Poster for Canada Savings Bond campaign, ca. 1950

A Floating Canadian Dollar (1950-62)

By mid-1950, the depreciation of the Canadian dollar against its U.S. counterpart the previous year, combined with rising commodity prices associated with the beginning of the Korean War in June 1950, had significantly strengthened Canada's trade balance with the United States. At the same time, the economic recovery in Europe, aided by the Marshall Plan, which provided European countries with convertible U.S. dollars, boosted Canadian exports (Muirhead 1999, 138). There were also strong inflows of direct investment into Canada. Short-term capital inflows also increased sharply, particularly through the third quarter of 1950, as speculation regarding a Canadian-dollar revaluation intensified.

In this environment, Canadian authorities became increasingly concerned about the inflationary impact of the inflows if Canada tried to maintain a fixed exchange rate. There was also concern that the inflows were leading to a "substantial and involuntary increase in Canada's gross foreign debt" (FECB 1950, 14).

On 30 September 1950, Douglas Abbott, the Minister of Finance, announced that

> Today the Government, by Order in Council under the authority of the Foreign Exchange Control Act, cancelled the official rates of exchange which had been in effect since September 19th of last year . . . . It has been decided not to establish any new fixed parity for the Canadian dollar at this time, nor to prescribe any new official fixed rates of exchange. Instead, rates of exchange will be determined by conditions of supply and demand for foreign currencies in Canada.

He also announced that any remaining import prohibitions and quota restrictions, imposed in November 1947, would be eliminated, effective

2 January 1951. Controls on imports of capital goods were also to be reviewed.

Interestingly, the idea of floating the Canadian dollar was widely discussed as early as the beginning of 1949. A then-secret memorandum prepared in January of that year by James Coyne, then Deputy Governor of the Bank of Canada, made the case for floating the currency while retaining exchange controls. In his paper, Coyne noted that it would be better to "have a natural rate which could move up or down from time to time as economic conditions might require." He also noted that government inertia made it very difficult for the authorities to adjust a fixed exchange rate in a timely manner (Coyne 1949).

Options other than floating the exchange rate were apparently dismissed as impractical, including revaluing the Canadian dollar upwards, widening the currency's permitted ±1 per cent fluctuation band, or restricting capital inflows. Given the criticism levelled against the government after the 1946 revaluation of the Canadian dollar, followed by the short-lived 1949 devaluation, another revaluation was viewed as unacceptable. It was also unclear how much of a revaluation would be required to stem the capital inflows. Widening the bands also posed problems, since it was unclear how wide the bands would have to be. Likewise, restrictions on capital inflows were seen as untenable from a longer-term perspective for a country dependent on foreign capital (Hexner 1954, 248).

This view is consistent with a speech on exchange controls given by Douglas Abbott, Minister of Finance, in December 1951,

> The conclusion I have come to is that we would be better advised not to rely on exchange restrictions, but rather on the general handling of our domestic economic situation to keep us in reasonable balance with the outside world and to maintain the Canadian dollar over the years at an appropriate relationship with foreign currencies.

Bank of Canada, $10, 1954 series
This was the first note series to feature Canadian landscapes. These notes were simpler in design and more modern in style. This was also the only series to feature the reigning monarch on each denomination. This was popularly known as the "devil's head" series because of the image discernible in the Queen's hair.

The system envisaged by Coyne in 1949 of a floating Canadian dollar within a system of foreign exchange controls was put into practice when markets opened on 2 October 1950. With interbank trading now permitted, the Canadian dollar quickly appreciated, rising five cents to roughly US$0.95.

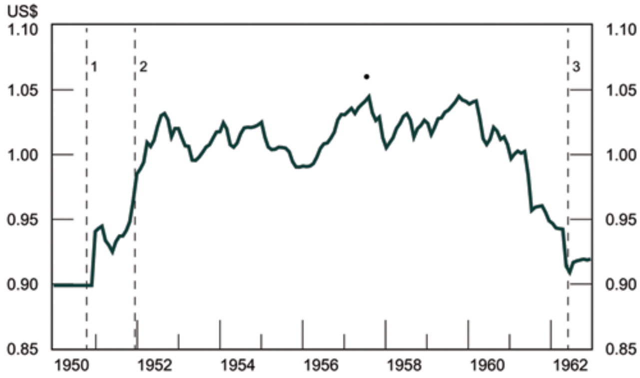
With the floating of the Canadian dollar, the rationale for the continuation of exchange controls came into question. Through 1951, controls were progressively eased. Finally, on 14 December 1951, the Foreign Exchange Control Regulations were revoked by an Order-in-Council. New regulations were passed that exempted all persons and all transactions from the need for permits to buy and sell foreign exchange. The Foreign Exchange Control Act itself, which had been renewed for another two-year period earlier in 1951, was repealed in October 1952.

After a quick rise to the US$0.95 level immediately after the float (Chart 5), the Canadian dollar continued to appreciate at a more gentle pace, moving to a small premium of about 2 per cent vis-à-vis the U.S. dollar by 1952. From then until the end of 1960, it traded in a relatively narrow range between US$1.02 and US$1.06. The peak for the Canadian dollar during this period was US$1.0614, touched on 20 August 1957. Foreign exchange intervention by the Bank of Canada through the Exchange Fund Account was limited to smoothing short-run fluctuations of the Canadian dollar.

Chart 5

Canadian Dollar in Terms of the U.S. Dollar

Monthly averages (1950–62)



* 20 August 1957: Modern-day Canadian-dollar peak: US$1.0614
1. September 1950: Canadian dollar floated
2. December 1951: Exchange controls lifted
3. May 1962: Canadian dollar fixed

Source: Bank of Canada; U.S. Federal Reserve System (1976)

While generally unpopular in business circles, the floating exchange rate was supported by many academic economists as a means of insulating the domestic economy from external shocks, either inflationary or deflationary.[78] It was also recognized

78. A fixed exchange rate required the Bank of Canada to direct monetary policy to maintaining the fixed rate. As a consequence, it could not pursue an independent monetary policy. Rather, it had to closely follow changes in U.S. interest rates, regardless of whether those interest rate changes were appropriate to Canadian circumstances. In contrast, a floating exchange rate gave the Bank of Canada the scope to direct policy at achieving and maintaining domestic price stability.

that the two-way risk associated with a flexible exchange rate could itself lessen large capital movements (Hexner 1954, 253).

Canada's successful experiment with a flexible exchange rate regime through much of the 1950s inspired considerable early academic work on the merits of a flexible exchange rate system. Later, it would provide a model for the rest of the world when the Bretton Woods system of fixed exchange rates finally collapsed during the early 1970s.

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Conflict with the IMF

As a member of the International Monetary Fund (IMF), Canada's decision to float the Canadian dollar was at odds with its commitment to the Fund to maintain a fixed exchange rate within the Bretton Woods system. In this regard, in 1949 the Canadian authorities had established with the IMF a "par value" of US$0.9091 with a fluctuation band of ±1 per cent. The decision was also taken over the opposition of IMF staff who recommended more vigorous foreign exchange intervention or the imposition of controls on capital inflows (IMF 1950).[79] There were also concerns that Canada had "gravely compromised and embarrassed" the IMF and had set a bad example for other "less responsible members" (Goforth 1950).

79. Given his close relationship with the IMF, the decision to float the Canadian dollar must have been difficult for Rasminsky. But since the economic argument in favour of a float was sound, he supported the decision. He also recognized that the international economic environment was not what had been expected. Unlike the 1930s, the predominant monetary issue of the day was inflation not deflation, and there had been no tendency towards competitive devaluations (Muirhead 1999, 140).

At least initially, floating was viewed as a temporary measure. The minister of finance noted the government's intention to remain in consultation with the Fund and

> ultimately to conform to the provisions of the Fund's Articles of Agreement which stipulate that member countries should not allow their exchange rates to fluctuate more than one percent on either side of the par values from time to time established with the Fund (Abbott 1950).

It would be almost 12 years before Canada reintroduced a fixed exchange rate and was again in the good graces of the IMF. Consequently, Canada came to be viewed as something of a maverick in international financial circles. The unwillingness to re-fix the exchange rate appears to have reflected concern about repeating the mistake of 1946 when the dollar was revalued upwards only to come under significant downward pressure the next year, followed by a devaluation in 1949. Subsequently, interest in re-pegging the currency waned as it seemed that Canada had the best of all worlds—a non-discriminatory trading system, an open capital market, and a reasonably stable exchange rate. While Canada's actions were not consistent with the IMF's practices, the outcome was certainly in line with its goals.

Establishment of the IMF

In July 1944, representatives from 44 countries met in Bretton Woods, New Hampshire to establish the post-war international financial architecture. Agreement was reached on creating the International Monetary Fund (IMF) which, among other things, would promote monetary co-operation and discourage competitive currency devaluations. After the IMF began operations in 1946, member countries agreed to establish "par values" for their currencies in relation to the U.S. dollar and to maintain them within narrow fluctuation bands. A par value change was permitted only to correct a fundamental disequilibrium. Louis Rasminsky, who was to become the Bank of Canada's third Governor, played a key role in the founding of the IMF, reconciling views and mediating between the British, led by John Maynard Keynes, and the Americans, led by Harry Dexter White. At Bretton Woods, Rasminsky chaired the key drafting committee (Muirhead 1999, 105). After the formation of the IMF, Rasminsky became Canada's first Executive Director, on a part-time, unpaid basis until September 1962, while remaining a senior official of the Bank of Canada (Muirhead 1999, 129).