist, was any consideration of "the general direction of long-run relations between Canada and the U.S."

Vernon suggested that the solution to this problem might lie in having the two governments develop a set of mutually agreed principles which would provide both the basis for a renewed sense of North American partnership and an institutional framework for dealing with bilateral problems as they emerged. As its starting point, the proposed statement of principles would recognize that both Canada and the United States possessed their own "distinct

⁸⁰ Ben Read to McGeorge Bundy, 10 September 1963, and attached memorandum from Raymond Vernon to Secretary of State, n.d., NSF, Country Files: Canada, Box 19, Kennedy Library.

national goals." However, both countries shared the desire "to have the maximum opportunity for profiting from the proximity of the two economies" and agreed that the "long-term desideratum is to increase even further the present easy flow of people, capital and goods across the U.S.-Canada border." Achieving this goal would be complicated. Each country would legitimately wish to pursue distinct policies in such fields as agriculture and energy, bringing about "the need from time to time for the reconciliation of national interests." Therefore, both countries must agree to reconcile divergent national interests "expeditiously ... using special procedures and standards appropriate to the unique interdependence of the two countries."

The statement of principles was intended to provide a rationale for managing the entire economic relationship, but the accompanying mechanisms for resolving disputes were more limited. In releasing the statement of principles, the joint ministerial committee would also create four working groups that would seek solutions for specific bilateral problems. The first, on energy, would explore how to implement the declaration by Pearson and Kennedy at Hyannisport that the two countries would "cooperate for the rational use of the continent's energy resources." It might be able to resolve two issues that had proven impossible to manage: Canadian pressure for relaxed American restrictions on oil imports and Canadian subsidies for domestic coal.

Vernon suggested that the United States might suggest that the ministerial committee create a second task force to examine how

American subsidiaries functioned in Canada. A thorough look at their operations would remove much of the sting from Canadian charges of American domination. The group might also issue a statement urging American subsidiaries to hire Canadian executives, to raise their equity capital in Canada and to operate their Canadian subsidiaries on purely economic considerations. This group would provide a forum to deal with such related issues as the withholding tax and the proposal to extend the automotive parts incentive scheme.

A third working group would explore the thorny and technical questions surrounding balance of payments, the impact that each country's measures had on the other, and "any new gimmickry which the Canadians may have in mind for altering their balance-of-payments situation." A final team would examine the extra-territorial application of American economic statutes. Its terms of reference might seek to have Canada agree that these regulations would normally be applied when efforts to achieve the identical objective through the use of the Canadian regulatory structure failed.

The State Department's Office of British Commonwealth Affairs thought it unlikely that Canada would be prepared to adopt such a far-reaching set of principles. In pressing ahead, however, Washington had other more immediate objectives in mind. The State Department hoped that "the stirring up of an intra-mural discussion among the Canadians would be a good thing;...it may give other Canadian ministers a chance to put a little heat on Walter Gordon;

and...it might even help to bring him around to some modification of his views."⁸¹ More immediately still, officials were anxious that two of the specific problems that the assembled ministers would be addressing - balance of payments and energy - be referred to working groups for further consideration.⁸²

Both Martin and Pearson had been intrigued by the fragmented reports from Washington on American thinking that seeped out of the State Department in July and August.⁸³ However, the scope of the proposal presented by Ball to the Canada-United States Ministerial Committee on Trade and Economic Affairs in late September was far greater than Martin, the head of the Canadian delegation, had ever contemplated. Surprised at the extensive nature of the American proposal, Martin was especially worried that the task force on the extra-territorial application of United States economic statutes might be American stalking horse designed to circumscribe Canada's more liberal approach to trade with the Communist bloc. Ed Ritchie shared at least some of his minister's suspicions, prompting Martin to ask for a recess in order to consider the draft statement of principles in detail.⁸⁴ Norman Robertson, the under-secretary of

⁸¹ Raymond Vernon to Secretary of State, n.d., NSF, Country Files: Canada, General, Box 19, Kennedy Library.

⁸² Joint U.S.-Canada Committee on Trade and Economic Affairs: Scope Paper, 18 September 1963, RG 40, Acc. NNN 3-40-87-1, Box 1, United States National Archives (USNA).

⁸³ J.D. Edmonds to Frank Stone, 16 August 1963, DEA File 50316-8-40, NAC.

⁸⁴ Paul Martin's marginalia on U.S. Draft of Agreed Statement of Principles, [20 September 1963]; See also, Summary Record of the Joint U.S.-Canada Committee on Trade and Economic

state for external affairs, asked by Martin for advice, was much more enthusiastic. Intimately acquainted with the long history of Canada's ineffective efforts to have the United States accept Canada's distinctiveness as legitimate, Robertson immediately recognized how far the Americans had come towards meeting Canadian preoccupations:

It strikes me as generally a skilful draft and [a] helpful presentation incorporating a number of points that we have made to the Americans over the years. The procedural suggestions at the end come as somewhat of an anti-climax to the very impressive introduction but nevertheless I think we can represent that all the working parties which are proposed deal with highly important matters and that their establishment would be helpful to Canada's interest in the broadest sense.⁸⁵

Martin rejected this advice. Instead, in the final session of the two day meeting he claimed to lack the necessary cabinet authority to agree to such an extensive statement. In any event, he added diplomatically, the declaration might have a greater impact if it emerged in some modified form from a meeting between the president and the prime minister.⁸⁶

The Canadian delegation also failed to achieve its primary objective at the September ministerial gathering. It was unable to convince the Kennedy administration to graciously accede to Canada's determination to exert greater control over its economy.

Affairs, 20-21 September 1963, DEA File 35-4-5-1-1963, Department of Foreign Affairs and International Trade (DFAIT).

⁸⁵ Ottawa to Washington, Tel No E-1625, 20 September 1963, DEA File 50136-8-40, NAC.

⁸⁶ Summary Record of the Joint U.S.-Canada Committee, 20-21 September 1964, DEA File 35-4-5-1-1963, DFAIT.

With the cabinet's decision targeting the current account deficit in his hip pocket, Gordon quickly emerged as the delegation's chief spokesman on this issue and made it clear that he spoke with the full authority of the Canadian government. Although Canada was grateful for its exemption from the IET, it obviously could not afford to be perpetually dependant on American generosity. Anxious to avoid adopting either exchange controls or import restrictions to combat Canada's current account deficit, Gordon emphasized the government's determination to increase the country's exports of agricultural, raw material and manufactured goods. So much Canadian industry was controlled from abroad and designed to supply the domestic market rather than competing with foreign parents in third-country markets that increasing exports was difficult. The Canadian government was therefore convinced that it must stop the rise of non-resident ownership, while promoting the growth of a distinctively Canadian secondary industry. In concluding his remarks, Gordon recognized that a shortage of Canadian capital would mean a continuing need for regular injections of American dollars during the next 20 to 30 years. In exchange for American patience and understanding, he held forth the promise of a stronger and more self-sufficient Canada that would ultimately benefit the United States as much as it did itself.

The American delegation greeted Gordon's presentation with undisguised hostility. The secretary of commerce, Luther Hodges, was especially outraged. He accused Ottawa of penalizing American investment and, in an oblique reference to the budget's still

undefined proposals to extend the transmission rebate scheme, of forcing American subsidiaries to export their production against their will. The minister of trade and commerce, Mitchell Sharp, and the minister of industry, Bud Drury, hastened to Gordon's side. They defended Ottawa's decision to target the automotive industry for action. After all, it was the largest single item on the current account deficit and its homogeneous character meant that any agreed proposal could be implemented with relative ease.

The American delegation was unconvinced. Ball hurried to join in the debate as tempers became testy. The American under secretary pulled no punches and declared his "fundamental disagreement" with the proposals announced in the Canadian budget to encourage Canadian industry. He denounced these as "short sighted changes in the rules applicable to United States investment and as contrary to the established policies of many international corporations." By interfering with the free flow of capital between the two countries, Ottawa was setting a bad precedent for other countries, encouraging investors to flee Canada and hindering its own ability to attract the capital needed to fuel industrial development. "[The] USA Government could not acquiesce in such measures affecting USA industry."

With neither delegation able to convince the other of the wisdom and desirability of its vision for the future course of North American economic relations, the meeting drew to an unhappy and inconclusive end. Despite Washington's emphatic expressions of concern about Canadian behaviour, the encounter produced no change

in Ottawa's attitude toward its plans for the Canadian automotive industry. During the first few weeks of October, Pearson's government put the final touches on its proposals to expand the 1962 transmission rebate scheme.⁸⁷ The Kennedy administration watched with mounting concern. In late October, it made a final effort to forestall Canadian action and offered "to explore with the Canadian Government the feasibility of dealing with the problem of trade in automobiles and automotive parts through positive and constructive measures." The American carrot was accompanied by the proverbial stick. Ottawa was reminded that the administration's "forbearance" on such issues as Canada's lumber exports, already besieged by protectionist interests in Congress, was not inexhaustible. Moreover, should one of the 25,000 American automotive parts manufacturers complain about the Canadian program, the administration would have no alternative under United States law but to impose punitive countervailing duties.⁸⁸

Ottawa refused to retreat. On 25 October 1963, Drury unveiled the details of the extended Canadian automotive rebate scheme in the House of Commons. Henceforth, for every dollar's worth of Canadian components exported, automotive manufacturers would be able to earn the remission of duties on one dollar's worth of

⁸⁷ Memorandum to Cabinet, 8 October 1963, Privy Council Office (PCO) File T-1-13-A-2, PCO.

⁸⁸ United States Aide-Memoire, 24 October 1963, DEA File 37-7-1-USA-2, DFAIT.

dutiable imports.⁸⁹ In Washington, Drury's announcement was greeted with considerable apprehension. It seemed to repudiate the economic liberalism that had characterized the postwar continental relationship. Equally important, it was certain to lead to pressure for retaliation, which would upset entirely Kennedy's policy of trying to discover a new basis for North American cooperation.

The administration in Washington moved quickly to respond to this threat to its Canadian policy. Kennedy himself appeared disturbed by the broader implications of the Canadian action and immediately appointed one of his assistants, William H. Brubeck, "as staff officer for Canadian affairs."⁹⁰ Ball quickly tackled the secretary of the treasury, whose department had already received its first formal complaints about the Canadian program and was beginning to limber up its machinery on countervailing duties. He insisted that treasury officials move slowly in applying retaliatory duties, allowing the State Department time to seek a solution with Ottawa. Turning his attention northward, Ball arranged with Gordon for officials from both countries to meet for

⁸⁹ C.M. Drury, Canada, House of Commons, *Debates*, 25 October 1963, p. 3999.

⁹⁰ McGeorge Bundy, Memorandum for the Secretary of State, 11 November 1963, NSF, Country Files: Canada, General, Box 19, Kennedy Library. On the relationship of Brubeck's appointment to the automotive rebate scheme, see H.B. Robinson, Memorandum of Discussion with Bill Brubeck, 23 December 1963, Robinson Papers, Vol 12, File 7, NAC. Staff at the Canadian embassy in Washington welcomed this development. Brubeck "struck me as calm and sensible, and I think he should be a real asset to us," the minister-counsellor, Basil Robinson, recorded, "especially with problems involving relations between different United States Government departments." See his Memorandum for the Ambassador, 23 December 1963, Robinson Papers, Vol 12, File 7, NAC.

a preliminary discussion of the Canadian program.⁹¹ Relieved to learn from Canadian officials that Pearson's government had no similar plans for other industries, the administration considered the meeting a moderate success. With the retaliatory machinery temporarily stalled and its political backside protected from any additional Canadian surprises, the White House was ready for an all-out assault on the general problem of Canadian economic nationalism.⁹²

⁹¹ Walter Gordon to Bud Drury, 8 November 1963, DEA File 37-7-1-USA-2, DFAIT.

⁹² William H. Brubeck, Memorandum for the President, 19 November 1963, NSF, Canada: General, Box 19, Kennedy Library.

Chapter Two

The Hegemonic Hug: Continental Trade Relations

On Thursday, November 21, 1963, Kennedy began to deploy his administrative resources for a White House assault on Canadian economic nationalism. At his final cabinet meeting that morning, the president asked the under secretary of state, George Ball, to chair a National Security Council (NSC) sub-committee to re-examine U.S. policy towards Canada.¹

Kennedy's initiative, like so much else, collapsed after his assassination the following day in Dallas. Neither Lyndon Johnson, bewildered by the sudden change in his position, nor his inherited advisors, unsure of the new president's capacity to govern, were inclined to press forward with a full-scale reassessment of American policy towards Canada. Indeed, for the hesitant Texan, whose political career had been bound up in domestic issues and who lacked any real foreign policy experience, Canada represented a safe certainty in the midst of rapid change. When the Canadian ambassador, Charles Ritchie, met Johnson at the airport as he returned to Washington to take up his duties, the president fastened upon the comfortable old bromides. "Pearson," he said. "Your prime minister. My best friend. Of all the heads of

¹ Memorandum to Ted Sorenson, 10 December 1963, White House Central Files (WHCF), Country Files: Canada, Box 18, Johnson Library.

government, my best friend."²

As Johnson discovered shortly after moving into the Oval Office, however, relations with Canada were headed for trouble. Congressional opposition to the Canadian automotive incentive plan limited the president's ability to seek a negotiated solution, and eventually provoked a direct confrontation with Canada. The American threat to impose retaliatory duties confronted Pearson's government with a clear choice: cooperate with the United States to integrate the North American automotive industry, or construct a Canadian automotive industry alone, relinquishing access to the huge and lucrative American market. At the same time, the debate over Canadian trade relations with the United States was joined on the multilateral front, where the prospect of negotiations under the General Agreement on Trade and Tariffs (GATT) created a similar dilemma. Canada could obtain improved access to the valuable American market, accepting the economic integration that would follow, or it could decline to participate, undermining the government's efforts to increase exports, eliminate the current account deficit and reduce unemployment. In both instances, Pearson's cabinet was sharply divided. One wing, led by the nationalist minister of finance, Walter Gordon, hesitated to endorse any measure that would lead to closer economic relations with the United States. A second faction, represented by Mitchell Sharp, the minister of trade and commerce, expressed a more

² Cited in Lawrence Martin, *The Presidents and the Prime Ministers: Washington and Ottawa Face to Face: The Myth of Bilateral Bliss* (Toronto: 1982) p. 212.

traditional liberal view: as a country whose prosperity depended on international commerce, Canada should encourage those developments that promised to reduce tariffs and improve trade. The debate came to a head in the fall of 1964, when cabinet agreed in quick succession to accept American proposals for a continental automotive industry and to offer significant tariff reductions at the GATT. These two decisions confirmed and reinforced the North American orientation of the Canadian economy.

For one American official intimately acquainted with the state of bilateral relations, 1963 seemed to end pretty much as it began: despite Washington's best efforts, relations between the two countries remained mired in controversy. A new approach to the "Canadian problem" was obviously required. As Johnson settled into the White House, the timing was clearly favourable. In his annual year-end report, which he distributed widely throughout the White House, Walt Butterworth, the American ambassador to Canada, advanced the case for a new departure in U.S. policy. Reviewing the course of Canadian foreign policy since the mid-1950s, Butterworth contended that Canadian policy-makers were labouring under the naive and idealistic view that:

Canada had clean hands, a pure heart, and no axe to grind, a circumstance which would be recognized by both Communists and neutrals if only Canada were sufficiently careful not to damage this treasured image. Moreover, all these notions were seen as somehow compatible with membership in NATO and alliance with the U.S.³

³ American Embassy to Department of State, Airgram A-581, 3 January 1964, National Security Files (NSF), Country File: Canada, Box 165, Johnson Library.

In Butterworth's view, it was these illusions that ultimately resulted in the Diefenbaker government's tergiversations over accepting nuclear weapons. Only in January 1963, when the State Department publicly accused the prime minister of misleading Canadians about the nature of the impasse between the two governments, was the issue resolved. The American intervention reinforced Pearson's recent, albeit reluctant, decision to accept nuclear weapons. "The entire process of rejecting Diefenbaker, of choosing Pearson, and of accepting limited nuclear responsibilities was a painful but significant step by Canadians [towards national maturity]".⁴

Butterworth thought that Canadians still held many illusions about the nature of modern Canada. Although the country had come to accept the military obligations imposed by its close proximity to the United States, Canadians showed few signs of coming to grips in a realistic fashion with the increasingly close economic partnership dictated by geography. Consequently, quarrels over the course of North American economic relations were certain to multiply. While Butterworth mused that some kind of "economic union" might ultimately be the best solution, he dismissed this approach as currently "unattainable." Instead, he urged Washington to give the relationship a "sense of direction" by adopting policies that promoted the mutual development of continental resources, encouraged the growth of sectoral free trade and protected U.S. investment in Canada. The United States had to

⁴ *Ibid.*

"place [its] economic relations with Canada on a mature basis, recognizing the depth of both our mutually advantageous interdependence and our mutual independence [sic]."

For Butterworth, the major obstacles to achieving a mature bilateral relationship lay primarily north of the 49th parallel. While acknowledging that Canadians were a vigorous and hard-working people, the American officials confidently asserted that Canadians "have yet to decide what they want to be." As a consequence, Canadian policy towards the United States was frequently ambiguous. Pleading that history and geography entitled them to favoured treatment, Canadian policy-makers chose to cooperate with Washington when it suited their interests but pleaded a compelling national need to go their own way when it did not. As long as the United States continued to accept the pleadings of Ottawa for a "special relationship," this ambiguity would continue. The solution, concluded Butterworth, was obvious:

[I]t is time, it seems to me, for us to be less ready than we have been in the past to cater to Canadian special pleading. It is time for Canadians to realize that however sympathetic we may be to their problems, we must as a matter of course look first to our own national interests and international responsibilities and to ask a reasonable quid for every quo. In manner, we should be matter-of-fact, neither clasping them in a suffocating embrace of friendship when they see eye to eye with us nor retreating into petulance when they do not. We should, in short, take greater account of their interests than their sensitivities and help them realize [that] the two are not always the same.

Butterworth's trenchant despatch arrived in Washington in early January 1964 just as an inter-agency discussion of the new administration's policy towards Canada was drawing to an end. The ambassador's opinions, which differed sharply from the under

secretary of state's well-defined views on the future course of bilateral relations, had little impact. Instead, Ball's conciliatory approach to Canadian affairs emerged as the essential characteristic of Johnson's Canadian policy.

There were several reasons for this. As chairman of the inter-agency NSC sub-committee on Canada-U.S. relations, Ball was ideally placed to dominate the mechanism through which American policy was created. Kennedy's assassination increased the influence wielded by the Department of State over the policy-making process. Anxious to avoid upsetting its allies, the new administration early on decided to eschew any immediate changes in its foreign policy. Inadequately prepared for his international responsibilities, the new president was inclined to rely heavily on the State Department for foreign policy advice.⁵ Indeed, when his attention was drawn to the unsatisfactory state of relations with Canada in early December 1963 by the secretary of commerce's continued displeasure at the Canadian automotive parts incentive program, he quickly turned to

⁵ H.W. Brands, *The Wages of Globalism: Lyndon Johnson and the Limits of American Power* (New York, 1995), pp. 6-10. In order to emphasize the continuity between the two administrations, Johnson retained many of Kennedy's most important domestic and foreign policy advisors. This group included Dean Rusk, who remained secretary of state and Robert McNamara, who stayed on as secretary of defence. McGeorge Bundy and George Ball continued to serve as national security advisor and under secretary of state respectively. See also David Kaiser, "Men and Policies: 1961-69," in Diane B. Kunz (ed.), *The Diplomacy of the Crucial Decade: American Foreign Relations During the 1960s* (New York, 1994), pp. 11, 26 and Robert Dallek, *Flawed Giant: Lyndon Johnson and his Times, 1961-1973* (New York, 1998), pp. 86-90. For Canada see, President's Meeting with Prime Minister Pearson, NSF, Subject Files: President's Meetings, November 25-29, 1963, Box 94, Johnson Library.

Rusk for guidance. The secretary of state acknowledged the "increasingly sticky" nature of bilateral relations - the inevitable result of the contradiction between Canada's continuing need for American capital and its fear of U.S. economic control - but confidently reassured the president that Ball and his sub-committee would deliver proposals to smooth relations with Canada in plenty of time for Johnson's January meeting with Pearson.⁶

If Rusk expected Ball to produce the kind of extensive review of bilateral relations that Kennedy seemed to have had in mind, he was to be disappointed. When Ball's sub-committee on Canada met briefly in early January 1964, its mood was marked by "a general, though tacit, doubt as to whether the Committee [with Kennedy dead] had any future."⁷ As a consequence, its members were perhaps reluctant to devote much time and effort to exploring new ideas for dealing with either the specific problems associated with Canada's automotive incentive plan or the more general problem of Canadian economic nationalism. The committee simply endorsed the Department of State's existing policy on both these key questions.

Despite continuing nervousness among officials from the departments of commerce and treasury about the mounting domestic pressure on the administration for action against Ottawa's automotive parts scheme, the committee agreed with the State Department's view that a nasty confrontation with Canada would

⁶ Dean Rusk, Memorandum for the President, 12 December 1963, NSF, Country Files: Canada, Box 165, Johnson Library.

⁷ Bill Brubeck, Memorandum for Mr. Bundy, 7 January 1964, NSF, Country Files: Canada, Box 165, Johnson Library.

complicate bilateral relations:

The application of countervailing duties would ruin the Canadian scheme. It surely would produce a violent reaction in Canada, which would be seriously harmful to political relations, would damage Pearson's standing, and help Diefenbaker.⁸

In order to reduce the pressure for precipitate action and to provide time during which the two countries could reassess their positions, the committee agreed with Ball's proposal that the president and the prime minister establish "an intergovernmental committee to explore continental rationalization of the auto industry and report back in six months."⁹ Equally important, Ball used the committee to resurrect his earlier project for a statement of principles that would recognize the unique and special nature of the bilateral relationship while simultaneously checking Canadian economic nationalism.¹⁰ Acknowledging that "[w]e have no easy solutions to problems with Canada other than patience, effort, and good will," the State Department recommended that the president make the quest for a statement of principles the primary objective of his forthcoming meeting with Pearson.¹¹

Canada's goal in pursuing an early meeting between Pearson and

⁸ George Ball to McGeorge Bundy and attached Memorandum for the President, 7 January 1964, RG 59, Box 1247, United States National Archives (USNA).

⁹ *ibid.*; see also, Administrative History: Department of State, Chapter 3, Part D, p. 17, [1968], National Security Council (NSC) Records, Vol 1, Johnson Library.

¹⁰ Bill Brubeck, Memorandum for Mr. Bundy, 7 January 1964, NSF, Country Files: Canada, Box 165, Johnson Library.

¹¹ Dean Rusk, Memorandum for the President, [14 January 1964], NSF, Country Files: Canada, Pearson Visit Briefing Book, 1/21-22/64, Box 167, Johnson Library.

Johnson was less precise but no less important. While Kennedy's assassination generated no major re-examination of Canadian policy towards the United States, its timing could not have been worse. The emerging dispute over the Canadian automotive incentive plan had already sent ripples of anxiety through Canada's policy-making community. Alerted by Charles Ritchie to the depth of American opposition to the scheme, Pearson had already decided to abandon temporarily his plans to introduce legislation protecting the Canadian magazine industry from U.S. competition when Kennedy's assassination suddenly added more grounds for anxiety.¹²

Although the new president was expected to return American foreign policy to the State Department's reassuring hands, Canadian policy-makers feared that Johnson, who had risen to prominence as a domestic legislator in the Senate, was likely to favour national constituencies and to cooperate with Congress at the expense of American interests abroad. This comparatively unknown Texan was rumoured to be an emotional man, who was inclined to perceive issues personally and in terms of the personalities involved. The Department of External Affairs concluded somewhat cryptically that Johnson was "a more familiarly American type of politician than his predecessor ... [which may] ... be a limitation in dealing with the complex problems of the [western] alliance."¹³ Indeed, as the

¹² Washington to Ottawa, 4 November 1963, and Paul Martin, Memorandum for the Prime Minister and Pearson's marginalia, 6 November 1963, DEA File 37-7-1-USA-1, DFAIT.

¹³ H.H. Carter, Memorandum (and attachment) for European Division, 18 December 1963, Department of External Affairs (DEA) File 20-Cda-9-Pearson, National Archives of Canada (NAC).

opposition in Ottawa hurried to point out, at least one leader of the alliance - the Canadian prime minister - would no longer enjoy an assured entrée to the president.¹⁴

Pearson set out to dispel this view. After Kennedy's funeral, he and the secretary of state for external affairs, Paul Martin, had a brief meeting with Johnson. The prime minister sought to establish some common ground with the new president. He described the Great Lakes labour dispute that continued to pose domestic problems for both governments, explaining that he and Kennedy frequently discussed the issue "as one practising politician to another" and that "both understood the practical considerations of each other's position."¹⁵ The prime minister's appeal to the president's essential political character worked. Although White House officials had already urged the over-burdened president to avoid committing himself to a visit from Pearson, Johnson agreed to the prime minister's proposal for an exchange of visits. Pearson would initiate the exchange with a visit to Washington once the president had had a "few weeks" to get organized.¹⁶

Exploiting this initial success was difficult. Canadian

¹⁴ Jack Valenti, Memorandum for the President, 12 December 1963, Statements of LBJ: Visit of PM Pearson, Box 94, Johnson Library.

¹⁵ Memorandum of Conversation, 25 November 1963, United States, Department of State, *Foreign Relations of the United States (FRUS)*, Volume XIII: Western Europe and Canada (Washington, 1994) pp. 1214-16.

¹⁶ *Ibid.*; See also, President's Meeting with Prime Minister Pearson, NSF, Subject Files: President's Meetings, November 25-29, 1963, Box 166, Johnson Library.

representatives lost little time in approaching their American colleagues in order to plan for an immediate summit with the kind of substantial agenda that would withstand comparison with the Pearson-Kennedy gathering at Hyannisport. With pleasant memories of the New England encounter in the background, the secretary of state for external affairs and embassy personnel in Washington enthusiastically reassured their American contacts that the prime minister "was an informal kind of man."¹⁷ Martin suggested that a casual overnight stay at the LBJ Ranch in Texas might be appropriate, but Rusk objected.¹⁸ The State Department then proposed a lengthy lunch at the White House. Canadian officials, who had hoped for an overnight stay at Camp David at least, were dismayed.¹⁹ Only after considerable discussion and debate did the president finally agree to a two-day visit that included dinner at the Canadian ambassador's residence followed by formal meetings the next day.²⁰ Far from soothing Canadian uneasiness about the new administration, the effort to secure even this limited victory

¹⁷ H.B. Robinson to O.W. Dier, 12 December 1963, DEA File 20-Cda-9-Pearson, NAC.

¹⁸ Washington to Ottawa, Tel No 4010, 5 December 1963, DEA 20-Cda-9-Pearson, NAC.

¹⁹ H.B. Robinson to Orme Dier, 12 December 1963, DEA File 20-Cda-9-Pearson, NAC; see also H.B. Robinson, Memorandum for File, 3 December 1963, and H.B. Robinson, Memorandum for the Ambassador, 23 December 1963, Robinson Papers, Vol 12, File 7, NAC. The Americans explained their reluctance to invite Pearson to the ranch by noting that they were proceeding on the basis that "timeliness was more important than display."

²⁰ H.B. Robinson, Memorandum: Prime Minister's Visit to Washington, 19 December 1963, DEA File 20-Cda-9-Pearson, NAC.

hinted at a foreboding future. Indeed, as one Canadian official remarked after yet another inconclusive scheduling meeting with American officials, it seemed clear "that we don't have very many heavy-weights pulling for us in the tug of war for influence here."²¹

This was not an altogether accurate assessment. Given the opportunity, the Johnson administration proved anxious to signal its willingness to accord Canadian problems the degree of attention they had traditionally enjoyed in the postwar White House. When Johnson was asked by Pearson in late December to veto a Congressional bill which would effectively inhibit the import of British Columbian softwood lumber, the president agreed.²² "This bill," he explained to Congress, "would aggravate our relations with Canada at a time when we are trying to improve those relations at every level."²³ Still, on the eve of Pearson's visit to Washington, Canadian misgivings lingered.²⁴

For the most part, these apprehensions retreated during the course of the two day visit. Pearson and his entourage, who were warmly received at the White House on the morning of 21 January

²¹ *Ibid.*

²² N.A. Robertson, Memorandum for the Prime Minister, 12 December 1963; O.W. Dier, Memorandum for the Prime Minister, 26 December 1963; O.W. Dier, Memorandum for the Prime Minister, 27 December 1963, Pearson Papers, Volume 284; See also Cabinet Conclusions, 27 December 1963, RG 2, Volume 6253, NAC.

²³ *Public Papers of the Presidents of the United States: Lyndon B. Johnson, 1963-64, Book 1* (Washington, 1965), p. 103-04.

²⁴ Cabinet Conclusions, 23 January 1964, RG 2, Volume 6264, NAC.

1964, later remarked with evident relief on the "relaxed atmosphere which characterized the whole visit."²⁵ Relations between the two leaders at the start of the visit, however, were "brittle [and] not very comfortable." Already preoccupied with the deteriorating situation in Vietnam, which he had observed with interest while serving as Kennedy's vice-president, Johnson lacked "any feeling for Europe." In contrast, Pearson was inclined to celebrate his North Atlantic identity.²⁶ At dinner that evening, which began poorly when the prime minister presented the bemused Texan with an English-style RCMP side-saddle, the differences dividing the two men were evident. While Pearson gossiped with Rusk about their experiences at Oxford, Johnson grew quiet and withdrawn:

[T]he general effect on Johnson was to make him feel uncomfortable...you good see it happening - you could feel it. Johnson was trying to give up smoking. He had a cigarette in his mouth but he would not light it...[and]...there he was, having to listen to these guys talking about their fun and games in England.²⁷

Things improved once dinner was over. Sticking close to his briefing notes, Johnson drew Pearson aside for a short discussion of France's recent decision to recognize Communist China. He repeated this manoeuvre, which was designed to flatter and impress the Canadian delegation, the following day at the formal meeting. For over an hour, the two men strolled through the White House

²⁵ Ottawa to Washington, Tel No M-14, 23 January 1964, DEA File 20-Cda-9-Pearson, NAC.

²⁶ Author interview with H.B. Robinson, 5 October 1994 and author interview with Walt Rostow, 4 May 1992.

²⁷ Author Interview with H.B. Robinson, 5 October 1994.

gardens and exchanged opinions on a range of international and bilateral questions. Pearson, reassured by his discovery that the president was inclined to adopt a "calm and moderate approach to cold war problems," declared the trip a success:

It was a good talk. Once or twice the President flattered me by throwing away diplomatic proprieties and using language which showed he felt very much at home!

On the whole, however, he was quiet, confident and relaxed, in spite of the current difficulties.²⁸

Johnson shared Pearson's judgement. The president thought that the visit had gone "extremely well." According to the White House, Johnson "had liked the prime minister, found him easy to talk to, and was particularly pleased to find that he could talk politics with him."²⁹

The president had a specific reason to feel contented; the Canadian had responded positively to his suggestion that the two countries begin work on Ball's projected statement of bilateral principles.³⁰ But Johnson failed to persuade the prime minister to

²⁸ L.B. Pearson, *Mike: The Memoirs of the Rt. Hon. Lester B. Pearson, Volume III: 1957-1968* (Toronto, 1975) p. 124. Paul Martin's judgement was less favourable. He thought that Johnson "appeared to be paying little attention to the responsibility of government and matters of state. For example, the President had, the previous day received fourteen different delegations which had nothing to do with the business of government. This was a luxury which a President of the United States could ill afford. However, the President had only acceded to his new position recently; this was an election year, and his attitude might become a more reassuring one in the longer term." See, Cabinet Conclusions, 23 January 1964, RG 2, Vol 6264, NAC.

²⁹ H.B. Robinson, Memorandum for File, 2 February 1964, DEA File 20-Cda-9-Pearson, NAC.

³⁰ Meetings between President Johnson and Prime Minister Pearson in Washington, January 21-22, 1964, DEA File 20-Cda-9-Pearson, NAC; Memorandum of Conversation: Statement of Principles

strike a bilateral committee to examine the Canadian automotive incentive program and the prospect of rationalizing the industry on a continental basis. However limited the president's exposure to Canada, Studebaker's recent decision to relocate its North American operations in Hamilton and the resulting furore in Congress had made a substantial impact on him. Both Johnson and Rusk raised the problem with Pearson and Martin during dinner on the first evening of the visit. The two Canadians hastened to reassure them that the American auto-maker's decision, whatever the company's claims to the contrary, was the result of local economic factors and not the Canadian automotive parts incentive plan.

For Johnson, who was fully aware of the economic rationale justifying the Studebaker move, this argument was irrelevant. The issue was primarily a political one and Johnson returned to it when he met Pearson privately the following day. Again, the president pointed out the problems which Studebaker's move were causing his administration and also expressed his worry that the Canadian program might eventually flood the American market with cheap vehicles. Again, Pearson explained that the Studebaker move was unrelated to the automotive parts incentive plan and that the scheme would not result in appreciably cheaper Canadian cars

of United States-Canadian Relations, 22 January 1964, NSF, Country File: Canada, Pearson Visit 1/22/64, Box 167, Johnson Library.

In February 1964, Pearson and Johnson asked a Canadian, Arnold Heeney, and an American, Livingston Merchant, to constitute the study group. Each had served two terms as ambassador to the other's country. The process of drafting their report, is discussed in Heeney's *The things that are Caesar's: Memoirs of a Canadian public servant* (Toronto, 1972), pp. 190-94.

flooding into the United States.

Inside the White House, Ball adopted a tougher line when he discussed this issue with Martin. As long as the automotive program continued to cause the administration problems, there was little hope that other troubling bilateral issues could be put to rest. He made it clear, for instance, that Canada's desire to amend the Canadian-United States double taxation treaty in order to reflect the changes necessitated by Gordon's budget would "be approached in the context of other problems in the financial and economic fields, eg the withholding tax and the auto policy."³¹ He described the Canadian automotive scheme as "a considerable problem," which had resulted in "active Congressional interest" and "a crescendo of complaints." Ball repeated American warnings that countervailing duties remained a distinct possibility, but promised to delay their implementation if Canada agreed to suspend its program while a joint working group was established "to examine the auto industry on a continental basis, to see what might be done of a broad and general nature."³²

Martin side-stepped Ball's proposition. Although consultation was unobjectionable, he explained disingenuously, he had not discussed this possibility with the responsible minister, Bud Drury. In any case, there was little chance that Canada would agree to amend the program as it had already begun to operate. Ball

³¹ Washington to Ottawa, Tel No 312, 27 January 1964, DEA File 37-7-1-USA-2, DFAIT.

³² Memorandum of Conversation, 22 January 1964, NSF, Country Files: Canada, Pearson Visit 21-22/01, Box 167, Johnson Library.

subsequently appealed directly to Pearson. The prime minister refused to be drawn. Martin intervened more firmly and insisted that Canada had exhaustively studied the possible alternatives and was convinced that the current program was the only one which would achieve the results desired by the government. There would not be any change to the program. Obviously frustrated, the American under secretary grimly noted that there would certainly be some excitement in Congress and that someone would eventually insist on a formal investigation. He concluded ominously that "there was a real possibility that the courts in the United States might find that there was [a subsidy involved]."

Johnson found it difficult to understand the Canadian refusal to assist the administration in seeking a bilateral solution to the automotive problem. Having vetoed the lumber bill, the president was "puzzled as to why Canada was giving him trouble just after he had done something for Canada."³³ Johnson was not alone. Officials in the State Department, the Department of Commerce and the Treasury Department were also disturbed at Canada's steadfast refusal to seek a bilateral solution to the continuing impasse over automotive parts. Sceptical of Martin's categorical assurances that Ottawa had no intention of extending the plan to other industries, U.S. officials were increasingly determined that the automotive parts incentive plan should not be allowed to stand as an example

³³ H.B. Robinson, Memorandum for File, 2 February 1964, DEA File 20-Cda-9-Pearson, NAC.

of Canadian unilateralism.³⁴ When the Modine Manufacturing Company of Racine, Wisconsin asked the Commission of Customs to apply countervailing duties against imported Canadian radiators in mid-April, the need for action became acute.³⁵

The April 1964 meeting of the Canada-United States Ministerial Committee on Trade and Economic Affairs provided the Johnson administration with an opportunity to resolve the dispute. The chairman of the American delegation, Douglas Dillon, the secretary of the treasury, was delighted with reception accorded him and his colleagues:

The meeting was characterized by a far greater spirit of cooperation and understanding than had characterized our first meeting with the present Canadian Government.... The Canadians made the point both privately and publicly of improved relations with the United States.... [W]hile the present government retains the traditional Canadian sensitivity on matters of national pride, they now apparently consider it good politics in Canada to play up their success in improving relations with the U.S.³⁶

There were plenty of good reasons for the meeting's relaxed tone. The White House, for example, was delighted with Canada's recent decision to send a contingent of Canadian peacekeepers to Cyprus, where a conflict between Greek and Turkish Cypriots threatened the

³⁴ Washington to Ottawa, Tel No 902, 9 March 1964, DEA File 37-7-1-USA-2, DFAIT.

³⁵ Joint United States-Canada Committee on Trade and Economic Affairs, Ottawa, April 29-30, 1964, Position Paper: Canadian Automotive Duty Remission Plan and attached annexes, RG 40, Acc. NN3-40-87-1, Box 2, USNA.

³⁶ Douglas Dillon, Memorandum for the President, 1 May 1964, WHCF, Country File: Canada, Box 19, Johnson Library.

stability of NATO's south-eastern flank.³⁷ Washington was also pleased with Ottawa's decision, taken when talks between Gordon and Dillon underlined the administration's refusal to amend the double taxation treaty to take into account the changes required by the 1963 budget, to abandon the proposed increase in the withholding tax from 15 to 20 percent.³⁸

Unfortunately, the two delegations made no progress on finding a solution to their disagreement over Canada's automotive incentive plan. Dillon adopted a sympathetic tone. He acknowledged Canada's desire to develop its secondary industries, but explained that the current program exposed the administration to a steady increase in Congressional pressure and raised the spectre on Capitol Hill of "lay offs and industrial and political unrest." As both countries agreed on the desirability of rationalizing continental automotive production, it seemed counter-productive to carry on arguing at cross-purposes. The solution to the current impasse, he contended, lay in the president's suggested bilateral study group. At the very least, the group might persuade Modine to withdraw its complaint or delay further action.

Gordon, armed with a recent cabinet decision endorsing the

³⁷ L.B. Pearson, *Mike*, Vol III, pp. 134-35; Paul Martin, *A Very Public Life, Volume II: So Many Worlds* (Toronto, 1985), pp. 540-48; Summary Record of the Joint U.S.-Canada Committee on Trade and Economic Affairs, 29-30 April 1964, DEA File 35-4-5-1-1964, DFAIT.

³⁸ W.L. Gordon, Memorandum for the Honourable Paul Martin, 17 February 1964, DEA File 35-4-5-1-1964, DFAIT; Cabinet Conclusions, 12 March 1964, RG 2, Vol 6264, NAC.

existing program, refused to budge.³⁹ The American proposal to explore the rationalization of the North American industry "seemed practical only in the context of a greater degree of integration than existed at present." He doubted that such integration would be healthy for the Canadian economy, and drew the discussion to an abrupt close.⁴⁰

In early May, Philip Trezise, the deputy assistant secretary of state for economic affairs, made one last effort to draw Ottawa into negotiations on terms acceptable to Washington. He suggested a number of modifications to the Canadian plan that would reduce the political pressure on the administration and that would form the basis of talks between the two countries.⁴¹ First, he proposed that Ottawa eliminate the credit earned on the export of replacement parts to the United States as American replacement parts exported to Canada were not covered by the program and were subject to the full duty. More substantially, he contended that Canadian-made parts which were shipped to the United States for incorporation into larger components should count as part of the Canadian-content requirement necessary for duty-free entry. In addition, Trezise suggested that the list of parts currently

³⁹ Cabinet Conclusions, 27 April 1964, RG 2, Vol 6264, NAC.

⁴⁰ Summary Record of the Joint U.S.-Canada Committee on Trade and Economic Affairs, 29-30 April 1964, DEA File 35-4-5-1-1964, DFAIT; See also W.R. Maroney to Mr. Seigel, [1 May 1964] Accession NN3-40-87-1, Box 2, Joint U.S.-Canada Committee on Trade and Economic Affairs, 1964, USNA.

⁴¹ Philip Trezise to Ed Ritchie, 4 May 1965; Washington to Ottawa, Tel No 1607, 4 May 1964, DEA File 37-7-USA-2, DFAIT.

admitted duty-free to Canada should be frozen rather than shrinking as the range of Canadian-produced parts increased under the scheme. Finally, he urged that automotive parts imported duty-free by the United States under the provisions of the Defence Production Sharing Plan should not qualify for remission of duty.

This last point struck a sympathetic chord in Ottawa. The minister of industry, Bud Drury, was inclined to think that this might eventually be conceded to the Americans.⁴² In the meantime, Canadian officials tried to buy more time, conscious that the longer the program continued in its present form, the harder it would be for Washington to alter it. Responding to Trezise's overture, Ritchie indicated that the American's ideas could be taken up later that summer as part of the Kennedy Round consultations. This was particularly true of the proposals regarding Canadian content requirements which were bound to the United States under the GATT. The letter went on to hint at a possible concession on the defence production sharing problem and to indicate Canadian willingness to explore the problems of replacement parts. This did not, however, signal a Canadian retreat. Ritchie made it quite clear that Trezise's proposal to freeze the current duty-free list would strike at the heart of the Canadian program and was simply not acceptable.⁴³

The State Department dismissed Ritchie's letter as an obvious

⁴² R.B. Bryce to the Minister, RG 19, Vol 3947, File 8705-08-16 part 2, NAC.

⁴³ A.E. Ritchie to Phil Trezise, 14 May 1964, DEA File 37-7-1-USA-2, DFAIT.

delaying tactic. In late May, it summoned Canadian representatives for a short lesson in American civics. The White House harboured a "large store of goodwill towards Canada ... right to the top" and was reluctant to see countervailing duties imposed both because of their impact on Canada-American relations in general, and because of the unfortunate precedent it would set for American protectionists. Nevertheless, even the White House could not ignore Congressional pressure indefinitely. The administration now felt forced to allow the Modine petition to proceed and would publish the official notice of the investigation the following week. The inquiry's terms of reference, remarked the State Department casually as it dropped its bombshell, would include not only radiators but all Canadian automotive parts exported to the United States.⁴⁴

Canadian officials, who had apparently been convinced that the initial investigation would focus only on the Modine complaint against the importation of radiators, were momentarily uncertain of the significance of the American decision to target the entire Canadian industry.⁴⁵ For Gordon, who received a copy of a more detailed Treasury Department press release later that day announcing the start of the inquiry in terms which seemed to have already settled the matter in Washington's favour, the full import of the American action was immediately obvious. As the American

⁴⁴ Washington to Ottawa, Tel No 1929, 28 May 1964, DEA File 37-7-1-USA-2, DFAIT.

⁴⁵ B.G. Barrow to O.G. Stoner, 29 May 1964, DEA File 37-7-1-USA-2, DFAIT.

investigation dragged on, investment in Canadian plant would grind to a halt, orders would be delayed, and the heart would be torn from the Canadian program. Gordon denounced the American action to the first member of the administration he could find and threatened to build a "people's car" if the Canadian program was frustrated.⁴⁶ Washington's response was equally firm. Dillon made it clear that the United States had no intention of backing down. Gordon concluded grimly that "[h]aving proceeded with this show of strengthen, they probably feel they have us at a disadvantage. And this is true."⁴⁷

While Gordon set finance officials to work examining Canada's possible options, the Americans moved steadily ahead in a pre-emptive effort to establish the agenda. Trezise, accompanied by the White House's Canadian expert, Bill Brubeck, met with Canadian embassy staff in early June to discuss how to "pick up the pieces." The two countries might try either to reduce extensively Canadian and American tariffs on automobiles and automotive parts on a Most-Favoured-Nation (MFN) basis, or to create "a limited customs union between Canada and the United States covering the automotive

⁴⁶ Author interview with Philip Trezise, 25 October 1995. See also, John Kirton and Robert Bothwell, "A Proud and Powerful Country: American Attitudes toward Canada, 1963-1976," *Queen's Quarterly*, Vol 92, No 1, (Spring 1985), p. 113.

⁴⁷ W.L. Gordon, Memorandum for File: Automobile Policy, 1 June 1964, RG 19, Vol 3947, File 8705-08-16, NAC. A copy of this memorandum, together with an exchange of messages between Dillon and Gordon, was sent to the Department of External Affairs where one official described the American message as "The iron hand in the velvet glove." In reply, another quipped: "Not much velvet, either." See, DEA File 37-7-1-USA-2, DFAIT.

field."⁴⁸

Senior Canadian officials in Ottawa initially reacted with scepticism to both these ideas. Simon Reisman, the combative assistant deputy minister of finance who had created the original automotive parts incentive scheme, doubtfully described the idea of a customs union as "pretty bold and unrealistic (unless carefully worked out conditions and guarantees as to Canadian output)."⁴⁹ However, as Canadian officials explored the options open to Canada over the course of the next few days, the American notion of a customs union seemed increasingly workable. It was certainly not practical to retain the present program and fight Modine through the courts. Negotiating with the United States on the basis of the proposals presented by Trezise in May would also quickly destroy the Canadian program.

It might be possible, mused officials, to develop an entirely new program which would encourage Canadian automotive manufacturers to capture a larger share of the domestic market. But this approach also had its disadvantages. It would increase the cost to consumers and might require the government to restrict American automotive imports. This would be particularly difficult since Canadian tariffs on these imports were bound to the United States under the GATT and could only be altered by negotiation. Only one option remained - a negotiated settlement "based on the concept of

⁴⁸ Washington to Ottawa, Tel No 2027, 5 June 1964, DEA File 37-7-USA-2, DFAIT.

⁴⁹ S.S. Reisman's marginalia on Washington to Ottawa, Tel No 2027, 5 June 1964, RG 19, Vol 3947, File 8705-08-16, NAC.

rationalization within the North American market, but not involving remissions and thus not risking countervailing duty."

Drawing together the various issues each side had emphasized during their periodic discussions of the issue - "rationalization through exports, avoiding the risk of countervailing duty, and the United States preference for a settlement of this issue as part of the Kennedy approach" - Canadian officials proposed working towards a carefully qualified variant of Tresize's "limited customs union." Under the general terms proposed, the United States would agree not to oppose Canadian efforts to secure "a certain minimum production of automobiles and parts in Canada." The minimum would be defined as "that share of the North American market which is now produced in Canada, plus that production for export which Canada could reasonably have expected under the present programme and, of course, an appropriate share of the growth of the market." Specifically, this would require the United States to allow Canada to use the threat of import controls to ensure that the automotive industry agreed to produce a certain share of their total output in Canada. The United States would also agree to cut its tariffs on automobiles and parts by 50 percent in the Kennedy Round. In exchange, Canada would dismantle its present automotive parts incentive program, reduce its tariffs on cars and parts and re-examine existing Canadian-content provisions.⁵⁰

The Cabinet Committee on Finance and Economic Policy seemed

⁵⁰ S.S. Reisman, Memorandum for the Cabinet Committee on Finance and Economic Policy, 9 June 1964, RG 19, Vol 3946, File 8705-02, NAC.

less disposed to compromise. Gordon deeply resented the American attempt to thwart the existing Canadian program. As chairman of the committee, he was able to dominate the discussion and convince his colleagues to give the official-level paper a much harder edge. Although the committee agreed to seek a mutually agreeable solution with the United States on the basis of continental rationalization, it authorized Canadian negotiators to make it clear that the alternative was a protectionist "inward-looking policy designed to accord Canadian producers a larger share of the domestic market." Officials were also instructed to threaten "that Canadian support for the Kennedy Round of tariff negotiations would inevitably be affected by the United States attitude toward the objectives of the Canadian automotive policy." Even so, Gordon was by no means fully committed to continental rationalization, and he refused to abandon completely his plans for a self-reliant Canadian automotive industry. His committee instructed officials to begin detailed work on the protectionist option, designed to reserve the domestic market for Canadian producers.⁵¹

Led by the liberal-minded minister of trade and commerce, several ministers queried the committee's recommendations when they were presented to the full cabinet. Worried that the deliberately antagonistic approach adopted by the committee was designed to torpedo the negotiations, Mitchell Sharp reminded his colleagues

⁵¹ J.F. Grandy, Memorandum for Cabinet, 11 June 1964, RG 19, Volume 3947, File 8705-08-16, NAC. According to John Fletcher, Access to Information Officer at the Privy Council Office, there are no minutes for the Cabinet Committee on Finance and Economic Policy.

that Canadian officials might accomplish more if they refrained from threatening their American interlocutors. Instead, they should stress Canada's genuine desire to cooperate in seeking a joint solution to the automotive problem. Canadian threats should be carefully veiled and go no further than hint that Canada could seek unilateral solutions to its problems and that Washington's desire to cooperate on this question would probably be regarded as indicative of its commitment to the underlying purposes of the Kennedy Round. In addition to amending the instructions to take Sharp's views into account, the cabinet also insisted that Canadian officials begin to prepare two detailed reports on the options available to Ottawa, one outlining the elements of a negotiated settlement and a second describing a protectionist solution.⁵²

This more temperate approach seemed to pay some immediate dividends. When Canadian and American officials met on July 7 in Ottawa for the first exploratory discussion, the two sides quickly came close to overcoming most of their differences. Led by Reisman and Warren, the Canadian delegation made it clear from the start that they were only prepared to consider alternative arrangements which would "ensure trade, investment and employment benefits for

⁵² Cabinet Conclusions, 11 June 1964, RG 2, Vol 6265, NAC. It seems pretty clear that Canadian officials would not have carried out very effectively the approach endorsed by Gordon's committee. In July 1964, Reisman and an interdepartmental team reviewing Canadian negotiating tactics concluded that it would be pointless to threaten the United States. It would be more fruitful to build on the American administration's earlier expressions of sympathy for Canada's need to develop more secondary industry. See Record of Discussions on Auto Incentive Program, 6 July 1964, DEA File 37-7-1-USA-2, DFAIT.

Canada at least equivalent to those that would result from the present system." Trezise, who headed an American delegation which included Robert McNeal and Julius Katz, readily acknowledged the importance the government attached to the automotive program and Ottawa's determination to achieve its objectives. Washington was ready to consider new arrangements to meet these goals, even "if under such new arrangements Canada should receive a more than proportional share of new investment." Emphasizing that the United States only questioned the current program's methods, Trezise suggested that the two countries replace it by rationalizing the North American automotive industry through tariff reductions. Already authorized to cut tariffs by 50 percent under Kennedy's Trade Expansion Act, the administration was ready to ask Congress for authority to make further cuts in order to satisfy Canadian requirements.

Canadian officials were clearly intrigued by the American suggestion. However, simply reducing tariffs, which would allow the industry to rationalize production in one country if it so wished, was obviously not the final answer. Reisman proposed some kind of "conditional" free trade agreement. After "extensive discussion," both sides agreed on four basic provisions that would necessarily underlie this agreement. The two countries would reduce tariffs and the United States would explicitly accept the objectives of the existing Canadian program, informing the industry in both countries of this understanding. The agreement would also have to contain a provision for bilateral consultation to ensure that measurable

progress was being made towards its objectives, and a clause acknowledging Canada's right to restrict automotive imports if, within a reasonable time, its industry had not grown at a satisfactory rate. With the fundamental principles of an agreement apparently in place, the two delegations agreed to meet again in mid-August after consulting their respective automotive industries and governments.⁵³

To the chagrin of Canadian officials, the Cabinet Committee on Finance and Economic Policy was ambivalent about the apparent breakthrough.⁵⁴ It eventually agreed to the approach developed in July, but Gordon's committee fought a determined rearguard action. Again, it tried to commit the government to an industrial strategy freed from American influence. Gordon asked the government to acknowledge that "if a solution ... designed to achieve greater efficiency on a continental basis proved unacceptable to the United States, an alternative approach would have to involve measures to reserve a larger share of the Canadian market for the Canadian industry."⁵⁵ However, Sharp and his allies rejected this possibility and insisted that "it would be premature for the

⁵³ My account of the 7 July 1964 meeting is based on the following sources: Memorandum of Conversation: Possible Free Trade Arrangement in Automotive Products, 7 July 1965; Ottawa to the State Department, Tel No 6148, 8 July 1964, RG 59, Box 1249, File IT 7-12-CAN, USNA; Memorandum to the Cabinet Committee on Finance and Economic Policy, 10 July 1964, RG 19, Vol 3946, File 8705-02, NAC.

⁵⁴ Russ McKinney to O.G. Stoner, 26 July 1964, DEA File 37-7-1-USA-2, DFAIT.

⁵⁵ Memorandum for Cabinet, 12 August 1964, RG 19, Vol 3946, File 8705-02, NAC.

Cabinet to commit itself." The full cabinet agreed, and, for the moment, Canada remained committed to a continental solution.⁵⁶

The August 17 meeting of experts was disappointing.⁵⁷ In confidential corridor conversations, Trezise and McNeal quietly confessed that the administration had been unable to withstand growing Congressional pressure in an election year and had been forced to abandon the approach the two groups of officials had sketched out in July. Although American officials expressed their sympathy with Canada's desire to increase the production of cars and parts in Canada through rationalization, they rejected the idea of a bilateral agreement which guaranteed Canada a precise share of the North American market. Neither the administration nor Congress nor the industry would support this kind of a settlement, which was much more specific than the outline Reisman had presented in July. Nor could the United States agree to waive in advance its right to retaliate in the event that Canada felt it necessary to restrict imports in order to achieve the desired market share.

In any event, the American delegation contended, the automotive industry knew exactly what the Canadian government required of it. If the two countries negotiated a settlement that

⁵⁶ Cabinet Conclusions, 13 August 1964, RG 2, Vol 6265, NAC.

⁵⁷ My account of the August meeting is based on the following sources: M. Cadieux, Memorandum for the Minister, 24 August 1964, DEA File 37-7-1-USA-2; R.Y. Grey to R.B. Bryce, 19 August 1964 and R.Y. Grey, Memorandum for the Minister, 24 August 1964, RG 19, Vol 3946, File 8705-02, NAC; Memorandum of Conversation: Free Trade Arrangements for Automobiles, 17 August 1964 and Ottawa to State, Tel No A-198, 31 August 1964, RG 59, Box 1249, File IT 7-12-CAN, USNA.

eliminated tariffs, and included a general statement of the program's objectives and the consultative mechanisms to be used if they were not realized, Canada would naturally achieve an increased share of North American production. The accord could also include an escape clause that would allow either government to terminate the agreement if, after an initial period, its objectives were not being achieved.

The American counter-proposal was clearly unacceptable. Without a precise definition of the Canadian share of the North American market in place, Canada was being asked to undertake a "colossal gamble." Since it would be impossible to reverse the process of integration once it had started without staggering political and economic costs, the escape clause was meaningless. When further exchanges confirmed that it would be impossible to negotiate a set of precise objectives, the discussions were broken off and an impasse declared.

Despite this disappointing conclusion, there remained a slender hope in some quarters that Canadian objectives could still be achieved through a less precise agreement.⁵⁸ During the August talks, Canadian and American officials had toyed briefly but inconclusively with the notion of a tripartite accord binding the two governments and the automotive industry to an agreed set of objectives. The Canadian need for assurances, the counsellor for economic affairs at the United States Embassy, Francis Linville,

⁵⁸ R.J. McKinney, Memorandum for the Under-Secretary of State for External Affairs, 28 August 1964, DEA File 37-7-1-USA-2, DFAIT.

suggested to Reisman over drinks in early September, might be met by having the individual automotive manufacturers voluntarily undertake to expand their production in Canada in exchange for a reduction in duties.⁵⁹ Trezise agreed and urged the Canadian embassy in Washington to invite the automotive industry to join the talks and to help develop a program to rationalize the North American automotive industry.⁶⁰

The American suggestion was welcomed in the Department of Finance where officials had begun to develop new proposals to overcome the objections raised by the American delegation in August. The recommended course of action envisioned a bilateral agreement recording in general terms both governments' desire to see that Canada achieved a more equitable share of the North American automotive industry. Ottawa would subsequently obtain precise indications from the motor vehicle producers of the steps they would take to realize their share of new production and export during the next three year period. If these met the objectives of the current program - \$260 million worth of new production annually by 1968 - the United States and Canada would agree to reduce or eliminate tariffs on vehicles and original parts. If the automotive manufactures failed to meet their objectives, the government could terminate the agreement and adopt other, less palatable, policies

⁵⁹ Ottawa to State, Tel No 306, 4 September 1965; See also, Ottawa to State, Airgram A-539, 21 January 1965, RG 59, Box 1248, File IT 7-12-CAN, USNA.

⁶⁰ Washington to Ottawa, Tel No 3209, 8 September 1964, DEA File 37-7-1-USA-2, DFAIT.

to achieve these objectives. To protect the inefficient Canadian parts manufacturing sector, only bona-fide Canadian motor vehicle manufacturers were to be eligible to import parts and vehicles duty-free.⁶¹

Because it was still not clear that Gordon and his allies could be persuaded to endorse a course of action that committed Canada to increased economic integration with the United States, officials prepared two additional options. Neither of these "made-in-Canada" solutions was very attractive. The first essentially amended the existing duty remission plan. This approach advocated remitting duties for Canadian vehicle and parts manufacturers who adopted programs intended to achieve "greater rationalization, improved efficiency and expanded investment and production in Canada." As exports were only one of the criteria taken into consideration, the new scheme would not be liable to American countervailing duties. By the same token, it would only help the government increase employment in the industry and do little to reduce Canada's trade deficit with the United States.

The second option - a package of technical measures adjusting tariff and Canadian content regulations - promised to reserve a bigger proportion of the domestic market for Canadian automotive manufacturers. Its most important innovation, however, would involve the imposition of an excise tax high enough to discourage the sale of imported luxury cars in Canada and so encourage

⁶¹ Memorandum for the Cabinet, 16 September 1964, RG 19, Vol 3946, File 8705-02, NAC.

economies of scale in smaller and medium sized cars. The drawbacks associated with this option were manifold. It offered no help with reducing the current account deficit, it did not allow Ottawa to predict the amount of new production, and, most important, it was certain to raise the ire of both American automobile manufacturers and Canadian consumers.

While these options awaited ministerial consideration, in Washington a renewed sense of urgency was beginning to grip senior administration officials. Luther Hodges, the secretary of commerce, was "dismayed" by the collapse of the August talks, which he blamed on Canada's unreasonable demands "for assurances that would, in effect, make a free trade scheme practically riskless for them." He urged Rusk to remain firm, convinced that there was no feasible alternative to the imposition of countervailing duties.⁶² Dillon agreed and in mid-September he prepared a memorandum for the president which recommended that retaliatory duties take effect 1 November 1964.⁶³ Aware that this recommendation would soon have to be made public, the administration was under tremendous pressure to act.⁶⁴ Rusk, who met Martin in New York on September 13 and Johnson, who encountered Pearson briefly three days later while visiting British Columbia during a western campaign swing, both

⁶² Luther Hodges to Dean Rusk, 25 August 1964, RG 59, Box 1249, File IT 7-12-CAN, USNA.

⁶³ Luther Hodges to Douglas Dillon, 17 September 1964, RG 59, Box 1249, File IT 7-12-CAN, USNA.

⁶⁴ Bill Brubeck, Memorandum for Mr. Bundy, 12 September 1964 and Bill Brubeck, Memorandum for Mr. Bundy, 18 September 1964, NSF, Country File, Canada, Box 165, Johnson Library.

raised the matter with their Canadian interlocutors.⁶⁵ Though neither Pearson nor Martin needed to be reminded of the importance of this issue, the American interest was duly reported to the Cabinet Committee on Finance and Economic Policy when it met on 15 September to consider its options. Both the cabinet sub-committee and the full cabinet readily endorsed the suggestion that Canada, the United States and the automotive industry try to negotiate a tripartite agreement to overcome the stalemate.⁶⁶

A meeting between the Canadian and American negotiating teams was arranged in Washington for September 24-25, while, Ball and McGeorge Bundy, the national security advisor, approached Dillon and convinced him to delay any further action until the results of this gathering were available.⁶⁷ From the Canadian perspective, the results of this third exploratory meeting were "reasonably satisfactory."⁶⁸ The American negotiators exhibited a "lively

⁶⁵ Cabinet Conclusions, 17 September 1964, RG 2, Vol 6265, NAC. Johnson, ostensibly in British Columbia to conclude arrangements related to the development of the Columbia River system, exploited the visit to demonstrate to American voters his capacity to handle foreign policy, one of his acknowledged weaknesses. Canadian officials (and presumably their political masters) were aware of the dangers of allowing Canada to be used as a political prop in the American presidential elections. See also Lawrence Martin, *The Presidents and the Prime Ministers*, p. 218 and L.B. Pearson, *Mike, III*, p. 125.

⁶⁶ Cabinet Conclusions, 17 September 1964, RG 2, Vol 6265, NAC.

⁶⁷ NSF, Administrative Histories, Department of State, Chapter 3, Part D, [1968], Vol 1, Johnson Library.

⁶⁸ My account of the September meetings is based on the following sources: J.F. Grandy, Memorandum for the Minister of Finance, 25 September 1964, RG 19, Vol 3946, File 8705-02, NAC; Marcel Cadieux, Memorandum for the Minister, 29 September 1964, DEA

interest" in the Canadian proposal. They seemed to accept the scheme in principle and appeared ready to agree that the agreement should come into force as quickly as possible.

However, several points disturbed the Americans. Mindful of their country's continuing exchange problems, they were reluctant to commit the United States to a program that would weaken its payments position without maintaining some room to manoeuvre. They argued that the Canadian government's understandings with the producers should "leave room for extraneous forces to be taken into account." Canadian officials responded by insisting that these agreements would have to be "as precise as possible." The American delegation also queried the suggestion that the intergovernmental agreement should include a "specific recognition by the United States of the Canadian Government's fundamental objective of bringing about a better balance between Canada's share of production and consumption." Although the administration was ready to accord Canada more than its fair share of the industry's growth during the next few years, it would not be able to sell such a specific undertaking to Congress and the American industry. Again, Canadian officials made it clear that this basic objective of the scheme must be included in the final agreement.

Despite these differences, there seemed to be a substantial basis for continuing to talk as long as - and the Canadian negotiators were very emphatic about this - the United States

refrained from imposing countervailing duties. After consulting their respective cabinet ministers and automotive industries, officials from Canada and the United States met again in early October and late November to consider the Canadian proposal in greater detail. Convinced that the Canadian scheme represented a means to defuse the threat posed by the existing automotive incentive plan to the administration's domestic and bilateral fortunes, the White House instructed the American delegation to pursue the latest proposal on a "very serious" basis.⁶⁹

The two negotiating teams met in early October and late November to consider the Canadian proposal in greater detail. Ball's NSC sub-committee on Canada approved a recommendation from Trezise and McNeal that the United States proceed with a deal along the lines of the Canadian proposal. The sub-committee was pleased with the shape of the agreement, which would enable Canada and the United States to avoid a nasty trade war, rationalize production, and move towards still closer commercial relations after several years of bickering. The cost to the United States - a "modest increase in Canadian automotive production" - was "not

⁶⁹ My account of the two meetings in October and November is based on the following sources: Marcel Cadieux, Memorandum for the Minister, 19 October 1964, DEA File 37-7-1-USA-2, DFAIT; Memorandum to the Cabinet Committee on Finance and Economic Policy, 16 November 1964 and Memorandum for the Cabinet, 18 November 1964, RG 19, Vol 3946, File 8705-02, NAC; Memorandum of Conversation: Possible US-Canadian Free Trade Arrangement in Automotive Products, 9 October 1964, and Memorandum of Conversation: Possible Free Trade Arrangement in Automotive Products (4th General Round of Discussions), 12-13 November 1964, RG 59, Box 1249, File IT 7-12 CAN, USNA.

unreasonable."⁷⁰ The president concurred.⁷¹ At last, it seemed to Butterworth, "the nationalism of several Liberal Party economic, financial and industrial policies during the past two years has taken a back seat to more constructive flexibility."⁷²

As the final touches were placed on the automotive parts agreement, Canada and the United States were about to embark an equally important set of trade negotiations - the Kennedy Round of the General Agreement on Tariffs and Trade (GATT). Preparations for this set of GATT negotiations had been in the works for several years. In 1961, ministers of the member countries of GATT had agreed that the traditional item-by-item technique used to negotiate tariffs had become too complex and was no longer adequate. They recommended that some form of linear tariff reductions be adopted. In January 1962, this approach was given added impetus when Kennedy asked Congress to approve legislation whose principal provisions gave the administration the authority to cut tariffs by 50 percent and remove completely those tariffs which were under five percent. For the Kennedy administration, launching a new GATT round of tariff reductions was important both as a trade

⁷⁰ Philip Trezise to Henry Wilson and attached Memorandum for the President, 25 November 1964, Francis Bator Papers, Box 1, Chron (NSC) 9/1/64-12/31/64; See also NSF, Administrative Histories, Department of State, Chapter 3, Part D, [1968], Vol 1, Johnson Library.

⁷¹ McGeorge Bundy, Memorandum for the President, 27 November 1964, Francis Bator Papers, Box 1, Chron (NSC), 9/1/64-12/31/64, Johnson Library.

⁷² Ottawa to State, Tel No 897, 13 January 1965, NSF, Country File: Canada, Box 165, Johnson Library.

liberalization measure and as part of Kennedy's 'grand design', a program to strengthen "the unity and coordination of the free world."⁷³

For the most part, Canada shared Washington's view of the Kennedy Round, welcoming the president's efforts to use the GATT to reduce economic divisions within the North Atlantic Alliance. More important, the United States administration was prepared to reduce its tariffs as never before, with obviously important implications for Canada, which sent over 50 percent of its exports to the U.S. in 1962.⁷⁴ At the same time, Washington was determined to use its bargaining power to improve access to the European market and seek an international settlement on grains and wheat, where surpluses from the mid-1950s and European import restrictions had resulted in cut-throat competition among the major exporting nations. At the November 1962 GATT session, Canada joined with the United States to call for a ministerial meeting to prepare for the new round and promised "to play an active role in the negotiations, offer important concessions, and pay fully for tariff concessions by others of benefit to Canadian exporters."⁷⁵

Despite their general support for the Kennedy Round, there was widespread agreement among Canadian officials and ministers that

⁷³ M. Schwarzmann, Memorandum for the Ambassador, 15 april 1963, RG 25, Vol 3175, File GATT 1954-63, NAC.

⁷⁴ F.H. Lacey (ed.), *Historical Statistics of Canada, Second Edition* (Ottawa, 1983), p. G415-428.

⁷⁵ Memorandum, 23 April 1963, RG 20, Accession 85/86/665, Box 66, File Kennedy Round (Result), NAC.

the linear approach was not suitable for Canada: Maurice Schwarzmann, an assistant deputy minister of trade and commerce, put it well:

Since we import about ten times more manufactured goods than we export, a linear cut in Canadian tariffs to match a similar cut in the tariffs of our major trading partners could clearly be out of balance in terms of compensating benefits received and given by Canada, as well as being out of all proportion in terms of the degree of adjustment that would be required in Canadian industry as compared with the mass production industries of the U.S. and Europe.⁷⁶

Although Canadian officials repeatedly outlined this position, they did so with little apparent effect. The United States, which wanted to secure a strong expression of Canadian support in order to help convince the reluctant Europeans to participate, was not convinced by the Canadian argument. Schwarzmann cautioned from Washington in late April 1963 that "Canadian reservations about [the] linear approach are regarded with great suspicion and are interpreted more as an attempt to get a 'free ride' or to cater to protectionist groups in Canada."⁷⁷ The administration insisted that Canada's concerns were "exaggerated" and reflected "an unduly 'static' and short-term assessment of [the] benefits accruing to Canada." Canadians should place more emphasis on the benefits to be achieved by an general expansion in world trade than on a simple calculation of reciprocity. They argued that the Canada position could be met "through special devices or procedural modifications in the linear

⁷⁶ Cited in J.L. Granatstein, *A Man of Influence: Norman A. Robertson and Canadian Statecraft, 1929-68* (Toronto: 1981), p. 365.

⁷⁷ Maurice Schwarzmann, Memorandum for the Ambassador, RG 25, Vol 3176, File GATT 1954-64, NAC.

formula," rather than rejecting the linear proposal out of hand.⁷⁸

To contain these differences over the linear approach, Kennedy sent his special representative for trade negotiations, Christian Herter, to Ottawa only four days after Pearson's election. Herter was to seek assurances that Canadian hesitations about the linear approach "[w]ould not be highlighted" and that Ottawa would avoid "explicit reservations."⁷⁹ In exchange, the United States would accommodate the unique Canadian position. Although the government had yet to determine its detailed approach to the Kennedy Round, Herter's meeting with Pearson, Gordon, Sharp and Martin went smoothly. The Canadian ministers continued to insist on the unsuitability of linear cuts for Canada, but made it clear that they were "very willing to look for a formula which would enable [them] not to attack the U.S. position on linear cuts." Herter was convinced that Canada did "not want to be free riders" and that Ottawa "may well come up with some proposal that [Washington] felt was acceptable without sacrificing their secondary industry."⁸⁰ A few days later, Pearson himself reassured Kennedy at Hyannisport "that if there is to be a failure at Geneva it won't be [the]

⁷⁸ Washington to Ottawa, Tel No 1182, 24 April 1964, RG 25, Vol 5649, File 14051-2-40, NAC.

⁷⁹ Washington to Ottawa, Tel No 1182, 24 April 1963, RG 25, Vol 6549, File 14051-2-40, NAC.

⁸⁰ Carl Kaysen, Memorandum to McGeorge Bundy, 29 April 1963 and Christian Herter, Memorandum for the President, 29 April 1963, NSF, Country Files: Canada, Box 19, Kennedy Library.

Canadians' fault."⁸¹

Led by Sharp and Jake Warren, an assistant deputy minister for trade and commerce, the Canadian delegation to the May ministerial meeting went to Geneva armed with instructions not to endorse the linear approach. It was told to "avoid ... impairing or prejudicing U.S. efforts to obtain agreement on such a negotiating procedure for countries for which this technique is appropriate."⁸² The meeting, Sharp later reported, was "very difficult."⁸³ Much of the problem stemmed from differences between the United States and the European Economic Community (EEC), which feared that the linear approach would reduce its relatively low tariffs to meaningless levels while leaving the protective effect of higher American tariffs intact. At the last minute, after agreement was reached with the Americans, the EEC turned on Canada and forced Sharp to explain why Canada should be exempt from the linear approach. With American support, the Canadian exemption survived unscathed and the ministers agreed that the next round of negotiations would formally begin in May 1964. Special provisions were made for those countries with a "trade and economic structure such that a linear cut by them would not yield reciprocity."⁸⁴

⁸¹ Department of State to Geneva, Tel No 1067, 16 May 1963, NSF, Country Files: Canada, Box 19, Kennedy Library.

⁸² Memorandum for the Cabinet, 9 May 1963, DEA File 37-7-3, DFAIT.

⁸³ Cabinet Conclusions, 24 May 1963, RG 2, Vol 6253, NAC.

⁸⁴ Washington to Ottawa, Tel No 1850, 10 June 1963, RG 25, Vol 5649, File 14052-1-40, NAC.

The May 1963 ministerial meeting also established a Trade Negotiations Committee (TNC) and a host of sub-committees and commodity groups to elaborate the rules and procedures that would govern the trade negotiations. Though progress was difficult and painstakingly slow, by April 1964 there were signs that the two principal antagonists, the United States and the EEC, were moving slowly towards an agreement. The TNC consequently turned its attention to the rules governing Canada's participation in the Kennedy Round. A recent decision by Japan and the low tariff Scandinavian countries to adopt the linear approach left Canada almost alone in its opposition to these cuts. Ottawa was increasingly worried that, without explicit recognition by the TNC of its unique pattern of trade and economic structure, Canada would come under pressure at the forthcoming ministerial meeting to adopt the linear approach.⁸⁵

For its part, the United States, which could count on little support from either the EEC or the United Kingdom, was worried that the Canadian offer would be disappointingly small and further undermine the Kennedy Round. American officials in Geneva pressed for a greater Canadian commitment to the negotiations. They asked that Canada table its offer at the same time as the other participating countries listed their "exceptions." To avoid a "token offer" from Canada, the Americans insisted on an explicit

⁸⁵ Head, Office of Trade Relations and Trade Committee to Hector McKinnon, 1 April 1964, Privy Council Office (PCO) File U-3-11(a), PCO. See also Ottawa to Geneva, Tel No E-707, 17 April 1964 and Ottawa to Geneva, Tel No E-760, 23 April 1964, DEA File 37-7-3, DFAIT.

statement that the offer would be "designed to pay for all the concessions Canada expects to receive." In addition, Washington asked Canada to agree to consult with its trading partners both before and after the offers were announced. These were all reasonable demands and at the April 1964 meeting of the Canada-United States Ministerial Committee on Trade and Economic Affairs, the assembled cabinet ministers again reiterated their support for the rough arrangement that made close bilateral cooperation at the GATT possible. The United States would continue to recognize Canada's unique position, while Canada agreed to make the kind of forthcoming and realistic offer that would advance the Kennedy Round.⁸⁶

At the TNC meeting in May, Canada was formally identified as a non-linear country. In exchange, Sharp, as head of the delegation, assured his international counterparts of Canada's determination to play a substantial role in the negotiations:

I wish to reaffirm that from the beginning, Canada will be a full and active participant over the whole range of these negotiations... We regard the Kennedy Round as a unique opportunity to help raise world trade to new levels and thus to contribute to higher levels of economic activity and employment in our countries. We see them as a stimulus to a more efficient world economy. Canada will seek improved terms of access for Canadian products in all markets and we are prepared to pay fully in exchange for benefits received.⁸⁷

Throughout the summer of 1964, work on the Canadian offer proceeded

⁸⁶ Summary Record of the Joint U.S.-Canada Committee on Trade and Economic Affairs, 29-30 April 1964, DEA File 35-4-5-1-1964, DFAIT.

⁸⁷ Quoted in Charlotte Girard, *Canada in World Affairs, Volume 13: 1963-1965* (Toronto, 1980), p. 129.

in Ottawa under the direction of Norman Robertson, who had been appointed chief negotiator in February, and his deputy, Hector McKinnon, the former chairman of the Tariff Board. The two men crossed the country throughout the spring and summer of 1964, holding over 450 sessions with a range of Canadian businesses. Despite the qualms expressed by the Canadian Manufacturers' Association, many of the submissions received by Robertson's Tariffs and Trade Committee were positive. One informal press survey reported that the Canadian negotiators would probably "have a strong free-trade mandate."⁸⁸ Sharp seemed to concur. Many industries and businesses, he told the House of Commons in April 1964, were ready "to forgo at least part of the protection afforded them by the Canadian tariff ... provided the concessions requested are forthcoming."⁸⁹

While this was certainly true, there was also a great deal of nervousness in Ottawa. Gordon and some of the more protectionist officials in the Department of Finance were reluctant to engage in a tariff cutting exercise that would diminish their capacity to use protective tariffs to shelter Canadian industry and to create a strong, domestically-controlled manufacturing sector. As the government began to consider the draft offer drawn up by Robertson and McKinnon, the minister of finance forced it to retreat from the relatively liberal position adopted by Sharp in Geneva. In late

⁸⁸ Quoted in John Saywell (ed.), *Canadian Annual Review for 1965* (Toronto, 1966), p. 289.

⁸⁹ Canada, House of Commons, *Debates*, 14 April 1964, pp. 2161-65.

October, officials began exploring the possibility that Canada might only make some form of "token offer," delay the offer or even withdraw from the tariff negotiations.⁹⁰ Robertson was appalled. He warned the prime minister and Gordon Robertson, the clerk of the privy council, not to retreat. A vague statement, which promised a more precise offer later, would not suffice. "[I]t would not be regarded as satisfying Canada's previous undertakings," the chief negotiator explained, "and would leave us open to charges that we were impeding the progress of the negotiations."⁹¹ Robertson argued that at a time when Franco-American and Franco-German differences were calling into question postwar cooperative arrangements in the Western alliance, it was important for Canada that "there should be some positive movement forward in at least one significant area, the Kennedy Round."⁹²

Pearson was persuaded and agreed to proceed with the offer largely as drafted, although the government decided to hold back its concessions on a number of sensitive products until later in the negotiations. He telephoned Johnson, and assured him that the Canadian offer would be "good and reasonable."⁹³

It was. Canada offered to impose a general ceiling on its

⁹⁰ [Jim Grandy], Kennedy Round: Alternative Approaches, 26 October 1964, PCO File U-3-11(a), PCO.

⁹¹ O.G. Stoner, Memorandum for Mr. Robertson, 3 November 1964, PCO File U-3-11(a), PCO.

⁹² A.R. Ritchie, Memorandum for the Under-Secretary, 4 November 1964, DEA File 37-7-3, DFAIT.

⁹³ Ottawa to Washington, Tel No G-167, 9 November 1964, PCO File U-3-11(a), PCO.

tariffs at a moderate level, with some exemptions for especially sensitive items. On items below the ceiling, Canada offered to reduce its tariffs by 50 percent on a broad range of semi-fabricated products, and to remove duties on most industrial raw materials. It also offered to reduce its tariff on fish by 50 percent (provided there was a reciprocal offer), and go free on some agricultural products, while cutting duties by 50 percent on others. In return, Canada wanted the main industrial countries to cut their tariffs on all industrial items of actual or potential interest to Canada, and to include agricultural products as part of the negotiations.⁹⁴

With the tabling of offers, the ground was set for serious negotiations to begin. During the next six months, these proceeded slowly as the linear participants explored their offers and justified their exceptions. Throughout these discussions, which lasted until February 1965, the Canadian role was "necessarily somewhat passive."⁹⁵ Robertson had a number of exploratory discussions with the American negotiators, but serious negotiations were not expected to begin until at least late April. Negotiations with the EEC and Japan, which would have to wait until the results

⁹⁴ J.L. Granatstein, *A Man of Influence*, p. 369. The Canadian offer also included an offer of free entry on tropical and semi-tropical products on the condition that other developed countries made the same offer. In addition, the offer as a whole was conditional on reaching an agreement on binding margins of preference.

⁹⁵ Tarifdel to Ottawa, Tel No 23, 23 March 1965, DEA File 37-7-3, DFAIT; See also R.G. Robertson, Memorandum for the Prime Minister, 26 March 1965, PCO File U-3-11(a), PCO.

of bilateral talks with the United States, remained a long way off. Still, by the spring of 1965, the Kennedy Round was beginning to take shape. Plans were adopted for informal discussions in the pulp and paper, textile, chemical, and metal sectors, where the most important industrial talks would take place. At the same time, the EEC declared that it had reached internal agreement on wheat pricing, and was finally prepared to begin to negotiate a commodity agreement on cereals.

During the spring and summer of 1965, Canada and the United States conducted an "item-by-item" review of bilateral trade, clearing "the ground for the substantive negotiations."⁹⁶ These discussions confirmed that in addition to the great number of items of interest to Canada in Washington's initial linear offer, the Americans were prepared to grant free entry for Canadian fish, lumber and metals if the two could agree on additional Canadian concessions. However, real negotiations were suspended when the EEC, on whose offer much of the United States linear offer was dependant, was forced to withdraw temporarily from the talks following a confrontation between the French president, General Charles de Gaulle, and the European Commission over the community's agricultural policies.

Only in July 1966, then, did Canada and the United States begin to come to grips with the differences dividing them.

⁹⁶ Tarifdel to Ottawa, Tel No 195, 27 July 1965, DEA File 37-7-3, DFAIT. These discussions covered lumber and wood products, paper and paper products, non-ferrous metals, non-metallic minerals, fisheries and most manufactured goods, except textiles and chemicals.

Following an extensive review of the two offers, during which the delegations reconciled Canadian and American statistics, they agreed that the two offers were uneven. While the Canadian offer applied to U.S. \$1.2 billion worth of imports from the United States, the American offer would reduce duties on more than U.S. \$1.45 billion worth of Canadian exports. The exercise reinforced the growing conviction among members of the Canadian delegation that their offer would have to be improved. At the same time, they were hopeful that this review demonstrated to the United States how small a gap separated the two positions.⁹⁷

There were additional reasons for strengthening the Canadian offer at this time. Talks between the United States and the EEC had gone poorly during the summer and it was widely expected that the United States would begin to withdraw parts of its offer in the autumn. By improving its offer to the United States, Canada might be able to influence which products the United States decided to withdraw. Moreover, Canada would improve its general negotiating position and, not least of Ottawa's considerations, "strengthen the hand of the U.S. negotiators who are working for the best available Kennedy Round and who are reluctant to withdraw offers if this can be avoided, well aware this could provoke general withdrawals."⁹⁸

In October, the Canadian offer was substantially improved with the addition of important concessions on chemicals and machine

⁹⁷ Tarifdel to Ottawa, Tel No 224, 3 August 1966, DEA File 37-7-3, DFAIT.

⁹⁸ Sydney Pierce to Hector McKinnon, 25 August 1966, DEA File 37-7-3, DFAIT.

tools. Machine tools alone represented almost U.S. \$400 million worth of American exports to Canada.⁹⁹ The United States delegation was not appeased. It admitted that the amended Canadian offer removed the imbalance in the trade coverage but maintained that the American offer, which provided for a 50 percent reduction in tariffs, was much better. Moreover, while only U.S. \$333 million worth of Canadian exports to the United States were not covered under the American offer, almost U.S. \$1 billion worth of exports were excluded from the Canadian offer. Blumenthal demanded reductions on another U.S. \$500 worth of goods, and threatened to withdraw U.S. \$180 million worth of concessions from its original offer.¹⁰⁰ On a more positive note, the American negotiator offered to go free on fish (worth U.S. \$82 million) and indicated that he was also authorized to go free on additional low tariff items. Sydney Pierce, who had replaced an ill and tired Robertson in June 1965, rejected the American's "arithmetical balance sheets," and argued that it was not the depth of the cut which was important, but the tariff level over which trade flowed.

The two delegations agreed to leave aside the question of the overall balance of the two offers when they met again in early 1967. Instead they focused on examining the Canadian offers on

⁹⁹ Ernest Preeg, *Traders and Diplomats*, p. 188. See also Tarifdel to Ottawa, Tel No 272, 6 October 1966, DEA File 37-7-3, DFAIT.

¹⁰⁰ Tarifdel to Ottawa, Tels No 349 and 351, 6 December 1966, DEA File 37-7-3, DFAIT. The United States threatened to withdraw concessions on whisky alone worth US \$100 million. Groundwood printing paper and non-agricultural tractors were the other two major items threatened.

chemicals and machinery. While the two countries argued over exactly how the reduction in duties on machine tools was to be computed, Pierce was confident that a bilateral agreement would emerge from Geneva. Its principal features would include a 50 percent reduction in a wide range of industrial products of interest to Canada, as well as the complete elimination of American tariffs in the lumber, fisheries, and agricultural sectors. By mid-April, the task of reconciling the overall balance was all that remained.¹⁰¹

The outlook for negotiations in the cereals group, which began to meet regularly in the fall of 1966, was not as optimistic. International grain sales were an especially difficult problem for Ottawa in its relations with the United States. During the late 1950s and the early 1960s, grain production soared while the major markets, the EEC, the United Kingdom, and Japan reduced imports in favour of domestic producers. This led to fierce competition among wheat exporters for market-share, and rendered international efforts to stabilize the market through the International Wheat Agreement (IWA) ineffective. The immense American economy gave the United States a distinct advantage in this struggle as successive administrations pursued greater market-share for subsidized wheat by large grants of food aid, concessional sales and deep price cuts. Although Canada and the United States had consulted regularly since the mid-1950s on wheat prices, these discussions had grown

¹⁰¹ Tarifdel to Ottawa, Tel No 77, 7 March 1967 and Tarifdel to Ottawa, Tel No 130, 10 April 1967, DEA File 37-7-3, DFAIT.

progressively less fruitful, as the United States became more and more determined to seize a larger share of the market. Canada's search for price stability and a viable return on its growers' investment seemed irreconcilable with Washington's determination to increase its market-share. It was by no means certain that the United States and Canada could find a basis on which to cooperate in the GATT discussions on wheat, where agreement was regarded in Geneva, Ottawa and Washington as essential for the successful conclusion of the Kennedy Round.¹⁰²

The first real test came in October 1966 when the four major exporting countries - Canada, the United States, Australia and Argentina - tried to forge a common front for their negotiations with the main importers. Sharp differences emerged over prices and market-sharing proposals. Canada, with support from Australia and Argentina, suggested that the exporters begin by offering a minimum price of U.S. \$1.85/bushel for No. 2 Hard Winter ex-Gulf, retreating if necessary to U.S. \$1.77. The United States refused to go higher than U.S. \$1.70/bushel for No. 2 Hard Winter, leaving a difference of 7 cents. "[U]nless this gap was closed," the Canadian representatives threatened, "there appeared little possibility of Canada being prepared to proceed with the cereals negotiations in

¹⁰² The surplus issue is discussed in Theodore Cohn (with Inge Bailey), "Canadian-American Relations and Agricultural Surpluses: The Case of Barter," in Irene Sage Knell and John English (eds.), *Canadian Agriculture in a Global Context: Opportunities and Obligations* (Waterloo, 1996), pp. 175-98.

Geneva." ¹⁰³

Canada and the United States were also divided over the price differentials to be applied to different grades of wheat. Ottawa sought fixed differentials which would apply to every grade of wheat at every price level, while the United States favoured a more flexible system. In addition, the two countries differed over American proposals for market-sharing. The United States wanted exporters to agree in advance on the market-share each country would get for various grains when trading was at or near the minimum price. Market-share would be regulated by raising prices, withholding wheat, or turning down sales. However, the United States implied that the exporters would avoid largely this situation by agreeing in advance to share the international wheat market at all times.¹⁰⁴

The Washington meeting uncovered the profound differences dividing the two countries and set alarm bells ringing in Ottawa. The ministers of trade and commerce, finance and agriculture and their officials were inclined to ask Pearson to take up the issue with Johnson. This idea was scotched when the two countries' differences over Communist China and Washington's unresolved request to station nuclear weapons at Argentina were considered.¹⁰⁵

¹⁰³ Memorandum: Kennedy Round Cereals Negotiations, 21 October 1966, PCO File U-3-11(a), PCO.

¹⁰⁴ *Ibid.*

¹⁰⁵ Draft Memorandum: Kennedy Round Cereals Negotiations, 28 October 1966 and O.G. Stoner, Memorandum for Mr. Robertson, 31 October 1966 and Gordon Robertson, Memorandum for the Prime Minister, 31 October 1966, PCO File U-3-11(a), PCO.

It was left to Australia to approach the United States "at the highest political level" and secure assurances that Washington would support the proposal for an initial minimum price of U.S. \$1.85/bushel for No. 2 Hard Winter. Informal telephone discussions between Warren and Herter's deputy in Washington, William Roth, revealed that the United States was ready to moderate its position in other respects as well in order to achieve exporter unanimity. It accepted reluctantly the idea of fixed differentials.¹⁰⁶ Roth also agreed that the American market-sharing proposals would only operate at the minimum price level. Although Canadian officials doubted that importing nations would agree, they promised to support the concept when the United States advanced it at Geneva. The two trade officials also reached agreement on the amount of wheat that the EEC, the United Kingdom and Japan would be asked to import, and on a 10 million ton multilateral food aid program involving a Canadian commitment of \$75 million.¹⁰⁷

The Canadian-American agreement was confirmed by the full group of exporters in early November, although the exact value assigned each grade of wheat was still to be negotiated among importers and exporters in Geneva. Similarly, the precise details of the market-sharing arrangement were left undefined so that the

¹⁰⁶ Memorandum: Kennedy Round Cereals, 2 November 1966, PCO File U-3-11(a), PCO.

¹⁰⁷ Note on U.S. Position as set out in Washington Message Telegram 3231 of October 25th, and Gordon Robertson, Memorandum for the Prime Minister, 2 November 1966, PCO Files U-3-11(a), PCO.

discussions with importing nations could begin at once.¹⁰⁸ This tactic allowed the exporters only a short respite from their differences. By February 1967, two months after their offer was tabled with the GATT secretariat, discussions in the cereals group ground to a halt as the importers waited for exporters to elaborate their views on differentials and market-sharing. This proved no easier in Geneva than in Washington.

After several weeks of effort, Canada and the United States remained divided on both differentials and market-sharing. Pushed hard by their Department of Agriculture, the American negotiators adopted an "unyielding and somewhat belligerent approach." They clung tenaciously to proposals that called for export restrictions and permitted exporters to breach the minimum price in order to retain their traditional markets. These suggestions undermined the very concept of a minimum price and Schwarzmann rejected them out of hand. In response, Blumenthal and Roth threatened to table the American proposals alone, a step that would effectively destroy the common front on minimum price levels. The American posture, with its rigid and unfamiliar unilateralism, worried the Canadians:

We are concerned and puzzled about real inwardness of USA position. While USA support is essential to our objectives, conflicting pressures and motivations behind their approach make them an unpredictable partner. This has been reflected in

¹⁰⁸ C.R. Nixon, Memorandum for Mr. Stoner, 22 November 1966, and attached Memorandum: Kennedy Round Cereals Negotiations: Exporter Position, 16 November 1966, PCO File U-3-11(a), PCO.

their delays in resuming exporter negotiations and in their intransigence in moving from extreme positions.¹⁰⁹

It also worried the Australians, who helped work out a compromise in the final weeks of February. This was only achieved after "difficult and protracted negotiations" between Canadian and American representatives, discussions marked by "misunderstanding and suspicion." The new market-sharing arrangements would come into effect when a certain volume of wheat sales were concluded at prices close to the minimum. At that time, a "prices consultative committee" would meet and adjust prices so that traditional trading patterns were maintained. If this did not result in "equitable market sharing" after 60 days, the committee would take "additional measures."¹¹⁰

Despite the agreement on market-sharing, the United States and Canada remained far apart on the price differential between various grades of wheat. It was becoming "clear that as long as the issue of quality differentials remained unresolved between Canada and United States, we were in daily risk of the spilt among exporters being exposed and of the USA moving off price position."¹¹¹ The

¹⁰⁹ Tarifdel to Ottawa, Tel No CE&, 19 February 1967, DEA File 37-7-3, DFAIT. On these discussions, see also Economic Division to J.C. Langley, 17 February 1967, and Tarifdel to Ottawa, Tel No CE13, 27 February 1967, *ibid* and Memorandum to Ministers: Kennedy Round - Cereals negotiations, 9 February 1967, PCO Files U-3-11(a), PCO.

¹¹⁰ Economic Division to Mr. J.C. Langley, 22 February 1967 and Tarifdel to Ottawa, Tel No CE9, 21 February 1967, DEA File 37-7-3, DFAIT.

¹¹¹ Tarifdel to Ottawa, Tel No CE19, 6 March 1967, DEA File 37-7-3, DFAIT.

Canadian concern was shared by American negotiators, who suggested as a compromise that differentials should only be fixed for the highest and lowest grades of wheat. This would effectively establish reference levels which could be used to work out prices for other grades as they were traded provided that the exporting countries accepted "close arrangements for cooperation."¹¹² In early April, Canada and the United States agreed on a schedule of "indicative minimum prices for a number of major grades," supplemented by procedures for consultation "which would provide, or at least not exclude a breach in the minimum [price] if agreement is not reached." As well as solving the differentials problem, this new pricing system replaced the market-sharing arrangements concluded in February.¹¹³

During the last few weeks of April 1967, importers and exporters hurried unsuccessfully to reach agreement. Although exporters reduced their minimum price to U.S. \$1.80/bushel, importers refused to increase their offer beyond U.S. \$1.699/bushel. Similarly, the two groups were divided over access commitments. The EEC would only agree to maintain its ratio of imports to consumption at 11 percent, while the exporting countries wanted it fixed at 13.4 percent. (The United Kingdom insisted on maintaining this ratio at 28 percent; exporters wanted it fixed at 37.6 percent.) The access question was complicated by an additional

¹¹² Tarifdel to Ottawa, Tel No CE26, 16 March 1967, DEA File 37-7-3, DFAIT.

¹¹³ Tarifdel to Ottawa, Tel No CE31, [4 April 1967], DEA 37-7-3, DFAIT. The telegram is erroneously dated 4 March 1967.

United States demand for access guarantees for coarse grains that was firmly rejected by the EEC. Finally, there was no agreement on a multilateral food aid program. Japan rejected it entirely, while the EEC and the UK accepted it only in principle. As a result, in late April, Eric Wyndem White, the long-time secretary general of the GATT, concluded that "as matters stand at this time, there is no basis for agreement."¹¹⁴

Against the background of White's statement, and a declaration by the U.S. delegation that a "cereals agreement was essential to successful conclusion of the total Kennedy Round," the GATT's steering group met on April 29 to assess the round's progress. It was a gloomy session.¹¹⁵ The impasse over cereals was duplicated in the chemical sector where the United States and the EEC were deeply divided. Winters and his senior officials departed for Geneva in early May and a final round of negotiations, worried that "[t]he Kennedy Round was in danger of failing."¹¹⁶

In the final two weeks of intensive negotiations, the elements of a trade deal fell into place. In a surprising change in policy, the United States abandoned the demand for access guarantees. The cereals negotiations were quickly focused on the more malleable

¹¹⁴ Tarifdel Geneva to Ottawa, Tel No CE39, 29 April 1967, DEA File 37-7-3, DFAIT.

¹¹⁵ Tarifdel to Ottawa, Tel No 170, 29 April 1967, DEA File 37-7-3-, DFAIT.

¹¹⁶ Marcel Cadieux, Memorandum for the Minister, 8 May 1967, DEA File 37-7-3, DFAIT; See also Kennedy Round Briefing Material, 10 May 1967, RG 20, Acc. 85-86/665, Box 68, NAC and Memorandum: Kennedy Round - Present State of Play, PCO Files U-3-11(a), PCO.

questions of price and food aid.¹¹⁷ Meeting day and night, the cereals group finally agreed on the central elements of a new international grains agreement. Prices were established on a range of wheat, with the bench-mark minimum price for U.S. No. 2 Hard Wheat set at U.S. \$1.73/bushel, and a prices review committee was authorized to reduce price levels further when necessary. The group also agreed on a multilateral food aid program of 4.5 million tons.¹¹⁸

Resolving the differences between the United States and Europe over chemicals was even more difficult, but eventually a compromise emerged.¹¹⁹ Throughout these last minute negotiations with the EEC, the United States put the finishing touches on its bilateral negotiations with Canada. This was not as straightforward a task as it might once have appeared. In a late April meeting, Blumenthal insisted that the Canadian and American offers were not balanced. He asked for additional concessions on a variety of agricultural products and threatened to withdraw agricultural offers worth \$27.5 million. The American also requested additional concessions on the industrial side. Although surprised by the strength with which the United States put forward its case, the Canadian delegation was not entirely unprepared. It had anticipated a last-minute stiffening of the American position as a bargaining tactic, and held back almost

¹¹⁷ Tarifdel to Ottawa, Tel No CE45, 12 May 1967, DEA File 37-7-3, DFAIT.

¹¹⁸ Ernest Preeg, *Traders and Diplomats*, p. 253-54.

¹¹⁹ For details see, Ernest Preeg, *Traders and Diplomats*, pp. 189-95.

\$100 million worth of Canadian concessions. With the incidence (or overall impact) of tariff on machinery still to be resolved, Canada was well armed for the final round of negotiations.¹²⁰

The two delegations made steady progress, and by the time the Kennedy Round concluded at the end of June, they had agreed on a package affecting almost \$3 billion worth of bilateral trade. The United States agreed to abolish duties on Canadian exports valued at \$1.92 billion. Tariffs of 5 percent or less were eliminated on \$560 worth of Canadian exports, effectively introducing free trade for lumber, paper and some fisheries products. Agricultural tariffs were removed on exports valued at \$28.6 million. Duties on another \$1.06 billion in exports were reduced by 50 percent, while smaller reductions were made in tariffs on an additional \$298.3 million worth of exports. In return, Canada reduced its tariffs on \$1.09 billion worth of U.S. imports on a range of products that affected almost every sector of the tariff. The treatment Canada agreed to accord machinery was especially important. Canada eliminated the 7.5 percent tariff on machinery "not made in Canada," and reduced the tariff on machinery "made in Canada" from 22.5 to 15 percent, agreeing that the overall impact of the tariff on machinery would be reduced to 9 percent.¹²¹

¹²⁰ Kennedy Round Briefing Material, 10 May 1967, RG 20, Acc. 85-86/665, Box 68, NAC.

¹²¹ John T. Saywell (ed.), *Canadian Annual Review for 1967* (Toronto, 1968), pp. 336-38. See also Michael Hart, "Twenty Years of Canadian Tradecraft: Canada at the GATT, 1947-1967," *International Journal*, Vol LII (Autumn, 1997), pp. 603-04. On the importance of Canada's offer to reduce its tariff on machinery, see Ernest Preeg, *Traders and Diplomats*, p. 188.

Canada generally welcomed the results of the Kennedy Round.

The *Winnipeg Free Press* enthusiastically proclaimed:

The riches opened up to Canadian industry by the Kennedy Round of tariff reductions are almost impossible to exaggerate. In return for incredibly minor concessions to the products of other countries, this already prosperous and favoured land has been offered opportunities which are limited only by the willingness of its people to exploit them and by the vigour and competitiveness of its business community.¹²²

Together with the new automotive agreement, the tariff changes negotiated during the Kennedy Round were to have a profound and lasting effect on Canadian trade relations. In the words of the trade analyst, Michael Hart, "Canada and the United States took a giant step towards reducing barriers between them."¹²³ Historian J.L. Granatstein agrees: "It was not quite free trade, but to a substantial extent tariffs were now becoming almost inconsequential."¹²⁴

The impact of the two agreements on Canadian-American trade was striking and immediate. Bilateral trade in automotive products alone rose from \$1.2 billion in 1965 to \$3.5 billion in 1967 to

¹²² Cited in Michael Hart, "Twenty-five Years of Tradecraft," p. 606.

¹²³ *Ibid.*, p. 604.

¹²⁴ J.L. Granatstein, "Free Trade between Canada and the United States: The Issue That Will Not Go Away," in Denis Stairs and Gilbert R. Winham (eds.), *The Politics of Canada's Economic Relationship with the United States* (Ottawa, 1985), p. 46. On the importance of the Kennedy Round, see also Bruce Muirhead, "The Development of Canada's Foreign Economic Policy in the Second Post-War Decade: Britain, Europe and the GATT," in Gustav Schmidt and J.L. Granatstein (eds.), *Canada at the Crossroads? The Critical 1960s* (Bochum, 1994), p. 174-75.

\$6.7 billion in 1969.¹²⁵ Spurred on by the Kennedy Round, trade between the Canada and the United States soared. Total bilateral trade rose steadily from \$15 billion in 1967 to \$20.5 billion in 1969 to \$26.2 in 1972.¹²⁶ Goods shipped to the United States rose as a share of total Canadian exports from 55.4 percent in 1963 to 67.7 percent in 1968.¹²⁷ Despite its professed intention to reduce Canada's economic dependence on the United States, Pearson's government was responsible for a dramatic and significant increase in North American economic integration. And it could not easily be undone. This point was not lost on American observers:

Growing interdependence with the U.S. was a characteristic of other aspects of U.S.-Canadian economic relations during the Pearson Government's tenure. Our most important single negotiation in the Kennedy Round was with Canada and virtual free trade has been achieved in industrial raw materials, fossil fuels, forest products, fish, some agricultural commodities, farm machinery and automotive products. The Automotive Agreement was a major achievement. Our mutual automotive trade has increased in fantastic proportions ...

What is most significant about these development is their thrust toward economic interdependence. They are evidences, hopefully, of a nascent, pragmatic approach to the sharing of the resources of a continent which would accept a continental philosophy where such can be seen to be in the interests of both countries.¹²⁸

¹²⁵ Simon Reisman, *The Canadian Automotive Industry: Performance and Proposals for Progress: Inquiry into the Automotive Industry* (Ottawa, 1978), Appendix A-1. Figures are in Canadian dollars.

¹²⁶ F.H. Lacey (ed.), *Historical Statistics of Canada*, p. G401-407. Figures in Canadian dollars.

¹²⁷ *Ibid.*, p. G415-428.

¹²⁸ American Embassy to Department of State, Airgram A-1620, 4 September 1968, NSF, Country Files: Canada, Box 166, Johnson Library.

Chapter Three

Converging Currencies: Financial Relations

Despite Kennedy's decision to adopt the Interest Equalization Tax (IET) in July 1963, American balance of payments figures showed no sign of substantial improvement. Indeed, by the summer of 1964, the administration was forced to expand its effort to staunch the drain of American capital. This intractable problem preoccupied the White House for the rest of the decade as a strong international economy, the war in Vietnam, and attacks on the dollar's status as a reserve currency weakened the U.S. exchange position. Like the negotiations with the United States over the automotive incentive plan and the GATT round, Washington's increasingly severe balance of payments measures raised fundamental questions about Canada's future economic orientation.

Although Lyndon Johnson's administration acknowledged Canada's legitimate need for unrestricted access to American capital, it was under constant pressure to remove inequities in its various balance of payments programs. Congress viewed growing Canadian reserves with suspicion and urged the White House to tighten up regulatory loopholes which Canadian banks and American subsidiaries in Canada used to circumvent restrictions on the movement of United States capital. As Washington pressed Ottawa to regulate American dollars flowing to Canada under its exemption from the IET, the choice for Canada was clear: it could either assist the United States, which would reduce its capacity to shape financial policy independently, or it could refuse, accepting a devalued Canadian dollar, higher

interest rates and stagnant economic growth. The public and private discussion of this choice pitted economic nationalists against so-called continentalists. Although the Pearson government was forced to acknowledge nationalist demands and arguments, there was little doubt that it would accept the American constraints in exchange for continued economic growth.

While the legislation necessary to impose the IET wound its way through Congress during the spring and summer of 1964, the American balance of payments situation continued to worsen. By the fall of that year, the Treasury Department was no longer certain of the wisdom of its decision to exempt new Canadian securities from the tax. The passage into law of the IET and the Canadian exemption in early September 1964 immediately released between \$700 and \$800 million worth of new Canadian securities onto the New York market. The size of this demand for capital, which was twice as large as Treasury Department officials had anticipated, and an apparent increase in the level of Ottawa's reserves, created considerable concern in Washington.¹ By late October, American officials had completed a full-scale review of the Canadian exemption. The re-examination concluded that Canada's current account deficit had

¹ A.F.W. Plumptre to R.B. Bryce, 23 November 1964, RG 19, Vol 3852, File 8070/U58-4-1, National Archives of Canada (NAC). Gordon must accept a good part of the blame for the unrealistic American expectations. During the April 1964 meeting of the United States-Canada Committee on Trade and Economic Affairs, Gordon told United States cabinet members that optimistic forecasts suggested that Canada would only need \$400 million during 1964 to cover its deficit. See Minutes of the United States-Canada Committee on Trade and Economic Affairs, 29-30 April 1964, Department of External Affairs (DEA) File 35-4-5-1-1964, Department of Foreign Affairs and International Trade (DFAIT).

been declining steadily since 1960. The rising level of Canadian reserves suggested that Canadian borrowing in the United States was no longer directed exclusively towards covering the current account deficit. Canada, in this traditional Treasury Department view, was becoming an important part of the American balance of payments problem. Lisle Widman, director of the Treasury Department's Office of Industrial Nations and the study's author, suggested that Canada's exemption should be limited or even eliminated.²

In late November, Robert Roosa, the under secretary of the treasury, and Paul A. Volcker, his deputy, invited Wynne Plumptre, an assistant deputy minister of finance, to meet with them in Washington to review Canadian reserve levels and new security issues. In vain, Plumptre tried to calm the American fears. He pointed out that the recent burst of activity in Canadian securities was simply the result of the pent-up demand that had accumulated between July 1963 and September 1964, when the United States market was effectively closed to Canada while Congress debated the legislation giving effect to the IET and the Canadian exemption. Current interest rates spreads were low and unlikely to attract any extra funds from the United States during the next year.

More fundamentally, Plumptre rejected the notion that Canada's current account deficit was declining. Without the special sale of wheat to the USSR in late 1963, the current account deficit would

² Attachment to A.F.W. Plumptre to R.B. Bryce, 23 November 1964, RG 19, Vol 3852, File 8070/U58-4-1, NAC.

have risen from \$750 to \$900 million between 1963 and 1964. While the Canadian economy continued to expand and import more machinery, the current deficit was expected to grow to \$1000 million in 1965. The assistant deputy minister emphasized that the July 1963 agreement related only to the level of reserves, not the volume of new securities issued. He rejected the Treasury view that these reserves had increased. The American figures included the \$275 million that Ottawa had recently repaid the International Monetary Fund (IMF) for its 1962 emergency loan. This was unfair and unreasonable. Canada would never have agreed to the exemption if it had thought for a moment that its debt to the IMF would be counted as a credit in the calculation of its reserve levels. He was not very hopeful, however, that he had eased Washington's distress: "It was, of course, quite impossible for me to allay, in a matter of hours, doubts and worries that have been building up for weeks, even months."

Plumptre was right. American concerns were far from dissipated and he, with R.W. Lawson, the executive assistant to the governor of the Bank of Canada, returned to Washington a week later for another round of talks with Roosa. The administration was planning to ask Congress in the spring of 1965 to extend the IET until 1967 and was especially worried about fourth quarter borrowings. Roosa probed deeply into the nature of the recent flurry of securities and the borrowing pattern expected during the coming year in an effort to persuade the two visitors to admit that the exemption should be tightened. The response involved the delicate task of

convincing the Americans that Canada continued to require an unlimited exemption, while sounding vaguely hopeful that the actual amount required from the United States would not be too high. Fearing quotas or limits, Plumptre refused to admit that the current account deficit might be lower than expected. It could be anywhere from \$600 to \$1000 million, though most of his colleagues were inclined to accept the higher figure as the most probable. There were some hopeful signs. The proposed Canada Pension Plan would reduce the country's need for foreign financing, while recent cuts in the federal budget would result in declining federal government cash requirements. Plumptre added that the interest rate spread was expected to narrow in the near future.³

The Americans were not entirely convinced. Roosa admitted that the interest rate spread was indeed narrowing and agreed that the IMF loan should not be included in the Canadian reserve position. However, the new pension plan would not ease Canadian borrowing for it would only move savings from private to public accounts and would not change the actual savings rate. More important, there was the growing problem of short-term flow from the United States to Canada and onto the Euro-dollar market. This "pass-through" problem threatened to undermine the entire balance of payments program. He acknowledged the difficulties that Canada would face if the United States limited the exemption, but reminded Plumptre and Lawson that

³ Meeting in the U.S. Treasury on Friday, December 4, 1964, RG 19, Vol 4814, File 6285-01, NAC; See also Draft Memorandum of Conversation, 12 December 1964, Bank of Canada Records, File 4B-324, Bank of Canada Archives (BCA).

Congress was not about to give the president a "blank cheque." It would insist on some American control over the flow of its currency. Although he promised to explain the Canadian position to Congress, Roosa made it clear that the problem remained on the bilateral agenda. Meanwhile, Ottawa should hope for a lull in new issues and a period of quiet.

The Department of Finance took the hint and moved quickly to protect the IET exemption by trying to improve the payments figures. At the December 1964 federal-provincial meeting of finance ministers, Gordon urged his provincial counterparts to avoid the American market during the next six to eight months, while Congress reviewed the administration's request for an extension of the IET. Only Quebec protested: it was in the throes of Premier Jean Lesage's modernization program, and needed to borrow an estimated \$500 million over the next two years. The minister of finance, Eric Kierans, eventually agreed to seek the money on the short-term Canadian market.⁴ A few weeks later, lest Canada still did not understand the depth of American concern over the presentational problems created by the large volume of Canadian securities, the White House also intervened. During Pearson's visit to the LBJ Ranch in January 1965, Johnson asked the Canadian prime minister to alert him to any substantial securities issues which were

⁴ Meeting of Ministers of Finance and Provincial Treasurers, Ottawa, 7 December 1964, RG 19, Vol 5713, File 2070/U70-3, NAC.

impending.⁵

Postponing Canadian issues was clearly not a long-term solution, and American officials launched a renewed effort in early February 1965 to convince Canada to take some steps to reduce the outflow of American capital to Europe. The under secretary of the treasury, Frederick Deming, assured the group of Canadian officials who accompanied Plumptre to Washington that month, that there was no question of touching the Canadian exemption. The administration recognized that reducing Canada's ability to cover its current account deficit with the United States would force Canadians to limit American imports. As the White House prepared to extend the IET and expand it to cover bank loans, however, the size of the Canadian exemption was likely to give rise to concern in Congress and the administration wanted Ottawa's help in limiting it. Deming approached Plumptre with four general objectives in mind. Together these constituted a rough "working agreement" for managing the IET exemption during 1965. First, although aware that Ottawa could not control the level of provincial borrowing, the United States wished to receive "some reasonably firm assurances" that new Canadian issues would total no more than \$500 million in 1965. Second, the administration asked Canada to agree to use its interest rates to decrease short-term flows from the United States. Third, Canada must ensure that Canadian banks would not "actively seek" additional United States dollar deposits. Finally, Canadian banks

⁵ R.B. Bryce, Memorandum for A.F.W. Plumptre, 21 January 1964, RG 19, Vol 5713, File 2070/U70-3, NAC.

ought not to withdraw funds from their United States operations to make loans in Europe.⁶

Canadian officials tried to be helpful. Plumptre reviewed Gordon's recent efforts to convince the provinces to reduce their borrowing during the next two quarters, noting "that moral suasion was being used in Canada more extensively at the present time than at any time since the war." Acknowledging the difficulties that the administration might encounter in justifying the Canadian exemption to Congress, Plumptre announced that Gordon would happily visit Dillon in order to convince senators and congressmen of the importance of the Canadian exemption. The Canadian government was also ready to retire early two outstanding Canadian securities from the late 1950s worth about \$100 million. Lawson assured Deming that Canada was aware of its responsibilities under the 1963 agreement and would use its interest rate structure to ensure that there was no abnormal flow of United States dollars to Canada. However, on the major point around which the discussion revolved for two days - the total volume of anticipated Canadian issues during 1965 - Plumptre and Lawson refused to yield. The deficit on the current account for 1965, they insisted, was expected to reach \$1,000 million, and this would have to be covered by an inflow of United States capital.⁷

⁶ Douglas Dillon, Memorandum for the President, 8 February 1965, White House Central Files (WHCF), Country File: Canada, Box 19, Johnson Library.

⁷ Meeting in the U.S. Treasury, February 3, 1965 and Meeting in the U.S. Treasury, February 4, 1965, RG 19, Vol 4814, File 6285-01, NAC.

Disappointed with the discussions at the official level, Dillon asked the president to intervene directly with Pearson. Johnson was urged to avoid any discussion of specific objectives and to focus on convincing the prime minister to reaffirm "the existing Canadian commitment to avoid excessive borrowing from the U.S." In a telephone conversation with Pearson, Johnson asked him to approve, for inclusion in the president's forthcoming message to Congress on the administration's new balance of payments program, a carefully-worded sentence designed to help the administration "avoid heavy pressure ... to set a strict dollar limit for Canadian borrowings.":

To stop the excessive flow of funds to Canada under its special exemption from the Equalization Tax, I have sought and received firm assurance that the Canadian government will take the steps needed to hold these outflows to levels consistent with that special exemption.

The president told Pearson, inaccurately, that "this language merely affirmed the existing earlier Canadian undertakings."⁸

Neither Gordon nor Louis Rasminsky, the governor of the Bank of Canada, nor Gordon Robertson, the clerk of the privy council, was convinced by Johnson's claim. When Pearson consulted them on the language employed in the American draft, they revised it in order to remove the implication that the present level of borrowing was excessive, and that the Canadian government had failed to

⁸ McGeorge Bundy, Memorandum to the President, 9 February 1965, WHCF, Country File: Canada, Box 19, Johnson Library. Underlined in original. On Johnson's claim about the language, see Gist of conversation between the Prime Minister and the President - February 9, 1965, approximately 4 p.m., Gordon Papers, Vol 8, File: Finance, NAC.

police the 1963 agreement:

To prevent any excessive flow of funds to Canada under its special exemption from the equalization tax, I have sought and received firm assurances that the policies of the Canadian Government are and will continue to be directed toward limiting such outflows to levels consistent with the stability of Canada's foreign exchange reserves.

After slightly altering the paragraph's final phrase, Dillon accepted the sentence as amended.⁹ Whatever the actual language employed in the president's message, it was now clear on both sides of the border that Ottawa would need to be much more vigilant in monitoring the flow of American dollars to and from Canada.

The slate of measures which Johnson unveiled on 10 February 1965 to remedy the United States balance of payments problems had little immediate impact on Canada. The 1963 exemption from the IET on new Canadian securities protected it from the major component of the program, the decision to extend the IET until July 1967. Canada was also exempted from the Department of Commerce's new program asking American corporations to restrain their direct foreign investment voluntarily. Canada was not exempt from the extension of the tax to long-term bank loans and the creation of a voluntary program to limit short-term bank loans, but these channels were not routinely used by Canadians to raise large sums of money in the United States. Similarly, the reduction in the \$100 duty-free allowance enjoyed by returning American tourists was expected to have only a comparatively small impact upon the flow of capital to

⁹ L.B. Pearson, *Mike: The Memoirs of the Rt. Hon. Lester B. Pearson*, Volume 3: 1857-1968 (Toronto, 1975), p. 136.

Canada.¹⁰ However, in a precautionary measure designed simply to safeguard Canada's future position, Gordon warned Dillon that the cumulative impact of these several changes might increase the demand on the Canadian exemption.¹¹ In Washington, where the public response to Johnson's program was "quite reasonable and sympathetic from the Canadian point of view,"¹² American officials assured their Canadian contacts that they understood Gordon's argument and accepted its implications.¹³

For their part, Canadian ministers and officials understood the full implications for Canada of the renewed American drive to slow down the outflow of capital. In order to retain its exemption from the IET, Canada would have to adopt tough measures to ensure that it did not become a gap in the American defences. Within days of the president's statement, Gordon secured cabinet's approval to warn the Canadian banking community not to exploit the new American regulations. The new restrictions placed on foreign lending by United States banks created the possibility that Canadian financial institutions might use their own United States dollar balances to

¹⁰ For the president's message to Congress, see *Public Papers of the Presidents of the United States: Lyndon B. Johnson, 1965, Book II* (Washington, 1966), pp. 170-177; for an assessment of their impact on Canada, see Economic Division, Memorandum for A.E. Ritchie, 10 February 1965, DEA File 36-11-4-1-USA, DFAIT.

¹¹ Walter Gordon to Douglas Dillon, 12 February 1965, RG 19, Vol 4492, File 8092/U58-1, NAC.

¹² Washington to Ottawa, Tel No 568, 23 February 1965, RG 19, Vol 5713, File 2070/U58-3, NAC.

¹³ Washington to Ottawa, Tel No 703, 4 March 1965, RG 19, Vol 4492, File 8092/U58-2, NAC.

take over some of the business given up by their American counterparts. Gordon warned that this "would frustrate the declared intention of the President ... and would undoubtedly raise questions between the U.S. and Canadian Governments." He advised Canadian bankers to "be very careful not to put themselves in a position where any charge of this sort could be levelled against them."¹⁴

The major Canadian banks seemed ready to heed the minister. One was already reported to have stopped soliciting deposits from residents of the United States, and expected its American liabilities to decline sharply.¹⁵ Meanwhile, Canadian and American officials began to explore how to stop Canadian banks and other financial institutions from using the IET exemption to "pass-through" funds from the United States to third countries where the IET would normally apply. The United States, explained Volcker, hoped that as their liabilities to American residents came due, Canadian banks would meet these payments partly by liquidating some of their American assets and partly by liquidating their overseas assets. As Merlyn Trued, the assistant secretary of the treasury for international transactions, put it, the United States wanted "an undertaking that Canadian banks will not shorten their U.S.

¹⁴ A.F.W. Plumptre, Memorandum to the Minister and attachment, 11 February 1965, RG 19, Vol 4492, 8092/U58-2, NAC.

¹⁵ Meeting with Treasury and Federal Reserve Representatives - Washington - March 3, 1965, RG 19, Vol 4492, File 8092/U58-1, NAC.

position."¹⁶

Canadian officials objected to the American suggestion. The government had no legal authority to intervene in Canadian banking operations to that extent. More important, contended Alan Hockin, who succeeded Plumptre as the assistant deputy minister of finance responsible for this portfolio, the banks' assets in the United States usually represented their most liquid American dollar resources. They would want to protect this liquidity by drawing down funds in Europe to meet "some or all of any decline in their dollar deposits from the U.S."¹⁷ It was precisely this liquidity and its potential for transfer outside the United States that was the problem. This potential gap in the American regulations could be overcome by advising "Canadian banks to the effect that, at a minimum, any decline in their assets in the U.S. should not exceed any decline in their liabilities to U.S. residents."¹⁸ Officials from the Bank of Canada and the Department of Finance tried to develop a formula that would preserve for the banks some measure of liquidity in their U.S. assets, but this proved too difficult and

¹⁶ Meeting with Treasury and Federal Reserve Representatives - Washington - March 3, 1965, RG 19, Vol 4492, File 8092/U58-1, NAC.

¹⁷ Paul Volcker to A.F.W. Plumptre, 6 March 1965, RG 19, Vol 4492, File 8092/U58-2; See also Meeting with Treasury and Federal Reserve Representatives - Washington - March 3, 1965, RG 19, Vol 4492, File 8092/U58-1, NAC.

¹⁸ Paul Volcker to A.F.W. Plumptre, 6 March 1965, RG 19, Vol 4492, File 8092/U58-2, NAC.

they agreed to accept the American proposal.¹⁹ In early April, Gordon asked Canadian bankers to ensure "that the net position in U.S. dollars of your head office and Canadian branches vis-à-vis residents of the United States is not reduced below the position which existed on December 31, 1964."²⁰

The American desire to tighten up the Canadian exemption had a second important consequence. In mid-February, the United States renewed its suggestion (first presented in September 1963 as part of George Ball's package of reforms designed to integrate the two economies) for a joint committee, at the assistant deputy minister or under-secretary level, to keep balance of payments questions under review. "An important aim of the committee," noted Francis Linville, economic counsellor at the American Embassy in Ottawa, "should be to prevent problems from arising insofar as possible through regular full discussions and exchanges of views, rather than by depending, as we have done in the past, on ad hoc meetings

¹⁹ Draft Report of the Working Party on Ways in Which Canadian Banks Might be Asked to Co-operate with U.S. Balance of Payments Measures, 10 March 1966, RG 19, Vol 4492, File 8092/U58-2, NAC.

²⁰ W.L. Gordon to G.A.R. Hart, President, Bank of Montreal, 1 April 1964, RG 19, Vol 4492, 8092/U58-1. Gordon specifically asked:

In more detail, I am asking that the total claims of Canadian offices on residents of the United States, including your own U.S. agencies and branches, less deposit liabilities due to residents of the United States, be not diminished if it is a net asset position and be not increased if it is a net liability position."

after problems have arisen."²¹

The reaction in Ottawa to this suggestion was far from enthusiastic. Officials in several departments worried that the committee might give the United States too much influence on Canadian fiscal and monetary policy. They especially feared that such a committee might allow the United States to survey closely Canada's capital account and reserves, and implied a commitment to consult Washington before taking any decisions which might affect Canada's balance of payments position vis-à-vis the United States. In addition, officials were inclined to question the committee's usefulness in view of the two countries' very different payments outlook: while the United States would tend to dwell on the outflow of dollars to Canada, Canadian officials would focus on their country's current account deficit.²²

Despite these reservations, Ottawa realized that it could not oppose the American request without jeopardizing its exemption from Washington's balance of payments measures.²³ Canadian officials therefore tried to narrow the committee's terms of reference. After lengthy inter-departmental consultations, Ed Ritchie, the associate under-secretary of state for external affairs, suggested to

²¹ Francis Linville to A.E. Ritchie, 8 February 1965, Rasminsky Papers, Box 48, File 76-370, BCA.

²² J.R. McKinney, Memorandum for A.E. Ritchie, 12 March 1965, DEA File 36-11-4-USA. Arnold Heeney, then in the concluding stages of preparing his report on the bilateral relationship, also opposed the creation of any new machinery.

²³ On Gordon's decision to meet the American request, see R.B. Bryce to Alan Hockin and Wynne Plumptre, 18 February 1965, RG 19, Vol 5713, File 2070/U70-3, NAC.

Linville that the committee "review developments in the balance of payments on current and capital accounts between Canada and the United States and ... [discuss] payments problems which may arise therefrom."²⁴ United States officials were not fooled, rejecting Ritchie's draft terms of reference as too narrow and unduly limited to bilateral matters. Canada was reluctantly forced to accept a committee broadly charged "to review developments in the balance of payments of the United States and Canada and to discuss problems of mutual concern which may arise therefrom."²⁵

The balance of payments committee met for the first time in Washington on 26 July 1965 and provided both countries with an opportunity to review the bilateral balance of payments situation. The outlook was not reassuring. American officials were worried by their balance of payments figures for the remainder of 1965. Johnson's February payments program had succeeded so quickly that there was left little room for further improvements in the second half of the year. To complicate matters, Canadian officials admitted that Canada's current account deficit for 1965 might possibly exceed \$1.2 billion. American officials warned that this might "over-load" the Canadian exemption, but appeared to relax a little when they were assured that Canadian reserves were not

²⁴ A.E. Ritchie to Francis Linville, 18 June 1965, DEA File 36-11-4-1-USA, DFAIT.

²⁵ Francis Linville to E.A. Ritchie, 14 July 1965 and E.A. Ritchie to Francis Linville, 22 July 1965, DEA File 36-11-4-1-USA, DFAIT.

expected to increase.²⁶

By the early fall, American concern had reached new heights. United States officials hinted of potential bilateral trouble in discussions with the Canadian delegation to the annual IMF meeting in early October. The volume of new Canadian securities issued in 1965 coupled with an increase in Canada's reserves levels was beginning to worry the Treasury Department.²⁷ The extent of Washington's concern, which was compounded by growing evidence that the "pass-through" problem was greater than ever, was revealed in late October. In a meeting with Steven Handfield-Jones, the Canadian Embassy's economic counsellor, Widman announced that the Treasury Department had examined the deteriorating balance of payments situation and attributed a good deal of the blame to Canada, whose reserves had increased by \$200 million in the third quarter alone. That figure, which was expected to grow in the final quarter, probably under-estimated the impact of Canadian transactions on the United States balance of payments position. Canadian insurance companies, which were exempt from the IET, had developed a lucrative business in the "pass-through" field.

Widman emphasized the importance attached to this whole problem in Washington. The Treasury Department was reviewing Canada's exemption from the guidelines on long-term securities

²⁶ Briefing for [the] Meeting between the Hon. W.L. Gordon and the Hon. H.H. Fowler, 30 July 1965, RG 19, Vol 4492, 8092/U58-2, NAC.

²⁷ A.B. Hockin, Memorandum for R.B. Bryce, 5 October 1965, RG 19, Vol 5713, File 2070/U70-3, NAC.

issued by American non-banking financial institutions and re-examining the priority given to Canada in the over-all guideline targets. Still more disturbing, the United States had begun to explore circumstances under which the Canadian IET exemption might be withdrawn altogether. While this review proceeded, Widman insisted that something must be done before the end of the fourth quarter and the November 19 meeting of the balance of payments committee.²⁸ In order to remove any lingering doubts in Ottawa about the seriousness with which the United States viewed the situation, Johnson asked Rusk to call Pearson to urge immediate bilateral discussions.²⁹

On 28 October 1965, Hockin and Handfield-Jones met with a strong delegation from the Treasury Department that included Deming, Joseph Barr, the special assistant to the secretary of the treasury, and Stanley Surrey, the assistant secretary of the treasury for tax policy. Barr and Deming briefly reviewed the deteriorating American balance of payments situation, which they felt had been exacerbated by the unexpected volume of new Canada securities and the continuing "pass through" problem. Aware of the difficulties created by the Canadian election scheduled for 8 November, the United States did not wish to explore Canadian-American balance of payments in detail. The real need was for immediate action to salvage fourth quarter figures. The United

²⁸ Washington to Ottawa, Tel No 3381, 22 October 1965, RG 19, Vol 4492, File 8092/U58-1, NAC.

²⁹ R.B. Bryce, hand-written notes dated 25 October 1965, RG 19, Vol 5713, File 2070/U70-3, NAC.

States suggested that Ottawa join it in asking Canadian borrowers to defer any new issues until the new year. Hockin agreed that a sixty day deferment might be possible and was certainly "preferable to action of a more open-ended nature." Ominously, the officials from the Treasury Department declined to indicate what further, long-term, changes in policy might be necessary to ease the American balance of payments problem.³⁰

Although willing to accede to the American request, both the prime minister and the minister of finance were anxious that balance of payments questions not become an election issue.³¹ On 1 November 1965, the Conservative Party leader, John Diefenbaker, had attacked the government for its July 1963 agreement on reserve levels, and it was still echoing through the Department of Finance. Gordon worried that an approach to Canadian borrowers might raise doubts about the stability of the U.S. and Canadian dollars, and spark a currency crisis in the final week of the election campaign. Henry Fowler, the secretary of the treasury, agreed and accepted Gordon's claim that "he would be in a better position to bring his influence to bear next week immediately after the election."³²

³⁰ Washington to Ottawa, Tel No 3450, 29 October 1965, RG 19, Vol 4492, File 8092/U58-1, NAC; See also, A.B. Hockin, Memorandum for R.B. Bryce, 25 October 1965, *ibid*.

³¹ R.B. Bryce, Notes dated 25 October 1965, RG 19, File 2070/U70-3, NAC; See also, Deferral of New Canadian Securities, [November 1965], RG 19, Vol 4492, File 8092/U58-2, NAC.

³² For Diefenbaker's criticisms, see *Globe and Mail*, 2 November 1965; See also, R.B. Bryce, W.L. Gordon - Notes of call with Fowler in Notes dated 25 October 1965; [R.B. Bryce] Notes for Conversation with Deming, 2 November 1965; R.B. Bryce, Memorandum for the Minister, 4 November 1965, RG 19, Vol 5713, File 2070/U70-

With the timing settled, Gordon agreed to help persuade the "larger Canadian borrowers" to defer their new securities on the understanding that the deferral was only temporary and the United States would take no action that would prevent them from issuing new securities in early 1966. The American undertaking, which was confirmed the following day in a conversation between Deming and R.B. Bryce, the deputy minister of finance, was not as unequivocal as the Canadian authorities might have wished. "[I]n general," Deming commented, the United States "did not contemplate any new action aimed at Canadian new issues. There is nothing in the mill of that nature there." There was no question, however, of delaying the project while this was resolved. Although Deming was "friendly and understood the difficulties involved in this operation," the under secretary "was firm about [its] necessity." He even insisted that Ottawa approach "relatively small borrowers ... including municipalities."³³

The operation went almost perfectly. Over the weekend of November 5-6, Rasminsky and Bryce put the finishing touches on a complex plan to ensure short-term bridging funds for the Canadian borrowers who were to defer their issues.³⁴ On Tuesday, 8 November, Gordon called the assorted borrowers, while officials from the Bank

3, NAC.

³³ R.B. Bryce, Memorandum to the Minister, 4 November 1965, RG 19, Vol 5713, File 2070/U70-3, NAC.

³⁴ R.B. Bryce, Memorandum for the Minister, 5 November 1965; R.B. Bryce to Walter Gordon, 6 November 1965, RG 19, Vol 5713, File 2070/U58-3, NAC.

of Canada approached the Canadian securities dealers. Only Quebec objected. When contacted by Gordon, Jean Lesage, the Quebec premier, renewed his complaints of a year earlier. Lesage, Bryce noted at the time, was "in one of his impossible moods" and was "thoroughly unreasonable." He initially insisted that Quebec would take whatever American money it required.³⁵ Although the Quebec premier was finally persuaded not to issue Hydro Quebec's new securities until January, he dispatched a senior economist, Jacques Parizeau, to Ottawa later that month to register Quebec's concern at the sudden and capricious manner in which the provinces were denied access to the American capital market. In contrast to the previous year's exercise, Parizeau described the recent experience as a "traumatic" one, which had forced Quebec to "run great risks of damaging their credit [sic]."³⁶

For the time being, however, the Department of Finance could afford to ignore Parizeau's complaints about the restrictions on American capital. The deferment exercise appeared to satisfy the United States, whose preliminary third quarter balance of payments figures were much better than originally anticipated. While the Treasury Department continued to study how to strengthen the country's balance of payments guidelines - examining the Canadian exemption on direct investment as well as the continuing "pass-through" problem - American officials reassured their counterparts

³⁵ R.B. Bryce, [Notes on Walter Gordon's lunch with Lesage], 8 November 1965, RG 19, Vol 2070/U70-3, NAC.

³⁶ R.B. Bryce, Memorandum for Mitchell Sharp, 15 November 1965, RG 19, Vol 5713, File 2070/U79-3, NAC.

in the Canadian Embassy "that the IET exemption was not being questioned."³⁷

The outlook changed completely within days. On their way to the second scheduled meeting of the bilateral balance of payments committee in November, Trued and Andrew Brimmer, the assistant secretary of the treasury, met privately with Hockin and Ritchie. After reviewing the poor American balance of payments situation, the two Washington officials revealed that they were contemplating a new series of balance of payments guidelines. Two measures, about which they wished to receive Ottawa's comments in advance, would have a direct impact on Canada. The general guidelines on direct foreign investment were to be replaced by ones with "explicit targets" for individual companies. American corporations would only be allowed to increase their direct foreign investments in 1966 by a limited percentage increase over a base period. The existing guidelines, which encouraged the repatriation of profits and short-term assets, would be included in the amended regulations, and Canada would no longer be exempt.³⁸

Changes contemplated in the rules governing the purchase of new securities with an initial term to maturity of over 10 years were even more disturbing. The United States planned to restrict the volume of new securities purchased by individual financial institutions in the United States. Each company would be allowed a

³⁷ Washington to Ottawa, Tel No 3629, 16 November 1965, RG 19, Vol 4492, File 8092/U58-1, NAC.

³⁸ A.B. Hockin, Memorandum for Mr. Sharp, 22 November 1965, RG 19, Vol 4492, File 8092/U58-2, NAC.

certain percentage increase, which was non-transferable, beyond a base period. The total effect would be to reduce portfolio investment outside the United States by \$200 million. The impact of this reduction would not be uniform. American officials expected that countries like Canada, which were exempt from the IET and were therefore especially attractive destinations for American capital, would receive most of the allowable increase and emerge untouched. Western Europe, on the other hand, would experience a net loss in American portfolio investment.³⁹

In Ottawa, where this information was a closely-guarded secret, the reaction was profound shock. The guidelines on direct investment were burdensome, but they could be absorbed without too much difficulty. The restrictions on new securities seriously threatened the Canadian economy. Although Washington had clearly tried to keep the Canadian need for capital in mind while they drew up its payments measures, it failed to understand (as it had in July 1963) that any limit, however hypothetical, on the amount of new Canadian issues might provoke doubt among investors about American willingness to support the Canadian dollar. Rasminsky, Bryce and Sharp, the acting minister of finance, speculated that the decision to limit new securities was "very likely to cause immediate and serious trouble in our capital markets with the possibility of an exchange crisis such as we suffered in July

1963."⁴⁰ Ritchie alerted his minister, Paul Martin, to impending trouble. "While it would be in Canada's interest to cooperate as far as practicable [sic] in supporting efforts to maintain the strength of the United States' dollar, the proposed new measures would seem to be asking too much."⁴¹

Over the weekend, Pearson and Sharp decided to send Bryce and Rasminsky to Washington on Monday morning to outline the Canadian problem to Deming, Trued and William Martin, the chairman of the Federal Reserve Board. As a matter of tactics, they agreed that the two officials would object to the guidelines on direct investment, but that they would not press this point. Bryce and Rasminsky would concentrate instead on the limits to be placed on long-term foreign investment by non-banking financial institutions. The two men would also underline the danger to the Canadian dollar and review the reasons why the United States agreed to give Canada an unlimited exemption from the IET in July 1963.

There was, agreed the small group of officials and politicians in Ottawa, a better and safer way for the United States to meet its objectives. In exchange for assurances that "access to U.S. markets of Canadian issues exempt from the IET would be permitted without restriction, and that investors could buy such Canadian issues in accordance with ordinary market judgements," Ottawa was prepared to

⁴⁰ R.B. Bryce, Notes for telephone conversation with Mr. Deming, Under-Secretary of the Treasury, 20 November 1965, RG 19, Vol 4492, File 8092/U58-2, NAC.

⁴¹ A.E. Ritchie, Memorandum for the Minister, 20 November 1965, DEA File 36-11-4-1-USA, DFAIT.

buy from American holders enough Canadian securities held in the United States to keep its reserves at an agreed level. To sweeten this deal, Bryce and Rasminsky were to offer several additional concessions. As additional help to the United States and as "visible evidence of our confidence in the dollar," Canada would sell Washington \$200 million worth of gold from its reserves at the official price of U.S. \$35 per ounce. At the same time, Ottawa would refrain from purchasing American gold during 1966. The government would also ask Parliament to permit it to hold short-term United States dollar bonds issued by the International Bank for Reconstruction and Development in its Exchange Fund in order to relieve even more of the pressure on Washington. Finally, the two Canadians would offer to reduce Canada's reserves from the agreed level of \$2692 million to \$2600 million.⁴²

The meeting with senior officials from the Treasury Department and the Federal Reserve Bank went well. Bryce and Rasminsky reviewed the initial justification for the unlimited exemption from the IET and met no opposition from the American delegation. As soon as Bryce revealed that the government was prepared to purchase outstanding Canadian securities held in the United States in order to maintain reserves at an agreed level, the two groups of American officials appeared to fall into line. Indeed, Bryce later reported

⁴² R.B. Bryce, Memo of Points for Discussion re New U.S. Balance of Payments Measures, 20 November 1965, RG 19, Vol 4492, File 8092/U58-2, NAC; [R.B. Bryce], Notes for Discussion with U.S., 22 November 1965 and L. Rasminsky, My Talking Notes on Points 4 & 7 of R.B. Bryce's Memo of 22 November 1965, Rasminsky Papers, LR76-367, Box 48, BCA.

to his minister that "it was evident that we were likely to get what we wanted without mentioning our intentions with regard to gold."⁴³ To be on the safe side, he offered to sell the United States \$200 million worth of gold over the next six to eight months. The two sides concluded their discussions by agreeing that Canada would try to reduce its reserves from \$2692 million to \$2600 million during 1966.

The government was sanguine when the revised American balance of payments program was announced on 5 December 1965.⁴⁴ In addition to securing an exemption from the new measures on Canadian securities, the Department of Finance had (as it had the previous February) played a role in drafting the statement's references to Canada. American investors were specifically reassured that they could continue to purchase new Canadian securities "on the basis of market considerations."⁴⁵ Moreover, as it turned out, the measures governing direct investment for the two year period of 1965-66 were sufficiently generous that Canada would probably not even need the limit allowed it for 1965.⁴⁶ When he responded in public to the

⁴³ R.B. Bryce, Memorandum to Mr. Sharp, 3 February 1966, Rasminsky Papers, LR76-369, Box 48, BCA; on this meeting, see also R.B. Bryce's hand-written notes, For Deming et al, 22 November 1965, RG 19, Vol 4492, File 8092/U58-2, NAC.

⁴⁴ *Public Papers of the President of the United States: Lyndon B. Johnson, 1965, Book II* (Washington, 1966), pp. 1135-37.

⁴⁵ [R.B. Bryce], Suggested Revision in U.S. Draft Statement, 30 November 1965 and marginalia on attached note to Mr. Sharp, RG 19, Vol 4492, File 8092/U58-2, NAC.

⁴⁶ R.G. Miller, Memorandum for C.L. Read, 7 December 1965, RG 19, Vol 4492, File 8092/U58-2, NAC. Under the American program, direct investment during 1965 and 1966 was limited to 90 percent of

American announcement, Sharp therefore emphasized the government's success in securing continued access to the American capital market. He complained only in the most guarded tones about the direct investment guidelines, noting that these were generally consistent with the government's own policy of reducing the level of American direct investment in Canada.⁴⁷

Ottawa's moderate response to the new guidelines on direct investment, though appreciated in Washington, under-estimated the growing concern in some Canadian quarters over the price being paid for unimpeded access to American capital.⁴⁸ Eric Kierans, Quebec's minister of health and its acting minister of revenue, contended that the guidelines represented an extra-territorial extension of American jurisdiction. After studying the American program for two weeks, Kierans denounced the federal government in an interview with *The Globe and Mail* on 24 December for selling Canada short. "[I]nstead of boasting about how much they managed to salvage, they should have told the Americans to go ahead and impose their tax."⁴⁹ Rasminsky tried to restrain Kierans in a lengthy telephone conversation, explaining that the government had accepted the guidelines to ensure access to American capital and arguing that

total direct investment in the period 1962 to 1964.

⁴⁷ Peter C. Newman, *The Distemper of our Times* (Toronto, 1968), pp. 410-11; see also, John Saywell (ed.), *The Canadian Annual Review for 1965* (Toronto, 1966), p. 350.

⁴⁸ Merlyn Trued to Alan B. Hockin, 21 December 1965, RG 19, Vol 4490, File 8070/U58-4-1, NAC.

⁴⁹ *Globe and Mail*, 24 December 1965.

"you people in Quebec should know we are doing this particularly for you."⁵⁰ Kierans was not convinced by this reference to the recently deferred Hydro Quebec issue and told a friend "that he regarded this issue as the greatest threat to Canadian independence since the War of 1812."⁵¹

Kierans opposed the measures for two reasons. In the first instance, they directed American subsidiaries operating abroad to raise capital locally whenever possible instead of seeking money in the United States. This placed an added burden on the already overloaded Canadian capital market. In addition, to the extent that American subsidiaries followed the guidelines in raising capital or in repatriating profits, they would no longer be acting as independent businesses but as arms of the United States government. On 4 January 1966, the combative Kierans wrote directly to the American secretary of commerce, J.T. Conner, to complain:

This program would have 'an impact' on Canadian and Quebec priorities....Subsidiaries in Canada and Quebec are Canadian and as such are subject to our laws and are expected to collaborate in the attainment of Canadian and Quebec economic objectives....It has always been understood...that foreign capital and corporations are subject to the political authority and direction of the host country not of the home government.⁵²

Kierans' letter was immediately the centre of controversy. The

⁵⁰ Peter Strusberg, *Lester Pearson and the American Dilemma* (Toronto, 1980), p. 226.

⁵¹ Peter C. Newman, *The Distemper of Our Times*, p. 411. This episode played an important part in shaping Kierans' nationalism. See Jamie Swift, *Odd Man Out: The Life and Times of Eric Kierans* (Toronto, 1982), pp. 136-38, 141-47.

⁵² Eric Kierans to J.T. Conner, 4 January 1966, RG 19, Vol

prime minister was livid. He publicly berated the Quebec minister and described his letter as "highly irregular."⁵³ Nevertheless, there was considerable support in some parts of the country for the substance of Kierans' argument. *The Toronto Star*, for instance, pointed out that "Mr. Kierans had something pertinent to say, and he has said it with more clarity and force than the Pearson government has lately been able to muster on the subject of foreign investment and the conduct of foreign-owned companies in this country."⁵⁴

The IET exemption was also under attack on a different front. The Canadian economy had expanded steadily throughout 1965 and by mid-summer there were already signs that it had reached its capacity in some parts of the country and that inflationary pressures were becoming a problem. The consumer price index, for example, rose from 136.9 in January 1965 to 140.2 in November.⁵⁵ During the same period, the seasonally-adjusted national unemployment figures declined from 4.3 percent to 3.6 percent. The decline was more precipitous in industrial Ontario and British Columbia and in the booming western provinces, where the spectre of a labour shortage loomed by the end of the year.⁵⁶ In contrast, the American economy grew more slowly and the Federal Reserve Bank

⁵³ John Saywell (ed.), *The Canadian Annual Review for 1966* (Toronto, 1967), p. 209.

⁵⁴ *The Toronto Star*, 10 January 1965.

⁵⁵ John Saywell (ed.), *The Canadian Annual Review for 1965*, p. 312.

⁵⁶ *Ibid.*, p. 318.

continued to set low interest rates to stimulate growth.

Bound by the 1963 agreement on reserve levels, the Bank of Canada was unable to increase its interest rates to curb the inflationary pressures in the Canadian economy without attracting additional United States dollars and adding excessively to its reserves. The time had come, argued at least one influential observer, for Canada to free its monetary policy from this American albatross. Earle McLaughlin, the president of the Royal Bank of Canada, used his annual address to his shareholders to call upon the government to surrender its exemption and use the resulting freedom to pursue a monetary policy that would combat domestic inflation.⁵⁷

The government flatly rejected McLaughlin's prescription. His assumptions - that Canada would continue to have free access to American capital and that Ottawa could add to its exchange reserves (as appropriate in an inflationary period) - were wrong. If Canada gave up the exemption, maintained the assistant deputy minister of finance, Canadian borrowers in the United States would not only be subject to the original IET but would, under the latest guidelines, face actual limits on the amount of money that they could borrow. These conditions would almost certainly spark a stampede to the American market and "very unstable conditions in the Canadian market." In addition, the United States was unlikely to allow Canada to build up its exchange reserves and, as a result, "the

⁵⁷ John Saywell (ed.), *The Canadian Annual Review for 1966*, p. 297.

central bank would still need to implement monetary policy with regard to the capital flows between Canada and the United States." In any event, the recent decision to buy and sell Canadian securities in order to keep reserves at the agreed level would reduce the government's dependence on interest rates and give it some modest room to adjust monetary policy if necessary.⁵⁸

It was less easy for the government to dismiss the arguments advanced by Kierans and his nationalist allies. Cabinet ministers moved quickly to reassure Canadians that the guidelines would have very little impact. Sharp, admitting that the government agreed with some of the points made by Kierans, promised to act quickly if the American guidelines threatened "to affect Canadian industry and our balance of trade."⁵⁹ At the same time, the minister of trade and commerce, Robert Winters, asked the heads of sixteen of the largest American subsidiaries operating in Canada to meet with him to discuss the potential impact of the guidelines on their operations. The meeting provided the government with another opportunity to reassure the public. In a press statement released after the gathering, Winters said that the discussion had produced "no evidence that to date the application of the guidelines by U.S. parents ... had impinged on the Canadian companies' normal pattern

⁵⁸ A.B. Hockin, Memorandum for R.B. Bryce, 17 January 1966, RG 19, Vol 4492, File 8092/U58-2, NAC; Also see Sharp's statement in the House of Commons, 2 February 1965

⁵⁹ Canada, House of Commons, *Debates*, 2 February 1966, pp. 605-06 and 617-20.

of procurement and trade."⁶⁰

While this was certainly true, the meeting also revealed that there was a great deal of uncertainty among the representatives about the future impact of the guidelines.⁶¹ The government's growing unease over the guidelines was reinforced by the widespread attention that Kierans' views continued to attract across the country.⁶² During a visit to Washington in mid-February, Martin complained about the "extra-territorial flavour" of the guidelines and suggested to Rusk that their application to Canada would not improve the United States balance of payments position as "a change in the flow of capital must be offset by a change in our trade balance."⁶³ The Canadian foreign minister made it clear that the guidelines would be discussed again at the forthcoming meeting of the Canada-United States Ministerial Committee for Trade and Economic Affairs, a gathering to which Canada increasingly "attached a great deal of significance."⁶⁴

The United States did not approach the 10th joint ministerial

⁶⁰ Press Release attached to Minutes of Meeting with Heads of Canadian Subsidiaries of United States Companies Concerning the Impact of the United States Balance of Payments Programme, 7 February 1966, RG 19, Vol 4901, File 8092/U58-2, NAC.

⁶¹ Minutes of Meeting with Heads of Canadian Subsidiaries of United States Companies Concerning the impact of the United States Balance of Payments Programme, 7 February 1966, RG 19, Vol 4901, File 8092/U58-2, NAC.

⁶² John Saywell (ed.), *The Canadian Annual Review for 1966*, p. 299.

⁶³ Marcel Cadieux, Memorandum for the Minister, 17 February 1966, DEA File 26-11-4-1-USA, DFAIT.

⁶⁴ *Ibid.*

meeting on economic relations with the same degree of interest. "The U.S.," a State Department briefing paper noted "has, at the moment, no trade or economic problem with Canada that is of major importance and has, therefore, little of a concrete nature to gain from this Meeting."⁶⁵ Nevertheless, the United States was still anxious to resolve the continuing "pass-through" problem, which it had raised briefly at the November 1965 meeting of the balance of payments committee. At that meeting, Trued had provided Canadian officials with a confidential Treasury Department study of the question. The United States had no idea of the exact size of the problem, but its officials had unearthed a long list of strategies involving Canada which were being used to circumvent the IET. These ranged from simple transactions through which American corporations ostensibly borrowed money in the United States for their Canadian subsidiaries to more complicated arrangements in which American pension funds deposited money with Canadian non-banking financial institutions, which in turn invested that money in Europe.⁶⁶

As Canadian officials studied the "pass-through" difficulties, the Treasury Department tried to curb the problem unilaterally. In mid-January, the Department of Finance learned that the United States had warned the Sun Life Insurance Company against proceeding with its plan to invest its reserve of United States dollars in

⁶⁵ Joint United States-Canadian Committee on Trade and Economic Affairs: Scope Paper, 25 February 1966, *Freedom of Information Act (FOIA) Request 9202777*.

⁶⁶ U.S. Treasury Department, *The Channelling of U.S. Capital to and through Canada*, 18 November 1965 and Lawson, *Note on the Pass-Through Question*, Bank of Canada Records, File 297-2-1, BCA.

Euro-dollars.⁶⁷ In view of the continuing furore over the guidelines on direct investment, this evidence of Washington's continued interest in eliminating the "pass-through," added to Sharp's anxieties:

I find this troublesome. For the U.S. government to direct a Canadian company in the investment of its own funds even if they are held in the U.S. is a provocation which if it were known could arouse protests in Canada and might lead to demands that we should direct Canadian subsidiaries on the investment of their reserves accumulated out of their Canadian operations.⁶⁸

Ottawa was more directly apprised of Washington's desire to solve this problem a few days later when Trued asked the Department of Finance to stop Canadian companies from selling their holdings of United States corporate securities and using the proceeds to invest in securities issued by American subsidiaries in Europe. "[T]his would amount to requesting these institutions," he wrote, "not to shorten their position vis-à-vis the United States."⁶⁹ Hockin was prepared to comply immediately with the American request because in his view it was relatively narrow in scope and did not ask Canada to influence "the investment of funds which have not hitherto been invested in U.S. dollar securities in the U.S."⁷⁰ However, in the Department of External Affairs, Ritchie proposed

⁶⁷ A.B. Hockin, Memorandum for R.B. Bryce, 17 January 1966, RG 19, Vol 4492, File 8092/U58-2, NAC.

⁶⁸ Sharp's marginalia on *ibid*.

⁶⁹ Merlyn Trued to Alan Hockin, 19 January 1966, RG 19, Vol 4492, File 8092/U58-2, NAC.

⁷⁰ A.B. Hockin, Memorandum for Mr. Bryce, 24 January 1966, RG 19, Vol 4492, File 8092/U58-2, NAC.

holding up a response to the American proposal until ministers had discussed the entire question of guidelines at the forthcoming ministerial meeting. The minister of finance agreed, recognizing that the American request provided Canada with some slight leverage in its fight against the guidelines on direct investment and suggested that Canada might "be willing to agree to issue guidelines to Canadian firms in return for an exemption for Canada from US guidelines."⁷¹

At the March 1966 meeting of the United States-Canada Committee on Trade and Economic Affairs, ministers and officials from the two countries patched together an informal arrangement which permitted both governments to avoid any further bilateral and domestic difficulties over the American guidelines. The basis of the deal was largely worked out by Canadian officials in the week before the March meeting. Canadian ministers undertook to stop the "pass-through," although the government's effort was designed to look as if it was protecting the Canadian capital market from the effects of the American guidelines rather than the exchange market. On his return to Ottawa, Sharp asked Canadians to restrain their borrowing abroad in the national interest:

To help ensure that Canadian savings are available to meet the present large demands for capital in Canada, the Government is asking all Canadian investors, including financial institutions such as the banks, life insurance companies, and trust and loan companies, as well as other corporations, pension funds and individuals, not to acquire securities, denominated in Canadian or U.S. dollars, which are

⁷¹ Sharp's marginalia on *ibid.*

subject to the U.S. Interest Equalization Tax if purchased by U.S. residents.⁷²

In exchange for this gesture of support in combatting the "pass through" problem, the United States delegation agreed to include in the ministerial meeting's final communiqué an interpretation of the guidelines that would help Ottawa deflect the kind of criticism levied by Kierans and other nationalists:

The United States members made clear that the U.S. government was not requesting U.S. corporations to induce their Canadian subsidiaries to act in ways that differed from their normal business practices, as regards the repatriation of earnings, purchasing and sales policies, or their other financial and commercial activities. The U.S. members re-emphasized the view that U.S. subsidiaries abroad should behave as good citizens of the country where they are located.⁷³

At the end of March 1966, the minister of trade and commerce unveiled an elaborate set of "guiding principles of good corporate behaviour."⁷⁴ Winters also planned to ask large and medium-sized

⁷² Mitchell Sharp, Canada, House of Commons, *Debates*, 16 March 1966, pp. 2755-56; On the background to this statement, see R.B. Bryce, Memorandum for Mr. Sharp, 28 February 1966, DEA File 36-11-4-1-USA, DFAIT and R.B. Bryce, Memorandum for Mr. Sharp, 3 March 1966, RG 19, Vol 4901, File 8092/U58-2, NAC.

⁷³ Communiqué from the Joint United States-Canadian Committee on Trade and Economic Affairs, Washington, 4-5 March 1966. The exact process of negotiating the bilateral deal and the communiqué is unclear. There do not appear to have been any records kept of these discussions. The official record of the meeting makes it clear that the issue was discussed primarily outside the meeting. See Joint United States-Canadian Committee on Trade and Economic Affairs, 4-5 March 1966, Draft Summary Record, DEA File 35-4-5-1-1966, DFAIT. A routine follow-up telegram from Washington suggests that a deal along these lines was indeed arranged, but provides no details. See Washington to Ottawa, Tel No 730, 9 March 1966, DEA File 35-4-5-1-1966, DFAIT.

⁷⁴ Robert Winters, Canada, House of Commons, *Debates*, 31 March 1966, pp. 3643 and 3713-14. The 14 individual guidelines urged subsidiaries to adopt a number of policies which would enhance their status as "Canadian" companies. For example,

subsidiaries to provide confidential information on their operations and financing. The government's guidelines were well-received across the country and neatly took much of the sting out of nationalist charges. The *Montreal Gazette*, for example, pointed out that Winters' principles "nullif[ied] the American ones" and made "it plain that as far as these companies are concerned it should be Canada first."⁷⁵

For the remainder of 1966, the reserve agreement worked smoothly and provoked little domestic criticism. In the first three quarters of year, the government purchased \$145 million in Canadian government securities as well as \$23 million worth of bonds from the International Bank for Reconstruction and Development (IBRD). By the end of the year it had sold \$200 million worth of gold to the United States at the official price of U.S. \$35 per ounce.⁷⁶ As a result, Canadian reserves dropped steadily throughout 1966, finally dropping below the agreed target level in August. By November of that year, Canadian reserves had fallen to \$2242 million from \$2681 million a year earlier.

Depleted by the escalating costs of the Vietnam War, Washington's balance of payment figures remained unsatisfactory and

subsidiaries were urged to develop export opportunities, competing where necessary against parent corporations. They were also expected to build manufacturing centres in Canada when appropriate, to undertake local research and development, and to work toward a "Canadian outlook within management."

⁷⁵ Cited in John Saywell (ed.), *The Canadian Annual Review for 1966*, p. 301.

⁷⁶ John Saywell (ed.), *Canadian Annual Review for 1966*, pp. 296-97.

the United States showed no inclination to reduce the pressure on Canada to keep lowering its reserves. Indeed, at the November 1966 balance of payments committee meeting the United States pressed Canada to reduce its reserves by a further U.S. \$500 million. The Treasury Department's assistant secretary for international affairs, Winthrop Knowlton, suggested that the definition of Canadian reserves be revised to include the U.S. \$500 million that Canadian banks held in their international reserves.⁷⁷

The immediate Canadian reaction was negative. For a number of reasons, Ottawa simply was not able to control the banks' reserve position. The banks provided the government with day-to-day short-term reserve flexibility. Canadian officials also wondered how the government could ask the banks to assume a short position on American dollars raised overseas. Far more disturbing, the American suggestion seemed to challenge the nature of the 1963 reserves agreement:

We wondered how well their proposal fitted into the general nature of our bilateral relations. Our common objective as we saw it was to find the means whereby we could have free movement of capital between our two countries and at the same time protect the U.S. balance of payments by ensuring that the net flow of capital from the U.S. to Canada would not be in excess of Canada's requirements. The current U.S. proposal seemed directed in major part at influencing the capital flows in particular channels between the two countries.⁷⁸

The more officials in the Department of Finance and the Bank of Canada considered Knowlton's suggestion, the more problematic it

⁷⁷ R.W. Lawson, Memorandum for the Governor, 11 November 1966, Rasminsky Papers, File LR-76-37, Box 48, BCA.

⁷⁸ *Ibid.*

appeared. The virulent debate over the government's new and controversial Bank Act made it virtually impossible for the Department of Finance to ask the banks to limit their international reserves at this time. Moreover, since the reserve agreement with the United States was concluded in July 1963, Canada's international transactions had increased by roughly 40 percent, reducing the relative value of the country's reserves to a dangerously low level.⁷⁹ In mid-November, Sharp warned Fowler of the Canadian objections. The American cabinet minister reacted with sympathy and his officials quickly abandoned their proposal. In doing so, however, officials in the Treasury Department made it clear that they would like to see Canadian reserves decline by an additional \$200 U.S. million.⁸⁰

American officials continued to use the balance of payments committee to force Canada to monitor ever more closely the flow of capital between the two countries. At the committee's meeting in April 1967, Knowlton revived his earlier suggestion that the net foreign exchange position of Canadian banks be taken into account in defining Canadian reserves, an issue which had become especially important since Congress had begun to consider the White House's request for a further extension of the IET. The Canadian exemption,

⁷⁹ W.A. Kennett, Memorandum to File, 23 November 1966, RG 19, Vol 4901, File 8092/U58-2, NAC; R.W. Lawson, Note on Canadian Reply to U.S. Proposal of November 10, 1966, 31 November 1966, Rasminsky Papers, File LR 76-370, Box 48, BCA.

⁸⁰ R.W. Lawson, Note on Canadian Reply to U.S. Proposal of 10 November, 1966, [31 November 1966], Rasminsky Papers, File LR76-370, BCA; J.F. Grandy, Memorandum for Mr. Bryce, RG 19, Vol 4901, File 8092/U58-2, NAC.

which Dillon had described to Congress in 1963 as normally worth about \$500 million per year was now valued at almost \$1 billion annually and exposed the administration to considerable criticism.⁸¹

Again, Canadian officials rejected Knowlton's suggestion. Canada's reserve position, contended Hockin, was uncomfortably low. The 1963 agreement, he pointed out, was cobbled together quickly with the expectation that American balance of payments difficulties would end shortly. Therefore, it contained no provisions to allow Canadian reserves to grow with the expanding Canadian economy. The logic in the Canadian position was unassailable and the American delegation retreated. Despite Canada's reluctance to reduce its reserves further, Washington generally felt "that the agreement was operating in a satisfactory manner."⁸²

Yet, it was becoming increasingly difficult for Washington to stem the pressure on the dollar in an ordered fashion. In mid-October 1967, the two countries again reviewed bilateral balance of payments figures and agreed that the United States would maintain the Canadian exemption, despite an expected deficit of close to \$1300 million. The Canadian delegation was informed in advance that the 1968 balance of payments measures would be tightened, but

⁸¹ Minutes of the Canada-United States Balance of Payments Committee, 27 April 1967, Bank of Canada Records, File INT 4B-312, BCA.

⁸² Joint U.S.-Canada Committee on Trade and Economic Affairs: Operation of U.S.-Canadian Reserve Agreement, 13 June 1967, RG 40, Accession NN3-40-87-1, Box 2, United States National Archives (USNA).

reassured that there were no substantial changes affecting Canada.⁸³ This was confirmed in mid-November when revised guidelines were released to the public.⁸⁴ However, by this time the United States dollar was under tremendous international pressure. On 18 November 1968, the British pound, under siege since late 1966 amid rumours of Britain's retreat from "East of Suez," was devalued. As speculators jumped into the international gold market in the hope that the United States would sever the link between the American dollar and gold's official price of U.S. \$35 per ounce, the United States dollar was placed under enormous strain. During the final six weeks of 1967, Johnson wrestled with the speculative tide. He conferred at length with Congressional leaders in order to determine the price they would extract for a domestic tax increase. Deming was hastily sent to Europe in an effort to garner support for the dollar and the gold pool. By mid-December, the White House was forced to conclude that the payments deficit "threaten[ed] to turn the year into a disaster."⁸⁵

⁸³ Minutes of the Canada-United States Balance of Payments Committee, 18 October 1967, Bank of Canada Records, File 4B-312, BCA.

⁸⁴ A.B. Hockin, Memorandum for the Minister, 17 November 1967, RG 19, Vol 4901, File 8092/U58-2, NAC.

⁸⁵ Diane B. Kunz, "Cold War Dollar Diplomacy: The Other Side of Containment," in her collection, *The Diplomacy of the Crucial Decade: American Foreign Relations during the 1960s* (New York, 1995), p. 106.

To stem the exodus of American dollars, Johnson sent another balance of payments message to Congress on 1 January 1968.⁸⁶ Hastily concocted in secret by Fowler and opposed by a number of his senior officials, the measures were substantially tougher than the earlier versions. The voluntary direct foreign investment guidelines for American corporations were made mandatory and the levels of allowable investment reduced. American direct investment in Canada was limited to 65 percent of the amount invested during 1965-66. The regulations tightened the restraints on lending abroad by banks and other financial institutions, limited foreign travel, and decreased Washington's expenditures overseas. Canada's exemption from the IET, however, protected it from most of these measures.

The president also included in his message a set of measures to improve the competitive position of the United States economy. A small domestic tax increase would supply the administration with greater fiscal capacity. At the same time, inflationary pressures would be curtailed by new wage and price controls. More important, the administration threatened to impose a border tax in retaliation for the European Union's new value-added-tax (VAT) system, which

⁸⁶ *Public Papers of the Presidents of the United States: Lyndon B. Johnson 1968-69* (Washington, 1970), pp. 1-13.

discriminated against American exports.⁸⁷ In addition, Johnson announced a series of measures to encourage American exports.

The administration's program was not a complete surprise to Canada. On the eve of the president's message to Congress, Anthony Solomon, assistant secretary of state for economic affairs, briefed the prime minister, who was vacationing in Florida, before heading to Ottawa to inform Sharp and Canadian officials about the new measures.⁸⁸ Solomon carried with him a warm letter from the president. Johnson reviewed the tumultuous events of the past year, which he characterized as "marked by our traditionally close consultation and cooperation at all levels of government."⁸⁹ He drew particular attention to Canada's work in NATO and in the Kennedy Round, and underlined his gratitude for Canadian efforts in November and December to limit the damage that followed the devaluation of sterling. "I have been particularly gratified by

⁸⁷ On 1 January 1968, West Germany introduced a new system of valued-added taxation which had the effect of imposing an additional 2.4 percent tax on imports. The United States was particularly upset with this development since West Germany was already a creditor nation and seemed bent on improving its competitive position. The West German VAT was permissible under the General Agreement on Trade and Tariffs (GATT) which allowed indirect taxes to be removed from exports and placed on imports. However, the United States did not use indirect taxes and was consequently unable to adjust its taxation policies in a manner consistent with its obligations under the GATT. It proposed instead that West Germany suspend their VAT or that the United States be permitted to introduce either a tax or an export subsidy equivalent to between 2 and 3 percent.

⁸⁸ Ottawa to London, Tel E136, 5 January 1968, DEA File 36-11-4-1-USA.

⁸⁹ L.B. Johnson to Mitchell Sharp, 31 December 1967, DEA File 36-11-4-1-USA.

Canada's staunch support and cooperation at that time." These efforts had not gone unnoticed in the White House, where Canada's need for American capital had been fully understood and taken into account:

In making my decisions, in which you and your country have a vital interest, I want you to know that the effects on Canada are very much on my mind. Your need for a high rate of investment is well understood here, and we have done our best to minimize the effects our new measures will have on your economic progress and development.

The immediate Canadian reaction was positive. In a statement which he subsequently described to the president as "generally helpful," Sharp cautiously welcomed "these further measures to strengthen the United States balance of payments, stop speculation, and maintain confidence in the United States dollar."⁹⁰ He praised American efforts to take into consideration Canada's unique position, and reassured investors that the country retained its exemption from the IET and its unlimited access to American capital. The mandatory guidelines on American direct investment, he added, were not likely to reduce substantially U.S. direct investment in Canada and would permit American subsidiaries to conduct their business "in accordance with normal commercial practices."

During the first few days of the new year, as officials in Ottawa studied the U.S. action in more detail, they discovered no real reason to revise their initial assessment. However, there were

⁹⁰ Mitchell Sharp to L.B. Johnson, 2 January 1968, DEA File 36-11-4-1-USA; See also John T. Saywell (ed.), *Canadian Annual Review for 1968* (Toronto, 1969), pp. 310-311.

aspects of the American actions which bore watching. The Department of External Affairs was worried by the extra-territorial overtones in the mandatory character of the new guidelines on direct investment. While the regulations did not have an extra-territorial quality from a strictly legal point of view, Marcel Cadieux, the under-secretary of state for external affairs, worried that they might cause some American firms to act in a manner which ran counter to government policy and which would effectively diminish Ottawa's jurisdiction:

[S]ome of the features of the United States programme ... may prove controversial in the reaction of the Canadian public. People are particularly sensitive at present to questions of sovereignty, especially because of their relationship to the problem of national unity; hence it might be useful for this aspect of the United States action to be raised at the highest level and in broad political terms.⁹¹

Preliminary talks with State Department officials revealed that they were fully aware of these potential difficulties. They reassured embassy officials in Washington, the United States would apply the guidelines "delicately and with due regard to [the] problems of others, including political problems."⁹² This was welcome news in Ottawa where it was becoming clear that Canada could not afford a jurisdictional dispute with the United States. By the end of the first week of January, Johnson's plan to impose

⁹¹ Marcel Cadieux to R.B. Bryce, 2 January 1968, DEA File 36-11-4-1-USA.

⁹² Marcel Cadieux, Memorandum for the Minister, 11 January 1968, DEA File 36-11-4-1-USA, DFAIT.

a border tax was assuming greater significance.⁹³ As Washington's largest trading partner, Canada would be profoundly affected by the American action: even a small border tax would damage the bilateral balance of trade, upset the country's balance of payments, and weaken the Canadian dollar. Should the United States proceed with its plan, Canada would need to take immediate compensatory action to harmonize its custom and excise regime with Washington's.

In the short-term, the international implications of Washington's proposed tax were even more disturbing. It would almost certainly cause the European Union to retaliate and might spark an "unravelling" of the tariff negotiations agreed to during the Kennedy Round. Indeed, Canadian officials argued that "there is a very great danger that the proposed USA action might disturb irreparably the international trade and payments systems developed since 1945."⁹⁴ Bilateral consultations in the middle of January provided little comfort. Solomon explained to a senior level Canadian delegation, which included Ed Ritchie, now ambassador to the United States, and Maurice Schwarzmann, the deputy minister of trade and commerce, that the European Union would not dismantle its VAT, despite the threatened American border tax. As a consequence, the White House was actively considering a tax adjustment. The assistant secretary of state thought that Europe would probably

⁹³ *Ibid*; see also Marcel Cadieux, Memorandum for the Minister, 10 January 1968, DEA File 26-11-4-1-USA, DFAIT.

⁹⁴ Economic Division, Memorandum to the Under-Secretary of State for External Affairs, 12 January 1968, DEA File 36-11-4-1-USA, DFAIT.

accept the American action and would take no retaliatory measures. He added ominously that the United States would regard such steps as "a declaration of war."⁹⁵

The inflexible American attitude disturbed Canadian officials, who thought that neither the United States nor the European Union fully understood the other's position or the issues at stake. The imposition of a border tax, the Department of External Affairs concluded after taking its own soundings in Europe, was likely to provoke "a very strong reaction."⁹⁶ Canadian officials advised the prime minister to ask the American president to delay acting on the border tax until world-wide balance of payments problems could be considered in their proper context. Isolated from its allies by its pursuit of the unpopular war in Vietnam, the United States seemed in danger of losing touch with world opinion. "In the present international circumstances there does not appear to be any other government in a position to speak frankly to the American Government about their potential effects."⁹⁷ Pearson and his colleagues in cabinet were initially reluctant to advise the White House, but, as the situation worsened, they agreed to act. In the

⁹⁵ R.Y. Grey, Memorandum for Mr. Langley, 15 January 1968, RG 19, Vol 3955, File 8780/U58-2-3, NAC.

⁹⁶ Marcel Cadieux, Memorandum for the Minister, 17 January 1968, DEA File 36-11-4-1-USA, DFAIT.

⁹⁷ *Ibid.*; See also Marcel Cadieux, Memorandum for the Prime Minister, 21 January 1968, DEA File 36-1-4-1-USA, DFAIT; R.Y. Grey, Memorandum for Mr. Bryce, 17 January 1968; and M.A. Crowe, Memorandum to Mr. Grey, and attached Memorandum for Ministers, RG 19, Vol 3955, File 8780/U58-2-3, NAC.

final week of January, Pearson counselled Johnson to seek an international solution to his balance of payments difficulties:

I hope that, if you determine that some action by the United States is required, you will place proposals before the appropriate international bodies for consideration before taking such action. I believe that in this way we can avoid a cumulative process of action and counter-action whose consequences would be very damaging not only to the gains achieved through the Kennedy Round but also to the whole system of international trade and payments created under United States leadership since the war.⁹⁸

Canadian officials continued to monitor closely the White House's deliberations on this issue, but there was no additional action that Canada could take. In any event, their ministers were increasingly preoccupied with Canada's own developing exchange crisis. There were a number of causes for the rapidly weakening Canadian dollar. The American guidelines were partly at fault as United States subsidiaries begin repatriating capital. The looming possibility of border taxes also increased the dollar's instability as American importers refused to negotiate long-term contracts with Canadian suppliers. More important, the government's failure in the November 1967 budget to address the inflationary pressures that threatened Canada's competitive position left the dollar exposed, just as nervous international investors were rebounding from the devaluation of sterling.⁹⁹ These several factors contributed to a gradual, but steady, decrease in the value of the dollar. Despite

⁹⁸ L.B. Pearson to L.B. Johnson, 22 January 1968, Pearson Papers, Vol 281, file 852 Secret, NAC.

⁹⁹ Gerald Wright, *Cooperation and Independence*, pp. 191-93; see also John Saywell (ed.), *The Canadian Annual Review for 1968*, p. 311.

the Bank of Canada's efforts in late 1967 and early 1968 to sustain it (an effort which cost \$350 million dollars), the dollar slipped to U.S. \$91.76 by January 18, its lowest level since 1951.¹⁰⁰ When the market closed for the week, investors began to speculate that the government was planning to devalue the dollar.¹⁰¹

Sharp quickly denied this rumour, but he realized that some more concrete gesture of support for the dollar was necessary. Over the weekend, he and the prime minister agreed to ask Washington for an exemption from the direct investment guidelines. The United States secretary of the treasury, however, refused the Canadian request. After consulting several American corporations with subsidiaries in Canada, Fowler reasonably concluded that there was "no evidence that the pressure on the Canadian dollar was attributable to the direct investment regulations."¹⁰² In the

¹⁰⁰ John Saywell (ed.) *The Canadian Annual Review for 1968*, p. 311.

¹⁰¹ Alan Hockin, Memorandum for the Minister, 18 January 1968, Rasminsky Papers, Box 64, File LR-502, BCA. Hockin was a good deal more complacent than most observers in Ottawa:

We have enormous resources at our disposal to defend the dollar if it should need it. Our reserves have been above the target. We are a substantial creditor of the IMF ... The "swap network" between central banks is very large (\$750 million for Canada) and we could draw on it immediately if we needed to. There was, of course, the whole of our regular position with the IMF. These are very large sums. Anyone who wanted to bet against the house really had the cards stacked against him!

¹⁰² Marcel Cadieux, Memorandum for the Minister, 22 January 1968, DEA File 36-11-4-1-USA, DFAIT. Fowler also arranged for parallel conversations with Peter Towbridge, the secretary of commerce. On these see Jake Warren to R.B. Bryce, 25 January 1968 and attached note on the Discussions in Washington with the Secretary of Commerce ... Concerning Impact on Canada of the New U.S. Balance of Payment Regulations, 22 January 1968, RG 20, Vol

circumstances, he would only agree to issue a statement reminding United States companies that there was no reason for their subsidiaries in Canada to engage "in abnormal transfers of earnings or withdrawals of capital."¹⁰³

With the American statement as a starting point, Sharp and Rasminsky tried to shore up the dollar before the markets opened. On Sunday evening, the Bank of Canada increased its interest rate from 6 to 7 percent. It also asked Canadian chartered banks "to discourage the use of bank credit to facilitate abnormal transfers of funds abroad by Canadian subsidiaries of foreign companies" and to block attempts by subsidiaries "to meet requirements in Canada which have in the past been met by parent companies."¹⁰⁴ The minister of finance addressed the House of Commons early Monday morning, making clear the government's determination to take whatever steps were necessary to defend the dollar.¹⁰⁵

During the course of the following week, these measures helped stabilize the dollar. Nevertheless, the market remained tense and, as the parliamentary secretary to the minister of finance observed, "everyone, including Mike [Pearson] seemed to have the jitters."¹⁰⁶

1640, File 30-33-1, NAC.

¹⁰³ John Saywell (ed.), *The Canadian Annual Review of 1968*, p. 311.

¹⁰⁴ *Ibid.*

¹⁰⁵ Canada, House of Commons, *Debates*, 22 January 1968, pp. 5761-62.

¹⁰⁶ Walter Gordon, Memorandum, 26 January 1968, Gordon Papers, Vol 16, NAC. This memorandum records a discussion with Edgar Benson.

For the government's nationalist wing, the fate of the dollar provided an opportunity to pursue the enduring debate over American control of the Canadian economy. Its cabinet representative, Walter Gordon, the president of the privy council, had come to share the view of some nationalist economists that the government would increase its capacity to pursue made-in-Canada economic policies if it adopted a floating exchange rate. By allowing the value of the dollar to "float" down by two or three percent, the government could pursue its expansive domestic economic policy by encouraging exports at the expense of imports.¹⁰⁷ Gordon, who had pressed Pearson to consider this idea several times during the preceding six months, returned to the attack. At lunch with the prime minister on 31 January, he urged him to convene a small group of senior officials and ministers to consider carefully the "pros & cons of devaluation, or devaluation under IMF auspices & control vis-à-vis a floating rate."¹⁰⁸ Pearson agreed.

Gordon, however, was already being out-manoeuvred. Rasminsky, who had been one of the original architects of the fixed exchange rate in 1962, met the prime minister and a small group of ministers in early February to discuss the crisis. Gordon was not invited. Rasminsky was clearly "very worried." The Bank of Canada's exchange

¹⁰⁷ On the debate over a fixed versus floating exchange rate see A.F.W. Plumptre, *Three Decades of Decisions: Canada and the World Monetary System, 1944-75* (Toronto, 1977), pp. 222-32. Plumptre's Bibliographical Note (pp. 292-98) contains an extensive look at the academic literature on this question.

¹⁰⁸ Walter Gordon to L.B. Pearson, 4 February 1968, Gordon Papers, Vol 14, NAC.

losses in January alone totalled \$350 million or 15 percent of the country's reserves. The central bank could not continue to sustain losses at that rate. "We have shot our bolt and no more help is to be looked for from monetary policy." It was up to the government "to restore confidence that its overall policies will be coherently directed towards arresting erosion in the value of money."¹⁰⁹

Some ministers questioned the program of budget reductions and domestic tax increases favoured by Rasminsky to strengthen the dollar and wanted the government to adopt a floating exchange rate. Rasminsky easily dominated the discussion. The United States, he warned, would certainly not continue to exempt Canada from the IET if the Canadian dollar was allowed to float and to disrupt an important market for American exports. If the dollar continued to weaken, the government should ask the United States to guarantee the Canadian exchange rate.¹¹⁰

While the prime minister weighed the conflicting advice that he had received from Gordon and Rasminsky, the dollar continued to weaken. Figures showing a decline in Canada's reserve levels were released at the end of January and triggered a brief flurry of

¹⁰⁹ L. Rasminsky, Meeting with Prime Minister and Ministers, 4 February 1968, Rasminsky Papers, Box 64, File LR-525, BCA. With the race to succeed Pearson, who announced his decision to retire on 14 December 1967, now in full swing, Rasminsky made a point of remarking that the crisis was "worthy of the concentrated and continuous attention of most senior Ministers."

¹¹⁰ Walter Gordon, Memorandum, 9 February 1968, Gordon Papers, Vol 14, NAC.

speculation against the dollar.¹¹¹ The defeat of the government's anti-inflationary tax bill on 19 February and the subsequent lack of leadership on the government benches sparked a second speculative stir.¹¹² Although neither event provoked an immediate and large outflow of U.S. dollars, the cumulative cost to the Bank of Canada of these depredations was beginning to mount. By February 23, it had spent U.S. \$750 million in support of the Canadian dollar, or just over 30 percent of the country's foreign exchange reserves.¹¹³

Two days later, as the financial crisis gathered momentum, Rasminsky met again with Pearson and a few select ministers and officials. Gordon was not present and again Rasminsky dominated. The banker insisted that the government could not go on defending the dollar indefinitely. The time had come for remedial action. For good reasons, he rejected either devaluing or floating the dollar. Domestically, both courses would lead to sharp increases in the cost of living and to "serious economic dislocation."¹¹⁴ These steps might also provoke other countries to devalue their

¹¹¹ John Saywell (ed.), *The Canadian Annual Review for 1968.*, pp. 312-13.

¹¹² Gerald Wright, "Cooperation and Independence: Canada's Management of Financial Relations with the United States, 1963-1968," (Unpublished Ph.D. thesis, John Hopkins University, 1976) p. 193.

¹¹³ L.R. Rasminsky to Mitchell Sharp, 27 February 1968, Rasminsky Papers, Box 64, File LR-552, BCA.

¹¹⁴ L.R. Rasminsky to Mitchell Sharp, 26 February 1968, Rasminsky Papers, Box 64, File LR-552, BCA.

currencies, renewing pressure on the U.S. dollar and threatening the entire international balance of payments system.

The crisis confronting the government reflected the market's collapsing confidence in the Canadian dollar. Rather than blaming the United States, whose balance of payments program was only a small part of the problem, Rasminsky pointed the finger at Ottawa. The government's own fiscal policies and its inability to address the inflationary pressures in the domestic economy were important factors in the current difficulties. The government needed to reduce expenditures, pass the defeated tax bill, and take steps to control wages and prices. It should also ask Washington to exempt Canada from its balance of payments guidelines on direct foreign investment or, at least, establish Canada as a separate category with a quota of 100 percent of the base period. This would have the effect of further integrating the two capital markets, he emphasized, as Ottawa would need to ensure that the exemption had no impact on the United States balance of payments situation by rigorously adhering to the reserve agreement. Finally, the Bank of Canada could seek a substantial international line of credit.¹¹⁵

Rasminsky's advice was noted and, for the moment, ignored. During the last week of February, the government continued to drift. Neither Sharp nor Pearson wanted to attract the ire of nationalists by appealing to Washington for help. They were equally

¹¹⁵ *Ibid.*

reluctant to adopt Gordon's floating exchange rate.¹¹⁶ The government was finally forced to act, however, when the Bank of Canada lost U.S. \$100 million defending the dollar on 1 March.¹¹⁷ Sharp, who was in Washington for a meeting with the United States secretary of the treasury to reiterate Canada's opposition to the proposed American border tax, asked Fowler for help. He suggested that the United States either exempt Canada from the balance of payments guidelines or establish a separate category for Canada. Fowler admitted that the problem was serious but he, and the White House, remained reluctant to exempt Canada completely from the guidelines. While the administration waited to see how the crisis developed, the Treasury Department lined up international credits for Canada and explored the possibility of issuing a "statement of intent that we would re-examine our investment guidelines for Canada if they were proving to be a serious problem."¹¹⁸

¹¹⁶ Walter Gordon, *A Political Memoir* (Toronto, 1977), p. 309.

¹¹⁷ Walter Gordon, Hand-written Note, 3 March 1968, Gordon Papers, Vol 14, NAC.

¹¹⁸ Walt Rostow, Memorandum for the President, National Security Files (NSF), Country File: Canada, Box 166, Johnson Library. It is not clear from this heavily sanitized document precisely why the United States was not ready to exempt Canada. Possibly, Washington was worried that making an exception of Canada would force the United States to deal with complaints from other countries. Alternatively, Sharp's presentation may not have offered the quid pro quo that Rasminsky suggested in his 25 February presentation. The only Canadian source for Sharp's remarks is a note by Walter Gordon, recording a conversation with Edgar Benson, Sharp's parliamentary secretary. See Walter Gordon, Hand-written Note, 3 March 1968, Gordon Papers, Vol 14, NAC.

The American response to Sharp's entreaties was clearly not going to solve Canada's financial problems. On Sunday, 3 March, Rasminsky, Sharp and Pearson together with their senior officials gathered once more at the prime minister's residence to discuss the situation before the markets opened.¹¹⁹ Rasminsky recommended that the government send him to Washington to negotiate a full exemption for Canada, or at least a special category for Canada with a direct foreign investment quota of 100 percent of the 1965-66 average. He suggested that, in exchange, Ottawa should offer to police the "pass-through" problem rigorously and to hold its reserves in a form which would not constitute a liquid claim on the United States. This time, Rasminsky was authorized to proceed to Washington.¹²⁰

On March 6, after explaining the Canadian position to American and European central bankers for two days, Rasminsky was invited to Washington to meet with Fowler. He reviewed with him the domestic and international factors that lay behind Canada's current financial crisis. If Canada's reserves, which stood at only \$1,700 million when the talks opened at 3:45 pm, fell to \$1,500 million, Rasminsky said that Ottawa would have no choice but to allow the dollar to float. Citing the Bank of Canada's recent decision to

¹¹⁹ Again, Gordon was not present. Gordon was invited to a meeting the following day. Although this meeting travelled over much the same ground, the decision in favour of seeking an American exemption had already made. See Walter Gordon, Memorandum, 4 March 1968, Gordon Papers, Vol 14, NAC.

¹²⁰ L.R. Rasminsky, Memorandum for File, 17 March 1968, Rasminsky Papers, Box 64, File LR-502, BCA.

increase interest rates and the government's determination to seek legislative authority for additional tax revenue, he assured the American cabinet official that the government was actively wrestling with the domestic causes of the crisis. These steps would matter very little, however, if it were not possible to put to rest fears that Canada would not be able to fund its persistent current account deficit by borrowing in the United States. This could only be achieved, argued Rasminsky, if Washington was to grant Canada a complete exemption from its balance of payments guidelines.

The need for action, he insisted, grew more urgent by the hour. With a sharp sense of the dramatic, Rasminsky announced immediately after dinner that Canada's reserves had dropped that afternoon to \$1,600 million. When the discussions resumed at 8:30 p.m., Fowler quickly agreed to grant Canada its exemption provided Ottawa would, as Rasminsky promised, take steps to solve the "pass-through" problem and to hold its reserves in a form which did not represent a liquid claim on the United States. Having achieved his victory, the Canadian banker cautioned that there were limits on how far he was prepared to go to accommodate the American program:

We would not regard this offer as implying that we were harnessing our wheel completely to the American chariot. If they thought, for example, that the price of this exemption was that we would duplicate the United States balance of payments programme, I had to say that I would not recommend to the Canadian Government that the offer should be accepted.¹²¹

¹²¹ L.R. Rasminsky, Memorandum for File, 17 March 1968, Rasminsky Papers, Box 64, File LR-502, BCA. For a brief discussion of these negotiations by one of the American participants, see Robert Solomon, *The International Monetary System, 1945-1976: An Insider's View* (New York, 1977), pp. 117-18.

Nevertheless, Rasminsky's proposals to eliminate the "pass-through" problem were extensive. Ottawa promised to institute regulations allowing it to control the participation of Canadian banks in the Euro-dollar market and stop Canadian corporations from borrowing in the United States to raise capital for investments elsewhere. The government would also make sure that American subsidiaries in Canada did not use the exemption to invest in third countries, where the IET would normally apply. Fowler and Eugene Rostow, under secretary of state for political affairs, were delighted with these suggestions; over the course of the next few hours (the talks dragged on until 3 a.m. the following morning) the final touches were placed on the deal.¹²²

During the spring of 1968, Ottawa drafted rules and regulations to control the flow of American dollars to Canada, effectively establishing "a form of continental common market for capital."¹²³ Butterworth observed that new system represented the

¹²² The final, formal terms of the arrangement are continued in an exchange of letters between Sharp and Fowler. These are reprinted in Canada, House of Commons, *Sessional Papers, 1967-68*, No. 32e. For his part, Rasminsky was livid with the publicity that Sharp arranged for this exchange. He wondered if Sharp understood the possible implications for a country's foreign exchange position of admitting that the central banker was negotiating for help at 3 a.m.? Rasminsky also resented the minister's attempt to use his efforts in Washington to advance his bid for the Liberal Party's leadership. See L.R. Rasminsky, Memorandum for File, 17 March 1968, Rasminsky Papers, Box 64, File LR-502, BCA.

¹²³ Gerald Wright and M.A. Molot, "Capital Movements and Government Control," in A.B. Fox, Alfred O. Hero and Joseph Nye (eds.), *Canada and the United States: Transnational and Transgovernmental Relations* (New York, 1976), p. 90. See also, William Diebald, "Canada and the United States: twenty-five years of economic relations," *International Journal*, Vol XXXIX, No 2 (Spring 1984), p. 398.

recognition that the two countries had developed "a new dimension in financial interdependence."¹²⁴ The arrangement worked reasonably well and responded to Canadian requirements until the two countries simultaneously dismantled it when the IET was eliminated in 1974. The continuing struggle to secure an exemption from the interest equalization tax, however, left its mark on officials in Ottawa. Increasingly, they came to hold the view that the Canadian economy, which continued to require unfettered access to American capital (and American markets), could not depend on the kind of ad hoc consultative mechanisms used in the 1960s. It was dangerous to rely on the capacity of Canadian officials to explain to Washington how interdependent the two North American economies were every time the United States acted without considering the impact on Canada. This lesson was driven home in August 1971 when Canada failed to win an exemption from a ten percent surcharge imposed by President Richard Nixon on imports to the United States. Increasingly, for many Canadian policy-makers, Canada's uncertain experience with the IET and the August surcharges pointed to one obvious conclusion: in order to respond quickly and effectively to American policies that might have an adverse impact on Canada, Ottawa needed to pursue an even closer and more formal economic partnership with the United States.

¹²⁴ Embassy Ottawa to Secretary of State, 4 September 1968, NSF, Country Files: Canada, Box 166, Johnson Library.

Chapter Four

Defending the Deterrent

During the summer of 1963, defence relations between Canada and the United States resumed much of their old intimacy. From May until September, delegations from both countries worked steadily to carry out the promise Prime Minister Lester B. Pearson made at Hyannisport to accept nuclear weapons for Canada's NATO squadrons and to store nuclear warheads in Canada for American forces. The two sides accepted almost without change the draft agreement that Canadian officials had drawn up for Diefenbaker two years earlier. Nuclear warheads for Canada, it was agreed in mid-August 1963, would be held in American custody and released only following authorization from both governments.¹ With this agreement as a starting point, Ottawa and Washington concluded negotiations in late September on the terms and conditions governing the storage of nuclear warheads in Canada for American detachments at Goose Bay and Harmon Field. These weapons would also remain in American hands and would normally be used only when authorized by both governments.² The agreements committed the two governments to

¹ Record of a Committee of the Privy Council, PC 1305, 16 August 1963. A copy of this minute was given to the author by John Clearwater.

² Secretary of State for External Affairs to the United States Ambassador, Note No 162, 28 September 1963, Department of External Affairs (DEA) File 27-11-Cda/USA-1, Department of Foreign Affairs and International Trade (DFAIT). See also John Clearwater, *Canadian Nuclear Weapons: The Untold Story of Canada's Cold War Arsenal* (Toronto, 1998), pp. 241-45.

define as soon as practical the exact conditions governing "authorization and consultation."

Even as the Pearson government completed this piece of unfinished business, there were growing pressures for changes in Canada's defence policy. The government's campaign commitments to a host of new social programs - old age security, medicare and regional development - sparked a scramble for money and left the Department of Defence's budget exposed just when the possibility of detente and super-power stalemate in Europe made Canada's small contribution to western defence seem insignificant and expendable. Budgetary pressures, however, were only part of the equation. A number of cabinet ministers, including the prime minister, and influential officials in the Department of External Affairs were anxious to carve out a more distinctive and independent international role for Canada as the likelihood of conflict in Western Europe receded. The dangerous instability in the developing world that followed the collapse of European colonialism promised plenty of scope for independent activity when diplomatic initiative was combined with innovative defence policy.

The Pearson government announced its new defence policy in the 1964 *White Paper on Defence*. Although the paper confirmed Canada's continued commitment to NATO and NORAD, it emphasized Ottawa's growing interest in peacekeeping. During the following two years, Canadian resources and attention shifted towards peacekeeping and related aid activities in the developing world. At the same time, the government's reluctance to integrate completely North American

defence and its support for a less rigid and more accommodating western alliance irritated the United States. Some American officials, including Washington's bombastic ambassador to Canada, Walt Butterworth, were inclined to view Canadian defence policy as increasingly "neutralist" and untrustworthy. Others, conscious that Canada's interest in peacekeeping and in the developing world was at least partly the result of American encouragement, suggested that the real problem with bilateral relations in this sphere stemmed from Washington's uncertainty about what it wanted from its Canadian ally. There was widespread support for this view in the American capital, and by the spring of 1967, the State Department and the Department of Defense had reassessed Canadian defence policy and set out some modest objectives for Canada's contribution to western defence. However, by then the relentless conflict in Vietnam had undermined popular support in Canada for sharing the western burden in NATO and NORAD, and transformed these American expectations into remote and politically difficult goals for the Pearson government.

When the Liberals promised during the 1963 election campaign to establish a special parliamentary committee to examine Canadian defence policy, no one expected the kind of searching review that was eventually undertaken. Pearson's ambitious minister of national defence, Paul Hellyer, who had clearly-developed ideas on both the administration and the make-up of the armed forces, saw the review as his opportunity to make his mark. It afforded the minister the chance to realize his desire for a more flexible, mobile and

conventionally-armed military, and allowed him to begin modernizing his department's administration. Disgusted by the waste and duplication he witnessed as a non-commissioned officer during the Second World War, and armed with a recent report by the Royal Commission on Government Organization which attacked his department's bureaucratic structure as "unsuited" and "uneconomic," Hellyer was determined to complete the process of integration that had begun in the 1950s. Thus, while the special parliamentary committee held public hearings in the summer of 1963, the minister asked R.J. Sutherland, chief of operational research for the Defence Research Board, to undertake a confidential and more extensive study of Canadian defence policy.³

In August 1963, as the parallel reviews gathered steam, Pearson and his cabinet began to examine closely their spending priorities for the next fiscal year. This process would also have a profound impact on the government's defence policy. Determined to repair the damage that his reputation suffered in the wake of his first budget and effectively prevented from addressing the question of foreign ownership by Washington, the minister of finance, Walter Gordon, turned his attention to the domestic agenda. In order to balance the budget and find the money required to fund the government's ambitious plans for pension reform and medicare, he systematically went over government spending. Given the apparent

³ Tom Axworthy, "Soldiers without Enemies: A Political Analysis of Canadian Defence Policy, 1945-1975," (Unpublished Ph.D. thesis, Queens University, 1978), pp. 382-65; see also Paul Hellyer, *Damn the Torpedoes: My Fight to Unify Canada's Armed Forces* (Toronto, 1990), pp. 2-4, 32-39.

easing of international tension that followed the Cuban missile crisis and the signing of the August 1963 Nuclear Test Ban Treaty, the defence budget was an obvious target and in early September, Hellyer and Gordon agreed tentatively to freeze defence spending at \$1.5 billion for the next three years.⁴ Thus, even before the public and private defence reviews were complete, the government was forced to cancel existing plans to procure frigates for the Royal Canadian Navy (RCN) and CF101 and CF104 aircraft for the Royal Canadian Air Force (RCAF).⁵

Hellyer was confident that the armed forces would be able to limit the impact of this budgetary ceiling by streamlining their administration. Indeed, from his perspective the decision to cap defence spending and to cancel existing purchasing programs, freed the government to adopt radically new directions and policies. However, rather than representing a significant departure in Canadian defence policy, the initial draft of Hellyer's white paper was singularly unimaginative and politically inept.⁶ Intended to justify defence policy for the next ten years, the draft

⁴ R.L. Raymont, "Report on Integration and Unification, 1964-1968," Raymont Papers, File 759, Directorate of History and Heritage, Department of National Defence (DHist). See also, Denis Smith, *Gentle Patriot: A Political Biography of Walter Gordon* (Toronto, 1973), p. 194; Walter Gordon, *A Political Memoir* (Toronto, 1977), p. 279; and Tom Axworthy, "Soldiers without Enemies," p. 390.

⁵ Canada, House of Commons, Special Committee on Defence, *Minutes of Proceedings and Evidence*, No. 19, 5 November 1963, pp. 665-67.

⁶ Draft White Paper, 19 December 1963, DEA File 27-11-1, DFAIT.

emphatically rejected the possibility of East-West detente and dismissed as unimportant developments in the newly emerging states of Asia and Africa. While Hellyer allowed that Canada might play a role as a peacekeeper in these regions, his paper rejected suggestions (advanced more than once by the prime minister himself) that Canada maintain part of its military forces specifically for peacekeeping duties as impractical and poorly conceived. The country's primary military function for the next decade lay in Western Europe and the North Atlantic. The North Atlantic alliance's new determination to ensure that it had the capacity to respond with conventional weapons to limited Soviet aggression when appropriate - the doctrine of flexible response - made Canada's role in western defence clear: to enhance the conventional deterrent in Europe.

Hellyer suggested that Canada maintain its existing brigade in West Germany while improving the mobility of its two Canada-based brigades. This would be done by stockpiling large amounts of equipment in Europe over the next ten years in preparation for eventual deployment and by investing in a large fleet of air transports. In addition, a fourth specially-trained brigade would be created for service with either the United Nations or NATO. Two assault ships, one stationed on either coast, would provide this brigade with enhanced mobility. The RCAF's nuclear attack role in Europe would be phased out and replaced with eight squadrons of "high performance" tactical aircraft capable of providing ground support to the four Canadian brigades. Canada would maintain its

traditional anti-submarine role in the North Atlantic, a mission strengthened by the purchase of two nuclear-powered submarines.

The purchase of new equipment would be financed largely by the savings that the minister confidently predicted would result from his proposal to integrate and then unify the three branches of the armed services. Hellyer also forecast significant savings in North America. He proposed phasing out at the end of their operational life the three squadrons of CF-101s committed to NORAD. Canada would rely instead on the United States and its anticipated anti-ballistic missile system.

The reaction in Ottawa to the draft white paper was uniformly hostile. The Department of Defence Production, whose minister, Bud Drury, was also partly responsible for implementing the government's policy of reducing Canada's current account deficit by expanding its manufacturing sector, was disturbed by the paper's complete disregard for the interests of Canadian industry.⁷ Gordon too was upset by Hellyer's plans for continued large-scale defence spending and renewed his suggestion that the government channel its defence budget into more socially useful domestic spending. He reminded the prime minister of the unique set of circumstances that had initially produced Canada's post-war role in Europe and contended that, as Western Europe was now able to defend itself, "Canada's commitments there should be substantially reduced."⁸

⁷ G.W. Hunter to C.M. Drury, Raymont Papers, File 759, DHist.

⁸ Cited in Denis Smith, *Gentle Patriot*, p. 194.

Although neither Pearson nor Martin agreed with Gordon's desire to reduce drastically Canada's commitment to Europe and NATO, they shared his view that the international circumstances in which Canadian foreign and defence policy were made had changed profoundly since the 1950s. In the Department of External Affairs, where officials agreed that altered international conditions merited some adjustment in Canadian policy, Hellyer's paper was seen as a welcome opportunity to secure formal government approval for the department's struggle to shift the focus of Canadian efforts for collective security from NATO and the North Atlantic region to United Nations peacekeeping operations and the dissolving empires of Asia and Africa.⁹ Martin and his officials criticized the draft for emphasizing Canada's function in NATO while failing to take into account Western Europe's renewed capacity to undertake its own defence. More important, the proposals paid insufficient attention to the threat that decolonization represented to international order and the role that Canada had already begun to assume in response to this threat:

the omission of adequate emphasis on one of the most important developments of the post-war period -- the vast increase in the numbers of newly independent and unstable nations as a consequence of the closing of the colonial era -- seems to neglect a factor which is having a significant effect on the military requirements for the effective maintenance of international peace. This has led to a downgrading in the paper of the role of the United Nations and the significant contribution which Canadian armed forces have made to its peace-keeping activities. Indeed, throughout the paper, there is a basic misconception of the role performed by the United

⁹ Greg Donaghy, "The Rise and Fall of Canadian Military Assistance in the Developing World, 1952-1971," *Canadian Military History*, Vol 4, No 1 (Spring 1995), pp. 75-84.

Nations as a versatile instrument for the preservation of peace and security.¹⁰

Martin also pointed out that any assessment of Canada's future defence requirements should take into consideration "the changing nature and locale of the continuing struggle for influence between Communist and non-Communist worlds" that was the product of the East-West stalemate in Europe and of decolonization.

Pearson shared the East Block's interest in international peacekeeping and was alert to the implications of decolonization and European renewal for Canadian defence policy. He was "appalled" by Hellyer's effort.¹¹ When interested ministers gathered at the prime minister's residence for an informal meeting to discuss the paper in February 1964, Pearson led the attack and insisted that the paper be completely rewritten. In addition to shifting its focus away from Europe, the redrafted paper must emphasize integration and unification and must avoid specific long-term financial commitments.¹²

¹⁰ Paul Martin to Paul Hellyer, 21 December 1963, Raymont Papers, File 768; see also Ross Campbell to Air Chief Marshall F.R. Miller, 6 February 1964, with attached draft, Raymont Papers, File 759, DHist.

¹¹ Tom Kent, *A Public Purpose: An Experience of Liberal Opposition and Canadian Government* (Kingston and Montreal, 1988), p. 312.

¹² Marcel Cadieux, Memorandum for the Minister, 12 February 1964; Minutes of a Committee of Officials, 15 February 1964; Norman Robertson, Memorandum for the Minister, 20 February 1964, DEA File 27-11-1, DFAIT. Hellyer describes the experience in his diary thus: I was shocked at the nature of the discussion. The PM was the most sympathetic but he, too, took the attitude that we didn't have to set an example in NATO. He didn't want NATO to break up but was unwilling to support the concept of an 'effective' Canadian contribution. Paul Martin...was preoccupied with

The final version of the *White Paper on Defence* was approved without difficulty by the full cabinet on 25 March 1964 and tabled in the House of Commons the following day.¹³ The initial response to the paper's proposal to integrate the three branches of the armed forces as the "first step towards a single unified defence force" was positive.¹⁴ At a time when innovation and change were becoming popular watchwords, Canadians were intrigued by this experiment in military organization. The country was also gratified by the far-sighted and imaginative perspective that this version of the paper adopted on Canada's role in world affairs. Unlike Hellyer's initial draft, it outlined a flexible and adaptable defence policy that suited an international environment in the midst of dramatic and rapid change. Though detente was not yet a reality, the paper welcomed the possibility as real and speculated that "increasing importance will probably now be attached to the quest for security through negotiations." While tensions in Europe would persist, the *White Paper* argued that communist pressure would

sovereignty and favoured bringing the Air Division home to augment Air Defence, thereby making it unnecessary to permit dispersal of U.S. interceptors in Canada. WLG[ordon] suggested cutting defence expenditures an additional 500 million and giving the money to the provinces."

See Paul Hellyer, *Damn the Torpedoes*, p. 46.

¹³ Cabinet Conclusions, 25 March 1964, RG 2, Vol 6264, NAC. See also Canada, Department of National Defence, *White Paper on Defence* (Ottawa, March 1964).

¹⁴ J.L. Granatstein, *Canada 1957-1967: The Years of Uncertainty and Innovation* (Toronto, 1986), p. 236. For a critical view, see Leonard Beaton, "The Canadian White Paper on Defence," *International Journal*, Vol. XIX (Summer 1964), pp. 364-70. Beaton called it "a very thin meal handsomely presented."

focus on "fermenting and support[ing] so-called 'wars of liberation' in less-developed areas." As the resulting instability called for "containment measures which do not lend themselves to Great Power or Alliance action ... the peacekeeping responsibilities devolving upon the United Nations can be expected to grow."¹⁵

In this kind of uncertain international situation, nations were naturally required to maintain the forces necessary for their defence. The bulk of Canada's military forces were, as in Hellyer's first draft, generally reassigned to their existing roles in NATO and NORAD. Canada would maintain an infantry brigade in West Germany, supported by two additional brigades stationed at home. The Air Division's eight squadrons would also remain in France and Germany, although their CF-104s would slowly be replaced by an unspecified "high performance aircraft" able to provide Canadian ground forces with direct support. These aircraft would also be available for the defence of North America, where they would eventually replace the CF-101s employed by the three squadrons currently assigned to NORAD. The *White Paper* assumed that the navy's primary role would continue to be its long-standing NATO anti-submarine mission in the North Atlantic.¹⁶

In contrast to Hellyer's initial proposals, each of these missions had a new built-in element of mobility and flexibility. These were designed not only to fulfil alliance roles but also to

¹⁵ *White Paper on Defence*, p. 11.

¹⁶ *Ibid.*, pp. 22-23.

ensure that Canada was able to play a larger part in United Nations' peacekeeping operations. For instance, the *White Paper* explained that the two reserve infantry brigades would no longer be "ear-marked primarily for the European theatre." Instead, they would be "re-equipped and re-trained as a mobile force" so that they might be deployed "in circumstances ranging from service in the European theatre to UN peace-keeping operations." In addition, the air force and the navy were both given new missions to develop the capacity to move troops and equipment quickly "to any trouble spot where their presence might be valuable to maintain peace or assist in the limitation of local outbreak [sic]."¹⁷

The evolution of Canadian defence policy in the first six months of the Pearson government's mandate was observed carefully and with mounting concern by the United States. In early January 1964, Butterworth speculated that the review may "reflect the hope of avoiding any additional direct involvement with nuclear weaponry" and warned that the "reappraisal may substantially alter the Canadian contribution to NATO ... [and] force us to make a careful new appraisal of our future defence requirements for the use of Canadian real estate."¹⁸ Butterworth's suspicion that the defence review was in part an exercise designed to allow Pearson's government to abandon its commitment to nuclear weapons - a view which was strengthened later that month when the prime minister

¹⁷ *Ibid.*, pp. 11, 22-24.

¹⁸ Embassy Ottawa to State Department, Airgram A-581, 3 January 1964, National Security Files (NSF), Country Files: Canada, Box 165, Johnson Library.

remarked on television that he hoped Canada would reduce and eventually abandon its nuclear role - reinforced Washington's determination to ensure "that the revised defence policy does not impair Canadian commitments to [the] joint defence of North America and NATO."¹⁹ Butterworth, the State Department and the Department of Defense agreed to use the next meeting of the Permanent Joint Board on Defence (PJBD) to remind Ottawa that the "maintenance of [an] effective deterrent to aggression against North America or members of the North Atlantic alliance will continue to be fundamental to Canada's defence policies and programs."²⁰

With the publication of the *White Paper on Defence* much of this concern evaporated. The *White Paper* exceeded Washington's expectations. It not only reiterated Canada's support for NATO and NORAD, reported Butterworth, it seemed to go out of its way to signal Ottawa's willingness to remain a reliable member of the western alliance. The ambassador, whose report was soon cited authoritatively in the State Department, emphasized the limited prospects for detente that the paper outlined and pointed out that it provided a justification for the acquisition of nuclear weapons "in terms of [the] western alliance's realistic defense needs rather than in terms of [the] necessity [to] honor 'commitments'

¹⁹ Visit of Canadian Prime Minister Pearson: Background Paper on Joint Defence, 17 January 1964, NSF, Country Files: Canada, Pearson Visit 1/22/64, Box 167, Johnson Library.

²⁰ Ottawa to State Department, Tel No 937, 21 January 1964 and State Department to Ottawa, Tel No 614, 22 January 1964, RG 59, File Def 4 Canada-US, United States National Archives (USNA).

entered into by [the] previous government."²¹ Butterworth mistakenly interpreted the policy statement as a clear indication that the Canadian government "views its forces primarily as components of the western alliance with UN peacekeeping in a secondary role."²²

Although the minister of national defence thought this, it was not clear that the rest of the government, especially Martin and Pearson, agreed. In the months following the release of the *White Paper*, there were a number of developments that forced the American ambassador to re-evaluate the relative weight that Ottawa attached to its peacekeeping and related activities. As if to emphasize the importance the government attached to peacekeeping, Pearson sent Canadian troops to maintain the peace in Cyprus when Turkish and Greek militants threatened to go to war over the small island in the spring of 1964. The day after the U.N. mission was launched, the prime minister exclaimed with evident delight that "[t]his was the kind of thing I like to see Canada doing."²³

The crisis in Cyprus reinforced the prime minister's long-standing interest in some kind of permanent international peacekeeping machinery. As he pointed out in an important article

²¹ Ottawa to State Department, Tel No 1253, 26 March 1964, RG 59, Box 1612, File Def 1 Can, USNA; On the influence of Butterworth's report, see H.B. Robinson, Memorandum for the Ambassador, 2 April 1964, Robinson Papers, File 12-11 April 1964, National Archives of Canada (NAC).

²² Ottawa to State Department, Tel No 1253, 26 March 1964, RG 59, Box 1612, File Def 1 Can, USNA.

²³ Cited in John Saywell (ed.), *Canadian Annual Review for 1964* (Toronto, 1965), p. 226.

in the popular newsmagazine, *Maclean's*, if the United Nations was unable or unwilling to establish such machinery, there were others who could assume this responsibility:

If the UN Assembly ... is unable to agree on permanent arrangements for a 'stand-by' peace force -- then why should a group of nations who feel that this should be done not do something about it themselves?... As a leading middle power, with a well-known record of support for the United Nations peace-keeping operations ... Canada is in a unique position to take the initiative. It is prepared to do so.²⁴

In November 1964, as a step towards establishing this kind of international force, Ottawa invited 22 major peacekeeping nations to discuss the technical issues involved in peacekeeping.²⁵

At the same time, cabinet approved a general program of military assistance to the developing world. The possibility that Canada might establish this kind of program had been debated sporadically in Ottawa during the late 1950s and early 1960s, only to re-emerge in the summer of 1963 when the Tanzanian prime minister, Julius Nyerere, asked Pearson for help with establishing a national air force. The Tanzanian request and a subsequent Malaysian petition for assistance in its confrontation with Indonesia confirmed the established Canadian view that military training assistance represented an important contribution to international stability and collective security. In addition to

²⁴ L.B. Pearson, "A New Kind of Peace Force," *Maclean's*, 2 May 1964, reprinted in J.L. Granatstein (ed.), *Canadian Foreign Policy since 1945: Middle Power or Satellite?* (Toronto, 1969), pp. 151-54.

²⁵ John Hilliker and Donald Barry, *Canada's Department of External Affairs, Vol II: Coming of Age, 1946-1968* (Kingston and Montreal, 1995), pp. 386-87.

enhancing the strength of local police and military units, forces which Ottawa characterized as "usually ... good influence[s] for law and order," western aid usefully displaced destabilizing Communist bloc assistance.²⁶

The United States did not object to Canada's growing role as an international peacekeeper. The president himself encouraged Pearson to undertake the Cyprus mission.²⁷ Washington also welcomed the Ottawa peacekeeping conference and praised Ottawa's efforts to establish a military assistance program.²⁸ Still, by the end of 1964, American authorities were beginning to worry that Canada, with its limited resources, might find itself spread too thinly and become anxious to reduce its role in NATO and NORAD in order to maintain its international peacekeeping activities. The government's new five year, \$1.5 billion procurement program, which Hellyer announced on 22 December, gave Washington real grounds for concern. The program included no funding for equipment designed exclusively for nuclear weapons or warheads. It made no provision for replacing the aging fleet of CF-104s and indicated that the government would buy the cheaper and simpler F-5 rather than the "highly sophisticated and expensive" Phantom F-4 fighter-bomber as the "high performance tactical aircraft" promised in the *White*

²⁶ Greg Donaghy, "The Rise and Fall of Canadian Military Assistance," p. 78.

²⁷ L.B. Pearson, *Mike: The Memoirs of the Rt. Hon. Lester B. Pearson, Volume III: 1957-1968* (Toronto, 1975), pp. 134-35.

²⁸ State Department to Ottawa, Airgram CA-798, 21 July 1964, *Freedom of Information Act (FOIA) Request 9202777*.

Paper.²⁹ Whether these decisions actually anticipated a reduction in Canada's commitment to NATO and NORAD was, as Butterworth noted in his annual year-end report, "unclear." However, the American was clear on what the wavering Canadian policy meant for the United States:

Canada's self-chosen UN peace-keeping role is...of singularly constructive help, to the West and to world order, but its pursuit should not be at the expense of Canada's part in the Atlantic and North American communities. Canada may well see the Western alliances and participation in UN peace-keeping operations as posing a choice, a political as well as a military choice. Many Canadian leaders already find more purity and more opportunity for influence in the "neutral" role. The United States should not hesitate wherever and whenever to remind Canada of its basic political and military commitments.³⁰

Butterworth's exhortation to his colleagues to persist in their efforts to convince Canada to assume its full share of the western defence burden was timely. By early 1965, Washington had become increasingly frustrated at its inability to convince Ottawa to adopt its set of priorities in NATO and NORAD. From Washington's perspective, the two nuclear agreements negotiated in August and September 1963 were only the first steps in a more extensive program to integrate fully continental defence. As early as Pearson's meeting with Kennedy at Hyannisport, the United States had made it clear that the defence of North America called for two

²⁹ John Saywell (ed.), *Canadian Annual Review for 1964* (Toronto, 1965), p. 218. For a discussion of the politics involved in this decision see Paul Hellyer, *Damn the Torpedoes*, pp. 129-32. A different, more critical, perspective is offered in General Jean Allard (with Serge Bernier), *The Memoirs of Jean Allard* (Vancouver, 1988), pp. 223-24.

³⁰ American Embassy, Ottawa to State Department, 6 January 1965, NSF, Country File: Canada, Box 165, Johnson Library.

additional major bilateral projects. First, in order to reduce the damage that a Soviet first strike might inflict on NORAD's capacity to defend North America against a bomber attack, the United States wanted to disperse 44 squadrons of interceptors across nine remote Canadian bases. Second, Washington insisted that Canadian and American naval units serving on Canada's east coast required nuclear weapons in order to carry out their anti-submarine mission (ASW) effectively .

At Hyannisport, Kennedy had accepted Pearson's plea that he lacked the political support to move ahead on these two issues and agreed to defer them for the time being.³¹ With the agreements on nuclear weapons for Canadian and American forces in place by the fall of 1963, the United States began to press for action on the question of dispersing American interceptors in Canada and equipping ASW operations with a nuclear capacity. At the October 1963 meeting of the PJBD, the American delegation outlined the argument in favour of providing nuclear weapons to Canadian and American naval forces stationed in Canada and alerted the board to its determination to pursue this topic "at an appropriate moment."³² The United States, armed with a military assessment by Admiral Moorer, the Supreme Allied Commander, Atlantic (SACLANT), outlining NATO's need for a nuclear ASW capability in North

³¹ McGeorge Bundy, National Security Action Memorandum (NSAM), No 248, 3 June 1963, FOIA Request 9202777.

³² Dana Wilgress to the Prime Minister, 21 October 1963, DEA File 27-4-PJBD-1963; See also, State Department to Ottawa, Tel No 617, 22 January 1964, FOIA Request 9202777.

America, announced at the next meeting of the PJBD in February 1964 that it wished to begin negotiations on this subject as soon as possible.³³

Later that spring, as preparations began for the first meeting of the Canada-United States Ministerial Committee on Joint Defence since 1959³⁴, the White House decided to make an effort to resolve all outstanding nuclear weapons questions. In early April, the National Security Council reversed Kennedy's prohibition on discussing the interceptor question and asked Ottawa to put it and the ASW problem on the meeting's agenda.³⁵ At the same time, President Lyndon Johnson suggested to Pearson that the two countries begin to negotiate the terms of the agreement for consulting on and authorizing the use of nuclear weapons that was promised in the exchange of notes in August and September 1963.³⁶

The prime minister had been carefully assessing the domestic political costs associated with meeting the American requests for further nuclear facilities for some time. Hellyer, to whom Pearson had turned in late February for political advice on the question of the American interceptors, was reassuring. Although a small, but

³³ Dana Wilgress to the Prime Minister, 11 February 1964, DEA File 27-4-PJBD-1964-Winter, DFAIT; See also State Department to Ottawa, Tel 617, 22 January 1964, FOIA Request 9202777.

³⁴ For the origins of this committee and a description of its functions, see William R. Willoughby, *The Joint Organizations of Canada and the United States* (Toronto, 1982), pp. 189-96.

³⁵ Walter Stoessel to Acting Secretary of State, 30 June 1966. The actual decision is recorded in NSAM No 302, 22 May 1964. FOIA Request 9202777.

³⁶ Confidential Source.

vocal, minority would oppose the deployment for idealistic reasons, most Canadians would be more forgiving:

The economic advantages of allowing the U.S. dispersal would be applauded by the majority [of Canadians], and particularly those in the areas affected...Our experiences in the recent [defence] cuts indicates very clearly that, in most cases, individuals and communities place economic considerations above all others.³⁷

Hellyer's advice was far from decisive. The prime minister's own inclination to avoid any extension of Canada's nuclear role was strengthened by the opposition to nuclear weapons expressed by several Quebec cabinet ministers during the cabinet's discussion of the *White Paper on Defence* in March 1964.³⁸ Thus, while Pearson agreed to discuss the procedures for consultation and authorization, he asked the president to defer consideration of the proposals to disperse American interceptors and to store ASW nuclear weapons in Canada. Johnson, who "did not want to risk politically embarrassing Prime Minister Pearson," agreed and the two items were promptly removed from the agenda of the joint ministerial meeting.³⁹

The president's decision left the problem of consultation and authorization as the only substantial issue for ministerial

³⁷ Paul Hellyer to L.B. Pearson, 26 February 1964, Raymont Papers, File 1108, DHist.

³⁸ The general lines of the discussion can be found in Cabinet Conclusions, 25 March 1964, RG 2, Vol 6264, NAC. For more specific observations about the meeting and its actual impact on the prime minister's thinking, see Memorandum of Conversation: Canadian Government Attitude toward Nuclear Weapons, 19 July 1964, RG 59, Box 1613, File Def 12 Can, USNA.

³⁹ William Tyler, Memorandum for the Secretary of State, 24 June 1964, NSF, Country Files: Canada, Box 165, Johnson Library.

consideration. Negotiations at the official level, which began in Washington the week before the ministers gathered, ended in deadlock. Having accepted nuclear weapons for Canadian forces, Ottawa was determined to transform NORAD into a genuinely shared command. Canadian negotiators, led by Ross Campbell, an assistant under-secretary of state for external affairs, proposed making the use of NORAD's nuclear weapons by the alliance's American Commander-in-Chief (CINCNORAD) anywhere in North America subject to joint authorization by the two governments. When there was time, consultation, either in person or by telephone, would precede authorization. In an emergency, CINCNORAD would be authorized to use nuclear weapons anywhere in North America on his own authority. (An emergency included an attack against North America which CINCNORAD judged "strategic" or an imminent or actual attack against Alaska where "delay might seriously prejudice the defense of the area involved.")

While American negotiators readily accepted the conditions under which the two countries would normally consult, they were reluctant to accept the idea that CINCNORAD would not be free to deploy the nuclear forces at his command anywhere in the continental United States and Alaska without prior Canadian authorization. The United States Joint Chiefs of Staff explained that the United States might need to act alone, in a hurry, if Alaska was attacked. When Canadian negotiators offered to draft a special provision addressing this eventuality, American resistance stiffened. The Pentagon objected in principle to the concept of a

joint command and refused to surrender its freedom to employ United States forces in the United States as it wished.⁴⁰

While the ministerial meeting on defence failed to resolve the deadlock, it did make some progress. The Canadian delegation continued to insist that authorization and consultation arrangements should be as uniform as possible throughout NORAD's operational area. The American secretary of state, Dean Rusk, who was anxious to make the meeting as successful as possible, was more conciliatory. He maintained the American position, suggesting that it might be better to focus efforts on the problem of authorizing the use of nuclear weapons in Canada alone, but agreed that the two negotiating teams should meet again to see if the Canadian proposals could be amended to satisfy the American position.⁴¹

By late July, provisions had been drafted which met United States military requirements and allowed the United States to use nuclear weapons under the operational control of CINCNORAD to respond to non-strategic attacks. In addition, they permitted the use of NORAD command and control facilities "to the extent necessary for the effective employment of the national forces." The State Department, worried that ongoing opposition to the Canadian proposals would give Pearson (and his French Canadian colleagues)

⁴⁰ Confidential Source; see also John Clearwater, *Canadian Nuclear Weapons: The Untold Story*, pp. 246-55.

⁴¹ William Tyler to the Secretary of State, 24 June 1964, NSF, Country Files: Canada, Box 165, Johnson Library and attachment, Canada-U.S. Ministerial Meeting on Joint Defence: Nuclear Weapons Authorization and Consultation Procedures, FOIA Request 9202777.

an excuse to abandon Canada's nuclear role, was prepared to accept Ottawa's terms. The Pentagon, however, continued to resist and refused to sanction the draft agreement. Rusk appealed to the White House. Following the 1964 elections, during which consideration of the potentially awkward problem had been suspended, Johnson concurred with the State Department and the Canadian proposal became the basis for an agreement that was eventually signed in September 1965.⁴²

If the White House hoped that this forthcoming gesture would soften attitudes in Ottawa towards nuclear cooperation in North America, it was soon disappointed. During the winter and spring of 1965, Canadian delegations to PJBD meetings refused to address either the dispersal problem or the issue of nuclear ASW weapons storage, forcing the United States to change its approach.⁴³ In preparation for the June 1965 session of the board, the Pentagon abandoned its search for nuclear weapons storage for both Canadian and American anti-submarine forces; instead, it asked for storage

⁴² J. Harold Shullaw to Mr. Tyler, 9 July 1964; Draft Memorandum for McGeorge Bundy: Canadian Proposal Regarding Use of NORAD Nuclear Weapons, [October 1964]; J. Harold Shullaw to Mr. Tyler, 2 November 1964; Scott George to Acting Secretary of State, 16 November 1964 and attached letter from Llewellyn E. Thompson to John McNaughton, 16 November 1964, FOIA Request 9202777. See also John Clearwater, *Canadian Nuclear Weapons: The Untold Story*, pp. 52-53.

⁴³ Marcel Cadieux, Memorandum for the Prime Minister, 29 September 1964, DEA File 27-4-PJBD-1964-Fall, DFAIT; Dana Wilgress to the Prime Minister, 15 February 1965, DEA File 27-4-PJBD-1965-Winter, DFAIT.

facilities in Canada for American ASW detachments only.⁴⁴

While this suggestion awaited a Canadian response, the United States amended its tactics for dealing with the interceptor problem. Partly on the basis of advice received from David Kirkwood, the secretary of the Canadian section of the PJBD, the United States carefully re-examined its need for dispersal in Canada and concluded that, rather than nine bases, it only required four.⁴⁵ At the September 1965 meeting of the PJBD, the American delegation hinted casually that formal notes asking for these facilities would soon be presented. This development, warned Wilgress, signalled a stiffening of Washington's attitude and its growing lack of patience with Canada. "[T]his matter, having been dormant as long as the U.S. considered it necessary to be extremely cautious in their nuclear relations with us, will soon again require consideration."⁴⁶

American pressure mounted gradually during the fall of 1965. During a visit with Hellyer in September, Moorer referred to the American request for nuclear storage facilities for ASW weapons, leading the minister of defence to conclude by mid-October that "we

⁴⁴ William Tyler to John T. McNaughton, Assistant Secretary of Defence, 23 April 1965, FOIA Request 9202777; Dana Wilgress to the Prime Minister, 21 June 1965, DEA File 27-4-PJBD-1965-Summer, DFAIT.

⁴⁵ Memorandum of Conversation: Interceptor Dispersal to Canada, 26 May 1964, RG 59, Box 1613, Def 12 Can, USNA; Dana Wilgress to the Prime Minister, 30 September 1965, DEA File 27-4-PJBD-1965-Fall, DFAIT.

⁴⁶ Wilgress to the Prime Minister, 30 September 1965, DEA File 27-4-PJBD-1965-Fall, DFAIT.

could no longer delay satisfying U.S. wishes in this regard."⁴⁷ However, for the time being, Hellyer alone prodded the prime minister. Despite advice from his officials, Martin refused to join in urging the prime minister to agree to the American request in the face of the opposition expressed by some French Canadian members of cabinet.⁴⁸ Wilgress attended the next meeting of the PJBD in February 1965 with instructions to avoid committing Canada.

On his return from the PJBD session, Wilgress again warned the prime minister that American patience was wearing thin:

I believe that you would wish to know that at the meeting our United States colleagues clearly required the dispersal proposal as being in principle compatible with the general commitment to integrate the air defences of the continent which we undertook in the NORAD agreement. They also felt that somewhat similar considerations applied with respect to the ASW proposal, both in a NATO and a continental defence context.⁴⁹

Pearson continued to seek refuge in delay; Washington continued to press. At the PJBD's May 1966 meeting, the American delegation warned again that the United States would soon ask Ottawa formally for permission to disperse its squadrons in the Canadian north and to store nuclear ASW weapons in Canada. Wilgress maintained that the United States, in threatening to force a response from Canada, was fully aware of Pearson's political difficulties. Irritated by the unrelenting pressure and the American decision to use the PJBD

⁴⁷ H.B. Robinson to Defence Liaison (1), 7 October 1965, DEA File 27-16-2-USA-2, DFAIT.

⁴⁸ Marcel Cadieux, Memorandum for the Minister and attachment, 20 January 1966, DEA File 27-16-2-USA-2, DFAIT.

⁴⁹ Dana Wilgress to the Prime Minister, 28 February 1966, DEA File 27-4-PJBD-1966-Winter, DFAIT.

as a lobby platform, Pearson received Wilgress' report with uncharacteristic pique. "I think," he minuted Martin in frustration, "we should have an assessment of the value of the PJBD in present circumstances."⁵⁰

The prime minister's frustrations over defence relations were shared south of the border. Indeed, by the spring of 1966, they were perhaps felt more acutely in Washington than in Ottawa, for in addition to Pearson's hesitations over NORAD, the United States had had to cope since the fall of 1963 with Canada's increasingly restless attitude towards NATO.⁵¹ Europe's economic recovery and growing integration made the North Atlantic alliance much less amenable to American domination. While the United States assumed the "western burden" in former European colonies like Vietnam and the Congo, decolonization offered Europe new freedom. The gradual emergence of detente in the wake of the Berlin and Cuban Missile crises added to strained relations among the allies as they increasingly disagreed on how to deal with the Soviet Union.⁵² These structural obstacles to allied unity were exacerbated by growing divisions over NATO's strategic posture. The doctrine of "flexible response," for instance, raised questions about the

⁵⁰ Pearson's marginalia on Dana Wilgress to the Prime Minister, 10 June 1966, DEA File 27-4-PJBD-1966-Spring, DFAIT.

⁵¹ For a fuller treatment of this question, see Greg Donaghy, "Domesticating NATO: Canada and the North Atlantic Alliance, 1963-68," *International Journal*, Vol LI (Summer 1997), pp. 446-63.

⁵² Henry Kissinger, *The Troubled Partnership* (Toronto, 1965), pp. 5-10. See also, Francis A. Beer, *Integration and Disintegration in NATO* (Columbus, 1969), pp. 28-46.

United States' willingness to risk its own security in defense of Europe. American efforts to resolve these divisions by promoting closer North Atlantic economic relations and by giving each member of the alliance some share in its nuclear planning through projects like the Multilateral Nuclear Force (MLF) were unsuccessful, and stretched relations between Washington and Paris almost to the breaking point.⁵³

Although firmly committed to NATO, Pearson and Martin assumed office conscious of the need to address the growing tensions within the alliance. Sensitive to Soviet advances and disappointed over the lack of political consultation, the prime minister saw the pursuit of detente as a new and politically invigorating role for the Alliance. In contrast, Martin saw the alliance as an important arena in which Canada could further develop its relations with France and forestall Quebec's efforts to develop its own international personality. Martin was also convinced that Canada was uniquely qualified to mediate between France and the United States. As he pointed out on more than one occasion, "we have a French population in Canada, [and] we think it helps us to understand the French.... the Americans have not understood sufficiently well how to handle the French effectively. It was not reasonable to expect a man like President Johnson to understand

⁵³ Frank Costigliola, "Lyndon B. Johnson, Germany and the 'End of the Cold War'", in Warren I. Cohen and Nancy Bernkopf Tucker (eds.), *Lyndon Johnson Confronts the World: American Foreign Policy, 1963-1968* (Cambridge, 1994), pp. 179-181. See also, H.W.Brands, *The Wages of Globalism: Lyndon Johnson and the Limits of American Power* (New York, 1995), pp. 88-89.

General de Gaulle."⁵⁴ Although the Canadian objectives - a renewed alliance and closer relations with France - sometimes collided uncomfortably, they had one thing in common: both goals irritated Washington, which suspected the government in Ottawa of subordinating Canada's international responsibilities to its domestic interests.

Martin's initial effort to mediate between Washington and Paris was distinctly unsuccessful. In the early fall of 1963, during his first visit with Rusk, the Canadian minister tentatively offered to relay a message to the French president, General Charles de Gaulle, but was rebuffed by the American.⁵⁵ Rusk's reaction cooled but did not completely extinguish Martin's ardour and in the spring of 1964, he made it clear to his fellow foreign ministers that Canada would not take sides in the growing Franco-American dispute, but would continue its efforts to mediate between Paris and Washington:

We feel there is much too much loose talk on both sides about good allies and bad allies ... about the difficulties of cooperating with this, or with that, country ... I will be frank with you. I don't know whether it is because of the bilingual character of my country, but close as we are to USA ... we are, nevertheless anxious to be able to understand the position of other partners, even some who take positions that are not supported by too many here, but taken by them in the light of what they believe to be their national needs at the moment.⁵⁶

⁵⁴ Author Interview with Paul Martin, 15 June 1992.

⁵⁵ Washington to Ottawa, Tel No 4010, 5 December 1963, RG 25, File 20-Canada-9-Pearson, NAC.

⁵⁶ Ottawa to NATO Paris, Tel No. DL-628, 20 March 1964; NATO Paris to Ottawa, Tel No 950, 20 May 1964, Rg 25, File 20-Canada-9-Pearson.

The government's concern with the future of France's relations with NATO grew throughout 1964. At the December ministerial meeting, the secretary of state for external affairs proposed and secured support for an exercise designed "to establish a set of principles or general guidelines which could form the basis for an examination of the future of the Alliance."⁵⁷ Martin also used the meeting to demonstrate to France that Paris was not alone in its opposition to American plans to meet European demands for a nuclear role through a revived MLF. The State Department, which had overcome its doubts about Martin's earlier initiative - "a proposal which is so vague and could lead to platitudes or premature discussion in NAC of fundamental differences between member states" - in order not to offend Canada, was livid about the attack.⁵⁸ The White House was also concerned. Although the United States was aware of Canada's practical objections to the MLF, Johnson had been led to believe by Pearson's remarks at Hyannisport that Canada's opposition would be muted and that he could hope "for as much understanding and support from Canada as possible." When McGeorge Bundy, the National Security Advisor, outlined the president's anxieties to Charles Ritchie, the Canadian ambassador to the United States replied that the United States must realize "that Canada was torn between her fervent belief in Atlantic integration and her necessary concern to avoid seeming to join in isolating France." He

⁵⁷ Ottawa to NATO Paris, Tel No DL-2256, 10 November 1964, 27-4-NATO-12-1964-Fall, DFAIT.

⁵⁸ Briefing Notes for NATO Ministerial Meeting, [December 1964], FOIA Request 9202777.

promised, however, to bring the White House's interest to Pearson's attention.⁵⁹

Procedural bickering and the continuing controversy over the MLF and arrangements for nuclear sharing effectively postponed any discussion of Martin's initiative until the fall of 1965. By then, NATO's relations with France, which was rumoured to be preparing its own proposals for restructuring the alliance, were so strained that the exercise was quickly shelved as too controversial and divisive. However, as Washington and the other members of the alliance grew increasingly impatient with de Gaulle, the minister remained anxious to appease France. When de Gaulle abruptly announced his decision to withdraw France from NATO's integrated military structure in March 1966, Martin ensured that Canada's position was among the most moderate in the alliance. Cabinet agreed that Canada should seek "to limit the damage to the unity and effectiveness of the Alliance ... [and] accept without rancour and seek constructive adaptations to France's considered positions, even where they are in conflict with our own." Canada should "continue to demonstrate confidence in France as an ally ... leave the door open for the eventual return of France to full participation in the collective activities of the Alliance ... [and] continue, in spite of the NATO crisis, to develop our

⁵⁹ McGeorge Bundy, Memorandum to A/Secretary of State George Ball, 16 December 1964, NSF, Country File: Canada, Box 165, Johnson Library.

bilateral relations with France."⁶⁰

To achieve its primary objective - the preservation of alliance unity and the maintenance of some form of French participation within NATO - Canada tried to moderate both the procedural and substantive positions for negotiating with Paris that were suggested in a British aide-memoire circulated with the support of most other NATO delegations. Although Canada agreed with the general principles and future objectives as laid out in the British paper, two aspects of the British position were especially worrying. Implicit in London's approach was the idea that Paris be presented with the minimum demands of the "fourteen," a tactic that seemed designed to provoke a confrontation with France. In discussions with the British, Martin counselled a more circumspect approach, explaining that "[i]t was particularly important for us in Canada to foster continued French association with the Alliance, otherwise we would be misunderstood if we did not."⁶¹

More important, the British paper failed to address the problem of East-West relations in a manner which would unite the alliance by addressing France's desire to accelerate detente. In telegraphed instructions to Canadian representatives in London, Washington, Brussels and Bonn, where governments were known to have the United Kingdom paper, the department asked that they make clear

⁶⁰ Draft Memorandum for Cabinet, 29 March 1966 and Record of Cabinet Decision, 31 March 1966, DEA File 27-4-NATO-3-1-France.

⁶¹ Summary Record: Discussion between SSEA and British Minister for NATO Affairs, 18 May 1966, Martin Papers, Vol 226, NAC.

the Canadian view that:

there is apparently general agreement among the fourteen that at Brussels NATO should demonstrate its determination to pursue actively the search for further detente in Europe ... The political advantages of producing a good statement on this subject, and of having the statement appear in the communique in the name of the Alliance as a whole justify a special effort both on what should be said and on obtaining French concurrence. In this way the continuing solidarity of NATO will be most effectively demonstrated, and at the same time de Gaulle's effort to appropriate to himself the initiative in the field of East-West relations will be contained and controlled.⁶²

At the end of March 1966, cabinet agreed that Canada should strive to draft a ministerial statement on East-West relations that would signal NATO's determination to address detente and constitute a basis for compromise between the "fourteen" and the French.⁶³ On the following day, a draft along these lines was sent to Paris. Acknowledging that NATO was more than simply a "defensive shield," the statement welcomed any development that might lead to improved relations with the Soviet Bloc. Attempting to reconcile the differences dividing those members like France, who insisted on their independent right to pursue relations with the Eastern Bloc, from those like the United States, who favoured a collective approach to the problem of East-West relations, the Canadian draft urged that NATO members:

accept that diversity of approach need not be a source of weakness. Their common objectives in the field of East-West relations can be pursued in various ways including both bilateral and collective exchanges with the Eastern countries.

⁶² Ottawa to London, Washington, Brussels and Bonn, Tel NO DL-126, 20 May 1966, DEA File 27-4-NATO-12-1966-Spring.

⁶³ Memorandum to Cabinet, 30 May 1966 and Record of Cabinet Decision, 31 May 1966, DEA File 27-4-NATO-12-1966-Spring.

Continuous consultation in the alliance concerning developments in this field ensures that the collective interests are fully protected.⁶⁴

Canada's mediatory efforts were far from exhausted. Although the American, German, British, and French foreign ministers reached the major decisions on the procedures governing France's withdrawal without substantial Canadian help, Martin frequently intervened. He convinced the "fourteen" to postpone a decision on moving the North Atlantic Council from Paris to Brussels, thereby retaining, albeit temporarily, a symbol of France's continuing political relationship with NATO.⁶⁵ The fate of Canada's proposal on East-West relations, which was incorporated in the final communiqué, was similarly gratifying.⁶⁶ Uppermost in Martin's mind, as the American delegation noted with irritation, were the domestic considerations:

Persistent theme from Martin ... was his insistence that 14 must make no moves to pre-empt France in any decision not already taken by France. He insisted that Canadian Government, Parliament and people would not understand if there was any failure on the part of 14 to make every effort to salvage every possible French link with NATO.⁶⁷

In pursuing such a prominent and unpopular role, Canada incurred the wrath of most of its NATO allies.⁶⁸ J.A. Roberts, the Canadian

⁶⁴ External to NATO Paris, Tel No DL-1504, 1 June 1966, DEA File 27-4-NATO-12-1966-Spring.

⁶⁵ Paul Martin, *A Very Public Life, Volume II: So Many Worlds* (Toronto, 1985), pp. 45-76.

⁶⁶ Ottawa to NATO Paris, Tel No DL-1607, 15 June 1966, DEA File 27-4-NATO-12-1966-Spring.

⁶⁷ Brussels to Department of State, Tel No. Secto 46, 5 June 1966, FOIA Request 9202977.

⁶⁸ Ottawa to NATO Paris, Tel No DL-1607, 15 June 1966, DEA File 27-4-NATO-12-1966-Spring.

deputy secretary general of NATO, informed the under-secretary that "he had encountered opinions in Paris, particularly among the Americans and British, that Canadian policy in NATO tended to be equivocal. This was being attributed to Canada's alleged paramount interest in bilateral relations with France."⁶⁹ Rusk, whom the White House credited with holding "'the family of fourteen' together despite the stubborn soggiess of the Canadians,"⁷⁰ was especially irritated and characterized Martin's approach as "being more royalist than the king."⁷¹ It was clear to the secretary of state that Canada would "require some special bilateral attention in the weeks to come."

In this atmosphere, Pearson's decision to use a speech in Springfield, Illinois, to speculate about NATO's present problems and future directions was decidedly impolitic. Bemoaning the alliance's failure to evolve with the times, the Canadian prime minister seemed almost anxious to endorse de Gaulle's actions. He raised questions about Washington's leading role in the alliance and suggested that Europe's renewed strength might allow American and Canadian forces in Europe to be deployed elsewhere.⁷²

The speech, which evoked expressions of concern from several

⁶⁹ J.S. Nutt, Memorandum for File, 18 March 1966, DEA File 27-4-NATO-3-1-FR.

⁷⁰ Walt Rostow, Memorandum to the President, 9 June 1966, NSF, Memoranda to the President, Box 8, Volume 5, Johnson Library.

⁷¹ Dean Rusk for the President, 9 June 1966, NSF, Memoranda for the President, Box 8, Volume 5, Johnson Library.

⁷² L.B. Pearson, "At the Atlantic Award Dinner," reprinted in his *Words and Occasions* (Toronto, 1970), pp. 254-59.

American officials, sent Canadian diplomats scrambling to develop a line of interpretation that would render Pearson's comments less harmful. Ambassador Averell Harriman, one of Johnson's stable of international trouble-shooters, quickly arranged to see the prime minister. He was pleased to learn that the speech reflected speculative thinking on Pearson's part, but pointedly reminded him of the dangers of speaking his mind in public. In late June, an assistant secretary of state for external affairs, H.B. Robinson, travelled to Washington to review NATO developments in more depth with Harriman and a high-powered American delegation that included senior officials from the State Department and the Pentagon. Robinson reported that the theme of the wide-ranging discussion was "burden-sharing":

There is a pervading consciousness in Washington of the heavy burden of responsibility now being carried by the United States. This stems predominantly from Vietnam but spills over into other fields, such as external aid and NATO. Many U.S. officials spoke in almost appealing terms to underline the point that the U.S. would need continuing and increasing support from its friends if the Administration were to be successful in persuading Congress to carry on even with the present U.S. efforts abroad. They feel very keenly that U.S. capacity and willingness to share generously in the burdens of providing global security may be circumscribed by the unwillingness of its allies to accept responsibility for a proportionate share.⁷³

Although Harriman levelled no specific charges against Canada, it was not surprising that he should strike this note. The governor was not alone. In view of the differences over peacekeeping, NORAD and NATO that had emerged between Ottawa and Washington since 1963,

⁷³ H.B. Robinson, Memorandum for the Under-Secretary, 30 June 1966, DEA File 27-8-USA, DFAIT.

several State Department officials had already started to consider how Canada might best contribute to the defence of the free world. The answers, however, were not as apparent as one might suppose. John Leddy, head of the State Department's bureau responsible for Canada, first tackled the question in September 1965. Obviously, Ottawa's frozen defence budget, Canada's ill-equipped military forces and the country's reluctance to accept its nuclear responsibilities constituted damning evidence that "[i]n terms of Free World foreign policy aims, as the U.S. sees them, Canada's performance leaves something to be desired."⁷⁴

This analysis, however, was only one side of the equation. On most major foreign policy questions, Leddy contended that "Canadian hearts are in the right place." What American policy-makers needed to understand was that there were sound domestic political reasons why Canadian leaders were instinctively and unconsciously reluctant simply to echo American foreign policy. Not least, he pointed out, was the desire of Canadians, particularly English Canadians, to use foreign policy to assert Canada's uniqueness:

As Canada is a nation without heroes or unique institutions or compelling traditions, foreign policy appears to [them] to be one of the few vehicles which [they] can use to raise a distinctive voice both at home and in international councils.⁷⁵

In order to develop and maintain a distinctive foreign policy, Canada was inclined to assume roles and responsibilities which,

⁷⁴ John Leddy (through S/S) to Ambassador L. Thompson, [September 1965], RG 59, Box 1979, File Pol 1 Can, USNA.

⁷⁵ *Ibid.*

even though they met American objectives and were frequently encouraged by Washington, allowed Canada to operate in a more independent fashion. Canada's commitment to the United Nations, for instance, was "whole-hearted" and its extensive peacekeeping duties were undertaken with "good grace." Moreover, under Pearson, Canadian foreign aid had shown "considerable improvement [and] there was visible progress both in the amount of aid and its form." Canada also supplied considerable military assistance to Tanzania and Malaysia. If the United States was dissatisfied with Canada's effort on behalf of the free world part of the problem lay in Washington's unwillingness to recognize and account for the factors which determined Canadian foreign policy. The search for a solution, concluded Leddy, would need to begin in Washington:

Obviously Canada can do more to support Free World objectives, but before we as a Government seek ways of persuading them to do more... we ought to take a careful look at what roles, in the large sense, we wish Canada to play. For example, should its armed forces emphasize peacekeeping or NATO? Are nuclear-capable weapons in Canadian hands important to the defense of the West or not? Should Canada be encouraged to play a larger role in the Commonwealth, where they could be grateful for the absence of the U.S. ... or should Canada devote more of its attention and money to, say, Latin America?

In his 1965 annual report, Butterworth adopted a similar theme. The time had come for Washington to review its approach to bilateral defence relations. Throughout 1965, the United States had faced obstacles in securing cooperation in NORAD and Canada's commitments to NATO remained only partial fulfilled. Moreover, complained the ambassador, the prime minister seemed anxious to withdraw Canadian troops from Europe. "In short," concluded Butterworth, "no likelihood was seen in 1965 that Canada might

eventually assume a proportionate share of the military burden of the Western Alliance. The emphasis in Canada's present defence policy continues to be participation in UN peacekeeping operations."⁷⁶

While Butterworth thought that the United States should continue to press Canada to assume its share of the cost of western defence, he wondered "whether our policy is fully up-to-date and realistic." As the two countries adopted increasingly different defence priorities, it was more important than ever before that Washington "know precisely what we want the Canadians to do and that what we ask is necessary and reasonable." Did it make sense to alienate Canadian authorities by pressuring them to purchase a costly follow-on aircraft to the CF-101, when the United States was in the midst of cutting back its own defences against manned bombers? Would NATO really require Canadian aircraft in a nuclear strike role by the time the CF-104 was obsolete? Perhaps "there was some other role into which the Canadian effort in NATO and NORAD might be channelled?" Given the importance Canada's geography would continue to play in the defence of North America against Soviet or Chinese missile attacks, maybe there was "a role for Canada in the development of a system of defense against attack by intercontinental missiles?" Together, concluded Butterworth, these questions pointed to one conclusion:

In view of the questions raised above I urge a review of our policy with respect to Canada's contributions to NATO and

⁷⁶ American Embassy, Ottawa, to State Department, Airgram A-638, 6 January 1968, FOIA Request 9202777.

NORAD. We are going to have difficulties with Canadians in defense matters in any case, and I consider it urgently essential that we have the most up-to-date, persuasively realistic defense policy to pursue here which it is possible to devise if we are to accomplish our purpose.

Butterworth's recommendations were received warmly in the State Department.⁷⁷ The question of renewing the NORAD agreement, which was due to expire in 1968, lent added urgency to the review which finally got underway in August 1966.⁷⁸ On the whole, the completed study, which was drafted by James Goodby of the State Department's Policy Planning Council with help from the European branch and the Department of Defense, was surprisingly optimistic in its approach to the future of bilateral defence relations:

There are reasons enough ... to be apprehensive, if not downright discouraged, about the future. This paper concludes, however, that current trends in Canadian defense policy are not likely to be reversed. And it is suggested not only that the United States can live with these trends but also that Canada's defence policies may turn out to be good for us as well as good for Canadians.⁷⁹

In support of this conclusion, Goodby began by explaining for his American readers the fundamental tensions that seemed to threaten Canada's existence. Close economic and cultural ties with the much larger and overwhelming United States, as well as continued French-English tensions, "undermined the psychological foundations of Canadian nationhood." Postwar Canadian politicians,

⁷⁷ Benjamin H. Read, Memorandum for Mr. Walt Rostow, 9 May 1966, FOIA Request 9202777.

⁷⁸ Walter Stoessel to Mr. Owen S/P, 7 June 1966, FOIA Request 9202777.

⁷⁹ James Goodby, The Future of US-Canadian Defense Relationships, April 1967, NSF, Country File: Canada, Box 165, Johnson Library.

Liberal and Conservative alike, have tried to counter these domestic strains by pursuing "an independent and influential role in world affairs." Canada's defence posture has been directed, in NATO and especially at the UN, "toward providing the means for an active foreign policy."

The final result of this search was the 1964 *White Paper on Defence*. In Goodby's view the promised reorganization of Canada's forces into mobile and flexible units which were suited more to peacekeeping than to Canada's traditional roles in NATO and NORAD reflected "a significant shift in Canada's view of its proper role in the world, generally in the direction of a peculiarly Canadian, nationalistic approach to defence questions." At the same time, a very low ceiling was placed on the Canadian defence budget as the federal government tried to resolve Canada's domestic tensions by directing more money to the provinces and into social programs. As these two developments reflected deep-rooted pressures within the Canadian federation, they would not and could not be swept away. The implications for the United States seemed obvious. Rather than trying to "induce the Canadians to return to the kind of comfortable junior partnership arrangement which has been typical in the past ... the United States may find that it must be more selective in what it asks Canada to do in the defense field and that [it] must become more accustomed to 'leading from the rear'."

Washington should begin to accommodate Canada's new defence and foreign policy postures by acknowledging frankly that while the two countries have a mutual interest in a number of different

defence relationships, they accorded these partnerships different priorities. Washington maintained that Canada and the United States shared a common interest in defending the North American continent, in deterring Soviet aggression in Western Europe, and "in encouraging social, political, and economic progress in the developing areas of the world while avoiding the violence and disorder which might bring major powers into collision with each other." Canada, however, reversed the order Washington assigned these three priorities.

Developing a working and successful defence partnership, Goodby pointed out, would mean working with Ottawa's priorities and exploring how Canada could contribute to American objectives on its own terms. Washington should recognize that Canada's plan to reorganize its military into mobile and flexible units could be a source of American and western strength. After all, Goodby reminded his readers, "[t]his Canadian philosophy fits neatly with our own perception of the kind of wars that are most likely in the future ... [and] a military posture which appeals to the special Canadian outlook and which could augment our own limited war and peacekeeping capabilities especially for use where a U.S. presence might not be desirable, ought to be as important to us as it is to the Canadians."

Rather than press Ottawa to strengthen its forces to meet Soviet aggression (especially when Washington was not able to convince the Europeans to augment their defences), the United States ought to encourage Canada's new defence posture. Washington

should also press Ottawa to fulfil the promises it made in the 1964 *White Paper* to equip these forces properly. Over the long run, the United States should encourage Canada to play a military role that extended beyond simply peacekeeping for the U.N. Canada might be persuaded to supply a mobile force to extinguish a "brushfire" war in a Commonwealth country or to restore order at the behest of an established government in the developing world. There were limits implicit in asking Canada to assume a greater share in policing the world's trouble spots: "Naturally, we will not convince Canada that its interests are everywhere the same as ours, but there should be enough instances of overlapping viewpoints to make a Canadian peacekeeping role outside the UN an important adjunct to our own efforts."

Having accepted that a substantial part of Canada's military effort would be directed towards peacekeeping, the State Department's study further acknowledged the need to accept adjustments in Canada's contribution to NATO and NORAD. The United States could easily afford to allow Canada to opt out of its nuclear role in NATO and should stop regarding "the acceptance of nuclear weapons ... as a test of Canada's fidelity to the United States." Instead, as questions were raised in Canada about the Canadian presence in Europe, Washington should concentrate on encouraging Canada to maintain its brigade group in West Germany. From a military perspective, the departure of the Canadian brigade, would substantially weaken NATO's forces on the North German Plain and "would reinforce the tendency of the smaller European countries

to cut back their contributions." In turn, this would promote American-German bilateralism and weaken the alliance as a whole. Washington should exploit Canada's interest in maintaining "its political membership and influence in NATO" and make the Canadian government aware that anything smaller than a brigade "would hardly be noticeable in either military or political terms."

Goodby's study adopted similarly reduced expectations about Canada's contribution to NORAD. It was no longer clear that the United States required nuclear storage facilities in Canada or that Canada's contribution to North American defence required the use of nuclear weapons. Indeed, the study dispassionately concluded that a host of technological changes might even eliminate the need for NORAD all together. Improved long-range interceptors, for instance, would soon reduce the need for forward air defence bases in northern Canada. The diminishing Soviet bomber threat also lessened the need for interceptor aircraft and bases. Moreover, while it might be helpful to have Canada's assistance in watching for the new threat posed by Soviet and Chinese missiles, it was no longer necessary. Missiles could be tracked from bases in the United States and from airborne warning and control systems (AWACS). An anti-ballistic missile (ABM) system could probably be stationed successfully in the United States alone. Finally, improvements in non-nuclear ASW weapons would soon render the need for American nuclear ASW storage facilities in Canada obsolete. Goodby concluded that "[t]he only absolutely essential requirement we ... have to levy on the Canadians would be use of their air space. Everything

beyond this would appear to be a bonus ... pleasant to have but not at the price of cutting back Canadian efforts in other fields." Nevertheless, with this fairly flexible bottom line in mind, there were good reasons why the United States should pursue NORAD's renewal. The agreement was beneficial to both countries "as a means of facilitating U.S. retention or acquisition of certain military rights in Canada, as a means of communication and consultation, and, in general, as a symbol of cooperation."⁸⁰

By the time the Goodby study was completed in the spring of 1967, Pearson's government was finding it difficult to meet even these diminished expectations. Throughout 1966 and early 1967, American excesses in Southeast Asia and the apparent thaw in Western relations with the Soviet Union began to reduce popular support for Canada's military alliances with the United States. Popular attitudes towards NORAD's nuclear weapons, which many feared made it more difficult to resolve East-West differences, shifted profoundly:

⁸⁰ The Goodby study has been treated very differently elsewhere. Graeme Mount briefly cites the study as further proof that the United States resented Canada's failure to pull its weight during the 1960s. He overlooks completely Washington's evolving expectations about Canada's contribution. See his paper, "Canada's Identity as a Cold War Ally, 1961-1981," paper presented to the Canadian Historical Association Annual Meeting, June 1995, p. 48, n2.

Acceptance of Nuclear Weapons by the Canadian Public⁸¹

	Nov. 1962	March 1963	June 1966
Yes	54.4	48.6	34.4
No	31.6	31.0	43.8
No Opinion	8.2	14.0	17.5
Qualified	5.6	3.5	4.1
Rejects		2.5	
	<u>99.8</u>	<u>99.1</u>	<u>99.8</u>

A younger generation of scholars, who did not share the war-time and post-war experiences that shaped the worldview of most senior Canadian policy-makers, mounted a sustained attack on Canada's role in both NORAD and NATO. Two of the earliest critics, Lloyd Axworthy and John Warnock, urged the government in 1966 to scrap NORAD because it was "useless" in light of the declining bomber threat. More important, it symbolically linked Canada to Washington's military adventurism in Southeast Asia.⁸² They were joined in their attack by the New Democratic Party (NDP), which moved from moderate support for NORAD in 1963 to strong opposition by 1966. The party's defence critic, Andrew Brewin, described the agreement as "obsolete" and urged the government to direct more of

⁸¹ R.B. Byers, "Canadian Foreign Policy and Selected Attentive Publics," December 8, 1967 (paper prepared for Defence Liaison (1) Division, mimeo), DFAIT Library, p. 68.

⁸² Lloyd Axworthy, "Canada and the World Revolution," *Canadian Dimension*, Vol 3 (March-April 1966), pp. 31-33; John W. Warnock, "Canada and the Alliance System," *ibid*, pp. 36-39. The critical academic literature of the period is surveyed in Denis Stairs, "Publics and Policy Makers: The Domestic Environment of Canada's Foreign Policy Community," *International Journal*, Vol XXVI, No 2 (Winter 1970-71), pp. 229-31.

the country's efforts towards United Nations peacekeeping.⁸³

At the same time, public doubts about NATO were expressed with increasing frequency. In the wake of France's withdrawal from the alliance, the influential University of Toronto political scientist and Liberal strategist, Stephen Clarkson demanded that Ottawa re-examine its commitment to NATO. In the House of Commons, Brewin left no doubt about where the NDP stood: "We should withdraw our brigade and air divisions from Europe.... [and] concentrate on a tri-service, unified, slightly armed, highly mobile force available for peace keeping and other intervention roles."⁸⁴ Within a year, a small, but important group of Progressive Conservatives had also begun to question Canada's attachment to NATO. The party's president, Dalton Camp, gave voice to this view when he observed that the "psychological, political and military reasons for Canada's military presence in Europe may have already disappeared."⁸⁵

By the spring of 1967, criticism of NORAD and NATO was heard more and more often at the cabinet table. Ministers like Pierre Trudeau, Gerald Pelletier and Jean Marchand, who had never agreed with Pearson's 1963 decision to accept nuclear warheads for Canadian forces, found a champion for their views in Walter Gordon. Gordon, who had rejoined the cabinet in January 1967 and had become

⁸³ John English, draft paper, "NORAD and Defence Cooperation with the United States," p. 5.

⁸⁴ Cited in John Saywell (ed.), *Canadian Annual Review for 1967* (Toronto, 1968), p. 263.

⁸⁵ *Ibid.*, p. 266.

president of the privy council in April, was increasingly anxious to press upon the government a more "independent" foreign policy.

The prime minister, who continued to entertain his own doubts about the nature of Canada's commitment to NATO and NORAD, was certainly aware of the shifting balance of opinion in cabinet. Following the British and American decision in April 1967 to reduce their force levels in continental Europe, he wrote Martin to express concern over "the developing inflexibility of our position re: Canadian forces with NATO." He added, "I think that we should give consideration to our own position; especially the maintenance overseas of RCAF squadrons in a nuclear attack role."⁸⁶ Martin responded vigorously and challenged the prime minister's premise regarding the "inflexibility" of Canada's NATO contribution, pointing out that in 1967 alone the government had reduced from eight to six the number of air squadrons in Europe. He also noted that further cuts to Canada's forces in Europe were anticipated. Greater reductions than those now being considered, the minister warned, "would open us to USA pressure to help carry the 'Western burden' elsewhere, perhaps in Southeast Asia where the British are withdrawing. Rapid withdrawal from Europe would also expose us to a scale of commitment for a Vietnam peacekeeping operation which would be costly to maintain in both financial and manpower terms."⁸⁷

⁸⁶ L.B. Pearson, Memorandum for the Hon. Paul Martin, Pearson Papers, Vol 280, File 832 Secret, NAC.

⁸⁷ Paul Martin, Memorandum for the Prime Minister, 6 May 1967, *ibid.*

Pearson acquiesced and let the issue drop for the time being; other members of cabinet did not. On 12 and 13 May 1967, Gordon delivered two speeches on Canadian foreign policy to audiences in southern Ontario. In one, he criticized Ottawa's support for American policy in Vietnam. In the other, he questioned Canadian participation in NATO and NORAD, two alliances that he clearly felt were symbolic of American domination. Gordon wondered whether Canada should maintain air squadrons in Europe. The answer was obvious:

The French don't want us; the countries of Western Europe are now quite prosperous enough to maintain their own defence establishments if they wish to; both the U.S. and Britain have stated their intentions to withdraw some of their troops from Europe. In these circumstances what is the sensible thing and the right thing to do?⁸⁸

Referring to the continuing uncertainty in the United States over the possibility of deploying an expensive ABM system, Gordon pondered Canada's future in NORAD:

The alternative for a country of our size may be to opt out of the contest altogether on the grounds that if there should ever be a nuclear war between the U.S. and the Soviet Union, there would be nothing effective we could do about it anyway. In circumstances such as these, Canada, instead of stepping up her defence budget considerably, might decide to concentrate her efforts on the maintenance of mobile peace-keeping or peace-restoring units to be available to the United Nations.⁸⁹

Martin and Hellyer were furious. So too was Pearson, although he was increasingly sympathetic to Gordon's views, especially on the conflict in Vietnam. In a public statement rebuking his cabinet colleague, the prime minister declared that Gordon's speeches went

⁸⁸ Walter Gordon, *A Political Memoir*, pp. 285-86.

⁸⁹ *Ibid.*, p. 286.

beyond "anything we have discussed - let alone decided - in the Cabinet as to what we should do about NORAD, NATO and U.S. policy in Vietnam."⁹⁰

Both NATO and NORAD, however, were on the cabinet's agenda before the end of the month. On the basis of discussions between the State Department and the Department of Defense during the first stages of the Goodby study, the United States had decided in September 1966 to ask Canada to begin talks on renewing NORAD with suitable provisions for incorporating an ABM system if the two countries decided to deploy one.⁹¹ Canada's cautious response to the American overture reflected the country's growing unease with the alliance. Martin, who thought that the United States had approached the question of NORAD's renewal in a very circumspect manner, was anxious to cooperate. Potential domestic criticism might be muted, he thought, if Ottawa went no further at this stage than informing the State Department that Canada had begun interdepartmental studies on the future of air defence that assumed "continued Canadian participation in the integrated air defence of the continent ... after 1968."⁹² The prime minister concurred, but warned the Canadian delegation to the October 1966 PJBD meeting to avoid saying anything "at this stage which would prejudice our

⁹⁰ John English, *The Worldly Years: The Life of Lester Pearson, Volume II: 1949-1972* (Toronto, 1992), p. 377.

⁹¹ John Leddy to the Acting Secretary of State, 22 September 1966, FOIA Request 9202777.

⁹² Paul Martin, Memorandum for the Prime Minister, 30 September 1966, DEA File 27-14-NORAD-1, DFAIT.

position in regard to the changes we might wish to make to the present form of air defence integration through NORAD."⁹³

Pearson's doubts about NORAD continued to hinder the efforts of Martin and Hellyer to adopt a more welcome forthcoming position for the next meeting of the PJBD in February 1967. The two ministers based their positions on recent studies by the Department of National Defence which concluded "that regardless of changes in the threat, or in the nature of the defences, there will be a continuing need for an automatic, integrated response system."⁹⁴ They recommended to Pearson that Canada inform the American section that, while Ottawa continued to study the future of NORAD, the government had concluded that "the principles of the present NORAD Agreement are as valid today as they were in 1958."⁹⁵ Pearson was not convinced. After reassuring Gordon that there would be a full debate in cabinet on NORAD, he summoned Martin and officials from the Department of External Affairs and told them that he would not approve the renewal of NORAD until Ottawa was given more information on American plans to deploy an ABM system. In the meantime, he could not argue in cabinet that the present principles remained valid and he instructed the minister that Canada was "to express no views one way or the other with regard to any suggestion that might be made concerning the extension of the NORAD Agreement

⁹³ Jacques Corbeil, Memorandum for Defence Liaison (1) Division, 3 October 1966, DEA File 27-14-NORAD-1, DFAIT.

⁹⁴ Real Admiral R.W. Murdoch, Deputy Chief of Plans to Vice-CDS, 17 March 1967, Raymont Papers, File 343, DHist.

⁹⁵ *Ibid.*

either in duration or in responsibilities and activities.⁹⁶

The information that Pearson wanted on American plans for the proposed ABM system was obtained in early April when Hellyer met the American secretary for defense, Robert McNamara, in Washington. The American explained that current plans called for the deployment of an ABM system in the United States only. Naturally, Canada would be welcome to join the system at a later stage, but for the time being, the question of an ABM system should not get tangled up in the discussions for NORAD's renewal:

The main theme running through these briefings was that Canadian cooperation in ballistic missile defence was not necessary from a United States point of view and that Canada would be entirely free to decide on the extent of its own involvement in the event that the United States decided to deploy ABMs."⁹⁷

The prime minister remained sceptical and thought that the ad hoc system for North American air defence in place before 1958 would do just fine. Nevertheless, he agreed to let Martin and Hellyer put the question of NORAD's renewal to cabinet in preparation for the June meeting of the PJBD.

Well aware that Gordon's May speech reflected the mounting opposition in cabinet to NORAD, Martin proceeded with considerable caution. His submission to cabinet was modest. He reassured his colleagues that there were no plans to have NORAD include ABM defences. He reminded them that the bomber threat would continue

⁹⁶ H.B. Robinson, Memorandum for Defence Liaison (1) Division, 10 February 1967, DEA File 27-14-NORAD-1, DFAIT.

⁹⁷ Paul Martin, Memorandum for the Prime Minister, 19 May 1967, DEA File 27-14-NORAD-1.

simply because the Soviet Union would not put all its eggs in the missile basket. To counter that threat and mobilize quickly and effectively, the defences of Canada and the United States required the kind of integrated command that NORAD currently provided. The alliance placed no specific demands on Canada, although there was an "implicit obligation...to contribute in some fashion to North American air defence be it equipment, air space, bases, etc."

Allowing NORAD to lapse would only make bilateral relations more difficult for Canada since it would continue to be confronted with American demands for help in defending the continent. Instead of having to deal with one over-arching agreement, the government would be faced with the prospect of negotiating several individual agreements on such questions as overflights, nuclear authorization and consultation, and American bases. Each agreement exposed the government to potential domestic political pressure and placed additional strain on the country's relations with the United States. Moreover, added Martin, allowing NORAD to lapse might well provoke Washington into cancelling the joint defence production agreements of 1959 and 1963. While there was little scope for amending what was a very basic agreement, he tried to mollify the treaty's opponents by suggesting that Canada could shorten the agreement's term and add a termination clause. Setting aside the future of NORAD for the moment, Martin urged cabinet at least to allow him to inform Washington that Canada "intends to cooperate

with the United States in continental air defence."⁹⁸

In addition to this memorandum on the future of NORAD, the cabinet had before it instructions for the forthcoming NATO ministerial meeting. Martin, with the prime minister's approval, was anxious to weigh cabinet support for Gordon's view of the alliance. In a relatively routine document requesting approval for the delegation's instructions, Martin outlined his current thinking on the force levels for Canada's contribution to NATO for the next five years. The reductions in Canada's commitment to NATO were small. While the brigade group would remain in West Germany, the number of CF-104 squadrons stationed in Europe would decline from six to four. Even this minor change would be subject to consultation and negotiation among the allies.⁹⁹

For those responsible for Canada's relations with the United States, the results of the meeting were deeply disturbing. The cabinet deliberations took place against the backdrop of the war in Vietnam. The French Canadian ministers, especially Marchand and Trudeau, questioned the five-year commitment. Other ministers suggested using the newly created Mobile Command Force to fulfil the Canadian commitment to NATO from bases in Canada.¹⁰⁰ So hostile was the discussion that Martin decided not to seek approval for the

⁹⁸ Paul Martin, Memorandum to Cabinet, 31 May 1967, DEA File 27-14-NORAD-1, DFAIT.

⁹⁹ Memorandum to the Cabinet, 31 May 1967, DEA File 27-4-NATO-12-1967-Spring, DFAIT.

¹⁰⁰ John English, "Problems in Middle Life," in Margaret MacMillan and David Sorenson (eds.), *Canada and NATO: Uneasy Past, Uncertain Future* (Waterloo, 1990), pp. 47-66.

five-year commitment:

There had been a certain amount of questioning of the necessity for making commitments applying to a five-year period and some indication on the part of some Ministers of scepticism as to the need for our continued military contribution to the Alliance.¹⁰¹

NORAD fared slightly better in the cabinet discussion. Martin was authorized to inform the United States that Canada would cooperate in an unspecified manner in the defence of North America. However, as Arnold Heeney, who succeeded Wilgress as the chairman of the Canadian Section of the PJBD in early 1967, observed, this decision "did little more than gain us further time for dealing with the U.S. authorities."¹⁰²

Neither Pearson nor Martin had any trouble grasping the significance of the cabinet discussion. Particularly concerned with the division between Martin and Gordon, the prime minister suggested that the two attend the forthcoming meeting of NATO foreign ministers in Luxembourg together.¹⁰³ The trip did little to reduce Gordon's hostility toward NATO. On the way back to Canada, he asked Robinson to meet with him, Trudeau and Marchand to discuss NATO and NORAD. The results of this unorthodox exercise were mixed. Gordon insisted that Canada's relative decline in international

¹⁰¹ H.B. Robinson, Memorandum for Defence Liaison (1) Division, 2 June 1967, DEA File 27-4-NATO-12-1967-Spring.

¹⁰² H.B. Robinson, Memorandum for Defence Liaison (1) Division, 1 June 1967, DEA File 27-14-1, DFAIT. Heeney comments on the value of the PJBD in his memoirs. See *The things that are Caesar's: Memoirs of a Canadian public servant* (Toronto, 1972), pp. 199-200.

¹⁰³ Paul Martin, *So Many Worlds*, p. 480; Gordon recalls this episode differently in his memoirs, *A Political Memoir*, p. 286.

stature since the mid-1950s and the recent decisions by France, the United States and the United Kingdom to unilaterally change their contribution to NATO necessitated some adjustment in Canada's position. He was "quite scornful" that Canadian action would "set up pressures in Washington." He was not, after all, suggesting that Canada withdrawal from NATO. He simply thought that it should be possible for Canada to reduce its contribution to Europe much faster than Martin and Hellyer anticipated. At the end of his discussion with Robinson, Gordon seemed uncertain what position he would ultimately take in cabinet:

Mr. Gordon is torn between a general acceptance of the political value of continued membership in NATO and a fairly healthy scepticism about the value of the military contribution to Europe.¹⁰⁴

On the question of NORAD, however, the president of the privy council turned out to be much more flexible. He accepted the case Robinson made for the necessity of NORAD and integrated air defence. His central concern was Washington's proposed ABM system. He worried that Canada would not be able to avoid participating in developing this system with all the expense that this involved if NORAD was renewed. But Gordon also had another objection, this time philosophical:

My concern is a broader one. If the world fails to reach agreement on anti-proliferation, is there any point in continuously expanding our defence systems? In the last analysis, might we not be safer -- or at least no less vulnerable -- if we acknowledge frankly that there can be no

¹⁰⁴ H.B. Robinson, Memorandum for the Under-Secretary, 2 July 1967, DEA File 27-4-NATO-1, DFAIT.

real defence for us in a war between the United States and the Soviet Union (with or without China).¹⁰⁵

If Ottawa can continue to keep an ABM system out of NORAD, Robinson concluded "Mr. Gordon will not oppose renewal of the Agreement."¹⁰⁶

By the end of August, Martin and Hellyer were again ready to seek cabinet approval for their NATO and NORAD policies. They had some reason for confidence. Marcel Cadieux, who had replaced Robinson as an intermediary with the recalcitrant members of cabinet in July, thought that he had convinced "Gordon and company" to accept for the time being "the idea of an evolutionary approach to the contribution of forces in Europe." Moreover, the under-secretary of state for external affairs reported, "they would not oppose a renewal of NORAD provided there were a reservation about ABMs and a suitable termination clause."¹⁰⁷

Still, Martin and Hellyer were taking no chances. In early September, they presented cabinet with four detailed and lengthy memoranda on NATO and NORAD. The first submission, on which no decision was required, placed NATO and NORAD in their larger context as part of Canada's post-war effort to erect an effective system of collective security and sought to illustrate how they contributed to Canada's foreign policy objectives::

¹⁰⁵ Walter Gordon, Memorandum Re: NORAD, 27 June 1967, Gordon Papers, Vol 16, NAC.

¹⁰⁶ H.B. Robinson, Memorandum for the Under-Secretary, 28 June 1967, DEA File 27-14-NORAD-1, DFAIT.

¹⁰⁷ Jim Nutt to H.B. Robinson, 28 July 1967, DEA File 27-14-NORAD-1; Walter Gordon, *A Political Memoir*, p. 287. Martin claims that the views Gordon expressed at the time were more favourable to NATO; see Paul Martin, *So Many Worlds*, p. 480.

For Canada, collective defence arrangements not only contribute to our own security but also represent one of the ways in which we have sought to play an international role recognized as being responsible. At the same time, in relation to the United States, these commitments have enabled Canada to maintain its sovereignty and have obtained for us a measure of influence with the United States Government. By accepting commitments in Europe, Canada has been able to develop its links with the area in which its principle overseas interests lie. A drastic unilateral reduction in the Canadian contribution to collective defence either in Europe or North America would mean that we could no longer contribute to our own security and would reduce the general effectiveness of Canadian foreign policy.¹⁰⁸

The second and third memoranda focused directly on NATO and the immediate question of Canada's submission of a five-year plan to the NATO forces review. Although they acknowledged that the military threat that NATO was formed to counter was less immediate than it had been in 1949, they contended that "the improved climate of East-West relations depended on the maintenance of sufficient force in the West to balance the Soviet Union." The desire to improve East-West relations had to be weighed against the fact that "major force reductions or withdrawals can only be safely undertaken in the West if they are in some way balanced by corresponding action by the Soviet Union." This balance, cautioned the memoranda, must not be upset by unilateral troop reductions lest "we ... give up our bargaining power, and at the same time tip the local power balance in the Soviet favour."

These two memoranda also presented specific arguments against Canadian withdrawal. Membership in NATO fostered relations with Europe which "offset the preponderant United States influence on

¹⁰⁸ Memorandum for the Cabinet, 5 September 1967, Pearson Papers, Vol 280, File 830 Secret, NAC.

Canada." It also represented a forum where smaller powers could influence the policies of larger ones, and where Canada could "secure a voice in an eventual European settlement." Moreover, Canada did not have the same resources as France to direct towards its own deterrent, and so, the alliance represented a relatively inexpensive solution to the problem of Canadian security. "In sum," concluded the memoranda, "while Canada might continue to be accepted as a member of NATO if it limited its defence activity to contributing to North American defence, we should lose those important political advantages which flow from our contributions to the defence of Europe."¹⁰⁹

There was little debate. Martin began his presentation of the three memoranda by referring to a recent discussion with Rusk on the possibility of negotiating with Moscow. Rusk "agreed with the established Canadian policy that reductions should be part of a collective process of bargaining with the Soviet Union for gradual disengagement."¹¹⁰ Martin argued that Canada's small contribution to Europe "carried with it very considerable influence" and warned that Canada's withdrawal might well cause the alliance to disintegrate. With a nod of support from Mitchell Sharp, the minister of finance, he underlined how low Canadian defence expenditures actually were. The only opposition came from Walter Gordon, who repeated yet again his view that altered international

¹⁰⁹ Memorandum for the Cabinet: Canada and NATO, 5 September 1967, Pearson Papers, Vol 280, File 830 Secret, NAC.

¹¹⁰ Confidential Source.

circumstances demanded a change in Canadian policy. At this point, the prime minister intervened quickly and decisively. Canada's present contribution represented, he said, "the minimum price for club membership." Canada's withdrawal from Europe would leave an alliance dominated by "the United States and Germany, with the United Kingdom acting as a junior partner and France withdrawing completely." This, he insisted, would destroy NATO. Cabinet approved continued membership in NATO and the level of contributions requested.

The fourth and final memorandum under consideration asked cabinet to authorize negotiations with the United States for the renewal of NORAD on the basis of the existing agreement.¹¹¹ While there was little opposition, several members of the cabinet took the opportunity to remind Martin and Hellyer that they would only approve an agreement that was limited to a five-year term with a termination clause allowing either party to abrogate the agreement with one year's notice. Gordon unrealistically insisted that this decision did not commit the government to concluding an agreement with the United States.¹¹²

The actual negotiations for the new NORAD agreement were easy and straightforward. The Canadian position was presented to the Americans at the PJBD meeting in late September, where it quickly removed much of the tension that had begun to cloud bilateral

¹¹¹ Memorandum for the Cabinet: NORAD, 5 September 1967, Pearson Papers, Vol 280, File 830 Secret, NAC.

¹¹² Confidential Source.

defence relations. Although American defence planners worried that the five-year term proposed by Ottawa was too short to allow for effective bilateral planning, the United States agreed not to counter-offer.¹¹³ By early February 1968, a draft agreement was ready for cabinet. With the addition of clauses which terminated the pact in five years and specifically excluded ABM systems from its purview, the agreement was "substantially" the same as the 1958 treaty.¹¹⁴

However, as Martin prepared to present the new text to cabinet, Gordon retreated from his September position of reluctantly supporting NORAD's renewal. In a letter to Pearson, he advanced several reasons for now opposing renewal. He reiterated his concern about the cost of air defence, and the prospect of updating the nuclear-armed BOMARC missiles and Canadian interceptors. He continued to wonder whether NORAD was still useful in the missile age. He was inclined to think that it was not and that NORAD's renewal would eventually lead to a North American ABM system. However, the real reason for his opposition was the continuing war in Vietnam. Citing rumours that the United States was thinking of using tactical nuclear weapons in Southeast Asia and that some officers in the Pentagon "would like to provoke a war with China which necessarily would become a nuclear war," Gordon

¹¹³ A.D.P. Heeney, Report on the P.J.B.D. Meeting and H.B. Robinson to E.A. Ritchie, 6 October 1967, DEA File 27-4-PJBD-67-Fall, DFAIT.

¹¹⁴ Memorandum to Cabinet, 7 February 1968, Gordon Papers, Vol 16, NAC.

implied that renewing "a defence alliance with the United States" might drag Canada into a nuclear war in Asia.¹¹⁵

Gordon was alone in his opposition to renewing NORAD. When cabinet met in late February to discuss the issue, only Pearson agreed with Gordon's suggestion that the decision be left over for the new government. When Gordon insisted that there be a full discussion on NORAD's renewal, debate was inconclusively adjourned. Gordon was tired, and when he saw Pearson later that evening, he explained that he would continue to oppose NORAD in view of the Vietnam conflict, even though the cabinet, the caucus and the public seemed to support it. However, he did not wish to upset the government as the prime minister prepared to retire, and he asked Pearson to delay its final approval until his resignation, submitted two weeks earlier, had taken effect.¹¹⁶ Pearson agreed. He accepted Gordon's resignation on 11 March 1968, delaying formal approval for NORAD's extension until 14 March 1968.

Not all Canadians were convinced that Pearson's government had gone far enough in adjusting Canadian defence and foreign policies to take into account the declining Soviet threat, Europe's recovery and domestic pressures for a distinctly Canadian approach to the world. In April 1968, Trudeau, newly elected leader of the Liberal Party, expressed his desire for real and far-reaching change: "Most of our foreign policy today is based on ... pre-war premises or

¹¹⁵ Walter Gordon to L.B. Pearson, 15 February 1968, Gordon Papers, Vol 16, NAC.

¹¹⁶ Walter Gordon's handwritten notes, 27 February 1968, Gordon Papers, Vol 16, NAC.

immediate post-war premises ... complete re-assessment is needed."¹¹⁷ Some American observers were similarly unhappy with the Pearson government's altered approach to defence and foreign policy questions. Butterworth's assessment was blunt:

Canada's progressive withdrawal toward neutralism and its greater willingness to let the U.S. and others bear the burdens of security should make us take a new, clear look at our northern neighbour, good and grey as he used to be remembered. We have to keep in mind that an attack from our two most likely mortal enemies would no doubt include flights over the pole and Canada. Our trade and investment ties with Canada and its economy are so many and bulk so large that we should think what kind of place it is and what dependence we can or dare place on it.¹¹⁸

Clearly, bilateral disagreements over Canada's proper role in the western alliance would continue. However, the 1960s made it equally clear that there was scope for Canada to pursue its own foreign and defence policies without jeopardizing bilateral relations. Under Pearson and Johnson, Ottawa and Washington began the difficult process of adjusting the close postwar military and political alliance in ways that made sense to both partners. This was never easy, but a willingness to accommodate each others' legitimate interests made it possible for the two countries to reconcile most of their foreign and defence policy differences.

¹¹⁷ Thomas Axworthy, "'To Stand Not So High Perhaps but Always Alone': The Foreign Policy of Pierre Elliott Trudeau," in Thomas Axworthy and Pierre Trudeau (eds.), *Towards a Just Society: The Trudeau Years* (Markham, 1980), p. 18.

¹¹⁸ American Embassy, Ottawa to State Department, Airgram A-772, 2 January 1968, FOIA request 9202777.

Chapter Five:

The Asian Conundrum

Throughout the mid-1960s, the bilateral effort to reapportion Canada's contribution to western defence and to shape a new North American defence relationship was complicated by Washington's growing preoccupation with the war in Southeast Asia. President Johnson's decision in July 1965 to escalate the war in Vietnam placed that conflict and western relations with the People's Republic of China at the centre of domestic politics in both the United States and Canada. Public opposition to the war and Washington's irrational determination to continue to exclude Peking from the international community raised questions about the very nature of American society and Canada's relationship with it.

The Pearson government was caught between domestic demands for a distinctive response to the Asian crisis (one that reflected Canadians' evolving self-image as a peacemaker) and Washington's expectations about the behaviour of a close and loyal ally. As the war intensified, there was clearly little chance that sharply divergent Canadian and American views on the Far East could be reconciled. Instead, these differences over Asia needed to be managed constantly and carefully contained. Though constrained by his complicated relationship with Paul Martin, the secretary of state for external affairs, Prime Minister L.B. Pearson increasingly seized control of Canada's Asian policy, deflecting his foreign minister's efforts to pursue a course in the Pacific

independent of American interests in the region.¹ Pearson resisted popular pressure to adopt extreme positions, and in so doing, by the end of 1966, he largely disarmed the threat posed by the war to relations between the two North American governments.

By the time that Pearson's government assumed office in the spring of 1963, the continuing crisis in Southeast Asia had already become a fixture on the Canada-United States bilateral agenda. For almost a decade, the two countries had worked closely together in the uneasy peace that followed the signing of the Geneva Accords in 1954. As the western representative on the three ineffectual international commissions established to oversee the provisions of the cease-fire agreements in Laos, Cambodia and Vietnam, Canada had watched communist insurgents work with effective impunity to undermine the Geneva settlements in Indochina with mounting frustration.² For just as long, the United States had sought,

¹ Martin's relationship with Pearson is explored more fully in Greg Donaghy, "Minding the Minister: Pearson, Martin and American Policy in Asia, 1963-1967," in Norman Hillmer (ed.), *Pearson: The Unlikely Gladiator* (Kingston and Montreal, forthcoming, 1998).

² There is an extensive historiography on Canada's role on the International Commission for Supervision and Control in Vietnam (ICSC). Among the most important studies are the following: Charles Taylor's polemical attack on Canadian policy, *Snow Job: Canada, the United States and Vietnam (1954 to 1973)* (Toronto, 1974); in the same vein, but grounded in a good deal of archival research, is Victor Levant, *Quiet Complicity: Canadian Involvement in the Vietnam War* (Toronto, 1986); the tensions in early Canadian policy in Indochina are explored in a more balanced but still critical fashion in James Eayrs, *In Defence of Canada, Volume V: Indochina: Roots of Complicity* (Toronto, 1983).

The question is approached from a more analytical and comparative perspective in Ramesh Thakur, *Peacekeeping in Vietnam: Canada, India, Poland and the International Commission* (Edmonton, 1984). The best work remains Douglas Ross, *In the*

through an array of military assistance programs and an ever-growing number of military advisors to create a stable, independent and anti-communist South Vietnam.³ Exposed to the same influences and exchanging information regularly, Canada and the United States shared the view that the Viet Cong insurgency in South Vietnam was inspired and supported by Communist Hanoi.

Washington's failure to secure the kind of stability in South Vietnam in the early 1960s that was a prerequisite for an effective anti-communist crusade worried the new prime minister. Pearson harboured doubts about the nature and legitimacy of the American role in Asia, reflecting his experiences during the Korean War.⁴ During his meeting with Kennedy at Hyannisport, he reportedly encouraged the American president to abandon South Vietnam.⁵ Paul Martin and his officials in the Department of External Affairs, on the other hand, were much more sanguine about American policy in Vietnam. Despite the collapse of the corrupt and ineffective regime of Ngo Dinh Diem in an American-sponsored coup in November 1963, and the rapid succession of military coups which followed, Martin

Interests of Peace: Canada and Vietnam, 1954-73 (Toronto, 1984).

³ The best single-volume introduction to American policy in Vietnam is George C. Herring, *America's Longest War: The United States and Vietnam 1950-1975* 2nd Edition (New York, 1986).

⁴ John English, *The Worldly Years: The Life of Lester Pearson, Volume II: 1949-1972* (Toronto, 1992), p. 328.

⁵ L.B. Pearson, *Mike: The Memoirs of the Right Hon. Lester B. Pearson, Volume III: 1957-1968* (Toronto, 1975), p. 137. See also Robert McClintock to George Ball, 12 May 1966, RG 59, Box 1984, File POL 15-1 CAN, United States National Archives (USNA).

and his principal advisors retained their confidence in Washington's ability to direct events in South Vietnam. "The U.S.A. attitude on Vietnam at present," the Canadian Embassy in Washington reported in early 1964, "appears to be characterized by a mixture of caution, patience and determination."⁶

Washington's inability to convince Hanoi that it was determined not to allow communist insurgents to take over South Vietnam precipitated Ottawa's increasingly direct involvement in Southeast Asia in the spring of 1964. In a late April meeting with Pearson and Martin, the American secretary of state, Dean Rusk, asked for Canada's help in ensuring that Hanoi understood the United States position. Rusk, whose approach was designed to soothe any possible Canadian concerns, stressed that Washington was determined to work within the existing Geneva framework. The United States was not anxious to widen the war, but wished simply to tell Hanoi "that it would be wrong for the Viet Minh to expect that the United States were getting discouraged and were thinking of pulling out. It was important for them to realize that if they didn't put a stop to their operations they would be in deep trouble." Rusk asked the Canadians to send Blair Seaborn, who was soon to replace Gordon Cox as Canada's representative to the ICSC, to Vietnam as quickly as possible and to authorize him to act as an intermediary

⁶ Washington to Ottawa, Tel No 1002, 16 March 1964, Department of External Affairs (DEA) File 20-22-Viets-2, Department of Foreign Affairs and International Trade (DFAIT).

between Washington and Hanoi. The two Canadians readily concurred.⁷

Despite the forthcoming position adopted by Pearson and Martin, Rusk suspected that Ottawa would place clearly defined limits on its cooperation.⁸ He was right. In late May, Pearson met secretly with President Johnson in New York to review the general lines of the Seaborn mission. The prime minister agreed with the president's determination to avoid withdrawing from Vietnam and carefully endorsed the use of conventional bombing "if [the] action could be carefully limited and directed [to] the interdiction of supply lines from North to South." He cautioned Johnson against the use of tactical nuclear weapons, an idea then being touted by Republican presidential candidate Senator Barry Goldwater, and warned "that any drastic escalation would give great problems both in Canada and internationally."⁹ The boundaries of Canadian cooperation were clearly laid out.

Simultaneously, Martin and his officials met in Ottawa with William Sullivan, head of the State Department's Vietnamese

⁷ Minutes of Rusk-Under Secretary of State for External Affairs Meeting, 30 April 1964, DEA File 20-22-Viets-2-1, DFAIT. See also telegram from the Department of State to the Embassy in Vietnam, 1 May 1964, United States, Department of State, *Foreign Relations of the United States (FRUS)*, 1964-68, Volume I: Vietnam 1964, (Washington, 1992), pp. 281-82.

⁸ George C. Herring (ed.), *The Secret Diplomacy of the Vietnam War: The Negotiating Volumes of the Pentagon Papers* (Austin, 1983), p. 18.

⁹ Memorandum for the Record of a Conversation Between President Johnson and Prime Minister Pearson, Hilton Hotel, New York, May 28, 1964, 6:15-6:45 p.m., *FRUS* 1964-68, Volume 1: Vietnam, p. 395. See also Michael R. Beschloss (ed.), *Taking Charge: The Johnson White House Tapes, 1963-1964* (New York, 1997), p. 376-77.

Coordinating Committee. Officials quickly established the ground rules that would govern Seaborn's employment; not unexpectedly, the Canadians insisted that all communication with Seaborn pass through Ottawa, while Sullivan stressed the importance of transmitting American messages as faithfully as possible, whatever the Canadian government might think of them.¹⁰ Martin was irritated and suspicious at the lapse in time between Rusk's initial approach in April and the present exercise in briefing Seaborn. The foreign minister wondered whether the mission had already been left too late. Twice during the meeting, he emphasized the domestic problems that would be created by an American decision to intensify the war. "[T]he Opposition tended to be suspicious of United States policy in Indochina," Martin explained, warning that "he would find it difficult to condone...direct [United States] intervention."¹¹ Like Pearson, Martin used the Seaborn mission as an opportunity to establish the limits of Canadian support.

The results of Seaborn's first visit to the Democratic Republic of Vietnam (DRVN) seemed likely to assuage Canadian fears. In a meeting with the North Vietnamese prime minister, Pham Van Dong, Seaborn delivered the American message, which underscored the administration's determination to defend South Vietnam, the

¹⁰ Record of Conversation: Visit of Messrs Sullivan and Cooper to the Department, 3 June 1964, DEA File 20-22-Viets-2-1, DFAIT.

¹¹ *Ibid.* In his memorandum of the conversation, Sullivan thought that Martin's nervousness about the domestic consequences of escalation was worth drawing to the attention of Ambassador Lodge. See *FRUS 1964-68, Volume 1: Vietnam*, p. 395, n. 5.

consequences that would follow continued aggression, and the material benefits that would flow to Hanoi from a peaceful accommodation. Although the encounter resulted in no change to Hanoi's position, Ottawa was pleased that Phan Van Dong was ready to meet Seaborn again and that a channel had been successfully established between Washington and Hanoi.¹²

For different reasons, Washington was also grimly satisfied. By mid-summer, the administration had forged a "scenario" according to which the president, after securing a Congressional resolution authorizing him to act, would launch a series of graduated air strikes against targets in North Vietnam. Seaborn's report confirmed the American view of an intransigent North Vietnam and the need to carry the war northward.¹³ In August 1964, the United States was given cause for action when the administration concluded that North Vietnamese torpedo boats had attacked the *U.S.S. Maddox* in international waters off the coast of North Vietnam.

From the Canadian perspective, the American reaction to the Gulf of Tonkin crisis was measured and reassuring. On Johnson's instructions, Rusk informed Pearson personally of the attack and explained that the United States intended to respond "but would ensure that the retaliation was relevant to the provocation and to

¹² Tom Delworth, *A Study of Canadian Policy with Respect to the Vietnam Problem, 1962-1966*, Historical Section, DFAIT.

¹³ George C. Herring, *America's Longest War*, pp. 118-19. For Johnson's view of the Seaborn missions, see L.B. Johnson, *The Vantage Point: Perspectives of the Presidency, 1963-1968* (New York, 1971), pp. 67-68.

the attack."¹⁴ In Washington, Charles Ritchie found the same considered tones echoed in discussions with members of the administration. "My impression ... is that the USA is fully aware of the gravity of the steps it has felt forced to take."¹⁵ United States bombing strikes in the fall of 1964 had little immediate impact on Canadian policy. If anything, by signalling the American intention to respond militarily to North Vietnamese aggression, the crisis reinforced Ottawa's inclination to lend Washington a helping hand. Nowhere, perhaps, was this more apparent than on the ground in Vietnam, where the Canadian representative to the ICSC redoubled his efforts to have the commission "take account of communist infringements of [the] Geneva Agreement, and build up a record of meaningful findings."¹⁶ At the same time, Ottawa announced, in response to a request by the United States ambassador to Saigon, Henry Cabot Lodge Jr., that it would substantially increase its non-military aid to South Vietnam.¹⁷

Even as it brought Canada's public posture more closely into line with Washington's more aggressive attitude toward North

¹⁴ L.B. Pearson, *Mike, Volume III*, pp. 137-38.

¹⁵ Washington to Ottawa, Tel No 2821, 5 August 1964, DEA File 20-22-Viets-2, DFAIT.

¹⁶ Ottawa to Saigon, Tel No Y-682, 28 September 1964, DEA File 20-22-Viets-2, DFAIT.

¹⁷ H.O. Moran, Memorandum for the Minister, 21 September 1963, Pearson Papers, Box 281, File 845/IV666 Crisis 1964, National Archives of Canada (NAC). As a member of the Colombo Plan for Southeast Asian economic development, South Vietnam received \$700,000 worth of assistance in the 1963-64 fiscal year. It would increase to \$1.2 million in 1964-65.

Vietnam, Ottawa was becoming worried about the course of American policy. In the aftermath of the Gulf of Tonkin, Canadian observers had watched Washington's interest in using the Seaborn channel evaporate, but had remained hopeful that the United States might become more accommodating after the November presidential election.¹⁸ However, by early December, it was clear that the election had produced no desire among American officials for serious talks with Hanoi. Only after repeated Canadian prompting did the United States agree in mid-December to send another message to Hanoi through Seaborn.¹⁹ Washington added nothing new to this message and even diminished its significance by insisting that Seaborn deliver it as his own personal estimate of American determination.²⁰ Canadian officials were disappointed at Washington's obvious lack of sincerity and resented its patronizing attitude towards the Canadian channel. These sentiments were accompanied by a growing sense that American officials were less than frank in discussing the evolving nature of United States policy in Vietnam.²¹

Pearson was even more uneasy than Martin and his officials in the East Block. His January 1965 meeting with Johnson at the LBJ

¹⁸ Marcel Cadieux, Memorandum for the Minister, 6 October 1964, DEA File 20-22-Viets-1, DFAIT.

¹⁹ Washington to Ottawa, Tel Nos. 4189 and 4190, 3 December 1964, DEA File 20-22-Viets-2-1, DFAIT.

²⁰ Ottawa to Saigon, Tel No Y-885, 4 December 1964, DEA File 20-22-Viets-2-1, DFAIT.

²¹ Tom Delworth, *A Study of Canadian Policy*.

Ranch in Texas stripped away the veneer of correctness that had defined their first two meetings and exposed their profound differences in outlook and temperament. Dressed in a formal black suit and diplomat's homburg, Pearson was discomfited on arriving at the ranch to discover the president in a cowboy suit. A barrage of television cameras awaited the two men, whose meeting began poorly when Johnson introduced Pearson as "Prime Minister Wilson." There was no time during the two-day meeting for the kind of leisurely, wide-ranging discussion of international developments that Pearson enjoyed. Instead, loaded into three cars, Johnson and Pearson, the "press" and the "ladies" embarked on a whirlwind tour of the ranch. The president dispensed drinks liberally and swore loudly. Dinner was a hurried and informal affair; steak and catfish on the same plate. Throughout, aides and valets bustled about and telephones rang. "General MacArthur would not have approved, nor, I suspect," Pearson observed, "John Kennedy."²² The visit left him feeling deeply disturbed.

In early February 1965, the war in South Vietnam entered a new and more dangerous phase when Washington responded to a Viet Cong raid on the American base at Pleiku with a limited campaign of air strikes against North Vietnam. Within days, this series of raids was replaced by the gradually intensifying bombing campaign that signalled the start of Operation Rolling Thunder.²³ Pearson tried to discuss the situation with Johnson over the telephone but was

²² L.B. Pearson, *Mike*, Volume III, pp. 126-27.

²³ George Herring, *America's Longest War*, pp. 128-29.

rebuffed. He feared "escalation" and thought that the South Vietnamese "were the first to want to get rid of the Americans, and that a compromise would have to be reached."²⁴

The prime minister was given an opportunity to voice some of his apprehensions in early February, when India appealed for an unconditional halt in hostilities and a Geneva-style conference on February 8. In drafting a statement for the prime minister's use which endorsed Prime Minister Lal Bahadur Shastri's call for a negotiated settlement, Ben Rogers, the head of the Far Eastern Division, and Marcel Cadieux, the under-secretary of state for external affairs, were aware of a small but distinct shift in Canadian policy.²⁵ Though hedged with conditions designed to secure the United States position in Indochina, the conference proposal clearly represented a retreat from the steadfast support accorded American policy thus far in Vietnam.

Pearson went even further than Martin or his officials expected when he delivered his speech to the Canadian Club on 10 February 1965. With one eye on the growing number of domestic critics of the bombing, he hinted at Canada's growing disagreement with the United States over the militarization of American policy. Pearson's oblique criticism of American policy was neatly presented in the context of defending "quiet diplomacy." Acknowledging that

²⁴ Patricia Smart (ed.), *The Diary of André Laurendeau* (Toronto, 1991), p. 127.

²⁵ R.L. Rogers, Memorandum for the Under-Secretary of State for External Affairs, 9 February 1965, DEA File 21-13-Viets-ICSC.

Canada's security depended on American support, Pearson warned his audience that "official doubts about certain United States foreign policies often should be expressed in private, through the channels of diplomacy." The prime minister dutifully acknowledged the role of North Vietnamese aggression in expanding the war, but went on to observe that "we cannot overlook the fact that U.S. policies in Vietnam seem to have found no solid basis of support through a South Vietnam government of strength and popularity."²⁶

The difference in view between Pearson and Martin grew wider as the bombing intensified and rumours concerning the use of napalm and nerve gas made the rounds in early March. It was widely assumed that Pearson had Washington's ear and the international pressure on him to do something to stop the bombing mounted. During a meeting with the prime minister, U Thant, the United Nations secretary general, begged Pearson to use his influence as the United States closest ally "to convince [the] Americans that no lasting settlement in Vietnam could be achieved by [the] use of force alone."²⁷ Canadian missions in the Soviet Union and Eastern Europe, where the bombing seemed likely to complicate Sino-Soviet relations

²⁶ L.B. Pearson, "Address to the Canadian Club of Ottawa", 10 February 1965, Department of External Affairs, *Statements and Speeches*, 65/6. American observers missed this slight shift in Canadian policy and reported that Pearson, who "displayed a full understanding of the U.S. position and the western stake in the Vietnam situation," had "come down strongly in support of U.S. objectives in Vietnam." See American Embassy, Ottawa to State Department, Airgram A-616, 15 February 1965, RG 59, Box 1989, POL 15-1 CAN, USNA.

²⁷ New York to Ottawa, Tel No 349, 8 March 1965, DEA File 20-Viets-1-4, DFAIT.

further by driving North Vietnam into closer alignment with Peking, reported that their interlocutors hoped that Canada would help reduce Washington's enthusiasm for bombing.²⁸

The bombing helped the various elements of the increasingly vocal Canadian anti-war movement to coalesce. Disproportionate among their numbers were the intellectuals and younger members of Canadian society whom Pearson wished to attract to the Liberal Party. Pearson was also influenced by the views of his wife, Maryon, and his son, Geoffrey, who both thought that American policy was dangerous.²⁹ Escott Reid, an old friend, who had served Pearson in the Department of External Affairs, joined in urging the prime minister to speak out.³⁰ Gradually, Pearson moved toward the idea of making public his concerns about American bombing.

Still very much undecided on his next step, the prime minister asked Cadieux to incorporate the idea of using a bombing pause to test Hanoi's willingness to talk in a speech he was scheduled to deliver at Temple University in Philadelphia. When told of Pearson's plans, Martin tried to dissuade the prime minister from making his suggestion and cautioned "that a proposal of this kind would be more effective if it were put forward, in the first

²⁸ Moscow to Ottawa, Tel No 324, 24 March 1965; Moscow to Ottawa, Tel No 334, 26 March 1965; Warsaw to Ottawa, Tel No 162, 23 March 1965, DEA File 20-22-Viets-2, DFAIT.

²⁹ John English, *The Worldly Years*, p. 367.

³⁰ Escott Reid, *Radical Mandarin: The Memoirs of Escott Reid* (Toronto, 1989), p. 372.

instance, privately to President Johnson."³¹ Ritchie suggested that Pearson give the White House an advance copy of his speech.³² Pearson agreed, and a meeting with Johnson at the White House was immediately arranged.

On 30 March 1965, Pearson met with Marquis Childs, the chief Washington correspondent of the *St. Louis Post-Dispatch*, whom he had known since his first posting to the American capital in the early 1940s. Drawing upon information picked up in Washington, Childs warned Pearson "that President Johnson was embarked upon on a course which, in the next three or four weeks, would bring the United States perilously close to war with Communist China and the U.S.S.R."³³ Isolated and encircled by a small group of like-minded advisors, Johnson needed to hear a different point of view. Childs reassured Pearson that the general line of his speech "'would not be resented' in Washington." The prime minister decided to go ahead. Worried that Johnson might persuade him to abandon his call for a bombing pause, Pearson cancelled his meeting with the president and informed Martin that he planned to suggest a brief halt in the bombing.³⁴

Martin threatened to resign, but quickly withdrew his threat

³¹ Paul Martin, Memorandum for the Prime Minister, 29 March 1965, 20-Canada-9-Pearson, NAC.

³² John English, *The Worldly Years*, p. 362.

³³ John Hilliker and Donald Barry, *Canada's Department of External Affairs, Volume II: Coming of Age, 1946-68* (Montreal and Kingston, 1995), pp. 371-72.

³⁴ Author Interview with Michael Shenstone, 6 December 1996.

when he saw that it would have no impact on the prime minister. On 2 April, Pearson addressed Temple's graduating class. Firmly located within the context of continued Canadian support for American objectives in Vietnam, Pearson's suggestion for a bombing pause was decidedly understated:

After about two months of air strikes, the message should now have been received loud and clear. The authorities in Hanoi must know that the United States with its massive military power can mete out even greater punishment. They must also know that, for this reason, the cost of their continued aggression against South Vietnam could be incalculable... There are many factors which I am not in a position to weigh or even know. But there does appear to be at least the possibility that a suspension of such air strikes against North Vietnam, at the right time, might provide the Hanoi authorities with an opportunity, if they wish to take it, to inject some flexibility into their policy without appearing to do so as the direct result of military pressure."³⁵

The president's reaction was immediate. Pearson had violated one of Johnson's rudimentary but sacrosanct political precepts: "you don't piss on your neighbour's rug."³⁶ Moreover, the prime minister's timing could not have been worse. Johnson had just helped Pearson secure an exemption from American balance of payments measures and was struggling to get the Autopact through Congress, a battle he had reluctantly undertaken at the prime minister's behest. The Canadian's transgression occurred in the midst of an internal debate over the direction of American policy, a discussion in which Johnson perceived himself as the moderate,

³⁵ L.B. Pearson, *Mike*, Volume III, p. 138.

³⁶ Quoted in Norman Hillmer and J.L. Granatstein, *For Better or For Worse: Canada and the United States to the 1990s* (Toronto, 1991), p. 224.

resisting hardline demands for a greater American role in Vietnam.³⁷ The president was worried that Pearson had undercut his own position and invited the prime minister for lunch at Camp David. After a tense meal, during which he spent most of the time on the phone, Johnson led Pearson into the garden for a frank exposition of his position. From a distance, Ritchie watched the pantomime as the two men talked. The president "strode the terrace, he sawed the air with his arms, with upraised fist he drove home the verbal hammer blows ... From time to time Mike [Pearson] attempted a sentence - only to have it swept away on the tide."³⁸ "We are

³⁷ According to his most recent biographer, the constant effort involved in Vietnam policy-making was already having a profound impact on the president. During this period, Johnson was increasingly subject to "paranoid outbursts and depressive reactions." See Robert Dallek, *Flawed Giant: Lyndon Johnson and His Times, 1961-1973* (New York, 1998), p. 282.

³⁸ Charles Ritchie, *Storm Signals: More Undiplomatic Diaries, 1962-1971* (Toronto, 1983), pp. 79-80. See also, McGeorge Bundy, "Canada, the Exceptionally Favored: An American Perspective," in Lansing Lamont and J. Duncan Edwards (eds.) *Friends So Different: Essays on Canada and the United States in the 1980s* (Ottawa, 1989), p. 238-39. This kind of behaviour was not unusual. Dean Rusk describes the "Johnson treatment" in the following terms:

Taller than most men, LBJ used his height to his advantage. He would draw close to his target, look down at him, stick a finger in the man's chest, and launch a barrage of extravagant language to make his point....and he knew where his opponents vulnerable points were, when to appeal seductively, and when to apply pressure.

Dean Rusk (as told to Richard Rusk), *As I Saw It* (New York, 1990), p. 333.

American anger was compounded when they compared the circumstances surrounding Pearson's speech with those surrounding a speech that George Ball, the under secretary of state, was invited to give in Toronto in March. After consulting Canadian officials, Ball accepted Ottawa's advice and declined to make the speech lest it embarrass the government. See State Department to Ottawa, Tel No 1074, 6 April 1965 and Ottawa to State Department, Tel No 1258, National Security Files (NSF), Country Files:

confident," the United States under secretary of state, George Ball, observed later with deliberate under-statement, that "Pearson sensed [the] President's displeasure over import of speech at April 3 meeting."³⁹

Once back in Ottawa, Pearson tried to undo some of the damage. He explained why he had made the speech in a lengthy and detailed letter to Johnson. Canada was anxious to give "all possible support, difficult and thankless... [of] aiding South Vietnam to resist aggression." But, continued the prime minister, there was "a quite genuine feeling [in Canada] that current U.S. policy in Vietnam is wrong and heading for trouble... [which] a minority Government cannot merely brush off ... as unimportant." It was against this background that he felt compelled to suggest that the United States might at some point suspend the bombing. Pearson explained exactly how circumscribed his suggestion really was:

In my proposal for a 'suspension' or 'pause' in the series of 'increasingly powerful retaliatory strikes', I did not argue it should be done now but might be considered 'at the right time'; that it would be 'for a limited time'...

My point is that, once the destructive effects of air strikes are really being felt by the Hanoi Government, they might wish to 'cry quits' but without being accused of doing so in the face of continued air action. In other words, this 'pause' would give them an opportunity to stop the fighting in the South - if they wished to use it for that purpose. If they didn't, then their aggressive intransigence would have been exposed and it would be made very clear who was preventing a negotiated solution. I should have thought that this would have strengthened your position diplomatically, without weakening it militarily, because the suspension would only be

Canada, Box 166, Johnson Library.

³⁹ State Department to Ottawa, Tel No 1074, 6 April 1965, NSF, Country Files: Canada, Box 166, Johnson Library.

for a short time; long enough for Northern Communist intentions to be made clear.⁴⁰

In Washington, Pearson's letter was grudgingly acknowledged as suitably repentant. Nevertheless the relationship between Pearson and Johnson, never close, was seriously strained.

Despite the unpleasant American reaction to the Temple speech, both Pearson and Martin remained anxious to find some means of helping the United States escape from Southeast Asia. This was especially true following Johnson's decision in July 1965 to send large numbers of American troops to Vietnam. This step, which fundamentally changed the nature of the conflict, meant that the war could no longer be treated as just a struggle for the freedom of South Vietnam. It had become part of the American effort to contain Communist China and, therefore, heightened the risk of a confrontation with China or the Soviet Union.⁴¹ Indeed, in private, Pearson had already "expressed concern over the possible use in Viet Nam of Chinese nuclear weapons, which seemed to him to be a real possibility."⁴²

Pearson and Martin differed - and this difference would grow over the course of the following year - on the right approach to take toward helping the United States extricate itself from Vietnam. The prime minister was much more inclined to wait and take

⁴⁰ L.B. Pearson, *Mike*, Volume III, p. 156-57.

⁴¹ Marcel Cadieux, Memorandum for the Minister, 6 August 1965, DEA File 20-22-Viets-2-1, DFAIT.

⁴² American Embassy, London to State Department, Airgram A-3179, 22 June 1965, RG 59, Box 1989, POL 15-1-CAN, USNA.

his cue from Washington. In August 1965 he let the White House know informally that he was ready to help the United States whenever he was needed:

It is the hope and desire of the Prime Minister that he can be useful to the President in behind-the-scenes talks, probings, and searchings which have as their objective unconditional discussions....as a winner of the Nobel Peace Prize, the Prime Minister has contacts throughout the world which would allow him, if the President determined it wise, to quietly seek out ways to bring the matter off the battlefield and into a meeting hall.⁴³

Pearson was given his opportunity to help in late December, when the United States unilaterally extended a Christmas bombing pause. The American gesture seemed genuinely designed to test North Vietnam's willingness to negotiate, to uncover any competing concerns among the interested Communist states and to garner public support for the administration's efforts in Vietnam.⁴⁴ Pearson was delighted with the president's conciliatory gesture and the news that Johnson was prepared to negotiate without conditions. The prime minister instructed the Canadian high commissioner in New Delhi, Roland Michener, to approach the Indian government and endorse Washington's difficult decision:

We are encouraged by this latest American endeavour to find a peaceful solution to the Vietnam conflict. Please impress on [prime minister] Shastri that I am convinced this is a genuine and sincere attempt by President Johnson and not just an attempt to score propaganda points. This attempt may not be

⁴³ Jack Valenti, Memorandum for the President, 2 August 1965, White House Central Files (WHCF), Confidential Files, Johnson Library.

⁴⁴ George Herring, *America's Longest War*, pp. 165-66.

successful but the Americans should be given full points for trying.⁴⁵

Canada's action in underwriting the extension of the bombing halt was appreciated in Washington; after all, this was the kind of intimate sharing of information and diplomatic effort that had been the hallmark of Canadian-American relations during the mid-1950s.⁴⁶

However, Pearson's "quiet diplomacy" was no longer enough for Martin, who was convinced that the seriousness of the international situation demanded extraordinary efforts to get talks underway.⁴⁷ Martin was in part responding to the hostile public reception that greeted the publication in July 1965 of the Merchant-Heeney study on the Principles of Partnership. Its sensible conclusion that "[i]t is in the abiding interest of both countries that ... divergent views between two governments should be expressed and if possible resolved in private" was widely denounced in Canada as a "diplomatic sell-out."⁴⁸ The foreign minister wondered whether "we

⁴⁵ Ottawa to New Delhi, Tel No G-440, 20 December 1965, DEA File 20-22-Viets-2-1, DFAIT.

⁴⁶ Washington to Ottawa, Tel No 4088, 30 December 1965, DEA File 20-22-Viets-2, DFAIT.

⁴⁷ Author Interview with Basil Robinson, 7 June 1994.

⁴⁸ A.D.P. Heeney and Livingston Merchant, *Canada and the United States: Principles for Partnership* (Ottawa, 1965), Annex A. For the reaction to the report see A.D.P. Heeney, *The things that are Caesar's: Memoirs of a Canadian public servant* (Toronto, 1972), pp. 195-98; Norman Hillmer and J.L. Granatstein, *Empire to Umpire: Canada and the World to the 1990s* (Toronto, 1994), pp. 275-76; Robert Bothwell, *Pearson: His Life and World* (Toronto, 1976), p. 176. John Holmes reflects on the value of the report and its recommendations in "Merchant-Heeney Revisited: A Sentimental View," in Lauren McKinsey and Kim Richard Nossal (eds.), *America's Alliances and Canadian-American Relations* (Toronto, 1988), pp. 180-199.

could stick with the United States in defence of its basic purpose, if we did not show that we were taking extraordinary steps towards getting negotiations started." Moreover, and quite legitimately, Martin was anxious for the kind of personal diplomatic triumph that would secure his position as the front-runner in the undeclared race to succeed Pearson.

After considering several possible initiatives using the ICSC, Martin approached Pearson in mid-January with a proposal to send Chester Ronning, a retired Canadian diplomat, to Peking and Hanoi. Martin had toyed before with the idea of using Ronning to break the United Nations deadlock on Chinese representation and to duplicate the minister's 1955 success in solving the problem of the admission of new members.⁴⁹ Now it appeared that Ronning was being asked to resolve the question of Chinese representation while seeking to determine whether North Vietnamese views had shifted under the brunt of the American bombing campaign. The son of American missionaries in China, Ronning spoke fluent Mandarin and was acquainted with leading members of both the Chinese and North Vietnamese governments. He was a seasoned diplomat, who had accompanied Pearson to the 1954 Geneva Conference and served as high commissioner to India and head of the Canadian delegation to the 1962 Laos conference.⁵⁰

⁴⁹ Paul Martin, *So Many Worlds*, pp. 178-217, 510.

⁵⁰ For a biographic sketch of Ronning, see Brian Evans, "Ronning and Recognition: Years of Frustration," in Paul M. Evans and Michael B. Frolic (eds.), *Reluctant Adversaries: Canada and the People's Republic of China* (Toronto, 1991), pp. 148-67.

Martin was clearly motivated by a number of considerations in selecting this particular enterprise. He was naturally attracted to the domestic political benefits that would follow a successful mission. "Public opinion in Canada would welcome an initiative," he assured his prime minister, "which could be presented as a contribution to the search for peace in Vietnam."⁵¹ The secretary of state for external affairs was also convinced that Johnson's willingness to undertake unconditional negotiations was genuine and that his declarations to this effect were an invitation to act. Recalling Washington's earlier request for Seaborn's help, the minister argued that Ronning would fulfil an American need for a mediator and add to Canada's standing in Washington:

It seems to me that, however things may shape up in Vietnam in the months to come, such influence as we may have in Washington in relation to this problem could be enhanced if we respond to the invitation in way that is regarded as useful from the United States point of view.⁵²

Pearson was sceptical, but allowed Martin his head.

As the prime minister suspected, American officials greeted the projected mission with undisguised hostility. In so far as Martin's scheme was presented in the context of the president's peace offensive, American policy-makers felt that they had no option but to agree to the Ronning mission.⁵³ In addition, most American officials viewed Ronning, who was widely known to be

⁵¹ Paul Martin, Memorandum for the Prime Minister, 20 January 1966, DEA File 20-22-Viets-2-1-1.

⁵² *Ibid.*

⁵³ George Herring, *The Secret Diplomacy of the Vietnam War*, p. 173.

critical of American policy in Asia, with unfriendly suspicion.⁵⁴ Martin's sponsorship of the mission was a further problem. American officials were uncomfortable with his tendency to "politicize everything" and were inclined to discount him and his diplomacy.⁵⁵ The American assistant secretary of state for Far Eastern affairs, William Bundy, dismissed him as "pas sérieux."⁵⁶ Rusk tended to treat Martin, a little indulgently perhaps, as a "nuisance."⁵⁷ Any chance that the scheme had of achieving some sort of standing in Washington disappeared in late January when Pearson (perhaps to protect his own fragile standing among American policy-makers) pulled away the ground on which his minister stood:

Pearson confirmed [that the] Ronning mission was Martin's idea, that it entailed greater dangers than Martin had perhaps appreciated and that he had "scared the hell out of Paul last night" ... if anything went wrong, his government would disavow any involvement in the Ronning mission.⁵⁸

Not surprisingly, Rusk dismissed the Canadian initiative. "Quite frankly," he assured the American ambassador to Saigon, "I attach no importance to his [Ronning's] trip and expect nothing out of it."⁵⁹

⁵⁴ *Ibid.*, p. 173; see also Robert S. McNamara (with Brian VanDeMark), *In Retrospect: The Tragedy and Lessons of Vietnam* (New York, 1995), p. 247.

⁵⁵ Author interview with Alexis Johnson, 8 June 1992.

⁵⁶ Confidential Interview.

⁵⁷ Author Interview with H.B. Robinson, 7 June 1994.

⁵⁸ *Ibid.*, p. 171.

⁵⁹ *Ibid.*, p. 176

Ronning's initial meetings with the North Vietnamese authorities were unrewarding. In the first two days of his visit, the Canadian emissary met with a number of senior officials, including the foreign minister, Nguyen Duy Trinh, without discerning any movement in the DRVN position. The DRVN's representatives politely but staunchly insisted that the possibility of negotiations rested entirely on Washington's willingness to accept Hanoi's "Four Points."⁶⁰ Only in the final stages of a two-hour meeting with the prime minister, Pham Van Dong, did Ronning unearth an apparent shift in DRVN policy. Under persistent questioning, Pham admitted that North Vietnam would be prepared to undertake preliminary talks in exchange for "an official declaration that it [the United States] will unconditionally stop for good all military operations against [the] territory of [DRVN]."⁶¹ Ronning was delighted, although Pham's meaning was not entirely clear because he added that North Vietnam "had already suggested a similar offer in the January 4th [1966]

⁶⁰ On 8 April 1965, Hanoi indicated that it would only enter into discussions with the United States if Washington agreed in advance to withdraw all American forces from Vietnam, to respect the 1954 Geneva Accords, to include the Viet Cong in the talks, and to agree to the "peaceful reunification of Vietnam ... without any foreign interference." The Johnson administration dismissed these conditions as unacceptable. See United States, Department of State, *Foreign Relations of the United States, 1964-68, Volume II: Vietnam* (Washington, 1995), pp. 544-45.

⁶¹ Saigon to Ottawa, Tel No 184, 11 April 1966, DEA File 20-22-Viets-2-1-1. For Ronning's account of the discussions in Hanoi see Chester Ronning, *A Memoir of China in Revolution: From the Boxer Rebellion to the People's Republic* (New York, 1974), pp. 255-69.

foreign ministry statement."⁶² In this response to the Christmas bombing halt, Hanoi dismissed the exercise as propaganda and insisted that:

[A] political settlement of the Vietnam problem can be envisaged only when the US.... has accepted the 4-point stand of the [DRVN], has proved this by actual deeds, has stopped unconditionally and for good its air raids and all other acts of war against the [DRVN].⁶³

In linking his offer to Ronning with the foreign ministry's statement, Pham had introduced a dangerous element of ambiguity.

Ronning was nevertheless inclined to think that he had achieved a small breakthrough. Although he realised that such terms as "official declaration" would need to be defined before progress could be made, he was quite sure that Pham had offered a "condition which if accepted by [the] USA, could result in negotiations."⁶⁴ Seaborn's successor on the ICSC, Victor Moore, accompanied Ronning and sent a report to Ottawa that also overlooked the ambiguous nature of Pham's offer. He contended that Pham's offer "lifted from its context in January 4th foreign ministry statement bombing issue and made it [the] sole condition for negotiations."⁶⁵ This was the

⁶² Saigon to Ottawa, Tel No 184, 11 April 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

⁶³ Cited in George Herring, *The Secret Diplomacy of the Vietnam War*, p. 123.

⁶⁴ Saigon to Ottawa, Tel No 184, 11 March 1966, DEA File 20-22-Viets-2-1-1.

⁶⁵ Saigon to Ottawa, Tel No 188, 12 March 1966, DEA File 22-20-Viets-2-1-1, DFAIT. The verbatim text of the interview between Ronning and Pham was prepared and forwarded to Ottawa on 14 March 1966. In it, Pham's remarks are even more ambiguous. For instance, the translator had difficulty with what Pham meant when he talked of halting hostilities against DRVN "for good and

only explicit attempt made by any Canadian official to locate Pham's offer within the context of Hanoi's January declaration. Martin accepted without question Moore's contention that it represented an unequivocally new offer. In early March, he called Rusk to say that Ronning had brought back a proposition and that "we attached importance to it as possible evidence of an unblocking of channels."⁶⁶

In Washington, where Ronning arrived on 20 March 1966 to debrief State Department officials, the discussion turned on the question of the relationship between Pham's offer and the January declaration. Neither Ottawa nor Ronning had anticipated this. During the talks which followed his presentation, Ronning admitted that Pham had "started to hedge ... [and] had implied that his statement was nothing more than had already being said in the DRVN foreign ministry statement of 4 January."⁶⁷ William Bundy seized on this remark and pointed out "that the link between the DRVN's 4

unconditionally." In the verbatim transcript the link between the 4th January statement and the offer to Ronning was far more explicit. Moreover, in an effort to be as precise as possible about the nature of his offer, Pham added that "when the USA have made a declaration corresponding to our requirements, we shall, for our part, contemplate it and decide what to do." Neither Ronning nor Moore reported this important qualification. By that time, of course, opinion in Ottawa had begun to coalesce on the basis of the first set of messages and no one appears to have tried to factor in this new data that might have forced a new assessment of the evidence. See Saigon to Ottawa, Tel No 189, 12 March 1966, DEA File 22-20-Viets-2-1-1.

⁶⁶ Paul Martin's marginalia on Marcel Cadieux, Memorandum For the Minister, 18 March 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

⁶⁷ Washington to Ottawa, Tel No 838, 21 March 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

points and the declaration of cessation of bombing was ambiguous in the January 4th statement ... it could conceivably be argued, if certain punctuation was accepted, that there was a hint that issuance of declaration on bombing would imply an acceptance of the 4 points." Ronning's certainty wilted: "[H]e might be entirely wrong in concluding that DRVN was separating bombing from the Four Points but this was undoubtedly the impression that Pham Van Dong wished to create."⁶⁸ Not surprisingly, Washington interpreted this to mean that "on balance, [Ronning] frankly did not himself think anything significant had emerged from his visit."⁶⁹ The question was closed, as far as Bundy and his American colleagues were concerned.

Martin and his officials were disappointed at Bundy's lack of enthusiasm. Despite his legitimate concerns about Pham's offer to Ronning, Martin waited hopefully for a more considered and positive reaction. None was forthcoming. In early April, Bundy brushed off the first of several informal Canadian requests for a response.⁷⁰ After repeated prompting, the American official replied that the United States did not wish to respond to Hanoi through the Canadian

⁶⁸ *Ibid.*

⁶⁹ George Herring, *The Secret Diplomacy of the Vietnam War*, p. 179. On Washington's reaction, see also *Foreign Relations of the United States, 1964-1968, Volume IV: Vietnam* (Washington, 1998), pp. 287-90. In his memoirs, *In Retrospect*, McNamara maintains that the North Vietnamese position was ambiguous, but suggests nevertheless that the United States should have "probed the meaning of Pham's words more deeply." (p. 248).

⁷⁰ Washington to Ottawa, Tel No 1003, 2 April 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

channel at the present time.⁷¹ The unyielding American behaviour troubled Canadian officials. Moore seemed particularly concerned and reminded Ottawa that now was the time to act: Hanoi's patience was not inexhaustible. He warned that, since the United States had already begun to consider bombing Hanoi and Haiphong, the risks associated with employing Ronning were beginning to mount.⁷²

Cadieaux discounted the dangers connected with a renewed Canadian mediatory effort on the basis of reports from Washington, where the ambassador tried to pin down the articulate and elusive William Bundy on the question of future American air strikes. "There was no intention of intensifying air strikes against the North in a dramatic and needlessly provocative fashion."⁷³ In order to get a second Ronning mission started, he wanted to send the State Department a list of Moore's scheduled ICSC visits to remind it of Ottawa's desire to see the momentum maintained. Martin was inclined to go even further. He "impulsively picked up the telephone" and called Bundy directly, upbraiding the American official for Washington's failure to provide Hanoi with a more positive response and pointing out that the Canadian government attached the "greatest importance to [the] channel which had been opened up by Ronning. In [the] current situation it appeared to us

⁷¹ Washington to Ottawa, Tel No 1099, DEA File 20-22-Viets-2-1-1, DFAIT.

⁷² Saigon to Ottawa, Tel No 309, 16 April 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

⁷³ Marcel Cadieux, Memorandum for the Minister, 18 April 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

to be one of the very few channels which held any promise of opening up possibilities of moving towards some kind of peaceful settlement of Vietnam conflict."⁷⁴ Bundy promised a reaction soon.

The official American response - presented as a memorandum to the Canadian government - was prepared largely in an effort to patch up relations with Martin.⁷⁵ The State Department acknowledged the potential worth of the Canadian channel, which it wished to keep open, but pointedly reminded Ottawa that the United States had been in direct contact with Hanoi throughout the bombing pause without success. Since then, North Vietnam had continued to insist that the United States accept its 'Four Points' prior to any negotiations. If Pham's offer to Ronning suggested that North Vietnam's position was beginning to moderate, its exact meaning remained open to interpretation. "It seems most probable," concluded the memorandum, "that this was still intended to be linked with acceptance of the 'four points'."⁷⁶

Despite this pessimistic conclusion, the United States was ready to make another effort to determine precisely what Pham's suggestion meant and to pursue the matter through either a Canadian

⁷⁴ Ottawa to Washington, Tel No Y-288, 22 April 1966, DEA File 20-22-Viets-2-1-1, DFAIT. The American record is reprinted in George Herring, *The Secret Diplomacy of the Vietnam War*, p. 187. Martin also raised the matter of a second Ronning mission with Averell Harriman on 20 April 1966. See A. Harriman, Memorandum of Conversation, 20 April 1966, RG 59, Box 1984, File POL 15-1, USNA.

⁷⁵ George Herring, *The Secret Diplomacy of the Vietnam War*, p. 184.

⁷⁶ *Ibid.*, pp. 185-86.

intermediary or "the established direct channels." Included in the American memorandum was the text of an oral message that Washington wished to convey to Hanoi. This categorically rejected the North Vietnamese proposal. The United States simply reiterated its willingness either to talk unconditionally or to agree to a reciprocal reduction in military activity to de-escalate the conflict.⁷⁷

Canadian officials seemed uncertain how much significance they should attach to this effort to contact Hanoi. The draft American message, which seemed too pessimistic, was a particular concern. Some of this worry was alleviated when the message was redrafted, making it clear that Canada was not acting simply as an American spokesman but as a state whose position on the ICSC gave it an independent and unique interest in the conflict in Vietnam. The new emphasis that the revised message placed on Washington's interest in maintaining the Canadian channel was also reassuring, if not entirely accurate.⁷⁸

As momentum gathered around the second Ronning mission, an unrealistic sense of optimism replaced the initial apprehension experienced by Canadian officials. Despite continued evidence of Hanoi's intransigence, the North Vietnamese decision to receive

⁷⁷ *Ibid.*, p. 186.

⁷⁸ Suggested Re-draft of U.S. Message (to be discussed in Washington, 30 April 1966 and Washington to Ottawa, Tel No 1361, 10 May 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

Ronning a second time was encouraging.⁷⁹ Ronning and Klaus Goldschlag, the director of Far Eastern Division, met Bundy and Paul Kreisberg, the officer-in-charge of Mainland China Affairs, in early May to discuss the amended message. The attitude adopted by the two State Department officials, who were satisfied that the Canadian revision accurately reflected their original intentions, was comforting:

The Americans regard this exchange as serious. Because it involves issues which are of the greatest importance from their point of view, they are anxious to re-open a direct channel of communication with the North Vietnamese... Meanwhile, they appreciate the availability of the Canadian channel and would wish to see it kept open.⁸⁰

Washington seemed to accord such importance to the Canadian channel that it asked Ronning to carry a second message addressing the growing prisoner-of-war problem.⁸¹

These positive indications were misleading. By the end of May, the mission was fraught with tension. In a further effort to emphasize the Canadian nature of the initiative and to preserve Ottawa's local standing in Vietnam, Martin insisted on briefing South Vietnam about Ronning.⁸² American officials in both Washington and Saigon were "disturbed" by this Canadian effort to

⁷⁹ Saigon to Ottawa, Tel No 412, 24 May 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

⁸⁰ Klaus Goldschlag, Vietnam: Operation Smallbridge, 2 May 1966, DEA File 20-22-Viet-2-1-1, DFAIT.

⁸¹ George Herring, *The Secret Diplomacy of the Vietnam War*, pp. 189-90.

⁸² Ottawa to Saigon, Tel No Y-349, 14 May 1966 and Saigon to Ottawa, Tel No 409, 21 May 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

insert themselves into a relationship that they regarded with proprietary interest.⁸³ On the other hand, Canadian officials were distressed to learn from published reports in early June that the United States had conveyed the sense of the second Ronning message to Chinese officials at the regular monthly Sino-American meetings held in Poland. Indeed, the Americans had gone much further and had explained that they would suspend the bombing in exchange for arresting the infiltration of North Vietnamese troops and equipment.⁸⁴ Having misread the American commitment to the second Ronning exercise, Canadian officials were surprised at the apparent American effort to sabotage the mission:

While this is not something you will wish to say to Rusk, we find it difficult to comprehend why a message on these lines should be conveyed to Hanoi through the intermediary [Peking] which is known to be most vehemently opposed to any form of accommodation in Vietnam.⁸⁵

They urged Martin, then in Paris for the NATO ministerial meeting, to explore with Rusk the relationship between the Canadian and Chinese messages. Rusk declined to answer the minister's question directly and explained that there could be no bombing suspension without a stop to the infiltration. This, Martin remarked plaintively, was not the message that Ronning was carrying.⁸⁶

⁸³ George Herring, *The Secret Diplomacy of the Vietnam War*, p. 193.

⁸⁴ *Ibid.*, p. 193. See also K. Goldschlag to Charles Ritchie, 24 May 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

⁸⁵ Ottawa to Brussels (for SSEA), Tel No Y-114, 4 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

⁸⁶ Nato Paris to Ottawa, Tel No 400, 5 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

Moore observed that Ronning's message lacked any new elements and argued that the mission was destined to fail. Washington, he asserted perceptively, had already reached this conclusion and had adjusted its strategy accordingly. "The Americans appear to be putting Hanoi behind the eight-ball again and to be escalating what was allegedly a serious and practical cease-fire overture into a peace offensive reminiscent of their campaign last January."⁸⁷ Pearson was distraught. "It would be a sad ending to our initiative in this matter," he telegraphed Martin, "if we became merely an instrument of USA propaganda or for putting the DRVN on the spot."⁸⁸

Officials in Ottawa did not share the prime minister's concern. They insisted that the United States remained interested in receiving the DRVN's confidential response and that this represented the most important element of the Canadian mission. Moreover, if these Canadian concerns were raised in Washington, the United States might simply suggest that Ronning not visit Hanoi. The prime purpose of the Ronning exercise was increasingly limited "to making sure that the channel we have been able to open up to Hanoi is not closed."⁸⁹ Encouraged to believe that Canada's role as an intermediary might be preserved, Martin decided to proceed, but

⁸⁷ Saigon to Nato Paris (via Ottawa), Tel No 450, 6 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

⁸⁸ Ottawa to Nato Paris (for SSEA), Tel No M99, 6 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

⁸⁹ Ottawa to Brussels (for SSEA), Tel No Y-405, 6 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

cautioned his officials against having any "illusions as to possible success."⁹⁰

The new set of instructions prepared for Moore made a virtue of necessity. The general nature of the original Canadian message made it possible for Ronning to range widely in seeking a positive response from Hanoi. Ronning's role was effectively transformed from channel to mediator, and he was instructed to "make the point that if the cause of peaceful settlement of [the] Vietnam problem is to be advanced ... there will have to be willingness on both sides to move beyond their present positions."⁹¹ Canada was ready to help advance this process. In the event that such probing failed, Ronning was to explore in detail Pham's interpretation of the third of Hanoi's "Four Points." This had been the subject of discussions between the United States and North Vietnam during the Rangoon contacts, and there was a distant possibility that something might emerge upon which a subsequent exchange could be based. "It is important that in any event," the instructions concluded, "Ronning should do everything to keep open the contact, regardless of the result."

Even as Canada moved towards an increasingly exposed position as a mediator running an independent operation, there were further indications that American motives had changed. After a long debate, Robert MacNamara, the secretary of defense, had agreed in early

⁹⁰ Nato Paris to Ottawa, Tel No 420, 7 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

⁹¹ Ottawa to Saigon, Tel No Y425, 9 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

June to authorize bombing strikes against petroleum facilities in Hanoi and Haiphong. He pressed Rusk for support. Rusk counselled delay and suggested that the United States wait for the results of Ronning's second message. These would almost certainly reveal Hanoi's continued intransigence and justify the bombing in the eyes of those allies, like Wilson and Pearson, who questioned American policy. In the meantime, Rusk promised his colleague that he would ask to receive an early report on the Ronning mission.⁹² Bundy made no effort to hide the American intention to link the scale of hostilities in Vietnam with the results of the Ronning mission. The request was made "so that USA authorities could receive info on situation as soon as possible in case some prompt USA response, such as a change in the scale of USA activities, appeared desirable."⁹³ Martin and his officials were concerned at this latest development, but agreed that Ronning would reveal the "general flavour" of the exchange if he considered that this might have an "immediate" bearing on American deliberations.⁹⁴

Ronning was treated "courteously and hospitably" on his arrival in Hanoi on 14 June and he transmitted the oft-revised American message to Nguyen Co Thach, the vice-minister of foreign affairs. Four days later, he was received by the deputy prime minister, Nguyen Duy Trinh, who dismissed the American message as

⁹² *Ibid.*, p. 192.

⁹³ Washington to Ottawa, Tel No 1725, 10 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

⁹⁴ Ottawa to Saigon, Tel No Y-438, 16 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

nothing "that had not already being published in the western press."⁹⁵ He accused the United States of insincerity and denounced the Canadian effort. Ronning had little success in discovering any flexibility in the North Vietnamese position. After persistent challenges, however, Trinh qualified his remarks and acknowledged that the Canadian channel remained open. Ronning and Moore were delighted and moved quickly to protect the Canadian investment, fearful that the United States might "take the position that the Canadian initiative has failed due to DRVN intransigence...and thus repeat the Seaborn episode (exploiting publicly the results of Canadian exploration as 'confirming a negative')."⁹⁶ The two Canadians thought that in the circumstances no information should be passed to the United States until Canadian officials had developed "a carefully qualified interpretation" of the North Vietnamese response.⁹⁷

Ottawa did its best to preserve the Canadian channel. Martin asked Rusk to ensure that the United States did not step up its bombing operations in the immediate aftermath of Ronning's visit. He did not divulge Hanoi's response.⁹⁸ On 20 June, the minister

⁹⁵ Saigon to Ottawa, Tel No 524, 18 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT. Polish diplomats in contact with North Vietnam described Hanoi as "deeply disappointed by the proposals made by Ronning." See *FRUS*, 1964-68, Volume IV, p. 468.

⁹⁶ Saigon to Ottawa, Tel No 525, 18 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

⁹⁷ Saigon to Ottawa, Tel No 529, 19 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

⁹⁸ Confidential Source.

called in officials from the American embassy and repeated the request that the United States not jeopardize the Canadian channel by increased bombing so soon after Ronning's return from Hanoi. Again, he refused to reveal the results of Ronning's visit.⁹⁹ This tight-lipped approach was resented in Washington as an effort "to keep us hemmed in on the grounds that the channel is still open."¹⁰⁰ When the results of the mission were at last given to Bundy on the afternoon of 21 June, Martin interpreted the North Vietnamese rejection in the best light possible, underlining Hanoi's declared interest in using the Canadian channel again. He drew Washington's "attention to the adverse effects which an early escalation of U.S. activities against North Vietnam is likely to have both retroactively on the Ronning mission and potentially on the future use of the Canadian channel."¹⁰¹ The Canadian presentation was so convincing that Bundy himself was initially uncertain exactly how Martin saw the results. However, he was not long distracted by the Canadian interpretation: "Basically, Hanoi turned Ronning down cold on their paying any price whatever for the cessation of bombing."¹⁰²

⁹⁹ Ottawa to Washington, Tel No Y-449, 21 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT. See also George Herring, *The Secret Diplomacy of the Vietnam War*, pp. 196-97.

¹⁰⁰ Walt Rostow to the President, 8 June 1966, NSF, Memoranda to the President, Vol 5, Box 8, Johnson Library.

¹⁰¹ Points to be Put to State Department Representative, 20 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

¹⁰² George Herring, *The Secret Diplomacy of the Vietnam War*, p. 197. See also *FRUS*, 1964-68, Volume IV, pp. 448-49.

That evening, Martin and his officials debriefed Bundy more fully over dinner. Martin was especially discouraged and complained bitterly that the American position "had not been forthcoming enough."¹⁰³ Within a week, there were grounds for further recriminations. In late June, news of the Ronning mission was leaked: on the respected television program, *Meet the Press*, the American under secretary of state explained that "there was nothing in what Ambassador Ronning brought back which gives any encouragement that Hanoi was prepared to come to a conference table. In fact, the line that they have been taking seems to us to be quite as hard as it has been at any time." Martin was outraged and "spoke very vigorously to Ambassador Butterworth."¹⁰⁴ A few days later, he was dismayed to learn that the United States had begun to bomb petroleum facilities near Hanoi and Haiphong. Butterworth was quickly told of the minister's displeasure.¹⁰⁵

The Ronning missions and the unseemly bickering between Bundy and Martin that accompanied them had two important consequences. In Ottawa, they undermined Pearson's confidence in Martin's judgement. The prime minister's unhappiness with Martin had been growing since Ronning's first mission in early 1966, and he did not try to hide

¹⁰³ William Bundy, Memorandum for the Record, 22 June 1965, RG 59, Box 1984, POL 15-1 CAN, USNA. See also, P.H. Kreisberg, Memorandum of Conversation: Visit of Ambassador Ronning to Hanoi, 21 June 1966, FOIA Request 9202977.

¹⁰⁴ A.E. Ritchie, Note for Mr Collins, 28 June 1966, DEA File 20-22-Viets-2-1-1, DFAIT.

¹⁰⁵ Ottawa to Washington, Tel No 4476, 30 June 1966, DEA File 20-22-Viets-2-1, DFAIT.

his distress from official Ottawa.¹⁰⁶ In the fall of 1966, he told Walter Gordon that Martin's views on foreign policy no longer mattered.¹⁰⁷ A few months later, he remarked to Paul Hellyer, the minister of national defence, that he "wanted to get Paul Martin out of External Affairs ... [he] is getting too involved in the Vietnam thing to the exclusion of our overall relations with the U.S."¹⁰⁸

In Washington, the Ronning experience fuelled concerns in the White House and the State Department about the drop in public support in Canada for American policy in Vietnam and the effect that this might have on bilateral relations. In his year-end report, Butterworth, explained to Washington how difficult it was becoming to maintain Canadian support for American policies in Asia:

We wrung from Pearson and Martin fulsome official statements of support for U.S. policy in Vietnam, but the Prime Minister in particular and the Government in general continued to have grave misgivings about the conflict's escalation, were prone to be oversensitive to criticism from Canadian Vietnicks, and still had difficulty relating Vietminh/Vietcong aggression to their own and Western security. If and as the war worsens, we can expect to find that whatever lip-service they give to our effort will be extracted from them in future, as in the past, against their emotional predilection. A by-product will be their restraint from doing what they are fully inclined to do,

¹⁰⁶ John English, *The Worldly Years*, p. 357. See also, Walter Gordon, Memorandum: Lunch with LBP, 30 March 1966, Gordon Papers, Vol 16, NAC.

¹⁰⁷ John English, *The Worldly Years*, p. 347.

¹⁰⁸ Paul Hellyer, *Damn the Torpedoes: My Fight to Unify Canada's Armed Forces* (Toronto, 1990), p. 209.

such as recognizing Red China and voting for its admission to the UN.¹⁰⁹

Polling conducted in April and May showed that Canadian support for Washington's "handling" of the war had declined sharply; although 35 percent still approved of the American effort in southeast Asia, a startling 34 percent disapproved.¹¹⁰ Johnson demanded to know if there is "anything constructive we can do in relation to Canada at the present time."¹¹¹ Rusk, on Butterworth's advice, responded with a recommendation that Johnson visit Canada as "this would undoubtedly constitute the most important single step that we could take to emphasize the enduring common interests between the US and Canada." The trip would help dispel the widespread popular doubt in Canada about Washington's Asian policies:

[T]he political and psychological climate in Canada suggests that a visit by you could have a tremendous impact in focusing the attention of Canadians upon the 'enduring common interests between our countries and in redirecting their fixation away from such problem issues between us as Vietnam and China, which they persistently view so astigmatically.'¹¹²

¹⁰⁹ American Embassy, Ottawa to State Department, 6 January 1966, Airgram A-38, FOIA Request 9202977.

¹¹⁰ Robert E. Kantor, Memorandum For the President, 17 June 1966, WHCF, Country Files: Canada, Box 19, Johnson Library.

¹¹¹ Benjamin H. Read, Memorandum to Ambassador J. Leddy, FOIA Request 9202977.

¹¹² Dean Rusk, Memorandum for the President, 7 May 1966, NSF, Memoranda for the President, Vol 2, Box 7, Johnson Library. See also, for Butterworth's views, American Embassy, Ottawa to Secretary of State, Tel No 1455, 27 April 1966, FOIA Request 9202977.

Throughout the summer, Rusk and his department continued to press Johnson "to make a substantial visit to Canada."¹¹³ After all, as the veteran American diplomat Robert McClintock noted to Ball, Pearson "despite his harsh criticism, particularly over Viet Nam, ... is still one of the best friends the United States has."¹¹⁴

Increasingly reluctant to leave Washington and the business of running the war in Vietnam, Johnson hesitated before deciding impetuously in early August to pay a brief visit to New Brunswick, where Canada and the United States were transforming Franklin D. Roosevelt's summer home into an international park. Vietnam - "our military restraint, our non-military efforts and our continued hope for some sign of reason from Hanoi" - topped the president's agenda.¹¹⁵ Isolated in the White House by domestic opposition to the war, Johnson was encouraged by the popular reception accorded the presidential cavalcade as it swung north through the New England states to Campobello Island. He arrived in New Brunswick in a good mood, and his private talks with Pearson "took place in the most friendly atmosphere throughout."¹¹⁶ American officials were

¹¹³ Francis M. Bator, Memorandum for Marvin Watson, 5 August 1966, Bator Papers, Box 3, Chronological Files (NSC), 05/01/66 - 06/15/66, Johnson Library.

¹¹⁴ Robert McClintock to George Ball, 12 May 1966, RG 59, Box 1984, File POL 15-1 CAN, USNA.

¹¹⁵ Francis M. Bator, Memorandum for the President, 10 August 1966, NSF, Memoranda for the President, Box 9, Johnson Library.

¹¹⁶ Summary of Prime Minister's Meeting with President Johnson, August 21, for Consulates in the United States, 30 August 1966, DEA File 20-1-2-USA, DFAIT.

gratified by the results of the meeting.¹¹⁷ When Pearson hinted that his government might drop its opposition to Communist Chinese representation at the United Nations, Johnson made clear his disagreement and insisted that the two allies approach this problem together: "He thought that the two governments should keep in close touch on the issue and that the relationship [being] what it is between our two countries we could always work out any differences between us."¹¹⁸ The implication for Canadian officials was clear:

[H]is intention to talk to us later on the matter seems to presage at least the possibility of pressure on us to support the United States position as the vote draws near. It would, therefore, appear that, if the Canadian Government wishes to change its vote, the timing and tactics to use vis-à-vis the United States will be important and delicate.¹¹⁹

The president's views, expressed in the midst of a debate in Ottawa over how far Canada should go toward seeking a resolution to the problem of Peking's exclusion from the United Nations, almost certainly reinforced Pearson's inclination to proceed cautiously in this matter. Martin, however, remained anxious to press on with the

¹¹⁷ See American Embassy, Ottawa to State Department, Tel No 292 (in two parts), 23 August 1966 and American Embassy, Ottawa to State Department, Tel No 325, 26 August 1966, FOIA Request 9202977. Canadian officials were also pleased and thought that the meeting had "achieved very successfully the objectives which might have been hoped for on the Canadian side [and]... further consolidated the personal relationship between the Prime Minister and the President." See H.B. Robinson, "Memorandum for File," 24 August 1966, DEA File 20-1-2-USA, DFAIT.

¹¹⁸ R. Smith, Memorandum of Conversation: Communist China and Admission to UN, 21 August 1966, NSF, Country File: Canada, Box 166, Johnson Library.

¹¹⁹ H.B. Robinson, Memorandum for File, 24 August 1966, DEA File 20-1-2-USA, DFAIT.

second part of his two-pronged approach to resolving the conflict in Vietnam and admitting Peking to the United Nations. Ronning, whom the Chinese had refused to see on his way to Hanoi in March, had failed to advance this project. Martin was inclined to try a more direct approach. He endorsed a proposal that Canada abandon its opposition to the traditional Albanian resolution, which called on the United Nations to expel Taiwan from the international organization and assign the Chinese seat to Peking. Instead, Canada would abstain and support a simple resolution that gave Peking a seat in the United Nations without explicitly mentioning Taiwan.¹²⁰

Pearson was doubtful. He rejected his minister's assertion that an abstention would have a minimal impact on Canada's relations with the United States. Washington, he noted, would consider an abstention a "radical departure" from Canada's established position and no less irritating than a decision to take an active role in the expulsion of Taiwan. He objected to Martin's reluctance to pursue a "two-Chinas" resolution, arguing that "we are too emphatic against delaying tactics - they may turn out to be the best of evils." To bolster his case, he enlisted the support of Norman Robertson, the venerable former under-secretary of state for external affairs, who shared Pearson's view that recent developments in Vietnam made it "unwise ... for Canada to

¹²⁰ Paul Martin, Memorandum for the Prime Minister, 28 June 1966, DEA File 20-China-14, DFAIT.

contemplate a shift [in policy] this year."¹²¹ The prime minister decided to defer his decision until the probable American reaction could be explored more fully.¹²²

During the course of the following few weeks, Martin had ample opportunity to learn how the United States would respond to a Canadian initiative on the Chinese question. Rusk made it perfectly clear in late September that he considered any move to legitimize Peking's international status to be inimical to Western interests in Southeast Asia.¹²³ The Washington embassy reported an equally rigid attitude among American officials in the State Department.¹²⁴ This confirmation of the Liberal leader's fears made it difficult for Martin to sell Pearson on a China initiative. The foreign minister was therefore obliged to adopt Pearson's view that Canada should promote a "'one-China, one-Taiwan' resolution that would have representatives of both governments seated in the Assembly as an interim solution."¹²⁵ While this resolution would please neither

¹²¹ Mary MacDonald to J.E. Hadwen, 11 July 1966 and Marcel Cadieux, Memorandum for the Minister, 22 July 1966, DEA File 20-China-14, DFAIT.

¹²² Paul Martin, Memorandum for the Prime Minister and attachments, 22 July 1966, and Pearson's marginalia, Pearson Papers, Volume 279, File 821/C539.11.Secret, NAC.

¹²³ H.B. Robinson, Memorandum for File, 22 September 1966, DEA File 20-China-14, DFAIT.

¹²⁴ Washington to Ottawa, Tel No 2791, 15 September 1966 and Washington to Ottawa, Tel No 2950, 29 September 1966, DEA File 20-China-14, DFAIT.

¹²⁵ [P.A. McDougall], Chinese Representation: Notes on Three Possible Courses of Action, 21 October 1966, DEA File 20-China-14, DFAIT.

Peking nor Taiwan, "the principles it enunciates are entirely in accord with the Canadian position and will appeal to a small but respectable group of middle powers who like ourselves do not like extreme positions." It would allow Canada to oppose an Albanian-type resolution, using this opposition to secure from Washington "passive acquiescence" for the Canadian initiative. Pearson approved this proposed plan; indeed, he was instrumental in pushing it through cabinet over the objections of "some ministers" who thought that Canada should immediately recognize Peking.¹²⁶

Significantly, the final position that Pearson forced on Martin was not all that different from the policy Washington was preparing to adopt. In late October, Martin informed Rusk of the Canadian decision to explore some form of "two-Chinas" resolution at the 21st General Assembly. The American response was "glum but restrained."¹²⁷ Rusk and the State Department did not minimize the importance of the Canadian decision to the American strategy of containing Peking: "The Canadian shift makes a critical difference. If we lose the support of these friends, it is probable that the Albanian resolution will obtain a simple majority for the first time [and] ... we will have suffered an important defeat." Canada, the State Department estimated on the basis of its recent contacts with Canadian officials, could not be dissuaded, and might even

¹²⁶ Cabinet Conclusions, 28 October 1966, RG 2, Vol 6321, NAC.

¹²⁷ Ottawa to Washington, Tel No Y-745, 27 October 1966 and Washington to Ottawa, Tel No 3273, 28 October 1966, DEA File 20-China-14, DFAIT.

attract the support of Belgium and Italy, whose governments were under strong left-wing pressure to accommodate Peking. The United States could not simply "stand pat" since passage of the Canadian resolution, with its suggestion that Peking assume China's seat on the Security Council, was not a position Washington could allow the General Assembly to endorse.

In early November, Rusk urged Johnson to compromise, and to support a resolution which would establish a "study committee" to examine the issue before the next General assembly. As the United States would neither control the membership of this committee nor its terms of reference, Rusk was not sanguine in anticipating the exercise's results: "At a minimum, I would expect that this Committee would recommend some form of 'two-Chinas' solution."¹²⁸ In effect, Canada and the United States differed, and only marginally, over a question of timing.

After discussing the problem with Johnson, the secretary of state wrote Pearson, reiterating the familiar American position. A move forward would simply encourage Peking's belligerent policies in Southeast Asia and Vietnam. In addition, Rusk outlined a number of problems with the specific wording of the Canadian resolution. There was only one possible American response to the Canadian initiative as it now stood:

we would have to oppose your resolution in its present form, if it were introduced, and indeed, would have to exert every ounce of our influence to defeat it by the heaviest possible

¹²⁸ Dean Rusk, Memorandum for the President, 5 November 1966, FOIA Request 9202977.

margin. I need not underscore the seriousness of such a split between our two nations.

As an alternative course, Rusk proposed, Canada might join with one or two other countries in sponsoring a resolution to establish a study committee that would examine the question of Chinese representation at the United Nations.¹²⁹

The negative American reaction was echoed in the capitals of some of Canada's closest allies, who learned of the Canadian demarche on 7 November 1966. The Canadian resolution, thought Australia, was "regrettable, untimely and possibly leading to disaster."¹³⁰ The Japanese reaction was equally blunt.¹³¹ The level of support from Belgium and Italy, with whom Canada had frequently consulted on this question, was also limited. Belgium would only support the Canadian resolution subject to a number of presentational amendments, while Italy wished to redraft the entire resolution to take into account U.S. objections.¹³²

Pearson was disturbed by the American and international reaction, but Martin was determined. He indicated that, subject to the prime minister's views, the Canadian Permanent Mission in New York should continue its consultations with the Italians, the

¹²⁹ Dean Rusk to L.B. Pearson, 9 November 1966, Pearson Papers, Volume 7, File 821/C359.1.Conf., NAC.

¹³⁰ Canberra to Ottawa, Tel No 729, 11 November 1966, DEA File 20-China-14, DFAIT.

¹³¹ H.B. Robinson, Memorandum for the Prime Minister, 9 November 1966, DEA File 20-China-14, DFAIT.

¹³² Brussels to Ottawa, Tel No 785, 8 November 1966 and Rome to Ottawa, Tel Nos 1401 and 1409, 8 November 1966, DEA File 20-China-14, DFAIT.

Belgians and the Americans. The delegation should be prepared to discuss the American suggestion for a study committee but without any implicit or explicit commitment, using the possibility of a Canadian abstention on the Albanian resolution as a threat "to induce the USA and Italians to move to [a] position which is in closer accord with our own resolution."¹³³

The following day, 12 November 1966, George Ignatieff, Canada's permanent representative to the United Nations, reached an agreed text with his Belgian counterpart. Should the Italians be brought round to the Belgian-Canadian position, the American delegation hinted to Ignatieff, Washington might be convinced to abandon its study committee proposal.¹³⁴ Late in the evening of 16 November, the Italian, Belgian and Canadian representatives in New York agreed upon a final text *ad referendum*.¹³⁵ Though quite different from the original Canadian resolution, the tripartite draft did contain an important reference to "the conflicting territorial claims of the two governments [of China] and the need to seek an appropriate solution taking into account ... the political realities of the area." Unfortunately, the Italians retreated the next day, and with Chile's support, began to solicit support for a resolution establishing a study committee.

¹³³ H.B. Robinson, Memorandum for the Prime Minister, 11 November 1966, DEA File 20-China-14, DFAIT.

¹³⁴ Ottawa to Rome, Tel No Y-125, 12 November 1966, DEA File 20-China-14, DFAIT.

¹³⁵ H.B. Robinson, Memorandum for the Minister, 17 November 1966, DEA File 20-China-14, DFAIT.

With debate on the Chinese question scheduled to begin shortly in the General Assembly, Martin turned to the cabinet for advice. The government had to decide whether the Italian-Canadian-Belgian draft represented the minimum Canada could accept, and if so, whether Canada should disassociate itself publicly from the Italian initiative. In addition, the government needed to consider how Canada would vote on the Italian and the Albanian resolutions. Martin hoped that "the Canadian delegation [would] be left free to vote in the negative or to abstain from voting" on an Albanian-type resolution.¹³⁶ Cabinet endorsed most of Martin's recommendations: it agreed that Canada could go no further than the tripartite compromise resolution and that it should make a full statement explaining its position and its unsuccessful efforts to advance Chinese representation. Pearson refused to allow Martin to abstain on an Albanian-style resolution without prior consultation, effectively retaining control over Canadian policy.

The prime minister's reluctance forced Martin to return to New York in search of a compromise. On arrival, he was met by the United States ambassador to the United Nations, Arthur Goldberg. Martin explained to him that the government could not support a study committee without appearing to retreat from its stated policy. The Canadian suggested that Ottawa's position might be met if the Italian resolution could be amended to include a brief reference to the competing claims of Peking and Taiwan. While

¹³⁶ Cabinet Conclusions, 18 November 1966, RG 2, Vol 6321, NAC.

Goldberg undertook to consult Rusk and Johnson, Martin telephoned Pearson, who agreed that Canada would co-sponsor an amended resolution.¹³⁷ Washington, however, rejected the amendment and the following day, in a meeting of interested delegations, Italy announced its determination to proceed with its own resolution.

During the following week, Martin was faced with conflicting advice from the members of the Canadian delegation to the General Assembly. Officials from the Department of External Affairs, convinced that Canada had gone as far as it could with its forceful advocacy of its resolution, pressed the minister to oppose the Albanian resolution. Younger members of the delegation, including Pierre Trudeau, the prime minister's parliamentary secretary, vigorously pressed Martin to abstain.¹³⁸ Pearson hoped that Canada would support the Italian resolution for a study committee.¹³⁹ On 23 November 1966, Martin intervened in the General Assembly debate on the question of Chinese representation and carefully explained why the Canadian government found both the Italian and the Albanian resolutions unsatisfactory. While indicating that Canada would support the proposal for a study committee, he did not reveal how Canada would vote on the Albanian resolution.

¹³⁷ H.B. Robinson, Memorandum for U.N. Division, 21 November 1966, DEA File 20-China-14, DFAIT.

¹³⁸ Don Page, "The Representation of China in the United Nations: Canadian Perspectives and Initiatives, 1949-1968," in Paul M. Evans and Michael Frolic (eds.), *Reluctant Adversaries*, pp. 96-99.

¹³⁹ Norman St. Amour, "Sino-Canadian Relations, 1963-1968: The American Factor," in *ibid*, p. 120.

During a meeting with Rusk, two days prior to the vote, the question was not addressed. Instead, the Americans simply asked the minister to inform their allies in Asia that Canada had been pursuing its own policy during the preceding months and was not acting as an American stalking horse.¹⁴⁰ On the morning of 29 November 1966, Martin telephoned the prime minister and discussed how Canada might cast its vote. The minister contended that an abstention would disarm the government's domestic critics. It would also lend weight to the idea of an independent Canadian policy. Martin reassured the prime minister that an abstention would not greatly anger the Americans.

There was something in these assertions. Directed by Pearson, Martin had come so close to reaching a compromise with the United States that the differences between the two countries could be safely disregarded. When Pearson agreed that Canada would abstain, the Americans said little. Indeed, after discussing the question with leading members of the United States delegation, J.G. Hadwen, the minister's special assistant, concluded:

The general tenor of our exchanges...was satisfactory. I would take it as the kind of exchange which Canadian and U.S. officials have on points on which their governments disagree...I don't see, to judge from this conversation, that we will likely get any serious Washington fallout.¹⁴¹

¹⁴⁰ State to Taipei, Tel No 91450 and W.J. Stoessel, Memorandum of Conversation: Secretary's Conversation with Canadian Foreign Minister Martin: Chirep, 25 November 1966, FOIA Request 9202977. During this conversation Rusk showed some signs of irritation about the lack of consultation about the evolution of Canadian policy.

¹⁴¹ J.G. Hadwen, Memorandum to Far Eastern Division, 30 November 1966, DEA File 20-China-14, DFAIT.

In contrast to the differences that divided Washington and Ottawa over NATO, NORAD and defence policy, the divisions over Asia were not easily or successfully reconciled. Canadian and American approaches to the Vietnam War and Communist China reflected their fundamental disagreement over the proper Western role in the Far East. As a global power with a historic stake in the Pacific, the United States naturally accorded Asia considerable significance. Canada, a small power whose interests were still dominated by its traditional European and North Atlantic connections, did not. As the Johnson administration became engaged in the crisis in Vietnam, Canada offered only limited assistance. Ottawa's few small gestures of support for its great power ally were still too much for some Canadians, and by early 1965, Pearson was under pressure to take steps to distinguish Canadian and American policy.

This was increasingly difficult to do. The hostile reception that greeted the prime minister's Temple University speech and Martin's unhappy efforts to find grounds for negotiations underlined clearly the risks associated with meddling in "Johnson's war." Pearson consequently assumed more control over Canadian policy, forcing Martin to moderate his approach to China. This did not reconcile Canadian and American differences over Asia, but minimized and contained them, largely removing the Far East as a source of bilateral tension. The struggle to sustain this moderate posture, which won few friends on either side of the border, would become the central feature of Pearson's Far Eastern policy in the final year of his mandate.

Chapter Six:

Containing the New Nationalists

The differences in view over Western strategy in Asia that emerged during 1966 left policy-makers in Ottawa and Washington shaken and uneasy. This divergence could not have come at a worse time. Though temporarily checked by the hostile reaction accorded the 1963 federal budget, the nationalist impulse that the Liberals had ridden into power refused to subside and was beginning to flower on the eve of the country's centennial celebrations. The lengthy struggle by cultural nationalists to secure government protection found expression in 1964 and 1965 in legislation to preserve Canada's mass media from American competition. Careful Canadian diplomacy in Washington and a sharp eye for legitimate American economic interests muted the impact of these measures on Canada's relations with the United States.

For a while it seemed that Ottawa's efforts to address the other major item on the nationalist agenda - the 'Canadianization' of the small American-owned Mercantile Bank - might also be dealt with in a pragmatic fashion. Unfortunately for relations between the two governments, both Walt Butterworth, the American ambassador to Canada, and Walter Gordon were determined to use this issue as a platform from which to force their respective governments to resolve the questions associated with the role and status of American investment in Canada. In transforming the Mercantile Bank's status into a symbol, the two men sparked a nasty and very

public brawl that threatened to poison relations between the two countries.

The affair fed the anti-Americanism from which Canadian nationalists drew much of their inspiration. As they sought to distinguish Canadians from Americans and Canada from the United States, nationalists focused with increasing vehemence on the single most obvious difference between the two governments - the war in Vietnam. Opposition to the war reinforced cultural and economic nationalism and created a new, radical critique of Canada's relations with the United States. Neither Pearson nor Martin could ignore the antiwar movement forever, and over the course of 1967, Ottawa slowly distanced itself from United States policy in Southeast Asia. Observers in Washington were distressed, and for a short while in the fall of 1967, the two countries seemed headed for the kind of collision that had marred relations during Diefenbaker's final year in office.

Canadian magazines, held sacred by several generations of nationalists as outlets for the expression of Canadian attitudes and opinions, had been under threat since the early 1920s.¹ The problem had become acute by the mid-1950s. American periodicals, which enjoyed much cheaper unit production costs than their Canadian competitors, held 80 percent of the Canadian market by

¹ For a discussion of this problem, see Mary Vipond, "Canadian Nationalism and the Plight of Canadian Magazines in the 1920s," *Canadian Historical Review*, LVIII (March 1977), pp. 43-63. An important publisher's view of the question is Floyd S. Chalmers, *Both Sides of the Street: One Man's life in Business and the Arts in Canada* (Toronto, 1953), pp. 221-32.

1954. Moreover, Canadian editions of American magazines like *Time* and *Reader's Digest* attracted almost 40 percent of the money spent on periodical advertising in Canada and threatened to bankrupt magazines like *Macleans* or *Saturday Night*.² In 1956, the Liberal minister of finance, Walter Harris, had tried to protect Canadian magazines by imposing a 20 percent tax on advertising in non-Canadian periodicals. This was withdrawn in 1958 and in its stead a royal commission on publications, chaired by Grattan O'Leary, publisher and editor of the *Ottawa Journal*, was appointed. It reported in May 1961 and recommended that expenses incurred for advertising directed at the Canadian market in foreign periodicals (including Canadian editions of American magazines) should not qualify for an income tax deduction. O'Leary also urged that the customs act be amended to prevent the entry into Canada of foreign periodicals containing Canadian domestic advertising.³ In January 1963, Diefenbaker announced that he would carry out O'Leary's recommendations, exempting the Canadian editions of *Time* and *Reader's Digest* on the grounds that they were already established in Canada.⁴

Diefenbaker's legislation never appeared and, when the new

² Isaiah Litvak and Christopher Maule, *Cultural Sovereignty: The Time and Reader's Digest Case in Canada* (New York, 1974), pp. 30-31.

³ Royal Commission on Publications, *Report*, (Ottawa, 1961), p. 74. See also, Grattan O'Leary, *Recollections of People, Press and Politics* (Toronto, 1977), pp. 138-40.

⁴ Issiah Litvak and Christopher Maule, *Cultural Sovereignty*, p. 65.

Liberal government took office in April 1963, it immediately came under intense pressure to act. Two days after the election, C.J. Laurin, vice-president of Maclean-Hunter Publishing and president of the Canadian Periodical Association met with Walter Gordon, the minister of finance, and urged him "most strongly to deal with the matter in the June budget."⁵ Gordon, however, was inclined to delay, a decision which reflected the sound advice offered by his assistant deputy minister of finance, A.F.W. Plumptre:

In this field, as in others, it is undesirable, indeed dangerous, for the Government to announce that it is going to do something until it has a fairly clear idea of what it intends to do. The dangers in this field are in fact greater than in most because of the complexity of the subject, the wide variety of views that are held, and the strong feelings that are aroused.⁶

Pearson agreed that nothing would be done before the parliamentary summer recess.⁷

During August and September, Plumptre and Robert Bryce, the deputy minister of finance, tried to find some means of protecting Canadian magazines from their American competition. They focused their efforts on three possible solutions. First, the government

⁵ The pressure on the government was intense. See, for example, C.J. Laurin to Walter Gordon, 23 April 1963, Laurin to Gordon, 10 May 1963 and Laurin to Gordon, 28 May 1963, Gordon Papers, Volume 10, National Archives of Canada (NAC). The effort was ultimately counter-productive as besieged officials tended to pass the epistles along, marginally dismissing them with notes that observed that the "situation is as usual extremely urgent." R.B. Bryce, Memorandum for Mr Gordon in Cabinet, 16 July 1963, RG 19, Volume 5201, File 8891-07, NAC.

⁶ A.F.W. Plumptre, Memorandum for the Minister, 25 April 1963, Gordon Papers, Volume 10, NAC.

⁷ See Bryce's marginalia on his Memorandum for Mr. Gordon in Cabinet, 16 July 1963, RG 19, Vol 5201, File 8891-07, NAC.

could revert to some version of the Harris tax, though this step "would be loudly opposed by the whole advertising fraternity, and ... by many daily newspapers." Second, the government could adopt O'Leary's recommendation to disallow income tax deductions on advertising costs incurred in foreign periodicals, modifying it to exempt *Time* and *Reader's Digest*. Third, the government could erect a punitive tariff on imported editorial content in order to deal with American magazines tailored for the Canadian market. Bryce noted that the Canadian Periodical Association wanted the government to increase the postal rates charged *Time* and *Reader's Digest* by denying them the discount enjoyed by other Canadian publishers.

Bryce, who thought that an amendment to the postal rates was too radical, was sceptical of the value of all these courses of action. The time for action, he argued, had long since past:

The magazine publishing industry in Canada is now dominated by *Time* and *Reader's Digest*. The cost, in terms of relations with the U.S.A., of forcing these two publications out of Canada will be very high and yet action short of forcing out *Time* and *Reader's Digest* may be nothing more than temporary stimulant. The United States Government will find it very difficult to condone such measures as are under consideration, even if *Time* and *Reader's Digest* are made exempt.

The deputy minister of finance reminded the prime minister that amending the customs act would involve complicated international negotiations under the General Agreements on Tariffs and Trade (GATT), and that any move in this field was likely to disrupt the Canadian advertising community. In short, "[t]he proposed omelette cannot be made without breaking a number of eggs." Bryce concluded: "I remain of the view that the time is past when it would have been

worthwhile to take the drastic action that is really required, and to pay the inevitable price in terms of relations with the USA and in terms of the various Canadian interests that would inevitably be affected."⁸

Unwilling to antagonize either the Canadian press or the United States, Pearson asked officials in early September to continue their search for a solution. The views of E.P. Zimmerman, publisher of the Canadian edition of *Reader's Digest*, were canvassed. He suggested that additional revenue for Canadian magazines could be generated by placing a levy on all magazines sold in Canada, the funds to be distributed to publications which incurred a certain proportion of their editorial and production costs in Canada.⁹ Tom Kent, the prime minister's principal assistant, joined the discussion at this point and strongly endorsed the idea that *Time* and *Reader's Digest* pay first-class postage rates rather than the subsidized rate enjoyed by other Canadian periodicals. Kent calculated that this would cost the two magazines over \$5.5 million and effectively exclude them from the Canadian market. A tariff barrier against special editions completed Kent's prescription. Although he argued that removing the postal subsidy could be more readily explained and easily defended than adjustments in the income tax act, he recognized that any

⁸ R.B. Bryce, Memorandum for the Prime Minister, 12 August 1963, RG 19, Vol 5201, File 8891-07, NAC.

⁹ E.P. Zimmerman to R.B. Bryce, 4 September 1963, and Bryce to A.F.W. Plumptre, 4 September 1963, RG 19, Vol 5201, File 8891-07, NAC.

effective action ultimately involved defying Washington:

Of course, if we did this we would be blasted by *Time* and *Digest*, and their powerful friends in the U.S., with fury beyond bounds. But this is true for anything effective we do. Anything effective means destroying *Time* and *Digest* in Canada. The only alternative is the death, sooner or later, of *Macleans* and the continued absence of any other significant Canadian magazines. We have to decide whether we're prepared to pay the price. If not, we must sooner or later expect more foreign control of the Canadian printed word. It will be a bit late to wring our hands, or try to lock the stable door, then.

¹⁰

Zimmerman and Kent failed to sway the Department of Finance. The first advocated a solution that was too novel and radical for a government anxious to avoid controversy and the second, a course of action that was simply foolhardy. Gordon urged the cabinet to do nothing.¹¹

Kent responded by urging the prime minister to do something to reinforce Canadian magazines, which he described as the country's "only national voice." He agreed that the government could not afford to take on Washington in the wake of Gordon's first budget. He proposed giving *Time* and *Reader's Digest* "squatter's rights." The risk of a major confrontation with Washington over action to eliminate the threat of future "Canadian editions" was much smaller and one the government ought to run "for an important national purpose." After all, as Kent pointed out wryly, "[w]e have hitherto annoyed the Americans for less purpose." The government ought to

¹⁰ Tom Kent, Memorandum for R.B. Bryce, 9 September 1963 and attached Memorandum for the Prime Minister, 5 September 1963, RG 19, Vol 5201, File 8891-07, NAC.

¹¹ Walter Gordon, Memorandum to Cabinet, 30 September 1963, Privy Council Office (PCO) File T-1-20, PCO.

proceed on the basis of the two O'Leary recommendations, exempting *Time* and *Reader's Digest*.¹²

Kent's intervention was decisive, and Gordon's recommendation to do nothing was turned back by the cabinet committee on economic policy, trade and employment in early October. At the end of October, after Kent's proposals were reviewed by both the cabinet committee and an ad hoc interdepartmental committee of officials, the full cabinet agreed "to take a preliminary decision to act along the lines of a modified O'Leary proposal." In order to overcome the opposition of those who feared a hostile reaction from Washington, the government would consult the United States administration before taking a final decision.¹³

The prime minister himself handled much of the diplomacy involved with stick-handling the compromise through Washington. He wisely delayed consultations with the Americans until the furore over the government's expanded automotive incentive scheme had subsided.¹⁴ By then, rumours of the impending action had already reached the State Department and when Charles Ritchie, Canada's ambassador to Washington, called on United States officials, he

¹² Tom Kent, Memorandum for the Prime Minister, 2 October 1963, Kent Papers, Box 3, Queen's University Archives (QUA).

¹³ L.B. Pearson, Memorandum for the Cabinet, 11 October 1963, PCO File T-1-20, PCO and Report of the ad hoc Interdepartmental Committee, 18 October 1963, RG 19, Vol 5201, File 8891-07, NAC.

¹⁴ Washington to Ottawa, 4 November 1963, and Paul Martin, Memorandum for the Prime Minister and Pearson's marginalia, 6 November 1963, Department of External Affairs (DEA) File 37-7-1-USA-1, Department of Foreign Affairs and International Trade (DFAIT).

found them more or less reconciled to Canadian policy. Philip Trezise, the deputy assistant secretary of state for economic affairs, explained that the United States could live with Canada's policy if the reaction from the American media was not "too passionate." Nevertheless, he warned that the restrictions would be criticized as interfering with the free flow of ideas and "aimed at a particularly sensitive area of Canada-USA relations." On the whole, Ritchie characterized the American reaction as "quite mild."¹⁵ When Pearson raised the issue with President Lyndon Johnson during his January 1964 visit to Washington, he received an equally reassuring response from George Ball, the under secretary of state.¹⁶ Six weeks later, Pearson unveiled the new policy in the House of Commons.¹⁷

In contrast to the subdued response in Washington, the reaction in Canada to the government's proposed legislation was hostile. Although a Maclean-Hunter's representative called it "the best practical solution," most commentators were quick to denounce the government's decision to exempt *Time* and *Reader's Digest*. J.A. Daly, president of Southam Business Publications, claimed that the

¹⁵ Washington to Ottawa, Tel No 3796, 20 November 1963, DEA File 37-7-1-USA-1, DFAIT.

¹⁶ Memorandum of Conversation: Royal Commission on Periodicals, 22 January 1964, *Freedom of Information Act (FOIA)* Request 9202777.

¹⁷ Canada, House of Commons, *Debates*, 20 February 1964, pp. 57-59.

government was only "locking the door after the horse was stolen."¹⁸ The *Toronto Star* claimed that the legislation meant "a fatal weakening of the O'Leary Report... the death-knell for Canadian national magazines."¹⁹ Its publisher, Joseph Atkinson, worried that the legislation "may actually work to our disadvantage by according Canadian status to *Time* and *Reader's Digest*, thus removing the last psychological bar to Canadian business advertising in foreign publications."²⁰ The opposition was so virulent that Floyd Chalmers, president of Maclean-Hunter, reversed his company's position and withdrew its lukewarm support for the government's measures.²¹

The Parliamentary support on which Pearson's minority government depended to pass its legislation quickly evaporated. Although the opposition Conservatives had promised virtually identical legislation in 1962, they made it clear that their support was no longer certain.²² More troubling still, a number of Liberal backbenchers and cabinet ministers, unhappy with the decision to exempt *Time* and *Reader's Digest*, were threatening to

¹⁸ Cited in Isaiah Litvak and Christopher Maule, *Cultural Sovereignty*, p. 70. See also J.D. Daly to L.B. Pearson, 2 February 1964, PCO File C-2-3(g)-2, PCO.

¹⁹ *Toronto Star*, 24 February 1964.

²⁰ Atkinson to L.B. Pearson, 20 March 1964, PCO File C-2-3(g)-2, PCO.

²¹ Floyd Chalmers to Mitchell Sharp, 26 March 1964 and Floyd Chalmers to Mitchell Sharp, 4 May 1964, Sharp Papers, Volume 19, File 6, NAC.

²² R.G. Robertson, Memorandum for the Prime Minister, 14 April 1964, PCO file C-2-3(g)-2, PCO.

oppose the government.²³ Sensing defeat, Gordon refused to table the resolutions necessary to give effect to the government's policy when he introduced his second budget in late March 1964.²⁴ Convinced "that the legislation in its present form might fail to pass," the finance minister urged cabinet in early April to either rescind the exemptions for the two magazines or abandon the legislation.²⁵

Aware that the government might be tempted to strengthen its legislation in order to disarm its domestic critics, the American embassy warned Canadian officials "than any departure from the basis of the legislation outlined in the Prime Minister's statement to the House would provoke violent criticism in the United States."²⁶ To underline the importance it attached to this question, Washington asked that the proposed legislation be placed on the agenda of the forthcoming meeting of the Canada-United States Joint Committee on Trade and Economic Affairs. Officials hurriedly reminded the secretary of state for external affairs and

²³ Tom Kent, *A Public Purpose: An Experience of Liberal Opposition and Canadian Government* (Kingston and Montreal, 1988), p. 319.

²⁴ Stephen Azzi, "The Limits of Affluence: Walter Gordon, Foreign Ownership, and the Politics of the Independence Issue," (Unpublished Ph.D. thesis, University of Waterloo, 1996), pp. 227-28.

²⁵ Cabinet Conclusions, April 16, 1964, RG 2, Volume 6264, NAC.

²⁶ Marcel Cadieux, Memorandum for the Minister, 14 April 1964, DEA File 37-7-1-USA-1, DFAIT; See also R.G. Robertson, Memorandum for the Prime Minister, 14 April 1964, PCO File C-2-3(g)-2, PCO.

the prime minister, that with the automotive incentive program under attack in Washington, now was not the time to act.²⁷ Caught between the domestic opposition and the vigilant administration in Washington, the government scrambled to find "positive measures for Canadian magazines to add to the mix."²⁸

In early May, Kent provided the prime minister with the solution. Acknowledging that it would be neither right nor wise to include *Time* and *Reader's Digest* in any measures that would force them to leave the country, Kent suggested that the government do "something else to satisfy the people who are opposed to *Time* and *Digest*." He noted that the most vociferous opponents of the exemption were also the most strident advocates of general "Canadian ownership" policy for media and suggested that the measures to protect Canadian magazines should be extended to newspapers, radio and television. The exemption for *Time* and *Reader's Digest*, as well as one or two small newspapers which had acquired similar "squatter's rights," would be qualified by giving these publications three years to achieve 55 percent Canadian content. Kent's proposals were obviously attractive: "[b]ecause we would be taking action over a broader field, there would be far more satisfaction to nationalism and therefore it would be easier to get away with not requiring Canadianization of *Time* and *Reader's*

²⁷ Marcel Cadieux, Memorandum for the Minister, 14 April 1964, DEA File 37-7-1-USA-1, DFAIT.

²⁸ R.G. Robertson, Memorandum for the Prime Minister, 17 April 1964, PCO File C-2-3(g)-2, PCO.

Digest in ownership and control."²⁹

Pearson introduced Kent's suggestions to cabinet, where Gordon immediately grasped their significance for his own, more economic, nationalist objectives. He withdrew his opposition to the exemption for *Time* and *Reader's Digest* in exchange for extending the measures to a broader field. "[T]he protests of the periodical press seemed of less importance than the protection of Canadian ownership of media generally," he explained to his colleagues, "and the action taken on the latter score would be likely to satisfy, or at least mollify, those who were critical of the failure to protect Canadian magazines."³⁰ Gordon's shift was important, but while the cabinet agreed that the legislation should be extended to other media, it remained divided over the question of imposing Canadian content requirements on *Time* and *Reader's Digest*, a move that some members felt was unfair to the two magazines and certain to antagonize the United States.³¹

During the summer, the government made some progress in

²⁹ Tom Kent, Memorandum for the Prime Minister, 11 May 1964, Kent Papers, Box 3, QUA. Kent owed some of the credit for the suggestions on Canadian content to R.G. Robertson. See Robertson's Memorandum for the Prime Minister, 4 May 1964, PCO File C-2-3(g)-2, PCO.

³⁰ Cabinet Conclusions, 21 May 1964, RG 2 Vol 6264, NAC. See also, L.B. Pearson, Memorandum for the Cabinet, Cabinet Document 222/64, PCO File C-2-3(g)-2, PCO.

³¹ Cabinet Conclusions, 25 May 1964, Volume 6264, NAC. Cabinet members were also concerned that the proposal to give *Time* and *Reader's Digest* three years to meet their targets would expose the government to the three-year campaign against the legislation. See Tom Kent to Walter Gordon, 24 May 1964, Gordon Papers, Vol 14, NAC.

resolving its differences over media policy. By early October 1964, the prime minister was ready to ask the cabinet committee on economic policy, trade and employment for its views. Pearsons's measures were a good deal stiffer than those unveiled the previous February. He wanted to amend the income tax act to disallow deductions for advertising costs in foreign-owned newspapers, radio and television stations and to modify the existing exemption for *Time* and *Reader's Digest* to require them to achieve 25 percent Canadian content within one year. Moreover, the postmaster general was to explore the feasibility of reducing the postal subsidies given to *Time* and *Reader's Digest*.³²

The Department of External Affairs was alarmed by these proposals and urged Martin to protest vigorously. Washington had never shown much sympathy for these measures, acquiescing only because the exemption to *Time* and *Reader's Digest* effectively protected its real interest. Diluting the exemption would attract "very strong criticism from the whole range of U.S. communications media," that part of the population best able to express themselves. The decision to include newspapers and other media would also provoke comment, since it was difficult to argue that there existed a problem in these areas. Most important, the prime minister's timing was disastrous:

With the looming United States elections and the accompanying dangers of irritations in United States-Canada relations, it does not seem like a very good moment to bring this issue

³² L.B. Pearson, Memorandum for the Cabinet Committee on Finance and Economic Policy, Cabinet Document 448/64, PCO File C-2-3(g)-2, PCO.

forward again. If we are to have any success with such important negotiations as for example those taking place with regard to the rationalization of the automobile industry, we will need a good deal of support and understanding from United States public opinion.³³

Though Martin accepted the arguments put forward by his officials, they made little impression on Pearson, who seemed increasingly anxious to remove this tiresome item from the cabinet's agenda. He dismissed Martin's concerns and secured cabinet's approval to begin drafting the necessary legislation.³⁴

Work on the legislation proceeded slowly, hindered in part by dogged opposition from officials in the Department of External Affairs.³⁵ The department was given another opportunity to advance its case in early February 1965 when the ad hoc inter-departmental drafting group turned to the cabinet for more guidance. The group recommended scrapping the earlier suggestions for Canadian content regulations, which had proven too difficult to administer without tripping up the ethnic press in Canada. It asked cabinet to decide whether it wished to limit *Time* and *Reader's Digest* to an intermediate preferential rate or ordinary second class privileges. Whatever the decision, the government should expect an adverse reaction from the United States, and charges of "nationalism" and "interference in the free flow of ideas." Clearly swayed by the

³³ Marcel Cadieux, Memorandum for the Minister, 7 October 1964, DEA File 37-7-1-USA-1, DFAIT.

³⁴ Cabinet Conclusions, 22 October 1964, RG 2, Vol 6265, NAC.

³⁵ See Marcel Cadieux, Memorandum for the Minister, 11 February 1965, DEA File 37-7-1-USA-1, DFAIT.

arguments advanced by the External Affairs, the inter-departmental panel warned that "[t]he timing of the introduction of these new proposals ... should therefore be looked at against other current issues in U.S.A.-Canada relations, including the Congressional debate on the automotive programme and on the interest equalization tax renewal."³⁶

The warning had a sobering effect, and even Kent began to hesitate.³⁷ In cabinet, Martin was joined by Mitchell Sharp, the minister of trade and commerce, and Jack Pickersgill, the minister of transport, in opposing any action. Martin pointed out that none of the advocates of protection had gone out of business since the 1963 election. Sharp worried about the possible adverse impact on bilateral arrangements with the U.S. for marketing Canadian oil and wheat. Gordon, however, challenged the three ministers:

The present proposals were justifiable and considerably more realistic than those that had been made earlier. He saw no reason to subsidize *Time* and *Reader's Digest*, which in his view constituted dumped material in Canada.³⁸

The time had come, he concluded, to stop the United States from taking over Canada's newspapers. Confronted again with a divided cabinet, Pearson turned the problem back to his officials.

Gordon's intervention swung the momentum of the debate clearly in favour of the nationalist contingent. The following week Pearson

³⁶ L.B. Pearson, Memorandum to Cabinet, 24 February 1965, PCO File C-2-3(g)-2, PCO.

³⁷ See Tom Kent to the Prime Minister, 26 February 1965, Tom Kent Papers, Box 4, QUA.

³⁸ Cabinet Conclusions, 2 March 1965, RG 2, Volume 6271, NAC.

returned to cabinet with three clear recommendations. The income tax act would be amended along the lines set out in his February 1964 statement to Parliament, with the provisions for magazines extended to cover newspaper, radio and television advertising. *Time* and *Reader's Digest* were to be given their promised exemption but would have to use ordinary second class mail in the future. The customs act would be amended to prohibit the importation of special Canadian editions.³⁹ This time, Pearson's strong commitment to the measures guaranteed cabinet's approval.⁴⁰

In keeping with its commitment to inform Washington of developments in this field, Ottawa instructed Ritchie to give copies of the proposed legislation to the State Department in mid-March.⁴¹ The reaction was "surprisingly strong." Tresize reiterated Washington's philosophical objections to the measures, but denounced in particular those clauses which discriminated between Canadian and non-Canadian publications on postal rates. He argued that this would materially diminish the value of the exemption provided *Time* and *Reader's Digest*:

The Department of State must express its particular regret that the Canadian Government has decided to proceed with these measures at the time when, over the past year, considerable progress has been made in improving United States-Canada economic relations to the mutual benefit of both countries.

³⁹ L.B. Pearson, Memorandum for the Cabinet, 8 March 1965, PCO File C-2-3(g)-2, PCO.

⁴⁰ Cabinet Conclusions, 9 March 1965, RG 2, Volume 6571, NAC.

⁴¹ Ottawa to Washington, Tel No E-602, 18 March 1965 and Washington to Ottawa, Tel No 891, 19 March 1965, DEA File 37-7-1-USA-1, DFAIT.

The proposed measures in publications would clearly be out of keeping with the recent trend and would be regarded as a retrograde step in USA-Canada relations.⁴²

Ritchie was clearly impressed by the vehemence with which Trezise insisted that United States subsidiaries in Canada should be given the same treatment as domestic companies and he warned Ottawa:

I do not think they will be satisfied with a mere re-statement of our position. Moreover, given number of significant outstanding bilateral issues that are currently in train or coming up for consideration presently, I would have some concern about effect negative response to USA approach might have on general climate of our relations. I would therefore hope Embassy might be able to let State Department know reasonably soon that we are willing to re-examine postal rate question in light of their objections.

The next day, Joe Scott, the minister at the United States Embassy and Francis Linville, the economic counsellor, called on Ed Ritchie, the assistant under-secretary of state for external affairs, to underline Washington's concern.⁴³

The impact of the American representations was immediate. The idea that Canada might try to convince the Americans to accept the revised postal rates was dropped.⁴⁴ Instead, within a week, cabinet decided that Gordon would announce only the proposed changes to the income tax and customs act, and simply refer to the government's intention to review the postal rates paid by *Time* and *Reader's*

⁴² Washington to Ottawa, Tel No 1134, 12 April 1965, DEA File 37-7-1-USA-1, DFAIT.

⁴³ A.E Ritchie, Memorandum to Economic Division, 13 April 1965, DEA File 37-7-1-USA-1, DFAIT.

⁴⁴ See, for example, R.G. Robertson, Draft Memorandum for the Prime Minister, 13 April 1965, PCO File C-2-3(g)-2, PCO.

Digest as part of a general review of rates.⁴⁵ Gordon's supporters were devastated. One of his most ardent champions, a former editor at *Maclean's*, Peter Newman, denounced the minister of finance to a friend:

You are reading the letter of an ex-Walter Gordon disciple. His militant sponsorship of legislation forever garotting Canadian periodicals and awarding *Time* and *Digest* a monopoly over the Canadian magazine industry, is a step that has disillusioned me ... Gordon has now handed over to two American magazine empires the monopoly over the printed word for national distribution in Canada. I think he's inconsistent and stupid.⁴⁶

Washington, however, was gratified by cabinet's decision and was reassured to discover that the more extreme manifestations of Canadian nationalism might still be kept safely at bay.⁴⁷

American observers, however, did not expect the nationalist problem to disappear completely. The issue, as Butterworth well knew, was deep-rooted and reflected Canada's historical ambiguity about the attractions and dangers of a close relationship with the United States:

Canada's economic relations with the United States are still beset by the dichotomy between belief that economic growth depends on close ties with the United States and the fear that economic interdependence with the United States would eventually lead to political absorption.⁴⁸

⁴⁵ Ottawa to Washington, Tel No G-115, 26 April 1965, DEA File 37-7-1-USA-1, DFAIT.

⁴⁶ Quoted in Stephen Azzi, "The Limits of Affluence," p. 232.

⁴⁷ Washington to Ottawa, Tel No 1289, 26 April 1965, DEA File 37-7-1-USA-1, DFAIT.

⁴⁸ Embassy Ottawa to State Department, Airgram A-638, 6 January 1966, FOIA Request 9202777.

Butterworth argued that Pearson's re-election in November 1965 as head of the country's third consecutive minority government "was symptomatic of [Canada's] uncertainty ... and immaturity." Among the many fundamental questions that Canadians still had to resolve was the choice between seeking closer economic ties with the United States or pursuing economic nationalism and multilateralism. As a result, he warned the State Department, Canadian nationalism was likely to continue to plague the relationship "in odd ways."

Still, he thought, there were hopeful indicators that the next little while might be less trouble for Washington than the past few years. The uncertain election results were a chastening experience for both the government and the opposition, and would encourage them to adopt "a more cautious approach to U.S.-Canadian problems which should auger well for United States interests in the economic area." The humiliation of Gordon, who accepted responsibility for the government's poor showing and resigned from the cabinet after the election, was counted "a great gain for us." Butterworth was also encouraged by the addition of Robert Winters as minister of trade and commerce, and Sharp's promotion to minister of finance. These changes, he thought, "will have a definite strengthening, and perhaps conservative, effect [on the government]."

Butterworth's optimism was not entirely misplaced. During the first few months of 1966, it was clear that Sharp and the new government seemed inclined to adopt a more flexible approach to the question of foreign investment in Canada. This was evident in how they proposed to deal with the problems created for the Mercantile

Bank by the revision of the bank act. The dispute first arose in the summer of 1963, when representatives of the First National City Bank of New York (Citibank) met with Gordon and explained to him that they had just concluded an agreement in principle to purchase the small, Dutch-owned Mercantile Bank. Gordon, who was convinced that it was "most important that Canadian control be maintained of our principal financial institutions ... [for] [t]hese institutions form the very core of our financial and business system," warned his American interlocutors on July 18, 1963 that the government would probably amend the bank act to limit foreign ownerships of banks and 'near banks'. Despite this warning, Citibank proceeded with its purchase.⁴⁹

The new bank act was only introduced in the spring of 1965. It included clauses limiting foreign ownership to 25 percent and restricting individual holdings to 10 percent. The bill was not retroactive and Citibank was spared these provisions. Section 75(2)(g), however, specifically targeted the Mercantile Bank. It prohibited any bank from having liabilities of more than twenty times its authorized capital stock if more than 25 percent of its shares were owned by any one individual owner or group of owners. This clause effectively meant that Citibank would need to reduce its holdings in the Mercantile Bank to 25 percent before the bank

⁴⁹ The confusion surrounding this discussion is discussed in John Fayerweather, *The Mercantile Bank Affair: A Case Study of Canadian Nationalism and a Multinational Firm*, (New York, 1974), pp. 50-77. Fayerweather assumes that all the participants are telling the truth for "it would be exceptional for highly placed executives in a major business enterprise to engage in wilful deception or similar actions."

could expand.

Though Gordon's bill died on the order paper when the 1965 election was called, Sharp was expected to reintroduce a bill to revise the bank act early in the new session. Not unexpectedly, the United States, which had remained silent on this issue during the 1965 federal election campaign, protested against the provisions in Gordon's original legislation at the March 1966 meeting of the Joint Canada-United States Committee on Trade and Economic Affairs. The American delegation pointed out that the legislation was both discriminatory and retroactive and rejected as unfounded Canadian fears that the Mercantile Bank would ever be in a position to dominate banking in Canada.⁵⁰

The exchange was not especially bitter. Off the record, T.C. Mann, the United States under secretary of the treasury, volunteered to help Sharp work out a compromise with Citibank which would limit Mercantile's growth and remove the need for offensive provisions in the legislation.⁵¹ Later that month, Sharp met with Butterworth to pursue this possibility. Well aware of Gordon's looming presence on the government's backbench, Sharp refused to amend the bill to eliminate section 75(2)(g). However, he was ready to risk a public dispute with Gordon in order to permit the Mercantile Bank to increase its capitalization under the present

⁵⁰ Draft Summary Record, Joint United States-Canada Committee on Trade and Economic Affairs, March 4-5, 1966, DEA File 35-4-5-1-1966, DFAIT.

⁵¹ T.C. Mann to Mitchell Sharp, [March 1966], File LR 76-576-4-6, Rasminsky Papers, Bank of Canada Archives (BCA).

legislation. The American ambassador immediately understood the significance of this concession. It would effectively "finesse Mercantile's problem" by allowing the bank to expand before the restrictive legislation was in place.⁵²

The United States kept up a gentle pressure on the Canadian government, registering a formal objection with the Department of External Affairs in mid-April. The protest note, which hinted broadly at the possibility that Canadian banks in the United States might suffer if Ottawa discriminated against American banks in Canada, was a clever piece of diplomatic drafting. Although it was not intended for publication, the note was unclassified, and could therefore be made public without Canada's permission if Washington later wished to escalate the disagreement into a confrontation. The note itself addressed only the principle of discrimination against American banks in Canada, and did not mention the Mercantile Bank by name, allowing both governments considerable room to manoeuvre. When he delivered it, Charles Wootton, the United States Embassy counsellor for economic affairs, made it clear that it was designed essentially to encourage a settlement. While the United States complaint may have been about banking in general, the problem really was "a de facto one and related to Mercantile." Washington

⁵² Walt Butterworth to Department of State, Letter No A-941 and attached Memorandum of Conversation, RG 59, Box 838, FN 6, United States National Archives (USNA). There is some evidence that Sharp may have had this contingency in mind as early as February 1966. See his Memorandum for Cabinet, 28 February 1966, PCO File F-1-7, PCO. On clause 75(20(g)), the memorandum noted: "It has been asserted that this is discriminatory legislation but it should be noted that it is within the powers of the Treasury Board to grant relief by approving an increase in authorized capital."

wanted primarily "a solution ... which would be satisfactory to Mercantile ... a compromise of some sort which would avoid a head-on collision."⁵³

By early May, a solution along the lines that Sharp had outlined to Butterworth in March was within reach. The minister of finance approached Robert MacFadden, the Canadian president of the Mercantile Bank, early that month to discuss how the bank might circumvent the coming legislation. They discussed in detail Mercantile's expansion plans and agreed that they could be met by allowing it to increase its capitalization before the new bank act came into effect. The timing was left open, though Sharp proposed "to say when he moves the legislation that this is the Government's view -- that it is the Government's intent -- to allow an increase in the capitalization of Mercantile." All that remained was to seek cabinet's approval for the arrangement. Bryce conveyed the news to Butterworth. "[A]mid their mutual laughter at the reference to the July 18 misunderstandings," the ambassador was ready to accept the deal "with reservations."⁵⁴

While the two United States principals involved - the State Department and the Mercantile Bank - considered Sharp's suggestion, the finance minister's operating environment changed for the worse. In early May, Gordon published *A Choice for Canada: Independence or Colonial Status*, and ignited a public debate over the Mercantile

⁵³ Embassy Ottawa to Department of State, Airgram No A-1021, 15 April 1966, RG 59, Box 838, File FN 6 Can, USNA.

⁵⁴ Walt Butterworth, Memorandum of Telephone Conversation, 2 May 1966, RG 59, Box 834, FN 6 Can, USNA.

Bank. In his polemic, Gordon reviewed his July 1963 meeting with representatives from Citibank, and claimed that they had been fairly warned not to proceed. Mercantile responded with its own press release.⁵⁵ Drawing on his nationalist allies in caucus, Gordon launched an active campaign against any adjustment in the provisions relating to the Mercantile Bank. Increasingly suspicious of Sharp, whom he accused of stealing his ideas for a national development fund, he floated the idea of moving an amendment to the bank act from the floor of the House of Commons to give Parliament, rather than cabinet, the power to increase bank capitalization. At the same time, Gordon attacked the central feature of Sharp's version of the revised bank act, the provision for removing the six percent ceiling on bank loans.⁵⁶

In this context cabinet met repeatedly throughout May and June to review the bank act. Sharp's version of the legislation included the same provisions limiting the growth of the Mercantile Bank as Gordon's, but Sharp proposed to amend the clause in a manner which would delay its coming into effect until 31 December 1967.⁵⁷ He also planned to inform Parliament that "any reasonable request for an increase in the authorized capital of the Mercantile Bank ...

⁵⁵ Walter L. Gordon, *A Choice for Canada: Independence or Colonial Status* (Toronto, 1966), pp. 94-95. The response to this work is discussed extensively in Stephen Azzi, "The Limits of Affluence," pp. 264-68. For the Mercantile Bank's account of the July meetings, see John Fayerweather, *The Mercantile Bank Affair*, pp. 79-80.

⁵⁶ Cabinet Conclusions, 17 May 1966, RG 2, Vol 6321, NAC.

⁵⁷ The Minister of Finance to Cabinet, 2 May 1966, PCO File F-1-7, PCO.

would be given sympathetic consideration."⁵⁸ Sharp argued that the bank could be allowed to double its size without it having any appreciable impact on the Canadian banking system. There was considerable support for this position. Martin, Winters, and John Turner, minister without portfolio, were united in warning that the legislation as drafted by Gordon was "discriminatory and would complicate relations with the United States."⁵⁹ However, with Gordon's threatened amendment gathering support in caucus, Pearson and other ministers urged Sharp to maintain the government's original, unyielding position.⁶⁰

As he sought to negotiate a suitable compromise with Gordon and his supporters over the decision to lift the 6 percent ceiling on interest rates, Sharp was in no position to force the government to give the Mercantile Bank more generous treatment. In the end, he only secured cabinet's support for his technical amendment, which would allow the Mercantile Bank to grow until the end of December 1967 if authorized by cabinet.⁶¹ It was a hollow victory since cabinet was under no circumstances going to permit the bank to increase its capitalization.

Officials at the United States embassy reacted with anger when they learned that the compromise sketched out by Sharp and the

⁵⁸ Cabinet Conclusions, 9 May 1966, RG 2, Vol 6321, NAC.

⁵⁹ Cabinet Conclusions, 17 May 1966, RG 2, Volume 6321, NAC.

⁶⁰ Cabinet Conclusions, 9 May 1966, RG 2, Volume 6231, NAC.

⁶¹ Cabinet Conclusions, 24 June 1966, RG 2, Volume 6321, NAC.

Mercantile Bank had collapsed. Wootton urged Washington to "express its extreme displeasure" at the Canadian action. Although this would be unlikely to lead to any changes in the legislation, the economic counsellor thought that it might help the Mercantile Bank to secure an increase in its authorized capital. He urged the administration to eliminate the preferential treatment enjoyed by Canadian banks in the United States:

It is only in this way that we will bring home to the GOC our determination to protect U.S. economic interests in Canada and to resist further inroads such as might be directed against other types of U.S. firms on another occasion.⁶²

In early July, Sharp introduced his bill to amend the bank act, undeterred by the threat of retaliation. The Canadian banking community in the United States was thought to be too small to merit much sustained attention from the administration. Moreover, Sharp and his officials were well aware that the United States government lacked the constitutional authority to retaliate since banking was a state responsibility. Nevertheless, when his bill came up for its second reading in the House of Commons in early October, Sharp hinted that he would be prepared to authorize United States banks to open agencies in Canada if Washington muted its opposition to the bank act.⁶³

Mercantile was not interested in this meagre offer, which did little to address the immediate threat to its interests. Instead,

⁶² Embassy Ottawa to Department of State, Airgram A-1342, 30 June 1966, RG 59, Box 838, FN 6 Can, USNA.

⁶³ John T. Saywell (ed.), *Canadian Annual Review for 1966* (Toronto, 1967), pp. 318-19. See also Ottawa to Washington, Tel No E-3167, 10 October 1967, DEA File 36-13-1, DFAIT.

Walter Wriston, the executive vice-president of Citibank, and Harry Harfield, the bank's counsel, arranged to meet the acting secretary of state, Nicholas Katzenbach, in Washington. The two bank executives explained that they had heard from "unnamed friendly sources" in the Liberal Party that Sharp would withdraw the offending clauses in his bank act if ordered to do so by the prime minister. A message from Johnson to Pearson, they continued, would have the desired effect. Katzenbach was non-committal, but after further discussions with Citibank, State Department officials concluded that a stern note to the Canadian government was in order. They turned to Butterworth for advice.⁶⁴

The American ambassador relished the prospect of a fight. He insisted that the proposed note, and the verbal message that would accompany it must be strong - strong enough to convince Ottawa that the United States was determined to see the Mercantile Bank treated fairly. More important, the note must convince the Canadian government once and for all of Washington's fundamental opposition to "retroactive discrimination." This principle remained vitally important to all United States companies in Canada for they could all be "adversely affected by retroactive changes in the rules of the game." Indeed, the affair had global implications since "not a few underdeveloped countries are looking over Canada's shoulder to see how she makes out in bilking Uncle Sam's investment." The

⁶⁴ Rufus Smith, Memorandum of Conversation: Discriminatory Canadian Banking Legislation, 2 November 1966 and Department of State to Embassy Ottawa, Tel No 719, 2 November 1966, RG 59, Box 838, FN 6 Can, USNA.

ambassador recalled the discriminatory dividend tax in Gordon's first budget:

This is test number 2. The stakes are the same and we must mean what we say for should they disregard our formal warning and we act accordingly, we will nevertheless by retaliation ensure that retroactive discrimination will never be tried again.⁶⁵

Butterworth's views were influential in shaping both the note to be delivered to Canada and the tactics to be followed in handing it over. On 11 November 1966, A.E. Ritchie, who succeeded Charles Ritchie as Canadian ambassador to the United States in July 1966, was called into the State Department to receive the formal American protest from Katzenbach. The under secretary of state emphasized the degree of concern felt by the United States, and explained that this was "not limited to specifics of Mercantile case but arose in great part because of precedent which legislation would set with regard other US interests both [in] Canada and abroad."⁶⁶ The written protest which accompanied Katzenbach's oral presentation was described by Ritchie as "a very rough note." It asked Ottawa to remove the offending clauses in the bank act and threatened retaliation not only against Canadian banks but also against any Canadian economic interest in the United States since the legislation undermined "the ground rules on which all American-

⁶⁵ Embassy Ottawa to Department of State, Tel No 748, 3 November 1966, RG 59, Box 838, FN 6 Can, USNA.

⁶⁶ Department of State to Embassy Ottawa, Tel No State 83614, 11 November 1966, RG 59, Box 838, FN 6 Can, USNA.

owned firms operating in Canada must rely."⁶⁷

Officials and politicians in Ottawa alike were appalled. The threat of retaliation was particularly disturbing since it was only a matter of time before the existence of the note would become public in leak-prone Ottawa, painting the government into an uncomfortable corner.⁶⁸ Sharp, who was scheduled to visit New York on 15 November, arranged to travel on to Washington to meet with Henry Fowler, the United States secretary of the treasury. The visit was intended both to determine how united the administration was behind their hard-line and to let the United States know how little room Sharp had to manoeuvre.

On meeting his American counterpart, it was soon apparent to Sharp that the administration was not completely united. Fowler agreed with the United States position but he did not like the note. He explained that "he had not come down on the points raised in the note" and he quickly offered his "good offices in discussing [the] issue with State Department." In his view, there were two possible solutions: Ottawa could agree to increase Mercantile's authorized capital, or it could amend the legislation to allow foreign-owned banks to maintain a ratio of total liabilities to authorized capital that was the same as national average. Either

⁶⁷ The text of the note and Ritchie's report on his discussion with Katzenbach are reprinted in Peter C. Newman, *The Distemper of our Times: Canadian Politics in Transition, 1963-68* (Toronto, 1968), pp. 515-18.

⁶⁸ Pearson's cabinet was notoriously prone to leaks. In mid-1966, Diefenbaker met with Pearson to "demand that he be kept at least as well informed as the press about public business." See Cabinet Conclusions, 25 August 1966, RG 2, Volume 6321, NAC.

approach would allow the Mercantile Bank to grow without permitting it to dominate the banking industry in Canada.⁶⁹

The State Department was also entertaining some second thoughts about its tactics following Sharp's visit to Washington. Rufus Smith, the department's officer responsible for Canadian affairs, suggested to Butterworth that the United States had accomplished its primary objective when it registered its opposition to discriminatory legislation in the November note. This question could be pursued later in order to drive the point home. Meanwhile, Smith thought he had found a device to defuse the crisis "which is consistent with our basic position, but which might still avoid taking us very far down path of retaliation." Ottawa might ask all banks to inform or consult the Treasury Board or the Bank of Canada before they increased their ratio of liabilities to authorized capital. In effect, Canada would adopt the same kind of "voluntary guidelines approach" that the United States used to address its balance of payments problem. This would allow the Canadian government to claim that it had preserved the essential purpose of the legislation - monitoring the activities of foreign banks in Canada - while at same time "maintain[ing] 'free enterprise' in the banking system." At the same time, the United States could claim that the discriminatory features of the

⁶⁹ George Kidd, Memorandum for File, 18 November 1966, DEA File 36-13-1, DFAIT; See also, Department of State to Embassy Ottawa, Tel 93230, 29 November 1966, RG 59, Box 838, FN 6 Can, USNA.

legislation had been removed and no precedent had been set.⁷⁰

Butterworth rejected the suggestions advanced by Fowler and Smith. Having expressed the American viewpoint so strongly in the November note, the ambassador believed that a decision to withdraw now would mean retreat and defeat. Intensifying the crisis represented the most effective American option:

I do not believe our interest will be served by back-tracking. After all, if Canadians push through legislation and U.S. follows though with its promised retaliation, we gain broader advantage of demonstrating to Canadians, as well as to other countries peering over their shoulders, high cost of retroactive discrimination against U.S. interests. In my view, therefore, it is not up to us but rather to Canadians to suggest compromise.⁷¹

The ambassador's judgement was again decisive. The administration remained committed to the terms of its November note.

Developments in Canada were further eroding the government's ability to seek a negotiated solution. As Sharp and his officials had anticipated, news of the American note become public in an article by Peter Newman, writing in the *Toronto Star*.⁷² Sharp was immediately faced with a host of hostile questions in the House of Commons.⁷³ Anxious to dampen the controversy, the minister of finance approached MacFadden, who was scheduled to appear before the House of Commons Committee on Finance, Trade and Economic

⁷⁰ Department of State to Embassy Ottawa, Tel No 90666, RG 59, Box 838, FN 6 Can, USNA.

⁷¹ Embassy Ottawa to Department of State, Tels No 900 and 901, 30 November 1966, RG 59, Box 838, FN 6 Can, USNA.

⁷² *Toronto Star*, 1 December 1966.

⁷³ Canada, House of Commons, *Debates*, 2 December 1966, pp. 10663-64.

Affairs to testify on the bill early the following week. Sharp asked the bank president to postpone his appearance until January. At the same time, the minister called Ritchie, asking him to let Katzenbach know what he was trying to accomplish, with the implication that Washington might do the same.⁷⁴

Katzenbach was non-committal; Butterworth was not. Learning of Sharp's growing concern over the crisis, the ambassador insisted that MacFadden should testify as scheduled and advised the administration in Washington not to give way: "It seems to me all the more important that our own course must now be steady. We must not allow ourselves to be deterred by GOC ploys from defending [the] principle of non-retroactive discriminatory treatment of our interests."⁷⁵ The State Department concurred, and although MacFadden agreed to delay his testimony, Smith made it clear to representatives of Mercantile that the administration was not

⁷⁴ Rufus Smith, Memorandum of Conversation: Controversy over Mercantile Bank, 2 December 1966, RG 59, Box 838, FN 6 Can, USNA and Washington to Ottawa, Tel No 3773, 3 December 1966, DEA File 36-13-1, NAC.

⁷⁵ Embassy Ottawa to Department of State, 5 December 1966, RG 59, Box 838, FN 6 Can, USNA. Sharp's efforts were not helped by all Canadian officials. In the final paragraph of the above telegram, Butterworth reported:

Since the above was dictated, permanent under-secretary Cadieux had lunch with me. While avoiding being specific, he clearly conveyed predilection for the validity of our view. He asked about MacFadden and expressed hope that he would make a straightforward forceful defence of the right of First National City Bank to come in here and conduct legitimate commercial business under existing Canadian law.

interested in settling.⁷⁶ Asked for his advice in mid-December on receiving word from Sharp hinting that Ottawa was willing to try again to change the legislation to meet Citibank's needs, Smith told the Mercantile representative that:

any response Citibank makes ... should carry clear caveat that what might be satisfactory to Citibank would not necessarily be acceptable to USG. Smith explained position USG remains as set forth in representations to GOC and stem from concern over principle ... Smith declined to predict outcome but saw no sign US would back away from principle. Such stance, he thought, was essential to broad interests in Citibank and other US interests both Canada and elsewhere even though in short run it may not solve Mercantile problem.⁷⁷

Citibank, which surely never anticipated that its interests would diverge quite so sharply from Washington's, had little choice but to stay the course.

There was now every indication that Ottawa too would not retreat. In early January, the prime minister invited Walter Gordon to re-enter his cabinet in an effort to appease the party's progressive and nationalist wing.⁷⁸ Pearson, Sharp and Gordon met at the prime minister's residence the night before the decision was made public to settle their differences over economic policy. Gordon was "bitter and uncompromising" and the three men agreed "that there would be no compromising on the subject of the

⁷⁶ Department of State to Embassy Ottawa, Tel 103634, 15 December 1966, FN 6 Can, USNA.

⁷⁷ *Ibid.*

⁷⁸ On the events leading to Gordon's return, see John English, *The Worldly Years: The Life of Lester Pearson, Volume II: 1949-1972* (Toronto, 1992), pp. 375-76.

Mercantile Bank."⁷⁹ Cabinet later approved a defiant note in response to the Washington's November protest, but Sharp continued to hint that a compromise might eventually be possible. At the same time, the Department of Finance stepped up its propaganda efforts, releasing additional material on the two July 1963 meetings when Citibank was warned of the government's plans.⁸⁰

The American bank replied in kind. On 24 January, MacFadden and James Rockefeller, the president of the First National City Bank, appeared before the House of Commons committee considering the bank act, armed with a bulky and extensive press kit. Their appearance was singularly inept. Questioned by the committee on the Mercantile Bank's version of the July 1963 meetings with Gordon, Rockefeller frequently was condescending and disingenuous, at one point during the hearings, characterizing the former minister of finance as a simple "accountant." He claimed to be entirely

⁷⁹ Cited in Stephen Azzi, "The Limits of Affluence," p. 276. Sharp, Gordon and Pearson offer different accounts of this meeting. Gordon eventually charged that he had been deliberately misled. See Walter Gordon, *A Political Memoir* (Toronto, 1977), pp. 261-62 and Memorandum, 4-5 January 1967, Gordon Papers, Vol 16, NAC; Mitchell Sharp, *Which Reminds Me...A Memoir* (Toronto, 1994), pp. 150-51. L.B. Pearson, *Mike* Vol. 111, pp. 228-29. Pearson's account is the most plausible and rings true. The object of the meeting was to find some basis for agreement between Sharp and Gordon, and as an accommodation with the United States seemed very unlikely at that point, the three men could agree in good faith that the government would not compromise. As Pearson admitted, what exactly this meant was never defined:

Sharp and I felt we had agreed only to no change of policy but that we were not precluded from giving an extension of time, to remove allegations of unfair discrimination, if the Bank agreed to become 75 percent Canadian.

⁸⁰ John Fayerweather, *The Mercantile Bank Affair*, p. 93.

ignorant of Gordon's nationalism and insisted that "we did not call on the State Department." Committee members were openly sceptical, and one member was heard to remark that "[t]hose _____ are lying through their teeth."⁸¹

The press revelled in the controversy, but more responsible observers in Ottawa and Washington were worried that the public posturing might spin out of control. Ritchie reported "serious and widespread" concern in Washington and urged the government to compromise.⁸² Fowler, whose efforts to deal with Washington's continuing balance of payments difficulties required Canadian help, disassociated himself from the November protest.⁸³ Bryce Mackasey, a Liberal member of parliament and a member of the Committee on Finance, Trade and Economic Affairs, shared this concern, and decided to negotiate on his own. After clearing his idea with Sharp and Pearson, he headed for New York on 28 January. During a series of meetings with MacFadden, senior Mercantile Bank executives, and Rockefeller over the next two days, the Canadian convinced Citibank not to "rule out the sale of some Mercantile shares to the Canadian public at some future date."⁸⁴

The minister of finance was told of the bank's small, yet important, concession. A meeting was quickly scheduled between

⁸¹ *Ibid.*, p. 101. Deleted in the original.

⁸² Washington to Ottawa, Tel No 418, 30 January 1967, PCO File F-1-7(g), PCO.

⁸³ A.E. Ritchie, Memorandum for File, 2 February 1967, DEA File 36-13-1, DFAIT.

⁸⁴ John Fayerweather, *The Mercantile Bank Affair*, p. 113.

Sharp and the bank's representatives. It was clear, however, that he would not easily get cabinet's approval for a compromise. When he broached the question of a meeting with Citibank on 30 January, Gordon insisted that "no major concession should be made." Indeed, the new minister without portfolio insisted that Mercantile not be allowed to increase its authorized capital until it had sold 90 percent of its shares. Sharp pressed ahead, and suggested that the bill be amended to include a provision specifying that "during a certain period of time, [Citibank] would sell their stock to Canadians while at the same time obtaining approval of an increase in authorized capital." Gordon restated his opposition, and cabinet refused to let Sharp begin negotiating on this basis with the First National City Bank.⁸⁵ Replying to Ritchie, the prime minister could offer little that was "hopeful or helpful at this stage."⁸⁶

The next day, as scheduled, Sharp met with Stewart Clifford. Sharp was asked about his willingness to give the bank more time to sell its shares, but without cabinet's support no firm answer was possible. The minister testified before the House of Commons Committee on Finance, Trade and Economic Affairs a few days later, using the occasion to explore in public the possibility of a

⁸⁵ Cabinet Conclusions, 31 January 1967, RG 2, Vol 6323, NAC.

⁸⁶ Ottawa to Washington, Tel No PCO 1, 1 February 1967, PCO File F-1-7(g), PCO. Pearson was obviously very worried about the Mercantile Bank affair. Visiting with the prime minister that evening, John Holmes found his friend "completely preoccupied by the problems of Canada-United States relations." See John Holmes to A.E. Ritchie, 3 February 1967, Holmes Papers, File A/1/26, Canadian Institute of International Affairs Archives (CIIAA).

compromise. He reported that he had been told indirectly that the Mercantile Bank was ready to sell its shares, that he was aware of the difficulties this posed for the bank, and that he was willing to listen to any suggestions. He thought two possibilities existed: allow an increase in Mercantile's authorized capital with the new shares issued to Canadians, or extend the deadline.

Sharp declined to pursue either course until February 22, when Citibank agreed in writing "to seek share participation by Canadian residents when it is appropriate to make an attractive offering." Appearing before the House of Commons committee, the minister of finance was led by Mackasey's gentle questioning to reiterate his own preference for a compromise and to invite the committee to come up with a solution:

That the Mercantile Bank is now prepared to declare its intent to offer shares is such a step forward in this controversy that I believe that this committee should not in any way discourage the bank from doing that. I do not believe that an extension of the date is contrary to the spirit of the act, and it is possible that it would advance the cause of converting the Mercantile Bank into a predominantly Canadian-owned institution ... I am inclined to believe that there is likely to be a more constructive outcome if some time is given to the bank to get its affairs in order before they are required to sell shares.

Mackasey moved to amend the bill. The amendment, a draft of which was conveniently found in the briefcase of the Inspector General of Banks, gave Citibank five years to expand before it had to sell 75 percent of its stake in the Mercantile Bank. Seconded by Colin Cameron, the New Democratic Party's financial critic (thereby securing Sharp's left flank), it was adopted that afternoon.

Travelling in western Canada, Gordon was justifiably livid

when he learned of these developments. Only days before, he had asked Pearson what was going to happen with the bank act:

Mike replied that Sharp had decided not to do anything at all -- certainly at this time. He might bring the matter up again later on but there will be no changes proposed in the present Bank Act revision. I repeated my concern about the matter and said I was pleased nothing was going to be done.⁸⁷

Gordon immediately returned to Ottawa, where a cabinet meeting had been scheduled for the next day, determined to scuttle the deal. Like Butterworth, Gordon had come to see the entire issue as having "symbolic significance insofar as the whole foreign control issue is concerned."⁸⁸ He insisted that there be no concessions. If there was to be some sort of a compromise, Citibank should be forced to reduce its holding in the Mercantile Bank to ten percent. "Sharp was completely adamant that he would make no concessions to me whatever," Gordon recorded, adding "that in these circumstances he or I would have to go."⁸⁹

The cabinet turned the problem over to the prime minister and a group of ministers, who eventually reached a compromise in early March. The government would make two amendments to the legislation. Shareholders who held more than 10 percent of a bank's shares were prohibited from acquiring additional shares. In addition,

⁸⁷ Walter Gordon, Memorandum, 20 February 1967, Gordon Papers, Vol 16, NAC.

⁸⁸ Walter Gordon, Memorandum, 24 February 1967, Gordon Papers, Vol 16, NAC.

⁸⁹ Walter Gordon, Memorandum: Note of My Remarks to Cabinet, 24 February 1967, Gordon Papers, Vol 16, NAC; Mitchell Sharp later described the debate in cabinet as "rough and tough." See *Which Reminds Me*, p. 144.

Citibank's five-year extension was made conditional on cabinet's periodic approval. Both Gordon and Sharp agreed to these amendments. The ministers also agreed that cabinet would adopt two additional resolutions. Citibank's extension would not be forthcoming unless it gave cabinet compelling evidence of its intention to sell 75 percent of its shares to Canadians, and the Mercantile Bank's authorized capital would not be allowed to grow until Citibank's holding was reduced to 10 percent. Consideration of these two resolutions was deferred until an actual request for an increase in authorized capital was received from the Mercantile Bank, avoiding a cabinet split over the issue.

Gordon's success in transforming the Mercantile Bank into a nationalist symbol signalled the arrival in late 1966 and 1967 of a more sustained and integrated critique of the United States and its influence on Canada. By the spring of 1967, the tenets of economic and cultural nationalism were fused with the growing opposition to United States foreign policy, particularly the war in Vietnam, and recast into a potent and popular brand of anti-Americanism. Against the backdrop of the war in Southeast Asia, the export of American popular culture and United States foreign investment took on a more sinister coloration. Partly inspired by the work of radical social and political theorists from the former European colonies of Africa and Asia, who were exploring in critical terms the nature of colonialism, a growing number of Canadians were inclined to depict Canada-United States relations in neo-colonial terms. In April 1967, for instance, the political

scientist Gad Horowitz described Canada's "relationship with the United States ... [as] analogous to the relationship of Finland with the Soviet Union."⁹⁰ Mel Watkins, a professor of political economy at the University of Toronto, recalled that "[t]he anti-war movement in Canada developed into anti-imperialism and ... that translated into nationalism."⁹¹

Canada's artistic and literary communities quickly adopted the neo-colonial rhetoric as their own. Nourished on a diet of Canada Council grants, a new generation of writers and critics forcefully signalled their coming of age in 1967 with the creation of the House of Anansi Press in Toronto. Its early authors included Dennis Lee, Dave Godfrey, Margaret Atwood and Al Purdy. A disparate group, recalled Douglas Fetherling, Anansi's first employee, they shared one defining characteristic: "they were all, at some fundamental level, against more or less the same thing: Americanism, with its republican brutality and hatred of culture."⁹² Their profound distrust of modern America and its values was reflected in the work of George Grant, the McMaster University professor of philosophy, whose influential 1965 critique of Ottawa's failure to respond to the depredations of American corporations, *Lament for a Nation*, set

⁹⁰ Cited in J.L. Granatstein, *Yankee Go Home: Canadians and Anti-Americanism* (Toronto, 1996), p. 179.

⁹¹ Cited in Stephen Azzi, "The Limits of Affluence," p. 252.

⁹² Douglas Fetherling, *Travels by Night: A Memoir of the Sixties* (Toronto: Lester Publishing, 1994), p. 113.

the shrill tone which infused the "new nationalism".⁹³ Like Grant, the poet Lee attacked Canada's "Liberal" elite for producing a "nation of losers and quislings":

In a bad time, people, from an outport of empire I write
bewildered, though on about living. It is to set down a
nation's
failure of nerve; I mean complicity, which is signified by the
gaseous stain above us....
And the consenting citizens of a minor and docile colony
are cogs in a useful tool, though in no way
necessary and scarcely
criminal at all and their leaders are
honourable men, as for example, Paul Martin⁹⁴

Others launched their assaults directly against the United States, whose foreign policy and urban race riots seemed an accurate and disturbing reflection of the country's raw and violent character. A verse from Atwood's poem, "Backdrop Addresses Cowboy," succinctly combined the poet's observations on United States popular and political culture into a sudden, savage attack on the bombing in Vietnam:

Your righteous eyes, your laconic
trigger-fingers
people the streets with villains:
as you move, the air in front of you
blossoms with targets⁹⁵

Artists like Joyce Wieland and Greg Cunroe reflected this anti-American sentiment visually. The text on a 1965 graphic by Wieland

⁹³ George Grant, *Lament for a Nation: The Defeat of Canadian Nationalism* (Toronto, 1965).

⁹⁴ Dennis Lee, "Third Elegy (Nathan Phillips Square, Toronto), *Canadian Dimension*, Vol 4, No 6, (September-October, 1967), pp. 32-33.

⁹⁵ Margaret Atwood, "Backdrop Addresses Cowboy," in Al Purdy (ed.), *The New Romans: Candid Canadian Opinions of the United States* (Edmonton, 1968), p. 10.

left no room for misunderstanding: "Patriotism/Big Cash Savings/Canada Si Yankee No!/Human Missiles/Marrow Death/Pesticides/Orbital Spies/Genocide/Pepsi/C.I.A."⁹⁶

The celebrations to mark Canada's centennial in 1967 helped stoke the nationalist fervour. Pearson's government poured money into the festivities. New arenas, libraries and statues were erected across Canada.⁹⁷ Centennial projects resulted in hundreds of subsidized works on Canada and its accomplishments.⁹⁸ To the unforgettable strains of Bobby Gimby's catchy tune, "CA-NA-DA," the government sent the Centennial Train, a travelling museum of Canadiana, across the country, while tens of thousands of Canadians made the pilgrimage to Montreal to visit the 1967 World's Fair.⁹⁹

The nationalist mood was also fortified by the first wave of postwar baby-boomers coming of age in the mid-1960s. Largely freed from want by the postwar economic boom that provided their parents with safe, clean and prosperous suburbs, these young people pressed uneasily against the established order. The *Globe and Mail* noted in 1966 that they shared "a curious mood of rebellion, of resentment, not perhaps clearly recognized but nevertheless expressed."¹⁰⁰ Rock an' roll, drugs and collapsing sexual mores helped create and

⁹⁶ Cited in J.L. Granatstein, *Yankee Go Home*, p. 235.

⁹⁷ The author learned to skate and played his first indoor hockey game in North York's Centennial Arena.

⁹⁸ J.L. Granatstein, *Yankee Go Home*, p. 162.

⁹⁹ Judy Lamarsh, *Memoirs of a Bird in a Gilded Cage* (Toronto, 1969), pp. 184-228.

¹⁰⁰ Cited in Stephen Azzi, "The Limits of Affluence," p. 248.

sustain an atmosphere of experimentation and innovation.¹⁰¹ The anti-American and nationalist critique of United States domestic and foreign policy advanced by Grant and his disciples reverberated among campus audiences. The large number of American academics who taught in the country's rapidly expanding universities, and the increasing number of draft-dodgers who made their way north into Canada added their own brand of anti-Americanism to the volatile mixture.¹⁰² Early in 1967, the cries for the United States to get out of Vietnam - and Canada - began to spill into the streets.

The government's failure during 1966 to advance materially the cause of peace in Vietnam, either directly through Canadian "good offices" or indirectly by securing a United Nations seat for Peking, left it exposed to this growing domestic criticism. In mid-January 1967, a delegation from the Faculty Committee on Vietnam from the University of Toronto's Victoria College met with Martin and Pearson to express their concern with the war. Specifically, the faculty members asserted that the government's support for a negotiated settlement in Vietnam conflicted with its policy of selling arms to the United States under the terms of the Defence Production Agreement. The protesters had a point; the war in Vietnam had been good to the Canadian defence industry. In the four-year period prior to 1965, Canadian military exports to the

¹⁰¹ Doug Owsram, *Born at the Right Time: A History of the Baby boom Generation* (Toronto, 1996), pp. 188, 194-95, 204-06, 262-64. See also J.L. Granatstein, *Yankee Go Home*, pp. 179-80.

¹⁰² Paul Hollander, *Anti-Americanism: Critiques at Home and Abroad, 1965-1990* (New York: Oxford University Press, 1992), p. 416.

United States averaged approximately \$150 million per year. These exports ballooned to \$260 million in 1965 and increased again in 1966 to \$300 million, easing Canada's balance of payments position and reducing the country's continuing need for American capital.¹⁰³ When the problem was first recognized in 1965, the United States had made it clear that it would not accept any limits on its use of military equipment purchased from foreign suppliers.

Pearson's government was caught:

So far as Canada is concerned, our participation in arrangements leading to the integration of Canadian and U.S. defence industry, with the result that Canada has become the sole source in North America of certain lines of military equipment, clearly implies a long-term commitment not to place restrictions on the export of arms to the U.S. The consequences of attempting to reverse this policy would thus have far-reaching effects, not only in the economic sphere, but also on our political relations with the U.S.¹⁰⁴

Pearson and Martin vigorously defended the program against the Faculty Committee's charges, pointing out that the agreement was designed to meet the country's overall North American and NATO defence commitments as well as contributing to a positive balance of trade with the United States.¹⁰⁵

In late January 1967, a Canadian Press story reignited the

¹⁰³ Douglas Ross, *In the Interests of Peace: Canada and Vietnam, 1954-73* (Toronto, 1984), p. 259.

¹⁰⁴ Marcel Cadieux, Memorandum for the Minister, 16 January 1967, DEA File 27-11-2-USA, DFAIT.

¹⁰⁵ L.B. Pearson, "Canada, the United States and Vietnam," [March 1966], Department of External Affairs, *Statements and Speeches*, 67/8, reprinted in Norman Hillmer, *Partners Nevertheless: Canadian-American Relations in the Twentieth Century* (Mississauga, 1989), pp. 121-25.

controversy.¹⁰⁶ In the House of Commons, Martin reiterated the government's opposition to the war in Vietnam and reviewed his efforts to use Canada's connections in Washington and Hanoi to get the talks started. While the government's position might be illogical, he admitted, it was only fair to consider the circumstances under which the program had originally been developed in 1959.¹⁰⁷ The issue was further complicated when the government refused free transportation of medical supplies to North and South Vietnam for Quaker relief groups on the grounds that this would be inconsistent with government policy, which called for recipient countries to pay shipping charges.¹⁰⁸

In late May, the government was faced with a new set of charges when Gerald Clark, associate editor of the *Montreal Star*, charged that Canadian members of the International Commission for Supervision and Control (ICSC) were "betraying their trust by acting as informants for U.S. intelligence agencies ... [by] functioning as spies when they are supposed to be serving as International Civil Servants."¹⁰⁹ Martin vehemently denied the accusations. While there was no doubt that Canadian diplomatic and

¹⁰⁶ Paul Martin, Memorandum for the Prime Minister, 27 January 1967, DEA File 27-11-2-USA, DFAIT.

¹⁰⁷ Canada, House of Commons, *Debates*, 13 February 1967, p. 12966.

¹⁰⁸ Canada, House of Commons, *Debates*, 2 February 1967, p. 12361; 3 February 1967, p. 12617; 6 February 1967, pp. 12679-80; and 7 February 1967, p. 12730.

¹⁰⁹ Cited in John T. Saywell (ed.), *Canadian Annual Review for 1967* (Toronto, 1968), p. 208.

military representatives on the ICSC provided American intelligence authorities with information on conditions in North Vietnam, it was equally clear that they did not break the rules that governed diplomatic behaviour. In the heated domestic debate, however, this distinction was lost on the government's critics.

The domestic criticism during the first few months of 1967 worried Martin, who was anxious to score a diplomatic success as he pressed his bid to become Pearson's successor. At the same time, however, his capacity for independent action was considerably reduced. While rumours of Pearson's unhappiness with Martin did not quash the minister's interest in pursuing a settlement in Vietnam, they did encourage him to confine his efforts largely to more modest initiatives which derived their legitimacy from Canada's status as a member of the ICSC and which were unlikely to embarrass the United States. This probing for an opening, which the United States encouraged by its constant efforts to reassure Martin that Canada's role as a member of the ICSC had a place in American considerations, may have provided the minister with some consolation that he was not entirely inactive. It did little to help him quiet his domestic critics.¹¹⁰

Consequently, Martin turned his own hand to peace-making in April 1967. In a statement before the House of Commons Standing Committee on External Affairs, he proposed a "stage-by-stage return to the Geneva cease-fire arrangements." This would be accomplished

¹¹⁰ See, for example, Washington to Ottawa, Tel No 734, 21 February 1967, DEA File 20-22-Viets-2-1; and Washington to Ottawa, Tel No 1030, 16 March 1967, DEA File 20-22-Viets-2-1.

in four distinct steps. First, it would be necessary to restore the demilitarized zone and reactivate those provisions of the Geneva Accords which prohibited the use of either North or South Vietnam for carrying out acts of hostility against the other. Second, there would be an undertaking "to freeze the course of military events at its current level," a step which implied a prohibition on the import of military material and reinforcements. Third, all hostilities would stop. The fourth step envisioned a return to the complete Geneva Accords with the repatriation of prisoners-of-war and the withdrawal of all outside forces.¹¹¹

Hanoi flatly rejected the minister's effort. In Washington, where Martin's domestic difficulties were understood, the Canadian plan was given a sympathetic, if sceptical, reception. Secretary of State Dean Rusk made it clear to Ritchie that the forthcoming American and South Vietnamese responses were intended to permit the minister to show his domestic critics that the United States was not the problem in Vietnam.¹¹² Unfortunately, the available evidence suggested otherwise. In a frank and distressing conversation with Goldberg in late April, Martin learned that rumours of a possible escalation in the American commitment were true. Johnson was determined to persist in his present course even at the risk of his presidential nomination. Goldberg, claiming that

¹¹¹ Canada, House of Commons, Standing Committee on External Affairs, *Minutes of Proceedings and Evidence*, No. 10, 11 April 1967, pp. 312-14.

¹¹² Ed Ritchie to Marcel Cadieux, and attachment, 20 April 1967, DEA File 20-22-Viets-2-1.

moderates like himself and McNamara no longer had any influence, warned Martin against any public appeals against the bombing, but urged the Canadian to get together with other powers "at the highest ministerial level to throw out ideas for negotiation in the hope that they might be taken up in direct dialogue between Washington and Hanoi."¹¹³

It was becoming more difficult for Martin to resist demands that he act. A growing number of officials and cabinet members wanted him to bring more pressure to bear directly on the United States. In early May, the acting Canadian High Commissioner in London, Geoff Murray, quietly suggested that Ottawa seek to persuade the United States to halt the bombing in conjunction with the proposed truce marking Buddha's birthday.¹¹⁴ Similarly, the Canadian embassy in Paris suggested that the heads of government from several countries friendly to the United States jointly urge Johnson to suspend the bombing in Vietnam. Cadieux quickly scotched these suggestions.¹¹⁵ He could do nothing, however, to control the public musings of critical cabinet ministers. In a speech in Toronto, Gordon maintained that the United States had become bogged down in a civil war "which cannot be justified on either moral or strategic grounds." He called on Martin and Pearson "to continue to

¹¹³ Permisny to Ottawa, Tel No 1087, 28 April 1967, DEA File 20-22-Viets-2-1.

¹¹⁴ London to Ottawa, Tel No 2385, 3 May 1967, DEA File 20-22-Viets-2-1.

¹¹⁵ Far Eastern Division to Under-Secretary of State for External Affairs, 16 May 1966, DEA File 20-22-Viets-2-1, DFAIT.

do everything in their power to press the Americans to stop the bombing."¹¹⁶ They, in their turn, were outraged. The prime minister publicly repudiated Gordon's remarks, but allowed him to remain in cabinet, thus according his speech a certain legitimacy.¹¹⁷

The United States was not unaware of the pressure mounting on Pearson and Martin. As it prepared for the president's visit to Expo '67, the White House was anxious to counter "the criticism [the U.S.] has gotten recently from some top-level Canadians" and urged Johnson to remind the prime minister of his repeated efforts to have Hanoi begin negotiations.¹¹⁸

The president's peace efforts, however, were not the subject of the talks between Johnson and Pearson during their brief meeting at Harrington Lake in late May. When the two met privately after lunch, the president was "calm and relaxed" when discussing Vietnam, emboldening Pearson to suggest that the United States should stop the bombing without any conditions. Johnson promised to consider this suggestion, but when they were joined by Martin and their various advisors, he "was more vigorous in his defense of the present policy of bombing and more reluctant to consider proposals of any kind for a change which was not associated with a concession of some kind on the part of the north." He spoke with great feeling

¹¹⁶ Walter Gordon, *A Political Memoir* (Toronto, 1977), p. 281-82.

¹¹⁷ John English, *The Worldly Years*, pp. 377.

¹¹⁸ Walt Rostow, Memorandum for the President, 25 May 1967, National Security Files (NSF), Memoranda for the President, Box 16, Johnson Library.

about the loss of American lives, emphasizing that whenever he called a pause, "blood of Americans and their friends who were killed was 'on my hands ... if our casualties go up from 337 a week to 1037 I am the one who will be responsible.'"

Neither Pearson nor Martin knew precisely what to make of their talk with the president. To Pearson, Johnson was "more of an enigma than ever, only he is now an older and more impatient and irascible enigma; feverish in his insistence on activity, verbal and physical; moving so much and so fast in the hope, perhaps, that movement is progress."¹¹⁹ "[A]s a result of the President's visit," Martin explained to the British prime minister, "we did not seem to know a great deal more than before as to how the U.S. intended, in practical terms, to approach a settlement."¹²⁰

Martin continued to press the United States in private to adopt a more flexible policy. Accompanied by Gordon, to whom he wished to demonstrate the alliance's usefulness, Martin attended the June 1967 NATO ministerial meeting hopeful that some progress might be made. In the restricted session reviewing the international situation, the secretary of state for external affairs was critical of Washington's refusal to stop the bombing and blamed it for unfairly placing its allies in an awkward

¹¹⁹ L.B. Pearson, *Mike III*, pp. 144-47. See also, Walt Butterworth, Memorandum: Draft, 26 May 1967 and R.P. Davis, Memorandum of Conversation: President's Conversation with Prime Minister Pearson, 25 May 1967, NSF, Country File: Canada, Box 166, Johnson Library.

¹²⁰ Talks between Prime Minister Wilson and Prime Minister Pearson, 1 June 1967, DEA File 20-22-Viets-2-1, DFAIT.

position with their domestic audiences. Gordon recorded the scene:

It was an excellent presentation and took courage. Dean Rusk replied somewhat superciliously and proceeded to slap Paul [Martin] down. In doing so, he made it clear that, when it comes to foreign policy, the U.S. sees things in blacks and whites; there is nothing between, certainly no place for grey ... No one else said anything.¹²¹

He was not joined by any of the allies.

In Martin's subsequent discussion with Rusk, who this time made an effort to take the Canadian's preoccupations seriously, the results were initially more hopeful. Martin found the secretary of state preoccupied with the war in the Middle East and "receptive to suggestions that the bombing [in North Vietnam] be stopped." Rusk indicated that he was prepared "to stop the bombing permanently in exchange for an undertaking from Hanoi that they would accept an international force in the [demilitarized zone]." Martin offered to have the new Canadian commissioner, Orme Dier, deliver the message. Officials in Ottawa reacted optimistically and even suggested that Cadieux, who was in Paris with Martin, could stay behind to discuss the idea with North Vietnamese representatives. In Washington, the assistant secretary of state for far eastern affairs, William Bundy, quickly put an end to the notion of an international force.

Throughout the summer, domestic opposition to the war continued to mount. Escott Reid, Douglas LePan and A.F.W. Plumptre, respected figures from the "golden age of Canadian diplomacy" and prominent Canadian academics, made public a letter to the prime

¹²¹ Denis Smith, *Gentle Patriot: A Political Biography of Walter Gordon* (Edmonton, 1973), p. 325.

minister urging him to call a bombing halt.¹²² By August, 41 percent of Canadians wanted the United States to withdraw from Vietnam; only 18 percent thought that it should stay.¹²³ Given the government's efforts to resist these pressures to disassociate Canada from United States policy in Vietnam, Martin was dismayed to learn in early September that the United States wished to have its friends on the UN Security Council, where Canada was serving a two-year term, confront the Vietnam problem. A nicely balanced resolution, urging both Hanoi and Washington to de-escalate the war would help the administration meet its critics at home without weakening American support for the government in Saigon. Martin was doubtful. He warned Rusk that such a resolution was likely to be amended by the Soviet Union so that it called on the United States to stop its bombing unilaterally. In view of the growing domestic opposition to the war, the Liberal government would not be able to vote against an amended motion.¹²⁴

Washington's interest in using the United Nations to protect the administration's domestic flank undoubtedly made it much easier for Martin to adopt a public position that reflected Canadian domestic opinion more closely. When the Danish foreign minister

¹²² Escott Reid, *Radical Mandarin: The Memoirs of Escott Reid* (Toronto, 1989), p. 372-75. On the origins of this appeal, see Escott Reid to John W. Holmes, 15 May 1967, John Holmes to Douglas LePan, and John Holmes to A.W. F. Plumptre, 16 May 1967, File C/IV/14, Holmes Papers, CIIAA.

¹²³ John English, *The Worldly Years*, p. 379.

¹²⁴ Ottawa to New York, Tel No Y-537, 8 September 1967, DEA File 20-22-Viets-2-1, DFAIT.

urged the United States to stop the bombing in a speech at the UN General Assembly, Martin concluded that "it might be necessary for Canada to say something of the same sort."¹²⁵ His speech to the General Assembly, though, was a study in ambiguity. He urged Washington to halt the bombing:

There is not the slightest doubt in my mind now that the first step in that direction [toward peace] will involve the question of the bombing of North Vietnam. It seems clear that all attempts to bring about talks between the two sides are doomed to failure unless the bombing is stopped.

Martin quickly qualified his suggestion: "But we must not for a moment pretend that a halt in the bombing would in itself bring an end to the war." He linked the bombing halt to the first step in his April 1967 program for disengagement and implied that any halt in the bombing must be accompanied by a reciprocal gesture from Hanoi: "as a first step toward disengagement, the bombing of the North might be terminated and the demilitarized zone restored to its intended status subject to effective international supervision."¹²⁶

The speech could not have been delivered at a more inopportune moment. In the fall of 1967, the bilateral agenda was suddenly

¹²⁵ New York to Ottawa, Tel No 2490, 22 September 1967, DEA File 20-22-Viets-2-1, DFAIT.

¹²⁶ Paul Martin, "Canada and the Universal Forum for Peace," An Address to the United Nations General Assembly in New York on September 27, 1967, Department of External Affairs, *Statements and Speeches*, 67/30. In his memoirs, Martin calls his speech one of the earliest public calls for a bombing halt. See *A Very Public Life, Volume II: So Many Worlds* (Toronto, 1985), pp. 454-55. However, in March 1968, he emphasized that his speech not only called for a bombing halt, but "also comprised other essential elements." Paul Martin, Memorandum for the Prime Minister, 12 March 1968, DEA File 20-22-Viets-2-1, DFAIT.

crowded with a host of irritants, both minor and major. The Mercantile Bank affair, which had been dormant for several months, re-surfaced in August when the United States delivered a final protest against the new bank act.¹²⁷ The review of the post office act promised in 1965 was now also complete, and Ottawa informed Washington in late September that it would proceed with its plan to increase the postal rates charged *Time* and *Reader's Digest*.¹²⁸ These irritants, combined with Martin's failure to consult Washington over his speech to the United Nations, stirred the redoubtable Butterworth into action. In late October, he dispatched a particularly "flamboyant" telegram to Washington, denouncing the "anti-American tone of recent Canadian Government actions" and warning that "there were both quantitative and qualitative strains on our relations [with Canada] at the present time." While the very number of issues dividing the two countries created "stresses and strains," the differences between Canada and the United States over Vietnam weighed most heavily.¹²⁹

Ritchie, who quite possibly picked up echoes of Butterworth's analysis in Washington, adopted a remarkably similar diagnosis of the state of bilateral relations. Like Butterworth, he argued that the very number of issues at play in the fall of 1967 created a

¹²⁷ H.B. Robinson, Memorandum for the Minister, 21 August 1967, DEA File 36-13-1, DFAIT.

¹²⁸ Ottawa to Washington, Tel No E-3241, DEA File 37-7-1-USA-1, DFAIT.

¹²⁹ Walt Rostow, Memorandum for the President, 10 October 1967, NSF, Country Files: Canada, Box 167, Johnson Library.

unique strain on the relationship. Any one of these subjects, could easily be blown out of proportion and ignite a bilateral confrontation:

[A]t the present time there appears to be a noticeable atmosphere in Washington, particularly in some important quarters of the State Department, of a growing dissatisfaction and impatience with Canada and that this coupled with the Administration's preoccupation over Vietnam (bordering on a sort of neurosis) and with the forthcoming election campaign, provides an environment where even minor differences can quickly get distorted and be treated as major disagreements. In such an atmosphere perspectives in Washington are becoming badly warped; an issue which in other circumstances might pass quietly or go almost unnoticed may come to be regarded as a test of almost our whole relationship with the United States.

Ritchie warned the government (as he had in the spring of 1963) that Canada needed to choose carefully which issues it wished to pursue with the United States. With this consideration in mind, he suggested that Ottawa try to defuse tensions by postponing its efforts to increase the postal rates applied to *Time* and *Reader's Digest*.¹³⁰

Rusk, like Ritchie and Butterworth (whose telegram he almost certainly read), initially reacted with alarm at the mounting number of bilateral differences between the two countries. At a reception at the Nepalese Embassy in early November, he cornered the Canadian ambassador, and "vigorously" announced that "we were headed for trouble."¹³¹ Ritchie could hardly have been surprised,

¹³⁰ Washington to Ottawa, Tel No 3993, 30 October 1967, DEA File 20-1-2-USA, DFAIT.

¹³¹ Washington to Ottawa, Tel No 4254, 17 November 1967, DEA File 20-1-2-USA, DFAIT.

and he quickly arranged to meet Rusk for a private discussion.¹³² The talk provided an opportunity for a balanced examination of the relationship and proved immensely reassuring. Armed with a lengthy brief from his officials on the state of bilateral relations across the full spectrum of issues, Rusk was "considerably more relaxed" and the "whole conversation was low-keyed and ... friendly throughout."

The secretary of state began "with a tone of humor," asking Ritchie if "anti-Americanism was good politics in Canada." He went on to acknowledge Canada's help with the Kennedy Round at GATT and with United States balance of payments problems, noting Canada's increased foreign aid and its peacekeeping commitments. Rusk remained concerned, however, with Ottawa's attitude toward the war in Vietnam, accusing Ottawa of adopting a policy of neutrality on the international control commission. When pressed, he retreated from this absurd claim, admitting that he had been shocked to learn that Canada would have been forced to vote for a unilateral bombing halt if such a resolution had been presented to the United Nations. He was disappointed that Ottawa had not solidly endorsed Johnson's most recent peace plan.¹³³

All in all, Rusk's appreciation of the relationship was not unduly disturbing. The White House too arrived at a fairly balanced

¹³² E.A. Ritchie to Dean Rusk, 3 November 1966, FOIA Request 9202777.

¹³³ R. Straus, Memorandum of Conversation: US-Canadian Relations, 16 November 1967, FOIA Request 9202777; See also, Washington to Ottawa, Tel No 4254, 17 November 1967, DEA File 20-1-2-USA, DFAIT.

analysis. Increasingly hardened to criticism of its Vietnam policy, it largely ignored Martin's speech to the United Nations, which National Security Council officials characterized as simply "marking a further edging away from the United States position."¹³⁴ Similarly, the National Security Advisor, Walt Rostow, dismissed Butterworth's views as unnecessarily alarmist:

The developments Butterworth describes are not new. Nor do they require immediate U.S. action. In part they reflect the present unsteady condition of Canadian politics. The Liberal Party is divided and dispirited. The Quebec issue is cutting deep. Martin is trying to establish a reputation for himself, in part at Pearson's expense. ... In such a climate, the nationalist drum is a good one to beat.¹³⁵

By the end of the year, the flurry of concern had completely passed. Not once during "several good talks" which Martin and Rusk enjoyed during the December NATO ministerial meetings did the two foreign ministers feel compelled to discuss bilateral questions.¹³⁶

This was hardly surprising. Ottawa and Washington were both aware of the constraints that Canadian nationalism placed on the Pearson government. Bilateral pragmatic compromises permitted some measure of control over these volatile forces. This point had been underlined in 1966 when bilateral mechanisms collapsed during the Mercantile Bank affair, and the dispute assumed mythic proportions,

¹³⁴ Briefing Paper for Mr. Walt Rostow and Mr. Ernest Goldstein, [19 October 1967], NSF, Country File: Canada, Box 167, Johnson Library; see also, Marcel Cadieux, Memorandum for the Minister, 11 October 1967, DEA File 20-1-2-USA, DFAIT.

¹³⁵ Walt Rostow, Memorandum for the President, 26 October 1967, NSF, Memoranda for the President, Box 48, Johnson Library.

¹³⁶ Paul Martin, Memorandum for the Prime Minister, 27 December 1967, DEA File 20-1-2-USA, DFAIT.

threatening to rage out of control. Consequently, it became all the more imperative in 1967 for both countries to acknowledge their differences. In some ways, Washington's moderate response to Canadian efforts to distance Ottawa from American policy in Vietnam was a first step in admitting that the two countries would have to live together despite sometimes profound differences.

Conclusion

Pearson's government came to power as the postwar economic and political order began to fragment, confronting Ottawa with the kind of fundamental choices and opportunities that it had not dealt with since the 1940s. The booming 1950s, which allowed the United States and Canada to submerge their bilateral economic differences in the general prosperity, had collapsed. The European Economic Community, with its protective trade policy, and Washington's balance of payments problems threatened to undermine the liberal trading regime on which North American postwar prosperity depended.

At the same time, cold war tensions eased, holding out the prospect of more stable relations with the Soviet Union and the People's Republic of China. Western Europe's political and economic recovery left NATO unsettled, as France and West Germany sought new roles in the alliance, raising questions about the nature of the Canadian contribution to western security. As the prospect of war in the North Atlantic receded, Ottawa redirected its resources to domestic social programs. The United States, however, was sceptical of detente, and worried about western fortunes in the emerging nations of Africa and Asia, where communism mixed easily with indigenous nationalism. Pearson responded to this shifting economic and political landscape in ways that changed the character of Canadian-American relations in significant and lasting ways.

The most important developments during the Pearson era were economic. The Liberal Party came to office in April 1963 uncertain

about its approach to economic relations with the United States. Nationalists like Finance Minister Walter Gordon, who wished to reduce Canada's dependency on American markets and capital, vied for influence with those members of the party who held a more traditional, liberal perspective. The conflict between these two views was brought to a head in early 1964 when Washington challenged the finance minister's unilateral scheme to improve Canada's balance of trade with the United States by encouraging automotive exports through duty rebates.

Washington worked hard to convince Ottawa that its objectives, a larger domestic automotive industry and increased exports, could be achieved through a negotiated agreement that emphasized the two countries' shared economic interests. At the same time, Canada was offered an opportunity to secure its access to the American market by negotiating far-reaching bilateral tariff reductions under the General Agreement on Tariffs and Trade (GATT). The automotive dispute and the prospective tariff negotiations faced Ottawa with a fundamental choice: Canada could either seek an integrated and more structured economic partnership with the United States or it could pursue its future independently, without the security provided by the large and lucrative American market.

The debate in cabinet raged quietly, but fiercely, throughout 1964. Gordon stood out against both the Autopact and the Kennedy Round, certain that they would reduce Canada's freedom to shape its economic future. The effort was futile. Gordon's opponents, led by Mitchell Sharp, the minister of trade and commerce, convinced

cabinet to endorse measures that integrated the North American automotive industry and to offer significant tariff reductions at the GATT. These two steps created a more structured and formal economic relationship with the United States, strengthening Canada's continental orientation.

This was a lesson that was reinforced during the 1960s by Ottawa's efforts to deal with Washington's increasingly elaborate proposals to strengthen its balance of payments. Securing an exemption from the American guidelines, a complicated diplomatic and political exercise, was no sure thing. In the short term, the process emphasized a shared North American interest in the dollar's future, and the importance of a continental common market for capital. Its long term impact was even more profound. The government's uncertain experience with its exemption from the interest equalization tax - an exemption that it lost in 1971 - helped convince many policy-makers in Ottawa of one important lesson: to deal effectively with American policies that might adversely harm its interests, Canada needed to pursue still closer and more formal economic relations with the United States.

While Pearson's government thus took the first few steps towards a new form of North American economic partnership, it also demonstrated that this kind of close economic relationship need not impair Canada's ability to pursue distinctive foreign and defence policy. Between 1963 and 1968, the Liberal government adopted new diplomatic and military postures that acknowledged the diminished Soviet threat, European recovery and growing domestic demands for

a uniquely Canadian approach to the world. It undertook this task carefully, with due regard for Washington's strategic interests in North Atlantic solidarity and continuing bilateral arrangements for continental defence. The United States generally accepted Ottawa's evolutionary approach, and realistically amended its expectations for Canadian policy. As a result, by the time Pearson left office in the spring of 1968, the process of adjusting the close cold war alliance to accommodate the altered international climate and the evolving needs of both countries was well underway in Washington and Ottawa.

The Pearson government's pursuit of closer economic relations with the United States and its contradictory desire to adopt an increasingly distinct approach to the world reflects the ambiguity that has traditionally characterized continental relations. That Pearson choose to pursue simultaneously two courses so divergent is, therefore, not surprising; that he accomplished this without seriously damaging his government's relations with Washington is more noteworthy. Pearson clearly had not lost the sure and smooth touch that had characterized his diplomacy in the 1940s and 1950s. He proved capable in the 1960s of devising the kinds of pragmatic compromises that allowed Canada to straddle the gap between dependence and independence.

This was especially true of Canadian policy in Asia, where the conflict in Vietnam exposed Canadian ambiguity to attack and made it difficult for Ottawa to reconcile domestic pressures for a distinct Canadian response to the crisis with American demands for

diplomatic and material support. Edging aside Paul Martin, the secretary of state for external affairs, Pearson dominated policy-making in this field. The prime minister resisted demands that his government adopt extreme positions, minimizing Canada's differences with the United States over Asia. He did not eliminate fully these distinctions, but encouraged carefully hedged initiatives at the United Nations to seat Red China and to suspend bombing in Vietnam. These established the Canadian position without irritating Washington too much or inviting retaliation.

Although Pearson's handling of the Vietnam war defused the conflict as a source of continuing bilateral controversy, rising nationalist sentiment made it difficult to preserve cooperative relations during the 1960s. Containing extreme manifestations of Canadian nationalism was a joint enterprise that relied on policy-makers in Ottawa and Washington adhering to a shared vision of the future course of bilateral relations and working together to shape practical compromises. The two governments found the common ground required to amend the legislation protecting Canada's magazines to take into account American interests. They were much less effective in solving the problem created by the sale of the Mercantile Bank to American interests. The initial effort to negotiate a settlement was upset when influential policy-makers in each capital tried to define the issue in symbolic terms. Although the prime minister was eventually able to engineer a compromise, the affair underlined the growing strength of the "new nationalism."

Unwilling to accept the uncomfortable compromises that

partnership sometimes demanded, the nationalist movement would plague Pearson's successor, driving him to experiment with options and policies that tried unsuccessfully to refute Canada's destiny as a North American nation.

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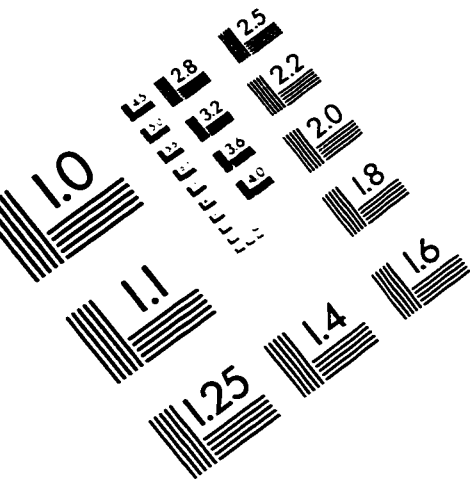
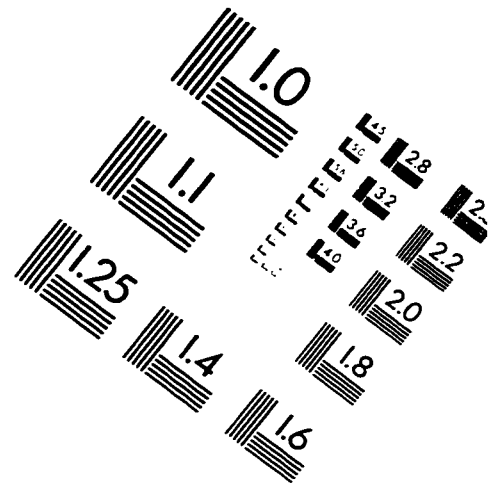
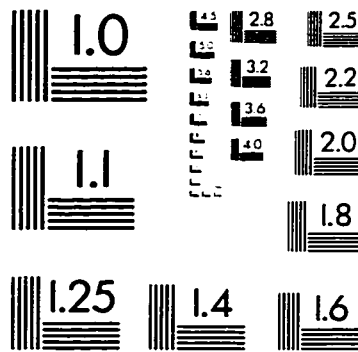
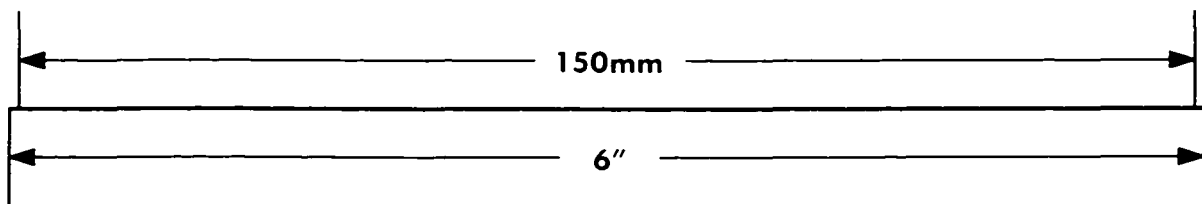
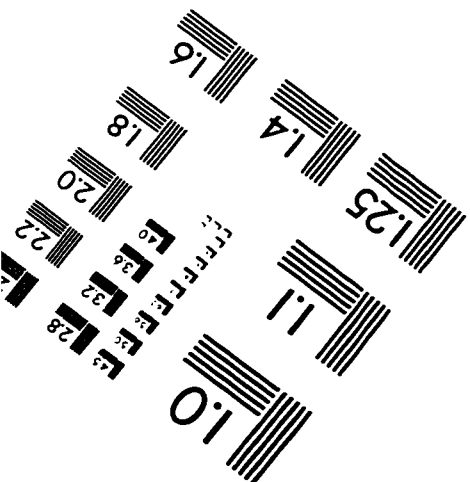
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